THE GENERAL ANTI-AVOIDANCE RULE

IMPACT ON TAX DECISION MAKING

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INTRODUCTION & SCOPE

The General Anti-Avoidance Rule (GAAR) is a wide-ranging legislative measure intended to combat aggressive tax avoidance. Since virtually all business decisions have tax implications in today's world, it follows that GAAR will radically affect the decision-making process across levels in organizations.

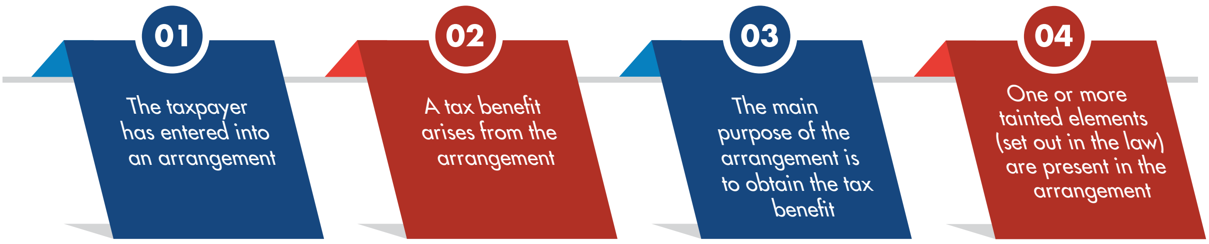
GAAR came into force on 1 April 2017. But that does not mean that taxpayers were at liberty to adopt aggressive measures to reduce their tax burdens before then. Tax authorities and Courts historically applied certain broad anti-avoidance rules that targeted sham transactions (i.e. transactions conducted with an element of deceit so as to conceal its true nature) and 'colourable devices' (i.e. resorting to dubious means to obtain a tax benefit). These however were largely fact-specific, ad hoc, and involved the application of a 'smell' test.

GAAR, on the other hand, empowers the tax authorities, to not only target sham transactions and colourable devices, but also to counteract the abusive elements of arrangements that are otherwise legally valid. Historically, '*substance*' in the form of movement of funds, presence of employees, premises, local expenditure etc. were strong defenses against allegations that an arrangement was a '*sham*'. This is not necessarily the case under GAAR, where the focus is on '*purpose*' (i.e. whether the arrangement was entered into with the main purpose of obtaining a tax benefit?), rather than only '*substance*' (whether the arrangement really happened the way it is said to have happened).

Similarly, GAAR is not restricted to cross-border arrangements, or other arrangements that involve esoteric elements. It could apply to commonly undertaken, routine day-to-day transactions as well. For instance, it could potentially be invoked in cases of corporate restructurings, funding arrangements, exit planning and other similar structures. Grandfathering provisions have been introduced in a limited way for some pre-2017 investments, but the general rule is that GAAR can extend to tax benefits arising after 2017, even if the arrangements giving rise to these benefits were undertaken much before GAAR came in.

This begs the question - Is tax planning dead? Is a taxpayer truly immune from GAAR only if he opts for the most tax-inefficient strategy imaginable?

If one were to view GAAR as a simplistic '*smell test*' that targets transactions giving rise to tax benefits, one may perhaps be justified in believing that this is the case. But the structure of GAAR is different - though it is wide-ranging, it does not give carte blanche to the tax authorities to go after anything that they find distasteful. Under the law, GAAR can be invoked only if the tax authorities can demonstrate that:



The above elements may be broadly worded, but they nonetheless carry specific meanings and are subject to the usual rules of statutory interpretation. Hence, it is necessary that a step-by step analysis of each of these is undertaken, in light of the business and commercial implications of the arrangement, in order to assess whether GAAR can apply.

As the discussion in this publication will show, such a step-by-step approach indicates that even after the enactment of GAAR, it is still perfectly acceptable for businesses to consider tax factors while evaluating business strategies, and in fact, even to look for solutions that are most advantageous from a tax standpoint. But, arrangements that are only 'tax driven' having little to no commercial rationale, will undoubtedly be hit by GAAR. The challenging part, of course, lies in knowing where one's transactions fall.

What does all this mean for a company, its directors and its officials? To what extent are existing structures at risk from GAAR? Are there any general safeguards that can be put in place to better manage the risks and uncertainties arising from the introduction of GAAR? And if GAAR were to be asserted, what are the defenses that one could rely on?

These are addressed in some detail in this publication.

WHEN CAN GAAR BE INVOKED – THE PRE-CONDITIONS

GAAR can be invoked by the tax authorities only if they can demonstrate that:

1. The taxpayer has entered into an arrangement
2. A tax benefit arises from the arrangement
3. The main purpose of the arrangement is to obtain the tax benefit
4. One or more tainted elements (set out in the law) are present in the arrangement

Each of these points are discussed in detail below.

I. The taxpayer has entered into an arrangement

Existence of an arrangement

The existence of an 'arrangement' is central to the concept of GAAR. Section 102(1) of the Income-tax Act, 1961 (Act) defines an 'arrangement' as any step in, or a part of or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding.

This is not an inclusive definition and it is therefore necessary that there is a transaction, operation, scheme, agreement or understanding to invoke GAAR. Having said this, the words used in the definition are extremely wide in their scope, and there may be very few cases which may fall outside the scope of this definition.

One could perhaps make a reference to the judicial precedents rendered in the context of the erstwhile Excess Profits Tax Act, 1945 to understand the scope of the term 'arrangement'. The Excess Profits Tax Act contained an anti-abuse provision which could be invoked when the main purpose of a transaction was to avoid or reduce a person's liability under the said Act. Illustratively, a gift/ sale of a business was considered as a 'transaction' under the Excess Profits Tax Act. Similarly, an amendment to the articles of association of a company or opening of a new branch of business was regarded as a 'transaction'. This implies that even unilateral actions could potentially be covered within the ambit of the term 'arrangement'.

As a positive, the Act puts the burden of proving the existence of an arrangement on the tax authorities. It is also relevant to note that the Act also provides that any step in, or part of any of the transaction, operation, scheme, agreement or understanding can itself qualify as an 'arrangement' within the meaning of section 102(1) of the Act. This makes it significantly easier for the tax authorities to establish the existence of an arrangement for the purposes of invoking GAAR.

When can the taxpayer be said to have entered into an arrangement

For the provisions of GAAR to be invoked, it is imperative that the arrangement has been entered into by the taxpayer. The term 'enter' is generally understood as 'engaging in' or 'bind oneself by (an engagement, contract, treaty, etc.).

While the determination of whether the taxpayer has entered into an arrangement is fairly intuitive and fact-specific, interesting issues could arise in determining the same in cases of certain shareholder actions such as:

- Casting of vote by a shareholder in favour of an arrangement
- Non-exercise of option available to a shareholder in cases such as buyback, capital reduction, rights issue, etc.
- Value shift in favour of one shareholder as a result of actions involving other shareholders and company
- A binding arrangement on a shareholder due to a majority decision inspite of the shareholder having cast his vote against the arrangement.

II. A tax benefit arises from the arrangement

What is a tax benefit

The term 'tax benefit' as defined in the Act is very wide in nature and includes reduction or avoidance of tax, increase in refund of tax, reduction in total income, increase in the loss amongst other situations. Although the language of the section does not explicitly mention this, the 'tax benefit' must have a direct nexus with the arrangement.

From the definition, one could infer that 'tax benefit' would not include cases of reduction in stamp duty or tax benefits arising in a foreign country. However, the scope of 'tax benefit' could extend to tax or any other amount payable under the Act i.e. such as Dividend Distribution Tax, Buyback Tax and Minimum Alternative Tax. Arguably even cases of increase in foreign tax credit could be covered in the ambit of tax benefit.

Rule 10U of Income-tax Rules, 1962 (Rules) inter alia provides that the provisions of GAAR will not apply to arrangements where:

(a) the tax benefit arises prior to 1 April 2017 (discussed in detail in para– below);

(b) the tax benefit in the relevant assessment year does not exceed INR 3 crore

It is to be noted that the threshold of INR 3 crore is not taxpayer specific and it has to be determined with regard to all the parties to the arrangement. Further, the Rules also provide that the tax benefit shall be with reference to the amount of tax, and in the case of an increase in loss, it will be with reference to the tax that would have been chargeable had the increase in loss referred to therein been the total income.

Section 99 of the Act provides that for the purposes of determining whether a 'tax benefit' exists:

- the parties who are connected persons in relation to each other may be treated as one and the same person;
- any accommodating party may be disregarded;
- the accommodating party and any other party may be treated as one and the same person;
- the arrangement may be considered or looked through by disregarding any corporate structure.

The term connected person is defined as any person who is connected directly or indirectly to another person and to include several specific categories of persons set out therein. Thus, in addition to the specific categories, it may still be possible for a person to be a connected person on the basis of the general test.

When does a tax benefit arise

The question of when a tax benefit arises is relevant for two reasons. First, if the tax benefit arises before 1 April 2017, the question of GAAR does not arise. Second, the monetary threshold of INR 3 crores for invocation of GAAR is an annual test, and must be determined qua each assessment year.

In most situations, the tax benefit will arise in the year in which there is a reduction, avoidance, or deferral of tax, or an increase in loss. An issue may however, arise in the context of losses as to whether the 'tax benefit' arises in (a) the year in which the loss is incurred (i.e. the year of increase in loss) or (b) the year in which the loss is set off (i.e. the year of reduction in the amount of tax).

Has tax benefit arisen out of the arrangement

To determine whether the 'tax benefit' is arising out of an arrangement, logically a comparison has to be made as to whether an alternative but similar arrangement would have occurred without any 'tax benefit' arising. This is referred to as the counter-factual. Determining the counter-factual is a highly fact specific exercise and it essentially involves the identification of an alternative arrangement which would lead to a similar legal and economic outcome, but would be undertaken without abusive tax considerations. The requirement of determining the existence of the counter-factual is not a clear requirement under the Act and hence, the question of whether the tax authorities are bound to demonstrate the existence of the counter-factual could prove contentious.

III. The main purpose of the arrangement is to obtain the tax benefit

Main purpose of an arrangement

An impermissible avoidance arrangement is broadly defined as an arrangement, the 'main purpose' of which is to obtain a tax benefit, and that one of the tainted elements exist in the arrangement. Thus, for the provisions of GAAR to apply, the main purpose of the arrangement should be to obtain a tax benefit. Along with this condition, one of the following tainted elements should also exist in the arrangement –

(a) It creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) It results, directly or indirectly, in the misuse or abuse, of the provisions of the Act;

(c) It lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(d) It is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

Since the word 'main purpose' has not been defined in the Act or Rules, it should be understood in its ordinary and plain sense. The word 'main' means 'principal', and the word 'purpose' generally implies 'intent'.

Main purpose does not mean sole purpose, and in cases where an arrangement may have many purposes, the main purpose will need to be identified. However, when there is only one purpose, that purpose becomes by default the main purpose.

Purpose is not the same as a motive behind the action. For the purposes of the statute, what is relevant is the 'purpose' and not the 'motive'. In other words, it will suffice to show that the intent was to obtain the tax benefit, even though the motive, may have been (for example) to use the tax savings to obtain a competitive advantage in the market.

Another aspect that has to be considered is the application of the 'main purpose' test i.e. whether it has to be applied subjectively (i.e. having regard to the actual intention of the parties) or objectively (i.e. having regard to whether, depending on the relevant facts a reasonable taxpayer would have entered into the arrangement without corresponding the tax benefit).

The section suggests that an objective evaluation of the 'main purpose' test will be required and it will eventually be immaterial whether the actual intention of the taxpayer was to obtain the tax benefit or not. What matters is only whether, objectively speaking, a reasonable taxpayer would have intended while entering into an arrangement.

The onus of proving that the main purpose of the arrangement is to obtain a tax benefit lies solely on the tax authorities. Takeaways on this point from some judicial precedents are set out below:

a) The mere fact that the arrangement resulted in a tax benefit would not be sufficient to arrive at a conclusion that the main purpose was to obtain a tax benefit. It will also be necessary for the revenue to show the existence of circumstances that point to the conclusion that the main purpose for which the arrangement was entered into was to obtain a tax benefit.

b) In many cases, it may not be possible for the tax authorities to lead direct evidence to prove that the main purpose of the arrangement was to obtain a tax benefit. However, this does not shift the burden of proof to the taxpayer to demonstrate that the main purpose was not to obtain such a benefit.

c) It is the duty of the tax authorities to demonstrate that the facts and circumstances lead to a reasonable inference that the main purpose was to obtain a tax benefit.

d) Once a prima facie inference can be drawn, based on evidence adduced by the tax authorities, that the main purpose of the arrangement was to obtain a tax benefit, the burden may shift to the taxpayer who has to demonstrate that there were other reasons/objects for undertaking the arrangement.

It should also be noted that the question of whether the main purpose of the arrangement is to obtain a tax benefit is a factual question. The application of the main purpose test is largely a fact intensive exercise and will depend substantially on the documentation and the conduct of the parties as well as the surrounding facts and circumstances. Some points that must be kept in mind are set out below:

a) The 'main purpose' test involves ascertaining the 'main' purpose of the arrangement. This is different from demonstrating the 'substance' of an entity or an arrangement. In other words, this test goes to the root of *why* an arrangement is undertaken, and not *how* it is undertaken.

b) It is sufficient for the Department to show that the main purpose of the part of the arrangement was to obtain a tax benefit. However, the converse is not true, and it is not sufficient for the taxpayer to defend an arrangement by establishing a non-tax purpose for only a part of the arrangement. Therefore, while evaluating an arrangement from a GAAR perspective, one must look at every step or part of the arrangement to assess whether the 'main purpose' test is satisfied.

c) Obtaining a non-tax benefit or other economic benefit will usually support a taxpayer's position that the main purpose of the arrangement is not to obtain a tax benefit. However, since this is a 'main purpose' test, it will be necessary that such benefit is substantial.

Further, it has been stated that the provisions of GAAR will not apply in cases where a taxpayer avails of specific incentives available to him under tax law and thereby mitigates his tax liability. Similarly, in response to a specific question on this issue, Circular 7 of 2017 clarified that GAAR will not interplay with the right of a taxpayer to select or choose a method of implementing a transaction. There might arise certain scenarios in which this issue might raise. For e.g., setting up of a unit in a SEZ or undertaking a buyback as opposed to declaring a dividend. Clarity does not exist on how the revenue will view such arrangements from the GAAR perspective, but as long as the 'main purpose' is not to obtain a tax benefit, the provisions of GAAR may not be invoked in such a case.

IV. Whether tainted elements exist in the arrangement

For the provisions of GAAR to apply, along with the 'main purpose' test, it also needs to be demonstrated that <u>any one</u> of the four elements (tainted elements) exist in the arrangement. The four tainted elements are discussed below:

I. The arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

This is an objective, facts and circumstance test. In applying this test, it will be necessary to see:

(a) what unrelated parties would have done in a similar situation;

(b) the rights and obligations in question should have arisen as a result of the arrangement, and that they should not have existed prior to it; and

(c) such rights and obligations are usually created between unrelated parties, and not whether such rights and obligations have ever been created between them.

For instance, a taxpayer who transfers assets at less than market value in a distress sale to raise urgent funds, cannot be compared with unrelated parties who are not similarly distressed.

II. The arrangement results, directly or indirectly, in the misuse or abuse, of the provisions of this Act;

This test is likely to be widely used and tested in situations where the law is followed in letter or form but not in spirit or substance; or where the arrangement results in consequences which are not intended by the legislation. In other words, it will not be enough for the taxpayer to claim that his activities or the arrangement entered into by him complies with the letter of the law

A literal reading also suggests that the misuse or abuse in question must be of the provisions of Income-tax Act alone and not of any other law, no matter how abusive the arrangement is.

III. The arrangement lacks commercial substance or is deemed to lack commercial substance under Section 97, in whole or in part;

There are two limbs to this test i.e. it covers:

- Arrangements that lack commercial substance; and
- Arrangements that are deemed to lack commercial substance under section 97 of the Act

The first limb significant expands the scope of this test, in that it is open ended. Thus, even in respect of arrangements that are not specifically caught within the ambit of section 97, it can potentially be alleged by the tax authorities that these lack 'commercial substance' as generally understood.

Even though the phrase 'commercial substance' has not been defined, draft versions of GAAR provided that an arrangement will be deemed to be lacking commercial substance if:

"it does not have a significant effect upon the business risks, or net cash flows, of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained but from the provisions of section"

This basically implies that the taxpayer should also have a commercial substance in the arrangement.

The statute also clarifies that the following factors shall be relevant, but not sufficient for determining whether an arrangement lacks commercial substance.

a) The period of time for which the arrangement exists;

b) The fact of payment of taxes, directly or indirectly, under the arrangement;

c) The fact that an exit route is provided by the arrangement

There are seven other factors listed in section 97, which have the effect of deeming the arrangement to be lacking in commercial substance. The presence of any one them will be sufficient for the test to be satisfied.

(i) Where the substance of the arrangement is inconsistent with the form its individual steps;

(ii) When the arrangement involves 'round trip financing'; The term 'round trip financing' is not used in the sense under exchange management regulations i.e. as movement of funds outside India for the eventual purpose of it being invested in India. This is defined to include situations where, through a series of transactions (a) funds are transferred among parties to the arrangement; and (b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit.

Thus, any movement of funds through a series of transactions can potentially be caught within the scope of this condition. For example, routing of funds through a favorable treaty jurisdiction for investing/lending to India can be considered a 'round trip financing arrangement' under this clause.

(iii) When the arrangement involves an accommodating party;

(iv) When the arrangement involves elements that have the effect of cancelling each other;

(v) The arrangement involves/includes a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of the transaction;

This factor is apparently intended to cover situations where transactions are undertaken by persons through others, so as to disguise their identities, location, source, value etc.

(vi) The arrangement involves the location of the asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit for a party;

(vii) The arrangement does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained

IV. The arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

This test deals with the manner in which the arrangement is entered into or carried out. Basically, this is a manner test and not a purpose test.

If a taxpayer adopts artificial or contrived means to arrive at a particular result, then he can get caught within the scope of this test. Practically, this test is whether there was a simpler/direct alternative to carry out the arrangement than the one adopted.

GRANDFATHERING/ EXCLUSIONS FROM APPLICABILITY OF GAAR

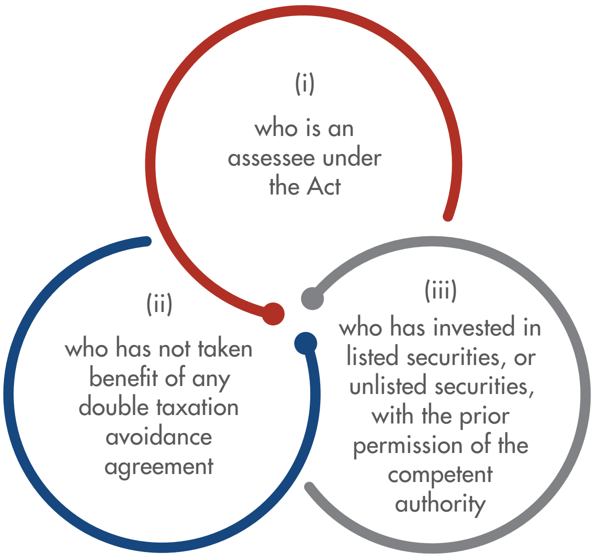
Rule 10U of the Income-tax Rules provides for certain exclusions from the provisions of GAAR, which are discussed below:

a) Monetary Threshold

As discussed above, there is a monetary threshold of INR 3 crores for the applicability of GAAR. The threshold has to be seen with respect to each assessment year. Also, the threshold is not taxpayer-specific and it has to be determined with regard to all the parties to the arrangement.

b) Exemption to Foreign Institutional Investors (FII) and Foreign Portfolio Investors

The Rules provide that the provisions of GAAR are not applicable to an FII:



The exclusion in respect of FIIs does not however provide absolute immunity from GAAR in respect of the arrangements as a whole. For instance, it may be possible for the tax authorities to invoke GAAR in the case of any other party to the arrangement and deny any tax benefit arising to him from the arrangement.

c) Exclusion for P-Notes/Investments in FIIs

The provisions of GAAR shall not apply to a person who is a non-resident in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly in a FII. The term 'offshore derivative instruments' mainly indicates investments made by way of P-Notes. Further, there is no threshold in respect of this investment. Even *de minimis* stakes are grandfathered by this clause.

d) Grandfathering of pre-April 2017 investments

This clause provides for an exclusion from the applicability of GAAR for any income, accruing to or arising to, or deemed to accrue or arise, or received or deemed to be received by any person, from transfer of investments made before 1 April 2017 by such person.

It is pertinent to note that the exclusion is limited to income arising from the transfer of investments, and not any other income that arises from the investments. (for example, dividend from shares). An issue of contention could be whether the word income includes loss. While, there are several judicial decisions supporting that the word income includes loss, but this could be a matter of intense litigation.

Further, the word 'investment' has not been defined either in the Act or the Rules, and is a word of large import. There is no clarity on how wide the term 'investment' will be construed by the tax authorities. One can expect litigation on questions like whether the 'investments' will include debt instruments, loans, stock in trade, etc.

WHAT ARE THE CONSEQUENCES OF GAAR BEING INVOKED

GAAR has been brought into effect from 1 April 2017. Hence, it might take at least a couple of years to gauge how and when the tax authorities invoke GAAR and how far-reaching the implications would be. The Act meanwhile contains provisions relating to the consequences of an impermissible avoidance arrangement, the particulars of which are briefly discussed below.

Section 95 of the Act dealing with the applicability of GAAR opens with a non-obstante clause i.e. the clause should prevail despite anything to the contrary in the provision mentioned in such clause. Hence, the consequences in relation to tax arising from an arrangement can be determined, regardless of the consequences that would otherwise arise in respect of the arrangement under the normal provisions of the Act.

The Act provides that the power to determine the consequences shall include (but not be limited to):

a) disregarding, combining or recharacterizing any step in, or part of or whole of the impermissible avoidance arrangement;

b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;

c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;

e) reallocating amongst the parties to the arrangement—

   (i) any accrual, or receipt, of a capital nature or revenue nature; or

   (ii) any expenditure, deduction, relief or rebate;

f) treating—

   (i) the place of residence of any party to the arrangement; or

   (ii) the situs of an asset or of a transaction,

   at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

g) considering or looking through any arrangement by disregarding any corporate structure.

It is also provided that, while determining the consequences, any equity can be recharacterized as debt or vice versa, any accrual or receipt of a capital nature can be treated as revenue or vice versa & any expenditure, deduction, relief or rebate might be recharacterized.

The provision clearly specifies that the consequences are not limited to the list provided and that they can be determined in any manner deemed appropriate by the tax authorities depending on the circumstances of the case. The power given to the tax authorities to determine the consequences of an impermissible avoidance arrangement are extremely open ended.

However, it must be kept in mind that the consequences determined must be *in relation to tax*. It would be necessary for the tax authorities to show that the determination of the tax consequences is appropriate with regards to the circumstances of the case. This would imply that the tax consequences must be aimed at counteracting the tax benefit that would have arisen from the arrangement in the absence of GAAR, rather than punishing the taxpayer.

Another question that arises is whether corresponding adjustments are permissible. It has been represented that corresponding adjustments should be permitted while determining the consequences of GAAR. For example, if by applying GAAR, an interest payment is recharacterized as dividend and the payer is required to pay Dividend Distribution Tax (DDT), then the tax liability of the recipient should be computed by treating the payment as exempt dividend. This observation is merely a policy view and not based on interpretation of the statute. However, corresponding adjustments too must be subject to the overall limitation that they are appropriate in the circumstances of the case.

MISCELLANEOUS ASPECTS

A few other aspects relating to GAAR are briefly discussed below:

Onus of Proof

The entire onus of proof relating to the invocation of GAAR is on the tax authorities. As discussed in the beginning, the onus lies on the tax authorities to demonstrate that

- There is an arrangement
- The arrangement leads to a 'tax benefit'
- The main purpose of the arrangement is to obtain a tax benefit
- The arrangement has one or more of the tainted elements

Despite of the onus being on the tax authorities to prove the above points relating to a taxpayer, the taxpayer is not totally immune from having to establish the bona fides of his case.

SAAR v. GAAR

Similar to GAAR, there exist certain anti avoidance rules which are particular to an issue. They are referred to as Specific Anti-Avoidance Rules (SAAR). Since the time the provisions of GAAR were introduced into public domain through draft and committee reports, it has been argued by the stakeholders that GAAR should not apply where SAARs exist i.e. there are specific anti-avoidance rules already present in the Act relating to that case.

However, this argument was not accepted and a circular[1] specifically addressed this issue by clarifying that the provisions of SAAR and GAAR can co-exist and are applicable, as may be necessary in the facts and circumstances of the case. Hence, the position on this issue is a policy one and not a legal one and a defense to the invocation of GAAR in cases where a SAAR exists will need to be based on the factors such as existence of arrangement, tax benefit, main purpose, tainted element/s etc.

Judicial anti-avoidance in a GAAR era

After the coming into force of GAAR, a question might arise whether the judicial anti-abuse doctrines can continue to be invoked by the tax authorities. A view can be taken that once GAAR is enacted, it is not permissible for the tax authorities to use these judicial principles to target the abusive transactions since the provisions of GAAR are now codified in the statute. A codifying statute is one which restates legal subject matter previously contained in earlier statutes. The courts generally presume that a codifying statute supersedes prior case law.

Since GAAR is intended to codify the general principles of anti-avoidance doctrine, it follows that it should solely govern all abusive situations to the complete exclusion of the judicial principles that were in force prior to GAAR coming into force.

Penalties

The penalty provisions of the Act seek to levy penalty in cases of under-reporting of income and misreporting of income. In cases of under-reporting of income, penalty @ 50% is leviable, while in the cases of misreporting of income, penalty @ 200% is applicable.

Under-reporting of income is, inter-alia, objectively defined to be the difference between assessed income and income determined as per provisions of the Act.

If the provisions of GAAR are held to be applicable, the penalty of under-reporting i.e. 50% could apply automatically, but the penalty for misreporting cannot be said to be automatic. This is because the taxpayer can be said to have misreported his income only in a few specified circumstances. (viz. misrepresentation or suppression of facts, failure to record investments or any receipts in the books etc.) Thus, as long as the case of the taxpayer does not fall in any of the specified circumstances, the penalty for misreporting of income cannot apply even if provisions of GAAR are held to be applicable.

Procedural Aspects

The statute contains a provision that requires the Assessing Officer to make a reference to the Principal Commissioner or Commissioner, at any stage of the assessment or reassessment proceedings before him having regard to the material available if he considers it necessary to declare an arrangement as impermissible avoidance arrangement and to determine the consequences based on the provisions of GAAR.

The Assessing Officer is required to issue a notice in writing to the taxpayer seeking any objections before making any reference to the Commissioner. Before issuing a notice to the taxpayer, the Commissioner is required to form an opinion and list out the reasons of issuance of the notice.

The provisions of GAAR also demand a reference to an Approving Panel if the Commissioner is not satisfied with the explanation offered by the taxpayer. The Approving Panel which will consist of three members – a retired High Court judge, a tax officer with the rank of Chief Commissioner and an outside expert will also have the power to cause further enquiries to be made as well as to call for records to the matter.

Since the process of declaring an arrangement as an impermissible avoidance arrangement must originate with the Assessing officer, the powers of the Commissioner or the Approving Panel are limited to those arrangements in respect of which a reference has been made by the Assessing Officer. It must be noted that no appeal lies against the directions issued by the Approving Panel.

1. Circular 7 of 2017

Advance Ruling

An advance ruling can be sought on the question of whether an arrangement which is proposed to be undertaken by any person being a resident or a non-resident is an impermissible avoidance arrangement.

Such an advance ruling can be sought by both residents and non-residents and only in respect of arrangements proposed to be entered into by the person.

GAAR CHECKLIST

1. Do any of the exclusions in Rule 10U(1) apply?
   - Is the tax benefit in the relevant assessment year less than INR 3 crore?
   - Is the taxpayer an Foreign Portfolio Investor who qualifies under Rule 10U(1)(b)?
   - Is the investment made by a non-resident, by way of an offshore derivative instrument or otherwise, in an Foreign Portfolio Investor?
   - Does the income arise from transfer of investments made before 1 April 2017?
2. Is there an arrangement?
3. Has the assessee entered into the arrangement?
4. Is there a tax benefit arising out of the arrangement?
5. Is the main purpose of the arrangement to obtain a tax benefit?
6. Is the tainted element test satisfied?
   - Does the arrangement create rights, or obligations which are not ordinarily created between persons dealing at arm's length?
   - Does the arrangement result, directly or indirectly, in the misuse or abuse of the provisions of the Act?
   - Does the arrangement lack commercial substance?
   - Is the arrangement deemed to lack commercial substance under section 97?
   - Is the arrangement entered into, or carried out, by means, or in a manner which are not ordinarily employed for bona fide purposes?

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- Technical depth and quality

We believe in thinking out of the box, handholding our clients in implementing complex solutions and working towards achieving results. We have offices in Mumbai, Ahmedabad, Bengaluru, Delhi, Pune, Singapore, Dubai, Bahrain and USA. We advise clients across multiple sectors including financial services, IT and IT-enabled services (ITES), real estate and infrastructure, telecommunications, oil and gas, pharmaceuticals, chemicals, consumer goods, power, as well as media and entertainment.

Dhruva Advisors is a member of the WTS Alliance, a global network of selected firms represented in more than 100 countries worldwide.

Our recognitions

- Dhruva Advisors has been named "India Tax Firm of the Year" at International Tax Review's Asia Tax Awards for both 2017 and 2018
- Dhruva Advisors has been named India Disputes and Litigation Firm of the Year 2018 at ITR's Asia Tax Awards, 2018
- Dhruva Advisors has been consistently recognized as a Tier 1 Firm in the International Tax Review's World Tax Guide to the world's leading tax firms.
- Dhruva Advisors was named the Best Newcomer of the Year 2016 - ASIA by International Tax Review

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