AN ANALYSIS OF THE CONCEPT OF TAX AVOIDANCE AND ODYSSEY OF GAAR IN INDIA

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There has been extensive debate about the implementation of General Anti-Avoidance Rules (GAAR) in India. The need for GAAR is felt because it is believed that such provisions will not only improve the integrity of the taxation system of the economy as a whole but also reinforce the system of controlling illegal avoidance of tax by parties taking advantage of Foreign Taxation Avoidance Agreements. Discussing concepts like tax evasion, avoidance and planning, and the differences inter se, this research article goes further and dissects the provisions of General Anti Avoidance Rules in detail as also chronologically narrating the events connected with their origin, development and deferral. It analyses the odyssey of GAAR right from its inception till its recent deferment by current Finance Minister of India, Mr. Arun Jaitley till 2017.

Introduction

"Every government has a right to levy taxes. But no government has the right, in the process of extracting tax, to cause misery and harassment to the taxpayer and the gnawing feeling that he is made a victim of palpable injustice."[1]

Indian Tax Authorities have always felt the need to tap revenue from all the sources that show enough potential to help improve the ever-prevalent and chronic fiscal deficit of the economy, that go untapped. For a long time, the Revenue has fought tooth and nail to keep a check over the rising instances of tax avoidance despite having numerous tools at its disposal. Adding another similar tool to its arsenal, the Indian Government chose to introduce General Anti Avoidance Rules (GAAR) as a part of the draft Direct Taxes Code Bill released on 12 August, 2009 to control and tap revenue from rising instances of agreements lacking commercial substance. The aspect of whether these provisions came into force has been dealt with later in this article. Nonetheless, it is important to be clear why GAAR is necessary. Not all countries have them, and not all GAARs are the same. There is no international norm for GAAR or the need for one. However, it is said that necessity is the mother of invention. The need to control rising number of tax avoidance cases made way for the rising importance of GAAR in India.

Tax Avoidance and Implication of GAAR

The recent verdict by the Hon'ble Supreme Court on Vodafone case[2] generates fresh debates on whether India needs a review of her existing legal framework particularly with respect to

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[1] Kanga & Palkhivala, The Law And Practice Of Income Tax, IX (Dinesh Vyas ed., 2004).

offshore transactions and introduction of GAAR. Before delving into what GAAR is and how it would impact the taxpayer, serious discussions are essential for a clear distinction between tax evasion, tax avoidance and tax planning.

a) **Tax Evasion**

Tax evasion is an *illegal* practice where the assessee escapes paying taxes to the government through deliberate concealment or misrepresentation of its tax liability by suppressing the income or inflating the expenditure showing the income lower than it actually is and resorting to various types of deliberate manipulations. "Tax avoidance and tax evasion are two expressions which find no definition either in the Indian Companies Act, 1956 or the Income Tax Act, 1961. But the expressions are being used in different contexts by our Courts as well as the Courts in England and various other countries, when a subject is sought to be taxed."[3]

b) **Tax Avoidance**

Tax avoidance is the "minimization of one's tax liability by taking advantage of legally available tax planning opportunities".[4] When a taxpayer escapes his/her tax liability by exploiting legal ambiguities or in other words resorts to non-compliance of tax payments, such an act *prima facie* being entirely within the framework of the law, i.e., not violating any law, it amounts to tax avoidance. Another way to make a distinction between tax evasion and avoidance is that in the case of tax avoidance, details are not hidden by tax payers, i.e., transactions are usually on record, whereas in case of evasion, transactions are mostly unreported due to the natural tendency of avoiding punitive actions.

c) **Tax Planning**

Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately, in full, benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. In other words, all those arrangements by which tax is saved by ways and means which comply with the legal obligations and requirements and are not colourable devices or tactics to meet the letters of law would constitute tax planning.

d) **Judicial Trend Regarding Tax Evasion, Tax Avoidance And Tax Planning**

The Hon'ble Supreme Court in *McDowell & Co. Ltd. v. Commercial Tax Officer*[5] observed that, "tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be a part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting

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[2] *Vodafone International Holdings B.V. v. Union of India & Anr.* [S.L.P. (C) No. 26529 of 2010, Dated 20 January 2012].

[3] *Supra* note 2, para 76

[4] Black's Law Dictionary, 9th ed. (2009).

[5] (1985) 154 ITR 148.

to subterfuges." According to the *Westminster principle*[6]**,** which originated in Britain and which has been applied in the context of India in a number of cases, every man is entitled if he can to order his affairs so as to diminish the burden of tax. However, Justice Chinnappa Reddy, in the McDowell case held that, "the principle of Westminster had been given a decent burial and in that very country where the phrase 'tax avoidance' originated, the judicial attitude towards tax avoidance had changed and the smile, cynical or even affectionate though it might have been at one time, had now frozen into a deep frown. No one could now get away with a tax avoidance project with the mere statement that there was nothing illegal about it", he had said.

According to the *Ramsay principle*[7], "the fiscal consequences of a preordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole. It is not to be ascertained by dissecting the scheme and considering each individual transaction separately."

In *Union of India v. Azadi Bachao Andolan*[8]**,** it was argued that any tax planning which results in avoidance must be struck down in the light of McDowell case[9]. Rejecting this argument, the court upheld the legitimacy of tax planning. The Apex court referred to the Privy Council judgment in *Bank of Chettinad Ltd v. CIT*[10] which accepted the principle laid down in Duke of Westminster case[11]. The judgment was the law when the Constitution came into force. The legal position continues by virtue of Article 372 by which all laws in force in the territory of India immediately before the commencement of the Constitution shall continue in force until altered or repealed or amended by a competent Legislature or other competent authority. Maintaining the applicability of the Westminster principle, unless reversed by a Supreme Court Judgment or an Act of the Parliament, the Court observed as follows: "We are unable to agree with the submission that an act which is otherwise valid in law can be treated as non-est merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests, as perceived by the respondents."

In the landmark judgment of *Gregory v. Helvering*[12], the United States Supreme Court held that "any one may arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

It should thus be noted that tax planning should not be done with the intent to defraud the revenue. There could be an instance where although all transactions entered into by the assesse could be legally correct, yet on the whole, these transactions may be devised to defraud the revenue. All such devices where statute is followed in strict sense but actually, the spirit behind the statute is defeated would be termed as colourable devices and they do not form part of tax planning. All transactions in respect of tax planning must

[6] Laid down in *Inland Revenue Commissioners v. Duke of Westminster* [1935] All ER 259 (H.L.).
[7] Laid down in *Ramsay v. IRC* [1982] A.C. 300; *IRC v. Burmah Oil Co. Ltd.* [1982] S.T.C. 30, H.L.(Sc.).
[8] [2003] 263 ITR 706 (SC).
[9] *Supra* note 5.
[10] (1941) 43 BOMLR 132.
[11] *Supra* note 6.
[12] 293 U.S. 465 (1935)

be in accordance with the true spirit of statute and should be correct in form and substance.

Various judicial pronouncements have laid down the principle that substance and form of the transactions shall be seen in totality to determine the net effect of a particular transaction. The Hon'ble Supreme Court has held, "The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of the relationship."[13] The form and substance of the transaction is the real test of any tax- planning device. The form of transaction refers to transaction as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

e) **Difference Between Tax Planning And Tax Avoidance**

The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of malafide motive involved in tax avoidance also. Any planning which, though done strictly according to legal requirements, defeats the basic intention of the Legislature behind the statute could be termed as instance of tax avoidance. It is usually done by adjusting the affairs in such a manner that there is no infringement of taxation laws as well as by taking full advantage of the loopholes therein so as to attract the least incidence of tax. Most of the amendments to law are now aimed at curbing the practice of tax avoidance.

The distinction between tax avoidance and tax planning is often difficult to make. The ambiguity arises since both the concepts are related with the activity of non-payment of tax liability being within the framework of the law. For instance, a person may adopt different accounting methods for different sources of income or invest in tax saving securities or adopt other tax-planning schemes which may all may reduce his/her tax liability without violating any law (tax planning). However, some strategies for reducing tax liability (for instance transfer mispricing) are often intended for the sole purpose of non-payment of taxes and hence, are controversial (tax avoidance). Therefore, tax avoidance is controversial and often treated as unacceptable whereas tax planning is not. But the distinction between the two in practice is extremely difficult since both are legal (though now the trend with respect to tax avoidance is changing). Therefore if a person/company is accused of tax avoidance in a negative sense, that person/company may claim that the intention is only that of 'tax planning' and not of 'tax avoidance'. The debate then ultimately boils down to identifying what transactions should be treated as legal and what should not. Given the exploitation of sophisticated devices by companies for non-compliance of legitimate tax payments, tinkering with the existing legal provisions has become essential. Most people would want to pay taxes as less as possible. However, the approach towards reduction of the incidence of tax is crucial for understanding what is legitimate and what is not. For instance, an economic entity in

[13] *CIT v. B. M. Kharwar* [1968] 72 ITR 603(SC)

India may engage in ‘tax planning’ by investing in a judicious portfolio of tax saving instruments (e.g. National Savings Certificates, Equity Linked Savings Schemes, etc.) to minimize its overall annual tax payments. On the other hand, a practice of circulating back same amount of money via the route of tax haven countries (or the so called ‘round tripping’) to the origin country or parking higher profits in lower tax jurisdictions and lower profits in higher tax jurisdictions via ‘transfer mispricing’ may be ‘tax avoidance’. Another way of looking into the difference between tax planning and tax avoidance is that while an economic entity tries to minimise the overall tax burden by utilizing the available options in case of tax planning (and does not try to escape from tax payments), in case of tax avoidance an entity tries to escape from tax burden by creating sophisticated methods for non-compliance of legitimate tax payments. However, it is difficult to treat the latter practice as blatantly illegal since it is done within the framework of the law, even in cases where the sole purpose is noncompliance of taxes and nothing else.

f) **Implication of Implementing GAAR**

Qui sentit commodum sentire debet et onus- He who receives the advantage ought also to suffer the burden- It is a perfect maxim that applies in case of such international transactions that lack commercial substance and the aim of which is usually only to avoid payment of tax by taking advantage of one or more Tax Avoidance Treaties between India and any other country. The implication of GAAR is that the Income-tax department will have powers to deny tax benefit if a transaction was carried out exclusively for the purpose of avoiding tax. For example, if an entity is set up in Mauritius with the sole intention of claiming exemption from capital gains tax arising out of a transaction of transfer of capital assets of an entity connected with the territory of India(similar to what happened in the Vodafone Case), the tax authorities shall have the right to deny the claim for exemption provided under the India-Mauritius tax treaty. It simply means that GAAR shall have an overriding effect over any Tax Avoidance treaty that India might have with any other nation and the transaction whose sole purpose would be to skip payment of tax to Indian Tax Authorities shall be taxed by implementing GAAR provisions.

Brief Background and Present Status of GAAR

The Government of India chose to introduce General Anti Avoidance Rules (GAAR) as a part of the draft Direct Taxes Code Bill (DTC 2009) released on 12 August, 2009 with discussion paper for public debate. Subsequently, a Revised Discussion Paper was released in June 2010. As a result, a bill known as the Direct Taxes Code Bill, 2010 (the Code) was tabled in the Parliament on 30 August, 2010. Sections 123 to 125 of the Code contained provisions pertaining to GAAR. The Code was meant to replace the current Income-tax Act, 1961. The Code had been pending consideration before the Standing Committee of Finance. However, in the meantime, GAAR provisions were included in Chapter X-A(Sections 95 to 102) of the Finance Act, 2012 which came into force on 1 April, 2012. Due to uproar over the controversial GAAR provisions that the new Act contained, The Parthasarathy Shome panel was formed by previous Prime Minister Manmohan Singh in July 2012, for drawing up the final guidelines on GAAR and mainly to bring about tax clarity and address the concerns of foreign investors. The panel, headed by tax expert Parthasarathi Shome, Director and Chief Executive, Indian Council for Research on International Economic Relation provided various recommendations to revive the inflow of foreign capital and advocated postponement of the controversial tax provision by three years till 2016-17 *inter alia*. Therefore, implementation of Chapter X-A of the Finance Act, 2010 containing GAAR provisions was deferred till 1 April, 2016 by the then Finance Minister Mr. P. Chidambram.

Currently, as conveyed by present Finance Minister of the NDA Government, Mr. Arun Jaitley, the Direct Taxes Code Bill, 2010 shall be considered as lapsed with the dissolution of the 15th Lok Sabha and it shall no longer be considered for implementation. This does not mean that GAAR is out of the picture now. Presenting his first full budget in March, 2015, Mr Jaitley deferred implementation of GAAR by 2 further years taking it to the year 2017.

Conclusion

The GAAR provisions are similar to a double-edged sword and need to be judicially invoked by the revenue authorities. In my opinion, introduction of GAAR would have a deep, much needed impact on the economy of India if seen in a positive light. Some might say that a concept like GAAR is a little premature for the Indian Economy and the tax payers of India despite there being a need for such provisions in the country but just the way time keeps moving forward, so does the need to evolve the law with it, thus giving that dynamic quality to it as a body of rules governing our actions. Presently in India, the tax payers are given an option to avoid the incidence of tax by way of tax planning provided it is within the four corners of the taxing statute. The implementation of GAAR would be a hindrance to the unauthorized tax avoidance activity which has always been in existence and followed to minimize one's incidence of tax thus bringing in more revenue to the economy.

On comparing the provisions of GAAR with similar provisions prevailing in other countries, it can be said that the Indian provisions are more stringent than those of other nations. Leaving less scope for tax avoidance, where on one hand would benefit the economy financially would on the other hand, create an unnecessary burden of tax on the shoulders of the investors and further discourage the much needed investment from Foreign Investors.

The recent report of the Expert Committee on General Anti Avoidance Rules (GAAR) headed by Mr. Parthasarathi Shome suggested that income from sale of listed securities should be fully exempt from tax *inter alia*. Investors from Mauritius and Singapore may also look forward to more certainty on entitlement to tax treaty benefits.

The GAAR Committee has recognized the right of taxpayers to mitigate taxes through arrangements that are not abusive, contrived or artificial. GAAR should therefore be used as a last resort and not a first recourse. As a measure of fairness, it has been proposed that existing investments should be grandfathered. The Committee has recommended that GAAR should only apply to abusive, artificial and contrived arrangements. This qualitative threshold helps in preserving the taxpayer's right to plan his affairs and mitigate taxes. The recommendation to issue a negative list of arrangements where the provision of GAAR cannot be invoked will be positively help a bona fide person in not getting trapped into the stringent provisions of GAAR. Being deferred till 2017, GAAR needs more time to be implemented as the present status of the economy doesn't demand such a stringent legal action to be taken so soon, especially, when the Modi Government is striving to attract foreign investors and openly promoting his 'Make in India' campaign to revive the Indian economy desperately.