Gearing up for GAAR April 2017 Brahmayya&co. www.brahmayya.com

Introduction

The Finance Act 2012, incorporated anti avoidance provisions in the form of General Anti Avoidance Rules ("GAAR") under Chapter X-A (consisting of Sections 95 to 102) of the Income Tax Act ("the Act"), w.e.f Assessment Year 2014-15.

Various stakeholders raised concerns on the "over-reach" of GAAR provisions, therefore an expert committee headed by Dr. Parthasarathi Shome called the "Shome Committee" was set up by the, then Prime Minister Dr. Manmohan Singh to examine the concerns raised. The major recommendations of the Expert Committee were accepted by the Government with some modifications.

During the 2015 Budget session of the Parliament, the Finance Minister Shri. Arun Jaitley quoted "there are certain issues relating to GAAR which need to be resolved. It has therefore been decided to defer the applicability of GAAR by two more years. Further, it has also been decided that when implemented, GAAR would apply prospectively to investments made on or after 1st April 2017". GAAR provisions are thus slated to come into effect from Assessment Year 2018-19.

The basic consideration which compelled these anti-avoidance rules to come into force were the various "tax saving" modes adopted by the assessees. They may be broadly classified in the following heads:

- Tax Evasion Illegal arrangements where liability to tax is hidden or ignored. Deliberate steps are taken by the tax payer in order to reduce the tax liability by illegal or fraudulent means.
- **Tax Avoidance** A term used to describe an arrangement of a tax payer's affairs that is intended to reduce the liability and, that although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow.
- **Tax Mitigation** A situation where the taxpayer takes advantage of a fiscal incentive granted by the tax legislation by actually submitting to the conditions and economic consequences that the particular tax legislation entails.

Specific Anti Avoidance Rules

The Income Tax Act provisions, has already in place Specific Anti Avoidance Rules (SAAR). SAAR is the set of rules which are more specific and provide certainty to a tax payer while arranging the affairs or while formalizing an arrangement. Examples of SAAR provisions, among other, include:

- Section 2(22)(e) Deemed Dividend
- Section 60 to 64 Clubbing of Income
- Section 93 Tax avoidance by transactions resulting in transfer of income to non-resident
- Section 94 Dividend Stripping
- Section 56(2) Tax avoidance by transfer of property at Nil or inadequate consideration
- Section 40A(2) Disallowance of excessive or unreasonable payments to associated persons.

In comparison to SAAR which is more specific, GAAR has a broader application resulting in it being interpreted in a more extensive manner.

Basic Facts

Effective Date of Applicability

Originally it was set to be introduced from April 2012 as per the Finance Bill 2012, but now it is applicable from April 2017, i.e., AY 2018-19.

Onus of the Tax Authority

Onus is on the Assessing Officer to show that a particular transaction is an impermissible tax avoidance arrangement (IAA).

Monetary Limit

Monetary limit of INR 3 Crores of tax benefit in the arrangement will attract the provisions of GAAR. Tax benefit may be considered for each arrangement separately. In case of a tax deferral, the tax benefit shall be determined based on present value of money. Present value is to be calculated by adopting interest rate as applicable for non-payment of advance tax.

Commercial Substance Test

The Expert Committee has recommended restoring the definition of 'lacks commercial substance' as present in DTC 2009 and DTC 2010. The said definition gives due regard to the presence of significant business risks or net cash flow impact on any party to the arrangement. The test implies that, apart from a commercial purpose, the taxpayer also has commercial substance which changes the economic position of the taxpayer.

Tax Benefits

There could be an IAA only if the main purpose is to obtain tax benefit. This term 'tax benefit' has been defined in Section 102(10) as to include:

- reduction or avoidance or deferral of tax or any other amount payable under the Act in the relevant previous year or any other previous year; or
- an increase in a refund of tax or other amount under the Act in any previous year; or
- a reduction or avoidance or deferral of tax or other amount that would be payable under the Act, as a result of a tax treaty in any previous year; or
- an increase in a refund of tax or other amount under this Act as a result of a tax treaty in any previous year; or
- · a reduction in total income; or
- an increase in loss in the relevant previous year or any other previous year.

Transaction

The term 'transaction' is a word of wide import. It can be interpreted as 'that which has been transacted; a piece of business, the action of passing or making over a thing from one person, thing or state to another.

[Karumuthu Thiagaraja Chetty & Co. [1961] 42 ITR 788 (Mad.)].

Scheme

A carefully arranged and systematic program of action', a 'systematic plan for attaining some object', 'a project', 'a system of correlated things'

[State of West Bengal v. Swapan Kumar Guha AIR 1982 SC 949].

Agreement

Every promise and every set of promises forming the consideration for each other is an agreement [section 2(e) of Indian Contract Act, 1872]. There is mutual assent to the proposal when the proposal is accepted and in the result an agreement is formed

[Andhra Sugars Ltd. v. State of A. P. AIR 1968 SC 599].

Operation

An act or instance, process, or manner of functioning or operating. A particular process or course; mental operations. A business transaction, esp. one of a speculative nature; deal: a shady operation.

Understanding

The word means something quite different from a binding legal contract; at most the word connotes a gentleman's agreement

[Milner v. Percy Bilton [1966] 2 All ER 894]

When GAAR is triggered?

GAAR is triggered only if there is an Impermissible Avoidance Arrangement. There is an IAA, if following conditions are satisfied:

- a) there is an **arrangement** (Any step in, or a part 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), and
- b) the main purpose of the arrangement or any step in it, or a part of it is to obtain *tax benefit* as defined in Section 102(10), and
- c) an arrangement satisfies anyone of the following:
 - It creates rights which are not ordinarily created between persons dealing at arm's length
 - It creates obligations which are not ordinarily created between persons dealing at arm's length
 - It results, directly or indirectly, in the misuse or abuse of the provisions of the Act
 - It lacks commercial substance in whole or in part
 - It is deemed to lack commercial substance in whole or in part within the meaning of Section 97
 - It is entered into by means, or in a manner, which are not ordinarily employed for bona fide purposes
 - It is carried out by means, or in a manner, which are not ordinarily employed for bona fide purposes

Lack of Commercial Substance

An arrangement shall be deemed to lack commercial substance, if –

- a) The substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or
- b) It involves or includes -
 - Round trip financing
 - An accommodating party; (It means that where a party is included in an arrangement mainly for obtaining tax benefit to the taxpayer, then such party may be treated as an accommodating party)
 - any element that has the effect of offsetting or cancelling each other;
 - a transaction which is conducted through one or more person(s) and disguise the nature, location, source, ownership or control of fund.

It is not necessary that such party should be connected to the taxpayer and the following factors are NOT considered relevant in determining whether an arrangement lacks commercial substance:

- Period of time for which an arrangement exists.
- · Payment of taxes, directly or indirectly, under the arrangement.
- Availability of exit route under the arrangement.

Clarification by CBDT

On 27th January, 2017, CBDT issued Circular No. 7/2017 where it resolved the questions raised by stakeholders on the implementation of GAAR.

- The circular clarifies that the Provisions of GAAR and SAAR can coexist. GAAR can be applied even if SAAR exists to curb a specified tax avoidance situation
- In case the avoidance is sufficiently addressed by Limitation of Benefit in the relevant treaty, GAAR may not be invoked
- GAAR will not interplay with the right of taxpayer to select or choose method of implementing a transaction.
- GAAR shall not be invoked merely on the ground that the entity is located in tax efficient jurisdiction. If the jurisdiction of Foreign Portfolio Investment (FPI) is based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.

- Grandfathering protection shall be available to compulsory convertible debentures, compulsory convertible preference shares, foreign currency convertible bonds and GDRs, even when such instruments get converted into shares etc. after 31st March 2017. Grandfathering protection shall be available to bonus issuance, split or consolidation of holdings in the hands of same investor.
- Lease contracts and loan arrangements are, by themselves, not "investment" and hence grandfathering would not be available.
- GAAR will not apply if arrangement is held as permissible by Authority for Advance Ruling (AAR).
- GAAR will not be invoked if the arrangement is sanctioned by an authority such as Court, National Company Law Tribunal or is in accordance with judicial precedents.
- GAAR provisions are applicable to IAA as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.
- To declare an arrangement as an IAA under GAAR, it will be vetted first by the Principal Commissioner / Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.
- If the arrangement is covered under section 96 as an IAA, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.
- Stakeholders requested for clarification on definite time limit such as 5-10 years of existing arrangement where GAAR Provision shall not apply. CBDT responded that period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.
- Circular clarifies that adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of other participant will not be made/allowable.
- The application of the tax laws is jurisdiction specific and GAAR is arrangement specific. GAAR is applicable if the tax benefit exceeds INR 3 crores. The Circular clarifies that tax benefit of INR 3 crores shall be calculated on the basis of the benefit enjoyed in the Indian jurisdiction with respect to an assessment year by one or more taxpayers.
- If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in any subsequent year.
- Levy of penalty depends on the facts and circumstances of the case and is not automatic. No blanket exemption for a period of 5 years from penalty provision is available under law. The assessee may at his option, apply for benefit under section 273A of the Act if he satisfies conditions prescribed therein.

Gearing up for GAAR

Conclusion

The prospective applicability of GAAR provision is a welcome move which will provide certainty and will also help to boost confidence of the taxpayers and foreign investors. However, the overreach of the provisions are to be kept in mind. The wider scope of GAAR may result in tax litigations. A clearer tax regime would boost confidence and promote economic stability. An effective tax administration is the key to successful implementation of GAAR.



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