GENERAL ANTI-AVOIDANCE RULE

1. Background of General Anti-Avoidance Rule (GAAR) in India

Introduction to GAAR

The General Anti-Avoidance Rule (GAAR) is an anti-tax avoidance law in India, introduced to combat aggressive tax planning strategies. It was initially proposed in the Direct Tax Code (DTC) 2009 but was formally introduced into the Income Tax Act, 1961, through the Finance Act, 2012.

Key Developments and Provisions

1. **Initial Introduction and Revisions**:

   - **Finance Act, 2012**: GAAR was first introduced in Sections 95 to 102 and 144BA of the Income Tax Act, with an initial applicability date set for A.Y. 2014-15. However, due to opposition, these provisions were revised and replaced by new sections through the Finance Act, 2013, with a deferred applicability date of A.Y. 2016-17.

   - **Finance Act, 2013**: The revised provisions aimed to address concerns raised by stakeholders. An expert committee was formed to finalize GAAR guidelines, leading to modifications that preserved the basic thrust of GAAR while ensuring a well-defined procedure for its invocation.

2. **Expert Committee and Modifications**:
   An expert committee, including the Parthasarathy Shome Panel, was set up to review and refine GAAR guidelines. The committee's recommendations led to legislative amendments and guidelines for GAAR's implementation.

3. **Deferred Implementation**:
   In 2015, the Finance-Minister announced a further two-year deferment of GAAR's implementation, making it applicable prospectively from A.Y. 2018-19 (financial year 2017-18). This decision aimed to ensure positive investment sentiment and resolve outstanding issues related to GAAR.

4. **Final Implementation**:
   - GAAR came into effect on April 1, 2017, and applies to assessment year 2018-19 onwards. It targets arrangements lacking genuine commercial substance, ensuring that tax planning aligns with legitimate business purposes.

Objectives and Applicability

- **Objective**: GAAR aims to prevent aggressive tax avoidance by ensuring that transactions have genuine commercial substance and are not solely for tax benefits.

- **Applicability**: It applies to both domestic and international transactions, focusing on arrangements that lack commercial substance or are primarily for tax benefits.

GAAR vs. SAAR

- **GAAR**: General Anti-Avoidance Rule, targeting broad tax avoidance strategies.

- **SAAR**: Specific Anti-Avoidance Rules, addressing specific tax avoidance schemes on a case-by-case basis.

Impact and Legal Framework

- GAAR operates under the Income Tax Act, 1961, and is framed by the Department of Revenue under the Ministry of Finance.

- It targets transactions that are prima facie legal but result in tax reduction, distinguishing between tax mitigation (permitted) and tax avoidance (undesirable) .

2. GAAR Provisions

Section 95: This section provides that an arrangement entered into by an assesse may be declared to be an impermissible avoidance arrangement. The tax arising from such declaration by the tax authorities will be determined subject to provisions of sections 96 to 102. It is also stated in this section that the provisions of sections 96 to 102 may be applied to any step or a part of the arrangement as they are applicable to the entire arrangement. Section 95(2) provides that Sections 95 to 102 shall apply from A/Y:2018-19 and onwards. Rule 10U of the Income tax Rules provides that Sections 95 to 102 shall not apply to an arrangement where the tax benefit in the relevant assessment year, to all parties to the arrangement, does not exceed ₹3 Crores.

Impermissible Avoidance Arrangement (Section 96):

i) Section 96 explains the meaning of Impermissible Avoidance Arrangement to mean an arrangement, the main purpose of which is to obtain a tax benefit and it -
   a) Creates rights or obligations which would not ordinarily be created between persons dealing at arm's length.
   b) Results, directly or indirectly, in misuse or abuse of the provisions of the Income tax Act.
   c) Lacks commercial substance, or is deemed to lack commercial substance under section 97, in whole or in part, or
   d) Is entered into or carried out, by means, or in a manner, which are not ordinarily employed for bonafide purposes.

ii) An arrangement whereby there is any tax benefit to the assesse shall be presumed to have been entered into

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or carried out for the main purpose of obtaining tax benefits, unless the assessee proves otherwise. It will be noticed that this is a very heavy burden cast on the assessee. The Finance-Minister has, however, declared on 7/5/2012 that the onus of proof will be on the department who has to establish that the arrangement is to avoid tax before initiating the proceedings under these provisions.

Lack of Commercial Substance (Section 97):

i) Section 97 explains the concept of Lack of Commercial Substance in an arrangement entered into by the assesse. It states that 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 of such steps.

b) It involves or includes

- Round Trip Financing
- An accommodating party.
- Elements that have the effect of offsetting Or canceling each other or 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 such transaction.

c) It involves the location of an asset or a transaction or the place of residence of any party which is without any substantial commercial purpose. In other words, the particular location is disclosed only to obtain tax benefit for a party, or

d) 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.

ii) For the above purpose, it is provided that round trip financing includes any arrangement in which through a series of transactions:

a) Funds are transferred among the parties to the arrangement, and,
b) Such transactions do not have any substantial commercial purpose other than obtaining tax benefit.

iii) It is further stated that the above view will be taken by the tax authorities without having regard to the following:

a) Whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement.

b) The time or sequence in which the funds involved in the round trip financing are transferred or received, or

c) The means by, manner in, or mode through which funds involved in the round trip financing are transferred or received.

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iv) The party to such an arrangement shall be treated as "Accommodating Party" whether or not such party is connected with the other parties to the arrangement, if the main purpose of, direct or indirect, tax benefit under the Income tax Act.

v) It is clarified in the section that the following factors may be relevant but shall not be sufficient for determining whether the arrangement Lacks commercial substance.

a) The period or time for which the arrangement exists

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

c) The fact that exit route, including transfer of any activity, business or operations, is provided by the arrangement.

Consequence of Impermissible Avoidance Arrangement (Section 98):

Under section 144 BA, the Commissioner has been empowered to declare any arrangement as an impermissible arrangement. Section 98 states that if an arrangement is declared as impermissible, then the consequences, in relation to tax or the arrangement shall be determined in such manner as is deemed appropriate in the circumstances of the case. This will include denial of tax benefit or any benefit under applicable Tax Treaty. The following is the illustrative list of consequences and it is provided that the same will not be limited to this list.

i) Disregarding, combining or re-characterising any step in, or part or whole of the impermissible avoidance arrangement.

ii) Treating, the impermissible avoidance arrangement as if it had not been entered into or carried out;

iii) Disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

iv) Deeming persons who are connected persons in relation to each other to be one and the same person;

v) Re-allocating between the parties to the arrangement, (a) any accrual or receipt of a capital or revenue nature or (b) any expenditure, deduction, relief or rebate;

vi) Treating (a) the place of residence of any party to the arrangement or (b) situs of an asset or of a transaction at a place other than the place or location of the transaction stated under the arrangement.

vii) Considering or looking through any arrangement by disregarding any corporate structure.

viii) It is also clarified that for the above purpose the tax authorities may re-characterise (a) any equity into debt or any debt into equity, (b) any accrual or receipt of Capital nature may be treated as of revenue nature or vice versa or (c) any expenditure, deduction, relief or rebate may be re-characterised.

It may be noted that if only a part of the arrangement is declared to be impermissible under this section, Rule

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10UA provides that the consequences in relation to tax shall be determined with reference to such part only.

Section 99: This section provides for treatment of connected persons and accommodating party. The section provides that for the purposes of sections 95 to 102, for determining whether a tax benefit exists -

i) The parties who are connected persons, in relation to each other, may be treated as one and same person.

ii) Any accommodating party may be disregarded.

iii) Such accommodating party and any other party may be treated as one and the same person.

iv) The arrangement may be considered or looked through be disregarding any corporate structure.

Section 102 : Some Definitions

i) "Arrangement" means any step in, a part or whole of any transaction, operations, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding.

ii) "Benefit" includes a payment of any kind whether in tangible or intangible form.

iii) "Connected Person", in relation to a person who is an Individual, Company, HUF, Firm, LLP, AOP or BOI is defined in more or less the same manner as the term "Related Person" is defined in Section 40A(2). It may be noted that, for this purpose, the definition of the word "Relative" is wider in as much as the definition of "Relative" given in Explanation to Section 56(2) (vi) is adopted, whereas in section 40A(2) the narrower definition of "Relative" given in Section 2(41) is adopted.

iv) "Fund" includes (a) any cash, (b) cash equivalents and (c) any right or obligation to receive or pay in cash or cash equivalent.

v) "Party" means any person, including Permanent Establishment which participates or takes part in an arrangement.

vi) "Relative" has the same meaning as given in section 56(2) (vi) – Explanation. It may be noted that this definition is very wide as compared to the definition given in section 2 (41) which is adopted for the purpose of explaining related person in section 40A (2).

vii) The definition of a person having substantial interest in the company and other non- corporate body is the same as given in section 40A(2).

viii) "Step" includes a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement.

ix) "Tax Benefit" includes (a) a reduction, avoidance or deferral of tax or other amount payable under the Income tax Act, (b) an increase in a refund of tax or other amount under the Act, (c) a reduction, avoidance or deferral of tax or other amount that would be payable under the Act, as a result of tax treaty,(d) an increase

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in a refund of tax or other amounts under the Act as a result of tax treaty, (e) a reduction in total income or (f) increase in loss in the relevant accounting year or any other accounting year.

x) "Tax Treaty" means Agreements entered into by the Government with any foreign county, territory or Association u/s 90 or 90A.

Section 144 BA: Procedure for declaring an arrangement as impressible under sections 95 to 102 is given in this section. This section will come into force from A.Y. 2018-19

i) The Assessing Officer can, at any stage of assessment or reassessment, make a reference to the Commissioner for invoking GAAR. On receipt of reference the Commissioner has to issue a notice to the assesse to make his submissions and give a hearing within such period not exceeding 60 days. If he is not satisfied by the submissions of taxpayer and is of the opinion that GAAR provisions are to be invoked, he has to refer the matter to an "Approving Panel". In case the assesse does not object or reply, the Commissioner can issue such directions as he deems fit in respect of declaration as to whether the arrangement is an impermissible avoidance arrangement or not. Under Rule 10UC (1)(i) no such direction can be issued after expiry of one month from the end of the month in which the date of compliance of the notice to the assesse u/s 144BA(2) is given.

ii) The Approving Panel has to dispose of the reference within a period of six months from the end of the month in which the reference was received from the Commissioner.

iii) The Approving Panel can either declare an arrangement to be impermissible or declare it not to be so after examining material and getting further inquiry made. It can issue such directions as it thanks fit. It can also decide the year or years for which such an arrangement will be considered as impermissible. It has to give hearing to the assesse before taking any decision in the matter.

iv) The Assessing Officer (AO) can determine consequences of such a declaration of arrangement as impermissible avoidance arrangement.

v) The final order, in case any consequence of GAAR is determined, shall be passed by the AO only after approval by Commissioner.

vi) The period taken by the proceedings before Commissioner and the Approving Panel shall be excluded from time limitation for completion of assessment.

vii) The Central Government has to constitute one or more Approving Panels. Each Panel shall consist of 3 members, including a chairperson. The constitution of the Panel shall be as under.

a) Chairperson – He shall be a sitting or retired judge of a High Court

b) Members - One member shall be IRS of the rank of CCIT or above. One member shall be an academic or scholar having special knowledge of matters such as direct taxes, business accounts and international trade practices.

The term of the Panel shall ordinarily be for one year and may be extended from time to time upto 3 years. The

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Panel shall have power similar to those vested in AAR u/s 245U. CBDT has to provide office infrastructure, manpower and other facilities to the Approving Panel's members. The remuneration payable to Panel members shall be decided by the Central Government.

viii) In addition to the above, it is provided that the CBDT has to prescribe a scheme for efficient functioning of the Approving Panel and expeditious disposal of the reference made to it. No such scheme has been prescribed by CBDT so far.

ix) Appeal against the order of assessment passed under the GAAR provisions, is to be filed directly with the ITA Tribunal and not before CIT (A). Section 144 C relating to reference before DRT does not apply to this assessment order and, therefore, no reference can be made to DRT when GAAR provisions are invoked. No appeal can be filed by the AO against the directions given by the Approving Panel.

3. Procedure (Rules 10U to 10UC)

1. It is provided in section 100 that the provisions of sections 95 to 102 shall apply in addition to, or in lieu of, any other basis of determination of tax liability. Section 101 gives power to CBDT to prescribe the guidelines and lay down conditions for application of sections 95 to 102 relating to General Anti- Avoidance Rule (GAAR). It may be noted that for this purpose Rules 10U to 10UC and Forms 3CEG to 3CEI have been inserted in the Income tax Rules.

2. Rule 10U provides that the GAAR provisions of chapter X-A (Sections 95 to 102) shall not apply in respect of the following:

a) To an arrangement where the tax benefit in the relevant assessment year arising to all the parties to the arrangement does not exceed, in the aggregate, ₹3 Crores.

b) To a Foreign Institutional Investor (FII) who is assesse under the Income tax Act and has not taken benefit of DTTA u/s 90 or 90A. Further, such FII should have made investment in listed or un-listed securities with prior permission of SEBI under the applicable Regulations.

c) To a Non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly in a FII.

d) To any income accruing, arising or received by any person from transfer of Investments made before 1-4-2017 by such person.

e) Without prejudice to (d) above, it is clarified in the Rule that GAAR Provisions will apply to any arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after 1-4-2017. This will mean that if any impermissible arrangement is entered into prior to 1/4/2017, GAAR provisions will apply to the tax benefit obtained after 1/4/2017.

f) The term (a) FII, (b) offshore derivative instrument, (c) SEBI and (d) tax benefit are defined in the Rule.

3. Rule 10 UB provides for Forms and Notice for reference under Section 144BA. If the Assessing Office is of the view that GAAR provisions are to be invoked to a particular arrangement or transaction he has to issue a

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notice to the assesse seeking his objections, if any, to the applicability of the provisions of Chapter X-A (i.e. Sections 95 to 102). In this notice A.O. has to state-

a) Details of the arrangement to which provisions of Chapter X-A are proposed to be applied.

b) The tax benefit arising under the arrangement

c) The basis and reasons for considering that the main purpose of the arrangement is to obtain tax benefit.

d) The basis and reasons as to why conditions provided in Section 96(1) are satisfied.

e) The A.O. has to give a list of the documents and evidence relied upon by him supporting his reasons stated under (c) and (d) above.

4. After receiving the objections from the assesse, the A.O., if not satisfied with the objections, can make a reference to the CIT u/s 144BA (1) in Form No. 3 CEG. If the CIT, after considering the reference by the A.O. and the objections filed by the assesse is satisfied that provisions of chapter X-A are not applicable to the facts of the case, he shall issue directions to A.O. in Form No. 3CEH. Such directions are to be given within a period of 2 months from the end of the month in which the final submissions of the assesse in response to notice issued u/s 144BA (2) are made.

5. If the commissioner decides to refer the matter to the Approving panel u/s 144BA(4), he shall record his satisfaction regarding the applicability of the provisions of Chapter X-A in Form No.3CEI and enclose the same with the reference. Rule 10UC provides that no reference shall be made to the Approving panel u/s 144 BA (4) after the expiry of 2 months from the end of the month in which final submissions of the assesse in response to notice u/s 144BA(2) is received.

4. To SUM UP:

1. The above GAAR provisions will have far reaching consequences for assesses engaged in the business with Indian or Foreign parties. GAAR is not restricted to only business transactions. Therefore, all assesses who are engaged in business or profession or who have no income from business or profession but have income from some source will be affected by these provisions. It appears that any assesse having any arrangement, agreement, or transaction with a connected person will have to take care that the same is at Arm's Length Consideration. In particular, an assesse will have to consider the implications of GAAR while (a) executing a WILL or Trust, (b) entering into partnership or forming LLP, (c) taking controlling interest in a company, (f) entering into amalgamation of two or more companies, (c) effecting demerger of a company, (f) entering into a consortium or joint venture, (g) entering into foreign collaboration, (h) acquiring an Indian or Foreign company or (i) making a Gift. It may be noted that this is only an illustrative list and there may be other transactions which may attract GAAR provisions.

2. From the wording of the above provisions of sections 95 to 102, 144BA and Rules it appears that the provisions of GAAR can be invoked even in respect of an arrangement made prior to 1-4-2017. The CIT or the Approving Panel can hold any such arrangement entered into prior to 1-4-2017 as impermissible and direct the AO to make adjustments in the computation of income or tax in the assessment year 2018-19 or any year

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thereafter. As suggested in Para 15.15 of the report of the Standing Committee on Finance on DTC Bill, 2010 GAAR provisions should have been applied prospectively so that they are not made applicable to existing arrangements / transactions. Even in the Press Note issued by the Central Government on 14-1-2013 it was stated that transactions entered into prior to 30-8-2010 will not be made subject to GAAR provisions. This has not been provided in the above sections and, therefore, the above GAAR provisions may have retroactive effect. The only exception made in Rule 10U is with reference to income from transfer of certain investments made prior to 1-4- 2017.

3. The Government has not yet issued notification for constitution of Approving Panel u/s 144BA. Moreover, the CBDT has not yet issued the scheme for efficient functioning of the Approving Panel and expeditious disposal of the reference made to it.

4. The provisions in Rule 10U that GAAR Provisions will not apply where the aggregate tax benefit does not exceed ₹3 Cr., is welcome. Let us hope that in other cases the tax department will take a reasonable view while dealing with commercial arrangements made by tax payers while conducting their economic activities.

The Concept of GAAR is new in our Country. Therefore, it is necessary to educate the tax payers about the nature of arrangements and transactions which will be considered by the tax department as impermissible arrangements. For this purpose, the CBDT should issue detailed guidelines giving illustrations of different types of arrangements which may be considered as impermissible. This can be given in question answer form. Such guidelines will enable tax payers to take care while entering into any arrangement or transaction. This will also reduce litigation.

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