CBDT gives its views on the applicability and implementation of GAAR

February 08, 2017

In brief

The General Anti-Avoidance Rules (GAAR) are included in Chapter X-A of the Income-tax Act, 1961 (the Act) and shall come into force from 01 April, 2017. While certain rules in relation to the scope of GAAR were introduced earlier, the stakeholders had raised certain queries in relation to the implementation of GAAR provisions. The Central Board of Direct Taxes (CBDT) constituted a Working Group in June 2016 for considering such issues. The CBDT, after considering the comments of the Working Group, has issued a Circular[1] providing its views on some aspects of GAAR.

These include its views on the interplay between GAAR and specific anti avoidance rules (SAAR) and the Limitation of Benefit (LOB) test under certain tax treaties. The CBDT has also indicated the manner of determination of the threshold for tax benefit for invoking and the scope of investments, which will be grandfathered from the applicability of GAAR.

In detail

The CBDT has issued its views in a question-answer form. We have dealt with the significant ones in the table below.

Question No.	Query	CBDT response
1	Will GAAR be invoked if SAAR applies?	Specific anti-avoidance provisions may not address all situations of abuse, and there is need for general anti-abuse provisions. The GAAR and SAAR can coexist as applicable in the facts of the case.
2	Will GAAR be applied to deny treaty eligibility in a case where LOB clause under the treaty has been complied with?	Anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies, and the same are required to be tackled through GAAR. If a case of avoidance is sufficiently addressed by the LOB, GAAR shall not be invoked.
3	Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?	GAAR will not interplay with such right of the taxpayer.

[1] Circular No. 7 of 2017

Question No.	Query	CBDT response
4	Will GAAR apply where the jurisdiction of FPI is based on non-tax commercial consideration, and such foreign portfolio investor (FPI) has issued P-notes referencing Indian securities? Will GAAR apply to deny treaty benefits to a Special Purpose Vehicle (SPV) on the ground that it is located in a tax friendly jurisdiction, or on the ground that it does not have its own premises or employees?	GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of the FPI is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.
5	Will GAAR apply to (i) bonus shares issued for original shares acquired prior to 01 April, 2017, (ii) shares issued post 31 March, 2017 on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares, Foreign Currency Convertible Bonds, Global Depository Receipts acquired prior to 01 April, 2017, (iii) shares that are issued consequent to the split up or consolidation of such grandfathered shareholding?	Grandfathering will be available to investments made before 01 April, 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalised at the time of issue of such instruments. Shares brought into existence by way of split up or consolidation or bonus issuances in respect of shares acquired prior to 01 April, 2017 will also be eligible for grandfathering in the hands of the same person.
7 and 8	Will GAAR apply if arrangement has been held as permissible by the Authority for Advance Ruling (AAR) or if the arrangement is sanctioned by an authority such as a Court, National Company Law Tribunal, or is in accordance with judicial precedents, etc.?	GAAR will not apply if the arrangement is held as permissible by the AAR. Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.
13	It may be ensured that in practice, the consequences of a transaction being treated as an impermissible avoidance arrangement are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence were applied in the hands of one of the participants, there would be corresponding adjustment in the hands of other participant.	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 participants as a result of GAAR, corresponding adjustment in the hands of the other participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences, and corresponding tax adjustments across different taxpayers could militate against deterrence.
14	Tax benefit threshold of INR 30 million may be calculated in respect of each arrangement and each taxpayer and for each assessment year separately. The review should extend to tax consequences across territories. The tax impact of INR 30 million should be considered after taking into account impact to all the parties to the arrangement, i.e., on a net basis and not on a gross basis (i.e., impact in the hands of one or few parties, selectively).	For calculation of threshold of INR 30 million, only the tax benefit enjoyed in Indian jurisdiction due to the arrangement or part of the arrangement is to be considered. Such benefit is assessment year specific. GAAR is with respect to an arrangement or part of the arrangement and limit of INR 30 million cannot be read in respect of a single taxpayer only.

Views of CBDT on some other aspects

- Lease contracts and loan arrangements are by themselves not "investments," and hence grandfathering is not available to such arrangements.
- Admissibility of claim under treaty or domestic law in different years is not a matter to be decided by GAAR provisions.
- Proposal to declare an arrangement as an

impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner/ Commissioner (PCIT), and at the second stage by an Approving Panel headed by a High Court judge. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.

- If an arrangement is covered as impermissible avoidance arrangement, then the arrangement will be disregarded by application of GAAR, and necessary consequences will follow.

- The period of time for which an arrangement exists is only a relevant factor, and not a sufficient factor, to determine whether an arrangement lacks commercial substance.

- If the PCIT/ Approving Panel has held the arrangement to be permissible in one year and the facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in the subsequent year.

- Levy of penalty depends on facts and circumstances of the case, and is not automatic. No blanket exemption from penalty provisions for a period of five years is available under law. The taxpayer may apply for benefit under section 273A if he satisfies conditions prescribed therein.

The takeaways

- The Circular provides a much welcomed clarity on certain elements in respect of application of the GAAR provisions.

- The Circular however leaves open issues related to sufficiency of a SAAR/ LOB clause *vis-a-vis* GAAR, and under what situations a Court would be seen to have adequately considered tax implications of an arrangement.

- Interestingly, however, the Circular goes further than some of the recently amended tax treaties, in specifically indicating availability of grandfathering benefits to instruments derived from convertible investments held prior to April 1, 2017 or certain situations like subsequent consolidation, split or bonus issue.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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