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Draft guidelines regarding implementation of General Anti Avoidance Rules in terms of section 101 of the Income-tax Act, 1961

Background

General Anti Avoidance Rules (GAAR) were incorporated in the Income-tax Act, 1961, providing a basic framework/structure for its application and consequences. GAAR is a broad set of provisions which grants powers to authorities to invalidate any arrangement for tax purposes, if the main purpose or one of the main purposes of entering into the transaction by the taxpayer is to obtain a tax benefit. Besides the “tax benefit” test, the arrangement also has to test positive any one of the following four specified additional tests:

- It creates rights or obligations which would not ordinarily be created between persons dealing at arm’s length.

- It results in the misuse or abuse of the provisions of the Act.
- It lacks commercial substance or is deemed to lack commercial substance in whole or in part.
- It is entered into or carried out by means or in a manner, which would not normally be employed for *bona fide* purposes.

Furthermore, it was prescribed in the Income-tax Act, 1961 (the Act) that GAAR provisions would be applied in accordance with such guidelines and subject to such conditions and in the manner as may be prescribed.

For the purpose of formulating these guidelines, a Committee was constituted under the chairmanship of Director General of the Income-tax (International taxation). The Committee, after having discussions with various stakeholders has come out with the following guidelines¹ which would need to be incorporated in Circulars and the Income-tax Rules, 1962.

Recommendations

Monetary threshold

The Committee has recommended for providing a threshold limit for invoking GAAR provisions to avoid the indiscriminate application of the GAAR provisions and to provide relief to small taxpayers. The threshold limit is yet to be prescribed.

Prescription of statutory forms

The Committee has prescribed statutory forms for making internal references by the assessing officer and the Commissioner to ensure principles of natural justice, consistency and transparency in the procedures.

Prescribing the time limits

The Commissioner has been provided a period of six months from the end of the month in which reference is received from the Assessing Officer to decide as to whether GAAR provisions would be applicable or not. In case the Commissioner is of the view that GAAR provisions are applicable, then reference needs to be made to the Approving panel within 60 days of the receipt of the objection from the taxpayer. However, if he is of the view that GAAR provisions are not applicable, then his decision needs to be communicated to the assessing officer within 60 days of receipt of the taxpayer's objection.

Setting up of the Approving Panel

The Committee has recommended the following in respect of the Approving Panel.

- The Approving Panel shall be situated at Delhi initially.
- The Central Board of Direct Taxes (CBDT) should review the number of Approving Panels required on the basis of the workload in the financial year 2014-15.
- The Approving Panel should comprise of three full time members. Two of the three members should be of the level of Chief Commissioners of Income -tax and third member should be an officer of the level of joint secretary or above from the Ministry of Law.
- The Approving Panel should be provided the secretariat staff to be headed by an officer of the level of Joint/Additional Commissioner of Income-tax along with appropriate budgetary and infrastructure support by the CBDT.

Detailed Circular to be issued on GAAR

For the purpose of explaining the provisions of GAAR and its better understanding, the Committee has suggested a Circular to be issued. The Circular *inter alia* analyses the GAAR provisions and one of the significant observations therein is that the onus of proving the following is on the Revenue:

- There is an arrangement,
- The arrangement leads to a 'tax benefit',
- The main purpose or one of the main purposes of the 'arrangement' is to obtain a 'tax benefit', and

¹ <http://www.pib.nic.in>

- The arrangement satisfies one of the four specified additional tests

It also provides that GAAR provisions does not deal with cases of tax evasion and tax mitigation.

Safe harbour for Foreign Institutional Investors

The Committee has recommended that GAAR provisions shall not apply to **Foreign Institutional Investors (FIIs)** or to the non-resident investors of the FII in case the FII chooses not to take tax treaty benefit and subjects itself to tax in accordance with the domestic law provisions.

Furthermore, the Committee has recommended that where an FII chooses to take a treaty benefit, GAAR provisions may be invoked in the case of the FII, but would not be invoked in the case of non-resident investors of the FII.

Prospective operations of the GAAR

The Committee has clarified that GAAR provisions will apply to the income accruing or arising to the taxpayers on or after 1 April, 2013.

SAAR v. GAAR

The Committee has recommended that under normal circumstances, where Specific Anti-Avoidance Rules (SAAR) are applicable, GAAR will not be invoked. However, in an exceptional case of abusive behaviour on the part of a taxpayer that might defeat a SAAR, GAAR could also be invoked.

Definition of ‘connected person’

The Committee has clarified “connected person” to include the definition of “associated enterprise” given in section 92A of the Act, the definition of ‘relative’ in section 56 of the Act and the “persons” covered by section 40A(2)(b) of the Act.

Tax consequences of a part of the arrangement being impermissible

The committee has recommended that it must be clarified in the Rules that where only a part of the arrangement is impermissible, the tax consequences of “impermissible avoidance arrangement” will be limited to only that part of the arrangement.

Illustrative cases under GAAR

The guidelines provide for indicative list of examples to illustrate the scenarios wherein GAAR provisions would be applicable. The illustrative cases laid down are summarised as below:

GAAR applicable	GAAR not applicable
Tax benefit by taking advantage of a fiscal incentive where there is diversion of packaging activity under the guise of manufacturing in a unit availing fiscal incentives	Tax mitigation by taking advantage of a fiscal incentive provided under the Act by putting in substantial investment of capital and carrying out manufacturing activity
Circular leasing i.e. taxpayer leasing an asset and through various sub-leases, taking it back on a lease	Investment from a low tax jurisdiction provided the investor has substantial commercial substance in that country such as adequate manpower, capital and infrastructure of its own, meeting of board of directors is conducted in that country
Non-anonymous transaction wherein parties come together or are brought together by an intermediary to adjust	Situations wherein controlled foreign company (CFC) provisions are applicable such as parking of income by

GAAR applicable	GAAR not applicable
profit and losses between themselves	an Indian group (from multiple subsidiaries) in a subsidiary set up in low tax jurisdiction
Capital gains tax exemption to a company interposed in a low tax jurisdiction wherein shares of Indian company are held by such company but all rights of voting, management, right to sell etc are vested in its holding company	Merger of loss making entity with profit making entity
Capital gains tax exemption to a company located in a low tax jurisdiction which acquired shares of Indian company through funding from its holding company	Decision of leasing vis-à-vis purchase of an asset
Capital gains tax exemption on selective buy back of shares by a company located in a low tax jurisdiction	Raising funds through equity vis-à-vis loan
Capital gains tax exemption to a company located in a low tax jurisdiction wherein shares of Indian company are transferred to it on liquidation by consent of its subsidiary which holds shares of Indian company	Transactions subject to transfer pricing provisions. However, commercial substance of the transaction may still be examined under GAAR provision such as in case of interest payment to a connected party, sources of funds and location of connected party may be

GAAR applicable	GAAR not applicable
	examined
Tax benefit on interest on loan finalised from one country and assigned to another country to take benefit of a favorable tax treaty	Sale/purchase through stock market transactions wherein buyer and seller are anonymous
Capital gains tax exemption on sale of shares of Indian entity by splitting a transaction into many transactions at short intervals below the threshold limit to take benefit of tax treaty (there are a few treaties where capital gains tax liability triggers on non-resident on sale of shares only once threshold limit is exceeded)	
Capital gains tax exemption on sale of shares of an Indian company held by a company located in a low tax jurisdiction where holding company includes interest payments on loan borrowed from connected concerns for acquiring the shares to overcome the threshold expenditure prescribed in 'limitation of benefit' test laid down in the tax treaty	
Import and export of goods through subsidiary of a Indian company located	

GAAR applicable	GAAR not applicable
in low tax jurisdiction when day-to-day management operations of the subsidiary are carried out in India	
Tax benefit arising to an employee on redemption of preferential shares issued by employer or on sale of preferential shares to a group company of the employer, where consideration for sale/redemption reflects a portion of salary or bonus of the employee	
Tax benefit on realisation of actionable claims by a company when such claims belonged to a group entity and were acquired by it through series of transactions at nominal value of the claim	
Tax benefit to a company through set off of short-term capital losses arising on sale of shares of its subsidiary companies where the shares were acquired by it at inflated cost. The funds for acquisition of shares were borrowed by the company and it finally reaches the group company of the lender through series of aforesaid transactions	

Conclusion

The guidelines seem to have taken cognisance of the Standing Committee Report on the Direct Taxes Code. They are silent on the grandfathering aspect of the current structures/arrangements and do not deal with a host of practical situations. However, the overall tone of the guidelines indicates some semblance of balance.

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