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Update on India General Anti Avoidance Rules (GAAR)

The Finance Minister issued a statement earlier today setting out the decisions taken by the Government in the context of the recommendations of the Expert Committee constituted to review GAAR provisions. This News Alert summarises the key takeaways from the announcement.

GAAR - Current Status

Budget 2012 amendments

The Income-tax law was amended by the Finance Act, 2012 to incorporate GAAR provisions. The GAAR provisions, to be effective from Financial Year 2013-14, were to be applied in accordance with the guidelines to be prescribed by the Income-tax authorities.

Draft GAAR guidelines

The draft GAAR guidelines were released in June 2012. The Government received a number of representations against GAAR provisions from various stakeholders, especially foreign investors, leading to constitution of an Expert Committee in July 2012 by the Prime Minister of India under the chairmanship of Dr. Parthasarthi Shome.

Expert Committee

The Expert Committee released its draft Report for public comments on 1 September 2012 and submitted its final report on 30 September 2012 (which was available in public domain today).

Announcement by Finance Minister

The Finance Minister released a statement today suggesting that the Government has considered the report of the Expert Committee and the major recommendations of the Expert Committee have been accepted, albeit with some modifications. We have tabulated below the decisions taken by the Government vis-a vis the provisions under the current law and the recommendations of the Expert Committee.

Particulars	**Provisions under the Income-tax Act, 1961**	**Expert Committee recommendations**	**Decisions by the Government**
Date of applicability of GAAR provisions	1 April 2013 (Financial Year 2013-14)	1 April 2016 (Financial Year 2016-17)	1 April 2015 (Financial Year 2015-16)
Purpose	GAAR to apply in case where the main or *one of the main purpose of an arrangement* is to obtain a tax benefit	GAAR to apply only in case where *the main purpose* of an arrangement is to obtain a tax benefit	Recommendation accepted
Applicability to a part of the transaction	No provision	Where a part of the arrangement is an impermissible avoidance arrangement, GAAR will be restricted to the tax consequence of that part which is impermissible and not to the whole arrangement.	Recommendation accepted
Consideration of factors like time period, tax payments, etc.	Following factors would not relevant for determining whether arrangement lacks commercial substance: (i) the period or time for which the arrangement (including operations therein)	Factors may be considered as relevant but not sufficient	Recommendation accepted

Particulars	Provisions under the Income-tax Act, 1961	Expert Committee recommendations	Decisions by the Government
	exists; (ii) the fact of payment of taxes, directly or indirectly, under the arrangement; (iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement		
Approving Panel	The Approving Panel shall consist of not less than three members being: -Income-tax authority not below the rank of Commissioner and -an officer of the Indian Legal Service not below the rank of Joint Secretary to the Government of India. Directions of the Approving Panel binding only on Income-tax authorities	The Approving Panel should consist of five members being: - The Chairman should be a retired judge of the High Court. - Two members should be from outside Government and persons of eminence drawn from the fields of accountancy, economics or business, with knowledge of matters of income tax; and - Two members should be Chief Commissioners of income tax; or one Chief Commissioner and one Commissioner	The Approving Panel shall consist of three people being: - a Chairperson who is or has been a Judge of a High Court - one Member of the Indian Revenue Service not below the rank of Chief Commissioner of Income-tax - one Member who shall be an academic or scholar having special knowledge of matters such as direct taxes, business accounts and international trade practices Directions of the Approving Panel binding on both, the tax-payer as well as the Income-tax authorities

Particulars	**Provisions under the Income-tax Act, 1961**	**Expert Committee recommendations**	**Decisions by the Government**
Corresponding adjustment	No provision	Corresponding adjustment to be allowed in case of the same taxpayer in the same year or different years	Same income will not be taxed twice in the hands of the same tax-payer in the same year or in different years
Grandfathering of existing investments	No provision	All investments (though not arrangements) existing *as on the date of commencement of the GAAR provisions* to be grandfathered	Only investments made before *August 30, 2010* (the date of introduction of the Direct Taxes Code Bill, 2010) will be grandfathered
Non-applicability to FIIs	No provision	GAAR not to apply to FIIs that choose not to take any benefit under an agreement under section 90 or section 90A of the Act. GAAR should also not apply to non-resident investors in FIIs	Recommendation accepted
Monetary threshold for applicability of GAAR provisions	No threshold prescribed	INR 30 million of tax benefit to a taxpayer in a *year*. In case of tax deferral, the tax benefit shall be determined based on the present value of money	INR 30 million of tax benefit in the *arrangement*
GAAR v. SAAR	No provision	GAAR not applicable where Specific Anti Avoidance Rules ("SAAR") exists	*Only one out of GAAR and SAAR will be applicable*; guidelines in this regard will be issued

Particulars	Provisions under the Income-tax Act, 1961	Expert Committee recommendations	Decisions by the Government
Reporting by Tax Auditor	No provision	Tax Audit report to include reporting of tax avoidance scheme above specified threshold of tax benefits of INR 30 million or which the Tax Auditor considers to be more likely than not an impermissible avoidance arrangement	Tax Auditor required to report any tax avoidance arrangement

Conclusion

Some of the other important recommendations of the Expert Committee such as prescription of a “negative list” of transactions for non-applicability of GAAR, GAAR provisions not to apply to examine genuineness of residency of Mauritius entities (as codified in Circular No 789 of 2000), the process to be followed at the time of withholding, etc. remain to be clarified.

Even the suggestion of abolition of Short-term Capital Gains Tax in lieu of increase in Securities Transaction Tax is not discussed.

Nonetheless, the pragmatic approach of the Government in accepting the key recommendations of the Expert Committee needs to be lauded. Some of the decisions announced earlier such as deferral of GAAR by two years and grandfathering of investments up to a certain date are steps in the right direction.

Many of the changes require amendments to the existing income-tax law which are being drafted by the Finance Ministry and may be presented as a part of the Budget 2013 proposals (due on 28 February 2013). The fine print with respect to the changes and the GAAR guidelines will be eagerly awaited.

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