

Article: GAAR – Tax planning’s mayhem?

The Finance Minister through the Union Budget 2012-13 has introduced several amendments in the income-tax law having far reaching implications on the tax payers. A key tax proposal introduced is the General Anti-Avoidance Rules (GAAR) which intends to address the issue of aggressive tax planning and codify the doctrine of "substance over form". GAAR is proposed to be implemented with effect from AY 2013-14.



CONDITIONS FOR INVOKING THE PROVISIONS OF GAAR:

1. An arrangement whose main purpose or **one of the main purposes** is to obtain a **tax benefit** and which also satisfies at least one of the four tests, can be declared as an **"impermissible avoidance arrangements"**
2. The four tests referred are–
 - a. The arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length
 - b. It results in misuse or abuse of provisions of tax laws
 - c. It **lacks commercial substance** or is deemed to lack commercial substance
 - d. Is carried out in a manner, which is normally not employed for bonafide purpose

WHAT IS "TAX BENEFIT"

The primary condition for attracting the GAAR provisions is that the tax payer should obtain a tax benefit due to the arrangement. Tax benefit has been defined under the proposed section 102(11) as:

- A reduction, avoidance or deferral of tax or other amount payable under the Act **or under the treaty**
- An increase in refund of tax or other amount under the Act **or under the treaty**
- A reduction in total income including increase in loss

Impact of the above provision

As per the existing tax regime, a taxpayer can avail the provisions of either the Act or a tax treaty, whichever is more beneficial. However, under GAAR, if the above stipulated conditions for tax benefit are satisfied, the taxpayer **would not be able to avail the treaty benefits** which are more beneficial.

ONUS OF PROVING GENUINENESS OF THE ARRANGEMENT

The Finance Bill stipulates that the **onus lies on the tax payer** to prove that the main purpose of the arrangement executed by the taxpayer is not for availing tax benefit as defined above.

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WHAT IS COMMERCIAL SUBSTANCE?

The following arrangements shall be deemed to be lacking commercial substance:

- 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 financing¹;
 - An accommodating party² ;
 - Elements that have effect of offsetting or cancelling each other; or
 - A transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of fund which is subject matter of such transaction; or
- c. It involves the **location** of an asset or of a transaction or of the **place of residence** of any party which would not have been so located for any substantial commercial purpose other than obtaining tax benefit for a party.

In considering the above deeming fiction, it is provided that following circumstances shall not be considered while determining ‘lack of commercial substance’ test for an arrangement:

- Period of existence of arrangement,
- Taxes arising from arrangement,
- Exit route,

Impact of the above provision

1. Whole or part of an arrangement:

Even if an individual step in the whole arrangement signifies one of the main purpose as a tax benefit, the whole arrangement could be classified as “impermissible avoidance arrangement”.

2. One of the main purpose

Even in a situation where the main purpose of the arrangement is for seeking commercial arbitrage, the arrangement shall be deemed to lack commercial substance if other main purpose is to seek tax benefit.

¹ Proposed Section 97(2) states 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

² Proposed Section 97(3) treats a party to be an “accommodating party” if the main purpose of the direct or indirect participation in the arrangement is to obtain, directly or indirectly, a tax benefit for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

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3. Prospective effect* (but conditions apply)!

Though the GAAR is applicable with effect from AY 2013-14, it specifically provides that the period of existence of arrangement shall not be taken into account while applying the 'lack of commercial substance' test and therefore, the tax benefit can apply to 'any' year. This would affect all the arrangements which have been entered even before implementation of GAAR.

4. Taxes paid

Fact of payment of taxes, directly or indirectly, under the arrangement shall not be considered

5. Exit route

Fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement shall be disregarded

ADDITIONAL STEPS WHICH COULD BE CONSIDERED TO DETERMINE WHETHER THERE EXISTS "TAX BENEFIT"

- a. The parties who are connected persons in relation to each other may be treated as one and the same person;
- b. Any accommodating party may be disregarded;
- c. Such accommodating party and any other party may be treated as one and the same person;
- d. The arrangement may be **considered or looked through** by disregarding any corporate structure.

CONSEQUENCES OF THE IMPERMISSIBLE AVOIDANCE ARRANGEMENT

An illustrative list of tax consequences is provided which includes the following:

- a. **Disregarding** or combining **any step** of the arrangement
- b. **Ignoring the arrangement** for the purpose of taxation law
- c. Disregarding or combining any party to the arrangement.
- d. **Reallocating expenses** and income between the parties to the arrangement.
- e. **Relocating place of residence** of a party, or location of a transaction or situs of an asset to a place other than provided in the arrangement.
- f. Considering or **looking through** the arrangement by disregarding any corporate structure.
- g. Re-characterizing equity into debt, capital into revenue etc

The above list is merely illustrative. The tax authorities have the power to determine consequences in a manner which is deemed appropriate to the circumstances of case.

Further, it is pertinent to note that these provisions shall be used in addition to or in conjunction with other anti-avoidance provisions or provisions for determination of tax liability.

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VODAFONE RULING ANNULLED

Supreme Court in the case of Vodafone³ had laid down the following factors for the tax authorities to determine whether or not a transaction is entered for the purpose of avoidance of tax:

- Concept of participation in investment,
- Duration of time during which the Holding Structure exists
- Period of business operations in India
- Generation of taxable revenues in India
- Timing of the exit
- Continuity of business on such exit.

The GAAR provisions seek to extricate all of the above ingredients laid down by the Apex Court.

Further, the Supreme Court had stated that the Revenue’s argument that u/s 9(1)(i) it can **“look through”** the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that s. 9(1)(i) **covers direct and indirect transfers** of capital assets **is not acceptable**. The same is now voided by GAAR provisions.

COMPARISON OF GAAR PROVISIONS IN THE FINANCE BILL, 2012 VIS-À-VIS DIRECT TAXES CODE (DTC)

Sr	Issue	Provisions in DTC/ recommendations of Standing Committee	Provisions in Finance Bill, 2012
1.	Onus of proving tax avoidance	On the tax authority	On the taxpayer
2.	Bona fide transactions	For genuine bona fide transactions, the tax payer should not be penalized	Even if a part of the arrangement is found to obtain a tax benefit, then, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit, the whole of the arrangement shall be deemed to have been entered for obtaining a tax benefit.
3.	Overriding effect on the tax treaty	Uncertainties with regard to application of tax treaty provisions should be removed while invoking GAAR so that India’s credibility as a reliable tax treaty partner is not	Provisions of the tax treaty shall be redundant if proved that the arrangement is for the purpose of tax benefit

³ Vodafone International Holdings B.V. v UOI 341 ITR 1 (SC)

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		affected.	
4.	Prospective effect	GAAR provisions should have suitable grandfathering provisions to protect the interest of the taxpayers who have already entered into arrangements prior to the commencement date of GAAR.	Though applicable from FY 2012-2013, it contains specific provisions that the period of existence of arrangement shall not be taken into account while applying the 'lack of commercial substance' test.
5.	Threshold	To avoid frivolous cases, a threshold may be prescribed as also a threshold for specific amount of tax, which may be reviewed with experience.	No such proposal

SOLI DASTUR'S POST BUDGET SPEECH

Mr Soli Dastur, senior advocate, in his post budget speech provided the following examples where the tax authorities could invoke GAAR provisions:

- 54EC investment of sale proceeds of property;
- Transaction involving demerger – the real intention is to sell the assets;
- Loss on sale of shares on the stock exchange is not allowed, therefore, any sale under private arrangement was only with purpose to set off loss.
- Dividend stripping;
- Sale and lease back transactions.

RECENT DEVELOPMENTS

The Finance Minister in his speech on 7th May 2012 postponed the implementation of GAAR provisions with effect from Financial Year 2013-14, thereby pre-empting the mayhem of tax planning.