

# General Anti-Avoidance Rules India

Presented at Chamber of Tax Consultants  
Intensive Study Group on International Taxation,  
Study Circle on International Taxation  
And  
Study Circle on Direct Taxes

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# *Tax planning, avoidance and evasion*

- Lord Tomlin in Duke of Westminster (1935) AC 1 (UK H.L.)  
*“Every man entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax”*

# *Judicial anti avoidance doctrines*

- Sham

*Acts done or documents executed by parties which are intended to give third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual rights and obligations which the parties intended to create [Snook v. London & West 1967 All ER 518 (CA)]*

- Artificiality, an element of deceit
- If legal result of a transaction is exactly what parties had intended, not sham
- Lack of bona fide business purpose not sham

- Substance over form

- Legal substance over form-
  - indicates true relationship or true legal effects of a transaction govern over formal description or labels

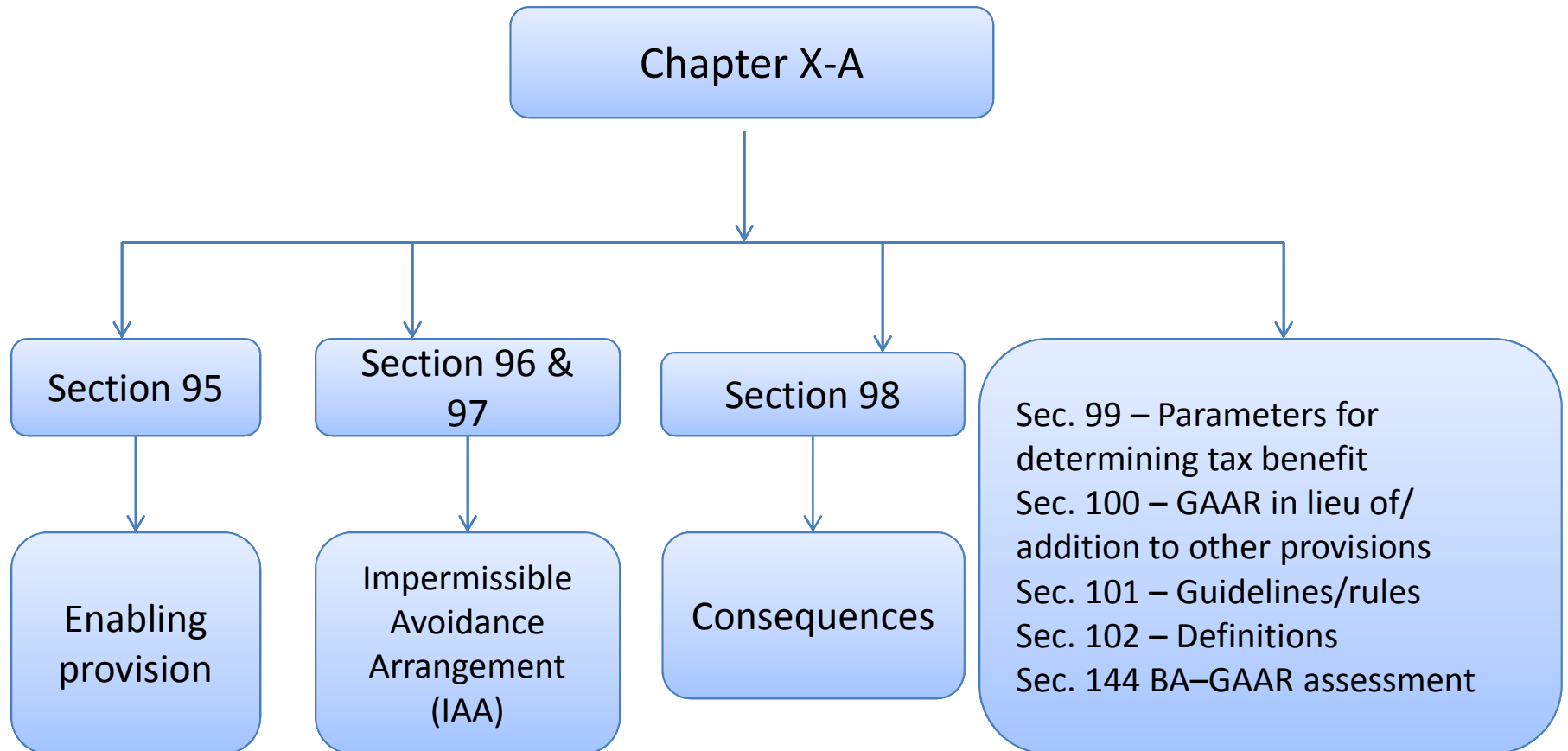
- Step transactions

- Examine whether series of transactions form a single composite transaction
- Examines the overall effect of individual steps of a transaction to assess the transaction as a whole

- Business purpose doctrine

- Transactions that do not possess a genuine and bona fide business purpose to be disregarded
- Used in the US, rejected by courts elsewhere as an independent anti avoidance doctrine

# GAAR provisions



# *Impermissible Avoidance Arrangement*

- *“.... the use of artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived ‘loopholes’ in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament.”*  
[SARS 2005 Discussion Paper]
- An arrangement means (s. 102(1))
  - **Any step in** or a part or whole of
  - any transaction, operation, scheme, agreement or understanding
  - Whether enforceable or not
  - Includes alienation of property in such transaction
- Requires two or more persons?
  - Dealings with PE?
- Alienation of any property in such transaction, operation, etc
  - Included in SA GAAR “to partly counter effect of judgment & partly due to high prevalence of property-related transactions” [*Draft Comprehensive Guide (2011)*]
  - Object of this inclusion unclear, unnecessary

# *Primary test – Tax benefit*

- Tax benefit includes [s. 102(10)]
  - Reduction or avoidance or deferral of tax payable under ITA or due to a tax treaty
  - Increase in refund of tax or other amount under ITA, as a result of a treaty or otherwise
  - Reduction in total income or increase in lossIn the relevant previous year or any other previous year
- Not all reduction tax benefit [King (1947) 14 SATC 184(A)]
- Tax benefit where the taxpayer has effectively stepped out of the way of, escapes or prevented **an anticipated liability**
  - Which may be an imminent, certain prospect, or a vague, remote possibility, before the liability has been determined. [Smith (1964) (1) SA 324(A)]
- Re-characterisation for determining tax benefit [s. 99]
  - Prevents party from shifting an existing income stream to connected person (run down)
  - Actual transaction to be compared with arrangement so re-characterised and not any hypothetical arrangement
  - Re-characterisation only for this purpose, and not for determining other elements
  - Onus of proof on Revenue; need not define alternative or comparable arrangement
- ‘But for’ test
  - Would a tax liability have existed but for this transaction

# *Primary test - main purpose*

- Main purpose - Subjective or objective test?
  - Is the intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (Subjective test)
  - Does the actual effect of the arrangement support non-tax benefit stated intention of the arrangement? (Objective test)
- Under South African law
  - *Amendment a more objective standard, provides uniform basis for tax treatment of identical transactions by removing reliance on purely subjective intention of parties [SA Draft Guidance 2011]*

## *Pre-2006*

- *Transaction was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit [s. 103(1) of IT Act pre-2006]*

## *Post-2006*

- *...an impermissible avoidance arrangement if **its** sole or main purpose was to obtain a tax benefit [s. 80A , IT Act]*
- *Presumption that arrangement entered into for the main purpose of obtaining tax benefit unless the party proves that, reasonably considered in the light of the relevant facts and circumstances, obtaining a tax benefit not the sole or main purpose of the avoidance arrangement. [s. 80F , IT Act]*

# *Primary test - main purpose*

- Indian situation
  - Subjective intention of taxpayer –
    - Mere assertion not enough - Parties to lead objective evidence that main purpose was not tax benefit on the basis of preponderance of probabilities
  - Can presumption be, thus, presumed?
- Onus on Revenue to prove tax benefit and main purpose obtaining a tax benefit  
*[CBDT Draft Guidelines (2012)]*
- Other relevant considerations
  - If there is more than one purpose, is the main (dominant?) reason for arrangement for obtaining the tax benefit?
  - If same commercial result achievable in a different manner and taxpayer selected the manner attracting less or no tax, then obtaining of tax benefit not the sole or main purpose of the arrangement



# *Secondary tests*

- Tainted elements
  - Abnormality tests
    - Creates rights or obligations ***not ordinarily created*** between parties dealing at arms' length
    - Entered into or carried out by ***means or in a manner not ordinarily employed*** for bona fide purposes
  - Results in ***misuse or abuse*** of the provisions of the Act
  - Lacks ***commercial substance*** or is deemed to lack commercial substance, in whole or in part
- Absent main purpose or tax benefit, secondary tests irrelevant
- Onus on the Revenue

# Abnormality elements

- *Creates rights or obligations not ordinarily created between unrelated parties*
  - Distinct from arms' length price in s. 92
  - Indicators
    - Do the parties strive to obtain best possible advantage for themselves?
    - Would unconnected persons have acted similarly in this situation?
  - Indicia for abnormality
    - Complexity of the arrangement
    - Introduction of tax-indifferent parties to the arrangement (overlap with deemed lack of commercial substance test)
- *Means not ordinarily employed for bona fide purposes*
  - Not a bona fide purposes test, but a 'means and manner' test
  - Hypothetical enquiry
    - To examine whether both the means and the manner of the transaction would not normally be entered into for bona fide purposes
    - Not normal merely because a particular form of transaction is commonplace or commercially acceptable
  - Whether obtaining tax benefit a bona fide purpose
    - Absence of the words "*bona fide purposes other than tax benefit*" [s. 96(1)(d)]
  - Use of court-approved merger route to set-off losses whether normal
    - Adequate SAARs in ITA, so GAAR would not apply [Draft Guidelines (2012) Ex. 5]
    - Only if courts have explicitly & adequately considered tax implications [Cir. 7 of 2017 Q. 8]

# *Misuse or abuse of the Act*

- Misuse and abuse – whether to be examined disjunctively
  - Arguably, misuse include abuse
- Requires contextual and purposive interpretation of relevant provisions
- Misuse or Abuse where
  - When taxpayer relies on specific provisions to achieve an outcome those provisions seek to prevent
  - When a transaction defeats the underlying rationale of the provisions relied upon
  - When an arrangement circumvents application of certain provisions in a manner that frustrates or defeats their object, spirit or purpose
- Onus on the Revenue
  - to establish object, spirit and purpose of provision
  - to demonstrate misuse/abuse
- Exemption claimed in an unforeseen manner not necessarily misuse
  - Eg. Sec 54EC limit
  - Subsequent amendment to close loophole not indicative of pre-existing policy

# *Lack commercial substance*

- Indications
  - Actual economic expenditure or loss incurred by a party and the value of the tax benefit disproportionate
  - A loss claimed that significantly exceeds any measurable reduction in net worth.
- US economic substance doctrine
  - Definition
    - transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position (objective test), and
    - the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction (subjective test).
  - 'Commercial substance' akin to objective test of US economic substance doctrine

# *Deemed to lack commercial substance*

- Substance or effect of the arrangement as a whole differs from the form of its individual steps
  - Distinct from transaction where true intention of parties not reflected in the legal form (sham)
- Involves or includes
  - Round trip financing
  - An accommodating party
    - If the main purpose of participation of a party to an arrangement is to obtain a tax benefit for the taxpayer
  - Has elements that are offsetting or cancelling each other
    - Eg cross-gifts to avoid clubbing provisions
  - Transactions which disguise the value, location, source, ownership or control of funds
- Involves location of an asset or of a transaction or place of residence of any party without substantial commercial purpose
- No effect upon business risks or net cash flows of any party
- Elements, relevant but not sufficient to establish commercial substance
  - Period of time for which an arrangement exists
  - Taxes paid under the arrangement
  - An exit route is provided in the arrangement

# *Consequences*

- Disregarding, combining or re-characterising any step
  - Treating equity as debt or vice versa
  - Capital receipt as revenue or vice versa
  - Re-characterise any expense, deduction, relief or rebate
- Ignoring the entire arrangement
- Disregarding an accommodating party or treating it and any other party as one person
- Deeming connected persons as one person
- Reallocating amongst the parties-
  - Any accrual, or receipt of capital or revenue nature
  - Any expenditure, deduction, relief or rebate
  - Treating the place of residence, situs of an asset/transaction at a different place
- Disregarding or looking through any corporate structure

# *Exceptions*

- Where tax benefit in a relevant assessment year to all parties does not exceed Rs. 3 crore
  - R. 10U(1)(a) r.w. r. 10U(3)(iv) – “amount of tax”
    - To exclude surcharge, cess, interest, penalties and other sums
    - S. 102(10) (“tax or other amount”)
- Foreign institutional investor
- A non-resident making an investment in off-shore derivative instruments in a FII
- Any income accruing to a person from transfer of investments made before 1<sup>st</sup> April, 2017 by such person
  - However, Chapter applies in respect of tax benefit from an arrangement whenever entered on or after 1<sup>st</sup> April, 2017

# *Other provisions*

- GAAR –alternative basis of assessment
  - To enable invoking of GAAR concurrently/alternatively
    - “The provisions of this Chapter shall apply in addition to or in lieu of any other basis for determining tax liability.” [sec. 100]*
  - if expense disallowed/additions made
    - Absent tax benefit, GAAR inapplicable
  - Permitting Revenue to invoke GAAR as an alternative basis of assessment - administratively and judicially economical
- Assessment proceedings [s. 144BA]
- Approving Panel
  - 3 members, sitting or retired High Court Judge (as Chairman), one IRS official and one eminent person
  - Only if assessee objects to invoking of GAAR
  - Directions of Panel binding on the assessee and Revenue
- Appeal to ITAT against order of AO pursuant to directions of Panel and Pr. CIT/CIT



# *Cir 7 of 2017*

- Both GAAR and a SAAR can co-exist
  - CBDT Draft Guidelines (2012) GAAR will not be invoked
    - in context of merger (Example 5) & Transfer pricing (Example 8)
- Where LOB in treaty complied
  - All tax avoidance strategies may not be addressed sufficiently by LOB
- Location of entity in low-tax jurisdiction, SPV for investments, etc
  - To be resolved based on s. 96
  - If non-tax commercial considerations main purpose, no GAAR
- Grandfathering of investments made before 1<sup>st</sup> April, 2017
  - Applies to bonus shares, splits or consolidation in the hands of the same investor
  - compulsorily convertible instruments if terms decided at the time of their issue
  - Lease contracts and loan arrangements not Investments
- If AAR has held the arrangement permissible, AAR Rulings binding on the Revenue
  - Rulings pre-GAAR?
- Compensating/corresponding adjustments in the hands of counter-party
  - Not be available, GAAR an anti-avoidance provision; deterrence will get diluted if adjustments made
- Tax consequences in other jurisdictions cannot be taken into account for determining tax benefit
- GAAR with respect to arrangements not parties
- If arrangement permissible in one year, GAAR will not be invoked in a subsequent year

# Trade through connected party

## *AO's findings*

- The 'a' sold goods to the HUFs and HUFs earned substantial profits on resale of such goods over and above that earned by 'a'.
- Creation of HUF business **merely a subterfuge or a contrivance to divert profits** of 'a' to their HUFs.
- If by resorting to a "device or contrivance", income which would normally have been earned by 'a' is divided between the 'a' and another person, ITO entitled to bring entire income to tax as if it had been earned by him.

## *Supreme Court*

- If the goods were nominally transferred to the HUFs where they are merely benamidars for the 'a', and profits earned in truth by 'a', income earned by HUFs may be chargeable to tax as income of 'a'. **But no such case was attempted to be made out.**
- **Law does not oblige a trader to make the maximum profit.** Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed not prohibited.
- Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it **may lawfully be circumvented.**
- Taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of which depends **not upon considerations of morality, but on the operation of the ITA.**

\*A Raman & Co (1968) 67 ITR 11 (SC)

# Trade through connected party

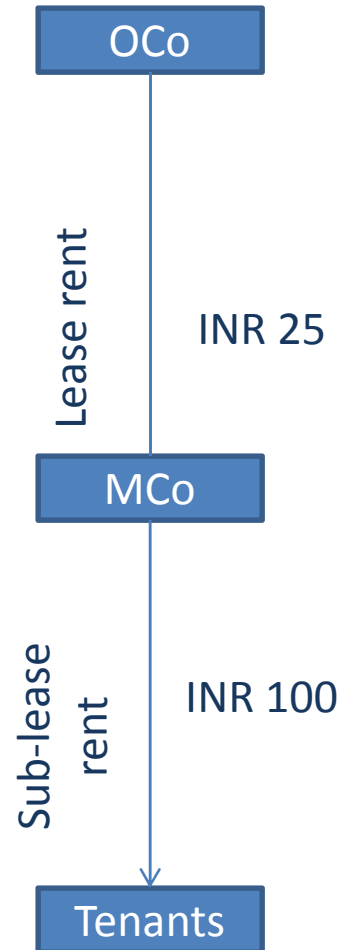
Indicia	Conclusions
Is there an arrangement	Yes
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	Yes
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	Yes; (if no?)
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate above intention</li> </ul>	Actual result is lower tax liability on 'a'.
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	Yes; transferring of goods at below ALP abnormal.
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	No. Arguably, tax benefit not excluded from 'bona fide purposes'.
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	No

# Trade through connected party

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
<ul style="list-style-type: none"> <li>substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part</li> </ul>	NA; one transaction, no parts.
<ul style="list-style-type: none"> <li>involves round trip financing</li> </ul>	No
<ul style="list-style-type: none"> <li>involves an accommodating party</li> </ul>	If surplus accrues to HUFs, their main purpose is then not tax benefit to 'a'. So not an accommodating party.
<ul style="list-style-type: none"> <li>involves offsetting or self-cancelling elements</li> </ul>	No
<ul style="list-style-type: none"> <li>transaction conducted through one or more persons &amp; disguises value, location, source, ownership or control of funds</li> </ul>	No
<ul style="list-style-type: none"> <li>involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose</li> </ul>	No
<ul style="list-style-type: none"> <li>No significant effect on business risks /net cash flows of parties</li> </ul>	No
<b>Does arrangement lack commercial substance generally</b>	
<ul style="list-style-type: none"> <li>Is the expenditure/loss disproportionate to tax benefit gained</li> </ul>	No
<ul style="list-style-type: none"> <li>Is there no corresponding reduction in net worth</li> </ul>	No

- IAA, GAAR applies. Presence of TP provisions (SAAR) better targeted.
- If 'a' runs down its business?

# Sub-lease



- **High Court**
  - Rental income taxed in MCo's hands; taxing the same income in hands of OCo not permissible
  - No cogent evidence that transactions not genuine
  - Merely a common director in OCo & MCo not enough to label the transaction a sham
- **Issues**
  - Whether connection between rent received by and paid by MCo real and intimate, synchronised?
  - Risk of not letting out the property borne by which party?
  - Credit/Default risk for not collecting rent from tenants on whom?
  - Rent received by MCo at its disposal?
  - If this arrangement is tax motivated?
- **GAAR effect?**
  - Tax benefit to OCo -main purpose ?
  - Lease rent at arm's length
  - Commercial substance-
    - Is MCo an accommodating party

# Sub-lease

Indicia	Conclusions
Is there an arrangement	Yes
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	No; rental income not understated; Can Revenue still re-characterise OCo & MCo as single person [s. 99]
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	NA
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	Yes; (if no?)
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate above intention</li> </ul>	Diversion of income by OCo to MCo resulting in tax benefit to OCo
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	No
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	No
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	No

# Sub-lease

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No
• involves round trip financing	No
• involves an accommodating party	If surplus accrues to Mco, its main purpose is not tax benefit to OCo. So not an accommodating party.
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No
• No significant effect on business risks /net cash flows of parties	No
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	No
• Is there no corresponding reduction in net worth	No

- Can the Revenue recharacterise the arrangement for determining tax benefit?
- Commercial substance- Is MCo an accommodating party

# *Depreciation allowance*

## ***Facts –***

- Admission of company as partner on reconstitution of firm
- Revaluing fixed assets on same date for adjusting the partners' capital interest
- Dissolution shortly thereafter wherein the assets are taken over by the company and partners get shares in the co.
- Valuation certificate provided

## ***AO's finding –***

- Only a ruse/design/device to reduce tax liability by setting up claim for higher depreciation allowance on enhanced value of assets

## ***High Court***

- Firm /partners being commercial men would value the assets only on a real basis and not at cost or book value; real rights of partners cannot be mutually adjusted on any other basis.
- Inflation of cost became possible on account of the change-over; other reasons may exist for revaluation but the “main purpose” is reduction of tax liability by claiming depreciation on enhanced value...
- Exln 3 to sec. 43(1) applies

## ***GAAR effect***

- If Exln 3 is absent, depreciation on enhanced cost available
- GAAR may not apply if the reconstitution is genuine and the partners' capital adjusted based on fair value.

\*Poulose & Mathen (1996) 236 ITR 416 (Ker)



# Depreciation allowance

Indicia	Conclusions
Is there an arrangement	Yes
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	Yes; through higher depreciation on enhanced cost.
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	No
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate above intention</li> </ul>	No; Revaluation of asset and issue of shares resulted in higher depreciation.
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	No; commercial men would recognise real value of assets.
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	Normal for partners to adjust values inter se based on real value of assets.
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	Depreciation available on actual cost; Cost to firm is based on valuation.

# Depreciation allowance

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No
• involves round trip financing	No
• involves an accommodating party	No
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No
• No significant effect on business risks /net cash flows of parties	No
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	No
• Is there no corresponding reduction in net worth	No

- Partners' capital adjusted based on real value of asset
- Shares in company allotted to partners based on their adjusted capital.
- Not IAA.
- SAAR necessary to prevent depreciation on enhanced cost.

# *Sham transactions*

## ***Facts***

- Appellant received race winnings in Jackpots and Treble events in races
- These winnings became taxable only from subsequent year

## ***Supreme Court***

- No dispute that amounts received by appellant from various race clubs on the basis of winning tickets presented by her. What is disputed is that they were really the winnings of the appellant from the races. This raises the question whether the apparent can be considered as real.
- Matter to be considered **in light of human probabilities** having regard to conduct of the appellant as well as other material on the record; reasonable inference that winning tickets were purchased by the appellant after the event.

\*Sumati Dayal (1995) 214 ITR 801 (SC)

# Sham transactions

Indicia	Conclusions
Is there an arrangement	Yes
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	Reduction of income by showing it as race winnings.
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	No
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate above intention</li> </ul>	No
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	Yes
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	Object, spirit and purpose of exemption to person who buys winning ticket before race

# Sham transactions

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No steps
• involves round trip financing	Yes
• involves an accommodating party	Yes, seller of ticket after the race
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	Yes
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No
• No significant effect on business risks /net cash flows of parties	Yes
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	
• Is there no corresponding reduction in net worth	

- Jackpot winnings a sham; Application of GAAR unnecessary
- Human probabilities & Judicial anti-avoidance rules still relevant

# Capital loss

## **Facts**

- 'a' has capital gains from sale of investments
- 'a' sold its investments in shares of listed companies which have eroded in value to related party
- Sales off-market
- Results in a capital loss and is set-off against other gains.

## **Analysis pre-GAAR**

- Share sale genuine
- Actual transfer of shares
- At fair value
- cash received towards consideration (if not?)
- Parties' real rights and obligations consistent with the form
- Transferee the real owner, entitled to the risk and reward

## **GAAR effect**

- Shome Committee recommendations
  - Include in negative list timing of transactions for e.g. sale of property in loss when there is profit in other transactions – not accepted
- CBDT Draft Guidelines (2012)
  - GAAR could be invoked where transactions between related parties [Example 9]

# Capital loss

Indicia	Conclusions
Is there an arrangement	Yes
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	Yes
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes (actual txn compared with txn recharacterised (s.99))
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	Admittedly, no
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate a non-tax intention</li> </ul>	No
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	No
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	No
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	Off-market trades permitted by law; Income exemption only where STT paid (s. 10(38)); Set-off of loss against gain permitted (s. 70)

# Capital loss

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No
• involves round trip financing	No
• involves an accommodating party	Yes, if main purpose of related party is to obtain tax benefit for 'a'
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No
• No significant effect on business risks /net cash flows of parties	No
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	No
• Is there no corresponding reduction in net worth	No

- Moot point is whether the purchaser (whether or not connected party) has a commercial purpose in buying the shares or is tax-indifferent to the transaction.
- If purchaser is connected party, Revenue can determine tax benefit by considering the taxpayer and such party as one person or recharacterise in other manner [s. 99]



# *Sale and Dmat entries*

## **Facts**

Shares held in unlisted company in Dmat account

<b>Year</b>	<b>Details</b>	<b>No of shares</b>	<b>Cost per share Rs.</b>
<b>2004</b>	Purchase	25	10
<b>2007</b>	Bonus	25	-
<b>2016</b>	Rights	50	100

Assessee transfers 50 shares into a new Dmat account

Assessee thereafter sells 30 shares and delivers from old Dmat Account

Books

## **Pre-GAAR**

- Circular No. 768 stipulates FIFO basis for determining date of transfer and period of holding
- Assessee has a right to choose what shares to sell and from which Dmat account as in case of physical shares

# Sale and Dmat entries

Indicia	Conclusions
Is there an arrangement	Yes (operation)
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	Yes
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	No
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate a non-tax intention</li> </ul>	No
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	NA
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	No
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	No. Right to choose with 'a'.

# Sale and Dmat entries

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No
• involves round trip financing	No
• involves an accommodating party	No
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No
• No significant effect on business risks /net cash flows of parties	No
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	No
• Is there no corresponding reduction in net worth	No

- Though tax purpose for the arrangement, right to choose what to sell with the 'a'
- No misuse or abuse of s. 45(2A)
- Not an IAA.

# *Shifting of residence*

Rajan, who is a studying in school has developed an App.

A foreign buyer has made an offer to buy that App for an obscene sum after receiving which Rajan or his family and will never have to work again.

The family has been advised to move to Cayman Islands before the deal and later enjoy the money without paying any Indian tax.

## **Pre-GAAR**

- No bar on choosing residence
- Intention of 'a' not relevant

# Shifting of residence

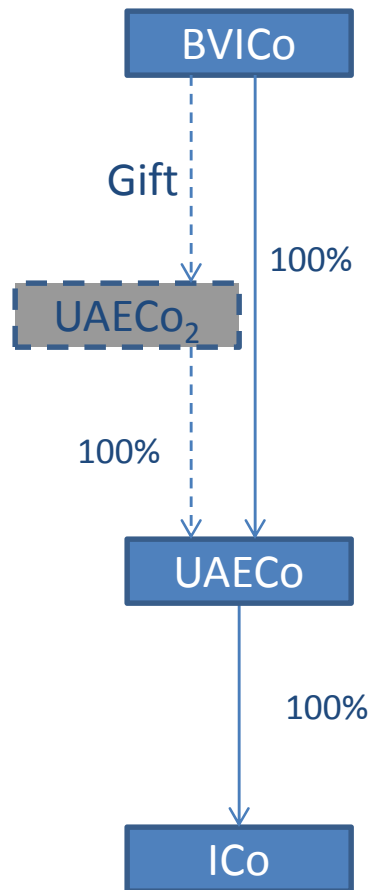
Indicia	Conclusions
Is there an arrangement	Whether operation?
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	Yes
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	Admittedly, no.
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate a non-tax intention</li> </ul>	No
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	NA
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	NA? Tax benefit whether bona fide purpose??
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	No. Residence determined by objective rules, intention of 'a' irrelevant.

# Shifting of residence

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	NA
• involves round trip financing	NA
• involves an accommodating party	NA
• involves offsetting or self-cancelling elements	NA
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	NA
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	Though involves location of residence of 'a', arguably, 'substantial commercial purpose' condition may be irrelevant for natural persons.
• No significant effect on business risks /net cash flows of parties	NA
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	No
• Is there no corresponding reduction in net worth	No

- Not an IAA.

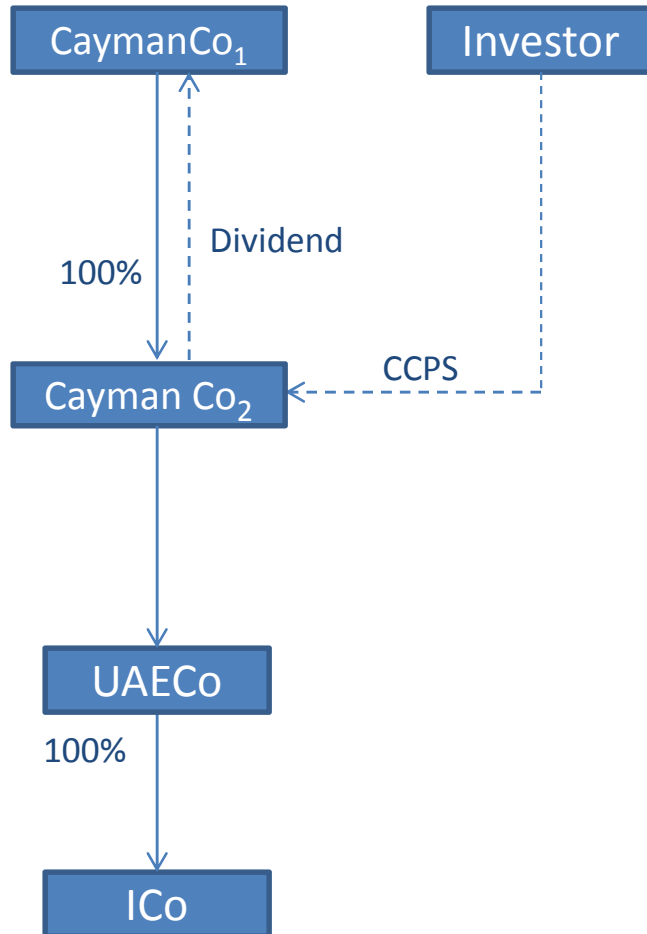
# Grandfathering



- **Rule 10U(1)(d)**

- Any income accruing or arising to any person from transfer of investments made before 1<sup>st</sup> April, 2017 by such person

# Grandfathering



## Transactions

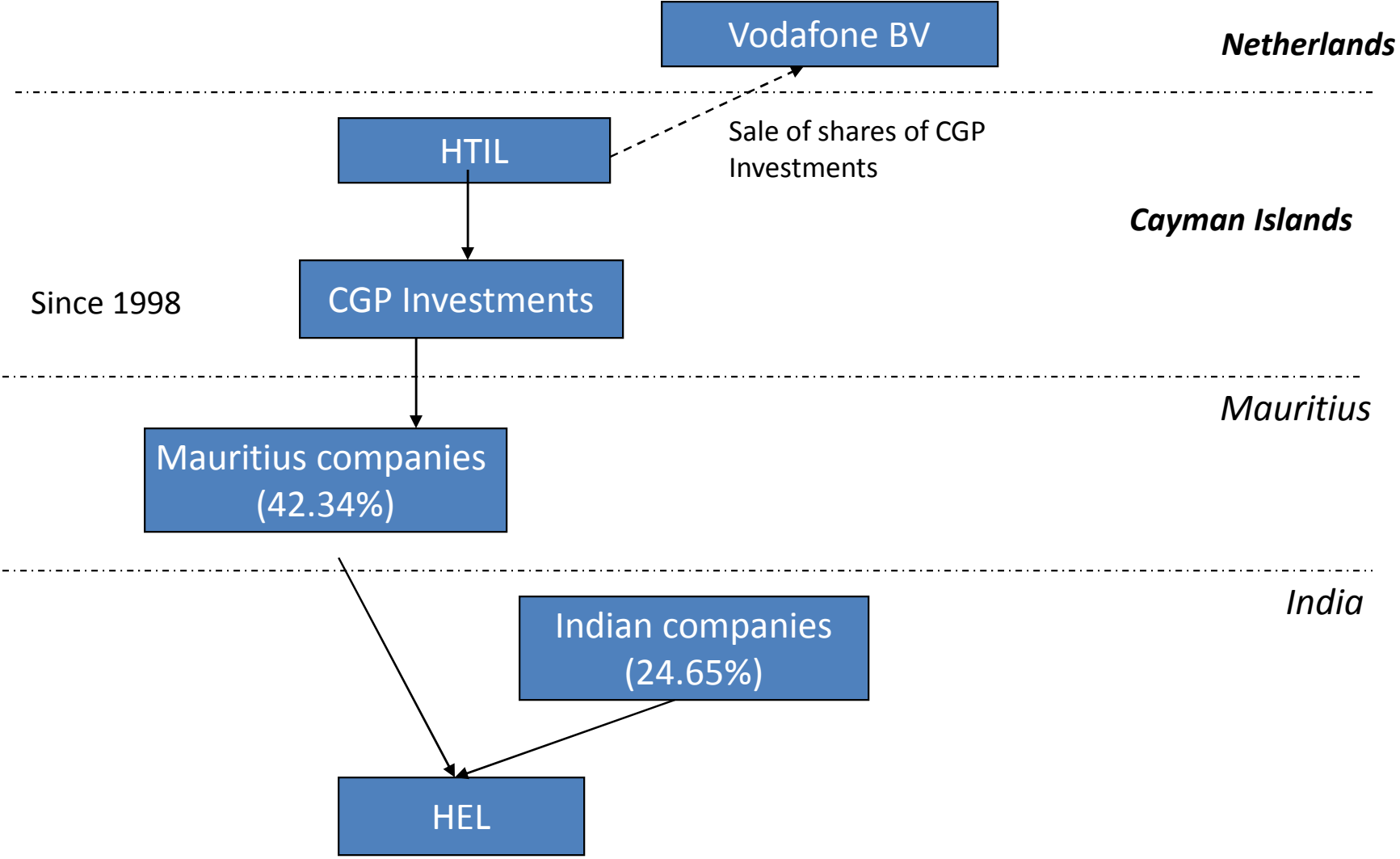
- Subscribe to CCPS at a premium before 1<sup>st</sup> April, 2017
- Dividend distributed out of issue proceeds
- Conversion of CCPS into equity shares & sale of original holding to investor, both post-Apr 17
- Alternatively,  
Fresh investment & buyback?

## Rule 10U(2)

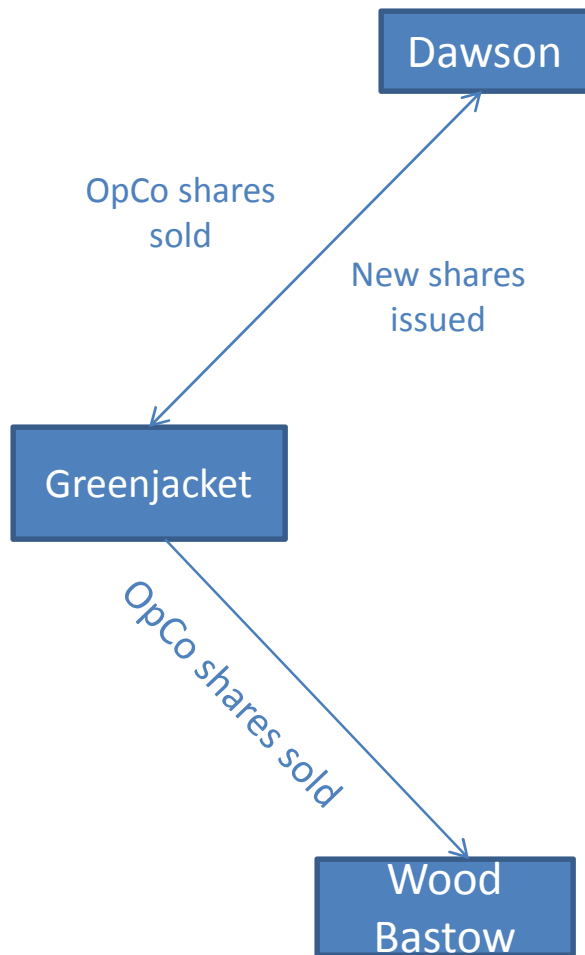
- Without prejudice to r. 10(u)(1)(d), GAAR shall apply to any arrangement irrespective of the date on which entered into in respect of tax benefit obtained from the arrangement on or after 1<sup>st</sup> April, 2017



# Shareholding structure



# Series /Composite transaction



## Background

- Deemed to be no disposal of shareholding if shares in a company transferred to another company which thereby acquires control, in exchange for shares in the transferee company.
- Tax on capital gains deferred until such time Dawson disposed of Greenjacket shares.

## House of Lords

- Involves two findings of fact,
  - first whether there was a pre-ordained series of transactions, i.e. a single composite transaction.
  - Secondly, whether that transaction contained steps which were inserted without any commercial or business purpose apart from a tax advantage
- When one moves from a single transaction to **a series of inter-dependent transactions** designed to produce a given result, it is perfectly legitimate to draw a distinction between the substance and the form of the composite transaction without in any way suggesting that any of the single transactions which make up the whole are other than genuine.

\*Furniss v Dawson 1984 HL

# *Step in or part of an arrangement*

- GAAR can be applied to any step in or part of an arrangement [s. 95 Expln]
  - Revenue to identify the step or part
    - Rebuttable? Ground?
  - How small a step or part?
    - To pick a particular feature of a transaction is “to miss woods for the trees” [Louw (1983) 45 SATC 113]
    - Such narrowly defined arrangement need not stand on its own [SA Draft Guide (2011)]
- Arrangement presumed to be mainly for tax benefit if a step or a part for tax benefit [s. 96(2)]
- *Arrangement means [s. 102(1)]*
  - *Any step in or part or whole of*
  - *any transaction, operation, scheme, agreement or understanding*
- Step includes [s. 102(9)]
  - *a measure or an action,*
  - *particularly one of a series*
  - *to deal with or achieve a particular thing or objective in an arrangement*
- “scheme is a wide term .... little doubt that it is sufficiently wide to cover a series of transactions [Meyerowitz (1963) 25 SATC 287 (A)]
- Pre-ordained series of transactions or one single composite transaction [Burmah Oil (1982) STC 30]

# Series- Craven vs White

- A transaction not pre-ordained when at that time it is wholly uncertain whether that disposal will take place, or a fortiori when neither the identity of the purchaser nor the price to be paid nor any of the other terms of the contract are known.... transactions in the series can be regarded as pre-ordained only if at the time when the first of them is entered into the taxpayer is in a position ... to secure that the second also is entered into..... [Lord Keith]
- there should be no sensible and genuine interruption between the intermediate transaction and the disposal to an ultimate purchaser [Lord Oliver]
- ....when negotiations/arrangements for carrying through as a continuous process of a subsequent transaction which actually takes place ...thereafter such arrangements were carried through to completion without genuine interruption [Lord Jauncey]
- An interval of time between two transactions is irrelevant save as evidence to be taken into account ... to decide whether the two transactions were independent of one another or ... form(ed) part of a pre-planned tax avoidance scheme.... after the tax avoidance transaction has taken place, the taxpayer must retain power to carry out his part of the intended taxable transaction ... the intended taxable transaction must in fact take place.... [Lord Templeman].
- I do not regard the "practical certainty" test as apposite. This is because "pre-ordained" does not mean "predestined" ; it means decided or planned in advance, but not foredoomed ..... The mere fact that a series of transactions planned as part of a single scheme may not in fact be carried out to the end, does not prevent those transactions, if performed, constituting a composite transaction for the purposes of the principle [Lord Goff]

# Shareholding structure

Indicia	Conclusions
Is there an arrangement	Arguably, not a series or scheme.
Is there a 'tax benefit'	
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	No; liability remote when structure set up
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes
Is tax benefit the <b>main purpose</b> of the arrangement	
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	Yes; commercial reasons quoted
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate a non-tax intention</li> </ul>	No
<b>Abnormality elements</b>	
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	No; such investments through SPV commonplace
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	No; also, bona fide purpose does not exclude tax benefit.
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	No.

# Shareholding structure

Indicia	Conclusions
<b>Does the arrangement deemed to lack commercial substance-</b>	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No parts (as per reasoning above)
• involves round trip financing	No
• involves an accommodating party	No; (unless SPV is treated as one)
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	Location of residence of CGP without substantial commercial purpose.
• No significant effect on business risks /net cash flows of parties	No
<b>Does arrangement lack commercial substance generally</b>	
• Is the expenditure/loss disproportionate to tax benefit gained	No
• Is there no corresponding reduction in net worth	No

- Whether transaction has commercial substance depends on-
  - Substantial commercial purpose in locating CGP in a low-tax jurisdiction and
  - Commercial substance in CGP to determine whether it is an accommodating party

# *Thin Capitalisation*

- Original facts
  - ICo, an Indian company is highly leveraged.
  - ICo borrows further to finance its expansion plans by issuing CCDs to FCo, its Holding Co at LIBOR + 300 basis point interest till conversion.
- Amended facts
  - Instead of issuing CCDs, ICo borrows from a nationalised bank;
  - Loan guaranteed by Fco.

# Thin Capitalisation

Indicia	Conclusions Original facts	Conclusions Amended facts
Is there an arrangement	Yes	Yes
Is there a 'tax benefit'		
<ul style="list-style-type: none"> <li>Has the 'a' avoided an anticipated liability</li> </ul>	No	Yes
<ul style="list-style-type: none"> <li>Would there have been a tax payable but for the arrangement?</li> </ul>	Yes	Yes
Is tax benefit the <b>main purpose</b> of the arrangement		
<ul style="list-style-type: none"> <li>Is the intention of the 'a' non-tax purpose</li> </ul>	Yes; for its funding needs	Yes.
<ul style="list-style-type: none"> <li>Does actual effect of arrangement corroborate a non-tax intention</li> </ul>	Yes	No
<b>Abnormality elements</b>		
<ul style="list-style-type: none"> <li>Does the arrangement create rights or obligations <b>not ordinarily created between third parties</b></li> </ul>	??	No
<ul style="list-style-type: none"> <li>Is it entered into or carried out by means or in a manner which are <b>not ordinarily employed for bona fide purposes</b></li> </ul>	No.	No
Does it result in any <b>misuse or abuse</b> of provisions of IT Act	No.	??



# Thin Capitalisation

Indicia	Conclusions Original facts	Conclusions Amended facts
<b>Does the arrangement deemed to lack commercial substance-</b>		
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No	No
• involves round trip financing	No	No
• involves an accommodating party	No	No
• involves offsetting or self-cancelling elements	No	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No	No
• No significant effect on business risks /net cash flows of parties	No	No
<b>Does arrangement lack commercial substance generally</b>		
• Is the expenditure/loss disproportionate to tax benefit gained	No	No
• Is there no corresponding reduction in net worth	No	No

- Whether lending by FCo indicate creation of rights and obligations not ordinarily created between third parties? Arguably, no.

- SAAR (like sec. 94B) required

Amended facts

- Purposive interpretation of s. 94B determines whether GAAR applies.

*Thank you!*