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GENERAL ANTI AVOIDANCE RULE

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ABSTRACT

We know that utmost of the profit which the government generates is from levies which they collect from individualities, associations, etc. Everyone wants to profit from the duty assessed on them. numerous times they indulge in malpractice to get saved from levies. The General Anti Avoidance Rule (GAAR) was brought about by the Indian government to check duty elusion and avoid duty leaks. In India, the GAAR provision was brought by the government after the notorious case of Vodafone International.

WHAT IS GENERAL ANTI AVOIDANCE RULE

General Anti Avoidance Rule (GAAR) is an anti-tax avoidance law for keeping a check on the businesses that entered into an agreement with the ideal of avoiding duty. Chapter X-A of the Income Tax Act, 1961 of India deals with the conception of GAAR. GAAR was introduced in the time 2012 during the budget session in 2012 by also Finance Minister Pranab Mukherjee. Composition 265 of the Constitution of India gives power to the government to levy or collect duty from the people of India. It's generally presumed that every citizen is liable to pay reasonable duty within the vittles of duty bills. The person escaping from paying duty generally would be liable for elusion under Indian laws. occasionally associations try to lower their liability to pay duty to the government which is known as duty avoidance. GAAR was introduced by the Finance Act, 2012¹ with the end that any planning or arrangement which involves any duty benefit, whether done directly or laterally, would be taboo and liable under the provision of said law. Black Law's wordbook defines 'duty avoidance' as minimization of one's duty liability by taking advantage of fairly available duty planning openings.

¹ <https://www.indiabudget.gov.in/budget2012-2013/ub2012-13/mem/mem1.pdf>

NEED FOR GENERAL ANTI-AVOIDANCE RULES (GAAR)

Ample of legal doctrines and judicial precedents recommended and stressed the need for General Anti-Avoidance Rules (GAAR), especially, in the case of *Union of India v. Azadi Bachao Andolan*² and *Vodafone International effects B.V. v. Union of India* stated the significance of legalistic daises and expressed the significance of policy decision in a matter of General Anti-Avoidance Rules (GAAR). Justice Kapadia and Justice Swatantra Kumar expressed the need for General Anti-Avoidance Rules (GAAR) in following words “duty policy certainty is pivotal for taxpayers (including foreign investors) to make rational profitable choices in the most effective manner. Legal doctrines like Limitation of Benefits and look Through are matters of policy. It's for the Government of the day to have them incorporated in the covenants and in the laws so as to avoid disagreeing views. Investors should know where they stand. It also helps the duty administration in administering the vittles of the exacting laws.”

In durability to the below- mentioned compliances, Justice Radhakrishnan¹ also observed the significance for legislation as follows:

“duty avoidance is a problem faced by nearly all countries following civil and common law systems and all partake the common broad end, that's to combat it. numerous countries are taking colorful legislative measures to increase the scrutiny of deals conducted by non-resident enterprises. Australia has both general and specific anti-avoidance rule (GAAR) in its Income duty Legislations. In Australia, GAAR is in Part IVA of the Income Tax Assessment Act, 1936, which is intended to give an effective measure against duty avoidance arrangements. South Africa has also taken action in combating about duty avoidance or duty harbors. Countries like China, Japan etc. have also taken remedial measures.

Direct Tax Code Bill (DTC) 2010, proposed in India, envisages creation of an economically effective, effective direct duty system, proposing GAAR intends to help duty avoidance, what's inequitable and undesirable.”

As with the courts' above- mentioned views and compliances, there are number of compliances across the world about the significance and need for anti-avoidance rules to help abuse of Double Taxation Avoidance Justice K.S. Radhakrishnan stated in the Judgment of *Vodafone International effects B.V v. Union of India & Anr*³ Covenants (DTAT). The points and objects

² 263 ITR 706 (SC)

³ (2012) (6) SCC 613

of anti-avoidance rules linked by the number of experimenters are distributed and presented below

- To help the taxpayer from indulging in any ingenious scheme or device in order to exclude or reduce their taxability;
- To discourage taxpayers from entering into vituperative arrangements;
- To offset the vituperative duty advantage which a taxpayer attempts achieving; and
- To include a number of safeguards that ensure that any reasonable choice of a course of action is kept outside the target area of the anti-avoidance rules.”

The significance of General Anti-Avoidance Rules (GAAR) was explained by numerous courts of foreign countries, especially, in the court of New Zealand in CIR v. BNZ Investments case⁴ the significance of the General Anti-Avoidance Rules (GAAR) was explained as follows “GAAR is an essential pillar of the duty system designed to cover the duty base and the general body of taxpayers from inferior duty avoidance bias. By discrepancy with specific anti-avoidance rules which are directed to particular defined situations, the council through GAAR has raised a general anti-avoidance mark by which the line between licit duty planning and indecorous duty avoidance is to be drawn.

Line delineation and the setting of limits fete the reality that commerce is legitimately carried out through a range of realities and in a variety of ways; that duty is an important and proper factor is business decision timber and family property planning; that commodity further than an actuality of a duty benefit in one academic situation compared with another is needed to justify attributing a lesser duty liability; that what should nicely be stuck at are sleights and other arrangements which have duty convinced features outside the range of respectable practice, utmost tax avoidance involves a false transaction; and that certainty and pungency are important but not absolute values. ”

OVERVIEW OF GENERAL ANTI-AVOIDANCE RULES (GAAR) 2012

The Explanatory Memorandum to the Finance Bill, 2012 outlines the reasoning behind the introduction of the General Anti-Avoidance Rule (GAAR) as follows:

While there are specific anti-avoidance provisions within the Act, general anti-avoidance has typically been addressed only through judicial decisions in specific cases. Some courts have ruled that the legal form of a transaction can be disregarded in favour of considering its true

⁴ (2001) 20 NZTC 17,103 (CA).

substance for tax purposes, while others have insisted on upholding the form. In the context of moderate tax rates, it is essential to ensure the correct tax base is taxed in the face of aggressive tax strategies and the use of low-tax jurisdictions for residence and capital sourcing. Many countries have codified the 'substance over form' principle through the General Anti-Avoidance Rule (GAAR). In this context, there is a need for a statutory provision to enshrine the 'substance over form' doctrine, where the real intention and effect of a transaction are considered for tax purposes, regardless of any legal structure designed to conceal the true intent. Thus, GAAR has been introduced in the Income-tax Act to address aggressive tax planning.

KEY FEATURES OF THE GENERAL ANTI AVOIDANCE RULE (GAAR)

The Government of India's 2012⁵ memorandum explains the core features of GAAR, which include:

- i) An arrangement designed with the main purpose, or one of the main purposes, of obtaining a tax benefit and meeting at least one of four criteria may be deemed an "impermissible avoidance arrangement."
- ii) These four criteria include:
 - Creation of rights and obligations not normally found in arm's-length dealings.
 - Misuse or abuse of tax laws.
 - Lack of commercial substance, or being deemed to lack it.
 - Conducted in a manner not typically used for bona fide purposes.
- iii) An arrangement is considered to lack commercial substance if:
 - The overall substance or effect contradicts the form of individual steps or parts.
 - It involves round-tripping or financing through an accommodating party.
 - It includes offsetting or cancelling elements.
 - A transaction is carried out through intermediaries, obscuring the value, location, source, ownership, or control of the funds involved.
 - The location of assets or transactions, or the residence of any party, is shifted for reasons other than substantial commercial purposes.

The provision also clarifies that certain factors, such as the duration of an arrangement, taxes

⁵ OM.F.NO.500/111/2009-FTD-1 Dated 27 February, 2012

arising from it, or an exit strategy, are not to be considered when determining if commercial substance is lacking. Once an arrangement is deemed impermissible, the tax consequences related to the arrangement can be assessed, taking into account the specific case circumstances.

Possible actions include:

- Disregarding or combining steps of the arrangement.
- Ignoring the arrangement for tax purposes.
- Disregarding or combining parties involved.
- Reallocating income and expenses among the parties.
- Relocating the residence of a party or the location of a transaction or asset.
- Disregarding corporate structures.
- Recharacterizing transactions, such as converting equity to debt or capital to revenue.

These provisions can be used alongside other anti-avoidance measures or tax liability rules. To prevent treaty abuse, a limited treaty override is also provided.

GAAR UNDER INCOME TAX ACT 1961⁶

- Section 95: Describes the application of GAAR and specifies that an arrangement can be deemed impermissible, with tax consequences determined based on the case details.
- Section 96: Defines "impermissible avoidance arrangement" and outlines the conditions under which an arrangement may be presumed to have been made primarily for tax benefit.
- Section 97: Specifies situations where an arrangement may lack commercial substance, including round-tripping financing, accommodating parties, and transactions designed to obscure critical details like asset location or ownership.
- Section 98: Sets forth the GAAR provisions, detailing how arrangements can be disregarded, combined, or restructured to prevent tax avoidance.
- Section 99: Allows the tax authorities to treat connected parties as one for tax benefit assessments.
- Section 100: Clarifies that GAAR provisions supersede other methods of determining tax liability.
- Section 101: Specifies that the guidelines and conditions for applying GAAR will be prescribed.

⁶ Income-tax Act, 1961 was amended by Finance Bill, 2012 to add Chapter X-A titled 'General Anti- Avoidance Rule'

- Section 102: Provides definitions for terms like "arrangement," "asset," "tax benefit," and "connected person."

INCOME TAX RULES, 1962⁷

Rules	Description
Rule 10U	GAAR not to apply in certain cases
Rule 10UA	Determination of consequences of impermissible avoidance arrangement
Rule 10UB	Notice and Forms for reference under Sec. 144BA
Rule 10UC	Time limits for various stages of assessment procedure in GAAR cases
Rule 10UD	Reference to the Approving Panel
Rule 10UE	Procedure before the Approving Panel
Rule 10UF	Remuneration of Approving Panel

The Central Board of Direct Taxes (CBDT) has released Circular No. 7 of 2017, dated 27.01.2017, which provides crucial clarifications regarding the implementation of GAAR provisions under the Income-tax Act, 1961, in the form of 16 Questions and Answers.

IMPERMISSIBLE AVOIDANCE AGREEMENT (IAA)

- Section 96(1) defines an IAA as an arrangement where the primary goal is to secure a tax benefit, in addition to involving one of the four elements listed in Section 96.
- The term "arrangement" is defined in Section 102(1).
- GAAR will apply to a step or part of an arrangement if the primary purpose is to obtain a tax benefit, even if the overall arrangement's primary purpose isn't tax avoidance.

CONDITIONS FOR IAA

- As per Section 96(1), an IAA is an arrangement with the main purpose of obtaining a tax benefit and includes one of the four tainting elements.

⁷<https://pib.gov.in/PressReleasePage.aspx?PRID=1481279#:~:text=The%20necessary%20procedures%20for%20Application,the%20Income%20Tax%20Act%2C%201961.>

- Section 96(2) presumes that if a step or part of an arrangement's main purpose is to gain a tax benefit, the entire arrangement is deemed to be aimed at obtaining a tax benefit, unless proven otherwise by the taxpayer.
- Section 97 lists conditions that indicate an arrangement lacks commercial substance, such as if the arrangement's form is inconsistent with its substance, involves round trip financing, or manipulates the location or ownership of funds to secure a tax benefit.
- If the arrangement meets the conditions under Section 96, it can be declared an IAA by the Assessing Officer following the process outlined in Section 144BA. The tax consequences of an IAA, including denial of tax benefits or benefits under a tax treaty, will be determined by the Assessing Officer as specified in Section 98.

MAIN PURPOSE – NEW CONSIDERATIONS

- As per Section 96⁸, an arrangement can only be classified as an IAA if the main purpose is tax avoidance.
- "Arrangement" has a broad definition, including transactions, schemes, or agreements, which can be unilateral or bilateral. It doesn't have to be enforceable.
- The burden of proving that the main purpose is to secure a tax benefit lies with the tax authority. However, as the taxpayer is familiar with the arrangement's objectives, the tax authority will likely need to gather basic evidence from the taxpayer. The taxpayer must provide tangible evidence to substantiate their claimed purposes.
- Unlike the pre-GAAR approach, which focused on "what" the taxpayer did, GAAR examines "why" the taxpayer did it.
- If the arrangement's primary purpose isn't to obtain a tax benefit, GAAR won't apply, and no further inquiry will be required. Proper documentation and explanation of the commercial purpose behind an arrangement will be beneficial for the taxpayer.
- Codified GAAR is different from judicial GAAR (JAAR) in that it allows for the examination of individual steps within an arrangement, rather than only the arrangement as a whole. For instance, merging profit and loss-making businesses may be driven by commercial goals, but individual steps, like the merger of loss-making entities with profit-making ones, could be motivated by tax-related reasons.

⁸Income Tax Act, 1961, S. 96(2)

<https://www.scconline.com/blog/post/2023/03/06/critical-analysis-of-gaar-in-light-of-the-constitution-of-india-and-dtaa/>

- To determine the "main" purpose of an arrangement, the revenue must consider relevant factors and determine if other purposes can be disregarded in favour of focusing solely on the tax benefit. These factors must be examined carefully when applying GAAR to an arrangement.

ANTI-AVOIDANCE RULES: SAARs AND GAAR

Anti-avoidance rules are primarily categorized into two types: General Anti-Avoidance Rules (GAAR) and Specific Anti-Avoidance Rules (SAARs). SAARs, also referred to as Targeted Anti-Avoidance Rules (TAARs), are designed to address specific tax avoidance strategies through clearly defined tests that taxpayers must meet. Indian tax laws include several SAARs such as Transfer Pricing regulations⁹, Section 40A (2), Section 64, Section 93, Section 94(7), Section 94B, and Section 80-IA(3).

SAARs focus on particular areas of tax law, introduced by the government to counter known tax avoidance methods through specific legal provisions. However, the complexity of tax legislation has allowed for 'creative compliance,' where taxpayers exploit these rules, making it challenging for courts to curb such practices due to their specific nature.

A major drawback of SAARs is that taxpayers can structure their affairs to technically comply with these rules without adhering to their intended purpose, leading to continuous amendments to close legal loopholes. This reactive approach has made tax laws more complex and provided opportunities for new avoidance schemes. Since frequent amendments and new SAARs proved insufficient to prevent tax avoidance, the government introduced GAAR as a comprehensive statutory measure.

GAAR, as per Section 100 and the overriding clause in Section 95, supersedes SAARs and other tax provisions.¹⁰ That while SAARs address specific tax abuses, a general anti-abuse framework like GAAR is essential. Both GAAR and SAARs can coexist and be applied as required based on the facts of a case. An OECD GAAR expert affirmed that no GAAR restricts its application due to the presence of specific anti-avoidance provisions.

⁹ The Finance Act, 2001 introduced Transfer Pricing Regulations.

¹⁰ The Central Board of Direct Taxes (CBDT), through Circular No. 7 of 2017.

GAAR IN THE CONTEXT OF BEPS

From the government's standpoint, both the General Anti-Avoidance Rules (GAAR) and the Base Erosion and Profit Shifting (BEPS) initiative aim to achieve similar objectives. However, taxpayers and businesses seek legal frameworks that ensure certainty, consistency, and ease of compliance. As highlighted in the Finance Minister's speech during GAAR's introduction, its primary purpose was to curb black money generation and prevent treaty abuse. While black money pertains more to tax evasion than tax avoidance, treaty abuse is effectively addressed by BEPS Action Plan 6. Additionally, measures such as the retrospective taxation of indirect share transfers, exemptions for Foreign Institutional Investors (FIIs) not claiming treaty benefits, and the gradual elimination of tax exemptions and deductions limit GAAR's scope.

Notably, some BEPS reports advocate for the inclusion of GAAR-like provisions, recognizing that anti-abuse clauses in tax treaties alone cannot fully prevent tax avoidance that exploits domestic tax laws. For example, BEPS¹¹ Action 6 introduces the Principal Purposes Test (PPT), which denies treaty benefits if one of the main purposes of a transaction is to gain such benefits, unless aligned with the treaty's objectives. However, BEPS primarily recommends Specific Anti-Avoidance Rules (SAAR) for targeted BEPS issues, rather than broad-based anti-avoidance measures like GAAR.

While addressing tax evasion and aggressive tax avoidance is essential, the government must avoid excessive legislation that hampers business operations, increases litigation, and creates complexity and uncertainty. GAAR in India, despite procedural safeguards, is often criticized for its complexity such as the numerous defined terms under Section 102—and the broad authority it grants tax authorities to recharacterize transactions, which could elevate business costs and uncertainty. India's reputation as a challenging tax jurisdiction, particularly due to inconsistent enforcement at lower levels, may further deter foreign investment.

The 2016 Budget is expected to implement BEPS measures in line with OECD guidelines while addressing taxpayer concerns about the uncertainty in Indian tax laws, especially in cross-border transactions. Given that BEPS covers many of India's tax concerns, it may be prudent for India to reassess GAAR's implementation. Taxpayers need adequate time to adapt to BEPS changes, and introducing GAAR in alignment with global best practices, after assessing BEPS

¹¹ <https://www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html>

impact, would be preferable. In conclusion, implementing GAAR in its current form may ultimately do more harm than good.

VODAFONE INTERNATIONAL HOLDING BV VS UNION OF INDIA¹²

In this landmark 2012 case, the Revenue argued that the judgment in the *Azadi Bachao Andolan* case should be overruled to the extent that it deviated from the principles established in *McDowell & Co. Ltd.* However, the Supreme Court disagreed and made several key observations:

- The Westminster Principle asserts that if a document or transaction is genuine, the court cannot disregard it in favor of an assumed underlying substance. This principle has been reaffirmed as a fundamental doctrine in subsequent judgments by English courts.
- The *Ramsay* case did not reject the Westminster Principle but instead contextualized it, holding that any transaction deemed a colorable device must be treated as a fiscal nullity. Thus, *Ramsay* provides a framework for statutory interpretation rather than establishing a broad anti-avoidance rule in tax law.
- The Court clarified that the binding ratio in the *McDowell & Co. Ltd.*¹³ case is the opinion expressed by Justice Mishra, with whom three other judges concurred, and supplemented by Justice Reddy's observations on tax avoidance.
- It was emphasized that the Revenue cannot impose taxes without explicit statutory authority. Moreover, taxpayers are within their rights to structure their financial affairs to minimize tax liability and are not obligated to adopt arrangements that maximize revenue for the state. The Revenue's argument that the *McDowell* ruling contradicts the *Azadi Bachao Andolan* judgment was deemed unsustainable by the Court, which found no need for reconsideration by a larger bench.

INTERPLAY BETWEEN GAAR AND THE ANTI-ABUSE RULE (PPT RULE) IN TAX TREATIES

The interaction between the General Anti-Avoidance Rules (GAAR) and the Anti-Abuse Provisions in tax treaties under the Multilateral Instrument (MLI) an OECD initiative to implement Base Erosion and Profit Shifting (BEPS) measures merits consideration, particularly in relation to the Principal Purpose Test (PPT Rule) and GAAR.

¹² 2012 (6) SCC 757, at 68 [MANU/SC/0105/2009]

¹³ *McDowell & Co. Ltd. v. CTO* (1985) 3 SCC 230

LIMITED SCOPE FOR CONFLICT BETWEEN PPT AND GAAR

In practice, GAAR should not deny treaty benefits when the PPT Rule does not apply to an arrangement. However, there may be instances where both PPT and GAAR could be applicable, or where PPT applies but GAAR does not. This ensures that if a taxpayer successfully satisfies the PPT requirements, GAAR will not override those treaty benefits. In India, with the MLI effective from April 1, 2020, for 28 countries,¹⁴ the likelihood of disputes over GAAR overriding tax treaties is minimal, provided that the MLI is applied only to Covered Tax Agreements notified by both India and its treaty partners.

DIFFERENCES IN CONDITIONS FOR PPT RULE AND GAAR APPLICABILITY

Under the PPT Rule, treaty benefits can be denied if obtaining such benefits is one of the principal purposes of a transaction, not necessarily the sole or dominant purpose. This "one of the principal purposes" standard, as stated in Article 7(1) of the MLI, sets a lower threshold compared to GAAR, which requires the "main purpose" to be tax avoidance. Thus, the PPT Rule may have a broader scope than GAAR. Additionally, GAAR is triggered only when certain elements such as non-arm's length rights or obligations, misuse of tax provisions, lack of commercial substance, or arrangements not undertaken for bona fide purposes are present. Therefore, GAAR is unlikely to apply if a taxpayer meets the PPT requirements.

GAAR also includes a de minimis threshold, applying only when the combined tax benefit exceeds Rs. 3 crores in a financial year, while the PPT Rule has no such limit. Furthermore, GAAR does not apply to income from investments made before April 1, 2017, but no such grandfathering exists for the PPT Rule.

Notably, Sections 90(2A) and 90A (2A) of the Income Tax Act provide that GAAR overrides tax treaties, even when treaty provisions are more favourable to taxpayers.

¹⁴ On 25th June, 2019, India has deposited the Instrument of Ratification to OECD, Paris along with its Final Position in terms of Covered Tax Agreements (CTAs), Reservations, Options and Notifications under the MLI, as a result of which MLI will enter into force for India on 01st October, 2019 and its provisions will have effect on India's DTAAAs from FY 2020-21 onwards.

CONCLUSION

Tax collection from organizations is crucial for funding government initiatives like infrastructure development, which benefit society. GAAR was introduced to prevent tax avoidance through deliberate arrangements. While beneficial for the country, GAAR has certain loopholes that need addressing. Many companies fear harassment by tax authorities under GAAR, even when they comply with tax laws, highlighting the need for balanced and fair implementation by the government.

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