



CODIFICATION OF GAAR- A WELCOMING STEP?

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General Anti-Avoidance Rule or GAAR is a legislative measure introduced to restrict abusive and contrived tax avoidance measures taken by taxpayers. Sections 95-102 of the Income Tax Act, 1961¹ lay down the GAAR provisions. The principle codified by GAAR has been set as judicial precedents through various judgments of the Supreme Court. Courts have affirmed that if a transaction is genuine and within the permissible limits of law, it is acceptable, but if a transaction is found to be colorable, dubious, sham or fraudulent, it must be disregarded by applying doctrines such as piercing of corporate veil.² The Apex Court has also declared that “*courts are now concerning themselves not merely with the genuineness of a transaction, but with the intended effect of it for fiscal purposes. No one can get away with a tax avoidance projects with the mere statement that there is nothing illegal about it.*”³ The judicial response to legislative anti avoidance has been that they are dealing with an extraordinary situation and because of an essential element of arbitrariness, it should be sparingly used as a remedy.⁴ This is primarily

why there is no unanimity in the decisions of anti avoidance cases. The standards used in the cases might be similar like bona fide purpose test, economic or commercial substance test, etc. but the matter can only be decided after a detailed and close analysis of the facts and circumstances of each case. The issue which is usually in discourse regarding GAAR is the kind of transactions it would be applicable for. There is uncertainty when attempting to answer this because a very fine line exists between tax planning, tax avoiding and tax evasion. Even though the former two (when done under the realms of tax law) are legal but tax evasion is illegal. A particular transaction which is part of a chain of transactions for tax avoidance might in itself not be illegal, but when an arrangement is seen as a whole made solely for the purpose of avoiding tax payment, it is considered undesirable and inequitable. Avoidance undermines equity irrespective of whether it acts as a burden on non-avoiders or not, it does cause citizens who should be taxed similarly to be taxed differently.⁵

One of the main features of GAAR is to look at transactions with the lens of ‘substance over form’. The fundamental phrase for action under GAAR is “impermissible avoidance agreement (‘IAA’)”⁶, the understanding of which is forwarded in section 96 of the Income Tax Act, 1961. What we have to analyze here is whether

benefit and which contains any of the following elements: creation of rights or obligations not normally created between persons dealing at arm's length, resulting directly/indirectly in misuse or abuse of the DTC, lacking commercial substance in whole or in part and finally, being entered into or carried out by means which are not normally employed for bona-fide purpose.

¹ The Income Tax Act, 1961 (Act 43 of 1961)

² *Vodafone International Holdings v. Union of India* (2012) 6 SCC 613

³ *Mc Dowell & Company Limited v. The Commercial Tax Officer* 1986 AIR 649

⁴ NLIU LR (2014) 116

⁵ A. Shenfield, *The Political Economy of Tax Avoidance*, at 19 (London, IEA) (1968)

⁶ This phrase is defined to include any step or part of an arrangement whose main purpose is to obtain a tax



codification of GAAR was a welcoming step. This question majorly arises because the manner in which GAAR was first introduced created widespread opposition from taxpayers, FIIs and MNEs and had a vast impact on the business and industry sentiment. This is largely because it was introduced in a time where the global economies were facing huge contingencies in terms of economic stability.⁷ I would first highlight the challenges associated with codification of GAAR and then discuss the manner in which these were addressed. Certain amendment proposals were made to the GAAR provisions which addressed concerns raised by various stakeholders. As a result of this, its implementation was deferred until 2017⁸, even though it was introduced in the Finance Bill, 2012.

When GAAR was codified for the first time in India, the following problems were associated with it: *firstly*, the general understanding was that the provisions gave wide powers to the tax administration to review every transaction using the GAAR lens⁹ and bring such transaction within its ambit. The premise behind this contention was that the burden of proof was on the taxpayer to show that no tax has been avoided.¹⁰ This was because of the contrary principle settled by judicial decisions that avoidance and evasion have to be proved by the revenue authorities.¹¹ *Secondly*, the ‘grandfathering clause’ present in GAAR

provisions has been an issue of heated debates.¹² The grandfathering of arrangements as was proposed initially would confer protection in perpetuity to the arrangements, which was not desirable. *Thirdly*, there were provisions relating to retrospective taxation in conjunction of GAAR as an instrument.¹³ *Fourthly*, GAAR under the Finance Act had broadened the scope of its application to transaction where one of the many purposes was to avail a tax benefit. This covered a lot more arrangements than what would have fallen within GAAR’s ambit if a transaction was scrutinized to check if its main purpose was to avoid tax. This led to the stakeholders doubting whether they would have to pay the penalty for the entire transaction amount or only the part which reflected tax benefit.¹⁴ This also would have led to a manifold increase in litigation and persecution of taxpayers. *Fifthly*, GAAR could have been invoked by the commissioner of income tax and the common notion was that there is an absence of high level of scrutiny.¹⁵ *Sixthly*, the drafting of GAAR provision left room for interpretation by both the tax authority and taxpayer to forward arguments that suited their cases.¹⁶ *Seventhly*, GAAR provisions could override tax treaties and international tax agreements (the main concern here was with regard to the Limitation of Benefit (LoB) clause present in bilateral treaties). Generally, it is a well established principle that if a domestic law provision contradicts

⁷ NLIU LR (2014) 116

⁸ PwC, *GAAR decoded*, November 2017, available at <https://www.pwc.in/assets/pdfs/publications/2017/gaar-decoded.pdf>

⁹ R.R. Singh & Neetika Kaushal Nagpal, *India’s Investment Climate: Addressing Concerns about Tax Policy*, ICRIER (2014)

¹⁰ Sukumar Mukhopadhyay, *General Anti-Avoidance Rule in Income Tax Law*, 47 EPW 22, 24-28 (2012)

¹¹ *K Chellaram v. CIT* 1980 (125) ITR 713 (SC); *KG Thomas v. CIT* 1985 (156) ITR 412 (SC)

¹² NLIU LR (2014) 116

¹³ NLIU LR (2014) 116

¹⁴ SINGH, *supra*, note 9

¹⁵ Y. Shiva Santosh Kumar, *India’s Taxation Regime: Perspectives on the Proposed Changes*, 23 NLSIR 2, 28-43 (2012)

¹⁶ SINGH, *supra*, note 9



with an international tax treaty, the one that is more beneficial to the taxpayer prevails.¹⁷ Lastly, how do GAAR provisions interact with SAAR (Specific Anti-Avoidance Rule) provisions which were already codified?

To address these concerns, an expert committee under the chairmanship of Dr. Shome was setup in 2012 by the then Prime Minister.¹⁸ The committee released its guidelines¹⁹ for application of GAAR after detailed consultation with various stakeholders and general public. Majority of the suggestions forwarded by this committee were adopted in the legislation. These were: arrangements where the main and not one of the purposes is to obtain tax benefit will only be considered IAA.²⁰ The assessing officer will be required to issue a show cause notice with reasons to invoke GAAR provisions.²¹ The assessee will also have an opportunity to justify the transaction/arrangement.²² The onus to prove that tax avoidance has taken place shifted from the taxpayer to the tax authority.²³ They laid down certain limitations for applicability of GAAR provisions such as it would not be relevant if the tax benefit from a transaction would be less than Rs. 3 Crore. The position regarding applicability of GAAR provision was clarified and it was stated that it would only apply to the part of transaction done for

accruing a tax benefit and not the entire transaction.²⁴ The taxpayers were given a right to apply for a ruling from the Authority for Advance Ruling (AAR) to determine the applicability of GAAR for transactions they propose to undertake.²⁵ Additionally, it was clarified that only the investment structures prevailing prior to 30 August, 2010 would fall within the purview of GAAR provisions and would be grandfathered.²⁶ They also decided that the provisions of GAAR and SAAR could co-exist and be applied as per what the case demands.²⁷

Furthermore, the Central Board of Direct Taxes (CBDT) issued a set of 16 clarifications in the form of questions and answers to further elaborate on the intended application of the GAAR provisions.²⁸ CBDT has put in place a two-stage approval process for initiating GAAR to ensure that the anti-abuse framework is implemented in a “fair and rational” manner and officials do not enjoy much discretion.²⁹ Proposals to apply GAAR will be vetted first by a principal commissioner or commissioner of income tax and at the second stage by an approving panel headed by a high court judge.³⁰ It also clarified that investments made prior to April 2017 involving compulsorily convertible instruments, bonus issuances or splitting or consolidation of

¹⁷ KUMAR, *supra*, note 15

¹⁸ *General Anti-Avoidance Rules (GAAR) India and International Experience*, March 2017 <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-gaar-india-and-international-experience-noexp.pdf>

¹⁹ Expert Committee, *Final Report on General Anti-Avoidance Rules (GAAR) in Income Tax Act, 1961* (2012), available at https://www.finmin.nic.in/sites/default/files/report_gaar_jtact1961.pdf

²⁰ Statement of the Finance Minister on GAAR, Press Release, Jan 1, 2013

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ *Ibid.*

²⁸ Anonymous, *With Safety Belts in place, GAAR ready to take off on April 1*, ECONOMIC TIMES, Jan 28, 2017

²⁹ *Ibid.*

³⁰ *Ibid.*



holdings will also not attract GAAR.³¹ They also filled in the gap for a concern which was not addressed through the amendment regarding overriding effect of GAAR provisions over tax treaties. CBDT said that GAAR will not be invoked if a case of avoidance is “sufficiently” addressed by LoB provisions, which restrict the scope of bilateral tax treaties. However, if some unaddressed concerns still remain and all tax-avoidance strategies are not addressed, the gaps would be filled through the domestic provision/s applicable to the situation. This to some extent fulfils a long-standing demand of the industry.

The evolution of GAAR provisions in India has been mentioned in detail. No cases have come up before the court after the government accepted the recommendations of the Shome Committee and the set of clarification has been issued by CBDT. The clarification regarding implementation of GAAR provisions provided by the government depicts attempt to prevent any misuse or abuse of these provisions. There are some writers that propose that instead of having GAAR provisions, why cannot the legislature codify its intent through Specific Anti-Avoidance Rules (SAAR)?³² I would like to differ from this position because the legislative intent behind codifying any statute is to avoid any violation of the principle on which the statute is drafted. Usually, codification reflects the kind of offences that are most often committed and have to be addressed by the government. When follow up statutes are made on a single subject to cater to prevention of any incidental offences

or when a single statute is amended many times, it does not illustrate the inefficiency of the legislature while drafting the parent statute. But, as new kinds of cases come to light and people think of ways to escape the law, such actions have to be taken by the government. Consider for example- there is a country A where the people have never evaded or avoided taxes and have been very genuine in the way they plan their tax. In such a scenario, there is very little likelihood that stringent tax evasion or tax avoidance laws are present in the domestic legislation. Now, if in this country some people start evading taxes, they are bound to go scot-free until the government could bring tax regulations in place. The point I am trying to make here is that it is nearly impossible for the legislature to be able to forecast all the channels and methods in which people might think of avoiding taxes. Making such a demand from the government is an act of unreasonableness. No statute enlists exhaustive situations in which its provisions may or may not apply.

There are still some terms like ‘commercial substance’ which have not been conclusively defined and leads to some uncertainties in the implementation of the GAAR provisions but these are likely to be resolved with passage of time. Uncertainty also persists in relation to the operational scope of these provisions, their interaction with SAAR and their application in the context of tax treaties³³, but some uncertainty regarding application of a new law is not specific to the GAAR provisions. The only distinct feature about them as compared to a new legislation is that the terms which form the basis of

³¹ *Ibid.*

³² Ashutosh Chaturvedi, *GAAR: Here's what may hinder the business environment*, FINANCIAL EXPRESS, April 22, 2017

³³ PwC, *supra*, note 8



understanding the principle of tax avoidance have been used in judiciary since a long time and there is a broad understanding of how and in which cases they are to be used. Since the GAAR provisions are applied sweepingly for all tax paying corporate or individual, the compliance requirements are bound to rise and since India has all kinds of tax paying entities, the small scale tax payers might have to face difficulties but this is a mild hardship in comparison to the benefit these provisions extend for the society at large.

The true purpose behind codification of GAAR must be kept in mind whenever applying it to any transaction/arrangement. GAAR should not become a revenue raising measure nor should it be considered to be a charging section because it is meant to protect the tax base and not expand it.³⁴ Expansion of tax base could be a consequence of GAAR but it must be unintended and this should not be the reason behind operation of GAAR.³⁵ By interpreting GAAR efficiently and promoting a prosperous atmosphere to commercial activity, codification of GAAR would definitely be a progressive and welcoming step in the development of taxation laws in India.

³⁴ KUMAR, *supra*, note 15

³⁵ KUMAR, *supra*, note 15