TAX AVOIDANCE AND PLANNING – DUTY OF COURTS TO SHUN THE FORMER AND NOT TO CLOTHE IT WITH THE LATTER

By Neha
LL.M. (Corporate Laws)
From National Law University, Jodhpur

“Taxes are what we pay for civilized society. I like to pay taxes. With them I buy civilization”
- Mr. Justice Holmes

I INTRODUCTION

The judgement of the Supreme Court of India appearing to favor avoidance techniques in Vodafone International Holdings B.V. v. Union of India, (2012) 341 ITR 1 led to the adoption of the General Anti Avoidance Rules (hereinafter, GAAR) under the Income Tax Act, 1961, which came into effect from 1st April, 2017. This judgement has been regarded by many as having accorded legal recognition to the attempts of non-resident entities to avoid having to pay tax in India, by making use of complex tax avoidance devices/structures. As per the facts of this case to be dealt later in detail, despite there being clear cut evidences of existence of a ‘business connection’ in India giving rise to tax liability under sections 5 read with 9 of the Income Tax Act, 1961, the Supreme Court declared the tax structure involved in the transaction in question as legal thereby absolving Vodafone of the liability to deduct tax to the tune of USD 2.1 billion. The Supreme Court accorded legal recognition to the right of any entity to plan its corporate structure in such a way that it is most advantageous for tax purposes, provided that this does not involve abusive practices, in accepting as evidence that the structure had been operational for many years without being questioned by the tax authorities.\(^1\)

So, the mere fact that seemed to have resonated with the Supreme Court was the continued use of the structure without any question being raised from the tax authorities prior to this case. The Court seemed to have been more inclined towards protecting the interests of foreign investors who otherwise may have been deterred from investing in India had the decision gone against Vodafone. However bona fide the intentions may have been behind this judgement, one cannot ignore the ill-effects of such pronouncements declaring tax avoidance techniques as mere tax planning methods which in turn leads to huge loss of tax revenue. In fact, such interpretations attract investors who do not wish to contribute to the development of the host country’s economy, they rather intend to do the opposite. Therefore, it becomes very important to clearly lay down the criteria for differentiating between tax planning and tax avoidance.

The concepts of tax avoidance, planning and evasion are of great significance in taxation regimes of all countries with their legal consequences being very different from each other. While tax avoidance and planning are legal, tax evasion is illegal and subject to prosecution by the concerned authorities. Though tax evasion is something that tax

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\(^1\) Dr. Patricia Lampreave, Anti-Tax Avoidance Measures in China and India: An Evaluation of Specific Court Decisions, IBFD 49, 58 (2003).
II TAX AVOIDANCE, PLANNING AND EVASION

Avoidance and evasion of tax are activities which are far from being unheard of in India as much as in any other country of the world, though the extent to which these are in play may vary from country to country. In fact, these concepts are as old as the concept of taxation itself.² “Tax avoidance”, “tax evasion” and “tax planning” – these terms are frequently used by people involved in all sorts of economic and business-related activities, and yet not many can claim that they fully understand what these terms mean and the legal consequences that they entail. It is very important to ensure that one at least has a workable idea about these concepts lest they should end up getting entangled in the legal system. The big MNCs and corporate giants though are not included in this innocent lot. We know that the liability to pay tax is not exactly a quid pro quo and is more of a compulsion than an option which makes the taxpayers want to avoid having to comply with the relevant directives of the law in this regard. This is commonly referred to as “tax aversion”, by which is meant that taxpayers do not think of taxes as a necessary expense accruing in their interest, but, rather, as a cost that may be avoided by seeking the most judicial doctrines and methods developed by courts across the world to deal with tax avoidance devices. Part V discusses the above three landmark judgements credited with shaping the tax jurisprudence in India. Part VI contains a brief description of GAAR. And lastly, Part VII is the conclusion containing the author’s opinion on the Supreme Court judgements and on the issue of tax avoidance as a whole.

advantageous tax structures to achieve this purpose.\textsuperscript{3} Hence, as the law of tax has developed, along with it has grown the creative ways in which individuals/entities bypass the rigors of the law and fool the government that they are meeting their tax obligations while the reality is as a matter of fact the opposite. The scope of this paper is though limited to the liability of the big corporate giants to pay taxes and how they manage to reduce this liability by employing unfair means thereby causing huge revenue loss to the government. Companies hire consultancy firms specializing in this area whose main task is to devise innovative tax avoidance schemes which exercise often turns out to be fruitful as being overlooked by either the tax authorities or the courts owing to prevailing uncertainty in the mechanism of differentiating between these terms or a total lack thereof.\textsuperscript{4} The present paper in the upcoming parts will give a brief account of the colourable devices and anti-avoidance techniques both judicial and legislative commonly known and in practice among the various nations of the world. This brings us to the starting point of the instant discussion, what do these terms mean? While, tax avoidance is an indefinable concept that is constantly changing, it basically entails taxpayer reducing his tax liability by taking advantage of the loop-holes and ambiguities in the relevant legal provisions.\textsuperscript{5} Justice Reddy calls it the “art of dodging tax without breaking the law”.\textsuperscript{6} There is no legal sanction against tax avoidance unlike tax evasion which is use of illegal means to avoid paying taxes, for example, the direct violation of a tax provision by not declaring income earned. Accordingly, the main point of difference between tax avoidance and tax evasion is that while the former is the use of illegitimate means with the intent to evade the payment of tax, the latter is not illegal as such, which results in it being confused with what is known as “tax planning” or “acceptable tax avoidance” or “tax mitigation”.\textsuperscript{7} Tax mitigation results from a taxpayer using a fiscal incentive available to him in the tax legislation by submitting to the conditions and economic consequences that the particular tax legislation entails.\textsuperscript{8} An example would be a Special Economic Zone where a taxpayer sets up his establishment or avails a backward area linked tax incentive or uses provisions for accelerated depreciation or one among various alternatives offered under the income tax regime of a particular country. Several developing countries such as Brazil, India and China offer such incentives.\textsuperscript{9} It is not very problematic for tax authorities to identify tax evasion and tax frauds, the main issue often arises while figuring out whether a particular corporate structure is truly legitimate to squarely fall under tax planning or involves tax avoidance techniques which though not strictly illegal may consequently be considered to be illegal, as such a structure’s sole objective is to reduce or eliminate the tax burden. This is, therefore, an indirect violation of the law, i.e., a distortion of the interpretation of the law in

\textsuperscript{3} Dr. Patricia Lampreave, Anti-Tax Avoidance Measures in China and India: An Evaluation of Specific Court Decisions, IBFD 49, 49 (2003).
\textsuperscript{4} Prashant Bhushan, Legitimising Tax Avoidance, 47 EPW 37, 37 (2012).
\textsuperscript{5} Rajendra Nayak, Navigating India’s Proposed GAAR, 23 INT’l TAX REV. 48, 49 (2012).
\textsuperscript{6} T.P. Ostwal and Vikram Vijayaraghavan, Anti-Avoidance Measures, 22 NLSIR 59, 61 (2010).
\textsuperscript{7} Rajendra Nayak, Navigating India’s Proposed GAAR, 23 INT’l TAX REV. 48, 49 (2012).
\textsuperscript{8} Parthasarathi Shome, Addressing Tax Avoidance: Cross Country Experience and an Indian Case Study, 6 LSE Law 01, 19 (2019).
\textsuperscript{9} Ibid.
the taxpayer’s interest. Tax avoidance has more to do with one’s questionable morals and violation of social contract while tax evasion is a crime. Tax avoidance is not regarded as illegal because there is no violation of the law in the strict sense, it simply involves taking advantage of poorly drafted provisions of the governing law. There is often a thin line between acceptable tax avoidance, also known as tax planning and unacceptable tax avoidance where a tax structure falls within the letter of the law, but runs counter to its spirit. And it’s not just the tax authorities, but even the courts have fallen short of coming up with mechanisms to correctly differentiate between tax avoidance and tax planning, which has resulted in contradictory judgements being passed in this respect. We are a welfare state and we cannot afford to let the menace of tax avoidance take its toll on the state exchequer. The unjust consequences of tax avoidance are too many to ignore, the predominant one being substantial loss of much needed public revenue. The task is not as simple as it sounds, there’s no straight-jacketed formula to distinguish between tax avoidance and tax planning. This is a debatable topic and there can hardly ever be a consensus on this issue, particularly when taxpayer’s rights are at stake. What we need is a way to check that if a structure claims to be truly legitimate, then the same is actually free from any abusive tax practices. What we need is a balanced approach towards this issue, so that collection of revenue on one hand and taxpayer’s legitimate claims and interests on the other are equally protected. For this purpose, countries have come up with General Anti-Avoidance Rules (GAAR) as a legislative measure for dealing with aggressive tax practices. This along with the judicial principles/doctrines developed by courts should act as enough of a deterrent in the effort to curb tax avoidance practices.

III TAX AVOIDANCE TECHNIQUES/COLOURABLE DEVICES

There are a number of tax avoidance techniques that companies employ for availing tax benefits that they are not entitled to. Treaty shopping, controlled foreign corporation, thin capitalization, transfer pricing manipulation and tax havens are some of the techniques widely known to have been in use by corporations at fault. Countries tackle these devices by adopting OECD Guidelines, framing Specific Anti-Avoidance Rules (SAAR). The aforesaid practices are briefly discussed as below:

1. Treaty Shopping – This involves the abuse of tax treaties by persons who were not intended to benefit from the concerned tax treaties, in order to derive benefits that the treaty was not supposed to give. It is a premeditated effort to carefully select the most favourable tax treaty for a specific purpose. Companies seek to take advantage of tax treaties between two contracting states using a shell company based in a third jurisdiction. For example, company A in Cayman Islands licenses its intellectual property to company B in South Africa via company C in a European country. There is no tax

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treaty between Cayman Islands and South Africa, but there is one between the European country and South Africa which provides for no withholding of tax on royalties. Since domestic laws of European countries provide for no withholding of tax on outbound payments, royalties are not taxable in either companies A, B or C. The national policies of many countries apparently favour treaty shopping. They simply see it as an approach of efficient tax planning unless of course it appears to be disadvantageous to the interests of the country in which case the tax treaties get revoked. The Supreme Court of India in Union of India v. Azadi Bachao Andolan (2003) 263 ITR 706 upheld the legality of treaty shopping.

2. Controlled Foreign Corporation – Any income originating from foreign corporations is taxed after it is accrued as income in the country of residence of the recipient and therefore it becomes possible to avoid tax payment on foreign dividend income until it is repatriated (for example, by not declaring dividends or receiving them in an entity located in a “tax haven”).

3. Thin Capitalization – This refers to a technique where excessive use of debt over equity capital is involved which is brought into effect via hidden equity capitalization through excessive loans (or) the artificial use of interest-bearing debt instead of equity by shareholders with the sole or primary motive to benefit from tax advantages.

4. Transfer Pricing Manipulation Transfer pricing affects situations when goods and services are provided, knowingly or otherwise, on a non-arm’s length basis by related entities. Companies by charging above or below the market price, can use transfer pricing to transfer profits and costs to other divisions internally to reduce their tax burden. For example, an automobile manufacturer has two divisions, A which makes software and B which manufactures cars. Division A is in a higher tax country than Division B. A charge B with a lower price than market value which makes the sale of software less profitable for A and because the cost price for B is lower, its profits get a boost and B being in a lower tax country will be taxed at a lower rate. Hence, Division A’s decision not to charge market pricing to Division B allows the overall company to evade taxes.

5. Tax Havens – Tax havens are jurisdictions which tend to have nil or low taxation. Tax havens may also be jurisdictions which have other benefits like financial secrecy, minimum reporting requirements, ring fencing, discretionary tax privileges, allowing ownership to be held in trust, no registry of companies and partnerships, no taxes on dividends and interest payments to

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15 Ibid at 87.
non-residents, etc.\textsuperscript{17} Zero-tax jurisdictions: Panama, Cayman Islands, Bahamas, etc. Low-tax jurisdictions: Guernsey, Jersey, Bermuda, Isle of Man, etc.\textsuperscript{18} Such countries are often blacklisted so as to ensure that companies do not misuse the benefits as made available by establishing shell companies in the tax havens.\textsuperscript{19}

\textbf{IV JUDICIAL ANTI-AVOIDANCE MEASURES/DOCTRINES}

As it has been rightly pointed out in the initial paragraphs of this paper, tax avoidance and tax evasion methods are as old as taxation itself. Hence, countries all over the world have developed anti-avoidance measures through general rules (e.g., GAAR), specific anti-avoidance legislations (e.g., SAAR) targeting specific tax avoidance techniques, administrative and judicial solutions to deal with the problem of tax avoidance. This part focuses on the judicial doctrines developed by the Courts across the world with only the more important ones being discussed here.

There are basically two guiding principles in judicial anti-avoidance measures, viz., the business purpose rule and the substance over form rule.

The “business purpose rule” mandates that a transaction must serve a business purpose, i.e., commercial justification, other than tax avoidance. In the landmark judgment \textit{Helvering v. Gregory} 69 F.2d 809 (2nd Cir. 1934) the U.S. Supreme Court held that a corporate reorganization under the law solely for tax purposes did not qualify for tax benefits.

The substance over form rule as defined by the 1987 OECD report is \textit{“the prevalence of economic or social reality over the literal wording of legal provisions”}.\textsuperscript{20} The court pass judgements on a case-to-case basis where they either literally interpret the legal provisions, accept the legal form and allow the taxpayer’s claim of deductions; or acknowledge the substance of the transaction when entire structure is devised solely to avoid payment of tax. This often involves a crucial debate about when one should stop literally interpreting the provisions and start piercing the corporate veil. This rule finds its relevance and application in a number of tax avoidance methods as discussed below;

1. **Sham Transaction** - A sham transaction essentially conceals the true nature or reality of a transaction that exists in form only. The legal form is retained but the underlying substance is not genuine. The tax avoiders give effect to a transaction, which they do not carry out, or do not intend to carry out or is a cover up for another transaction or relations.

2. **Wrong Label** - In this method, parties use incorrect labels to classify or characterize a transaction or relationship for tax purposes.

3. **Step Transaction Doctrine** - The intermediate steps in a chain of preordained, even if bona fide, transactions may be disregarded and several related transactions may be treated as a single composite transaction. Alternatively, a single transaction may be

\textsuperscript{17} T.P. Ostwal and Vikram Vijayaraghavan, \textit{Anti-Avoidance Measures}, 22 NLSIR 59, 92 (2010).
\textsuperscript{19} \textit{Ibid}.
\textsuperscript{20} \textit{Ibid} at 64.
broken into distinct steps too to determine its tax acceptance.

4. **Piercing the Corporate Veil** - An interesting Indian case related to corporate veil piercing in Company Law is the Wood Polymer case *(In re: Wood Polymer Limited (1977), 109 ITR 177 (Guj.))*. In this case, the company asked for grant of sanction of scheme of amalgamation under section 391(2) of the Companies Act, 1956. The Gujarat High Court while refusing to sanction the scheme of amalgamation observed as under,

“...It must be confessed that it is open to a party so as to arrange its affairs so as to reduce tax liability. ...but it must be within the power of the party to arrange its affairs. If the party seeks the assistance of the Court to reduce its tax liability the Court should be the last instrument to grant such assistance or judicial process to defeat a tax liability. ...here the tax cannot be avoided unless the Court lends its assistance, namely, by sanctioning the scheme of amalgamation. In other words, the judicial process is used or polluted to defeat the tax by forming an appropriate device or subterfuge. Such a situation can never be said to be in the public interest and on this ground the Court would not sanction the scheme of amalgamation.”

India’s stance in case of corporate veil piercing has been that courts will generally not pierce corporate veil in tax cases. However, there has been a change in this trend as observed in the recent decisions. Ansaldo Energia SPA case *(Ansaldo Energia SPA v. ITAT, Tax Case No. 1303 of 2007, Jan. 12, 2009 (Mad.))* where ASPL India was “pierced” and 4 contracts were treated as a composite contract. The recent Vodafone case is discussed in more detail in the next section.

**JUDICIAL DOCTRINES** - Certain doctrines applied by many countries to control general tax abuse are listed as under;

1. **Abuse of Right** - The abuse of right is the manipulation of the intention or spirit of the law. Courts typically disregard the legal form where transactions are solely undertaken to avoid tax.

2. **Abuse of Law** - Under this, the Court disregards any transaction entered for tax avoidance purposes and substitutes it by a normal transaction.

3. **Doctrine of Simulation** - In such cases tax authorities disregard the simulated/hidden transaction and replace it with the real one.

**V TREATMENT OF TAX STRUCTURES BY SUPREME COURT**

The Supreme Court of India in the Vodafone case accorded renewed recognition to the Westminster principle established in the landmark UK judgement of *Duke of Westminster v. Commissioner of Inland Revenue, [1936] 1 A.C. 19 (H.L.) (U.K.)* in which payments were made by the taxpayer to domestic employees in the form of deeds of covenant (which were tax-deductible) instead of regular wages (which were not tax-deductible). The House of Lords in this case had refused to disregard the form of the transaction over the substance and in doing so laid down the cardinal principle that “every man is entitled, if he can, to order his affairs so that the tax attaching under the
appropriate Acts is less than it otherwise would be”.

Further on in *IRC v. WT Ramsay Ltd* (1981), the House of Lords cautioned against a series of transactions which are pre-ordained, inserted into which are steps that have no commercial purpose apart from tax avoidance. Ramsay was a turning point in the interpretation of tax laws in England and was followed by subsequent House of Lords decisions in *IRC v. Burmah Oil Co Ltd* (1982) (‘Burmah Oil’) and in *Furniss v. Dawson* (1984) (‘Dawson’). These judgements depicted a change in the approach of the courts emphasizing on the need to identify and condemn complex structures solely aimed at tax avoidance. This positive change was short-lived as in *Craven v. White* (1988) (‘Craven’), the House of Lords held that Revenue cannot start with the question as to whether the transaction was a tax deferment/tax-saving device but that Revenue should look at the transaction as a whole to ascertain its true legal nature. It observed that genuine strategic planning had not been abandoned. Post Craven, the House continued to uphold the Duke of Westminster principle in subsequent rulings, most prominent in this line of cases being *Macniven v. Westmoreland Investments Ltd.*, (2001) 1 All ER 865 (H.L.) (U.K.).

In India, the three important judgements which have shaped the interpretational approach of the Supreme court in tax cases are *McDowell case* (1985), *Azadi Bachao Andolan case* (2003) and the more recent *Vodafone tax case* (2017). In McDowell case, the five-judge bench of the Apex Court in very clear terms observed as under,

“Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges.”

Despite such a clear observation by the Supreme Court in the McDowell case, two recent judgments of smaller benches of the Supreme Court have distinguished the McDowell case and declared such artificial tax avoidance devices as legitimate tax planning. The first case is Azadi Bachao Andolan (2004) and the second one is the Vodafone tax case (2017).

Important pronouncements in the three cases are discussed in brief as under;

1. **McDowell & Company Limited vs The Commercial Tax Officer**
   
   (1985 SCR (3) 791)

   The Supreme Court’s constitutional bench opined that while tax planning is absolutely permissible, it cannot be done by making use of ‘colourable devices’ or ‘subterfuges’, and that it actually then takes the form of tax avoidance which is though not strictly illegal, must be discouraged because of its grave consequences on the economy of the taxing state. The observation implies that the Court did not decide on the merits of any method of tax planning etc., but merely made a suggestion on the desirable line of analysis.

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that courts must undertake in order to arrive at a just decision bearing a proper outcome on the basis of the facts of each tax related case. The Court did not make any authoritative pronouncement as such on what kind of transactions are to be permissible or impermissible, instead it merely pointed out as to how courts must deter the use of tax avoidance techniques and to reject any claim of tax deduction on the basis of a transaction which has been structured in a manner meant solely for the purpose of tax avoidance.


In this case, the Double Taxation Avoidance Agreement (DTAA) between India and Mauritius (dated 01.04.1983) and Circular no. 789 dated 13.04.2000 were at the centre of the dispute. This treaty signed in 1983, which applies to residents of India and Mauritius provides that a company would be taxed only in the country where it is domiciled. Foreign Institutional Investors (FIIs) though based in other countries (mainly United States and Europe) claimed the benefit of this treaty by virtue of being registered in Mauritius under the Mauritius Offshore Business Activities Act (MOBA). An interesting point to note here is that companies registered under this Act are not allowed to acquire any property in, deal with any resident in, raise any funds in, make any investment in or conduct any business in Mauritius. Hence, these companies incorporated in Mauritius were merely “post box companies” with their place of effective management elsewhere in the United States or Europe. The tax authorities allowed them to get away with not having to pay any capital gains tax and effectively no tax at all for many years. This led to most of the foreign investment in India by the year 2000 being routed through Mauritius. The

Tax authorities after realizing that these FIIs were making huge profits in India and were in fact liable to pay capital gains tax, issued show cause notices to these FIIs. The Income Tax Officer lifted the corporate veil of these companies and found that the companies were actually operating from the US and Europe and that the relevant DTAA between India and these countries would come into play according to which capital gains tax would be levied in the country where the gains had accrued i.e., India. In response to these show cause notices, the Central Board of Direct Taxes issued a circular (No. 789, dated 13.04.2000) to all tax authorities in India that once a company had obtained a tax residence certificate from Mauritius, it would not be taxable in India. This circular was challenged in the Delhi High Court in PILs filed by the Azadi Bachao Andolan and a retired Chief Commissioner of Income Tax, Mr. S.K. Jha. A division bench of Chief Justice S B Sinha and Justice A K Sikri allowed the writ petitions on 31 May 2002 and quashed the CBDT circular holding that it was violative of the Income Tax Act and would encourage treaty shopping and tax avoidance by companies, which had nothing to do with Mauritius.

The government challenged the above order of the Delhi High Court before the Supreme Court where it argued that such a circular was needed to attract foreign investment in India. Resultantly, a bench of Justice Srikrishna and Justice Ruma Pal, allowed the appeal filed by the Government and set aside the Delhi High Court judgement by clothing the corporate structure of the FIIs as an act of legitimate tax planning and that the circular was valid and not violative of section 119 of the Income Tax Act, 1961 in as much as CBDT had the authority to issue directions to the subordinate tax authorities and the circular
was meant to attract foreign investment in India. It was also held that the provisions of India-Mauritius DTAA being specific rules would prevail over general provision under section 90 of the Income Tax, 1961 as per the rules of interpretation governing inconsistency between special and general provisions. Supreme Court rejected the argument of the respondents that FIIs cannot be considered to be ‘residents’ of Mauritius under the DTAA because they are not ‘liable to tax’ in Mauritius on account of tax exemption on sale of shares under the Mauritian Income tax Act. Supreme Court held that just because certain exemptions have been granted under Mauritian law, this does not mean that the FIIs are not liable to tax in Mauritius.

The respondents had placed reliance on the decision of McDowell case to which the Supreme Court opined that McDowell case did not lay down any binding guidelines/criteria to be considered for distinguishing between, corporate structures which are meant for tax planning and are perfectly permissible under the provisions of the law, from colourable devices created solely for the purpose of tax avoidance and that the rule in McDowell cannot be read as laying down every attempt at tax planning is illegitimate. Moreover, the Supreme Court declared treaty shopping as valid in the eyes of law in as much as it contributes to efficient tax planning and the court saw no harm if companies indulging in this activity of picking the most beneficial treaty which was not intended for their benefit, provided there are no limiting provisions specifically mentioned in the relevant DTAA as was the case with India-Mauritius DTAA. The court was of the opinion that since the treaty did not specifically prohibit third parties from deriving benefits thereunder, the corporate structure adopted by the FIIs was not vitiated in the eyes of the law. The Supreme Court rejected the submission that an act which is otherwise valid in law can be treated as invalid merely on the basis of some underlying motive supposedly resulting some economic detriment to the national interests, as perceived by Revenue.

3. Vodafone International Holdings BV v. UOI (2012) 341 ITR 1

In 2007, Hutchinson Telecom International (HTIL) which was directly or indirectly holding 67% of the shareholding of Hutch Essar Limited (HEL), an Indian telecom company, sold its entire holding to Vodafone International (VIH BV) (another foreign company) for an amount of over $11 billion. Both companies issued press releases announcing that Hutchinson had sold and Vodafone had bought 67% of the shares and interest in the Indian company for over $11 billion.

The income tax department demanded capital gains tax on this transaction which Vodafone was liable to withhold from the amount they paid to Hutchinson. Vodafone, however, argued that the transaction was not liable to tax since it was achieved by transferring the shares of a Cayman Island based holding company and there being no transfer of a capital asset situated in India, no question arose for withholding capital gains tax. The Bombay High Court rejected this contention by holding that HEL was at all times intended as the target company and a transfer of the controlling interest in HEL was the purpose which was achieved by the transaction.

The Supreme Court, however, accepted Vodafone’s claim that the capital gain had arisen only from the transfer of the single share in the Cayman Island company and
therefore had nothing to do with the transfer of any asset situated in India and therefore does not fall within section 9 of the Income Tax Act, 1961.

Justice Radhakrishnan highlighted the importance of foreign direct investment in the following words,

“The question involved in this case is of considerable public importance, especially on Foreign Direct Investment (FDI), which is indispensable for a growing economy like India. Foreign investments in India are generally routed through Offshore Finance Centres (OFC) also through the countries with whom India has entered into treaties. Overseas investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues of global business in India.”

VI GENERAL ANTI-AVOIDANCE RULES (2017)

Internationally, the concept of GAAR has been introduced in their respective domestic law by various countries across the world like Australia, Belgium, Brazil, Canada, Germany etc. Post the judgement of Vodafone tax case, a need was felt for GAAR to be implemented in India as well because the Supreme Court’s approach in tax dispute cases seemed to be too inclined in taxpayer’s favour thereby costing the government billions of dollars in revenue.

Chapter X-A of the Income Tax Act, 1961 incorporating the provisions pertaining to General Anti-Avoidance Rules came into effect from 1st April, 2017. India already had specific anti-avoidance provisions (SAAR) in the form of sections 37(1) and 40A (2) under Income Tax Act, 1961. GAAR and SAAR complement each other and are applicable as required by the facts and circumstances of the case. It has been internationally accepted that mere SAAR provisions may not be in a position to deal with all situations of tax abuse.

The GAAR provisions enacted by India seek to incorporate ‘substance over form’ doctrine in Indian tax law. The provisions have been made applicable on ‘impermissible avoidance arrangement’ (IAA) and enable tax authorities to re-characterize such arrangements and deny tax benefits or treaty benefits so as to curb tax avoidance practices.

CONCLUSION

In one of the initial chapters of this paper, there mentioned is the ‘substance over form’ doctrine which as per the definition given in the 1987 OECD report means “the prevalence of economic or social reality over the literal wording of legal provision”. This is the point which makes all the difference and leads to contradictory approaches of courts while dealing with tax cases. If the court is bent towards adopting a strict/literal interpretation of the applicable legal provisions imposing tax liability, giving importance to form over substance, then we get judgements like the Duke of Westminster, Craven and Macniven in the United Kingdom and Azadi Bachao Andolan and Vodafone case in India. On the other hand, if courts follow the ‘substance over form doctrine’ and pierce the corporate veil to check the economic reality and implication of the corporate structures in question, then we get judgements like Ramsay, Burmah Oil and Dawson in UK and Wood Polymer Ltd. and McDowell in India.

To a layman, the structures in dispute both in Azadi Bachao Andolan and Vodafone cases would clearly appear to have been created to avoid payment of tax but the Supreme Court
accorded legal recognition to the devices on the basis of technicalities like want of appropriate specific legal provisions prohibiting the structures, thereby totally ignoring the “substance over form” doctrine. The appropriate way to interpret a taxing statute would be to consider whether the transaction is a complex mechanism to avoid having to pay tax, and whether the transaction has been designed in such way that it is likely to be approved by courts. But the courts do not seem to be interested in checking whether the end objective of the device is to avoid tax, and end up legitimizing tax avoidance devices by simply holding that not every method of tax planning is illegitimate, in effect accepting the portrayal of tax avoidance techniques as tax planning. Though McDowell and other cases are important in as much as they forbid the use of dubious methods to avoid payment of tax, they fall short of laying down guidelines on how to differentiate between tax planning and tax avoidance which is the root cause of the problem. It is no doubt a difficult task to bring about a comprehensive set of rules which not only distinguishes between tax planning and tax avoidance but at the same time strikes a balance between conflicting interests of government’s right of revenue collection and taxpayer’s right of tax planning. So far, GAAR seems to be a positive step in this direction if not the best solution. The GAAR provisions enacted by India seek to incorporate ‘substance over form’ doctrine in Indian tax law which should now at least be enough to compel the courts to do what they have avoided doing thus far, i.e., to carefully examine the effect of the corporate structures.

Rajendra Nayak, Navigating India’s Proposed GAAR, 23 INT’I TAX REV. 48 (2012).
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