GENERAL ANTI AVOIDANCE RULES: CURBING TAX AVOIDANCE OR NURTURING TAX TERRORISM?

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INTRODUCTION

Leon Panetta stated that, *"If we don't do something to simplify the tax system, we're going to end up with a national police force of internal revenue agents."*

Internationally, there has been an increase in corporate re-structuring. India is also adopting pliable measures for Mergers & Acquisitions to enhance value, to achieve the elusive synergy and to consolidate business operations. The basic rationale behind this is the supposed belief that two separate companies together create a greater value than a company on an individual stand. The purpose of this route is majorly linked with the objective of wealth maximization and tax minimization. This minimization includes tax evasion and avoidance methodologies that are often utilized by enterprises with the purpose of expanding investor return. The avoidance of tax is being perceived as a region of concern and nations are exhibiting agitation over this. Various countries have enacted or are enacting new anti-avoidance rules in their taxation laws or are strengthening their current legislations on this.[1] One such being the General Anti-Avoidance Rules or 'GAAR', enacted in their direct taxation codes, which allows the revenue authorities to declare vitiated arrangements as 'Impermissible Avoidance Arrangements.' It would be fair to make a statement that General Anti Avoidance Rules (GAAR) is a global effort.

Tax avoidance, similar to tax evasion, genuinely undermines the accomplishments of the general society fund goal of gathering incomes in a proficient, impartial and compelling way.

[1] Munesh Khanna & Anshu Khanna, *New Dimensions in M&A Regulatory Framework*, GRANT THORNTON (Nov. 3, 2017), http://gtw3.grantthornton.in/assets/GrantThorntonIndiaLLP-Assocham-M&A-report.pdf.

Corporate sectors oftentimes resort to strategic engineering to avoid taxes, which consequently, creates contortions in the distribution of resources. Subsequently, this leads to a generic assumption in the documentation of taxation policies that all tax avoidance is financially unwanted and discriminatory. For global economic productivity and parity, corporations should not be permitted to utilize lawful developments or arrangements to abuse horizontal equity.

There are distinct routes by which companies can get away from their tax obligations. There is a very thin line of contrast between "*overcoming tax burden*" and "*escaping tax liability*". In simple terminology, '*Tax Avoidance*' is the lawful use of the regime to further bolster one's good fortune, to decrease the measure of tax that is payable by law whereas, '*Tax Evasion*' is the general term for endeavours to not pay taxes by unlawful means. Judiciary has tried to give some variation between an admissible tax avoidance and inadmissible tax evasion under the scope of "*tax planning*". But still corporations have time and again resorted to literal construal of taxation measures and have utilized it as a shield to defeat the purpose of law.

One of the major reasons for the introduction of GAAR in India was the setting up of corporate entities as shell companies in countries that had lower tax rates in force. These corporations had no commercial reason for working in those countries. Their major motive was to route investment into India, using the DTAA signed between the two countries. A lot of avoidance measures were taken up by the government through specific enactments but to no avail. Industries somehow advance new gadgets that enable them to get away from the black letters of law.[2] This is when the government decided to shift from specific to generic legislations.

In the setting of these changes, the paper makes a review of the positioning of GAAR in tax provisions and its effect on Mergers and Acquisitions. The evaluation of this relationship is undertaken beyond the legalistic setting, to draw lessons from a hypothetical and pragmatic outlook on how GAAR abets changes in corporate governance styles as opposed to the taxation provisions already at play. *Part I* gives a comprehensive understanding of corporate governance and analyses the impact of GAAR upon the predominant corporate culture inclined towards adopting tax avoidance arrangements. *Part II* highlights the various irregularities in

[2] D.M. Schizer, *Sticks and Snakes: Derivatives and Curtailing Aggressive Tax Planning*, SOUTHERN CALIFORNIA LAW REVIEW 1339, 1349 (2000).

this new legislation and tries to put forth some suggestive measures that may be considered and looked into for better implementation of GAAR.

GENESIS OF GAAR IN THE INDIAN TAX SCENARIO

Generally, there is a very thin line between tax avoidance and tax planning. While tax planning is superbly genuine, tax avoidance is frequently seen as legitimate in "*form*", however, not in "*substance*". Tax avoidance results in the loss of a decent amount of income for governments. Hence, with diminishing tax rates, the concentration of the Indian Revenue Authority has moved to "*legitimate tax structuring*" circumscribing along the lines of tax avoidance embraced by the corporate sector to enhance their business operations. The *Vodafone case*[3] provides great jurisprudence in this area.

There are increasing concerns to tackle '*Tax Avoidance*' at international level as well. Organization for Economic Co-operation and Development (OECD) launched Base Erosion Profit Shifting Project (BEPS) Action Plans to address the problems of tax avoidance. They clarify that tax treaties do not intend to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance.[4] BEPS measures aim to close gaps in international tax rules that allow multinational enterprises to legally but artificially shift profits to low or no-tax jurisdiction. Action Plan 6 of BEPS suggests to make domestic anti-avoidance rules (like GAAR) to prevent cases of treaty abuse. An extensive regime for General Anti-Avoidance Rules (GAAR) has been already enacted in 9 jurisdictions around the world. India is also taking active steps to deal with these issues. In order to acquire satiating data, India has gone into Tax Information Exchange Agreements (TIEAs) with a few nations with whom India hasn't signed the Double Taxation Avoidance Agreement. These TIEAs will empower India to acquire data from different jurisdictions for the application of Indian taxation measures. Another giant step taken by India is the incorporation of GAAR in its domestic taxation laws.

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[3] Vodafone International B.V. v. Union of India, (2012) 6 S.C.C. 613.

[4] Hiten Kotak, *Mergers and Acquisitions: The Evolving Indian Landscape*, P.W.C. (Nov. 5, 2017), https://www.pwc.in/assets/pdfs/trs/mergers-and-acquisitions-tax/mergers-and-acquisitions-the-evolving-indian-landscape.pdf.

On 16th March, 2012, GAAR arrangements were proposed under the Union Budget Plan. It is an arrangement of guidelines under which the tax authorities get the privilege to investigate corporate arrangements like takeovers, amalgamations, mergers and acquisitions that they think are undertaken with the primary motive of achieving a "*tax benefit*." It is incorporated in Chapter X-A of the Income Tax Act, 1961 and has come into force from 01 April, 2017.

The implementation of these Rules will not be hassle free. The probability of inconsistency and uncertainty in the provisions cannot be ruled out.[5] The provisions are extremely wide in their scope and give a lot of control to the tax authorities. GAAR can prove to be a turning point for the future corporate arrangements as well as for the ones entered prior to its implementation. Even the clarifications issued by CBDT, earlier this year, have not sufficiently answered all the uncertainties surrounding GAAR.

IMPACT OF GAAR ON CORPORATE RE-STRUCTURING

Corporate entities shall witness a drastic change in the approach of the revenue departments towards tax assessment of transactions, arrangements and structures. These anti avoidance rules are considerably overriding in nature and would affect all corporate re-structuring, including outbound and inbound mergers/de-mergers, acquisitions, amalgamations, FDIs and PE reserves. Impact may also be seen within two units of one corporation, and even in everyday business exchanges. A portion of the rising concerns, which will affect the corporate sector, are discussed herein.

Exceedingly Wide Scope of GAAR Provisions:

The realm of GAAR is extensively broad because it strives to bring under its scope almost every transaction that bears a component of "*tax benefit*". This standard requirement has to be accompanied with either of the four-additional tests, i.e., the arrangement should "*not be at arm's length*"[6] or it represents "*misuse or abuse of the provisions of the Code*"[7] or it "*lacks commercial substance*"[8] or it has not been normally employed for "*bona-fide purposes*".[9] Every

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[5] D.P. Mittal, *Law and Practice relating to General Anti Avoidance Rules*, TAXMAN'S NEW DELHI 121, (2016).
[6] Income Tax Act, 1961 § 96, cl. 1(a).
[7] Income Tax Act, 1961 § 96, cl. 1(b).
[8] Income Tax Act, 1961 § 96, cl. 1(c).
[9] Income Tax Act, 1961 § 96, cl. 1(d).

arrangement, that meets the above requirements and culminates in a lower tax liability for the companies, will be brought under the scope of GAAR and may be declared as *Impermissible Avoidance Agreement.*[10]

A correlation of the Indian GAAR provisions *vis-a-vis* different nations shows that the provisions are extensively on the lines of the South African Tax Legislation. Under the Indian GAAR, even if an arrangement in its entirety is a bona fide one, the revenue department may still summon the GAAR provisions, if '*any of the part or a step*' of the arrangement on an independent basis is found to give a tax benefit.[11] Thus, even genuine commercial arrangements may come under the wide ambit of GAAR. This is contradictory to the South African GAAR, wherein a more objective test is adopted to ascertain the sole or main purpose of the arrangement by taking into consideration the relevant purpose of the entire transaction. Moreover, there is lurking uncertainty in regard to the *procedure* of ascertaining the main purpose of the arrangement. These subjective guidelines may be interpreted by tax authorities in their favour and assessment ramifications will be resolved in a way which is regarded appropriate by them.

Due to the presence of such inborn uncertainty in the GAAR provisions, there should be sufficient protections to assure sensible application of GAAR, which ought to be guaranteed by the legislature by enacting comprehensive guidelines for its application by the tax department.

Wide-Ranging Powers of the Commissioner of Income Tax:

The charge of the invocation of GAAR provisions, when required, is given to the Commissioner of Income Tax (CIT).[12] The CIT is the chief of the tax department, having Assessing Officers (AOs) working under him. He is in charge of achieving the goals of tax collection given to him by the State. He can declare any arrangement as *Impermissible Avoidance Agreement* if he is satisfied that the entire transaction has been undertaken just for the primary motive of getting a *tax benefit.*

[10] Income Tax Act, 1961 § 96.
[11] Income Tax Act, 1961 § 95, cl. 2.
[12] Income Tax Act, 1961 § 144BA, cl. 2.

The discretionary powers of the Commissioner are exceptionally subjective. He may issue a notice to the companies asking them to bring particulars and evidences on which they relied upon to substantiate their stance that the arrangement, in question, is not an impermissible one. Once the GAAR provisions are invoked in regard to any arrangement and it has been declared as impermissible, the CIT has wide powers to determine the tax consequences of that corporate arrangement. He can disregard, set aside, re-characterize or negate the arrangement or any of its part thereof. He can also disregard or treat different parties as one.[13] Furthermore, he can reallocate or re-characterize any gross income and expenditure amongst the parties, whether in the nature of debt or equity and may also treat the arrangement as if it had not been entered into. For instance, he might regard a loan as capital and exclude the deduction of interest.

The GAAR provisions allow the tax authorities to use standards like 'substance over form', 'piercing of corporate veil' and 'thin capitalization rules' to find out the true motive behind the arrangement.

Substance over Form:

The justification behind GAAR is to systemize the tenet of "*substance over form*". The basic concept of this principle is to view the underlying substance of the arrangement by ignoring the hollow legitimate form. The revenue authorities may evoke this standard test only after they are able to corroborate that the arrangement is a sham or tax avoidant transaction or if they are able to establish that the new structure has no business or commercial substance and has been introduced just to dodge taxes.[14] GAAR aims that the genuine goal of the arrangement, and the rationale adopted for such a course of action comes to the forefront so that the legal structure, utilized by the parties as a camouflage to shroud their genuine plan, can come under scrutiny. However, there is still debate going on whether one should only look at the *legal form*, or should take into consideration the *economic substance* as well.

'*Legal form*' would allude to the portrayal of an in depth study of the commitments and obligations in a legitimate relation while '*economic substance*' is the American idea under which the financial substance is controlled by taking a look at both subjective and objective

[13] Prashant Bhushan, *Legitimizing Tax Avoidance*, 47 ECONOMIC AND POLITICAL WEEKLY, 14 (2012).
[14] Deloitte, *General Anti Avoidance Rules (GAAR): The Indian and International Experience*, (Nov. 10, 2017), https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-gaar-india-and-international-experience-noexp.pdf.

elements to check whether there is any potential for benefit other than tax savings, or if there is any significant alteration in the economic position of the corporation. Under GAAR, principle of economic substance will be followed and any arrangement lacking the same will be disregarded.

Moreover, prior to the enactment of GAAR, the Hon'ble Supreme Court in the case of *Vodafone International Holdings BV,*[15] held that "in absence of a codified anti-abuse rule, the '*substance'* of a transaction would be taken into account if the '*form'* adopted merely represents a colourable device or a subterfuge or is counterfeit or is sham." The principle outlined in this case was codified in GAAR as an attempt to bridge the gap between avoidance and evasion. Nevertheless, a reasonable inclination exists for Revenue experts to counter any sort of undesired result (in their eyes) of a particular arrangement, by applying the substance over form principle. Corporations can just hope that the unbridled powers given to the Authorities are not used by them according to their whims and fancies.

Piercing the Corporate Veil:

Piercing of corporate veil in the matter of tax avoidance to look into the real transactions is a well settled law. The court possesses the power to negate the separate personality of a corporation if it was used for circumventing tax obligations.[16] GAAR provisions are essentially based on the same principle of lifting of the corporate veil and provide a specific power to taxing authorities to look into the transactions and lift the veil if there is any kind of fraud or evasion of tax by the company.

For economic growth, it is important to expand commercial structures by takeovers, mergers, amalgamations and acquisitions. It is a characteristic mode of business friendly corporations to utilize the legitimate system to augment benefits and limit costs and other liabilities. These objectives could possibly be undermined if corporate veil is pierced arbitrarily by the tax authorities in exercise of their uninhibited powers. A corporation by ideals of its incorporation relishes the benefits of a separate legal entity[17] and this should not be disturbed but for in exceptional circumstances.[18] The doctrine of piercing the corporate veil is meant as a last resort

[15] Vodafone International B.V. v. Union of India, (2012) 6 S.C.C. 613.
[16] C.I.T. v. Shri Meenakshi Mills Ltd., A.I.R. 1967 S.C. 819.
[17] P.L. DAVIES & L.C.B. GOWER, GOWER AND DAVIES: PRINCIPLE OF MODERN COMPANY LAW 462, (London: Sweet & Maxwell 2008).
[18] Juggilal Kamlapt v. C.I.T., A.I.R. 1969 S.C. 932.

or a residual provision. However, the CIT would have tremendous discretionary powers for reduction or prevention of the applicable tax advantage by piercing the veil and decide the consequences of the transaction.[19]

Thin Capitalisation Rules:

The expression 'thin capitalisation' is commonly used to describe a situation where capital structure of a company includes greater proportion of debt as compared to equity. Finance Ministry authorities have expressed that thin capitalisation rules will come under GAAR.[20] It was done because interest paid on loans is exempted from taxation and companies had progressively started utilizing it as a tax sparing instrument.[21] They adopted loan financing to acquire a "*tax benefit*". Nevertheless, through GAAR provisions, revenue authorities can re-characterize debt as equity thereby disallowing the excessive tax deductible expenditure claimed by an entity by way of interest expense. It has also been proposed by Government of India in Finance Bill, 2017 that a new section, section 94B may be introduced in the Income Tax Act, 1961 to overcome loss of revenue by way of thin capitalisation. The same shall be applicable with effect from the Annual Year 2018-19.

CHANGING JURISPRUDENCE IN THE NORMS OF ONUS

The onus of proving that a course of action or arrangement has not been undertaken for the "*main purpose*" of getting a "*tax benefit*" rests with the corporate entity,[22] while the revenue department might not have any proof of the avoidance of tax. The enactment of GAAR impacts many years of jurisprudence and would affect the prevalent finances and active re-structuring because established legal principles have been disturbed.

This will leave a wide purview for the revenue authorities to brand any re-structuring as an "*Impermissible Avoidance Arrangement*" and leave the onus to prove otherwise, on the corporate entity. An anti-abuse provision which puts the whole onus on the corporation would

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[19] Dhaval Kothari & Hriday Khurana, *General Anti Avoidance Rules (GAAR): An Indian and An International Perspective*, (Nov. 5, 2017), http://www.academia.edu/2400155/GAAR.

[20] Gautam Ahuja, *Forget Tax Planning; Get Ready for GAAR in the Direct Tax Code*, ITAT ONLINE (2011).

[21] K.R. Girish & Kanchan Dinakar, *Controlled Foreign Corporation- Is India ready for this Tax Regime?*, THE HINDUSTAN LINE (Sept. 2011).

[22] Income Tax Act, 1961 § 96, cl. 2.

prove to be extremely troublesome for the entity because then it would have to demonstrate a negative contention, particularly in the light of complicated business structures. This in a way is also against the fundamental principle that suspect is presumed innocent until proven guilty. These powers of shifting the burden of proof on the taxpayer should be given to tax officers only when there is rampant evasion and when stringent scrutiny has already been done before taking such action.

Overriding Effect of GAAR on Taxation Treaties and its Impact on Cross Border Mergers and Acquisitions:

Taxation treaties are administered by the Vienna Convention on the Law of Treaties. The Vienna Convention evidently stresses that treaties ought to be interpreted and should be implemented by parties to it in "*good faith.*"[23] In the event that any treaty prompts unintended results like the avoidance or evasion of taxes, or stream of benefits to inadvertent individuals, it is discretionary upon the parties to the treaty to find a way to meticulously prevent the misuse of treaty. Corrective advances, like these, are in line with the obligations accorded to parties under the Vienna Convention. Further, anti-abuse provisions in the internal laws of a country, isn't in strife with the provisions of the treaty.[24]

According to the rules, provisions of GAAR would automatically apply to corporate entities irrespective of the fact whether the treaty provisions are more benefitting. Corporations might be enticed to misuse the assessment laws of a country by abusing the contract between the legislations of different nations. Endeavours, like these, might be combated by jurisprudential guidelines or measures that are a piece of the internal law of the respective country. Then it becomes highly improbable for such a country to agree to bilateral taxation treaties that would have the impact of permitting abusive transactions that can, in some way or another, be precluded by measures and principles contained in its domestic legislation. In a nutshell, it is concurred that States don't need to allow the advantages of a taxation treaty where the provisions of the treaty have been abused or misused.

Impact on Foreign Portfolio Investors:

[23] Vienna Convention on the Law of Treaties, 1969 art. 31.
[24] OECD, *Commentary on Article 1 of the Model Tax Convention*, PUBLIC DISCUSSION DRAFT (March 2014).

Prime advantages that are provided to the foreign portfolio investors (FPI) under the amended taxation treaties with Singapore, Cyprus and Mauritius may be invalidated by the enactment of GAAR. In case of a dispute, domestic anti avoidance laws will triumph over treaty advantages under Singapore and Mauritius DTAAs. This could intimidate the lower assessment charges for FPIs in the two years between April 1, 2017, and March 31, 2019. Under the amended treaties, short term capital gains for FPIs is 15%. Nevertheless, this will be 7.5% for now, and eventually multiply to 15% in March, 2019. Numerous FPIs are also stressed that the advantages under the amended treaties for derivatives and debt instruments may be examined in GAAR. The exemption from capital gains from the sale of derivatives and debt instruments, which continues even under the revised treaties with Mauritius and Singapore, is not subject to any expenditure threshold under those two treaties. So, it is all the more likely that GAAR can be invoked in those cases and may put a dampener on the exemption.[25] Additionally, investment in other instruments apart from equity may also be impacted.

Impact on Foreign Institutional Investors:

Based on the recommendations of the Expert Committee, the Foreign Institutional Investors (FIIs), which have invested in Indian securities with prior permission of the competent authority, have been kept out of the GAAR net. Non-resident FIIs and the ones who have not availed treaty benefits, have been exempted from the applicability of GAAR.[26] The manner in which this provision has been drafted clarifies the intent of the legislator that even in multi-layer investment structures, only those investments which, directly or indirectly, are made by non-resident in such FIIs by way of offshore derivative instruments qualify for GAAR exemption.[27]

Offshore derivative instrument includes participatory notes, a widely used instrument by non-resident individual investors to invest in the Indian securities markets through registered FIIs. The major drawback, in relation to this, will be that participatory notes will promote infusion of black money into the Indian system. Surprisingly, these concerns did not find merit with the Expert Committee and they went on to suggest that investment in participatory notes from FIIs should be exempt. However, the legislators took note and addressed this in a different manner

[25] Sachin Dave, *Investors worried: GAAR may Impact Tax Treaty Benefits*, THE ECONOMIC TIMES, Jan. 21, 2017.
[26] Income Tax Rules, 1962 § 10U, cl. 1(b)(ii).
[27] Income Tax Rules, 1962 § 10U, cl. 1(c).

by tightening the noose on operations of participatory notes by notifying strict fee requirements through a notification in July 2017. In hindsight, this appears to be a more practical approach which addresses the real concern by use of a simple regulatory yardstick.

Ambiguities in the Relationship of GAAR with Taxation Treaties:

There is no doubt that tax treaties operate to facilitate cross border trade and investment. Earlier, Specific Anti-Avoidance Rules (SAAR) were enacted from time to time and a focused approach was taken up to fill the gap at whatever point a void was perceived or troubles were experienced in inspecting the avoidance of tax. The revenue department's approach was balanced and viable as SAAR offered certainty to the shareholders. GAAR, on the other hand, offers nothing but uncertainty.

Even the clarification issued by CBDT could not provide much precision. The clarification states that GAAR provisions will not be invoked if the Limitation of Benefits (LOB) clause in the treaty 'sufficiently addresses' the anti-avoidance rule.[28] This bestows wide discretionary powers on the tax authorities because the term 'sufficiently addressed' has not been defined anywhere, which leaves room for their subjective interpretation. There might be a situation in the future where a transaction qualifies the LOB test, but still the tax authorities may want to question its genuineness and may mould the interpretation of the term 'sufficiently addressed' in their favour. This can be viewed as deterrent to foreign investors from investing in India.

Moreover, there is uncertainty in the revenue's adjustment of the interlaced connection between the treaty and domestic override provisions. For example, if a specific arrangement qualifies for deriving the advantages of a taxation treaty, including the LOB clause, the local anti-avoidance rules can still be invoked by the tax authorities to penetrate the veil of the corporation to deny treaty advantages. This will hurt a lot of investment sentiments especially in the absence of proper guidelines.

[28] Central Board of Direct Taxes Cir. Jan. 27, 2017.

THE FACADE OF GRANDFATHERING PROVISIONS

The Code stipulates that incomes from transfer of investments made prior to April 1, 2017 are grandfathered and would not come within the scope of GAAR.[29] Grandfathering provision ensures that the old rule continues to apply to the existing situations, while new rules apply to all future situations.

Clauses 1 and 2 of Rule 10U(1)(d) seem to suggest that there is no effective grandfathering that is available in respect of investments made up to the cut-off date (31st March, 2017). While on one hand, clause 1 provides that "*the provisions of Chapter X-A shall not apply to any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investment made before the 1st day of April, 2017 by such person.*" Clause 2, on the other hand, is an overriding provision, which denies any benefit in respect of incomes from any arrangement arising after the cut-off date by stating that "*the provisions of Chapter X-A shall apply to an arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtain from the arrangement on or after the 1st day of April, 2017.*" If a stepped transaction is entered into, the entire outcome of which is not in one year but could occur in five years, it will come under GAAR. This means that corporations cannot grandfather their transactions. For instance, an investment is made in January 2013, is sold in September 2017, resulting into a tax benefit of Rs. 5 Cr, which is exempted under a particular tax treaty. In such a scenario, can it be argued by corporations that the tax benefit after the cut-off date should be grandfathered since it falls under the purview of clause 1(d)?[30]

Given that the true intent of the grandfathering is to provide effective shelter to gains arising from legitimate investments that were made up to the cut-off date, a clarification is necessary for the two clauses to operate harmoniously, failing which, the existing 'diluted' grandfathering provisions would operate only in respect of tax benefit recorded up to the cut-off date.

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[29] Income Tax Rules, 1962 § 10U, cl. 1(d).
[30] Sunil Arora & Varun Sharma, *GAAR Exemptions and Uncertainties*, A.S.A. & ASSOCIATES L.L.P., (Oct. 2017), http://www.asa.in/filedownload?file=%2FUpload%2FfldInsights%2FGAAR+Exemptions+And+Uncertainties.pdf&mac=%2B8yGYUbfxkXyfESz%2BV1UDXVhZ4lafMR%2BiHIZMoZaqpc%3D.

Irregularities in the Working of GAAR:

The newly enacted General Anti-Avoidance Rules seem to lack in a few aspects. The new legislation contains loopholes and a lot of scope for uncertainty that need to be addressed for a more efficient implementation of these Rules.

Firstly, tax avoidance has been broadly characterized to include various situations and instances of tax avoidance in corporate restructuring, prompting uncertainty and opening gates to endless litigation.

Secondly, the Commissioner of Income Tax is supposed to issue notice to the corporations mandating them to produce evidence, particulars, etc. on which they depended in support of their claim that the arrangement in question is not an "*Impermissible Avoidance Arrangement*". Surprisingly, '*no particular time limit*' has been specified for issuing such a notice.[31] This would vest subjective powers in the CIT to issue a notice whenever he wants to, even after the completion of the relevant assessment year.

Thirdly, Mergers or Demergers in India are usually undertaken through a court appointed process. It has been clarified that where any court or authority such as the National Company Law Tribunal (NCLT) has "*explicitly and adequately*" considered the tax implications of an arrangement, GAAR will not apply to such Mergers or Demergers. While this is a welcome clarification but the wording of the same may create a lot of repercussions. For instance, in case of a merger, it is probable that the NCLT does not explicitly opine on the tax implications while granting sanctions to a scheme of amalgamations. A copy of the scheme of merger is required to be sent to various authorities such as RBI, SEBI, tax authorities, etc.[32] These authorities are required to raise objections on the merger within 30 days. In case the tax authorities do not raise objections during this period, it may be open to them to invoke GAAR provisions to deny the benefits of the merger or acquisition afterwards.

Fourthly, it has not been expressly clarified that whether GAAR will be invoked in a situation where a private limited company is re-structured into a limited liability partnership (LLP) and its gains are distributed. It has also not been specified as to what will happen when a company

[31] Ernst and Young, *GAAR Rising: Mapping Tax Enforcement's Evolution*, (Feb. 2013), http://www.ey.com/Publication/vwLUAssets/Mapping_tax_enforcement%E2%80%99s_evolution/$FILE/GAAR.pdf.
[32] Companies Act, 2013 § 230, cl. 5.

with substantial reserves is merged into a new concern and the resultant entity is converted into a LLP. The clarifications issued by CBDT need to encompass every possible combination so that no disparity remains in the sector.

Fifthly, another situation which lacks clarity is whether the gifting of a listed corporation's controlling stake to an individual would be covered under GAAR. More clarity is required on consolidations through amalgamations, by which the profits and losses of certain entities are set off against each other.

Sixthly, CBDT in its clarification said that in considering the quantum of tax benefit, only the benefit arising in the Indian jurisdiction is seen. However, the CBDT Circular does not seem to have envisaged a situation wherein, a Corporation derives incidental tax benefit by virtue of an Impermissible arrangement outside India, which is also the *main purpose* of such arrangement. Going by the plain reading of the CBDT Circular, such a scenario may lead to GAAR applicability in India unless the entity can establish that obtaining a tax benefit 'in India' was not the main motive of such arrangement.

Lastly, the Act specifies that the tax benefit is applicable to the "*relevant previous year or any other previous year.*"[33] This expression appears to be in contradiction with "*relevant assessment year*" quote in Rule 10U of Income Tax Rules, 1962, which talks about the exemptions granted under GAAR. Since, the quantification of tax benefit is a key criteria for trigger of GAAR provisions, more clarity in this respect is required so that different views do not arise based on threshold fulfilment, on the same arrangement in different years.

RECOMMENDATIONS

For the proper functioning of the corporate sector, there is a dire need for reforms in the GAAR provisions. If not done so, it may prove as a deterrent to investors and thereby decline trade. Therefore, some recommendations are provided herein so as to bring flexibility in the working of these provisions.

[33] Income Tax Act, 1961 § 102, cl. 10.

Firstly, it is highly recommended that for the proper functioning of the corporate sector, the onus of proof that the entire arrangement has not been entered into with a view to obtain a tax benefit should be shifted from the taxpayer to the revenue department. In practice, it would be very difficult for the taxpayer to prove a negative assertion especially in complex legal structures; therefore, the onus of proof should be shifted on the tax authorities.

Secondly, provisions of GAAR should be worded in such a way so as to leave no room for subjective interpretation by the Tax Authorities.

- The definition of *Impermissible Avoidance Agreement* should be limited or curtailed. GAAR would be activated if the "*main purpose*" of any transaction or of any step therein is to acquire a tax benefit. The "*main purpose*" test should be replaced by "*sole purpose*" test to make the provision practically workable.
- Negative definitions of 'round tripping' and 'bona-fide purpose' should be changed.
- Test of "Commercial Substance" should be analyzed from the point of view of a businessman and not from the discretionary perspective of the revenue department.
- The clarifications provided by CBDT states that GAAR provisions will not be invoked if the Limitation of Benefits (LOB) clause in DTAAs "sufficiently addresses" the anti-avoidance rule, but the term "sufficiently addresses" has not been defined anywhere. So, to increase lucidity, the revenue department must provide a detailed definition of this term because this is very important for cross border mergers and acquisitions.

Thirdly, the Approving Panel, which looks into the case for the application of GAAR, should comprise certain industry expert(s) form the corporate sector, who have a better understanding of corporate re-structuring and the reasons for undertaking them. Moreover, there should also be a re-training exercise in tax administration to build a dedicated cadre of specialist Tax Officers to deal with cases under GAAR.

Fourthly, there should be expressed provisions in GAAR like "*Permissible Tax Avoidance*" and "*Restrictions to the Invocation of GAAR*". These provisions can be in the form of '*exceptions'* to safeguard genuine transactions. Having these provisions is relevant in the light of cross border mergers and acquisitions, considering that GAAR can prevail over the LOB clause in DTAAs.

Fifthly, the monetary threshold of INR 3Cr of tax benefit to trigger the GAAR provisions should be revised in the future years based on improved profit reporting by Indian companies.

Lastly, clarification should be issued of an inclusive list of taxes that would be covered in computing 'tax benefit'. It is suggested that scope of tax benefit should be restricted to income tax, dividend distribution tax and profit distribution tax and should not include other amounts like interest, income, etc. Reference in this regard can be made to UK's HM Revenue and Customs regulation which has provided an inclusive list of taxes to which UK GAAR shall apply.

CONCLUSION

The present GAAR arrangements appear to have been considered principally from the perspective of the tax department but it doesn't imply that there would be no scope for any kind of savings in taxes; nor does it imply an end to "*tax planning*". In any case, it calls for a change in perspective and in outlook, about what might be admissible as tax planning and what might be considered as tax avoidance. Despite various clarifications and intense public consultations, the taxpayers are nervous and wary of the consequences of the implementation of GAAR. The legislature should act wisely and release more clarifications prescribing genuine cases where corporation's right to select methods of implementing a transaction is safeguarded. GAAR should be invoked only as an exception and not as a rule. It should not be used as a tool of harassment but one of deterrence, which should furthermore be used sparingly. There should be clarifications based on every permutation and combination because it is the hard earned money of the taxpayers that the revenue department has the power to loot. The rules are not '*general*' in their approach rather an erroneous expanded version of '*specific*'. It would have been better to amplify the scope of SAARs rather than going through the labour of enacting a new code under the head of 'General' Anti Avoidance Rules. It is nothing but a code favouring tax terrorism by the revenue authorities.