

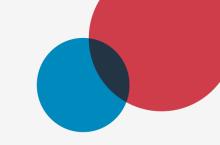
# **CONTENT**



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6	Way forward
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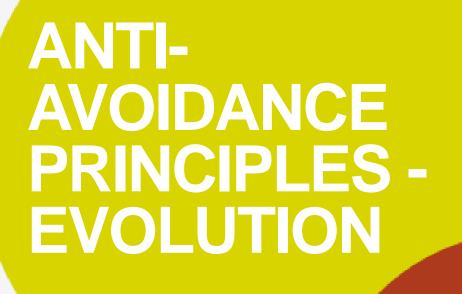
## **GLOSSARY**



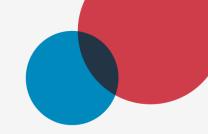
Abbreviation	Full form
GAAR	General Anti Avoidance Rules
BEPS	Base Erosion and Profit shifting
LOB	Limitation of Benefit
SAAR	Specific Anti Avoidance Rules
FII	Foreign Institutional Investors
SC	Supreme Court
IAA	Impermissible Avoidance Agreement
CSI	Clear statement of intent
PPT	Principal purposes test







## WHAT IS TAX AVOIDANCE?



#### Tax evasion

- Prohibited by law
- It is a result of unlawful, illegal, willful suppression and misrepresentation of facts

GARR doesn't apply

#### Tax avoidance

- Legal utilization of the tax regime to one's own advantage, in order to reduce the amount of tax that is payable by means that are within the law
- Involves the exploitation of loopholes and gaps in tax and other legislation in ways not anticipated by the law

GAAR shall apply to unacceptable tax avoidance

### Tax planning

Tax planning is a process of looking at various tax options and using the available fiscal incentives to determine when, whether, and how to conduct business and personal transactions so that taxes are eliminated or reduced

GAAR may not apply



# **MORALITY OF TAX AVOIDANCE (1/2)**



#### Lord Tomlin, IRC vs Duke of Westminster (1936 AC 1)

"Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax"

### Lord Sumner, IRC vs Fishers Executors (1926 AC 395)

"My Lords the highest authorities have always recognised that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed term or of any emotions that he can find in his favour in taxing Acts. In so doing he neither comes under liability nor incurs blame"



# **MORALITY OF TAX AVOIDANCE (2/2)**



#### Indian Apex Court, McDowell and Co Ltd (154 ITR 148)

Tax planning may be legitimate provided it is within the framework of law. Colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable 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

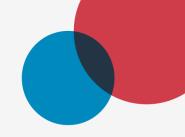
#### Indian Apex Court, UOI vs Azadi Bachao Andolan (263 ITR 706)

In the absence of anti-abuse provision in the tax treaty, 'treaty shopping' is not illegal. Motives of setting up Mauritius residents (to take tax benefits) does not affect the legality of transactions

Based on judicial precedence, tax avoidance may be moral as a matter of law but what is the moral status of tax avoidance according to the basic principles of ethics?



## **GAMUT OF ANTI-AVOIDANCE RULES**



#### SAAR

# The Act specifically provides for SAAR. Examples are as under:

- Transfer Pricing Regulations;
- Thin Capitalization Norms;
- Controlled Foreign Corporations;
- Deemed dividend:
- Indirect transfer;
- Transfer of income without transfer of asset; etc

#### **GAAR**

#### Following are two types of GARR

- Judicial GAAR: Principles that are not codified in legislation but are developed by the judicial precedents.
- Statute based GAAR: Statute based GARR is extended and codified version of Judicial GARR. It codifies and gives legal recognition to principles laid by Judicial GARR

"SAAR does not address all situations of abuse. GAAR and SAAR can co-exist"
- CBDT Circular 7 of 2017



## **INDIAN JUDICIARY ON ANTI-AVOIDANCE**

#### Mc Dowell & Co Ltd (SC)

- Precedence of substance over form
- Tax planning may be legitimate provided it is within the framework of law -Colourable devices cannot be part of tax planning
- Time to depart from the cardinal principle established in 'Duke of Westminster'
- Reliance on principles established in 'Ramsay' and 'Burmah Oil Co'

#### Azadi Bachao Andolan (SC)

- Diluted reasoning in the McDowell case
- Lawful acts cannot be treated as non-est merely on the basis of underlying motive supposedly resulting in economic detriment / prejudice to the national interests
- Westminster principle followed relying upon 'Bank of Chettinad' and 'Mathuram Agrawal'

#### **Vodafone International (Bom HC, later reversed by SC)**

- Look through provisions may be adopted in certain areas of law
- Transactions with no business purpose other than tax avoidance to be disregarded
- Authorities bound to determine true legal relationship resulting from transaction



## PRINCIPLES BY JUDICIAL GAAR



#### **Sham Doctrine**

Applied by courts in cases where the substance of a transaction, as intended by the parties, is not correctly represented by the documentation, i.e. the rights and obligations apparently created differ from those actually intended by the parties

#### Substance over form

Courts look into the economic or fiscal substance of a transaction, rather than the legal effects of a transaction, to determine the tax consequences of the transaction

#### **Step transaction**

Transactions that are undertaken for no purpose other than to avoid tax, and involve a series of legally ineffective steps, are taxed on the basis of their ultimate result, thereby ignoring the intervening steps

#### **Business purpose test**

Transactions are tested for a real business purpose, or any legitimate non-tax purpose, i.e. transactions largely motivated by the desire to minimize or avoid tax are ignored



# **JUSTIFICATION FOR STATUTORY GAAR**

- Negate abusive tax avoidance arrangements that result in revenue loss;
- **Codification of the principle of "Substance over form"**;
- Enact appropriate provisions for examining cases of tax avoidance & planning;
- Plugging loopholes in law that result in tax avoidance;
- Critical examination of inbound/outbound transaction and check treaty shopping;
- Deterrent against use of legal constructions to avoid tax; and
- Preserve the tax base of the country from erosion

Rule of Law: requires absolute supremacy or predominance of regular law as opposed to influence of arbitrary power

- A V Dicey (Introduction to the study of law of Constitution)

Law should be capable of guiding people, and thus must be clear and its application relatively certain, otherwise no one will know what is permitted and what is forbidden

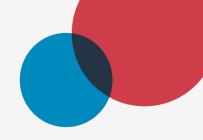
- John Prebble







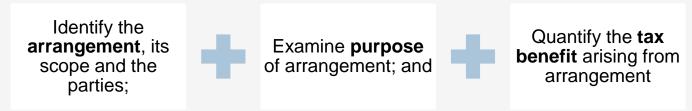
## INTERNATIONAL PERSPECTIVE



#### Many countries have introduced GAAR to combat tax avoidance, such as:

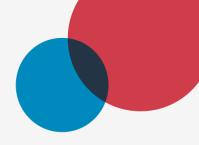
Netherlands	Australia	France	Germany	Canada	Singapore
Ireland	South Africa	New Zealand	China	US	India
		UK	Poland		

Jurisdictional GAAR provisions are customised, however, the following are the common international parameters for determining GAAR





## **US GAAR**



#### **Background**

- There are no GARR provisions in US Statute.
- However, in 2010, the economic substance doctrine was codified in US law through insertion of Section 7701(o)

#### **Economic substance test**

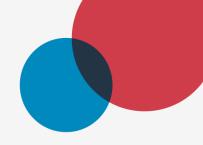
Tax benefits under the transaction are not available if following conditions are not satisfied:

- The transaction changes taxpayers' economic position in a meaningful way
- Existence of substantial purpose for entering into the transaction

#### **Burden of Proof**

- Tax payer is required to provide all documents and information in tax return
- Tax authorities can enquire into the business objectives and economic sense of the transaction

## **CANADIAN GAAR**



#### **Background**

- GAAR was introduced in Canada in 1988
- Intended to prevent abusive tax avoidance transaction but at the same time not intended to interfere with legitimate commercial and family transactions

#### **Conditions for applicability of Canadian GAAR:**

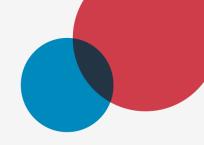
- There must be a 'tax benefit' arising from a transaction or series of transactions of which the transaction is a part;
- The transaction giving rise to the tax benefit must be an 'avoidance transaction';
- The avoidance transaction must result in a 'misuse' or 'abuse' of the provisions of the Canadian Income-tax Act

#### **Burden of Proof**

- Onus of proof is on the taxpayer to prove that transaction is not avoidance transaction
- Once it is discharged, burden shifts on tax authorities



## **NEW ZEALAND GAAR**



#### **Background**

Introduced in Income Tax Act under Section BG-1 in 1878

#### Tax avoidance includes

- Altering the incidence of any income tax
- Relieving person from any current or potential liability of income tax
- Avoiding, postponing or reducing any liability of income tax

#### Tax Avoidance Arrangement means an arrangement that directly or indirectly

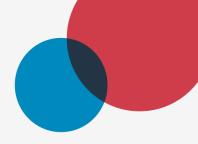
- Has tax avoidance as its purpose or effect;
- Has one of the purpose as tax avoidance whether or not other purposes refer to ordinary business

#### Factors for determining whether transaction is a tax avoidance arrangement

- Determining Parliament's purpose behind a tax act provision
- Commercial and economic reality of the transaction
- Classic indicators of avoidance and substance over form



## **SOUTH AFRICAN GAAR**



#### **Background**

- Introduced in 1962 and amended in 2006;
- South African GAAR applies to **impermissible avoidance agreements** and tax consequences are similar to present Indian GAAR

#### **Applicability conditions**

An arrangement is impermissible avoidance agreement if its main purpose was to obtain tax benefit and where one or more tainted elements are present.

#### **Tainted element test**

For tainted element test, one or more of the following should be present, in the context of business –

- not normally be employed for bona fide business purposes, other than for obtaining of a tax benefit
- lacks commercial substance, in whole or in part
- Creation of non-arm's length rights or obligations
- Results in misuse or abuse of the provisions of the South African Tax Act



## **AUSTRALIAN GAAR**



#### **Background**

- GAAR introduced in 1981
- Arrangements of a normal business or family kind, including those of a tax planning nature, will be beyond the scope of Australian GAAR

#### **Essential features for application of GAAR**

- There must be a 'scheme'
- The taxpayer must derive a 'tax benefit' from that scheme
- Scheme must have been entered into for the **sole or dominant purpose** of obtaining a tax benefit

#### Eight listed criteria to determine whether 'tax benefit' derived

manner, form and substance, timing of the scheme, connection between parties, change in the financial position of the parties, etc

#### Onus of proof

- Primary responsibility to prove that GAAR is not applicable is on taxpayer
- Burden to prove counterfactual is on tax authorities



## **UK GAAR**



#### **Background**

UK GAAR was introduced by the UK Finance Act, 2013. For any arrangement to be covered under UK GAAR, it has to be an **abusive tax arrangement** which results in a **tax advantage**.

#### **Tax Arrangement**

Arrangements with main purpose or one of the main purpose of obtaining a tax advantage

#### **Abusive Tax Arrangement**

Tax arrangements are 'abusive' if they cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provision, having regard to the following factors:

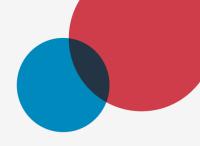
- Object and purpose of the law;
- Presence of contrived / abnormal steps; and
- Whether the arrangement exploits any shortcomings in the tax provision

#### Onus on tax authorities to prove

- Presence of an abusive tax arrangement; and
- Proposed adjustments are just and reasonable



## **JOURNEY OF INDIAN GAAR**



Proposed Direct
Tax Code, 2009
GARR was first
introduced in India

# **Supreme Court on GARR**

In Vodafone's case, SC made observations on GARR

#### **GARR** deferred

Applicable from April 1, 2015 and monetary limit set at INR 3 crores

2009 2010 2012 2012 2013 2015

#### **Direct Tax Code**

Formal bill to enact law was tabled before the parliament

#### **Union Budget 2012**

GARR was presented before the parliament by Finance Minister in Union Budget

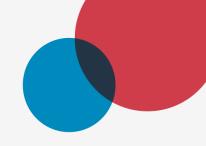
#### **Union Budget 2015**

GARR applicability deferred by 2 years i.e., from April 1, 2017



CA NZ SA AU UK IND

## **EXEMPTION FROM GAAR**



Arrangements where tax benefit arising to all parties (in aggregate) does not exceed INR 30 million

FIIs who do not avail tax treaty benefits

**GAAR** not applicable

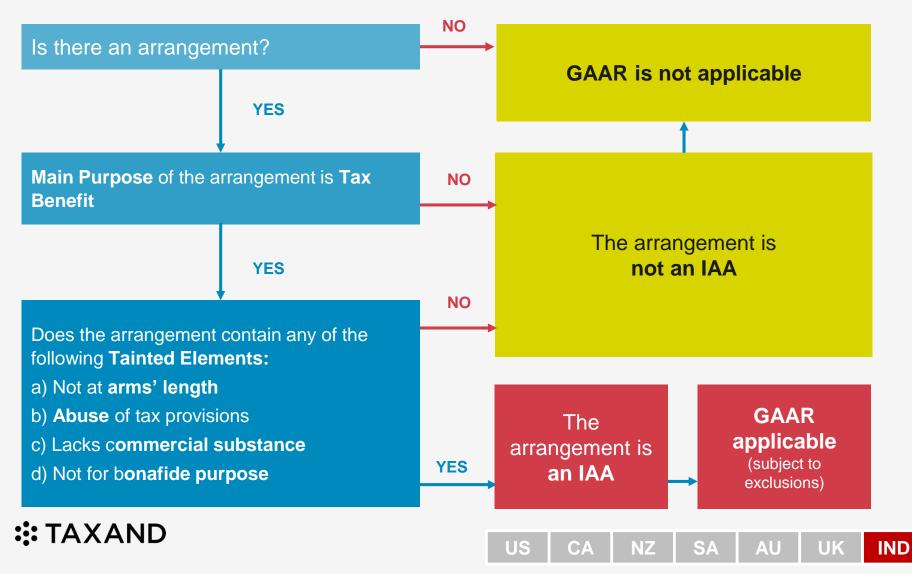
Non-resident investors in such FIIs

Arrangements entailing income accruing or arising to a person from transfer of an investment made before 1 April 2017

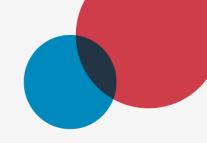


## **GIST OF INDIAN GAAR PROVISIONS**





# CONSEQUENCES OF INVOKING GAAR



Disregarding, combining or recharacterizing any arrangement Treating the arrangement as if it had not been entered into or carried out

Disregarding any accommodating party or corporate structure

Reallocating income, expenditure, deduction, relief, rebate

Reassigning place of residence, situs of asset or transaction

Denying treaty benefit





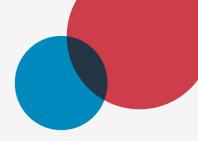


# INTERPLAY WITH BEPS ACTION PLAN 6 (1/2)

- Action Plan 6 of the OECD /G20 BEPS Project provides safeguards against treaty abuse, and in particular against treaty shopping
- To address tax avoidance strategies that circumvent provisions of domestic tax laws, domestic anti-abuse rules must be framed
- **Three-pronged approaches** recommended to address treaty shopping arrangement:
  - CSI
  - LOB
  - PPT



# INTERPLAY WITH BEPS ACTION PLAN 6 (2/2)



#### **CSI**

Clear statement of intent in tax treaties to avoid creation of opportunities for nontaxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements

#### LOB

- Legal Introduction of specific anti-abuse rule, for instance, the LOB rule, that limits availability of treaty benefits to entities meeting certain conditions
- Conditions based on legal nature, ownership in, and general activities of the entity to ensure sufficient link between entity and State of residence
- Such clause currently exists in certain treaties entered into by India and USA

#### **PPT**

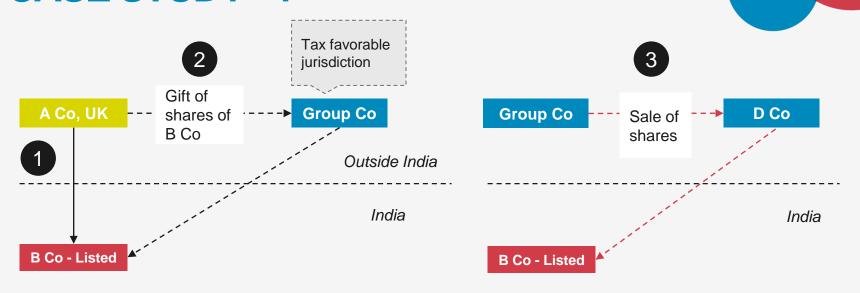
- Introduction of a more general anti-abuse rule based on the PPT
- Treaty benefits shall be denied if one of the principal purposes of any arrangement / transaction is to obtain treaty benefits, unless established that benefits would be in accordance with the object and purpose of the treaty







## **CASE STUDY - 1**



**Objective –** Tax neutral transfer of the shares of B Co to D Co - off the exchange deal

#### **Mechanics**

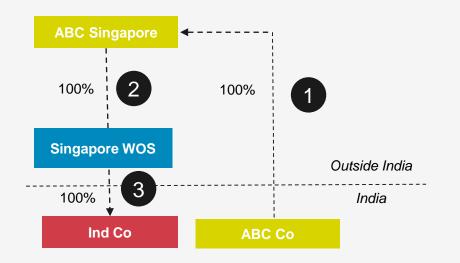
- A Co, based in UK, holds the shares in B Co
- Shares are gifted to Group Co in a tax favorable jurisdiction (eg Singapore, Netherlands) Transaction not taxable in India
- Group Co sells shares of B Co to D Co No capital gains

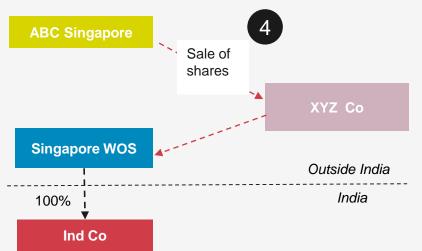
Whether GAAR can be stretched to the first leg treating the same as an impermissible avoidance agreement ??



## CASE STUDY - 2







**Objective -** Tax neutral transfer of holding in Ind Co to XYZ Co

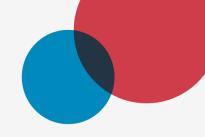
#### **Mechanics**

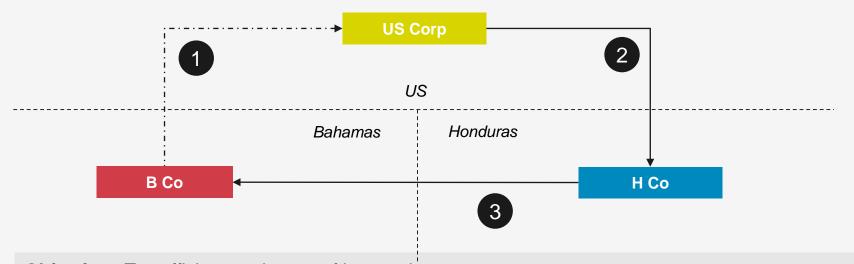
- 1-3 ABC Co sets up a Wholly Owned Subsidiary ('WOS') in Singapore, ie ABC Singapore, which sets up a step down subsidiary in Singapore ie Singapore WOS which in turn makes investment in Ind Co Singapore entities to satisfy substance test
- 4 ABC Singapore transfers shares of Singapore WOS to XYZ Co No capital gains under the India-Singapore tax treaty, if ABC Singapore satisfied LOB tests in the DTAA

Applicability of GAAR??



## CASE STUDY - 3





Objective - Tax efficient remittance of interest income

#### **Mechanics**

- 1 B Co advanced loans to its subsidiary US Corp
- 2-3 US Corp sets up H Co and transmits the interest payments to B Co through H Co attempting to take advantage of a tax arbitrage between US and Honduras *Withholding taxes minimized*

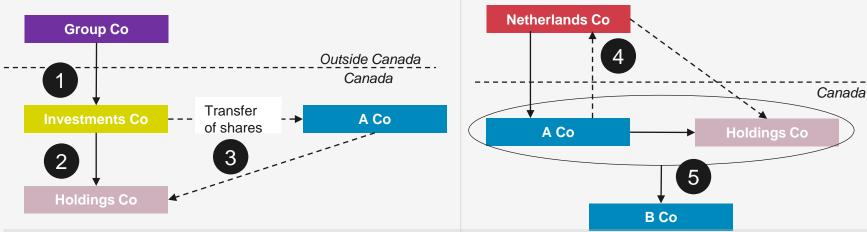
Whether GAAR can be applied??

Whether H Co would succeed in the business purpose test???



## **CASE STUDY - 4 (1/2)**





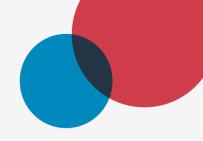
Objective - Tax neutral extraction of funds from Investments Co and A Co

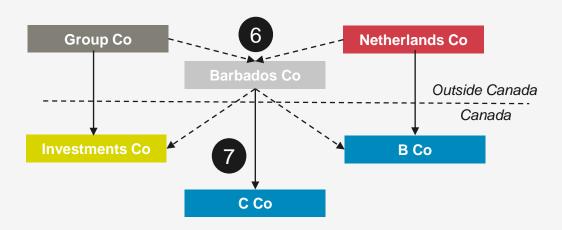
#### **Mechanics**

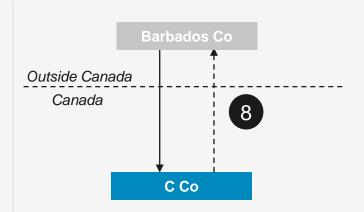
- 1 Investments Co, whose paid up share capital is \$ 100 million, is held by non-resident group companies
- 2 Investments Co invests \$ 60 million in shares of Holdings Co, a WOS
- 3 Shares held in Holdings Co are transferred to A Co at nominal value
- 4 Netherlands Co, the parent of A Co acquires the shares of Holdings Co from A Co Holdings Co becomes a sister concern of A Co, which was formerly a subsidiary of A Co
- 5 A Co and Holdings Co amalgamate to form B Co Paid up share capital amounts to \$ 60 million, essentially being the share capital of Holdings Ltd



# **CASE STUDY - 4 (2/2)**







Objective - Tax neutral extraction of funds from Investments Co and A Co (ultimately 'C Co')

#### **Mechanics**

- Barbados Co acquires shares of Investments Co and B Co Capital gains arising to Netherlands Co not taxable in Canada as per the Canada-Netherlands tax treaty
- 7 Investments Co and B Co amalgamate to form C Co Paid up share capital amounts to \$ 160 million, being the sum of share capitals of Investments Co and B Co
- 8 C Co buys back shares from Barbados Co and pays \$ 140 million as consideration Taxpayer claims that deemed dividend provisions cannot apply since the consideration paid is less than the paid up share capital

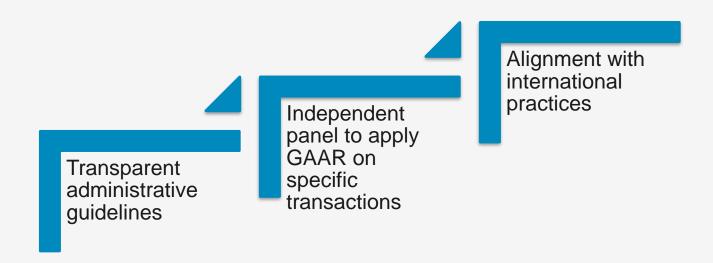
Whether GAAR can be stretched to treat the transfer of shares to make Holdings Co a sister concern of A Co as an impermissible avoidance transaction and can the paid up share capital of C Co be considered to be \$ 100 million and the excess consideration of \$ 40 million be treated as deemed dividend??





## **WAY FORWARD**







## **THANK YOU**



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