



## General Anti Avoidance Rule (GAAR) in India

### 1. Introduction on GAAR in India

- (i) GAAR is a tax avoidance **regulation**. GAAR is a set of the rules under the Income Tax Rules, **1962**.
- (ii) GAAR is **empowering** the Income tax **authorities** to **deny** the Income tax **benefits** on the transactions or arrangements where transactions or arrangements do **not** have any **commercial substance over form** or commercial consideration except avoiding or reducing the Income tax liability.
- (iii) GAAR is consisting a set of **broad rules** based on the general principles to check the **potential avoidance** of the Income tax liability.
- (iv) Hence GAAR is consisting of **general** anti avoidance rule.
- (v) GAAR is applicable on the **Individuals** and **companies**. Hence GAAR is **not applicable** on **non Individuals** and companies.

### 2. Income Tax avoidance includes:

- (i) Income Tax avoidance is a **deliberate measure** to avoid or to reduce the Income tax liability.
- (ii) Income Tax avoidance is **broadly not defined** in the Income Tax Act, **1961**.
- (iii) Income Tax avoidance is the outcome of the **actions** as taken by the **taxpayers** like by Individual or by company.
- (iv) Income Tax avoidance is **not illegal** or **forbidden** by the Income Tax Act, **1961** as applicable in India.
- (v) Hence meaning of the Income tax avoidance is to **avoid** or to **reduce** the Income tax liability.

### 3. Need for introduction of the GAAR includes:

- (i) Income Tax avoidance is a *legal* in *India* and also outside India.
- (ii) Taxpayers are exercising the Income tax planning through *aggressive* Income tax *avoidance tools*
- (iii) Income tax authorities are *losing tax* revenues through aggressive Income tax avoidance tools.
- (iv) Hence GAAR is introduced for *avoiding* the *revenue losses* through tax avoidance rules to protect revenue loss to the Govt. of India.

### 4. GAAR versus SAAR

- (i) Full form of GAAR is *General* Anti Avoidance Rule where general anti-avoidance set of rules are framed to avoid aggressive Income tax avoidance *planning without* any commercial substance over form in the transactions or arrangements like *incorporating a company in Cyprus etc without having any commercial substance over form*.
- (ii) Full form of SAAR is *Specific* Anti Avoidance Rule where specific anti-avoidance rules are *already incorporated* in the Income Tax Act, 1961 and correspondingly in the Income Tax Rules, 1962 like Transfer Pricing (*TP*) provisions and Arm Length Price (*ALP*) principle as specific anti-avoidance measures.

### 5. GAAR in India

- (i) GAAR concept was *first time* introduced in India through the Direct Tax Code (*DTC*) Bill, *2009*.
- (ii) Further a *revised discussion* paper was released with the provisions as containing the GAAR under the DTC Bill *2010*. The bill was aimed to introduce the GAAR provisions as involving in the DTC from *1<sup>st</sup> April 2012*.
- (iii) Hence the GAAR was *first time* introduced in the budget *2012-13* by the Finance Minister Dr. Pranab Mukherjee.

- (iv) However the provisions as **introduced** in the budget **2012-13** were widely criticized due to lack of clarity, lack of safeguards and increased scope for the subjective authorization by the Income tax officials.
- (v) (a) Thereafter the Govt. of India has set up a committee under the leadership of **Mr. Parthasarathy Shome** to review the GAAR proposal.
- (b) The Committee has suggested that the GAAR proposal should be **deferred** for a period of **5 years** i.e. up to March **31, 2017** as more time was desired to create the administrative machinery for GAAR implementation and for intensive training to the Income tax officials.
- (vi) (a) Hence GAAR was actually inducted in the **statute** through a press release as issued by the Central Board of Direct Taxes (CBDT)
- (b) Now GAAR is applicable from the assessment year **2018-19** for the financial year ending March **31, 2018**. Hence GAAR is **applicable** from April **01, 2017**
- (c) GAAR is contained in the **Chapter X-A** of the Income Tax Act, **1961**.
- (d) Procedures for **application** of the GAAR and conditions as to be applied are inserted under Income-tax Rules **1962**.

## **6. Applicability of the GAAR**

- (i) GAAR is applicable on the individuals and companies as **resident of India**
- (ii) GAAR is **not applicable** where the business transactions or arrangements are **bona fide** and also executed on the ALP principles.
- (iii) Hence GAAR is **applicable** where the business transactions or arrangements are **not bona fide** and also **not executed on the ALP** principles
- (iv) (a) GAAR is **not applicable** on the Foreign Investors (**FIs**) where they have taken benefits of the Double Taxation Avoidance Agreements (**DTAAs**)
- (b) Hence GAAR is applicable on the **FIs** where they have **not taken benefits** of the DTAAs

(c) However GAAR is applicable on the FIs where they have made any kind of *non bona fide* transactions or arrangements without commercial substance over the form.

## 7. GAAR versus DTAA's

- (i) DTAA's and GAAR are *2 sets* of the *regulations* as to be used by the Income tax administration for handling the *duplication* of the Income tax liability in India and also outside India through DTAA's and for avoiding the anti-tax practices through GAAR.
- (ii) GAAR is *restricted* to the *tax jurisdictions in India* where the DTAA's are also extended to the tax jurisdictions outside India.
- (iii) Hence the *DTAA's* provisions are to *override* the *GAAR* provisions where there is a conflict between GAAR and DTAA's.
- (iv) However *GAAR* provisions are to *override* the *DTAA's* provisions where Impermissible Avoidance Arrangements (IAAs) are existed in the DTAA's
- (v)
  - (a) The *CBDT* has *clarified* through press release about introduction of the GAAR provisions and applications of the GAAR on the DTAA's where IAAs are existed in the DTAA's.
  - (b) Hence GAAR is to be used where Anti-Avoidance Rule as already existed in the DTAA's are *not sufficient* to address *100% Income tax avoidance planning's* tools.
  - (c) However *GAAR* is *not to be used* where Limitation of Benefits (LoB) provisions are already existed in the DTAA's and also *LoB provisions* are *100% sufficient* to address the Income tax avoidance planning's tools.

## 8. Special Features of Impermissible Avoidance Arrangements (IAAs)

- (i) GAAR is *empowering* the Income tax *authorities* to *declare* any transaction or arrangement as IAAs and also to determine the Income tax consequences after declaring any transaction or arrangement as IAA.

- (ii) IAAs include the transactions or arrangements where *main purpose* of the transactions or arrangements to obtain the Income *tax benefits* and also transactions or arrangements is *lacking* the commercial *substance* over form.
- (iii) IAAs are already *defined* under section *124(15)* of the *DTC*.
- (iv) Taxpayers are liable to prove the transactions or arrangements as these are *not made* for the *specific purpose* of obtaining of Income tax benefits only.
- (v) The GAAR is providing wide *discretionary powers* to the Principal Commissioner of Income Tax (*PCIT*) or Commissioner of Income Tax (*CIT*) to invoke the GAAR provisions on the taxpayers.
- (vi) GAAR is also empowering the Income tax authorities to *scrutinize* the transactions or arrangements or business deals which are already existed in the DTAA's and also to *declare* as IAAs and to apply the GAAR provisions accordingly.
- (vii) ● Now in accordance to the DTC provisions and the amendments as made by the Govt. of India after recommendations of the Shome Committee that the transactions or arrangements are to be *treated* as IAAs where *2* mandatory *conditions* are satisfied.
- (a) Where *main purpose* of the transaction or arrangement is to obtain the Income *tax benefits* only.
- (b) Where *main purpose* of the transaction or arrangement is to obtain the Income *tax benefits* only along with *4* mandatory *conditions*:
- (ba) Where *100% violations* of the ALP principles.
- (bb) Where results of the transactions or arrangements are to be directly or indirectly for the purpose of *misusing* or *abusing* the *DTC* provisions.
- (bc) Where commercial substance over form are *fully* or *partly not existed* in the transactions or arrangements.
- (bd) Where the transactions or arrangements are *not* for *bona fide* business purposes and also *not* with the *good intentions*.

(viii) *The DTC provisions are comprehensively defining the impermissible avoidance transactions or arrangements, Income tax benefits, commercial substance over form and bona fide for business purposes "etc".*

## **9. Special Features for the GAAR**

- (i) GAAR is *not applicable* where Income tax benefits are *not exceeding INR 3 crores*
- (ii) GAAR is further *not applicable* to the Foreign Institutional Investors (FII) where *100% transactions* or arrangements are *not declared* as IAAs by the PCIT or CIT.
- (iii) GAAR is to be applied where *partial* transactions or arrangements are *declared* as IAAs by the PCIT or CIT. Hence GAAR is to be applied on the *partial transactions* or arrangements also.
- (iv) Hence GAAR is to be further applied on the *portion* of the transactions or arrangements which are *declared* as IAAs by the PCIT or CIT.
- (v) GAAR is *not* to be *applied* where investments were *made before April 01, 2010* but investments are still continuing as on April **01, 2017**.
- (vi) (a) GAAR is to be applied through invoking a *lengthy procedure* of several Income tax administration institutions.  
(b) *Notice* is to be *issued* by the PCIT or CIT through declaring the transactions or arrangements as IAAs based on the reference as received from the assessing officer (AO).
- (vii) *AO* is required to *make reference* to the PCIT or CIT about the GAAR potential cases.
- (viii) PCIT or CIT is permitted to issue a *notice* to the *taxpayers* after finding the case that the particular transactions or arrangements are IAAs.
- (ix) The taxpayers are required to *submit* the *documents* as explaining that the transactions or arrangements are *not IAAs*.
- (x) PCIT or CIT is required to *refer* the case to the *approving panel* where he is not satisfied with the documents as submitted by the taxpayers that the transactions or arrangements are *not IAAs*.

- (xi) (a) Approving panel is required to **examine** the GAAR notice as issued by the PCIT or CIT and also the **documents** as submitted by the taxpayers.
- (b) Approving panel is also required to **give directions** to the PCIT or CIT and also to the taxpayers where the **directions** are to be **mandatory** accepted by the PCIT or CIT and also by the taxpayers.
- (xii) AO is also required to **prepare** and to **send** an **order** to the taxpayers where the transactions or arrangements are **declare** as **IAs** after proper examination by the approving panel and also rectification by the PCIT or CIT if needed.

## 10. Difficulties for implementation of the GAAR

- (i) GAAR is itself an unconventional type of the Income tax legislation for **bringing** the Income **tax avoidances** through a scrutiny by the Income tax officials.
- (ii) GAAR regulations are tough to implement and to **differentiate** between different types of Income **tax avoidance** planning's tools as being used by the taxpayers.
- (iii) The difference between an **objectionable avoidance** and the **permissible** Income **tax planning's** tools is very thin.
- (iv) It's very difficult to **filtrate** a **permissible transactions** or arrangements from the IAs
- (v) Hence GAAR is to be targeted for the transactions or arrangements where the sole or **main purpose** of the transactions or arrangements to achieve an Income **tax advantage** only.

## 11. GAAR outside India

- GAAR has already been enacted in the **16 countries** outside India:
  - (i) **Australia**
  - (ii) **Belgium**
  - (iii) **Canada**
  - (iv) **China**
  - (v) **France**
  - (vi) **Germany**
  - (vii) **Italy**
  - (viii) **Ireland**

- (ix) **Kenya**
- (x) **Netherlands**
- (xi) **New Zealand**
- (xii) **Poland**
- (xiii) **Singapore**
- (xiv) **South Africa**
- (xv) **United Kingdom (UK)**
- (xvi) **United States of America (USA)**

● **Tax avoidance control mechanism before GAAR (before April 01, 2017)**

- (i) *Indian courts* were dealing the Income tax avoidance cases *before* inserting GAAR from *April 01, 2017* through the *inferences* from the decisions as *pronounced* by the *English Courts* like *Duke of Westminster* where it was affirmed that the documents or transactions or arrangements which were *not bona fide* for the Income tax authorities and also these documents and transactions or arrangements were restricted from dissecting the underlying commercial substance over form.
- (ii) This principle has resonated in the Indian Courts in the rulings of the *Azadi Bachao Andolan* and the *Vodafone* cases.
- (iii) However the Indian Courts have also concluded that where transactions or arrangements were *found* to be *colorable* or *dubious* should be disregarded by applying doctrines including piercing of the corporate veil and commercial substance over form.
- (iv) Therefore the introduction of GAAR as a codified law to address the widespread issues of Income *tax avoidance* against Income *tax mitigation*.
- (v)
  - (a) *TP provisions* are in the genre of the *SAAR* which was introduced in India in *2001* where many other countries had already the TP provisions since year *1981*.
  - (b) However due to introduction of the TP provisions the Income tax *controversies* have been rise in several areas and litigation has *increased exponentially*.
  - (c) *No other country* has *generated litigation* of this magnitude like in India.



(d) Before the TP provisions the Income tax authorities were *labeling* the certain *transactions* or arrangements as *sham* or *subterfuge* and disregarded them for Income tax purposes

## ●● Conclusion on GAAR

- (i) (a) The Govt. of India has realized the *challenge* of *implementing* GAAR. Hence implementation of GAAR was originally held back for *5* more years.
- (b) The Govt. of India has set up a standing committee to provide input on the draft law and to introduce the *Safe Harbour* and levels of approvals before GAAR is *implemented* by the Govt. of India.
- (ii) (a) However despite above mentioned measures the GAAR is having diversity of the situations where GAAR is to be *applied* are *still unresolved* which may result in uncertainty in people's minds. Hence it may be deterrent to the business growth and investments in India.
- (b) Under the GAAR regime the taxpayers are required to *demonstrate* the *commercial substance* over form for every transaction or arrangement that may lead to an increased emphasis on documentation of the business rationale for any transaction or reorganization like merger or acquisition etc.
- (iii) The purpose of the introduction of GAAR to evolve the India's tax policy and legislation in simple terms. Hence *GAAR codifies* the principle of commercial substance over form and brings the *law principles* that the several *landmark* court's *cases* have dealt with over the years.
- (iv) (a) GAAR is *empowering* the Income tax authorities to *deal effectively* and also to guard against the schemes as being designed for Income tax avoidance.
- (b) Hence the GAAR is strengthening the arms giving to the Income tax authorities for sweeping powers to *disregard* or *re-characterize* the transactions or arrangements and to *re-determine* the resultant Income *tax consequences* where the transactions or arrangements are designed with the main purpose of availing Income tax benefit(s) and also lacking the commercial substance over form.

- (v) Many developed countries have already implemented the GAAR. Hence their Income tax laws have already incorporated the principles similar to those have effected in India to *authorize* the Income tax Authorities to *deny* the Income *tax benefits* against the transactions or arrangements which are *declared* as *IAAs* by the PCIT or CIT.
- (vi) (a) Before introduction of GAAR in India there were many transactions or arrangements designed to avoid Income tax. Hence these transactions or arrangements were dealt through Indian *court's decisions* and through SAAR like *TP regulations* and the *ALP principles* as mandatory requirement under the Income-tax Act, 1961.
- (b) Moreover the Indian courts are consistently affirming the cardinal principle where the documents or transactions or arrangements were genuine. Hence Indian courts have *not disregard* the *existing structure* of the *bona fide* transactions or arrangements.
- (vii) However the Indian courts have disregarded the transactions or arrangements where Indian courts have found the transactions or arrangements as *colorable* or *dubious*. Indian courts have applied the *doctrines* including *piercing* of the *corporate veil* and commercial substance over form.
- (viii) Hence with the help of judicial precedents the Govt. of India is to re-evaluate through the prism of GAAR. Therefore it is essential to understand the *fine line difference* between the acceptable Income *tax mitigation* and *actual* Income *tax avoidance*. The lack of clarity in this area will expose the taxpayers for potential Income tax-related risks.
- (ix) This Article is prepared to decode the GAAR and to enable a *basic understanding* of the *conditions* are to be *satisfied* for application of GAAR and also for the approval and redressal mechanisms are to be used by the Income tax authorities to implement the GAAR.

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