

The Institute of Chartered Accountants of India

33RD REGIONAL CONFERENCE WIRC



**TAX PLANNING IN THE CURRENT ANTI-AVOIDANCE
SCENARIO**

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A BRIEF ABOUT TAX PLANNING

Tax planning is an art and science of paying the right amount of taxes after giving due consideration to all the tax benefit provided by the law in the form of legality as well as substance.

With the focus on providing seamless service alongside initiatives like Make in India, has opened global avenues for the Indian as well as foreign business in India. In order to achieve the same a tax system would have to be competitive and should offer certain tax incentives for various investment and development in the tax economy.

Let us understand with an example Export oriented Unit (EOU), which has a genuine tax exemption of NIL taxes over a certain period if the majority of the products are exported outside India.

However, **the above mentioned tax planning could be termed as tax avoidance**, if for the sake of getting export benefit a domestic company sets up a subsidiary abroad to route transaction through such a subsidiary.

CONCEPT OF AGGRESSIVE TAX PLANNING

A quick summarisation of difference between tax planning and tax avoidance is that, it is nothing but the intent of the activity combined with the actual occurrence of the event. **So, in case the reality and legality speak the same language , it could be considered as a tax planning tool. However, in the case where both of them do not match, and yet things are considered legal, the scale would be tilted towards tax avoidance**

This is a concept in between tax planning and tax avoidance, which is newly coined term knowns as “Aggressive Tax Planning”. In many cases of tax avoidances, the underlying substance is absent or is minuscule, which is later covered by building substance through artificial measures to colour the avoidance in order to portray planning

Parameters	Whether Legal	Whether Moral
Tax Planning	Yes	Yes
Tax Avoidance	Yes	No
Tax Evasion	No	No
Aggressive Tax Planning	Yes	Depends (GAAR)

RELEASE OF OFFSHORE SECRETS

Paradise
Papers

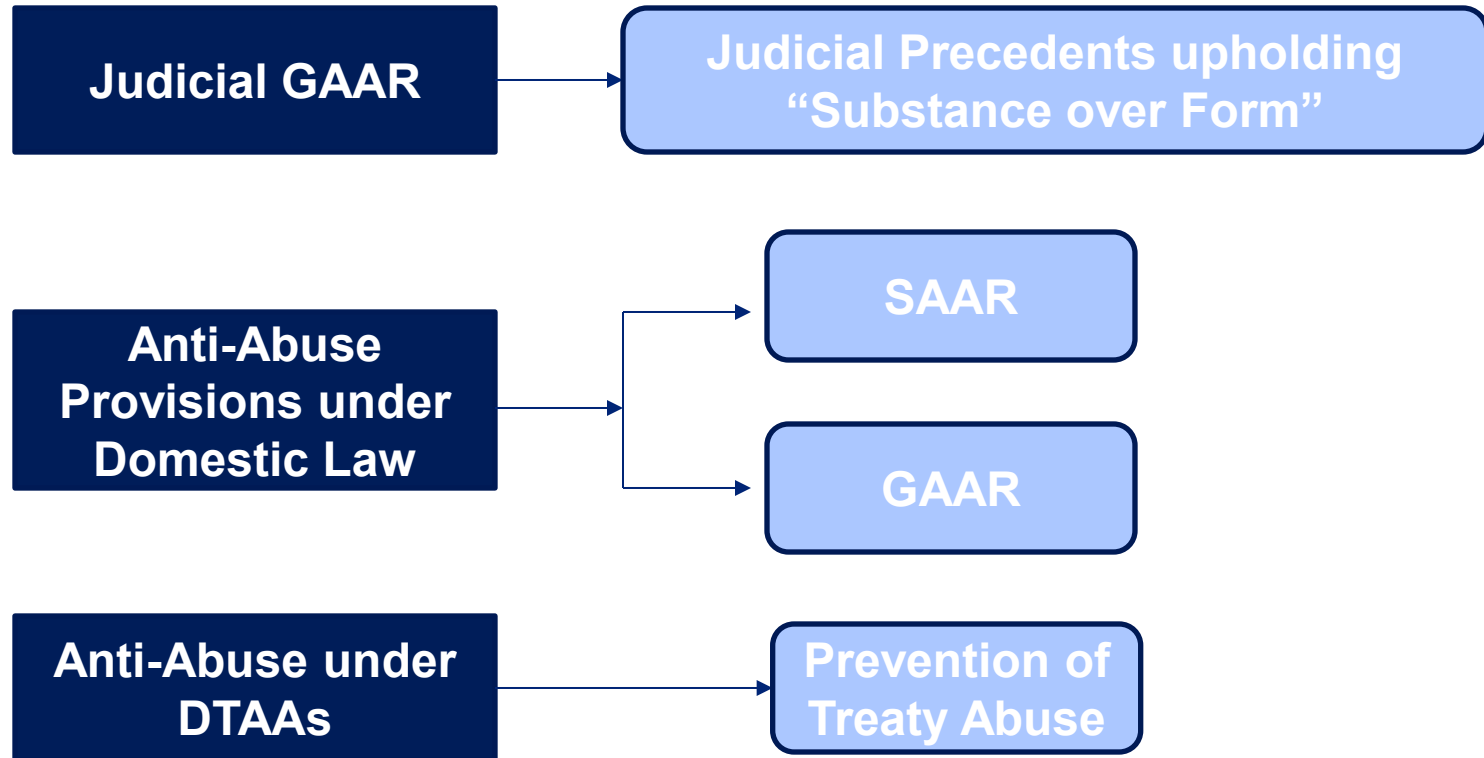
Panama
Papers

Mossack
Fonseca

Wiki
leaks

HSBC

ANTI-ABUSE PROVISIONS



JUDICIAL ANTI AVOIDANCE

MCDOWELL & CO LTD V COMMERCIAL TAX OFFICER (1985) 154 ITR 148 (SC)

So far as the contention that it is open to everyone to so arrange his affairs as to reduce the brunt of taxation to the minimum, was concerned, the tax planning maybe 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 honorable to avoid the payment of tax by resorting to dubious methods. It is obligation of every citizen to pay taxes honestly without resorting to subterfuges. Courts are now concerning themselves not merely with the genuineness of a transaction, but with the intended effect of it for fiscal purposes.

CIT V A. RAMAN & CO (1968) 67 ITR 11 (5C)

The law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to trader is taxable in his hands: income which he could have, but has not earned, is not taxable as income accrued to him. By adopting a device, it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous

JUDICIAL ANTI AVOIDANCE

CIT V A. RAMAN & CO (1968) 67 ITR 11 (5C)

assessment, a case for commencing proceeding for reassessment under section 147(b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented.

The Duke of Westminster Case

It could be considered as one of the most cited cases in the history of tax avoidances. The Duke of Westminster employed a gardener and paid him a substantial portion of Duke's income. This gardener although should have been on a wage bill, was said to be compensated through annual payments that Duke considered as taxable allowances against the profits, which were documented and drafted in a deed prepared by Duke's solicitors.

JUDICIAL ANTI AVOIDANCE

Although the case in today's world could have been a tax evasion and not even avoidance, the Inland Revenue lost the case. Lord Tomlin held:

“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. if he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax”

The Ramsay Principles

It took more than 47 years (from 1935 - 1982), to overturn the doctrine set by the Duke of Westminster case. It was in the case of Ramsay Ltd that the principle laid in the case of Duke of Westminster was considered as overstated or overextended. In the Ramsay case, a company which had made a substantial capital gain had entered into a complex and self-canceling series of transactions which had generated an artificial capital loss. The House of Lords decided that where a transaction has pre-arranged artificial steps which serve no commercial purpose other than to save tax, then the proper approach is to tax the effect of the transaction as a whole.

JUDICIAL ANTI AVOIDANCE

- Gains on sale of CCDs carrying no interest but only convertible in to shares at different prices depending on period of holding are interest, taxable under article 11 and not capital gains under article 13.4 of Mauritius DTAA. This is especially so when issuer company is mere puppet of holding company and issuer company and holding company are one and same entity - '**Z' Mauritius, In re [2012] 20 taxmann.com 91 (AAR - NewDelhi) upset in TS- 464 – HC – 2014 Delhi HC**
- Assessee purchased shares from group company which were subsequently sold to the same group company at a loss, claiming urgency owing to huge tax demand, referring to tax payment challan evidencing payment during March 2009 to January 2010. ITAT approves CIT(A) order, holds assessee's transaction of purchase and sale of shares with group concern as sham and thus, disallows claim for short term capital loss: **[TS – 57 – ITAT – 2016 (DEL)]**

GAAR UNDER DOMESTIC LAW

Indian GAAR – A Snapshot

“Main Purpose” is to Obtain a “Tax Benefit”

AND

Not at
“Arm’s Length”

OR

“Misuse/Abuse” of
Tax Provisions

OR

Lacks “Commercial
Substance”

OR

Not for Bona Fide
Purposes

Impermissible Avoidance Arrangement

Consequences

**Disregard/Re-
characterize the
Arrangement**

**Disregard
Corporate
Structure**

**Deny Treaty
Benefit**

**Reassign Place
of Residence/
Situs of Assets
or Transaction**

**Reallocate
Income,
Expenses,
Relief, etc.**

**Recharacterize
Equity-Debt,
Income-Expense,
Relief, etc.**

Applies to both Indian Residents and Non-Residents

BASIC SCHEME OF GAAR

GAAR [Chapter-XA]

Sec. 95 to 102

Sec. 95

Basic
enabling
provision

Sec. 96
& 97

Impermissible
Avoidance
Arrangement
(IAA)

Sec. 98

Consequences

- S.99 – Parameters for determining tax benefit
- S.100 – Provisions in lieu of / in addition to
- S.101 – Guidelines and conditions
- S.102 – Definitions
- S.144BA – GAAR Assessment

MANDATE OF GAAR

- ❑ The assessee is bound to not to get into IAA
- ❑ Entering into IAA is not barred by law
- ❑ It is only at the instance of AO, can an arrangement be declared as IAA
- ❑ Unlike Sec. 92, which make a *suo motu* mandate, here the assessee is not bound to *suo motu* declare his arrangement as IAA
- ❑ It resembles the concept in Sec. 14A read with Rule 8D which can be invoked only at the instance of revenue
Holcim India P Ltd [Delhi HC 2014-TIOL-1586-HC-DEL]
- ❑ Thus, there should not be any penalty when GAAR is invoked

EXCLUSIONS

As per Rule 10U, GAAR does NOT applies to:

- an arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of **Rs. 3 crore**;
- a **Foreign Institutional Investor**,—
 - (i) who is an assessee under the Act;
 - (ii) who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and
 - (iii) who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments;
- a person, being a non-resident, in relation to investment made by him by way of **offshore derivative instruments** or otherwise, directly or indirectly, in a Foreign Institutional Investor;

GRAND FATHERING

- ❑ *“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 **investments made before 1st April 2017** by such person” – Rule 10U(1)(d)*

Except

- ❑ *“Without prejudice to the provisions of clause (d) of sub-rule (1), the provisions of Chapter X-A shall apply to any **arrangement**, irrespective of the date on which it has been entered into, in respect of the **tax benefit obtained from the arrangement on or after 1st April 2017.**” – Rule 10U(2)*

S.96 : IMPERMISSIBLE AVOIDANCE ARRANGEMENT (IAA)

Essential two conditions:

1. The **Main Purpose** + Obtain **Tax Benefit** (part or whole or in any step of such arrangement)
2. “Either of the given four conditions”:
 - a) Not at Arm’s Length
 - b) Represents Misuse or Abuse of the provisions of the Act
 - c) **“Lacks Commercial Substance”**
 - d) Entered or carried on in a manner not normally employed for *“Bona-fide Purposes”*.

"arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

TAX BENEFIT : RULE 10U(3)(IV) V/S. SEC. 102(10)

Rule 10U(3):

(iv) "tax benefit" as defined in clause (10) of section 102 and computed in accordance with Chapter X-A shall be with reference to—

- a) sub-clauses (a) to (e) of the said clause, the **amount of tax**; and*
- b) sub-clause (f) of the said clause, the tax that would have been chargeable had the increase in loss referred to therein been the total income.*

Sec. 102:

(10) "tax benefit" includes,—

- a) a reduction or avoidance or deferral of **tax or other amount** payable under this Act; or*
- b) an increase in a refund of **tax or other amount** under this Act; or*
- c) a reduction or avoidance or deferral of **tax or other amount** that would be payable under this Act, as a result of a tax treaty; or*
- d) an increase in a refund of **tax or other amount** under this Act as a result of a tax treaty; or*
- e) a **reduction in total income**; or*
- f) an **increase in loss**,
in the relevant previous year or any other previous year;.*

TAX BENEFIT : RULE 10U(3)(IV) V/S. SEC. 102(10)

- ❑ Sec 102(10)(a) to (d) consider **tax or any other amount** while Rule 10U(3)(iv)(a) limits it to the **amount of tax**
- ❑ Sec. 102(10)(e) considers reduction in **total income** while Rule 10U(3)(iv)(a) limits it to the **amount of tax**
- ❑ Therefore, **Rule 10U(3)(iv)(a)** significantly reduces the scope for application of GAAR by reducing the scope of Tax Benefit

S.96 : RIGHTS AND OBLIGATION NOT AT ARM'S LENGTH

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

- ❑ This condition aims to test the motive of the parties getting into an arrangement. However, the word arm's length is too subjective. Perhaps, an interesting comparison can be made on the scope of the term 'arm's length' when used in the context of transfer pricing provisions (which are SAAR) whereas in the context of GAAR.
- ❑ Under the TP, arm's length principle is applicable where arrangement is between two associated enterprises, whereas in light of the present definition even the arrangement between parties (un-associated), dealing in normal commercial terms, may be construed to be not at arm's length.
- ❑ **Hence, will uncontrolled transactions are required to be bench marked with other uncontrolled transactions ?**

S.96 : ABUSE OR MISUSE OF PROVISIONS

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

- ❑ In order to understand the difference between the word ‘misuse’ and ‘abuse’ reference can be had to **Canada Ruling in case of OSFC Holdings** wherein court stated that:

*“...the **misuse** analysis looks to specific provisions in isolation from the broader scheme of the ITA, while the **abuse** analysis looks to the purpose, scheme or policy reflected in the provisions of the ITA as a whole...”*

S.97 : ARRANGEMENT TO LACK COMMERCIAL SUBSTANCE

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

❑ This condition is essentially an articulation of the internationally known “substance over form doctrine”, where the legislative intent is to prevent transactions entered merely to avail the tax benefit with no legal substance thereby resulting into abuse of provision of the law.

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).

❑ It is unclear as to what is the meaning of the word ‘significant’ as it is used in connection with effect on the business risk or net cash flow. The overall concept of the aforesaid provision is to cover within its scope the arrangements or transactions which are internationally known as sham transactions and is essentially an articulation of the “economic substance doctrine”.

S.97 : ARRANGEMENT TO LACK COMMERCIAL SUBSTANCE

*(b)(i) it involves or includes **round trip financing**;*

S.97(2): Round trip financing includes any arrangement in which, through a series of transactions—

*(a) funds are transferred among the **parties to the arrangement**; and*

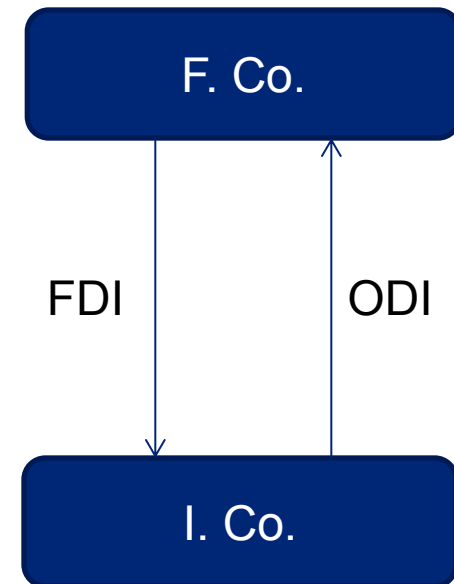
*(b) such transactions **do not have any substantial commercial purpose other than obtaining the tax benefit** (but for the provisions of this Chapter),*

without having any regard to—

(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

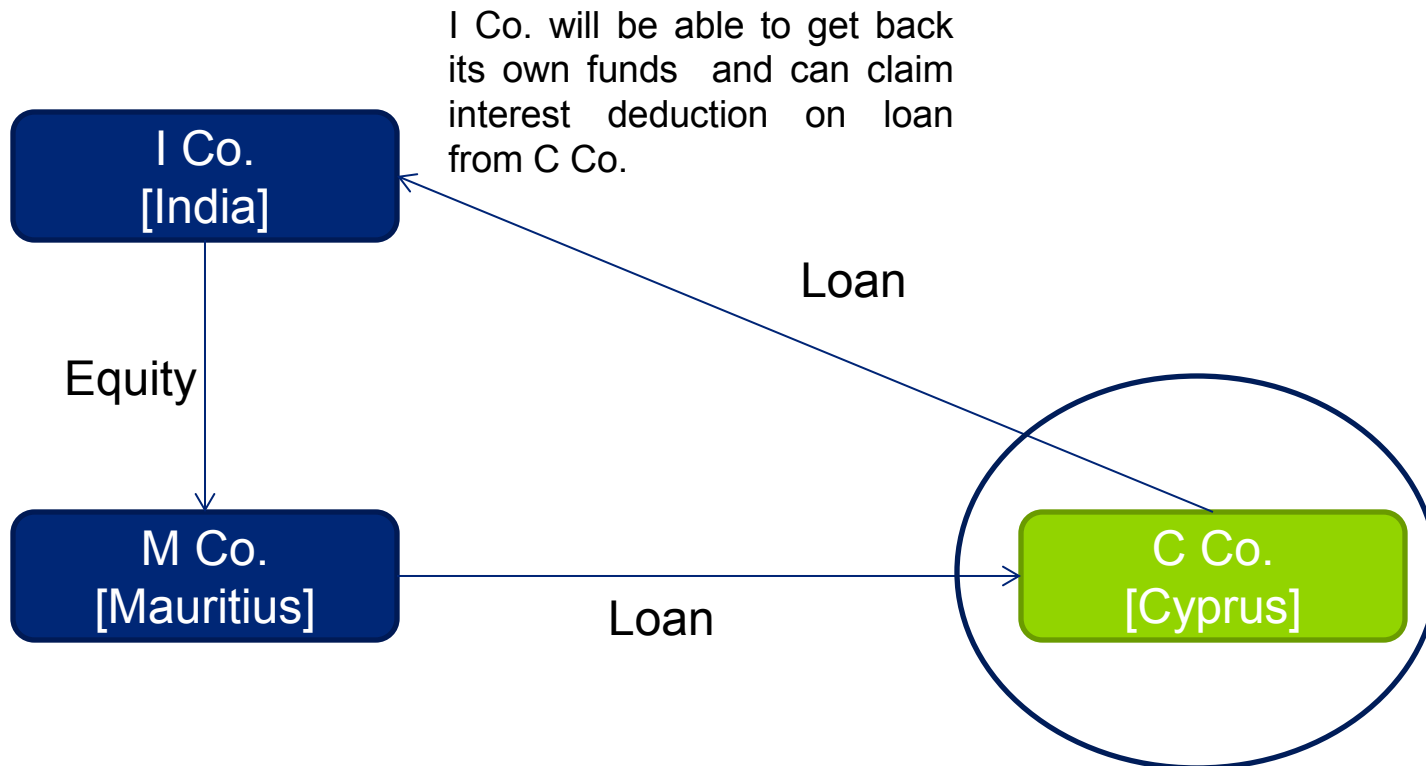
(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.



S.97 : ARRANGEMENT TO LACK COMMERCIAL SUBSTANCE

(b)(ii) it involves or includes an **accommodating party**

S.97(3): A party to an arrangement shall be an accommodating party, if the **main purpose** of the direct or indirect **participation of that party in the arrangement**, in whole or in part, is to obtain, directly or indirectly, a **tax benefit** (but for the provisions of this Chapter) for the assessee **whether or not the party is a connected person in relation to any party to the arrangement.**



S.97 : ARRANGEMENT TO LACK COMMERCIAL SUBSTANCE

(1)(b)(iii) it involves or includes elements that have effect of offsetting or cancelling each other

(1)(b)(iv) it involves or includes a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction

(1)(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party; or

(4) For the removal of doubts, it is hereby clarified that the following may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not, namely:—

- i. the period or time for which the arrangement (including operations therein) exists;*
- ii. the fact of payment of taxes, directly or indirectly, under the arrangement;*
- iii. the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.*

S. 96 : BONA FIDE PURPOSE

(1)(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

(2) An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

S. 144BA : PROCEDURE

Section 144BA

a) AO

- a) Makes reference to CIT – S. 144BA(1)
- b) Where direction of AP relates to any PY, AO to proceed as per directions / Chapter X-A without having to make reference to AP for such PY – S.144BA(11)...

Commissioner

- a) Issues notice to assessee – S. 144BA(2)
- b) Issues direction, if assessee doesn't object – S.144BA(3)
- c) If not satisfied with objection, refers case to AP – S.144BA(4)...

Approving Panel

- a) Issues direction upon reference – S. 144BA(6)
- b) Hearing to be granted – S. 144BA(7)
- c) Power to cause further enquiry, call for & examine records...

a) Pass assessment / re-assessment order to give effect to tax consequences – S. 144BA(12)

d. If satisfied, passes an Order dropping proceeding – S. 144BA(5)

e. Grants prior approval to order passed under S. 144BA(12)

d. Decision by majority – S. 144BA(9)

e. Directions are binding on AO – S. 144BA(10)

S. 144BA : PROCEDURE

Role of AO/ CIT/ AP

Declaring IAA

CIT

AP

S. 144BA(3)

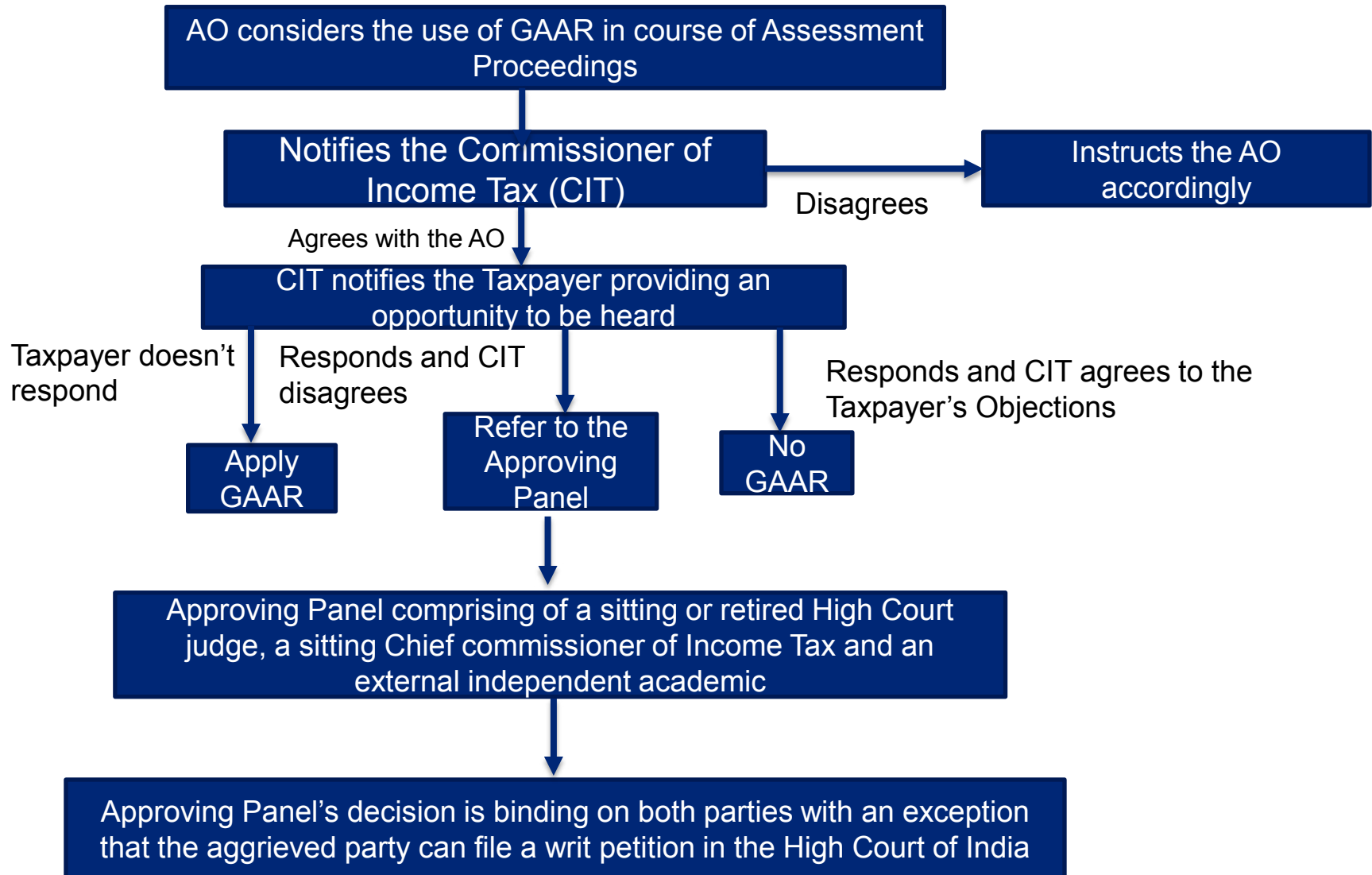
S.144BA(6)

Determining Tax Consequence

AO

S.144BA(11)
S.144BA(12)
S.98

EXECUTIVE SUMMARY OF GAAR PROCESS



DEFINED / UNDEFINED TERMS

DEFINED TERMS		UNDEFINED TERMS
“ARRANGEMENT”	→	“ MAIN PURPOSE ”
“TAX BENEFIT”		
“LACKS COMMERCIAL SUBSTANCE”	→	SIGNIFICANT EFFECT ”
“ROUND TRIP FINANCING” “FUNDS”		
“BONA FIDE PURPOSE”	→	“MISUSE OR ABUSE”
“ACCOMMODATING PARTY”		

GAAR V. SEC. 4 & 5

- ❑ GAAR provisions, though override Sec. 90, does not override the Sec. 4 & 5. Sec. 5 read with Sec. 4 creates a charge on the Scope on **Income** of an assessee and Income u/s 2(24) does not include Capital Receipts unless specially mentioned therein.
- ❑ Sec. 98(2)(ii) which read as “*any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa;*”, permits any capital accrual to be treated as a revenue accrual. Does it thus permit to convert a non-income as an income?
- ❑ However, GAAR does not enable to advance an accrual or make a non-accrual an accrual. But GAAR covers tax deferral in its scope by defining it under the definition of **Tax Benefit**

GAAR CRITERIA

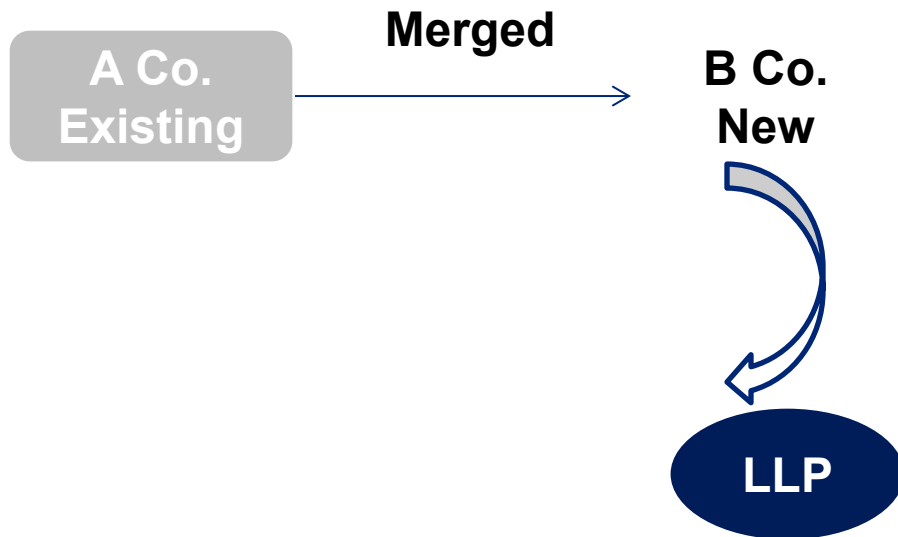
1. Is there an 'arrangement' ?
2. Is there a 'tax benefit'
 - Has the 'a' avoided an anticipated liability
 - Would there have been a tax payable but for the arrangement?
3. Is tax benefit the **main purpose** of the arrangement
 - Is the intention of the 'a' non-tax purpose
 - Does actual effect of arrangement corroborate above intention
4. Abnormality elements
 - Does the arrangement create rights or obligations **not ordinarily created between third parties**
 - Is it entered into or carried out by means or in a manner which are not **ordinarily employed for bona fide purposes**
5. Does it result in any **misuse or abuse** of provisions of IT Act

GAAR CRITERIA

6. Does the arrangement **deemed to lack commercial substance-**
 - substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part
 - involves round trip financing
 - involves an accommodating party
 - involves offsetting or self-cancelling elements
 - transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds
 - involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose
 - No significant effect on business risks /net cash flows of parties

7. Does arrangement lack commercial substance generally
 - Is the expenditure/loss disproportionate to tax benefit gained
 - Is there no corresponding reduction in net worth

CONVERSION OF COMPANY INTO LLP-CASE STUDY 1



- ❑ A co., and Indian Co. is having a turnover of 1000Cr, huge asset base and huge reserves.
- ❑ A Co. Intends to convert itself into LLP but the same would not be tax neutral as it will violate the conditions provided in section 47(xiiib).
- ❑ The promoters of A co. incorporates a new company B Co. and operates it for a year. B.co revenue during the year Rs. 25 lacs and assets of Rs. 50 lacs.
- ❑ A co. is then merged into B co. and then B co. is converted into LLP

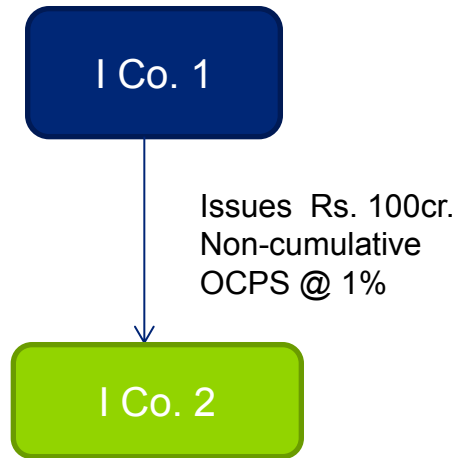
OFF-MARKET SALE V. ON MARKET SALE-CASE STUDY 2

- Mrs. X has sold her inherited residential property in April 2017 and has earned huge capital gains on sale.
- Even after exhaustion of benefits under Sec. 54, she would yet have to pay tax on remaining gains.
- Mrs. X had purchased shares of A Ltd. in the IPO and today the market value is much lower than the listing price.
- She decides to sell such shares to her husband off-market (but at the trading price) and set off LTCG on sale of residential property against LTCL on sale of A Ltd. shares.

Off market transactions to make the loss coming from non exempt source [non10(38)] cannot be dubbed as tax evasion :Mridu Hari Dalmia Parivar Trust 68 Taxmann.com 376 Dehli ITAT

ISSUING OCPS TO RESIDENTS-CASE STUDY 3

- I Co. 2, an AE of I Co., requires fund for expansion. A bank is ready to finance I Co. 2 but with a condition to bring in funds from its promoter group.
- I Co.2 issues non-cumulative Optionally Convertible Preference Shares (OCPS) of Rs. 100 cr. @ 1% to I Co. 1. with option to convert into Equity shares after 10 years or redeem the CCPS at Rs. 100 Cr.



- After 10 years, the Preference share holders do not exercise the option to convert the OCPS and hence the company redeems the CCPS at Rs. 100 Cr.
- The OCPS holders will get the indexation of 10 years and will make a long-term capital loss which would be available for set-off against other LTCG.
- Can GAAR be invoked in such a scenario ?

TAX MITIGATION – GAAR CANNOT BE INVOKED

- ❑ Setting-up of a unit in SEZ which results into a tax benefit, is a case of tax mitigation since the taxpayer is taking advantage of fiscal incentive offered to him by submitting to the conditions and economic consequences of the provisions in the legislation
- ❑ A company chooses asset on lease over outright purchase and consequently claims higher deduction for lease rentals rather than depreciation. Being an investment decision of the company, GAAR provisions shall not apply
- ❑ An Indian Co. has raised fund from a foreign company incorporated in a low jurisdiction outside India through borrowings, when it could have issued equity. An evaluation of whether business should have raised funds through equity instead of debt should generally be left commercial judgement of a taxpayer. Further, the newly introduced thin capitalization provisions are enough to act as a safe harbour for the Revenue.
- ❑ A company sets off losses in the stock market against gain which is aimed to balance the portfolio. In such case, sale/purchase through stock market transaction and timing of transaction would not come under GAAR provisions.

SAAR UNDER DOMESTIC LAW

SAAR UNDER DOMESTIC LAW

Section	Provision
2(22)	Deeming certain transactions with shareholders/their related parties as dividend
9	Explanation 5 – Indirect Transfer
14A	Disallowance of expense in relation to exempt income
40A(2) & 92	Expenses or payments not deductible in certain circumstances involving related parties
50C, 50CA, 50D	Deeming sales consideration in case of transfer of land, building, unquoted shares or where such consideration is not ascertainable or determinable
56(2)	Treating any receipt of property at NIL or inadequate consideration as income of recipient
60	Transfer of income without transfer of assets
61 & 62	Taxation of revocable and irrevocable trust

SAAR UNDER DOMESTIC LAW

Section	Provision
64	Transfer of income by husband to wife vice versa
72A	Carry forward and set off of losses in case of amalgamation/demerger
79	Carry forward and set off of losses in case of change of shareholding
80IA, 80IB, 80IC	Tax Holiday – Inter company/Intra company Transfers
93	Avoidance of income-tax by transfer of income to non-residents through transfer of assets, rights, Interest
94	Dividend Stripping/ Bonus Stripping
94B	Thin Capitalisation
94CE	Secondary Adjustments, etc.

INTERPLAY BETWEEN SAAR & GAAR

DRAFT GUIDELINES FOR GAAR IMPLEMENTATION UNDER DIRECT TAX CODE BILL, 2010 (“DTC”)

The committee examined this issue and gave the below recommendation:

“While SAARs are promulgated to counter a specific abusive behavior, GAARs are used to support SAARs and to cover transactions that are not covered by SAARs. Under normal circumstances, where specific SAAR is applicable, GAAR will not be invoked. However, in an exceptional case of abusive behaviour on the part of a taxpayer that might defeat a SAAR....., GAAR could also be invoked.”

INTERPLAY BETWEEN SAAR & GAAR

CONTRADICTORY TO SHOME COMMITTEE REPORT:

“It is a settled principle that, where a specific rule is available, a general rule will not apply. SAAR normally covers a specific aspect or situation of tax avoidance and provides a specific rule to deal with specific tax avoidance schemes.”

“In view of the above, the Committee recommends that that where SAAR is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/element.”

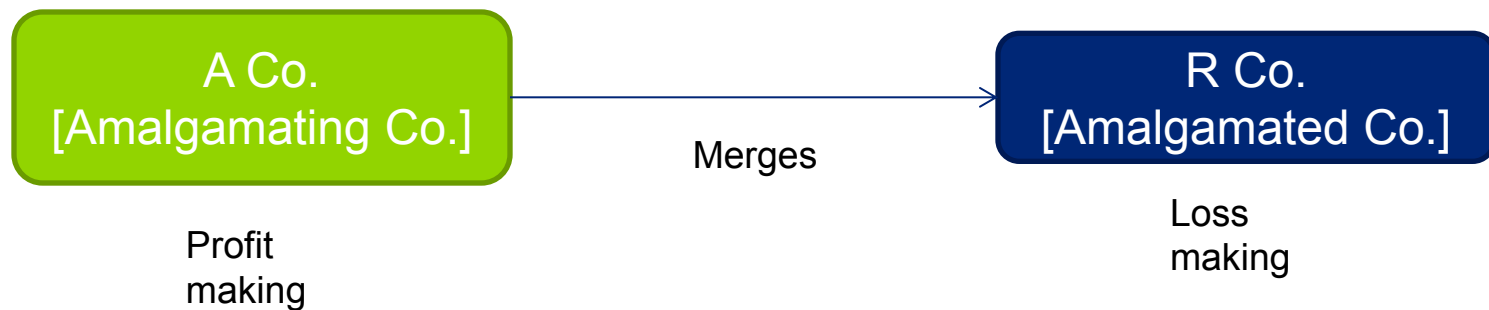
CIRCULAR NO. 7 of 2017 dated 27/01/2017

“Question no. 1: Will GAAR be invoked if SAAR applies?”

Answer: It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislations. **The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.”**

REVERSE MERGER-CASE STUDY 4

The merger of a profit making company into a loss making one results in losses off setting profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed under GAAR ?



The merger is covered by SAAR (NCLT approval) and the CBDT circular clarifies that GAAR would not be invoked if the NCLT has adequately and explicitly considered the tax implication while sanctioning the arrangement.

REVERSE MERGER

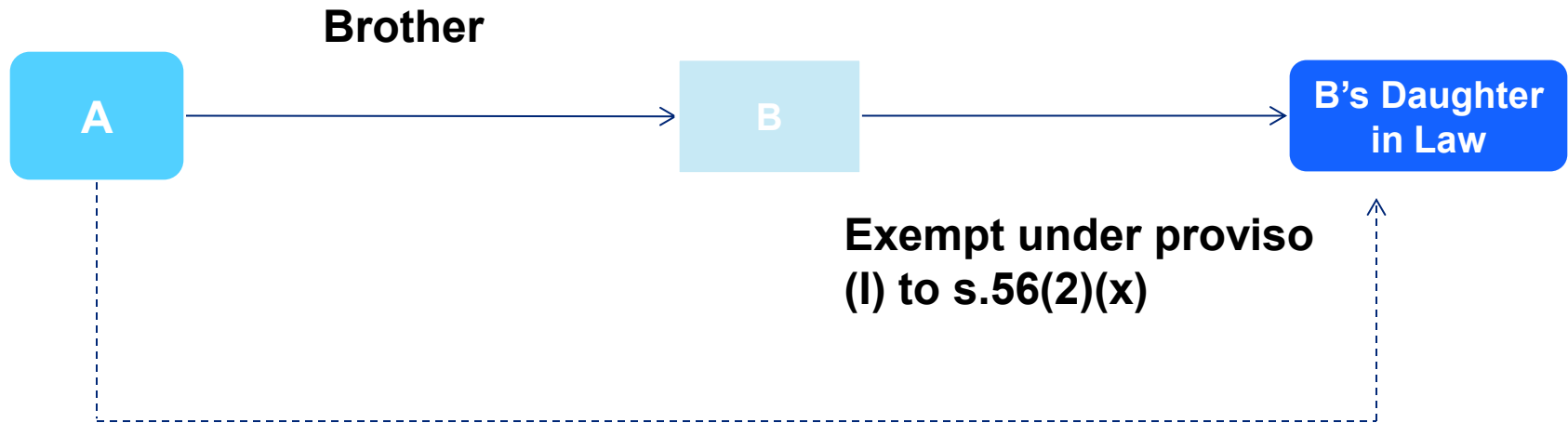
- The proceedings at NCLT u/s 230 of the Companies Act, 2013 require approval / presence of Income Tax Authority inviting their comments on a proposed arrangement and Circular No.1/2014 issued by the MCA dated 15th January 2014 provides that when there is no response from the Income Tax Department, it may be presumed that the department has no objection to the proposed arrangement.
- Assuming that the tax authorities did not appear for the proceedings / provide any response to comments sought, the NCLT order has been passed permitting the merger with either of the following comments:

Nobody appeared on behalf of the Income Tax, therefore no opinion has been provided on the tax implications of the merger.

Nobody appeared on behalf of the Income Tax, therefore the tax implications of such merger have not been examined.

Nobody appeared on behalf of the Income Tax, therefore it is presumed that that tax department has no objection to the proposed merger.

INTERPLAY BETWEEN SAAR & GAAR-CASE STUDY 5

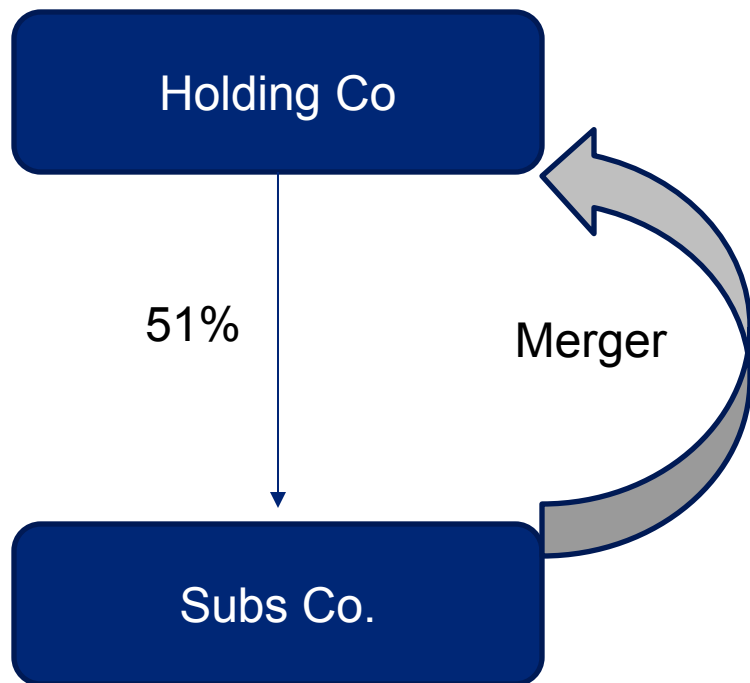


- A and B are brothers; A is financially affluent
- Son of B, recently expired in an accident; the son is survived by his widow and children
- A, out of concern for B's family and well being, gifts a sum of Rs 10 Cr.

INTERPLAY BETWEEN SAAR & GAAR

- B, out of his own volition, gifts sum of Rs. 10 Cr. to his daughter-in-law (i.e. son's widow)
- Gift by A to B is exempt under proviso (I) to s.56(2)(x) as received from relative (brother)
- Gift by B to daughter-in-law is exempt under proviso (I) to s.56(2)(x) as received from
 - relative (lineal ascendant of spouse i.e. husband's father)
- However, gift from A to B's daughter-in-law is not protected under s.56(2)(x)
- Can GAAR be invoked to tax B's daughter-in-law under s.56(2)(x)?

MERGER-CASE STUDY 6



Facts:

- Sub Co. has substantial carried forward losses where as Hold Co. is a profit making company. **Both are into same business segment**
- The scheme is a qualifying amalgamation u/s 2(1B)
- Transfer exempt u/s 47(vi)
- Hold Co. will be allowed to set – off the losses u/s 72A

ANTI-ABUSE PROVISIONS IN DTAA/MLI

ACTION PLAN – 6 - AN OVERVIEW/ ARTICLE 7– MLI

- Action 6 provides safeguard against '**Treaty Abuse**' and in particular '**Treaty Shopping**'
- Three-pronged approach recommended to address treaty shopping arrangements:

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

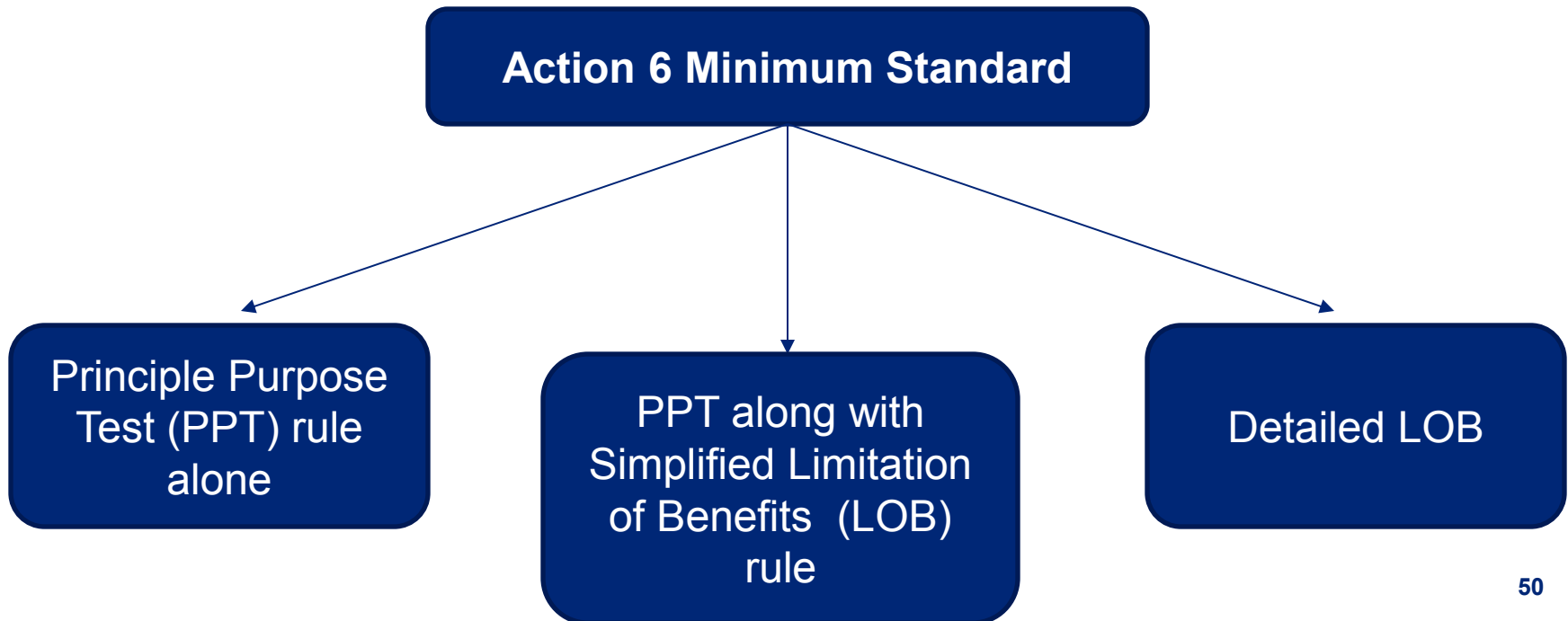
Introduction of a more general anti-abuse rule based on the **principal purposes test**

Introduction of specific anti-abuse rule, for instance, the **Limitation-of-Benefits** rule, that limits availability of treaty benefits to entities meeting certain conditions

Conditions based on legal nature, ownership in, and general activities of entity to ensure sufficient link between entity and State of residence

ACTION PLAN – 6 (CONT'D...)

- ❑ **Minimum Standard** – to include in the tax treaties an express statement that common intention is to eliminate double taxation without creating opportunities for non-taxation, tax evasion or avoidance



SIMPLIFIED LOB [ART. 7 (PARA 8-13)] OF MLI

- ❑ It is a SAAR aimed at treaty shopping

- ❑ Treaty benefits to be denied to a resident of a Contracting State who is not a 'Qualified Person'

- ❑ 'Qualified Person' to include -
 - An individual;
 - The State, its political subdivision, entities owned by the State;
 - Certain charities and pension funds;
 - Certain public entities and their affiliates;
 - Certain entities that meet certain ownership requirements and/or turnover requirements;
 - Certain collective investment vehicles;
 - Entities permitted by competent authorities.

- ❑ If a person is not a 'Qualified Person', the benefit of treaty would be available on satisfaction of certain conditions

PRINCIPLE PURPOSE TEST [ART. 7 (PARA 1)] OF MLI

*“Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that **obtaining that benefit was one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit,*

unless

*it is established that granting that benefit in these circumstances would be **in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement**”*

PPT – BURDEN OF PROOF

- Obtaining tax benefit is one of the principal purposes – Onus on the tax department
- Arrangement is in accordance with the object and purpose of the treaty – Defence available with the tax payer

PPT v/s INDIAN GAAR

Action Plan 6

- “arrangement or transaction” to include any:
 - Agreement
 - Understanding
 - Scheme
 - Transaction
 - Series of transactions
- Whether or not they are legally enforceable [explained in Article X.7(9)]
- X.7(9) gives an example of “arrangement”
 - *“Where steps are taken to ensure that meetings of the Board of Directors of a company are held in a different country in order to claim that the company has changed its residence”*

Section 102(1) of the Act

- “arrangement” means:
 - Any step in, or a part or whole of any:
 - Transaction
 - Operation
 - Scheme
 - Agreement
 - Understanding
 - Whether enforceable or not
 - And includes:
 - Alienation of any property in such transaction/operation/scheme/agreement/understanding

PRINCIPAL PURPOSE IS TO OBTAIN TREATY BENEFITS – HOW TO DETERMINE IT?

- Undertake an objective analysis of aims and objects of **all persons involved** in putting arrangement / transaction in place
- Why are all of them a party to it?
- Conclusive proof – not required
- “reasonable to conclude” after objective analysis
- Looking merely at the “effect” **is** not sufficient
- What is a reasonable explanation of:
 - *“Why you have done what you have done?”*
- Mere denial is not sufficient

INTERPLAY BETWEEN LOB AND PPT

- LOB is SAAR, PPT is GAAR
- PPT supplements LOB
- PPT does not restrict LOB
- Even if LOB Test is passed, PPT can apply
 - Example – Public listed company – Passes LOB Test but if involves in Treaty Shopping – PPT will deny benefit

ILLUSTRATIONS

- India – Ireland DTAA definition of royalty includes use of CIS equipment (excluding aircraft). Major hub for aircraft leasing business across the globe. Whether GAAR applies?
- India – Philippines DTAA no separate article of FTS. Philippines is a major hub for repairs and maintenance of plant and machinery for various equipment manufactures across the globe. Whether GAAR applies?
- India – UK DTAA restricts the scope of FTS. It excludes managerial services. Whether using UK for providing managerial services could be hit by GAAR.

CASE STUDY-7

- R. Co. for expanding its business globally has identified three different countries with similar economic and political environments. It selects State S for setting up its business on account of favourable treaty with State R. Will PPT apply? Expansion of business in the principal purpose.
- R. Co is a collective investment vehicle managing diversified portfolios of investment globally. It has significant investments in State S on account favourable treaty on dividend taxation. Whether PPT applies? The intent of treaties is to provide benefit to encourage cross border investments
- Would GAAR apply if PPT is cleared?

GAAR Vs TREATY

Constitution of India

- Article 51 - The State shall endeavor to:
 - (c) Foster respect for international law and treaty obligation in the dealings of organized peoples with one another

Vienna Convention

- Article 26 - Every treaty in force is binding upon the parties to it and must be performed by them in good faith - "PACTA SUNT SERVANDA"

Section 90 (2A)

- Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions³⁹ are not beneficial to him

GAAR Vs TREATY

DTC - Draft Guidelines

- Where SAAR is applicable, GAAR will not be invoked;
- In an exceptional case of abusive behavior which might defeat SAAR, GAAR could be invoked;

Shome Committee Recommendations

- Where anti-avoidance rules are provided in a tax treaty in the form of limitation of benefit (as in the Singapore treaty) etc., the GAAR provisions shall not apply overriding the treaty

Circular No 7 of 2017 - FAQ

- Question no. 2: Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?

Answers: *Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.*

MAIN PURPOSE v/s PRINCIPAL PURPOSE

'MAIN' Purpose

▪ Dictionary Meaning

- Alyar's Judicial Dictionary - *substantially, as far as practicable or so far as possible;*
- New Collegiate Dictionary – *the chief part, principal;*
- Merriam Webster's Collegiate Dictionary – *chief, principal;*

▪ Judicial Interpretation

- CIT v. C. Jayalakshmi (132 ITR 82) - *The word mainly is not to be confused with 'wholly' and has to be understood as principally;*
- CIT v. Srikrishna Tiles & Potteries (Madras) (P.) Ltd. (53 Taxman 151) - *The expression mainly would cover cases of the principal or the predominant activity*

One of the 'PRINCIPAL' Purpose

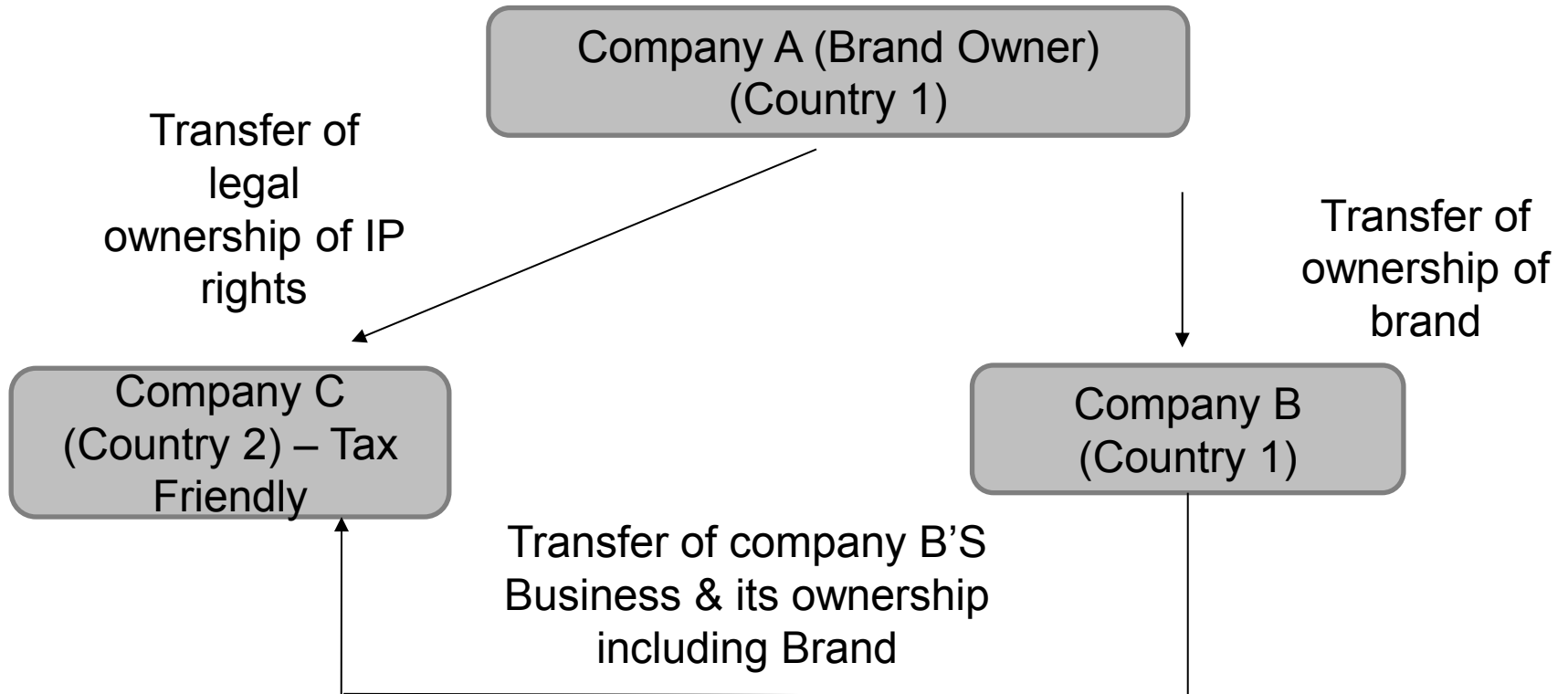
▪ Dictionary Meaning

- Black' Law Dictionary, seventh edition – *Chief, most important;*
- New Collegiate Dictionary – *initial, primary;*
- Merriam Webster's Collegiate Dictionary – *most important;*

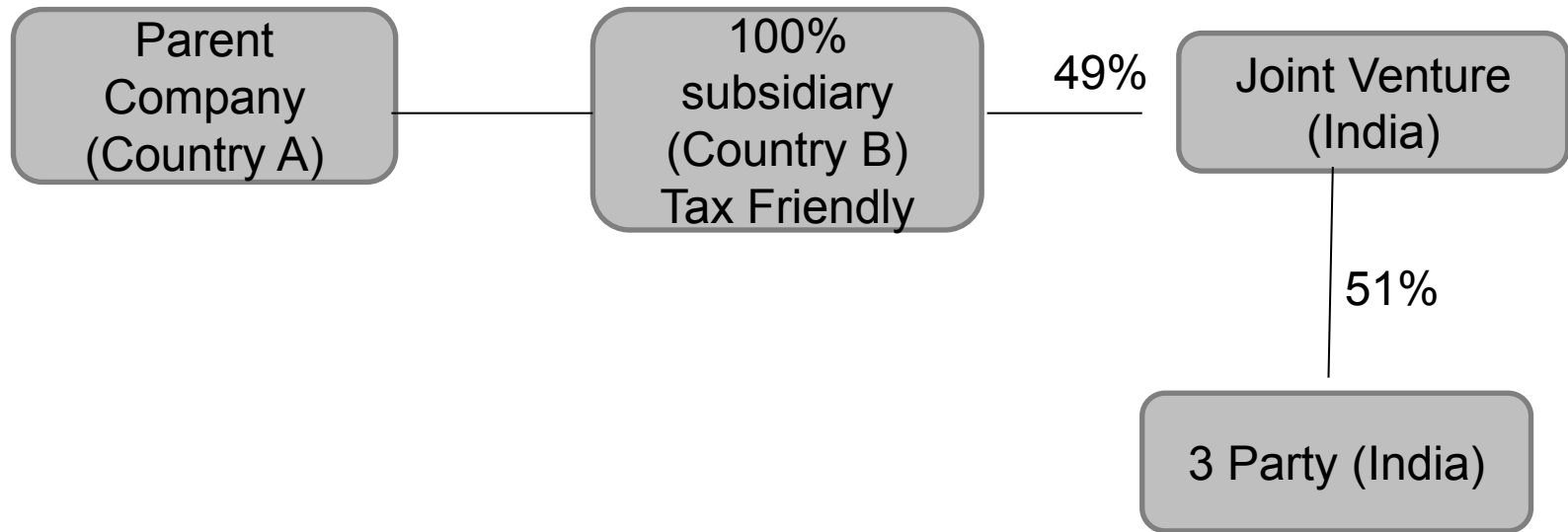
▪ Judicial Interpretation

- ITI Ltd. V. District Judge (AIR 1998 All 313) - *The word 'principal' means; the first in importance: chief, main;*
- Fountain Head Developers v. Mrs. Maria Arcangela Sequeira (AIR 2007 Bom 149) – *The word 'principal', thus, clearly indicate only one court being the highest in rank or chief ;*

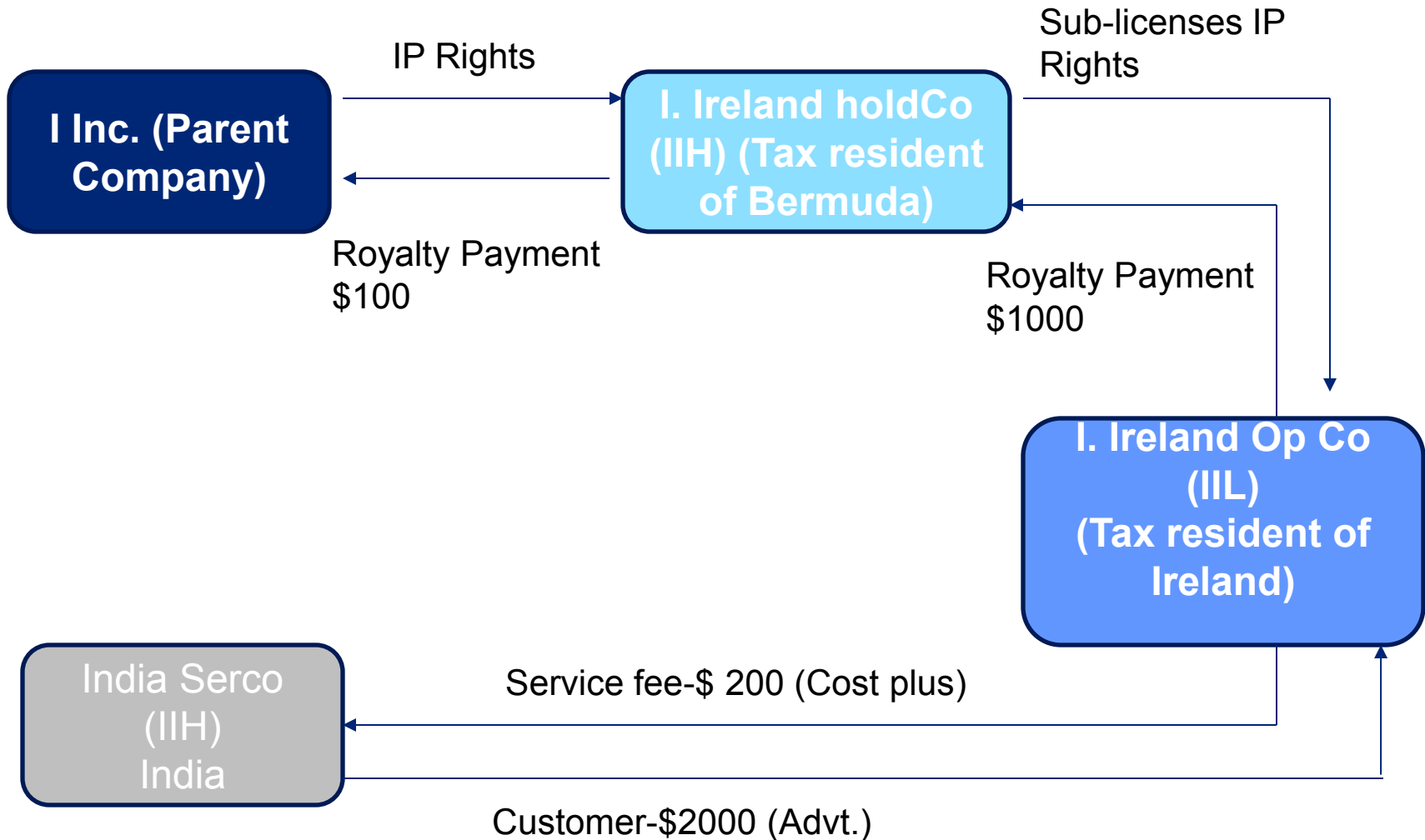
TRANSFER OF INTANGIBLES ABROAD- CASE STUDY 8



FOREIGN JOINT VENTURE INVESTMENT- CASE STUDY 9



OUTRIGHT TRANSFER OF ROYALTY –CASE STUDY 10



OUTRIGHT TRANSFER OF ROYALTY –CASE STUDY 10

Total Tax Liability in Ireland (IIL)	Amount (\$)
Sales	2,000
Less: Service Fee	200
Less: Employment cost	500
Less: Royalty Pay-out	1000
Profit	300
Tax @12.5%	37.5

We can see that due to huge royalty Pay-out to IIL in Ireland (**which is tax resident in Bermuda**), there is an overall reduction in the profitability of IIL. Further, Bermuda being tax heaven has a corporate tax rate of 0%

CASE STUDY-11

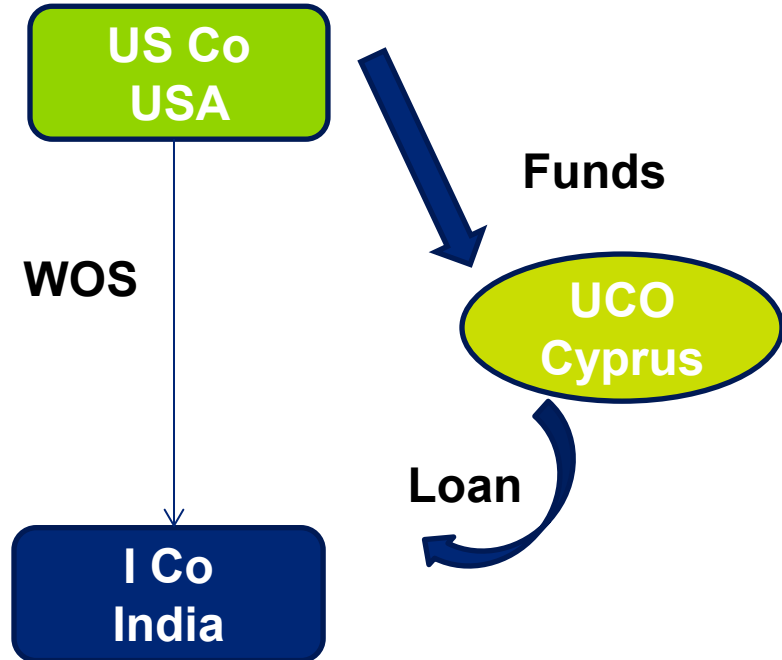
Facts:

US Co, a company resident of USA, owns all of the shares of I Co, a company resident of India

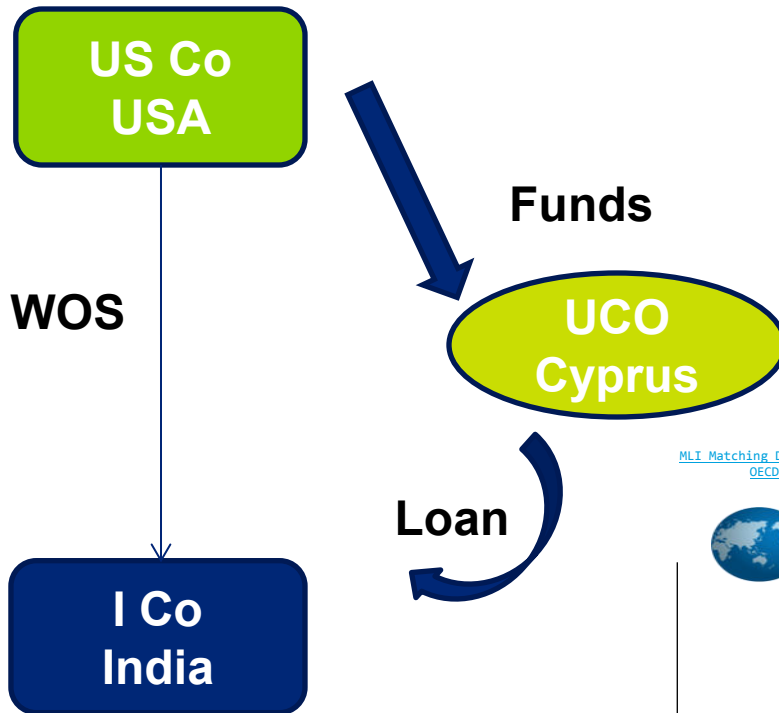
US Co has for a long time done all of its banking with UCO, a bank resident of Cyprus which is unrelated to US Co and I Co, because the banking system in Cyprus is relatively unsophisticated. As a result, US Co tends to maintain a large deposit with UCO

When I Co needs a loan to fund an acquisition, US Co suggests that I Co deal with UCO, which is already familiar with the business conducted by US Co and I Co.

I Co discusses the loan with several different banks, all on terms similar to those offered by UCO, but eventually enters into the loan with UCO, in part because interest paid to UCO would be subject to a lower withholding tax in India pursuant to the treaty between India and Cyprus,



CASE STUDY-11



whilst interest paid to banks resident of US would be subject to higher withholding tax in India

Whether such structure could stand the test of PPT?

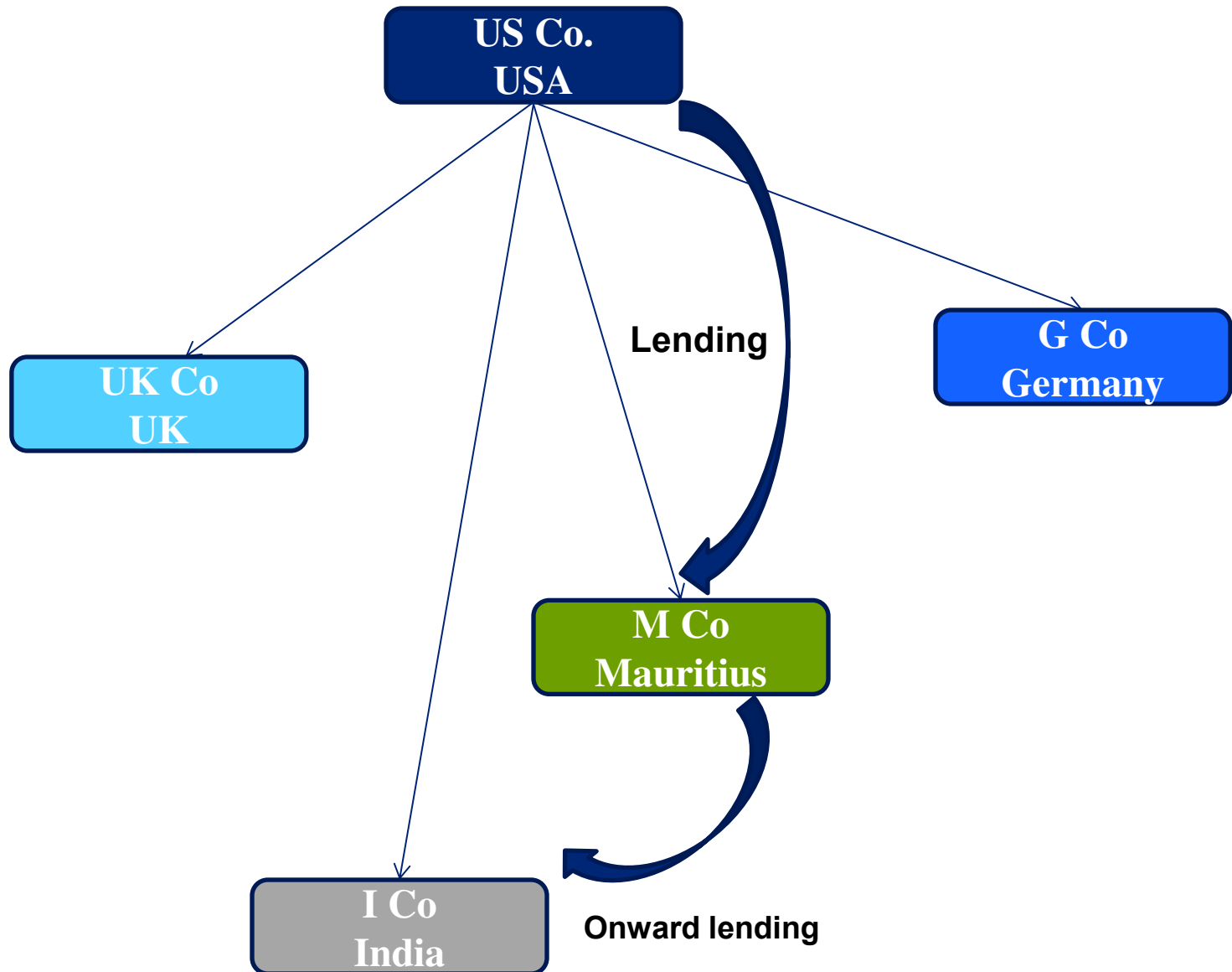
Whether AO can invoke GAAR and deny the treaty benefit?

[MLI Matching Database beta @ OECD 2017](#)



Select jurisdictions:	<u>India</u>	<u>Cyprus</u>	Read the Disclaimer
	India	Cyprus	
Signature MLI	07-06-2017	07-06-2017	
Status of List	Provisional	Provisional	
Article 2 Covered Tax Agreement	The agreement would be a 'Covered Tax Agreement'.		
Article 7 Prevention of Treaty Abuse	Article 7(1) would apply and supersede the provisions of the agreement to the extent of incompatibility. Article 7(4) would not apply. The Simplified Limitation on Benefits Provision would not apply.		

CASE STUDY-12



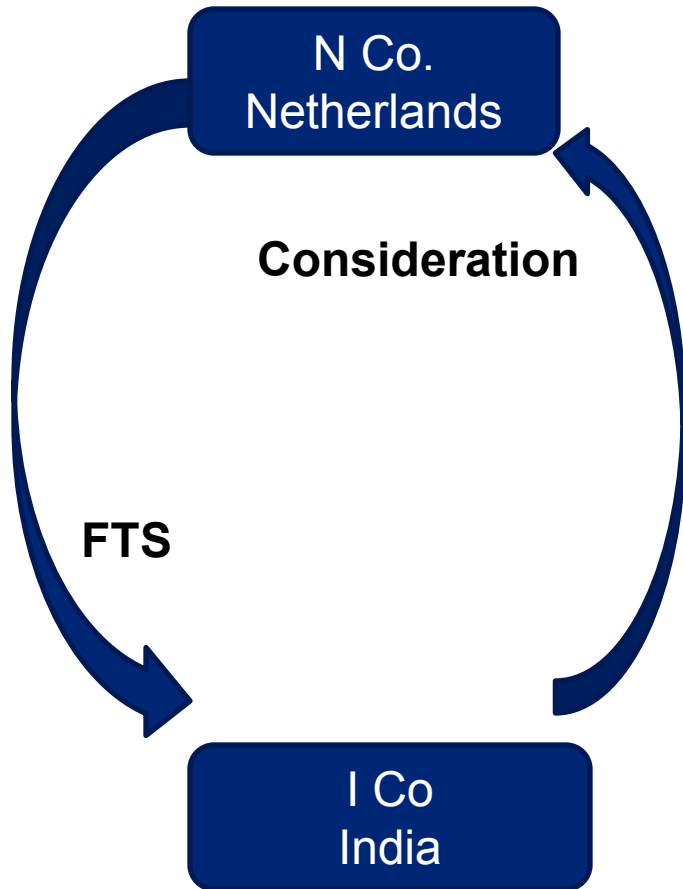
FACTS:

- US Co is a publicly traded company resident in USA. US Co is a parent of a worldwide group of companies, including M Co, a company resident in Mauritius and I Co, a company resident in India.
- I Co is engaged in the active conduct of trade and business in India. M Co is responsible for co-ordinating the financing of all subsidiaries of US Co.
- M Co maintains a centralised cash management accounting system for US Co and its subsidiaries in which it records all intercompany payables and receivables. M Co is responsible for disbursing or receiving any cash payments required by transactions between its affiliates and unrelated parties. M Co enters into interest rate and foreign exchange contracts as necessary to manage the risks arising from mismatches in incoming and outgoing cash flows.
- The activities of M Co are intended (and reasonably can be expected) to reduce transaction costs and overhead and other fixed costs. M Co has 50 employees, including clerical and other back office personnel, located in Mauritius
- US Co lends to M Co 15 million USD at 5 % interest annually. On the same day, M Co lends 15 million USD to I Co at 5 % interest annually.

ISSUES FOR CONSIDERATION

- **whether the structure will stand the test of PPT as Incorporated in the Multi lateral Convention**
- **Whether GAAR could be invoked Pre-MLI?**

CASE STUDY-13



Facts:

N Co, a company resident in Netherlands, is in the business providing service in nature of FTS for manufacturing of certain product

It is now considering establishing a manufacturing plant (through a WOS) in developing countries where this product has a huge market. N Co would provide all kind of technical service which can not be made available

After a preliminary review, possible locations in three different countries including India were identified. All three countries provide similar economic and political environments.

After considering the fact that India is the only one of these countries where there is a make available clause with respect to Fees for technical service, the decision is made to build the plant.

ANTI-FRAGMENTATION RULE

PRE BEPS OECD MODEL ERA..

Article 5(4)

4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

PRE BEPS OECD MODEL ERA..


Article 5(4)

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

ANTI FRAGMENTATION RULE PROPOSED

ARTICLE 13(4) MLI-BEPS ACTION 7



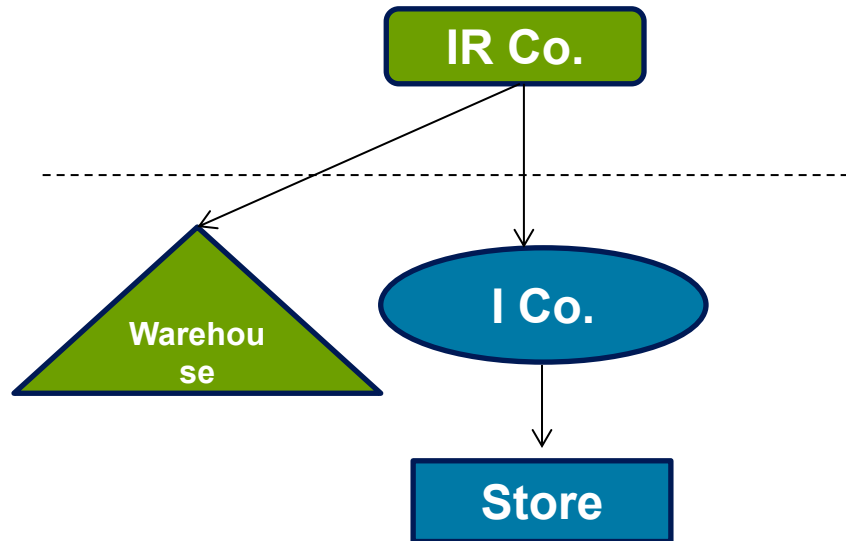
“4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and:

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.”

ANTI FRAGMENTATION RULE- CASE STUDY 14



IR Co, a company resident of Ireland, manufactures and sells appliances. I Co, a resident of India that is a wholly owned subsidiary of IR Co, owns a store where it sells appliances that it acquires from IR Co

IR Co also owns a warehouse in India where it stores goods displayed in the store owned by I Co

Whenever any product is completely sold out from the store, the warehouse supplies such product to the store. It also delivers directly to the customer when a large quantity of any product is ordered

Q1. Whether warehousing activity in India which is in nature the of auxiliary services constitute PE of IR Co. in India?

Q2. Whether the warehouse would constitute a PE in terms of the new Anti-Fragmentation Rule?

Q3. Can GAAR be invoked?

SPLITTING OF CONTRACTS

PRE BEPS OECD MODEL ERA..

Article 5

5(1) For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

5(3). A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

*** In UN Model the time threshold is six months instead of twelve months**

SPECIFIC ANTI –ABUSE RULES

ARTICLE 14(1) MLI- BEPS ACTION 7

“1. For the sole purpose of determining whether the period (or periods) referred to in a provision of a Covered Tax Agreement that stipulates a period (or periods) of time after which specific projects or activities shall constitute a permanent establishment has been exceeded:

- a) where an enterprise of a Contracting Jurisdiction carries on activities in the other Contracting Jurisdiction at a place that constitutes a building site, construction project, installation project or other specific project identified in the relevant provision of the Covered Tax Agreement, or carries on supervisory or consultancy activities in connection with such a place, in the case of a provision of a Covered Tax Agreement that refers to such activities, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding the period or periods referred to in the relevant provision of the Covered Tax Agreement; and*

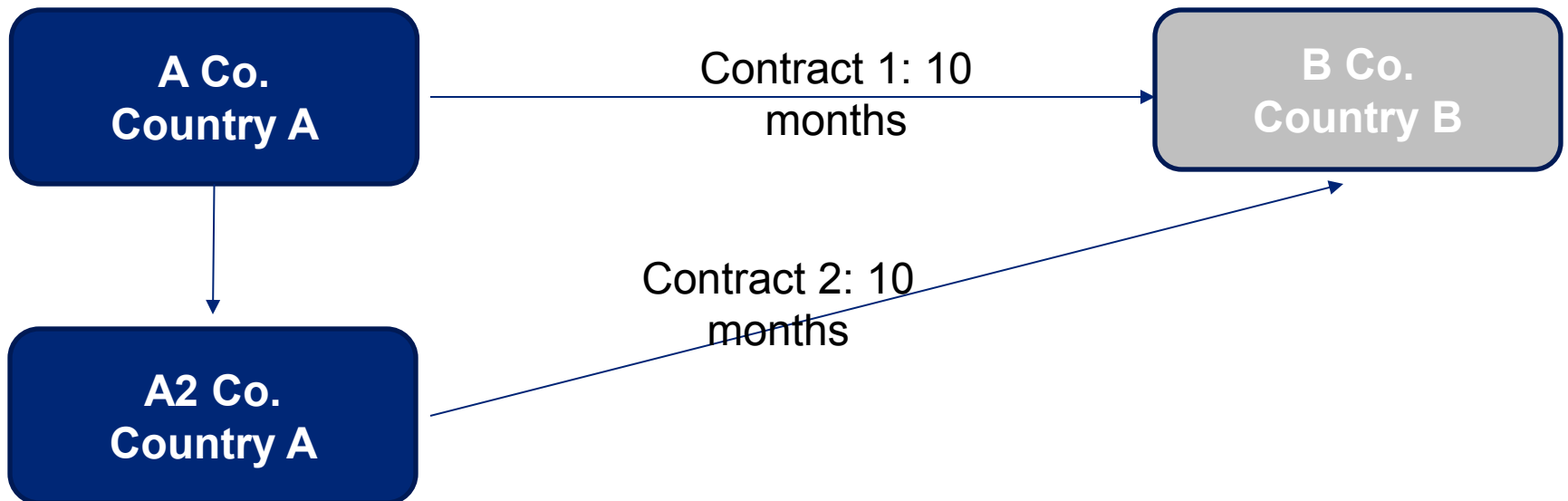
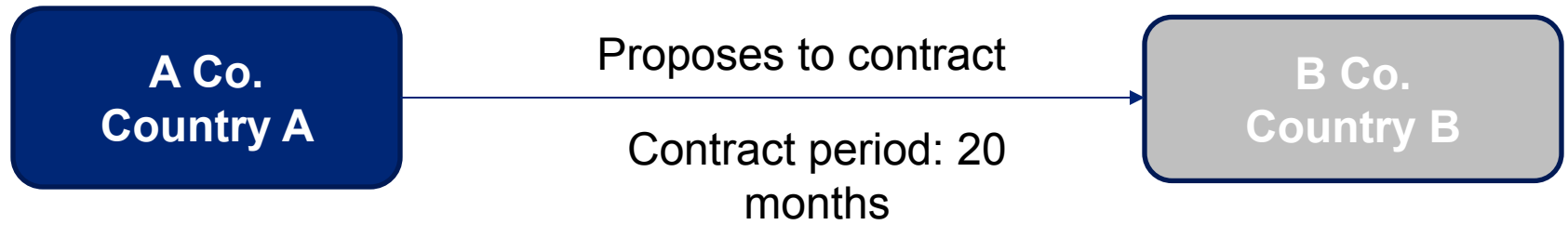
SPECIFIC ANTI –ABUSE RULES

ARTICLE 14(1) MLI- BEPS ACTION 7

b) where connected activities are carried on in that other Contracting Jurisdiction at (or, where the relevant provision of the Covered Tax Agreement applies to supervisory or consultancy activities, in connection with) the same building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise,

these different periods of time shall be added to the aggregate period of time during which the first mentioned enterprise has carried on activities at that building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement.”

ARTIFICIAL SPLITTING OF CONTRACTS- CASE STUDY 15



ARTIFICIAL SPLITTING OF CONTRACTS- CASE STUDY 15

Facts

1. A co. proposes to contracts with B Co. an unrelated party for a contract period of 20 months
2. A Co. forms wholly owned subsidiary A2 Co. and then splits the contract term along with the division of contracts into 10 months each with B Co.

TAX PLANNING SOLUTION

Only solution

Is

**Substance
Substance
Substance**

THE PRESENCE OF A GAAR REGIME DOES NOT AFFECT THE NEED TO PLAN APPROPRIATELY TAKING INTO ACCOUNT TAX CONSEQUENCES. RATHER, IT MEANS THAT TAX PLANNING SHOULD CONTINUE IN A THOUGHTFUL MANNER, WITH PRACTICAL STEPS TAKEN THROUGH ALL STAGES OF THE TAX LIFE CYCLE TO PROTECT THE BUSINESS FROM A GAAR CHALLENGE

THANK YOU

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