WESTERN INDIA REGIONAL COUNCIL

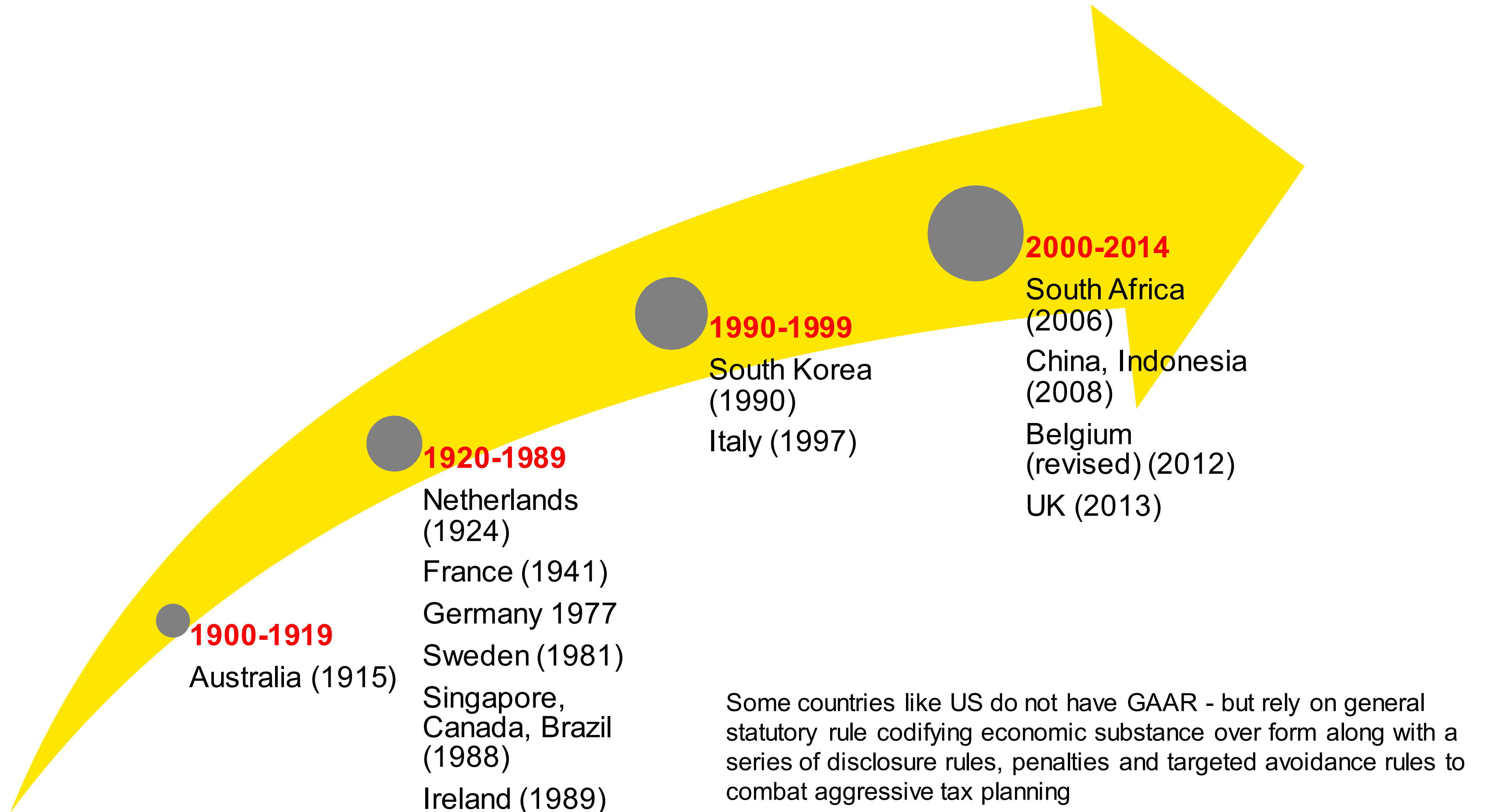
DIRECT TAX REFRESHER COURSE OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

GENERAL ANTI-AVOIDANCE RULES (GAAR)

13 JULY 2019

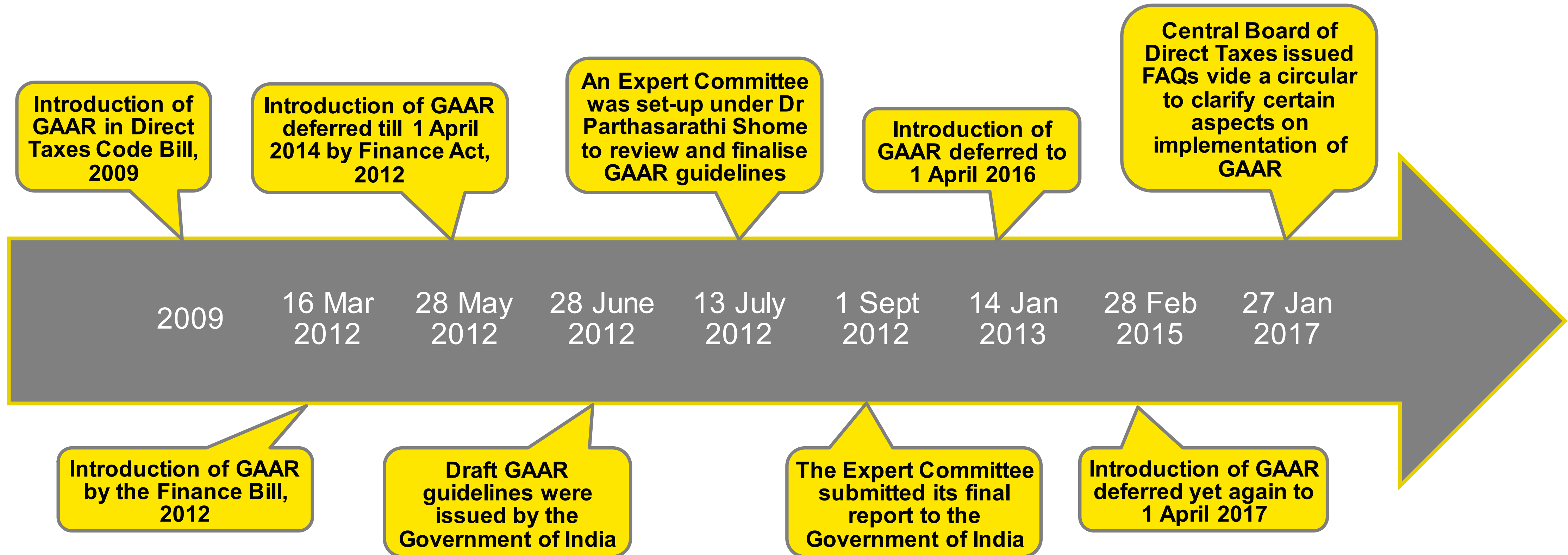
ANISH THACKER

GAAR – Around the World



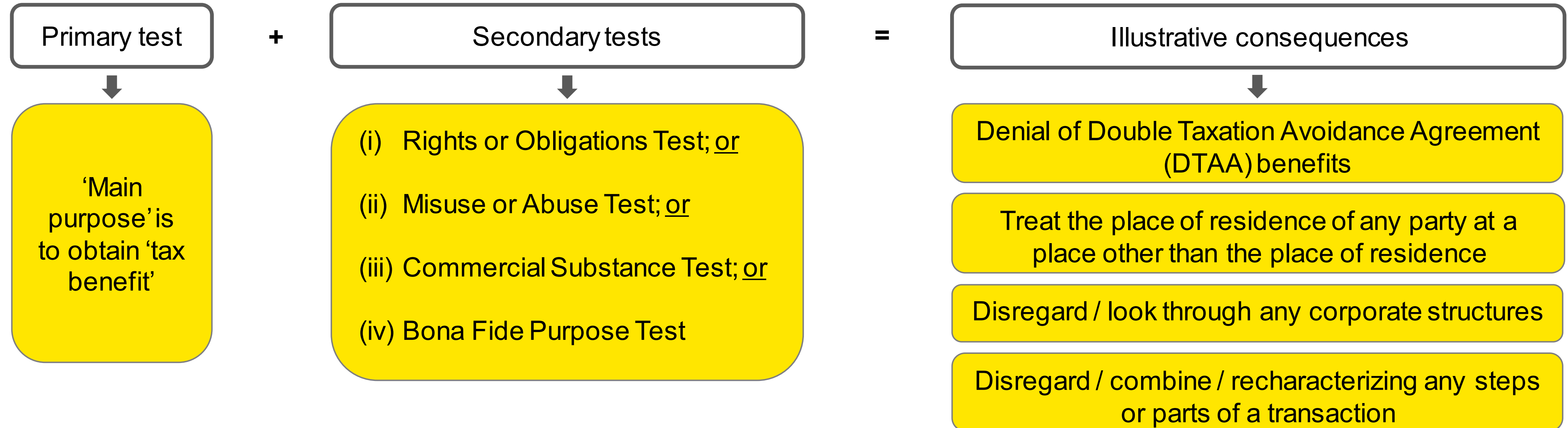
Some countries like US do not have GAAR - but rely on general statutory rule codifying economic substance over form along with a series of disclosure rules, penalties and targeted avoidance rules to combat aggressive tax planning

Indian GAAR – The Journey So Far…



GAAR – An Overview

An arrangement is an **“impermissible avoidance arrangement” (IAA)**



Exclusions

- An arrangement where the tax benefit arising to all the parties in a year does not exceed Rs 3 crore
- Foreign Portfolio Investors (FPIs) not availing benefits of a DTAA and investing in accordance with the extant regulations
- To non-residents in respect of investments made, *inter alia,* in ODIs in a FPI
- In respect of income from transfer of investment made before 1 April 2017

Exclusions from GAAR – FPIs [Rule 10U(1)(b) and (c)]

Rule 10U(1)(b) and (c)

"(1) The provisions of Chapter X-A shall not apply to -

(a) …

(b) 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;

(c) 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"

Can treaty benefit claimed under an Article (say interest income) make an FPI ineligible from the exclusion of GAAR for another source of income (say capital gains)?

Exclusions from GAAR – Certain Investments [Rule 10U(1)(d)]

Rule 10U(1)

"(1) The provisions of Chapter X-A shall not apply to -

(c) …

(d) 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 the 1st day of April 2017 by such person"

Key takeaways/ food for thought:

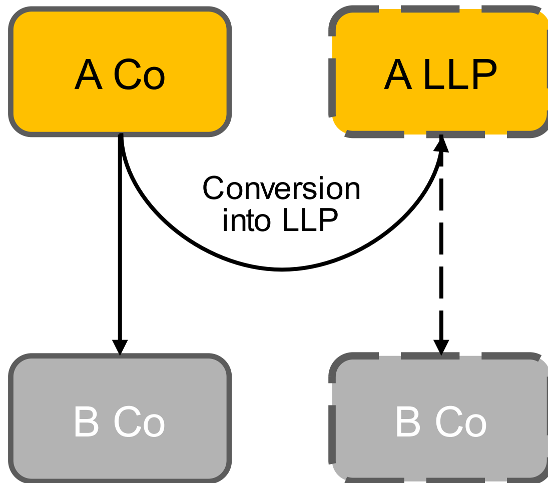
1. **Exclusion limited to 'transfer' – as defined under section 2(47) of the Income-tax Act, 1961 (Act)**
2. **Meaning of investment – to be exported from Indian Accounting Standards?**
3. **Would income include loss?**
4. **Special cases – Partly-paid shares and payment of share allotment money**
5. **Relevance of 'by such person'**

Exclusions from GAAR – 'By such person' [Rule 10U(1)(d)]

Illustrative examples

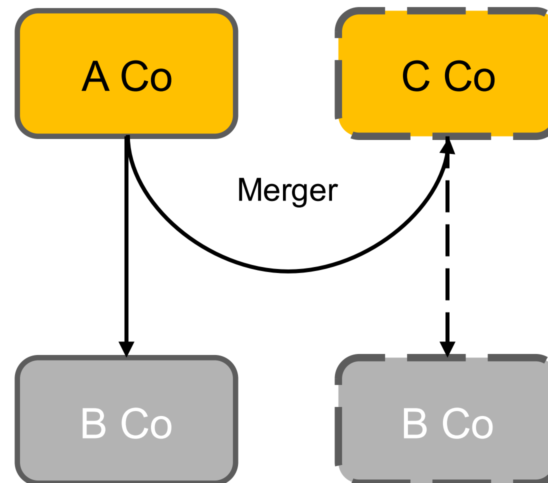
1. On transfer of shares received by way of gift/ inheritance
2. On settlement of shares into a Trust/ distribution of shares by a Trust

3\. Conversion into LLP



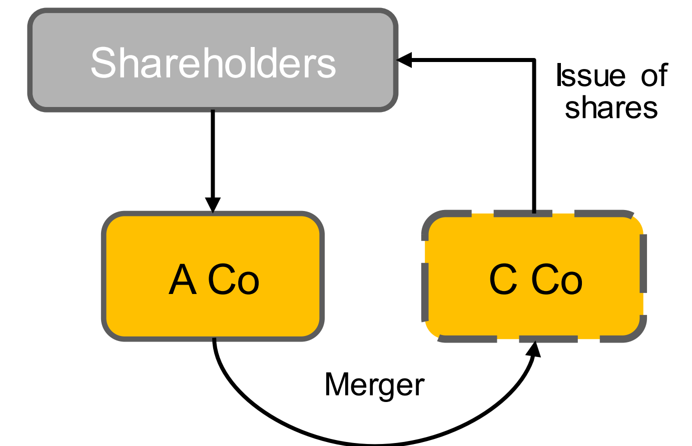
Q. Will A LLP get the grandfathering benefit if conversion takes place after 1 April 2017?

4\. Change of shareholding on account of merger



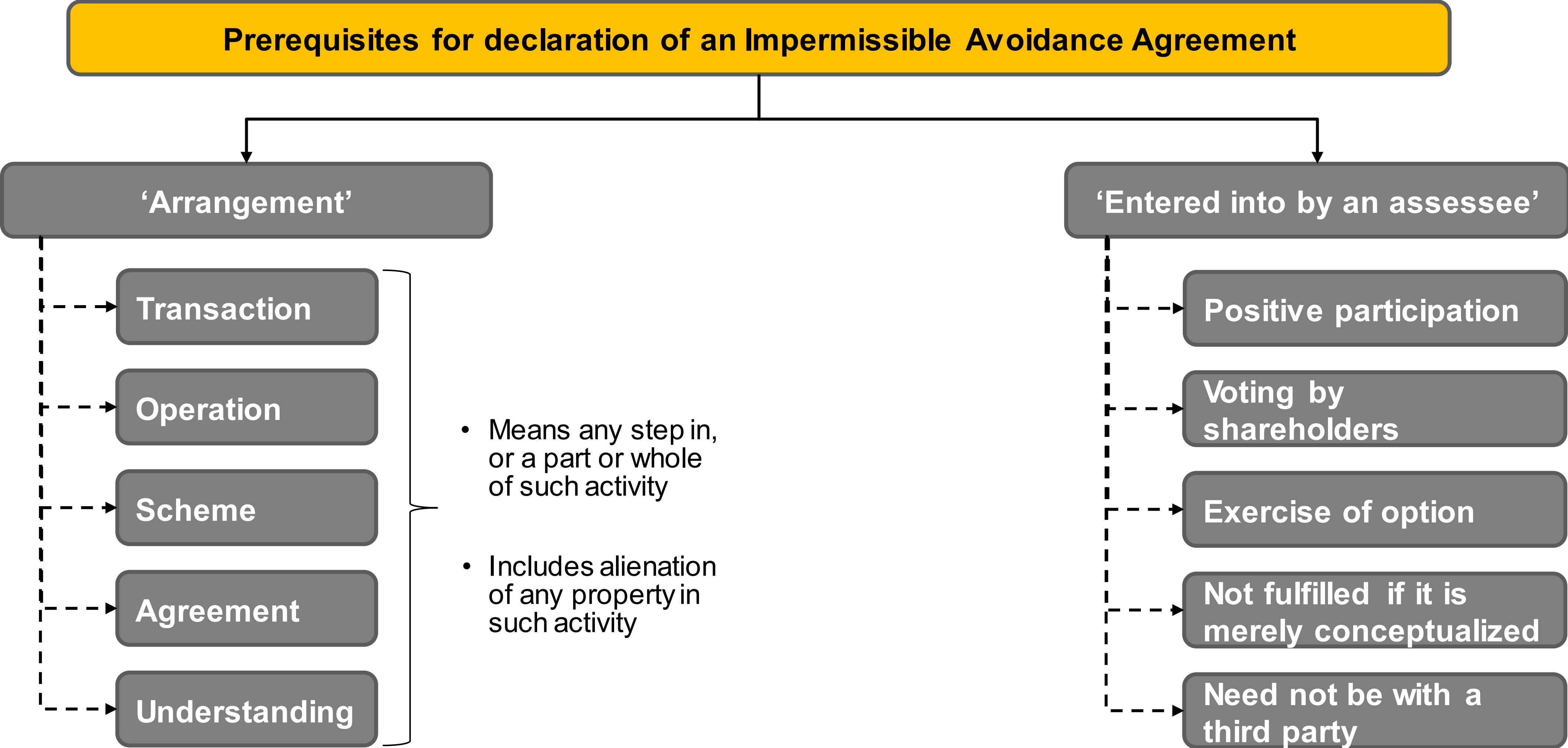
Q. Will C Co get the grandfathering benefit if appointed date of merger is after 1 April 2017?

5\. Shares received pursuant to merger



Q. Will shareholders get the grandfathering benefit if appointed date of merger is after 1 April 2017?

Applicability of GAAR – Prerequisites for an IAA



IAA – ‘Main purpose’ being tax benefit

- The term ‘main purpose’ has not been defined in the Act
- References can be drawn from dictionaries/ lexicons as well international GAAR jurisprudence
  - Stroud’s Judicial Dictionary of Words and Phrases, 7th Edition, 2008, defines ‘main purpose’ of a company ***as the one which is its leading distinctive idea***
  - The Oxford Dictionary defines ‘purpose’ as:

    “The reason for which something is done or created or for which something exists”
  - The Law Lexicon by Ramanatha Aiyar [5th edition reprint 2017] defines ‘purpose’ as follows:

    Purpose – “the object which one has in view; that which a person sets before himself as an object to be reached or accomplished; the end or aim to which the view is directed in any plan, manner or execution; intention.”

IAA – ‘Main purpose’ being tax benefit

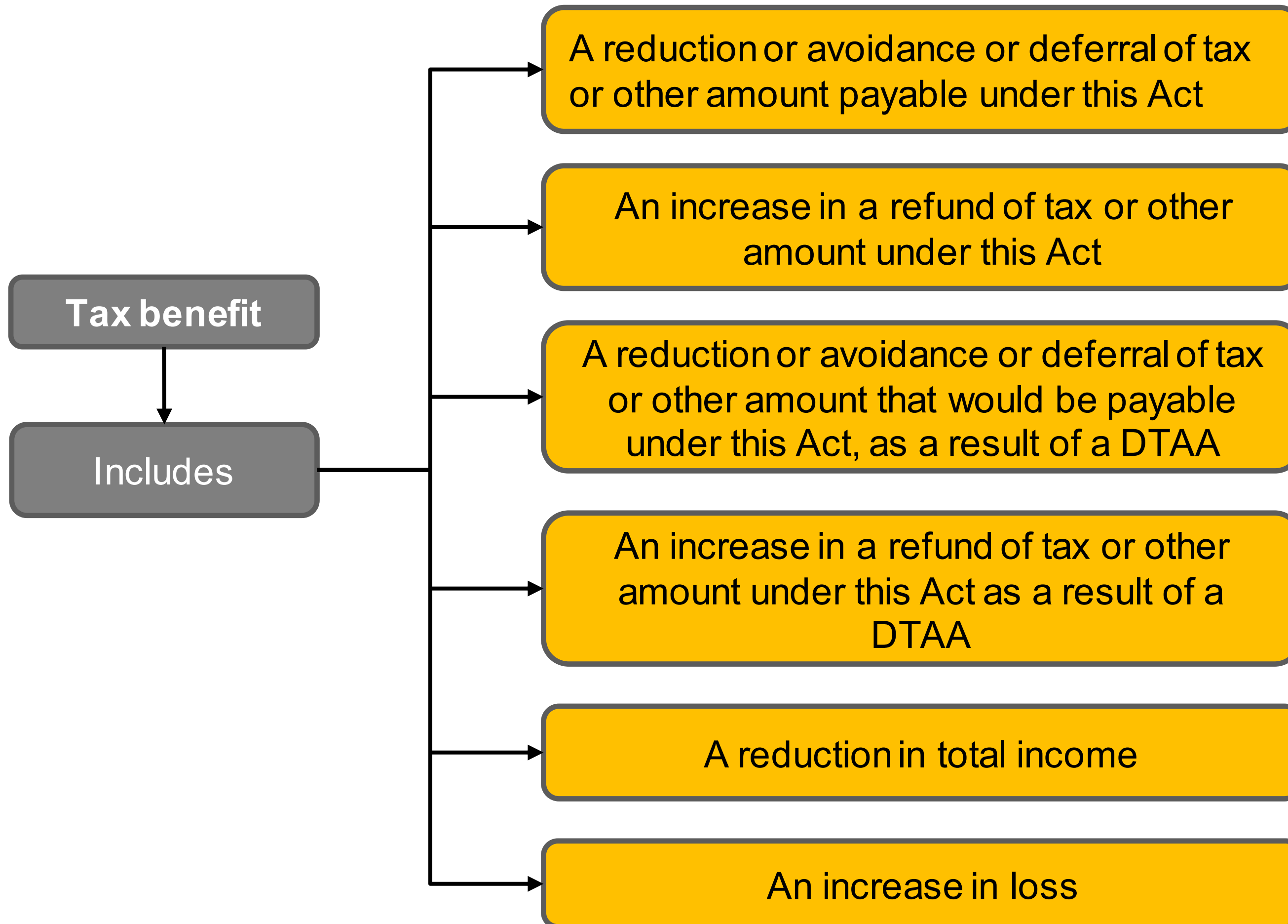
– In South Africa, while discussing the term ‘main purpose’, it was held in the case of *CIR v Bobat and Others, 2003 (N) 67 SATC 47* that:

“a main purpose is obviously one which must be dominant over any other, because in ordinary language ‘mainly’ means for the most part, principally or chiefly”

– In Australia, while discussing the term ‘dominant purpose’ [the term used in Australian GAAR] , in the case of *FCT v Spotless Services Limited (1996) 141 ALR 92*, it was held that

“In its ordinary meaning, ‘dominant’ indicates that purpose which was the ruling, prevailing, or most influential purpose”

IAA – Main purpose being 'tax benefit'



What is covered?

- Dividend Distribution Tax (DDT)
- Buyback tax
- Minimum Alternate Tax
- Penalties/ interest

What is not covered?

- Tax benefits in a foreign country
- Indirect taxes
- Equalisation levy
- Stamp duty
- Securities Transaction Tax
- Accounting benefits
- Procedural simplification

Q. Would minimization of any risk (such as Place of Effective Management) qualify as 'tax benefit'?

IAA – Main purpose being ‘tax benefit’

Other key points:

- Ability to quantify ‘tax benefit’ – principle laid down in the Supreme Court ruling of B.C. Srinavasa Shetty
- Quantifying tax benefit in case of deferred consideration
- Is a counter-factual required?
- Nexus with the arrangement
- Does tax benefit in year of set-off of loss?
- Would GAAR apply if arrangement was entered in the past (prior to 1 April 2017)?

IAA – Tainted Element Test

Rights or Obligations Test

- This test deals with the creation of any rights or obligations, which would not be ordinarily created between persons dealing at arm's length
  - GAAR provisions do not explain circumstances that would help conclude whether a taxpayer is fulfilling this test. Terms such as 'rights' or 'obligations' are not defined
- Further, it is unclear whether an arm's length dealing between the various parties to an arrangement (whether associated/related or otherwise) would be sufficient to argue that the right and obligations between the parties are ordinary. Thus, this test presently appears to confer wide discretionary powers to the IRA
- The discussion in the Expert Committee Report highlights that so long as the parties to an arrangement deal amongst themselves on an arm's length basis, this test should not be satisfied

Misuse or Abuse Test

- The second test refers to an arrangement which results in 'misuse' or 'abuse' of the provisions of the tax law. The aforesaid terms are not specifically defined and therefore would be the subject matter of interpretation
  - The Law Lexicon by Ramanatha Aiyar [5th edition reprint 2017] defines the terms 'abuse' and 'misuse' as follows:
    Abuse: *"That which is contrary to good order or established usage"*
    Misuse: *"To use wrongfully"*
- As per the Expert Committee Report, it implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law

IAA – Tainted Element Test

Commercial Substance Test

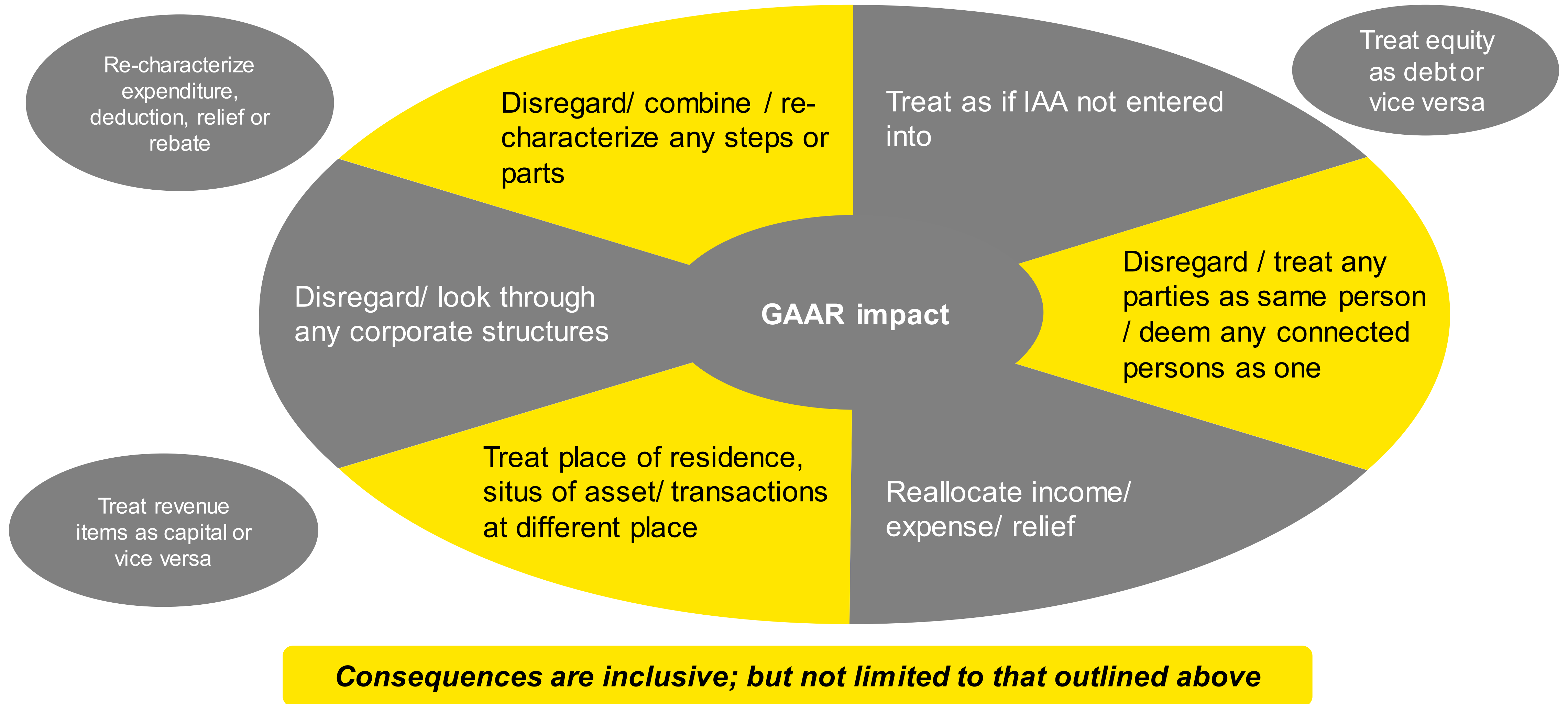
- This test deals with whether an arrangement is lacking commercial substance
- The Act has deemed an arrangement to lack commercial substance if:
  - the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or
  - it includes or involves—
    - round trip financing;
    - an accommodating party;
    - any elements having the effect of offsetting or cancelling each other; or
    - a transaction which is conducted through one or more persons and disguises the nature, location, source, ownership, or control, of the funds which is the subject matter of such transaction; or
  - it involves the location of an asset / transaction / place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit for a party; or
  - 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

IAA – Tainted Element Test

Bona Fide Purpose Test

- This test requires that the arrangement which is carried out in, or by means of, a manner which is normally not employed for a bona fide purpose
  - The term 'bona fide' has not been defined under the Indian GAAR provisions; as per Black's Law dictionary 'bona fide' means:
    "Made in good faith; without fraud or deceit"
- In other words, it means an arrangement that possesses abnormal features
- This is not a purpose test but a manner test
- It should imply, therefore, that so long as various steps and transactions in an arrangement have an appropriate commercial purpose and are not artificially introduced, this test should not be satisfied
- If a transaction entered in the ordinary manner or means in the business, then such transaction should not be considered as a transaction with a non-bona fide purpose

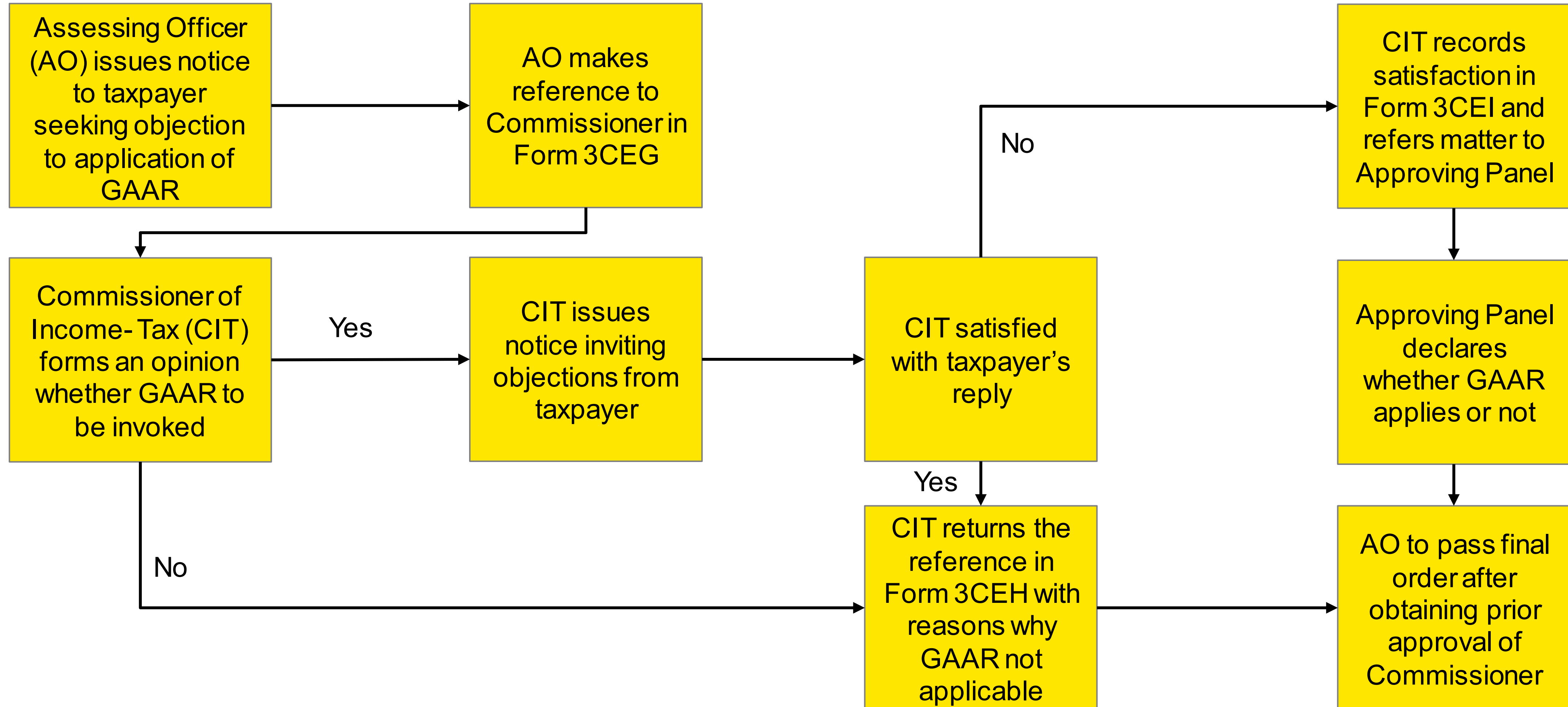
Consequences



Consequences are inclusive; but not limited to that outlined above

Procedure for invocation of GAAR

Section 144BA and Rule 10UB



Time limits in GAAR procedure

<table>
<tr><th>Action</th><th>Time limit for action</th></tr>
<tr><td>Issue of notice by Tax Authority to taxpayer seeking objection, if any, on application of GAAR</td><td>Not specified</td></tr>
<tr><td>Reference by Tax Authority to the Commissioner</td><td>Not specified</td></tr>
<tr><td>Commissioner is satisfied that GAAR is not to be invoked based on reference by Tax Authority</td><td>One month from the end of the month in which the reference from Tax Authority is received</td></tr>
<tr><td>Commissioner is of the opinion that GAAR applies and notice to be issued to the taxpayer to submit objections, if any</td><td>As specified in the notice, not to exceed 60 days</td></tr>
<tr><td>Where taxpayer does not raise any objections, Commissioner to issue such directions as he deems fit for Tax Authority to apply GAAR</td><td>One month from end of the month in which time permitted for taxpayer to raise objections before the Commissioner</td></tr>
<tr><td>Commissioner is satisfied that GAAR provisions are not to be invoked based on response by taxpayer</td><td rowspan="2">Two months from end of month in which final submission of taxpayer is received by the Commissioner</td></tr>
<tr><td>Commissioner records satisfaction that GAAR applies and makes a reference to Approving Panel</td></tr>
<tr><td>Approving Panel gives directions as appropriate</td><td>Six months from the end of the month in which reference from Commissioner is received excluding any court stay, time taken to obtain information from competent authority outside India</td></tr>
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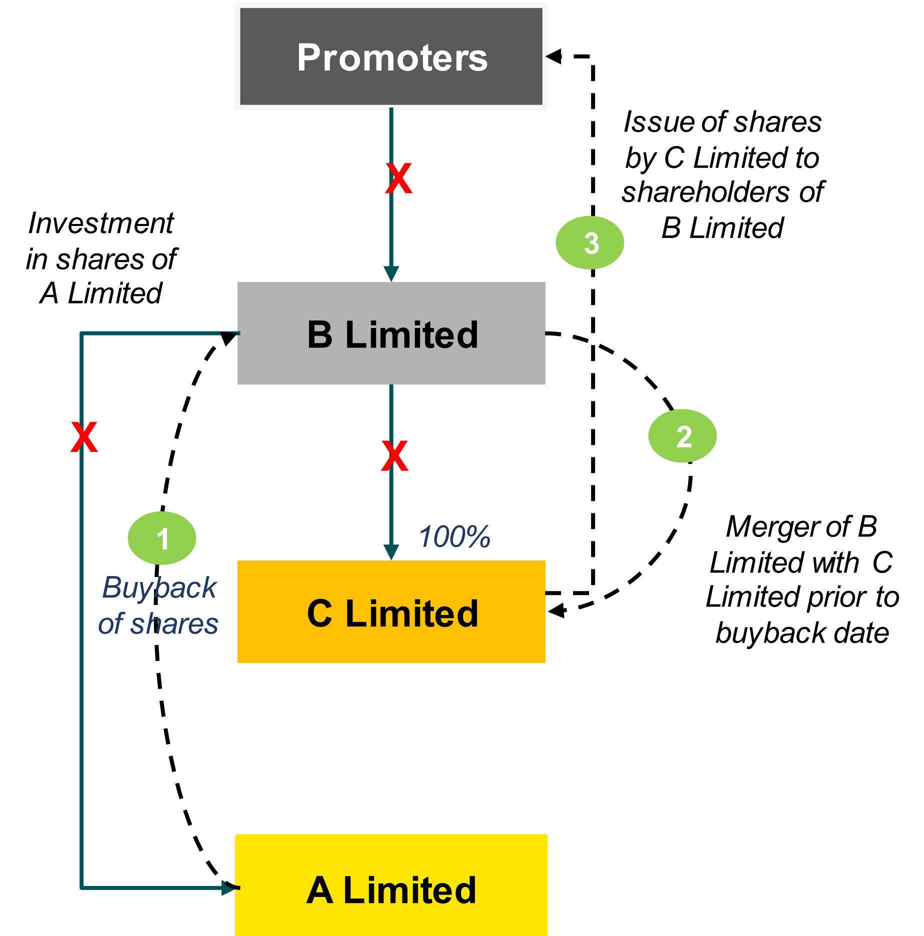
Approving Panel (AP)

Section 144BA

- Composition of Approving Panel
  - Chairperson who is or has been a judge of High Court
  - One member from IRS not below rank of Chief Commissioner of Income-Tax/ Principal Chief Commissioner One member shall be an academic or scholar having special knowledge of matters, such as direct taxes, business accounts and international trade practices
- Opinion of majority to prevail
- Term of AP shall ordinarily be for one year and may be extended from time to time up to a period of three years
- AP can issue such directions as it deems fit in respect of declaration of an arrangement as an IAA specifying previous years for which such directions apply
  - Directions issued after giving taxpayer an opportunity of being heard
  - Power to institute further enquiry, call for records
  - AP has powers of a civil court similar to powers vested in AAR
- Directions of AP binding on taxpayer, tax authority – no appeal permitted
  - Appeal permitted before Income-tax Appellate Tribunal against assessment order giving effect to directions of AP

Case study 1 - Facts

- A Limited, a listed company, is desirous of distributing accumulated surplus to its shareholders
  - The company decides to undertake buyback of shares instead of distributing the surplus as dividend
- B Limited is one of the shareholders of A Limited and C Limited is a wholly owned subsidiary of B Limited
  - C Limited is engaged in the manufacturing of machines under the brand name 'John' owned by B Limited
- A foreign investor agrees to partner with B Limited for technical collaboration
  - Such collaboration is subject to the condition that the brand and the actual manufacturing operations shall be housed under a single entity
- Accordingly, B Limited is merged with C Limited
  - Appointed date of merger is prior to the date of buyback
- Pursuant to merger, C Limited issues shares worth the fair value of B Limited (including fair value of brand 'John' and shares of A Limited) to shareholders of B Limited



Case study 1 – Dividend vs Buyback

Possible contentions by tax department

- Main purpose
  - Buyback chosen as preferred alternative over dividend distribution since it results in saving of DDT for A Limited
  - Saving in DDT to qualify as 'tax benefit' since definition of 'tax benefit' under section 102 of the Act, *inter-alia*, includes reduction or avoidance of tax or any other amount payable under the Act
  - Long term capital gains arising to shareholders on transfer of shares pursuant to buyback would also be exempt under section 10(38) of the Act
- Tainted element test - ?

Possible contentions by taxpayer

- Buyback of shares *vis-à-vis* dividend distribution constitutes business choice of a company
  - Buyback of shares undertaken to reduce the capital base and improve EPS of the company
- Dividend distribution and buyback are options offered by law and selection of one of such options offered by law cannot form basis for the purpose of invoking GAAR
- The Expert Committee recommended that GAAR may not be applied to such decisions involving selection of one of multiple options offered in law – this recommendation not directly incorporated in the Act
- CBDT Circular no 7 of 2017 dated 27.1.2017 clarifies that GAAR will not interplay with the right of taxpayer to select or choose method of implementing transaction

Case study 1 – Merger of B Ltd with C Ltd

Possible contentions by tax department

- Main purpose
  - Shares of A Ltd would be recorded at fair value in books of C Ltd pursuant to merger
  - Such cost step-up in books in respect of shares of A Limited would reduce MAT liability for C Ltd on buyback of shares since the appointed date of merger is prior to the date of buyback
  - Saving in MAT to qualify as 'tax benefit' under section 102 of the Act since MAT is amount payable under the Act
  - Merger would also result in recognition of brand 'John' in books of C Ltd and consequent tax break on account of depreciation on brand under normal tax provisions and amortisation in the books under MAT provisions
- Tainted element test
  - Arrangement lacks commercial substance

Possible contentions by taxpayer

- Merger undertaken primarily for bringing the brand and manufacturing operations under a single entity
  - Sale of brand vis-à-vis merger constitutes business choice of the company
- The option to record assets and liabilities of transferor company at carrying amount or fair value is provided under purchase method of accounting under Accounting Standard-14
  - Tax savings in MAT on account of cost step-up of shares of A Limited and tax break on account of depreciation on brand are incidental benefits
- Claim of depreciation mandatory under Explanation 5 to section 32(1)(ii) of the Act
- Allowance for depreciation on intangible assets like brand acquired pursuant to amalgamation also upheld by various judicial precedents

Case study 1 – Merger of B Ltd with C Ltd

Possible contentions by tax department

- Arrangement carried out by means or in a manner not ordinarily employed for bona fide purposes
  - Instead of opting for merger, B Ltd could have sold the brand to C Ltd for appropriate consideration in order to fulfil conditions stipulated by foreign investor

Possible contentions by taxpayer

- Even where GAAR is invoked, can determination of tax consequences under section 98 of the Act involve recomputation of book profits for MAT?
  - Both section 95 and section 115JB of the Act start with non-obstante clause – whether GAAR overrides section 115JB of the Act?
    - Section 115JB(5) of the Act provides that save as otherwise provided in this section, all other provisions of the Act shall apply to the company
  - No specific stipulation under section 98 of the Act for recomputation of book profit on account of GAAR
  - No specific stipulation under section 115JB of the Act for adjustment to book profit on account of GAAR
  - Supreme Court in case of *Apollo Tyres Ltd vs CIT (2002) 255 ITR 273* has held that the assessing officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account

Case study 1 – Merger of B Ltd with C Ltd

Possible contentions by tax department

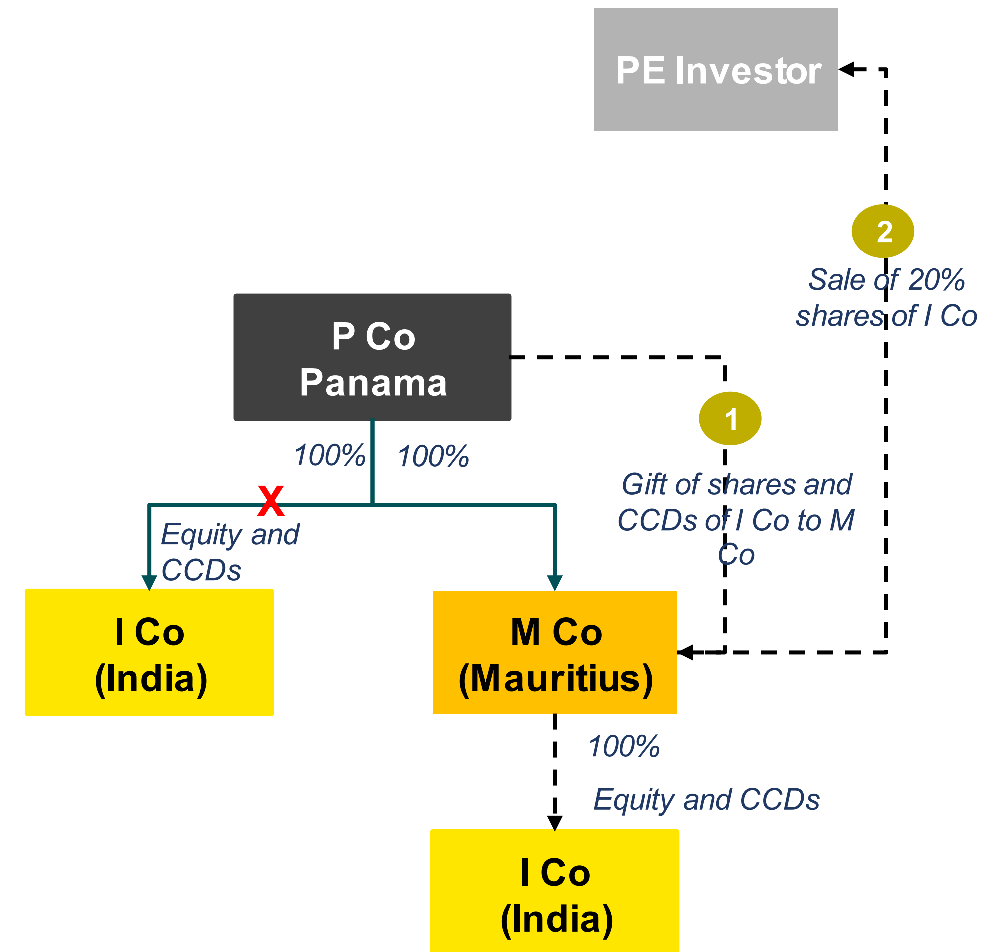
Possible contentions by taxpayer

except to the extent provided in the Explanation to Section 115JB of the Act

- GAAR only overrides other provisions of the Act – It does not override Accounting Standards

Case study 2 - Facts

- I Co is an Indian company engaged in the business of power generation
- I Co is eligible for tax holiday under section 80-IA of the Act
- Capital structure of I Co comprises of 70% debt (in form of CCDs) and 30% equity
- I Co is held wholly by P Co, a company incorporated in Panama
- Considering the recent news relating to Panama papers, it is desired to migrate holding of I Co from Panama to Mauritius
- For this purpose, P Co gifts shares and CCDs of I Co to M Co, a company incorporated in Mauritius on 1 October 2016
- I Co pays an annual interest of Rs 15 crores to M Co on the amount of CCDs
- Under the thin capitalisation provisions under section 94B of the Act, the Assessing Officer has already disallowed interest of Rs 10 crores
- However, since I Co claims a deduction under section 80-IA of the Act, the additional income on account of disallowance is also considered as exempt
- On 31st March 2018, it is further decided to divest 20% shares in I Co to a Private Equity investor in India



Case study 2 – Gift of shares and CCDs to M Co

Tax implications

- Gift of shares and CCDs of I Co by P Co to M Co not liable for capital gains tax in India as per section 47(iii) of the Act
- Receipt of shares and CCDs of I Co by M Co without consideration taxable in its hands under section 56(2)(viia) [now section 56(2)(x) of the Act] of the Act
- In view of gift of shares and CCDs of I Co before 31 March 2017, such other income taxable only in Mauritius as per Article 22 of the then applicable India-Mauritius DTAA

Possible contentions by tax department

- Main purpose
  - Main purpose of gift of shares and CCDs to obtain the above mentioned tax benefit
  - Instead of selling shares and CCDs of I Co by P Co to M Co, gift of shares and CCDs of I Co results in tax benefit to P Co in form of saving in capital tax liability in India
- Tainted element test
  - The arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length

Possible contentions by taxpayer

- Main purpose not to obtain tax benefit but to migrate the holding from Panama to Mauritius
- Option to implement the transaction either by way of gift or by way of sale
- CBDT Circular no 7 of 2017 dated 27.1.2017 clarifies that GAAR will not interplay with the right of taxpayer to select or choose method of implementing transaction

Case study 2 – Divestment of shares of I Co by M Co

Tax implications

- Gift of shares of I Co by P Co to M Co on 1 October 2016
- Shares of I Co acquired by M Co before 1 April 2017 – Transfer of shares of I Co by M Co to PE investor taxable only in Mauritius as per India-Mauritius DTAA
  - Acquisition of shares of Indian company by a Mauritius resident before 1 April 2017 grandfathered – amended Article 13 of India-Mauritius DTAA not to apply to capital gains arising on alienation of such shares

Possible contentions by tax department

- Main purpose
  - Tax department may contend that shares of I Co transferred to a company in Mauritius with the main purpose of obtaining benefit of India-Mauritius DTAA on future divestment
- Tainted element test
  - The arrangement results in misuse or abuse of provisions of the DTAA

Possible contentions by taxpayer

- Rule 10U(1)(d) of Income-tax Rules – Grandfathering of investments made before 1 April 2017
- Chapter X-A of the Act not to apply to any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before 1 April 2017 by such person
- The term 'investment' not defined under the Act or Rules

Case study 2 – Divestment of shares of I Co by M Co

Possible contentions by tax department (continued)

- It lacks commercial substance – it involves place of residence of a party (M Co) which is without any substantial commercial purpose other than obtaining a tax benefit

- GAAR provisions can override provisions of DTAA – section 90(2A) of the Act expressly provides for treaty override

Possible contentions by taxpayer (continued)

- Grandfathering under India-Mauritius DTAA available to acquisition before 1 April 2017 whereas grandfathering under Rule 10U(1)(d) available to investment made before 1 April 2017
- Whether gift of shares covered within the purview of the term 'investment'?

Case study 2 – Redomiciliation from Panama to Mauritius

Tax implications

- Where P Co is a tax resident of Panama –
  - Tax withholding on payment of interest by I Co to P Co: 20% (if money is borrowed in foreign currency) / 40% (other cases)
  - Capital gains on divestment of shares of I Co taxable in India
- Where P Co is a tax resident of Mauritius –
  - Tax withholding on payment of interest by I Co to P Co: 7.5%
  - Capital gains on divestment of shares of I Co by P Co taxable only in Mauritius (since shares of I Co are not acquired by P co after 1 April 2017)
- Mauritius is a beneficial jurisdiction from the perspective of taxability of interest and capital gains

Possible contentions of tax department

- Main purpose
  - Redomiciliation to Mauritius undertaken with the main purpose of obtaining tax benefit discussed in earlier slide
- Tainted element test
  - The arrangement results in misuse or abuse of provisions of DTAA

Possible contentions of taxpayer

- Contentions for benefit on account of savings in capital gains tax
  - Benefit of India-Mauritius DTAA should not be denied in respect of capital gains arising on sale of 20% stake in I Co to PE investor
  - Shares of I Co (being transferred) were acquired by P Co before 1 April 2017

Case study 2 – Redomiciliation from Panama to Mauritius

Possible contentions of tax department (continued)

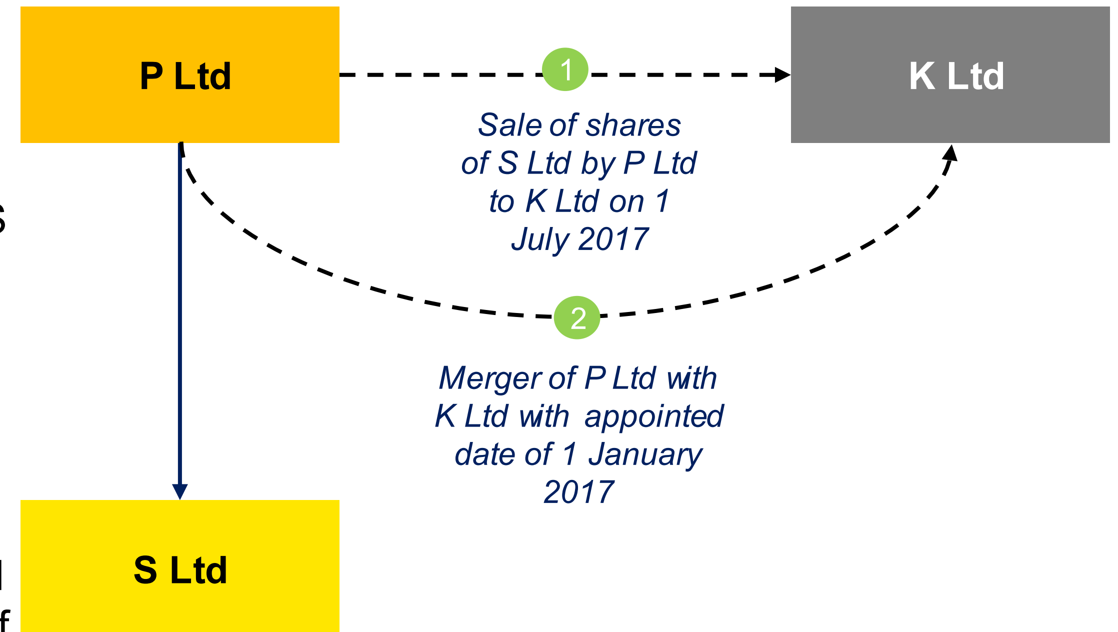
- It lacks commercial substance – it involves place of residence of a party (M Co) which is without any substantial
- GAAR provisions can override provisions of DTAA – section 90(2A) of the Act expressly provides for treaty override

Possible contentions of taxpayer (continued)

- As per Rule 10U(1)(d), income from transfer of investments made before 1 April 2017 grandfathered from GAAR provisions
- Contentions for benefit on account of lower tax withholding rate
  - Pertinent to ensure adequate substance in M Co and have strong commercial rationale for selection of Mauritius as a jurisdiction

Case study 3 - Facts

- P Ltd is a global technology company and holds shares in S Ltd
- S Ltd houses defence technology IP of the Group
- K Ltd, an Indian conglomerate, proposes to takeover the business of P Ltd
- For this purpose, it is proposed to merge P Ltd into K Ltd
- However, K Ltd was particularly interested in acquisition of S Ltd on an immediate basis for expanding its defence technology business
- It was envisaged that merger would take longer time to be implemented. Accordingly, it was decided to sell shares of S Ltd to K Ltd
- On 1 July, 2017, P Ltd sells shares of S Ltd to K Ltd
- Such sale of shares results in capital gains in hands of P Ltd
- Subsequently, P Ltd is merged with K Ltd under a scheme of arrangement sanctioned by NCLT
- The appointed date of scheme of merger is 1 January, 2017



Case study 3 – Merger with retrospective appointed date

Tax implications

- Transfer of shares of S Ltd by P Ltd to K Ltd to result in capital gains tax liability in hands of P Ltd
- Merger of P Ltd with K Ltd with retrospective appointed date to result in mitigation of capital gains tax exposure in hands of P Ltd
- Appointed date of merger – 1 January 2017 (prior to date of sale of shares of S Ltd)
- Merger to take effect from appointed date - *Marshall Sons & Co. (India) Ltd vs ITO (1997) 223 ITR 809*
- Merger with retrospective appointed date to have effect as if K Ltd had sold shares of S Ltd to itself

Possible contentions of tax department

- Main purpose
  - Merger with a retrospective appointed date implemented with main purpose to avoid capital gains tax liability in hands of P Ltd
- Tainted element test
  - The arrangement involves sale of shares followed by merger – The arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes

Possible contentions of taxpayer

- The main purpose of merger is to takeover the business of P Ltd (including investment in K Ltd) and not to avoid capital gains tax liability of P Ltd
- Sale of shares of S Ltd undertaken prior to merger considering the commercial expediency
- Considering the commercial urgency in acquiring the business of S Ltd on a priority basis and the time involved in scheme of merger, sale of shares was undertaken prior to merger

Case study 3 – Merger with retrospective appointed date

Possible contentions by taxpayer (continued)

- Had direct merger been undertaken (without selling shares of S Ltd prior to merger), there would not have been capital gains tax exposure for P Ltd
- Even if the main purpose of merger is held to be obtaining of tax benefit, since investment in shares of S Ltd was held by P Ltd before 1 April 2017, grandfathering under Rule 10U(1)(d) should apply
- Subject matter of GAAR in the instant case is savings in capital gains tax by P Ltd on sale of shares of S Ltd
- Provisions of Chapter X-A of the Act should not apply to income arising to P Ltd on transfer of investment made in shares of S Ltd (before 1 April 2017) as per Rule 10U(1)(d)

Potential GAAR exposure on subsequent sale of S Ltd by K Ltd

- Assuming that –
  - K Ltd enters into an arrangement in future which involves sale of shares of S Ltd
  - The main purpose of entering into such arrangement is to obtain tax benefit and such arrangement is held to be impermissible avoidance arrangement
- In such case, can K Ltd contend that since shares of S Ltd were acquired by it before 1 April 2017 (by virtue of merger with retrospective appointed date), grandfathering under Rule 10U(1)(d) should apply?

Case study 3 – Potential GAAR exposure on subsequent sale of S Ltd by K Ltd

- Assuming that –
  - K Ltd enters into an arrangement in future which involves sale of shares of S Ltd
  - The main purpose of entering into such arrangement is to obtain tax benefit and such arrangement is held to be impermissible avoidance arrangement
- In such case, can K Ltd contend that since shares of S Ltd were acquired by it before 1 April 2017 (by virtue of merger with retrospective appointed date), grandfathering under Rule 10U(1)(d) should apply?

Case study 3 – Scheme sanctioned by NCLT – Invocation of GAAR?

- Does tax department have power to disregard scheme of arrangement approved by NCLT?
- Recommendation of Expert Committee – amalgamations and demergers (as defined under the Act) should be included in negative list for invoking GAAR
- CBDT Circular no. 7 of 2017 dated 27 January 2017 – Question 8

Question: Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial presents, etc.?

Answer: Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement

Case study 4 - Facts

- Mr A is a person of Indian origin
- After completing his post-graduation from India, Mr A changed his name to Mr X and decided to settle in USA
- Mr X has been residing in USA for last 15 years. However, he now intends to relocate to India
- Prior to relocating to India, Mr X forms an overseas trust in a tax efficient jurisdiction and settles all his overseas wealth in the offshore trust
- The trust holds such investments through an offshore holding company
- The beneficiaries of the trust are family members of Mr X and the trustee is an overseas professional corporate trustee
- Mr X relocates to India in financial year 2017-18 and again changes his name to Mr A
- In subsequent years (when Mr A is a tax resident of India), the offshore holding company divests from overseas operating companies and earns substantial capital gains
- However, the sale proceeds are not repatriated to India

Case study 4 - Analysis

- Sale of overseas investments by offshore holding company not liable for capital gains tax in India
- Had Mr X not transferred overseas investments to the trust, income in form of capital gains would have accrued in hands of Mr X
- This would have resulted in capital gains tax liability for Mr X in India
- Transfer of overseas investments to offshore trust by Mr X may be regarded as an arrangement entered into with the main purpose of obtaining tax benefit in form of savings in tax liability that would arise on alienation of overseas assets by Mr X when he becomes tax resident of India
- As per section 95(1) of the Act, an arrangement *entered into* *by an assessee* may be declared to be an impermissible avoidance arrangement
- Arrangement to be entered into by an assessee
- Arrangement (involving transfer of overseas investments to offshore trust) entered into by Mr X when he was non-resident in India – Mr X was not an 'assessee' under the Act at the time of transfer of his overseas wealth to offshore trust
- *Point of time at which test of assessee should be satisfied – whether at the time of entering into the arrangement or at the time of obtaining tax benefit from such arrangement?*

Thank you