



CBDT clarifications on implementation of General Anti-Avoidance Rules under the Income-tax Act

The provisions relating to the General Anti Avoidance Rules (GAAR) contained in Chapter X-A of the Income-tax Act, 1961 (the Act) come into effect from the Financial Year (FY) 2017-18¹. The procedures for application of GAAR and conditions, under which it shall not apply, have been provided in Rules 10U to 10UC of the Income-tax Rules, 1962 (the Rules).

Based on representations received from industry associations and other stakeholders, the Central Board of Direct Taxes (CBDT) constituted a Working Group to examine the issues raised.

Recently, CBDT has issued a Circular² in the form of answers to specific questions on the implementation of the provisions of GAAR. The Circular has been summarised as follows:

Qn. No.	Question	Response/Answer
1.	Will GAAR be invoked if Specific Anti-Avoidance Rule (SAAR) applies	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 legislation. The provisions of GAAR and SAAR can co-exist and are applicable, as may be necessary, in the facts and circumstances of the case.
2.	Will GAAR be applied to deny treaty eligibility in a case where there is compliance with Limitation of Benefit (LOB) test of the treaty	Adoption of anti-abuse rules in the 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 tax treaty, there shall not be an occasion to invoke GAAR.
3.	Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction	GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.
4.	Applicability of the provisions of GAAR where the jurisdiction of the FPI is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing	GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalised based on non-tax commercial considerations and the main purpose of

¹ Assessment Year (AY) 2018-19

² Circular No. 7 of 2017 dated 27 January 2017

	<p>Indian securities</p> <p>Will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.</p>	<p>the arrangement is not to obtain tax benefit, GAAR will not apply.</p> <p>For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under Section 96 of the Act.</p>
5.	<p>Applicability of GAAR provisions to:</p> <p>i. any securities issued by way of bonus issuances so long as the original securities are acquired prior to 1 April, 2017; shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017;</p> <p>ii. shares which are issued consequent to split up or consolidation of such grandfathered shareholding</p>	<p>Grandfathering under Rule 10U(1)(d) of the Rules will be available to investments made before 1 April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalised at the time of issue of such instruments.</p> <p>Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1 April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 10U(1)(d) of the Rules.</p>
6.	<p>Whether grandfathering would extend to all forms of investments including lease contracts (say, air craft leases) and loan arrangements, etc.</p>	<p>Grandfathering is available in respect of income from transfer of investments made before 1 April 2017. As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.</p>
7.	<p>Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling (AAR)</p>	<p>If arrangement is held permissible by AAR, GAAR will not apply. The AAR ruling is binding on the Principal Commissioner of Income-tax (PCIT)/ Commissioner of Income-tax (CIT) and the Income-tax authorities subordinate to them in respect of the applicant.</p>
8.	<p>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 precedents etc.</p>	<p>Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.</p>
9.	<p>Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions?</p>	<p>In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.</p>
10.	<p>How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference</p>	<p>The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner/ Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.</p>
11.	<p>Can GAAR lead to assessment of notional income or disallowance of real expenditure</p>	<p>If the arrangement is covered under Section 96 of the Act, then the arrangement will be disregarded by application of GAAR and necessary consequences will</p>

		follow.
12.	Whether a definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions regard to section 97(4) ³ of the Act.	Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under Section 97(4) of the Act to determine whether an arrangement lacks commercial substance.
13.	It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.	In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.
14.	Tax benefit of INR 3 crores defined in Section 102(10) of the Act may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. The tax impact of INR3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).	The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the 'Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. GAAR is with respect to an arrangement or part of the arrangement and therefore limit of INR3 crores cannot be read in respect of a single taxpayer only.
15.	Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year.	If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.
16.	No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.	Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under Act. The taxpayer, may at his option, apply for benefit under Section 273A of the Act if he satisfies conditions prescribed therein.

Our comments

The clarifications with respect to GAAR provisions were eagerly awaited. The CBDT circular providing questions and answers on some of the relevant aspects provide much needed clarity. However, there are still certain aspects which are not dealt by the Circular.

The clarifications attempt to address the interplay between the LOB article and the domestic anti-avoidance provisions by stating that if the case is sufficiently addressed by the LOB article in the tax treaty, there shall not be an occasion to invoke GAAR. In some of the recent tax treaties, India has incorporated LOB article as well as Principal Purpose Test (PPT)⁴. The Circular does not deal with PPT conditions. Pursuant to the implementation of the OECD Base Erosion Profit Shifting (BEPS) Action Plan, India may enter into Multilateral Instruments (MLI) with some of the countries. Based on the provisions agreed in the MLI, the government may need to issue another clarification vis-à-vis applicability of GAAR.

The Circular clarifies that where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement. The Circular also clarifies the binding nature of the AAR on the PCIT/CIT and the resultant non-applicability of GAAR. However, some of the clarifications provided in the Circular are subjective in nature and it may lead to further litigation.

³ The period of time for which an arrangement (including operations therein) exists may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance.

⁴ Also recommended by the BEPS Action Plan 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

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