

Budget 2017: GAAR Is Not Too Far... Anymore

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Every time GAAR has been due for implementation in India, the clamour to delay the tax change has risen too. But the Narendra Modi government remains steadfast in its decision to implement General Anti Avoidance Rule (GAAR).

So in its second pre-budget move, the first being the issue of POEM or [place of effective management guidelines](#), the Central Board of Direct Taxes (CBDT) issued some GAAR-related clarifications on Friday.

The most important one – that GAAR implementation is on track and will become effective starting April 1, 2017.

“ The GAAR provisions shall be effective from assessment year 2018-19 onwards, i.e. financial year 2017-18 onwards.

CBDT Circular (January 27, 2017)

'Main Purpose' Test

Besides reiterating the implementation deadline, Friday's clarifications also offer relief to Foreign Portfolio Investors (FPIs). The CBDT has clarified that GAAR will not apply simply because the FPI is located in or investing via a tax-efficient jurisdiction. The litmus test will be that there are non-tax commercial considerations that justify the choice of jurisdiction and the main purpose of the arrangement is not to obtain tax benefit.

Pratibha Jain, a tax partner at law firm Nishith Desai Associates, said this test will apply to all types of foreign investors, not just FPIs.

“ FPIs, as a category, has been extremely vociferous in expressing its concerns; perhaps this is why the Circular mentions FPIs. The discontent of FPIs with a policy is also very visible in terms of the stock market impact vis-à-vis private equity or venture capital. It is safe to assume that this test will apply to foreign investors across the board.

Pratibha Jain, Partner, Nishith Desai Associates

Grandfathering Provisions

In 2012, the Standing Committee on Finance, headed by Parthasarathi Shome, had recommended that all investments made by a resident or non-resident and existing as on the date of commencement of the GAAR provisions should be grandfathered so that on exit (sale of such investments) or after this date, GAAR provisions are not invoked for examination or denial of tax benefit.

Much to the relief of the investor community, the recent clarification by the tax department adopts this position, at least for certain types of investments.

“ Grandfathering as per IT Rules will be available to compulsorily convertible instruments, bonus issuances or split/consolidation of holdings in respect of investments made prior to April 1, 2017 in the hands of same investor CBDT.

Circular (January 27, 2017)

Girish Vanvari, national head of tax at KPMG, said, in an emailed comment to BloombergQuint, that the grandfathering should have covered more situations.

“ Clarification is provided for investments made prior to April 1, 2017 and also to bonus on these shares, splits and consolidation thereon and shares acquired on the conversion of compulsory convertible instruments. Strangely, acquisition of shares in mergers and demergers are not grandfathered though the original shares are acquired prior to April, 1, 2017. The definition of investments is expanded to mean more than shares, ie: investments as appearing in the books of accounts earning rent, interest and dividends.

Girish Vanvari, National Head of Tax, KPMG

Safety Net

Another positive development is CBDT's stance on the interplay between GAAR and tax treaties. The department has clarified that:

“ If a case of avoidance is sufficiently addressed by Limitation of Benefits (LoB) provisions in the tax treaty, there shall not be an occasion to invoke GAAR.
CBDT Circular (January 27, 2017)

A Limitation of Benefits or LoB clause is a safeguard against treaty misuse. It determines criteria or thresholds that an entity must meet to avail of a beneficial tax clause in the treaty.

Doshi explained that this CBDT clarification allayed the fear that in spite of companies meeting the LoB requirements, the department may still go ahead and apply GAAR.

But, he warned, there may still be situations where GAAR could prevail over treaties.

“ Certain LoB clauses are applicable only to capital gains benefits and not to royalty and interest provisions of the treaty. The amended India-Mauritius tax treaty provides for a withholding tax rate of only 7.5 percent versus 10 percent in Netherlands, Cyprus, Singapore and other treaties. Therefore, GAAR can be invoked against an investor who is coming via Mauritius primarily to avail of interest provisions under the treaty and lacks substance.

Maulik Doshi, Partner, SKP Business Consulting

'Your Honour' Shall Prevail

CBDT has also clarified that if a court sanctions an arrangement taking into account the tax implications, GAAR will not be applied.

Sudhir Kapadia, national tax leader at EY, told BloombergQuint that since courts ordinarily stay away from commenting on tax implications, this clarification may not be material.

But Goenka said this clarification will typically apply in the case of mergers and demergers, which earlier required approval of the High Court, and now of the National Company Law Tribunal (NCLT).

“ The new process under the NCLT requires a specific no-objection to be obtained from the tax authorities, and to that extent, it appears that the NCLT would be considered to have explicitly and adequately considered the tax implications. However, in respect of schemes approved earlier by the High Courts, barring exceptions, tax matters were not looked into in any detail by the Court, and in fact, in some cases findings were made that the approval of the Court would not prevent the tax authorities examining the tax consequences separately.

Abhishek Goenka, Partner, PwC

Other positive clarifications include GAAR immunity for arrangements permitted by the Authority for Advance Rulings (AAR) and ones permitted by the Principal Commissioner of Income Tax, the Commissioner of Income Tax and the Approving Panel, as long as the facts and circumstances remain the same in subsequent years.

While most experts BloombergQuint spoke to lauded the CBDT circular, they also expressed concern over the lack of comprehensive GAAR guidelines. The government had promised they would be issued well before the rules are implemented and there's little time to spare now.

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