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A GENERAL ANTI-AVOIDANCE RULES (GAAR): CRITICAL ANALYSIS

NORMAS GERAIS ANTI-ELISIVAS GAAR): UMA ANÁLISE CRÍTICA

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ABSTRACT: There has been a development of considerable literature on GAAR as countries have introducing legislation on it and as an issue has arisen of the suitability of individual country GAAR's in the context of the multilateral Base Erosion and Profits Shifting (BEPS) project of the OECD under the auspices of the G20. The views in the literature cannot be said to be unanimous in opinion though there appears to be a steady convergence on the matter with time. This paper reviews selected advanced country experiences in particular those of Australia, the European Union, the United Kingdom and the United States as well as emerging economies Brazil, China and South Africa, with an elaboration for the case of India and, with that overall background, recalls the probable objectives of a GAAR and comments on whether countries have adhered to them. Finally, it opines on the authenticity of international co-operation on revenue collection and the likelihood of future co-operation going forward while, at the same time, keeping in mind the facilitation of tax compliance, taxpayer rights and undue powers to tax authorities in the backdrop of global economic growth and development.

Keywords: General Anti-Avoidance Rules (GAAR), BEPS, countries experiences, tax compliance.

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RESUMO: Tem ocorrido um desenvolvimento de literatura considerável sobre norma geral antielisiva (GAAR, em inglês) à medida que os países introduzem legislação sobre ela e como essa questão surgiu da adequação dos GAARs de países individuais no contexto do projeto multilateral de Erosão Básica e Transferência de Lucros (BEPS) da OCDE sob os auspícios do G20. Não se pode dizer que as opiniões na literatura sejam unânimes na opinião, embora pareça haver uma convergência constante sobre o assunto com o tempo. Este artigo analisa experiências avançadas de países selecionados, em particular os da Austrália, União Européia, Reino Unido e Estados Unidos, bem como economias emergentes como Brasil, China e África do Sul, com uma elaboração para o caso da Índia e, com essa visão geral, recorda os objetivos prováveis de um GAAR e comenta se os países aderiram a eles. Finalmente, opina sobre a autenticidade da cooperação internacional na cobrança de receitas e a probabilidade de futura cooperação avançar, ao mesmo tempo, tendo em mente a facilitação do cumprimento das obrigações fiscais, direitos do contribuinte e poderes indevidos às autoridades fiscais. o pano de fundo do crescimento econômico global e desenvolvimento.

Palavras-chave: Norma Geral Antielisiva (GAAR), BEPS, experiências de países, cumprimento tributário (*tax compliance*).

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1. CROSS-COUNTRY GENERAL ANTI-AVOIDANCE RULES (GAAR)

After introducing SAAR (Specific Anti-Avoidance Rule) measures in their legislations, tax authorities the world over are incorporating GAAR provisions. Some countries have had GAAR as statutory law for quite some time while others have been introducing GAAR only quite recently. And this pertains to both advanced and emerging economies.

An early, broad-spectrum GAAR: Among the early countries was Australia which introduced GAAR in 1981. It has “operated as an effective means to challenge

arrangements that are deemed to be entered into with an impermissible Australian motivation.”¹ Subsequently in 2013, the GAAR corrected ‘technical deficiencies’ as pointed out in federal court rulings during 2010-11. Thereby the government attempted to emphasize the ‘dominant purpose test’ that would be applied to check if a ‘scheme achieves a tax benefit in conjunction with a broader economic benefit for the taxpayer involved,’ and if that was the sole or dominant purpose. And, if so, if the lesser tax outcome ‘would,’ or ‘might reasonably be expected’ not to have occurred in the absence of the scheme. Then GAAR could take effect.

A late entry, narrowly focused GAAR: As opposed to Australia, the UK “for many yearshas been an outlier in a world of statutory GAAR’s. Despite having been instrumental in the enactment of GAAR’s in many of its former colonies, it has not seen the need to introduce any such legislation in the UK itself. In addition, for a long time the judicial approach to statutory interpretation in tax cases was a somewhat literal one.”² The GAAR that was ultimately introduced in 2013 eschewed the word ‘avoidance’ and replaced it with “abuse’. Freedman opines that the word “avoidance in the extended sense is almost impossible to define so as to give a viable operational rule. The UK GAAR, therefore, covers a defined area of egregious abuse and not everything that might be described as avoidance in recent popular discourse.” (p.4). This is quite important in the sense that the UK is ostensibly the only country that has defined avoidance narrowly enough to confine itself to abusive, contrived, and artificial arrangements, not leaving any

¹ Tax Insights, from Tax Controversy and Dispute Resolution, October 14, 2016, PwC, www.pwc.com, page 2.

² Judith Freedman, “General Anti-Avoidance Rules (GAARS) – A Key Element of Tax Systems in the Post-BEPS Tax World?”, Legal Research Paper Series, University of Oxford, April 24, 2016.

room for 'roving enquiries' in a so-called "broad-spectrum GAAR" that is otherwise explicably popular among global tax administrations.

The UK approach has also been covered in some detail by Ved and Kenkre³. They point out that, " There may be tax avoidance arrangements that are challenged by HMRC using other parts of the tax code, but if they are not abusive, they are not within the scope of the GAAR.....It is narrower in scope that India's which relates to misuse and abuse. In essence, the outcome of UK' consultation process has been to opt for a model that will be applied to exceptional cases where there is clear evidence of an extremely aggressive arrangement to escape tax." (p.256). It may be concluded that the authorities had in mind the protection of legitimate investors and the economic growth process of the UK economy when they limited the scope of the initial 2013 legislation on GAAR.

Subsequently, however, that scope broadened, perhaps inevitably. In the March 2016 Finance Bill, new measures introduced included GAAR penalties, and the ability of HMRC to take 'provisional counteraction' measures and issue 'binding notices' to taxpayers who enter a tax arrangement equivalent to one against which a counteraction notice exists. And the penalty was stipulated at 60 percent of the counteracted advantage.⁴

Absence of any GAAR: The United States has no GAAR. Rather, common law has given rise to doctrines—primarily economic substance and business purpose—that could lead to lead to denial of tax benefits. The application of the doctrines has intensified somewhat with outcomes supporting the government. Thus, in effect the GAAR approach exists without, however, its usual procedural safeguards.

³ Uday Ved and Akshay Kenkre, "General Anti-Avoidance Rules (GAAR)—Establishing Substance over Form," Bloomesbury, New Delhi, 2018.

⁴ PwC, *op cit*, page 17.

Anti-avoidance is of course addressed in domestic legislation, mainly on “thin capitalization (earnings stripping), expatriation tax, transfer pricing, substance over form, step transaction, economic substance, limitation on hybrid entities, anti-conduit regulations, and foreign Account Tax compliance Act (FATCA) rules.” Anti-avoidance rules also exist in bilateral treaties comprising beneficial ownership, limitation on benefits, and limitation on residents.”⁵ And a mainstay of commentaries has been whether, with such comprehensive anti-avoidance characteristics in its tax law, a statutory GAAR is essential or appropriate.

Japan would also be categorized in the group of countries with no statutory GAAR. While the absence of a GAAR has been critiqued among some commentators, others have emphasized that not having a GAAR should not be confused with slowness with BEPS Actions. This group strongly disagrees with the view that “academic debate on tax avoidance in Japan is ‘lagging’ ”.⁶ There is, however, general agreement that GAAR, inasmuch as it would not have limitation in scope of application, would confirm and clarify case law doctrines and interpretations.

Grouping emerging economies: Since the revival of the Group of 20 (G20) and BRICS, it has been common to group them—Brazil, China, India and South Africa (excluding Russia)—together in academic work to compare their experiences and to project their trajectories to economic growth. Interestingly, the microcosm of GAAR is one area where the dissimilarities in the country experiences is quite

⁵ Reuven S Avi-Yonah and Oz Halibi, “US Treaty Anti-Avoidance Rules: An Overview and Assessment,” Law and Economics Working Papers No. 45, University of Michigan Law School Scholarship Repository, January 31, 2012.

⁶ Takayuki Nagato, “GAAR and the Rule of Law in Japan,” *Public Policy Review*, Vol. 13, No. 1, Policy Research Institute, Ministry of Finance, Japan, June 2017, page 35.

stark, revealing the error of putting them on the same plate for policy purposes even where it is perceived that their interests may lie close to one another.

Brazil: Brazil has no statutory GAAR even though, among the four, it is the country with the longest independent experience in taxation.⁷ For example, it was the first country to introduce a comprehensive VAT in the mid 1960's.⁸ Nevertheless, despite two decades of attempting to legislate a GAAR by the federal tax authorities since "there is no unanimous interpretation of the current existing rules,"⁹ it has not been successful.

Of course the existing concepts have been applied to some tax planning cases. In case of identifying artificial transactions and arrangements, tax authorities may file a 'deficiency claim' if there evidence of "malice, fraud or by means of wholly artificial transactions." To fortify it, in 2001, a paragraph was added in Article 116 of the Tax Code thus,

The tax authority may disregard transactions or contracts made with the purpose of dissimulating the occurrence of a taxable event or the nature of any element related to such taxable event, according to procedures to be established by the law of the competent federative entity.

⁷ Derzi M.A.M., Moreira A.M., de Moura Fonseca F.D., "Taxation in Brazil: A Comparative Law Approach," in Brown K. ed. *Taxation and Development – A Comparative Study*, Global Studies in Comparative Law, Vol.21, Springer, 2017. <https://link.springer.com/chapter/10>.

⁸ Arguments that France was the first is erroneous since it introduced the debit-credit principle in the calculation of tax for selected goods while Brazil introduced the tax on a comprehensive base; and it was fiscal federal VAT comprising three levels—federal (central), state and municipal—of government. The fact that Brazil's VAT needs fundamental reform in current times is another matter; it reveals the wearing out of the VAT with age, and the difficulty in forging understandings, leave alone agreements, between the states on the one hand, and the centre, on the other. See Parthasarathi Shome, "Brazil: Value Added Tax Reform", Chapter IV.4, pp. 357-375, in his *Taxation Principles and Applications: A Compendium*, Lexis Nexis, New Delhi, 2014.

⁹ Flavio Rubinstein and Gustavo G. Vettori, "Closing the Brazilian Tax Gap: Public Shaming, Transparency and Mandatory Disclosure as Means of Dealing with Tax Delinquencies, Tax Evasion and Tax Planning," in *Derivatives & Financial Instruments*, Vol. 18, No. 1, International Bureau of Fiscal Documentation (IBFD), Amsterdam, March 2016.

While this came closer to a GAAR orientation than before, it nevertheless led to disagreements over whether the paragraph had altered the sense of earlier practice in an effective way, other than to pave the way for the tax authorities to introduce, as and when necessary, 'rules to establish a specific procedure to disregard a wholly artificial arrangement.' Others argued that, were there no intention to move forward decisively towards a GAAR like instrument, why would the paragraph be added at all.

The embedded "taxpayer-friendly principle of free enterprise...has been in conflict with the federal government's design....This gave rise to a type of GAARto re-characterise for tax purposes a transaction entered into solely for tax purposes."¹⁰ This allows recharacterisation towards taxation of a transaction entered into solely for tax purposes. Nevertheless, Brazil could be said to have stayed away from a statutory GAAR. And attempts in 2002 by the tax authority to form sharpened rules were thwarted by Congress (parliament) reflecting "the high unpopularity of such rules among taxpayers and scholars alike."¹¹ And, in continuance, "To avoid entering into the GAAR discussion, authorities usually classify the planning structures as wholly artificial arrangements."¹²

At the same time, Brazil was one of the leaders in the advent of safe harbor rules among emerging economies, working on the same from the early 1990's with the objective of achieving simplification and minimizing the likelihood of litigation. It reveals, to no small extent, a continuous attempt not to overlook economic productivity and growth resulting from private sector activity in favor of its revenue potential for government.¹³ Those who have pointed towards the

¹⁰ Derzi et al, op. cit.

¹¹ Rubinstein and Vettori, op. cit.

¹² Rubinstein and Vettori, op. cit.

¹³ The marginal productivity of public sector activity is likely to be below that of the private sector, a matter that is often ignored when considering the tax revenue potential from productive activity of a private enterprise.

so-called lagging sharpening of the tax law of Brazil tend to mix this with its incidence of corruption at high levels. Dissecting the matter should reveal that the two are two quite independent matters though one could argue in favor of an extraneous link between the two.

China: Moving on to China, GAAR became effective from January 1, 2008, for arrangements without reasonable commercial purpose, and resulting in elimination, **reduction** or deferral of taxable income. A primary focus has been to raise issue with "indirect transfer of Chinese companies by non-residents through the disposal of interposed offshore companies (so-called 'offshore indirect equity transfers')"¹⁴, a matter of paramount in recent Indian taxation history as well.¹⁵ In 2009, a circular specified that GAAR may be invoked to look into intermediate holding companies with the objective of recharacterising any gain from the disposal of a Chinese sourced asset, and thereby apply a withholding tax.

In February 2015, following the introduction of specified GAAR rules (see below), China widened the scope from offshore indirect equity transfers alone to include "transactions involving either the transfer of immovable property in China or the transfer of assets held under the establishment and place in China by a foreign company via an offshore transfer of a foreign intermediate holding company."¹⁶

China's GAAR does not focus on indirect transfers alone but applies it using rules delineated in December 2014. It is of importance that a tax avoidance scheme is one the sole or main purpose of which is to obtain a tax benefit. Thus

¹⁴ PwC, op. cit., page 7.

¹⁵ In India, the matter became controversial between the judiciary and the executive branch of government, resulting in a government committee, chaired by Parthasarathi Shome, to be formed in 2012. Its view was that indirect transfers should not be taxed on retrospective basis, as the executive had attempted to do in contraposition to a Supreme Court verdict in a case between the Indian government and Vodafone. See *Expert Committee Report on Retrospective Amendments Relating to Indirect Transfers*, Ministry of Finance, New Delhi, 2012.

¹⁶ PwC, op. cit., page 8.

it stands apart from India's first attempt at defining it as 'one of main purposes of which' etc. China also specifies that a tax benefit may be by the tax rules, but economic substance would determine taxability. Both these purpose test and substance test are assessed to determine if a tax avoidance scheme exists. The use and application of GAAR is believed to comprise an instrument of last resort, and taken up only if the application of SAAR cannot eliminate the undue tax benefit.

So far the Chinese GAAR has been applied cautiously and, as of the end of 2016, was used to examine only cross-border arrangements, in the context of offshore indirect equity transfers. Nevertheless, two issues have emerged that may expand the GAAR's application in the future. First, Chinese local authorities have questioned offshore indirect transfers. Though there is no domestic legal provision for it, the central authorities may begin to recognize its validity. Second, the advent of BEPS and China's participation in it could make China reexamine its use of GAAR in the backdrop of tightening of rules in the multilateral context.

South Africa: Introduced in 2006, the South African GAAR focuses on checking the commercial substance test against the 'sole or main purpose to obtain a tax benefit.'¹⁷ Note that it is not 'main or one of the main purposes. There are three tainted elements mentioned as 'abnormality, lack of commercial substance, and misuse or abuse of tax provisions of the same Act,' leading to 'any avoidance, postponement or reduction of any liability for tax.'

It is interesting that a country such as South Africa that should be keen to draw investment to propel investment has, instead, legislated a harsh, statutory GAAR which specifies that:

"The Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by

¹⁷ Ved and Kenkre, op. cit., page 267. See also Government of India report on GAAR, op. cit.

- Disregarding, combining or re-characterising any steps or parts of the (arrangement)
- Disregarding any accommodating or tax-indifferent party or treat such parties and any other party as one and the same person
- Deeming persons who are connected persons in relation to each other to be one and the same for the purpose of determining the tax treatment of any amount
- Reallocating any gross income, receipt or accrual of a capital nature, expenditure on rebate amongst the parties
- Recharacterising any gross income, receipt or accrual of a capital nature or expenditure, or
- Treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such manner as in the circumstances of the case the commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.

Also to be noted is that the first attempt by India in 2012 to introduce GAAR resembled South Africa's version rather closely. And, like India, South Africa also applies various SAAR's such as a broad definition of connected persons for natural persons, trusts, members of any partnership, companies and closed companies. Connected persons appear to resemble the understanding of a 'related party', but is more complex, with multiple thresholds for each category of connected persons.¹⁸

India: Given that India will be covered in detail in the next section, only a mention is made here. India has spent quite a few years in formulating, legislating, reexamining and reintroducing its GAAR. It was found to be extraordinarily harsh to begin with and, after scrutiny by an expert committee, it was toned down somewhat when it was reintroduced at a later date. Nevertheless, the tax authorities have reattempted to reinstate some of the clawbacks, the main lesson to learn from which is that tax authorities in general, and in India in particular, are

¹⁸ Ved and Kenkre, op. cit., page 268.

not in the habit of a broad perspective of placing taxation in the context of the overall economy or its growth, but primarily if not exclusively on the production of tax revenue. This outcome tends to be exacerbated if the structure and administrative rules covering the bureaucracy has little accountability for actions taken—which differs from country to country. Thus it appears that there is not much uniformity in the global experience.

This does not, however, mean that no harmonization has been attempted internationally with respect to GAAR. For example, in July 2016 the European Union attempted it through an Anti-Tax Avoidance Directive (ATAD) with the objective of reducing avoidance in its internal market.¹⁹ “ATAD imposed a legally binding obligation on EU member states to incorporate (selected recommendations that took the form of BEPS Actions in the areas of):

- Hybrid mismatch arrangements (Action 2)
- Controlled foreign company (CFC) rules (Action 3)
- Interest deductions (Action 4)

Scholars believe that this “has secured a certain uniformity of national implementing measures across the EU. In addition, ATAD has also set out a GAAR an exit tax provisions, which further strengthen the EU’s baseline protection of tax revenues.”²⁰ It should not be forgotten, however, that the EU is a group of by and large homogeneously thinking European economies with a strong executive that plays the role of rule setting, implementation and refereeing among its members. Thus the EU experience could be considered an exception in the larger global context comprising advanced and emerging economies.

To conclude, what is observed is little cohesion in the GAAR laws across countries, whether advanced or emerging. Some have opted for statutory GAAR’s,

¹⁹ Anzhela Cedelle, “The EU Anti-Tax Avoidance Directive: A UK Perspective,” Centre for Business Taxation, CBT Working Papers, Oxford, 2016.

²⁰ Cedelle, op. cit., page 1.

some of which have sharp aspects to it such as South Africa, as if designed in a vacuum that disregards any context of economic growth. Others have introduced a GAAR slowly if not reluctantly while being observant to GAAR's probable deleterious growth effects, such as China and the UK. Yet others have eschewed a formal GAAR using SAAR's as necessary to address tax avoidance, such as Brazil, Japan and the US. India is a case where the government's harsh approach has been at least temporarily scaled back through the examination and subsequent implementation of the recommendations of an expert committee. Thus the cross-country experience with GAAR is veritably diverse and is unlikely to be reined in with much uniformity in the foreseeable future.

2. THE INDIA GAAR EXPERIENCE

The development of the Indian GAAR can be said to have appeared from 2009 when an initial draft of a comprehensive Direct Tax Code (DTC09) was published for open consultation. At that early stage, GAAR was proposed to be applied where a taxpayer entered into an arrangement, the main purpose of which was to obtain a tax benefit and such arrangement

- was entered or carried on in a manner not normally employed for bona-fide business purposes, or
- was not at arm's length, or
- abused the provisions of the DTC, or
- lacked economic substance.

On invoking GAAR, an Assessing Officer may determine the tax consequences for the taxpayer by disregarding the arrangement. After the consultation and some modifications published as DTC10, GAAR was introduced in the Indian tax law in 2012 and was to be applied from 2013, but it faced severe opposition from taxpayers emanating from

- certain changes made including replacing 'main purpose' with 'one of the main purposes'
- fear that these would not necessarily be applied uniformly by tax officers
- lack of perceived awareness among tax officers who had the responsibility to invoke such an advanced instrument, and
- lack of proper sensitization of both domestic and foreign investors to whom the rules would apply

There were several SAAR elements already in the income tax law and, being specific, provided certainty to taxpayers while GAAR, being general in nature, was prone to be widely interpreted without adequate experience or comprehensive guidance to the implementing officers.

Since GAAR was generally intended for deterrence of abusive practices of creating corporate structures for the main purpose of avoiding tax, administrators would need to be guided regarding the manner in which it was to be applied for which significant preparation time was needed.

Those considerations led the Indian Government to set up an independent Expert Committee in July 2012 to re-examine the proposed GAAR provisions and make appropriate modifications prior to introduction of GAAR. The formal terms of reference (ToR) are elaborated in Annex 1 as an illustration of how a government may need to revisit a complex tax issue and specify, time and again, the compulsion to re-consult and re-examine every issue as delineated in the ToR.

The Committee recommended drastic changes in both the approach of GAAR and its application together with a deferment of implementation to 1st April 2016. Consequently, several modifications to the legislation and accompanying rules were incorporated. In the central government's 2016-17 annual budget, the Union Finance Minister (FM) announced the implementation of GAAR from 1st April, 2017.

Acceptance of Committee recommendations: It is of some relevance to recount how the government altered its position in acceptance of the Committee's recommendations. Among those accepted were

- GAAR should be applicable only to arrangements which have the main purpose (and not one of the main purposes) of obtaining tax benefit
- Factors such as the period for which the arrangement exists; the fact of payment of taxes, directly or indirectly, under the arrangement; and the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement, are relevant but may not be sufficient to prove commercial substance. This condition was important in that they had been specifically denied in the first version
- A requirement of detailed reasoning by the Assessing Officer in the show cause notice to the taxpayer may be prescribed in the rules
- Time limits for actions by various authorities and statutory forms for making reference by income tax authorities should be prescribed
- While determining the tax consequences of an impermissible avoidance arrangement, it should be ensured that the same income is not taxed twice in the hands of the same tax payer in the same year or in different assessment years.
- GAAR should not apply to a foreign institutional investor (FII) which chooses not to take any benefit under a Double Taxation Avoidance Agreement (DTAA) entered into by India and subjects itself to tax in accordance with domestic law provisions.
- A monetary threshold of Rs. 30 million (Rupee100 = UK Pound 1 approximately) for tax benefit to a taxpayer in a year should be provided for the applicability of GAAR provisions.
- The tax audit report may be amended to include reporting of tax avoidance schemes above the threshold of tax benefit of Rs. 30 million.
- Where only a part of the arrangement is impermissible, the tax consequences of an "impermissible avoidance arrangement" should be limited to that portion of the arrangement. (accepted in 2017)

Setting aside Committee recommendations: Having acceded to several of the Committee's report as listed above, in 2017 the Central Board of Direct Taxes (CBDT) indicated that, "GAAR is with respect to an arrangement or part of the

arrangement and therefore limit of Rs. 30 million cannot be read in respect of a single taxpayer only".

Further, some recommendations of the Committee were not immediately accepted, by Government. These included

- GAAR should be applicable only in cases of abusive, contrived and artificial arrangements.
- 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 should not apply overriding the treaty
- GAAR should not be invoked in intra-group transactions which may result in tax benefit to one person but overall tax revenue is not affected either by actual loss of revenue or deferral of revenue.
- The GAAR provisions should be subject to an overarching principle that tax mitigation should be distinguished from tax avoidance before invoking GAAR.

An illustrative list of tax mitigation or a negative list for the purposes of invoking GAAR was provided by the Committee but neither recognised by Government nor included in the teaching syllabus of the National Academy of Direct Taxes (NADT).

Presumption of purpose: What is of significance is the nature of thought, if not presumption and, therefore, preoccupation, among some country tax authorities, in embodying their GAAR's. This is revealed in the original definition in India of the presumption of purpose that was subsequently set aside as an outcome of the Committee's recommendations.

Both DTC09 and DTC10 contained a provision that an arrangement which results in any tax benefit 'shall be presumed' to have been entered into for the main purpose of obtaining the tax benefit, unless the taxpayer proves otherwise. This provision was also introduced in Finance Bill 2012 [Section 96(2)],

but was later dropped and not brought into the ITA. The same was also removed in DTC13 which resulted from the recommendations of the Committee.

Presumption of purpose for entire arrangement if main purpose of a step is for obtaining tax benefit: However, both DTC09 and DTC10 contained another provision which was brought into the Income Tax Act and subsequently to DTC13 which states that 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 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".

Accordingly, a press release of government dated January 14, 2013, clarified that GAAR will be applicable even where a part of the arrangement is considered an impermissible avoidance arrangement, but the tax consequence will not apply to the whole arrangement but will be restricted to that part. This was reflected in Finance Act 2013, with the expectation that it will be implemented through subordinate legislation or rules, though there was good reason for it to have been incorporated in the principal legislation.

3. TAXING INDIRECT TRANSFERS

Following its GAAR report, the same Committee was asked to examine the issue of taxing indirect transfers in India as a consequence of a complicated series of court cases and respective conflicting judgments in a dispute between the Government of India and Vodafone. This calls for some attention as some emerging economies including China as discussed earlier have found this area to be contentious, spending much of their GAAR resources on this one issue.

'Indirect transfers' refers to income arising from the transfer of shares between foreign companies of underlying assets. Its taxation is another method

adopted by the tax administration to protect the tax base. The concept of taxability of indirect transfers in India has been the subject of debate, with the tax authorities inserting explanations in sections 2 and 9 to 'clarify' terms such as "property", "transfer", "through" and "situate in India" for taxation of indirect transfers.

These clarifications were made through Finance Act 2012; what was contentious, however, was that it was carried out with retrospective effect from 1st April, 1962, or the start of the application of the ITA itself.

In the ITA, income accruing or arising, whether directly or indirectly, through the transfer of capital asset situated in India, is deemed to accrue or arise in India. It was clarified (with retrospective effect from 1st April, 1962) that an asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value 'substantially' from the assets located in India.

"Substantially" is not defined in the ITA. DTC10, however, provided for a 50% threshold of global assets to be located in India for taxation of income from indirect transfer in India. Later this was moved down to 20% as explained next.

DTC13 provided for a reduced threshold to 20% of global assets to be located in India for taxation of income from indirect transfer in India. The argument of government was that the 50% threshold was too high which could result in situations where a company has 33.33% assets in three countries and yet not get taxed anywhere. An exemption on transfer of small share holdings (up to 5%) outside India was written in, thereby excluding small Participatory Note (PN) holders in an FII from the ambit of indirect transfer taxation (thus deeming to be situated in India would become irrelevant for their taxability).

Though the proposed provision in DTC13—which could be basically viewed as a government proposal in making—offered certainty and clarity for taxpayers because of those clarifications, they were not initially incorporated in law until the presentation of the subsequent central government budget.

Government again attempted to expand the scope of taxation of indirect transfers. On December 21, 2016, the CBDT issued a clarification on the scope of indirect transfer provisions that sought to apply these provisions even to FPIs. This would have taxed any profits made by funds with underlying assets (including equities) in India. However, following obvious pressures, CBDT in a press release on 17th January, 2017 held back the circular on the taxation of indirect transfer of shares.²¹

4. ISSUE OF RETROSPECTIVE APPLICATION

The indirect transfer legislation with retrospective application that took back applicability to the beginning of the Income Tax act, in particular obviating an earlier Supreme Court decision on the matter of indirect transfers, created universal adverse reaction in the global investor community. The language and scope of the amendments led to apprehensions about the certainty, predictability and stability of tax laws in India.

Investors viewed the amendments dating back to more than 50 years as causing tax uncertainty 'going into the past', since any tax understanding forged today could be altered tomorrow (through new and unanticipated legislation by the authorities) that would impact on investment decisions taken and projects undertaken yesterday. Government responded by adding the matter

²¹ See, *CBDT puts on hold circular on taxation of indirect transfer of shares*, LiveMint, 18 January, 2017.

of taxation of indirect transfers to the ToR of the Expert Committee on GAAR.²² The Committee's recommendations were under consideration of the Government for a long time.

The thrust of the Committee's view was that retrospectivity tests the strength of the full force of applicability in future cases by shifting focus to the past. Also an 'impossibility of performance' is likely to be caused for taxpayers because of an absence of knowledge of the future ramifications of the prevailing taxation laws that could be changed tomorrow with effect from yesterday.

The Committee recommended that retrospective application of tax law should occur in exceptional or rarest of rare cases, and with particular objectives such as

- To correct apparent mistakes/anomalies in the statute
- To apply to matters that are genuinely clarificatory in nature, i.e. to remove technical defects, particularly in procedure, which have vitiated the substantive law, or
- To "protect" the tax base from highly abusive tax planning schemes that have the main purpose of avoiding tax, without economic substance, but not to "expand" the tax base
- Moreover, retrospective application of a tax law should occur only after exhaustive and transparent consultations with stakeholders who would be affected, and
- Government finally made statements indicating they would not apply new taxes retrospectively.

The matter of retrospectivity in taxation is still unincorporated in law even though government has assured that it would not apply tax law retrospectively.

²² The Committee's ToR for GAAR, together with the later addition on the taxation of indirect transfers appears in Annex 1.

5. SEARCH AND SEIZURE RULES

Search and seizure are an instrument are an instrument that should be used as a last resort as is the case in advanced countries. Historically India has used it on a regular basis perhaps in reflection of the accepted premise of high incidence of illegal tax evasion through various innovative means in the country. However, in the last two years, apprehension has escalated of more intensified use of search and seizure reflecting certain amendments in the law. This has translated into a lack of confidence, if not whispered fear, of the tax administration.

Butani²³ has summarised related aspects. Amendments to the Income Tax Act were made to existing provisions²⁴, based on 'reason to believe' or 'reason to suspect'. The Supreme Court had already ruled in 2015 that 'reasons for belief' would not be communicated to the taxpayer (subject to such search). The Court, however, stated that requisite material may have to be disclosed to the taxpayer after the completion of search and seizure, at the assessment proceedings, to ensure that taxpayer rights are protected. What is to be pondered is whether such steps have the potential to minimise accountability of the tax administration citing reasons of confidentiality and sensitivity, with the sole assertion that the reasons behind search and seizure would be disclosed only before the courts. What is more is that the amendments have been given retrospective applicability, thereby validating past actions of the search officials.

Powers of the authorities now include

- Extending the powers to call for information to tax authorities below the Commissioner level

²³ Mukesh Butani, "Budget 2017 Confers Unfettered Powers on Taxman at the Cost of Taxpayers," *Financial Express*, New Delhi, March 6, 2017.

²⁴ Sections 132 and 132A.

- Widening the scope of 'Survey' to include places where activities for charitable purposes are undertaken, which was earlier restricted to place of business or profession;
- Empowering the CBDT to make a scheme for centralised issuance of notice calling for information, etc.

In contrast, the third report of the Tax Administration Reform Commission (TARC)²⁵ had recommended

- Search and seizure operations should be limited to cases where hardcore tax evasion is suspected
- Economic intelligence should be better developed and exchanged
- non-invasive Surveys based on credible information and a technology-based tax collection system
- non-intrusive, should be used to identify non-filers

Recognizing that the new provisions vary from TARC's recommendations, in the least what could be hoped for is that taxpayer concerns can be addressed through ensuring that the new provisions are not misused or that officers do not act on a whim, unsubstantiated suspicion or rumours, but there has to be conscious recognition followed by assurance as well as practice. And the implementation of a strict internal code for granting authorisation, administering a strict audit mechanism, releasing timely instructions, updating of search manuals, guidance on code of conduct for search officials, would go a long way in reducing that taxpayers are not harassed.

²⁵ In August 2013, the Indian government had set up a high powered Commission (TARC) comprising a Minister of State designate as Chairman, ex-Chairmen of the Central Board of Direct Taxes and Central Board of Excise and Customs and two ex-Members thereof, an ex-CFO and an ex-Vice President for Tax of Indian multinational companies that, in five volumes, made voluminous recommendations for imperative structural change in the Indian tax administration. The ToR of TARC appears in Annex 2. The contents of the Report does not appear in the Ministry of Finance website any longer, though they are found in parts in the websites of the Department of Economic Affairs and the NADT.

6. TAX EFFICIENCY, AVOIDANCE AND EVASION: A RETROSPECTIVE

We have now reviewed the experiences of a group of countries with particular reference to India. In this what appears that tax authorities, with a few exceptions, are likely to possess a tendency towards mixing the above motivations of taxpayers and thereby tend to be oblivious of their actions of their respective economies' economic growth. This is a concern that should be discussed rather than remaining untouched due to the obvious immense power of the tax administration as an institution.

Tax mitigation results from a taxpayer using a fiscal incentive available to him in the tax legislation by submitting to the conditions and economic consequences that the particular tax legislation entails. An example would be a Special Economic Zone where a taxpayer sets up his establishment or availing a backward area-linked tax incentive or using provisions for accelerated depreciation of one among various alternatives offered in the Income Tax Act itself. Tax authorities should not spend staff resources by raising issues with such legal provisions offered by government.

Tax avoidance remains outside of the tax law. While there is overall understanding of what it might comprise, different tax authorities explain it differently. Thus

- It involves the legal exploitation of tax laws to a taxpayer's own advantage
- While strictly legal, it takes advantage of selected provisions by identifying alternatives one of which results in less tax than another though the outcome does not reflect the intention of the tax law
- A tax avoidance arrangement is one designed solely for obtaining a tax advantage without a backdrop of economic content

The upshot is that, while a taxpayer may consider his right to arrange least tax payment as long as it is strictly, tax authorities may consider some strictly

legal schemes to erode the tax base unnaturally thus reducing the effective rate of tax. Thus, though legal, such schemes are not acceptable to tax authorities. It is for this that SAAR, and more recently, GAAR, are being enacted.

Tax evasion is unlawful, occurring from illegality, suppression misrepresentation and fraud.

When we keep the three behavioural attitudes in mind, actions to be taken by tax authorities should become clear. First, tax mitigation has to be allowed on a regular basis and should not be confused with tax avoidance. Some tax administrations reveal a tendency to focus unduly on tax mitigation characteristics within the tax law, easier as it is to identify the measures opted for from the tax returns themselves. But this practice should be strictly eschewed and tax officers should be redirected to detect and take counter-measures against tax avoidance.

Tax evasion has to be eradicated. This is where search and seizure, as discussed, has a role to play. However, there could be a tendency towards heavy use of these measures on the basis of suspicion rather than proof. Such means should be used cautiously and sparingly. Of course, incarceration is called for in the case identified tax evaders as is the definite result in most advanced countries. For this to materialize, the justice system should be unbiased and rapid, a feature more often than not absent in emerging economies other than dictatorships (where the judiciary itself is unreliable and taxpayer rights take a backseat). Thus where search and seizure as an instrument is essential, one proof of the efficacy of the tax administration is how judiciously it is used to identify and correct tax evasion.

This leaves us with tax avoidance which is the most obfuscated and thus difficult for tax authorities to contend with. Professionals—lawyers, accountants, advisers—often make their living out of it, either designing tax

avoidance arrangements, calculating tax payments or defending clients when called out by the authorities. This happens only because tax avoidance is not illegal while the authorities question it, leaving wide room sometimes for argumentation against or in favour of the taxpayer. Therefore it has the potential of a high incidence of litigation as indeed it occurs in some countries such as Brazil and India.

And, in order to minimize tax avoidance, a very high number of tax authorities have enacted GAAR's. Here again it is how this instrument is used is what lends credibility to a tax authority. If GAAR is used even at the margin as a revenue raising instrument, then that credibility disappears. It is also important to place the onus of initial proof on the tax authority rather than on the taxpayer. When the latter is familiar with what the initial issue was that led to the initiation of GAAR against him, only then he can assemble meaningful information to respond intelligently to the authorities. These concerns led to the specification of the recommendations of India's Expert Committee on GAAR and they are delineated in Annex 3 for the interested authorities that are contemplating its introduction in the near future. Clearly, GAAR is here to stay; but let us not shave legitimate global productive economic activity. The world is too heavily supply constrained for tax authorities the world over to rein in economic productivity.

7. CONCLUDING REMARK

On a final note, while the thrust of this paper is not on the Base Erosion and Profit Shifting (BEPS) project, it is anticipated that soon more voices will be raised against the demands on productive and tax compliant MNC's to allocate considerable financial and staff resources on reporting—country-by-country, master file and local files—to various country tax authorities where the MNC's

operate, without receiving information on how such data would be mined or used on a regular basis by the authorities.

It is fully apparent that MNC's are beginning to argue that the BEPS process and recommendations were heavily biased towards tax authorities over the private productive sector in both consultations and recommendations. It remains a mystery why academicians and researchers have remained relatively silent on the matter thus far and, hopefully, they will also critically analyse the matter in the near future.