
Indian Finance Minister announces decisions on Indian GAAR regime

January 15, 2013

In brief

During 2012 the Indian government introduced General Anti-Avoidance Rules (GAAR) in Indian domestic tax legislation effective April 1, 2013.

Following representations from various stakeholders, the Indian government formed a special Committee (the Shome Committee) to reconsider the rules and submit recommendations to the government. The Shome Committee submitted its draft report to the Indian government in September 2012 (see [*Asia Pacific Tax Newsalert: Expert Committee's report on India's GAAR regime is welcome news for foreign investors*](#) dated September 4, 2012).

The Indian Finance Minister has now made a formal announcement indicating the government's intent to accept several of the Shome Committee's proposals. Significantly, the Finance Minister has indicated that the GAAR regime's effective date will be deferred until April 1, 2015.

The government also announced that:

- investments made before August 30, 2010 will be grandfathered
- it will issue guidelines to address situations where both GAAR and Specific Anti-Avoidance Rules (SAAR) could apply
- GAAR will not apply to Foreign Institutional Investors (FIIs) that do not avail treaty benefits; and
- there is a monetary threshold for invoking GAAR.

This newsalert summarizes the announcements by the Indian government that are likely to impact foreign investors in India.

In detail

GAAR deferred to 2015

After considering recommendations by stakeholders and by the Shome Committee, the government will defer the application of the GAAR regime to April 1, 2015. Although the Shome Committee

had recommended deferral until April 1, 2016, investors should welcome the two-year deferral.

Grandfathering investments made before August 30, 2010

The Shome Committee recommended that all investments existing at the

GAAR regime's introduction date should be grandfathered.

However, the government has announced that only investments made prior to August 30, 2010 (i.e., when the new draft Indian Direct Taxes Code containing GAAR

proposals initially were presented by the government) will be grandfathered.

GAAR and Specific Anti-Avoidance Rules

The Shome Committee recommended that GAAR should not be invoked in situations where SAAR could apply.

The government has announced that either SAAR or GAAR will be invoked in transactions where both rules are per se applicable, and that it would develop guidelines to address when each regime applies.

Applicability to FIIs

The government has accepted the Shome Committee's recommendations that GAAR should not apply to those FIIs which do not avail tax treaty benefits but choose instead to be governed by Indian domestic law. GAAR will also not be invoked against non-resident investors in the FII.

However, the government remained silent on suggestions that it abolish the capital gains tax on securities' sales.

Monetary threshold prescribed

The government has accepted the Shome Committee's recommendation that GAAR should be invoked only when the tax benefit of an arrangement exceeds INR 30 million (approx. US\$ 550,000). Note however, that at the moment, the government has not indicated whether the threshold would be applied on an annual basis or on a transactional basis.

'Main purpose' test to invoke GAAR

The government has accepted another Shome Committee suggestion that it prescribe that GAAR will only be invoked in cases where the main purpose (as opposed to one of the

main purposes) of an arrangement is to obtain a tax benefit.

Applicability of GAAR to arrangements

The government, based on the Shome Committee's recommendations, has prescribed that the GAAR will impact only the part of an arrangement that is regarded as abusive, (and not to the entire transaction / arrangement).

Show cause notice

Tax authorities will be required to issue a show cause notice to taxpayers, stating why they propose to invoke GAAR.

In turn, taxpayers will be given adequate opportunities to demonstrate why transactions should not be covered under the GAAR regime.

GAAR Panel

The government, in its draft GAAR proposals, provided for a three-member Approving Panel (GAAR Panel) to approve cases under GAAR (as opposed to five members recommended by the Shome Committee later).

The government has retained its decision to have three members of the GAAR Panel but has accepted, in part, the qualifying criteria for members as recommended by the Shome Committee. Under these criteria, the Panel's Chairperson would be a High Court Judge, one member would work for the Indian Revenue Services (with a minimum rank of Chief Commissioner of Income Tax), and a third member would be an academic or scholar (having special knowledge of direct taxes, business accounts, and international trade practices).

The GAAR Panel will be required to consider various factors when deciding whether cases should invoke GAAR. These factors include the

investments' holding period and whether taxes have been paid.

The GAAR Panel's decisions will be binding on taxpayers and the revenue authorities.

Connected persons for the purpose of GAAR

For purposes of invoking GAAR a "connected person", has the same meaning as the term "associated purpose" as defined under the GAAR regulations and "associated person" as defined under the Indian transfer pricing regulations.

Income adjustments under GAAR

The government has prescribed that if GAAR is invoked, the same income will not be taxed twice in the hands of the same taxpayer in the same or different tax years.

Reporting by tax auditor

The government has prescribed that tax auditors (i.e., Indian CPAs) will be required to report any tax avoidance arrangement.

The takeaway

These announcements (through the Finance Minister) would provide considerable relief to those investing into India.

We expect the government to present its proposals to Indian Parliament for formal approval prior to amending the domestic tax legislation.

We expect the annual Indian Finance Budget, which covers various fiscal and tax policy changes, to be announced at the end of February. Investors should study the specific legislative amendments proposed to the GAAR regime and assess its impact.

We also expect the government to announce shortly rules and guidelines

for the legislation relating to taxing the indirect transfer of Indian interests.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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