

Indian Central Board of Direct Taxes offers opinions on GAAR's applicability and implementation

February 21, 2017

In brief

The general anti-avoidance rules (GAAR), found in Chapter X-A of the Indian Income-tax Act, 1961 (the Act), will take effect April 1, 2017. While certain rules within the GAAR's scope already have been introduced, stakeholders had raised certain queries in relation to the GAAR's implementation. The Indian Central Board of Direct Taxes (CBDT) created a Working Group in June 2016 to consider such issues. The CBDT, after considering the Working Group's comments, issued a Circular providing its opinions on the GAAR's applicability and implementation.

The CBDT offered views on the interplay between GAAR and specific anti-avoidance rules (SAAR) and the Limitation of Benefit (LOB) test under certain tax treaties. The CBDT also indicated how to determine the tax benefit threshold at which GAAR would be invoked and the scope of investments that would be grandfathered and therefore not subject to GAAR.

In detail

The CBDT has issued its views in a question-answer form. The significant questions are as follows:

No.	Question	CBDT Response
1	Will GAAR be invoked if specific anti-avoidance rules (SAAR) apply?	Specific anti-avoidance provisions may not address all abuse situations, and there is need for general anti-abuse provisions. Thus the GAAR and SAAR can coexist if they apply based on the taxpayer's facts.
2	Will GAAR be applied to deny treaty eligibility where the taxpayer has complied with the LOB clause under the treaty?	If an anti-abuse rule in a tax treaty does not address all tax avoidance strategies, GAAR may apply. However, if the LOB sufficiently addresses an avoidance case, the GAAR shall not be invoked.

3	Will GAAR prevent a taxpayer from choosing a method for implementing a transaction?	GAAR will not prevent a taxpayer from choosing such an implementation method.
4	Will GAAR apply where the foreign portfolio investor's (FPI) jurisdiction is based on non-tax commercial consideration, and such FPI has issued P-notes referencing Indian securities? Will GAAR apply to deny treaty benefits to a Special Purpose Vehicle (SPV) 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 employees?	GAAR shall not be invoked merely because the entity is located in a tax-efficient jurisdiction. If the FPI's jurisdiction is finalized based on non-tax commercial considerations and the arrangement's main purpose is not to obtain a tax benefit, GAAR will not apply.
5	Will GAAR apply to (i) bonus shares issued for original shares acquired prior to April 1, 2017, (ii) shares issued post March 31, 2017 on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares, Foreign Currency Convertible Bonds, or Global Depository Receipts acquired prior to April 1, 2017, (iii) shares that are issued consequent to the split up or consolidation of such grandfathered shareholding?	Grandfathering will be available to investments made before April 1, 2017 with respect to instruments compulsorily convertible from one form to another, at terms finalized at the time of such instruments' issue. Shares brought into existence by way of split up or consolidation or bonus issuances with respect to shares acquired prior to April 1, 2017 will also be eligible for grandfathering in the hands of the same person.
7 & 8	Will GAAR apply if the Authority for Advance Ruling (AAR) has held that an arrangement is permissible, or if an authority such as a Court or National Company Law Tribunal has sanctioned the arrangement, or if the arrangement is in accordance with judicial precedents, etc.?	GAAR will not apply if the AAR holds that an arrangement is permissible. Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply.
10 & 15	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? Further, will a contrary view be taken in subsequent years if arrangement held to be permissible in earlier year?	A proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner/ Commissioner (PCIT), and then by an 'Approving Panel' headed by a High Court judge. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in appropriate cases. Further, 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 the arrangement in a subsequent year.

13	The government should ensure that, in practice, the consequences of treating a transaction as an impermissible avoidance arrangement are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. The government should also clarify that if a particular consequence were applied to one participant, there would be corresponding adjustment to the other participant.	Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied to one participant as a result of GAAR, a corresponding adjustment will not be made to the other participant. GAAR is an anti-avoidance provision with deterrent consequences, and corresponding tax adjustments across different taxpayers could militate against deterrence.
14	A tax benefit threshold of INR 30 million may be calculated with respect to each arrangement, each taxpayer, and for each assessment year separately. The review should extend to tax consequences across territories. The tax impact of INR 30 million should be considered after taking into account the 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).	For calculating the INR 30 million threshold, only the tax benefit enjoyed in the Indian jurisdiction due to the arrangement or part of the arrangement is to be considered. Such benefit is assessment-year specific. GAAR is with respect to an arrangement or part of the arrangement and the INR 30 million limit cannot be read with respect to a single taxpayer only.

CBDT's views on other issues

- Lease contracts and loan arrangements are by themselves not 'investments,' so grandfathering is not available for such arrangements.
- The admissibility of claims under treaty or domestic law in different years is not covered by the GAAR provisions.
- If an arrangement is covered as an impermissible avoidance arrangement, then the arrangement will be disregarded through application of GAAR and necessary consequences will follow.
- The time period for which an arrangement exists is only a relevant factor, and not a sufficient factor, to determine whether an arrangement lacks commercial substance.
- Penalty levies depend on the facts and circumstances of the case, and are not automatic. A blanket exemption from penalty provisions is not available for a period of five years under law. Taxpayers may apply for benefit of waiver of penalty under section 273A of the Act upon satisfying the conditions prescribed therein.

The takeaway

- The Circular provides welcome clarification on certain issues related to applicability of the GAAR provisions.
- The Circular goes further than some recently amended tax treaties by specifically indicating the availability of grandfathering benefits to instruments derived from convertible investments held prior to April 1, 2017, or certain situations such as subsequent consolidation, split, or bonus issue of shares.

- The two level vetting for invoking GAAR should ensure judicious application. It needs to be seen now how the tax authorities will implement the GAAR rules.

Let's talk

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

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