Anti-avoidance Rules in Indian Tax Law – A Revenue View

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Presentation by : Akhilesh Ranjan

Issues in anti-avoidance

- Ethics – moral duty of citizens ?
- Rule of Law
- Roles of Legislature, Executive, Judiciary
- Equity and efficiency of tax system
- Drafting complexity
- Compliance costs
- Administrative costs and mechanisms

Issues in anti-avoidance

- Revenue view – tax avoidance is a problem for any tax system

  - erodes revenues that the system is designed to generate

  - undermines the fairness of the system, lesser burden on taxpayers with greater resources

Indian tax law – a historical perspective

- Legacy of a colonial regime
- Post-Independence : socialistic pattern
- Multiple taxes, high tax rates
- Reforms in the 1990's
    - rates rationalised
    - Estate duty, Gift-tax abolished
    - process of simplification
- Increasing compliance, but avoidance still a problem

Current challenges

- Apparent scope for increasing tax-GDP ratio
- Government committed to increasing revenues by broad-basing, rather than higher taxes
- Massive investment required in social sector and infrastructure
- Political consensus on reducing budgetary deficits – FRBM Act

Task force on FRBM

- Primary strategy – augment revenues
- Roadmap suggested

  - reduce rates

  - cut compliance costs

  - withdraw/phase out exemptions & incentives
- Reduced to numbers- revenue loss/neutral
- Critical assumption: better compliance

Task force on FRBM

- Report requires careful consideration
  - will reduced rates lead to better compliance?
  - is it practically possible to phase out incentives?
  - will the package reduce propensity to avoid taxes?
- Answers may be in the negative- taxpayer psyche, historical legacy, commercial considerations, political & socio-economic compulsions

Tax system: avoidance-prone

- Tax arbitrage possibilities
  - differences in effective tax rates
  - tax exempt bodies
  - incentives & welfare deductions
  - major economic activities not taxed
- Slow response- administrative & legislative
- Judicial view
- Low audit risk
- Tax-avoidance industry

Compliance spectrum

- Pure compliance - tax paid according to legislative intent
- Tax mitigation – reducing tax as intended by Parliament
- Tax avoidance – arrangement yielding result not intended by Parliament
- Tax evasion – non-disclosure or false information provided

Existing anti-avoidance rules in Indian tax law

- Transfer of income without corresponding transfer, or with revocable transfer, of beneficial ownership of assets

    - sections 60, 61

- Clubbing of income of spouse, minor children, other persons, in certain situations

    - section 64

- Bond-washing transactions

    - section 94

Existing anti-avoidance rules in Indian tax law

- Market value rules for related party transactions

  - transfer pricing

  - section 40A(2) – expenditure involving payment to related persons

  - sections 80 IA/IB/IC – tax benefit to eligible business units- transactions with other units of same person, or of associated person, to be at arm’s length

Existing anti-avoidance rules in Indian tax law

- Inclusive definitions & deeming provisions
  - dividends: section 2(22)
  - salary/perquisites: section 17
  - business: section 28
  - capital gains: section 45
  - gifts: section 56
- Restrictions on loss set-offs
  - capital losses: sections 70,71,74
  - speculation losses: section 73
  - dividend/bonus stripping: section 94

Existing anti-avoidance rules in Indian tax law

- Restrictions on expense deductions

  - sections 14A – expenses for earning exempt income

  - section 40A(3) – expenses in cash

- Other specific provisions

  - section 10(10D) – single premium insurance policies

  - section 93 –income payable to non-residents by virtue of certain transfers of assets

Experience with SAARs

- Effective, but inherent limitation of scope
- Reactive, not proactive
- More effective if retrospective
- Have added cumbersome detail to law
- Increased litigation

Judicial view

- Basic confusion – is tax-avoidance acceptable?
- Literal approach to interpretation
- Tax laws interpreted like criminal law
- Judiciary conscious of its role – not a law-making body

Why not a GAAR?

- Unconstitutional; seeks to impose tax by analogy, not by law
- Contrary to rule of law
- No certainty of taxation
- Comes in the way of business
- Inherent subjectivity; litigation
- Problems of drafting – definitions etc.
- Courts competent to develop anti-avoidance doctrines

A possible revenue view….

- Parliament competent to enact any law for achieving objectives set by it
- Rule of law paramount when concerned with curtailment of personal freedom – not so relevant in tax matters involving artificiality and questionable motives
- Judiciary cannot be expected to take on the role of the legislature

A possible revenue view….

- Problems of drafting and litigation are equally faced in SAARs
- Indian judiciary is capable of comprehending legislative intention, primary purpose of a transaction
- Revenue gains may justify administrative costs of advance ruling systems

GAAR in Indian tax law?

- Many other immediate challenges in the Indian tax system
  - developing effective information systems
  - redesigning business processes in tax administration
  - managing litigation
- Interaction with existing SAARs may be a problem
- Application to and interaction with tax treaties needs examination
- Alternatives like mandatory disclosure of tax planning schemes, need to be explored

Nothing can stop an idea whose time has come.

Perhaps the time has not yet come for a GAAR in India

THANK YOU

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