



ANTI-AVOIDANCE AND SUBSTANCE ISSUES IN THE DTC

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Three broad concepts

➤ **Tax Evasion**

Intentional illegal behavior; deliberate under-reporting of taxable income

➤ **Tax Avoidance**

Generally, used to describe the arrangement of a tax payer's affairs that is intended to reduce his tax liability. Although the arrangement may strictly be regarded as legal, it may be against the spirit of the law

➤ **Tax Planning**

Arrangement of a person's business in order to minimize tax liability

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Judicial approach thus far

- **State of UP vs. Renusagar Power Co. (1988, 4 SCC 59) (SC)**

It is high time to reiterate that in the expanding of horizons of modern jurisprudence, the lifting of the corporate veil is permissible. This must, however, depend primarily on the realities of the situation

- **Tata Engineering vs. State of Bihar (1964, 6 SCR 895) (SC)**

The doctrine of the lifting of the veil postulates the existence of dualism between the company on one hand and its shareholders on the other



Judicial approach thus far

- **Sunil Siddharthbhai vs. CIT, Ahmedabad, (1985, 4 SCC 19) (SC)**

In the task of determining whether a transaction is a sham or illusory transaction or a device, the tax authority is entitled to penetrate the veil covering it and ascertain the truth

- **CIT vs. Sri Meenakshi Mills Ltd (1961, 1 SCR 934) (SC)**

In certain exceptional cases, the court may lift the veil of the corporate entity and pay regard to the economic realities behind the legal facade



Judicial approach thus far

➤ **CIT vs. A. Raman & Co. (1968, 67 ITR 11) (SC)**

Avoidance of a tax liability by arranging commercial affairs such that charge of tax is distributed is not prohibited

➤ **CIT vs. B.M Kharwar (1969, 72 ITR 603) (SC)**

The legal effect of a transaction cannot be displaced by probing into the “substance of the transaction”

➤ **CIT vs. Cal Discount Co. Ltd. (1973, 91 ITR 8) (SC)**

An assessee can arrange his affairs to minimize tax burden



Judicial approach thus far (contd.)

- **Mcdowell & Co. Ltd. vs. CTO (154 ITR 148) (SC)**
Any tax planning intended to and results in tax avoidance must be struck down
- **IRC vs. Duke of Westminster (1936) 19 TC 49 AC 1**
Every man is entitled to order his affairs so that the tax is less than it otherwise would be
- **UOI vs. Azadi Bachao Andolan (263 ITR 706) (SC)**
An act otherwise valid in law cannot be treated non est based on underlying motive.



New Approach to Tax Avoidance – GAAR

Any arrangement entered into by a taxpayer may be declared as an **impermissible avoidance arrangement, if:**

- the main purpose is to obtain a **tax benefit** (part or whole in any step of such arrangement)
- It creates rights and obligations not normally created between persons dealing at arm's length;
- It results, directly or indirectly, in the abuse of provisions of DTC;
- It lacks **commercial substance**, in whole or in part; or
- It is not for a **bona fide** business purpose.



Recent Jurisprudence

- ***Aditya Birla Nuvo Limited*** where the Bombay High Court by lifting the corporate veil denied tax treaty benefits to the Mauritius company on transfer of shares of the Indian company and stated that the Mauritius company was only a permitted transferee of its US parent
- ***Richter Holdings*** where the Karnataka High Court, while quashing the writ petition of the taxpayer, directed the authorities to lift the corporate veil and look into the real nature of the transaction
- ***Vodafone International Holdings BV***, where the Bombay High Court upheld that the transfer of shares of the foreign company between two non-residents resulted in the indirect transfer of the Indian company's assets



Recent Jurisprudence (contd.)

- ***Vodafone Essar Gujarat Limited*** where the Gujarat High Court rejected the scheme of demerger on the grounds of tax evasion
- ***Indo Tech Electric Company*** where the Chennai High Court pierced the corporate veil to hold the sum paid for the transfer of an ongoing profitable concern to be in the nature of goodwill
- ***TVS Motors Company Ltd.***, where the Chennai Income-tax Appellate Tribunal held that if the scheme of amalgamation was sanctioned by the High Court, the Assessing Officer could not reject the same on the grounds that it was a mere device to avoid taxes



Satisfying “substance test”

- **Own or lease office space** in the intermediary offshore location (“IOL”)
- **Chairman of the Board** could ideally be a **permanent resident** and citizen in the IOL
- Board meetings of the offshore entity (“OE”) should be held in the IOL with substantive business issues being deliberated upon during those meetings
- Directors in the OE **must be the key decision makers and not just nominees**. This should be recorded in the minutes of the meeting held by the Board.



Satisfying substance test (contd.)

- The **management and control** of the IOL must at all points of time be only from that IOL
- The **tax residency certificate** of the OE must be obtained from the concerned tax authority and should be renewed on a yearly basis, if required under the local laws in the IOL
- OE's decision to **invest outside its jurisdiction should be made from the IOL** (and documented through minutes of the meeting)



Satisfying substance test (contd.)

- The Board of the OE should **monitor its investments** from that location (documented through minutes)
- The **day-to-day administrative and business matters** of the OE must be conducted in the IOL (general administration and operations, payment of salary, rent, electricity, telephone, travel, other operating expenses, etc.)
- OE must **maintain its statutory books of account and records** in the IOL



Satisfying substance test (contd.)

- The **Bank accounts** for the OE must be opened and **maintained** at the IOL
- The **business correspondence** of the OE should be carried out from the IOL
- The **corporate tax returns** of the OE should be regularly filed with the tax authorities on a yearly basis



Satisfying substance test (contd.)

- The OE may appoint a **company secretary** to operate from the IOL
- No correspondence relating to the OE should be carried out from India or any other location using the letterheads of the OE
- The OE in the IOL should be a distinct entity having its own identity and **not be a permitted transferee or nominee of the parent company**



Satisfying substance test (contd.)

- The OE should be able to demonstrate a level of **active involvement in the decision making process** relating to investments into India or sale or transfer of its shares to another foreign entity
- The involvement of the OE must not be limited to the mere **rubber stamping** of the decisions taken by its parent company



Defusing the GAAR tension

- GAAR should **apply prospectively**
- **Advance Rulings** on GAAR will be of assistance
- A **detailed FAQ / guidelines** by the CBDT on GAAR will be useful (similar to those on FBT)
- If certain transactions are already covered by specific anti-avoidance rules, then GAAR should not be applied



Defusing the GAAR tension (contd.)

- If judiciary has decided on certain matters, GAAR should not be invoked
- The burden to initiate GAAR **should be qualified** (i.e., reason to believe or is of the opinion or reason to suspect)
- There should be a **time limit** for invoking GAAR



Thank You

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