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General Anti-avoidance Rules

Provisions in the DTC Bill, 2010

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Scope…

- Broadly, any arrangement yielding tax benefit may be declared an impermissible avoidance arrangement, with following consequences:
  - Treat the arrangement as void
  - Disregard accommodating parties/treat parties as one and the same
  - Re-allocate income, expenses, relief, etc
  - Disregard/combine/re-characterise the arrangement
  - Deem connected persons as same, etc
  - Re-characterise equity, debt, income, expenses, relief, etc

…Scope…

- Applicability – Every “arrangement” (widest possible meaning)
  - Any “step” can taint the “whole”
- Tax benefit – very widely defined
- Is in addition to large number of SAARs
  - Transfer price (other than unrelated domestic parties)
  - Place of Effective Management – proposed
  - Controlled Foreign Corporations - proposed
  - Revocable Transfers/Transfer of Income/Transfers to Related Parties/Gifts
  - Conditions/definitions regarding cost, depreciation, deductions, exemptions, incentives covering most commercial situations

…Scope

- Extensive – Covers every conceivable situation
  - Transaction not at arm's length (Criterion 1)
  - Misuse or abuse of Code (not law in general) (Criterion 2)
  - Lacks commercial substance (Criterion 3)
    - No significant effect on business risks or cash flows
    - Legal substance inconsistent with legal form
    - Involves round trip financing
  - Not bonafide (Criterion 4)
    - Refers back to misuse and commercial purpose test

Interpretation

- How will Courts interpret – likely to look at purpose rather than language – Hence, in any case, likely to have wide coverage
- Criteria (2) and (4) are more subjective than criteria (1) and (3)
- If criteria (2) and (4) are deleted
  - Assessee's will have greater comfort – objective tests which they can satisfy
  - Revenue will still cover the same scope
- Burden of proof – entirely on assessee – unfair
- Will override tax treaties – mode of application not clear
- Will it also cover preventive avoidance (out of abunant/excessive caution)?

Pros & Cons

Pros

- More certainty than judicial/executive intervention
- Fair and transparent tax regime

Cons

- Violates principle of delegating too much subjective discretionary power
  - Administrative measures not adequately geared to handle the level of discretion
- Creates very uncertain atmosphere – disincentive to transactions, investment, growth.
- Wide consequential powers – no clarity on set-off/balancing adjustments

Suggestions…

- Define as objectively as feasible
- Clarify/provide for permissible tax mitigation
- Incorporate guidelines and threshold in the Act
- Provide for notification of observed impermissible avoidance mechanisms
- Commissioner to invoke GAAR only in notified matters
  - For new avoidance, to seek notification (decision at higher level)
- DRP to be independent Tribunal

…Suggestions

- Provide for Advance Ruling to identify tax mitigation
- If invoked, provide corresponding set off/corollary effect – do not treat as penalty (Sec 120/121)
- Preliminary onus on department – tax benefit plus prima facie existence of criteria – tax benefit alone not enough justification

Thank You