

GENERAL ANTI-AVOIDANCE RULES (GAAR)

Overview

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Why GAAR?

Object:

- Counteract any known or novel form of tax avoidance
- Substance over form
- Give power to tax authorities to deny tax benefit when an arrangement is undertaken with sole motive of tax benefit or avoidance
- Plugging loopholes that may result in tax avoidance

Effective date:

- GAAR is effective from any assessment year beginning on or after 1/4/2018

Applicability of GAAR

TAX EVASION	Unlawful, against the provision of law	Covered under normal provision of the Act
TAX AVOIDANCE	Use of legal steps Restructuring in tax reduction	GAAR may apply if the tax avoidance is the main purpose
TAX MITIGATION	Involves legal measures provided under the Act for tax taxes	GAAR should not apply if action is allowable under the tax structure itself

When can GAAR apply?

Applies to an arrangement which is impermissible avoidance arrangement within the meaning of Section 96 & 97 of the Income Tax Act.

What is Impermissible Avoidance Arrangement (IAA)?

- Main purpose is to obtain tax benefit
- Which creates right / obligation which are not normally between parties when dealing at Arms Length
- Misuse or abuse of Provisions of the Income Tax Act
- Lack of commercial substance
- Transaction entered into in a manner which are not normally employed for bonafide purpose

What is Tax Benefit?

- A reduction or avoidance or deferral of tax payable under the Act or as a result of tax treaty
- An increase in a refund of tax or other amount that would be payable under the Act
- A reduction in total income including an increase in loss

Lack of Commercial Substance

- Substance of arrangement as a whole is inconsistent with or differ significantly from its Form
- Arrangement involve or include round tripping financing and accommodating party
- Arrangement involves location of an asset or of the place of residence of any party and such location is without any substantial commercial purpose
- Arrangement does not effect significantly the business risk or any cash flow of any party to the arrangement and only attributes tax benefit

Consequences of Impermissible Avoidance Arrangement

- Disregarding, combining or recharacterizing and step-in / part or whole of the IAA
- Ignoring the IAA as if it has been entered into
- Disregarding any accommodating party or treating any accommodating party and any other person as one and the same person
- Relocating income / expenditure / deduction / rebate
- Disregarding corporate restructuring
- Reassigning place of residence situs of asset or transaction

Important Definitions

- Arrangement means any step in, or a part of whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or undertaking.
- Asset includes property, or right, any kind
- Benefit includes a payment of any kind whether in tangible or intangible form
- Relative shall have the meaning assigned to it in the Explanation to Clause (vi) of sub-section (2) of Section 56
- Reduction or avoidance or deferral of tax or other amount payable under this Act

Exemption from GAAR

- Rs. 3 crore tax benefit
- Foreign Institutional Investor
- Grandfathering of Existing Investment as on 1/4/2017

Administration of GAAR

Section 144BA of the Act:

- AO makes reference to PCIT / CIT to invoke GAAR
- PCIT / CIT communicate tax payer for furnishing objections, if any
- If PCIT / CIT satisfied with the tax payer's objection – GAAR not be invoked
- If not satisfied, then refer to approving panel which consist of 3 members
- Approving panel provide opportunity to tax payer
- If approving panel satisfied with the explanation of tax payer – GAAR not to be invoked

Administration of GAAR (Continued)

- If approving panel does not satisfy, then issue direction to Tax Officer to invoke GAR and complete the assessment
- To complete the assessment and serve on the payer
- Tax payer can file an appeal before ITAT

Rule 10UA, Rule 10UB and Rule 10UC

The entire process under section 144 BA has to done in accordance with these Rules

CBDT Circular No. 7 dated 27/1/2017

Case Study-(1)

“A” Pvt Ltd has substantial accumulated reserve of Rs.10 crore which is entirely invested in liquid form. To avoid invocation of Section 2(22)(e) of the Act, the management invested funds as long term deposit in related entity i.e. “B” Pvt Ltd.

After some time “B” Pvt Ltd give advance to related entity of “A” Pvt Ltd.

Under the normal Provision of the Act, There is no violation of any law and deemed dividend cannot be taxed in the hands of shareholder of “A” Pvt Ltd but the AO can invoke GAAR as an abuse / misuse of Provision of the Act by involving an accommodating entity.

Case Study-(2)

“A” Pvt Ltd owns a residential flat which is depreciable asset in the books. If the residential flat is sold, there would be Short Term Capital Gain in the hands of the Company which would be treated as Short Term Capital Gain would be subject to tax @ 30%. Instead of selling the flat, the shareholder of “A” Pvt Ltd sell their investment in “A” Pvt Ltd to prospective buyer of the flat and declare the Capital Gain on sale of share which is available for further investment under exemption clause.

Here, GAAR could be invoked as structure has been done basically to avoid Short Term Capital Gain in the hands of the Company for which no exemption if available and tax at a higher tax.

Case Study-(3) Conversion of company into LLP

“A” Pvt Ltd is a closely held company having surplus funds of Rs.20 crore lying in the bank and also having investment in equity shares amounting to Rs.10 crore.

Shareholders of “A” Pvt Ltd cannot use the fund for their personal purpose as any withdrawal from “A” Pvt Ltd would attract deeming provision of section 2(22)(e) of the Act besides paying MAT in the company.

They therefore created a new structure under which “A” Pvt Ltd will merge with “B” Pvt Ltd having total assets value less than Rs.50 lakh and enjoying exemption of capital gain tax under the Act.

After merger “B” Pvt Ltd will be converted into LLP so that the partners who were the shareholders of “A” Pvt Ltd can withdraw the money without paying any tax and also LLP does not have MAT.

In this case AO can invoke GAAR as the provision of the Act has been abused/ misused for benefits of tax.