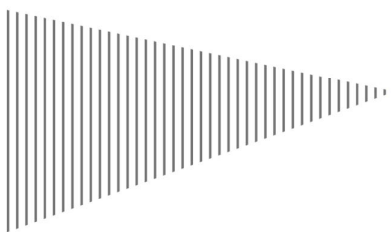


27 September 2013

# EY Tax Alert

## CBDT notifies GAAR rules



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### Executive summary

This Tax Alert summarizes a recent notification<sup>[1]</sup> issued by the Central Board of Direct Taxes (CBDT) on the Income-tax (17th Amendment) Rules, 2013 (Rules) for application of General Anti-avoidance Rules (GAAR). The Rules prescribe a threshold limit of INR30m of aggregate tax benefit to all parties to the arrangement for invoking GAAR. The Rules also carve out exceptions in case of certain investments by Foreign Institutional Investors (FIIs) and nonresident investors in FIIs. The Rules make it clear that GAAR applies to all tax benefits obtained on or after 1 April 2015 irrespective of the date of arrangement. However, income from transfer of investments made before 30 August 2010 is protected from GAAR impact. It is also clarified that, where a part of an arrangement is tainted, the tax consequences would be limited to the tainted part only. The Rules also prescribe various forms for reference by the Tax Authorities having regard to the various stages of reference. The time limits for such procedures have also been stipulated. The Rules would be effective so as to apply for tax year beginning 1 April 2015 and subsequent years.

### Background

In order to address aggressive tax planning and tax avoidance, GAAR provisions were first proposed to be introduced as part of the Direct Taxes Code Bill, 2010 (DTC 2010). However, Finance Act, 2012 introduced GAAR provisions under the present Indian Tax Laws (ITL) even prior to implementation of DTC 2010<sup>[2]</sup>, much to the anguish of various stakeholders. The Prime Minister, therefore,

<sup>[1]</sup> Notification No. 75 dated 23 September 2013

<sup>[2]</sup> Refer EY Tax Alert dated 20 March 2012 "Budget Plus 2012 – Key anti abuse provisions in the Finance Bill 2012"



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constituted an Expert Committee under the chairmanship of Dr. Parthasarathi Shome, which submitted its recommendations on GAAR. The Finance Minister also issued a statement In January 2013 on the decisions taken by the Government of India (GOI) after considering these recommendations<sup>[3]</sup>. Consequently, GAAR provisions were amended by Finance Act, 2013 to reflect some of the decisions. Significantly, its application was restricted to the arrangements which have the main purpose (as opposed to one of the main purposes) of tax benefit and its applicability was deferred to tax year 2015-16<sup>[4]</sup>. Also, the Approving Panel<sup>[5]</sup> was broad-based to comprise a Chairman who is or has been a judge of a High Court; a member from the Indian Revenue Services not below the rank of Chief Commissioner and an independent expert.

## Rules for application of GAAR

The Rules are to come into force on 1 April 2016. It would, therefore, apply for tax year beginning 1 April 2015 and subsequent years.

The Rules reiterate that GAAR applies to any arrangement in respect of tax benefit obtained from tax year 2015-16 onwards.

The Rules also provide a monetary threshold in addition to certain exceptions where GAAR would not apply. These are as follows:

- ▶ Any arrangement where the aggregate tax benefit to all parties of the arrangement in the relevant tax year does not exceed INR30m. Tax benefit would be computed with respect to reduction, deferral or avoidance of tax or with reference to increase in refund of tax. In case of increase in loss, the tax

benefit is tax that would have been chargeable had such increased loss been the total income.

- ▶ In case of an FII which:
  - ▶ is assessed as per the provisions of the ITL;
  - ▶ has not claimed benefits under an Indian Double Taxation Avoidance Agreement ; and
  - ▶ has invested in listed or unlisted securities with prior permission of the competent authority in accordance with the applicable regulations.
- ▶ A nonresident investor in an FII who has invested in an FII, directly or indirectly, by way of an offshore derivative instrument or otherwise.
- ▶ Any income derived from transfer of investments made prior to 30 August 2010 (the date of introduction of DTC 2010) is protected from GAAR<sup>[6]</sup>.

The Rules also clarify that, where a part of an arrangement is GAAR-infected, the tax consequences would be determined with reference to such infected part only.

## Procedural matters

The ITL provides that, on satisfaction of the conditions for invoking GAAR at any stage of assessment or reassessment proceedings, the Tax Authority can make a reference to the Commissioner. The Commissioner, if he is satisfied that GAAR is required to be invoked, should issue a notice to the taxpayer for submitting objections. Where no objections are received within the prescribed time, the Commissioner can issue such directions as he may deem fit for applying GAAR. However, if the taxpayer objects to invoking GAAR and the Commissioner is not satisfied with the taxpayer's explanations, he would need to refer the matter to an Approving Panel. The Approving Panel shall either declare an arrangement to be impermissible or otherwise, after examining the relevant material and making further inquiry.

The Rules provide for mode, manner, form and time limit for the various steps involved in the procedure for invoking GAAR.

<sup>[3]</sup> Refer EY Tax Alert dated 14 January 2013 "Press Release from the Ministry of Finance and Final Report of the Expert Committee on GAAR"

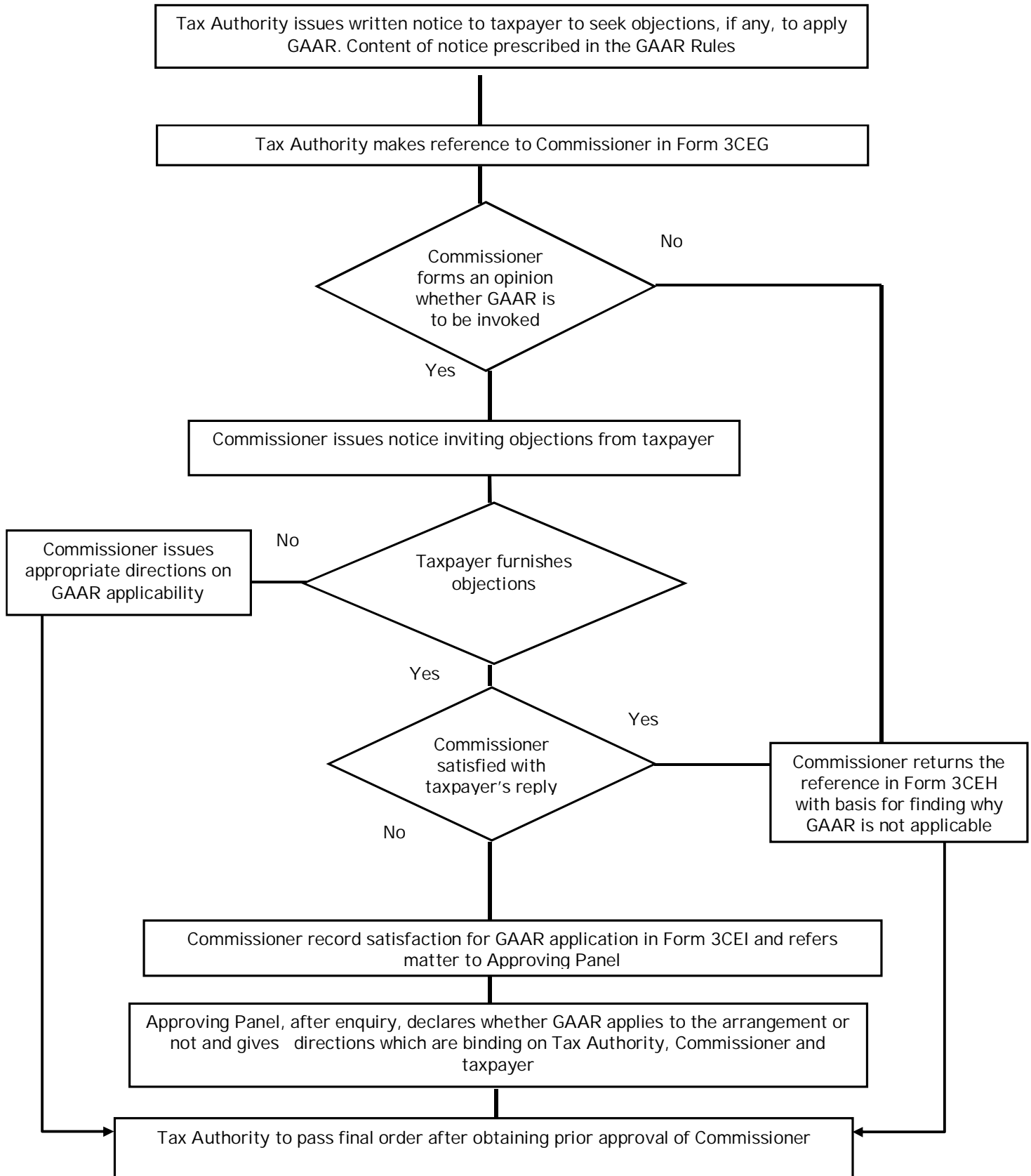
<sup>[4]</sup> Refer EY Tax Alert released on 1 March 2013 "Budget Plus 2013 - Key international tax provisions in the Finance Bill 2013".

<sup>[5]</sup> Approving Panel is the panel to which the Commissioner is obligated to make a reference when he is not agreeable with the taxpayer that GAAR is not applicable. However, where the taxpayer does not object or reply, the Commissioner shall, *suo moto*, determine applicability of GAAR.

<sup>[6]</sup> In the Press Release dated 14 January 2013, the Ministry of Finance stated that investments made before 30 August 2013 (the date of introduction of DTC 2010) were to be grandfathered

Procedure	Content	Time limit	Prescribed Form
Issue of show notice by Tax Authority to taxpayer seeking objection, if any, on application of GAAR	(a) Details of arrangement in respect of which GAAR is proposed to be applied (b) tax benefit, (c) basis and reason for considering that the main purpose is to obtain tax benefit (d) Basis and reasons, why the tainted element test is satisfied (e) List of documents and evidence relied upon to arrive at such a conclusions for (c) and (d)	Not specified in the Rules. May be specified in the concerned notice.	Not specified
Reference by Tax Authority to the Commissioner	Details of taxpayer like name, PAN, status, address, relevant tax year, details of pending assessment, details of arrangement and how GAAR applies to such arrangement, computation of tax benefit and consequence of GAAR	-	3CEG
Commissioner is satisfied that GAAR is not to be invoked based on reference by Tax Authority	Basis of finding that GAAR provisions are not applicable	One month from the end of the month in which the reference from Tax Authority is received	3CEH
On receipt of reference by Tax Authority, Commissioner is of the opinion that GAAR applies, he is required to issue notice to the taxpayer to submit objections, if any. (As per ITL)	Reasons and basis of opinion	As specified in the notice, not to exceed 60 days	Not specified
Where taxpayer does not raise any objections, Commissioner to issue such directions as he deems fit for Tax Authority to apply GAAR		One month from end of the month in which date of compliance of notice falls [i.e. time permitted for taxpayer to raise objections before the Commissioner]	Not specified-
Commissioner is satisfied that GAAR provisions are not to be invoked based on response by taxpayer	Details of taxpayer and basis of finding that GAAR provisions are not applicable	Two months from end of month in which final submission of taxpayer is received by the Commissioner	3CEH
Commissioner records satisfaction that GAAR applies and makes a reference to Approving Panel	Details as given in reference by tax Authority to the Commissioner when he considers GAAR is applicable, reply furnished by taxpayer and detailed reasons for satisfaction of conditions for applicability of GAAR	Two months from end of month in which final submission of taxpayer is received by the Commissioner	3CEI

The GAAR procedure is pictorially depicted as follows:



## Comments

To a large extent, the Rules have addressed the concerns and anxieties of taxpayers. The carving out of exceptions for FII and investors in FII, subject to their satisfying certain conditions, should provide comfort. The specification of threshold of tax benefit is also welcome. Many other recommendations of the Shome Committee appear, by now, to have been incorporated, either in the ITL or in the Rules. Notably, the GAAR provisions in the ITL, read with the procedure prescribed in the Rules, provide for three opportunities to the taxpayer to raise its objections against invocation of GAAR, once before the Tax Authority, the second before the Commissioner and the third before the Approving Panel.

The Shome Committee Report had recommended grandfathering of investments existing as of the date GAAR becomes applicable. But, considering that the proposal of introduction of GAAR was already in the public domain as part of DTC 2010, the GOI had decided to grandfather investments made before 30 August 2010. The Rules do merely permit grandfathering income from transfer of such investment and do not grandfather other income streams (like interest, dividends, lease rentals, etc.). One would, therefore, need to carefully analyze tax implications in respect of investments made, including investments acquired as a result of group reorganization.

Based on the Shome Committee Report, there were expectations about an assertive acceptance of the overarching principles viz., that GAAR applicability may be restricted to cases of blatant abuse and contrived tax avoidance transactions. This expectation is not met. Also, there is no clarity on interplay between GAAR and Specific Anti-avoidance Rules (SAAR) as against the Committee recommendation that GAAR would not apply in a case where SAAR is applicable. There can, therefore, be ambiguity about the applicability of GAAR in a case where Limitation of Benefits (LOB) or similar provisions in the DTAA are satisfied. Clarifications on these, together with the formulation and publication of illustrative examples, will help provide certain clarity to taxpayers.

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