India’s CBDT issues rules for application of GAAR

Executive summary

This Tax Alert summarizes a recent notification issued by India’s 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 the 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 the transfer of investments made before 30 August 2010 is protected from the 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 with respect 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 the 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. As a result, the Prime Minister constituted an Expert Committee (the Shome Committee) 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.
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.

Rules for application of GAAR

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

The Rules reiterate that GAAR applies to any arrangement with respect to a 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. The tax benefit would be computed with respect to reduction, deferral or avoidance of tax or with reference to an increase in the refund of tax. In case of an increase in loss, the tax benefit is the tax that would have been chargeable had such increased loss been the total income.

- In the case of an FII which:
  - is assessed as per the provisions of the ITL;
  - has not claimed benefits under an Indian treaty; 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 the transfer of investments made prior to 30 August 2010 (the date of introduction of DTC 2010) is protected from GAAR.

The Rules also clarify that, where a part of an arrangement is GAAR-impacted, the tax consequences would be determined with reference to such impacted 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 refer the case 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.
The GAAR procedure is pictorially depicted as follows:

1. Tax Authority issues written notice to taxpayer to request objections, if any, to the application of GAAR. Content of notice prescribed in the GAAR Rules
2. Tax Authority refers the case to the Commissioner in Form 3CEG
3. Commissioner assesses whether GAAR is to be invoked
   - No
   - Yes
4. Commissioner issues notice requesting objections from taxpayer
5. Commissioner issues appropriate directions on GAAR applicability
   - No
   - Yes
6. Taxpayer furnishes objections
   - Yes
   - No
7. Commissioner satisfies with taxpayer’s reply
   - Yes
   - No
8. Commissioner returns the reference in Form 3CEH with basis for finding why GAAR is not applicable
9. Commissioner records satisfaction for GAAR application in Form 3CEI and refers matter to Approving Panel
10. Approving Panel, after inquiry, declares whether GAAR applies to the arrangement or not and gives directions which are binding on Tax Authority, Commissioner and taxpayer
11. Tax Authority to pass final order after obtaining prior approval of Commissioner
Implications

To a large extent, the Rules have addressed the concerns of taxpayers. The carving out of exceptions for FIIs and investors in FIIs, subject to their satisfying certain conditions, should address some of these concerns. The specification of the threshold of tax benefit is also positive. 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 three opportunities for the taxpayer to raise its objections against the 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 decided to grandfather investments made before 30 August 2010. The Rules 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 the 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 the Limitation of Benefits (LOB) or similar provisions in the respective treaty are satisfied. Clarifications on these, together with the formulation and publication of illustrative examples, will help provide certain clarity to taxpayers.

Endnotes

1. Notification No. 75 dated 23 September 2013.
5. 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.
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