CHAPTER 48: GAAR/ MAT with IND AS & FOREIGN TAX CREDIT

CONCEPT OF TAX PLANNING

Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. In other words, all arrangements by which the tax is saved by ways and means which comply with the legal obligations and requirements and are not colourable devices or tactics to meet the letters of law, would constitute tax planning.

The Hon'ble Supreme Court in **McDowell & Co. vs. CTO** (1985) 154 ITR 148 has observed that "tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods." Tax planning should not be done with intent to defraud the revenue; though all transaction entered into by an assessee could be legally correct, yet on the whole these transactions may be devised to defraud the revenue. All such devices where statute is followed in strict words but actually spirit behind the statute is defeated would be termed as colourable devices and they do not form part of tax planning. All transactions in respect of tax planning must to be in accordance with the true spirit of statute and should be correct in form and substance.

Various judicial pronouncements have laid down the principle that substance and form of the transactions shall be seen in totality to determine the net effect of a particular transaction. The Hon,ble Supreme Court has held that, "The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of relationship."

The form and substance of a transaction is real test of any tax-planning device. The form of transaction refers to transaction, as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

RIGHT TO PLAN TAX LIABILITY

The Supreme Court held in the case of McDowell & Co. vs. CTO (1985) 154 ITR 148 (SC) has said that it is true that planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay taxes honestly without resorting to subterfuges. It is also true that in order to create an atmosphere of tax compliance, taxes must be reasonably collected and when collected, should be utilized for proper expenditure and not to be wasted.

TAX PLANNING, TAX EVASION AND TAX AVOIDANCE

In the context of saving tax, there are three commonly used practices, namely (a) Tax Evasion; (b) Tax Avoidance; (c) Tax Planning.

(a) **Tax Evasion:** It refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the income or by inflating the expenditure showing the income lower than the actual income and resorting to various types of deliberate manipulations. An assessee guilty of tax evasion is punishable under the relevant laws. Tax evasion may involve stating an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper accounts of income earned (if required under the law) omission of material facts in assessments. An assessee who dishonestly claims the benefit under the statute by making false statements, would be guilty of tax evasion.

(b) **Tax Avoidance:** The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of malafide motive involved in tax avoidance also. Any planning which, though done strictly according to legal requirements defeats the basic intention of the Legislature behind the statute could be termed as instance of tax avoidance. It is usually done by adjusting the affairs in such a manner that there is no infringement of taxation laws and by taking full advantage of the loopholes therein so as to attract the least incidence of tax. Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. In the latest judgement of the Supreme Court in McDowell's case 1985(154 ITR 148) SC, tax avoidance has been considered as heinous as tax evasion and a crime against society. Most of the amendments are now aimed at curbing practice of avoidance.

(c) **Tax Planning:** It means arranging the financial activities in such a way that maximum tax benefits are enjoyed by making use of all beneficial provisions in the tax laws which entitle the assessee to get certain rebates and reliefs. This is permitted and not frowned upon by law. Thus, tax planning would imply compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income-tax Act so that the incidence of tax is the least. Tax planning can neither be equated to tax evasion nor to tax avoidance with reference to a company, it is the scientific planning of the company's operations in such a way so as to attract minimum liability to tax or postponement or for that matter deferment of the tax liability for the subsequent period by availing various incentives, concessions, allowances, rebates and reliefs provided for in the tax laws. They are meant to be availed of and they have certain clear objectives to achieve. Tax planning may, therefore, be regarded as a method of intelligent application of expert knowledge of planning corporate affairs with a view to securing consciously provided tax benefits on the basis of the national priorities in consonance with the interests of the Sate and the public.

GENERAL ANTI-AVOIDANCE RULE (GAAR)
INTRODUCTION

- GAAR provisions do not deal with cases of Tax Evasion.
- GAAR provisions do not deal with cases of Tax Planning.
- GAAR provisions do not apply with cases where there are specific provisions under the Act for anti-avoidance.
- Provisions of Specific Anti-Avoidance Rules and GAAR can co-exist.
- GAAR provisions are applicable for Assessment Year 2018-19 and onwards.
- Investments made/ acquired prior to 1st April 2017 not covered by GAAR provisions.
- GAAR provisions apply where the aggregate tax benefit in the relevant Assessment Year arising to all the parties to the arrangement exceed **Rs.3 crores**.
- Exemption from GAAR provisions to the following:
  - Foreign Institutional Investor ('FII') who:
    - is an assessee under the Act;
    - has not taken benefit of a DTAA; and
    - has invested in listed or unlisted securities with prior permission.

TAX AVOIDANCE vs. TAX EVASION/ TAX PLANNING

(1) Tax Avoidance vs. Tax Evasion

'Tax evasion' is generally **the result of illegality, suppression, misrepresentation and fraud. 'Tax avoidance1** is the **result of actions taken by the assessee, none of which or no combination of which is illegal or forbidden by the law itself.**

The GAAR provisions do not deal with cases of tax evasion. Tax evasion is clearly distinct from tax avoidance and is already prohibited under the current provisions of the Income-tax Act.

(2) Tax Avoidance vs. Tax Planning

'Tax Planning' is a situation where the taxpayer takes advantage of a fiscal incentive afforded to him by the tax legislation by actually complying to the conditions attached to that fiscal incentive.

An example of tax planning is the setting up of a business undertaking by a taxpayer in a specified area such as a Special Economic Zone ('SEZ'). In such a case the taxpayer is taking advantage of a fiscal incentive offered to him by complying with conditions of the SEZ provisions in the Income-tax Act e.g., setting up the business only in the SEZ areas and export from the SEZ area. Tax planning, as distinct from tax avoidance, is allowed under the tax statute. The GAAR provisions also do not deal with case of tax planning.

NEED FOR AND RATIONALE OF GAAR

i. There is a growing concern amongst the revenue authorities in many countries that taxpayers structure their transactions to reduce the taxes. In order to combat and address such practices followed by the taxpayers, countries have implemented various measures to prevent tax avoidance in various cases.

ii. Hitherto, the Indian Income-tax Act, 1961 contained only **Specific Anti-Avoidance Rules (SAARs) to prevent tax avoidance**. Specific examples of SAAR which are present in the Income-tax Act are as under:
- **Section 40A(2)**: Excessive or unreasonable payments to related parties not deductible
- **Section 92 to 92F:** Transfer pricing regulations applicable to international/certain domestic transactions
- **Section 94:** Avoidance of tax by certain transactions in securities (For example: Dividend Stripping, Bond Washing)
- **Section 94A:** Transactions with persons located in notified jurisdictional areas (NJA)
- **Section 40(a)(i)/(ia):** Disallowance of expense for non-deduction of tax at source
- **Explanation 1 to 13 to Section 43(1):** Determination of actual cost of assets ignoring agreements, etc.

However, as the name suggests, SAAR is tailor made to particular situation or particular instance.

iii. In order to codify the **"substance over form" doctrine** and to further confer broad powers on the tax authorities to deny tax benefits (including tax benefits applicable under DTAAs), where such tax benefits arise from arrangements that are 'impermissible avoidance arrangements', provisions of GAAR have been introduced under the Income-tax Act under Chapter X-A. GAAR is based on the principle that transactions have to be real and are not to be looked at in isolation. Where there is no business purpose and no commercial expediency, except to obtain a tax benefit, GAAR will be attracted.

SECTION 102
Definitions

In this Chapter, unless the context otherwise requires,—

(1) **"arrangement"** means any step in, or a part or 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 understanding;

(2) **"asset"** includes property, or right, of any kind;

(3) **"benefit"** includes a payment of any kind whether in tangible or intangible form;

(4) **"connected person"** means any person who is connected directly or indirectly to another person and includes,—
   (a) any **relative** of the person, if such person is an individual;
   (b) any **director of the company** or any **relative of such director**, if the person is a company;
   (c) any **partner or member of a firm or association of persons** or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals;

(d) any **member of the Hindu undivided family** or any relative of such / member, if the person is a Hindu undivided family;

(e) any **individual who has a substantial interest** in the business of the person or any relative of such individual;

(f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;

(g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member;

(h) any other person who carries on a business, if—

(i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or

(ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

(5) "**fund**" includes—

(a) any cash;

(b) cash equivalents; and

(c) any right, or obligation, to receive or pay, the cash or cash equivalent;

(6) "**party**" includes a person or a permanent establishment which participates or takes part in an arrangement;

(7) "**relative**" shall have the meaning assigned to it in the Explanation to section 56(2)(x);

(8) **a person shall be deemed to have a substantial interest in the business, if,**—

(a) in a case where the business is carried on by a company, such person is, at any time during the financial year, the beneficial owner of equity shares carrying twenty per cent or more, of the voting power; or

(b) in any other case, such person is, at any time during the financial year, beneficially entitled to twenty per cent or more, of the profits of such business;

(9) "**step**" includes a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement;

(10) "**tax benefit**" includes,—

(a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or

(b) an increase in a refund of tax or other amount under this Act; or

(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or

(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

(e) a reduction in total income; or

(f) an increase in loss,

in the relevant previous year or any other previous year;

(11) **"tax treaty"** means an agreement referred to in section 90(1) or section 90A(1).

SECTION 95 { DO NOT READ BARE ACT DURING EXAMS}

Applicability of GAAR

(1) Notwithstanding anything contained in the Act, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.

(2) This Chapter shall apply in respect of any assessment year beginning on or after the 1st day of April, 2018.

Explanation.—For the removal of doubts, it is hereby declared that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.

♦ ANALYSIS OF SECTION 95 ♦

- GAAR provisions are applicable to **"impermissible avoidance arrangement".** Consequences in relation to tax arising there from are to be determined in accordance with Chapter X-A.
- GAAR provisions are applicable from Assessment Year 2018-19 and onwards.
- In order to plug any loophole, GAAR provisions will apply to any step in or a part of an arrangement as they are applicable to the whole arrangement.

- **OVERRIDING EFFECT OF GAAR**

  GAAR has an overriding effect on other provisions of the Income-tax Act. Provisions of GAAR would be applicable, irrespective of other provisions of the Act.

  The provisions of GAAR shall also override the DTAA provisions.

  However, in cases where the Income-tax Act specifically provides tax incentives to the taxpayers upon fulfilment of prescribed conditions, provisions of GAAR shall not be applicable. Further, where there are specific provisions which deals with ways of stopping tax avoidance, GAAR shall not apply, but specific provisions will apply.

Example 1

Facts:

M/s India Chem Ltd. is a company incorporated in India. It sets up a unit in a Special Economic Zone (SEZ) in F.Y. 2018-19 for manufacturing of chemicals. It claims 100% deduction of profits earned from that unit in F.Y. 2020-21 and subsequent years as per section 10AA of the Act. Is GAAR applicable in such a case?

Interpretation:

There is an arrangement of setting up of a unit in SEZ which results in a tax benefit. However, this is a case of tax mitigation where the tax payer is taking advantage of a fiscal incentive offered to him by complying with the conditions imposed and economic consequences of the provisions in the legislation e.g., setting up the business unit in SEZ area. Hence, the Revenue would not invoke GAAR as regards this arrangement.

Example 2

Facts:

In the above example 1, let us presume M/s India Chem Ltd. has another unit for manufacturing chemicals in a non-SEZ area. It then diverts its production from such manufacturing unit and shows the same as manufactured in the tax exempt SEZ unit, while doing only the process of packaging there. Is GAAR applicable in such a case?

Interpretation:

This is a case of misrepresentation of facts by showing production of non-SEZ unit as production of SEZ unit. Hence, this is an arrangement of tax evasion and not tax avoidance.

Tax evasion, being unlawful, can be dealt with directly by establishing correct facts. GAAR provisions will not be invoked in such a case.

Example 3

Facts:

In the above example 2, let us presume that M/s India Chem Ltd. does not show production of non-SEZ unit as a production of SEZ unit but transfers the product of non-SEZ unit at a price lower than the fair market value and does only some insignificant activity in SEZ unit. Thus, it is able to show higher profits in SEZ unit than in non-SEZ unit, and consequently claims higher deduction in computation of income. Can GAAR be invoked to deny the tax benefit?

Interpretation:

As there is no misrepresentation of facts or false submissions, it is not a case of tax evasion. The company has tried to take advantage of tax provisions by diverting profits from non-SEZ unit to SEZ unit. This is not the intention of the SEZ legislation. However, such tax avoidance is specifically dealt with through transfer pricing regulations that deny tax benefits. Hence, the Revenue would not invoke GAAR in such a case.

Example 4

Facts:

In the above example 3, let us presume, that both units in SEZ area (say A) and non-SEZ area (say B) work independently. M/s India Chem Ltd. started taking new export orders from existing as well as new clients for unit A and gradually, the export from unit B declined. There has not been any shifting of equipment from unit B to unit A. The company offered lower profits from unit B in computation of income. Can GAAR be invoked on the ground that there has been shifting or reconstruction of business from unit B to unit A for the main purpose of obtaining tax benefit?

Interpretation:

The issue of tax avoidance through shifting/reconstruction of existing business from one unit to another has been specifically dealt with in section 10AA of the Act. Hence, the Revenue would not invoke GAAR in such a case.

~~SECTION 96{ DO NOT READ BARE ACT DURING EXAMS}~~

~~Impermissible Avoidance Arrangement~~

~~(1) An **impermissible avoidance arrangement** means an arrangement, the **main purpose of which is to obtain a tax benefit,** and it–~~

~~**(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;**~~

~~**(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;**~~

~~**(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or**~~

~~**(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.**~~

~~(2) **An arrangement shall be presumed,** unless it is proved to the contrary by the assessee, **to have been entered into, or carried out, for the main purpose of obtaining a tax benefit**, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.~~

~~SECTION 97{ DO NOT READ BARE ACT DURING EXAMS}~~

~~Arrangement to Lack Commercial Substance~~

~~(1) An arrangement shall be **deemed to lack commercial substance, if** –~~

~~(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or~~

~~(b) it involves or includes–~~

~~(i) round trip financing;~~

~~(ii) an accommodating party;~~

~~(iii) elements that have effect of offsetting or cancelling each other; or~~

~~(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or~~

~~(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party; or~~

~~(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).~~

~~(2) For the purposes of sub-section (1), **round trip financing includes any arrangement** in which, through a series of transactions–~~

~~(a) funds are transferred among the parties to the arrangement; and~~

~~(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),~~

~~without having any regard to—~~

~~(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;~~

~~(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or~~

~~(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.~~

~~(3) For the purposes of this Chapter, a party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.~~

~~(4) For the removal of doubts, it is hereby clarified that the following may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not, namely:—~~

~~(i) the period or time for which the arrangement (including operations therein) exists;~~

~~(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;~~

~~(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.~~

Note: The aforementioned provisions are struck off not because they are omitted from the Income Tax Act, but it is struck off so that a student does not invest time on them on the day of exams.

♦ ANALYSIS OF SECTION 96 AND SECTION 97 ♦

1. An arrangement is an "impermissible avoidance arrangement" (IAA) if the following twin conditions are satisfied:

~~conditions~~

Primary Condition

Main purpose is to obtain tax benefit

+

Tainted element presence test

Creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length **(Test 1)**

Or

results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act **(Test 2)**

Or

Lacks commercial substance or is deemed to lack commercial substance in whole or in part **(Test 3)**

Or

Is entered into or carried out by means or in a manner which are not ordinarily employed for bonafide purposes **(Test 4)**

Thus, an arrangement would qualify to be termed as an IAA if it satisfies the primary condition and any one of tainted element presence test.

2. PRESUMPTION OF PURPOSE

An arrangement is presumed to have been entered into for main purpose of obtaining tax benefit even if:

- Main purpose of whole arrangement is not to obtain a tax benefit; but
- Main purpose of step in, or a part of, the arrangement is to obtain tax benefit.

3. ANALYSIS OF EACH OF THE TAINTED ELEMENT PRESENCE TESTS

I. Test 1: Arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length.

♦ ANALYSIS OF TEST 1 ♦

The first tainted, element refers to non-arm's length dealings where an arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length. As there are SAAR applicable to international transactions and certain specified domestic transactions, this tainted element is to be examined only in those transactions which are not covered by Transfer Pricing regulations and where the main purpose of the arrangement is to obtain tax benefit.

Illustration:

Facts:

Y Tech Ltd. is a company resident of country C1. It enters into an agreement with Z Energy Ltd., an Indian company for setting up a power plant in India. It is a composite contract for an agreed price of US$ 100million. The payment has been split in the following parts as per separate agreements

(i) US$ 10 million for design of power plant outside India (payment for which is taxable at 20% on gross basis)

(ii) US$ 70 million for offshore supplies of equipment etc (not taxable as no role is played by any PE in India. These are not subject to import duty)

(iii) US$ 20 million for local supplies and installation charges (taxable on net income basis)

It is found that the fair market value of offshore design is about USD 30 million; therefore it is under invoiced. On the other hand, offshore supplies were over invoiced. The arrangement resulted in significant tax benefit to the taxpayer. Can GAAR be invoked in such a case?

Interpretation:

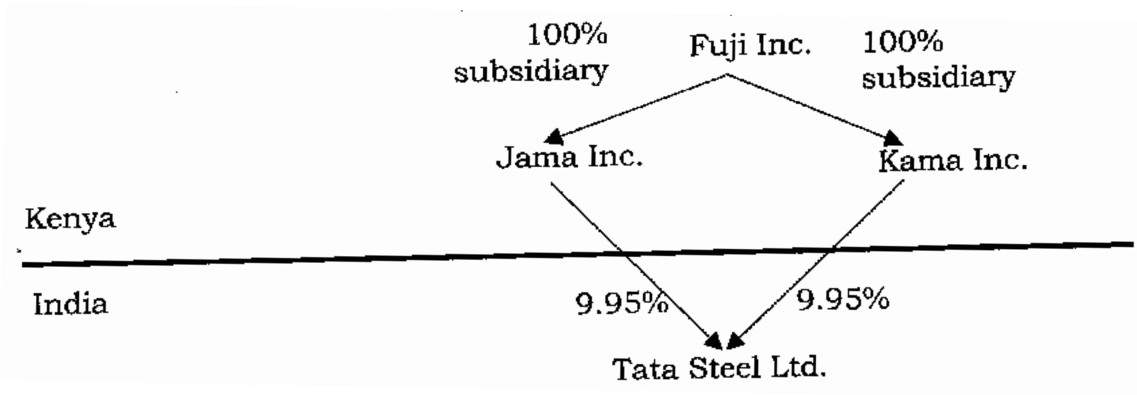
The allocation of price to different parts of the contract has been decided in such a manner as to reduce tax liability of the foreign company in India. Both conditions for declaring an arrangement as impermissible are satisfied. (1) The main purpose of this arrangement is to obtain tax benefit; and (2) the transactions are not at arm's length. Consequently, GAAR may be invoked and prices would be reallocated. However, determination of arm's length price should be based on transfer pricing regulations under the Act, if the enterprises are associated enterprises.

II. **Test 2: Arrangement results, directly or indirectly, in the misuse or abuse, of the provisions of this Act**

♦ ANALYSIS OF TEST 2 ♦

The second tainted element refers to an arrangement which results in misuse or abuse of the provisions of the tax law. It implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law.

Illustration:



Facts:

Under the provision of DTAA between India and Kenya, any capital gains arising from the sale of shares of Tata Steel Ltd., an Indian company would be taxable only in Kenya if the transferor is a resident of Kenya and holds not more than 10% equity capital of Indian company. However, where the transferor holds more than 10% interest in the capital stock of Indian company, then such capital gains shall be taxable in India.

A company, Fuji Inc., being resident in Kenya, makes an investment in Tata Steel Ltd. through two wholly owned subsidiaries (Jama Inc. and Kama Inc.) located in Kenya. Each subsidiary holds 9.95% shareholding in Tata Steel, the total adding to 19.9% of equity of Tata Steel. The subsidiaries sell the shares of Tata Steel and no tax is payable in India as per DTAA as each is holding less than 10% equity shares in Tata Steel Ltd. Can GAAR be invoked to deny DTAA benefit?

Interpretation:

The above arrangement of splitting the investment through two subsidiaries appears to be with the intention of obtaining tax benefit under the DTAA. Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor Fuji Inc. in any manner (i.e. on business risks or cash flow), and reveals a tainted element of abuse of tax laws. Hence, the arrangement would be treated as an IAA by invoking

GAAR. Consequently, DTAA benefit would be denied by ignoring Jama Inc. and Kama Inc., the two subsidiaries. By treating Jama Inc. and Kama Inc. as one and the same company for tax computation purposes, the profits from sale of shares shall be taxable in India.

III. **Test 3:** This test covers the following situations:

a) Arrangements that lack commercial substance; and

b) Arrangements that are deemed to lack commercial substance under section 97 of the Act

in whole or in part.

♦ ANALYSIS OF TEST 3(a). i.e Lacks Commercial Substance ♦

As regards the first limb, the term "commercial substance" has not been defined and has to be understood in common parlance.

Illustration:

Facts:

Sun India Ltd., an Indian company is in the business of import and export of certain goods. It purchases goods from Singapore and sells the same in Dubai. It sets up a subsidiary Moon Inc. in Cyprus - a zero tax jurisdiction. The director of Sun India Ltd. finalizes the contracts in India but shows the documentation of the purchase and sale in the name of Moon Inc. set up in Cyprus. The day to day management operations are carried out in India. The goods move from Singapore directly to Dubai. The transactions are recorded in the books of Moon Inc. in Cyprus, where the profits are tax exempt as per DTAA.

Make a Chart of Facts here:

Interpretation:

The company is camouflaging the sale and purchase transactions as Cyprus based transactions. By this arrangement, Sun India Ltd. has obtained a tax benefit. There was no need to set up the subsidiary Moon Inc. in Cyprus. The arrangement lacks commercial substance. The DTAA with Cyprus shall be ignored and the profits of Moon Inc. shall be taxable in India applying GAAR.

Thus, an arrangement is likely to be lacking commercial substance if it has not been undertaken for a bonafide purpose and does not have a significant effect upon the business of the party, apart from the tax benefit.

♦ ANALYSIS OF TEST 3(b). i.e Sec 97.Deemed to lack Commercial Substance ♦

As regards the second limb, there are other factors provided under **section 97**, which have the effect of deeming the arrangement to be lacking in commercial substance. The **presence of any one of these** following factors **will be sufficient for the test to be satisfied**:

a) **Where the substance/ effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part**

Clause (a) is the codification of substance v. form doctrine. It implies that where substance of an arrangement is different from what is intended to be shown by the form of the arrangement, then tax consequence of a particular arrangement should be assessed based on the "substance" of what took place. In other words, it reflects the inherent ability of the law to remove the corporate veil and look beyond form.

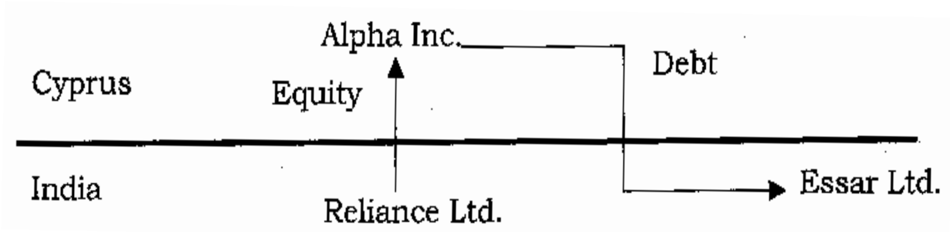
b) When the arrangement involves/ includes any of these:

b) (i) Round Trip Financing

Illustration on (b)(i):

Facts:

Reliance Ltd., an Indian Company, incorporates a subsidiary company Alpha Inc. in Cyprus (No Tax Jurisdiction) with equity of USD 100 million. Alpha Inc. gives a loan of USD 100 million to another Indian company (Essar Ltd.) at the rate of 10% p.a. Essar Ltd. claims deduction of interest payable to Alpha Inc. from the profit of business. There is no other activity in Alpha Inc. Can GAAR be invoked in such a case?



Interpretation:

The arrangement appears to be to avoid payment of tax on interest income by Reliance Ltd. in case loan is directly provided by Reliance Ltd. to Essar Ltd. The arrangement involves round tripping of funds even though the funds emanating from Reliance Ltd. are not traced back to Reliance Ltd. in this case. Hence, the arrangement may be deemed to lack commercial substance. Consequently, in the case of Reliance Ltd., Alpha Inc. may be disregarded and the interest income will be taxed in the hands of Reliance Ltd.

b) (ii) **An accommodating party**

b) (iii) **Elements that have effect of offsetting or cancelling each other**

b) (iv) A transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction

This factor is intended to cover situations where transactions are undertaken by persons through others, so as to disguise their identities, location, source, value etc.

Illustration on (b)(iv):

Facts:

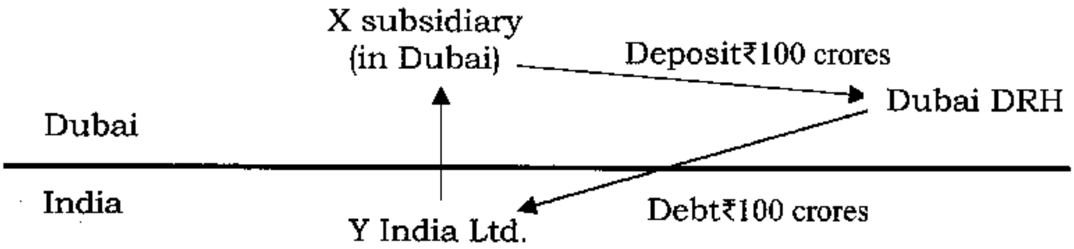
(i) Dubai DRH is a banking institution in Dubai (No Tax Jurisdiction);

(ii) There is a closely held company X in Dubai which is a wholly owned subsidiary of another closely held Indian company Y;

(iii) X has reserves and, if it provides a loan to Y, it will be treated as deemed dividend under section 2(22)(e) of the Act.

(iv) X makes a term deposit with Dubai DRH and Dubai DRH, on the basis of this security, provides a back to back loan to Y.

India-Dubai DTAA provides that interest payment to a Dubai banking company is not taxable in India. Can this be examined under GAAR?



Interpretation:

This is an arrangement whose main purpose is to bring money out of reserves in X subsidiary to India without payment of due taxes. The tax benefit is saving of taxes on income to be received from X subsidiary by way of dividend or deemed dividend. The arrangement disguises the source of funds by routing it through Dubai DRH. Dubai DRH may also be treated as an accommodating party. Hence, the arrangement shall be deemed to lack commercial substance.

Consequently, in the case of Y, the loan amount would be treated as dividend income received from X subsidiary to the extent reserves are available with X subsidiary; and no expense by way of interest would be allowed.

In the case of Dubai Ltd, exemption from tax on interest under the DTAA may not be allowed as Dubai DRH is not a beneficial owner of the interest. GAAR may be invoked to deny DTAA benefit as arrangement will be perceived as an attempt to hide the source of funds of X subsidiary.

c) When the arrangement involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit for a party.

Illustration on (c):

Facts:

Beta Inc. is incorporated in Mauritius as a wholly owned subsidiary of company Gama GmbH, a resident of Germany. Say, the India-Mauritius DTAA provides for non-taxation of capital gains in India (the source country) and Mauritius charges no capital gains tax in its domestic law. Some shares of Alpha Ltd., an Indian company, are acquired by Beta Inc. in the year after date of coming into force of GAAR provisions. The entire funding for investment by Beta Inc. in Alpha Ltd. was done by Gama GmbH These shares are subsequently disposed of by Beta Inc. after 5 years. This results in capital gains which Beta Inc. claims as not being taxable in India by virtue of the India-Mauritius DTAA. Beta Inc. has not made any other transaction during this period. Can GAAR be invoked?

Make a Chart of Facts here:

Interpretation:

This is an arrangement which has been created with the main purpose of avoiding capital gains tax in India by routing investments through a favourable jurisdiction. There is neither a commercial purpose nor commercial substance in terms of business risks or cash flow to Gama GmbH in setting up Beta Inc. It should be immaterial here whether Beta Inc. has office, employee etc. in Mauritius. Both the purpose test and tainted element tests are satisfied for the purpose of invoking GAAR.

d) **When the arrangement does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained.**

IV. **Test 4: The arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes**

♦ ANALYSIS OF TEST 4 ♦

This test deals with the manner in which the arrangement is entered into or carried out. **For example**, if an arrangement could be carried out in a simpler/ direct way and the parties adopt a different route, the same may fall under the ambit of this test.

SECTION 98{ Just read it once }

Consequences of Impermissible Avoidance Arrangement

(1) If an arrangement is declared to be an impermissible avoidance arrangement, then, the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined, in such manner as is deemed appropriate, in the circumstances of the case, including by way of but not limited to the following, namely:-

- (a) disregarding, combining or recharacterising any step in, or a part or whole of, the impermissible avoidance arrangement;
- (b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;
- (c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;
- (d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;
- (e) reallocating amongst the parties to the arrangement-
  - (i) any accrual, or receipt, of a capital nature or revenue nature; or
  - (ii) any expenditure, deduction, relief or rebate;
- (f) treating-
  - (i) the place of residence of any party to the arrangement; or
  - (ii) the situs of an asset or of a transaction,

  at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or
- (g) considering or looking through any arrangement by disregarding any corporate structure.

~~SECTION 144BA~~ {SEE THE CHART DIRECTLY}

~~Reference to Commissioner in Certain Cases~~

~~(1) If, the Assessing Officer, at any stage of the assessment or reassessment proceedings before him having regard to the material and evidence available, considers that it is necessary to declare an arrangement as an impermissible avoidance arrangement and to determine the consequence of such an arrangement within the meaning of Chapter X-A, then, he may make a reference to the Commissioner in this regard.~~

~~(2) The Commissioner shall, on receipt of a reference under sub-section (1), if he is of the opinion that the provisions of Chapter X-A are required to be invoked, issue a notice to the assessee, setting out the reasons and basis of such opinion, for submitting objections, if any, and providing an opportunity of being heard to the assessee within such period,~~ **~~not exceeding 60 days~~**~~, as may be specified in the notice.~~

~~(3) If the assessee does not furnish any objection to the notice within the time specified in the notice issued under sub-section (2), the Commissioner shall issue such directions as he deems fit in respect of declaration of the arrangement to be an impermissible avoidance arrangement.~~

~~(4) In case the assessee objects to the proposed action, and the Commissioner after hearing the assessee in the matter is not satisfied by the explanation of the assessee, then, he shall make a~~

~~reference in the matter to the Approving Panel for the purpose of declaration of the arrangement as an impermissible avoidance arrangement.~~

~~(5) If the Commissioner is satisfied, after having heard the assessee that the provisions of Chapter X-A are not to be invoked, he shall by an order in writing, communicate the same to the Assessing Officer with a copy to the assessee.~~

~~(6) The Approving Panel, on receipt of a reference from the Commissioner under subsection (4), shall issue such directions, as it deems fit, in respect of the declaration of the arrangement as an impermissible avoidance arrangement in accordance with the provisions of Chapter X-A including specifying of the previous year or years to which such declaration of an arrangement as an impermissible avoidance arrangement shall apply.~~

~~(7) No direction under sub-section (6) shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interests of the revenue, as the case may be.~~

~~(8) The Approving Panel may, before issuing any direction under sub-section (6),—~~

~~(i) if it is of the opinion that any further inquiry in the matter is necessary, direct the Commissioner to make such inquiry or cause the inquiry to be made by any other income-tax authority and furnish a report containing the result of such inquiry to it; or~~

~~(ii) call for and examine such records relating to the matter as it deems fit; or~~

~~(iii) require the assessee to furnish such documents and evidence as it may direct.~~

~~(9) If the members of the Approving Panel differ in opinion on any point, such point shall be decided according to the opinion of the majority of the members.~~

~~(10) The Assessing Officer, on receipt of directions of the Commissioner under subsection (3) or of the Approving Panel under sub-section (6), shall proceed to complete the proceedings referred to in sub-section (1) in accordance with such directions and the provisions of Chapter X-A.~~

~~(11) If any direction issued under sub-section (6) specifies that declaration of the arrangement as impermissible avoidance arrangement is applicable for any previous year other than the previous year to which the proceedings referred to in sub-section (1) pertains, then, the Assessing Officer while completing any assessment or reassessment proceedings of the assessment year relevant to such other previous year shall do so in accordance with such directions and the provisions of Chapter X-A and it shall not be necessary for him to seek fresh direction on the issue for the relevant assessment year.~~

~~(12) No order of assessment or reassessment shall be passed by the Assessing Officer without the prior approval of the Commissioner, if any tax consequences have been determined in the order under the provisions of Chapter X-A.~~

~~(13) The Approving Panel shall issue directions under sub-section (6) within a period of 6 months from the end of the month in which the reference under sub-section (4) was received.~~

~~(14) The directions issued by the Approving Panel under sub-section (6) shall be binding on—~~

~~(i) the assessee; and~~

~~(ii) the Commissioner and the income-tax authorities subordinate to him,~~

~~and notwithstanding anything contained in any other provision of the Act, no appeal under the Act shall lie against such directions.~~

~~(15) The Central Government shall, for the purposes of this section, constitute one or more Approving Panels as may be necessary and each panel shall consist of three members including a Chairperson.~~

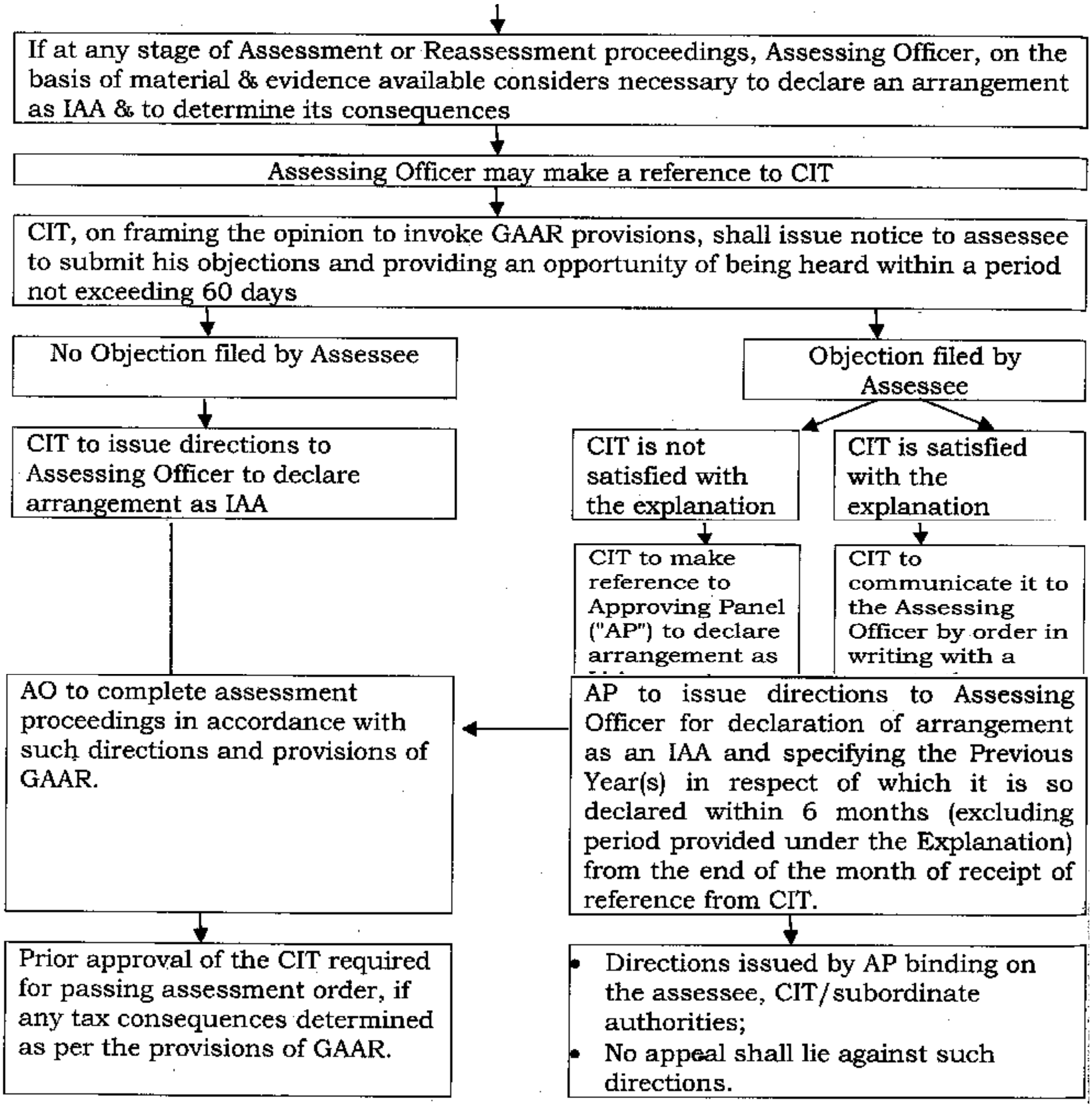
Explanation. ~~– In computing the period referred to in sub-section (13), the following shall be excluded–~~

~~(i) the period commencing from the date on which the first direction is issued by the Approving Panel to the Commissioner for getting the inquiries conducted through the authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is last received by the Approving Panel or one year, whichever is less;~~

~~(ii) the period during which the proceeding of the Approving Panel is stayed by an order or injunction of any court.~~

♦ ANALYSIS OF SECTION 144BA*

Assessment Procedure for GAAR Invocation



MAT AND IND AS
SECTION 115JB

PART A: EXISTING COMPLAINT OF IND AS:

For computation of book profit, one may proceed as follows -

Step 1	Find out net profit [before other comprehensive income (OCI)] as per statement of profit and loss of the company.
Step 2	Make adjustments which are given under the existing provisions under section 115JB. In Explanation to sec 115JB
Step 3	Make further adjustment pertaining to OCI items that will be permanently recorded in reserves (£e., never to be reclassified to the statement of profit and loss).
Step 4	Make specific adjustments in the case of demerger as given by new sub-section (2B) to section 115JB.

Adjustments pertaining to *Step 3* and *Step 4* are given below -

STEP 3:

Add/Less:

Sr No.	Items	Add/Less
1.	All amounts credited to OCI which will never be classified to P&L Account{ i.e. Notional gains}	ADD
2.	All amounts debited to OCI which will never be classified to P&L Account{i.e. Notional Loss)	LESS
	Exceptions to above 2 points: 1. Change in Revaluation surplus for assets as per IND AS 16 (PPE) & IND AS 38 (Intangible Assets). { Do not Add/ Less} 2. Gains and losses from Investments in equity instruments designated at fair value through other comprehensive income (IND AS 109) {Do not Add/ Less} Note 1: In case of the above 2 exceptions the BOOK PROFIT shall be increased (i.e. Actual Gain) or decreased (i.e. Actual Loss) in the PY in which such assets are retired, disposed, realized or transferred. Note : 2 In all other cases the Notional Gain / Notional Loss shall be included in Book Profit every year in which they arise.	

STEP 4:

PART A: Distribution of Non Cash Asset by Demerged Company:

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders (for example, in a demerger) shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the profit and loss account. This difference arising on demerger shall be excluded from the book profits.

PART B: Revaluation by Resulting Company of Assets & Liabilities received from Demerged Company:

In the case of a resulting company, where the property and the liabilities of the undertaking being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computing of book profit of the resulting company.

PART B: MAT ON FIRST TIME ADOPTION. (i.e on Convergence from AS to IND AS)

TRANSITION AMOUNT ON COVERGENCE:

"TRANSITION AMOUNT" on Convergence from existing Accounting Standards to IND AS would be adjusted in Book Profit 1/5th in 5 years.

"Transition amount" means the amount adjusted in the other equity (excluding capital reserve, and securities premium reserve) on the convergence date but not including the following,—

(A) amount adjusted in the other comprehensive income on the convergence date which shall be subsequently re-classified to the profit or loss;

(B) revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38 adjusted on the convergence date;

(C) gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109 adjusted on the convergence date;

(D) adjustments relating to items of property, plant and equipment and intangible assets recorded at fair value as deemed cost in accordance with paragraphs D5 and D7 of the Indian Accounting Standards 101 on the convergence date;

(E) adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost in accordance with paragraph D15 of the Indian Accounting Standards 101 on the convergence date; and

(F) adjustments relating to cumulative translation differences of a foreign operation in accordance with paragraph D13 of the Indian Accounting Standards 101 on the convergence date.

FOREIGN TAX CREDIT

RULE 128
Foreign Tax Credit (FTC)

(1) An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

(2) The foreign tax referred to in sub-rule (1) shall mean,—

(a) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;

(b) in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 91.

(3) The credit under sub-rule (1) shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty. **(Therefore, FTC shall not be allowed against any interest, fee or penalty)**

(4) No credit under sub-rule (1) shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee:

(5) The credit of foreign tax shall be given effect to in the following manner:

(i) the credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income.

If foreign income is **Rs.** 10,00,000 on which tax is deducted in foreign country is **Rs.**4,00,000 and tax on such income in India is **Rs.**3,00,000, then FTC shall be allowed for **Rs.**3,00,000 and not **Rs.**4,00,000.

(ii) the credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted. **(Therefore, if the tax was deducted in foreign country say on 10th Feb., 2018, then such tax shall be converted into Indian currency by applying TTBR of foreign currency on 31.1.2018)**

(6) In a case where any tax is payable under the provisions of section 115JB or section 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").

(7) Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or section 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section 115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored.

(8) Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee, namely:–

(i) a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;

(ii) certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,–

(a) from the tax authority of the country or the specified territory outside India; or

(b) from the person responsible for deduction of such tax; or

(c) signed by the assessee:

Provided that the statement furnished by the assessee in clause (c) shall be valid if it is accompanied by,–

(A) an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;

(B) proof of deduction where the tax has been deducted.

(9) The statement in Form No. 67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) shall be furnished on or before the end of the assessment year relevant to the previous year in which the income referred to in sub-rule (1) has been offered to tax or assessed to tax in India and the return for such assessment year has been furnished within the time specified under sub-section (1) or sub-section (4) of section 139:

Provided that where the return has been furnished under sub-section (8A) of section 139, the statement in Form No. 67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) to the extent it relates to the income included in the updated return, shall be furnished on or before the date on which such return is furnished.

(10) Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

♦ ANALYSIS OF FOREIGN TAX CREDIT PROVISIONS ♦

Amendment provides that:

- if a company/assessee is entitled to FTC and it is allowed against tax payable under section 115JB/115JC of the Act, then,

- if FTC exceeds FTC admissible against tax payable by the company/assessee on its total income, as per the normal provisions of the Act,
- while computing Credit under the section, the excess FTC should be ignored.

Illustration 1:

Particulars	Normal provision of the Act Rs.	MAT/AMT Rs.
Tax liability	200	500
FTC admissible/allowable	200	260
Balance tax payment	N.A.	240

MAT/AMT credit to be carried forward as under:

	Rs.
Tax liability as per MAT/AMT (A)	500
Tax liability as per normal provision of law (B)	200
MAT/AMT credit available (A-B=C)	300
Less: Excess foreign tax credit (300-200JJD)	60
Actual MAT/AMT credit allowed to be c/f (C-D)	240

Illustration 2:

If there is no difference in allowability of FTC under MAT/AMT provisions as well as normal provisions of the Act.

Particulars	Normal provision of the Act Rs.	MAT/AMT Rs.
Tax liability	200	500
FTC admissible/allowable	200	200
Balance tax payment	N.A.	300

MAT/AMT credit to be carried forward as under:

	Rs.
Tax liability as per MAT/AMT (A)	500
Tax liability as per normal provision of law (B)	200
MAT/AMT credit available (A-B=C)	300
Less: Excess FTC (200-200) (D)	0
Actual MAT/AMT credit allowed to be c/f (C-D)	300

SECTION 155(14A)

Rectification on Settlement of Dispute of Foreign Tax Credit

Where in the assessment for any previous year or in any intimation or deemed intimation under section 143(1) for any previous year, credit for income-tax paid in any country outside India or a specified territory outside India referred to in section 90, section 90A or section 91 has not been given on the ground that the payment of such tax was under dispute, and if subsequently such dispute is settled; and the assessee, within six months from the end of the month in which the dispute is settled, furnishes to the Assessing Officer evidence of settlement of dispute and evidence of payment of such tax along with an undertaking that no credit in respect of such amount has directly or indirectly been claimed or shall be claimed for any other assessment year, the Assessing Officer shall amend the order of assessment or any intimation or deemed intimation under section 143(1), as the case may be, and the provisions of section 154 shall, so far as may be, apply thereto.

Provided that the credit of tax which was under dispute shall be allowed for the year in which such income is offered to tax or assessed to tax in India.

Illustration

For assessment year 2015-16, tax was deducted in foreign country of **Rs.**3,00,000 on foreign income of **Rs.** 10,00,000. There was a dispute on the allowability of this tax of **Rs.**3,00,000, therefore, Assessing Officer did not allow credits of such FTC while making assessment under section 143(3). The dispute is finally settled on 01.01.2018 and it is established that assessee is entitled to FTC of **Rs.**3,00,000.

Now, Assessing Officer shall amend his order under section 143(3) and allow credit of FTC of **Rs.**3,00,000 if:

- Assessee by 31.07.2018 furnishes to the Assessing Officer evidence of settlement of dispute and evidence of payment of FTC of **Rs.**3,00,000
- Assessee also furnishes an undertaking that credit for the FTC has not been claimed and will not be claimed in any other assessment year.
- Assessee also proves that income of **Rs.**10,00,000 on which FTC has been claimed has been offered to tax in Assessment Year 2015-16.

Assessing Officer shall amend his order under section 143(3) for assessing year 2015-16 and give credit of FTC in assessment year 2015-16 and amendment order shall be passed by Assessing Officer by 31.03.2022.