Tanvi Tewari (Jindal Global Law School, 4th year, B.A.LLB

Is the codification of the General anti- avoidance regulations (GAAR) in India a welcoming step?

The notion of tax avoidance has always been a controversial one. Those engaging in tax avoidance, operate within the framework of the law but use and steer it in a way that defeats its very purpose.[1] To answer the question of whether or not GAAR was a welcoming step, it is essential to delve into why the need to codify GAAR was felt, to what extent tax avoidance is acceptable by law and what the legal context was like when discussions around GAAR began emerging. The answers to these questions may be observable through certain judgments highlighting the different perspectives that first came about.

The *A. Raman* case was the initial position of law on this matter. When addressing tax avoidance in this case, the court stated that escaping taxes through the creation and arrangement of commercial affairs so that its liability is spread out is not forbidden or even illegal.[2] The phrase used by the court when referring to this was "lawfully circumvented". Thus, after this 1967 judgment, precedent was that a taxpayer may create an alternative mechanism to divert their income prior to it arising or accruing to them. The efficiency and value of this mechanism would be arrived at through the procedures of the Income Tax Act (ITA) and not morality.[3]

There exists a house of lord's perspective, 'the Westminster principle', similar to this position as well, wherein, every individual is permitted to arrange their affairs in such a manner that the tax they are liable to pay is of a lower intensity than what it would have been without such an arrangement.[4] If this is the path an individual chooses to take, even if it is looked down upon by tax officials, there is nothing one can do to get that individual to pay an increased tax rate. It may be unacceptable but there is no liability on them as they are protected by law itself.[5]

Over time, as more cases were brought to light, different strands of thought would be invoked and different approaches would be applied. The *McDowell* judgment of 1985 emerged in this context

---

[1] *Butani, M. "India Searches for GAAR Best Practices" 22 Int'l Tax Rev. 28 (2011-2012)*
[2] *CIT v. A. Raman & company 1968 AIR 49, 1969 SCR (1) 10*
[3] *Id.*
[4] *IRC Vs. Duke of Westminster(1936AC1)*
[5] *Id.*

and put forward a more concrete position when dealing with this challenging matter. The court affirmed that "tax planning may be legitimate as long as it was within the framework of the law".[6] However, "colorable devices" did not fall within the ambit of tax planning and it was a legal duty of every citizen to pay due tax fairly without trying to dodge them. Any encouragement or support for the same from the law or the state would be incorrect.[7] J. Reddy went on to state that tax avoidance, essentially escaping tax liability but still operating within the law, was legal while tax evasion was not.[8] He further shed light on the *Ramsay case* wherein the court decided to look at the consequences of the relevant transaction, they decided to look at the relevant document but they abstained from looking at the document in isolation from the context to which it belongs. The Westminster principle was not overextended.[9] Thus, this witnessed a big shift in the Indian tax landscape as the schemes were up for scrutiny to assess where the profits really lie. One could no longer get away with tax avoidance simply because it was not illegal and a substance-over-form approach was adopted.

Even in the pertinent *Azadi bachao Andolan judgment* the court held that in the absence of an anti-abuse provision in the relevant tax treaty, 'treaty shopping' was not illegal. "Motives of setting up Mauritius residents (to take tax benefits) does not affect the legality of transactions."[10]
Therefore, the reason it was permitted was because it was not prohibited anywhere in the DTAA between India and Mauritius thus, it was termed as tax planning instead. If it is to be prohibited, the law should have been or must be be written to that effect, the fact that it did not and does not, clearly implies that the legislature does not distinguish between the two.[11]

However, the biggest shift of them all or rather the most prominent wake up call of them all was the *Vodafone case.* the courts at the time, used the 'look through' test, which permitted them to pierce the corporate veil, further permitting them to adopt a substance-over-form approach.[12]

---

[6] *Mc Dowell & Company Limited v. The Commercial Tax Officer 1986 AIR 649, 1985 SCR (3) 791*
[7] *Id.*
[8] *Ramsay v. Inland Revenue Commissioners, 11982] AC300*
[9] *Id.*
[10] *Union of India v. Azadi bachao Andolan (263 ITR 706)*
[11] *Id.*
[12] *Vodafone International Holdings v. Union Of India & Anr civil appeal No.733 OF 2012 (arising out of S.L.P. (C) No. 26529 of 2010)*

Over the decades, due to the conduct of the Government of India and a lack of any objection towards treaty shopping and usage of tax havens, many companies interpreted this as a green light to go ahead and treaty shop to avoid taxes. Due to the magnitude of the *Vodafone case,* India was jolted into reality and prompted into taking action.

Therefore, the *Vodafone case* of 2013 as well as the *Azadi bachao Andolan judgment* of 2004 were both held in favor of the taxpayers as the courts refused to create an anti avoidance law. They instead referred to the legislators and stated that if they as the law making body felt that anti avoidance measures need to be brought about then they must legislate and create laws to that effect. Thus, what was held in the *McDowell case* was essentially judge made law, as at the time, the need to regulate tax avoidance and prevent unacceptable tax avoidance was not codified.[13]

It was in this context that an amendment was made and now finally, exists before the country, a codification of the law when it comes to tax avoidance called General Anti-Avoidance Regulations (GAAR).[14] Contained in chapter X(A) of the Indian income tax act (ITA) and applicable from assessment year 2018-2019, GAAR codified the substance-over-form approach mentioned in previous cases and is structured in such a manner that the courts can evoke if they feel that a particular transaction lacks commercial substance, if the obligations or rights between the parties which are otherwise not created under normal circumstances have been created, if there is no bonafide reason for entering into the transaction among a variety of other circumstances.[15] Thus, this set of regulations blocks any gaps in the law that could result in unacceptable tax avoidance and also protects the nation's tax reserve from depletion.[16] It looks at the actual intention of the parties entering into any sort of arrangements, to affix tax liability onto them, regardless of the legality of said structure/regardless of whether or not it is still within the framework of the law.[17]

---

[13] *Supra note 5.*
[14] Chapter XA, the Income tax act, 1961.
[15] Mittal, Sanjiv et al. "Impact of GAAR on the Indian market". International Journal of Research in Commerce & Management. 2013, Vol. 4 Issue 10, p17-21. 5p.
[16] *Id.*
[17] Krishnamurthy, V. "India's GAAR: Nice Idea, Shame about the Execution"24 Int'l Tax Rev. 9 (2013-2014)

However, like everything else in this country, some of the provisions of GAAR and their consequences are also under scrutiny and prone to criticism. The most straightforward criticism is that it is too harsh a provision in nature. With the, far from successful records of the income tax officials in the country, the likelihood of them employing these regulations or rather, misusing these provisions towards even the sincere tax payer, seems quite high.[18] Though, GAAR is a welcoming step but in general, anti-tax avoidance regulations can prove extremely challenging to implement as there exists a fine line between an unacceptable act and an acceptable act when to comes to avoidance. Thus, as mentioned above, we have rules now that authorize the tax revenue authorities to deny tax benefits to a transaction which is a completely impermissible tax avoidance transaction. There is still no clarity on the framing of guidelines in section 101, which every provision in the Act would be subject to. Moreover, it is stated in a few reports that every case of tax avoidance should not be viewed under the lens of GAAR unless it is "abusive, artificial…" but these words are not mentioned anywhere in section 96 so that against is problematic.[19]

Breaking down the provisions contained within this chapter. Section 96 of the ITA, is the most relevant and also the most dangerous. This section, which refers to 'impermissible avoidance arrangements' is extremely widely worded and includes within its scope all sorts of arrangements, both legal or otherwise. It refers simply to an "arrangement carried out by the tax payer is having its main purpose of Tax benefit…".[20] It also explicitly states that even "a step" in the arrangement aimed towards tax benefit would be enough for it to fall under this provision. With such far reaching consequences, plenty of genuine transactions may also start falling under this section. Moreover, sub section 2 of the same section may also prove problematic as it states that "an arrangement is presumed unless it is proved to the contrary by the assesse, to have been entered into for the main purposes of obtaining a tax benefit". Thus, these provisions start with a negative presumption against the assesse.[21]

---

[18] Nayak, R. "Navigating India's Proposed GAAR"23 Int'l Tax Rev. 48 (2012-2013)
[19] Section 96, The income tax act, 1961
[20] Supra note 16.
[21] Jain, Tarun. "GAAR and corporate governance: will the stick do the trick?". *Journal on Governance, Vol. 1, No. 6, pp. 629-674, 2019*

When it comes to the relationship between DTAA's and GAAR, recent notifications state that the treaty provisions will override the GAAR except when there exist Impermissible Avoidance Arrangements (IAAs), which are the circumstances under which GAAR is applicable in the first place. However, on the bright side, not every income tax officer has the authority to invoke GAAR. It can only be invoked by the senior most officers which would be the principle commissioner.[22] At the second stage it will be approved by a panel chaired by learned individuals, for instance, retired judges, so this is a noteworthy safeguard to prevent GAAR from being made applicable in every possible scenario. GAAR can thus be invoked only in the rarest of the rare cases. At the end of the day, the problem with India is rarely ever with the law but rather, its implementation. Unless India can devise a way to effectively implement these regulations, GAAR though a welcoming step, would work only on paper and not in reality.

[22] *Supra note 1.*