

## **DRAFT GUIDELINES REGARDING IMPLEMENTATION OF GAAR**

On June 28, 2012 the Central Board of Direct Taxes (CBDT) issued draft guidelines for the implementation of General Anti Avoidance Rules (GAAR) in terms of Section 101 of the Income Tax Act, 1961. The guidelines are based on the recommendations of the committee which was constituted by the Chairman, CBDT for formulating the guidelines for proper implementation of GAAR and to suggest safeguards to curb the abuse of these provisions. The government has clarified that the guidelines are only 'Draft Guidelines' that have been released for receiving feedback and discussion on the issue and that they would be finalized only after Prime Minister, who also holds the Finance portfolio, approves them after considering the feedback received on the same.

Following are a few notable recommendations of the Committee which may be implemented by way of Circulars and the Rules notified by the government from time to time:

### 1. Guidelines u/s 101

- a) Monetary threshold should be set for invoking the GAAR in order to avoid indiscriminate application of its provisions and thus provide relief to small taxpayers.
- b) Prescription of statutory forms to make reference to the various authorities to ensure consistency of approach and transparency in the procedures.
- c) Prescribing the time limits during which the various actions under the GAAR provisions are to be completed by various authorities.

### 2. Recommendations for the Circular on GAAR

- a) Certain safe harbour rules have been extended to Foreign Institutional Investors (FIIs) subject to payment of domestic taxes. Therefore, where a FII chooses not to take any benefit under a Double Taxation Avoidance Agreement and subjects itself to tax in accordance with the domestic law provisions, then, the provisions of Chapter X-A shall not apply to such FII or to the non-resident investors of the FII. However, where an FII chooses to take a treaty benefit, GAAR provisions may be invoked in the case of the FII, but would not in any case be invoked in the case of the non-resident investors of the FII. The Committee rejected the recommendation of providing exemption to capital market transactions from GAAR provisions and a flat tax on FII's gains without any distinction between various transactions.
- b) The provisions of GAAR will apply only to income accruing or arising to the taxpayers on or after 01.04.2013.
- c) The Committee has clarified that under normal circumstances, where Specific Anti-Avoidance Rules (SAAR) are applicable, GAAR will not be invoked. However, in an exceptional case of abusive behavior on the part of a taxpayer that might defeat the provisions of SAAR, GAAR could also be invoked.

- d) The definition of “connected persons” has been clarified to include the definition of “associated enterprise” given in section 92A, the definition of “relative” in section 56 and the “persons” covered u/s 40A(2)(b).
- e) It was recommended that it must be clarified in the rules that where only a part of the arrangement is impermissible, the tax consequences of “Impermissible Avoidance Arrangement” will be limited to only that part of the arrangement.
- f) The Committee clarified that in order to invoke the provisions of GAAR, the following things needs to be proved by the Revenue Department:
  - a. there is an arrangement;
  - b. the arrangement leads to a tax benefit;
  - c. the main purpose or one of the main purposes of the arrangement is to obtain tax benefit; and
  - d. the arrangement has any one of the following characteristics:
    - i. it creates rights and obligations, which are not normally created between parties dealing at arm’s length;
    - ii. it results in misuse or abuse of the provisions of the tax law;
    - iii. it lacks commercial substance; or
    - iv. it is carried out by means or in a manner which is normally not employed for an authentic (bona fide) purpose.
- g) Concept of “Misuse or abuse”, “bona fide purpose” and “lacks commercial substance” were explained by giving 21 illustrations.