Domestic and Cross-Border Taxation- Post GAAR and BEPS

The debatable principles which have always been a topic of some credible discussions in the past are the principles of tax planning and tax avoidance. There is often a thin line between tax planning and tax avoidance. While tax planning is perfectly legitimate, tax avoidance is often perceived as legal in "form" but not in "substance" as it leads to loss of a fair share of revenue for the Governments. This debate became profound among the world leaders which led to the formation of G20 countries group. This Group brought out BEPS – Base Erosion and Profit Shifting to control this leakage! In the present article, the author has discussed all of this and more in detail. Read on to know more….

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In the past, the courts in various cases have ruled in favour of arranging one's affair so as to keep taxes as low as possible, provided it is within the framework of law. However, in the recent past, the momentum of aggressive tax planning has grown with complicated tax structures being used to achieve less tax payouts.

BEPS of Organization of Economic Cooperation and Development ("OECD") led by the G20 countries is predominantly centered on a coordinated drive by the countries across the world, to address the concerns of aggressive tax planning by Multinational Enterprises ("MNEs") by modernising the current framework of tax treaties and nationally-set-anti-

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tax avoidance laws. One of the focus areas of BEPS is the development of domestic rules, and treaty provisions, that counter the unintended use of treaties to avoid payment of taxes.

In the Indian scenario, India's growth story has attracted significant foreign direct investment. Foreign investors have been subject to aggressive tax planning to make arrangements/create artificial structures for tax avoidance. However, in India, there were only some specific anti-avoidance regulations but the general anti-avoidance has been established only through judicial precedents. Considering the aggressive tax planning with the use of sophisticated tax structures, there was an immediate requirement to look at the real intention of the arrangements and determine the tax consequences.

Given India's commitment towards the BEPS project and to protect its tax base, it led to the introduction of General Anti Avoidance Rules ("GAAR"), which aim at taxing transactions/arrangements/schemes where the sole intention is directly or indirectly obtaining tax benefits using the loopholes under the Indian Income-tax Act, 1961 ("IT Act").

GAAR

The legislative intent to introduce GAAR in India goes back several years, when the Direct Taxes Code 2009 was introduced for public discussion. Since the same faced a plethora of representations from the investors and professional community at large, it was revised in the year 2010.

GAAR was finally introduced in the IT Act as Chapter X-A by the Finance Act, 2012. The same was however never brought into force. Finance Act, 2013 modified the provisions substantially. However, it was further postponed. GAAR finally came into operation from April 1, 2017 after much opposition, postponement, and dilution.

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It *inter-alia* empowers the tax authorities to declare any transactions or arrangements as an *"Impermissible Avoidance Arrangement"* ("IAA") and thereby determine the consequences thereof, if the transactions or arrangements do not have any commercial substance or consideration (including a deeming provision) other than achieving the tax benefit. Once the tax authorities decide to treat any transactions or arrangements as an IAA, then the onus to prove otherwise is on taxpayers.

GAAR has a *non-obstante* provision, which can override all other provisions of the IT Act. Further, GAAR is not merely restricted to cross-border transactions, but applies to domestic arrangements also. Additionally, certain safe harbour rules have been prescribed, such as a threshold limit pertaining to tax benefit of ₹3 crore, exemptions to Foreign Institutional Investors ("FIIs") on qualifying certain conditions and grandfathering of existing investments.

Provided below are a few of the domestic and cross-border taxation issues post GAAR and BEPS:

- ***GAAR vs. SAAR***

  Specific Anti-Avoidance Rules ("SAAR") have been enacted from time to time by the legislature to avoid tax avoidance, in several sections such as Sections 40A(2), 94, 92, 69 to 69D etc. With the introduction of GAAR, concerns were raised as to where specific rules operate, then would the general rules also be applicable. However, the Government has adopted a different approach and, the Central Board of Direct Taxes ("CBDT") issued a clarification on January 27, 2017. The clarification stated that GAAR and SAAR can both co-exist based on the facts and circumstances of each case on a premise that SAAR may not be able to address all situations of abuse.

  However, it is a well settled principle wherein the Courts have previously held that where a specific rule is applicable, then a general rule will not apply. Going by this principle, where a SAAR exists covering a particular situation, GAAR should not apply to that situation. The CBDT clarification states otherwise. This provides room for ambiguity and potential misuse of GAAR even in genuine cases where the taxpayers have met the test of SAAR conditions to the satisfaction of the tax authorities. Also, the Courts may hold GAAR and SAAR to be mutually exclusive and this could be strongly litigated.

- ***Corporate restructuring***
  The CBDT vide its circular clarified that where any court or authority such as the National Company Law Tribunal (NCLT) "explicitly and adequately" considers the tax implication of an arrangement, while giving its sanction, GAAR will not apply to such an arrangement. This indicates that GAAR can be invoked on an arrangement sanctioned by the NCLT, if tax implications have not been adequately considered thereby giving room to the tax authorities to invoke the GAAR provisions even in the case of mergers which receive sanction of the NCLT.
  Further, it is unlikely that the NCLT will provide an explicit and adequate view on tax matters while sanctioning arrangements such as mergers, de-mergers and capital reduction. This could adversely impact by discouraging companies from pursuing efficiency-promoting restructuring mechanisms in fear of unpredictable tax implications.
- ***Decision by AAR vs. GAAR***
  This issue of whether GAAR will be applicable where an arrangement is held as permissible by AAR has been clarified by the CBDT to state that GAAR will not apply in case of ruling by the AAR as it is binding on the PCIT/CIT and also IT authorities subordinate to him in respect of the concerned applicant.
  Therefore, in order to achieve tax certainty in respect of a proposed transaction, a resident and non resident (regardless of the value of their transactions) can make an application for a ruling from the AAR to determine the applicability of GAAR for the proposed transactions. As clarified by the CBDT, the AAR ruling would be binding on them and the tax authorities in respect of the proposed transactions.

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- ***FII***
  As per the prescribed rules, it is clear that GAAR will not apply to FIIs on satisfying certain conditions, one of it being that FII should not claim any benefit under a Tax Treaty. However, the CBDT has clarified in its circular that if a case of avoidance is sufficiently addressed by the Limitation of Benefit ("LOB") clause in the Tax Treaty, then there shall not be an occasion to invoke GAAR. Therefore, a combined reading of the prescribed Rule and the clarification provided creates a scope for confusion and room for different interpretations. For instance, an FII satisfies the LOB clause in a Tax Treaty. However, GAAR provisions are applicable by virtue of the prescribed Rules. The same needs to be addressed.
- ***Grandfathering of existing investments***
  Although, vide Rule 10U(1)(d) the government provided that GAAR will not apply to income earned/received by any person from transfer of investments made before April 1, 2017, Rule 10U(2) on the other hand provides that GAAR will apply to any arrangement, irrespective of the date it has been entered into, if tax benefit is obtained on or after April 1, 2017.
  Therefore a combined reading of Rule 10U(1)(d) with Rule 10U(2) of the Rules, suggest that the existing arrangements which are felt to be aggressively structured to escape taxes in India could come under the tax authority's scrutiny irrespective of the date of entering into such arrangements, if the tax benefits are claimed in Financial Year 2017-18 or after. Therefore, the intent of grandfathering (to safeguard legitimate investments) is defeated leading to the existing grandfathering provisions being applicable only in respect of tax benefit recorded up to April 1, 2017.
- ***3 crores tax benefit threshold***
  It has been provided that the provisions of GAAR shall not be invoked in a scenario where the tax benefit in the relevant assessment year, in aggregate, to all the parties in the arrangement does not exceed a sum of Rs. 3 Crore. Further, the CBDT clarified that only the tax benefit enjoyed in Indian jurisdiction is to be examined in considering the quantum of tax benefit. Therefore, in case of an incidental tax benefit by virtue of an impermissible arrangement outside

With GAAR in place, Indian businesses need to have a re-look at all their business arrangements, not merely the ones made for tax avoidance. GAAR is being implemented in a period where MNE's have serious concerns on protracted litigation on tax issues. Every arrangement, either with a related party or an unrelated party, if resulting in a tax benefit, whether intentionally or un-intentionally, has to be relooked into.

India which is also the main purpose in such arrangement, it may lead to application of GAAR in India unless the taxpayer can establish that tax benefit in India was not the main purpose of such transaction. Again this is an area which will lead to more confusion – clarity is needed.

- ***GAAR vs. PPT***

  The BEPS Action Plan contains a number of Tax Treaty related measures to eradicate double non taxation, end Treaty abuse and ensure that profits are taxed at the place of value creation. Action Plan 6 (Prevent Treaty Abuse) report includes a minimum standard on preventing abuse and countries need to implement at least any one of the anti-abuse measures specified. With India opting for the Principal Purpose Test ("PPT") with a simplified LOB, once PPT comes into force in Tax Treaties the interplay between PPT and GAAR needs to be seen. The scope of domestic GAAR is more restrictive in comparison to PPT. Thus, issue arises whether principle of choice is available for Taxpayer to opt to be governed by GAAR vis-a-vis PPT to determine tax avoidance motive under Section 90(2) of the IT Act. Therefore, where taxpayer is able to establish that GAAR provisions are satisfied or it is covered by exclusions even though PPT test under treaty is not satisfied, taxpayer can avail treaty benefit. Even though this appears attractive, issue requires detailed deliberation and clarity to avoid uncertainty and protracted litigation.

With GAAR in place, Indian businesses need to have a re-look at all their business arrangements, not merely the ones made for tax avoidance. GAAR is being implemented in a period where MNE's have serious concerns on protracted litigation on tax issues. Every arrangement, either with a related party or an unrelated party, if resulting in a tax benefit, whether intentionally or un-intentionally, has to be relooked into. The onus would lie on the taxpayer to establish that a transaction is not undertaken with the objective of tax avoidance and would be required to maintain documentation to prove the business purpose of a transaction or arrangement.

The co-existence of GAAR and SAAR, as well as GAAR overriding the Treaty will certainly lead to complexities in implementation and does not leave much option for tax planning. The powers provided to tax authorities are open ended and will potentially lead to significant uncertainty and litigation therefore, the taxpayer would have to be proactive and preemptively identify explanations for each and every business transaction. This would definitively consume significant time and resources, but would protect against high-pitched and adverse tax adjustments.

With the array of significant changes being introduced in quick succession in the Indian Tax scenario, one would have to wait and watch as to how things unfold in the years to come. In short, in the post GAAR era, litigation could be on the rise contrary to Government claims!

BEPS

In the backdrop of concerns raised by Governments, revenue authorities and social organizations that MNEs are not paying their 'fair share' of taxes and are shifting profits to low tax jurisdiction, the G20 nations requested the OECD to develop action plans to tackle Base Erosion and Profit Shifting in a comprehensive manner.

Consequently, the OECD launched a 15-point Action Plan that gave governments the domestic and international arms they needed to combat BEPS. The Plan provides for a greater transparency and accountability and stop the growing disconnect between where money and investments are made and where MNEs report profits for tax purposes.

The final BEPS package prescribes four "minimum standards" and the G20 and OECD countries have agreed that they are committed to implementing these four minimum standards namely:

- Action 5, on harmful tax practices;
- Action 6, on preventing inappropriate granting of treaty benefits;
- Action 13, on transfer pricing ("TP") documentation and country by country reporting ("CbCR"); and
- Action 14, on improving efficiency of mutual agreement procedures ("MAP") and dispute resolutions.

Some of the G20 and OECD countries have jumped ahead and introduced BEPS minimum standards. India is also emerging as one of the most aggressive adopters of the BEPS project and has introduced certain changes which are in line with the BEPS package. The notable ones being:

- ***Action 13 - CBCR and Master file/Local file***
  One of the cornerstones of the BEPS project is CbCR, which is addressed in the Action 13 recommendations and is one of the four minimum standards.
  The Finance Act, 2016 introduced Section 92D and Section 286 of the Act providing for maintaining and furnishing of Master file and CbCR in respect of an International Group. Further, the final rules in this regard were notified on October 31, 2017.
- ***Action 14 - Dispute resolution***
  The Indian Finance Act, 2017 introduced a secondary TP adjustment provision to ensure that profit allocation between associated enterprises ("AEs") is consistent with a primary TP adjustment. Under the provision, a primary adjustment resulting in an increase in taxable income or reduction in loss and arising on account of certain prescribed instances needs to be repatriated to India within a prescribed time. The amount not repatriated to India would be deemed to be an advance made by the taxpayer to its AE and interest would be charged on the advance in the manner prescribed. The CBDT has, by notification dated June 15, 2017, issued rules to support the implementation of this provision.
- ***Action 15 - Multilateral Instrument***
  The first joint signing ceremony of the Multilateral Instrument ("MLI") was held on June 7, 2017, whereby 68 contracting states (including India) signed the MLI. The MLI will modify India's treaties in order to curb revenue loss through treaty abuse by ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created. A task not easy as this can be very subjective.
- ***Action 4 – Limitation of Interest***
  The Finance Act, 2017 adopting the recommendations of OECD's BEPS Action Plan 4 inserted Section 94B which denies deduction of excess interest while computing the taxable income of a taxpayer. 'Limitation on interest deduction' provisions would apply to payment of interest to a non-resident AE by an Indian company, or a PE of a foreign company being the borrower, in respect of any form of debt issued.
- ***Action 6 - Treaty abuse***
  On June 22, 2016, the CBDT issued a notification providing for grandfathering of income from the transfer of investments made before 1st April 2017 from the application of the new domestic GAAR and to specify that the GAAR will apply to tax benefits obtained on or after 1st April 2017.
- ***Action 1 - Digital economy***
  In line with BEPS Action Plan 1, the Finance Act of 2016 introduced Equalization Levy. A levy of 6 percent is chargeable on the gross payment, for specified digital services and facilities, provided by a non-resident who does not have a Permanent Establishment in India.
- ***Action 5 - Countering harmful tax practices***
  In compliance with Action 5 of BEPS project, the Competent Authority of India has decided that all future unilateral APAs will contain a provision allowing the exchange of the high-level details of each such APA with the competent authority of all countries in which associated enterprises of the Indian entity are located, including the immediate, intermediate and ultimate parent companies.
  From the above, we see that how much BEPS is relevant for India and India's quick reactiveness in adopting and implementing the BEPS recommendations. Quite an interesting contrast whereas India is still not a member of the OECD by choice but, has accepted all recommendations of BEPS in full!

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One high-profile area is transfer pricing. Companies will need to assess whether the allocation of profits to business functions is in line with the new guidelines and, if there are discrepancies, assess the risk of challenge. From an India perspective, the introduction of CbCR and the Master file is a noteworthy step in this regard. This will provide the tax authorities sufficient data to allocate taxable profit to jurisdiction where the value is created.

A significant impact of this will be seen with respect to intangibles. BEPS Action 8 deals with transfer pricing and intangibles, one of the most important of which is intellectual property ("IP"). The BEPS recommendations prevent companies from assigning the profit arising out of IP to a group company simply because it has legal ownership. Instead, it will need to be shared between those parts of the group entities that have responsibility for the development, enhancement, maintenance, protection and exploitation ("DEMPE") of that IP. Companies will need to revisit how they look at IP ownership and how their global R&D organisation is set up because the potential tax cost for the R&D function has just become more important.

Another significant impact area is with respect to Permanent Establishment ("PE") covered under Action Plan 7. Fragmentation of cohesive operating business into several smaller operations in order to avoid PE status will no longer hold good. Even something as minor as giving foreign customers the benefits of contingent inventory arrangements, for example, may trigger PE status in some circumstances. More generally, those firms that in the past have used commissionaire sales arrangements, where a company directly employs a local sales agent in a foreign country or pays a commission for such services may also trigger a permanent establishment. A lot of global businesses may experience an explosion in the number of PEs.

BEPS recommendations concerning interest deduction caps will also have far-reaching business implications. The tax and treasury department of the MNE will need to work much more closely together on how the financing will have to be structured going forward.

Further, given that the world's international tax regimes are undergoing a change and tax authorities under pressure to increase collections, the potential for tax disputes will see a rising trend and is expected to swell into an avalanche of controversy in the years to come.

Major economies, including India, are realigning their tax policies in accordance with BEPS project and the MNEs will have to revisit and restructure their operations because the tax implications of the BEPS project may play out across almost all aspects of a multinational's operations, from every stage of the supply chain to the way MNCs value intellectual property.

The level of transparency that the BEPS project demands and the robust infrastructure needed to share data between governments could lead to a paradigm shift in how businesses deal with tax authorities. We may see that all business functions will increasingly work with the tax function to consider the implications that BEPS reforms will have for business operations. Current supply chain, HR, treasury and other policies and strategies now bring tax risks.

The international tax landscape in India has changed drastically in the past decade. The BEPS Project has been both a vehicle and a catalyst for some of the significant changes. The evolving tax regime in India demands much more transparency and accountability, and the tax authorities are having a better picture of what the overall tax position of the group looks like rather than focussing on one country.

While India is going aggressive on the implementation of the BEPS recommendation, what will be interesting is to see how India, and rest of the developing nations, will find a sweet spot between maximising tax revenue and attracting investment.

The question now is that should not India go for group consolidation of tax returns in line with developed countries? Should India not adopt the global best practices for dispute resolution, rather than leaving the assesee to litigate in Courts? It is time now for India to take a holistic view rather than tinkering with international tax laws just because it has positive revenue implications!

On one hand, the criteria is to make India a more business friendly destination and should it not come out clearly that GAAR cannot have a Treaty override wherever India has adopted a LOB or a limited PPT? These are areas which need serious attention if we really want to make India an attractive destination for doing business. ■

The positive thinker sees the invisible, feels the intangible and achieves the impossible. - Winston Churchill