Having introduced the concept more than six years ago, the government is now keen to go ahead with implementation of General Anti-Avoidance Rule (GAAR) provisions from the intended date of 1 April 2017.¹ The agenda of government seems to be clear in light of various measures taken in the last few years to curb tax leakages in the form of several information exchange agreements, amendments in Cyprus, Mauritius and Singapore tax treaties, adoption of certain BEPS measures and so on so forth.

With the introduction of GAAR, the anti-avoidance principles were codified in the law. The GAAR provisions being enacted by India, are largely modeled on South African GAAR, which seek to incorporate the ‘substance over form’ doctrine in Indian tax law. Broadly speaking, GAAR will be applicable to arrangements which are regarded as ‘impermissible avoidance arrangements’ (‘IAA’) and can enable tax authorities, among other things, to re-characterise such arrangements and deny tax benefits or treaty benefits so as to curb any means of tax avoidance.

With date of implementation of GAAR provisions being in sight, detailed guidelines were expected on the mode of implementation of GAAR in various contentious situations. The Central Board of Direct Taxes (CBDT) has issued much awaited clarifications² on 27 January 2017. The clarifications are in the form of Frequently Asked Questions (‘FAQs’) based on the comments received from a Working Group constituted in June 2016.

Internationally, the concept of GAAR has also been introduced by several other countries such as Australia, Brazil, Belgium, Canada, Germany, etc. These countries have introduced and implemented the provisions of GAAR in their respective domestic law.

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The following diagram illustrates the working of GAAR:

Main purpose is to obtain tax benefit

Not at arm’s-length or Misuse/ abuse of tax provisions or Lacks commercial substance or Not for bona-fide purposes

There are certain scenarios as per Rule 10U of the Income-tax Rules 1962, where GAAR shall not be invoked and the arrangement shall not be regarded as IAA:

a. Aggregate tax benefit in a year to all parties does not exceed INR30 million
b. Approved investments by Foreign Institutional Investors (‘FII’) in listed/unlisted securities –benefit not claimed under tax treaty
c. Investment by a non-resident in FII by way of derivative instruments or otherwise
d. Income from transfer of investments made before 1 April 2017.

However, the exclusion is specific to investments made before 1 April 2017 and does not apply to each and every arrangement before 1 April 2017, tax benefit from which accrues post 1 April 2017.

GAAR provides an unfettered power, as summarised below, once the arrangement is regarded as IAA:
GAAR impact and uncertainty

GAAR is likely to impact many business functions and as such, needs a closer examination from several perspectives. The impact might be on nearly all the transactions relevant for business encompassing M&A, supply chain structures, inbound and outbound investments, EPC contracts, cash repatriation, employee compensation, etc.

The CBDT had formulated a Working Group in June 2016 to address queries received from various stakeholders. It has touched upon various issues highlighted in several representations made to it. Key guiding principles emanating from few of these recently issued FAQs have been listed below:

- **FAQ 1:** GAAR and specific anti avoidance provisions (‘SAAR’) can co-exist.
- **FAQ 2:** If a case of avoidance is sufficiently addressed by limitation of benefits (‘LOB’) article of the tax treaty, there shall be no occasion to invoke GAAR.
- **FAQ 3:** GAAR will not interplay with the right of the taxpayer to select or choose the method of implementing a transaction.
- **FAQ 4:** GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction [clarified in context of Foreign Portfolio Investor (‘FPI’) and Special Purpose Vehicle (‘SPV’)].
- **FAQ 5:** Grandfathering under Rule 10U(1)(d) in respect of investments made before 1 April 2017 will be available to instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments.
- **FAQ 6:** Grandfathering in respect of investments made before 1 April 2017 is not applicable to lease contracts and loan arrangements.
- **FAQ 7 and 8:** GAAR will not apply if an arrangement has been sanctioned as permissible by the AAR or Court, if at the time of sanctioning an arrangement, the Court has explicitly and adequately considered tax implications
- **FAQ 13:** Corresponding adjustment in the hands of another participant will not be made.
- **FAQ 14:** The threshold of INR 30 million cannot be read in respect of each single taxpayer in the arrangement.
- **FAQ 15:** If the arrangement has been held to be permissible in one year and the facts and circumstances remain the same, GAAR will not be invoked for that arrangement in subsequent years.

While the above clarifications provide directional approach of the CBDT, the same are generic in several instances such as interplay of GAAR with SAAR or LOB and do not cover specific issues, clarity on which by way of illustration could have helped to avoid uncertainties. Below is the illustrative list of areas that are likely to be impacted and need further clarification:

**Business transactions business structures, existing/ interprose of SPV, etc. that may be impacted**
- Tax depreciation on goodwill created pursuant to merger
- Migration to LLP structure
- EPC contracts: Offshore vs onsite split
- Migration to SEZ
- Employee secondments
- Supply chain structures: Toll manufacturing/ limited risk distributors, etc.
- Compensation structures such as car lease scheme, conveyance allowance, meal vouchers, etc.

**Cause of concern**
- GAAR may be applied despite SAAR (Transfer Pricing, BEPS, etc.), LOB clauses in tax treaty (FAQ 1 and 2)
- Assessment of notional income or disallowance of real expenditure (FAQ 11)
- Possible double taxation (FAQ 13)
- Clarity required on overlap of Principle Purpose Test rule in tax treaty that would get applicable through Multilateral Instrument
- GAAR trigger despite arrangement being in place for long period of time
- Negative list/ Safe harbour not specified, which may increase uncertainties

**Open areas**
- Consequent withholding tax applicability on recharacterisation
- FAQ 3 widely worded, whether it would cover below situations:
  - Funding options for inbound investment, acquisitions.
  - Company conversion into LLP and mode of conversion
  - Buyback vs dividend, as a cash repatriation option
  - Options for Intermediary holding jurisdiction
- Taxing accruals in outbound investments, in absence of CFC
How we can help?

We adopt a four phase approach to help our clients comply with the new guidelines:

1. **High level impact analysis**
   - Understanding of existing group structure and major transactions undertaken in the past years
   - Identifying risk exposure on the above transactions and providing guidance on GAAR and BEPS provisions

2. **Do’s and Don’ts**
   - Based on the risks identified, evaluating necessity of amending structures within the framework of law
   - Suggesting possible do’s and don’ts to mitigate the exposure

3. **Implementation**
   - Assisting in making appropriate filings/applications for approvals from the tax and regulatory authorities
   - Advising on changes in business structure and consequent, implementation assistance
   - Possibility of approaching AAR to obtain certainty on effects of GAAR

4. **Effective monitoring**
   - Conducting periodical review of changes to the structure due to dynamic business environment
   - Keeping a tab on actions necessiated due to changes in statutory framework and judicial interpretations

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