MNCS AND TAX AVOIDANCE: GAAR PROVISION TO OVERRIDE DTAA IN CASE OF ABUSE

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ABSTRACT

This article explores the issue of tax avoidance by multinational corporations (MNCs) and the use of General Anti-Avoidance Rules (GAAR) to override Double Taxation Avoidance Agreements (DTAA) in cases of abuse. The article discusses the various techniques used by MNCs to avoid paying taxes and the challenges faced by tax authorities in detecting and preventing such practices. It then examines the role of GAAR provisions in addressing this issue and the extent to which they can be used to override DTAA provisions. The article concludes that while GAAR can be an effective tool in preventing tax avoidance, its implementation should be balanced with the need to provide certainty and predictability for taxpayers.

Introduction

MNCs are attempting to increase their worldwide footprint in the wake of globalisation. Businesses turn to a variety of tax preparation strategies as they grow. As far as risk mitigation through tax planning is concerned, it is acceptable. Governments, on the other hand, have begun implementing anti-avoidance measures as a result of MNCs using avoidance strategies. These measures have been adopted by many nations under their different tax laws as Specific Anti-Avoidance Rules (SAAR) or as a separate set of anti-avoidance rules known as General Anti-Avoidance Rules (GAAR).

What is Tax Avoidance?

Deliberate measures to avoid or reduce the tax burden by an individual or a company.

What is GAAR and DTAA?

Cross-border income taxation is difficult and frequently contentious. Through Double Taxation Avoidance Agreements, emerging nations like India give tax breaks to foreign investors in an effort to entice greater foreign investment (DTAAs).

India has enacted the General Anti-Avoidance Rule (GAAR) to combat tax evasion and stop tax leakage. It becomes effective on April 1st, 2017[1]. The 1961 Income Tax Act includes the GAAR provisions. The government of India has the authority to impose or collect taxes from its citizens under Article 265[2] of its Constitution. GAAR is a method for detecting aggressive tax planning, particularly those corporate transactions or agreements engaged into with the intention of avoiding taxes. It is primarily intended to reduce revenue losses to the government brought on by aggressive tax avoidance techniques used by businesses. One of the primary motivations behind the creation of GAAR was the Vodafone case[3], the greatest case in Indian tax history.

What is the Difference between GAAR and SAAR?

There are two types of anti-avoidance regulations in various nations:

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[1] "Tax Laws & Rules > Acts > Income-tax Act, 1961"
[2] Taxes not to be imposed save by authority of law No tax shall be levied or collected except by authority of law
[3] 2009(4)BomCR258, (2008)220CTR(Bom)649

- GAAR which is general.
- Individuals are the focus of special regulations known as Particular Anti Avoidance Rules (SAAR), which are based on case-by-case specific requirements.

It is widely acknowledged that generic anti-abuse provisions in domestic legislation are necessary since specific anti-avoidance rules might not cover every instance of misuse. Both the GAAR and SAAR's provisions are applicable and can coexist depending on the specifics of the situation.

Why GAAR, when DTAA was already there?

Companies frequently use the opportunities/loopholes granted in DTAA tax legislation to avoid paying taxes, which is a significant defect with DTAAs. Cross-border investors abuse a number of Double Taxation Avoidance Agreements (DTAA) to lower their tax obligations. The frequently cited DTAA between India and Mauritius is a prime example.

Will GAAR be applied to deny treaty eligibility in a case where there is compliance with the LOB test of the treaty?

All tax avoidance methods may not be sufficiently addressed by the adoption of anti-abuse regulations in tax treaties, and so these must be addressed through domestic anti-avoidance rules. There will be an opportunity to apply GAAR if a matter of avoidance is not satisfactorily handled by LOB in the treaty. According to LoB, foreign investors seeking tax exemptions in India must present documentation proving their residency in the foreign country in question (eg Mauritius). The term "LoB" refers to the procedural requirement that the beneficiary in question be a citizen of the treaty country. The treaty parties' bilateral DTAAs include the Limitation of Benefit (LoB) Clause. The benefit of the tax concession will only be available to those organisations that produce the document. (for example, the company proving that its residence is in Mauritius).

"GAAR being an anti-abuse provision can prevail over the treaty if it is proved that it is an abuse of the treaty. With the Limitation of Benefits clause in the treaty being fulfilled, it may be difficult to establish that the treaty is being misused," said Ex-Revenue Secretary Hasmukh

Adhia.[4]

When will DTAA override GAAR?

Treaty provisions will override the GAAR except when there are Impermissible Avoidance Arrangements (IAAs).

Impermissible Avoidance Arrangements (IAA)

Section 96[5] of Income Tax Act defines the term "impermissible avoidance arrangement" and places the burden of proof on the taxpayer to demonstrate that the primary goal of a certain transaction was not to earn a tax benefit.

Several nations have expressed worry about tax evasion and avoidance, which has been acknowledged as a global problem. This is also clear from the fact that each country is either tightening its current tax code or legislating the doctrine of general anti-avoidance regulations.

Procedure for invoking GAAR

First, the assessing officer mentions a matter to the tax commissioner that could be a GAAR issue.

After confirming that the referenced agreement is an impermissible avoidance arrangement (IAA), the tax commissioner issues a notice to the taxpayer.

When claiming that their arrangement is not an IAA, the taxpayer next produces the document.

If the Tax Commissioner is not pleased with the response after it is filed, the case is forwarded to the approving panel.

The approving panel looks at every aspect of the case before giving direct instructions to the taxpayers and tax officials.

The assessing officer then issues an order to the taxpayer.

[4] 'GAAR to override bilateral tax treaty provisions: Revenue Secretary Hasmukh Adhia', *The Economics Times,* May 11, 2016, 03:10 PM IST, Retrieved 7 March 2023
[5] Section 96 of the Income Tax Act: Impermissible avoidance arrangement

Major Features of GAAR

1. The tax benefit threshold of 3 crores must be exceeded for the GAAR rules to be applicable.

2. Subject to meeting a few requirements, Foreign Institutional Investors ("FII") are exempt from GAAR.

3. When a portion of an arrangement is an impermissible avoidance arrangement, the tax repercussions are decided only in light of that portion.

4. The Direct Taxes Code, Bill, 2010, which was introduced in April, would grandfather investments made prior to that date (from GAAR).

Substance Over Form Doctrine

The GAAR is based on the doctrine of substance over form, according to which, regardless of the transaction's or agreement's legal framework, the true intention of the parties is determined when they engage into an agreement to determine the tax consequences. The following four tests are listed:

1. The agreement establishes rights and obligations that are not mutually exclusive.

2. A deal or transaction leads to the abuse or misuse of a tax law's provision.

3. It is not commercially viable.

4. The deal was not done in a legitimate way.

The landmark **Helvering v. Gregory**[6] judgment says "anyone may arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

Way back in 1936, the Appellate Court in **IRC v. Duke of Westminster**[7], held that a citizen has the legal right to dispose of his capital and income so as to attract upon himself the least amount of tax. Avoidance of tax is not evasion and carries no ignominy. It was observed that

[6] Helvering, 293 U.S. 465 (1935)

[7] "Inland Revenue Comrs v Duke of Westminster [1935] UKHL 4 (7 May 1935)"

"given a document of the transaction is genuine the court cannot go behind it to some supposed underlying substance ".

In **M/s McDowell and Company Limited v. Commercial Tax officer**[8]**,** it was held that if a transaction was carried with the intention to avoid taxes it was up to the judiciary to decide whether the same ought to be regarded. In other words, the duty to decide the validity of the transaction was left to the court.

In **Vodafone International Holdings BV v. Union of India**[9], it was held that even if a transaction was carried out with the intention to avoid taxes, it did not, on its own, become illegal unless a statute prohibited the same.

Although McDowell maintains that the court has the authority to determine the impact of a transaction, the judiciary ultimately has to make decisions based on the dictates of the legislature (as held by the Vodafone case).

The Apex Court in **Azadi Bachao Andolan Case**[10] held that "If the court finds that notwithstanding a series of legal steps taken by an assessee, the intended legal result has not been achieved, the court might be justified in overlooking the intermediate steps, but it would not be permissible for the court to treat the intervening legal steps as non-est based upon some hypothetical assessment of the real motive of the assessee. In my view, the court must deal with what is tangible in an objective manner and cannot afford to chase a will-o-the-wisp."

Azadi Bachao Andolan Case was correct to the extent it held that the legislature was not clear. However, it overstepped when it misinterpreted the McDowell case.

The reasoning put forward in the Duke of Westminster case was thus rejected in the McDowell case, and the Azadi Bachao Andolan case rejected McDowell's argument that Westminster still represents a sound legal concept.

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[8] 1986 AIR 649, 1985 SCR (3) 791

[9] Siva, Meera (17 February 2014). "All you wanted to know about the Vodafone tax case". The Hindu Business Line. Retrieved 7 March 2015.

[10] UOI/Azadi Bachao Andolan v. UOI (2002) 175 CTR 371/256 ITR 563 (Delhi)(HC) (CA Nos. 8161& 8162 of 2003 and 8163 & 8164 of 2003 dt.

Latest development

The Taxation Laws Amendment Bill, 2021 was introduced in Lok Sabha by the Ministry of Finance on August 5, 2021. The problematic retrospective[11] tax demands were eliminated by this statute. Any tax demanded for the indirect transfer of Indian assets prior to May 2012 would be nullified under this new statute provided certain requirements were met. The requirements include a commitment that no further claims for damages will be made, as well as the withdrawal of any litigation that such taxpayers have already filed. The amendment also suggests returning the taxpayer's already paid taxes, but without charging interest. Vodafone company, which was engaged in a legal dispute with the Government of India, benefited from the central government's decision.

Conclusion

It is essential for the government to collect taxes from businesses because these funds are used to implement new laws that benefit society in a variety of ways, such as by constructing bridges, highways, and other infrastructure. The government created GAAR in order to recoup taxes from businesses that consciously organise to not pay taxes.

Although it is advantageous for the nation, there are some flaws that the government must fill. Many businesses worry that even if they are honest taxpayers, the tax authorities may pursue them under GAAR, what has to change is this.

Except in cases where there are Impermissible Avoidance Arrangements (IAAs), DTAA requirements will prevail over GAAR. MNCs should therefore ensure that the tax avoidance mechanism is not being abused (IAA).

[11] 5 facts about the general anti-avoidance rule (GAAR)". NDTV. 14 May 2012. Retrieved 7 March 2023.