
COMPREHENSIVE ANALYSIS OF INDIA'S GENERAL ANTI-AVOIDANCE RULE (GAAR): LAW, PRACTICE, AND POLICY

J R Disha, Hidayatullah National Law University

ABSTRACT

This paper is an in-depth understanding of GAAR in India, including its legal basis, its operation, and the multi-dimensional effect it had on India's tax environment. Exploring its development as judicially applied principles to the current codified statute, the book analyses the elements of GAAR, the shortcomings in the OECD model which GAAR seeks to overcome and offers new insight into its application. It discusses the written law, procedural protections, ongoing judicial interpretation and interaction with international tax treaties and the wider global anti-BEPS movement. Comparatively, the paper is informed by existing GAAR regimes in the UK, Canada, South Africa and Australia. Upon this diagnosis of the problems it identifies, the report offers a battery of policy proposals aimed at creating a more certain and just tax system that would facilitate. The analysis identifies important problems in this respect (concerning certainty and discretion) and uses them to suggest policy changes for sustainable economic growth.

Keywords: GAAR (General anti avoidance Rule/Tax avoidance/Tax Mitigation/Tax Mitigation/Impermissible Avoidance Arrangement (IAA)/Commercial substance/Approving Panel/Shome Committee/Double Taxation Avoidance Agreement (DTAA)/ Base Erosion and Profit Shifting (BEPS)

I. Introduction

This is evident from the increasing number of jurisdictions that have introduced General Anti-Avoidance Rules (GAARs) in response to the rapid transnational dissemination of complex tax avoidance schemes, frequently taking advantage of gaps in national legislation and cross-border tax agreements. These provisions enable tax authorities to defeat schemes which are essentially engineered to achieve a tax advantage without a bona fide commercial purpose. The ultimate goal would be to protect the tax system and avoid unfair revenue payments¹.

India is a fast-emerging economy and has significant fiscal challenges² due to tax avoidance by corporations. There are estimates that the country is losing in excess of US\$40 billion each year through such activities. This major fiscal kleptomania highlights a national issue of life or death: the resources that are siphoned to enrich a few through aggressive tax planning, could have been invested in essential public services such as poverty reduction and basic human services for the most vulnerable. The scale of the potential loss of revenue, and its direct relevance to national development objectives, raises the protection of the tax base above just a general policy goal to an emergency strategic national priority. This context implies that India's GAAR is not only a function of acceding to global best practices but, just as significantly, is an organic response to the exigencies of immediate domestic economic and social conditions³.

In this article, the authors provide an exhaustive study of India's GAAR⁴, and examines in detail its legislative framework, application, and other policy implications. "It offers an organized summary of a historical background to the rule, the current rule in its operational status, and the future supply rule in the context of the Indian tax system. There is a basic difference in case laws between tax evasion and tax avoidance and tax mitigation. These concepts are important also for accommodating the target of GAAR.

Tax Evasion is both wrong and illegal⁵ it is defined as the deliberate act with full knowledge, whether under oath or not, facts are omitted and lies are told and it is strictly prohibited by law.

¹ Press Release, Cent. Bd. of Direct Taxes, Clarifications on implementation of GAAR provisions under the Income-tax Act, 1961 (Jan. 27, 2017), Press Info. Bureau, <https://pib.gov.in/PressReleasePage.aspx?PRID=1481279>

² Ministry of Finance (India), Economic Survey 2016–17: Overview (2017), <https://www.indiabudget.gov.in>.

³ The Constitution of India art. 265 (taxes only by authority of law).

⁴ Income-tax Act, 1961, ch. X-A, §§ 95–102 (India).

⁵ Income-tax Act, 1961, § 277 (India).

GAAR is not meant to bring down tax evasions since the present legal framework is considered adequate to handle that kind of illegitimate behaviour.

Tax Avoidance, on the other hand⁶ refers to tax payer's action that are not illegal or explicitly prohibited by law, but are still considered unnecessary harsh or inequitable for opposing the objective of efficient revenue raising. GAAR is intended as a measure to curb these tax evasion techniques⁷.

Tax Mitigation is a "good"⁸ and is associated with situations where taxpayers use the tax structure to their benefit. That means abiding by the stated terms and then taking the economic hit for their decisions. GAAR is not meant to and will not apply to the normal commercial activities or genuine tax planning in the nature of tax mitigation.

The line between acceptable tax planning⁹ and unacceptable tax avoidance continues to be less than clear. And yet, one overarching feature of the legal process finally adopted is the continued reiteration that GAAR is aimed at "aggressive tax planning" and "impermissible avoidance" whereas "tax mitigation" and "ordinary commercial transactions" are given a very wide berth which is the important distinction in this inherently broad and changing landscape. The challenge is the subjective interpretation of terms like "commercial substance" or "principal purpose," which creates ambiguity for taxpayers. The introduction of GAAR in itself, although with all its in-built cushions, is a move away from a "letter of the law" form of taxation to more of a "spirit of the law" interpretation of the tax system¹⁰.

II. Evolution of Anti-Avoidance Jurisprudence in India

Prior to the introduction of statutory GAAR, tax avoidance was dealt with by the judiciary in India and the Specific Anti-Avoidance Rules (SAAR). The courts generally adhered to the principle that if a transaction had substance its legal form would not be ignored. Nevertheless, "colourable" or "doubtful" transactions were supposed to be overridden if worked out through the doctrines of piercing the corporate veil or substance over form¹¹.

⁶ OECD, Addressing Base Erosion and Profit Shifting 13–15 (2013).

⁷ OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report (2015).

⁸ HMRC, GAAR Guidance part A1 (July 2013, updated), <https://www.gov.uk>.

⁹ Finance Act 2013, c. 29, sch. 43 (UK).

¹⁰ OECD, Multilateral Instrument (MLI) – Explanatory Statement ¶¶ 11–16 (2017).

¹¹ *McDowell & Co. Ltd. v. CTO*, (1985) 154 ITR 148 (SC) (India).

Supreme Court's decision in *McDowell & Co. Ltd. v. Commercial Tax Officer* (1986)¹² was a watershed moment in the tax jurisprudence of India. The Court held that though tax planning provided it is within the limits of the enactment is perfectly legitimate "colourable devices" cannot be part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to 'colourable devices'. This decision also signalled the adoption of a more purposive approach because previously, the tax legislation was strictly analogy of the words with tax statutes. Such judicial statement, which was rendered many years before the statutory GAAR, already suggested that the legal form should not be the sole factor to consider when the true intent of a transaction was to avoid taxes. The later addition of GAAR, with its emphasis on "commercial substance" and "main purpose" is, arguably, the statutory embodiment of the principles of *McDowell*. The bill symbolizes a move away from nebulous judicial "smell tests" to a more codified legal regime in which tax authorities are given explicit powers that were formerly only available via judicial construction.

Union of India v. Azadi Bachao Andolan also noted, "that the DTAA's override domestic laws in case of conflict" and "the limit to treaty-shopping cannot be stretched to such an extent as to mean that if the terms of a treaty are more beneficial to an assessee, the treaty may be ignored." However, by upholding the treaty benefits in this case, the Court also emphasized the ease of "treaty shopping" and "double non-taxation"¹³ via these arrangements.

Supreme Court in the *Vodafone*¹⁴ *International Holdings v. Union of India* (2012) was a major transition. The Court held for *Vodafone* that the Indian revenue authorities did not have jurisdiction to tax an offshore share transfer between two foreign non-resident companies, notwithstanding that the transfer is in respect of Indian assets. This decision, prescribing purposive instead of a dissection approach to transactions, was a key trigger that propelled codification of a GAAR¹⁵.

The government saw a clear requirement for specific anti-abuse rules¹⁶ to deal with the manner in which widespread tax avoidance could not effectively be addressed in case law alone, such that a number of highly contrived tax schemes were not being addressed.

¹² *Union of India v. Azadi Bachao Andolan*, (2003) 263 ITR 706 (SC) (India).

¹³ CBDT Circular No. 789, Tax Residency Certificate—Mauritius (Apr. 13, 2000).

¹⁴ *Vodafone Int'l Holdings B.V. v. Union of India*, (2012) 341 ITR 1 (SC) (India).

¹⁵ Finance Act, 2012, No. 23 of 2012, § 65 (India) (inserting ch. X-A).

¹⁶ Direct Taxes Code, 2009 (Discussion Paper), ch. XI (proposed GAAR).

The Vodafone case was legally correct and valid upon existing legislation, but did reveal the shortcomings of a judicial anti-avoidance doctrine as it pertains to complex, cross-border structures. The follow through was the government's strong and hasty step to enshrine GAAR in legislation (GAAR being retrospective), which shows a legislative intent to make up lost ground and bring in express statutory powers to tackle what it, by and large, was at least interpreting as aggressive tax avoidance, without being bound to have the courts "stretch the provisions" or accommodate on evolving judicial doctrines. The course of events would suggest that, to a large extent, GAAR was less a policy choice in the positive sense, and more a reactive tool of legislation following judicial decisions that had fettered the revenue in taxing.

GAAR was first suggested under the Direct Taxes Code (DTC) 2009¹⁷, 2010 and 2013 to target tax avoidance mechanisms. It was finally inserted as Chapter X-A of the Income Tax Act, 1961, by the Finance Act, 2012.

Introduced in 2012, GAAR was repeatedly postponed¹⁸ in the face of substantial stock market and industry opposition and fears it could apply retrospectively to foreign deals done in the past. To address these apprehensions an Expert Committee has been set-up in July 2012 headed by Dr. Parthasarathi Shome to review and rework the GAAR guidelines¹⁹.

The recommendations of the Shome Committee resulted in the introduction of several checks and balances, the most important of which was the basis rule (when only the transaction becomes taxable/disallowable, the impugned benefit is denied) although, here, the effective date of GAAR was put in a risk-free zone till April 1, 2017. Significant other changes were stricter "main purpose" (versus "one of the main purposes") and particular monetary thresholds, and extensive grandfathering of investments that had been made in the past. Repeated deferrals of the implementation of GAAR and the formation of the Shome Committee evidence a marked change in policy direction from the era of an aggressive "only revenue matters" mindset, towards a balanced approach that also takes into account investor sentiment and demand for certainty. This first "negative reaction of the stock market and industry" made it clear that there would be a short-term economic impact from the perception of uncertainty. The later introductions of limitations are indicative of a government accepting the need to tackle avoidance but which must be done in a way that does not prevent genuine market and business

¹⁷ Report of the Expert Committee on GAAR (Shome Committee) (Sept. 2012).

¹⁸ Ministry of Finance Press Release, Implementation of GAAR Deferred (Mar. 14, 2013), <https://pib.gov.in>.

¹⁹ Shome Committee, First Report (Sept. 2012) & Final Report (2013).

behaviour. This is a useful reminder that the real-world development of tax policy owes much to the physical world and the actions of key players.

Table 1: Key Milestones in India's GAAR Journey²⁰

Year/Date	Event/Development	Key Impact/Significance
August 12, 2009	Draft Direct Taxes Code (DTC 2009) released	First public proposal of GAAR provisions in India
March 16, 2012	GAAR introduced in Finance Bill, 2012	Legislative enactment of GAAR into the Income Tax Act, 1961
July 13, 2012	Expert Committee on GAAR (Shome Committee) constituted	Response to negative industry reaction, aimed at reviewing and refining GAAR guidelines
September 2012	Shome Committee recommends deferral by three years	Acknowledged industry concerns, proposed investor-friendly measures
January 14, 2013	Government accepts most Shome Committee recommendations; defers GAAR to April 1, 2016	Introduced safeguards, including "main purpose" test and monetary threshold
February 28, 2015	Implementation deferred by one more year to April 1, 2017	Further response to investor sentiment, allowing more time for refinement
January 27, 2017	CBDT Circular No. 7 of 2017 issued	Provided clarifications on GAAR provisions, confirming April 1, 2017 effective date
April 1, 2017	GAAR provisions become effective	Final implementation of the codified GAAR regime in India

²⁰ CBDT Press Release, Clarifications on implementation of GAAR (Jan. 27, 2017); PIB Tag page citing the same.

III. The Statutory Framework of India's GAAR

General Anti-Avoidance Rule provisions are codified in Chapter X-A of the Income Tax Act, 1961²¹. An important characteristic of these provisions is their overriding operation on other provisions of the law. This is generally done through a "non-obstante clause" of the Act, that provides that GAAR applies irrespective of any inconsistent provisions in the Act. This drafting decision denotes the wide and overriding source of GAAR and its role as a last-stop measure for tax planning, particularly using tax planning schemes which would otherwise be strictly following other provisions of tax law.

Sections 95 to 102 of the Income Tax Act, 1961 delineate the operative ambit, the conditions required to be satisfied and the ramifications that may accrue once an arrangement is found to attract GAAR²². These articles are the central legal texts used to operationalize the conventions.

An arrangement is considered to be an "Impermissible Avoidance Arrangement" (IAA) if its dominant purpose is to achieve a tax benefit, and it simultaneously contains one of four prescribed "tainted elements"²³.

The taxpayer must have the acquisition as its primary purpose to achieve some tax advantage²⁴. This was a significant amendment inserted in on the recommendation of the Shome Committee, which changed the test from 'one of the main purposes' to 'the main purpose'²⁵. It is this refinement that is a vital protection against overreach.²⁶ If the mere fact of being "one of the main purposes" were enough, nearly any transaction driven mainly by commercial considerations but with some element of tax advantage could be subject to review, giving businesses and investors vast uncertainty²⁷. By adding that "obtaining a tax benefit must [only] be the main purpose," the law acknowledges that, in legitimate business transactions, there are usually a variety of interests involved, not just securing the most tax favourable positioning. GAAR's intervention is, therefore, meant for cases where tax avoidance is the primary motive with the idea being to strike a balance between discouraging misuse and ensuring that there is

²¹ Income-tax Act, No. 43 of 1961, ch. X-A, §§ 95–102 (India).

²² *Id.*

²³ Income-tax Act § 96(1)–(2) (India).

²⁴ *Id.* § 96(1).

²⁵ Parthasarathi Shome Comm., Report on GAAR (2012), Ministry of Finance (India).

²⁶ *Id.* at 9–10.

²⁷ CBDT, Circular No. 7 of 2017, F. No. 500/43/2016-FTD-I, Q. 1 (Jan. 27, 2017).

no dis-incentivisation economically bona fide conduct²⁸. This clearly speaks to industry fears of uncontrolled application.

To meet the "main purpose" test, and thus to be designated an IAA, the arrangement also must have at least one of the certain "tainted elements" present²⁹. One of those elements, is the formation of non-arm's length rights or obligations, which is meant to cover situations in which a relationship is formed and rights or obligations arise that would not exist between independent parties dealing at arm's length. This kind of criterion echoes transfer pricing logic in its approach to so as to identify artificial or unnatural elements in the transaction structure. The second constituent is the misuse or abuse of provisions of the Income tax Act³⁰ which is to say where an arrangement while superficially complying with the letter of the law, as authoritatively interpreted, is nonetheless, such that it offends the object and spirit of the law the use of the expression contravention in the context supports the above view. This is a purposeful construction of the statute allowing tax authorities to look beyond the letter of the law³¹ to the spirit in which it is intended to be exercised.

The third component relates to lack of commercial substance³² (including deemed lack of it), which is intended at those transactions which do not have bona fide business purpose and are undertaken mostly to secure the tax benefits. Lack of substance. The complete absence of substance may be evidenced by indicators like round-trip financing and accommodating parties throughout the course of which the notional is being passed back and forth, offsetting or circular elements, or attempts to obscure the origin, value, ownership or control of funds. Last, the non-good faith performance of the arrangement is also acknowledged³³ as tainting movement, with an emphasis on whether the methods are usual and genuine for the performance (ex-ante) of similar commercial settings.

Together these trusts act as "gate keepers"³⁴ that apply to ensure that the GAAR is triggered only for arrangements which have tax avoidance as the main purpose and which demonstrate

²⁸ CBDT, Circular No. 7 of 2017, F. No. 500/43/2016-FTD-I, at 5 (Jan. 27, 2017) (India).

²⁹ Income-tax Act, No. 43 of 1961, § 96(1)–(2) (India).

³⁰ Income-tax Act § 96(1)(b) (India); see also OECD, Action Plan on Base Erosion and Profit Shifting 17 (2013).

³¹ CBDT, Circular No. 7 of 2017, F. No. 500/43/2016-FTD-I, Q. 4 (Jan. 27, 2017).

³² Id. § 97.

³³ Income-tax Act § 97(2)(e) (India).

³⁴ Parthasarathi Shome Comm., Report on GAAR 6–8 (2012), Ministry of Finance (India).

attributes that challenge the integrity of the tax system.

GAAR is applicable where certain monetary limits are reached. It is applicable only if the anticipated tax benefit in respect of a particular arrangement exceeds INR 30 million³⁵ in a financial year. This filter threshold served to guide the rules toward large transactions rather than minor compliance considerations, while minimizing any administrative burden on small no-structured transactions.

In addition, investments prior to April 1, 2017, which was when GAAR became applicable, are typically grandfathered³⁶. So, all income from the sale of such investments is untouchable by GAAR. This grandfathering provision is also valid for compulsorily convertible instruments, bonus issues, or split/consolidation of holdings in the case of investments made before April 2017, such investments are continuous in the hands of the same investor. The relationship between the monetary limit and the grandfathering provision is thus a strategic legislative decision³⁷ aimed at moderating the reach of GAAR and its effect on previous investments and smaller transactions. The threshold concentrates enforcement on high-value avoidance, while grandfathering seeks to provide certainty concerning past investment, and to insure against retroactivity and investor angst. This mix acts as a de facto dampener for the future planning of the taxpayers, as well as promotes genuine commercial arrangements in cases where the new investments may be above the threshold and also ensures that those with pre-GAAR structures are not hit³⁸.

IV. Operationalization and Procedural Safeguards

The procedural mechanism of GAAR involves a multi-level approval system. The powers under GAAR can be exercised by the Assessing Officer only after receiving approval of the Approving Panel³⁹. The Approving Panel will be headed by a Retd. Before this notice is served, the Commissioner is obliged to send a show cause notice⁴⁰ to the assessee, justifying the reasons for the proposed invocation of GAAR.

In the event the Commissioner is not satisfied with the explanation provided by the taxpayer to

³⁵ Income-tax Rules, 1962, r. 10U(1)(a) (India).

³⁶ Id. Q. 5–6.

³⁷ OECD, *Designing Effective Anti-Abuse Rules* (2015), at 28–29.

³⁸ CBDT, Circular No. 7 of 2017, *supra*, Q. 2.

³⁹ Id. § 144BA(4)–(6).

⁴⁰ Income-tax Act § 144BA(2) (India).

the show cause notice, the matter is referred to an independent Approving Panel⁴¹.

The Approving Panel assures a fair and knowledgeable review process. It consists of a Chairperson and a member of the rank of a Judge of a High Court⁴² and one qualified as a chartered accountant or held a senior position in the Indian Revenue Service not below the rank of a Chief Commissioner, both appointed by the central government by rule, in consultation with the Chief Justice of the Supreme Court and the Chairpersons of State Appellate Tribunals as it deems fit and an academic or an expert in direct taxes or business, a retired senior Indian Revenue Service who was not below the rank of Commissioner of Income-tax. "Such composition of the body, specifically having the independent judicial member, is supposed to address tax payers concerns about the fairness and objectivity of the process⁴³ of application of GAAR.

The Panel is required to give the taxpayer an opportunity of being heard and to determine the reference within 6 months. Its instructions are binding on the assessee⁴⁴ as well as on the Income-tax authorities. In addition to that, the period taken for the proceedings before the Commissioner and the Approving Panel is made 'dead time'⁴⁵ (not part of the time limit set for assessment) so that administrative delays cannot favour the Revenue or disadvantage the taxpayer. One of the main criticisms of GAAR, particularly its early editions, was the alleged unconfined discretion given to the tax administration. The creation of this multi-layered Approving Panel including a High Court Judge as Chairperson constitutes an important institutional check. This formula converts GAAR from a pure administrative remedy to Quasi-Judicial exercise⁴⁶ and boosts the due process and accountability. Panel directions have binding effect. The binding nature of the panel's directions also underscores the panel's role to ensure that GAAR is applied consistently, equitably and reasonably, addressing fears about nebulous applicability and certainty.

The onus of proving that there is an "impermissible avoidance arrangement"⁴⁷ in the first instance is on the Revenue authorities. But the moment the Income Tax chooses to treat an arrangement as an IAA and show cause notice is issued, the burden shifts to the assessee to

⁴¹ Id. § 144BA(3)–(4).

⁴² Income-tax Rules, 1962, r. 10UE(1)(a)–(c) (India).

⁴³ Shome Comm., Report on GAAR 8–9 (2012), Ministry of Finance (India).

⁴⁴ Income-tax Act § 144BA(13) (India).

⁴⁵ Id. § 153(3) (Explanation 1).

⁴⁶ Shome Comm., *supra*, at 10.

⁴⁷ CBDT, Circular No. 7 of 2017, Q. 4.

demonstrate that the arrangement is not an IAA. This fluctuating burden of proof is a finery of the GAAR. Although the evidential burden on the Revenue acts as a necessary safeguard, the burden on the taxpayer to rebut impermissibility is onerous. This encourages taxpayers to keep careful records⁴⁸ of the commercial justification and the economic substance of every transaction or relationship regardless of legal form. This suggests that compliance and sound internal governance⁴⁹ will take on greater importance in order to withstand the GAAR glare, which in turn affects taxpayer behaviour with a view to greater transparency and commercial cohesion.

Apart from the Approving Panel, there are numerous other safeguards in the GAAR structure, to ensure the rights of the taxpayer. Taxpayers are served with a show cause notice on the ground for invocation of GAAR and they are given an effective hearing before both the Commissioner and the Approving Panel⁵⁰.

In addition to that, taxpayers can also apply for an Advance Ruling on the GAAR's applicability on the transaction in question. If such a decision states that the arrangement is acceptable, it cannot be invoked for that arrangement from the angle of GAAR. It is also further clarified that if a transaction has been held allowable⁵¹ in one assessment year by the PCIT/CIT/Approving Panel, on the similar facts and circumstances, the said transaction cannot be held to be impermissible in another assessment year. These measures are intended together to provide some predictability and fairness to the GAAR which is supposed to be cast in a wide net⁵².

V. Policy Implications and Interaction with International Tax Regimes

The purpose of GAAR is to counter tax avoidance tax avoidance schemes which are entered into based on the norms of the law but not in spirit. SAARs on the other hand are specific rules aimed only towards a particular planning where transfer pricing abuse, thin capitalization, dividend stripping etc are involved⁵³.

⁴⁸ OECD, BEPS Action 12 – Mandatory Disclosure Rules 10–12 (2015).

⁴⁹ OECD, Tax Administration 2023: Comparative Info on OECD and Other Advanced Jurisdictions 33–34 (2023).

⁵⁰ Income-tax Act § 144BA(2) (India).

⁵¹ Id.

⁵² OECD, Implementing Anti-Abuse Rules Without Hurting Certainty (BEPS Toolkit), at 14–15 (2016).

⁵³ Income-tax Act, No. 43 of 1961, §§ 92–94B (India); see also OECD, BEPS Action 2–4 (2015).

The Central Board of Direct Taxes Circular No. 7 of 2017 clarified that GAAR and SAAR could co-exist as GAAR are not in conflict with SAAR. Normally, GAAR would not be applicable to situations already addressed by SAAR, "unless the arrangement is unduly abusive such that it is considered to be outside the intendment of SAAR"⁵⁴. It forms a fairly strict order within the family of anti-avoidance provisions. SAARs, as a "custom fit to specific circumstances" might thus serve as particularized "snipers"⁵⁵ where avoidance methods are known.

GAAR, on the other hand, operates as a "broad-spectrum anti-avoidance provision", like a "scatter-gun", intended to trap unanticipated or overly aggressive transactions which SAARs, by their nature, are unable to express with precision or to counter. The explanation that GAAR applies only if SAAR is not enough⁵⁶ to counter the avoiding means that SAAR is the first gate of defence while GAAR is the secondary or cut-off power. This twin strategy seeks to deliver targeted precision as well as maximum coverage recognising the fluid and ever-changing nature of tax avoidance schemes.

The GAAR is specifically for over-riding DTAA's. This implies that if GAAR holds the underlying transaction to be an Impermissible Avoidance Arrangement (IAA), the treaty benefits can be effectively denied.⁵⁷

The CBDT has also stated that LOB provisions-which are present in most DTAA's-work as anti-avoidance mechanisms, however, they cannot be interpreted to cover all complexities of tax avoidance schemes. In these circumstances, GAAR may still be imposed by the Indian tax authorities. But with a critical caveat. If particularly in case of one avoidance, it was so provided in the LOB (Limitation of Benefits) clause of the DTA that it fails to have effect, there is no question of GAAR being attracted. This sophisticated analysis will help avoid unwarranted invocation of GAAR when treaty-specific anti-abuse rules are sufficient.

Mauritius has been the largest source of FDI in India⁵⁸ (approx. 33 per cent of total inflows). The 0% capital gains tax on shares and securities under the former India-Mauritius DTAA

⁵⁴ Id.

⁵⁵ OECD, Designing Effective Anti-Abuse Rules 10–12 (OECD Publ'g 2015).

⁵⁶ CBDT, Circular No. 7 of 2017, *supra*, Q. 5.

⁵⁷ Id.; see also OECD, BEPS Action 6: Preventing Treaty Abuse 2015 Final Report 13–18 (2015).

⁵⁸ Ministry of Finance (India), Press Release, India–Mauritius Protocol on Taxation (May 10, 2016).

meant that this route was often employed for “treaty shopping”, raising spectres of “double non-taxation”.

While visits to the region seem to be increasing, Australian solicitor Damien Farrell says Australia has yet to agree a reciprocal agreement with India in light of the 2016 DTAA amending protocol⁵⁹ to determine where tax should be paid in the context of Mauritius and other tax havens. This amended treaty allowed India to tax capital gains resulting from the sale of shares and securities. A transition period of two years realised a further easing-in: from 1st April, 2017 till 31st March, 2019⁶⁰, capital gains were taxed at 50% of the prevailing rate (15%). The altered treaty in combination with the framing of GAAR is said to have substantially changed direction for investment: rather than using Mauritius as an investment route, direct investments into India have surged, which in turn has boosted tax collection of Indian authorities. The revision of the India-Mauritius DTAA and the concurrent roll-out of GAAR is a bold, well-timed policy move⁶¹. In the past, the DTAA allowed “treaty shopping” and “double non-taxation”⁶². While the amendment to the DTAA specifically dealt with the issue of capital gains, the GAAR gives a more general principles-based power to address any new or unexpected avoidance arrangement⁶³ that might arise under even amended treaties or even where LOB may not cover the same. The above shift to direct investments, as reported, indicates that this combined approach has worked well to counter treaty abuse and ensure India’s fair share of tax, and illustrates that domestic anti avoidance rules can provide significant support to international treaties.

Table 3: Impact of India-Mauritius DTAA Revision on FDI Inflows (Pre vs. Post 2017)

Period	Mean FDI Inflows (USD Million)	N	Std. Deviation	Std. Error Mean	Correlation (Before & After)	Significance (2-tailed)
Before Revised Treaty	552.45	6	470.113	191.923	0.759	0.080

⁵⁹ Damien Farrell, Interview in International Tax Review (Apr. 2017) (on Australia–India reciprocal protocol challenges).

⁶⁰ Id. art. 13(3C) (50% rate during transition phase).

⁶¹ OECD, BEPS Action 6 – Preventing Treaty Abuse: 2015 Final Report 13–14 (2015).

⁶² Union of India v. Azadi Bachao Andolan, (2003) 263 ITR 706 (S.C.) (India).

⁶³ Income-tax Act, No. 43 of 1961, §§ 95–102 (India); CBDT, Circular No. 7 of 2017, Q. 5.

After Revised Treaty	37.9753	6	22.84328	9.32573		
Paired Differences	Mean Difference	Std. Deviation	Std. Error Mean	95% Confidence Interval	t	df
Before Treaty - After Treaty	514.47292	453.01665	184.94327	Lower: 39.06110, Upper: 989.88473	2.782	5

Source: Adapted from, Tables 9, 10, 11

Qualitative Observation: The statistical data indicates a significant reduction in FDI routed through Mauritius after the revised DTAA came into force, suggesting a shift towards direct investments and increased revenue for India⁶⁴.

India has played a dynamic role in at the OECD's Base Erosion and Profit Shifting (BEPS) project. The BEPS Action Plan was developed in response to perceived weaknesses⁶⁵ in the standards of international tax areas that limited the ability of multinational corporations to move profits to countries with a more favourable tax rate at a cost to the tax bases of other countries.

GAAR is considered to be a key element of India's sweeping legislative framework rolled out in the wake of the completion of the BEPS project. The specific reference to preventing tax treaty abuse as a minimum standard⁶⁶ was already mentioned in the BEPS Action Plan (Action 6) by (inter alia) the introduction of anti-abuse rules, such as a Principal Purpose Test (PPT) or LOB clauses, in tax treaties. It is clear that GAAR is a domestic anchor of India's BEPS implementation framework. Although the BEPS actions cover specific areas, such as transfer pricing and treaty abuse, GAAR is a broad based, anti-avoidance rule that operates as a catch-all for all of these actions. This showcases India's adherence to international tax consistency and pro-active approach⁶⁷ in safeguarding its tax base from intricate cross-border tax structures.

⁶⁴ Reserve Bank of India (RBI), "FDI Equity Inflows by Country," Monthly Bulletin (2017–2021).

⁶⁵ OECD, Action Plan on Base Erosion and Profit Shifting 7–10 (2013).

⁶⁶ OECD, BEPS Action 6, *supra*, at 13.

⁶⁷ UN Tax Committee, India Country Report – BEPS Alignment and GAAR (2020).

GAAR which when introduced was a source of concern for a variety of reasons within the business community particularly when it was initially introduced with retrospective tax amendments⁶⁸. There was concern that these steps would discourage foreign investment and create considerable uncertainty in the Indian tax system. This lack of certainty with regard to taxation is generally recognized as an obstacle to capital flow⁶⁹.

To address these concerns the frequent postponements of the applicability of GAAR and the laid down strict conditions by introduction of the monetary limits, earlier parting of the property, special circumstances etc and setting up of the Approving Panel have no doubt been made to send strictly investor friendly signal and to revisit the law to make it a better norm by striking a desirable balance. Even though there were some initial concerns, but on the policy level, India has been seen as an investment friendly destination⁷⁰, pushing for BITs to protect investments and advance aspects of bilateral cooperation. The country has attracted more than 1 trillion FDI during the period from April 2000 to March 2025. The story surrounding the effect of GAAR on FDI has a deep enigma. Although GAAR seeks to promote a "fair" tax regime and to prevent revenue erosion⁷¹ (which, in principle, will create a more stable and predictable environment for genuine investors), its "broad nature" and "subjectivity" led to "uncertainty" and a "negative reaction of the stock market and industry"⁷² to it. The government's subsequent impetus to bring in safeguards was clearly a response to such concerns; in seeking to bridge the gap between deterring aggressive avoidance and attracting genuine investment. This underscores the fine line tax policymakers need to walk in creating successful anti-avoidance rules⁷³: ones that work, without also accidentally smothering economic activity, or putting off potential investors.

VI. Judicial Scrutiny and Emerging Practice

GAAR came into force from April 1, 2017. Specific Detailed Published Decisions Applying GAAR post 2017 at the level of ITAT Although the Income Tax Appellate Tribunal (ITAT) has a search portal where you may search case status GAAR decisions, detailed published

⁶⁸ Vodafone Int'l Holdings B.V. v. Union of India, (2012) 341 ITR 1 (S.C.); see also Finance Act, 2012, § 113 (retrospective clarification).

⁶⁹ IMF, "Tax Certainty: IMF/OECD Report for G20 Finance Ministers" 4–6 (2017).

⁷⁰ UNCTAD, World Investment Report 2023: Country Fact Sheet – India.

⁷¹ OECD, Addressing Base Erosion and Profit Shifting 13–16 (2013).

⁷² The Economic Times, "Markets react sharply to GAAR threat," (Apr. 2012).

⁷³ OECD, Tax Policy Reforms 2022: Special Feature on Tax Certainty, ch. 3 (2022).

decisions are not narrated in abundant available material at ITAT level after 2017⁷⁴.

There was a big change in the judicial attitude though when the constitutional writ petition challenging the Revenue's invocation of GAAR in a tax-treaty situation was dismissed by the Telangana High Court. The Court in this case highlighted that the GAAR legislation would, by reason of the non-obstante clause, prevail over other parts of the Income Tax Act. In the context of this Telangana High Court matter, it was held that GAAR would prevail over Specific Anti-Avoidance Rules (SAARs) given its non-obstante clause, particularly if there is no specific SAARs, which covered the facts of the present case⁷⁵. The court held that the arrangement at issue was devoid of economic substance and met both the tainted elements test and main purpose tests which supported applying GAAR. This early affirmation of GAAR's overriding impact on the statute is an important precedent for how the Indian courts might construe its legislative competence. This decision which is not an across-the-board affirmation of the GAAR on the face of it but clearly indicates the judiciary's readiness to endorse the legislature's power to give GAAR "a very special status in the Indian statute" should effectively end subsequent debate on the constitutional validity of the GAAR once and for all. That adds a layer of legal certainty with respect to GAAR⁷⁶ and its use as an all-encompassing anti-avoidance instrument to even the most mount ever side with complex fact patterns not subject to SAAR.

Although the GAAR rules have numerous checks and balances, they are still high-level and issues thematically arise, the main one being one of uncertainty. Taxpayers often struggle to anticipate with certainty which tax planning strategies will become impermissible given such inherent judicial discretion⁷⁷. When sufficiently ubiquitous, such uncertainty can discourage legitimate business expansion and development.

A major contentious issue under GAAR is subjective interpretation of "main purpose" test particularly in multiple-purpose transactions⁷⁸. Critics say it promotes statutory complexity and lends itself to part use, even abuse, by tax agencies. This demonstrates the tension between the principles-based approach of flexibility to counteract the unexpected avoiding provisions and

⁷⁴ ITAT e-Courts Portal, <https://itat.gov.in>.

⁷⁵ Ayodhya Rami Reddy Alla, *supra*.

⁷⁶ *Id.*

⁷⁷ IMF–OECD, Tax Certainty: IMF/OECD Report for G20 Finance Ministers 5–7 (Mar. 2017).

⁷⁸ Anup N., Super Power or Super Haven? GAAR in India – Part II, Kluwer Int'l Tax Blog (Apr. 2020), <https://kluwertaxblog.com>.

the taxpayers' demand for certainty and predictability⁷⁹. It invites litigation and discourages real transactions, and it calls for minute regulations and constant judicial construction⁸⁰. Terms such as "misuse", "abuse", "commercial substance" and "main purpose" need judicial clarity, evident in Telangana High Court's positive verdict, which can bring about a combination/alliance of jurisprudence addressing the natural ambiguity⁸¹.

VII. Comparative Perspectives: Lessons from Global GAAR Regimes

General Anti-Avoidance Rules (GAARs) are found in a number of countries: Australia, Canada, China, New Zealand, Pakistan, Poland, South Africa, etc., but also in France, Germany, the UK, the US and in Singapore⁸². Although all are intended to curtail tax avoidance and evasion activity, they differ in character, process and consequence which provide some important learnings for India.

UK GAAR was introduced in 2013 to counter "abusive" tax arrangements in the areas of income tax, corporation tax and inheritance tax⁸³. "Abuse is measured by two objective standards a transaction is abusive if it is structured in one of two ways: First, transactions are abusive if they are contrived in such a way that no reasonable person would act in such a way⁸⁴. The verdicts are built up into a body of such decisions from an independent panel of experts, which the GAAR Anti-Avoidance Rule Panel issues in respect of HMRC cases so that there is balance and fairness as the onus is on the tax authorities⁸⁵. The courts have warned of the danger of over-reliance on GAAR, especially in the presence of express provisions, as in *RFC 2012 Plc v. HMRC*⁸⁶.

Canada's GAAR, which is found in Section 245 of the Income Tax Act, draws a line between lawful tax planning and abuse through a test which includes three steps: first Tax Benefit, second Tax Purpose, and third Abusive Tax Avoidance⁸⁷. The Supreme Court's ruling in *Canada Trustco* highlighted the integrated textual, contextual and purposive approach.

⁷⁹ OECD, Tax Administration 2023: Comparative Information 27–29 (2023).

⁸⁰ CBDT, Circular No. 7 of 2017, Q. 4–6.

⁸¹ OECD, Tax Certainty 2021: Country Experiences and Lessons Learned 14–15 (2021).

⁸² OECD, BEPS Action 6: Preventing Treaty Abuse 2015 Final Report 17–21.

⁸³ HM Revenue & Customs, GAAR Guidance Part A ¶¶ A1.3–A2.2 (2013), <https://www.gov.uk/government/publications/gaar-guidance>.

⁸⁴ Income-tax Act, No. 43 of 1961, § 144BA (India); CBDT, Circular No. 7 of 2017, Q. 4.

⁸⁵ *RFC 2012 Plc v. Revenue & Customs Comm'rs* [2019] UKFTT 442 (TC).

⁸⁶ *Id.* ¶¶ 27–30.

⁸⁷ *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, [2011] 3 S.C.R. 721, ¶¶ 66–69.

Economic substance or having none is a powerful indication of abuse, so the attachment to legislative intent should be praised similar to India's "lack of commercial substance"⁸⁸.

Attracted by bright and multi-coloured flowers, they immediately seek nectar-gathering and then form stable nectar pools on the flowers when nectar is present⁸⁹. SARS has extensive recharacterization powers, and courts prefer substance over form. India's GAAR, which draws heavily from South Africa's regime, having been inspired by the Australian, Canadian, and New Zealand approaches, mirrors equivalent definitions closely, also pointing that the Indian interpretation may be led by South African precedents⁹⁰. Australia shares the law dealing with tax avoidance (in Part IVA, 1981), which is directed at arrangements entered into for the 'dominant purpose of the tax benefit'⁹¹. Unlike India, that does not require "lack of commercial substance"⁹². This distinction allows for flexibility in Australia but India based its test of commercial substance as mandatory, which other countries do not have to follow and it makes it too restrictive for tribunals and a rigid structure is formed⁹³.

Comparison with other jurisdictions yields important points to note for India: the need for better drafting, strong procedural safeguards, consistent judicial interpretation and supervisory oversight. International experience demonstrates the importance of advisory panels, assignment of burden of proof, and strategic positioning of economic substance. These lessons indicate that the structure of India's GAAR can be improved to bring greater certainty to taxpayers and ensure the effectiveness of the GAAR⁹⁴.

Table 2: Comparison of India's GAAR with Selected International Regimes

Feature	India	United Kingdom	Canada	South Africa	Australia
Effective Date	April 1, 2017	2013	September 13, 1988	November 2, 2006	1981

⁸⁸ David Duff, "GAAR Reform and the Canadian Experience," in *The GAAR in Retrospect and Prospect* (John Avery Jones ed., 2014).

⁸⁹ Id. § 80A(c)-(e); South African Revenue Service (SARS), *Guide to the GAAR* (2013).

⁹⁰ Shome Committee, *Report on GAAR 6-7* (2012), Ministry of Finance (India).

⁹¹ SARS, *GAAR Guide* (2013); Bosch, *supra*.

⁹² Income-tax Act § 97 (India); cf. Australian legislation *supra*.

⁹³ HMRC, *GAAR Advisory Panel*; Income-tax Act § 144BA (India); SARS *GAAR Guide*.

⁹⁴ Shome Committee *Report on GAAR 11-12* (2012); OECD, *Designing Effective Anti-Avoidance Rules 22-24* (2015).

Legal Basis/Key Section	Chapter X-A, Income Tax Act, 1961	Finance Act, 2013	Section 245, Income Tax Act	Sections 80A-80L, Income Tax Act	Part IVA, Income Tax Assessment Act, 1936
Core Test for Abuse/Avoidance	Main Purpose + Tainted Elements	"Double Reasonableness" (cannot reasonably be regarded as a reasonable course of action)	Three-Step Test (Tax Benefit, Avoidance Transaction, Abusive - misuse/abuse of OSP)	Main Purpose + Tainted Elements	Sole or Dominant Purpose + Scheme
Commercial Substance Requirement	Yes, mandatory tainted element	Yes, implicitly via "contrived or abnormal steps" and economic outcomes	Important consideration, tends to indicate abuse if significantly lacking	Yes, a tainted element	No, not explicitly mandated
Burden of Proof	Initial on Revenue, then shifts to taxpayer	On HMRC to show abusiveness	Initial on taxpayer (tax benefit/avoidance transaction), then on Minister (abusiveness)	On taxpayer to prove main purpose is not tax benefit	On Commissioner to prove dominant purpose
Role of Advisory Body	Yes, Approving Panel (quasi-judicial, binding directions)	Yes, GAAR Advisory Panel (independent, approves guidance, provides opinions)	No explicit standing advisory body for case review	No explicit standing advisory body for case review	No explicit standing advisory body for case review
Treaty Override	Yes, explicitly overrides treaties	Yes, can override treaties	Yes, can override treaties	Yes, can override treaties	Yes, can override treaties

VIII. Challenges, Criticisms, and Recommendations

Critics of GAAR have always posited that it goes too far in giving tax administration a vague power abuse; critics are afraid that these powers would be abused. The very general and all-encompassing nature of GAAR provisions, although inevitable for being inclusive, may generate some confusion about the legality of specific tax planning schemes. That makes it difficult to know exactly which configurations may ultimately come under the application of GAAR. Derivative & foreign exchange market risk Such volatility may also act as a deterrent to real business growth and overseas investment⁹⁵, should it not be properly managed. This reflects an inevitable trade-off in the design of any GAAR. A deep and narrow, prescriptive rule is needed to undermine the continually changing schemes of tax planning, which cannot be caught with the help of Specific Anti-Avoidance Rules (SAARs). But this generality introduces ambiguity and therefore uncertainty for taxpayers in interpretation and application. This is a fundamental challenge that cannot be entirely eliminated but must be managed⁹⁶ through robust administrative guidance and consistent judicial interpretations.

This is a fundamental concern that can never be fully eradicated but can only be addressed by tenacious administrative markers and regular judicial brush clearances. However, notwithstanding the series of CBDT circulars released and the voluminous exercise conducted by the expert committee, there still remain a number of open issues resulting in continued lack of clarity on the application of GAAR. To address this, a clear and sustained demand for the publication and frequent updating of comprehensive guidance⁹⁷ on GAAR is apparent. Guidance of this nature would describe the types of transactions that are considered artificial and legitimate, as well as the tax consequences of these arrangements. The current illustrative examples in the draft GAAR guidelines do have illustrations to explain the terms misuse or abuse, bona fide purpose, and lack of commercial substance, but further elaboration and fine-tuning in this respect, is essential.

There are several reforms that may be considered in order to enhance the workings of India's GAAR and to promote taxpayer certainty and a more congenial investment environment. One crucial requirement would be to introduce targeted tax disclosures/forewarnings⁹⁸ which force

⁹⁵ IMF, Managing Capital Flow Volatility 12–14 (2017).

⁹⁶ OECD, Implementing Effective Anti-Abuse Rules 8–11 (2020).

⁹⁷ OECD, Tax Certainty 2021: Lessons Learned, ch. 2–3 (2021).

⁹⁸ OECD, BEPS Action 12: Mandatory Disclosure Rules (2015), ch. 1.

tax advisers to make the report pro-actively of some particular schemes that are likely to come within the ambit of GAAR. This feature would give tax authorities up-to-date and relevant information on a timely basis, and would make audits more effective while removing part of the incentive for selling aggressive avoidance structures. In addition to this, establishing a special and rigorous penalty framework for breaches of GAAR would serve as a strong deterrent. In the case of recidivism, the law also might look to some serious remedies⁹⁹, such as winding-up, to impress upon the offender the seriousness of the failure to comply.

A further policy focus must be the global nature of tax avoidance. India should engage aggressively in renegotiating tax treaties outside MLI so that they have strong anti-abuse clauses with Principal Purpose Test (PPT) or (Limitation on Benefits) LOB clauses. With closure of the treaty loophole, India would be able to curb the misuse of treaty benefits and bring its law in line with best practices followed globally. Further, the country-by-country reporting (CbCR) threshold should also be re-evaluated¹⁰⁰.

Reducing the threshold would enlarge the detection net, and intensify supervision on multinational corporations. A wider discussion on the adoption of public CbCR in India would also help to enhance transparency and shed more public light on corporate tax behaviours. Finally, the credibility and predictability of GAAR are also a function of the certainty with which it would be enforced. Regular, detailed guidance publications are a key need, to ensure that both taxpayers and authorities are working to known standards. Similarly, the establishment of the rule of law is relevant to the minimisation of uncertainty¹⁰¹, particularly where the unlawful nature of an arrangement is partial. To increase faith in the system, the independence of the Approving Panel would need to further built upon the sole independent representative it currently includes and make its decisions public for all to see. Collectively, these measures would not only strengthen the effectiveness of GAAR¹⁰² in checking abuse as well as develop a more level playing field for tax compliance and investment certainty can co-exist.

IX. Conclusion

India's GAAR legislations, effective April 1, 2017, have signified a major shift from a general

⁹⁹ OECD, *Fighting Tax Crime: The Ten Global Principles* 10–12 (2017).

¹⁰⁰ Income-tax Rules, 1962, r. 10DB (India); OECD, BEPS Action 13 (2015).

¹⁰¹ World Bank, *Enhancing Tax Transparency and Legal Certainty* 6–8 (2020).

¹⁰² OECD, *Implementing Anti-Abuse Rules – Key Findings & Recommendations* (2022), ch. 5.

judicial-based anti-avoidance regime to an exhaustive statutory framework with the objective of protecting the tax base of the nation. In response to judicial constraints such as those highlighted in the Vodafone judgment. GAAR has given powers to revenue agencies to strike down deals that are concluded predominantly to evade tax.

Enshrined in Chapter X-A of the Income Tax Act, it includes important safeguards such as the main purpose test, monetary limits and grandfathering of old investments. Procedural protections such as the four-tier adversarial Approving Panel built as a result of the Ruiz lawsuit, and independent judicial review (uninfluenced by the commission) buttress transparency and fairness. Its compatibility with SAARs and amended DTAAs, especially the India–Mauritius treaty reflects a consistent approach against aggressive tax planning and supporting OECD’s BEPS project.

But GAAR’s principle-based application is ambiguous, which requires judicial clarity, comprehensive guidelines, harsher punishment, and re-negotiation of tax treaties for revenue integrity as well as to boost investor confidence.