GENERAL ANTI-AVOIDANCE RULE (GAAR): AN INDIAN AND INTERNATIONAL PERSPECTIVE

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Abstract

Internationally, tax avoidance has been recognized as an area of concern and several countries have expressed concern over tax evasion and avoidance. This is also evident from the fact that either nations are legislating the doctrine of General Anti-Avoidance Regulations in their tax code or strengthening their existing code. In India, the proposed Direct Tax Code seeks to address the issues relating to tax avoidance and evasion by bringing in General Anti-Avoidance Rules (GAAR). This paper firstly lays down the essential features of the proposed GAAR provisions. It gives a brief history as to the introduction of GAAR in India which is necessary because the introduction of such a provision is an important step for a fast growing economy of a developing country such as India. Recently, the implementation of GAAR was deferred yet

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again which only points to the magnitude of the implications of such a step. It is the opinion of the authors that despite such deferment, the issue of GAAR is nonetheless very relevant, and one that deserves discussion. The paper has for this reason covered the entire debate that surrounds the implementation of GAAR. The potential concerns that arise from it, the advantages that would be borne from it, and the alternatives to GAAR which could allow the exploitation of such advantages without the risk of these concerns. The paper also compares the proposed GAAR of the Direct Tax Code with provisions of GAAR established in five other countries, namely, United Kingdom, United States of America, South Africa, Canada and Australia and how these GAAR provisions have shaped and influences the Indian GAAR provisions. Lastly, the paper also explores the effect it will have on international law and treaty obligations. In conclusion, the authors submit that GAAR presents itself as the necessary solution to check tax evasion and tax avoidance.

I. INTRODUCTION

The aforementioned quotes provide an ideal curtain raiser for the core themes which this paper seeks to address. In the near future the

Companies, advisors, investors and consultants will frequently think of transactions as "GAAR-able." The Indian Government is the latest jurisdiction in the ever increasing line of jurisdictions to consider a wide catch-all measure that would ban tax-driven transactions. The act reflects a situation in which the Government is tired of seeing legal loopholes exploited by taxpayers and hence has come up with a provision which shall prevent such fiscal loss.

General Anti Avoidance Rules are not a novel idea; they have existed in many jurisdictions for many years. However, it is difficult to find a jurisdiction which has attained stability with its anti-avoidance rules. This loss is primarily due to the fact that the demarcation between "avoidance" and "evasion". Both the terms with respect to tax have some widely accepted traditional definitions[1] but the lack of acceptance across jurisdictions has led some of the commentators to use the term "avosion" in order to imply close and unresolved ties between the two terms.[2] The variations of this demarcation and the difference in laws in both letter and spirit add to the complexity of the subject at hand.

Almost twenty years ago, the OECD, with its Committee on Fiscal Affairs, prescribed three substantial features of avoidance schemes, which should be combated, i.e. artificiality, taking advantage of

[1]S. PICCIOTTO, INTERNATIONAL BUSINESS TAXATION: A STUDY IN INTERNATIONALIZATION OF BUSINESS REGULATION94 (Weidelfeld and Nicoloson 1992); Dr. Dionisios & D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 34(2004).

[2]B PETERS, THE POLITICS OF TAXATION: A COMPARATIVE PERSPECTIVE 192(Cambridge, Oxford, Blackwell, 1991); Dr. Dionisios & D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives,* 1 MANCHESTER J. INT'L ECON. L. 31, (2004).

loopholes in the law and secrecy.[3] Further, the Committee added that the revenue loss considerations and aspects of fairness among taxpayers establish a strong position against schemes involving the aforementioned components.

II. UNDERSTANDING TAX AVOIDANCE: PRACTICES, BELIEFS AND CAUSES

Some consider the practice of tax avoidance to be a reaction against the constraints imposed by tax. It has been considered an inevitable consequence of the very existence of taxes.[4] However, Sovereign states tend to look at tax avoidance as a serious budgetary problem and hence take measures to curb the practice. In most cases, tax avoidance for the citizen is a 'tax expenditure' for the government.[5]The term refers to the decision made by the government to forego taxation, when an individual spends money for a particular purpose or earns money in a particular way, as if it was making a direct public expenditure.[6] Such expenditures may generally be invisible to the public eye, they nevertheless, create uncertainty and complexity, since these are largely uncontrollable by the Government and moreover there may be difficulties in monitoring who actually

[3]20 OECD, WORK ON TAX AVOIDANCE AND EVASION: SUMMARY OF THE WORK OF THE OECD'S COMMITTEE ON FISCAL AFFAIRS ON COMBATING TAX AVOIDANCE AND EVASION139-144 (European Taxation 3rd ed.1980).

[4]G Trixier, *Definition, Scope, and Importance of International Tax Avoidance*, COUNCIL OF EUROPE, COLLOQUY ON INTERNATIONAL TAX AVOIDANCE AND EVASION 1, (1980).

[5]Dr. Dionisios & D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 8 (2004).

[6]B. PETERS, THE POLITICS OF TAXATION: A COMPARATIVE PERSPECTIVE 194 (Cambridge, Oxford, Blackwell1991).

receives the benefits.[7] From a legal point of view, the primary argument runs that avoidance undermines equity irrespective of whether it loads and extra burden on non-avoiders or not, it does cause citizens who should be taxed similarly to be taxed differently.[8]

Any attempt at an analysis of tax avoidance must pay heed to the fact that a legal method based on strict or literal interpretation is the essential prop that sustains tax avoidance.[9] The Revenue authorities, legislature and administrators are faced with a stern challenge of facing and responding to an ever shifting landscape of taxpayer responses to taxation. The judicial response to the legislative and even judicial anti avoidance has been that they are dealing with an extraordinary situation and as a remedy that should be used sparingly because of an essential element of arbitrariness which always borders on opening Pandora's Box.[10] The famous line of judicial decisions in the United Kingdom[11] stands testimony to this fact. Similarly, the question as to whether a transaction amounts to tax avoidance or tax evasion, and the debate regarding substance over form is one that has plagued the Indian Tax regime and judiciary for many years now.[12] The tax authorities as a result have in various instances attempted to tax transactions which are subject to such debate, but have not been

[7] *Id.*

[8] A. SHENFIELD, THE POLITICAL ECONOMY OF TAX AVOIDANCE 19 (London, LEA 1968).

[9] William B. Barker, *The Ideology of Tax Avoidance*, 40 LOY. U. CHI. L.J.229 (2008).

[10] YURI GRBICH, DOES SPOTLESS EXORCISE BARWICK'S GHOST? - TAX CATCH UPS: A PROSPECT INTELLIGENCE REPORT88, 105-12(Robert L. Deutsch ed.1997).

[11] Duke of Westminister v. IRC, (1935) All E.R 259 (HL), Ramsay v. IRC, (1981) All E.R. 865 (HL); Furniss v. Dawson, (1984) All E.R. 965 (HL), Craven v White, (1988) 3 All. E.R. 495 (HL).

[12] Union of India v Azadi Bachao Andolan, (2003) 263 I.T.R. 707 (SC); Vodafone International Holdings B.V. v Union of India, (2012) MANU/SC/0219/2012 (SC); McDowell & Co. Ltd. v Commercial Tax Officer, (1986) A.I.R. 649 (SC); Aditya Birla Nuvo Ltd. v DDIT, (2011) 242 C.T.R. 561.

successful because these transactions fall outside their jurisdiction on a strict interpretation of the law.[13]

India's tryst with codification is not unique or novel in any manner. Codification or discussions of codifications have been fairly common in the recent years. In the Unites States, codification of the economic substance doctrine has been proposed numerous times over the past decade, with its supporters lauding greater certainty and democratic legitimacy and the critics remarking at the lack of flexibility and difficulty of administration associated with such codification.[14] Further, both Australia and Canada, for example, have GAARs, which have been met with both qualified success and significant criticism.[15]

Thus, as the latest means to bell the cat, the Income Tax Act, 1961 has been proposed to be replaced by the Direct Taxes Code (DTC). The DTC greatly increased the scope of jurisdiction of the tax authorities empowering them to tax these transactions. One of the fundamental, salient changes proposed which would allow for the increase of jurisdiction was the introduction of General Anti Avoidance Rules (GAAR) in India. Although the DTC has not yet been implemented, the GAAR provisions[16] have been introduced by the Finance Act, 2012 which amended the Income Tax Act, 1961.[17]

[13]Vodafone International Holdings B.V. v Union of India, (MANU/SC/0219/2012); Union of India v Azadi Bachao Andolan, (2003) 263 I.T.R. 707 (SC).
[14]EX: NEW YORK STATE BAR ASSOCIATION, NYSB TAX SECTION COMMENTS ON TREASURY'S PROPOSAL TO CODIFY THE ECONOMIC SUBSTANCE DOCTRINE 19 (July 25, 2000)
[15]Julie Cassidy, *To GAAR or Not to GAAR - That is the Question,* 36 OTTAWA L. REV. 259 (2004).
[16]Direct Taxes Code 2011,§ 23, Bill No. 110 of 2010 (India).
[17]Finance Act 2012, § 95-102 (India).

III. APPLICATION OF GAAR: AN ANALYSIS OF SECTION 95- SECTION 102 OF THE INCOME TAX ACT, 1961

A. Statutory Provisions

Sections 95- 102 of the Income Tax Act, 1961, as amended by the Finance Act, 2012, are the General Anti Avoidance Rules provisions of the Act. The first condition for the application of the rule is that the main purpose or one of the main purposes of the arrangement is to obtain a '*tax benefit'* which has been defined under Section 102(11) as:

a. A reduction in avoidance or deferral of tax or amount payable under the Act

b. An increase in the refund of tax or other amount under this Act

c. A reduction or avoidance of deferral of tax or other amount that would be payable under this Act, as a result of tax treaty.

d. An increase in the refund of tax or other amount under this Act, as a result of a tax treaty

e. A reduction in the total income including the increase in loss, in relevant previous year or any other previous year.

For an arrangement to be termed as an "impermissible avoidance arrangement", it must be a combination of tax benefit and one of the following four conditions[18]:

1. It creates rights or obligations, which are ordinarily not created by persons dealing at arm's length.

[18]Income Tax Act 1961, § 96(1) No. 43 of 1961 (India).

2. It results, directly or indirectly, in the misuse or abuse, of the provisions of the Act.

3. It lacks commercial substance or is deemed to lack commercial substance under S. 97 in whole or in part, or

4. It is entered into, or carried out, by means, or in manner, which are not ordinarily employed for *bona fide* purposes.

While the Act clearly lays down the conditions for an impermissible avoidance arrangement, it does not substantiate or define the conditions further. Thus, for an understanding of these terms, we must refer to other jurisdictions having GAAR.

B. Main Purpose

The discussion paper on GAAR in South Africa[19] as well as the Information Circular on GAAR released by the Canada Revenue Agency[20] states that 'main' must be determined objectively by reference to the relevant facts and circumstances. As per the Act, an arrangement can be deemed to be an impermissible avoidance arrangement where the main purpose or '*one of the main purposes'* is to obtain a tax benefit. Further, as per the Act, even if the main purpose of only one of the steps of the arrangement is of a tax benefit, there is a presumption that the main purpose behind the entire arrangement is of tax benefit[21], thus significantly widening the scope of GAAR.

[19]*Discussion Paper on Tax Avoidance*, South African Revenue Service, 49, 81 (2005).
[20]IC 88-2 – General Anti-avoidance Rule: Income Tax Act § 245 (21 October, 1988).
[21]Income Tax Act 1961,§ 96(3), No. 43 of 1961 (India).

C. Misuse or Abuse

In the Canada Trustco case[22] the Supreme Court of Canada held that, "the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear." It further held that a single, unified approach to the textual, contextual, and purposive interpretation of the specific provisions of the Income Tax Act must be relied upon to determine abuse of the provisions. In the Copthorne Holdings case[23] the Court has taken the view that the misuse and abuse must be connected to a specific provision of law and that such misuse will be upheld only:

- Where the transaction achieves and outcome which the statutory provision was intended to prevent.
- Where the transaction defeats the underlying rationale of the provision
- Where the transactions circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose.

D. Bona fide Purpose

The objective circumstances[24] and overall result[25] of the transaction must be considered. A test would be to determine whether the taxpayer would have incurred taxation but for the transaction.[26] This test was substantiated by Courts holding that the test encompasses an

[22]Canada Trustco Mortgage Co. v. Canada, (2011) S.C.C. 36 (SC).
[23]Copthorne Holdings Ltd. v. Canada, (2011) S.C.C. 63 (SC).
[24]Cadbury Schweppes PLS v. Inland Revenue CommissionersC-196/04 (2007); Wallschutzky IG, *Towards a Definition of the Term 'Tax Avoidance*, AUSTRALIAN TAX REVIEW48-58 (Mar. 1985).
[25]COPTHORNE, *supra* note 23.
[26]ITC 1625 (1996) 59 SATC 383.

objective[27] comparison between the transactions and a hypothetical enquiry of how the transaction should have taken place.[28]. The standards are strict as the law does not require the whole arrangement to be designed in such a way so as to avoid payment of taxes as stated above.

E. Lacking Commercial Substance

This provision is a codification of the sham doctrine. The sham transaction doctrine states if the transaction is merely a charade in order to reap tax benefits with no other motivation, then the transaction will be ignored.[29] A transaction lacks commercial substance if the purpose is to obtain a fiscal advantage[30] or tax benefit[31] which cannot be accepted for taxation purpose.[32]. Further, the Act provides under Section 97 that a transaction shall deem to lack commercial substance in the following cases:[33]

1. The substance or effect of the arrangement as a whole is inconsistent with or differs significantly from, the form of its individuals steps or part
2. It involves or includes, (i) round trip financing (ii) an accommodating party (iii) elements that have the effect of

[27]Commissioner of Inland Revenue v Challenge Corporation Limited, (1986) 8 NZTC 5 (CA).
[28]ITC 1712 (2000) 63 SATC 499; FCT v. Peabody, (1994) 181 CLR 359 (HC).
[29]Knetch v. United States, (1960) 364 U.S. 361 (SC).
[30]Lupton v. F.A. and A.B. Ltd.,(1972) AC 634 (HL); Coates v. Arundale Properties Ltd., (1984) 1 WLR 1328; Overseas Containers (Finance) Ltd. v. Stoker (Inspector of taxes), (1991) 188 ITR 383 (CA).
[31]ACM Partnership v. Comm., (1998) 157 F.3d 231 (3rd Cir.);Compaq Computer v. Comm., (1999) 113 T.C. 214.
[32]Lerman v. Commissioner, (1991) 939 F.2d 44, 45 (3d Cir.); Aiken Industries v. Commissioner, (1971) 56.T.C. 925.
[33]*Expert Committee Final Report on General Anti Avoidance Rules (GAAR) in Income-tax Act,1961 (2012)*, http://finmin.nic.in/reports/report_gaar_itact1961.pdf.

offsetting or cancelling each other; or (iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which affects the subject matter of such transaction

3. It involves the location of an asset or a transaction or of the place of residence of any party which would not have been located for any substantial commercial purpose other than obtaining tax benefit (but for GAAR provisions) for a party.

F. Consequences of Impermissible Avoidance Arrangement

Once a transaction is characterized as an impermissible avoidance arrangement, the tax authorities are given wide powers over the arrangement which include, but are not limited to - [34]

- Disregard, combine or re-characterise any step, part or whole of a transaction;
- Treat the transaction as if it had not been entered into or carried out;
- Disregard any accommodating party or treating any accommodating party and any other party as one and the same person;
- Deeming connected persons in relation to each other as one;
- Reallocating receipts, expenditure, deduction, relief or rebate, amongst the parties to the arrangement;
- Relocating place of residence of a party or location of a transaction or situs of an asset to a place other than provided in the arrangement; and

[34]Income Tax Act 1961, § 98, No. 43 of 1961 (India).

- Considering or looking through an arrangement by disregarding any corporate structure

IV. GUIDELINES FOR IMPLEMENTATION

It is clearly apparent that the income tax authorities were given sweeping powers by virtue of the GAAR principles. The effect of the advancement of the GAAR provisions ahead of the implementation of the DTC was felt hard and adversely by the markets as the FIIs sought to withdraw their investments leading to a slump in the stock market and adding to the pressure on the already down sliding rupee.[35] In order to mitigate the situation and reduce the possibility of abuse, the following critical amendments were made to the Finance Bill, 2012 when it was passed[36] –

- Implementation of GAAR was deferred by one year to the fiscal year 2013-14.
- Onus of proof to prove that GAAR provisions are applicable was shifted to the tax authorities thereby greatly reducing their potential abuse of power by the tax authorities.
- Taxpayers can approach the Authority of Advanced Ruling to determine whether the GAAR provisions are applicable to them, further reducing scope of abuse of power.
- Special Committee constituted for formulating rules and guidelines for implementation of GAAR.
- GAAR panel is to have an independent member, to give approvals for invoking GAAR and to ensure objectivity and transparency.

[35] *All eyes on Pranab as Lok Sabha takes up Finance Bill today*, THE HINDU, May 7, 2012, http://www.thehindu.com/todays-paper/tp-national/article3392168.ece.
[36] Circular 3/2012, Central Board of Direct Taxes, Government of India, dated 12-06-2012.

V. THE SPECIAL COMMITTEE REPORT

The Special Committee was constituted to give recommendations and guidelines for proper implementation of GAAR and suggest safeguards so that it is not indiscriminately used in every case.[37] After deliberations and discussions, the Committee submitted the following recommendations –

> 1. Setting of a monetary threshold in order to prevent indiscriminate application of GAAR provisions and to provide relief to small tax payers.
> 2. Prescription of statutory forms so as to ensure that consistency is maintained which is essential in procedures in invoking GAAR Provisions requiring the tax authorities to give a detailed description as to the applicability of GAAR provisions in that instant case.
> 3. Prescription of time limits so that there is minimal hindrance to business transactions.
> 4. Setting up of the Approving Panel

Further, the Committee also suggested the issuance of a circular on GAAR explaining the provisions of GAAR, providing special provisions for FIIs, and dealing with the situation of interplay of GAAR and SAARs. The Guidelines also contained a list of illustrations as to when the GAAR provisions may and may not be invoked.[38] While these examples do provide a certain amount of

[37]GAAR Committee Constituted under the Chairmanship of Director General of the Income Tax (International Taxation) by the Chairman, CBDT, vide OM F. NO. 500/111/2009-FTD -1.
[38]*Id.* at 20.

clarity, it does not completely remove the ambiguity as to the imposition of these principles.

VI. SHOME COMMITTEE REPORT

After the Draft GAAR Guidelines were released, the PM constituted another Expert Committee under the chairmanship of Dr. Parthasarthy Shome to rework the guidelines based on comments from various stakeholders and the general public. The Shome Committee was setup with the term of reference to conduct consultations and dialogues with various stakeholders and the general public in order to provide a second draft of guidelines and a roadmap for the implementation of the GAAR provisions. The salient recommendations of the Report, submitted on August 31st, were[39] –

- **Main Purpose**– Only arrangements which have the main purpose of obtaining tax benefit, and not 'one of the main purposes' should be covered under GAAR. It also recommended that where the purpose of only a step of the arrangement is to obtain a tax benefit, then the tax consequences of an impermissible avoidance arrangement should be limited to that portion of the arrangement and not the whole arrangement as stated under Section 96(2) of the Act.
- **Procedural Requirements**– It prescribed the procedure that the Assessing Officer (AO) must make a reference to the Commissioner of Income Tax (CIT) for invoking GAAR, who shall then hear the taxpayer, and if he still wishes to invoke GAAR, then refer the matter to a five member Approving Panel (AP). The AP must declare the

[39]Report on General Anti-Avoidance Rules in Income Tax Act, 1961, Expert Committee, (2012).

arrangement as impermissible or permissible on further inquiry and the final order shall be given by the AO, against which an appeal would lie to the Appellate Tribunal. It further prescribed that the tax authorities must follow prescribed statutory forms within the prescribed time to ensure that principles of natural justice are followed and ensure transparency in the process.

- **Overarching Principle for Applicability of GAAR** – Important need to distinguish between tax mitigation and tax avoidance before invoking principles of GAAR, and that the GAAR should be invoked only in cases of 'abusive, contrived and artificial arrangements.'
- **Deferring Implementation of GAAR** –It stated that GAAR is an extremely advanced instrument of tax administration for which intensive training of tax officers is required, and that it should be deferred by three years so that the principles are better understood by both tax authorities and taxpayers, to remove ambiguities in the law, and so that there is a more conducive economic environment for the imposition of the principles.
- **Grandfathering of Existing Investments** – All investments, not the arrangement itself, made by a resident or non-resident and existing as on the date of commencement of the GAAR provisions should be grandfathered so that on sale of such investments on or after this date, GAAR provisions are not invoked for examination or denial of tax benefit.
- **GAAR and SAAR**– In cases where a Specific Anti Avoidance Rule (SAAR) is applicable, the GAAR provisions should not be invoked.
- **Treaty Override and Limitation of Benefit** – In cases where a Double Tax Avoidance Agreement (DTAA) has a specific anti avoidance provision such as a limitation of

benefits clause, then the GAAR shall not be applicable to such treaties.

- **Circular 789 of 2000 w.r.t. Mauritius DTAA** –Tax Residency Certificate issued by the Tax Authorities of Mauritius shall be sufficient proof for accepting status of resident of Mauritius and to avail the benefits of the DTAA[40], and that the GAAR provisions may not be invoked for such purpose.
- **Monetary Threshold** – A monetary threshold of Rs 3 crores tax benefit to a taxpayer in a year should be used for the applicability of the GAAR provisions.
- **Foreign Institutional Investors** – The GAAR provisions should not be applicable to FIIs who choose to not take benefits under any DTAA and subject themselves to the domestic law provisions, and that GAAR provisions will not apply to non-residents investing directly or indirectly in an FII having underlying Indian assets, irrespective of whether the FII chooses to take a DTAA benefit.
- **Capital Gains Tax** – Abolition of capital gains tax on the transfer of listed securities, whether in the nature of capital gains or business income.

VII. EFFICACY OF GAAR IN INDIA

The introduction of GAAR in India initially met with a very unwelcoming response. This was followed by the amendments in the Finance Bill, 2012 when passed in the Lok Sabha, then by the draft guidelines, and then finally by the guidelines and recommendations of the Shome Committee. While these changes from the original

[40]Central Board of Direct Taxes, Circular 789 of 2000, issued on 13th April 2000.

proposition of GAAR were much needed, and many were significant, critical changes without which GAAR would never work in India, the recommendations had both hits and misses which need to be analyzed.

A. Hits

- One of the most significant developments to have come out after the GAAR was first introduced is that the onus of taxation has been shifted to the tax department saving taxpayers from the creation of an unfair tax regime.
- A very important suggestion which has been unanimously put forth by both the committees is that GAAR should be introduced with a monetary threshold. This would prevent the indiscriminate application of GAAR provisions and would at the same time prevent the harassment of small investors.
- Another suggestion which holds prime value in terms of the eventual application of GAAR is the constitution of the Approving Panel. The recommendation of the Shome Committee, if followed would lead to the creation of a body which would have at least two non tax department members and a retired High Court judge as its chairman. Furthest, its decisions would also be binding on the tax authority. This could turn out to be one of the biggest achievements of the whole process and shall assist in providing confidence to the investors.
- The provision with regard to the time frame of invoking GAAR is also one which has been well received by the business community. Under this provision no action can be taken by the commissioner against the taxpayer after a period of 6 months from the date of receiving the report. Further, the actions of the commissioner have also been put in

a reasonable time frame. The recommendation provides that if the commissioner is not satisfied with the objections of the tax payer, he must make a reference to the Approving Panel within 60 days from the receipt of such objections. Alternatively if the commissioner is satisfied with the objections raised by the tax payer, he must communicate the same within 60 days from the receipt of such objections.

- The illustrations provided by the Expert Committee if approved, shall be helpful in achieving a standard of certainty in application of GAAR.

B. Misses

- The timing of the move has been questioned by many. In a scenario where the global economies are facing huge contingencies in terms of economic stability and India itself does not have a fiscal or current account deficit to boast of, it could do with higher investment.
- The time frame required by the Authority for Advanced Rulings is too long to help gain any confidence. Provisions must be made to allow rulings to be obtained within six months.
- There has been a lot of debate with regard to the "grandfathering clause". The authors agree with the line of opinion that 'grandfathering' of arrangements as existing on the date of introduction of GAAR would confer protection in perpetuity which is not desirable. Instead, all 'investments' rather than 'arrangements' made by a resident or non-resident should be grandfathered so that on exit of such investments, GAAR provisions are not invoked to deny tax benefits.

VIII. INTERNATIONAL PERSPECTIVES ON GAAR

While GAAR features in a wide host of jurisdictions as diverse as Sweden, Germany, and Hong Kong, in this paper, the authors shall be limiting their study of international application of GAAR to five countries – United Kingdom, United States of America, Canada, South Africa, and Australia.

A. United Kingdom

The UK does not have a codified GAAR and Anti-Avoidance principles in UK are laid down through judicial decisions and Targeted Anti Avoidance Rules[41], which are specific legislations against perceived unacceptable tax avoidance. While this sort of tax system is effective to an extent, it does not have the capability to deal with the unpredictability and complications of the more complex situations.

In 2010, the government constituted a study group to determine whether UK needed a GAAR system. The study group in its report submitted that a broad spectrum general anti avoidance rule would not be beneficial for the UK tax system as it would 'carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning.' Instead, it proposed a narrowly focussed GAAR targeted at 'abusive arrangements' only[42] and such a GAAR has been proposed for 2013.

B. United States of America

[41]Antony Seely, *Tax Avoidance: A General Anti-Avoidance Rule – Commons Library Standard Note*, http://www.parliament.uk/briefing-papers/SN06265.
[42]HC Deb 21 November 2011 cc2-3WS; HM Treasury press notice 130/11.

The United States does not have a codified GAAR. However, it recently codified its economic substance doctrine in order to bring uniformity to tax law.[43] The US tax code contains a set of broad mini-GAAR statutory rules as well as targeted anti-avoidance legislative fixes. For tackling avoidance transactions there are a variety of common law doctrines that are laid down by courts which are applied for the purpose of Anti Avoidance, such as Sham Transaction, Economic Substance, Business Purpose, Substance over Form, and Step Transaction Doctrine.[44]

C. Canada

The GAAR principles in the Canadian Tax Code are laid down in Section 245 of the Income Tax Act which came into effect in 1988. The Explanatory Note listed out for the purpose of GAAR stated that - *"New section 245 of the Act is a general anti-avoidance rule which is intended to prevent abusive tax avoidance transactions or arrangements but at the same time is not intended to interfere with legitimate commercial and family transactions."*[45]

In the case of Copthorne Holdings Ltd. v Canada[46], the Supreme Court of Canada held that there are three questions that need to be answered to determine whether the GAAR principles are to be invoked – i) Whether there was a tax benefit arising from the transaction, ii) Whether the transaction was an avoidance transaction, i.e. 'arranged primarily for bona fide purposes other than to obtain the tax benefit', and iii) Whether the avoidance transaction giving rise to the tax benefit was abusive. Section 245 of the Income Tax Act

[43]The Health Care and Education Reconciliation Act 2010, § 1409(a).
[44]Penrod v. Commissioner, (1987) 88 T.C. 1415, 1428.
[45]The Explanatory Notes to Legislation Relating to Income Tax issued by the Honourable Michael H. Wilson, Minister of Finance (June 1988).
[46]*Supra* note 23.

further defines the relevant terms such as 'tax benefit', 'transaction', and 'avoidance transaction' but does not define misuse or abuse either.

In the Canada Trustco case,[47] the Supreme Court laid down the procedural requirements regarding onus of proof. It held that it shall be a split burden, where the taxpayer needs to refute there is a tax benefit arising from a transaction and that the transaction is an avoidance transaction. The tax authority, on the other hand, needs to prove there was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.

In 1982 the Canada Revenue Agency released an Information Circular with reference to the application of GAAR.[48] The highlights of the Circular are summarized below -

- The Circular in paragraph 2 states that the CRA will issue advance rulings with respect to the application of the GAAR to proposed transactions and will publish summaries of the facts and rulings in those cases that will provide further guidance.
- In paragraph 4, it explained an avoidance transaction as a single transaction carried out primarily to obtain a tax benefit. Where a transaction, which is primarily tax motivated, forms part of a series of bona fide transactions that is carried out primarily for non-tax purpose, the single transaction will nevertheless be an avoidance transaction.

[47]*Supra* note 22.
[48]Information Circular 88-2 – General Anti Avoidance Rules issued under Section 245, Income Tax Act, Canada Revenue Agency, (1988).

- If it can be inferred from all the circumstances that the primary or principal purpose in undertaking the transaction is other than to obtain a tax benefit, for example, a bona fide business, investment, or family purpose, then the transaction is not an avoidance transaction.
- In paragraph 5 it gave a list of examples to explain the principles of misuse and abuse.

D. South Africa

GAAR in South Africa was introduced in 2006[49] and is codified under Section 80A-80L of the South Africa Income Tax Act, 1962 subsequent to the amendment to S. 103 which contained the General Anti Avoidance Rule. The Indian GAAR is heavily influenced by the GAAR in South Africa, and as a result, the provisions for application of GAAR are practically identical.

The SARS recently released a Draft Comprehensive Guide to the General Anti Avoidance Rule as a reference and guide to the application of the GAAR principles. In paragraph 7.3, the guideline provides that a tax benefit may be denied under the GAAR 'if such tax benefit would misuse or abuse the object, spirit or purpose of the provisions of the Income Tax Act that are relied upon for the tax benefit.[50]

E. Australia

Australia's GAAR was introduced in 1981 and is in part IVA of the Income Tax Assessment Act, 1936. There are three conditions for the Australian GAAR to be applicable – i) There must be a 'scheme'; ii)

[49]Amended by Revenue Laws Amendment Act, No. 20 of 2006.
[50]Draft Comprehensive Guide to the General Anti-Avoidance Rule, South Africa Revenue Service, released on 14-02-2011.

There must be a tax benefit obtained in connection with the scheme; and iii) It must be reasonable to conclude that at least one person entering into the scheme did so for the 'sole or dominant purpose' of obtaining a tax benefit.[51]

The definitions for 'scheme'[52] and 'tax benefit'[53] given under the Income Tax Assessment Act are very similar to the definitions for 'arrangement' and 'tax benefit' given under the Income Tax Act, 1961 in India. However, the Australian GAAR, unlike the GAAR of all other countries analyzed in this paper including India, has a list of eight criteria to determine 'sole or dominant purpose.'[54]

1. The manner in which the scheme was entered into or carried out;
2. The form and substance of the scheme;
3. The time at which the scheme was entered into and the length of the period during which the scheme was carried out;
4. The income tax result that, but for Part IVA, would be achieved by the scheme;
5. Any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
6. Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;

[51]Julie Cassidy, *The Holy Grail – The Search for the Optimal GAAR*, 126 SOUTH AFRICAN LAW JOURNAL 740 (2009).
[52]Income Tax Assessment Act 1936, § 177A (Australia).
[53]Income Tax Assessment Act 1936, § 177C(1) (Australia).
[54]Income Tax Assessment Act 1936,§ 177D (Australia).

7. Any other consequence for the relevant taxpayer or for any person referred to in (6), of the scheme having been entered into or carried out; and

8. The nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in (6).

The procedure for applying the GAAR provisions has been explained in detail in the Practice Statement released by the Commissioner of Taxation.[55] Another stark difference from all the GAAR provisions is that as per the Australian GAAR provisions, the onus of proof lies on the taxpayer. However, this deviation from the commonly applied principle may be rationalized taking into consideration the fact that the application of GAAR is very strict and rare in Australia and it is considered a method of last resort. The application is reviewed by an independent panel comprising of senior tax officers and business and professional people chosen for their ability to give expert advice.

F. Concluding remarks on International Perspectives

On an overall perspective of the GAAR provisions in all these countries, it is clear that there are a lot of points of similarity with regards to what amounts to a tax benefit, what amounts to tax avoidance, the scope of the arrangements that it has jurisdiction over, and the consequences of being treated as an impermissible avoidance arrangement. Another point of similarity in all these countries is that there were separate guidelines released for the implementation of the GAAR provisions after the introduction of the provisions. Thus it is clear that the GAAR provisions have a tendency to be sweeping in its power and nature, and that there is a universal need to keep such powers under check. However, in all these countries, despite such

[55]Application of General Anti-avoidance Rule, PS LA 2005/24.

guidelines being released, there still remain ambiguities in scope due to the vast complexities of the transactions it covers. Thus, while these provisions still have a scope of abuse, the responsibility lies, firstly, with the tax authority to ensure that these provisions are implemented only in cases of clear impermissible tax avoidance, and secondly, with the judiciary, to ensure that the application of the GAAR provisions is not arbitrary or abusive and it is not used as a revenue generating scheme by carefully analysing the facts of the situation, the intention of the parties and the intention of the legislature.

IX. MAJOR CONCERNS AND SOLUTIONS

In this part the authors aim to address the major surrounding GAAR and provide an analysis of the solutions to the same.

A. Uncertainty

If one were to rationally look at the issue it is not only a problem for the government; rather it is a problem for the society as a whole. The first principle of horizontal equity states that people in the same economic position should be taxed at the same rate.[56] Tax avoidance makes it more difficult for tax systems to be economically neutral. Economic neutrality requires the tax systems should cause minimum disruption to the workings of the market. However, the existence of avoidance opportunities frustrates this requirement as it leads to a person organising his business in a particular manner, only because

[56]RICHARD E. KREVER, STRUCTURE AND POLICY OF AUSTRALIAN INCOME TAXATION, AUSTRALIAN TAXATION: PRINCIPLES AND PRACTICE, (Richard E. Krever ed.) (1987).

that option grants him a tax benefit. However, such transactions are attractive not because of their intrinsic value but rather for their tax advantages. For example: A Company owns a wholly owned subsidiary based in Cayman Islands not because it sees at a business opportunity but rather because it sees it as trampoline for growth in areas where it can obtain a tax benefit due to this particular route.

One must with all due regard, consider the fact that the very prevalence of General Anti Avoidance Rules, in any form, indicates that an authority of a particular jurisdiction is of the view that the negative results from the absence of such provisions outweigh the breaches of rule.[57]

Hart was of the view that all laws admit of "core" situations, where the laws will definitely apply, and "penumbra", where it is less certain whether the law will apply.[58] The biggest concern with regard to GAAR is that of vagueness and has always been said to cause grave breaches of the rule of law[59] but to criticize GAAR because of the their application appears to subject them to higher standard than we demand of law in general.[60] If the concern is with regard to the size of the penumbra which GAAR brings along with it, the process initiated by the Government shall help everyone reach a balanced an acceptable situation.

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[57]Rebecca Prebble & John Prebble, *Does the Use of General Anti Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study*, 55 ST. LOUIS U.L.J. 21 (2010-2011).
[58]H.L.A Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593 (1958).
[59]GREAME COOPER, CONFLICTS CHALLENGES AND CHOICES - THE RULE OF LAW AND ANTI AVOIDANCE RULES, TAX AVOIDANCE AND THE RULE OF LAW (Greame Cooper ed.1997); Rebecca Prebble & John Prebble, *Does the Use of General Anti Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study*, 55 ST. LOUIS U.L.J. 21 (2010-2011).
[60]*Supra* note 57.

X. TREATY OVERRIDE: UNILATERAL MEASURES AGAINST TREATY SHOPPING

Internationalisation of movements of capital, people and services and interaction between economies has become a salient feature of today's world.[61] All these practices often give rise to a situation where the effects of actions extend beyond the limits of one country. This encourages the need for cooperation and assistance among states. The matters in this regard vary from basic fiscal jurisdictional matters to non discrimination concerns.[62] However, the problem of double taxation and its relief is of utmost importance, since it carries with it huge concerns regarding both over and under taxation.[63] Further, the effect of such actions tends to have a direct impact on investment and flow of gains and losses. In the absence of such cooperation, a State is compelled to take unilateral measures in order to protect its fiscal interests.

A. Status of unilateral measures under International Law

The Vienna Convention on the Law of Treaties[64] (VCLT) requires the States to fulfil their treaty obligations in accordance with the principle of *Pacta Sunt Servanda*.[65] Some are of the opinion that when a DTAA is signed states agree to provide tax benefits to the residents of the

[61]M PIRES, INTERNATIONAL JURIDICAL DOUBLE TAXATION OF INCOME, (Deventer, Boston, Kluwer Law & Taxation Publishers, 1989).
[62]R MARTHA, JURISDICTION TO TAX IN INTERNATIONAL LAW: THEORY AND PRACTICE OF LEGISLATIVE FISCAL JURISDICTION, (Deventer, Boston, Kluwer Law & Taxation Publishers1989).
[63]S. JAMES & C. NOBES, THE ECONOMICS OF TAXATION,(Oxford, New Jersey, Philip Allan Publishers, 3rd ed.1988); 28 V TANZI & H ZEE, TAXATION IN A BORDERLESS WORLD: THE ROLE OF INFORMATION EXCHANGE, (Intertax, 2nded. 2000).
[64]Vienna Convention on Law of Treaties, May 23, 1969, 1155 U.N.T.S. 33
[65]*Id.* art 26.

treaty partner and for this reason unilateral measures may result in a treaty breach.[66] To justify the same a state cannot rely on domestic law.[67] It necessarily has to rely on norms derived from sources of International Law such as Treaties,[68]customary international law[69] and general principles of law.[70]

Several canons of treaty interpretations support the contention that such unilateral measures are consistent with a state's obligation under a DTAA by arguing for a liberal interpretation of treaties.[71] Such canons look to the text of the treaty, treaty's object and purpose. Further, they also look at the signatories' subsequent practice.[72]

The VCLT provides for interpretation of treaties by giving effect to the ordinary meaning of their text and "in context and in the light of"[73] their object and purpose. Herein, lies the essential argument that a DTAA's purpose is both to avoid double taxation and prevent fiscal evasion. Purposive" interpretation of the DTAA's with reference to

[66]Detlev F. Vagts, *The United States and Its Treaties; Observance and Breach*, 95 AM. J. INTL L. 313(2001).
[67]*Supra* note 64, art. 26-27.
[68]*Supra* note 64, art. 11-19.
[69]Customary international law encompasses the rules adopted by the States in their practice or a "tacit agreement" of certain States to such rule, from which, nevertheless, other States may derogate. ANTONIO CASSESE, INTERNATIONAL LAW 153-154 (2nd ed.2005).
[70]The general principles of law are commonly understood as "the principles endorsed by the developed domestic legal systems of different states," for example, the principle of good faith. DAVID BEDERMAN ET AL., INTERNATIONAL LAW: A HANDBOOK FOR JUDGES 32 (2003); BING CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS 105-158 (1987); G.M. DANILENKO, LAW-MAKING IN THE INTERNATIONAL COMMUNITY 175 (1993).
[71]Nathalie Goyette, *Tax Treaty Abuse: A Second Look*, 51 CANADIAN TAX J. 764, 778 (2003).
[72]*Id.*
[73]*Supra* note 64, art. 26-27.

their object and purpose[74] of the treaty shall at least lead to a situation where unilateral measures are consistent with the pledge of the parties to prevent fiscal evasion

Even where anti-abuse measures do not merely complement or interpret a treaty, to constitute a violation of international law, such measures must "materially" breach a treaty. The VCLT distinguishes "material breach" from other acts of non-compliance by holding that a "material breach" is a "repudiation of the treaty" or a violation of a provision essential to the accomplishment of the object and purpose of the treaty.[75]

B. Status of conduits under International Law

Another argument which goes in favour of a state is one which states that conduits should not be considered to have the nationality of the treaty partner. While interpreting these treaties one must also keep in mind the status of conduits under International Law. Generally, a state may assert their claims only on behalf of their constituents or nationals.[76] "Nationality" under international law is not based on the act of a formal grant of citizenship by one state, but also on the basis of all relevant circumstances. In its *Liechtenstein v. Guatemala* decision[77] the International Court of Justice reasoned that "nationality *is a legal bond having as its basis a social fact of attachment , a*

[74]Maurice Cashmere, *GAAR for the United Kingdom? The Australian Experience*, 2 BRITISH TAX R. 125 (2008).
[75]*Supra* note 64, art. 60(3).
[76]Barcelona Traction Case (Belg. v. Spain), 1970 I.C.J. 3 (Feb. 5) 33-36 (the case found that Belgium may not assert a claim against Spain for an injury to a Canadian corporation owned by Belgian nationals and operating in Spain because the injured corporation, was not a Belgian constituent; the case did not implicate an *erga omnes* obligation - obligation owed to the international community as a whole, to refrain from aggression or genocide).
[77]Nottebohm Case (Liech. v. Guat.), 1955 I.C.J. 4 (Apr. 6).

genuine connection of existence, interests and sentiments, together with the existence of rights and duties".[78]As a conduit's existence is generally limited to a single desk or even less,[79] their ties with the treaty country are tenuous under International Law and hence, in such cases there should be no breach of duty owed to the treaty partner in the DTAA.

XI. OECD MODEL CONVENTION: ILLUSTRATIVE OF SUPPORT FOR UNILATERAL MEASURES

Amongst the countries which are members of the OECD, it is generally agreed that the OECD Model Convention[80] and its commentary are very important for interpretation of tax treaties as they provide a source from which courts of different states can seek a common interpretation.[81]

The 2010 Rome Congress of the International Fiscal Association provided a forum to analyse the relationship between treaties and the GAAR in a number of different tax jurisdictions. The General Reporter, Stef Van Weeghel, concluded in his summary of these reports that the vast majority of the 44 country reporters determined that their GAARs can be reconciled with their treaty obligations. By this he meant that, while most countries have statutory or judge made anti-avoidance rules (although there are a considerable number of

[78]*Id.*
[79]Lee A. Sheppard, *News Headlines: Preventing Corporate Inversions*, 26 TAX NOTES INT'L 8, 11 (2002).
[80]OECD, *Tax Treaty Override*, 1989, No.7, Oct. 2, 1989.
[81]KLAUS VOGEL, *ON DOUBLE TAX CONVENTIONS* (The Netherlands: Kluwer Law International, 3rd ed. 1997)

differences in the which these rules are applied),[82] these GAARs can, and do, apply to cross-border transactions. Van Weeghel concluded:[83]

> *"Without exception the GAARs can have international effect and there is no distinction in their application depending on the national or international effect."*

Paragraph 7.1 of the 2003 Commentary discusses the temptation of the taxpayers might experience to "abuse the tax laws of a State by exploiting differences between various countries' laws." The latter Commentary acknowledges such attempts at abuse may be countered by provisions or jurisprudential rules that are a part of the domestic law and suggests that the State would be unlikely to agree to the provisions of a tax treaty that would allow transactions when domestic law would counteract the tax benefit.

The brief comment which can be placed on the status of the 2003 commentary is that the nature of the changes brought about was clarifying changes rather than fundamental changes. This is because more significant changes with regard to the issue had been made in 1992. When the new paragraph was introduced in the Commentary in 1992, which picked up the viewpoint of a large majority of the Committee of Fiscal Affairs that there is no problem in applying anti-avoidance rules to double tax treaties expressed in the 1996 Base Companies Report.[84]

[82] *Id.*
[83] *Id.*
[84] Committee of Fiscal Affairs, *Double Taxation Conventions and the Use of Base Companies* (November, 1986).

XII. EFFECT ON FOREIGN INVESTMENT

The greatest concern with the introduction of GAAR was that it would curb foreign investments. It is widely recognised that a state's economic growth within an international open trading system is dependent on two basic factors, namely, promotion of exports and foreign borrowing.[85] Factors relating to the "host" country viz. where the investment is taking place are considered the most important while considering a Multi-National Corporation's decision to invest abroad.[86] A state's tax framework which comprises of relevant legislative, administrative or judicial developments is one of the essential components of the factors relating to the "host" country. The taxation policy may be classified as open or restrictive.

Some work under an assumption that there is a gap in the real world between international growth and worldwide efficiency in the allocation of resources, since the hypothetical standards of efficiency criteria, including perfect competition are not always fulfilled.[87] Tax incentives in their opinion help bridge the existing gap. This argument is however flawed as tax incentives do not lead to better competition rather they lead to mutually disadvantageous competition among the states, hence creating distortion in economic activity. Secondly, these

[85]B BRACEWELL MILNES & J HUSICAMP, INVESTMENT INCENTIVES: A COMPARATIVE ANALYSIS OF THE SYSTEMS IN EEC, USA AND SWEDEN, at 23 (Deventer, Kluwer, 1997).

[86]R ANTHONIE, TAX INCENTIVES FOR PRIVATE INVESTMENT IN DEVELOPING COUNTRIES: A STUDY OF THE INTERNATIONAL BAR ASSOCIATION, SECTION OF BUSINESS LAW, TAX COMMITTEE 3(Kluwer, 1979).

[87]Dr. Dionisios & D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 21(2004).

incentives are in themselves responsible for triggering the vicious circle which inevitably leads to tax avoidance or evasion.[88]

Hence, the solution to the problem of trade inflow is the one suggested by the Business and Advisory Committee which has at all stages maintained that the foreign investors would be better off without any incentives granted, and accordingly, without any restrictions from either host or home countries.[89] In their opinion a stable, low and simple tax regime is preferred to one with special tax incentives.[90]

XIII. SUGGESTIVE ALTERNATIVES TO GAAR

A. Judicial Anti-Avoidance doctrines

Many doctrinal or overriding GAAR principles are noticeable in the judicial decisions on anti-avoidance cases in common law countries.[91] These doctrines use two main rules to prevent avoidance. Firstly, the motive test which is applied using the business purpose rule and Secondly the artificiality test which is applied using the substance over form rule.

[88]*Id.*
[89]BIAC, TAX OBSTACLES TO INTERNATIONAL ROLE OF CAPITAL 195(BIFD 4th ed.1990).
[90]F. Ho, *Foreign Direct Investments into the DAE's: Tax Incentives versus Tax Neutrality*, (Paris, OECD, 1995).
[91]John Tiley, *Judicial Anti Avoidance Doctrines*, BRITISH TAX REVIEW (1991); John Ward, *Judicial Responses to Tax Avoidance*, EUROPEAN TAXATION (1995).

B. Movement towards Limitation of Benefits and other functional clauses

A Limitation of Benefits clause is the most popular suggestion as an alternative to GAAR. However, the biggest hindrance in such alternatives is that they require the cooperation of the partner treaty nation. There are various other clauses which would serve the purpose such as an express "savings clause" or a "gap filling clause" may also justify the adoption of anti-abuse rules. A typical savings clause will provide that nothing in the DTAA shall prevent the State from imposing tax on its residents and citizens, as if the tax was not in effect.[92] A gap filling clause would usually provide that terms which have not been expressly defined in the treaty shall be interpreted by reference to domestic laws as interpreted from time to time.[93] However, even at such instances the commentators are quick to caution that such clauses cannot be expanded indefinitely to provide blanket authorizations to domestic anti-abuse laws.[94] Herein exists a tension viz. the conflict between the dual objectives of providing relief from double taxation and preventing fiscal evasion that can only by the scope and nature of the anti-abuse measure.

C. Imposing a 'qualified resident' test

In one of the early alleged treaty overrides, the US congress under the Tax Reforms Act, 1986[95] imposed a new tax on foreign corporations

[92]U.S. Model Income Tax Convention of Nov. 15, 2006, [1 IRS Forms] Tax Treaties (CCH) P 209 (2007), http://www.ustreas.gov/press/releases/reports/hp16801.pdf.

[93]United Nations, Economic and Social Council, Committee of Experts on International Cooperation in Tax Matters; Treaty Abuse and Treaty Shopping, 21-24, U.N. Doc. E/C.18/2006/2 (2006).

[94]*Id.*

[95]Tax Reform Act 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

with branches in the United States. The statute acknowledged that the users of the DTAA could avail of the benefit of the same but such benefits would be denied in instances of "treaty shopping".[96] The rationale was to prevent non- residents of a treaty country from gaining benefits of the treaty commitments. To distinguish such non-residents the legislation provided for a test for "qualified residents".[97]

The "qualified resident" uses corporate ownership as a proxy for nexus with the treaty jurisdiction, with the intent of ensuring the entity claiming treaty benefits is not a conduit. Under this test, a foreign corporation does not qualify for treaty benefits if fifty percent or more is owned by non-residents of treaty jurisdiction or the United States, or if fifty percent or more of the corporation's income is directly or indirectly used to meet the liabilities of non-residents of such treaty jurisdiction or the United States.[98] However, the statute stated that Corporations publicly traded in the treaty jurisdiction or wholly owned by a U.S. Corporation also fall under the definition of "qualified resident".[99] The result of placing such a limitation was that it set an objective criterion which provided certainty to parties on both the sides of the bargain with regard to who shall be granted benefits and who won't. This test is efficient and effective as it works like a unilateral limitation of benefits clause and at the same time portrays a strong sovereign stance against treaty shopping

XIV. CONCLUSION

From an international perspective, even where unilateral anti-abuse measures are consistent with States obligations under DTAA's and

[96] *Id.*
[97] Tax Reform Act 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986), § 884.
[98] Tax Reform Act 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986), § 884(e)(4).
[99] *Id.*

where remedies for breach are available, unilateral measures as opposed to collective action are limited in a number of ways. Several states have adopted unilateral anti-abuse rules seeking to curb and combat treaty shopping. Moreover a comparative analysis on anti-abuse laws in different jurisdictions, such as Canada, United States, and the European Union demonstrate that States differ in views of the appropriate scope of anti abuse provisions. This highlights the dire need to raise the issue of anti-abuse provisions in the course of treaty negotiations which will lead to the development of mutually acceptable anti-abuse measures such as the Limitation of Benefits clause. Hence, the authors are of the opinion that a collaborative approach is better than an isolated one.

The complexity and diversification of the current international tax order has made the search for certainty and unified goals, the need of the hour. Technological improvements in new communications and transportation have made the global climate rife with international trade and investment. The direction of International Taxation should be based on the pillars of fairness and neutrality; it must strive to act as a facilitator and if not a facilitator at least not a distorter of trade and investment.[100] This is more of a concern with respect to India because historically our tax laws have been criticised for frequent amendments, lack of clarity which has led to excessive litigation.

India's tryst with codification is not unique or novel in any manner. Codification or discussions of codifications have been fairly common in the recent years. In the Unites States, codification of the economic substance doctrine has been proposed numerous times over the past decade, with its supporters lauding greater certainty and democratic

[100]R DOERENBERG, INTERNATIONAL TAXATION IN A NUTSHELL (4th ed.1999).

legitimacy and the critics remarking at the lack of flexibility and difficulty of administration associated with such codification.[101]

Keeping in view that one of the major criticisms of the Indian regime has been the frequent changes which are brought about in every year's financial bill. Such criticism is valid as the Government keeps on tackling symptom after symptom as they emerge rather than addressing the underlying cause which is the lack of clarity and consistency in the tax base. The presence of GAAR would enable the revenue authorities to tax most avoidance and evasion activities which would lessen the incentive for the taxpayers to attempt evasion in one form or other as the provision would be wide enough to cover for them. This would ensure that India presents a consistent system that is clear as well as forceful against tax evasion activities. Hence, on balance GAAR presents itself as the necessary solution to check tax evasion and tax avoidance.

The fact that still pervades over everything else is that every mature economy like Canada, Australia or China, has enshrined GAAR in its taxing statue. Hence, even if the country does decide to invoke GAAR, it will leave our tax laws richer on theory and principle; however, the application of the same would be the act one should watch out for.

[101]Ex: New York State Bar Association, *NYSB Tax Section Comments on Treasury's Proposal To Codify The Economic Substance Doctrine* 19 (July 25, 2000).