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Comparative Jurisprudence on Tax Avoidance

NALSAR session – October, 2022

What is tax avoidance?

- ‘Tax avoidance’ is essentially a ‘reaction’ to the ‘action’ of levying tax, and ‘anti avoidance’ provisions are the ‘reaction’ to the ‘action’ of adopting tax avoidance steps;
- It is the legal utilization of tax regime to one’s own advantage, to reduce the amount of tax that is payable by means that are within the four corners of law;
- ‘Tax avoidance’ - not defined under the Act or earlier legislations in India. Courts around the world have repeatedly interpreted and differentiated the terms ‘ tax planning’, ‘tax avoidance’, and ‘tax evasion’;
- Thin line exists between tax planning and tax avoidance; each country needs to protect its tax base and collect its rightfully due taxes;
- Prevalent tax avoidance techniques:
  - Treaty Shopping - use of favorable tax treaties;
  - Creation of artificial intermediary companies in low or no tax jurisdiction(s);
  - Excessive use of debt over equity;
  - Use of tax havens;
  - Transfer of residence.

Applicability of GAAR

Tax planning

Reducing tax liability by taking advantage of the legitimate concessions and exemptions provided in the tax law.

It involves the process of arranging business operations in such a way that reduces tax liability.

Tax evasion

Use of illegal means to reduce tax liability.

Usually, tax evasion involves hiding or misrepresenting income.

Tax avoidance

Legal exploitation of tax laws to one's own advantage.

Gamut of anti-avoidance rules

Specific anti-avoidance rules

TP Regulations; thin capitalization norms; Deemed dividend; Indirect transfer; Transfer of income without transfer of asset etc.

- **Judicial GAAR** - Principles that are not codified in legislation but are developed by the judicial precedents (*refer next slide*)
- **Statutory GAAR** - Statute based GAAR is extended and codified version of Judicial GAAR. It codifies and gives legal recognition to principles laid by Judicial GAAR

Judicial anti-avoidance doctrines

Bird eye view of the principles developed in the Pre-GAAR era

Lifting of the corporate veil

- Disregarding separate legal identity of a company and consequently taxing the shareholder.

Telco vs State of Bihar, Ansaldo Energia SPA v ITAT

Sham transaction

- Transaction not carried out or is not intended to be carried out or is a cover up for another transaction or relationship;
- Essentially conceals true nature or reality of transaction, legal form retained but underlying substance is not genuine.

Mc.Dowell case, Meenakshi Mills case

Economic substance test

- Economic substance of transactions is to be determined by looking at both objective and subjective factors;
- To see if there is any potential for profit other than tax savings or if there is any meaningful change in the economic position of the taxpayer.

Business purpose test

- Requires justification of transaction from commercial point of view;
- Mere tax advantage cannot be sole or main business purpose.

Gergory vs Helvering, Star TV Amalgamation AAR case

Label Doctrine

Use of incorrect labels to classify or characterize a transaction or relationship for tax purposes.

Ridge Securities v. IRC, 1964

Step transaction doctrine

Intermediate steps of a transaction disregarded, several transactions treated as single composite transaction.

Furniss vs Dawson, Ramsay case

Colorable Device

Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods.

McDowell and Co Ltd vs Commercial Tax Officer

Indian Perspective

Story so far……

1

- IRC v Duke of Westminster (UK)
- Gregory v. Helvering (US)

1935-36

2

- A Raman & Co, 1967
- WT Ramsay vs IRC (UK), 1982

3

- McDowell & Co Ltd, 1985
- Arvind Narottam, 1988

4

- Azadi Bachao Andolan, 2003
- Vodafone International, 2012
- AVM Capital 2012

5

Introduction of legislative GAAR under ITA, April 2015 *(application deferred to April, 2017)*

6

Release of Final BEPS Reports by OECD, October 2015

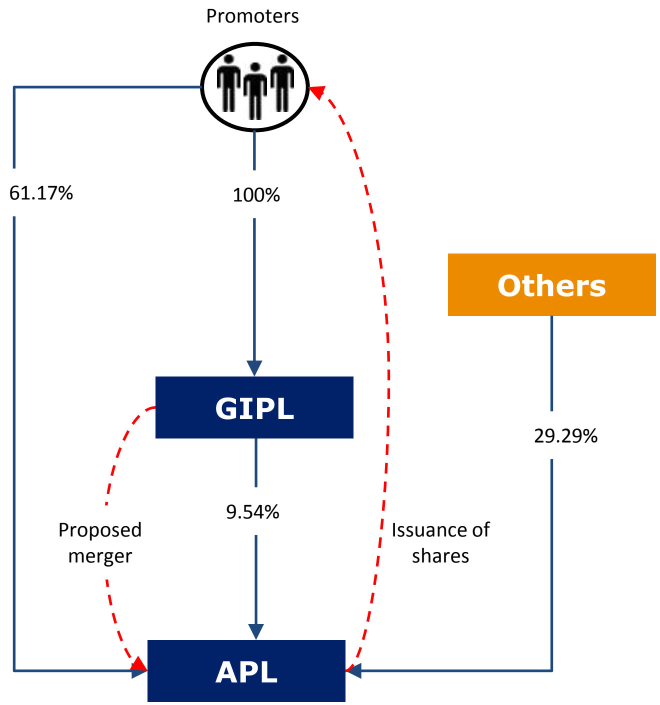
7

- Gabs Invts and Ajanta Pharma, 2018
- NIIT Technologies, *2018*

8

Deposit and ratification of MLI by India, 2019

Curious case of Ajanta Pharma



In another case the Delhi NCLT sanctioned a Scheme acknowledging that a taxpayer can arrange his affairs to reduce his tax burden in a lawful manner

Facts

- A scheme of merger was filed before NCLT proposing the following:
  - Merger of GIPL with APL (listed);
  - Reduction of share capital held by GIPL in APL
- GIPL had no other businesses other than investments in APL
- Rationale behind the scheme was to simplify the group structure and reduce the shareholding tiers for promoters to directly hold shares in APL
- IRA raised objections invoking GAAR – arguing that the scheme was an IAA resulting in a deliberate measure to avoid taxes of INR 4,217 million on following basis:
  - IRA assumed the shares would be sold in the open market and company would distribute profit on the sale of shares;
  - IRA arrived at income of INR 9,583 million;
  - IRA proposed to levy tax at the rate of 30 percent, amounting to INR 2,875 million by considering it as business income in hands of GIPL;
  - IRA computed a DDT of INR 1,342 million on post-tax profits

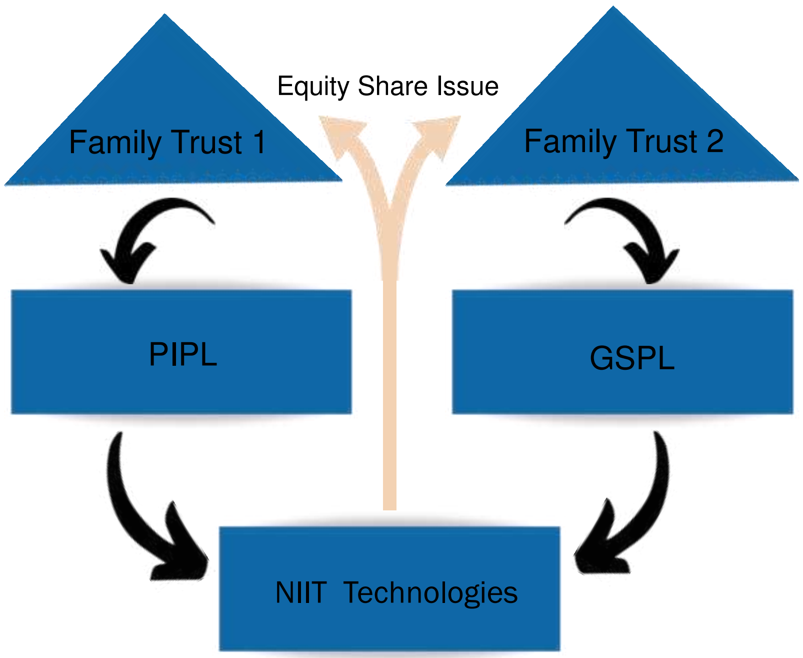
Mumbai NCLT ruling

- GIPL & promoters were avoiding tax liability through this scheme
- The scheme would benefit only promoters and was prejudicial to the public interest

Points to ponder

- *Where a taxpayer can achieve desired commercial objectives by two alternatives – should he choose the one with tax leakage?*

The case of NIIT Technologies



The NCLT had set aside the contentions raised by the Income Tax Authorities ('ITA'), terming the Scheme as a vehicle created solely to evade tax liabilities, as being unfair, unreasonable and resulting in a huge tax loss to the government.

Facts

- A scheme of amalgamation between PIPL and GSPL with a listed entity, NIIT Technologies Limited, was proposed;
- 100% of the equity shares of PIPL and GSPL were held by Family Trust 1 and Family Trust 2, respectively;
- Rationale behind the scheme was to simplify and streamline the shareholding structure, which will not only demonstrate the promoter group's direct engagement with the listed entity but will also enable succession planning of the promoters.
- Contentions raised by IRA:
  - Scheme solely benefited family trusts;
  - Purpose not to simplify structure, but to avoid tax liability;
  - Misuse of provisions of Sec 47 of Income-tax Act;
  - Scheme's appointed date fixed on March 31, 2017 to avoid implication u/s 56(2)(x)applicable from April 1, 2017.

NCLT Observations:

- The onus to prove tax avoidance is on tax authorities. Taxpayers can arrange their affairs to reduce tax burden in lawful manner;
- No change in shareholding, NIIT's shares not proposed to be transferred, but to be held by the existing promoters directly, instead of through private Companies;
- IRA is unable to demonstrate any tax avoidance based on appointed date, NCLT cannot alter such appointed date without sufficient reasons;
- Role of Income-tax Department limited as compared to Central Government or Regional Director. Its role is to point out if scheme is simply an instrument for abject misuse of provisions of Companies Act, 2013 for evading income tax.

Global Perspective

Canada

Canada Trustco Mortgage Co. v. Canada

Three elements are to be satisfied for the invocation of GAAR provisions:

1. There must be a tax benefit;
2. Must be an avoidance transaction; and
3. Must be an abusive transaction.

The Queen v. Spruce Credit Union

Mere fact that tax implications played an important role does not lead to the conclusion that the primary purpose is to obtain a tax benefit and that such transaction should be characterized as an avoidance transaction.

Queen v. Alta Energy Luxembourg S.A.R.L.

Merely because treaty benefits were taken, it cannot result in "abuse of treaty provisions". Once the compliance with the provision is shown, it is up to the tax authorities to show that object/ purpose of the provisions have been frustrated or defeated.

New Zealand

Ben Nevis Forestry Ventures Ltd & Others v. CIR

The Court endorsed a "tandem approach" to the interpretation of general anti-avoidance provisions i.e. the specific tax provisions and the general anti-avoidance provisions are to be read so as to give effect to each. They are meant to work in tandem. Each provides a context for determining the meaning and scope of the other, and neither should be treated as overriding.

Penny and Hooper v. CIR

The case demonstrated a further application of the principles adopted in the *Ben Nevis* case, allowing the court to determine whether the use of structure was beyond parliamentary contemplation and resulted in tax avoidance arrangement.

United Kingdom

IRC v. Duke of Westminster

Upheld the "form over substance" approach, with the legal form of a transaction being the determiner of its tax consequences.

Ramsay v. IRC

Exemplied the "form over substance" approach

Revenue & Customs ("HMRC") released an updated and extensive guidance to help recognize tax arrangements and process for counteracting them.

The Recent Cases

The Commissioners for Her Majesty's Revenue and Custom v. Euromoney Institutional Investor Plc.

In response to the issue whether the exchange formed part of a scheme or arrangements of which the main purpose - is the avoidance of liability to corporation tax the tribunal upheld replacing cash with preference shares for part consideration in share-transfer, as tax avoidance not main purpose.

Canada Inc., v. Her Majesty the Queen

Tax Court of Canada upholds applicability of GAAR provisions upon circumvention of provisions of Canadian Income-tax Act on recycling of Capital Dividend Account through cross - redemption of share.
The Court noted that three elements similar as observed in the *Canada Trustco Mortgage Co. v. Canada* are to be satisfied for the invocation of GAAR provisions:

In re SGL Carbon Holding S.L

In response to the issue before the Supreme Court of Spain - whether the taxpayer could access Mutual Agreement Procedure ("MAP") in cases where GAAR is triggered as per Article 24(1) of the tax treaty?
The Court held that MAP requests could not be permitted in tax abuse cases.

Conclusion

- The Supreme Court, first in *Union of India v. Azadi Bachao Andolan*, and later in *Vodafone International Holdings BV v. Union of India* balanced the two views and held that tax planning within the four corners of the law would be valid so long as it did not amount to a colourable device or a sham transaction, thereby re-affirming the form over substance doctrine, particularly in the absence of a domestic legislation allowing for such a look through.

- **Advance Ruling**:

– An advance ruling can be sought on the question of whether an arrangement which is proposed to be undertaken by any person being a resident or a non-resident is an impermissible avoidance arrangement;

– Such an advance ruling can be sought by both residents and non-residents and only in respect of arrangements proposed to be entered into by the person.

Thank you!

Annexures

CIT v. A. Raman (AIR 1968 SC 49)

- This decision of the Hon'ble Supreme Court endorsed the Westminster principle (every person has a right to plan his affairs in the most tax efficient manner) –

- The relevant para eloquently discussing the aforesaid principle:

> *"Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him. By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment a case for commencing a proceeding for reassessment under s. 147(1)(b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented."*

McDowell and Co. Ltd. v. Commercial Tax Officer [(1985) 3 SCC 230)

- In this case, J. Chinappa Reddy held that tax planning is not permissible including situations where the taxpayer resorts to a colourable device or a subterfuge to avoid taxes and that courts are not strictly bound by the legal form of the transaction alone.

Union of India v. Azadi Bachao Andolan [(1985) 3 SCC 230]

- In this case, the Supreme Court, after considering J. Chinappa Reddy's decision in *McDowell and Co. Ltd. v. Commercial Tax Officer,* differed from the same and reaffirmed the Westminster principle in the following words:

> *"As we shall show presently, far from being exorcised in its country of origin, Duke of Westminster continues to be alive and kicking in England. Interestingly, even in McDowell , though Chinnappa Reddy,J., dismissed the observation of J.C. Shah,J. in CIT v. A. Raman and Company based on Westminster and Fisher's Executors, by saying "we think that the time has come for us to depart from the Westminster principle as emphatically as the British courts have done and to dissociate ourselves from the observations of Shah J., and similar observations made elsewhere", it does not appear that the rest of the learned Judges of the Constitutional Bench contributed to this radical thinking….*
>
> *In our view, the principle in Duke of Westminster is very much alive and kicking in the country of its birth. And as far as this country is concerned, the observations of Shah,J., in CIT v. Raman are very much relevant even today."*

Vodafone International Holdings B.V. v. Union of India [2012] 341 ITR 1

- In this case, the Supreme Court reinforced the Westminster principle. Holding tax planning within the framework of the law to be legitimate, the Supreme Court observed as follows:

  “The majority judgment in McDowell held that "tax planning may be legitimate provided it is within the framework of law" (para 45). In the latter part of para 45, it held that "colorable device cannot be a part of tax planning and it is wrong to encourage the belief that it is honorable to avoid payment of tax by resorting to dubious methods". It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with para 46 where the majority holds "on this aspect one of us, Chinnappa Reddy, J. has proposed a separate opinion with which we agree". The words "this aspect" express the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colorable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible. In our view, although Chinnappa Reddy, J. makes a number of observations regarding the need to depart from the "Westminster" and tax avoidance - these are clearly only in the context of artificial and colorable devices. Reading McDowell, in the manner indicated hereinabove, in cases of treaty shopping and/or tax avoidance, there is no conflict between McDowell and Azadi Bachao or between McDowell and Mathuram Agrawal.”