

GENERAL ANTI-AVOIDANCE RULES AND DUBIOUS ADVANCE RULING: IGNORING THE ELEPHANT IN THE ROOM

Harish Choudhary *

I. INTRODUCTION

In the recent past, General Anti-Avoidance Rules (GAAR) was one of the most controversial and debatable issues in tax fraternity as to whether statutory GAAR⁸⁵ should be brought in India at all? If yes, whether the proposed model is the most appropriate model of statutory Anti-Avoidance Rules? Leaving behind this debate (as GAAR would be in force w.e.f 1.4.2016), it is pertinent to discuss the approach of the judiciary and quasi-judiciary which might deal with cases hit by GAAR in the near future. It is important to note that as per section 245N(a)(iv) by simply moving an application before the Authority for Advance Ruling (AAR), a person may, before entering into a transaction, get to know whether such transaction would be hit by GAAR. This mechanism has been discussed further in the paper. 'Who can be such applicant' is the core point that is being discussed in this paper. Merits or demerits of GAAR are left untouched in this paper, in the light of existing plethora of literature on the same. It is noteworthy to mention that, the issue of maintainability of the cases pertinent to GAAR in AAR, for advance clearance is least touched or in fact, is left untouched.

The article below seeks to present a hypothetical prospective simulation of the case before AAR, wherein maintainability of an *ongoing transaction* for advance clearance has been discussed and in pursuance of the same analyzes various defenses of both players viz. the Revenue (Commissioner of Income-Tax as Respondent) and the applicant. It is argued that advance clearance might be available to applicants of *ongoing transactions* provided that strict interpretation is not employed. This Article suggests that such a controversial advance ruling is the proverbial elephant in the room. It is the underbelly of the anti-avoidance rules in India: easily ignored or simply invisible to those who exercise it, although it is, quite literally, staring us in the face.

The Article has been divided into four parts. Part I sets out the relevant considerations to put the appraisal exercise in context. Part II explores the relationship between GAAR and AAR by going into brief conceptual jurisprudence of GAAR and AAR in Indian context. Part III then critiques the current black letter of law and examines the possible alternative criteria to make 'ongoing/ existing transactions' *intra vires*. Part IV discusses the constitutional validity of section 245N (a) (iv). And, Part V finally concludes that the advance clearance, from applicability of GAAR on 'ongoing transaction/ existing transaction', by AAR is a nearly herculean task, under the current black letter of law.

* Student, National Law University, Delhi, B.A. LL.B. (Hons.) 3rd Year

⁸⁵ T.P. Ostwal and Vikram Vijayaraghavan, 'Anti-Avoidance Measures' (2010) 22(2) National Law School of India Review, 63.

II. GENERAL ANTI-AVOIDANCE RULES AND ADVANCE RULING: SETTING THE 'CONTEXT'

Indian policymakers have taken the lead, by incorporating new provisions relating to avoidance to tax in Direct Tax Code Bill, 2010 (as incorporated into the Income Tax Act, 1961), from their western counterparts.⁸⁶ The prevailing wisdom for such a move seemingly is, that '*on consideration of economic efficiency and fiscal justice, a taxpayer should not be allowed to use legal constructions or transactions to violate horizontal equity*'.⁸⁷ Thus, the tax policy shift to usher in GAAR has followed the government's endeavour to give legislative teeth against questionable transactions that lead to tax leakage. GAAR gives wide powers to authorities to determine tax consequences of any arrangement that is deemed to be tax avoidance- transaction.⁸⁸ It empowers the Revenue to disregard any or all steps in a tax avoidance transaction, re-characterize income accruing on such transaction and lift the corporate-veil to give effect to the anti-avoidance rules.⁸⁹

The application of GAAR demands fair and effective treatment through reasonable safeguards.⁹⁰ For this reason only concept of *advance clearance*, as to whether a particular transaction is impermissible or not, is envisaged in Income Tax Act under section 245N (a) (iv). Advance clearance is a procedure that offers taxpayers opportunity to apply for 'clearance' or a 'ruling' to achieve certainty concerning the tax consequences of contemplated transaction.⁹¹ In GAAR's perspective such ruling provides administrative certainty of applicability of GAAR, for taxpayers in given factual circumstances, of their transaction.

Authority for Advance Ruling, under Chapter XIX-B of the Income Tax Act consisting of sections 245N to 245V, is a statutorily recognized high-level quasi-judicial authority created for the purpose of advance clearance in respect of transactions involving specified parties with a view to avoiding needless litigation and promoting better tax-payer relations.⁹² Yehonatan Givati argues that Advance Ruling is considered indispensable in the modern world of tax administration and compliance.⁹³

One of the distinctive features of the *Advance Ruling* in India is that AAR does not have any discretionary power regarding the admission of an application made before it.⁹⁴ As long as the application is made by specified applicants for determining its tax liability and does not fall within

⁸⁶ Tarun Jain, '*GAAR and Rule of Law: Mutually Incompatible*' (2013) 43 Chartered Accountant Practice Journal 425.

⁸⁷ Department of Revenue, Ministry of Finance, Government of India, '*Direct Taxes Code Bill and Discussion Paper*' (August 2009) <<http://www.itatonline.org/info/index.php/direct-taxes-code-bill-2009-discussion-paper/>> accessed 25 November 2013.

⁸⁸ Income Tax Act 1961, s 95.

⁸⁹ Income Tax Act 1961, s 98.

⁹⁰ Tarun Jain, '*GAAR and Corporate Governance: Will The Stick Do The Trick?*' (2012) 1(6) Journal on Governance 664.

⁹¹ Yehonatan Givati, '*Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings*' (2009) 29 Virginia Tax Review 138, 140.

⁹² Handbook on Advance Rulings' Authority for Advance Rulings (Income Tax) <<http://aarrulings.in/book.pdf>> accessed 22 November 2013.

⁹³ Yehonatan Givati, '*Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings*' (2009) 29 Virginia Tax Review 147.

⁹⁴ Harshal Shah and Bijal Ajinkya, '*The Rising Popularity of Advance Rulings in India*' (2009) 55(3) Tax Notes International 220.

the category of prohibited questions for which an advance ruling cannot be sought, the AAR is bound to pass a ruling on the question.⁹⁵ Section 245N of IT Act is the guiding provision which classifies certain applicants who can make applications before AAR for *advance ruling*.

With the advent of GAAR, Finance Act, 2013 inserted a new sub-clause (iv) in section 245N (a) so as to enable the applicants to know whether the transactions entered by them into are impermissible or not under Chapter X-A of the Income Tax Act.

Section 245N (a) (iv) states that-

*"A determination or decision by the Authority whether an arrangement, which is **proposed to be undertaken** by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not."*⁹⁶

It appears that once an advance ruling is obtained, the transaction in respect of which such ruling is obtained will not be subject to GAAR, since advance rulings would be binding on the Commissioner and the authorities below him. However, this route is available only for transactions, which involve certain specified class of assesseees. In respect of all other assesseees, advance ruling mechanism is not available. It would be important to have a similar mechanism for all assesseees across the board to achieve certainty in business transactions. It is proposed that the forum of Dispute Resolution Panel (DRP) will be available in cases of GAAR.⁹⁷ However, past experience has shown the practical limitations of DRP in granting any substantial relief to the assesseees. Therefore, the need to have an AAR mechanism is absolutely important.⁹⁸

It is noteworthy to mention that although, GAAR is applied *w.e.f.* 1-4-2016, revenue will not take into account the period or time for which the arrangement (including operations therein) exists (while determining the commercial substance of the arrangement)⁹⁹ or the time, or sequence, in which the funds involved in the round trip financing are transferred or received (while scrutinizing round trip financing in the transactions).¹⁰⁰ These provisions make it clear that transactions already in existence before the Financial Year 2016-17 or which are ongoing in the Financial Year 2016-17 or in subsequent financial years, may be declared as impermissible arrangements. It is not argued that declaration of such transactions as impermissible arrangements is unacceptable. However, these provisions create dilemma *w.r.t.* section 245N (a) (iv) as whether or not parties involved in such ongoing transactions can approach AAR.

To resolve this dilemma, the Article below seeks to present a hypothetical prospective simulation of the case of an 'ongoing transaction' if it had appeared before AAR and in pursuance of the same analyzes various defences both players are going to come up.

⁹⁵ *ibid.* See also 'Handbook on Advance Rulings' Authority for Advance Rulings (Income Tax) <<http://aarrulings.in/book.pdf>> accessed 22 November 2013.

⁹⁶ Income Tax Act 1961, s 245N(a)(iv).

⁹⁷ Income Tax Act 1961, s 144C (14A).

⁹⁸ Gautam Chopra, 'Indian GAAR – Need to Adopt Best Practices',

<<http://www.mondaq.com/india/x/147386/Income+Tax/INDIAN+GAAR+Need+To+Adopt+Best+Practices>> accessed 22 November, 2013.

⁹⁹ Income Tax Act 1961, s 97(4).

¹⁰⁰ Income Tax Act 1961, s 97(2) (B).

III. HYPOTHETICAL CASE ON ADVANCE RULING OF ONGOING TRANSACTION

Below are the possible arguments for and against the maintainability of ongoing/existing transaction before AAR for advance clearance (the maintainability is always challenged by the Revenue Commissioner of Income Tax)

A. STRICT INTERPRETATION V. LEGISLATIVE INTENT

Revenue can cleverly knock away the dying punch by asserting that in construing fiscal statutes and in determining the liability of a subject to tax one must have regard to the strict letter of the law,¹⁰¹ and by construing section 245N (a) (iv) strictly there is no leverage to give advance clearance to ongoing/existing transaction as in the section only a *proposed transaction* is mentioned and by no construction can an ongoing transaction fall under such language. AAR being a creature of the Act has limited jurisdiction and has to function within the four-corners of the statute creating it.¹⁰² When the legislature lays down that the power can be exercised only if a certain state of facts exists, the authority cannot act if the condition is not fulfilled.¹⁰³ Thus, the jurisdiction of the AAR is limited, by the operation of section 245N (a) (iv), to proposed transactions only.

Revenue can lead an unbreakable cuff that clauses (i) and (ii) of section 245N(a) include both transactions that have been undertaken as well as transactions proposed to be undertaken within their ambit. Clause (iv), which applies to impermissible avoidance arrangements in terms of Chapter X-A, only refers to transactions proposed to be undertaken. It is an established principle of law that the intention of the legislature is primarily to be gathered from the language used, which means that attention should be paid to what has been said as also to what has not been said.¹⁰⁴ Hence, it can be argued that the legislature has deliberately avoided the use of the word '*undertaken*' in section 245N (a) (iv).

Here, applicant can try a strong riposte by arguing that if the application is rejected, section 245N(a)(iv) will become wholly superfluous in its application to already existing and ongoing transactions, though section 144BA of the IT Act is being used to apply Chapter X-A to them. In this way, an Applicant can cut corners by making a blur move as a construction which fails the legislative object should be avoided. In construing an ongoing Act, the interpreter is to presume that Parliament intended the Act to be applied at any future time in such a way as to give effect to the original intention.¹⁰⁵ Therefore, the application should be maintainable as that would be in consonance with the legislative intent.

¹⁰¹ *AV Fernandez v State of Kerala* (1957) AIR 657 (SC). See also GP Singh, *Principles of Statutory Interpretation* (13th edn, LexisNexis Butterworths 2012).

¹⁰² *OP Gupta v Rattan Singh* (1964) 1 SCR 259 (SC); *D Ramakrishna Reddy v Addl Revenue Divisional Officers* (2000) 7 SCC 12 (SC).

¹⁰³ *Director of Income Tax (International Taxation) v Authority for Advance Rulings* 2011 SCC OnLine AP 672 : (2013) 352 ITR 185.

¹⁰⁴ *State of Jharkhand and Anr v Govind Singh* [2005] 10 SCC 437 (SC); *JP Bansal v State of Rajasthan and Anr* (2003) 5 SCC 134 (SC).

¹⁰⁵ *State of Maharashtra v Dr Praful B Desai* (2003) 4 SCC 601 (SC).

B. CASUS OMISSUS V. PRESUMPTION OF JURISDICTION AND BENEFICIAL INTERPRETATION

Revenue may land up a double blow to the applicant by arguing that *casus omissus* should not be readily inferred.¹⁰⁶ A construction which requires addition of words for its support should be avoided and the words of the statute should never, in interpretation, be added or subtracted without almost a necessity.¹⁰⁷ Proposed transactions and ongoing/existing transactions are two different categories of transactions based on timeline. They can never be called *ejusdem generis* and thereby, can never speak for each other. Moreover, there can be no ambiguity in differentiating between these two transactions. Thus, the intention of the legislature in limiting the scope of section 245N (a) (iv) is clear and unambiguous. Therefore, the jurisdiction of the AAR under s 245R (2) is limited by the operation of section 245N (a) (iv) to proposed transactions only.

The *Applicant* may assert that though AAR is a creature of the Act and its jurisdiction is circumscribed by the provisions of the Act and the rules made there under.¹⁰⁸ However, when a dispute arises as to the jurisdiction of the tribunal to deal with a matter, the endeavour ought to be to find the jurisdiction rather than deny the same.¹⁰⁹

Applicant may pack a punch by stating that it is a settled principle that when the interpretation of a fiscal enactment is open to doubt, the construction most beneficial to the assessee should be adopted.¹¹⁰ That the fiscal statute should be strictly construed, is applicable only to charging provisions or provisions imposing penalty, and not to those parts of the statute which contain machinery provisions.¹¹¹ All the parts of the act must be in harmony with the statutory intent.¹¹² Thus, the jurisdiction of the AAR will fall under such provisions that can be widely interpreted.

IV. CONSTITUTIONAL VALIDITY

In case an ongoing transaction is not entertained by AAR, section 245N (a) (iv) would be subjected to the constitutional validity test. Section 245N (a) (iv) of the Income Tax Act, 1961 creates a classification amongst the applicants. It divides them into two categories:

- a. Applicants of proposed transaction,
- b. Other remaining applicants (applicants of ongoing/existing transactions).

The Supreme Court has laid down the following two tests for any classification to be held to be valid under Article 14:¹¹³

¹⁰⁶ *CIT v National Taj Traders* (1980) AIR 485 (SC).

¹⁰⁷ PM Bakshi, *Interpretation of Statutes* (RP Kataria and R Chakraborty eds, 1st edn, Orient Publishing Company 2011).

¹⁰⁸ *Director of Income Tax (International Taxation) v Authority for Advance Rulings* 2011 SCC OnLine AP 672, (2013) 352 ITR 185.

¹⁰⁹ *Kihota Hollohon v Zachilhu* [1993] AIR 412 (SC); *Hakam Singh . Gammon (India) Limited* [1971] AIR 740 (SC).

¹¹⁰ *Hindustan Lever Ltd v Municipal Corporation of Greater Bombay* (1995) 3 SCC 716 (SC); *CIT v Naga Hills Tea Co Ltd* [1973] 89 ITR 236 (SC); *CIT v Poddar Cement (P) Ltd.*, [1997] 226 ITR 625 (SC).

¹¹¹ *CIT v National Taj Traders* [1980] AIR 485 (SC); *Commissioner of Income Tax v Kishoresingh Kalyan Singh Solanki* (1960) 39 ITR 522 (Bom). See also Dr KN Chaturvedi, *Interpretation of Taxing Statutes* (Taxmann Allied Services P Ltd 2008)103,105.

¹¹² *Duckering v Gollan* (1965) 2 All ER 115 (HL) 120. See also A.B. Kafaltiya, *Interpretation of Statutes* (Universal Law Publishing Co 2008)71.

¹¹³ *In Re: Special Courts Bill* [1979] AIR 478 (SC).

- a. The classification must be based on an intelligible differentia i.e. the groups created through the classification must be easily distinguishable from each other.
- b. The classification created must have a rational nexus to the object sought to be achieved by the Act

While section 245N (a) (iv) easily satisfies the first test, it is the second test where it fails. As already mentioned, the purpose of creating AAR is to give the opportunity to the applicants to know the fate of their transactions as to what revenue might overburden them with tax. However, nowhere has it been mentioned as to why only applicants of proposed transactions can approach AAR. Such a categorization of applicants seems arbitrary.

Thus, the section has failed to show a nexus between the classification created and its object, as there is nothing to suggest that only these categories of applicants can approach AAR. Thus, this section would be liable to be struck down as violative of Article 14 of the Constitution, if subject to judicial review.

V. CONCLUDING REMARKS

In sum if a purposive and principle based interpretation is adopted while dealing with such an issue as opposed to strict interpretation, it would complement and capitalize on the value of justice.¹¹⁴ On the other hand, strict construction would be subjected to the constitutionality test as it is prone to violate Article 14. The appraisal of *advance clearance* noted in this Article is a pointer to the future of tax litigation where *inter alia*:

- a. Continuation of essential tenet of fiscal statutes i.e. strict construction will be subjected to test,
- b. The limitations imposed by the Constitution and Supreme Court on reasonable differentia will require revisiting in case ongoing transaction is discarded from *advance clearance*,
- c. The debate on substantive due procedure will re-emerge.

It is also clear from the above analysis that conflict between strict interpretation and purposive interpretation of section 245N (a) (iv) is inevitable in the coming time. To resolve the predicament, judiciary, as argued by Srinivasan Ramaswamy¹¹⁵, should take a mid-way approach *i.e.* in favour of purposivism and search for a reason and spirit of the statute, but only in circumstances where a literal reading would result in an anomalous outcome inconsistent with the scheme of the legislation. Otherwise, only the words of the statute should be the basis of interpretation. Srinivasan Ramaswamy strongly suggested¹¹⁶ that 'immediate purpose'¹¹⁷ (as opposed to 'ultimate purpose' of

¹¹⁴Ronald M. Dworkin, 'The Model of Rules'(1967) 35(14) U CHI L REV 24,28.

¹¹⁵Srinivasan Ramaswamy, 'Interpretation of Tax Legislations: Has Principle of Strict Interpretation Met an Unfortunate Death?'(2013) 2 Company Law Journal 38, 39.

¹¹⁶*ibid* 39.

¹¹⁷Robert S Summers, 'The Formal Character of Law'(1992) 51 CLJ 242.

legislation) which may be derived from statutory text and legislative history itself, should be taken into account so as to avoid unnecessary and inevitable situations. In this way, though right from a small person to the top sophisticated entity, everybody will be willing to rush to an advance ruling, one should not be treated in an unfair and inequitable manner.

Apart from being tested or retested, whether or not '*advance clearance*' will serve its purpose, is also an issue which will be closely monitored and judged in coming times. Whatever be its success rate, one must not be unreasonably debarred from safeguards. In essence, the elephant in the room can no longer be ignored.