Response to the Draft Report of the Parthasarathi Shome Committee on GAAR

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I. CONTEXT AND BACKGROUND

Need for stepping up the Tax-GDP ratio for the country

The overall amount of resources available to the government in India has been inadequate in comparison to several other countries, mainly owing to the low magnitude of tax revenue in our country. India's tax-GDP ratio (16.64 % of GDP in 2011-12 BE[1]) compares poorly against those of several other countries such as Sweden 50.1 %[2], Brazil 34.2 %, Russia 32.3 % and UK 27.3 %. It is necessary that the Union Government takes adequate measures for stepping up the country's tax-GDP ratio, which would enable our government to provide more resources for development spending in crucial sectors.

Moving towards a progressive taxation regime: Need to rely more on Direct Taxes instead of Indirect Taxes

Of the total tax revenue of our country, while indirect taxes (that affect the poor more) account for 63 %, direct taxes account for only 37 %[3]. If India is to move towards a more progressive tax system, the government should rely more on direct taxes (such as, corporation tax, personal income tax, wealth tax, and capital gains tax). Policy measures that aim to reduce our dependence on direct taxes could further exacerbate the regressive nature of the country's tax system, as the proposed Goods and Services Tax (GST) is expected to result in greater revenue collection through indirect taxes.

Need to plug international taxation loopholes to address tax evasion and tax avoidance

According to the tax treaty between India and Mauritius, a company resident in Mauritius selling shares of an Indian company will not be liable to pay tax in India. Since there is no capital gains tax in Mauritius, the gain will escape tax altogether[4]. With approximately 40 % of FDI equity inflows being routed through Mauritius, it is important that this loophole is fixed definitively.

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[1] Indian Public Finance Statistics, 2011-12, Govt. of India

[2] Following the methodology of OECD Revenue Statistics, we do consider social security contributions (which are compulsory, unrequited and made to the government) as part of the tax revenue of the government.

[3] Indian Public Finance Statistics, 2010-11, Govt. of India

[4] http://www.frontlineonnet.com/stories/20120323290501700.htm

II. OBSERVATIONS ON THE PROPOSED GAAR

In the past, the response to tax avoidance has been the introduction of legislative amendments to deal with '*specific*' instances of tax avoidance. India presently has anti-avoidance principles based on court rulings, as well as some specific tax provisions. Since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spread across several tax jurisdictions. This has led to erosion of the country's tax base. In view of the above and consistent with the international trend, a '*general*' anti-avoidance rule has been introduced in the DTC which will serve as a deterrent against such practices. Hence, a wide spectrum GAAR is proposed to be codified for the first time.

However, given the amount of effect GAAR will have on tax avoidance and aggressive tax planning, it has been subjected to considerable pressure from the corporate lobby. As a result, some divergences have emerged between the proposals of original DTC, recommendations of the Parliamentary Standing Committee (PSC) on Finance, Finance Act for 2012-13 and Draft Guidelines by the Union Finance Ministry. A comparative analysis of key features of GAAR under DTC, PSC recommendations and the Finance Act for 2012-13 are as follows:

Table No. 1

Comparing GAAR Proposals

	DTC	Finance Act for 2012-13	PSC
Onus	Taxpayer	Taxpayer	Tax authority
Treaty override	Yes	Yes	No
Invoking powers	Commissioner IT	CIT / Department Panel	Independent Panel
Qualifying threshold	No	May be prescribed	Yes
Prospective application required	No	Yes	Yes

Source: PWC

As is clear from the table above, the GAAR proposed in the DTC grants necessary powers to tax authorities and the taxpayer is left with the responsibility to prove he has not entered into a tax avoidance arrangement. It needs to be mentioned that it is necessary to give wide powers to the administration if GAAR is desired to produce a deterrent effect. Also, it can be argued that PSC's recommendations on GAAR dilute some of the key provisions in the DTC. Against this background, the provisions on GAAR in the Finance Act 2012-13 are a welcome step.

We may also note that, with the PSC Report taking a lenient stand on GAAR provisions, former Member of Parliament (in Rajya Sabha) Moinul Hasan[5] had observed that the big corporates and MNCs are using tax avoidance treaties like India's DTAA with Mauritius to indulge in 'treaty shopping'. It is noteworthy that over 40 % of FDI inflows into India are routed through Mauritius, which only points towards tax avoidance and not "bona fide transactions". All the 'scams' in the recent period, e.g. the 2G 'scam', IPL 'scam' etc. have a Mauritius connection. This is leading to huge revenue losses. In this backdrop, Moinul Hasan had observed that the criticisms of the GAAR in the PSC draft report were harsh and misdirected. The tax authorities must be empowered to apply GAAR provisions and the onus of proving that a company is not avoiding taxes should lie on the companies, as is done in China.

Here, it needs to be mentioned that every mature economy, whether Canada, Australia, China or South Africa, has GAAR enshrined in its tax statute. Thus, India is not being out of line with this trend. It is a key international concept already existing in a number of countries. A comparison of GAAR provisions in a few key countries is provided below.

Table No. 2
Comparing GAAR Provisions in a Few Countries

	Australia	South Africa	China	USA
Codified law	Yes	Yes	Yes	Limited
Prospective application	1981	2006	2008	2010
Trigger points	Sole or dominant tax benefit	Tax avoidance & other tests	Tax avoidance	Lack of substance
Burden of Proof	Tax authorities	Taxpayer/Tax authorities	Taxpayer	Taxpayer
GAAR Panel / Advance Rulings	Yes	No	Yes	Yes
Guidance on applicability	Available	Available	Available	Available

Source: Compiled from information provided by PWC; and Mukhopadhyay, Sukumar (2012): 'General Anti-Avoidance Rule in Income Tax Law', Economic and Political Weekly, June 2.

[5]Parliament Standing Committee on Finance (2012), Appendices I, Dissent Note.

GAAR- China as a case study

With China having introduced strict anti-avoidance rules in 2008/2009 and the UNCTAD World Investment Report 2012 stating that FDI flows to China reached a "record level" of $124 billion in 2011, this would be a better model to follow for India rather than UK that the Shome Committee report highlights. Since the concern is the impact on FDI with the introduction of GAAR, Chinese experience clearly states otherwise.

China Corporate Income Tax (CIT) law introduced GAAR in 2008 and a series of circulars in early 2009 to address tax avoidance, provide guidance on implementation of provisions of double tax treaties and plug loopholes for cross-border transactions involving non- residents. The GAAR provision states that tax authorities can adjust arrangements undertaken 'without reasonable business purposes' that result in tax benefits. The implementation rules clarify that 'without reasonable business purposes' means any arrangement whose primary purpose is reducing, avoiding or deferring of tax payment (Gu et al, 2011). The State Administration of Taxation (SAT), under the circular Guo Shui Fa (2209) No. 2 (Circular 2), further clarified that GAAR will be directed to transactions intended to abuse tax incentives under the CIT Law, double tax treaties or corporate organisation structures, or to avoid tax by using tax havens (ibid). Interestingly, the burden of proof is on the taxpayers to prove that GAAR should not apply to the arrangement[6].

Circular 601 issued in October 2009, the Beneficial Ownership circular, clarifies that agent or conduit companies do not qualify as beneficial owners for DTA purposes (Chan, 2011). This Circular is supported by Circular 12 which laid out detailed requirements for applications to be made to Chinese tax authorities to obtain clearance for the treaty benefits (Gu et al, 2011). Circular 698, also introduced in 2009, emphasised the 'substance over form' principle which ensures that GAAR will be invoked if an intermediate holding company is found to have no commercial purpose except the avoidance of tax and gives guidance related to non-residents' equity sales (Chan, 2011). **Chan notes that China, in terms of some elements of taxation, is "rapidly making the transition from a developing to a more mature approach"** (Chan 2011; 9).

It is clearly time for India to adopt a more mature approach as well as the introduction of anti-avoidance measures in China has not impacted its FDI outlook. In fact, according to the UNCTAD World Investment Report 2012, transnational corporations rated China as the top investment destination for 2012-14, above USA.

[6] Asia Pacific Tax Notes 2012. Lead Article. PwC. Accessed here: http://www.pwccn.com/webmedia/doc/634747679324207057_aptn_jun2012_leadarticle.pdf

III. COMMENTS ON SOME OF THE RECOMMENDATIONS IN THE DRAFT REPORT OF THE SHOME COMMITTEE

Shome Committee Recommendation	*CBGA Submission*
The implementation of GAAR may be deferred by three years on administrative grounds.	The previous Finance Minister had announced that the Ministry is ready to roll this out in 2013. In addition, the draft DTC has been in consideration since 2009, which leaves ample time for administration to put in place the required processes to implement GAAR by 2013. If there are serious administrative hurdles, this should be flagged by the Revenue Department. But no such indication has been given by the recently released guidelines on GAAR by the Ministry of Finance. Therefore, we do not believe there is a strong enough case to postpone GAAR by 3 years. We do support prospective application of GAAR which should be rolled out from 2013 as initially proposed.
Abolish the tax on gains arising from transfer of listed securities, whether in the nature of capital gains or business income, to both residents as well as non-residents.	Abolishing capital gains tax would only mean that the government is favouring speculative finance, which would not be advisable considering the recent global financial crisis.
Only arrangements which have the main purpose (and not one of the main purposes) of obtaining tax benefit should be covered under GAAR.	This will dilute the deterrent effect that GAAR is expected to have. The version in the Finance Bill 2012, passed by the Parliament, should be retained: "An arrangement whose main purpose or one of the main purposes is to obtain a tax benefit…. can be declared as an "impermissible avoidance arrangements".
No treaty override	Anti-abuse provision should override treaties as has been explained by the OECD as well. As per the 2010 Commentary to Article 1 of

	the OECD Model Convention, the purpose of tax treaties includes prevention of tax avoidance and evasion. 7.1 states that "*Taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries' laws. Such attempts may be countered by provisions or jurisprudential rules that are part of the domestic law of the State concerned. Such a State is then unlikely to agree to provisions of bilateral tax treaty that would have the effect of allowing abusive transactions that would otherwise be prevented by the provisions and rules of this kind contained in its domestic law*[7]".
Where Circular No. 789 of 2000 with respect to Mauritius is applicable, GAAR provisions shall not apply to examine the genuineness of the residency of an entity set up in Mauritius.	In the CBDT, GoI report on Measures to Tackle Black Money[8], the report notes that the use of "Mauritius route and other tax havens, as channel for avoiding payment of taxes in India, with the help of loopholes in bilateral agreements on double taxation" could be stopped by withdrawing or amending Circular No. 789 issued by CBDT. With the acceptance that the circular itself could be a contributing factor to making Mauritius a haven for black money, the usage of this circular and Mauritius route should be applicable to GAAR provisions to address black money as suggested in the Government of India report.

[7] Also see articles 8, 9, 9.5 of OECD Model Tax Convention on Income and on Capital (Condensed Version), 2010
[8] Measure to tackle black money in India and abroad 2012, CBDT, Ministry of Finance, GoI

IV. CONCLUSION

CBGA supports the introduction of a strong and effective GAAR, as has been passed by the Parliament in the Finance Act for 2012-13, which shows that the government is serious about addressing the large scale tax avoidance taking place which are getting increasingly sophisticated with the help of a network of law firms/consultancy firms and advisors. We do not support the attempts by vested business interests attempting to dilute the provisions of GAAR to suite their narrow profit-making perspective. The above submission is keeping in view the socio-political ramifications of addressing tax avoidance that would allow the government to mobilise revenue so that this can be spent on much needed social infrastructure in the country such as education, healthcare, food security and so on.

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