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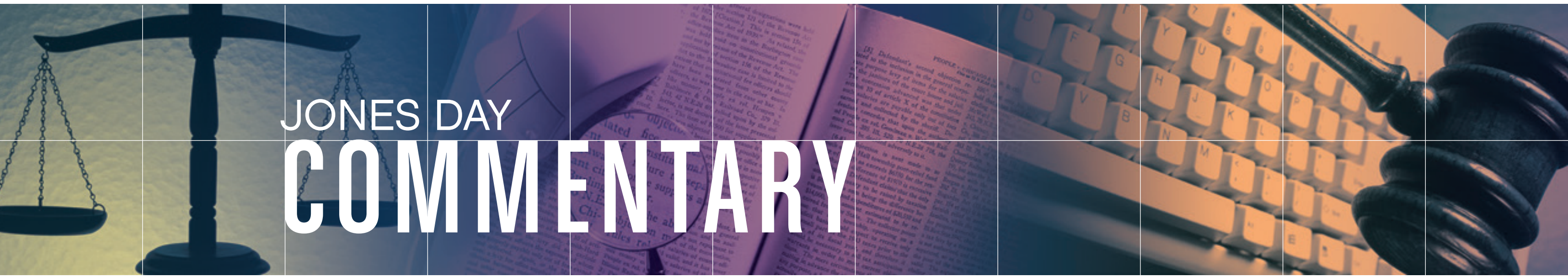

RECOMMENDATIONS OF THE EXPERT COMMITTEE ON THE INDIAN GENERAL ANTI-AVOIDANCE RULE: A WELCOME STEP

On September 1, 2012, the Shome Committee, which was constituted by Indian Prime Minister Manmohan Singh to review the General Anti-Avoidance Rule (the "GAAR"), submitted its 108-page Expert Committee Report to the Indian Government. The Committee recognized the GAAR's adverse impact on foreign investment in India and proposed safeguards to prevent the Indian tax authorities from applying the GAAR indiscriminately. It also proposed a three-year delay to the implementation of the GAAR and the grandfathering of existing investments. The Committee is scheduled to submit finalized guidelines and an implementation roadmap by September 30, 2012. Below is a summary of the key recommendations of the Committee.

DEFERRED IMPLEMENTATION OF GAAR

The Committee recommended that the GAAR's implementation be deferred to the tax year 2016–2017 to give the tax administrator sufficient time to train its officers. It also recommended that the Government immediately announce this to remove investor uncertainty.

GAAR APPLICABLE ONLY TO ABUSIVE, ARTIFICIAL, AND CONTRIVED ARRANGEMENTS

The Committee's guidelines clarified that the GAAR is subject to the overarching principle that the GAAR should operate only against certain instances of tax avoidance. Cases of tax mitigation and of tax avoidance that do not involve abusive, artificial, and contrived arrangements should not be subject to the GAAR. In this regard, the Committee suggested having a list of scenarios where the GAAR should not be invoked. These include:

- Selection of one option over a number of options offered in law (e.g., dividends vs. share buyback, branch vs. subsidiary, debt vs. equity, and purchase vs. lease of capital assets).
- Timing of transactions (e.g., selling property at a loss while profiting in other transactions).
- Court-approved mergers and spin-offs.
- Intra-group transactions that do not result in a loss in overall tax revenue.

GRANDFATHERING EXISTING INVESTMENTS, NOT EXISTING STRUCTURES

The Committee recommended that existing arrangements or structures should not be grandfathered; rather, it proposed that existing investments as of the date of commencement of the GAAR should be grandfathered and, thus, outside the scope of the GAAR when divested. Alternatively, in the event that the Government decided not to defer the GAAR's implementation, the Committee proposed that it apply only to income received or accruing to taxpayers after April 1, 2013.

BURDEN OF PROOF ON TAX AUTHORITIES

The Committee proposed that the onus be placed on the tax authorities to establish that the conditions for invoking the GAAR were satisfied, including a requirement that tax authorities provide the taxpayer detailed reasoning for their initiation of GAAR proceedings and fully disclose the information that they possess.

GAAR NOT APPLICABLE WHERE THERE IS A SAAR

The Committee recommended that the GAAR should not be invoked in cases where there is already a specific applicable anti-avoidance rule ("SAAR"). Similarly, where there is a double taxation agreement ("DTA") that has built-in anti-avoidance provisions (for example, the limitation of benefits clause found in the Singapore–India DTA), the GAAR should not override the DTA. Conversely, where a DTA does not have a built-in anti-avoidance provision, the GAAR may be considered in appropriate cases.

DE MINIMIS RULE

The GAAR should not be invoked in cases where the tax benefit (excluding interest) is less than INR 30,000,000 (approximately US$675,000). The Committee also recommended that tax audit reports prepared by auditors of the taxpayer should specifically report instances of tax where the tax benefit was at least INR 30,000,000 .

THE MAIN PURPOSE OF AN "IMPERMISSIBLE AVOIDANCE ARRANGEMENT" SHOULD BE TO OBTAIN TAX BENEFITS

The Committee also proposed clarification of the definition of an "impermissible avoidance arrangement" ("IAA") under the GAAR. In particular, an IAA should be confined to an arrangement whose main purpose is to obtain tax benefits (as opposed to any arrangement that has the obtaining of tax benefits as *one of* its main purposes).

COMMERCIAL SUBSTANCE TEST

The Committee proposed clarification of the concept of "commercial substance." The Committee suggested that an arrangement should be deemed to be lacking commercial substance if it did not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from the tax benefits the GAAR enjoined. Transactions involving round-tripping, or those that are self-cancelling in nature, would therefore be deemed to be lacking commercial substance. In contrast, the choice of a particular location for an asset, transaction, or residence should have substantial commercial purpose.

"CONNECTED PERSON" TO BE LIMITED ONLY TO "ASSOCIATED PERSONS" AND "ASSOCIATED ENTERPRISE"

Under the GAAR, a "connected person" is defined very broadly to mean any person directly or indirectly connected to another person, including associated persons. The Committee recommended that the definition of "connected person" be restricted to "associated persons" and "associated enterprises" (as defined in the Income Tax Act 1961), which is defined to mean two or more persons who join for a common purpose with a view to earn an income and where the term "person" includes any company or association or body of individuals, whether incorporated or not.

CERTIFICATE OF RESIDENCE ISSUED BY THE TAX AUTHORITIES IN MAURITIUS

Circular No. 789 of 2000 provides that a certificate of residence ("COR") issued by the Mauritian tax authorities is sufficient evidence of the residence and beneficial ownership status of a taxpayer for purposes of claiming DTA benefits. The Committee recommended that the GAAR should not be invoked to examine the genuineness of the residency of a Mauritius entity when Circular No. 789 applies.

FOREIGN INSTITUTIONAL INVESTORS

The Committee proposed that the GAAR should not be invoked if a Foreign Institutional Investor ("FII") decided not to avail itself of any DTA benefits. Similarly, nonresident investors who invested directly or indirectly in an FII should be exempt from the GAAR for investments the FII makes in listed securities in India.

CAPITAL GAINS TAX

The Committee proposed that capital gains tax should be abolished on transfer of listed securities.

WITHHOLDING TAX

The report argued that tax authorities should not invoke the GAAR in processing applications for reduced withholding tax at source if the taxpayer also submitted a satisfactory undertaking to pay any tax and interest, unless it is found that the GAAR was applicable in relation to the remittance.

TIME LIMITS

The Committee also suggested that, in cases where a taxpayer has filed objections, the Commissioner be required to make a reference to the Approving Panel within 60 days. It also recommended that the Commissioner provide a copy of the reference to the taxpayer.

ADVANCE TAX RULINGS FOR NONRESIDENTS WITHIN SIX MONTHS

It recommended that the tax administrator strengthen its administration so that residents and nonresidents alike may obtain an advance tax ruling within six months.

CONCLUSION

The Indian business community and foreign investors have welcomed the Committee's recommendations. The widespread consultative process initiated by the Government with various stakeholders before introducing the GAAR has been beneficial in providing feedback from the investor community. Although it remains to be seen what action the Government will take, the Committee's recommendations and sensible approach suggest that important provisions of the GAAR will be changed to encourage foreign investment and eliminate many of the GAAR's onerous provisions.

Jones Day does not practice Indian law, and the contents of this Commentary *do not constitute an opinion on or advice on Indian law.*

LAWYER CONTACTS

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