GAAR – Treaty Override Rider?

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Abstract:

*From a jurisprudential standpoint, in the absence of domestic law occupying the field, contents of International Conventions and norms assume significance in formulation of effective measures. Where domestic law occupies the field, principles of interpretation dictate that domestic law ought to be read harmoniously with International Conventions and norms, to the extent possible. However, in the event of an irreconcilable conflict, International Conventions and norms ought not to override domestic law, unless such treatment stands specifically sanctioned by the Legislature. Under the domain of international taxation, the Legislature has given an overriding effect to the provisions contained in the applicable Double Taxation Avoidance Agreement (**"DTAA"**), to the extent the same are more beneficial to a taxpayer than the corresponding provisions contained in the Income-tax Act, 1961 (**"ITA"**). This override right has, however, specifically been made subject to the General Anti-Avoidance Rule ("**GAAR"**) contained in Chapter X-A of the ITA. In fact, on a closer look, GAAR, ever since its induction and coming into effect, is actually a rider to all kinds of anti-abuse provisions contained in all the DTAAs that India has entered into, including amendments made post "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting".*

Introduction:

In India, the Executive is responsible for entering into an agreement with other countries. The content of such agreement, however, has to be included within the domestic law framework by the Legislature, so as to bind the institutions that it seeks to address. Accordingly, in India, there is no automatic operation or penetration of an agreement entered into at an international level in the domestic framework.

Therefore, as far as the legal domain is concerned, Parliamentary supremacy is absolute. In matters of taxation, provisions of the ITA, enacted by the Parliament, hold field. As per section 90(1) of the ITA, the Parliament has empowered the Executive to enter into a DTAA with the Government of any country outside India, for matters concerning taxation and relief therefrom. As per section 90(2) of the ITA, the Parliament has conferred a choice upon a taxpayer to seek entitlement of the provisions of the applicable DTAA or the provisions of the ITA, whichever are more beneficial. Therefore, the Parliament in the context of international taxation, has endorsed applicability of the provisions of the DTAA, only to the extent the same are more beneficial relative to the corresponding provisions in the ITA.

However, this choice given to a taxpayer between the provisions of the ITA or the applicable DTAA is limited by section 90(2A) of the ITA. Section 90(2A) of the ITA is a non-obstante provision and the sole exception to the treaty override provision contained in section 90(2) of the ITA[1]. It is a non-obstante provision, which provides that notwithstanding anything contained in section 90(2) of the ITA, provisions of Chapter X-A shall mandatorily apply, "***even if*** such provisions are not beneficial" to the taxpayer in question. Chapter X-A of the ITA embodies the concept of GAAR. In order for this phrase, "***even if*** *such provisions are not beneficial*" to not be rendered redundant, the provisions of GAAR must apply, irrespective of whether or not they are more beneficial in comparison to any anti-abuse provision in any DTAA that India has entered into.

Construct of Chapter X-A:

As per section 95(2) of the ITA, GAAR is stated to be applicable for Assessment Year (**"AY"**) beginning on or after April 01, 2018. As per section 95(1) of the ITA, Income Tax Department is entitled to declare an arrangement entered into by a taxpayer to be an "*impermissible avoidance arrangement*". This term is of the widest amplitude and is defined under section 96(1) of the ITA to mean an arrangement, the main purpose of which, is to obtain a "tax benefit", and which, inter-alia, lacks commercial substance or is deemed to lack commercial substance, in whole or in part, or is entered into, or carried out, by means, or in a manner, which is not ordinarily employed for bona fide purposes. The term "*tax benefit*" also has an expansive meaning. As per section 102(10)(c) read with section 102(11) of the ITA, "*tax benefit*" includes a reduction or avoidance or deferral of tax or other amount that would be payable under the ITA, as a result of a DTAA. In the event of an arrangement being declared an "*impermissible avoidance arrangement*", tax consequence include denial of "tax benefit" or benefit under the applicable DTAA, as the case may be.

Section 144BA of the ITA sets out safeguards and standards against misuse of Chapter X-A of the ITA by an Assessing Officer (**"AO"**). If an AO, having regard to the material and evidence, deems it necessary to declare an arrangement to be an "impermissible avoidance arrangement", then, the AO is required make a reference to a Commissioner. If the Commissioner concurs with the AO, then, the Commissioner is required to issue a notice to the concerned taxpayer, setting out reasons for formulation of opinion by the Commissioner and enabling an opportunity of being heard to the taxpayer. If no objection is received by the Commissioner from the taxpayer, then, the Commissioner is entitled to issue appropriate directions, declaring the arrangement in question to be an "*impermissible avoidance arrangement*". If, however, the taxpayer objects to the proposed action of the Commissioner and the Commissioner is not satisfied with the explanation offered by the taxpayer, then, the Commissioner is required to refer the matter to the Approving Panel. The Approving Panel is entitled to conclusively declare the arrangement in question to be an *"impermissible avoidance arrangement"*, however, before such declaration by the Approving Panel, an opportunity of being heard is required to be provided by it to the taxpayer. The directions issued by the Commissioner or the Approving Panel, as the case may be, are binding on the AO and the AO is required to frame assessment in conformity therewith. Prior approval of Principal Commissioner of Commissioner is a sin qua non for determination of tax consequence in Chapter X-A of the ITA.

As per section 101 of the ITA read with Rule 10U(1) of the Income-tax Rules, 1962 (**"Rules"**), Chapter X-A of the ITA, while applicable, cannot be pressed into operation for denial of a "tax benefit", where the case of a taxpayer falls within one of the conditions prescribed under the said Rule. Therefore, Rule 10U(1) of the Rules encapsulates exceptions from the applicability of Chapter X-A of the ITA or GAAR, in the event any of the below mentioned conditions stand satisfied:-

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Rule 10U(1)(a): an arrangement in which "tax benefit" in the

	relevant AY arising, in aggregate, to all parties to an arrangement does not exceed INR 3,00,00,000/-;
Rule 10U(1)(b):	a Foreign Institutional Investor ("**FII**"), upon fulfillment of specified conditions;
Rule 10U(1)(c):	a non-resident, in connection with investments made by way of offshore derivative instruments or otherwise, directly or indirectly, in a FII; or
Rule 10U(1)(d):	any income accruing or arising to or deemed to accrue or arise to or received or deemed to be received by, any person from transfer of investments made before April 01, 2017, by such person[2]. Therefore, Rule 10U(1)(d) of the Rules is a grandfathering provision, protecting retrospective applicability of Chapter X-A qua capital gains derived from investments already made before the coming into force of Chapter X-A of the ITA.

Domestic Anti-Avoidance and DTAA Override:

The supremacy clause, i.e., section 90(2A) of the ITA, should be viewed from the lens of absolute authority and exclusivity of the Parliament in formulating laws. Viewed accordingly, Chapter X-A of the ITA, codifying GAAR or the "*doctrine of substance over form*"[3], repudiates anti-abuse provisions contained in all the DTAAs that India has entered into. It is incumbent upon the Income Tax Department to apply the provisions contained in Chapter X-A of the ITA, including adopting the procedure under section 144BA of the ITA, notwithstanding the content of the anti-abuse provision contained in the applicable DTAA.In the event the provisions contained in Chapter X-A of the ITA are more beneficial than the anti-abuse provisions contained in the applicable DTAA, in terms of sections 90(2) and 90(2A) of the ITA, the former shall supersede the latter. Therefore, where Chapter X-A of the ITA read with Rule 10U(1) of the Rules, exempts certain transactions from the anti-abuse radar, it is not open for the Income Tax Department to simply surpass this explicit Legislative mandate, and to apply the anti-abuse provision contained in the applicable DTAA or even invoke the judicially evolved "*substance over form*"[4]. Specific instances of the beneficial provisions contained in Chapter X-A of the ITA holding field, are comprehensively set out below: -

(a) DTAA between India and Singapore ("**India – Singapore DTAA**"):-

From an Indian source taxation point of view, Article 13(4) of the India – Singapore DTAA, prior to its amendment in 2017, provided that capital gains from the transfer of shares of an Indian company by a Singaporean Resident, would be taxable in Singapore alone. This benefit was, however, subject to the anti-abuse provision contained in Article 3 of the 2005 Protocol to the India – Singapore DTAA.

Post amendment with effect from April 01, 2017, Article 13(4) of the India – Singapore DTAA was substituted by the existing Article 13(4A) to Article 13(5) of the India – Singapore DTAA. Article 13(4A) of the India – Singapore DTAA provides that capital gains from transfer of shares of an Indian company acquired on or before April 01, 2017, by a Singaporean Resident, are taxable in Singapore alone. This grandfathering provision has been made subject to the anti-abuse provision contained in Article 24A of the DTAA[5]. Therefore, the only exception to the availability of this grandfathering benefit, is the applicability of the anti-abuse provision contained in Article 24A in the India – Singapore DTAA, which requires that:-

1. The affairs of the Singaporean Resident transferor are not arranged with the primary purpose of taking advantage of, inter-alia, the grandfathering provision under Article 13(4A) of the India – Singapore DTAA. In other words, this condition requires that the Singaporean Resident transferor,

be a legal entity, having bona fide business activity.
2. The Singaporean Resident transferor is not a shell or a conduit. This condition requires that the Singaporean Resident transferor is not a legal entity with negligible or nil business operations or with no real and continuous business activities. The threshold for recognizing a legal entity as a shell or a conduit company has also been objectively set out in Article 24A of the India – Singapore DTAA.

The conundrum around taxability of capital gains, in the context of the India – Singapore DTAA has been recently settled[6]. It has been held by the Delhi High Court that the benefit under the capital gains provision under Article 13 of the India – Singapore DTAA, cannot be denied where:

1. The transferor of shares is a Resident of Singapore for tax purposes. To this end, it has been settled that the Tax Residency Certificate furnished by the transferor is irrefutably required to be accepted;
2. Such Singaporean Resident transferor is the legal owner of the asset, from transfer of which, capital gains have been derived.
3. The Singaporean Resident transferor meets the requisite threshold(s) under the anti-avoidance provision in the India – Singapore DTAA.

This position is fairly straightforward. Essentially, the allocation of taxing rights to Singapore qua capital gains arising to a Singaporean Resident, as per Article 13(4A) of the India – Singapore DTAA [erstwhile Article 13(4)], would cease, if requisites under the anti-abuse provision, i.e., Article 24A of the India – Singapore DTAA [erstwhile Article 3 of the 2005 Protocol], are not satisfied.

However, if at this point, one applies section 90(2A) of the ITA, which provides that the provisions of Chapter X-A of the ITA ought to apply mandatorily, Rule 10U(1)(d) of the Rules would kick in to automatically exempt transfer of shares acquired prior to April 01, 2017, from the antiabuse radar. This is also because this Rule being more beneficial to the taxpayer, would always take precedence given the mandate of section 90(2) of the ITA. Therefore, where the Parliament exempted certain transactions from the anti-abuse radar, there is no occasion for anyone to test the transaction under the anti-abuse provision contained in Article 24A of the India – Singapore DTAA. An interpretation that undermines the supremacy of Parliament as against an International Convention, would be wholly contrary to the scheme of the Indian Constitution. Therefore, the "*grandfathering*" or the "*tax benefit*" as per Article 13(4A) of the India – Singapore DTAA, as it stands today, is absolute and cannot be denied to a Singaporean resident holding a valid Tax Residency Certificate.

In fact, because of Rule 10U(1)(d) of the Rules, capital gains arising from transfer of investment made prior to April 01, 2017, cannot be subjected to any kind of anti-abuse scrutiny in India, irrespective of whether there is a DTAA operating in a factual scenario or not.

(b) DTAA between India and Mauritius ("**India – Mauritius DTAA**"): -

The case of the DTAA between India and Mauritius ("**India – Mauritius DTAA**") is even more curious. Article 13(4) of the India – Mauritius DTAA, prior to its amendment with effect from April 01, 2017, provided that capital gains from transfer of shares in an Indian company by a Mauritian Resident, would be taxable in Mauritius alone. Post the amendment with effect from April 01, 2017, Articles 13(3A) and (3B) were inserted in the India – Mauritius DTAA.

As per Article 13(3A) of the India – Mauritius DTAA, capital gains from transfer of Indian company shares acquired on or after April 01, 2017, by a Mauritian Resident, are entitled to be taxed in India. As per Article 13(3B) of the India – Mauritius DTAA, capital gains in terms of Article 13(3A) of the India – Mauritius DTAA, arising between a period of April 01, 2017, and April 01, 2019, are entitled to be taxed at a concessional rate. Further, even post amendment with effect from April 01, 2017, capital gains from transfer of Indian company shares acquired before April 01, 2017, by a Mauritian Resident, are taxable in only in Mauritius, as per the subsisting residuary provision, i.e., Article 13(4) of the India – Mauritius DTAA. Accordingly, capital gains from transfer of shares of an Indian company acquired before April 01,

2017, by a Mauritian Resident, are grandfathered under Article 13(4) of the India – Mauritius DTAA. Therefore, the India – Mauritius DTAA and the India – Singapore DTAA are identical insofar as the benefit of allocation of taxing rights in respect of capital gains arising to a Mauritian or Singaporean Resident, respectively, is concerned.

The critical difference between the India – Singapore DTAA and the India – Mauritius DTAA is the difference in the operation of the anti-abuse provisions contained in each of the DTAAs. The anti-abuse provision contained in the India – Mauritius DTAA, i.e., Article 27A of the India – Mauritius DTAA, can only be invoked to deny the benefit of the concessional rate of tax on gains in terms of Article 13(3A) of the India – Mauritius DTAA. Simply put, unlike the India – Singapore DTAA, there is no corresponding anti-abuse provision in the India – Mauritius DTAA, operating as an exception to the grandfathering of capital gains arising on account of sale of shares acquired prior to April 01, 2017.

Therefore, in the context of India – Mauritius DTAA, only anti-abuse provision under Chapter X-A of the ITA can be invoked, if at all, for denying the grandfathering benefit, as elaborated above. However, as has been previously stated, section 101 under Chapter X-A of the ITA read with Rule 10U(1)(d) of the Rules specifically exempts capital gains derived from transfer of investments made April 01, 2017, from the ambit of domestic anti-abuse provisions. Accordingly, the grandfathering benefit, in respect of capital gains arising from transfer of shares of an Indian company, acquired before April 01, 2017, cannot be denied at all to the Mauritian Resident provided it holds valid Tax Residency Certificate[7].

In fact, even if the provisions contained in Chapter X-A of the ITA are less beneficial than the anti-abuse provisions contained in the applicable DTAA, in terms of the rider, i.e., section 90(2A) of the ITA, the former shall supersede the latter. For instance, Article 24 of the DTAA between India and the United States of America ("**India – USA DTAA**") contains the Limitation on Benefits clause that seeks to curb treaty shopping. As per Article 24(1)(a) of the India – USA DTAA, an entity, which is a Resident of USA is assured tax benefits under the India – USA DTAA, if more than 50% of the beneficial interest therein is inter-alia owned directly or indirectly, by one or more individual Residents of either the USA or India. For such an entity, therefore, tax benefits under India – USA DTAA cannot be denied. However, it may be open for the Income Tax Department to deny such an entity tax benefit sought by it under the India – USA DTAA, by invoking GAAR, since, as has been stated, in terms of section 90(2A) of the ITA, provisions of GAAR must apply, notwithstanding the contents of the anti-abuse provision contained in the applicable DTAA.

Conclusion : The Parliamentary Supremacy Paradox:

To conclude, at the cost of repetition, in India, domestic law and International Conventions do not encompass a unified legal order, inasmuch as International Conventions penetrate into the domestic law and interact with it, only as per the conditions set out in the domestic law by the Parliament[8]. Parliament has dictated that codified anti-avoidance provision ought to supersede any negotiated International Convention, insofar as denial of any tax benefit provided for in the International Convention is concerned. Given this unequivocal mandate, there is no choice available with the Income Tax Department, but to test the facts of each case against the standards specifically set out and thereafter, to apply the procedures put in place, under the ITA, before denying any tax benefit otherwise available to a taxpayer under the applicable DTAA. Since DTAAs have no effect, nor can the DTAAs be applied to deny a tax benefit, the exercise to decipher whether anti-abuse provision under the applicable DTAA is more beneficial than that, which has been codified in Chapter X-A of the ITA, is one in futility. Therefore, as against the general principle that DTAAs apply to the extent the provisions contained thereunder are more beneficial to a taxpayer than the corresponding provisions contained in the ITA, in the context of antiabuse provision, Chapter X-A of the ITA is mandatorily required to be applied in the manner set out under section 144BA of the ITA. Consequently, the authors argue that anti-abuse provision in every DTAA, including Multinational Conventions, has been rendered redundant by the Parliament, by virtue of coming in force of Chapter X-A of the ITA read with section 90(2A) of the ITA.

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[1] Skaps Industries India Private Limited vs. ITO [TS-7455-ITAT-2018(Ahmedabad)-O]

[2] It is relevant to also take note of the "without prejudice" provision, i.e., Rule 10U(2) of the Rules. Rule 10U(2) of the Rules makes provisions of Chapter X-A of the ITA applicable on any arrangement,

irrespective of the date at which it has been entered into, in respect of "tax benefit" obtained therefrom on or after April 01, 2017. As per the decision in **Mohd. Riyazur Rehman Siddiqui vs. Deputy Director of Health Services**, [2008] (2) TN MAC 386 (FB) (Bombay High Court) and **Somyendra Roy Choudhary vs. UCO Bank and Others**, [2016] AIR CC 1474, a "*without prejudice*" provision does not affect the operation of the other provision, or any action taken under the "*without prejudice*" provision must not be inconsistent with the other provision. Therefore, the "*without prejudice*" provision, i.e., Rule 10U(2) of the Rules, applies to cases not specifically covered under Rule 10U(1)(d) of the Rules, i.e., to cases not involving transfer of investments made before April 01, 2017.

[3] Section 97 of the ITA (which part of Chapter X-A of the ITA) provides a deeming fiction as to when an arrangement could be considered to be lacking commercial substance.

[4] Reverse Age Health Services Pte Ltd. vs. DCIT [TS-67-ITAT-2023(DEL)]

[5] Article 24A of the India-Singapore DTAA is a mirror image of Article 3 of the 2005 Protocol to the India-Singapore DTAA and the same was inserted simultaneous to the deletion of Article 3 of the 2005 Protocol to the India-Singapore DTAA, with effect from April 01, 2017.

[6] Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd. vs. ACIT [TS-26-HC-2023(DEL)]

[7] In such a scenario, recourse to judicially evolved doctrine of "substance over form" cannot be resorted to either since the same stands codified in section 97 of the ITA, which is part of Chapter X-A, which also would stand excluded by virtue of Rule 10U(1)(d) of the Rules. Please see Reverse Age Health Services (supra).

[8] Gramophone Company of India Ltd. vs. Birendra Bahadur Pandey and Ors., (1984) 2 SCC 534 and Commissioner of Customs vs. G.M. Exports [TS-518-SC-2015-CUST]