International taxation Anti-avoidance Provisions

under the Income-tax Laws

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Place of effective management

under Income-tax Act, 1961

Section 6 (3) of ITA

A company is said to be resident in India in any previous year, if—

(i) it is an Indian company; or

(ii) ~~during that year, the control and management of its affairs is situated wholly in India.~~

Following clause (ii) shall be substituted for the existing clause (ii) wef 1st April, 2016 namely –

(ii) its place of effective management~~, at any time~~ in that year, is in India.

Explanation - "For the purposes of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made."

Explanatory Memorandum to FB 2015

Due to the requirement that whole of control and management should be situated in India and that too for whole of the year, the condition has been rendered to be practically inapplicable. A company can easily avoid becoming a resident by simply holding a board meeting outside India. This facilitates creation of shell companies which are incorporated outside but controlled from India. POEM is an internationally recognized concept for determination of residence of a company incorporated in a foreign jurisdiction….

…. Most of the tax treaties entered into by India recognise the concept of 'POEM' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation. Many countries prefer the POEM test to be appropriate test for determination of residence of a company. The principle of POEM is recognized and accepted by the OECD also. The OECD commentary on model convention provides definition of POEM to mean the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole, are, in substance, made.

The modification in the condition of residence in respect of company by including the concept of effective management would align the provisions of the Act with the DTAAs entered into by India with other countries and would also be in line with international standards. It would also be a measure to deal with cases of creation of shell companies outside India but being controlled and managed from India.

POEM in International Tax Treaties

- Article 4(3) – Residence
- Dual Residence for companies- Tie Breaker rule applicable
  - Deemed to be resident of the Contracting State where PoEM is situated
  - If POEM difficult to be determined, then 'MAP' route to determine tax residence
  - PoEM not defined in treaty –
    - Meaning of undefined terms Art. 3(2)
    - Recourse to ITA or autonomous meaning?
  - POEM being abandoned for tie-breaker in treaties [MLI Art. 4]

C&M & POEM – permanence attribute

- C&M
  - Subbayya Chettiar (HUF) [(1951)19 ITR 168 (SC)]

    "C&M signifies the controlling and directive power, the head and brain as it is sometimes called, and situated implies the functioning of such power at a particular place with some degree of permanence, ….

- *POEM –*
  - *"(ii) its place of effective management~~, at any time~~ in that year, is in India."*
  - To exclude from POEM stray instances of decision-making in India (like a single BoD meeting) *[Hon. FM in Lok Sabha]*
  - No snapshot approach –
    - guiding principles to be seen with reference to activities performed over a period of time during the previous year *[POEM Guidelines para 10]*.

C&M – *fragmentation attribute*

- C&M rule for residence
  - wholly in India (for companies) rule (until 31.3.2017)
  - wholly outside India (for non-companies) rule
- C&M can be in more than one place where its central authority is divided *[Koitaki Para Rubber Estates Ltd. versus Federal Commissioners of Taxation (1941) 64 O.L.R. 15, 241].*
- Subbayya Chettiar (HUF) [(1951)19 ITR 168 (SC)
  - *The word 'wholly' indicates the possibility of the seat of such power being divided between two distinct and separated places.*
- Nandlal Gandalal [40 ITR 1 (SC)]
  - The words "control and management" have been figuratively described as "the head and brain“.
  - The income-tax law anticipated that control and management of the affairs of Hindu undivided families (firms and association of persons) might easily be in two or more places, one or more coparceners being within the taxable territories and the other or others, without
- Narottam Pereira [23 ITR 454 (Bom)]
  - The word 'situated' implies the functioning of such power at a particular place with some degree of permanence, while 'wholly' recognises the possibility of the seat of such power being divided between two distinct and separated places".

POEM – What has changed?

- POEM - “wholly” absent, but…
  - Entity can have only one poem at any point of time [Guidelines, para 6]
    - Echoes OECD Model Comm [Art. 4, para 24]
      - Art. 4(3) – tie-breaker rule - to determine one place of residence
  - If POEM in India and also outside India in a previous year [Guidelines, para 10]
    - POEM presumed to be in India if it has been mainly/predominantly in India
      - ‘Main/predominant’ indicates the duration of time POEM in India

POEM definition –component parts

- POEM defined
  - *For the purposes of this clause "place of effective management" means a place where*
    - *key management and commercial decisions*
    - *that are necessary for the conduct of the business*
    - *of an entity as a whole*
    - *are, in substance made.*
- Circular No. 6 of 2017 dated 24.1.2017 [PoEM Guidelines]
- Circular No. 8 of 2017 dated 23.2.2017
  - Sec 6(3)(ii) not to apply to a company having turnover or gross receipts < = Rs. 50 Crore in a financial year *[Circular No. 8 of 2017]*
- Circulars will continue provided they are not inconsistent with the provisions of the new Act *[ITA 2025, s. 536(2)(j)]*

OECD Model Commentary

- PoEM Circular echoes OECD thinking
  - Place where key management and commercial decisions that are necessary for the conduct of entity's business are in substance made
  - Ordinarily, the place where the most senior person(s) (BoD) make decisions, or the place where actions to be taken by the entity as a whole are determined
  - More than one place of management possible – but only one place of effective management at a point in time
  - the place where the corporate's headquarters is located
  - the country which governs the legal status of the person
  - the place where accounting records are kept
- Evolution of para 24 of OECD Art 4 Comm.
  - until 1992, para 24 -"this expression (POEM) means the effective management of the enterprise"
  - 2000 Update –the place "*where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made and will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined.*"
  - 2008 Update - dropped the words "*the place where the most senior person or group of persons (for example a board of directors)*" – to accommodate Board-run and executive-run variations

POEM definition – entity as a whole

- Decisions necessary for the conduct of the business of the entity as a whole
  - Business of the entity –
    - Contrast with the old rule "*control & management of its affairs*"
    - Does the POEM rule apply only to entities carrying on business?'
      - eg. Companies not carrying on business, having income under other heads
    - 'Business' refers to the affairs of the company (in contrast to business carried on by it)?
  - the entity 'as a whole' –
    - Indicates a high degree of the pervasiveness of the expected impact of the decisions

C&M and POEM – A comparison

- C&M – pre-eminence to the location of the seat of *de facto* power
  - it is not the servants and agents that constitute the seat of power or the controlling and directing power. It is that authority to which the servants, employees and agents are subject, it is that authority which controls and manages them, which is the central authority. [Narottam Pereira [23 ITR 454 (Bom)]
  - Not to confuse the doing of business with central control and management of that business.
- POEM – key managerial and commercial decisions for the conduct of the business of the entity as a whole
  - ABOI – place where BoD meetings held or where persons making key decisions reside (if BoD standing aside)
  - NABOI – place where key decisions are in fact made
  - POEM to be based on all relevant facts related to the management and control of the company [POEM Guidelines, para 9]
  - Place where key decisions relating to the business of the entity as a whole are taken - converges with the seat of *de facto* power (C&M) also

Key management and commercial decisions

- Board (head & brain) vs Top-level Management (for POEM)
- General overview of how a company is run a useful indicator for POEM
- De facto (not de jure) exercise of decision-making power relevant
- Residence will not fluctuate merely by reason of individual decisions taking place in different territories

Key management and commercial decisions – illustrative list

Key management decisions

- Appointment, termination, compensation of key management personnel
- Global IT systems and MIS reporting
- M&A, restructuring, divestment
- Master sourcing agreements for goods and services
- Code of Conduct, Group ethos and Ethics
- Organizational reporting structure and key organization / management decisions

Key commercial decisions

- Sourcing of Raw Materials, selection of distributors and its quality control.
- Negotiations/execution of key contracts – laying down norms
- Borrowings, Capital Sourcing
- Product-mix decisions, manufacturing decisions
- Product pricing
- Expansion and modernization
- Accounting policies, R&D,
- IP licences, trademark/patent registrations

Key decisions of strategic significance to the organization
Holistic assessment of both management **and** commercial decisions

Active business outside India [para 5]

- Cumulative conditions
  - If passive income <= 50% of its total income.
  - Less than 50% of total assets situated in India.
  - Less than 50% of total number of employees situated in India or resident in India
  - Payroll expenses on such employees < 50% of total payroll expenses
- Passive Income – aggregate of
  - Income from transactions where both purchase and sale from/ to AEs
  - Royalty, Dividend, Capital Gains , Interest or Rent
- Income
  - As computed for tax purpose in country of incorporation or
  - As per books where no such computation required

Active business outside India

- Value of Assets
  - For individually depreciable asset –
    - Avg. value for tax purposes at beginning and end of year (as per country of incorporation)
  - For FA Block –
    - avg value for tax purposes at beginning and end of year
  - For any other asset –
    - as per books
- Number of employees
  - Avg. no. of employees at the beginning and at the end of the year
    - Includes persons who perform tasks similar to employees
- Payroll
  - Cost of salaries, wages, bonus and all other employee compensation costs borne by employer

If active business outside India

- If majority meetings of Board of Directors (BoD) outside India – POEM presumed outside India

- Exception- if BoD standing aside
    - i.e. powers of management are exercised by any other person resident in India – POEM in India
    - Merely because BoD follows general and objective principles of the group's global – BoD not standing aside
    - Regional Headquarters Companies in India serving group companies for payroll, accounting, HR functions, IT infrastructure and network platforms, supply chain functions, etc – BoD of group companies not standing aside

Non-ABOI

Two-stage process

- Identify or ascertain person(s) actually making key management and commercial decisions
- Determine the place where these decisions are made
  - Place where decisions are taken more important than the place where they are implemented
- Guiding principles

Non-ABOI – Guiding Principles

- Location where BoD regularly meets and makes decisions
- Where BoD has delegated some or all its authority to an executive committee – location of the members of the executive committee
- Location of HO
- Place where directors or persons taking decisions usually reside
- In case of Circular Resolution or Round Robin voting –location of person who has authority and exercises it to take decisions
- Matters reserved for shareholders' decisions - not relevant
  - However, where shareholder's involvement crosses the line of effective management – location where such decision is taken
- Examples of key commercial decisions affecting the company's business as a whole–
  - decision to open a major new manufacturing facility or to discontinue a major product line.
- Routine operational decisions by junior and middle management not relevant
  - Decisions by a plant manager appointed by senior management to run that facility concerning repairs and maintenance, implementation of company-wide quality controls and human resources policies
- If same persons take key management and commercial decisions as well as operational decisions– necessary to distinguish the former and assess the location.

Guidelines

- Secondary factors where above guidance fails to identify POEM *[para 8.3]*
  - Place of main and substantial activity or
  - Place of accounting records
- Isolated facts that do not establish PoEM *[Para 9]*
  - Completely owned by Indian Company
  - Existence of PE in India
  - One or some directors reside in India
  - Local management is situated in India in respect of Indian activities
  - Existence in India of support functions that are preparatory and auxiliary in character
- AO to seek prior approval of collegium of three commissioners to be constituted by PCIT

Case Study 1

Facts

The CEO of foreign SubCo has a power of attorney from its BoD with plenary powers of managing/ looking after its business. He has authority to take key decisions relating to SubCo's business.

He sends periodic reports to Indian HoldCo about progress of the business and expenses incurred. Regular accounts and cash flow statements are also sent to India. Instructions are issued by Indian HoldCo with reference to some of the matters connected with the business carried on overseas viz., on the number of personnel to be engaged, their wages, on optimizing costs, sale of produce at favourable market rates, etc.

Analysis/Posers

- Control and management of entity's affairs vs effective management of the company
- C&M where supervision/superintendence of managers carried out –
  - though manager exercises full authority in conduct of business, seat of power where his supervisors are
- Does PoEM push down examination to place where business decisions are taken?
- Decisions affecting the 'business of the entity as a whole' to be distinguished from decisions relating to running of the business -
  - Viz. To continue to carry on with the business, to arrange for capital, dealing with its profits or capitalising its losses

Case Study 2 -following advice

Facts

FCo is an overseas fund registered in a holding company jurisdiction by its parent, a US Company. FCo has made investments in India and other emerging markets. It earns dividend income and capital gains from India. Its Board consists of three directors, none of whom are resident in India. One is a professional director provided by a law firm that oversees regulatory compliances of FCo in that jurisdiction. All Board meetings are held only in that jurisdiction. FCo has engaged an investment advisory firm in India to advise it. FCo has an Investment Committee that makes recommendations to the Board on proposed investment decisions. The Committee consists of highly qualified members who are both Indian and foreign residents and holds its meetings both in India and outside.

Analysis/Posers

- Decisions by the Board, whether in substance made by the Board
- Following advice or direction of others *[Esquire Nominees (1973) 129 CLR 177]*

… even if ….the decision makers of the company did what the company's advisers told them to do, it did not necessarily follow that the c&m of the company's affairs lay with the advisers….. even if the advisers had power to exert influence on the company directors, that power of itself did not amount to the advisers exercising control and management of the company. Had the advisers instructed the directors to 'do something which they considered improper or inadvisable' not necessary that the directors would have acted on the instruction….. the directors in fact complied with the wishes of the advisers because they accepted that it was in the interest of the beneficiaries…..

Case Study 3- SPVs

Facts

ICo (an Indian company) incorporates SubCo in Mauritius as an SPV which was to hold an overseas investment for six months before divesting the same to ICo. Though the SPV had no commercial interest or gain from the transaction, this course of action was advised by Ico's advisors to be in the interests of the Group overall.

The Board of SubCo consists of two professional directors lent by a Mauritius law firm and the Company Secretary of ICo. The BoD elaborately discussed the decision to make the investment for short period not exceeding six months.

The Board also enquired about the tax and legal implications with the ICo's advisors and also made independent enquiries with its own lawyers about the legality and stamp duty implications of the proposed transactions. The BoD had extensive meetings in Mauritius to discuss these before taking the decision. All these meetings and events were duly minuted.

Case Study - SPVs

Analysis/Posers

- Short-term nature of SPV with specific mandate [Wood v Holden 8 [2005] EWHC 547 (Ch)]

  … possible and common in modern international finance and commerce for a company to be established which may have limited functions to perform, sometimes being functions which do not require the company to remain in existence for long. ….The mere fact that a 100% owned subsidiary carries out the purpose for which it was set up, in accordance with the intentions, desires and even instructions of its parent does not mean that central management and control vests in the parent. …..SPV are often brought into being for specific and short-term purposes, on the achievement of which they are wound down – does not shed any light on who has C&M

- Influence over the subsidiary different from control of the subsidiary or its key decision-making
- Whether Board's powers usurped or BoD a sham or abdication of its powers by the BoD?
- Indicators where BoD has abdicated its role [Development Securities Plc : [2020] EWCA Civ 1705]
  - Where BoD acts in breach of its duties towards the company when following Parent's directions
  - Where BoD takes decisions without having sufficient information
    - ill-informed or ill-advised decisions not by themselves indicate abdication by BoD
  - Where directors do not apply their minds –
    - some form of engagement by them with an attempt to understand the consequences of what they were signing or agreeing required, even if they are ill-informed.

Pointers

- Whether the BoD meets regularly to consider all strategic decisions to be made by the company?
- Whether the Board members have available documents and information necessary to consider the matters and take informed decisions?
- Do minutes record the discussions at the meeting of BoD and any issues/ questions raised by the directors?
- Do travel documents of decision-makers corroborate their attendance at BoD meetings when key decisions are taken?
- Do resident directors conduct themselves in such a way that may lead third parties to assume that they are authorised to negotiate on behalf of and bind the company without requiring approval of the BoD?
- Even where members participate through modern telecommunication means, the question of where key decisions are taken continues [POEM Guidelines recommend that HO to be where decisions are taken].

Specific anti-avoidance rules

Securities transactions *[s. 94] [ITA 2025, s. 175]*

- Bond washing [s. 94(1)]
  - Sells securities and reacquires same or similar securities
  - interest/dividend becoming payable to another person deemed to be his income and not income of any other person
  - No account to be taken of transaction in computing business profits of other person
- Bond washing [s. 94(2)]
  - Sells securities before interest/dividend accrues
  - Entire Interest/dividend deemed to be income of transferor
- Exemption from anti-bond washing provisions [s. 94(3)]
  - Assessee proves to AO's satisfaction that
    - there was no tax avoidance or
    - Avoidance was exceptional, not systematic and no avoidance of similar nature in past 3 years
- Anti-avoidance provision-
  - Systematic – planned, transfers far too distant to justify inference of tax avoidance [Vallabh Leasing (2004) 265 ITR 1 (MP)]

Securities transactions

- Dividend stripping *[sec. 94(7)]*
  - To earn dividend (when it was tax-free) and book STCL
  - Time range considered abusive with reference to record date
    - Securities - purchased 3 months prior to record date & sold within 3 months after
    - Units - purchased 3 months prior to record date & sold within 9 months after
  - STCL to be reduced by the amount of dividend
  - Both purchase and sale to fall in the time-range -conditions cumulative
    - Shambhu Mercantile Ltd 325 ITR 535 (Del)
    - Dividend stripping not sham or colourable per se; if conditions u/s 94(7) not cumulatively satisfied, loss to be allowed [Colvyn James Harris ITA No. 8925-Mum-2025 following Walfort Share & Stock brokers (SC)]
- Bonus stripping *[s. 94(8)]*
  - Sell original holdings after a bonus securities
  - Time range considered abusive
    - Securities purchased within 3 months prior to record date & sold within 9 months thereafter

Transfer of income to NR [s. 93][ITA2025, s. 174]

- *Where there is a transfer of assets by virtue or in consequence whereof, either alone or in conjunction with associated operations, any income becomes payable to a NR, the following provisions shall apply-*
- *Clause (a)*
  - *where any person has, by means of any such transfer, either alone or in conjunction with associated operations, acquired any rights by virtue of which he has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a NR person*
  - *which, if it were income of the first-mentioned person, would be chargeable to income-tax,*
  - *that income shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this section, be deemed to be income of the first-mentioned person for all purposes of this Act*
- *Clause (b)*
  - *where, whether before or after any such transfer, any such first-mentioned person receives or is entitled to receive any capital sum the payment whereof is in any way connected with the transfer or any associated operations,*
  - *then any income which, by virtue or in consequence of the transfer, either alone or in conjunction with associated operations, has become the income of a NR shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this section, be deemed to be the income of the first-mentioned person for all the purposes of this Act.*

Transfer of income to NR

- Clause (a)- an illustration
  - Resident firm transfers its overseas business to FCo (a foreign corporation) in lieu of shares of FCo allotted to its partners. The income earned by FCo assessed in partners' hands [Chidambaram Chettiar 60 ITR 28 (SC)]
- Clause (b) –
  - If transferor receives capital sum – payment of incomes to transferor disguised as loan- capital payments connected with original transfer unsupported by adequate consideration.
- Object-
  - to prevent residents from evading tax by transferring their assets to NRs while enjoying the income by adopting devious methods.
- Power to enjoy, not actual enjoyment of income (clause (a))
  - Enures for the benefit of the transferor, Power to control the application of income
- Chargeability to be seen every assessment year, not only in the year of transfer of asset/associated operations
- Not applicable if 'a' satisfies the AO that –
  - (a) neither the transfer nor any associated operation had for its purpose or for one of its purposes tax avoidance; or
  - (b) the transfer and all associated operations were bona fide commercial transactions and not designed for the purpose of avoiding tax.

Interest deduction limitation

- S. 94B *[ITA 2025, s. 177]* inspired by BEPS Action 4
- Applies to
  - an Indian company, or an Indian PE of a foreign company being the borrower,
  - incurs interest or similar expense > INR 1 crore deductible in computing PGBP in respect of any debt issued by a NR AE
- Excess interest to be disallowed
  - Total interest payable in excess of 30% of EBIDTA or interest payable to AE, whichever is lower
  - Excess interest to be carried forward for 8 assessment years
- Exclusions
  - Interest paid to an Indian PE of foreign bank
  - Interest paid by an Indian bank or insurance company or a finance company in IFSC or notified NBFC

Sec 94B - Issues

	Case I	Case 2	Case 3
EBIDTA	200	Loss	200
Total Interest	100	100	100
Interest to AE	30	30	30
TP adjustment towards AE interest ?	-	-	5
Disallowance :			
Interest > 30% of EBIDTA	40	Nil	40
Disallowance	30	30	25

- Proviso to ss. (1)

  … where the debt is issued by a lender which is not associated but an AE either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an AE.

  - Interest paid on Indian borrowing from unrelated party against security by NR AE?
- TP adjustment vs 94B
  - Noida Towers [2026] 182 taxmann.com 551(Delhi-Trib)
  - S. 94B – begins with non obstante clause
  - Interest subject to s. 94B limitation – interest deductible
- Not a thin capitalisation provision
- Non-discrimination clause in Treaties
  - Exp paid to NR deductible under the same conditions as paid to resident [Vestas Wind Technology India [2026] 184 taxmann.com 579 (Chennai - Trib.)]

General Anti-avoidance Rules

Judicial anti avoidance doctrines

- ***Sham***

  Acts done or documents executed by parties which are intended to give third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual rights and obligations which the parties intended to create [Snook v. London & West 1967 All ER 518 (CA)]

  - Artificiality, an element of deceit
  - If legal result of a transaction is exactly what parties had intended, not sham
  - Lack of bona fide business purpose not sham
- ***Substance over form***
  - Legal substance over form-
    - indicates true relationship; true legal effects of a transaction govern over formal description or labels
- ***Step transactions***
  - Examine whether series of transactions form a single composite transaction
  - Examines the overall effect of individual steps of a transaction to assess the transaction as a whole
- ***Business purpose doctrine***
  - Transactions that do not possess a genuine and bona fide business purpose to be disregarded
  - Used in the US, rejected by courts elsewhere as an independent anti-avoidance doctrine

GAAR - *object*

- Finance Minister's Speech introducing GAAR in 2012

  Introduced to counter aggressive tax avoidance schemes

- Explanatory Memorandum to FB 2012

  "…keeping in view the aggressive tax planning with the use of sophisticated structures, there is a need for statutory provisions so as to codify the doctrine of "substance over form…"

- SARS 2005 Discussion Paper

  "…. the use of artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived 'loopholes' in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament."

- Punjab Distilling Industries Ltd *[1965] 57 ITR 1 (SC)*

  "…… Tax can be evaded by breaking the law or avoided in terms of the law. When there is a factual avoidance of tax, in terms of law, the legislature steps in to amend the income-tax law so that it can catch such an income within the net of taxation."

GAAR provisions – An overview

- Chapter X-A
  - Section 95
    - Enabling provision
  - Section 96 & 97
    - Impermissible Avoidance Arrangement (IAA)
  - Section 98
    - Consequences
  - Sec. 99 – Parameters for determining tax benefit
    Sec. 100 – GAAR in lieu of/ addition to other provisions
    Sec. 101 – Guidelines/rules
    Sec. 102 – Definitions
    Sec. 144 BA–GAAR assessment

Impermissible Avoidance Arrangement

- An impermissible avoidance arrangement means
  - an arrangement,
  - the main purpose ~~or one of the main purposes~~ of which is to obtain a tax benefit and ……
- An arrangement means *[s. 102(1)][ITA 2025, s. 184]*
  - Any step in or a part or whole of any transaction, operation, scheme, agreement or understanding
  - Whether enforceable or not
  - Includes alienation of property in such transaction
- Requires two or more persons?
  - Dept. not shown any arrangement to have been made by petitioner while selling its shares; trading done by petitioner, not with any known parties [Smt. Anvida Bandi [2025] 177 taxmann.com 726 (Telangana)
- How arrangements defined in the facts of a case
  - Broader the scope, easier it is to substantiate a non-tax purpose and vice versa
    - Only a part of a scheme could be a scheme in itself- however, narrowing the scope only until the circumstances are incapable of standing on their own without being robbed of all practical meaning *[Commissioner v Peabody (1994) 181 CLR 359]*
    - A scheme need not stand on its own feet – tax benefit alleged would define the arrangement, for without tax benefit, identifying the arrangement would be futile *[FCT v Hart (2004) HCA 26]*
  - If main purpose of a step in or a part of an arrangement is to obtain tax benefit, the whole arrangement presumed to be for tax benefit unless assessee proves otherwise *[s. 96(2)][ITA 2025, s. 179]*

Primary test – Tax benefit

- Tax benefit includes *[s. 102(10)][ITA 2025, s. 184]*
  - Reduction/avoidance/deferral of tax or other amount payable under ITA or due to treaty
  - Increase in refund of tax or other amount under ITA, as a result of a treaty or otherwise
  - Reduction in total income or increase in loss

  In the relevant previous year or any other previous year
- No *de minimis* threshold for declaring an arrangement as an IAA
- Threshold for Chapter X-A to apply [u/rule 10U(1)]
  - Tax benefit arising in aggregate, to all parties to the arrangement exceeding INR 3 cr in the relevant AY.
  - Whether to take into account any tax payable by any of the parties to an arrangement - Double counting not ruled out –
- Application of threshold under rule 10U year-on-year basis while declaring impermissibility qua arrangement

Primary test – Tax benefit

- Australia – Tax benefit if
  - (i) they would not have been available or (ii) might reasonably be expected not to have been available to the taxpayer if the scheme had not been carried out.
  - "whether or not there were other ways (more convenient, or commercial, or frugal ways) in which the taxpayer might reasonably have achieved the substance and effect (tax implications aside) that it achieved from, or in connection with, the scheme" *[Memorandum to Tax Bill, 2013]*
  - Annihilation approach –
    - simply deleting the scheme resulting in tax benefit
    - 'Do nothing' counterfactual *[Commissioner v RCI Pty Ltd (2012) HCA Trans 29]*
  - Reconstruction approach –
    - Hypothesizing a reasonable alternative
    - First ascertain the main purpose to enable reconstructing a reasonable postulate, then determine whether there was a tax benefit
- South Africa
  - Would a tax liability have existed but for this transaction
  - *Revenue need not make a comparison to any other hypothetical arrangement [SAARS Draft Guide to GAAR]*

Primary test – Tax benefit

- Re-characterisation for determining tax benefit *[s. 99]*
  - connected persons may be treated as one and the same person;
  - any accommodating party may be disregarded;
  - accommodating party and any other party may be treated as one and the same person;
  - the arrangement may be looked through by disregarding any corporate structure.
- Object of such recharacterising-
  - Prevents a party from shifting an existing income stream to connected person (run down)
  - Actual transaction to be compared with arrangement so re-characterised and not any hypothetical arrangement (no counter-factual)
  - Re-characterisation only for this purpose, and not for determining other elements
  - Onus of proof on Revenue; need not define alternative or comparable arrangement

Primary test - main purpose

- Subjective or objective test?
  - Is intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (Subjective test)
  - Does the actual effect of the arrangement support non-tax benefit stated intention of the arrangement? (Objective test)
- Under South African law
  - *Amendment a more objective standard, provides uniform basis for tax treatment of identical transactions by removing reliance on purely subjective intention of parties [SA Draft Guidance]*
    - *Transaction was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit* [s. 103(1) of IT Act pre-2006]
    - *…an IAA if its sole or main purpose was to obtain a tax benefit* [s. 80A , SA IT Act]
- Indian situation
  - Intention to enter into an arrangement can only be at the threshold
    - 'an arrangement entered into by an assessee' *[s. 95(1)][ITA 2025, s. 178]*
    - 'an arrangement, the main purpose of which is to obtain tax benefit' *[s. 96(1)][ITA 2025, s. 179]*
  - Onus on Revenue to prove tax benefit and main purpose *[CBDT Draft Guidelines (2012), para 4.4]*

Primary test - main purpose

- Other relevant considerations
  - If there is more than one purpose, is the main (dominant?) reason for arrangement for obtaining the tax benefit?
  - If same commercial result achievable in a different manner and taxpayer selected manner attracting less or no tax, then obtaining of tax benefit not sole or main purpose
    - GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction *[CBDT Cir. 7 of 2017, Ans to Q 3]*
  - Subjective intention of taxpayer –
    - Mere assertion not enough - Parties to lead objective evidence that main purpose was not tax benefit on the basis of preponderance of probabilities

Secondary tests

- Tainted elements
  - Abnormality tests
    - Creates rights or obligations *not ordinarily created* between parties dealing at arms' length
    - Entered into or carried out by *means or in a manner not ordinarily employed* for bona fide purposes
  - Results in *misuse or abuse* of the provisions of the Act
  - Lacks *commercial substance* or is *deemed to lack commercial substance*, in whole or in part
- Absent main purpose or tax benefit, secondary tests irrelevant
- Onus on the Revenue

Abnormality elements

- *Creates rights or obligations not ordinarily created between unrelated parties*
  - Distinct from arms' length price in s. 92; not a TP test
  - Indicators
    - Do the parties strive to obtain best possible advantage for themselves?
    - Would unconnected persons have acted similarly in this situation?
  - Indicia for abnormality
    - Complexity of the arrangement
    - Introducing tax-indifferent parties to the arrangement (overlaps with deemed lack of commercial substance test)
- *Means not ordinarily employed for bona fide purposes*
  - Not a *bona fide* purposes test, but a 'means and manner' test
  - Hypothetical enquiry
    - Whether both means and manner of the transaction would not normally be entered into for *bona fide* purposes
    - Not normal merely because a particular form of transaction is commonplace or commercially acceptable
  - Use of court-approved merger route to set-off losses whether normal
    - Adequate SAARs in ITA, so GAAR would not apply *[Draft Guidelines (2012) Ex. 5]*
    - Only if courts have explicitly & adequately considered tax implications *[Cir. 7 of 2017 Q. 8]*

Misuse or abuse of the Act

- Requires contextual and purposive interpretation of relevant provisions
  - Misuse or abuse when-
    - taxpayer relies on specific provisions to achieve an outcome those provisions seek to prevent
    - a transaction defeats the underlying rationale of the provisions relied upon
    - an arrangement circumvents application of certain provisions in a manner that frustrates or defeats their object, spirit or purpose
- Misuse and abuse – whether to be examined disjunctively
  - Arguably, misuse includes abuse
- Onus on the Revenue
  - to establish the object, spirit and purpose of the provision
  - to demonstrate misuse/abuse
- Exemption claimed in a manner not foreseen by the law not necessarily misuse
  - Eg. Sec 54EC limit of Rs. 50 lacs in two financial years
  - Subsequent amendment to close loophole not indicative of pre-existing policy

Lack commercial substance

- Indications
  - Actual economic expenditure or loss incurred by a party and the value of the tax benefit disproportionate
  - A loss claimed that significantly exceeds any measurable reduction in net worth.
- U.S. economic substance doctrine
  - Definition
    - transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position (objective test), and
    - the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction (subjective test).
  - 'Commercial substance' akin to objective test of US economic substance doctrine

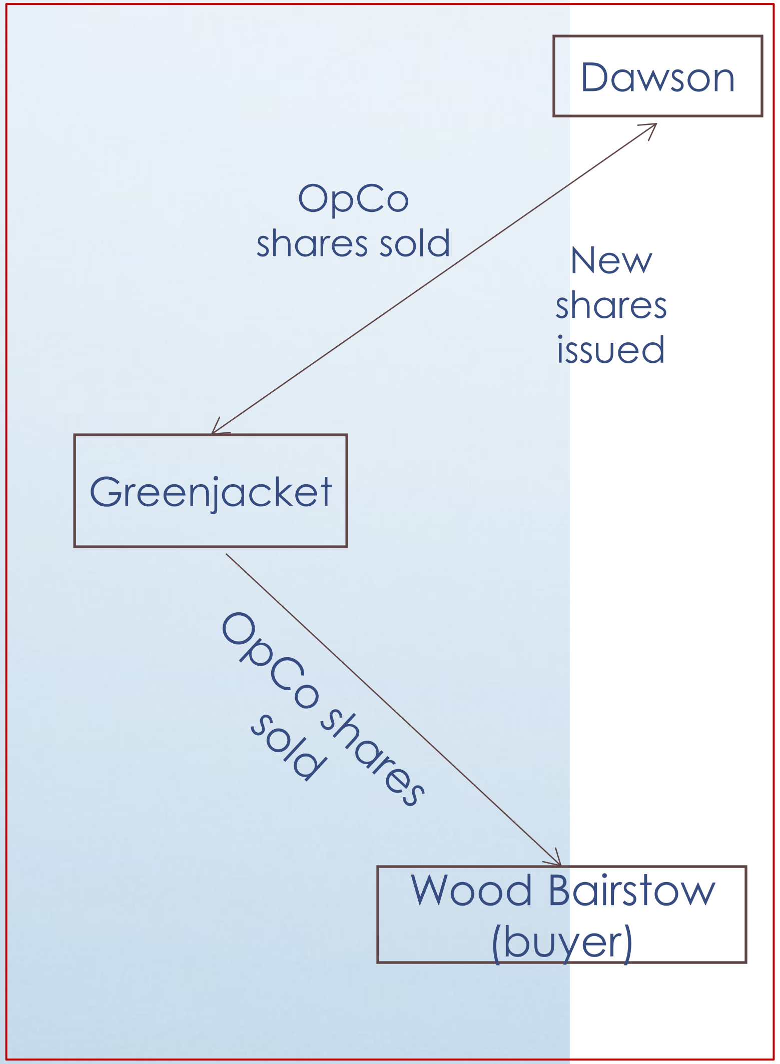
Deemed to lack commercial substance

- Substance or effect of the arrangement as a whole differs from the form of its individual steps
  - Distinct from transaction where true intention of parties not reflected in the legal form (sham)
- Involves or includes
  - Round trip financing
  - An accommodating party
    - If the main purpose of participation of a party to an arrangement is to obtain a tax benefit for the taxpayer
  - Has elements that are offsetting or cancelling each other
    - Eg cross-gifts to avoid clubbing provisions
  - Transactions which disguise the value, location, source, ownership or control of funds
- Involves location of an asset or of a transaction or place of residence of any party without substantial commercial purpose
- No effect upon business risks or net cash flows of any party
- Elements, relevant but not sufficient to establish commercial substance
  - Period of time for which an arrangement exists
  - Taxes paid under the arrangement
  - An exit route is provided in the arrangement

Step in or part of an arrangement

- GAAR can be applied to any step in or part of an arrangement [s. 95 Expln]
- Step includes *[s. 102(9)][ITA 2025, s. 184]*
  - *a measure or an action, particularly one of a series*
  - *to deal with or achieve a particular thing or objective in an arrangement*
- Revenue to identify the step or part
  - Rebuttable? Ground?
  - How small a step or part?
    - To pick a particular feature of a transaction is "to miss woods for the trees" *[Louw (1983) 45 SATC 113]*
    - Such narrowly defined arrangement need not stand on its own *[SA Draft Guide (2011), also Commr v Hart (2004) HCA 26]*
- Arrangement presumed to be mainly for tax benefit if a step or a part for tax benefit; presumption can be rebutted by taxpayer *[s. 96(2)][ITA 2025, s. 179]*
- *Arrangement means [s. 102(1)] [ITA 2025, s. 184]*
  - *Any step in or part or whole of*
  - *any transaction, operation, scheme, agreement or understanding*
- "scheme is a wide term … little doubt that it is sufficiently wide to cover a series of transactions" *[Meyerowitz (1963) 25 SATC 287 (A)]*
- Pre-ordained series of transactions or one single composite transaction *[Burmah Oil (1982) STC 30]*

Series /Composite transaction



*Furniss v Dawson 1984 HL

Background

- Deemed to be no disposal of shareholding if shares in a company transferred to another company which thereby acquires control, in exchange for shares in the transferee company.
- Tax on capital gains deferred until such time Dawson disposed of Greenjacket shares.

House of Lords

- Involves two findings of fact,
  - first whether there was a pre-ordained series of transactions, i.e. a single composite transaction.
  - Secondly, whether that transaction contained steps which were inserted without any commercial or business purpose apart from a tax advantage
- When one moves from a single transaction to a series of inter-dependent transactions designed to produce a given result, it is perfectly legitimate to draw a distinction between the substance and the form of the composite transaction without in any way suggesting that any of the single transactions which make up the whole are other than genuine.
- Valeo Bayen [2026] 186 taxmann.com 471 (Chennai - Trib.)
  - Sale of shares by Fco to IndCo (WOS) (claimed exempt u/s 47(iv) followed by merger of WOS with another Indian Sub.

Series- Craven vs White

- A transaction not pre-ordained when at that time it is wholly uncertain whether that disposal will take place, or a fortiori when neither the identity of the purchaser nor the price to be paid nor any of the other terms of the contract are known…. transactions in the series can be regarded as pre-ordained only if at the time when the first of them is entered into the taxpayer is in a position …. to secure that the second also is entered into……. *[Lord Keith]*
- there should be no sensible and genuine interruption between the intermediate transaction and the disposal to an ultimate purchaser *[Lord Oliver]*
- ….when negotiations/arrangements for carrying through as a continuous process of a subsequent transaction which actually takes place …thereafter such arrangements were carried through to completion <u>without genuine interruption</u> *[Lord Jauncey]*
- An interval of time between two transactions is irrelevant save as evidence to be taken into account …. to decide whether the two transactions were independent of one another or … form(ed) part of a pre-planned tax avoidance scheme…. after the tax avoidance transaction has taken place, the taxpayer must retain power to carry out his part of the intended taxable transaction … the intended taxable transaction must in fact take place…. <u>*[Lord Templeman].*</u>
- I do not regard the "practical certainty" test as apposite. This is because "pre-ordained" does not mean "predestined"; it means decided or planned in advance, but not foredoomed …….. The mere fact that a series of transactions planned as part of a single scheme may not in fact be carried out to the end, does not prevent those transactions, if performed, constituting a composite transaction for the purposes of the principle *[Lord Goff]*

Consequences *[s. 98][ITA 2025, s. 181]*

- Disregarding, combining or re-characterising any step
  - Treating equity as debt or vice versa
  - Capital receipt as revenue or vice versa
  - Re-characterise any expense, deduction, relief or rebate
- Ignoring the entire arrangement
- Disregarding an accommodating party or treating it and any other party as one person
- Deeming connected persons as one person
- Reallocating amongst the parties-
  - Any accrual, or receipt of capital or revenue nature
  - Any expenditure, deduction, relief or rebate
  - Treating the place of residence, situs of an asset/transaction at a different place
- Disregarding or looking through any corporate structure
- Powers of the AO
  - *in such manner as is deemed appropriate*
    - *Absent words "limited to the prevention or diminution of the relevant tax benefit" (as in SA GAAR).*
    - *Counteracting adjustments to be just and reasonable? (as in UK GAAR)*
    - *No requirement to annihilate the tainted arrangement and/or regard to a hypothetical to determine the consequences (as in New Zealand GAAR)*

Exceptions

- Where tax benefit in a relevant assessment year to all parties does not exceed Rs. 3 crore
  - R. 10U(1)(a) r.w. r. 10U(3)(iv) – "amount of tax"
    - To exclude surcharge, cess, interest, penalties and other sums for threshold
    - S. 102(10) ("tax or other amount")
- Foreign institutional investor
- A non-resident making an investment in off-shore derivative instruments in a FII
- Grandfathered
  - Any income accruing to a person from transfer of investments made before 1st April 2017 by such person [rule 10U(1)(d)]
  - Without prejudice to r. 10U(1)(d), Chapter applies arrangements irrespective of when entered, in respect of tax benefit from an arrangement on or after 1.4.2017
  - Tiger Global (SC) – grandfathering not available where IAA even if investment made < 1.4.2017
  - Amendment wef 1.4.2026 to even the keel.

Other provisions

- GAAR – alternative basis of assessment
  - To enable invoking of GAAR concurrently/alternatively

    "The provisions of this Chapter shall apply in addition to or in lieu of any other basis for determining tax liability." [sec. 100][ITA2025, s. 183]
  - Permitting Revenue to invoke GAAR as an alternative basis of assessment -administratively and judicially economical
  - Ch X-A acts as all-encompassing safety net designed to capture all ilicit arrangements [Ayodhya Rami Reddi [2024] 163 taxmann.com 277 (Telangana)]
    - Ch X-A not a backstop to SAARs, applies where arrangement has necessary attributes, if they are artificial, contrived or abnormal.
- Ch X-A overrides sec. 90(2)*[s. 90(2A)][ITA2025, s. 159]*
- Assessment proceedings *[s. 144BA][ITA 2025, s. 274]*

Procedure

- AO's reference to PCIT/CIT *[in Form 3CEG]*
- Pr CIT/CIT's Notice to assessee to set out reasons and the basis for his opinion *[s. 144BA(2)]*
- AO required to issue Notice setting out reasons and seeking objections *[r. 10UB(1)]*
- Pr CIT/CIT to record satisfaction regarding applicability of Ch X-A before reference to Approving Panel *[Form 3CEI]*
- Reference to Approving Panel only if objection raised by taxpayer *[in Form 3CEIA]*
- Approving Panel to consist of a sitting/retired HC Judge (as Chairperson), an IRS of Pr CIT/CCIT rank and an academic or research scholar with knowledge of tax, business and accounting matters
- Approving Panel's directions can be for assessment years other than one for which reference is made
- Panel's directions binding on AO and taxpayer
- Appeal lies to ITAT against the AO's order *[s. 253(1)(e)]*
- Strict timelines

SAAR and GAAR interplay

Facts

- ICo, an Indian company, is highly leveraged. It requires funds to finance its expansion plans.
- One option is to issue CCDs to FCo, its Holding Co at LIBOR + 300 basis point interest till conversion [assume situation before insertion of s. 94B].
- Post-insertion of s. 94B, Instead of issuing CCDs, ICo borrows from a nationalised bank; the loan is guaranteed by FCo.

Section 94B(1)

*Notwithstanding anything contained in this Act, where an Indian company, or a PE of a foreign company in India, being the borrower, **incurs any expenditure by way of interest** or of similar nature exceeding INR 1 crore which is deductible in computing income chargeable under the head "Profits and gains of business or profession" **in respect of any debt issued by a non-resident**, being an associated enterprise of such borrower, the interest shall not be deductible in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2) :*

***Provided** that where the debt is issued by a lender which is not associated but an associated enterprise either **provides an implicit or explicit guarantee** to such lender or deposits a corresponding and matching amount of funds with the lender, **such debt shall be deemed to have been issued by an associated enterprise**.*

SAAR and GAAR interplay

Indicia	If CCD issued to FCo	If borrowing from bank
Is there an arrangement	Yes	Yes
Is there a 'tax benefit'		
• Has the 'a' avoided an anticipated liability	No	Yes
• Would there have been a tax payable but for the arrangement?	Yes	Yes
Is tax benefit the **main purpose** of the arrangement		
• Is the intention of the 'a' non-tax purpose	Yes; for its funding needs	Yes
• Does actual effect of arrangement corroborate a non-tax intention	Yes	No
Abnormality elements		
• Does the arrangement create rights or obligations **not ordinarily created between third parties**	No	No
• Is it entered into or carried out by means or in a manner which are **not ordinarily employed for bona fide purposes**	No	No
Does it result in any **misuse or abuse** of provisions of IT Act	No	??

SAAR and GAAR interplay

Indicia	Conclusions If CCD issued to FCo	Conclusions If borrowing from bank
Is the arrangement deemed to lack commercial substance-		
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No	No
• involves round trip financing	No	No
• involves an accommodating party	No	Lending bank?
• involves offsetting or self-cancelling elements	No	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No	No
• No significant effect on business risks /net cash flows of parties	No	No
Does arrangement **lack commercial substance** generally		
• Is the expenditure/loss disproportionate to tax benefit gained	No	No
• Is there no corresponding reduction in net worth	No	No

- Whether guarantee by FCo indicate creation of rights and obligations not ordinarily created between third parties? Arguably, no.
- Purposive interpretation of s. 94B Proviso determines whether GAAR applies.

Bonus issue and subsequent sale

Facts

- ACo, an Indian company, acquires 70% of share capital of Bco, another Indian company.
- BCo issues 5:1 bonus after 3 months.
- Aco, soon after, sells Bco shares originally acquired and books a capital loss.
- The capital loss is adjusted against other capital gains by ACo.

Alternative facts

- Shares sold to Dco, a subsidiary of ACo.
- DCo funded by bank loan for the purchase. ACo has provided a corporate guarantee.

Pre-GAAR

- *Bonus stripping provisions not attracted*
- *Bonus shares received by other shareholders also*
- *Fall in value of Bco shares on issue of bonus shares normal economic effect.*
- *Sale by Aco at fair value.*
- *Cost of acquisition of original shares and bonus shares as mandated by sec. 55.*
- *On alternative facts*
    - *Sale transaction colourable as per Revenue*
    - *Defence*
        - *Sale to related party if genuine and not sham*
        - *Corporate guarantee for subsidiary normal corporate responsibility*

Bonus issue and subsequent sale

Indicia	If sale simplicitor	On alternative facts
Is there an arrangement	Yes	Yes
Is there a ‘tax benefit’		
• Has the ‘a’ avoided an anticipated liability	Yes	Yes
• Would there have been a tax payable but for the arrangement?	Yes	Yes
Is tax benefit the **main purpose** of the arrangement		
• Is the intention of the ‘a’ non-tax purpose	Yes	Yes
• Does actual effect of arrangement corroborate a non-tax intention	Yes	No
Abnormality elements		
• Does the arrangement create rights or obligations **not ordinarily created between third parties**	No	No
• Is it entered into or carried out by means or in a manner which are **not ordinarily employed for bona fide purposes**	No	No
Does it result in any **misuse or abuse** of provisions of IT Act	No. Bonus stripping not triggered; Cost of acquisition as per under law.	No. Bonus stripping not triggered; Cost of acquisition as per under law.

Bonus issue and subsequent sale

Indicia	If sale simplicitor	On alternative facts
Is the arrangement deemed to lack commercial substance-		
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	No	No
• involves round trip financing	No	?
• involves an accommodating party	No	Dco?
• involves offsetting or self-cancelling elements	No	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No	No
• No significant effect on business risks /net cash flows of parties	No	No
Does arrangement **lack commercial substance** generally		
• Is the expenditure/loss disproportionate to tax benefit gained	No	No
• Is there no corresponding reduction in net worth	No	No

- Considering connected parties as one u/s 99 only to ascertain tax benefit. Individual purposes of Dco and Aco need to be ascertained.
- Borrowing by Dco from Bank against guarantee of Aco cannot be disregarded
- Dco to prove its legitimate interest in the investment.
- In the absence of Bonus stripping rules being triggered, arrangement not IAA.

Sale and merger

Facts

- NorCo holds 100% stake in Aco and Bco, both Indian companies.
- Singco transfers its stake in Aco to Bco and claims exemption u/s 47(iv).
- Thereafter Aco merges into Bco under the fast-track merger route, thus consolidating NorCo group operations in India.

Pre-GAAR

- Is the share sale genuine
- Have shares actually been delivered/transferred
- Is the share sale at fair value
- Are parties' real rights and obligations consistent with the form
- Is transferee the real owner, entitled to the risk and reward

*Valeo Bayen [2026] 186 taxmann.com 471 (Chennai - Trib.)

Sale and merger

Indicia	Conclusions
Is there an arrangement	Yes
Is there a ‘tax benefit’	
• Has the ‘a’ avoided an anticipated liability	Yes
• Would there have been a tax payable **but for** the arrangement?	No
Is tax benefit the **main purpose** of the arrangement	
• Is the intention of the ‘a’ non-tax purpose	Admittedly, no
• Does actual effect of arrangement corroborate a non-tax intention	No
Abnormality elements	
• Does the arrangement create rights or obligations **not ordinarily created between third parties**	No
• Is it entered into or carried out by means or in a manner which are **not ordinarily employed for bona fide purposes**	No
Does it result in any **misuse or abuse** of provisions of IT Act	No; Capital gains on transfers between HoldCo and WOS exempt.

Sale and merger

Indicia	Conclusions
Is the arrangement deemed to lack commercial substance-	
• substance or effect of arrangement as a whole is inconsistent/ differs significantly from form of its individual steps or a part	NorCo continues to derive the value of its stake in Aco, now through Bco.
• involves round trip financing	No
• involves an accommodating party	No
• involves offsetting or self-cancelling elements	No
• transaction conducted through one or more persons & disguises value, location, source, ownership or control of funds	No
• involves location of an asset or transaction or of place of residence of any party without substantial commercial purpose	No
• No significant effect on business risks /net cash flows of parties	Yes; Aco continues to be owned by NorCo though indirectly after the purported sale.
Does arrangement **lack commercial substance** generally • Is the expenditure/loss disproportionate to tax benefit gained • Is there no corresponding reduction in net worth	Yes. Accumulated profits of Aco extracted without tax

- NorCo extracted accumulated profits of Aco by way of sale consideration which it would have got by way of taxable dividends.
- Arrangement has attributes that are artificial, contrived and abnormal.

Thank you!