India releases circular clarifying application of GAAR provisions

September 27, 2013

In brief

Earlier this year, as part of its annual budget, the Indian government deferred the effective date of the new General Anti-Avoidance Rules (GAAR) to April 1, 2015. (See Asia Pacific Tax Newsalert, Indian budget proposal retains indirect transfer tax but defers GAAR until 2015, February 28, 2013). However, the government retained the GAAR provisions in the same form as they had initially been proposed in 2012, without implementing either the Shome Committee's recommendations or the Indian Finance Minister's announcements (see Asia Pacific Tax Newsalerts, Expert Committee's report on India's GAAR regime is welcome news for foreign investors, September 4, 2012 and Indian Finance Minister announces decisions on Indian GAAR regime, January 15, 2013).

In a circular dated September 23, the Indian government has clarified the application of the GAAR provisions in certain circumstances. Significantly, the government has specified a monetary threshold for applying GAAR. Furthermore, the government indicated the period for which existing arrangements may be grandfathered, and clarified how GAAR would apply to foreign institutional investors (FIIs).

This newsalert summarizes those provisions in the circular that could affect foreign investors in India.

In detail

Monetary threshold

Following the Shome Committee's recommendations, the circular has set an INR 30 million (approx. US$ 500,000) tax benefit threshold. If the tax benefit exceeds this threshold amount in a tax year, then the GAAR provisions are invoked.

The relevant tax benefit is the total tax benefit of all parties to an arrangement in the relevant tax year.

Application of GAAR to FIIs

The circular clarifies that the GAAR provisions should not apply to FIIs that have not claimed treaty benefits but instead have subjected themselves to domestic law. As a corollary, GAAR may apply to FIIs that claim tax treaty benefits regarding their Indian investments.

Also, in a welcome move, the circular clarifies that direct or indirect investments made by non-resident investors in FIIs by way of offshore derivative instruments (such as participatory notes) should not be subject to the GAAR provisions. The circular, however, does not clarify how the FII that issues the offshore derivative instrument will be treated for GAAR purposes.

Grandfather provisions

The circular states that the GAAR provisions will not apply to income earned from the transfer of investments made before August 30, 2010 (the date when the GAAR provisions were first proposed in the draft Direct Taxes Code).

However, the circular adds that GAAR should apply to any arrangement, regardless of when it is entered into, for tax benefits obtained on or after April 1, 2015.

A reading of these provisions suggests some ambiguity in how investments would be grandfathered under the GAAR provisions. Importantly, the circular does not clearly explain whether investments made prior to August 30, 2010, will be grandfathered completely or would be subject to GAAR if the taxpayer obtains a tax benefit on or after April 1, 2015.

However, in a welcome step, the circular further clarifies that GAAR should apply only to the part of an overall arrangement that results in tax avoidance and not to the entire arrangement.

The takeaway

The circular is a positive development in clarifying certain aspects for applying the GAAR provisions and aligns with some of the Shome Committee's recommendations.

However, foreign investors would welcome additional clarifications on some remaining questions. These include the grandfather provisions, the application of GAAR to group restructuring transactions, and the application of specific anti-avoidance rules.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

International Tax Services, United States

Puneet Arora
+1 646 471 1691
puneet.arora@us.pwc.com

Dwarak Narasimhan
+1 646 471 0015
dwaraknath.e.narasimhan@us.pwc.com

Gautam Dalvi
+1 646 471 1402
gautam.r.dalvi@us.pwc.com

International Tax Services, India

Nitin Karve
+91 22 6689 1477
nitin.karve@in.pwc.com

Vishal J Shah
+91 22 6689 1455
vishal.j.shah@in.pwc.com