Domestic v/s Global anti-tax avoidance principles

- *Convergence and Challenges*

Workshop 5: IFA 2024 Asia Pacific Regional Conference, Hong Kong

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BASIC PRINCIPLES AROUND TAX AVOIDANCE

Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax...
- IRC v Duke of Westminster

When a transaction comprises a series of pre-arranged artificial steps, devoid of any genuine commercial purpose other than tax avoidance, the proper course of action is to scrutinise the transaction as a whole.

- W. T. Ramsay Ltd. v. Inland Revenue Commissioners

BASIC PRINCIPLES AROUND TAX AVOIDANCE

Key Elements of Ramsay Principle:

Pre-ordained Steps
The principle comes into play when a transaction features pre-arranged artificial steps that serve no genuine commercial purpose other than tax avoidance.

Analysing the Transaction as a Whole
Instead of isolating one step that produces a loss, the Ramsay Principle mandates examining the entire transaction's effect, which might include considering the overall impact of various elements collectively.

Purposeful Construction
The interpretation of statutory provisions should be purposeful, aiming to ascertain the nature of the transaction the statute intended to address.

Genuine Commercial Unity
Revenue statutes are chiefly concerned with the characterisation of transactions possessing commercial unity as a whole, rather than dissecting them into individual steps.

BASIC PRINCIPLES AROUND TAX AVOIDANCE

Commissioner of Inland Revenue v. Challenge Corp Ltd [1986] (referred to in case of Sabah Berjaya Sdn Bhd (2000))

Tax avoidance - Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had."

Tax mitigation - where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.

ILLUSTRATIVE PRINCIPLES AROUND TAX AVOIDANCE

India landscape – ratio laid down by Judiciary

- Tax planning permissible provided its within the four corners of the law; Colourable devises not part of tax planning but to be construed as tax avoidance (**Mcdowell – SC**)

- **Vodafone SC** – Reiterated Mcdowell's principle on tax avoidance; Additionally, held that there needs to be authority of law to question/ allege incidents of avoidance of tax

- Bilateral negotiations under Tax Treaty to be respected **(Azadi Bachao Andolan – SC)**

Evolution of ‘general’ Tax avoidance Rules – Domestic and under Treaty arrangements

Backdrop

- Existence of SAAR provisions under domestic laws, e.g.
  - Transfer pricing
  - Controlled Foreign Companies (‘CFCs’)
  - Place of Effective Management (‘PoEM’)
  - Thin Capitalization Rules / Earning Stripping Rules

- Under Tax Treaties – beneficial ownership (eg interest, dividend); LoB clause

- Need for codification of GAAR in addition to SAARs?
  - Court evolved ‘general’ anti-avoidance guidelines
  - Adopting ‘consistent’ approach to address tax avoidance instances

Evolution of ‘general’ Tax avoidance Rules – Domestic and under Treaty arrangements

Introduction of Domestic GAAR

- Civil and Common Law Jurisdictions
- International experience - broad comparison of Domestic GAAR provisions under different jurisdictions

Countries	GAAR Available?	SAAR Available?
Hong Kong	Yes	Yes
China	Yes	
India	Yes	
Singapore	Yes	
Japan	Yes	
Australia	Yes	
Philippines	No	
Indonesia	Yes	
Malaysia	Yes	
Thailand	No	

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OVERVIEW OF GAAR SITUATION

Malaysia

Power to disregard certain transactions

140. (1) The Director General, where he has reason to believe that any transaction has the direct or indirect effect of—

(a) altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;

(b) relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return;

(c) evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or

(d) hindering or preventing the operation of this Act in any respect,

may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counteracting the whole or any part of any such direct or indirect effect of the transaction.

OVERVIEW OF GAAR SITUATION

Singapore

Section 33 Singapore Income Tax Act

33.—(1) Subsection (2) applies where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly
(a) to alter the incidence of any tax that is payable by or that would otherwise have been payable by any person;
(b) to relieve any person from any liability to pay tax or to make a return under this Act; or
(c) to reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act.
(2) ---
(3) ---
(4) ---
(5) In this section —
"arrangement" means any scheme, trust, grant, covenant, agreement, disposition and transaction and includes all steps by which it is carried into effect;
"claimant company" and "transferor company" have the meanings given by section 37B(19);
"qualifying deduction" has the meaning given by section 37B(14).
(6) This section applies to any arrangement made or entered into before, on or after 7 December 2020, but not one made or entered into before 29 January 1988.
(7) This section does not apply to any arrangement carried out for bona fide commercial reasons and had not as one of its main purposes the avoidance or reduction of tax.

OVERVIEW OF GAAR SITUATION

AQQ Case (CIT v AQQ [2014] Singapore Court of Appeal 15)

- *A Malaysian listed group incorporated the taxpayer company AQQ to carry out a restructuring and financing arrangement in 2003. AQQ acquired 100% shares in four Singapore companies (which have significant amount of section 44 credits in their accounts) from related companies. AQQ then financed the purchase of these shares via round-tripping financing arrangements through two banks located in different countries). The Court of Appeal upheld the decisions of the Income Tax Board of Review and the High Court and ruled that section 33 was applicable. The Court of Appeal held that the restructuring and financing arrangements were not commercial transactions under which any tax avoidance or reduction was merely incidental. The Court of Appeal ruled that one of the main purposes of the restructuring and financing arrangement was to obtain a tax benefit by creating interest deductions to reduce the tax payable on the dividend income.*

- Three Step Approach:

  1. Whether an arrangement *prima facie* falls within any of the three threshold limbs of section 33(1) such that the taxpayer has derived a tax advantage; and if so,
  2. Whether the taxpayer may avail himself of the statutory exception under section 33(7); and if not,
  3. Whether the taxpayer has satisfied the court that the tax advantage obtained arose from the use of a specific provision in the Act that was within the intended scope and Parliament's contemplation and purpose, both as a matter of legal form and economic reality within the context of the entire arrangement.

OVERVIEW OF GAAR SITUATION

India – Purpose Test + Tainted elements test

CHAPTER X-A

GENERAL ANTI-AVOIDANCE RULE

Applicability of General Anti-Avoidance Rule.[53]

95. (1) Notwithstanding anything contained in the Act, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.

(2) This Chapter shall apply in respect of any assessment year beginning on or after the 1st day of April, 2018.

Explanation.—For the removal of doubts, it is hereby declared that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.

Impermissible avoidance arrangement.

96. (1) An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it—

(*a*) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(*b*) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(*c*) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(*d*) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes.

(2) An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

Income from investments/structure made prior to 31st March 2017 is grandfathered!!

The Netherlands

Example of a Civil Law Jurisdiction

- Fraus Legis (first application in 1926)
  - Subjective test; Decisive motive to avoid *Dutch* taxation
  - Objective test; contrary to the object and purpose of the law
  - (no practical, real consequences of the transaction, other than the contemplated tax advantage)
  - Substitution or elimination

- Fraus Tractatus
  - DTAs with Germany, Hong Kong (Article 27), and Panama

Evolution of ‘general’ Tax avoidance Rules – Domestic and under Treaty arrangements

Introduction of MLI – Rationale and modifying operation of Bilateral Treaties

Modification	• Existing bilateral treaties require modification to implement BEPS measures
Speed	• Avoids the need to bilaterally re-negotiate more than 3000 treaties globally
Consistency	• Ensures consistent application of the BEPS Measures to reduce disputes
Clarity & Transparency	• Detailed explanatory statements and application toolkits
Flexibility	• Flexibility in respect of coverage and application of non-mandatory provisions

Essentially addresses two aspects-

- **Macro - parameters for Treaty eligibility;**
- **Specific and identified issues of treaty abuse**

CURRENT LANDSCAPE

- Different countries are implementing the OECD BEPS 15 Action Points in stages, e.g.
  - Malaysia - Actions 4, 5, 6, 8-10, 13, 14 and 15
  - India – Progressively implemented almost all Action Points including on Digital economy taxation (eg Equalisation Levy); certain aspects even before Courts (eg Tax Treaty eligibility, PE profit attribution beyond ALP; interpretation of preliminary activities for PE determination etc)

- To effect BEPS through treaty changes, MLI has been used to amend tax treaties.

- MLI been signed by 102 countries as at Feb 2024

MLI- Key Constituents

- Amendment to **Preamble** of DTA:

  "Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangement aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)"

- **Principal Purpose Test (PPT)**

  "Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement"

- **Three Layers:**
  - Preamble – *guidance to interpret Treaty provisions*
  - PPT – *eligibility to claim Treaty benefits*
  - Specific Treaty abuse + dispute resolutions provisions

Interplay between Domestic GAAR and Treaty abuse provisions

- **Applicability**
  - Main purpose vs one of the main purposes;
  - Existence of ‘counter factual v/s. focus on actual transaction etc
- **PPT test** – Meaning of the term “*…unless it is established that granting the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention*”
  - Satisfaction of LoB conditions = meeting the PPT test?
- **Grandfathering/ prospective** applicability of the tests?
- Whether **minimum threshold** applicable?
- **Consequence** of failure of tests
  - Treaty benefit denial vs re-characterisation, re-allocation of income, discarding a step/entity etc]
- **Onus** (on tax officer or taxpayer?)
- **Administrative safeguards** to trigger anti avoidance provisions (eg reference to an Independent Panel)
- **Unilateral action** by jurisdictions to deny Treaty benefits on trigger of Domestic GAAR – whether appropriate?

How taxpayers should approach/prepare/plan their affairs/structures to mitigate trigger of anti-tax abuse provisions

- Focus on **'substance' over form** – economic nexus with profit generation resources/activities
- Factoring/ documenting **commercial/ non-tax parameters** for any proposed structure/ transactions
- Growing relevance of **access to information** by tax authorities
  - CbCR reporting;
  - Exchange of information provisions under Tax Treaty resorted to by the tax administration
- Disclosure on tax transparency/ risk policy – Mandatory requirement v/s. voluntary adoption (Corporate Governance)

Treaty-abuse provisions to address specific transactions – Illustrative provisions

- Beneficial owner – Dividend, interest, dividend – interplay with PPT test
- Digital transactions/ profit shifting – Pillar 1 and Pillar 2
- Dividend transfer transactions - minimum shareholding period
- Permanent Establishment avoidance
  - PE anti fragmentation rules (preliminary activities)
  - Extended DAPE / Independent Agency PE rules
  - Addressing issues for PE avoidance on account of digital transactions (eg Equalization levy, SEP provisions etc)
- Tie-breaker rule for treaty residency determination of dual residency persons other than Individual
- DEMPE functions – intangible assets profits shifting

Dispute resolution mechanisms/ Arbitration

- Mutual Agreement Process ('MAP') / Advance Pricing Arrangements ('APA') would become key in mutual dispute resolution (outside Court litigation)

- Arbitration - Fall back/ last resort avenue (optional) for mutual dispute resolution upon failure of mandatory MAP negotiations – adopted by 32 countries

- Arbitration clause under MLI – adopted by which countries?

  - Impacts 'sovereignty rights' of country?
  - Long way to go to achieve consensus on arbitration process for timely dispute resolution – practical implementation critical for more countries to adopt this route

Arbitration Clause under MLI adopted by countries

Final offer / Last best offer Arbitration (Note*)		Independent opinion approach
Australia	Ireland	Andorra
Austria	Italy	Greece
Barbados	Lesotho	Hungary
Belgium	Liechtenstein	Japan
Canada	Luxembourg	Malta
Curacao	Mauritius	Papua New Guinea
Denmark	Netherlands	Portugal
Fiji	New Zealand	Slovenia
Finland	Singapore	Sweden
France	Spain	
Germany	Switzerland	
United Kingdom		

- As per OECD, following 32 countries have updated their arbitration profile *(status as on 29th February 2024)*

- Note- *Subject to reservation on the scope of cases eligible to Part VI of the MLI of the respective countries

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Interplay between MAP and Arbitration

Mutual Agreement Procedure → Unresolved, If disagreement → **Arbitration**

MAP article of tax treaties based on the OECD and UN Models provides a mechanism to resolve disputes in cases where a taxpayer considers that he has been taxed in a manner inconsistent with the provisions of the treaty

Arbitration

Final Offer Arbitration

Default arbitration process

Independent Opinion Approach

This approach shall apply subject to mutual agreement by competent authorities

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Arbitration Approach

Final offer / Last best offer Arbitration

- Will apply by default
- Submit to arbitration panel a proposed resolution addressing all the unresolved matters
- Resolution shall only include monetary amounts or maximum tax rate charged
- Arbitration panel through a simple majority, adopt one of the proposed resolutions and will not include any rationale and explanation
- Delivered in writing (will not be used as precedent for other cases)

Independent opinion approach

- If not willing to choose final offer, this approach shall apply subject to mutual agreement by competent authorities
- Submit to arbitration panel any information that they may consider necessary for their independent opinion
- Arbitration panel will present the decision in writing indicating the sources of law relied upon and reasoning for the provided result
- Decision of the arbitration panel shall be adopted by a simple majority of the panel members

Q&A

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