International / India

General Anti-Avoidance Rule and Principal Purpose Test – New Era of Anti-Abuse Law

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General anti-avoidance rule (GAAR) provisions and the principal purpose test (PPT) rule have become operational in most jurisdictions. The criteria for their application may differ across jurisdictions. A taxpayer's obligations under each rule vary, making them vulnerable to one obligation though they manage to comply with the other, as both rules can be applied concurrently in a particular case. Can a taxpayer, having passed the litmus test of one rule, justifiably claim immunity from the other? This article provides insights into the intricacies of interpretating both rules and explores some unanswered issues. As both rules usher in a new era of anti-abuse law, their interplay is examined in a limited manner from the Indian perspective. Ultimately, the commercial substance of the transaction or arrangement, if properly documented and presented, remains the strongest safeguard for the taxpayer.

1. Introduction

In an era of growing cross-border trade and commerce, enterprises are often driven by both commercial and tax reasons when structuring entities across different jurisdictions in line with their business plans. It has been observed that tax benefits frequently influence these decisions without being supported by commercial substance. This approach can result in treaty shopping and abuse of law, which has become the core concern for tax authorities. When an enterprise claims a tax benefit that was not genuinely intended for it, such a claim may satisfy the letter of the law but violate its spirit. This is where tax authorities examine the substance of the arrangement to verify whether there exists an abuse of law. In order to address these concerns, most jurisdictions have introduced anti-abuse provisions in domestic law, commonly in the form of general anti-avoidance rules (GAARs).

Generally, GAARs can target structures that are fraught with abuse of law in both domestic and cross-border contexts. In order to make the treaty law more effective in addressing the treaty shopping and abuse, the OECD G20 Base Erosion Profit Shifting (BEPS) initiative identified the prevention of treaty abuse as a key agenda item, which resulted in the introduction of the principal purpose test (PPT). As a result, enterprises may be impacted by both GAAR provisions and the PPT rule when implementing business plans and structuring of entities across jurisdictions. It is interesting to visualize how an enterprise would navigate its business plans while addressing concerns of tax authorities both under GAARs and PPTs, given these rules are not mutually exclusive and may be applied concurrently. This article explores the nuances of these two rules and their interplay.

BEPS Actions 5, 6, 13 and 14 constitute the four minimum standards under the OECD/G20 BEPS Project. Among these, Action 6 specifically addresses the prevention of treaty abuse. To facilitate the implementation of treaty-related BEPS measures, the multilateral instrument (MLI) was developed under Action 15. It enables jurisdictions to swiftly amend their bilateral tax treaties to incorporate provisions from Actions 6 and 14. The MLI became effective in most jurisdictions, including India, from 2020.

Following this brief introduction, the article proceeds as follows:

- section 2 discusses the salient features of the PPT, focusing on its subjective component;
- section 3 explores the purposive interpretation of the PPT;
- section 4 examines its objective component;
- section 5 evaluates the object and purpose of relevant treaty provisions;

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