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GENERAL ANTI-AVOIDANCE RULES IN INDIA: STRIKING A BALANCE BETWEEN TAX PLANNING AND TAX EVASION

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Abstract

India's tax system has dramatically changed with implementing the General Anti-Avoidance Rules (GAAR), which are intended to curtail aggressive tax avoidance strategies without impeding legal tax plans. This study explores GAAR's goals, structure, and effects in India, paying special attention to its attempts to distinguish between legal tax planning and illegal tax evasion. Under GAAR, tax authorities can remove tax benefits obtained through arrangements primarily intended to get tax benefits or lack actual economic substance. Although its implementation strengthens the government's ability to combat profit shifting and erosion of the tax base, it raises questions about predictability, certainty, and the discretionary authority granted to tax officials. GAAR's legislative and judicial background is carefully assessed in this study, focusing on essential clauses, cutoff points, and procedural safeguards, such as the role of the Approving Panel. It also examines how GAAR might affect cross-border transactions, foreign investment, and India's overall business environment. Comparative analyses from other international jurisdictions provide a broader view of anti-avoidance frameworks, which helps contextualise India's approach. According to the paper, maintaining investor confidence and economic competitiveness while maintaining the tax system's integrity depends on the prudent application of GAAR. It concludes that for GAAR to deter tax evasion without becoming a tool of arbitrary taxation, there must be transparency, consistency in interpretation, and strong institutional safeguards.

Introduction

Instead of being based on subjective decisions, taxes should be based on clarity and predictability. Every taxpayer should know their debt, due date, and the payment method. Uncertain or ambiguous tax obligations give tax collectors undue power, which could be used to abuse the system, threaten taxpayers, or seek personal gain by threatening higher assessments. Even in cases where officials act appropriately, unclear tax obligations encourage abuse and foster distrust and discontent among the populace. More critical than fixing every small inequity in the system is ensuring that tax laws are transparent and unambiguous. This point of view emphasises the responsibility of legislators to draft tax laws that are clear, understandable, and straightforward. Tax regulations must be explained clearly so taxpayers can understand their duties without confusion. The rules should be strict enough to deter noncompliance and encourage responsible behaviour simultaneously. Additionally, tax authorities should have the authority to act against individuals trying to evade taxes. Still, they must

ensure this authority is used within reasonable and defined bounds.[1]

Society's expectations for a fair and consistent legal system are reflected in the principles of the "rule of law." It has historically been interpreted to mean that laws must take precedence over capricious judgments or authorities. Legal experts have expanded the concept to include essential elements that give the rule of law its practical significance, even though it could be understood as the existence of laws rather than specific directives. Among these, one key component is that laws should be able to guide individual conduct. For laws to accomplish this, they must be clear and consistently enforced, enabling individuals to comprehend what is required or forbidden. The Rule of Law is a fundamental principle in governance, ensuring that all government actions are based on legal authority rather than arbitrary decision-making. It necessitates that laws be transparent, predictable, and applied consistently, enabling individuals and organisations to organise their activities with a reasonable level of certainty.

When considering General Anti-Avoidance Rules (GAAR), issues emerge concerning the legal framework's predictability and objectivity. Suppose a transaction is thought to be primarily structured to obtain a tax advantage. In that case, tax authorities in India have the authority to refuse tax benefits under the broadly defined GAAR provisions. This extensive power may jeopardise the justice and certainty that the rule of law guarantees. There are challenges because GAAR is subjective, especially regarding the "main purpose" test and the "substance over form" doctrine. These theories create legal ambiguity and unpredictability by allowing tax authorities to investigate a transaction's accurate content outside its formal framework. This goes against the Rule of Law, which states that people must be able to predict how their actions will affect the law. Furthermore, the risk of arbitrary enforcement is increased by the absence of precise statutory definitions and the broad discretionary authority given to tax authorities to declare arrangements unlawful based on intent or alleged misuse. Critics claim this goes against Article 14 of the Indian Constitution, which guarantees equal treatment under the law and prohibits the state from acting arbitrarily.[2]

Even though this standard is typically met by many legal systems, creating legislation to stop tax evasion presents difficulties. In almost every jurisdiction, tax avoidance is a complex issue. It is not to be confused with tax evasion, which encompasses unlawful actions such as failing to file tax returns or underreporting income. Additionally, it is distinct from tax mitigation, which legally lowers tax liabilities by utilising exemptions or deductions permitted for charitable contributions. There is tax evasion between these two groups. Usually, it entails creating transactions, sometimes fictitious, to lower tax obligations in ways that contradict the goals of tax laws. It is difficult to determine when acceptable avoidance turns into legal tax planning. There is a point at which attempts to reduce liability are viewed as abusive, even though people are not obligated to arrange their financial affairs to pay the highest taxes possible. Legal frameworks frequently find it challenging to pinpoint this exact threshold. Some have sought to define tax avoidance as any arrangement whose primary goal is to bypass tax responsibilities, but this offers little clarity. Instead of depending solely on vague definitions, tax avoidance is often better understood through concrete examples. Such arrangements frequently exhibit features like artificiality, a deficiency of economic substance, minimal genuine business risks, or dependence on technical loopholes. In many situations, the structures employed in avoidance schemes exploit tax regulations meant to ensure fairness, taking advantage of them in ways lawmakers

[1] Ankita Bhattacharjee, General Anti Avoidance Rule (GAAR) and Its Functioning-A Study, iPleaders (21 July 2025, 06:36 AM) https://blog.ipleaders.in/general-anti-avoidance-rule-gaar-functioning-study/

[2] Tarun Jain, 'GAAR' and Rule of Law: Mutually Incompatible? Manupatra (21 July 2025, 05:03 AM) https://docs.manupatra.in/newsline/articles/Upload/A0134272-9B64-46B2-A070-09E4AC230715.pdf

likely never intended. A notable example stems from a case in the U.K. involving the sale of development land. A company planning to sell land valued over £250,000, which would generally be liable for development land tax, divided the land into five undivided shares and sold each to separate but related firms within its group. Each share was priced at £36,000 and then resold to the final buyer for £52,000. Although the sales seemed legitimate on paper, the economic reality was that there was only one transaction. Nonetheless, the courts upheld the transaction's form, permitting the company to avoid the tax. This case illustrates the challenges of addressing avoidance under conventional legal principles. Even though the transactions adhered to the letter of the law, they contradicted its spirit. Such cases emphasise the necessity for legal systems to balance allowing lawful tax planning and restricting strategies that diminish the tax base through technical manipulation of the law.[3]

People frequently look for methods to reduce their tax responsibilities, which results in new practices. The most prevalent of these globally are tax evasion and avoidance. Individuals and organisations commonly exploit loopholes or ambiguities in tax laws to reduce or avoid their tax obligations. The arrangement of financial affairs to minimise tax liability by taking advantage of legal loopholes without breaking the law is known as tax avoidance. Delaying, transferring, or reducing tax obligations in a manner that is technically acceptable but goes against the purpose of tax laws frequently entails using complex structures or timing techniques. This might entail rearranging investments or accounts to reduce tax obligations without outright breaking the law. On the other hand, tax evasion, which was formerly a little unclear, is now unmistakably illegal. It entails willful misrepresentation, withholding income, or fabricating documentation to avoid paying taxes. Actions such as underreporting income, exaggerating expenses, or incorrectly categorising personal expenses as business-related fall into this category and are subject to legal penalties.[4]

Worldwide, tax evasion has raised significant concerns for governments, leading to stricter regulation and the establishment of anti-avoidance frameworks. Numerous countries, including India, have implemented initiatives like the General Anti-Avoidance Rules (GAAR) to combat such activities. GAAR was introduced in India under the Income Tax Act of 1961 to address aggressive tax avoidance tactics and was put into effect on 1 April 2017. Its establishment was significantly influenced by the pivotal Vodafone-Hutchison case, which involved offshore transactions and had significant tax consequences.[5] Indian authorities claimed that the transaction resulted in a revenue loss exceeding USD 2 billion, although the Supreme Court eventually ruled in favour of Vodafone. GAAR empowers tax authorities to nullify transactions primarily conducted for tax benefits and lacking genuine commercial substance. GAAR aims to improve the fairness and effectiveness of the tax system while discouraging arrangements designed solely for tax avoidance. Tax revenue is essential for financing government functions and public services. However, it weakens the overall financial system when taxpayers seek to evade their obligations through deceit. By enforcing GAAR and similar regulations, the Indian government strives to close legal gaps, ensure compliance, and protect the country's revenue base from exploitative tax practices. In the case of Union of India and Another v. Azadi Bachao Andolan (2003),[6] the main argument presented to the Supreme Court was that any method of tax planning aimed at evading taxes should be considered invalid, according to the precedent

[3] Rebecca Prebble & John Prebble, Does the Use of General Anti-Avoidance Rules to Combat Tax
Avoidance Breach Principles of the Rule of Law? A Comparative Study, 55 St. Louis U. L.J. (2010).
Available at: https://scholarship.law.slu.edu/lj/vol55/iss1/8

[4] Tanishka Tiwari, What are General Anti-Avoidance Rules & their Impact on India, Law Insider India (21 July 2025, 06:58 A.M.) https://lawinsider.in/columns/what-is-general-anti-avoidance-rules-its-impact-on-india

[5] Vodafone International Holdings BV v. Union of India & Anr, 341 ITR 1 [2012]

[6] AIR 2004 SUPREME COURT 1107

established in McDowell & Co. v. Commercial Tax Officer (1985).[7] However, the Court rejected this argument and upheld the legitimacy of lawful tax planning. The Court referenced previous decisions, particularly the Privy Council's ruling in Bank of Chettinad Ltd. v. CIT (1940),[8] reinforcing the principle outlined in the landmark case of IRC v. Duke of Westminster (1935).[9] In this case, it was determined that individuals have the right to arrange their financial matters in a way that legally minimises their tax obligations according to the law in force. The Supreme Court emphasised that this principle remained relevant even after the Constitution of India was enacted, due to Article 372, which maintains all existing laws unless repealed or modified by an authorised body.[10] The Court firmly asserted that an action that is valid according to the law cannot be rendered invalid solely based on an alleged motive that may be economically disadvantageous or harmful to national interest by the opposing party. Despite this ruling, tax authorities have persisted in examining and disputing various taxpayer setups, particularly regarding international or cross-border transactions, questioning their legitimacy and purpose regarding tax avoidance.

Understanding GAAR

The General Anti-Avoidance Rule (GAAR) is a regulatory framework that prevents companies from engaging in arrangements primarily intended to lower or evade tax responsibilities. This rule is specified in Chapter X-A of the Income Tax Act 1961 in India.[11] GAAR was initially introduced during the 2012 Union Budget by Finance Minister Pranab Mukherjee as part of a broader tax reform initiative. The Indian Constitution, specifically Article 265, empowers the government to levy and collect taxes from its citizens.[12] It is a broadly accepted principle that everyone should contribute their fair share of taxes under the law. When individuals or organisations willfully evade their tax duties, such behaviour may be classified as tax evasion, which is punishable under Indian law. However, there are occasions when companies seek to minimise their tax liabilities through strategic fiscal planning, referred to as tax avoidance. Although such practices are not inherently illegal, they can undermine the intended purpose of tax laws. GAAR was established through the Finance Act of 2012 to tackle this concern. Its goal is to focus on arrangements specifically designed to gain a tax advantage that lacks genuine commercial substance, whether directly or indirectly. According to GAAR provisions, such arrangements can be deemed impermissible. Tax avoidance is legally defined as reducing tax liability by employing the methods allowed within the framework of existing tax laws. Nevertheless, GAAR seeks to establish a distinct boundary between legitimate tax planning and schemes crafted solely to exploit loopholes for tax benefits. Tax evasion refers to the intentional act of an individual or organisation to avoid paying taxes that they are legally obligated to pay to the government. This action is deemed illegal and subject to punishment under the law. Those guilty of tax evasion may face significant legal repercussions, including penalties and criminal charges. Conversely, tax avoidance is minimising tax liabilities through permissible methods. It is not considered unlawful, as it adheres to the legal framework. For instance, if a worker allocates a segment of their salary into government-sanctioned funds or instruments to obtain deductions, this is a valid form of tax avoidance. Even so, when used excessively or to take advantage of already-existing legal loopholes, such practices may come under scrutiny. Tax avoidance is using tax laws to reduce one's tax liability legally. While such actions are legally permissible, they frequently take advantage of unintentional gaps or loopholes in legislation. These arrangements are typically structured in ways that follow the letter of the law but not necessarily the spirit. To

[7] AIR 1986 SUPREME COURT 649
[8] (1941) 43 BOMLR 132
[9] [1936] A.C.;[1] 19 TC 490
[10] The Constitution of India, 1949, Art 372
[11] The Income Tax Act, 1961, § 95-102
[12] The Constitution of India, 1949, Art 265

prevent such transactions, especially those whose primary objective is to receive a tax benefit without offering actual commercial value, the General Anti-Avoidance Rule (GAAR) was implemented.[13]

The creation of the General Anti-Avoidance Rule (GAAR) in India represents a broader political and economic story than just a change in legislation. It represents the delicate balance the country must maintain between ensuring equity in its tax system, drawing in foreign investment, and collecting enough tax revenue. GAAR was not created in a vacuum within India's tax system; instead, it resulted from considerable discussion, substantial disagreements, and an increasing awareness worldwide of the need for strong instruments to counter complex avoidance strategies. The Direct Taxes Code Bill 2009 was the first legislation formally introducing the GAAR concept. Updating tax laws to reflect changing business practices was the goal. To shift profits and obtain tax benefits, authorities had started to notice increasingly fabricated transactions that were difficult to challenge under the current legal system. However, the Finance Act 2012, which then-Finance Minister Pranab Mukherjee introduced, formally incorporated GAAR into the Income Tax Act. This marked the beginning of its journey, but not without conflict. The announcement of GAAR caused a great deal of anxiety. While foreign investors voiced concerns about the broad powers granted to tax authorities, Indian businesses were concerned about increased uncertainty. This came after the Vodafone case's retroactive tax changes increased market anxiety worldwide. Its implementation was repeatedly delayed because of these concerns. GAAR finally went into effect in April 2017, although it was initially scheduled for April 2012.

The fundamental difficulty of maintaining the integrity of the country's tax system while maintaining investor confidence was brought to light by these postponements, which went beyond simple procedural issues. Companies and investors want uniformity, but GAAR's design allows tax officials to examine transactions that might seem legal, creating uncertainty in an already complex system. Simultaneously, there was growing domestic and international pressure for India to combat tax avoidance effectively. By committing to the OECD's Base Erosion and Profit Shifting (BEPS) initiative, India indicated its intention to align with global standards. Increasing scrutiny was also directed at digital giants and other multinational corporations profiting from Indian consumers while paying minimal taxes. The call for a comprehensive, principle-based legal framework became increasingly difficult to overlook. The eventual enactment of GAAR in 2017 was also politically significant. The Modi administration, which came to power in 2014 with reform and improved governance pledges, faced mounting pressure to address tax evasion and black money. The introduction of GAAR and the Goods and Services Tax (GST) rollout illustrated a more extensive agenda to revamp India's taxation landscape.[14]

Major corporations engaging in aggressive tax avoidance tactics can significantly diminish government revenue. The General Anti-Avoidance Rule (GAAR) was implemented to address such actions. GAAR is designed to identify and tackle arrangements primarily to obtain tax benefits by circumventing tax liabilities, utilising legal yet questionable structures. GAAR operates under the principle of "substance over form," meaning that tax authorities focus not just on the legal documentation of a transaction but also on its true intent and purpose. Even if a transaction seems legitimate on paper, it may still be challenged if it lacks genuine commercial substance. To assess if a transaction is subject to GAAR, four essential criteria are evaluated:

[13] Bhola Shankar, Critical Analysis of GAAR in light of the Constitution of India and DTAA, SCC Online Times (21 July 2025, 07:17 PM) https://www.scconline.com/blog/post/2023/03/06/critical-analysis-of-gaar-in-light-of-the-constitution-of-india-and-dtaa/

[14] Shatik Dhawan & Dr. Kritika Nagpal, The Role of GAAR In Combating Corporate Tax Avoidance in India: Legal Framework, Judicial Interpretation and Comparative Insights, Vol 13 Issue 4, IJCRT, 470-485 (2025) https://www.ijcrt.org/papers/IJCRT25A4699.pdf

whether the arrangement establishes rights or obligations that are not at arm's length; whether it results in the misuse or abuse of tax regulations; whether it lacks real commercial substance; and whether it was executed in good faith. Tax authorities determine that a transaction meets at least one of these requirements and is primarily intended to evade taxes. They may then declare it to be an illegal arrangement. In these situations, authorities can reclassify the transaction to ensure correct taxation and prevent a loss of government revenue.[15]

The General Anti-Avoidance Rule (GAAR) is not applicable in cases where a taxpayer opts for one legitimate method instead of another to execute a transaction. It operates on the principle of "substance over form," which enables tax authorities to delve deeper than the legal arrangement of a transaction to assess its genuine intent and economic essence. This principle aims to deter artificial setups established solely for tax advantages. However, its implementation is frequently perceived as subjective and uncertain.

The Bombay High Court highlighted this apprehension in the case of Provident Investment Co. Ltd. v. CIT, where the court warned against substituting the clarity provided by statutory provisions with vague discretionary interpretations.[16] The lack of objective standards under GAAR can result in tax officials' arbitrary exercise of authority, particularly in differentiating between legitimate tax planning and unacceptable avoidance. Furthermore, the absence of sufficient legislative protections intensifies the risk of exploitation.

The Supreme Court in Maneka Gandhi v. Union of India asserted that Article 14 of the Constitution prohibits arbitrary government action.[17] In its present state, GAAR arguably infringes upon this tenet due to the broad discretionary powers it bestows upon the tax authorities.[18] Likewise, in S.G. Jaisinghani v. Union of India, the Court noted that a fundamental aspect of the rule of law is eliminating arbitrary power, stating that executive decisions should be anchored in established legal standards. When ambiguous or unpredictable legal provisions compromise taxpayers' ability to manage their affairs effectively, they violate the constitutional mandate of equity.[19] Furthermore, the Supreme Court reiterated in I.R. Coelho v. State of Tamil Nadu that the rule of law is essential to the fundamental structure of the Constitution.[20] GAAR threatens this fundamental idea since it can operate arbitrarily and irregularly. To promote compliance and public trust, laws must be precise, dependable, and stable, particularly regarding taxes. A significant concern is the possible conflict between GAAR and India's obligations under Double Taxation Avoidance Agreements (DTAAs). These agreements promote global investment and trade while avoiding the duplication of income taxes. Section 90(2) of the Income Tax Act confirms that the provisions of a DTAA take precedence over conflicting domestic tax statutes when they benefit the taxpayer more.[21] This was affirmed by the Supreme Court in Engineering Analysis Centre of Excellence (P) Ltd. v. CIT, which held that DTAA provisions supersede conflicting provisions of the Income Tax Act.[22] Nonetheless, Section 90(2A) was later added to clarify that the provisions of Chapter X-A (GAAR) apply even if they are less advantageous to the taxpayer, thereby overriding DTAAs.[23] This raises concerns about the integrity of international treaties, as reiterated by the Delhi High Court in DIT v. New Skies Satellite BV, which ruled that domestic law cannot unilaterally change the terms of a treaty. The court also cited the Vienna Convention on the Law of Treaties (1969),

[15] Sharad Yadav, General Anti Avoidance Rule: Implication and Perspective, iPleaders (21 July 2025, 07:44 PM) https://blog.ipleaders.in/general-anti-avoidance-rule-implication-perspective/
[16] 1953 SCC OnLine Bom 35
[17] (1978) 1 SCC 248
[18] The Constitution of India, 1949, Art 14
[19] AIR 1967 SC 1427
[20] (2007) 2 SCC 1
[21] The Income Tax Act, 1961, § 90(2)
[22] (2022) 3 SCC 321
[23] The Income Tax Act, 1961, § 90(2A)

stipulating that the signatory nations must mutually agree upon any treaty amendments.[24]

The High Court underscored that while Parliament possesses the authority under Article 253 of the Constitution[25] to implement international treaties, this authority does not allow for the alteration or violation of such treaties through regular legislation enacted under Article 246.[26] Any unilateral actions in this regard would compromise India's international commitments.

GAAR aims to be a comprehensive solution against aggressive tax evasion, but its current form poses various constitutional and legal concerns. These include uncertainty, arbitrariness, inconsistency with treaty commitments, and violations of the rule of law. GAAR must have clearly defined boundaries, encourage transparency, and uphold its obligations under international treaties to be successful and constitutionally sound. Without such clarity, the risk of misuse remains high, and its implementation may result in unfair outcomes and legal uncertainty for taxpayers.

International perspectives on GAAR

Although general anti-avoidance rules (GAAR) exist in various jurisdictions, including Sweden, Germany, and Hong Kong, this discussion is limited to their application in the United Kingdom, the United States, Canada, South Africa, and Australia.[27]

United Kingdom The UK does not follow a codified GAAR system. Instead, it relies on judicial precedents and specific legislation known as Targeted Anti-Avoidance Rules, which address types of unacceptable tax avoidance. While this framework has proven somewhat effective, it fails to address complex and evolving tax arrangements. In 2010, the government set up a study group to evaluate the necessity of a GAAR. The group concluded that a broadly framed GAAR might negatively affect legitimate tax planning and business confidence. As a result, it recommended a narrowly focused GAAR that would only target abusive tax schemes. This proposal was considered for implementation in 2013.

United States The United States also lacks a comprehensive codified GAAR. However, it has recently incorporated the economic substance doctrine into its tax code to provide clarity and consistency. In addition to this doctrine, several judicial principles serve as anti-avoidance tools. These include Sham Transaction, Economic Substance, Business Purpose, Substance over Form, and the Step Transaction Doctrine. Each of these doctrines is used by courts to challenge transactions designed primarily to avoid taxes.

Canada

GAAR is codified under Section 245 of the Income Tax Act in Canada, effective since 1988.[28] This provision intends to prevent abusive tax avoidance while preserving legitimate commercial and family arrangements. Canadian courts have developed a three-step analysis to determine the applicability of GAAR:

(i) identifying a tax benefit resulting from the transaction,
(ii) assessing whether the transaction was primarily carried out for tax avoidance rather than for a bona fide purpose, and
(iii) evaluating whether the transaction was abusive. Key terms such as 'tax benefit', 'transaction', and 'avoidance transaction' are defined in the Act, though 'misuse' and 'abuse' are not.

In notable cases, such as Copthorne Holdings Ltd. v Canada and Canada Trustco, the Supreme Court has provided essential interpretations, including allocating the burden of proof between the taxpayer and the tax authority. The Canada Revenue Agency has also issued an information circular to clarify the application of GAAR, explaining how

[24] 2016 SCC OnLine Del 796
[25] The Constitution of India, Art 253
[26] The Constitution of India, Art 246
[27] Arshu John and Linesh Lalwani, General Anti-Avoidance Rule (GAAR): An Indian and International Perspective, Vol 4 Issue 1, NLIULR, 172-208 (2014) https://nliulawreview.nliu.ac.in/journal-archives-2/volume-vi-issue-i/general-anti-avoidance-rule-gaar-an-indian-and-international-perspective/
[28] The Canadian Income Tax Act, 1985, § 245

transactions are assessed, what constitutes avoidance, and offering examples of misuse or abuse.

South Africa South Africa introduced its GAAR provisions in 2006, codified under Sections 80A to 80L of the Income Tax Act, 1962.[29] These provisions replaced the earlier Section 103 and now serve as the country's primary anti-avoidance framework. Interestingly, India's GAAR regime has drawn heavily from South Africa's model, with both systems sharing many similarities in application and scope.[30] The South African Revenue Service has published a Draft Comprehensive Guide to GAAR to clarify implementation. According to the guidance, a tax benefit may be denied if it results in the misuse or abuse of the object, spirit, or purpose of the provisions of the Act relied upon to obtain that benefit.

Australia

Australia's experience with General Anti-Avoidance Rules (GAAR) can be analysed in two major phases: a time frame before 1981 and the developments that came after. Before 1981, the principal provision regarding tax avoidance was Section 260 of the Australian Income Tax Assessment Act (ITAA).[31] This clause gave the Commissioner of Taxation the authority to ignore or reclassify transactions meant to avoid paying taxes. Nevertheless, courts interpreted Section 260 rather narrowly despite its broad wording, which limited its effectiveness in several ways. The clause was criticised for being rigid and failing to handle intricate tax evasion schemes adequately.

Australia added Part IVA to the ITAA in 1981 to address these issues. This clause created a stronger legal foundation to combat tax evasion schemes. Any tax benefit obtained from an arrangement primarily designed to secure that benefit may be revoked by the Commissioner under Part IVA. Courts analyse each case according to its facts to determine whether Part IVA covers an arrangement. This is done by objectively assessing the arrangement's primary purpose.

A broadly worded ban on arrangements intended to change income incidence, reduce tax liabilities, or undermine the effectiveness of tax laws was included in Section 260. However, because of the provision's expansive wording, judicial tests had to be established to define its bounds. The prediction test was one such test that looked at whether a transaction's execution and design suggested that it was intended to avoid taxes. The transaction would typically be regarded as exempt from anti-avoidance laws if it followed accepted business practices. Another important idea was the choice principle, which recognised taxpayers' right to select from among options permitted by tax law, even if one option resulted in more favourable tax outcomes. This principle underscored the legitimacy of tax planning within legal alternatives, if the actions were not sham transactions or devoid of commercial purpose. Over time, courts began to favour this principle, viewing it as more consistent with commercial realities and taxpayer autonomy.

Australian courts later embraced the antecedent transaction doctrine to curb the misuse of the choice principle. This approach enabled courts to evaluate the final transaction and the earlier actions that led up to it. If a series of transactions was arranged primarily to secure a tax advantage, courts could look past the individual steps and examine the arrangement to ascertain its intent. This doctrine ensured that legitimate choices could not be exploited to hide tax avoidance intentions.

The implementation of Part IVA in 1981 represented a pivotal shift by substituting Section 260's broad and frequently ineffective measures with a more defined and structured anti-avoidance framework. Part IVA necessitates fulfilling three criteria: the existence of a scheme, the taxpayer gaining a benefit from it, and the arrangement being

[29] The South African Income Tax Act, 1962, § 80A to 80L
[30] The South African Income Tax Act, 1962, § 103
[31] The Australian Income Tax Assessment Act, 1936, § 260

created to achieve that benefit. The dominant purpose is evaluated objectively, factoring in eight specific elements detailed in Section 177D of the ITAA.[32] These elements encompass the scheme's design, timing, financial implications for the involved parties, and whether it lacked commercial substance.

A significant legal advancement under Part IVA was a seminal verdict concerning a corporation reorganising its operations to produce substantial tax savings without a commercial rationale. The judiciary determined that the arrangement was predominantly motivated by the objective to acquire a tax benefit and, as such, was encompassed by the provisions of Part IVA. This court ruling confirmed that even legally compliant transactions can be ignored if they are primarily planned to obtain tax benefits rather than having a legitimate business purpose. Since the introduction of Section 260, Australia's legal system has experienced significant change. Although early judicial doctrines like the choice principle and predication test shaped how tax laws were interpreted, their shortcomings made a shift to a more objective standard necessary with the creation of Part IVA. The current General Anti-Avoidance Rule (GAAR) framework aims to strike a balance between allowing reasonable tax planning and preventing aggressive tax avoidance strategies. As part of its extensive efforts to counteract base erosion and profit shifting (BEPS), Australia has recently expanded its GAAR provisions. The government announced changes to the GAAR in the 2023–2024 Budget that specifically targeted arrangements to reduce Australian tax liabilities by lowering withholding tax rates or receiving domestic income tax benefits, even when the primary goal was to reduce foreign tax obligations. These reforms exemplify Australia's enduring dedication to fortifying the integrity of its tax system while adapting to the dynamic landscape of international tax practices.[33]

New Zealand

New Zealand possesses one of the earliest frameworks for general anti-avoidance, establishing GAAR under Section BG-1 of the Income Tax Act in 1878. Tax avoidance, as specified in the Act, encompasses any scheme that modifies the application of income tax or aims to relieve an individual from present or future tax responsibilities. It includes actions designed to postpone, lessen, or eliminate tax duties. A transaction is considered to involve tax avoidance if one of its goals or outcomes, whether direct or indirect, is to obtain a tax advantage. Even if a transaction fulfils typical business purposes in addition to this, the mere presence of a tax avoidance motive is adequate for GAAR to come into effect. In assessing if a transaction constitutes tax avoidance, authorities consider the intent of the legislation being employed, the actual commercial and financial context of the transaction, and common signs of avoidance, such as a mismatch between legal form and economic substance.

Austria

Although Austrian tax law permits individuals and entities to organise their financial and business matters, this freedom comes with considerable restrictions under GAAR. Austrian authorities' primary concern is ascertaining whether a transaction's primary or sole purpose is to evade tax. Even if the arrangement seems distinctive or unconventional, this alone does not preclude examination. Austrian tax officials must establish that tax avoidance was the primary motivation behind the transaction.

Germany

Germany integrates its general anti-avoidance rule into the tax code through a concept known as Abgabenordnung (AO). The provision regarding "abuse of legal form" enables tax authorities to disregard the legal structure of a

[32] The Australian Income Tax Assessment Act, 1936, § 177D

[33] Sayed Qudrat Hashimy, A Tale of Two Tax Systems: A Comparative Analysis of General Anti-Avoidance Rules Provisions in India and Australia, Vol 9 Issue 3, JSSJLSR, 20-36 (2023) https://jsslawcollege.in/wp-content/uploads/2024/11/2.-A-Tale-of-Two-Tax-Systems-A-Comparative-Analysis-of-General-Anti-Avoidance-Rules-Provisions-in-India-and-Australia.pdf

transaction if it is primarily arranged to evade taxes. In enforcing these regulations, courts adhere to the principle of substance over form, emphasising the actual intent and economic reality of the transaction rather than its formal structure. Legal interpretation in these circumstances depends on principles such as teleological reduction and analogy. Germany ranks among the jurisdictions with the highest number of judicial rulings related to anti-avoidance, underscoring the country's proactive approach to combating tax avoidance practices.[34]

Efficacy of GAAR in India

Implementing the General Anti-Avoidance Rules (GAAR) in India was initially met with considerable scepticism and resistance. The original proposal underwent multiple stages of revision, including amendments in the Finance Bill of 2012, followed by draft guidelines, and finally the recommendations of the Shome Committee. While many of these adjustments were necessary and significantly improved the initial framework, the final version of GAAR still presents a mix of strengths and shortcomings that deserve closer examination.

Positive developments

One of the most essential improvements following the introduction of GAAR is shifting the burden of proof to the tax department. This change protects taxpayers from being subjected to an unfair and arbitrary tax regime. Additionally, both expert committees agreed on the need for a monetary threshold for applying GAAR. This approach helps prevent its indiscriminate use and shields small investors from undue scrutiny and administrative burden.

Another valuable recommendation is the formation of an Approving Panel. The Shome Committee suggested that this panel include at least two members not part of the tax department and be chaired by a retired High Court judge. Importantly, the decisions of this panel would be binding on the tax authorities. This measure is expected to enhance investor confidence by promoting transparency and objectivity in enforcement.

The provision establishing a time limit for invoking GAAR has also been well received. Under this rule, the commissioner cannot act against a taxpayer after six months of receiving the relevant report. Furthermore, if the commissioner disagrees with the taxpayer's objections, they must refer the case to the Approving Panel within 60 days. If the objections are accepted, a formal communication must also be made within the same period.

Lastly, if the illustrative examples provided by the Expert Committee are accepted, they could help standardise the interpretation and application of GAAR, offering greater clarity and predictability for taxpayers.

Areas of concern

Even with these advantages, there are still many problems. Concerns have been raised about the timing of GAAR's implementation, particularly considering India's fiscal and current account difficulties and the uncertain state of the world economy. Attracting foreign investment ought to be a top priority during these times. Another drawback is the time needed to receive decisions from the Authority for Advance Rulings. To reassure investors, a system for obtaining these decisions within six months ought to be in place. There has also been a lot of discussion about the "grandfathering clause." As of GAAR's introduction, giving all current arrangements permanent protection might not be wise. Protecting just those investments rather than the agreements made by residents and non-residents would be a more equitable course of action. Applying GAAR retroactively would guarantee that tax benefits are not withheld upon the exit of such investments. Applying GAAR retroactively would guarantee that tax

[34] Shubham Patkar and Simran Agarwal, Addressing GAAR: Cross Country Experience with Special Reference to India, Vol 2 Issue 6, IJIRL, 540-563 (2022) https://ijirl.com/wp-content/uploads/2022/11/ADDRESSING-GAAR-CROSS-COUNTRY-EXPERIENCE-WITH-SPECIAL-REFERENCE-TO-INDIA-.pdf

benefits are not withheld upon the exit of such investments.

GAAR Provisions and Foreign Investors

The primary goal of the General Anti-Avoidance Rules (GAAR) is to identify and address arrangements that are primarily designed to obtain tax benefits without a valid business purpose. Before investing, foreign investors usually assess a country's tax structure, especially the benefits and incentives it offers. Their main goal is to maximise profits, and the host nation must create an environment conducive to investment through its tax and regulatory policies. Foreign investors were alarmed by the GAAR's implementation, particularly considering the landmark Vodafone case, because they saw it as a reactive move by tax authorities and a possible danger to future investment agreements. Foreign investments have traditionally been governed by Double Taxation Avoidance Agreements (DTAAs) between countries. These agreements are intended to clarify and reduce the possibility of double taxation for foreign investors. However, there are questions about whether local laws can take precedence over such international agreements, given that GAAR applies broadly to various transactions. In India, tax treaties are superseded by GAAR. Global tax standards, which encourage nations to amend treaties to ensure they continue to be effective in the face of shifting local regulations, support this superior authority. As a result, treaties with countries like Singapore and Mauritius have been updated to include anti-abuse provisions to address tax avoidance concerns.

The Central Board of Direct Taxes' (CBDT) clarifications have increased openness about applying GAAR, especially concerning DTAAs. Essential topics such as tax-efficient jurisdictions, the applicability of limitation of benefits (LoB) clauses, and the grandfathering of current investments have all been covered in the guidance. These clarifications reassured foreign investors that GAAR would not take precedence over treaties that contain a clearly defined LoB clause, as is the case with Singapore and Mauritius. On the other hand, GAAR still applies to agreements with countries that lack such clauses, such as the Netherlands and Cyprus. However, more guidance is required to prove that investors are shielded from GAAR scrutiny by following LoB provisions. A proactive approach to addressing tax avoidance within the framework of the Mauritius tax treaty is demonstrated by recent amendments that allow capital gains taxation at the source. Given that treaties are already in place to allay such worries, this raises the question of whether GAAR is still required. GAAR's broad reach and discretionary authority have raised questions about whether it is legal to set up companies in low-tax jurisdictions to reduce liability. Opponents claim that choosing a tax-efficient structure is a valid business strategy. Tax authorities also see it as a way to protect tax revenues and uphold their taxation rights over income derived from Indian economic activity.

Legitimate tax planning and unacceptable avoidance must be distinguished from one another. Tax authorities' frequent changes to their definitions of abuse undermine taxpayers' certainty. However, due to the dynamic nature of business and cross-border trade, a thorough regulatory framework is necessary to counter new avoidance strategies. A general provision like GAAR is essential because specific anti-avoidance laws might not be able to handle all these situations. When compared to international peers, the Indian GAAR bears similarities to frameworks in nations such as South Africa. However, India's approach is more stringent. Even if only a portion of a transaction is arranged to achieve a tax benefit, the entire setup can be classified as tax avoidance. In contrast, countries such as South Africa, Canada, and the United Kingdom adopt a more measured perspective. For example, in Canada, transactions may still be considered valid if their principal goal is commercial, even if they result in some tax advantage.

The Indian method, in which tax benefits are frequently viewed as the primary goal, begs for more refining. A more nuanced categorisation, like the Canadian model, may improve the fairness of GAAR's application. This could entail distinguishing between transactions with a legitimate business goal and those in which only a portion is intended to reduce tax liability. While the CBDT has provided some explanations, it has not supplied sufficient examples or case-based illustrations to assist taxpayers. The previous Shome Committee report offered such instances, but this approach was not implemented in the final policy implementation, leaving potential for more openness and understanding.[35]

Suggestions

It is crucial to define its boundaries precisely to achieve clarity and predictability in enforcing GAAR. Tax advantages alone should not be the primary criterion for categorising a transaction as an impermissible avoidance arrangement, as this does not differentiate between valid tax planning and aggressive tax avoidance. Looking at global examples like the Aaronson Report, a tightly defined GAAR focusing solely on artificial and excessively contrived schemes while permitting genuine tax planning may be more appropriate for India. When determining whether a transaction falls under GAAR, actions taken by tax authorities must be based on objective and reasonable criteria. A phased introduction of GAAR, beginning with specific high-risk arrangements under direct tax regulations, can assist in managing its effects. Once these preliminary measures prove effective, the reach of GAAR can be expanded to tackle other types of avoidance tactics.

It is vital to provide clear safeguards to protect legitimate transactions, particularly those conducted for charitable reasons or without any intention of tax avoidance. Furthermore, the requirement for mandatory pre-approval from revenue authorities could be removed to alleviate administrative burdens. GAAR should depend on a fact-oriented examination to assess whether a transaction was primarily crafted to secure a tax advantage. A provision akin to the misuse or abuse clause in South African tax legislation could help confine GAAR's application to arrangements that contravene the law's intent.

Critical terms, including "impermissible avoidance arrangement," "main purpose," "bona fide," "lack of commercial substance," and "round tripping," must be accurately and definitively articulated to avoid arbitrary interpretation. An independent Approving Panel should be established as an advisory and review entity to ensure GAAR's fair and consistent application. The introduction of comprehensive guidance notes, ideally with straightforward examples, would aid taxpayers in differentiating between acceptable tax planning and disallowed arrangements. Taxpayers should also be able to respond if they are accused of engaging in impermissible transactions, consistent with natural justice principles.

Significantly, GAAR should not be applied retrospectively to transactions completed before it comes into force. Specific provisions could be instituted for foreign institutional investors to encourage and retain foreign investment, such as exemptions related to capital market investments, fixed tax rates, and safe-harbour rules for those operating outside Double Taxation Avoidance Agreements (DTAAs). Additionally, GAAR should not supersede international tax treaties that do not include a Limitation of Benefits (LoB) clause, which could result in double taxation. To prevent indiscriminate enforcement, a minimum monetary threshold should be established. Moreover, a statutory time frame must be set for commencing GAAR proceedings. The legislation should delineate a straightforward procedure for managing cases flagged under GAAR. Taxpayers dissatisfied with the Assessing Officer's ruling should be allowed to appeal to

[35] Shivayana Balodia, GAAR's Impact on Foreign Investors, iPleaders (21 July 2025, 10:56 P.M.) https://blog.ipleaders.in/gaars-impact-on-foreign-investors/

the Dispute Resolution Panel (DRP), where both sides can present their cases. The DRP can then issue a reasoned decision.

GAAR might be structured to function as a self-assessment system. Taxes paid under GAAR should be included in the taxpayer's regular return, lowering compliance expenses. While standard penalties for non-compliance should apply, excessively severe penalties are unnecessary unless there has been intentional nondisclosure of abusive transactions. In such instances, stricter penalties may be justified. Ultimately, the judiciary will remain essential in influencing the interpretation of GAAR. Courts should ensure that their decisions align with the legislative intent to provide clarity for taxpayers. They should not stop applying GAAR to reduce litigation, which may weaken its effectiveness.[36]

Conclusion

Many prominent countries, including Canada, Australia, and China, have already integrated General Anti-Avoidance Rules (GAAR) into their taxation systems, with the United Kingdom preparing to implement similar regulations. While several European Union nations may not have comprehensive GAAR frameworks, they have implemented distinct anti-avoidance measures. This international movement strongly supports the implementation of GAAR in India. Consequently, the objections from certain taxpayer groups in India seem unjustified. India is aligning its practices with global standards, and the proposed framework closely resembles those already working effectively in other countries.

Concerning the burden of proof, the government has adopted a fair strategy by revising Section 96(2) of the Finance Bill, which had previously sparked concerns. Tax authorities must establish a preliminary case demonstrating that the transaction lacks genuine commercial substance before GAAR can be enforced. The process for applying GAAR is also notably designed to be friendly to taxpayers. Initially, a commissioner will review the case, and only if GAAR is found applicable will it be sent to an Approving Panel. This panel comprises a senior official from the Law Ministry and three commissioners, ensuring that various viewpoints are considered before deciding. Interestingly, some critics, who once accused the government of failing to address black money issues, now oppose the introduction of GAAR, a tool specifically intended to prevent tax evasion and enhance compliance.[37]

India's implementation of General Anti-Avoidance Rules represents a significant move toward a stronger, more principled tax enforcement system. The main goal of GAAR is not to penalise legitimate tax planning but to prevent abusive practices that exploit legal loopholes solely to evade taxation. In this regard, GAAR seeks to maintain a crucial equilibrium between allowing businesses to optimise their tax obligations within legal boundaries and effectively challenging aggressive and artificial tax avoidance tactics.

The global consensus provides robust backing for India's choice, with many developed economies already having similar regulations. The development of GAAR in India, especially the numerous delays, modifications, and the addition of procedural protections, demonstrates the government's intention to address legitimate concerns while steadfastly protecting the tax base.

The current framework emphasises due process and fairness by mandating that tax authorities prove a prima facie case before invoking GAAR and processing it through a multi-member panel. Additionally, issues regarding retrospective application and investor uncertainty have been tackled through clear definitions, thresholds, and protections. As such, claims that GAAR will negatively affect investor

[36] Pranav Menon, General Anti Avoidance Rule-A Critique, Academia (21 July 2025, 11:24 PM) https://www.academia.edu/8463481/General_Anti_Avoidance_Rule_A_Critique

[37] Sukumar Mukhopadhyay, general Anti Avoidance Rule in Income Tax Law, Vol 47 No 22, EPW, 24-28 (2012) https://www.epw.in/journal/2012/22/commentary/general-anti-avoidance-rule-income-tax-law.html

sentiment or hinder economic activity are exaggerated.

Ultimately, GAAR is an essential instrument in India's legal framework to maintain the tax system's integrity. Its effectiveness, however, will rely on its meticulous and principled enforcement, characterised by clarity, transparency, and moderation. Only then can India achieve the right balance between facilitating strategic tax planning and preventing unacceptable evasion, promoting compliance and confidence in its taxation framework.

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