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ASSESSING THE LEGAL CHALLENGES OF CROSS-BORDER TAX AVOIDANCE POST-GAAR IMPLEMENTATION IN INDIA

~ *Bhuvan Raj A*

Abstract

This paper analyses the legal and practical challenges that India contends with in combating cross-border tax avoidance in light of the General Anti-Avoidance Rule (GAAR). GAAR, which is established in Chapter X-A, Sections 95-102 of the Income-tax Act, has provided Indian tax authorities with a wide-ranging discretionary mechanism for negating “impermissible avoidance arrangements.” At the same time, GAAR is helping to create a complicated legal environment, with some of the tensions between anti-avoidance goals and the need for taxpayer certainty, treaty obligations, administrative capabilities, and international tax trends including OECD BEPS, contributing to this complexity. This paper seeks to focus on issues and gaps that have not yet received ample scrutiny: the burden of proving facts and standard of proof set out in GAAR; the interaction and inconsistencies between GAAR and specific anti-avoidance rules (SAAR) and Double Taxation Avoidance Agreements (DTAAs); considerations regarding GAAR with respect to structures for digital-economy and intangibles; administrative, procedural, and rule-of-law challenges the tax authority faces (advance rulings, changes in the law to be retroactive, exposure to arbitration); the role of safe harbours and pre-clearance; and limits in the tax authority's institutional capacity (data, expertise, and cross-border enforcement, etc.). This paper recommends specific legislative amendments; procedural safeguards; enhanced international coordination; and practical administrative mechanisms to combine anti-avoidance goals with certainty for investment.

1. Introduction

India brought GAAR into the Income-tax Act via the Finance Act, 2012, and after significant debate and phased deferments, it became applicable from 1st April 2017 (assessment year

onwards 2017-18 in practical terms). GAAR gives tax authorities the power to declare arrangements “impermissible” where the main purpose is to obtain a tax benefit under GAAR, subject to thresholds and exceptions. GAAR is intended to be complementary to specific anti-avoidance rules (SAAR) and treaty-based protections; help genuinely abusive arrangements that are artificial and exploit gaps in the law. The Central Board of Direct Taxes (CBDT) released clarificatory guidance and a circular in 2017 to help guide implementation of GAAR.

The introduction of GAAR followed high-profile disputes in India concerning cross-border transactions (notably Vodafone and Cairn) and international pressure to align with the global anti-avoidance norms that were emerging, in particular OECD’s BEPS project (Action 6 on treaty abuse). The disputes highlighted two perennial tensions: (1) the state has a legitimate interest in taxing economic value situated in India, and (2) investors should have reliance on legal certainty, predictable treaty relief and protection against retrospective claims. GAAR was intended to be a domestic, prospective instrument to respond to arrangements for tax avoidance without having to resort to retrospective ad hoc legislation.

This paper does not restate all of the GAAR mechanisms. Rather this paper will investigate legal and operational issues that remain unexamined once GAAR is applied, and will offer reforms that are legally realistic and operationally plausible. In terms of conceptual and doctrinal foundation GAAR addresses and does not address:

GAAR is intentionally broad, taking a broad approach to “arrangements” and permitting authority to deny tax benefits where there is the existence of impermissible avoidance arrangements, as defined through indicators such as a lack of commercial substance, an improper or improper use of a tax treaty, round tripping through conduit entities, sham or preordained steps, or circular funds. GAAR however is not a free-standing taxing provision, GAAR only permits re-characterization on the basis of an existing provision or denying a tax benefit based on an existing provision. Therefore, the doctrinal foundation required to deploy GAAR must not be done in isolation with (a) provisions in the Income-tax Act (such as transfer pricing rules, source rules), and (b) obligations or treaties under international law through the use of DTAs.

Two points serve as an underpinning of the challenges noted below:

Discretion vs. Certainty: GAAR broadens administrative discretion; discretion allows GAAR to mitigate adaptive avoidance, however discretion is often antithetical to certainty, which adds to compliance costs and discourages investors.

Interrelationship with International Law: GAAR has to operate without violating treaty protections (e.g., Most-Favoured Nation, non-discrimination, or limitation-on-benefits/benefit-tests) – interrelationship to DTAA LOB issue or treaty shopping is still a live issue. CBDT guidance sought to clarify interrelationship, yet gaps are present.

3. Under-explored legal challenges in the post GAAR environment: taxonomy and analysis

What follows is a catalogue and analysis of legal challenges about which scholarly writing is either too scarce or too challenging in practice, and thus requires concentrated theory based remediation.

3.1. Evidentiary burdens and standard of proof: vacuous tests, heavy evidentiary burden

The issue: GAAR requires that a tax authority demonstrate that the “main purpose” of the arrangement was obtaining a tax benefit, and that there was the lack of commercial substance. “Main purpose” and “commercial substance” are undefined and unbounded terms which have unlimited meanings. What standard of proof in contested assessments and appeals is required? For penal consequences, what is required outside of civil (balance of probabilities) or quasi-criminal standard? How will courts treat inferences drawn from silence in document production or purportedly a “clean” power point or other written materials evidentiary package created by sophisticated advisers?

Importance of the issue: In assessing GAAR, determination of taxpayer intent and actual commercial reality involves analysing the entire cross-border chain of transactions, which can involve multiple jurisdictions. If the standard of proof is vague or inconsistent, the administrative cases are arbitrary or involve protracted appeals or arbitrations.

Legal analysis: Indian tribunals and courts have begun to develop methods, but there is no settled methodology for uniformly weighing (a) documentary evidence, (b) contemporaneous business purposes, (c) objective economic consequences and (d) intermediary jurisdictions. If there are no calibrated evidentiary standards, the consequences are an increasing = reliance on broad administrative interpretation.

Suggested remedy: Provide statutory or procedural guidance requiring that (i) GAAR must be grounded in objective commercial facts and reasonably contemporaneous documentation, and (ii) some weight for independent indicia of business purpose (e.g. functional substance, records of decision-making), and (iii) in cases of closely arguable circumstances, a default presumption of taxpayer certainty absent clear indicia of abuse. The solutions might include reasonable and

mandatory fact finding standards before assessment is even proposed, or simply a two-stage test: (1) prima facie indicia avoidance, then (2) inquiry into objective economic substance.

3.3. Dispute on treaty-level and MAP/Arbitration risk

Issue: GAAR initiated recharacterization can be contradicted to DTAA rights thereby triggering Mutual Agreement Procedure ("MAP") cases and possible investor-state arbitration claims. Previous cases (Vodafone; Cairn) have demonstrated that overly aggressive domestic measures and retrospective policy creating investor-state claims and reputational damage. Even if there is no express retrospective tax exposure GAAR is broadly interpreted counters treaty-protected transactions claims as CB bills or expropriation by treaty undermined.

Importance: The reputational standing of India's international tax, collectability of India's tax claims abroad, and sovereign exposure to adverse awards actions `enforcement methods can all be jeopardised.

Legal framework: GAAR and treaty obligations must engage and recognize treaty obligations. The CBDT's clarifications tried not to rescind treaty rights while citing timing or "when" GAAR treatment is initiated by MAP protocol. Tax authorities do not have a consistent or well thought of early coordination process with treaty partners or should not expose investors certainties they feel they have. Furthermore, taxpayers may be subject to domestic window appeals while MAP or ICSID processes are currently ordering in potential overlapping risk.

Proposed solution: Establish a statutory system of "GAAR-MAP coordination," where GAAR is applied to treaty benefit tax treaty policy use shall notify treaty partner and formal relief or our options. Statute can also clarify GAAR cannot preclude avenues prescribed remedy as well and regulatory timeframes also to limit at once unilateral.

3.4. Digital economy, intangibles and valuation break points

Problem: Much cross border avoidance today is reliant upon value extraction through intangibles, data, user-bases and platform effects – assets that are illiquid, mobile and difficult to value. First, the recharacterization powers of the GAAR are not well designed to deal with the distinctive economics of the digital business: ie where is the “Indian” source? Is profit properly attributable across data flows and algorithms? How is cross-border licensing, pricing algorithmically or “user contribution” value treated?

Why is this important: Ambiguity in characterization creates in shortage arbitrary use by the GAAR or inconsistent use of transfer pricing adjustments and heightens the risks of double taxation, potentially chilling cross-border digital investment.

Legal analysis: OECD/GloBE and Pillar One discussions seek to reallocate taxing rights for digital activities, but the global tax framework for digital activities is still in a state of transition. The broad language in GAAR could be used to correct mismatches but without standardized valuation methodology the scope for disputes is widened.

Proposed solution: (i) Prepare sectoral guidance and valuation benchmarks in relation to common digital arrangements (eg inter-company service fees, royalty rates for platform access, user-contribution premiums) (ii) More proactive use of advance pricing agreements (APAs) or multilateral advance pricing agreements (MAPAs) with treaty partners (iii) Establish a specialized tax tribunal/bench that has tax valuation competence in the digital economy to facilitate grievance process.

3.5. Safe Harbours, Advance Rulings and Absence of Pre-Clearance Mechanisms

Issue: The uncertainty of GAAR is worsened by the relative lack of broad, robust pre-clearance mechanisms. While both the Authority for Advance Rulings (AAR) and Advance Pricing Agreements (APAs) provide ways to provide certainty, their applicability to situations governed by GAAR is limited, expensive, and time-consuming; the consequential use of AAR judgments as precedents for subsequent decisions and the appeal process following judgments presents its own challenges.

Why it matters: Taxpayers looking to undertake and structure complex cross-border arrangements essentially have no real-world method to gain early comfort on whether or not the GAAR will even apply to their proposed behaviour which leads to increased costs of compliance and advisory engagement.

Legal Analysis: The use of advance certainty mechanisms could lead to much of the dispute on these arrangements being resolved before positive arrangements are undertaken and entered into. However, historical analysis of AAR rulings seem to imply inconsistency, consistency is also important for APAs but they rely on bilateral cooperation, and they also take time to achieve.

Proposed Solution: Expand and enhance existing advance rulings making it specifically GAAR related or GAAR focused and introduce a statutory safe harbour scheme that "pre-certifies" (or

provides clear disclosure rules) non-contested, low-risk cross-border arrangements that pass objective commercial tests. Both the fees and timelines requirements should be adjusted to allow something other than international large corporate taxpayers, specifically mid-market taxpayers.

3.6. Procedural fairness and taxpayer rights: reasons, appeal, penalties

The difficulty: GAAR assessments often involve re-characterizations that result in substantial changes to tax liabilities and penalties. This raises the possibility of assessments being poorly reasoned, the basis for the GAAR being insufficiently disclosed, and the taxpayer's ability to provide evidence of the economic substance of the transactions being limited prior to the assessment.

The importance: there are legal and political implications to procedural fairness; courts look closely at the quality of reasoning in administrative cases. Poor procedural safeguards undermine legitimacy and escalate cost of litigation.

Tax analysis: Indian tax procedural law provides a mechanism for appeals, however the unique characteristics of the GAAR, which requires an economic reconstruction of the events, suggests that additional processes ought to be put in place. For example, the tax authorities ought to provide mandatory issue-framing letters, tax payers should be entitled to provide evidence of substance in a reasonable time frame, and the case should be set out clearly so as to evidence how each of the indicators of the GAAR applies to the facts stated.

The solution: codification of procedural protections for GAAR cases, including (i) mandatory notice of proposed invocation of the GAAR with written reasons and an opportunity to respond within 60 days; (ii) an obligation on the part of the authorities to create contemporaneous reasoning, explanations, and economic analyses; and (iii) prohibitions of penalties until the invocation of the GAAR is finally assessed after appeals.

3.7. Evidence gathering, cross-border discovery and data access

Problem: Effective enforcement of GAAR is often predicated by the obtaining of cross-border documentary evidence etc. (board minutes, contracts, emails) which are located outside of India. This can be expensive and legally complicated, and slow. Sometimes there are simply no mutual legal assistance statutes or the process is very slow where it concerns civil tax matters.

Why it is important: In absence of effective access to documentary information, authorities must rely on circumstantial evidence or information exchanged under DTAA/EOI instruments. These circumstances may be satisfactory, but are also insufficient without access to documentary evidence.

Legal analysis: India has a sprawling network of DTAA's and Tax Information Exchange Agreements (TIEA) which provide formal and legal channels to obtain information, but significant lag-times and concerns for different countries' data protection laws impede timely access to evidence for GAAR enforcement. Additionally, certain conduit jurisdictions will simply refuse to provide the information needed in the first place.

Proposed solution: Develop and organize protocols for exchanging and developing evidence in GAAR investigations which includes dedicated channels for prioritized requests, and proactively negotiate clauses to DTAA bills for immediate exchange in those investigations asserting impermissible avoidance. Invest in a digital forensics service to use e-discovery, that can be used as evidence.

3.8. Interaction With Transfer Pricing and Hybrid Mismatch Rules

Issue: GAAR, transfer pricing rules, and hybrid mismatch rules (where applicable) can lead to inconsistent solutions—reclassifications under GAAR can negate the adjustments made under arm's length pricing and vice versa.

Importance: Consequences can involve double counting adjustments, mismatched timing, and cascading penalties.

Legal Analysis: Little jurisprudence exists that would direct tribunals on how to deal with how GAAR and TP adjustments should be reconciled in a single case, especially where GAAR recharacterizes the nature of the transaction that is subsequently subject to transfer pricing. There is no certainty about sequencing.

Proposed Solution: A statute or guidance should set an order of adjustments (for instance, first adjustment technical under the TP/SAAR, and GAAR applied only if these adjustments left a residual tax benefit indicating the use of impermissible avoidance strategy). Otherwise, propose a consolidated review process.

4. Broader Effects and Strategic Trade-Offs

4.1. The legitimacy paradox

The GAAR widens the state's ability to challenge contrived arrangements; however, that power risks legitimacy when applied in opaque and unpredictable ways. The state must balance deterrence and legal certainty; significant deterrence but low predictability may impact investment and generate expensive lawsuits.

4.2. The trade-off between fiscal and reputation

If aggression in applying GAAR only concerns the short-term revenue gain, its contribution would damage investment inflows in the longer term by making countries more reluctant to invest and potentially facing ISDS or diplomatic pushback. India's own experience with retrospective taxation (Vodafone, Cairn) demonstrates the reputational impact that follows sweeping measures. While the GAAR aims to target prospective arrangements, extensive application of GAAR can create retrospective outcomes by disturbing baseline expectations of treaty obligations.

4.3. Limits of Administrative Capacity

The promise of GAAR depends on reliable and skilled assessments of complicated economic facts. India has a substantial investment ahead in skills (both in traditional ways - economists, forensic accountants, digital assessment analysts), data systems, and creating collaborative channels for institutions to flash data (CBDT + MEA + RBI + SEBI + CBIC) and make coherent decisions across regulatory opportunities.

5. Lessons from comparisons and the international scene

There are a few lessons from elsewhere and the OECD BEPS process that are worth mentioning: Treatment of BEPS Action 6 and treaty abuse: The BEPS Action 6 work demonstrates that domestic anti-abuse measures paired with effective LOB provisions and a coordinated approach to MLI updates limit the potential for treaty shopping. India should consider calibrating its GAAR provisions against what is appropriate/acceptable at a treaty level, to avoid conflicts.

Advance certainty mechanisms: The majority of OECD Members employ concentrated processes of Advance Pricing Arrangements (APAs) and positive pre-filing consultations to manage contentious cross-border issues; India could benefit from expanding the use of these mechanisms.

Specialised tribunals and expertise: Other jurisdictions that establish specialised tax courts/tribunals with expertise in economics will limit inconsistent jurisprudence on technical valuation issues.

6. Suggestions: legal, procedural, and institutional reforms

Here are practical reforms intended to tackle the aforementioned problems that have not been adequately dealt with while maintaining GAAR's original intent.

6.1. Legislative and doctrinal reforms

Statutory evidence standard: The Income-tax Act should be modified (or binding rules issued by the CBDT), stating that in making a GAAR determination, the tax authority considers the matter on a "preponderance of objective economic evidence," and adopt statutory factors (ie.: business purpose, arm's length tests, contemporaneous documentation).

Statutory order of application rule: Provide that SAAR remedies must be utilized first to the extent the remedy applies directly to the taxpayer's case, and GAAR may only be used to the extent remaining secondary benefits would be captured or SAAR is blatantly inadequate.

Mandatory GAAR-MAP Protocol: Tax authorities must have a commitment to flagging treaty issues in notice stage, and all relevant treaty partners before the tax authority can assess or commence collection on the GAAR assessment.

6.2. Procedural protections

Greater notice and a right of response: It should be clear from the Income-tax Act that before a final assessment under GAAR, notice should be provided, and following notice an opportunity for the taxpayer to respond (including supporting evidence) should be available through the issuance of a "Notice of Proposed GAAR Determination" stating the potential GAAR determination and detail the reasons and all actions taken by the tax authority to analyze the taxpayer's situation, including the sequences of proposed GAAR results it proposes (in good conscience) would follow from the applied action taken by the taxpayer under the law.

A recordation and disclosure of economic rationale: In addition to above, the tax authority should be required to document and provide rationale for any analytical conclusion that supports pulling GAAR (including benchmark selections and ultimately conclusions).

Limitation on collection, assessment, and penalty measures: When there is a GAAR matter underway, any collection measures or penalties should delay at least until the first time an

appellate decision is rendered from the GAAR matter (or a potentially longer period if the taxpayer elects).

6.3. Advance Certainty and Safe Harbours

GAAR advance rulings: Establish a simplified GAAR pre-clearance process with accelerated timelines and proportional fees to the taxpayer's size. Substance safe harbour checklist: Specify objective substance metrics for conduit entities to gain eligibility for treaty protections.

6.4. Institutional Capacity Building

Create multidisciplinary GAAR units within the CBDT merging tax lawyers, economists, and data analysts with focused training on the digital economy and intangibles.

Establish fast-tracking lanes of information exchange with treaty partners and in TIEAs for urgent GAAR issues.

A specialized tribunal bench for economic valuation and complicated GAAR appeals will provide adjudicators better businesses models for compensation valuation and support consistency in adjudication and expertise in decision-making.

6.5. Digital Economy and Crypto Measures

Guidance will be provided by way of sector to include valuation standards dealing with common models (platform fees, data monetization) for purposes of taxation in the digital economy. Another governance measure would require crypto exchanges and large intermediaries to report on chain and off chain linkage data that can supply authorities with information in compliance with data-protection regulations.

7. Conclusion

GAAR is a critical tool in India's tax policy toolkit: it fills the gaps that specialized rules are not built to anticipate and captures a fundamentally shifted global anti-abuse environment. However, the promise of GAAR will only be fully realized with a tightly constructed suite of evidentiary and procedural rules, growing levels of international coordination, the evolution of robust pre-clearance and safe-harbour mechanisms, and significant investments into administrative capacity. While there are not few legal uncertainties raised in this paper — but evidentiary regimes, GAAR-SAAR interactions, treaty friction/MAP coordination, digital-economy valuations, and access to cross-border evidences are rightfully cited to pose the most significant institutional enforcement risk, and have the potential to cause many headaches for

foreign investors. It will be suggested that any legislative change that improves clarity, procedural protection and institutional reform, will allow India to deter abusive cross-border tax avoidance through GAAR while promoting legal certainty and maintaining India's attractiveness as a site for legitimate overlay in foreign investment.