



## The Role of a General Anti-Avoidance Rule in Protecting the Tax Base of Developing Countries

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## Overview

- Distinction between tax avoidance and tax evasion
- Techniques for combating tax avoidance
- Policy issues in designing a GAAR
- Major elements of a statutory GAAR
- The relationship between a GAAR and tax treaties
- Administrative aspects of a GAAR

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## Distinction between Tax Avoidance and Tax Evasion

- Tax avoidance is difficult to define precisely
- **Tax evasion:** intentional non-payment or underpayment of tax through fraud, non-disclosure or misrepresentation (criminal offence punishable by fines or imprisonment)
- **Tax avoidance:** reduction of tax legally (i.e., no fraud, non-disclosure or misrepresentation)
  - some tax avoidance may not be successful because of specific rules or court decisions
  - some tax avoidance is acceptable and some is unacceptable
  - tax avoidance is not usually illegal

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## General Anti-Avoidance Rule

- Unlike specific anti-avoidance rules, a GAAR is intended to apply to all types of transactions and arrangements, all types of taxpayers, all types of taxes (PIT, CIT, capital gains tax) and all types of payments and receipts
- Attempts to discourage or prevent tax avoidance before it occurs rather than dealing with it after it happens

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## Techniques for Combating Tax Avoidance

- Clearer tax legislation
- Judicial anti-avoidance doctrines
- Specific anti-avoidance rules
- Better enforcement
- General anti-avoidance rule

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## Is a GAAR Necessary?

- What is the extent of unacceptable tax avoidance? Difficult to measure
- Is a GAAR consistent with the rule of law and constitutional principles?
- Are specific anti-avoidance rule adequate?
- Is a GAAR too uncertain?

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## Is a GAAR Necessary?

- Most countries have concluded that a GAAR is necessary
  - Specific rules are inadequate
  - Extensive tax avoidance undermines public confidence in the tax system and fairness
- A GAAR can be judicial or statutory
- Most countries do not have well developed judicial anti-avoidance doctrines
- Therefore, a statutory GAAR is the only feasible option

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## Major Features of a GAAR

1. Definition of a transaction - series of transactions
2. Definition of a tax benefit
3. Purpose Test
4. Exception or relieving provision
5. The role of economic substance
6. Determination of tax consequences

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## Sample GAAR

- Transaction results in a tax benefit
- The sole, principal or one of the principal purposes of the transaction was to obtain the tax benefit
- The transaction frustrates, defeats or abuses the purpose of the relevant statutory provision

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## Canadian GAAR

Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

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## Canadian GAAR

An avoidance transaction means any transaction:

(a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit; or

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## South African GAAR

An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and —

- (a) in the context of business —
- (i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or
  - (ii) it lacks commercial substance, in whole or in part,

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## South African GAAR

- (b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit;

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## South African GAAR

- (c) in any context —
- (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or
  - (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act

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## Article 29(9) UN Model

Notwithstanding the other provisions of this Convention, a benefit under this Convention 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 this Convention.

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## Definition of Transaction

- Definition should be broad enough to cover any action that results in tax avoidance
- Terms used: transaction, arrangement, scheme
- Example: “any course of action, agreement, arrangement, understanding, promise, plan, proposal, or undertaking, whether express or implied and whether or not enforceable”

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## Series of Transactions

- GAAR should apply to a series of transactions
- Series should include at least transactions where there is a binding obligation to carry out one transaction if another one occurs
- Alternatively, series can be defined more broadly to include any transaction that is related or connected to another one
- Should apply to past and future transactions

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## Definition of Tax Benefit

- GAAR should apply only to transactions that result in reduction of tax
- “any reduction, avoidance or deferral of tax”
- Perhaps should also apply to other amounts such as interest, tax installments, and tax refunds
- Should be an easy condition to meet

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## Definition of a Tax Benefit

- Theoretically, definition may require a comparison of the tax consequences of the transaction with the tax consequences of an alternative transaction
- Benefit does not have to be quantified
- Problem where transaction does not result in immediate tax benefit, but allows benefit to be realized in the future (e.g. increase in cost)

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## Purpose Test

- Most GAARs contain a purpose test
- GAAR applies if the sole or primary purpose is to obtain a tax benefit
- New Zealand GAAR uses a one of the main purposes test as does UN Model general anti-abuse rule
- No difference between “main,” “dominant,” “primary” or “principal”
- Ancillary or incidental purpose is not sufficient

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## Purpose Test

- One of the main purposes test is easily satisfied
- If a transaction results in a tax benefit, it will be difficult for the taxpayer to argue that none of the purposes was to get that benefit
- Therefore, the exception will likely be the critical factor in applying the GAAR

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## Purpose Test

- A main or primary purpose requires that the purpose of obtaining a tax benefit is more important than any other purpose for the transaction
- Requires taxpayers, tax authorities and courts to determine if a transaction has multiple purposes and, if so, what is the main purpose
- Main purpose doesn't have to be more important than all the other purposes

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## Purpose Test

- Onus of proof may be an important factor in weighing multiple purposes
- Does the taxpayer or the tax authorities have the burden of proof with respect to purpose?
- Assessment may be presumed to be correct so burden is on the taxpayer

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## Purpose Test

- GAAR can be worded to put the burden on the taxpayer – “unless it is proved or established by the taxpayer . . .”
- Appropriate to put the burden on the taxpayer to establish that the main purpose of a transaction is not to obtain a tax benefit because the taxpayer has access to all the relevant information

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## Purpose Test

- Purpose should be determined on the basis of objective evidence rather than the taxpayer's subjective intention
- GAAR can refer to the purpose of the transaction rather than the taxpayer's purpose
- Also GAAR can refer to purpose "reasonably considered on the basis of the relevant facts and circumstances"

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## Exception or Relieving Provision

- Australian GAAR applies if the dominant purpose is to avoid tax without any exception
- If there is no exception, the GAAR might apply to transactions that are not offensive in terms of the policy of the statute
- Thus, such a GAAR relies on the discretion of the tax authorities not to apply the GAAR to transactions that avoid tax in accordance with the policy of the statute

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## Exception or Relieving Provision

- Most GAARs provide an exception or additional condition for the application of the GAAR
- Some GAARs apply only if the transaction is contrary to the object and purpose of the relevant provisions of the statute
- Some GAARs apply only if the transaction results in a "misuse or abuse" of the statute

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## Exception or Relieving Provision

- Exception is difficult to draft in language that provides clear guidance as to what transactions are caught by the GAAR
- Exceptions that refer to transactions that are in accordance with or not contrary to the object and purpose of the statute are effectively interpretive rules
- They require a determination of the purpose of the relevant provisions of the statute

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## Exception or Relieving Provision

- Exception that is an interpretive rule may be difficult to apply especially for courts that interpret tax statutes literally
- Risk that GAAR could be rendered meaningless
- Alternatives: base the exception on objective factors such as artificiality, lack of commercial or economic substance or list factors courts must consider

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## The Role of Economic Substance

- Economic substance is often the most important factor in applying a GAAR
- As a general principle, tax should apply to the economic substance rather than the legal form of transactions
- Most tax systems adhere to legal form to some extent
- Important for the GAAR to apply on the basis of economic or commercial substance

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## The Role of Economic Substance

- Meaning of economic substance is vague
- In general, it means the non-tax consequences of a transaction
- Indicators of a lack of economic substance: absence of pre-tax profit and no or limited risk of loss; tax-indifferent parties; no change in the financial position of the parties

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## Determination of Tax Consequences

- If the GAAR applies, how should the tax consequences be determined?
- Problematic to just ignore the transaction or treat it as void
- In general, the goal should be to deny the tax benefit
- Tax authorities need broad discretion to determine tax consequences properly

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## Determination of Tax Consequences

- Specific actions, such as denying deductions, attributing income to a person, recharacterizing amounts, can be listed
- Necessary to also allow adjustments to the tax situation of parties, other than the taxpayer, affected by the application of GAAR to a transaction

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## Relationship between the GAAR and Tax Treaties

- *Pacta sunt servanda* – Article 31 Vienna Convention – treaties prevail in the event of a conflict
- Whether there is a conflict depends on how treaty is interpreted and weight given to the Commentary on the OECD or UN Model
- Some countries have explicitly provided that the GAAR overrides their tax treaties

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## Relationship between the GAAR and Tax Treaties

- 2003 Commentary on OECD Model and 2011 Commentary on UN Model provide that generally there is no conflict between domestic anti-avoidance rules and tax treaties
- Issue may depend on whether treaty was entered into before or after 2003 or 2011
  - The role of subsequent Commentaries
- 2017 general anti-abuse rule added to OECD and UN Models

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## Relationship between the GAAR and Tax Treaties

- For treaties with GAAR, issue will be compatibility of domestic GAAR and treaty GAAR
- Countries should ensure that their domestic GAAR is consistent with their treaty GAAR
- Domestic tax base and tax treaties should be similarly protected against tax avoidance

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## Administrative Issues

- GAAR is a provision of last resort
- GAAR must be applied by the tax authorities even in a self-assessment system
- Ordinary or special assessment procedures
- GAAR may be primary or secondary basis of assessment

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## Administrative Issues

- Tax authorities should provide guidance as to the application of the GAAR
- Possibility of the use of a head office committee to approve the application of the GAAR (to ensure reasonableness and consistency in the application of the GAAR)
- Involvement of the private sector?
- Possibility of advance rulings process

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## Administrative Issues

- Appeal rights – taxpayers should be entitled to appeal all aspects of the application of the GAAR
- Should a penalty be imposed in cases where the GAAR applies?
- Useful tool to provide disincentive for taxpayers to engage in abusive tax avoidance
- Alters the risk/reward analysis of tax avoidance

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Thank you

[TaxffdCapDev@un.org](mailto:TaxffdCapDev@un.org)

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