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Tax Flash News

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General anti-avoidance rule can be invoked for a transaction not covered within the scope of specific anti-avoidance rule

Executive summary

The interplay between the applicability of the General Anti-Avoidance Rule (GAAR) and a Specific Anti-Avoidance Rule (SAAR) remains a contentious issue.

The Telangana High Court in a recent decision[1] upheld the Revenue's action of invoking the GAAR provisions for a share sale transaction in a situation where there existed the SAAR provision (bonus stripping provision) to deal with the transaction of such nature, but the transaction under consideration was not covered within the scope of that SAAR provision. The High Court also reasoned its conclusion with the overriding effect of the GAAR provisions and the subsequent enactment of the GAAR provisions vis-à-vis the SAAR provisions.

The Court also held that the Revenue had convincingly shown that the transaction under consideration qualified as an impermissible avoidance arrangement (IAA).

The High Court dismissed the writ petition filed by the taxpayer against the notice issued by the Revenue seeking objections to the invocation of the GAAR provisions.

[1] W. P. No. 46510 and 46467 of 2022 – Source: Taxsutra

Facts of the case

REFL, an Indian company, issued its shares to the taxpayer and another group company (OAC) on a private placement basis. Subsequently, the taxpayer purchased the shares in REFL from OAC.

Thereafter, REFL issued bonus shares which resulted in a reduction in the value of the existing shares.

Within a short span of time, the taxpayer sold the shares to another group company (ASP) and incurred a capital loss as the value of those shares had fallen pursuant to the issue of bonus shares.

The taxpayer set-off the loss against the gains from another transaction.

The Revenue[2] alleged that the above transaction was an IAA and issued a notice to the taxpayer seeking objections to the applicability of the GAAR provisions.

The taxpayer filed a writ petition against the notice, seeking the notice to be declared as arbitrary, *ultra vires* the Act and lacking the subject jurisdiction.

[2] In accordance with section 144BA read with Rule 10UB, the tax officer issued a notice to the taxpayer seeking objections on the applicability of GAAR provisions. The taxpayer responded to the notice by rebutting the allegations. Thereafter, the Principal Commissioner of Income Tax (PCIT) issued a notice to the taxpayer stating that the transaction qualifies as an IAA and sought objections from the taxpayer. The taxpayer filed writ petition against the PCIT's notice.

Relevant provisions of the Act

The Income-tax Act, 1961 (the Act) contains a specific anti-avoidance provision (popularly known as bonus stripping provision[3]) which requires the loss arising on the sale of units of the specified mutual fund to be ignored for computing the taxable income if the taxpayer has received bonus units[4] and sells the units within a specified time after the issuance of bonus units.

It may be noted that during the year under consideration, the relevant provisions did not cover the shares in a company which were included by way of a subsequent amendment. Accordingly, the loss arising in the instant case was not neutralised by the applicable SAAR provisions.

The Act also contained the domestic GAAR provisions[5] which are applicable to any arrangement entered into by the taxpayer which is declared as an IAA.

[3] Section 94(8) of the Act
[4] Additional units allotted without any payment on the basis of holding of original units
[5] Section 95 to 102 of the Act

Taxpayer's contentions

The transaction under consideration was covered by the bonus stripping provisions which are the specific provisions. The GAAR provisions are general in nature, and therefore, should not be applied to such transaction.

The Shome Committee[6] had recommended that where the SAAR is applicable to a particular transaction, then GAAR should not be invoked to look into that element.

The Parliament while enacting bonus stripping provisions never had the intention of including the shares in a company.

What has been specifically excluded from the SAAR provisions curbing the bonus stripping cannot be indirectly curbed by applying the GAAR provisions.

The application of the GAAR provisions would result in the expansion of the scope of a specific provision in the Act which is otherwise impermissible under the law.

Revenue's contentions

The writ jurisdiction is not meant to assail a show-cause proceeding unless there is some patent illegality on the ground of jurisdiction. There was no specific material available to entertain this writ petition.

The taxpayer should submit its objection with the Revenue for its consideration.

The series of transactions were undertaken by the taxpayer in quick succession resulting in a loss.

ASP did not have sufficient funds to buy the shares of REFL. The funds in this regard were provided by OAC to ASP[7]. The entire transaction was a round tripping of funds with no commercial substance and with the *mala fide* intention of avoiding the payment of tax by creating a loss.

[6] Before introducing the GAAR provisions, the Government had constituted an expert committee headed by Dr. Parthasarathi Shome to undertake the consultation with the stakeholders, and finalise the GAAR guidelines and a roadmap for the implementation

[7] There were other transaction of inter-corporate deposits and write-off of advances

High Court's decision

The taxpayer's contention that the bonus stripping provisions should take precedence over the GAAR provisions was not only fundamentally flawed but lacked consistency as the taxpayer itself asserted that for the year under consideration, the bonus stripping provisions were not applicable to the instant case involving the shares in a company. This inherent contradiction significantly weakens the overall credibility of the taxpayer's arguments.

In cases where the general provisions are already in force and the special provisions are enacted subsequently, the courts have held that the general provisions would not be invoked. However, in the instant case, the specific provision (bonus stripping provisions) was enacted prior to the general provision (the GAAR)[8].

The GAAR provisions[9] specifically provides that the provisions shall apply in addition to, or in lieu of, any other basis for determination of tax liability.

The GAAR provisions begin with non-obstante clause and has an overriding effect over the other existing provisions of the Act.

The above suggests that the legislative intention is that the GAAR provisions should act as all-encompassing provisions and should be used in conjunction with, or as a substitute, for other provisions of the Act. This again highlighted the selective and misinterpreted use of the legal provisions by the taxpayer.

The bonus stripping provisions might be relevant where the issuance of bonus shares has an underlying commercial substance. However, such provisions do not apply when the issuance of bonus shares was an artificial avoidance arrangement and lacks any logical justification.

Reliance on the Shome Committee report, in the given factual backdrop, was misplaced. The committee's stance that the SAAR should supersede the GAAR mainly pertains to international agreements, and not to the domestic cases. Further, only some of the recommendations of the committee were incorporated in the GAAR provisions.

[8] The bonus stripping provisions were inserted w.e.f. 1 April 2005 and the GAAR provisions were inserted w.e.f. 1 April 2016

[9] Section 100 of the Act

Subsequently, the Finance Minister[10] and the CBDT Circular[11] stated that the GAAR and the SAAR can co-exist, and their applicability would be determined based on the facts and circumstances of each case.

The taxpayer's argument that the facts of the case were irrelevant in determining the application of a general law contradicted the well-established legal principles. The law must be interpreted based on the specific facts of each case[12].

The business intentions behind a transaction could serve as strong evidence that the transaction is not a deceptive or artificial arrangement. The burden is on the Revenue to prove any fiscal misconduct[13]. However, the GAAR provisions[14] places the responsibility on the taxpayer to disprove the presumption of a tax avoidance scheme.

The GAAR provisions involve a comprehensive examination of all elements of the transaction, at multiple levels and from various perspective. It ensures that the process is thorough, fair and just.

The taxpayer has chosen to seek this Court's intervention instead of following the GAAR process. This circumvention of the GAAR process raised the questions about the taxpayer's motives.

In the instant case, there was convincing evidence to suggest that the entire arrangement was intricately designed with the sole intent of evading the tax. The taxpayer was not able to provide substantial and persuasive proof to counter this claim. The Revenue has convincingly shown that the transactions were IAA and therefore, the GAAR provisions would become applicable.

Accordingly, the writ petition was dismissed, and the Revenue was allowed to proceed with the procedure under the GAAR provisions.

[10] Statement of the Finance Minister, dated 14 January 2013

[11] CBDT Circular No. 7 of 2017, dated 27 January 2017

[12] *CIT* v. *S. Zoraster & Co* [1972] 83 ITR 729 (SC)

[13] *Vodafone International Holding B.V.* v. *UOI* [2012] 341 ITR 1 (SC)

[14] Section 96(2)

Our comments

The interplay of the domestic GAAR provisions with other anti-avoidance provisions, especially those contained in a tax treaty such as the principal purpose test (PPT), the limitation of benefit (LOB) clause, the beneficial ownership test etc. remains a controversial issue. The analysis of this issue involves application of various principles of interpretation of statute, some of which have been discussed below.

In this case, the taxpayer's argument is based on the principle of *generalia specialibus non derogant* i.e., a special provision excludes the operation of a general provision when both provisions occupy the same field.

One of the conditions to apply the above principle is that there must be nothing contained in the general provision indicating the legislative intent to overrule or set aside the specific provision. The High Court observed that the GAAR provisions override the other existing provisions of the Act.

It may be noted that in the context of a tax treaty, not only the GAAR provisions override section 90 of the Act, section 90(2A) also provides that the GAAR provisions will apply to the taxpayer even if such provisions are not beneficial to him vis-à-vis the treaty provisions

The High Court seemed to have followed the principle of *contemporanea expositio* (which permits the interpretation of a statute by reference to the exposition it has received from the contemporary authority) and gave emphasis on the statement of the Finance Minister and the CBDT circular.

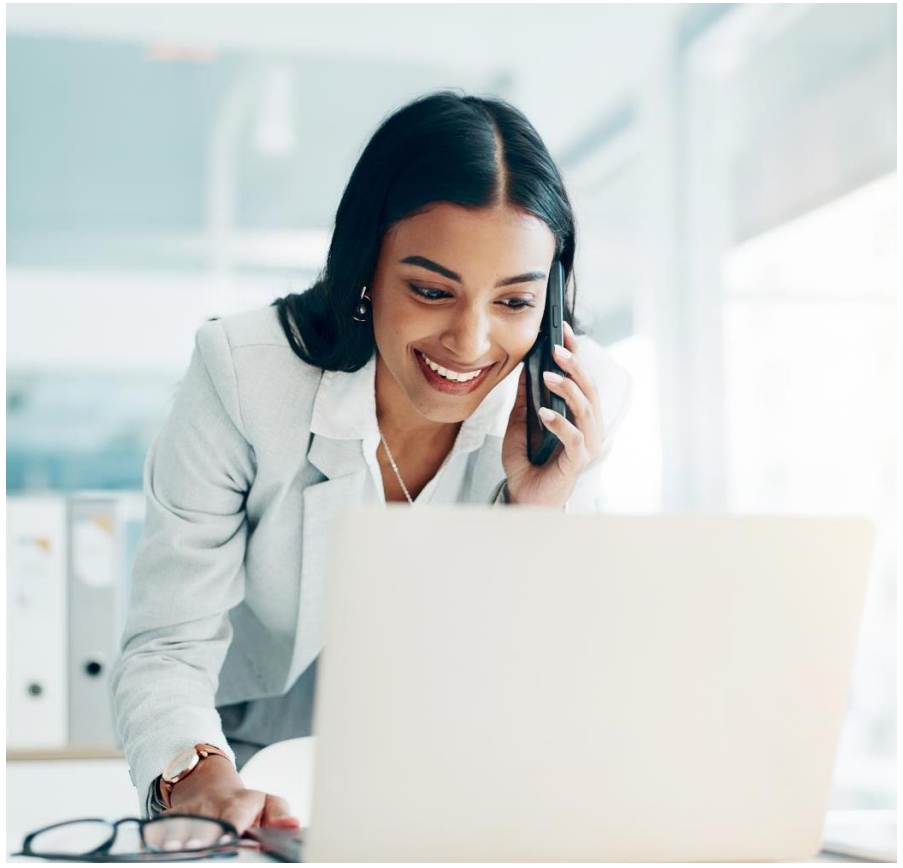
The High Court also seemed to have followed the legal principle of *lex posterior derogat priori*—a conflicting later law takes precedence over an earlier law to the extent of the conflict (as the subsequently enacted GAAR provisions took precedence over the earlier enacted bonus stripping provisions in the instant case).

It would be interesting to see how the courts will deal with an anti-avoidance provision, such as PPT, which has been enacted subsequent to the domestic GAAR provisions.

The High Court also observed that the bonus stripping provisions (which were effective at the relevant time) were not actually applicable in the instant case involving the shares in a company. It would be interesting to see how the courts will deal with the applicability of the GAAR provisions if another anti-avoidance provisions, say the LOB clause for capital gains under a tax treaty, are applicable and the tests laid down in the latter provision are complied with.

The judgment highlighted that no principle of interpretation is applicable universally or on a stand-alone basis. Some of these principles compete with each other and the application of one principle over the other is based on the facts of each case, the applicable provisions etc.

Lastly, this judgment has once again reiterated the need for a commercial substance in the arrangements among the group companies.



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