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GAAR v SAAR – High Court rules on how GAAR is general, yet special!

Snapshot

The High Court of Telangana dismissed the taxpayer's writ petition challenging the invocation of GAAR provisions by the tax department. The court determined that the taxpayer's transactions lacked commercial substance and were impermissible avoidance arrangements, thereby justifying the application of GAAR. The court also highlighted that GAAR provisions, introduced later than SAAR, contain a non-obstante clause, giving them an overriding effect over existing laws, including SAAR. Furthermore, the High Court noted that section 94(8) of the Act, which is a SAAR provision addressing bonus stripping, did not apply to shares during the assessment year in question.

The court also observed that the taxpayer had an adequate opportunity to present objections during the tax assessment process enshrined in GAAR provisions instead of resorting to writ petition and dismissed the petition.

Background & Context

In this case[1], the Hon'ble High Court of Telangana (the "High Court") considered admissibility of a writ petition submitted by the taxpayer which challenged the invocation, by the Income-Tax Department (the "Revenue"), of the provisions of General Anti-Avoidance Rules (GAAR) enshrined under Chapter X-A of the Income-Tax Act, 1961 (the "Act") read with rule 10U to 10UF of the Income-Tax Rules, 1962 (the "Rules").

For businesses, taxes are like any other cost which they incur and so it naturally follows that there is significant motivation to save such tax cost and operate the business more efficiently. But in doing so, it is often the case that the businesses resort to creative schemes to dodge tax without breaching the boundaries of tax laws[2]. Over the years, the Government of India (the "Government") has made efforts to identify such schemes and add/amend provisions in the law to specifically address such tax avoidance schemes/arrangements. These provisions are popularly referred to as "Specific Anti-Avoidance Rules" (SAAR). Nevertheless, SAAR provisions sometimes fail to adequately address the mischief which was sought to be remedied and the taxpayers win the battle again only for another futile attempt by the Government to plug the loophole.

With a view to curb, once and for all, each such ingenious schemes which taxpayers implement with

[1] Ayodhya Rami Reddy Alla [WP Nos. 46510 and 46467 of 2022]
[2] Chinnappa Reddy, J in – McDowell & Co. Ltd. [(1985) 3 SCC 230]

the main purpose of reducing their tax liability, GAAR provisions were introduced by the Government of India through Finance Act, 2013 (effective from 01.04.2016) and the applicability was deferred to 01.04.2018 *vide* Finance Act, 2015. The ethos of GAAR provisions is to identify and appropriately tax the schemes or arrangements (or steps therein) which lack commercial substance, and which are mainly motivated to save tax. In doing so, the Revenue has been provided with the widest powers to determine the tax treatments of such transactions including (*inter alia*) power to disregard steps in a transaction, disregard parties in a transaction, treat debt as equity (*vice-versa*) and so on (the list of such powers is not exhaustive!). Fortunately, along with such powers, the Act also provides for an elaborate procedure for invocation of GAAR provisions, which ensures that the transactions are thoroughly evaluated at multiple levels, with a comprehensive examination of all elements of the arrangements concerned while upholding the principles of fairness at each step.

The case before the Hon'ble High Court concerned the allowability of short-term capital loss incurred by selling original shares at a lower price following a bonus issue. This issue involved a series of complex transactions executed by the taxpayer and group companies, including the approval of an intercorporate deposit, the swift write-off of this deposit, and the sale of shares at a substantial loss immediately after the bonus issue, among several other related transactions. Section 94(8) of the Act is a SAAR which specifically addresses bonus stripping[3] and provides that such artificial loss shall be ignored while computing taxable income of the taxpayers. Since revenue viewed the entire scheme of events as dubious, GAAR provisions were invoked by the revenue as per the due procedure prescribed by the Act. Accordingly, in this case the High Court has provided its answer to one of the most fundamental questions pertaining to GAAR provisions namely, whether GAAR provisions can be invoked in cases where SAAR provisions already exist?

[3] Where shares in a company are subscribed to prior to the record date and the original shares are sold post-bonus issue to generate artificial tax losses

Facts of the case

Taxpayer was an Indian resident who had earned long-term capital gains in the financial year 2019-20 arising from sale of shares in a company as well as short term capital loss arising from sale of shares of another company (hereinafter referred to as 'RCo'). The series of events which took place are summarized in a tabular form below along with an illustrative computation of income to understand how bonus stripping operates to save taxes.

Date	Particulars	In RCo				
		Total shares*	COA Per share	FMV* Per share	COA Total	FMV* Total
		In Crores			In Crores	In Crores
7 February 2019	Taxpayer acquired shares in RCo	13	115	115	1,530	1,530
4 March 2019	RCo issued bonus shares (5:1 ratio)					
	Original shares (A)	13	115	19	1,530	255
	Bonus shares	67	0	19	0	1,275
	Total shares	80	19	19	1,530	1,530
14 March 2019	The taxpayer sold some original shares in RCo					
	Shares sold (B)	5	115	19	575	96
	Capital loss [Total COA (B) - Total FMV(B)]					**479 ~ 462 crores**
	Balance shares					
	Original shares (A) - (B)	8	115	19	955	159
	Bonus shares	67	0	19	0	1,275
	Total shares	75	13	19	955	1,434

**Some figures are illustrative/derived due to lack of information*

It is worth noting that all the above steps/transactions occurred in quick succession. The entire scheme was completed within a span of one (1) month.

Since the cost of the RCo shares sold was significantly higher than the consideration received against the same, the share sale resulted in a short-term capital loss of INR 462 crores!

Furthermore, intercorporate deposits of INR 350 crores were sanctioned on 05 February 2019 and INR 288.50 crores was written off in March 2019 and the losses were set-off against capital gains.

Considering these peculiar occurrences, the assessing officer initiated GAAR proceedings by issuing a notice under section 144BA (1) of the Act read with rule 10UB (1) of the Rules to the taxpayer seeking his objections to the applicability of the GAAR provisions. After duly following the process delineated under the Act, the Principal Commissioner of Income-Tax issued a show cause notice to the taxpayer highlighting that the transactions undertaken by the taxpayer qualified as impermissible avoidance arrangements (or "IAA") under section 96 of the Act, thereby attracted GAAR provisions and again sought objections from the taxpayer.

Taxpayer's Arguments

The taxpayer primarily challenged the applicability of the GAAR provisions and contended that since GAAR provisions were not applicable, the show cause notice issued by the Revenue u/s 144BA was without jurisdiction and unsustainable in the eyes of law.

In support of the contention that GAAR provisions were not applicable in his case, it was argued on behalf of the taxpayer that this was a case of "bonus stripping", and the Act already contained provisions under section 94(8) which specifically address tax avoidance *via* bonus stripping schemes. Hence, GAAR being a general provision addressing all types of tax avoidance schemes, should not apply in a case where there were specific anti-avoidance rules (or "SAAR") designed to curb tax avoidance through bonus stripping schemes.

The taxpayer also relied on precedents wherein the legal maxim *'generalia specialibus non derogant'* (i.e., general law yields to special law should they operate in the same field on same subject) has been upheld by the Hon'ble Supreme Court of India.

However, section 94(8)[4] as it stood during the assessment year in question, only covered bonus stripping pertaining to units of mutual funds. The taxpayer acknowledged this point and contended that since the legislature had conscientiously excludeoi d shares from the purview of section 94(8), it could not then be claimed that bonus stripping in shares was covered indirectly under the arsenal of the Revenue by virtue of GAAR. This, according to the taxpayer, was nothing but an expansion of scope of a specific provision in the Act, which is otherwise impermissible under the law.

Reliance was also placed on the Shome Committee Report (2012)[5], which recommended that if SAAR is applicable to a particular transaction, GAAR provisions should not be invoked.

Revenue's Arguments

The Revenue described, in detail, the chronology of events in the taxpayer's case in order to substantiate its suspicions that the transaction lacked commercial substance and hence it was within the law for the revenue to invoke GAAR provisions.

It was also argued on behalf of the Revenue that the writ petition itself was not maintainable because the taxpayer had challenged a show cause notice, and writ jurisdiction is not meant to assail show cause proceedings unless the authorities lack jurisdiction to do so. Since the taxpayer failed to present any material to substantiate these grounds, the writ petition should not be entertained. It was pointed out that, the taxpayer could duly appear before the respective tax authorities at this stage and take all the desired objections in support of his contentions

[4] Now, stands amended vide Finance Act, 2022 (w.e.f. 01-04-2023), includes bonus stripping for '*any securities or units*'

[5] Report of the Expert Committee (headed by Dr. Parthasarathi Shome) on General Anti-Avoidance Rules (GAAR), 2012

which the authorities shall duly consider. Hence, it was argued that no strong case was made out for interfering with the show cause notice in question.

Decision of the High Court

High Court dismissed the writ petition and decided against the taxpayer stating that the Revenue had persuasively and convincingly shown that the transactions in the instant case were impermissible avoidance arrangements and therefore the provisions of GAAR became applicable. In arriving at this conclusion, the High Court made some detailed observations.

On the reliance placed by the taxpayer over the Shome Committee Report (2012), the court mentioned that as per the committee, SAAR superseding GAAR was relevant only for the international cases, and not the domestic cases as the case at hand.

Reference was also made to the CBDT Circular on GAAR[6] which clarified that both GAAR and SAAR would be applied depending upon the specifics of each case.

Dissenting to the implicit contention of the taxpayer that the facts of the case were completely irrelevant since this was a case where general law stood overridden by the specific law, the High Court referred to the cases decided by the Hon'ble Supreme Court of India in *S. Zoraster and Company*[7], *the Vodafone judgement*[8] and *the McDowell case*[9] to conclude that commercial rationale is the most significant determinant of whether a particular transaction is a deceptive arrangement and hence, the taxpayer's arguments were flawed in this regard.

On specific provisions versus general provisions, the High Court observed that this was a case where the specific/special law (i.e., SAAR) already existed, and the general law (i.e., GAAR) was enacted at a later date. However, the Hon'ble Supreme Court of India as well as multiple High Courts have held that the specific law prevails over the general law in cases where the general provision of law already existed, and the specific provisions were subsequently enacted. Thus, the principle of 'specific overrides general' was not applicable in the taxpayer's case and this contention could not be accepted for inapplicability of GAAR provisions.

The High Court also laid emphasis on the overriding effect of GAAR, stating that section 95(1) (i.e., the enabling provision of GAAR) begins with a non-obstante clause to the effect that *"Notwithstanding anything contained in the Act, an arrangement entered into by an assessee [...]"*. In other words, this meant that by virtue of the aforesaid non-obstante clause, the provisions of chapter X-A get an overriding effect over and above the other existing provisions of law.

Further, the High Court analysed provisions of section 94(8) and concluded that section 94(8) was not applicable on bonus stripping of shares. It only covered bonus stripping involving units of mutual funds. It was also pointed out that this fact had also been accepted by the taxpayer in its submissions.

[6] CBDT Circular No. 7 of 2017, dated January 27, 2017
[7] M/s. S. Zoraster and Company [(1972) 4 SCC 15]
[8] Vodafone International Holdings B.V. [2012] 17 taxmann.com 202 (SC)
[9] McDowell & Co. Ltd. [(1985) 3 SCC 230]

KCM Comments (Critical Analysis)

At the outset, based on the facts and the arguments advanced from both the sides, this writ appears to have been a desperate attempt by the taxpayer to try and circumvent the GAAR machinery and avoid the inevitable. This is also supported by the fact that there is no defence by the taxpayer's side which attempts to provide a commercial rationale behind the actions which were undertaken.

In a nutshell,

The High Court's judgement on the first ever case on GAAR has concluded that –

a. Considering the non-obstante clause in GAAR, the same has an overriding effect over other provisions, including SAAR.
b. Further, the Court has mentioned that this was a case where the general law (GAAR) was enacted later in time, and the specific law (SAAR) already existed. High Court was of the view that the specific law overrides the general only in cases where the specific law was enacted later in time. Hence, the application of the principle of "specific overrides general" was misplaced.
c. It was also mentioned by the High Court that when addressing the issue GAAR v. SAAR, the Shome Committee Report (2012) mentioned that in case of conflict between the two, SAAR should be considered and not GAAR[10]. However, the court mentioned that as per the committee, this is relevant only for the international cases, and not the domestic cases such as this one.

Specific law versus general law

On the view of the High Court that 'specific overrides general' is applicable only in cases where the general law already exists and the specific law is enacted later, there is an alternate view possible – considering the Supreme Court decision of *R.S. Raghunath vs. State of Karnataka [[1992] (1) SCC 335]* where the apex court had examined a very similar case where the later general law had an overarching non-obstante clause appearing to override the existing special law, and held that –

> *"the non-obstante clause need not necessarily and always be co-extensive with the operative part so as to have the effect of cutting down the clear terms of an enactment and* ***if the words of the enactment are clear and are capable of a clear interpretation on a plain and grammatical construction of the words the non-obstante clause cannot cut down the construction and restrict the scope of its operation. In such cases the non-obstante clause has to be read as clarifying the whole position and must be understood to have been incorporated in the enactment by the Legislature by way of abundant caution and not by way of limiting the ambit and scope of the Special Rules."***

From the above, it is possible to conclude the provisions of GAAR and SAAR have to be harmoniously interpreted so as to co-exist, and not cancelling the effect of one another, while attributing due significance and meaning to the non-obstante clause contained in GAAR.

A non-obstante clause only applies in cases where there is a conflict between the provisions[11]. So, for the non-obstante clause in GAAR provisions what could be the conflict which it addresses? SAAR and GAAR have the same object of remedying the mischief of tax avoidance. Hence, it is difficult to construe them as conflicting to one other in case of an overlap.

[10] Para 3.19, Shome Committee Report (2012)

[11] Aswini Kumar Ghosh v. Arabinda Bose [1953] SCR 1; Union of India v. G.M. Kokil [1984] 3 SCR 292; Chandavarkar Sita Ratna Rao v. Ashalata S. Guram, [1986] 4 SCC 447

Continuing this line of thought, one possible view could be that Domestic GAAR should have application in case of schemes where SAAR's are not able to adequately prevent the abuse. If the facts and circumstances establish that an arrangement was designed to dodge a SAAR, the GAAR can be used to bring such arrangements within the tax net.[12]

Could the High Court have refused entertaining this writ?

Interestingly, the High Court completely ignored revenue's submission that the writ was unjustified, even though it is a well-settled law that writ against a show cause notice may be entertained only if it is established that the relevant authority (i.e., in this case, tax authority)

a. issued show cause notice without jurisdiction to issue such notice under statute or rules or,
b. there are allegation of mala fides raised against official concerned.[13]

In fact, the High Court also went as close to this as observing that taxpayer's motives appeared dubious to the High Court in view of the fact that the taxpayer approached writ court in spite of there being a fair and thorough mechanism available under section 144BA.

Another question which arises due to this decision...

Note that the High Court has not, in its analysis, distinguished a case where the SAAR provisions apply and adequately address the tax avoidance arrangement. Thus, the decision gives us the impression that GAAR provisions have a blanket overriding impact on all of the provisions of the Act. Considering this view, a question arises – whether GAAR provisions are to be mandatorily invoked by the tax authorities or can the tax authorities choose between invocation of GAAR and SAAR provisions? Although an important factor for the manner of invocation of GAAR proceedings, as this question was not relevant to the case it has not been addressed by the High Court in its judgement.

Conclusion

One can conclude with reasonable assurance that this decision just touches the tip of a gargantuan glacier. It is also expected that this High Court decision is just a beginning of the many decisions which would solve the complex puzzle of interpretation of law which introduction of GAAR has created. Many such highly consequential but extremely technical issues emerge, especially when GAAR is read with the international tax law concepts like the Multilateral Instrument (MLI), Limitation of Benefits (LOB) clause and of course the domestic SAAR.

This judgment marks an initial stride towards curtailing tax abuse facilitated by sophisticated tax arrangements. The government has persistently endeavored to tackle such dubious tax avoidance strategies by fortifying the existing tax framework through the introduction of SAAR and GAAR. Concurrently, the judiciary has also played a pivotal role in thwarting such schemes with its own set of regulations commonly referred to as Judicial Anti-Avoidance Rules (JAAR). Navigating through this intricate web of GAAR, SAAR, and JAAR, taxpayers will face a formidable challenge in circumventing legitimate tax obligations through intricately woven transactions and arrangements. Across the globe, tax

[12] Para 272 (Pg. 86), Unraveling GAAR, SAAR, PPT and LOB - Overlap and Intricacies (2024) by CA H. Padamchand Khincha, CA Pilar Shivanand Nayak and CA Bibhuti Ram Krishna

[13] Vicco Laboratories [2008] 2008 taxmann.com 520 (SC); Maya Appliances (P.) Ltd. v. ACIT [2021] 131 taxmann.com 163 (Madras HC); Elora Tabacco Company Ltd. [2024] 161 taxmann.com 539 (Madhya Pradesh HC); Mohd. Sajid Bains [2024] 159 taxmann.com 599 (Rajasthan HC); Smt. Soodamani Dorai [2018] 98 taxmann.com 481 (Madras HC); Mahavir Enterprise [2020] 117 taxmann.com 471 (Gujarat HC)

practitioners, advisors, and individuals involved in such arrangements are increasingly subjected to judicial scrutiny. Therefore, it is imperative for companies and advisors alike to adhere to ethical practices grounded in robust commercial rationale. The allure of immediate tax savings must be weighed against the long-term repercussions of embroilment in protracted judicial proceedings under GAAR, SAAR, or JAAR!!

For further analysis and discussion, you may please reach out to us.

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