

# Telangana High Court quashes GAAR proceedings in absence of an 'impermissible avoidance arrangement'

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## Background

The principles of General Anti Avoidance Rule or GAAR are incorporated under Chapter X-A of the Income Tax Act, 1961 (IT Act). Under the GAAR provisions, the tax authorities are empowered to declare a transaction as an 'impermissible avoidance arrangement' and deny any tax benefit, if it fulfils certain specified tests and the main purpose of the transaction is to claim a tax benefit. The IT Act lays down detailed procedure for invocation of GAAR.

In Smt. Anvida Bandi v Deputy Commissioner of Income Tax, [2025] 177 taxmann.com 726 (Telangana), a Division Bench of the Telangana High Court examined the applicability of GAAR in the context of sale and purchase of shares by an investor and offset of capital loss against capital gains. The Court allowed the writ petition of the taxpayer and set-aside the order passed by the GAAR Panel which sought to apply GAAR provisions in the context of a transaction to set-off of capital losses from sale of one asset against capital gain from another asset on the ground that the transactions were timed merely to take the benefit of set-off provisions under the law and avoid tax liability. The High Court relied on the Expert Committee Report on GAAR which recommended that GAAR provisions should not apply to transactions undertaken on stock exchange. The High Court further held that the tax department failed to bring any evidence on record to demonstrate that the ingredients of 'impermissible avoidance arrangement' were met, which is a pre-requisite for applicability of GAAR.

## Facts of the case

- Anvida Bandi (Taxpayer) is engaged in the business of making investments in shares and securities. During the year under consideration (FY 2019-20), the Taxpayer sold shares of one company held by her as an investment and earned income by way of long-term capital gains (Capital Gains).
- The Taxpayer utilised these funds to purchase shares of HCL Technologies Pvt. Ltd. (Shares) and invest in units of mutual funds.
- However, before the end of FY 2019-20, the Taxpayer sold some of the Shares and incurred short term capital loss (Capital Loss). This Capital Loss was set off against the Capital Gains in accordance with the IT Act while computing her tax liability for FY 2019-20.
- The tax officer alleged that timing of the sale and purchase transaction in the Shares indicates that the purchase and sale of the Shares was undertaken with the main purpose of claiming such set-off and thus, meets the test of an Impermissible Avoidance Arrangement (IAA) under the GAAR provisions. Accordingly, a reference was made to the GAAR Panel to declare the transactions in the Shares as an IAA and deny such set-off. The GAAR Panel agreed with the contentions of the tax officer and held the transactions in the Shares were an IAA and consequently, such set-off was denied to the Taxpayer.
- Aggrieved, the Taxpayer challenged GAAR Panel's decision by way of a writ petition before the Telangana High Court.

## Tax department's key arguments

- The timing of purchase and sale of the Shares by the Taxpayer clearly demonstrates that it is an IAA which has been undertaken with the primary intention of claiming the set-off and thus, reducing her tax liability on Capital Gains.
- Under Section 96(2) of the IT Act, there exists a presumption clause, and the onus is on the Taxpayer to rebut such presumption with cogent evidence to establish that the inference drawn by the tax authorities is unjustified and that there was no intention to obtain tax benefits.

## High Court ruling

The High Court ruled in favour of the Taxpayer and held that the transactions undertaken by the Taxpayer did not qualify as an IAA for the following reasons:

- Under the IT Act, the primary requirement for characterising a transaction as an IAA is the existence of an arrangement between two or more parties. However, the tax authorities failed to establish that the purchase and sale of Shares by the Taxpayer was carried out with any known person or related entity.
- No nexus was established between the purchase and subsequent sale of the Shares by the Taxpayer which is further bolstered by the fact that these transactions were undertaken on the stock exchange where the identity of the seller or the purchaser is not known to the Taxpayer.
- The High Court relied on the Expert Committee Report whose recommendations were that
  - (a) transactions for purchase and sale of Shares through the stock exchanges would not come under the GAAR provisions; and
  - (b) the timing of a transaction for sale or purchase of shares cannot be questioned under the GAAR provisions.
- The Taxpayer was a consistent investor engaged in the purchase and sale of shares for many years. Hence, the transactions in question were not isolated arrangements aimed at obtaining tax benefits. No cogent material was brought on record by the tax authorities to prove any existence of an IAA.

## Comments

This is the first ruling on the applicability of the principles of GAAR which deals with merits of the case. This ruling reiterates that a mere existence of a tax benefit should not result in invocation of GAAR provisions by tax authorities unless there is an existence of a tainted element. A 'tax planning' which is well within the four corners of law ought not to be challenged invoking GAAR when what is sought to be targeted by GAAR are tax avoidance arrangements. In cases where there are adequate commercial reasons and tax benefit is merely one of the offshoots of such arrangement, the provisions of GAAR should not be invoked by the tax authorities to challenge the genuineness or bona fides of a transaction or lack of commercial substance in a transaction.

The High Court reiterated the tax authorities while applying GAAR provisions have to support their allegations with proper evidence and should not proceed merely based on surmises and conjectures relying on the recommendations of the Expert Committee

The GAAR provisions were introduced in 2017 and are a powerful weapon in the hands of the tax authorities to challenge a transaction on the basis of lack of commercial substance or lack of bona fides. Thus, parties should be well-advised to examine GAAR provisions while doing a transaction or setting up a structure, etc. to avoid any potential challenges by the tax authorities.

- Sanjay Sanghvi (Partner) and Avin Jain (Principal Associate)



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