



Tax alert: HC allows capital loss set-off against slump sale gains, GAAR not applicable

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The Telangana High Court has held that General Anti Avoidance Rule (GAAR) is inapplicable to bona fide share transactions undertaken through recognised stock exchanges. The Court upheld set-off of short-term capital loss on listed shares against long-term capital gains on slump sale.

In a nutshell



The burden of establishing ingredients of GAAR rests upon the Revenue, as Chapter X-A of the ITA, visits the taxpayer with consequences of the gravest kind, including disregard or re-characterisation of transactions and denial of treaty benefits, none of which can follow upon a mere suspicion or upon the Revenue's disapproval of the commercial course a taxpayer has chosen to adopt.

The words "transaction", "operation", "scheme", "agreement or understanding" employed in section 102(1) of the ITA must be read in their setting, and each of those expressions read in the company of the others, connotes a degree of concert, design or arrangement between identifiable parties, or at the very least a pre-ordained set of steps whose outcome is within the control of the person said to have entered into it.



Section 96(1) requires the Revenue to establish that the main purpose of that arrangement was to obtain a tax benefit. The statute uses the words "main purpose", not "a purpose" or "an incidental consequence". The taxpayer, having incurred a loss, thereafter, claimed the set-off which the statute itself expressly permits, cannot by itself convert the earning of that loss into an exercise whose main purpose was the obtaining of a tax benefit.

When the taxpayer set off STCL against LTCG computed under section 50B on the slump sale, it did no more than compute its total income in the manner that the ITA itself prescribes. To describe the working out of a computation provision according to its own terms as the obtaining of a "tax benefit" is to misapprehend the nature of the levy.



A "tax benefit" within Chapter X-A must be something that the taxpayer secures by circumventing or subverting the scheme of the ITA and not something that flows from the direct and unavoidable operation of a computation provision upon a loss that was genuinely and commercially sustained.

Section 96(1)(b) which speaks of an arrangement that results directly or indirectly in the misuse or abuse of the provisions of the ITA was not attracted. There was no misuse and no abuse. Abuse connotes the employment of a provision for a purpose alien to that for which it was enacted. Set-off under section 70(2) exists precisely so that losses may be set against gains in arriving at total income, and the taxpayer used it for no other purpose.

Background:

- An Indian company (A Co) was engaged in the manufacture, sale, distribution and trading of apparel and accessories for men, women and children, marketing ethnic and formal wear under a brand name (say XYZ) and was counted among the largest fashion brands in southern India. B Co was another Indian company engaged in men's Indian wedding and celebration wear segment.
- In June 2017 i.e. during the Financial Year (FY) 2017-18 corresponding to Assessment Year (AY) 2018-19, A Co sold its business run under XYZ brand name, as a going concern, to B Co for an agreed consideration.
- Thereafter, A Co was amalgamated into another company named C Co vide an order of National Company Law Tribunal (NCLT) in June 2018 with effect from 1 April 2017. Subsequently, C Co merged into taxpayer company¹ vide an order passed by NCLT in December 2018 with effect from 1 April 2018.
- Post discharging the liabilities, the taxpayer (being A Co which was subsequently merged with the taxpayer) was left with a surplus, for which it had no immediate long-term requirement. The taxpayer was approached by numerous wealth managers offering their services to plan investment of the surplus.
- The taxpayer was advised that going by the historical market trends, the purchase of shares pre-bonus and their sale immediately upon allotment of bonus shares could yield a short-term additional return of 1% to 3% even within a period of a week or two. With a view to achieve the aforesaid objective, together with the possibility of earning such short-term returns on equity, the taxpayer invested an aggregate of say INR 100 in the pre-bonus shares of a number of large listed companies from time to time. It sold shares worth say INR 53 post-bonus and was left with a net investment of say INR 47.
- As the transfer of the business was effected as a going concern for a lump sum consideration, gains arising therefrom were computed under section 50B of the Income-tax Act 1961 (ITA) [section 77 of the Income-tax Act 2025]. The business undertaking was held by A Co for more than 36 months, long-term capital gains (LTCG) on the transfer were taxable.
- The taxpayer contended that the short-term capital loss (STCL) of INR 47 on sale of listed shares was liable to be set-off against the LTCG arising to it on the slump sale, under section 70(2) of the ITA [section 108 of the Income-tax Act 2025]. The income-tax return was picked up for scrutiny by issuing notice issued under section 143(2) of the ITA [section 270 of the Income-tax Act 2025].
- The Assessing Officer (AO) during the assessment proceedings enquired as to why the provisions of General Anti Avoidance Rule (GAAR) ought not to be invoked in relation to the transactions in bonus shares resulting in STCL, undertaken to offset the capital gains arising from the slump sale.
- The AO held that the sale-purchase transactions in shares resulting in the STCL, set-off against the LTCG from the slump sale, constituted an impermissible avoidance arrangement (IAA) under the GAAR provisions.
- Aggrieved, the taxpayer filed writ petition before the Telangana High Court (HC).

Relevant provisions of the ITA

Section 70

...“(2) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any short-term capital asset is a loss, **the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in**

¹ Ekge Retail LLP v ACIT, Hyderabad (2026) W.P No. 21210 of 2022 [Telangana-HC]

respect of any other capital asset...”

Section 96

“(1) An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it—

- (a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;*
- (b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;*
- (c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or*
- (d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes...”*

Section 102

“In this Chapter, unless the context otherwise requires,—

- (1) "arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding...”***

Decision of the HC:

The HC acknowledged that the issue for consideration was:

- whether the purchase of shares of large listed companies on a recognised stock exchange prior to the declaration of bonus, and the sale of an equivalent quantity of shares after allotment of the bonus resulting in STCL set-off against LTCG (arising from a slump sale), constituted an ‘arrangement’ within the meaning of section 102(1) of the ITA [section 184 of the Income-tax Act 2025], and
 - whether the same can be declared an “IAA” under section 96(1) [section 179 of the Income-tax Act 2025] to attract the consequences prescribed under Chapter X-A of the ITA (relating to GAAR).
- The scheme of Chapter X-A of the ITA (relating to GAAR) is one of the considerable rigour and for that very reason its conditions must be construed strictly.

Section 96(1) of the ITA declares an arrangement to be an IAA only where two conditions are cumulatively satisfied: firstly, that the main purpose of the arrangement is to obtain a tax benefit; and secondly, that the arrangement additionally answers any one of the four descriptions in clauses (a) to (d) under section 96.

- The threshold requirement, preceding both limbs, is that there must exist an “arrangement” as defined in section 102(1). The burden of establishing each of these ingredients rests upon the Revenue, as Chapter X-A of the ITA, visits the taxpayer with consequences of the gravest kind, including disregard or re-characterisation of transactions and denial of treaty benefits, none of which can follow upon a mere suspicion or upon the Revenue’s disapproval of the commercial course a taxpayer has chosen to adopt.
- The taxpayer purchased and sold shares of large and reputed publicly listed companies on a recognised stock exchange at prevailing open market rates in transactions that were entirely at arm’s length and wholly transparent. On a recognised exchange, the counterparty to any given trade is neither known nor capable of being identified by the transacting party; the price at which a transaction is concluded is determined by the market and by the multitude of factors that drive it and not by any concert between identifiable persons.
- The words “transaction”, “operation”, “scheme”, “agreement or understanding” employed in section 102(1) of the ITA must be read in their setting, and each of those expressions read in the company of the others, connotes a degree of concert, design or arrangement between identifiable parties, or at the very least a pre-ordained set of steps whose outcome is within the control of the person said to have entered into it.

- In present case, the quantum of gain or loss was not pre-ordained, being wholly dependent upon the movement of market prices over which the taxpayer exercised no control whatsoever, it was difficult to characterise the taxpayer's trade as an **"operation"** or **"scheme"** within the meaning of the definition. That the taxpayer's expectation of a favourable price movement post bonus happened to be borne out in some instances and evidently not in others is a consequence of market behaviour and not of any design of the taxpayer's making.
- Even assuming that the taxpayer's dealings could be brought within the expansive definition of "arrangement", section 96(1), requires the Revenue to establish that the main purpose of that arrangement was to obtain a tax benefit. The statute uses the words "main purpose", not "a purpose" or "an incidental consequence". The taxpayer, having incurred a loss, thereafter claimed the set-off which the statute itself expressly permits, cannot by itself convert the earning of that loss into an exercise whose main purpose was the obtaining of a tax benefit.
- The purchase of pre-bonus shares was undertaken as part of the equity allocation, upon advice that historical market trends indicated the possibility of a short-term arbitrage return which on an annualised basis would be very substantial. Of the aggregate money so invested, some shares were sold post-bonus, and the taxpayer retained a net investment, which it continued to hold. That retention was itself telling; a taxpayer whose sole object was the manufacture of a capital loss would have had no reason to remain invested to that extent in the underlying scrip.
- The Revenue authorities approached the question from the wrong end. Instead of asking whether the material established that the dominant purpose of the taxpayer's investment decisions was the obtaining of a tax benefit, the directions proceed from the premise that because a tax benefit resulted, the purpose must have been to obtain it. That is to reason backwards from effect to intention, and it is not the enquiry that section 96(1) mandates.
- It is well settled that a taxpayer is entitled to so arrange its affairs as to attract the least incidence of tax, provided it does so within the four corners of the law, and that the mere circumstance that a lawful course adopted by a taxpayer also happens to be tax efficient does not render that course impermissible.
- The total income of a taxpayer for a previous year can be arrived at only after the losses sustained in some activities are set off against the gains derived from others; that is not a concession granted to the taxpayer but an intrinsic feature of the manner in which taxable income is computed under the ITA.
- When the taxpayer set-off STCL against LTCG computed under section 50B on the slump sale, it did no more than compute its total income in the manner that the ITA itself prescribes. To describe the working out of a computation provision according to its own terms as the obtaining of a "tax benefit" is to misapprehend the nature of the levy. A "tax benefit" within the contemplation of Chapter X-A must be something that the taxpayer secures by circumventing or subverting the scheme of the ITA and not something that flows from the direct and unavoidable operation of a computation provision upon a loss that was genuinely and commercially sustained.
- Section 96(1)(d) is directed at the means and the manner, not at the outcome. Tested on that touchstone, the taxpayer's transactions cannot possibly attract the clause.
- Purchases and sales of listed securities on a recognised stock exchange regulated by the Securities and Exchange Board of India (SEBI), with Securities Transaction Tax (STT) and service tax duly discharged, represent the most ordinary, conventional and universally employed means of transacting in securities in this country. Transactions of enormous aggregate volume are executed through this very channel every trading day. There is no means more ordinary and no manner more bona-fide available to an investor wishing to deal in equities. To hold that recourse to a regulated stock exchange is a means not ordinarily

employed for bona-fide purposes would be to stand the clause upon its head.

- Also, Section 96(1)(b) which speaks of an arrangement that results directly or indirectly in the misuse or abuse of the provisions of the ITA was not attracted. There was no misuse and no abuse. Abuse connotes the employment of a provision for a purpose alien to that for which it was enacted. Set-off under section 70(2) exists precisely so that losses may be set against gains in arriving at total income, and the taxpayer used it for no other purpose.
- The Revenue failed to establish the existence of an “arrangement” within the meaning of section 102(1) of the ITA, failed to establish that the main purpose of the taxpayer’s transactions was the obtaining of a tax benefit within the meaning of section 96(1) of the ITA, and failed to bring the case within either clause (b) or clause (d) thereof.

Hence, the HC held that the Revenue’s finding of taxpayer’s transactions constituting as an IAA, therefore cannot be sustained. Hence, the taxpayer was entitled to the benefit of set-off under section 70(2) of the ITA in respect of the STCL against the LTCG arising on the slump sale.

Comments:

The application of GAAR continues to be a significant area of litigation. Key provisions in this context include the existence of an IAA involving examination of whether a transaction or arrangement has been undertaken primarily to obtain a tax benefit and whether it satisfies the prescribed tainted element tests. These tests need to be evaluated based on facts of each case.

Set-off provisions already exist in the tax law and are intended to form an integral part of the capital gains taxation framework questions may arise regarding the extent to which transactions resulting in tax-efficient utilization of such losses may be examined through the lens of the GAAR provisions.

The HC in this ruling has, inter-alia, held as follows:

- The burden of establishing ingredients of GAAR rests upon the Revenue, as Chapter X-A of the ITA, visits the taxpayer with consequences of the gravest kind, including disregard or re-characterisation of transactions and denial of treaty benefits, none of which can follow upon a mere suspicion or upon the Revenue’s disapproval of the commercial course a taxpayer has chosen to adopt.
- The words “transaction”, “operation”, “scheme”, “agreement or understanding” employed in section 102(1) of the ITA must be read in their setting, and each of those expressions read in the company of the others, connotes a degree of concert, design or arrangement between identifiable parties, or at the very least a pre-ordained set of steps whose outcome is within the control of the person said to have entered into it.
- Section 96(1) requires the Revenue to establish that the main purpose of that arrangement was to obtain a tax benefit. The statute uses the words “main purpose”, not “a purpose” or “an incidental consequence”. The taxpayer, having incurred a loss, thereafter claimed the set-off which the statute itself expressly permits, cannot by itself convert the earning of that loss into an exercise whose main purpose was the obtaining of a tax benefit.
- When the taxpayer set off STCL against LTCG computed under section 50B on the slump sale, it did no more than compute its total income in the manner that the ITA itself prescribes. To describe the working out of a computation provision according to its own terms as the obtaining of a “tax benefit” is to misapprehend the nature of the levy. A “tax benefit” within Chapter X-A must be something that the taxpayer secures by circumventing or subverting the scheme of the ITA and not something that flows from the direct and unavoidable operation of a computation provision upon a loss that was genuinely and commercially sustained.

- Section 96(1)(b) which speaks of an arrangement that results directly or indirectly in the misuse or abuse of the provisions of the ITA was not attracted. There was no misuse and no abuse. Abuse connotes the employment of a provision for a purpose alien to that for which it was enacted. Set-off under section 70(2) exists precisely so that losses may be set against gains in arriving at total income, and the taxpayer used it for no other purpose.

It is pertinent to note that the Telangana HC² in a judgement has upheld the similar principle that genuine share transactions conducted through stock exchanges and demat accounts could not be treated as an IAA.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

² Smt. Anvida Bandi vs. DCIT [2025] 177 taxmann.com 726 (Telangana)



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