MOOT PROBLEM

1. Singhania Private Limited (SPL), engaged in the business of manufacturing steel products, has three directors and shareholders, namely Asha, Lata and Hafiz each owning 1/3rd shareholding in the company. The shareholders are otherwise not related to each other. SPL earned a net profit of INR 92.00 Crs during the financial year 2018-19.

2. SPL is into steel business since past few decades. In absolute terms, it has been earning huge profits for the past 8 years and has been distributing dividend every year @ 60% of net profit for the relevant year. However, the profitability has shown a downward trend in the past three years. Net profit and dividend distributed for the said three years are as under:

Financial Year	Net Profit (INR in Crs)	Dividend (INR in Crs)	Pay-out ratio
2015-2016	140.25	84.15	60.00%
2016-2017	133.38	80.03	60.00%
2017-2018	119.70	71.82	60.00%

3. For the financial year 2019-20, Asha, Lata and Hafiz earned taxable income of INR 5 crores each, without including any investment income from SPL.

4. In line with the past practice, board meeting was called for approving the audited financial statements and declaring dividends for the financial year 2018-19. However, during the board meeting, Hafiz informed that in view of the cyclic nature of steel business and downward trend in profitability, he wanted to reduce his exposure to steel business i.e. in SPL. He thus proposed for buy-back by utilising the entire profits for the year, instead of distribution of dividend as usual, as that would be tax effective too. Asha and Lata, being optimistic about the future growth in steel business, had no intention of divesting from SPL.

   In absence of a consensus, the board did not pass any resolution with respect to distribution of dividend or buy-back of shares in the said board meeting, though the aforesaid discussion formed part of the minutes of the meeting.

5. In a subsequent meeting held after fortnight, the board passed a resolution for buy-back of shares. As per the buy-back scheme, SPL proposed to buy-back 1,12,500 equity shares @ INR 8178 per shares (i.e. for total consideration of INR 92.00 crores).

6. SPL's paid up capital and reserves as on 31.03.2019 were as follows:

Particulars	Amount (INR)
Share Capital & Share Premium (5,00,000 shares, FV INR 100 each issued @ 1800 each)	90.00 crores
Free Reserves (INR 260.86 crores + 92 crores)	352.86 crores

Total Paid Up Capital + Free Reserves	442.86 crores
Total Debt	150.00 crores

As per the Companies Act, 2013, SPL is permitted to buy-back up to 25% of its outstanding shares utilizing up to 25% of its paid up capital and free reserves after ensuring post buy-back debt-equity ratio to be at least 2:1. Accordingly, SPL can utilize INR 92.00 crore to buy-back 1,12,500 shares at per share price of INR 8,178 each.

7. The details of equity shares offered under buy-back and accepted by SPL with respect to each shareholder is as under:

Shareholder	Shares offered		Shares accepted	
	No. of shares	Total value (INR)	No. of shares	Total value (INR)
Asha	22500	18.40 crores	22500	18.40 crores
Lata	22500	18.40 crores	22500	18.40 crores
Hafiz	67500	55.20 crores	67500	55.20 crores
		92.00 crores		92.00 crores

All the necessary conditions and procedures mandated by the Companies Act, 2013 read with the applicable rules thereto are duly fulfilled / satisfied. There is no dispute on this aspect.

8. SPL discharged its tax liability with respect to the said buy-back as per the provisions of section 115QA of the Income-tax Act, 1961 (the Act) as under:

Particulars	Amount (INR)
Consideration paid on buy-back (INR 8178 for 1,12,500 shares)	92.00 crores
Amount received by SPL on issue of shares (INR 1800 per share for 1,12,500 shares)	20.25 crores
Taxable amount / Distributed income	71.75 crores
Tax thereon (@20% + 12% surcharge + 4% cess)	**16.71 crores**

The amounts received on buy-back of shares on which company has paid tax u/s 115QA is exempt in the hands of the shareholders u/s 10(34A) and their total taxable income is therefore INR 5 crores each.

9. SPL's file was selected for scrutiny for the assessment year 2020-21, wherein the Assessing Officer noticed that SPL had bought back the equity shares from its shareholders instead of distributing dividends and opined that the same was with the sole motive of reducing tax out go. Accordingly, scrutiny assessments were also initiated in the case of Asha, Lata and Hafiz by issuing notice under section 143(2) of the Act.

10. The Assessing Officer issued notices as per Rule 10UB(1) of the Income-tax Rules, 1962 (the Rules) to SPL, Asha, Lata and Hafiz, proposing to invoke the provisions of General

Anti-Avoidance Agreement (GAAR) under Chapter X-A of the Act, wherein it was stated as under:

"*It has been noticed that during the financial year 2019-20, Singhania Private Limited has distributed its profits for the financial year 2018-19 through a scheme of buying back equity shares from its shareholder instead of distributing dividends, with the main purpose of obtaining tax benefit. The said company along with its shareholders has obtained a tax benefit of Rs.16.40 crores collectively, as illustrated under:*

Particulars	*Amount (₹)*	*Remarks*
Tax payable if dividend was distributed		
Gross Dividend Amount (incl. DDT)	*111.48 crores*	
DDT (A)	*19.48 crores*	*15% + 12% SC + 4% Cess*
Dividend Declared (excl. DDT)	*92.00 crores*	*Net Profit for FY 2018-19*
In hands of shareholders (collectively)		
Dividend income	*92.00 crores*	
Tax u/s 115BBDA (B)	*13.09 crores*	*tax @ 10% + 37% SC + 4% cess on amount exceeding INR 10 lakh*
Total Tax payable (A+B)	***32.57 crores***	
Less: Tax paid on buy-back u/s 115QA	***16.17 crores***	
Tax benefit obtained	***16.40 crores***	

Accordingly, kindly explain as to why the aforesaid arrangement entered into by you should not be declared to be an Impermissible Avoidance Arrangement under section 95(1) of the Income-tax Act, 1961 and consequences in relation to tax arising therefrom be determined subject to the provisions of Chapter X-A i.e. General Anti-Avoidance Arrangement."

11. SPL, Asha, Lata and Hafiz (hereinafter collectively referred to as 'assessees') filed identical submissions in response to the aforesaid notice issued as per Rule 10UB(1) of the Rules, contending that :

(i) Firstly, the Assessing Officer has not complied with the provisions of Rule 10UB(2) of the Rules which require him to mention in the said notice - the basis and reasons for considering that the main purpose of the identified arrangement is to obtain tax benefit, the basis and the reasons why the arrangement satisfies the condition provided in clause (a), (b), (c) or (d) of sub-section (1) of section 96 of the Act and the list of documents and evidence relied upon in respect of the above;

(ii) SPL had bought back the equity shares under a buy-back scheme floated in compliance with the provisions of the Companies Act, 2013;

(iii) Buy-back scheme was floated to achieve strategic and commercial objective viz. to allow Hafiz to reduce his exposure to steel business and not with the motive to obtain tax benefit;

(iv) In any case, CBDT vide its Circular No.7 of 2017 dated January 27, 2017 has clarified that GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.

(v) Further, as per Rule 10U(1)(d) of the Rules, GAAR provisions are not applicable to any income accruing or arising to / received by any person from transfer of investments made before April 1, 2017 – Grandfathering Rule. Accordingly, since Asha, Lata and Hafiz had subscribed to the equity shares of SPL long before the said date, any income arising on buy-back of such shares cannot be tested for GAAR provisions.

12. Without disposing off the above objections, the Assessing Officer made a reference to the Principal Commissioner of Income-tax (PCIT) under section 144BA(1) of the Act.

13. The PCIT issued a notice under section 144BA(2) of the Act to the assessees setting out his reason and basis for opining that they had entered into an Impermissible Avoidance Arrangement (IAA). In addition to what was stated by the Assessing Officer in notice issued under Rule 10UB(1) of the Rules, the notice under section 144BA(2) of the Act stated that :

(i) In view of the fact that one of the agenda for the first board meeting was to declare dividend and yet SPL distributed profits under a buy-back scheme, the impugned arrangement attracts the provision of clause (b), (c) and (d) of section 96(1) of the Act;

(ii) Even if it was accepted that the impugned arrangement was entered into for facilitating Hafiz to reduce his exposure to steel business and not to obtain tax benefit, why did Asha and Lata also offer their share under the buy-back scheme when they had no intention of divesting from SPL.
Alternatively, SPL could have distributed dividend to the extent of 60% of the profits for financial year 2018-19 and subsequently buy-back scheme could have been floated to enable Hafiz to offer his shares to the extent of remaining 40% of the profits or even more.

(iii) The Assessing Officer's basis and reason for invoking GAAR provisions are supported by the minutes of the above referred board meetings as well as the financial statement of SPL over the years.

(iv) The assessees cannot claim benefit of grandfathering provisions since it is applicable only in case of transfer of any investment / shares and not buy-back. Also, Rule 10U(2) of the Rules provides that grandfathering does not exempt the entire arrangement from the applicability of GAAR, irrespective of the date on which it has been entered into.

14. In response, the assesses appeared before the PCIT and submitted their objections, which were same as the ones filed before the Assessing Officer, except the following:

(i) The impugned arrangement did not result in misuse or abuse of any provisions of the Act rather the assesses have discharged their tax liability diligently as per the Act and thus clause (b) of section 96(1) of the Act is not attracted

(ii) The impugned arrangement was entered into to achieve the commercial objective of facilitating Hafiz to reduce his exposure to steel business and thus it does not lack commercial substance so as to attract clause (c) of section 96(1) of the Act

(iii) The impugned arrangement complies with the provisions / procedure laid down in the Companies Act, 2013 and thus was not carried out, by means / in a manner which are ordinarily not employed for bona fide purposes so as to attract clause (d) of section 96(1) of the Act

(iv) Further, the Assessing Officer did not even dispose the objections filed by the assesses.

15. Being not satisfied with assessees' explanation, the PCIT made a reference to the Approving Panel as per section 144BA(4) of the Act, for the purpose of declaring the impugned arrangement as IAA.

16. Upon receipt of reference from the PCIT, the Approving Panel issued the following directions:

(i) Consideration received by Asha, Lata and Hafiz be considered as dividend distributed by SPL

(ii) Since the tax paid by SPL is more than tax that it was otherwise liable to pay as DDT on dividend distribution, SPL will not be liable to pay any further amount.

(iii) Asha, Lata and Hafiz be liable to pay income-tax under section 115BBDA of the Act @ 10% (plus applicable surcharge & cess) of the dividend received from SPL (in excess of INR 10 lakhs)

17. Aggrieved by the directions issued by the Approving Panel, assessees' filed a writ petition before the High Court praying for quashing of the entire GAAR proceedings including the said directions on the following grounds:

(i) Buy-back scheme was floated to achieve strategic and commercial objective viz. to allow Hafiz to reduce his exposure to steel business and thus it cannot be said that the main purpose of the same was to obtain tax benefit. Without prejudice to the above, even if it is opined that there was no commercial rationale for Asha and Lata to accept buy-back offer, GAAR provisions ought to be invoked and tax consequences thereon be determined only to the extent of that part of the impugned arrangement.

(ii) Neither the Assessing Officer nor the PCIT has established that the impugned arrangement attracts the provision of clause (b), (c) and (d) of section 96(1) of the Act.

(iii) In any case, CBDT vide its Circular No.7 of 2017 dated January 27, 2017 has clarified that GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.

(iv) The Assessing Officer failed to comply with provisions contained in Rule 10UB(2) as well as to give benefit of Rule 10U(1)(d) and went on to make reference to the PCIT without disposing off the objections (which *inter alia* included the above failures) filed by the assesses in response to notice issued as per Rule 10UB(1).

(v) Even if the impugned arrangement is declared to be IAA, adjustment should be made with respect to the excess tax paid by SPL under the buy-back scheme as against what it would be liable on distribution of dividend.

All the above grounds are without prejudice to each other.

18. Upon hearing the brief facts of the case on the first date of hearing and considering Revenue's objections against maintainability of the writ petition, the Court adjourned the matter to another date with a direction that on the next date, the matter would be heard for its admissibility as well as for final disposal (upon admission).