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EY Tax Alert

CBDT amends Income Tax Rules to clarify GAAR grandfathering provisions

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Executive summary

On 31 March 2026, the Central Board of Direct Taxes (CBDT) issued two Notifications¹ amending General Anti Avoidance Rules (GAAR) providing grandfathering benefit for income derived from transfer of investments which were made prior to 1 April 2017. The first Notification amends Rule 10U under Income Tax Rules (ITR), 1962 applicable to the erstwhile Income Tax Act (ITA), 1961, whereas the second Notification amends comparable Rule 128 under ITR 2026 applicable to the new ITA 2025 effective from 1 April 2026.

The Notifications state that GAAR provisions shall not apply with respect to any income derived from transfer of investments which were made before 1 April 2017 even though the arrangement, irrespective of the date on which it had been entered into, is not grandfathered.

The amendments to ITR 1962 are effective from 31 March 2026, while those relating to ITR 2026 apply from 1 April 2026.

¹ Notification No. 54/2026 (F. No. 370142/15/2026-TPL) under ITA 1961 and Notification No. 55/2026 (F.

No. 370142/15/2026-TPL) under ITA 2025



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Background

- ▶ Both the erstwhile ITA 1961 and the new ITA 2025 incorporate GAAR which grants wide powers to the tax authority to deny tax benefits (including tax treaty benefits) in relation to “impermissible avoidance arrangements” (IAA). Once the arrangement is declared to be an IAA, the tax authority can, *inter alia*, disregard, look through, or re-characterize the arrangement in “such manner as is deemed appropriate”, including denial of tax treaty benefits. The provisions which grant tax treaty benefits, if they are more beneficial than domestic tax laws, are subject to GAAR and, hence, GAAR can override tax treaty benefits.
- ▶ The GAAR provisions were introduced in ITA 1961 and made effective from tax year 2017-18 and onwards, to be applied in accordance with such guidelines and subject to such conditions, as may be prescribed.
- ▶ The GAAR provisions are contained in Chapter X-A of ITA 1961, (corresponding Chapter XI of ITA 2025) and the necessary procedures for application of GAAR and conditions under which it shall not apply are enumerated in Rules 10U to 10UC of ITR 1962 (corresponding Rule 127 to 130 of ITR 2026).
- ▶ Furthermore, Rule 10U of ITR 1962 (Rule 128 of ITR 2026) lay down the circumstances in which GAAR cannot be applied (grandfathering benefit). One such circumstance is provided under Rule 10U(1)(d), which provides that GAAR shall not apply to any income derived from transfer of investments made before 1 April 2017. However, Rule 10U(2) provides that “without prejudice” to Rule 10U(1)(d), GAAR shall apply to any “arrangement”, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after 1 April 2017.
- ▶ The exact interplay between Rule 10U(1)(d) which grants GAAR grandfathering benefit to income from transfer of investment made before 1 April 2017 and Rule 10U(2) which provides that, without prejudice to Rule 10U(1)(d), GAAR shall apply to tax benefit obtained on or after 1 April 2017 from an arrangement entered prior to that date, was the subject matter of controversy.
- ▶ The recent landmark Supreme Court (SC) ruling in the case of Tiger Global International Holdings², held that Rule 10U(2) overrides Rule 10U(1)(d), notwithstanding the “without prejudice” language. Thus, income from transfer of investment made before 1 April 2017 is not grandfathered if the arrangement is an IAA.
- ▶ This SC ruling created significant interpretational uncertainty by exposing pre-1 April 2017 investments to GAAR scrutiny,

contrary to the understanding gained by taxpayers, particularly, investors from Mauritius, Singapore and Cyprus. India’s tax treaties with these countries were changed with effect from 1 April 2017 to grant source taxing rights to India on capital gains arising from shares of companies resident in India, but with grandfathering benefit for shares acquired prior to 1 April 2017.

- ▶ The Indian Government’s press release dated 14 January 2013, as also the circular³ issued by the CBDT, assured taxpayers that investments made up to 31 March 2017 will be protected from GAAR.
- ▶ Furthermore, a circular⁴ issued by the CBDT clarified that grandfathering provisions under the above referred tax treaties shall remain outside the purview of the “principal purpose test” (PPT) provision, being governed, instead, by the specific provisions in this regard of the respective tax treaty itself.
- ▶ Post the Tiger Global ruling, various stakeholders raised their concerns before the Government that overarching interpretation of the SC ruling is likely to render the GAAR grandfathering benefit for investments made before 1 April 2017, redundant.
- ▶ In order to align the GAAR grandfathering rules with the original intent, the CBDT issued the Notifications which provide clarity on the scope of grandfathering benefit for investments made before 1 April 2017.

Notifications amending GAAR

- ▶ On 31 March 2026, the CBDT issued the two Notifications amending GAAR under ITR 1962 and ITR 2026.
- ▶ The Notifications clarify the interaction between the grandfathering provision under Rule 10U(1)(d) of ITR 1962 (Rule 128(1)(d) of ITR 2026) and the overriding GAAR trigger under Rule 10U(2) (Rule 128(2) of ITR 2026). They provide that GAAR shall not apply to income derived from transfer of investments which were made before 1 April 2017, even though the arrangement, irrespective of the date on which it had been entered into, is not grandfathered. In other words, while any other income (like dividends or interest) arising on or after 1 April 2017 from investments made before 1 April 2017 shall not be protected from GAAR, the income by way of transfer of such investments shall be protected from GAAR.
- ▶ Effective date:
 - Amendment to ITR 1962 is effective from the date of publication of the Notification in the official gazette i.e., 31 March 2026. Furthermore, the explanatory memorandum states that the amendment will have the effect that GAAR shall not be invoked on or

² Civil Appeal No. 262 of 2026

³ Circular No. 19/2015 dated 27 November 2015

⁴ Circular No. 1/2025 dated 21 January 2025

after 31 March 2026 in a case where income is derived by any person from transfer of investment which was made before 1 April 2017 by such person.

- Amendment to ITR 2026 is effective from 1 April 2026.

Comments

The Notifications issued to amend the GAAR grandfathering provision are a welcome change and address concerns raised by taxpayers post the SC ruling in Tiger Global. The present amendment makes it clear that GAAR provisions shall not apply to income arising from transfer of investments which were made before 1 April 2017, even if the arrangement is, otherwise, not grandfathered (i.e., any other income arising from such arrangement is not protected from GAAR).

The amendment to ITR 1962, read with the explanatory memorandum, states that GAAR chapter "shall not be invoked" on or after 31 March 2026 (being the date of notification), whereas the amendments to ITR 2026 take effect from 1 April 2026.

The amendments align with assurances provided to taxpayers in earlier press releases/circulars, including Circular No. 7/2017.

To recollect, CBDT Circular No. 7 of 2017 dated 27 January 2017 had clarified that grandfathering benefit will also be extended to compulsorily convertible instruments acquired before 1 April 2017 but converted later, and to shares coming into existence by split or consolidation of holdings, or by way of bonus shares if such action relates to original shares acquired prior to 1 April 2017. The said circular had also clarified that an investment represents an asset which is held by an enterprise for earning income by way of dividends, interest, rentals and capital appreciation.

In effect, the decisive factor for GAAR grandfathering for income from transfer of investment continues to be the date of investment prior to 1 April 2017, and not the date on which income or tax benefit is realized. However, since the arrangement itself is not grandfathered, any other income arising from the arrangement/investment (like dividend or interest) is not protected from GAAR.

The stakeholders impacted by the amended rules may also wish to explore if the amendment is curative in nature and provide benefit in respect of any proceedings pending or to be initiated in future for the past years. It may be noted that, procedurally, invocation of GAAR requires the tax authority to make a reference to the Principal Commissioner/Commissioner who, in turn, is required to give opportunity to the taxpayer to raise objections before they form an opinion that GAAR is required to be invoked. Furthermore, Principal Commissioner/Commissioner is then required to make reference to the approving panel who, after giving opportunity to both the tax authority and the taxpayer, has to issue directions to the tax authority as to whether or not to declare the arrangement as an IAA.

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



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