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Main Stories

- ▮ Taxation of Alternative Investment Funds
Page 1
- ▮ TPO must follow Section 92C(3) before rejecting the arm's length price of Intra-Group Services
Page 8
- ▮ Use of business advances for personal gain constitutes deemed dividend, regardless of stated business purpose or repayment timing
Page 15
- ▮ Settlement Commission and prosecution: SC reconciles statutory immunity with procedural compliance
Page 21
- ▮ Telecommunication towers not qualified for immovable property status despite exclusion from the plant and machinery category
Page 27

Dear Readers,

We are delighted to present the latest issue of *Tax Scout*, our quarterly update on the recent developments in direct and indirect tax laws for the three months ending September 30, 2025.

Our cover story provides an overview of the tax implication and evolving judicial scrutiny in the taxation of alternative investment funds in India. It deals with the issue of taxability of such alternate investment funds even when the names of the actual investors are not available and whether it should be regarded as a determinant trust or be construed as an indeterminant, as is sometimes claimed by the tax authorities.

This version of *Tax Scout* also deals with other important developments and judicial precedents in the field of taxation for this quarter.

We hope you find the newsletter informative and insightful. Please do send us your comments and feedback at at cam.publications@cyrilshroff.com.

Regards,

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Index

COVER STORY

▮ Taxation of Alternative Investment Funds	01
--	----

CASE LAW UPDATES - DIRECT TAX

International Tax	08
-------------------	----

▮ TPO must follow Section 92C(3) before rejecting the arm's length price of Intra-Group Services	08
--	----

▮ Karnataka HC rules no penalty for Assessee acting under bona fide belief on non-taxability of receipts	10
--	----

Transactional Advisory	12
------------------------	----

▮ Bombay HC decides on “commencement of business” controversy and taxability of interest income	12
---	----

▮ Use of business advances for personal gain constitutes deemed dividend, regardless of stated business purpose or repayment timing	15
---	----

Routine Direct Tax Case Law Updates	17
-------------------------------------	----

▮ Delay in passing final assessment order held to invalidate proceedings under Section 144C(13)	17
---	----

▮ Delhi HC reaffirms identity alone is insufficient; Assessee must prove credit worthiness and genuineness of transaction under Section 68	19
--	----

▮ Settlement Commission and prosecution: SC reconciles statutory immunity with procedural compliance	21
--	----

CASE LAW UPDATES - INDIRECT TAX

Routine Indirect Tax Case Law Updates	23
---------------------------------------	----

▮ Mandatory release of goods on non-issuance of SCN on seizure under Customs Act	23
--	----

▮ Bombay High Court upholds validity of entertainment duty levied on convenience fee	25
--	----

▮ Telecommunication towers not qualified for immovable property status despite exclusion from the plant and machinery category	27
--	----

Index

REGULATORY DIRECT TAX UPDATES	28
▮ CBDT clarifies applicability of interest waiver under Circular 5/2025	28
▮ CBDT provides relief from higher TDS/TCS rates for inoperative PANs subsequently made operative	28
▮ CBDT extends investment deadline under Section 10(23FE) to March 31, 2030	28
▮ CBDT extends due date for furnishing audit reports for FY 2024–25	29
▮ CBDT notifies that Special Courts will be designated under the Benami Property Transactions Act	29
▮ CBDT notifies that Foreign Portfolio Investors will be included under Rule 21AK	29
▮ CBDT notifies the amendment to Form No. 7 to include block periods	29
▮ CBDT notifies the introduction of monetary thresholds for perquisite valuation	30
▮ CBDT notifies the alignment of specified fund definition under Rule 21AIA	30
▮ CBDT notifies the clarification for IFSC insurance offices in Form 10CCF	31
REGULATORY INDIRECT TAX UPDATES	32
▮ Jurisdiction of Principal Bench for Specified GST Appeals	32
▮ Amendment to IGST liability for electronic commerce operators from September 22, 2025	32
▮ Exemption from annual return filing under CGST Act for taxpayers with turnover up to INR 2 crore	32
▮ Implementation of tariff concessions under India–EFTA (Norway)	32
▮ Amendment to export policy for non-basmati rice under specified ITC (HS) codes	33
GLOSSARY	34



Taxation of Alternative Investment Funds

Introduction and evolution

An alternative investment fund (**AIF**) is an entity that pools funds from select investors to invest in a variety of securities, including shares, debentures, bonds, and other financial instruments. An AIF may be structured as a company, a limited liability partnership, or a trust. In India, the concept of pooled investments vehicles is rooted in venture capital financing, where some venture capital firms pool money from investors to investment in unlisted companies, such as start-ups or early-stage companies.

The Government of India notified the Venture Capital Guidelines, 1988 (**Guidelines**), formalising venture capital funds (**VCFs**) in the country. However, these Guidelines restricted the setting up of such funds exclusively to banks or financial institutions. Further, in 1995, the IT Act was amended to provide tax exemptions for VCFs.

In 1996, to standardise the regulatory environment for VCFs, SEBI issued the SEBI (Venture Capital Funds) Regulations, 1996 (**VCF Regulations**), mandating the registration of all VCFs under it. Subsequently, efforts were made to consolidate all the guidelines and regulations dealing with VCFs on the recommendations of the KB Chandrasekhar Committee set up by SEBI. This included withdrawing the guidelines for overseas venture capital investment in India and making SEBI the nodal authority both for regulating investment funds including VCFs and consolidating the Guidelines and regulations concerning VCFs.

SEBI also notified the SEBI (Foreign Venture Capital Investors) Regulations, 2000, to regulate foreign investments inflow into VCFs.¹ For investments from foreign investors, SEBI had also introduced the SEBI (Foreign Institutional Investors), 1995, later replaced by the SEBI (Foreign Portfolio Investments) Regulations, 2014, and subsequently updated in 2019 (**FPI Regulations**). The intent behind these reforms was to streamline regulations concerning all foreign portfolio investments, including investment in pooled vehicles.

As the market of investment funds evolved, many such investment pooling funds emerged across various sectors in India that fell outside the ambit of existing regulations. Multiple regulations regulating multiple entities with different objectives made it difficult to ensure the simplicity of the regulatory framework. Hence, the need was felt not only for a common investor class allowed to invest in the entire securities segment but also for a common regulator to further promote them and ensure ease of doing business.

With these objectives in mind, SEBI replaced the regulations related to VCFs with the SEBI (AIF) Regulations, 2012 (**AIF Regulations**), to regulate all pooled investment funds in India, including VCFs and other such entities that could not be classified as VCFs. The AIF Regulations allow funds already registered under the VCF Regulations to continue to be governed by the old regulations until they are wound up, but do not allow launching any new schemes. Such funds have the option to voluntarily re-register under the AIF Regulations after obtaining the approval of two-thirds of their investors. As these provisions were introduced to ensure a smooth transition for existing VCFs, the VCF Regulations are applicable only until all funds

¹ SEBI, [Report of Advisory Committee on Venture Capital.PDF](#).

registered under the same are wound up or re-registered under the AIF Regulations.

Pertinently, AIFs set up in India receiving investments from non-residents are not required to register under the FPI Regulations to make further investments in India. India-domiciled AIFs function as Indian entities and may pool funds from investors in India and overseas, but the mere receipt of foreign capital cannot render an AIF as a non-resident entity. For foreign investments in an AIF, such investment in the AIF will be treated as foreign direct investment or foreign portfolio investment depending on the percentage of capital contributed and shall have to comply with regulations under the Foreign Exchange Management Act, 1999, and the FPI Regulations.

The AIF Regulations have defined AIF as:

“... any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which, -

- (i) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and*
- (ii) is not covered under SEBI (Mutual Fund) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of the SEBI to regulate fund management activities.”*

Legal recognition as a result of bringing AIFs under the regulatory ambit of SEBI has led to the significant growth of such funds in India, with corresponding developments in the taxation of AIFs aimed at providing a conducive environment to boost the AIF market. However, these developments have not been free of challenges and controversies.

The IT Act refers to an AIF as an investment fund and currently defines it as *“any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II AIF and is regulated under the AIF Regulations.”*²

Categories of AIFs

The AIF Regulations have prescribed that an entity cannot act as an AIF without obtaining a certificate of registration from SEBI. Regulation 3(4) of the AIF Regulations states that an entity may seek registration as an AIF in one of the following three categories:

1. Category I AIF

An entity may register as a Category I AIF if it seeks to invest in start-ups or early-stage ventures or ventures in sectors considered socially or economically desirable by the government or regulators (such as in infrastructure funds, social impact funds, etc.). Such funds often receive government incentives or concessions. For the purposes of IT Act, the AIF Regulations construes funds with positive spillover effects on the economy that are formed as trusts or companies as venture capital funds or venture capital companies, respectively.

2. Category II AIF

The AIF Regulations defines Category II AIFs as funds that do not fall in Category I or Category III AIFs and that do not undertake any leveraging or borrowing activities other than as permitted under the AIF Regulations, i.e., to meet day-to-day expenses.

3. Category III AIF

Under the AIF Regulations, funds that employ various trading strategies and undertake leveraging or borrowing activities in relation to their investments in listed or unlisted derivatives may seek registration as Category III AIF. This category may include hedge funds or funds that aim for short-term returns and open-ended funds with no specific investment objective. The focus of Category III AIFs is mainly quick short-term gains.

In 2023, the AIF Regulations were amended to introduce a fourth category, i.e., a specified AIF outside the ambit of the three categories. For this, SEBI has the power to lay down a framework for under Regulation 19 of the AIF Regulations, which provides SEBI the flexibility to regulate any new type of AIF in the market. Under Regulation 19 SEBI has introduced some new types of AIFs as this fourth category, including angel funds, special situation funds, and corporate debt market development funds. However, the AIF Regulations prescribe registering such funds as Category I AIFs.

From a tax perspective, the IT Act does not separately define AIFs or funds. However, it refers to different categories of AIFs that have been granted registration under the AIF Regulations by SEBI. Chapter XII-FB prescribes a special regime of taxation for the taxation of investment funds registered as Category I and Category II AIFs. The following section discusses this taxation regime in detail. On the other hand, as no special regime exists for the taxation of Category III AIFs, these are taxable depending

² Section 115UB, IT Act.



on their structure, i.e., whether as a trust, limited liability partnership, or a company. However, the IT Act has exempted certain streams of income for Category III AIFs located in any IFSC and with only non-resident investors.

Tax status of AIFs

Pre-AIF Regulations period

Despite the existence of guidelines and regulations for VCFs since 1988, up until 2000, the funds operated without any clear tax framework. The tax treatment of income from investments at different levels were ambiguous. These created uncertainty for investors and fund managers until the introduction of certain provisions in the IT Act in 1995 and subsequently in 1999, which became the first comprehensive guidance on the still-nascent stage of VCF taxation in India.

The Finance Acts of 1995 and 1999 inserted sub-sections (23F) and (23FA) under Section 10 of the IT Act, respectively, to exempt from taxation, any income earned by a VCF in the form of dividends or long-term capital gains from investments in equity shares in a venture capital undertaking.

In 2000, along with finalising a set of regulatory frameworks for the regulation of VCFs under SEBI, the Finance Act, 2000 (**FA 2000**), introduced certain amendments to taxation of income earned and distributed by VCFs. The memorandum to Finance Bill, 2000, stated these amendments were measures to provide incentives to promote venture capital as a stimulus for economic growth.³

Section 10(23FB) was introduced to exempt from tax all income from investments made by SEBI-registered VCFs, subject to prescribed conditions. Section 115U of the IT Act was inserted under the new Chapter XII-F, conferring a tax pass-through status to VCFs. This provided that income earned from VCFs be chargeable to income tax in the hands of the VCF investor, as if the investor had received such income through investments made directly. Hence, the VCF would not bear tax liability, and tax would be chargeable to the investor directly.

Post-AIF Regulations period

Following the introduction of the AIF Regulations in 2012, the Finance Act, 2015 (**FA 2015**), introduced provisions for the taxation of AIFs and clarified that the provisions for the taxation of VCFs would no longer be applicable.

Chapter XII-FA was introduced to the IT Act, prescribing the taxation of AIFs. Section 115UB accorded tax pass-through status to Category I and Category II AIFs registered under the AIF Regulations, with Explanation 1 to Section 115UB defining “investment fund” to include Categories I and II AIFs only and exclude Category III AIFs. From AY 2022–23 onwards, Category I and Category II AIFs regulated under the International Financial Services Centres Authority (Fund Management) Regulations, 2022, operating in the IFSC GIFT city, was also included under the ambit of this chapter.

The FA 2015 also inserted sub-sections (23FBA) and (23FBB) under Section 10 of the IT Act. Sub-section (23FBA) exempts from tax any income earned by an AIF, other than income categorised as “profits and gains of business or profession” (**PGBP**).

³ [Income Tax Department](#), Memorandum to Finance Bill, 2000.

Consequently, sub-section (23FBB) exempts income from PGBP earned by investors under Section 115UB shall be taxable in the hands of the AIF.

Hence, currently the tax status of AIFs can be summarised as follows.

Taxation of Category I and Category II AIFs:

Due to pass-through status of the AIFs, all income earned by the funds, except income from PGBP, shall be taxable in the hands of the investors as their own income. This income is taxed in the proportion of their investment, and the nature of income in the hands of the investors will remain the same as earned by the AIF.

Sub-section (6) of Section 115UB mandates that even if such income earned by the AIF in a financial year is not paid or credited to the investor in the same year, it shall be deemed to have been credited to the investors' account on the last day of the year in the proportion that they would have been credited so that it may be taxed in the hands of the investor. Explanation 2 to the section clarifies that the income that had been deemed to be credited in as per sub-section (6) shall not be included in the income of the investor in the year it is actually paid.

While the income of the AIF falling under PGBP shall be taxable in its own hands, distribution of such income post tax shall be exempt from tax in the hands of the investor. Where the AIF is structured as a company or body corporate, the PGBP income shall be taxable at the slab rates applicable under the IT Act. Where the AIF is structured as a trust, the PGBP income shall be chargeable to tax at the maximum marginal rate applicable.

Taxation of Category III AIFs

Considering Category III AIF has not been granted pass-through status, all income earned by the fund shall be taxable at the fund level, irrespective of the nature of income. If the AIF is structured as company or body corporate, the income is taxable as per the corporate slab rates applicable to it. Subsequently, the distribution of such income as dividend shall be taxable in the hands of the investors at the prescribed rates. At the time of distribution of dividends, the AIF structured as company shall have to deduct withholding taxes at the applicable slab rates for Indian investors and at 20 per cent for non-resident investors, subject to any beneficial rate for tax on dividend that may be provided in the relevant double tax avoidance agreement between India and the investor's country of residence.

If the AIF is structured as a trust, then the income of the trust may be chargeable to tax in the hands of the trustee as a representative assessee at the maximum marginal rate. The

post-tax income distributed to investors, being the beneficiaries of the AIF trust shall not be taxed in their hands. However, as shares of the investors as beneficiaries is determined and fixed, the income of the AIF may be taxed in the hands of the investors as per their share in such income.

Section 10(4D) of the IT Act exempts certain income earned by Category III AIFs located in IFSCs with only non-resident investors, such as capital gains on transfer of bonds, global depository receipts, rupee denominated bonds and derivatives in an IFSC, and where the consideration is in convertible foreign exchange, income from transfer of securities that are not shares of Indian companies, income from securities issued by non-residents, and income from securitisation trusts subject to certain conditions.

Issue of characterisation of income for Category I and Category II AIFs

As the taxability of various types of income differs for Category I and Category II AIFs, the characterisation of income becomes important. For instance, if income earned by an AIF is long-term capital gain, it will be taxable in the hands of a domestic investor at 12.5 per cent, whereas, if income is treated as PGBP, it will be subject to tax at the maximum marginal rate of 30 per cent, where the effective rate can go up to 42.74 per cent (in case of individuals) with applicable surcharge and cess, in cases where the AIF is structured as a trust. If the AIF is structured as a company, the PGBP income will be subject to tax at the corporate slab rates applicable, which shall be higher than the tax rate for long-term capital gains.

The issue of characterisation of income arises because the AIFs are incorporated for the purpose of and carrying the main activity of pooling funds and investing them in securities. In such a case, the securities could be regarded as either capital asset or stock-in-trade, and the gains from sale of securities could be regarded as capital gains or PGBP. As the IT Act had no provision for addressing this issue, this uncertainty meant that investors could not accurately predict their tax liabilities and fund managers faced the constant risk of tax authorities challenging their income characterisation positions. The lack of clarity also created compliance burdens, as AIFs had to maintain extensive documentation to support their treatment of securities as capital assets rather than stock-in-trade, relying on CBDT circulars and common law principles that were subject to interpretation. Hence, this was always open for challenge by the tax authorities and was a cause for concern.

For deciding such issues, it is relevant to rely on the CBDT's instructions and apply common law principles to determine the nature of income. The CBDT, *vide* Circular No. 4 of 2007 dated June 15, 2007, and Circular number of 2016 dated February 29, 2016, offered guidance on this issue, emphasising on how the assessee treats such asset shall be a key consideration in determining the nature of the asset and the nature of income from the sale of such asset.

Here, it shall be relevant to see how the assets are shown in the assessee's books of accounts. The 2007 Circular also noted that where the object of purchase of securities in a company was to earn income through dividends and not short-term gains from trading of securities, then income earned from the sale of such securities shall be capital gains and not PGBP.

The Finance Act, 2025, finally put this to rest by amending the definition of capital asset to include any securities held by Category I and Category II AIFs. Hence, gains derived from the sale of securities shall be regarded as capital gains, taxable in the hands of the investors. This amendment also brings characterisation of income from the sale of securities of AIFs with that of foreign institutional investors.

Controversy of taxation of AIFs structured as determinate trusts

The CBDT, *vide* its Circular No. 13 of 2014 dated July 28, 2014 (**Circular**), had issued clarification regarding the taxation of trusts under Section 164 of the IT Act, where the shares of the beneficiaries are unspecified or indeterminate. The clarification was specifically aimed at AIFs structured as trusts where the investors, i.e., the beneficiaries and their shares were unknown on the date of the trust being registered. Such information could only be available after the AIF received contributions from the investors.

The Circular stated that if at the time of registration, the trust deed does not specify the beneficiaries and their beneficial interests, then the income of the AIF trust shall be taxable under Section 164(1) of the IT Act in the hands of the trustees as representative assessee at the maximum marginal rate.

Here, it shall be relevant to understand the concept of trusts and their taxation. The Indian Trusts Act, 1882 (**ITA**), legally recognises the concept of trusts in India, where property is held in trust by a trustee(s) on behalf of and for the benefit of the beneficiaries. The ITA defines trusts as an obligation annexed to the ownership of property. It is also not included in the definition of a person under Section 2(31) of the IT Act. Hence, a trust is not a



separate legal entity under the ITA or a taxable entity under the IT Act.

A trust structured in India is represented by the trustee who hold and manage the trust property on behalf of and in the name of the trust. As the trust property is legally vested in a trustee, any income earned by a trust shall be taxable at the trust level, i.e., in the hands of the trustee as a representative assessee under Section 160(1)(iv) of the IT Act. If it is not taxed at the trust level, it shall be taxable in the hands of the beneficiaries. The manner of taxation of the trusts depends on the determinate or indeterminate nature of the trust.

A determinate trust is one where the beneficiaries of income are clearly specified in the trust deed or identifiable, and their individual shares are specified or ascertainable on the date the trust is executed. As per Section 161 of the IT Act, a trustee being a representative assessee shall be subject to assessment in his own name and tax on income shall be levied and recovered in the same manner and to the same extent as it would be levied and recovered from the persons represented by him. Hence, in a trust where the beneficiaries and their shares are known, the trustee would be assessed as many times as there are beneficiaries because the taxation in the hand of each beneficiary shall be different. In such a case, for convenience, income earned by each beneficiary may be taxed in their own hands. Sub-section (3) of Section 161 of the IT Act clarifies that there shall be no double taxation of the same income.

An indeterminate or discretionary trust is one where either the beneficiaries are not specifically named, or if named, their individual shares are not expressly stated and are unascertainable. Section 164 of the IT Act specifically prescribes

that for taxation of income in the hands of trustees under Section 160(1)(iv) of the IT Act in representative capacity, where shares of beneficiaries in the income or part of income are unknown, such income shall be taxable at the maximum marginal rate. Thus, the concept of the representative assessee allows the tax authorities to collect tax either from the trustee or directly from the beneficiaries.

Hence, as per these provisions, a determinate trust allows flexibility to the parties in the trust to either pay tax at trust level or at the individual beneficiaries level. If tax is payable at beneficiary level, then it may be advantageous for investors who are taxable at lower slab rates or who may claim any tax benefits that may be applicable. Therefore, investors sought to structure AIFs as determinate trusts by providing details of all investors and proportions of investments in the trust deed.

Where such details were not provided at the time of registration of trust deed, the same was annexed to the trust deed subsequently as addendums or amendments. The investors relied on common law principles of trusts and judicial precedents to claim that such trusts were determinate. While shares of beneficiaries must generally be ascertainable as on the date of the trust instrument for a trust to be considered determinate, judicial principles have evolved to state that an indeterminate trust can convert to a determinate trust if shares of beneficiaries become ascertainable pursuant to any amendment to the instrument. However, the Circular mandated that details and shares of beneficiaries have to be provided at the time of registration of the trust deed for it to be taxed as a determinate trust.

On the other hand, the AIF Regulations prescribe that the trust deed must be registered in order for the trust to seek registration with SEBI and then seek investment of funds from potential investors. The AIF trust cannot function or receive investments until registration. In such a situation, a trust must first be registered without details of the beneficiaries, then seek registration as an AIF, and subsequently seek investments to determine the shares of each investor or beneficiary. Hence, at the time of its registration, the trust deed cannot contain the details of the investor beneficiaries or their shares.

This created an impossibility for investors to seek taxation as a determinate trust where compliance with SEBI regulations exposed AIFs to taxation at the maximum marginal rate of 42.74 per cent even when the trust was structured to be determinate

by annexing details of investor beneficiaries as addendums to trust deed post getting registered under SEBI.

In *CIT v India Advantage Fund-VII*,⁴ the assessee was an AIF established as a trust to invest in certain securities. The IRA had preferred an appeal to the Karnataka HC contending that the trust was indeterminate as the exact share of each beneficiary should be quantifiable at the time of registering the trust deed, and there should not be an element of future determinability.

The Karnataka HC rejected the IRA's contentions. It held that Section 164 of the IT Act does not prescribe any date on which shares should be determinable. Nothing in the law states that the shares of determinate should be quantified at the time of registration of trust deed and that it cannot be changed in the future. The HC held that as it is clear from the provisions of the trust deed that benefits are to be shared by the beneficiaries in proportion to their investment, the shares are determinable for any person with reasonable prudence. Hence, it affirmed the ITAT's findings and held that the trust was determinate, and the income can be taxed in the hands of the individual beneficiaries.

Subsequently, in another case of *CIT v TVS Shriram Growth Fund*,⁵ where the question of applicability of the maximum marginal rate on the trust under Section 164 arose, the Madras HC relied on the case of *India Advantage Fund-VII* and held that Section 164 becomes applicable only where the share of beneficiaries in any income is unknown. Hence, where all income of the trust has to be distributed to the beneficiaries in proportion to their contribution, it cannot be said that share of investors in the income of the trust was not determinable. Hence, tax at maximum marginal rate under Section 164 was held to be not applicable.

However, the cases concerned situations before the issue of the Circular and did not discuss the implications of the same. Recently, the Delhi HC had the opportunity to analyse and read down the Circular in the case of *Equity Intelligence AIF Trust v CBDT*.⁶ The Assessee was a registered Category III AIF structured as a trust. The beneficiary investors and their shares were identified through separate contribution agreements executed after the registration of the trust deed. As the shares of beneficiaries were not set out in the trust deed, the IRA sought to tax the income earned by the AIF at maximum marginal rate pursuant to the Circular.

The Delhi HC noted the anomaly and held that it would be impossible to comply with the Circular and the AIF Regulations

⁴ *CIT v India Advantage Fund-VII*, [2017] 78 taxmann.com 301 (Karnataka).

⁵ *CIT v TVS Shriram Growth Fund*, [2020] 121 taxmann.com 238 (Madras)

⁶ *Equity Intelligence AIF Trust v CBDT*, [2025] 176 taxmann.com 903 (Delhi).



simultaneously. Concurring with the settled judicial principles in *India Advantage Fund-VII* and *TVS Shriram Growth Fund*, and in interest of harmonising the Circular and the AIF Regulations, the HC held that the Circular should be “read down” and that the trust with beneficiaries whose shares are determinable, shall be regarded as determinate trusts irrespective of whether such shares were determinable at the time of the trust getting registered.

This is a landmark development in the taxation of AIFs structured as trusts, because it not only reads down the Circular, but it also harmonises it and the provisions of the IT and the AIF Regulations, thereby addressing the regulatory impossibility created by them and providing clarity and uniformity regarding the taxation of all AIFs functioning as trusts in India.

Conclusion and suggestions

The evolution of taxation framework for AIFs in India reflects the Government’s progressive approach towards creating a conducive environment for the promotion of such investments while balancing regulatory oversight and revenue considerations. There have been significant legislative changes

in the taxation of AIFs throughout the years, in line with the developments of the industry and keeping track of the issues highlighted by stakeholders.

Despite these significant advances, several challenges remain that warrant the attention of policymakers and regulators. The Government is mainly focused on Category I AIFs such as VCFs and angel funds, which support many start-ups in India, rather than on Category II AIFs, which undertake trading and hedging activities for quick, short-term profits, even though this is also a booming category of AIFs. The absence of pass-through taxation for such AIFs makes them less competitive than similar investment vehicles in other jurisdictions. While the recent judicial developments providing clarity on determinability of trusts for tax purposes are welcome, it would be worthwhile to consider extending pass-through status to Category III AIFs, subject to appropriate safeguards and anti-abuse provisions, to align India’s tax regime with international best practices.

As India aspires to become a global hub for alternative investments, particularly through initiatives such as the IFSC GIFT City, a stable, predictable, and internationally competitive tax framework for AIFs will be essential to attract both domestic and foreign investments for growth of the industry.

CASE LAW UPDATES – DIRECT TAX

INTERNATIONAL TAX

TPO must follow Section 92C(3) before rejecting the arm's length price of Intra-Group Services

Introduction

In the recent case of **American Express**,⁷ the Hon'ble SC upheld the decision of the Hon'ble Delhi HC on the treatment of intra-group services (IGS) received under cross-border arrangements.

Facts

American Express Banking Corporation (**Assessee**), a company incorporated under the laws of the United States, established its Indian branch and was authorised to undertake banking operations including credit card issuance, traveller's cheque services, and acceptance of institutional deposits.

For AY 2009–10, the Assessee filed its return of income, disclosing substantial international transactions with AE, including the provision of back-office support services and receipt of IGS. Given the nature and volume of these transactions, the AO referred the matter to the TPO to determine the ALP. The TPO made a significant adjustment, most notably treating the ALP of IGS as INR Nil, citing lack of evidence of any services being received. Applying the Comparable Uncontrolled Price method, the TPO concluded that no independent entity would pay for such services without a cost-benefit justification.

On appeal, the CIT(A), acknowledged that the TPO could not question the Assessee's commercial judgment, however, due to the absence of third-party documentation, restricted the

adjustment to half the amount—an arbitrary determination lacking economic analysis. Both parties filed cross-appeals before the ITAT, which found that the INR Nil ALP was unsustainable and remanded the matter to the AO / TPO for fresh evaluation. The Assessee challenged this remand before the Delhi HC, which upheld the Tribunal's decision and emphasised compliance with statutory preconditions. The Assessee then filed a Special Leave Petition before the Supreme Court.

Issue

Whether the TPO was justified in determining the ALP of intra-group services IGS as Nil, solely on the ground that the Assessee had allegedly failed to demonstrate tangible benefits received from such services and by disregarding the transfer pricing documentation and economic analysis submitted by the Assessee without first satisfying the statutory preconditions under Section 92C(3) of the IT Act?

Arguments

The Assessee contended that the TPO had erred in determining the ALP of IGS at INR Nil by disregarding the MAP adopted by it, with the TPO unable to establish that the data was unreliable, incomplete, or not maintained in accordance with Section 92D of the IT Act. The Assessee further contended that the TPO had arbitrarily applied the CUP method without benchmarking or identifying comparable uncontrolled transactions.

The Assessee also argued the CIT(A)'s determination of ALP at 50 per cent of the claimed value as ad hoc and unsupported by any

⁷ American Express Banking Corporation (India Branch) Petitioner v. Assistant Director Of Income Tax, Circle 1(1), International Taxation, Special Leave to Appeal (C) No(s). 24885/2025 (SC).

economic analysis and submitted that the ITAT ought to have conclusively deleted the adjustment rather than remanding the matter.

The IRA, on the other hand, defended the TPO's approach, asserting that the Assessee had failed to provide evidence of actual services received or benefits derived. It argued that no independent entity would pay for services without conducting a cost-benefit analysis, and that the emails and internal communications the Assessee had furnished did not establish the necessity or utility of the services. The IRA relied on the OECD Transfer Pricing Guidelines to argue that incidental or duplicative services do not qualify as IGS warranting compensation.

Decision

The SC held that no substantial question of law or jurisdictional error had been demonstrated that warranted interference under Article 136 of the Constitution of India. It emphasised that the ITAT's decision to remand was a procedural correction aimed at ensuring that the ALP determination is carried out in accordance with law and based on a proper evaluation of the transfer pricing documentation.

The SC further noted that the HC had not made any final determination on the ALP but had merely directed the TPO to re-examine the matter in light of the statutory provisions and judicial precedents. In view of this, it concluded that the SLP did not raise any exceptional or compelling grounds for invoking its discretionary jurisdiction and, accordingly, dismissed the SLP, affirming the HC's decision.

Significant Takeaways

The **American Express** ruling establishes that the authority of TPO is not unfettered but is circumscribed by the statutory safeguards under Section 92C(3) of the IT Act. This provision requires the TPO to demonstrate specific deficiencies, such as improper application of prescribed methods, unreliable or incorrect data, failure to maintain documentation, or non-furnishing of information, before disregarding a taxpayer's transfer pricing study. Absent such findings, the TPO cannot substitute its own judgment, even if it disagrees with the commercial rationale of the transaction. This principle ensures that transfer pricing assessments remain grounded in law and evidence rather than the subjective notions of any individual.

The ruling clarifies that the existence and receipt of services is a factual matter not to be judged by a rigid "tangible benefit" test. This is especially relevant for multinational enterprises where services such as strategic planning, compliance, or risk management, etc., may not yield immediate or quantifiable revenue but could still provide real business value.

The rejection of the CIT(A)'s ad hoc 50 per cent determination further reinforces that transfer pricing is a technical discipline governed by statutory methods and that income attribution is not a matter of rough estimation. Finally, the SC's remand highlights that transfer pricing is inherently fact-intensive, requiring proper analyses at the tribunal level.

In sum, presses on statutory compliance by the TPO, rejection of arbitrary tests and ad hoc adjustments, and reliance on structured, evidence-based processes. These principles can be applied across industries and transaction types, offering proactive guidance in structuring cross-border arrangements.

“ If the statutory conditions as specified under Section 92C(3) of the IT Act are not satisfied, then arm's length pricing cannot be rejected. ”

Karnataka HC rules no penalty for Assessee acting under bona fide belief on non-taxability of receipts

Introduction

The Division Bench of the Karnataka HC, in **IBM Australia**,⁸ upheld the ITAT's order, setting aside the penalty imposed on IBM Australia for not offering to tax the sums received for rendering IT services and for incurring salary costs in respect of seconded employees. The Hon'ble HC observed that there exists a plausible judicial view that such receipts do not constitute "fees for included services" (**FIS**) and, therefore, a penalty cannot be imposed on the Assessee relying on such a view.

Facts

IBM Australia (**Assessee**), a tax resident of Australia, had provided IT support services and seconded certain employees to IBM India. The Assessee received a sum of INR 65,38,36,981 from IBM India for the IT services rendered and as reimbursement for the salary costs of the seconded employees. In AY 2018-19, while the Assessee duly reported these receipts, it did not offer them to tax, assuming the same were not taxable. However, at a later stage of assessment, following the issuance of a notice under Section 148 of the IT Act, the Assessee offered such receipts for tax by way of a revised computation.

Subsequently, the Assessee's case was selected for scrutiny, and the AO under Section 270-A of the IT Act, which deals with under-reporting of income, imposed a penalty for not offering the sum received to tax. The penalty was confirmed by the CIT(A). Aggrieved, the Assessee filed an appeal before the ITAT, which held that, given the nature of the dispute, two different views exist on whether such sums are taxable in India. Therefore, the penalty could not be levied.

Aggrieved by the ITAT's order, the IRA filled an appeal before the Hon'ble Karnataka HC, leading to the present judgment.

Issue

Whether penalty can be imposed on the Assessee for not offering to tax the reimbursement of salary costs and the sum received for IT support services, given the existence of divergent judicial views on their taxability as FIS/FIS?

Arguments

The Assessee argued that prevailing judicial precedents establish that the said payments do not fall within the meaning of FIS under Article 12 of the DTAA or FTS under Explanation 2 to Section 9(1)(vii) of the IT Act. Operating under this understanding and a *bona fide belief*, the Assessee did not offer the sum to tax while filing the return. However, to avoid prolonged litigation, the Assessee paid the tax at a later stage of assessment and contended that the initial non-offering of the sum to tax does not amount to concealment or under-reporting of income.

The Assessee relied on several judgments to argue that penalty cannot be levied in respect of an adjustment that is debatable or where two views are possible. Further, the Assessee maintained that although the sums were offered to tax, they continue to hold the view that the said sums were not chargeable to tax as FIS/FIS.

While the HC's judgment does not record the arguments they raised, the IRA appears to have contended that the Assessee had effectively admitted the taxability of the secondment receipts as FTS by offering them to tax during the assessment, thereby admitting under-reporting of income in the original return. They further contended that mere acceptance of tax liability does not preclude them from the levy of penalty. The IRA also argued that the Assessee's explanation was not *bona fide*, as no safeguard measures were taken to ensure that taxes were properly deducted on the payments. Additionally, they relied on **Centrica India Offshore (P.) Ltd. v. CIT**⁹ to assert that such sums fall within the ambit of FTS and are liable to be taxed in India.

Decision

The Hon'ble Karnataka HC observed that the definition of FIS, as provided in Paragraph 4 of Article 12 of the India-US DTAA, is considerably narrower than the definition of FTS under Explanation 2 to Section 9(1)(vii) of the IT Act. Given the presence of an express definition in the DTAA, the definition under the IT Act need not be referred to.

Having made this observation, the HC relied on various judicial precedents addressing the same question, i.e., whether such receipts fall within the scope of FIS, and held that most decisions do not treat such receipts as FIS. The HC also observed that several Courts have reached different conclusions on this specific issue. In **Flipkart Internet (P.) Ltd. v. Dy. CIT**,¹⁰ the Karnataka HC held that for any service to fall within the scope of

⁸ Principal Commissioner of Income-tax (International Taxation) v. IBM Australia Ltd. [2025] 177 taxmann.com 543 (Kar).

⁹ Centrica India Offshore (P.) Ltd. v. CIT [2014] 44 taxmann.com 300/224 Taxman 122/364 ITR 336 (Delhi).

¹⁰ Flipkart Internet (P.) Ltd. v. Dy. CIT (International Taxation) [2022] 139 taxmann.com 595/288 Taxman 699/448 ITR 268 (Kar).

FIS, it must satisfy the “make available” condition, which was not established on the facts of that case involving mere secondment of employees and hence, was not chargeable to tax in India.

In contrast, in **Centrica India Offshore (P.) Ltd. (supra)**, the Delhi HC found that the “make available” test was satisfied on the specific facts, where seconded employees were providing managerial services and transferring know-how to train local employees during the initial setup phase of the Indian subsidiary. The Delhi HC had also rejected the “reimbursement” characterisation, holding that the mere fact that the Assessee and the secondment agreement phrases the payment as reimbursement cannot be determinative, and that the nomenclature or lesser-than-expected amount charged for such services cannot change the nature of the services. The HC held that once it is established that there was a provision of services, the payment would be considered as payment for services.

Given the existence of these two lines of cases, the Hon’ble Karnataka HC in the present case held that penalty under Section 270A of the IT Act could not be levied on the Assessee, who had operated under a legitimate and *bona fide belief* that the payments received were not taxable under the Act. Consequently, the HC dismissed the appeal on the ground that no substantial question of law arose and upheld the ITAT’s order.

The ITAT had, in its order, distinguished **Centrica India Offshore (P.) Ltd. (supra)** on facts and relied on **Abbey Business Services (India) (P.) Ltd. v. Dy. CIT**,¹¹ wherein it was held that salary reimbursements for seconded employees were made on a cost-to-cost basis, with no profit element involved and, therefore, the question of taxability did not arise. Consequently, the ITAT had held that the Assessee’s conduct was *bona fide* and did not

warrant a penalty under Section 270-A, as the Assessee had relied on certain judicial precedents, voluntarily offered the sum for tax at a later stage, and not concealed any material facts.

Significant Takeaways

The Karnataka HC’s decision in this case provides meaningful clarity for multinational corporations that frequently engage in employee secondments. It reinforces the principle that when a taxpayer acts under a *bona fide belief* that an element of income, i.e., secondment reimbursement is not subject to tax in India, especially in situations where two legally plausible views exist, penalty under Section 270A should not be imposed. This decision serves as a shield for taxpayers navigating complex cross-border arrangements, affirming that filing returns based on genuine interpretational differences should not be penalised as concealment or under-reporting.

However, the ruling also underscores the importance of carefully structuring secondment and employment contracts. Taxpayers must closely examine whether the nature of services rendered by seconded employees could fall within the scope of FTS/FIS, particularly if they are imparting managerial or technical knowhow.

The HC also applauded the fact that the Assessee had voluntarily offered the subject income to tax and the fact no material fact was ever hidden from the tax authorities. So long as proper disclosures are made and a position is taken that derives its support from judicial precedents, the HC unambiguously declared that such Assessee cannot be held liable for penalty.

“ No penalty can be levied if adequate disclosure is made and a position is taken with the *bona fide belief* that the subject income is not taxable. ”

¹¹ Abbey Business Services (India) (P.) Ltd. v. Dy. CIT [2012] 23 taxmann.com 346.

CASE LAW UPDATES - DIRECT TAX

TRANSACTIONAL ADVISORY

Bombay HC decides on “commencement of business” controversy and taxability of interest income

Introduction

The Hon'ble Bombay HC, in **Modi Business Centre Pvt. Ltd.**,¹² addressed the controversy surrounding the commencement of business and treatment of interest income from group lending activities, where financing has been specified as a business object of the company. The case establishes critical principles regarding when business commences for income tax purposes, particularly in rental/leasing businesses. The Court ruled that business commences right from the stage of repairing and furnishing the property to be rented out and cannot be treated as commenced only when premises are actually let out to tenants. The case provides essential guidance on consistency in tax assessments and the treatment of certain activities as business activities.

Facts

Modi Business Centre Pvt. Ltd. (**Assessee**), a private limited company, was established with the principal object of constructing and leasing business centres and financing activities as one of its ancillary business objectives. During the year of its incorporation, the Assessee entered into a lease agreement with Citibank for premises known as “Telicom

Centre” and borrowed a sum from Citibank specifically for developing this business centre. The loan was obtained for the purpose of getting the Telicom Centre ready for leasing to prospective tenants.

During this period, the company advanced a part of this loaned money to five sister concerns, earning interest income on the same, while simultaneously paying interest to Citibank. The company was concurrently undertaking repairs, furnishing, and equipping the business centre to prepare for leasing.

During the period between incorporation and the end of FY 1991-92, a span of approximately 43 days, the company undertook these activities simultaneously. It claimed that the interest it paid should be set off against the interest received, treating both as business income and business expenditure, respectively. Since such deployment of funds to sister concerns was a prudent business decision to minimise interest costs while Telicom Centre was being prepared for leasing.

The AO disallowed the set-off, treating the interest received as “income from other sources” rather than business income, followed by the CIT(A) allowing the Assessee's appeal and permitting the set-off, as business had commenced and both transactions were part of business activities. The ITAT reversed the CIT(A)'s decision, holding that business had not commenced since the Telicom Centre was not ready for leasing and that the lending activity was fortuitous rather than genuine business activity. The Assessee ultimately appealed to the Bombay High Court challenging the ITAT's order.

¹² Modi Business Centre Pvt. Ltd. v. Deputy Commissioner of Income Tax, Bombay [TS-1090-HC-2025(BOM)].

Issue

- a. Whether the Assessee's business had commenced during the relevant Assessment Year 1992–93 and, hence,
- b. Whether the interest income earned from lending borrowed funds to sister concerns was taxable under the head "Business Income" or "Income from Other Sources" thereby being entitled to claim deduction of interest expenditure incurred on borrowed funds?

Arguments

The Assessee submitted that the allegation that its business had not commenced during the relevant AY and that lending monies to sister concerns did not constitute a business activity were perverse and contrary to settled legal principles. It also submitted that the entire arrangement of obtaining finance and its temporary utilisation formed one composite transaction, and interest received on temporary deployment should not be considered in isolation.

It also contended that its business had indeed commenced during the previous year relevant to AY 1992–93, having undertaken substantial preparatory activities, including entering into lease agreements, securing loans from Citibank, and initiating conversion of the business premises into a business centre. The Assessee relied on the SC judgment in **CIT v. Sarabhai Management Corporation Ltd.**,¹³ which held that business commences not only upon actual leasing but also at the stage of preparing property for lease.

The IRA on the other hand argued that the Assessee had not commenced business, as the Telicom Centre was not yet ready and preparatory activities like repairs and furnishing did not constitute business commencement. The IRA maintained that lending to sister concerns was merely fortuitous, not a genuine business activity, and that interest income should be treated as "other sources," disallowing set-off.

Decision

In its judgment, the Bombay HC allowed the Assessee's appeal, setting aside the ITAT order and restoring the CIT(A) order. The HC held that the Assessee was entitled to set off interest

expenditure incurred on borrowed funds against interest income earned from lending those funds to sister concerns during AY 1992–93.

Disagreeing with the ITAT, the HC held that the concept of "commencement of business" under the IT Act must be interpreted contextually, depending on the nature of the business. In the case of a business involving leasing of premises, the HC clarified that business commences not only upon actual letting but also at the stage of preparing the property for lease. The HC affirmed that even if acquisition of property is preparatory, the subsequent steps of making the property ready for lease does constitute commencement of business.

The HC further noted that financing was a stated object in the Assessee's MOA and that the ITAT and the AO had both accepted the same activity as a business operation in subsequent assessment years. It held that allowing inconsistent treatment of identical transactions across years would defeat the ends of justice.

In support of its reasoning, the HC referred to several other authorities. While **Club Resorts Pvt. Ltd.**¹⁴ had held that setting-up of office and hiring staff constituted commencement of business, **E-Funds International India**¹⁵ had held that preparatory steps for software development constituted business commencement. **L.G. Electronics**¹⁶ had held that the expenditure incurred by the Assessee before the actual commencement of business is allowable, while **Saurashtra Cement & Chemical Industries Ltd.**¹⁷ held that the extraction of limestone even before manufacturing activities began marked commencement of business.

Ultimately, the Bombay HC concluded that the ITAT's order was legally indefensible and based on a misapprehension of the nature of the Assessee's business. It restored the CIT(A)'s order, allowing the set-off of interest expenditure against interest income and directed that the assessment for AY 1992–93 be brought in line with the treatment accorded in subsequent years.

Significant Takeaways

The HC affirmed and clarified that business commencement is determined by the nature and substance of activities

¹³ Commissioner of Income-tax v. Sarabhai Management Corporation Limited, (1991) 192 ITR 151 (SC).

¹⁴ Commissioner of Income-tax Versus. Club Resorts P. Ltd. 2006 SCC Online Mad 1399 (Madras)

¹⁵ Commissioner of Income-tax Versus. E. Funds International India [2007] 162 Taxman 1 (Delhi).

¹⁶ Commissioner of Income-tax Versus. L.G. Electronics (India) Limited, 2005 SCC Online Del 1485, (Delhi)

¹⁷ Commissioner of Income-tax, Gujarat I Versus. Saurashtra Cement and Chemical Industries Limited, (1973) 91 ITR 170, (Gujarat).



undertaken, not by the timing of revenue generation. In rental and leasing businesses, it clarified that the “making ready” phase, involving repairs, furnishing, staffing, and equipping, constitutes valid business activity. This principle can be extended to other industries with gestation periods, such as infrastructure, manufacturing, and hospitality, where substantial operational groundwork precedes income. The HC’s rejection of the “actual letting out” requirement and its emphasis on systematic, purposeful activity aligned with business objects provides a practical framework for establishing business commencement. Additionally, the ruling underscores the importance of business intent, which defeated the Revenue’s claims of fortuitous or incidental activity and

recognised the dual business objects and accepted the temporary fund deployment. Overall, this judgment recognises preparatory activities as genuine business operations, enabling earlier deduction claims.

Further, the HC also emphasised the importance of consistency in tax treatment across years, holding that identical transactions must be assessed uniformly unless there is a material change in facts or law. It also noted that such inconsistency undermines judicial discipline and the integrity of the assessment process. The HC also reaffirmed the principle that where a fundamental aspect has been accepted and not challenged in subsequent years, it should not be arbitrarily reversed in earlier years on the same facts.

“ Business for the purposes IT Act commences from the stage of preparatory activities undertaken. ”

Use of business advances for personal gain constitutes deemed dividend, regardless of stated business purpose or repayment timing

Introduction

The Bombay HC, in **Jaykumar B. Patil (Deceased)**¹⁸ upheld that a business advance used for personal purpose constituted deemed dividend under Section 2(22)(e) of the IT Act. It emphasised that the determinative factor is the actual utilisation of the advance, not the stated purpose. The HC further held that mere repayment of the advance within the same FY does not alter its characterisation as deemed dividend, thereby reinforcing that even temporary financial arrangements may not escape tax liability.

Facts

Jaykumar B. Patil (**Assessee**) was the managing director and a substantial shareholder with more than 10 per cent shares of Ghatge Patil Industries Limited (**GPIL**), a company engaged in manufacturing castings and other components. GPIL had received a substantial order from Tata Engineering and Locomotives Company (**TELCO**), which was to be facilitated by Assessee's proprietary concern.

The Assessee was granted an advance against the execution of job work for GPIL, which was subsequently repaid during the same FY due to the cancellation of TELCO orders.

The IRA subsequently discovered that the Assessee had utilised the said advance amount towards his personal income tax liability on the same day of the receipt of advance. The IRA treated the said advance as deemed dividend under Section 2(22)(e) of the IT Act, which was upheld both by the CIT(A) and the ITAT.

Issue

Whether a business advance granted by a company to its shareholder, when not actually utilised for the said business purpose, can be treated as deemed dividend under Section 2(22)(e) of the IT Act?

Arguments

The Assessee contended that considering he maintained a running business account and because the advance was granted for job work, actual utilisation need not be demonstrated upon accepting the purpose of receipt of advance as a business transaction. The Assessee further relied upon the CBDT Circular No. 19 of 2017,¹⁹ which provides for the exclusion of advances made to shareholders for business purposes from being treated as deemed dividend. The Assessee also claimed that he had returned the advance he received in the same FY.

While emphasising that the advance fulfilled all ingredients of Section 2(22)(e) of the IT Act, where, as a substantial shareholder, the Assessee admittedly used the advance for payment of personal tax payments, the IRA averred that the advance was utilised for personal benefit rather than business execution. It further argued that mere repayment within the same FY was irrelevant.

Decision

The HC held that utilisation of advance for the execution of a particular business transaction is a *sine qua non* for exclusion from the ambit of deemed dividend under Section 2(22)(e) of the IT Act. The HC observed that *"the key is not the purpose for which the advance is made. The real key is the purpose for which the advance is utilised"*.

With respect to the CBDT Circular dated June 12, 2017, the HC analysed the common thread in the illustrations provided and decided that the exclusion was applicable only upon the actual utilisation of the advance/loan for the purpose of business transactions, including execution of job work, installation of plant and machinery, or actual use of business assets.

However, since the funds taken as business advance was used towards discharging personal income tax obligations, the HC rejected the contentions that the advance once disbursed for business transactions should be exclusively utilised for such business purposes, holding that any other interpretation would lead to absurdity, where shareholders could receive advances and utilise them for personal purposes while seeking tax exemption.

¹⁸ Jaykumar B. Patil (Deceased) v. Joint Commissioner of Income Tax, [2025] 177 taxmann.com 431 (Bombay HC).

¹⁹ CBDT Circular No. 19 of 2017 dated June 12, 2017.



The HC relied on the SC's decision in *Smt. Tarulata Shyam*²⁰ that held that repayment within the FY does not negate the taxation as deemed dividend. The HC further dismissed the relevance of maintaining a running account or demonstration of continuous business transactions, unless actual business utilisation is proven.

Significant Takeaways

The Bombay HC has emphasised that the decisive factor was not the stated purpose of an advance but the actual utilisation. This principle ensures that taxpayers cannot mischaracterise personal advances as business transactions to avoid tax liability. Importantly, the burden lies on the shareholders to demonstrate that any advance claimed as business-related is in fact deployed towards the execution of a genuine business transaction.

In doing so, the HC also clarified the ambit of CBDT Circular No. 19 of 2017, confirming that its benefit is restricted to advances

genuinely utilised for business purposes. Equally significant is the HC's ruling that the repayment timing has no bearing on classification, i.e., temporary borrowing arrangements or prompt repayments will not shield a transaction from being taxed as deemed dividend.

For taxpayers, the ruling is a clear reminder that form cannot override substance. Personal use of funds advanced in the guise of business, even if repaid within the same year, will attract tax consequences. To mitigate risk, it is critical to maintain robust, contemporaneous documentation that establishes a direct nexus between the advance and the underlying business purpose.

Finally, the judgment underscores that such transactions often fall within a fact-sensitive grey area, where outcomes depend heavily on documentation and structuring. Careful planning and meticulous execution at the outset are, therefore, essential to withstand scrutiny.

“ Actual utilisation of an advance for executing the business transaction is an indispensable condition for availing exclusion from the deemed dividend provisions. ”

²⁰ Smt. Tarulata Shyam v. Commissioner of Income-tax, (1977) 108 ITR 345 (SC).

CASE LAW UPDATES - DIRECT TAX

ROUTINE

Delay in passing final assessment order held to invalidate proceedings under Section 144C(13)

Introduction

In *Himalaya Drug Company*,²¹ the division bench of the Karnataka HC held that statutory timelines under Section 144C(13) of the IT Act are not mere procedural formalities but binding mandates, and any delay in passing the final assessment order renders such proceedings invalid.

Facts

Himalaya Drug Company (**Assessee**) is a partnership firm. The Assessee filed the return for AY 2011–12, declaring an income of INR 38,55,85,630. The file was referred to the TPO, who suggested certain adjustments. The Assessee then approached the DRP who gave their instructions on December 29, 2015, and the AO passed his final order on February 18, 2016. Aggrieved, the Assessee filed a case before the ITAT asking for relief, which the ITAT dismissed.

Aggrieved by the ITAT's order, the Assessee filed an appeal before the Hon'ble Karnataka HC, leading to the present judgment.

Issue

Whether the ITAT was justified in upholding the validity of the final assessment order passed by the AO beyond the time limit prescribed under Section 144C(13)?

Arguments

The Assessee argued that the final assessment order was contrary to Section 144C(13) of the IT Act, as the said provision mandates that the final assessment order must be passed within one month from the end of the month in which the order under Section 144C(5) of the IT Act is communicated. In the present case, the order passed by the DRP was communicated on December 29, 2015. While mandated to have passed the final assessment order on or before January 31, 2016, the AO passed the final assessment order on February 18, 2016, resulting in a delay of 18 days.

The Assessee further contended that the ITAT's reliance on *Rain Cements Ltd. v. Dy. CIT*²² was misplaced. In the said case, the Telangana HC held that the proceedings cannot be declared null and void merely because the AO passed the assessment order beyond the prescribed time limit. The Assessee argued that the AO's failure to pass the order within the statutory time frame results in the lapse of the proceedings.

The IRA on the other hand, argued that the appeal should be dismissed, asserting that the ITAT was justified in relying on the decision of the HC in *Rain Cements Limited (supra)*.

Decision

The Hon'ble Karnataka HC, after examining the text of Section 144C(13) of the IT Act and the arguments presented by both parties, held that the AO must complete the assessment within one month from the end of the month of receiving the DRP's direction. This can be done without providing any further

²¹ Himalaya Drug Company v. Deputy Commissioner of Income Tax [2025]176 taxmann.com 55 (Kar).

²² Rain Cements Ltd. v. Dy. CIT [2016] 75 taxmann.com 113 (AP and Telangana).



opportunity of being heard to the Assessee. In the present case, despite receiving the DRP's direction on December 29, 2015, and being mandated to pass the assessment order on or before January 31, 2016, the AO exceeded the time limit prescribed under Section 144C(13) of the IT Act and passed the order only on February 18, 2016.

The HC held that the time limit under this section is mandatory, and that the AO does not have any discretion in this regard. Relying on the judgment of the Delhi HC in **Louis Dreyfus Company India (P.) Ltd. v. Dy. CIT**,²³ the Karnataka HC held that the language and intent of Section 144C(13) did not grant the AO any discretion in framing the assessment order after the issuance of directions by the DRP.

The HC further held that reliance on **Rain Cements Limited (supra)** was misplaced, considering that decision involved a different factual situation in which the DRP had not issued any direction under sub-section (5) of Section 144C. In the present case, since the DRP had issued directions, the assessment order

ought to have been passed within the time prescribed under Section 144C(13) of the IT Act.

Significant Takeaways

The judgment provides clarity on the scope and application of Section 144C(13) of the IT Act. It affirms that the prescribed time limit is not a mere procedural formality, but a substantive safeguard designed to protect the interests of the Assessee. By enforcing a strict timeline, the HC imposes an obligation on the IRA to ensure that assessment proceedings are conducted in a time-bound manner, preventing it from exercising unfettered discretion to prolong the process according to its own whims.

It also reaffirms that any delay in passing the final assessment order after receiving the DRP's directions renders the proceedings invalid. By interpreting the timeline as mandatory, the HC has granted an opportunity to taxpayers, enabling them to challenge delayed assessments.

“ Delay in passing final assessment order under Section 144C(13) renders proceedings invalid. ”

²³ Louis Dreyfus Company India (P.) Ltd. v. Dy. CIT [2024] 159 taxmann.com 244/464 ITR 595 (Delhi).

Delhi HC reaffirms identity alone is insufficient; Assessee must prove creditworthiness and genuineness of transaction under Section 68

Introduction

In *Jaguar Buildcon*,²⁴ the Division Bench of the Delhi HC reaffirmed the three-fold test under Section 68 and held that the Assessee is required to establish not only the source of funds but also the genuineness of the transaction and the creditworthiness of the investor companies to avoid the addition of such funds to the assessable income under Section 68 of the ITA.

Facts

Jaguar Buildcon Pvt. Ltd. (**Assessee**) received substantial share capital in AY 2011-12 from three investor companies. In AY 2012-13, the Assessee received additional share application money from two investor companies.

The AO conducted detailed investigations and found that the funds were routed through multiple layers of paper entities, many of which shared the same official address. The AO observed that the second-layer companies had received funds from other entities shortly before transferring them to the Assessee. The AO also noted that these companies had failed to produce their controlling persons when summoned for inquiry. On the basis of these findings, the AO made additions under Section 68 of the IT Act, citing the Assessee's failure to establish the genuineness of the transactions.

The CIT(A) reversed the AO's findings and deleted the additions. On appeal by the IRA, the ITAT upheld the CIT(A)'s order, holding that the Assessee had submitted sufficient documentation to establish the nature and source of the credits. The ITAT noted that authorised representatives had appeared and that the AO's rejection of the Assessee's explanation was based on technical and whimsical reasons.

Aggrieved by the ITAT's decision, the IRA filed an appeal before the Delhi HC, resulting in the present judgment.

Issue

Whether the findings rendered by the ITAT in respect of deletion under Section 68 of ITA are rendered perverse in light of non-

examination of the genuineness of the transactions and creditworthiness of the investors?

Arguments

The HC did not record the arguments presented by the Assessee, but it noted that the Assessee had submitted confirmations from the investor companies, produced authorised representatives of some of them before the AO, and provided documents such as bank account statements to establish the genuineness of the transactions and creditworthiness of the investors in response to the allegations.

The IRA, on the other hand, contended that although they had specifically requested the Assessee to produce the directors / controlling person of the investor companies, the Assessee only produced individuals claiming to be ex-directors or authorised representatives. These individuals did not hold valid letters of authority and lacked supporting documents related to the transactions. The IRA further argued that their investigation revealed the investor companies were merely paper entities the Assessee had used to route its own funds into the books in the form of share application money. They also found that the investor companies had meagre incomes and that most of them shared the same official address.

Decision

The Delhi HC set aside the ITAT's order and held that it had clearly failed to engage with the findings of the AO. The ITAT focused primarily on the Assessee having to establish the source of funds, while completely overlooking the aspect of genuineness and creditworthiness, both of which are important ingredients for discharging the onus under Section 68 of the IT Act.

The HC placed significant reliance on *Commissioner of Income Tax v. NRA Iron and Steel (P) Ltd.*,²⁵ in which the SC had held that the initial onus lay on the Assessee to establish, by cogent evidence, the genuineness of the transaction and creditworthiness of investors under Section 68. The Assessee must satisfy the three-fold test, i.e., proof of identity of creditors, capacity of creditors to advance money (creditworthiness), and genuineness of transaction. The mere incorporation of a company or payment through banking channels does not, by itself, amount to satisfactory discharge of this onus.

²⁴ The Principal Commissioner of Income Tax v. Jaguar Buildcon Pvt. Ltd. [TS-1066-HC-2025(DEL)]

²⁵ Commissioner of Income Tax v. NRA Iron and Steel (P) Ltd, 2019 SCC OnLine SC 311.



The HC held that the ITAT in the present case had clearly failed to consider the aspects of creditworthiness and genuineness. Accordingly, the HC ruled in favour of the IRA, setting aside the ITAT's order, and restoring the AO's order of addition under Section 68 of the IT Act.

Significant Takeaways

The Delhi HC's judgment provides guidance on the application of Section 68 in cases involving complex fund routing structures. The decision reinforces the three-fold test under Section 68, which places a significant burden on the Assessee to not only establish the identity of the creditors but also prove their creditworthiness and the genuineness of the transaction.

The judgment reinforces the principle of substance over form. Mere production of documents, banking channel transactions, and formal compliance cannot shield Assessee from scrutiny when the underlying fund trails reveal paper company structures and implausible financial capacities.

The judgment clarifies that creditworthiness under Section 68 requires establishing real financial capacity, not just book entries or formal balance sheet figures. It reaffirms that when investor companies show minimal income but make substantial investments, and when funds are traced through multiple layers of dubious entities, the genuineness requirement is not satisfied. Therefore, Assessee must be prepared to demonstrate not only the formal aspects of transactions but also the economic reality and commercial rationale behind the investments.

“ Assessee must prove identity, creditworthiness, and genuineness to escape additions under Section 68. ”

Settlement Commission and prosecution: SC reconciles statutory immunity with procedural compliance

Introduction

In *Vijay Krishnaswami*,²⁶ the Hon'ble SC held that the IRA cannot initiate or continue prosecution under Section 276C(1) of the IT Act, in violation of the procedural safeguards prescribed by the CBDT. It held that prosecution under Section 276C(1) of the IT Act, where the penalty has been abated by the Settlement Commission, undermines the statutory safeguards and CBDT Circulars, rendering such action premature and legally unsustainable.

Facts

Vijay Krishnaswami (**Assessee**), an individual, was subjected to a search under Section 132 of the IT Act at his residence in 2016, resulting in the seizure of unaccounted cash. Subsequently, the IRA issued a show-cause notice, requiring the Assessee to show cause why prosecution should not be initiated against him. On the basis of the sanction accorded by the Principal Director Income Tax (Investigation), Chennai, a complaint was filed under Section 276C(1) of the IT Act in 2018, for the Assessee's alleged wilful attempt to evade tax with respect to AY 2017-18 and for not filing the correct return of income.

The Assessee challenged the prosecution by filing a quashing petition under Section 482 of the Code of Criminal Procedure, 1973, before the Madras HC. During the pendency of the petition, the Assessee approached the Settlement Commission under Section 245C of the IT Act, disclosing the additional income and seeking immunity from levy of penalty as well as prosecution, with respect to the alleged evasion of tax. In 2019, the Settlement Commission granted immunity from levy of penalty but refrained from granting immunity from prosecution due to the pending petition before the HC.

Thereafter, the HC dismissed the quashing petition, holding that the seized cash was not declared in AY 2017-18 and that the defence of favourable order from the Settlement Commission should be raised during the trial. Hence, an appeal was preferred before the SC.

Issue

Whether continuation of prosecution under Section 276C(1) of the IT Act, despite the Settlement Commission's order granting immunity from penalty, constitutes an abuse of the process?

Arguments

The Assessee contended that the Settlement Commission's order granting immunity from penalty under Section 245D(4) of the IT Act should be considered final and binding. The Assessee argued that the IRA's procedural lapses, including failure to not only consider the Settlement Commission's order but also comply with the Circulars^{27, 28} issued by the CBDT in 2008 and 2019 amounted to a serious misuse of legal process.

In response, the IRA argued that the prosecution was valid since the complaint preceded the application to the Settlement Commission, immunity from prosecution under Section 245H(1) of the IT Act could not be granted where prosecution had already been instituted. They emphasised that Section 276C(1) of the IT Act requires a wilful attempt to evade tax, and the HC rightly dismissed the quashing petition in the presence of unaccounted cash and non-disclosure thereof in the income tax return filed for AY 2017-18.

Decision

The SC underscored the binding nature of CBDT Circulars on tax authorities, as held in *UCO Bank*,²⁹ provided they benefit the taxpayer and do not override judicial interpretation or impose additional burdens beyond the statute. It also relied on *Merino Panel Product Ltd.*³⁰ to reiterate that the IRA cannot act contrary to CBDT Circulars, as doing so undermines consistency and predictability in the tax administration.

The SC observed that the initiation of prosecution proceedings did not adhere to the 2008 Circular, which, *inter alia*, requires that prosecution under Section 276C(1) of the IT Act can be launched only if the penalty amount under Section 271(1)(c) of the IT Act exceeded INR 50,000. The Prosecution Manual of 2009³¹ reiterates the same. It also highlighted non-compliance with the 2019 Circular, which prescribes not initiating prosecution without the prior approval of a collegium comprising senior officers of the rank of Chief Commissioner of

²⁶ *Vijay Krishnaswami v Deputy Director of Income-tax (Investigation)*, (2025) 177 taxmann.com 807 (SC).

²⁷ CBDT Circular dated April 24, 2008.

²⁸ CBDT Circular No. 24 of 2019 dated September 9, 2019.

²⁹ *UCO Bank v. Commissioner of Income-tax*, (1999) 104 Taxmann 547 (SC).

³⁰ *Commissioner of Central Excise and Service Tax v. Merino Panel Product Ltd.*, (2023).

³¹ Prosecution Manual 2009, Directorate of Income Tax, Clause 1.4 of Chapter III.

Income Tax or Director General of Income Tax in instances where the tax liability is below INR 25 lakh. The SC decided that these Circulars, being binding under Section 119 of the IT Act, underscore the necessity of strict adherence by the IRA, and any deviation would vitiate the prosecution proceedings as an abuse of process.

The SC placed reliance on **K.C. Builders**,³² which established that if penalty for concealment fails, the initiation of prosecution on the basis of the same facts would also fail. Thus, in the present case, the SC held that prosecution proceedings should not continue under Section 276C(1) of the IT Act when the foundational basis of wilful concealment or evasion has already been disproved, with respect to the penalty imposed under Section 271(1)(c) of the IT Act.

The SC noted that the Settlement Commission's findings are final. Moreover, since the Settlement Commission had not established wilful evasion in the present case, the continuation of prosecution was deemed unjustified and contrary to law.

Significant takeaway

The SC has now provided much-needed clarity to the long-debated issue of whether the Settlement Commission's findings on penalty would also influence prosecution. By reaffirming the principle established in **K.C. Builders**, the SC has clarified that prosecution cannot continue once penalty proceedings nullify the very foundation of wilful concealment or evasion. Importantly, this protection now extends to cases where the Settlement Commission has granted immunity from penalty.

This ruling strengthens the position that penalty and prosecution are not parallel or independent tracks but are interlinked, and their continuity depends on the validity of the underlying findings. The decision also underscores the need for strict procedural compliance, transparency, and fairness in tax administration.



The Court has unequivocally reaffirmed that CBDT Circulars are binding on Income-tax authorities, even if they appear to soften the rigour of statutory provisions. Until withdrawn or superseded, such Circulars must be followed by the authorities, who cannot question their validity.

Before embarking on disclosure or settlement strategies with the Income Tax Department, it is critical for taxpayers to assess whether procedural safeguards have been duly observed. This ruling makes it clear that even if prosecution has already been initiated, its continuation may be legally unsustainable if the underlying penalty is abated or invalidated. In this context, sequencing of actions, robust documentation, and a clear understanding of procedural thresholds become critical to avoiding unintended exposure.

In essence, the **Vijay Krishnaswami** ruling strengthens the jurisprudential link between penalty and prosecution, while also reinforcing the binding force of administrative guidance through CBDT Circulars on the IRA. For taxpayers, it highlights the need for a strategic, well-documented, and procedurally sound approach to disclosure and settlement.

“ Prosecution proceedings should not be initiated against taxpayers in case no penalties were levied on the taxpayers. ”

³² K.C. Builders v. Assistant Commissioner of Income-tax (2004) 135 Taxman 461 (SC).

CASE LAW UPDATES - INDIRECT TAX

ROUTINE

Mandatory release of goods on non-issuance of SCN on seizure under Customs Act

Introduction

In *Union of India & Ors. v. Jatin Ahuja*,³³ the SC addressed whether the provisional release of seized goods under Section 110A can override or suspend the mandatory requirement of issuing a SCN within the time prescribed under Section 110(2). It held that the statutory consequence of non-issuance of SCN, i.e., unconditional release of goods cannot be nullified by a provisional release.

Facts

The Respondent, Mr. Jatin Ahuja, a trader in luxury vehicles, purchased a brand-new Maserati car on December 7, 2010. On the same day, the DRI, acting under Section 110 of the Customs Act, detained the vehicle and executed a seizure *panchnama*. Subsequently, on October 24, 2011, the Commissioner of Customs (COC) extended the time for issuance of a SCN by six months, as permitted under the first proviso to Section 110(2).

The DRI later cancelled the *supurdarinama* and took physical possession of the car. The Respondent approached the Hon'ble Delhi HC via a writ petition, seeking unconditional release of the vehicle on the ground that no SCN under Section 124 had been issued within the statutorily prescribed time.

The HC allowed the writ petition, holding that the failure to issue a SCN within the extended one-year period rendered the seizure invalid and entitled the respondent to unconditional release of the car. The IRA appealed this decision before the Hon'ble SC.

Issue

Whether the provisional release of seized goods under Section 110A of the Customs Act, suspends or overrides the mandatory consequence under Section 110(2) for failure to issue a SCN within the prescribed time?

Arguments

The Respondent contended that Section 110(2) of the Customs Act is unequivocal in mandating the issuance of a SCN within six months from the date of seizure, extendable by a further six months by the Principal Commissioner of Customs or COC subject to the recording of reasons and prior intimation to the person from whom the goods were seized. In the present case, although an extension was granted, no SCN was issued within the extended period. Therefore, the statutory consequence of unconditional release of the seized goods must follow. The Respondent emphasised that the Customs Act does not permit indefinite retention of goods without initiating adjudicatory proceedings, and that the seizure stood dissolved by operation of law.

The IRA, on the other hand, relied on the Bombay HC decision in *Jayant Hansraj Shah v. Union of India*,³⁴ which held that provisional release of goods under Section 110A suspends the operation of Section 110(2). The IRA argued that the car in question had been provisionally released under Section 110A and, therefore, the limitation period under Section 110(2) did not apply. It contended that the provisional release constituted a quasi-judicial order and the seizure continued to subsist, thereby preserving the right to issue an SCN beyond the prescribed period. It was further contended that the respondent

³³ Union of India & Ors. v. Jatin Ahuja, Civil Appeal No. 3489 of 2024, decided on September 11, 2025 (SC).

³⁴ Jayant Hansraj Shah v. Union of India, reported in 2008 (229) E.L.T. 339 (Bom).

had voluntarily accepted the provisional release and could not now claim unconditional release on the ground of delay.

Decision

The SC dismissed the appeals filed by the IRA and upheld the decision of the Delhi HC.

The SC examined the statutory scheme under Sections 110, 110A, and 124 of the Customs Act. It observed that Section 110(2) provides that where goods are seized and no SCN under Clause (a) of Section 124 is issued within six months, the goods shall be returned to the person from whom they were seized. The first proviso permits an extension of six months, subject to procedural safeguards. The SC noted that the provision is couched in mandatory terms and prescribes a clear consequence for non-compliance.

The SC then looked at Section 110A, which permits provisional release of seized goods pending adjudication. It held that Section 110A is an enabling provision that facilitates interim relief to the person from whom goods are seized but does not contain any language that suspends or overrides the operation of Section 110(2). It emphasised that there is no *non obstante* Clause in Section 110A nor any indication that the time limit under Section 110(2) is inapplicable in cases of provisional release. It rejected the IRA's reliance on **Jayant Hansraj Shah (supra)**, holding that the Bombay HC's interpretation was context-specific and could not be generalised to override the plain meaning of the statute.

In support of its conclusion, the SC relied on the principle that where a statute prescribes a manner of doing an act and a consequence for non-compliance, the provision must be construed as mandatory. It upheld that the time prescription under Section 110(2) reflects a legislative intent to inject efficiency and discipline in customs enforcement, and to prevent indefinite seizure without adjudication.

The SC also examined the legislative history, noting that the second proviso to Section 110(2), which exempts the time limit in cases of provisional release, was introduced only in 2018 and was not applicable to the present case. It referred to the Finance Bill, 2018, and the instructions issued by the CBIC, which clarified

that the time limit under Section 110(2) remains applicable even in cases of provisional release.

Applying the above principles to the facts of the case, the SC found that the car was seized under Section 110(1), and no SCN under Section 124(a) was issued within the extended one-year period. Further, considering the absence of any valid extension beyond the initial six-month extension or any compliance with the procedural requirements for such extension has been prescribed, the SC held that the seizure stood dissolved by operation of law, and the respondent was entitled to unconditional release of the vehicle.

Significant Takeaway

The SC provides clarity on the nature of statutory timelines under Section 110(2) of the Customs Act by emphasising that it is not merely directory but mandatory. The consequence of non-compliance is statutorily embedded: The goods must be returned to the person from whom they were seized. This interpretation reinforces the principle that enforcement authorities must strictly adhere to statutory obligations, when coupled with express consequences for breach. This further ensures that administrative expediency does not dilute procedural safeguards. Clients facing seizure under the Customs Act should track SCN timelines rigorously and seek unconditional release if deadline lapse.

The Court adopts a strict textualist approach, reaffirming that in the context of fiscal statutes, where the statutory language is clear and unambiguous, the plain meaning of the text must prevail. Lastly, the amendment to Section 110(2) was also discussed and was specified to be prospective in nature and, thus, is not applicable to seizures made prior to its enactment. This clarification is significant as it delineates the temporal boundaries of legislative changes and prevents retrospective application that could adversely affect vested rights.

This decision reiterates the principle of statutory discipline and adherence to the prescribed timelines because the taxpayer should not be made to suffer because of lackadaisical approach adopted by the Customs Authorities. It should also serve as a timely wake-up to the Customs Authorities and, hopefully, motivate them to complete their work on time.

“ Failure to issue a SCN within the prescribed time period will result in unconditional release of goods seized. ”

Bombay High Court upholds validity of entertainment duty levied on convenience fee

Introduction

In *FICCI-Multiplex Association of India*,³⁵ the Bombay HC upheld the constitutional validity of an amendment to the Maharashtra Entertainments Duty Act (**MED**), which brought convenience fees charged by proprietors or ticket-booking service providers within the ambit of “payment of admission” liable to entertainment duty.

Facts

The case deals with two writ petitions filed under Article 226 of the Constitution of India by FICCI and Big Tree Entertainment. FICCI is an association of multiplexes, while Big Tree Entertainment is engaged in the business of booking online tickets for various theatres and other entertainment events. The said petitions challenged the validity of an amendment (**Impugned Amendment**) inserting the seventh proviso into Section 2(b) of MED to bring within the ambit of “payment of admission” the convenience fees charged for online ticket booking, if over INR 10, making these subject to entertainment duty.

Pursuant to the Impugned Amendment, demand notices were issued to FICCI. Although Big Tree Entertainment was served no such notices, it was apprehensive about being made subject to entertainment duty. Against this backdrop, both FICCI and Big Tree Entertainment challenged the Impugned Amendment as being ultra vires the Constitution of India and contrary to the scheme of the MED Act.

Issue

Whether the Impugned Amendment is ultra vires the Constitution of India and the scheme of the MED Act?

Arguments

The Petitioners contended that only the Union is empowered to levy service tax as per List I of the Seventh Schedule of the Constitution of India, while the State’s authority to levy tax under Entry 62 of List II is limited to taxing “entertainment.”

Based on this, they argued that the convenience fee charged for online ticket booking constitutes a service fee (and is subject to tax under the Finance Act, 1994) and is not related to entertainment and, therefore, the State is not competent to levy duty on the same

Further, the Petitioners argued that the Impugned Amendment is *ultra vires* because it seeks to tax new activity, i.e., online booking service, through redefining “payment of admission” without amending the charging Section 3 of the MED Act. They relied on the several provisions of the MED Act, *Tata Sky Limited vs. State of Madhya Pradesh & Ors.*³⁶ and other judgments to contend that a new activity or a service cannot be made subject to tax without amending the definition, charging and machinery provisions.

Further, Petitioners relied on Section 2(b)(iv) of the MED Act and contended that for any charge to attract entertainment duty, it must both be connected with entertainment and be a condition for attending or continuing to attend such entertainment. They argued that the convenience fee charged for online booking is distinct from the ticket price and is levied for a separate service, not for admission to entertainment. Since neither of the statutory conditions is satisfied, they argued that the levy of entertainment duty on such charges is contrary to the scheme of MED Act.

The IRA, on the other hand, argued that while interpreting entries under the Seventh Schedule, the principle of “pith and substance” should be applied. Based on this, they argued that, in essence, convenience fee constitutes part of the cost of enjoying entertainment and, therefore, would be covered under Entry 62 of List II. Further, the IRA relied on *Federation of Hotel and Restaurant v. Union of India*³⁷ to argue that overlapping entries in the Seventh Schedule must be harmoniously interpreted to avoid conflict. The IRA contended that while the Finance Act, 1994, taxes the service of online booking, Entry 62 of List II pertains to entertainment, and the impugned proviso merely adjusts the measure of tax to compute the entertainment duty, which is well within the legislative competence of the State.

The IRA, relying on the wording of Section 2(a) which defines “entertainment” and uses the phrase “or any other charges” and Section 2(b) which defines “payment of admission” argued that the said definitions are broadly worded enough to include convenience charges for online ticket booking within their ambit.

³⁵ FICCI-Multiplex Association of India & others v. State of Maharashtra, 2025 (8) TMI 486.

³⁶ Tata Sky Limited vs. State of Madhya Pradesh & Ors, (2013) 4 Supreme Court Cases 656.

³⁷ Federation of Hotel and Restaurant v. Union of India, AIR 1990 Supreme Court 1637.

Decision

The Hon'ble Bombay HC examined the scheme of the MED Act and held that the levy of entertainment duty on convenience fees satisfies the four essential components of a valid tax: (i) the subject matter of the tax (entertainment); (ii) the person liable to pay the duty (proprietor); (iii) the rate of duty (specified under Section 3 and is calculated on the payment for admission fixed by the proprietor); and (iv) the taxable event (payment for admission to entertainment). It emphasised the distinction between the nature of a tax and its measure and held that a change in the measure does not alter the nature of the tax and, therefore, does not affect legislative competence. The HC held that the inclusion of convenience fees charged on online ticket sales is a modification in the measure of tax, which does not alter the nature of the levy, i.e., tax on entertainment. It rejected the Petitioners' argument that online ticket booking constitutes a separate business activity, noting that they do not offer such services independent of the entertainment activity.

Addressing the interpretation of Section 2(b)(iv) of the MED Act, the HC held that the phrase "in relation to" must be construed broadly. The section defines "payment of admission" to include any payment, by whatever name called, for any purpose connected with entertainment, which a person is required to make as a condition to attending or continuing to attend the entertainment event. Applying this to the facts, the HC held that the convenience fees paid for online ticket booking are directly connected to the act of attending entertainment, and they are a prerequisite for obtaining a ticket and entering the theatre. Therefore, such fees fall squarely within the definition of "payment of admission" and form part of the measure of tax under Section 3. Accordingly, no amendment to the definition of "entertainment" or other provisions of the Act is necessary, as the impugned proviso does not introduce a new form of entertainment but merely adjusts the measure of tax.

Based on these findings, the HC upheld the constitutional validity of the Impugned Amendment levying entertainment duty on convenience fees.

Significant Takeaways

The Bombay HC had previously struck down orders passed by the State Government that prohibited cinema owners from levying convenience fees, affirming that such charges fall within their constitutionally protected right to carry on business under Article 19(1)(g), and cannot be curtailed without explicit legislative backing.³⁸ In the present case, the HC upheld the levy of entertainment duty on the same convenience fees.

The Bombay HC's judgment will impact how proprietors and service providers structure their pricing and contractual agreements. Proprietors and service providers must now revise their pricing models to account for entertainment duty on convenience fees. The HC held that while the inclusion of such fees constitutes a modification in the measure of tax, it does not alter the nature of the levy. This interpretation affirms the State's legislative competence under Entry 62 of List II. The ruling establishes a precedent that permits adjustments to the tax base without requiring changes to the charging provision.

The HC did not decide whether service providers are liable to pay entertainment duty. It noted that such determination would require a factual analysis of contractual arrangements. This exercise is outside the scope of writ jurisdiction under Article 226 of the Constitution. As a result, the question of liability remains unresolved. This uncertainty increases the importance of precise contractual drafting. Agreements between proprietors and service providers must clearly allocate tax obligations. Failure to do so may result in future disputes or adverse assessments.

“ Convenience fee on online ticket booking is subject to entertainment duty. ”

³⁸ PVR Limited vs. State of Maharashtra & Ors., Writ Petition No. 497 of 2014, Bombay HC.

Telecommunication towers not qualified for immovable property status despite exclusion from the plant and machinery category

Introduction

In *Bharti Airtel Limited v. Commissioner*,³⁹ the Hon'ble SC upheld the Delhi HC's decision that had refused to characterise mobile towers as immovable property, thereby granting ITC on inputs and input services used for setting up such passive infrastructure. The HC had held that the denial of ITC was unsustainable since these towers are movable property and not immovable. The SC dismissed the SLP against the said order at the admission stage.⁴⁰

Facts

Bharti Airtel Limited, Indus Towers Limited, and Elevar Digital Infrastructure Pvt. Ltd filed three writ petitions challenging proceedings under the CGST Act, which denied ITC on the ground that telecommunication towers constituted immovable property. The Delhi HC had held that such towers were movable property and that denial of ITC under Section 17(5) was unsustainable.

Issue

The issues before the HC were as follows:

- ⌋ *Whether telecommunication towers qualify as immovable property under the meaning of Section 17(5) of the CGST Act?*
- ⌋ *Whether ITC can be denied on inputs and input services used for construction or installation of telecommunication towers on the basis that they are immovable property?*
- ⌋ *The applicability and interpretation of the exclusion of telecommunication towers from the definition of "plant and machinery" under the Explanation to Section 17(5) of the CGST Act.*

Arguments

The Petitioners, before the HC, argued that telecommunication towers were movable items of essential equipment that can be dismantled and relocated and only the concrete base is immovable. They submitted that such erections were solely for stability and did not alter their fundamental nature as movable equipment.

The Respondents did not dispute the findings in *Bharti Airtel (supra)* but sought to distinguish the decision based on the Explanation appended to Section 17 of the CGST Act, which excluded telecommunication towers from the definition of "plant and machinery".

Decision

The Supreme Court was not persuaded that the case merited interference under its discretionary jurisdiction conferred by Article 136 of the Constitution. Accordingly, it dismissed the SLPs at the admission stage. This dismissal means that the Delhi HC's ruling that telecommunication towers are movable property and that ITC cannot be denied on the ground of immovability continues to hold the field.

Significant Takeaways

The SC's refusal to intervene reinforces the Delhi HC's precedent that telecom towers are movable property under the CGST Act. The exclusion of towers from the definition of "plant and machinery" does not, by itself, render them immovable property. The ruling provides clarity and relief to telecom companies and infrastructure providers by affirming their eligibility for ITC. Since the detailed reasoning of the Delhi HC was already discussed in an earlier *Tax Scout*, it suffices here to note that the SC has effectively endorsed that position by declining to interfere.

“ Telecom towers are movable property under the CGST Act, making them eligible for ITC. ”

³⁹ CGST Appeals-1, Delhi [TS-839-HC(DEL)-2024-GST].

⁴⁰ Commissioner, CGST Appeal-1 Delhi Etc. v. M/S Bharti Airtel Limited Etc.SLP Diary No. 35416/2025 [08.08.2025].

REGULATORY DIRECT TAX UPDATES

CBDT clarifies applicability of interest waiver under Circular 5/2025

The CBDT, *vide* Circular No. 8/2025⁴¹ dated July 1, 2025, has issued a clarification regarding Circular No. 5/2025⁴² dated March 28, 2025, which provided for waiver of interest levied under Sections 201(1A)(ii) and 206C(7) of the IT Act, 1961. These provisions relate to interest charged for failure to deduct or pay tax (in the case of deductors) and failure to collect or pay tax (in the case of collectors) to the credit of the Central Government.

The present circular clarifies that waiver applications may also be considered in cases where such interest was levied prior to the issuance of Circular 5/2025, provided that the application for waiver is filed within one year from the end of the financial year to which the interest pertains.

This clarification ensures that taxpayers facing genuine hardship due to past interest levies are not excluded from the benefit of the waiver scheme introduced earlier.

CBDT provides relief from higher TDS/TCS rates for inoperative PANs subsequently made operative

The CBDT, *vide* Circular No. 9/2025⁴³ dated July 21, 2025, has provided relief from the application of higher TDS/TCS rates under Sections 206AA and 206CC of the IT Act, 1961, in cases of short deduction or collection where the PANs of deductees or collectees were initially inoperative.

The relief applies to transactions carried out between April 1, 2024, and July 31, 2025, where the PAN was inoperative due to non-linkage with Aadhaar but was subsequently made operative. In such cases, if the PAN is made operative on or before September 30, 2025, the normal tax rates shall apply.

For transactions undertaken on or after August 1, 2025, the PAN must be made operative within two months from the end of the month of the transaction to avail the same relief.

The circular further clarifies that in such cases, deductors or collectors will not be treated as Assessees-in-default, and the short deduction or collection shall be eligible for rectification.

CBDT extends investment deadline under Section 10(23FE) to March 31, 2030

The CBDT, *vide* Circular No. 11/2025⁴⁴ dated September 2, 2025, has modified Circular No. 9 of 2022 to align with the amendments introduced by the FA, 2025, to Section 10(23FE) of the IT Act, 1961.

The amendment extends the deadline for eligible investments by specified persons such as sovereign wealth funds and pension funds from March 31, 2025, to March 31, 2030, effective from April 1, 2025.

Accordingly, all references to the earlier deadline of March 31, 2024, in Circular No. 9 of 2022, specifically in the opening paragraph. Paragraphs 4.6.2 and 4.6.3 shall now be read as March 31, 2030.

⁴¹ Circular No. 08/2025 dated July 1, 2025 [F. No. 275/92/2024-IT(B)].

⁴² Circular No. 05/2025 dated July 1, 2025 [F. No. 275/92/2024-IT(Budget)].

⁴³ Circular No. 09/2025 dated July 21, 2025 [F. No. 275/04/2024-IT(B)].

⁴⁴ Circular No. 11/2025 dated September 2, 2025 [F. No. 370142/32/2025-TPL].

CBDT extends due date for furnishing audit reports for FY 2024–25

The CBDT, *vide* Circular No. 14/2025⁴⁵ dated September 25, 2025, has extended the due date for furnishing audit reports under any provision of the IT Act, 1961, for the FY 2024–25 (relevant to AY 2025–26).

The original deadline of September 30, 2025, has now been extended to October 31, 2025.

This extension applies to Assessee referred to in Clause (a) of Explanation 2 to sub-section (1) of Section 139 of the IT Act, i.e., those who are required to furnish audit reports.

CBDT notifies that Special Courts will be designated under the Benami Property Transactions Act

The Ministry of Finance, *vide* Notification No. 117/2025⁴⁶ dated July 17, 2025, has amended the earlier Notification S.O. 5323(E) dated October 16, 2018, issued under Section 50(1) of the Prohibition of Benami Property Transactions Act, 1988. Section 50(1) empowers the CG, in consultation with the Chief Justice of the respective HCs, to designate one or more Sessions Courts as Special Courts for the purpose of trying offences under the Act. These Special Courts are responsible for adjudicating cases related to benami transactions, which involve property held in the name of one person but paid for by another, often to evade taxes or conceal illicit wealth.

In consultation with the Chief Justice of the respective HCs, the notification updates the designation of Special Courts in two jurisdictions. For serial number 5, the designated court is now “Court of XII Additional Sessions Judge, Raipur.” For serial number 21, the designated court is now “Special Court (Communal Riots), Jaipur.” These changes are reflected in the amended table of the original notification.

This amendment ensures that cases under the Benami Property Transactions Act are tried by appropriately designated courts in Raipur and Jaipur, thereby aligning judicial infrastructure with legislative intent. It enhances procedural clarity and supports efficient adjudication of benami property matters, contributing to the broader objective of curbing black money and improving transparency in property ownership.

CBDT notifies that Foreign Portfolio Investors will be included under Rule 21AK

The CBDT, *vide* Notification No. 126/2025⁴⁷ dated July 28, 2025, has notified the IT (Twentieth Amendment) Rules, 2025, to amend Rule 21AK of the IT Rules, 1962. These amendments have been made in exercise of powers under Section 295 read with Clause (4E) of Section 10 of the IT Act, 1961. The amendments expand the scope of Rule 21AK to include references to Foreign Portfolio Investors (**FPIs**) operating as units of International Financial Services Centres (**IFSCs**). Specifically, in sub-rule (1)(b), the term “over-the-counter derivatives” has been inserted alongside “offshore derivative instruments,” and the reference to FPIs as units of IFSCs has been added. In sub-rule (2), the term “FPIs” has been inserted alongside “offshore banking unit.” Further, in the Explanation to Rule 21AK, Clause (v) has been revised for punctuation; Clause (vi) has been updated to include the word “and” at the end; and a new Clause (vii) has been inserted to define “FPIs” as a person registered under the SEBI (FPI) Regulations, 2019, made under the SEBI Act, 1992.

This amendment aligns the tax treatment of derivative transactions involving FPIs with current regulatory frameworks and supports the development of IFSCs as global financial hubs. It provides clarity on the inclusion of FPIs within the scope of Rule 21AK and facilitates smoother compliance for entities operating in offshore financial markets.

CBDT notifies the amendment to Form No. 7 to include block periods

CBDT, *vide* Notification No. 132/2025⁴⁸ [G.S.R. 553(E)] dated August 14, 2025, has notified the IT (Twenty-First Amendment) Rules, 2025, to amend the IT Rules, 1962. These amendments have been made in exercise of powers under Section 295 read with Section 156 of the IT Act, 1961. Section 295 empowers the CBDT to make rules for carrying out the provisions of the Act, while Section 156 deals with the issuance of notices of demand by the AO when any tax, interest, penalty, fine, or other sum is payable under the Act.

The amendment pertains to Form No. 7 in Appendix II of the IT Rules, which is the prescribed format for issuing a notice of demand under Section 156. Specifically, in Paragraph 1 of the form, the existing phrase “AY.....a sum” has been substituted with the revised phrase “AY..... or the block period....., as the

⁴⁵ Circular No. 14/2025 dated September 25, 2025 [F. No. 225/131/2025/ITA-II].

⁴⁶ Ministry of Finance Notification No. 117/2025 dated July 17, 2025 [F. No. 149/144/2015-TPL-Part(2)].

⁴⁷ CBDT Notification No. 126/2025 dated July 28, 2025 [G.S.R. 503(E) / F. No. 370142/26/2025-TPL].

⁴⁸ CBDT Notification No. 132/2025 dated August 14, 2025 [G.S.R. 553(E) / F. No. 370142/34/2025-TPL].



case may be, a sum”. This change ensures that the form accommodates both AY-based demands and block period-based demands. Block period-based demands are relevant in cases of block assessments conducted under Chapter XIV-B of the Act, typically in search and seizure cases.

This amendment enhances the clarity and applicability of Form No. 7 by aligning its language with the provisions of Section 156 and the procedural requirements for block assessments. It is part of the ongoing efforts to streamline tax administration and ensure consistency in compliance documentation.

CBDT notifies the introduction of monetary thresholds for perquisite valuation

The Central Government, *vide* Notification No. 133/2025⁴⁹ dated August 18, 2025, has notified the IT (Twenty Second Amendment) Rules, 2025, to amend the IT Rules, 1962. These amendments have been made in exercise of powers under Clause (2) of Section 17 read with Section 295 of the IT Act, 1961. Section 17(2) of the Act defines “perquisites” under the head “Salaries” and includes various benefits provided by an employer to an employee, such as rent-free accommodation, employer contributions to provident funds, and other non-cash benefits. Clause (2) of Section 17 empowers the government to prescribe monetary thresholds or conditions for determining the taxability of such perquisites. Section 295 authorises the CBDT to make rules for carrying out the provisions of the Act.

The amendment introduces two new rules—Rules 3C and 3D—after Rule 3B. Rule 3C prescribes that for the purposes of item (c) of sub-clause (iii) of Clause (2) of Section 17, the income under the head “Salaries” shall be INR 4 lakh. This relates to the valuation of certain perquisites, such as employer contributions to specified funds, which become taxable only if the employee’s salary exceeds the prescribed threshold. Rule 3D provides that for the purposes of Clause (vi) of the proviso to Clause (2) of Section 17, the prescribed gross total income shall be INR 8 lakh. This clause deals with exemptions from taxability of certain perquisites based on the employee’s total income.

This amendment provides clarity on monetary thresholds relevant for valuation of perquisites under Section 17(2) of the Act. By prescribing specific limits for salary income and gross total income, the rules aim to streamline compliance and ensure uniform application of tax provisions related to perquisites, particularly in cases involving employer contributions to retirement or welfare funds.

CBDT notifies the alignment of specified fund definition under Rule 21AIA

CBDT, *vide* Notification No. 136/2025⁵⁰ dated August 21, 2025, has notified the IT (Twenty-Fourth Amendment) Rules, 2025, to amend the IT Rules, 1962. These amendments have been made in exercise of powers under Section 295 of the IT Act, 1961, which empowers the CBDT to make rules for carrying out the purposes

⁴⁹ CBDT Notification No. 133/2025 dated August 18, 2025 [G.S.R. 555(E) / F. No. 370142/27/2025-TPL].

⁵⁰ CBDT Notification No. 136/2025 dated August 21, 2025 [G.S.R. 566(E) / F. No. 370142/29/2025-TPL].

of the Act. The amendment pertains to Rule 21AIA, which deals with the computation of exempt income for specified funds under Clause (4D) of Section 10 of the Act.

Section 10(4D) provides an exemption to income earned by specified funds from certain transactions carried out on a recognised stock exchange located in an International Financial Services Centre (**IFSC**). These transactions include those in securities (excluding shares of Indian companies), derivatives, and units of mutual funds located in IFSCs. The exemption is subject to conditions such as the fund being registered with SEBI as a Category I or II Alternative Investment Fund, located in an IFSC, and having 100 per cent non-resident unit holders (excluding sponsor or manager holdings).

The amendment omits sub-rule (4) of Rule 21AIA and substitutes the Explanation to the rule. The revised Explanation clarifies that the term “specified fund” shall have the same meaning as assigned to it in sub-clause (i) of Clause (c) of the Explanation to Section 10(4D). This ensures that the definition used in the rules is fully aligned with the statutory definition under the Act.

This amendment simplifies the interpretation and application of Rule 21AIA by directly linking the definition of “specified fund” to the IT Act, thereby reducing ambiguity and ensuring consistency in the treatment of exempt income for eligible funds operating in IFSCs.

CBDT notifies the clarification for IFSC insurance offices in Form 10CCF

CBDT, vide Notification No. 135/2025⁵¹ dated August 20, 2025, has notified the IT (Twenty-Third Amendment) Rules, 2025, to amend

the IT Rules, 1962. These amendments have been made in exercise of powers under Clause (i) of sub-section (3) of Section 80LA read with Section 295 of the IT Act, 1961. Section 80LA provides deductions to units located in International Financial Services Centres (**IFSCs**) for income earned from specified activities such as banking, insurance, and financial services. Sub-section (3) of Section 80LA empowers the CBDT to prescribe the form and manner in which such deductions are to be claimed.

The amendment modifies Form No. 10CCF in Appendix II, specifically in Annexure A, which is used by IFSC units to furnish details for claiming deduction under Section 80LA. The clarification inserted in serial number 6 of the form states that if a unit is an IFSC Insurance Office undertaking insurance business, the term “gross income” shall be interpreted as profit and gains calculated in accordance with Section 44 and the First Schedule of the IT Act. Section 44 deals with the computation of profits and gains of insurance business and mandates that such income be calculated as per the rules laid out in the First Schedule of the Act. Similarly, the note added in serial number 9 states that for IFSC Insurance Offices where profits are computed under Section 44 and the First Schedule, the field for gross eligible income may be submitted as Nil.

This amendment provides necessary clarification for IFSC Insurance Offices regarding the computation and reporting of income in Form 10CCF. It ensures consistency with the special provisions applicable to insurance businesses under the IT Act and facilitates accurate compliance for entities operating within IFSCs.

⁵¹ CBDT Notification No. 135/2025 dated August 20, 2025 [G.S.R. 564(E) / F. No. 370142/33/2025-TPL]

REGULATORY INDIRECT TAX UPDATES

Jurisdiction of Principal Bench for Specified GST Appeals

The Department of Revenue, *vide* its Notification No. S.O. 4219(E) dated September 17, 2025, has notified that appeals falling within certain specified classes of cases under the GST framework shall be heard exclusively by the Principal Bench of the GST Appellate Tribunal. The specified classes of cases to which this directive applies are as follows:

1. Cases that are pending before two or more State Benches and involve an identical question of law;
2. Cases that raise one or more issues falling within the scope of Section 14 or Section 14A of the IGST Act;
3. Cases that raise one or more issues falling within the scope of Section 20 of the CGST Act.

This notification shall apply uniformly across all States and Union Territories.

Amendment to IGST liability for electronic commerce operators from September 22, 2025

An electronic commerce operator is required to discharge liability towards IGST on inter-State supplies of services regarding specified service categories, which include passenger transportation services, accommodation services in commercial lodging establishments, housekeeping services, restaurant services, and local delivery services. The Department of Revenue, *vide* its Notification No. 14/2017-Integrated Tax (Rate) dated September 17, 2025, has amended the previous notification

issued under the IGST framework to incorporate “electronic commerce operators”. They shall now be liable to pay IGST on inter-State supplies of services by way of local delivery, except in cases where the person supplying such services through the electronic commerce operator is independently liable for registration under the applicable provisions governing GST registration. This amendment has been made following the GST Council’s recommendations and have come into effect from September 22, 2025.

Exemption from annual return filing under CGST Act for taxpayers with turnover up to INR 2 crore

The CBIC, *vide* its Notification No. 15/2025-Central Tax dated September 17, 2025, has granted an exemption to registered persons whose aggregate turnover in any financial year does not exceed INR 2 crore. They are no longer required to furnish the annual return for a given financial year. This exemption shall be effective from FY 2024–25 onwards and has been issued following the GST Council’s recommendations. The intent of this notification is to relieve eligible taxpayers from the statutory obligation to file the annual return under Section 44(1) of the CGST Act, provided their aggregate turnover remains within the specified threshold.

Implementation of tariff concessions under India-EFTA (Norway)

The Government of India, *vide* its Notification No. 42/2025 dated September 30, 2025, has granted exemptions on imports

originating from Norway with respect to the levy of basic customs duty, Agriculture Infrastructure and Development Cess, and Health Cess. These exemptions apply to the extent that the applicable amounts exceed the specified reduced rates prescribed for the listed tariff items. This measure operationalises the first tranche of tariff concessions agreed upon under the India–European Free Trade Association Agreement, specifically in relation to Norway. The notification includes a tabulated schedule outlining the applicable concessional rates of basic customs duty, AIDC, and Health Cess for each relevant tariff item. The benefit of such exemptions shall be available exclusively where the importer is able to satisfy the jurisdictional Deputy Commissioner or Assistant Commissioner of Customs that the goods in question originate in Norway, in accordance with the Rules of Origin regime stipulated under the said agreement. The provisions of this notification shall have come into effect from October 1, 2025.

Amendment to export policy for non-basmati rice under specified ITC (HS) codes

The export policy pertaining to non-basmati rice, as classified under the specified Indian Trade Classification (Harmonised System) codes, has been amended *vide* Notification No. 33/2025-26 dated September 24, 2025. Under the amended policy, despite the export of such non-basmati rice continuing to be categorised as “Free” within the meaning of the FTP, such exports shall be permitted solely upon the condition that the corresponding export contracts are duly registered with the Agricultural and Processed Food Products Export Development Authority. This amendment has been issued in exercise of the powers conferred by the Foreign Trade (Development & Regulation) Act, 1992, and is in accordance with the relevant provisions of the prevailing FTP. The revised policy shall come into force with immediate effect and shall be applicable to the tariff entries listed under Chapter 10, Schedule II of the ITC (HS) 2022 classification.

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AO	Learned Assessing Officer
AY	Assessment Year
CBDT	Central Board of Direct Taxes
CBIC	Central Board of Indirect Taxes
CCIT	Learned Chief Commissioner of Income Tax
CENVAT	Central Value Added Tax
CESTAT	Hon'ble Customs, Excise and Service Tax Appellate Tribunal
CGST	Central Goods and Service Tax
CGST Act	Central Goods and Service Tax Act, 2017
CGST Rules	Central Goods and Service Tax Rules, 2017
Customs Act	Customs Act, 1962
CT Act	Customs Tariff Act, 1975
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeal)
CVD	Countervailing Duty
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DDT	Dividend Distribution Tax
DTAA	Double Taxation Avoidance Agreement
EPCG	Export Promotion Capital Goods
ESOP	Employee Stock Options
FA	Finance Act
FAO	Faceless Assessment Officer
FMV	Fair Market Value
FTP	Foreign Trade Policy
FTS	Fees for technical services
FY	Financial Year
GAAR	General Anti-Avoidance Rules

GLOSSARY

ABBREVIATION	MEANING
GST	Goods and Services Tax
HC	Hon'ble High Court
HUF	Hindu Undivided Family
IBC	Insolvency and Bankruptcy Code, 2016
IGST	Integrated Goods and Services Tax
IGST Act	Integrated Goods and Services Tax Act, 2017
INR	Indian Rupees
IRA	Indian Revenue Authorities
IT Act	Income-tax Act, 1961
ITAT	Hon'ble Income Tax Appellate Tribunal
ITC	Input Tax Credit
ITO	Income Tax Officer
IT Rules	Income-tax Rules, 1962
Ltd.	Limited
LLC	Limited Liability Company
JAO	Jurisdictional Assessing Officer
MAT	Minimum Alternate Tax
NCLT	National Company Law Tribunal
NCLAT	National Company Law Appellate Tribunal
NCD	Non-convertible Debenture
NFAC	National Faceless Assessment Centre
OECD	Organisation for Economic Co-operation and Development
PAN	Permanent Account Number
PCIT	Learned Principal Commissioner of Income Tax
PCCIT	Learned Principal Chief Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
RBI	Reserve Bank of India
SAD	Special Additional Duty

GLOSSARY

ABBREVIATION	MEANING
SC	Hon'ble Supreme Court
SCN	Show-cause Notice
SEBI	Security Exchange Board of India
SEZ	Special Economic Zone
SGST Act	State Goods and Services Tax Act, 2017
SLP	Special Leave Petition
TDS	Tax Deducted at Source
US	United States
UTGST	Union Territory Goods and Services Tax
UTGST Act	Union Territory Goods and Services Tax Act, 2017
VAT	Value Added Tax

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