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tax scout

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Main Stories

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 December 31, 2025.

Our cover story discusses the jurisprudence of General Anti-Avoidance Rules in India and interplay of its invocation by the tax authorities in transactions that have received judicial approval in the context of recent allegations regarding impermissible avoidance arrangement in the national company law tribunal–approved business restructuring of Hinduja Global Solutions Limited.

This version of the 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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Navigating GAAR's Boundaries: Lessons from India's Anti-Avoidance Experience

Introduction

One of the prominent questions confronting both the IRA and the taxpayers is: where does legitimate "tax planning and tax avoidance" end and impermissible "tax evasion" begin? For decades, the distinction shaped by judicial precedents and specific anti-avoidance rules addressed identified historical problems such as transfer pricing or dividend stripping operating, largely in remedy. However, sophisticated taxpayers invariably devised functionally equivalent alternatives that complied with the letter of the law while simultaneously gaining tax benefits. After a long line of judgments attempting to draw broad boundaries on perceiving and evaluating such alternative structures at the litigation stage, the operationalisation of the General Anti-Avoidance Rules (**GAAR**) under Chapter X-A comprising Sections 95 to 102 read with Section 144BA of the IT Act and Rules 10U to 10 UF of the IT Rules, marked a paradigm shift, moving from a specific rule approach to a comprehensive, principles-based framework. GAAR, made effective from April 01, 2017, was operationalised from the AY 2018–19. It was designed as a "backstop" mechanism rather than a primary enforcement tool. GAAR empowers the IRA to lift the veil of any formal legal structure of an arrangement to evaluate its substance. The IRA's investigation is no longer restricted to whether a transaction is legal, but extends to whether its main purpose is to obtain a tax benefit, even when the transaction lacks commercial substance. This is a departure from the earlier form-over-substance doctrine to a substance-over-form doctrine.

In recent years, the GAAR framework has encountered various institutional challenges. A scenario has emerged where GAAR is being invoked against transactions that have already undergone rigorous scrutiny under parallel regulatory regimes, such as NCLT-sanctioned schemes of arrangement or SEBI-regulated delisting processes. This places taxpayers under an immense pressure, shifting onto them the burden of proof to demonstrate the commercial substance of their transactions. Taxpayers must now withstand GAAR's "main purpose" test read, along with additional tests prescribed under the IT Act. The evidentiary burden now extends to ensuring that the transaction's documentary footprint does not accidentally narrate the arrangement as tax first and business second.

As litigation begins to surface across multiple jurisdictions, a question arises as to whether the IRA is adequately equipped to wield this extremely advanced legislative power. Moreover, is the restraint envisioned by the expert committee on GAAR sufficient or has it been morphed from a targeted deterrent against egregious abuse into a generalised mechanism enabling the IRA to second guess and challenge all transactions that resulted in certain amounts of tax minimisation, notwithstanding whether they are genuine or cases of flagrant tax evasion?

Tracing the evolution of GAAR in India through judicial precedents

The introduction of statutory GAAR represents a legislative codification of the substance-over-form doctrine. Any related discussion in India necessitates an examination of the evolution of its foundational principles and the paradigmatic shift in judicial thinking from form-over-substance to substance-over-form through successive judicial pronouncements.

One of the earliest and most influential decisions that established the legal principle of form-over-substance doctrine in the tax-planning context was *Inland Revenue Commissioners v. Duke of Westminster*,[1] which originated from the House of Lords. In this case, the Duke of Westminster sought to reduce his tax liability by recharacterising the ongoing salaries paid to his numerous servants as annual payments in consideration for past services, thereby rendering them tax-deductible. Notably, no business purpose was cited for this arrangement. The House of Lords held that all taxpayers are entitled, if able, to order their affairs so as to reduce their tax liability, emphasising that there exists no moral obligation on the taxpayer to pay more tax than what is legally applicable. This principle came to be widely recognised as the *Westminster principle*.

In the contemporary context of GAAR, whilst this precedent continues to be referred and relied on by Indian courts, there is growing tension between the textual interpretation of GAAR provisions and taxpayers' legitimate expectations regarding the reliability and certainty of their tax and business arrangements. Given these, the precedential value of this judgment in the current GAAR landscape is slowly being questioned in the courts, as the IRA challenges its authority.

Conversely, the House of Lords in *W.T. Ramsay Ltd v. IRC*,[2] marked a significant departure from the *Westminster principle*. Ramsay Ltd had realised a chargeable gain from a sale-leaseback transaction and sought to offset the tax liability by purchasing two artificially engineered assets, devoid of any commercial purpose, which resulted in tax-exempt gains and significant loss, respectively. The House of Lords affirmed that while the *Westminster principle* retains significance, it cannot be invoked to legitimise transactions deliberately structured to evade tax liability.

In *CIT v. A. Raman & Co.,*[3] the SC reinforced the *Westminster principle* in the Indian context, affirming that commercial arrangements statutorily permissible and legal under the IT Act cannot be questioned merely on grounds of tax efficiency. In this case, the taxpayer, a dealer in mill stores, sold goods to two concerns owned by Hindu Undivided Families (**HUFs**) whose managers were also its partners. The IRA alleged that this was a tax-evasion device to divert profits to the HUFs, but the taxpayer had filed full and correct returns disclosing all material facts, and no evidence was produced to establish the allegation. The Court held that a taxpayer may resort to a device to divert income before it accrues or arises, and the effectiveness of such a device depends on the operation of the Act, not morality.

This pronouncement directly aligned with the *Westminster principle* and gradually became the established norm in Indian tax jurisprudence. Consequently, any deviation by courts to examine the substance of transactions over their legal form became the exception rather than the rule, reinforcing the taxpayer's freedom to structure affairs within the letter of the law.

The SC subsequently delivered a landmark judgement in *McDowell & Co. Ltd. v. CIT*,[4] which sparked considerable debate surrounding the permissible boundaries of tax avoidance. In this case, McDowell & Co., a licensed liquor manufacturer, sold liquor to buyers who directly discharged excise duty to the excise authorities. Subsequently, the buyers presented passes to McDowell & Co., which then issued sale invoices excluding the excise duty component. McDowell & Co. remitted sales tax solely on the liquor price reflected in its invoices. The Commercial Tax Officer reopened such assessments on the premise that excise duty though discharged by buyers constituted the manufacturer's legal liability and formed part of its taxable turnover.

The majority opinion affirmed that tax planning may be legitimate when conducted within the framework of law, but emphasised that colourable devices cannot constitute legitimate tax planning and that tax avoidance through dubious methods should not be countenanced as honourable conduct.

It was, however, Justice Chinnappa Reddy's concurring opinion that garnered wider attention and interpretation in subsequent cases. After reviewing a series of English precedents, Justice Reddy noted that courts abandoned the *Westminster principle* in the United Kingdom, the place of its origin, with judicial sentiment having shifted from tolerance to disapproval. He recommended Indian courts to similarly depart from the *Westminster principle* and adopt a reimagined approach to interpretation that examines not just the technically validity or genuineness of a transaction but whether it amounts to a tax avoidance device worthy of judicial approval.

1 Inland Revenue Commissioners v Duke of Westminster [1936] AC 1 (House of Lords).
2 W.T. Ramsay Ltd. V. IRC [1982] AC 300 (House of Lords).
3 CIT v. A. Raman & Co., [1968] 67 ITR 11 (SC).
4 Mc Dowell & Co. Ltd., v. CIT [1985] 22 Taxman 11 (SC).

Subsequently, the SC's judgment in *Union of India v. Azadi Bachao Andolan*[5] addressed the systematic routing of inbound capital through Mauritius-based entities leveraging favourable capital gains provisions within the India–Mauritius DTAA. The CBDT initially acknowledged these structures as legally compliant, clarifying that capital gains on share sales by Mauritius residents were taxable only in Mauritius. The IRA challenged this using the substance-over-form doctrine, and the Delhi HC quashed the CBDT circular, holding treaty shopping and routing investments through tax havens as illegal. The SC, however, upheld the *Westminster principle*, clarifying that Justice Reddy's opinion in McDowell was merely concurring and reaffirming that tax planning is legitimate unless it involves colourable devices or sham transactions.

Azadi Bachao Andolan represented a classic formalist method of interpretation, where the courts are constrained from inquiring into taxpayer intentions without express statutory authority. McDowell embodied substance-oriented approach in which the courts possessed equitable powers to question arrangements that appeared contrived. These competing judgments, arriving at two different conclusions, resulted in a confusion.

The judgment in *Vodafone International Holdings BV v. Union of India*[6] sought to reconcile these seemingly divergent approaches. A Dutch company had transferred shares in an Indian company through a structured arrangement that, while compliant in form with statutory provisions and the India–Mauritius DTAA, was characterised by the IRA as lacking economic substance. The Court held that commercial purpose, participation in investment, duration of holding, generation of taxable revenues, and timing of exit, all evidenced genuine business intent, not a colourable device.

The *McDowell* majority opinion and Justice Reddy's concurring opinion diverged on the scope of judicial authority to examine substance behind form. This divergence had been substantially contained by *Azadi Bachao Andolan's* insistence upon statutory language as the determinative guide. In *Vodafone BV Holdings*, the confusions arising from interpretation of *McDowell* was reconciled by observing that Justice Reddy's repeated references to "schemes and devices" distinguished legitimate avoidance from impermissible manipulation, with the substance-over-form doctrine applying only to transactions manifesting extreme artificiality.

To counter SC's *Vodafone* decision, the then Government and the Parliament responded by making extensive retrospective amendments to the IT Act through the Finance Act, 2012, making such transactions taxable in India. It also capitalised on this opportunity to introduce GAAR to the Indian statutory lexicon under the IT Act. However, this retrospective amendment and the introduction of statutory GAAR provisions led to significant consternation among taxpayers across the world, forcing the Government to set up an expert committee on both retrospective taxation and GAAR, headed by reputed economist Dr. Parthasarathi Shome (**Shome Committee**).

The Shome Committee provided comprehensive guidance on GAAR's design and implementation, recommending an

5 Union of India v. Azadi Bachao Andolan [2003] 132 Taxmann 373 (SC).
6 Vodafone International Holdings BV v. Union of India [2011] 198 Taxman 418 (SC).

"overarching principle" that GAAR is applicable only to abusive, contrived, and artificial arrangements. The committee also suggested introducing a negative list keeping the timing of transactions and court-approved amalgamations and demergers outside the purview of GAAR.[7] Thereafter, the CBDT issued its clarifications and guidelines through a circular specifically addressing the interplay between GAAR, Specific Anti Avoidance Rules, and the application of GAAR to court-approved arrangements where tax implications had already been considered during such approval proceedings.

What is GAAR

The statutory framework of GAAR is contained in Chapter X-A of the IT Act comprising Sections 95–102.

Section 95 provides that, notwithstanding anything mentioned elsewhere, the IRA may disregard any arrangement that satisfies the threshold criteria for GAAR invocation under Rule 10U of the IT Rules. This inverts the burden of proof on the taxpayer to demonstrate the substance of the transaction overall rather than show a non-violation of any specific provision under the IT Act. Further, the definition of "arrangement" under Section 102 encompasses any step in, or a part or whole of, any transaction, scheme, or agreement and includes the alienation of any property pursuant to such transaction. This allows the IRA to isolate individual transactional steps within larger reorganisations and challenge those steps independently without disregarding the entire arrangement.

Section 96 of the IT Act establishes a two-part test to determine impermissible avoidance arrangements (**IAAs**) or artificial arrangements: (1) the arrangement's main purpose must be to obtain a tax benefit; and (2) the arrangement must satisfy at least one of the tainted elements tests. The tainted elements test comprises (a) creation of rights or obligations not ordinarily created between arm's length parties; (b) misuse or abuse of provisions of the IT Act; (c) lack of commercial substance; or (d) employment of means or manner not ordinarily employed for *bona fide* purposes. Section 97 further elaborates scenarios wherein an arrangement is deemed to lack commercial substance. These scenarios include arrangements involving round-trip financing, accommodating parties, elements that offset or cancel one another, or disguised value or fund flows.

The statutory framework attempts to provide predictability and broad boundaries, yet the inherent generality in concepts such as "misuse or abuse" and "*bona fide* purposes" ensures that substantial discretion persists with the administration as well as the judiciary.

Once the impermissibility of an arrangement is established, the IRA are allowed to disregard, combine, recharacterize, or reallocate the transactional components. This authority extends beyond simply denying tax benefits and allows rewriting the nature of the corporate structure true to its determined form and realigning the tax positions of the arrangement parties.

The procedural framework for the invocation of GAAR mandates a multi-tiered referral and approval process, which acts as a constraining factor against any unilateral administrative action. The officer may refer a suspicious IAA to a superior, who must provide the taxpayer a reasonable opportunity of being heard and then independently review the materials to assess whether the dominant purpose of the alleged transaction was to obtain tax benefits. If the superior is not convinced, the matter may die its natural death. However, if convinced about the impermissibility of the transaction, the superior may recommend the matter to the Approving Panel to seek their approval.

The Approving Panel must first comprehensively evaluate all material, including any evidence submitted by the taxpayer, to determine whether the proposed arrangement constitutes an IAA. Once declared impermissible, the matter is returned to the AO for determination of the consequences. Notably, the IT Act provides no appeal mechanism against the Approving Panel's direction, which has left taxpayers at this stage of the proceeding seeking writ remedies before their respective HCs. These guidelines and the procedural framework establish that GAAR cannot be ordinarily invoked and prescribes a high degree of restraint upon the IRA's discretionary power.

Despite eight years into GAAR's effective operation, considerable uncertainty is visible in its administrative invocation. The Shome Committee's final report characterised GAAR as an "extremely advanced instrument" of deterrence, requiring intensive training, disciplined show-cause reasoning, and calibrated selection of cases.[8] Early litigation now surfacing reflects exactly why GAAR can either be overused as a default lens of suspicion or misused as a revenue-generating tool, and recent court battles reveal both tendencies.

Recent Cases of Invocation of GAAR in India

Litigation around GAAR is still at a nascent stage, with courts still determining whether it should be treated as a procedural

[7] Final Report on General Anti-Avoidance Rules (GAAR) in Income Tax Act, 1961, Expert Committee (2012), at Pg.6.
[8] Final Report on General Anti-Avoidance Rules (GAAR) in Income Tax Act, 1961, Expert Committee (2012), at Pg.39.

machinery allowed to ordinarily run its course when the IRA alleges an abusive arrangement, or as an exceptional power that can be invoked only on disciplined, arrangement-specific evidence.

In an early application of GAAR provisions, the *Telangana HC in Ayodhya Rami Reddy Alla v. PCIT*[9] examined an arrangement involving multiple transactional steps and related entities. In this case, the Assessee had acquired shares in a particular company, which subsequently issued bonus shares in a specified ratio, mechanically depreciating the per share valuation. The Assessee then liquidated these shares with depreciated values within the same financial year, generating substantial short-term capital losses. These losses were then deployed to offset long-term capital gains derived from transactions involving unrelated entities, resulting in material reduction in overall taxable income for that particular assessment year.

When the IRA invoked GAAR through the standard procedural framework, the Assessee advanced arguments suggesting that particular statutory provisions governing securities transactions already addressed bonus stripping phenomena in specific contexts under Section 94 of the IT Act and that this specificity implicitly precluded GAAR's application. The contentions proceeded from a general interpretive principle that legislative specification in one domain operates as implicit exclusion from more general provisions.

The Telangana HC's response proved significant for GAAR jurisprudence. The Court rejected the specificity argument, holding that anti-avoidance rules addressing narrowly defined schemes do not foreclose GAAR's operation in functionally equivalent arrangements falling outside the specific rule's technical scope. The Court further emphasised that the governing inquiry under GAAR involves examination of the arrangement's predominant purpose and manifest characteristics of artificial design, if any, and not categorical classification under statutory provisions. Where courts identify that an arrangement manifests multiple indicators of artificiality, such as inter-company financing facilitating fund rotation, related-party participation lacking independent economic function, temporal sequencing that bear no relationship to ordinary commercial purpose, they are empowered to disregard formal statutory characterisation and examine whether the arrangement constitutes an IAA under GAAR.

This judgment underscored that to be legitimate, tax planning must proceed within the framework of law and reflect a degree

of commercial utility and business rationale extending well beyond mere tax minimisation.

While this decision created a certain amount of uncertainty and ambiguity in the minds of taxpayers, in striking contrast, the Telangana HC's subsequent determination in *Smt. Anvida Bandi v. DCIT*[10] provided a different judicial position and introduced a critical limiting principle regarding GAAR invocation. An individual investor with demonstrated history of continuous securities trading had purchased shares of a major technology company through regulated stock exchange transactions, subsequently selling those shares within the same financial year at losses. These losses were offset against concurrent long-term gains from separate transactions, reducing overall taxable income.

The AO perceived this transaction sequence as constituting an IAA, the argument proceeding from the observation that the arrangement of the purchase and sale transactions within a narrow and suspicious time window, coupled with their specific sequencing relative to the accrual of long-term gains, evidenced an intent to generate artificial losses for tax offset purposes. The matter was referred to the GAAR Approving Panel, which upheld the invocation, grounding its finding principally upon the timing of the transactions and the proximate relationship between purchase and sale.

The HC's reversed this determination, affirming that while the IRA's authority may invoke GAAR in appropriate circumstances, timing of the transactions alone could not and should not sustain GAAR invocation in the absence of material establishing an IAA that satisfies the statutory criteria of Section 96.

[9] Ayodhya Rami Reddy Alla v. PCIT [2024] 163 taxmann.com 227 (Telangana)
[10] Smt. Anvida Bandi v. DCIT [2025] 177 taxmann.com 726 (Telangana).

The Court further referred to the Shome Committee Report on GAAR, which explicitly stipulates that stock market transactions do not ordinarily fall within GAAR's purview. It emphasised inclusion of timing within the expression "factors not relevant for determining commercial substance" under Section 97(4) as the legislative intent that neither the period of duration nor the sequencing of transactions can serve as the basis for evaluating commercial substance in the absence of other cogent material.

The distinction between *Ayodhya Rami Reddy* and *Anvida Bandi* shows GAAR's jurisprudential trajectory. Both cases involved securities transactions generating tax losses through temporal alignment with other gains. They presented *prima facie* timing patterns appearing suspicious from the IRA perspective. The distinction is that *Ayodhya Rami Reddy* involved coordinated multi-entity manoeuvring, related-party participation, and deliberate creation of artificial pricing mechanics. *Anvida Bandi* involved unilateral trading decisions by investor through regulated market infrastructure, lacking any evidence of artificial orchestration. The principle that emerges suggests GAAR targets arrangements demonstrating evidence of coordinated design rather than unilateral transactional decisions, regardless of how suspicious timing patterns may appear retrospectively.

The matter of corporate restructuring has emerged as particularly contentious terrain for GAAR invocation, especially where transactions have obtained regulatory sanctions. *The Hinduja Global Solutions v. PCIT*[11] dispute exemplifies institutional tensions that remain substantially unresolved till date even as further developments are expected to unfold shortly.

Hinduja Global Solutions Ltd. (**HGS**), an entity engaged in the business of information technology–enabled business services, had undertaken comprehensive restructuring involving divestment of 100 per cent of its worldwide healthcare business process outsourcing services along with certain assets, contracts and employees for USD 1,200 million to wholly owned subsidiaries of Betadine BV.[12] This NCLT approved the divestment in January 2022, which generated substantial capital gains for AY 2023–24. Immediately thereafter, under a scheme of arrangement, HGS acquired the digital media and communications undertaking of NxtDigital Limited, a related party, citing the rationale of this arrangement as the consolidation of similar businesses into one single entity to achieve operational synergies. The NCLT approved this in November 2022, effective from February 01, 2022. Notably, NxTDigital Limited's digital undertaking carried significant unabsorbed losses and accumulated depreciation, which were set off against HGS's capital gains.

The IRA viewed the restructuring as a composite scheme rather than isolated transactions, characterising it as purposeful orchestration to facilitate loss utilisation against recently generated gains. The IRA based such allegations on the grounds that NxTDigital's continuously incurring losses and HGS's profitability implied such an arrangement could be not achieve synergies. The IRA's survey operations also identified email records and internal business communications between parties, suggesting obtaining tax benefits as the primary objective of the subsequent arrangement. The IRA also emphasised the time proximity between the realisation of such gains and the implementation of subsequent restructuring. The Approving Panel upheld the IRA's invocation of GAAR.

Subsequently, HGS sought a writ remedy before the Bombay HC to quash the Approving Panel's the order, contending that at the time of approval of the arrangement by NCLT, the IRA raised no objection despite being sent requisite notices. Additionally, the argument was centred around the *ultra vires* of invocation of GAAR, given the provisions of Section 72A, which allowed the transfer of accumulated loss and unabsorbed depreciation of NxTDigital. Upon *prima facie* consideration of the facts of the case, the Bombay HC granted interim stay on the operation and implementation of the impugned GAAR panel order. This raises the question: when the NCLT approval process involved comprehensive disclosures, valuation exercises, and stakeholder participation, can GAAR be invoked *ex post* facto? Permitting such GAAR invocation effectively bifurcates the review of corporate restructuring. In one regime, NCLT examines substance within a specialised regulatory framework, while at a later stage the IRA re-examines the same transaction through an anti-avoidance prism. This raises foundational questions about whether GAAR should extend to transactions already evaluated by specialised forums, especially when such an intervention attempts to unwind implemented arrangements.

Judicially sanctioned arrangements typically evidence that independent authorities such as NCLT have evaluated the commercial substance within statutory frameworks governing corporate reorganisations. Subsequent invocation of GAAR against such arrangements signals that prior judicial evaluation carries limited weight against re-determination for the purposes of tax. While GAAR addresses tax avoidance in a separate domain and the IRA is empowered to carry out a

[11] The Hinduja Global Solutions v. PCIT, Writ Petition No. 4867 of 2025 (Bombay HC).
[12] Hinduja Global Solutions Limited Annual Report for the FY 2021-22.

retrospective evaluation, separate determinations of the same commercial substance by distinct authorities examining overlapping documentary records raise coordination challenges between parallel governance regimes, as there is no established hierarchy between the machineries.

Conclusion

The first decade of GAAR's operation has exposed a regime testing the limits of its own framework. The debate is between balancing the IRA's interest in protecting the tax base with taxpayers' need for legal certainty in rational business planning. GAAR was conceived to address the inability to apply specific and targeted anti-avoidance rules to sophisticated-enough, complex, multi-entity arrangements that lack commercial substance. It can meet this legislative purpose only if administered with restraint, careful consideration, and respect for defined boundaries.

The Shome Committee's recommendations continue to remain the cornerstone of invoking GAAR, providing an indicative rulebook for the IRA. The committee's "negative list" highlighted that GAAR should not be invoked against court-sanctioned amalgamations and demergers, as this could lead to the discretion given to the IRA to nullify the finality of judicial orders and compromise transactional certainty. This could also be extended to capital-markets processes, where schemes and arrangements are vetted through NCLT and SEBI. Such arrangements should not be an ideal case for the invocation of GAAR provisions, unless artificiality is clearly demonstrated. Enforcement trends, however, show drift. The HGS demerger illustrates invocations even where commercial substance has been scrutinised through formal regulatory authorities, raising a moot question. Does administrative determination of the impermissibility of an already sanctioned arrangement necessitate concrete, arrangement-specific proof instead of general evidence?

Against this administrative backdrop, the Telangana HC has articulated two different judgments within one year. They largely reflect consistency in the underlying principles when viewed through their fact matrix rather than the perceived inconsistency in their outcome. In *Ayodhya Rami Reddy*, the HC addressed private orchestrated transactions among related entities where bonus share issuances were engineered to obtain tax benefits devoid of any commercial rationale. GAAR's role in neutralising such deliberate arrangement of affairs exploiting statutory provisions was upheld. Conversely, in *Anvida Bandi*, the HC examined an investor's routine portfolio activities carried out through institutions in wide public knowledge. Administrative discretion in invoking GAAR was constrained by the need for concrete evidence beyond mere suspicions. The courts continue to recognise the statutory prerogative available to taxpayers to structure transactions efficiently and GAAR as a tool to catch contrived arrangements rather than routine commercial optimisation.

The institutional prerequisites emphasised by the Shome Committee, such as specialised expertise, functional independence, and clarity regarding application, remain valid till date. Invocations based on timing and sequencing persist despite statutory signals that such factors are insufficient on a standalone basis. Reliance on subjective materials including personnel statements or internal communications in lieu of objective, arrangement-specific evidence dilutes evidentiary rigor. As matters continue through multiple HCs, including the Bombay and Delhi benches, and edge towards SC scrutiny, temporary doubts remain on how the judiciary shall deal with GAAR scenarios.

Courts must enforce stringent evidentiary standards and resist interchanging efficiency with avoidance and treat GAAR as an exceptional, last-resort remedy for egregious abuse, not a default lens for reviewing beneficial transactions. Equally, the system needs binding guidance that specifies the precise circumstances, evidentiary sufficiency, and documentation protocols that trigger GAAR scrutiny. Without this, the current pattern will persist where there is aggressive invocation, sceptical judicial response, and protracted litigation shakes legitimate planning structures while denting GAAR's anti-avoidance effectiveness.

Ultimately, the GAAR provisions should target contrived devices that strip the tax base while preserving space for *bona fide* structuring aligned with commercial substance and lawful efficiency. Until application boundaries are set through rigorous jurisprudence and disciplined administration, the line between "planning" and "avoidance" will continue to remain blurred and a matter of the sensitivities of the IRA. For practitioners, the practical implication is straightforward: restructuring transaction should involve designing and documenting transactions with demonstrable commercial substance, maintaining contemporaneous records evidencing objectives of a particular arrangement beyond tax benefits, and recognising and knowing that court-sanctioned routes are not absolute safe harbours. GAAR's promise is considerable, but its proper use must be justified robustly and administered predictably.

CASE LAW UPDATES - DIRECT TAX

INTERNATIONAL TAX

Absent specific DTAA provision, "virtual presence" / "virtual PE" cannot be read into PE provisions

Introduction

In a significant ruling on the concept of service PE and the emerging notion of virtual service PE, the Delhi ITAT in Clifford Chance,[13] held that non-resident providing legal advisory services to Indian clients, did not constitute a service PE in India as services were furnished for only 44 days in India after excluding vacation period, business development days, and common days, which was significantly below the 90-day threshold prescribed under Article 5(6)(a) of the India–Singapore DTAA. The ITAT further held that a virtual service PE cannot be constituted in India, as the DTAA contains no provision for such an establishment, and physical rendition of services in India is a prerequisite for creating a service PE in the other contracting state.

Facts

Clifford Chance Pte. Ltd. (**Assessee**), a tax resident of Singapore engaged in providing legal advisory services to several international clients in India, had filed its return of income in India. The Assessee's case was selected for scrutiny and a notice served, asking it to show cause why receipts from Indian clients in AY 2020–21 and 2021–22 should not be taxed on account of creation of service PE in India.

The AO did not accept the Assessee's submissions, proposing additions for the respective AYs in the draft assessment order. Aggrieved, the Assessee filed objections before the DRP, which directed the AO to reconsider the facts/information and material placed on record by the Assessee before passing the final assessment order. However, AO's final order held that the Assessee constituted service PE based on physical presence of employees in India and also virtual service PE as per Article 5(6) of the India–Singapore DTAA.

Aggrieved, the Assessee preferred an appeal to the Delhi ITAT.

Issue

Whether the Assessee constituted service PE in India under the India-Singapore DTAA?

Whether the concept of virtual service PE is recognised under the India–Singapore DTAA and whether services rendered remotely from Singapore can constitute a service PE in India?

Arguments

The IRA alleged that service PE was constituted in India since the Assessee's employees spent more than 90 days in India, the threshold prescribed in the India–Singapore DTAA for service PE creation in India. The IRA contended that the DTAA does not mandate that the employees providing services within India be stationed in India, therefore, services provided virtually from outside India should also be considered for the constitution of a service PE in India.

[13] Clifford Chance PTE Ltd. v. ACIT, [TS-160-ITAT-2024(Delhi)].

The Assessee submitted that it had no fixed base or office in India to constitute a fixed-place PE. For AY 2021–22, no employee visited India. During AY 2020–21, its employees' aggregate stay in India was 44 days, which was significantly less than the 90-day threshold. It further submitted that although two of its employees who travelled to India were physically present in India for 120 days, they devoted only 44 days for rendering legal advisory services, which would be relevant for computation of number of days for a service PE. Of the 120 days, the employees were on leave/vacation for 36 days.

Furnishing time sheets of the employees, leave records, and declarations from the employees that they did not work for the period of their vacation in India, the Assessee argued the period of 36 days should be excluded from the computation for threshold. It also submitted that these employees engaged in business development activities for 35 days. Since these activities did not involve any element of service and were non-revenue generating, such as customers identification, technical presentation/providing information to prospective customers, market development opportunities, fee estimates preparation for customers, etc., such days should also be excluded from the computation of threshold limit.

This also included 5 (five) common days in which both the employees were present in India, which had to be excluded. Thus, excluding the periods of 36 days, 35 days, and 5 days from the total period of 120 days, the Assessee had physical presence in India for only 44 days.

In relation to the grounds of constituting virtual PE, the Assessee submitted that Article 5(6) of the India–Singapore DTAA, furnishing of services within the source state means actual performance of services in the source state and, therefore, when services are furnished by the employees in India during the financial year, it shall be taken into consideration for computing the service PE threshold. The provisions of the DTAA do not contemplate inclusion of days where services have been furnished remotely from outside India. Hence, service PE will not be constituted through virtual furnishing of services.

Decision

The Delhi ITAT allowed the Assessee's appeal and held that it did not constitute a service PE in India. It held that three conditions need to be cumulatively satisfied for the of a service PE in India: (i) employees or the other personnel of the foreign entity should be present in India; (ii) there should be furnishing of services within a India through employees or other personnel; and (iii) furnishing of services should continue for a period exceeding 90 days in a fiscal year. Hence, it endorsed the Assessee's computation of 44 days and held that the Assessee's employees in India did not satisfy the 90-day threshold in the relevant AY for constituting a service PE in India.

The ITAT held that under the India–Singapore DTAA, actual performance of service in India is essential to constitute a service PE in India. Accordingly, only the services rendered in India with their physical presence shall be considered for computing the days for the threshold limit prescribed. It emphasised the term "within a Contracting State" to mean within the territorial boundaries of that country. Consequently, ITAT rejected the concept of a virtual service PE by holding that such a PE was not contemplated in the DTAA.

Significant Takeaways

This decision is among the first by an ITAT to conclusively hold that physical presence is an essential criterion for the constitution of a service PE under the standard service PE clauses provided in the DTAAs entered into by India. Although rendering of virtual services has become very common in a digital economy, the language of service PE in the DTAA has not been amended to include virtual presence to constitute a service PE. This case also observes that unless any amendments are made to the DTAAs, the concept of a virtual PE cannot be read into the existing DTAAs.

This is also in consonance with the understanding laid down in the OECD Interim Report 2018, which clearly mentions that in the absence of any amendments to the tax treaties, there cannot be a virtual service PE.

> **"To constitute a service PE, actual performance of service within India with physical presence is essential to be considered for the computation of the threshold limit."**

Operational and general administrative expenditure incurred exclusively for Indian branches are deductible only to the extent of statutory ceiling

Introduction

The SC, in ***American Express Bank Ltd.*,**[14] held that Section 44C of the IT Act applies to "head office expenditure" irrespective of whether such expenditure is common or incurred exclusively by the Indian branches. The plain language of Section 44C, when viewed against the backdrop of the specific mischief it sought to curtail, is unambiguous and the statutory definition contains no indication that "exclusive expenditure" has to be excluded from permissible deduction.

Facts

M/s American Express Bank (**Assessee**), a non-resident banking company engaged in providing banking-related services, filed its income tax return for AY 1997–98, by claiming the deductions for solicitation of deposits from non-resident Indians and expenditures incurred at the head office directly in relation to its Indian branches.

The IRA rejected the Assessee's claim and restricted the deduction by invoking Section 44C, noting that it is a non-obstante provision and was introduced to address difficulties in scrutinising books maintained outside India.

On appeal, the ITAT allowed the Assessee's claim, relying on the Bombay HC's ruling in ***Emirates Commercial Bank Ltd.*,**[15] holding that exclusive expenses incurred by the head office for Indian branches should be allowed under Section 37(1), without being clubbed with shared head office expenses under Section 44C. Further, the Bombay HC dismissed the IRA's appeal, as its counsel conceded that the issue had already been decided against the IRA in Emirates Commercial Bank.

Aggrieved by these orders, the IRA re-appealed before the SC, leading to the present judgment.

Issue

Whether expenditure incurred by the head office of a non-resident assessee exclusively for its Indian branches fall within the scope of Section 44C of the IT Act, thereby restricting the allowable deduction?

Arguments

The IRA contended that Section 44C of the IT Act applies when two conditions are satisfied: (i) the Assessee is a non-resident and (ii) the deduction claimed pertains to "head office expenditure." The allowable deduction is strictly limited to the lower of (a) a fixed cap of 5 per cent of the "adjusted total income" or (b) the actual expenditure attributable to the Indian business, thereby imposing an absolute ceiling on such claims.

The IRA further argued that the legislative intent behind Section 44C was to address the mischief of foreign companies reducing their Indian tax liability by inflating claims for head office administrative expenses, which were difficult for Indian authorities to verify. Therefore, the Section 44C substitutes subjective, case-by-case scrutiny with an objective statutory ceiling to prevent inflated deductions.

It was further submitted that Section 44C begins with a *non obstante* clause, granting it overriding effect over Sections 28 to 43A, including Section 37. Once an expense qualifies as "head office expenditure" under the Explanation, it must be governed exclusively by Section 44C. The Assessee's interpretation, according to the IRA, contradicts the plain statutory language, which provides a broad and inclusive definition of "head office expenditure." Even if the expenses were incurred exclusively for the Indian branch, they remain subject to the ceiling under clause (a), and accepting the Assessee's view would revive the mischief Section 44C of the IT Act was designed to eliminate.

Conversely, the Assessee argued that under Section 37(1), any expenditure wholly and exclusively for business purposes is deductible, without any requirement that it be incurred in India, and this position is reinforced by the DTAA. It was further contended that Section 44C applies only to "common" expenditure, where a portion is attributable to Indian operations, and distinguished this from "exclusive" expenditure incurred solely for Indian business.

The Assessee further asserted that the IRA's interpretation, that any expenditure incurred outside India by the head office automatically qualifies under Section 44C of the IT Act, is inconsistent with the statutory language and legislative intent, which was aimed at proportionate allocation of head office expenses, not exclusive expenditure.

[14] DIT v. American Express Bank Limited (Civil Appeal No. 8291 of 2015 & 4451 of 2016)
[15] CIT v. Emirates Commercial Bank Ltd., (2003) 262 ITR 55 (Bom.)

Decision

On review of the statutory provisions and judicial precedents, the SC held that Clause (c) of Section 44C of the IT Act employs the phrase *"head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India,"* without creating any exception for expenses incurred exclusively for Indian branches. The SC observed that "attributability" is a broader concept, of which "exclusivity" is merely a subset; therefore, in the absence of contrary legislative intent, exclusive expenditure must necessarily be treated as attributable expenditure.

The SC further clarified that, in the context of income tax laws, the expression "attributable to" has a wider import than "derived from" and thus, includes both common and exclusive expenditure. It held that if Parliament intended to restrict Clause (c) only to common or shared expenses, it would have used explicit language to that effect.

In examining the Memorandum to the Finance Bill, 1976, and CBDT Circular No. 202 dated July 5, 1976, the SC concluded that the term "proportion" was used solely to describe the quantum of expenditure attributable to Indian branches out of the total head office expenditure, and not to exclude exclusive expenses. The reference was intended to address the mischief of foreign entities arbitrarily inflating the proportion of head office expenses allocated to India, whether common or exclusive.

Accordingly, the SC held that the view expressed by the Bombay HC in the case of Emirates Commercial Bank does not correctly state the law. It reiterated that, for an expenditure to qualify as "head office expenditure" under the Explanation to Section 44C of the IT Act, it must satisfy the tripartite test: (i) incurred outside India, (ii) in the nature of executive and general administration, and (iii) falling within the specific categories enumerated in Clauses (a), (b), and (c), or prescribed under Clause (d).

As the lower authorities had not adequately examined whether the disputed expenditure meets these criteria, the SC remanded the matter to the ITAT, for the limited purpose of verifying compliance with the statutory definition of "head office expenditure."

Significant Takeaways

The SC reaffirmed that the Section 44C of the IT Act constitutes a special provision governing the quantum of permissible deductions for expenditure incurred by a non-resident Assessee under the category of "head office expenditure." Therefore, the applicability of this provision is contingent upon two conditions: (i) the Assessee must be a non-resident and (ii) the expenditure must strictly conform to the definition as provided in the provisions of the IT Act. Such definition requires that the expenditure satisfy any of the following conditions: (a) it must be incurred outside India; (b) it must pertain to executive and general administration; and (c) it must fall within the specific types as provided under the statutory provisions.

Therefore, the SC further clarified that the statutory language does not differentiate between "common" and "exclusive" head office expenditure; both categories are subject to the ceiling limits prescribed under Section 44C of the IT Act once the definitional criteria is satisfied.

"Section 44C covers head office expenses for Indian branches, whether they arepart of common global costs or specifically incurred for India."

Bombay HC reverses AAR Ruling: DDT subject to DTAA rate limitation

Introduction

The Bombay HC in ***Colorcon Asia Pvt. Ltd.,***[16] has reversed the ruling of the Board for Advanced Rulings (**BFAR**) on the contentious issue of Dividend Distribution Tax (**DDT**) and applied the DTAA beneficial tax rate for the taxation of dividends. The HC held that the rate of DDT will be restricted to the extent of rate of dividend income as prescribed in the applicable DTAA.

Facts

Colorcon Limited, United Kingdom (**Colorcon UK**), a company incorporated in the United Kingdom (**UK**), has a wholly owned subsidiary in India, Colorcon Asia Pvt. Ltd (**Assessee**). For AYs 2016–17, 2017–18, and 2018–19, the Assessee paid dividend to Colorcon UK and also paid DDT thereon at the rate specified under Section 115-O of the IT Act. The Assessee also paid interim dividend for AY 2019–20 and paid applicable DDT. The effective rate of DDT paid ranged from 20.36 per cent to 20.56 per cent on dividends declared, which was substantially higher than the rate of 10 per cent provided in the India–UK DTAA.

Hence, the Assessee filed an application under Section 245Q of the IT Act seeking an advance ruling from the BFAR on whether the tax rate on dividends distributed can be applied at the rate of 10 per cent as provided under Article 11 (Dividends) of the India–UK DTAA. If the answer was in affirmative, the Assessee further sought a ruling on whether the tax rate of 10 per cent can be further grossed up to compute the tax liability on dividends paid.

The BFAR passed the impugned ruling answering that the DDT paid by the Assessee to its shareholder fell squarely outside the scope of the DTAA. It also ruled that DDT did not fall within "Taxes covered" under Article 2 of the India–UK DTAA and that the Assessee's contention to restrict the tax rate of DDT to the extent of withholding tax rate on dividend income under Article 11 of the DTAA had no merit.

Aggrieved, the Assessee preferred an appeal to the Bombay HC.

Issue

Whether DDT paid by the Assessee to its UK-based shareholder will be governed by provisions of the India-UK DTAA or DDT prescribed under Section 115-O of the IT Act?

Arguments

The Assessee presented the legislative history of taxation of dividends in India and submitted that Section 115-O merely shifted the incidence of collection of tax on dividend from shareholders to the dividend declaring company, for administrative convenience. However, since the substantial provision remained unchanged. Hence, DDT was only a tax levied on the income of a shareholder from a dividend-declaring company. Being an "Additional tax", DDT was covered by the definition of "tax" as defined in Section 2(43) of the IT Act, which fell within the ambit of the charging provision of Section 4, which was also covered under the provisions of Section 90. Therefore, as DDT was a tax under the provisions of the IT Act, it was subject to any beneficial rate of tax that may be provided in a DTAA pursuant to Section 90.

The Assessee submitted that it fulfilled all four elements under Article 11 of the India–UK DTAA to trigger its application viz: (i) the payment must be the dividend as defined under Article 11(3); (ii) such dividend shall be by the resident of another State; (iii) such dividend shall be paid to a resident of other State; and (iv) such dividend, if beneficially owned by the resident of other State (UK) the rate of tax in accordance with Article 11(2)(b) cannot exceed 10 per cent. It argued that DDT only changed incidence of tax and not the nature of levy/ payment. It remained a levy on income in the nature of distribution of profits defined as "dividends" under Section 2(22) of the IT Act and also under Article 11(3) of India–UK DTAA.

The IRA submitted that the DDT was explicitly excluded from the scope of taxes covered under the DTAA and since DDT was not classified under the heading "Tax", the 10 per cent withholding tax rates stipulated under Article 11(2) would not apply and in such scenario, the dividend would be governed by the IT Act only. It also submitted that the DDT was an additional tax on a domestic company declaring dividends, and the shareholders were exempted from such tax. Hence, as this was not a tax on behalf of the shareholders and there was no incidence of tax on the non-resident shareholders, the provisions of any DTAA would not be attracted.

Decision

The Bombay HC allowed the appeal and set aside the BFAR ruling. It held that it was clear from the legislative history of Section 115-O and various memorandums to Finance Bills that DDT was a tax on dividend income, earned by shareholders of a company. Hence, DDT was a tax on the income of shareholders

[16] Colorcon Asia Pvt. Ltd. v. Joint Commissioner of Income Tax [TS-1623-HC-2025(BOM)].

and not on the domestic company. It agreed with the Assessee that a DDT was a tax covered under the IT Act was subject to Section 90 of the IT Act and, consequently, subject to any beneficial provisions in any international agreement or treaty.

The Bombay HC held that since the nature of payment had not changed and still fell within the definition of "Dividend" both under Section 2(22) of the IT Act and Article 11(3) of the India–UK DTAA, the unilateral change made in the domestic law over the years changing the incidence of tax could not alter or override the beneficial provisions of the DTAA. Hence, the Bombay HC concluded that the Assessee was entitled to restrict DDT to a maximum rate of 10 per cent on the dividends payable to Colorcon UK, as provided in Article 11 of the DTAA.

Significant Takeaways

The decision of the Bombay HC put to rest the controversy of whether a beneficial treaty tax rate on dividends would be applicable, overriding the domestic laws and clarified that provisions of the applicable DTAA could be applied to restrict the DDT rate applicable under the Indian tax laws. This is an important precedent for all pending cases dealing with the DDT controversy.

This case also established the person subjected to tax as irrelevant for application of provisions of the DTAA. The provisions of the DTAA nowhere suggest that a particular income must be taxed in the hands of the non-resident in India for applicability of the DTAA. If the nature of income earned by a non-resident is covered under the provisions of the DTAA and is taxed in India, the provisions of the DTAA shall be triggered and the beneficial DTAA rate shall apply, provided all other stipulated conditions are satisfied.

> **"DDT is subjected to a lower rate of tax specified under the India-UK DTAA."**

Bombay HC holds brought-forward losses cannot be denied by tax authorities post approval of resolution plan

Introduction

In ***Amns Gandhidham Ltd.,*** Bombay HC dismissed the writ petition filed by the IRA and held that as per Section 79(2)(c) of the IT Act, the company brought-forward losses could not be denied upon the approval of the resolution plan, as the IRA had not respond to the notice or filed any claims or submissions during the pendency of insolvency proceedings.

Facts

Amns Gandhidham Ltd. (**Assessee**), a tax resident of India, underwent a corporate insolvency resolution process, where the resolution plan submitted by AM Mining India Private Limited (**Resolution Applicant**) was approved by NCLT Ahmedabad Bench on April 13, 2023, under Section 31 of the Insolvency and Bankruptcy Code, 2016 (**IBC**). The implementation date of the resolution plan was May 6, 2023. During the pendency of the proceedings under the IBC, the resolution professional had intimated the IRA on June 27, 2022, regarding the proceedings. However, the IRA filed no claims.

The IRA issued notice on June 23, 2024, under Section 143(2) of the IT Act and on January 13, 2025, under Section 142(1) of the IT Act, initiating assessment proceedings for AY 2022–23 and AY 2023–24. The resolution plan was brought to the notice of IRA in responses filed for the these notices. However, the PCIT rejected the Assessee's objections by order dated February 7, 2025.

Aggrieved, the Assessee filed a writ petition before the Bombay HC.

Issue

Whether the notice issued for initiating assessment proceedings for the period preceding implementation of resolution plan can be considered as valid?

Arguments

The Assessee argued that once a resolution plan was approved in accordance with the provisions of IBC, the dues of the IRA would have to be governed by terms stated in the approved resolution plan. The resolution plan categorically stated that all claims not a part of resolution plan stood extinguished and no person was entitled to initiate or continue any proceedings not forming part of resolution plan. The NCLT placed reliance on the SC judgment in *Ghanashyam Mishra & Sons (P.) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.* On this basis, the Assessee argued that no demand could be raised, and the IRA could not deny its claim for carry forward of unabsorbed losses and unabsorbed depreciation.

The Assessee also argued that on issuance of notice by the resolution professional to the IRA, the opportunity of being heard was provided. However, since the IRA did not raise any objection during the insolvency proceedings, it cannot be permitted to re-examine the same. The Assessee also prayed that the clean-slate principle envisaged allowance of carry-forward losses, and denial of brought-forward losses would result in a tax demand due to the unavailability of carried-forward losses, which would be against the provisions of the IBC. The Assessee also submitted that the availability of such losses was undoubtedly one of the factors considered by the Resolution Applicant when the proposal was submitted.

On the other hand, the IRA relied on its earlier stance taken in the affidavit, in its reply to the objections raised by the Assessee, and the order dated February 7, 2025.

Decision

The Bombay HC observed that the implementation date of the resolution plan was May 6, 2023, whereas the proceedings related to AY 2022–23 and AY 2023–24, i.e., a time period prior to the resolution plan. The HC referred to the SC judgment in *Ghanashyam Mishra & Sons (P.) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd. (supra)*, which had held that all claims by government authorities not part of the resolution plan stood extinguished and hence, no proceedings could be initiated or continued with respect to the same. The HC also observed that the SC had held that the 2019 amendment to Section 31 of the IBC relating to the resolution plan was binding on all government authorities, was clarificatory and hence, applied retrospectively from the date of application of IBC.

The Bombay HC also placed its reliance on the judgments in *Vaibhav Goel* and *AMNS Khopoli Ltd.*, which also held that the tax dues for the period prior to effective date of resolution plan be extinguished, if they did not form part of resolution plan approved by NCLT. The Bombay HC also referred to certain other judgments on this issue.

It is relevant to mention that the Bombay HC squarely rejected the IRA's contention that the allowability of losses can be examined by it later. It referred to the fact that the notice was issued to the IRA during the pendency of the resolution proceedings, but it had failed to make any claims or submissions. The HC accepted that availability of losses could be one of the reasons why the Resolution Applicant submitted its proposal. The Bombay HC quashed the assessment proceedings initiated by the IRA and held that the Assessee cannot be denied carry forward of losses.

Significant Takeaways

Section 79 of the IT Act allows carry forward of unabsorbed losses only if the prescribed percentage of shareholding (i.e. 51 per cent) remains the same on the date on which the loss was incurred and the date on which the same was adjusted/ absorbed. However, Section 79(2)(c) provides an exclusion to the above condition for companies where the change in shareholding is pursuant to a resolution plan approved under the IBC, after affording the jurisdictional PCIT a reasonable opportunity to be heard.

In this case and other cases mentioned previously, the IRA was intimated about the resolution plan under consideration. However, if the IRA did not put any claims or demands during the pendency of the insolvency proceedings, the option to initiate any proceeding or raise a demand would not be available after the NCLT's approval of the resolution plan. The ITAT and the HC have adopted a similar stance in a few other cases on this issue.

The doctrine of clean slate is a key legal principle arising from the provisions of IBC in India. The intent of clean slate is to ensure that the company whose resolution plan is approved is able to get a fresh life, whereby the new buyer/ owner does not have to worry or spend its efforts, time, and resources to deal with pending issues, unless recognised and made a part of the resolution plan approved by NCLT.

> **“HC reinforces ‘clean slate’ principle by holding that brought forward losses cannot be denied post approval of resolution plan.”**

SC clarifies "derived from" test: Section 36(1)(viii) deduction "ring-fenced" to long-term finance profits only

Introduction

The SC, in ***National Cooperative Development Corporation***,[17] held that the income/receipts derived by the Assessee were not in the nature of "profits derived from the business of providing long-term finance", hence, not eligible for deduction under Section 36(1)(viii) of the IT Act. It clarified that the phrase "derived from" envisaged a direct and proximate connection, or a "first-degree nexus" between the income and the specific activity. Hence, if there were a lack of direct nexus between the receipt and the specific nature of business as provided in Section 36, deduction against the specific business could not be claimed.

Facts

National Cooperative Development Corporation (**Assessee**) is a statutory corporation mandated to advance initiatives for the production, processing, and marketing of agricultural produce and notified commodities. The Assessee claimed deductions Section 36(1)(viii) of the IT Act, which allows a deduction of 40 per cent of profits, but strictly limits this deduction to profits "derived from the business of providing long-term finance". The AO took up the Assessee's case for scrutiny and denied the benefit as the Assessee was generally engaged in financing, and not all income receipts qualify for this specific statutory deduction. The AO noted that merely because the Assessee was generally engaged in the business of long-term finance, it could not claim the specific deduction under Section 36(1)(viii) against all streams of business receipts such as return on investment in shares or interest on short-term bank deposits, which are distinct from interest earned on long-term loans.

On appeal, the assessment order was upheld by the CIT(A) and subsequently by the ITAT and the Delhi HC. Aggrieved, the Assessee preferred an appeal before the SC.

Issue

Whether Assessee is entitled to deduction under Section 36(1)(viii) of the Income Tax Act, 1961, in respect of all business income or the deduction shall be limited to receipts attributable to business activity strictly within the scope of long-term finance?

Arguments

The Assessee contended that the phrase "derived from" should be interpreted broadly to include receipts flowing directly from the business chargeable under Section 28 of the IT Act and that deduction under Section 36(1)(viii) should be available against it. It was also argued that the Assessee's business was indivisible and constituted an integrated activity. Hence, receipts could not be attributed specifically to long-term finance for the purpose of restricting the deduction.

The IRA submitted that the phrase "derived from" required a first-degree or direct nexus with the source of business receipt. It undertook a factual analysis of the Assessee's receipts and submitted that dividends received from investment in preference shares could not be said to be receipts from an activity of lending; service fees for advancing statutory Sugar Development Fund were fees from operations and could not be construed as income from advancing long-term finances; interest earned on short-term deposits with banks could also not qualify as derived from providing long-term finance.

Decision

The SC upheld the Delhi HC's decision that the deduction under Section 36(1)(viii) would be restricted to receipts only limited to business specifically derived from long-term financing activities. Section 36(1)(viii) allowed for a specific deduction in respect of any financial corporation engaged in providing long-term finance for industrial or agricultural development, capped at an amount not exceeding 40 per cent of the "profits derived from such business of providing long-term finance". The explanation defined "long-term finance" to mean any loan or advance where the terms provided for repayment along with interest thereof during a period of not less than 5 (five) years.

The SC analysed the legislative history and noted that the memorandum to Finance Bill, 1995, which replaced the phrase "attributable to" with "derived from", specifically stated that intent behind amendment to Section 36(1)(viii) was to ensure that financial corporations engaged in providing long-term finance for industrial or agricultural development who have now diversified into other activities do not misuse the deduction for all incomes. Hence, intent of the law was to restrict the deduction to receipts having direct nexus to the activity of long-term finance.

The SC further held that the phrase "derived from" connoted a requirement of a direct, first-degree nexus between the income

[17] National Cooperative Development Corporation v. Assistant Commissioner of Income Tax [TS-1633-SC-2025].

and the specified business activity. It has been consistently held by courts in cases involving various other sections of the IT Act that this phrase required a direct and proximate connection, or a "first-degree nexus," between the income and the specific activity. The addition of the words "the business of" simply clarified the source activity; it did not dilute the requirement for a direct link.

The SC also rejected the Assessee's contentions that it had an indivisible business and agreed with the IRA on the various streams of receipts that could not be classified as being derived directly from the business activity of providing long-term finance.

Significant Takeaways

The case clarified that the deduction under Section 36(1)(viii) Act was not a general exemption granted to a statutory corporation for all its business activities, rather, it was a specific incentive provided strictly respect of the profits arising from a defined activity, namely, the provision of long-term finance. It laid down that the head of income "profits or gains from business" was a general genus, which could specify species of profits such as profits derived from specific activities. For the purpose of claiming this deduction, it must be analysed whether the receipts could be classified as being derived from the specific activity.

It also reiterated the legislative intent of the amendment brought about by the Finance Act, 1995, to restrict the deduction to certain specific receipts and "ring-fence" the benefit.

> **"Deduction under 36(1)(viii) shall be available only to such income that has direct and proximate connection, or a "first-degree nexus," between the income and the specific activity."**

Multiple / repeated representations for initiation of proceedings not permissible

Introduction

The Uttarakhand HC, in ***Rajan Rajesh Kumar***,[18] held that multiple presentations and re-presentations of the proposal by the Assessing Officer was without jurisdiction and the act of the Competent Authority granting approval after the same that had been rejected at the very initial stage itself was also an *ultra vires* act. The Uttarakhand HC held that the proceedings of the Competent Authority impugned for granting sanction under Section 151 of the IT Act dated January 8, 2021, were wholly without jurisdiction.

Facts

Rajan Rajesh Kumar (**Assessee**) filed his returns for the AY 2015–16 declaring a total income of INR 6,54,730 on August 15, 2015. On September 8, 2015, and April 18, 2017, survey and search operations were conducted under Sections 133A and 132 of the IT Act against one Amit Sharma. He was a contractor of Uttar Pradesh Rajkiya Nirman Nigam Limited (**UPRNN**), and the Revenue alleged that he was a beneficiary of largesse in the form of award of contracts by the Respondent, who abused his position as managing director of the State Infrastructure and Industrial Development Corporation of Uttarakhand Ltd (**SIDCUL**).

The civil contracts of SIDCUL were awarded to UPRNN as per government order, and Amit Sharma was one of the sub-contractors of UPRNN. During the search, two loose sheets (LP 186 & 187) were found, and entries therein revealed transactions in bullion, silver, and cash to the tune of about INR 16,00,00,000/- favouring the Assessee. It was fairly admitted that UPRNN and SIDCUL are two different entities/state-owned corporations with separate chain of commands and management.

The file was first sent to the DCIT-Central on September 5, 2019, for approval within the stipulated period of four years. The Competent Authority under Section 151 of the IT Act, by proceedings dated March 18, 2020, refused to grant sanction on the premise that the reasons/grounds recorded by the Assessing Officer failed to corroborate the contents of pages 186 & 187. After the refusal, the JCIT (OSD) once again recorded reasons and forwarded the same to PCIT, Kanpur on June 23, 2020, by which time the period of four years from the end of the assessment year had passed. On October 8, 2020, ACIT, Dehradun once again recorded the reasons and forwarded the proposal for approval to PCIT, Kanpur under Section 151 of the IT Act, but the said proposal was not approved. Yet again, on December 7, 2020, the ACIT, Central Circle, Dehradun sent one more proposal for the fourth time, and this time, PCIT, Kanpur granted sanction without raising any query or seeking clarification.

Issue

a) *Whether the multiple presentations/repeated re-presentation of the proposal for initiation of proceedings under Section 148 of the IT Act to the Competent Authority under Section 151 is permissible under the IT Act?*

[18] Rajan Rajesh Kumar [TS-1712-HC-2025(UTT)].

b) *Whether there was non-compliance with the mandatory provisions of Sections 148, 149, and 151 of the IT Act?*

Arguments

The IRA contended that neither Section 148 nor Section 151 of the IT Act barred multiple presentations or re-presentation of the proposal. Further, in the absence of the restriction, it was open for the AO to seek approval any number of times. The IRA fairly conceded that there was no remedy available to the AO in the event of the Competent Authority refusing approval.

The IRA argued that the two loose papers numbered as 186 and 187 were incriminating materials impounded during the search and survey operation on September 8, 2015, which formed the basis and the reason to believe for the AO to seek reopening. The impounded documents contained reference to payments by way of cash, cheque transactions, gold-biscuits, and diamonds with a date-wise narration under the Header 'Sir Rajesh MD' demonstrating proximity between the Assessee and Amit Sharma.

The IRA placed reliance on an earlier decision by the Jharkhand HC[19] to contend that additions could be made on the basis of loose papers if the situation so warranted. Further, reliance was also placed on SC decisions[20] to argue that attributing income on the basis of circumstantial evidence and human probabilities was accepted.

The Assessee contended that there was no provision for repeated re-presentation of the proposal once the proposal stood rejected. The Assessee argued that the AO failed to follow the mandatory provisions of Sections 147 to 151 of the IT Act, and that non-application of mind was reflected by the fact that the PCIT who granted sanction/approval under Section 151 of the IT Act was the same authority who had filed the Rule-9 report before the Settlement Commission in the case of *Amit Sharma*, and the Competent Authority's approval of the reasons alleging income of INR 13.16 crore were contrary to his own observations made before the Settlement Commission.

The Assessee contended that the fact of lack of independent application of mind was reflected by the repetition of the reasons earlier discarded and, hence, the approval was mechanically granted without looking into material records. The sanctioning authority failed to appreciate that the very same authority had recorded a mere INR 20 lakh as the sum attributable to the Assessee.

The Assessee relied on judicial pronouncements[21] to argue that CIT having mechanically granted approval for reopening of assessment without application of mind rendered the same invalid and not sustainable, and that power granted under Section 151 of the IT Act could not be exercised casually.

Decision

The HC held that the multiple presentations and re-presentations of a proposal by the AO were without jurisdiction, and the act of the Competent Authority granting approval after the same was rejected at the very initial stage itself was also an *ultra vires* act. It held that the proceedings of the Competent Authority impugned for granting sanction under Section 151 of the IT Act dated January 8, 2021 were wholly without jurisdiction.

Significant Takeaways

In matters of taxing statutes, the principle of interpretation is one of strict construction. The argument that, in the absence of an explicit prohibition, a proposal may be presented and re-presented indefinitely is untenable. While the exercise of powers under Sections 147 to 151 of the IT Act are inherently subjective, it must be anchored in an objective evaluation of the material on record. Every proposal must be preceded by a *bona fide* 'reason to believe,' and the grant of approval or sanction must follow a genuine application of mind. Orders under Section 151 of the IT Act are amenable to judicial review, as they carry the potential for adverse civil and penal consequences for an assessee. The sanctioning authority is required to independently apply its mind before granting approval. Mechanical or perfunctory acceptance of proposals—particularly where they contradict the authority's own prior findings—amounts to non-application of mind and renders such approval invalid.

> **"Multiple representations of reassessment proposals with the same evidence is untenable."**

[19] Mahabir Prasad Rungta v. CIT(A) (2014) 266 CTR 175 (Jharkhand High Court).

[20] Sumati Dayal v. CIT (1995) 214 ITR 801 (SC) and CIT v. Durga Prasad More (1971) 82 ITR 540 (SC).

[21] Central India Electric Supply Co. Ltd v. ITO [2011] 10 taxmann.com 169 (Delhi), German Remedies Ltd. v. DCIT (2006) 287 ITR 494 (Bombay), United Electrical Co. P. Ltd. v. CIT (2002) 258 ITR 317 (Delhi), CIT v. Goyanka Lime [2015] 64 taxmann.com 313 (SC), and Chhugamal Rajpal vs. S.P. Chalina [1971] 79 ITR 603 (SC).

No prosecution under Section 276C of the IT Act despite delayed tax payment sans wilful tax evasion or suppression of income

Introduction

The Madras HC in ***G Square Layout Private Limited***,[22] held that criminal prosecution for the alleged offence under Section 276C of the IT Act could not be sustained where there was delayed deposit of tax without suppression or non-disclosure of real income or wilful evasion of tax.

Facts

G Square Layout Private Limited (**Assessee**) filed its return of income for AY 2023–24 belatedly under Section 139(4) of the IT Act on December 31, 2023, declaring a total income of INR 27.31 crore. As per the return, the total tax liability was INR 9.16 crore, with TDS credit of INR 43.49 lakh, leaving a self-assessment tax liability of INR 8.72 crore to be paid at the time of filing the return as mandated under Section 140A of the IT Act. However, the Assessee filed the return without paying the admitted tax liability.

A demand was quantified at INR 8.72 crore, *vide* order dated December 31, 2023, requiring payment of tax within 30 (thirty) days, and an email was sent on the same date. Despite notices issued by the Revenue on October 8, 2024, and November 8, 2024, the Assessee did not pay the tax dues. Subsequently, a show cause notice (**SCN**) was issued to the Assessee and its directors on December 2, 2024, requiring them to explain why prosecution under Section 276C(2) of the IT Act should not be initiated.

In response to SCN, the Assessee's authorised representative appeared on December 12, 2024, and submitted a written explanation stating that funds were locked in non-liquid assets and, therefore, the Assessee was unable to remit the self-assessment tax. Notably, after submission of the reply to the SCN, the Assessee paid INR 3.85 crore on December 19, 2024, and INR 4.87 crore on January 13, 2025, thereby discharging the entire tax liability for AY 2023–24. Thereafter, the Revenue filed a complaint on January 22, 2025, against the Assessee and its directors for the offence under Section 276C(2) of the IT Act before the Additional Chief Metropolitan Magistrate (Economic Offences)-II, Chennai.

Aggrieved by the criminal complaint, the Assessee filed a Criminal Original Petition under Section 528 of the Bharatiya Nagarik Suraksha Sanhita, 2023 (**BNSS**), seeking to quash the complaint.

Issue

Whether the Assessee can be prosecuted for wilfully evading the payment of tax under Section 276C(2) of the IT Act when the entire admitted tax liability has been paid, albeit belatedly?

Arguments

The Assessee contended that mere delayed payment of tax would not attract Section 276C(2) of the IT Act. It was submitted that even before cognizance was taken, the Assessee had settled the entire tax liabilities by paying INR 3.85 crore on December 19, 2024, and INR 4.87 crore on January 13, 2025. The Assessee argued that when the entire tax had already been paid, it could not be construed as a wilful attempt to evade tax payment. It was further contended that, to attract the offence under Section 276C(2), *mens rea* should be present, and unless the same existed, an attempt to evade tax could not be presumed. The Assessee also argued that since the Revenue had not imposed any penalty for non-payment of tax on time, it could prosecute for the same substantive act categorised as an offence under Section 276C(2) of the IT Act.

The Revenue contended that the Assessee, despite having voluminous assets to the tune of INR 129.11 crore during AY 2023–24 and having earned a net profit of INR 26.23 crore, had wilfully chosen not to pay the admitted tax liability of INR 8.72 crore at the time of filing the return on December 31, 2023, thereby clearly attracting the provisions of Section 276C(2) of the IT Act. It was argued that the payment of tax made eventually after issuance of notice could not absolve the prior non-compliance, and the proof of payment of entire tax ought to have been furnished at the time of filing of the return as per Section 140A of the IT Act. The Revenue further contended that the non-initiation of penalty proceedings does not lead to a presumption that the wilful default in payment can be condoned, and it is for the Assessee to establish that they did not have the *mens rea* in causing wilful default in payment of tax.

Decision

The HC, relying on its earlier judgment in ***S.P. Velayutham***,[23] held that to prosecute a person, there must be a wilful attempt on the part of the assessee to evade payment of any tax, penalty, or interest. The HC noted that the explanation to Section 276C(2) of the IT Act made it clear that evasion by way of any false entry or statement in the books of account or other document, or omission to make any entry in the books of account or other documents, or any other circumstances that will have the effect of enabling the assessee to evade tax, penalty, or interest

[22] G Square Layout Private Limited [TS-1371-HC-2025(MAD)].
[23] S.P.Velayutham v. Assistant Commissioner of Income Tax reported in (2022) 442 ITR 74.

chargeable or imposable under the Act or the payment thereof, alone could be prosecuted.

The HC observed that the Revenue's case was not that the Assessee had suppressed the real income or not disclosed any other source of income or fabricated documents or made any false entry in the statements or documents or omitted to make any such entry in the books of account or other document or acted in any other manner to avoid tax payment, but its only allegation was a delay in the payment of tax. The HC held that mere default in payment of taxes, unless such default arises out of any circumstances that would have an effect of the Assessee to defeat the payment, the word employed in the section, i.e., "wilful attempt", cannot be imported.

The HC further observed that although the Assessee did not make the tax payment while filing its return of income or even after issuance of notices, there was no suppression of real income and the Assessee had made the entire payment of the tax liability on January 13, 2025, after issuance of SCN on December 2, 2024. The HC opined that if the Assessee intended to evade tax payment was present from the very inception, the Assessee would have not made the payments even thereafter.

The HC noted that as per Section 220(4) of the IT Act, if the tax was not paid within the time limit, the Assessee would be deemed to be in default, but the word "wilful" is conspicuously absent in Section 220. The HC held that as long as the default was not wilful, mere delay in payment of tax would not attract the penal provisions. Many other provisions under the Act even impose fine or penalty for delayed payment. However, to prosecute a person, the act must be deliberate and *mens rea* should be present to commit the wilful default so as to attract the offence under Section 276C(2) of the IT Act.

The HC further relied on principles laid down by the SC in ***Tamil Nadu Housing Board***[24] and ***Prem Dass***,[25] and decisions of the Gujarat HC in ***Vijaychandra Chandulal Shah***[26] and ***Ganga Devi Somani***,[27] the Madhya Pradesh HC in ***Jiwal Lal Chironji Lal***,[28] and the Kerala HC in ***Forzza Projects Private Limited***[29] to establish that prosecution under Section 276C(2) of the IT Act requires a wilful intent and the presence of mens rea, which were absent in the present case. Accordingly, the HC exercised its powers under Section 528 of the BNSS to quash the criminal complaint under Section 276C of the IT Act.

Significant Takeaways

The judgment clarified the distinction between mere default in payment of tax and wilful evasion of tax under Section 276C(2) of the IT Act. Prosecution under Section 276C(2) of the IT Act requires the presence of "*mens rea*" and "*wilful intent*" to evade tax. The provision applies only where evasion arises from false entries, omissions, suppression of income, or acts enabling avoidance of tax, penalty, or interest.

The HC emphasised that delayed payment of tax, without any suppression or non-disclosure of real income, did not constitute a wilful evasion. The fact that the Assessee paid the entire tax liability after the SCN negated any intent to evade tax, even though the Assessee was deemed a defaulter under Section 220(4) of the IT Act. The IT Act provides for penalties and interest on delayed payment, however, prosecution under Section 276C(2) requires a higher threshold of wilful intent and deliberate evasion, which must be strictly construed as a penal provision.

This judgment reinforced the principle established in ***S.P. Velayutham*** and other precedents that penal provisions must be strictly construed, and the conduct of the assessee must demonstrate a deliberate and wilful attempt to evade tax, not merely a failure to pay tax on time. Therefore, it is crucial for the Revenue to establish the presence of *mens rea* and *wilful intent* before initiating prosecution under Section 276C(2) of the IT Act, and for assessees to understand that while delayed payment attracts civil consequences such as interest and penalties, criminal prosecution requires proof of deliberate evasion.

> **"Mere delayed payment of tax will not result in prosecution because it does not constitute wilful evasion."**

[24] Tamil Nadu Housing Board v. Collector of Central Excise [1995] Supp (1) SCC 50
[25] Prem Dass v. ITO [1999] 236 ITR 683 (SC)
[26] Vijaychandra Chandulal Shah v. State of Gujarat [1995] 213 ITR 307 (Guj)
[27] Ganga Devi Somani v. State of Gujarat [2021] 437 ITR 323 (Guj)
[28] Union of India (UOI) v. Jiwal Lal Chironji Lal MANU/MP/0143/2010
[29] Forzza Projects Private Limited v. Pr. CIT [2021] 17 ITR-OL 483 (Ker)

CASE LAW UPDATES - INDIRECT TAX

ROUTINE

Reading down of Section 16(2)(aa) to protect bona fide purchasers from supplier's default

Introduction

In ***M/s. McLeod Russel India Limited v. The Union of India***,[30] the Gauhati HC addressed whether Section 16(2)(aa) of the CGST Act, which ties a recipient's ability to claim ITC directly to the supplier's compliance with GST filing obligations, can be invoked to deny ITC to a *bona fide* purchaser for the supplier's default. It interpreted the provision restrictively to the extent that before denying ITC benefits to a *bona fide* purchaser, where the supplier acts truant, the purchaser ought to be given an opportunity to prove bona fides through tax invoices and other documents.

Facts

The Petitioner, McLeod Russel India Limited, a public limited company engaged in the business of production, blending, and supply of tea in India and other countries, filed a writ petition questioning the validity of Section 16(2)(aa) of the CGST Act and the Assam Goods and Services Tax Act, 2017 (**AGST Act**). Section 16(2)(aa) provides that no registered person shall be entitled to credit of any input tax unless the supplier furnishes the details of the invoice or debit note in the statement of outward supplies and communicates such details to the recipient in the manner specified under Section 37.

Issue

Whether the condition for availing ITC, which is linked the recipient's ability to claim ITC directly with the supplier's compliance under Section 16(2)(aa) of the CGST Act can deny ITC to a bona fide purchaser for factors totally in the hands of the supplier and not the purchaser, is unconstitutional or requires to be read down?

Arguments

The Petitioner challenged Section 16(2)(aa) of the CGST and AGST Acts as arbitrary, contending that it makes a purchaser's entitlement to ITC dependent on the supplier's compliance with filing invoice details in Form GSTR, a factor entirely beyond the purchaser's control. Since the GST law does not provide any mechanism enabling the recipient to compel or rectify the supplier's non-compliance, a *bona fide* taxpayer is unfairly penalised for the supplier's default, even after having paid the tax in full.

It was argued that denial of ITC in such circumstances is irrational, defeats the fundamental objective of GST to tax only value addition, and results in cascading and double taxation. The provision is said to impose an impossible burden on recipients to monitor supplier filings and reconcile GSTR, despite the absence of any statutory remedy. The Petitioner submitted that the provision should be declared unconstitutional or, alternatively, be provided a restrictive interpretation.

[30] M/s. McLeod Russel India Limited v. The Union of India, 2025 (12) TMI 756 - Gauhati High Court.

The Petitioner also relied on *Commissioner Trade and Tax, Delhi v. M/s Shanti Kiran India (P) Limited*, where the SC affirmed the decision of the Delhi HC and benefit of ITC was allowed to the registered purchaser/dealer who had paid taxes to the registered seller/dealer in terms of invoices raised by them although the sellers had not deposited the collected tax with the Government. The Delhi HC found out that the purchaser had paid taxes in good faith to the seller and, therefore, was entitled to the benefit of ITC, subject to due verification of invoices. Further, support was also drawn from circulars issued by the CBIC, which granted reliefs for periods prior to January 1, 2022.

The revenue submitted that ITC was not an absolute right but a statutory concession subject to conditions prescribed under Section 16 of the CGST Act. Section 16(2)(aa) applies uniformly to all registered persons and does not discriminate against any class. The Revenue contended that four conditions must be satisfied by a registered taxable person for availing ITC as per Section 16(2) of the CGST Act, 2017: (i) possession of tax invoice or debit note; (ii) receipt of goods or services; (iii) supplier paying the tax to the Government; and (iv) furnishing the return under Section 39. Thus, unless the supplier has paid the tax in respect of the said supply, the recipient cannot claim ITC on the said supply.

It also argued that Section 16(2)(aa) was introduced to strengthen compliance, curb tax evasion, eliminate provisional ITC, and ensure transparency in the GST system. Linking the recipient's ITC entitlement to the supplier's return filing was a conscious policy choice with a clear nexus to these objectives. Therefore, the provision was constitutionally valid.

Decision

The Gauhati HC disposed of the petition by reading down Section 16(2)(aa). It held that although tax is ultimately borne by the buyer, exemptions or concessions such as ITC are conditional and must be strictly proved by the claimant. While Section 16(2)(aa) lawfully imposes conditions on availing ITC, those conditions should not defeat the core objective of the GST regime, which is to prevent cascading impact of taxes.

The Court observed that making ITC dependent solely on reflection of invoices in GSTR, when such reflection depends entirely on the supplier's compliance, places an onerous and inequitable burden on a *bona fide* purchaser. Denial of ITC in such circumstances would be contrary to the purpose of the Act.

However, acknowledging that the amendment aims to curb fraudulent ITC claims and improve supplier compliance, the Court declined to declare Section 16(2)(aa) unconstitutional. Instead, it provided a restrictive meaning on to the extent that before denying ITC due to a supplier's default, the *bona fide* purchaser must be given an opportunity to establish genuineness through invoices and supporting documents.

This restricted interpretation shall operate until the CBIC formulates a practical mechanism to address the hardship caused to *bona fide* purchasers. Accordingly, the petition was disposed off.

Significant Takeaway

The judgment reflected a careful attempt by the Court to balance two competing imperatives under the GST regime: preventing fraudulent ITC claims and protecting *bona fide* taxpayers from undue hardship.

The Court correctly noted that making ITC contingent on supplier compliance places an onerous burden on the purchaser, who has no statutory control over the supplier's filing of GSTR returns or the consequent reflection in GSTR-2A/2B. This reasoning aligns with the foundational objective of the GST legislation to avoid cascading of taxes and acknowledges commercial reality, where purchasers act in good faith after paying tax to registered suppliers. By requiring that *bona fide* purchasers be given an opportunity to prove their genuineness through invoices and documents, the Court injected fairness and proportionality into the operation of Section 16(2)(aa).

The Court's clarification that the provision is read down only till the time CBIC comes out with any practical solution to the problem was also significant, as it placed the onus on the tax administration to devise a mechanism that balances the need to prevent fraudulent ITC claims with the protection of *bona fide* purchasers from supplier defaults. This temporal limitation has ensured that the restrictive interpretation is not permanent but serves as an interim measure pending systemic reforms.

> **"ITC benefit to a bona fide buyer cannot be avoided on account of supplier's default."**

Customs Scrutiny of Contract Manufacturing: Beneficial Ownership and IP Royalties

Introduction

In ***M/s. Xiaomi Technology India Pvt, Ltd. & Ors. v. Principal Commissioner of Customs, Chennai***,[31] the CESTAT Chennai addressed whether Xiaomi India, and not its contract manufacturers (**CMs**), is the beneficial owner of imported mobile phone parts and whether royalties and whether licence fees paid by Xiaomi India to Qualcomm and Xiaomi China should be added to the customs value under Rule 10(1)(c) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. It held that Xiaomi India exercised effective control over the imported goods and was the beneficial owner, and that royalties related to imported goods and constituting a condition of sale must be added to the assessable value for the purposes of payment of customs duty.

Facts

Xiaomi India is engaged in the business of distribution and sale of consumer electronic products in India. As on the relevant date, Xiaomi India does not undertake manufacturing activities on its own in India. Its business operations comprise (i) import of finished consumer electronic goods, including mobile phones, televisions and power banks, from Xiaomi entities based outside India, and/or (ii) procurement of Xiaomi-branded mobile phones manufactured in India by CMs using components and parts sourced from Xiaomi group entities.

For the purpose of trading in India, Xiaomi India imports complete/finished Xiaomi-branded mobile phones from Xiaomi China and its affiliated entities. In relation to such imports, Xiaomi India is required, under various licence and royalty agreements, to pay royalty/licence fees to Qualcomm Incorporated, USA, for the use of Qualcomm's intellectual property and proprietary technology embedded in the imported products. The applicable agreements include the Subscriber Unit License Agreement (**SULA**) dated January 1, 2010, the Master Patent License Agreement (**MPLA**) dated January 1, 2018, and the Master Software Agreement (**MSA**) dated November 27, 2010. Depending on the technology generation (2G, 3G, and/or 4G) and the relevant period, the royalty is payable either at specified rates, such as 5 per cent or 3.25 per cent of the net selling price of the complete terminal or in accordance with the terms stipulated in the respective agreements.

In addition to importing finished goods, Xiaomi India also purchases Xiaomi-branded mobile phones manufactured in India by its CMs. These mobile phones are manufactured using parts and components imported by the CMs from Xiaomi China, its affiliates and certain specified input vendors. In respect of such parts and components, Xiaomi India is liable to pay royalty/licence fees under various agreements. These include payments to Qualcomm USA for the use of Qualcomm's IPR and technology, under SULA, MPLA and MSA, at rates linked to the net selling price of the subscriber unit or complete terminal, as applicable. Separately, under the Licence and Royalty Agreement (**LRA**), Xiaomi India also pays licence fees to Beijing Xiaomi Mobile Software Co. Ltd. for licensed software and hardware technology, calculated at 2 per cent of the revenue generated by Xiaomi India from the sale of permitted products.

Multiple appeals arose from a common order adjudicating three SCNs covering the period 2017–2020, against Xiaomi India and four CMs. The DRI alleged that Xiaomi India paid royalties and licence fees under agreements with two of these manufacturers but did not disclose them to Customs or the Special Valuation Branch (**SVB**) until the DRI investigation. SCNs under Section 28(4) of the Customs Act were issued, and the common Adjudicating Authority redetermined the assessable value, demanded differential duty, held goods liable to confiscation, and imposed penalties. Both the Assessee as well as the Revenue appealed to the CESTAT.

Issue

Whether Xiaomi India is the beneficial owner with effective control and whether duty can be demanded from it by making it addable under Rule 10(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007?

Arguments

Xiaomi India contended that the parts and components used by the CMs were imported by the CMs on their own account and not on behalf of Xiaomi India. It was submitted that Xiaomi India neither exercised control over the importation of the components nor held any ownership or beneficial interest therein and, therefore, could not be treated as the "beneficial owner" or importer of such goods. Once a particular person has declared itself and has been accepted by Customs as the importer at the stage of importation and clearance, another person cannot subsequently be treated as the importer after clearance of the goods. Reliance was placed on judicial

[31] M/s. Xiaomi Technology India Pvt, Ltd. & Ors. v. Principal Commissioner of Customs, Chennai, 2025 (11) TMI 1120 - CESTAT Chennai.

precedents, including *Commissioner of C. Ex., Goa v. Cosme Farma Laboratories Ltd.* (2015 (318) ELT 545 (SC)) and *Tata Engineering and Locomotive Company Ltd. v. Union of India* (1988 (35) ELT 617 (Pat.), affirmed by the SC), to argue that mere prescription of specifications, quality control or supervisory rights by one party did not imply that manufacture or import was carried out on its behalf.

Xiaomi India further relied on CBIC Circular No. F.132/111/2007/CX.4 dated 18.07.2007 to submit that the expression "on behalf of" presupposes the involvement of three parties, whereas in the present case only two parties were involved, negating any agency relationship. The terms of the Product Purchase Agreement were specifically relied upon to demonstrate that the CMs acted independently and on a principal-to-principal basis. Clauses relating to transfer of ownership and risk, absence of agency or partnership, independent forecasting and ordering of components, inspection and acceptance of goods, responsibility for import licences and IEC, and restrictions on resale collectively established that the CMs bore the commercial risk and legal responsibility for the imported components. Accordingly, Xiaomi India argued that the imports could not be attributed to it, either directly or indirectly, and that the CMs could not be said to have imported the components on behalf of Xiaomi India.

The Revenue, on the other hand, argued that substance must prevail over form in contract interpretation and that nomenclature cannot camouflage the true intent. The Revenue also contended that the CMs lacked effective control and unfettered possession, while Xiaomi India exercised dominant control, including price construction and ring-fencing the CMs from government demands, evidencing that the CMs were not real buyers of the imported products and that Xiaomi India was the actual beneficial owner. The Revenue further argued that the royalty agreements with Xiaomi China and Qualcomm covered technologies and software embedded in the imported components and that payment was a condition of sale, making them addable under Rule 10(1)(c).

Decision

The CESTAT undertook a detailed examination of the contractual arrangements governing the relationship between Xiaomi India, Xiaomi China and the contract manufacturers, with particular emphasis on identifying who exercised real and effective control over the importation, pricing and use of the components. The CESTAT observed that under the Customs Act, "importer" includes beneficial owner under Section 2(26) and "beneficial owner" is any person on whose behalf goods are imported or who exercises effective control (Section 2(3A)), and that title is not determinative. While acknowledging that the contract manufacturers were, in a formal sense, the importers of record holding IECs, obtaining import licences and undertaking customs clearance the CESTAT held that such formal compliance was not determinative. Instead, the CESTAT adopted a substance-over-form approach and examined whether the contract manufacturers enjoyed genuine commercial and economic independence in relation to the imports.

On a cumulative reading of the agreements, the CESTAT observed that the contract manufacturers were contractually bound to sell the assembled mobile phones exclusively to Xiaomi India and had no freedom to sell either the finished goods or the imported components in the open market. The CESTAT attached significance to the fact that the CMs had no role in negotiating the procurement of components and had no autonomy in price fixation. All cost variations were either embedded in the net selling price or addressed through purchase price variance mechanisms borne by Xiaomi China, indicating that the contract manufacturers did not bear price or market risk. The CESTAT further noted that restrictions on repacking, resale and disposal of goods, coupled with the obligation to return unused parts, semi-finished and finished goods to Xiaomi India, reinforced the absence of independent commercial discretion.

The CESTAT also placed considerable weight on clauses demonstrating financial and legal control by the Xiaomi group. Xiaomi China's assumption of responsibility and liability for customs valuation disputes, together with indemnification of the contract manufacturers, was viewed as a strong indicator that the economic incidence of importation did not rest with the manufacturers. This conclusion was reinforced by provisions requiring Xiaomi India to reimburse all transaction and indirect taxes, fines, penalties, deposits and legal fees incurred by the contract manufacturers, and by Xiaomi India's contractual right to withhold payments in the event of non-remittance by the manufacturers to overseas vendors. Taken together, these factors led the Court to conclude that the contract manufacturers functioned under the effective control and direction of Xiaomi India and Xiaomi China, and that the imports of components, though formally undertaken by the manufacturers, were in substance attributable to the Xiaomi group.

The adjudicating authority also examined whether the royalty and licence fees paid by Xiaomi India to Qualcomm and other group entities were liable to be added to the assessable value of the imported goods under Rule 10(1)(c) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. It was found that the payments were intrinsically linked to the imported mobile phones and components, as the royalties were calculated as a percentage of the net selling price of the finished subscriber units or multimode terminals sold in India and were payable for the use of patented technology essential for the manufacture and sale of the imported goods. It was held that the payment of such royalties was a condition of sale of the imported goods, since without access to the licensed technology, the goods could neither be lawfully manufactured nor marketed. Rejecting Xiaomi India's contention that the royalties were post-importation expenses or related solely to domestic sales, the CESTAT concluded that the royalty and licence fees had a clear nexus with the imported goods and directly influenced their price, thereby warranting their inclusion in the assessable value.

Significant Takeaways

The decision affirmed a decisive substance-over-form approach in customs law by clarifying that, where effective economic and operational control was established, duty demands under Section 28(4) of the Customs Act may be raised against the beneficial owner and not merely the entity that filed the Bill of Entry. This reinforced the principle that contractual arrangements, rather than formal title or documentation alone, were central to determining importer status and valuation consequences.

Equally significant was the CESTAT's finding on royalty payments that royalties linked to embedded intellectual property that are integral to the manufacture or sale of imported goods were held to be "related to the imported goods" and a condition of sale, warranting inclusion in the assessable value under Rule 10(1)(c) of the Valuation Rules, even when paid under separate licensing agreements or to third-party licensors. The ruling serves as a cautionary precedent for importers operating contract manufacturing models in India, particularly where lump-sum or sales-linked royalties are involved, as such arrangements may create a sufficient nexus with imported goods to trigger valuation additions and duty demands. Overall, the judgment highlighted the need for careful, holistic structuring of supply, manufacturing and IP licensing agreements to clearly delineate risk, control and the true nature of royalty payments, in order to mitigate customs valuation exposure.

Having said the above, the decision also traded into the untraded territory wherein the royalties paid by Xiaomi India would have to be added to the products imported by third-party contract manufacturers. The timing and quantification of the duties payable along with the mechanism to be adopted to put in place a system will require careful consideration before its implementation.

> **“ Importing parts and components through contract manufacturers will not deny the liability of the beneficial owner to pay customs duty on import of products. ”**

Tax exemptions favouring local manufacturers struck down as discriminatory under Article 304(a) of the Constitution

Introduction

In ***M/s. U.P. Asbestos Limited & Ors. v. State of Rajasthan & Ors.***,[32] the SC addressed whether a notification granting exemption from payment of VAT on sale of asbestos cement sheets and bricks manufactured in the State of Rajasthan, having contents of fly ash up to 25 per cent or more by weight, violated Article 304(a) of the Constitution of India being discriminatory vis-à-vis goods imported from outside the State of Rajasthan. It held that the exemption was neither grounded in any manifest public purpose nor limited to a particular class such as "new industries" for a specified period, and that the notification granting VAT exemption discriminated against similar goods from outside the State and was *ultra vires* Article 304(a) of our Constitution.

Facts

The Appellants were manufacturers and sellers of fly ash–based asbestos cement sheets and bricks. They did not have any manufacturing units in the State of Rajasthan; however, they maintained sales depots within the State, which were duly registered under the applicable Central and State tax laws. The dispute pertains to the validity of Notification No. S.O. 377 dated March 9, 2007, issued by the Government of Rajasthan under Section 8(3) of the Rajasthan Value Added Tax Act, 2003 (**VAT Act**), granting exemption from VAT on the sale of asbestos cement sheets and bricks manufactured in Rajasthan with fly ash content of 25 per cent or more by weight, subject to certain conditions.

Historically, the State of Rajasthan had introduced a policy of granting tax exemptions to promote the use of fly ash and encourage local industrial development. Initially, under Section 15 of the Rajasthan Sales Tax Act, 1994, a notification was issued granting sales tax exemption to asbestos cement products manufactured within the State using fly ash as the main raw material. This benefit was available to units commencing commercial production up to December 31, 2001, and was to remain operative until January 23, 2010. The benefit was further extended to industries commencing commercial production by December 31, 2006, provided the fly ash content was at least 25 per cent by weight. These earlier notifications were never challenged by the Appellants.

With the repeal of the 1994 Act and the coming into force of the VAT Act on April, 1, 2006, the State issued notifications dated June 1, 2006, and July 5, 2006, under Section 8 of the VAT Act to continue the earlier exemption regime. One of the Appellants challenged these notifications before the Rajasthan HC. During the pendency of that writ petition, the State withdrew the notification dated July 5, 2006, and issued the impugned notification dated March 9, 2007. This notification continued the exemption for asbestos cement sheets and bricks manufactured within Rajasthan having fly ash content of 25 per cent or more, but restricted the benefit to manufacturers who had commenced commercial production by December 31, 2006, and limited its availability up to January 23, 2010.

The Appellants challenged the impugned notification before the HC, contending that it discriminated against goods manufactured outside Rajasthan and imported into the State, thereby violating Article 304(a) of the Constitution of India and the freedom of trade and commerce under Articles 301 to 304. The HC dismissed these writ petitions through orders dated August 2, 2007, and August 23, 2007, relying upon its earlier decision in *M/s Hyderabad Industries Ltd. v. State of Rajasthan*.

While the appeals were pending before the SC, the State amended Clause (iii) of the impugned notification, extending the exemption to a maximum period of 10 (ten) years from the date of commencement of commercial production, but in no case beyond January 23, 2016. This amendment was separately challenged by one of the appellants, M/s U.P. Asbestos Ltd., which was also dismissed by the HC on September, 5, 2012.

In dismissing the writ petitions, the HC relied upon a series of SC decisions, including *Video Electronics Pvt. Ltd. v. State of Punjab*, and held that tax exemptions granted to local industries for a limited period, aimed at encouraging industrial development and use of locally available resources such as fly ash, did not amount to unconstitutional discrimination. It further noted that the State had consistently followed the exemption policy since 2000 and was bound by promissory estoppel to continue the benefit until the originally specified period.

Aggrieved by the dismissal of their writ petitions and the continued operation of the impugned notification, the Appellants approached the SC.

Issue

Whether the notification granting exemption from payment of VAT on sale of asbestos cement sheets and bricks, manufactured in the State of Rajasthan, having contents of fly ash up to 25 per

[32] M/s. U.P. Asbestos Limited & Ors. v. State of Rajasthan & Ors., 2025 INSC 1154.

cent or more by weight subject to specific conditions, is violative of Article 304(a) of the Constitution of India for being discriminatory vis-à-vis goods imported from outside the State of Rajasthan?

Arguments

The Appellants contended that the impugned notification granting VAT exemption to locally manufactured asbestos products in Rajasthan was unconstitutional and violative of Article 304(a) of the Constitution, as it discriminated against goods imported from outside the State. They argued that the notification provided a blanket tax exemption to local manufacturers without any cogent or stated justification, thereby amounting to hostile discrimination, relying on precedents such as *Shree Mahavir Oil Mills, Laxmi Paper Mart, and Anand Commercial Agencies*.[33] It was further submitted that the notification did not require fly ash to be sourced from within Rajasthan, undermining the State's claim that the exemption was intended to promote utilisation of locally available fly ash. Even assuming such a requirement existed, the exemption would still be unconstitutional in light of *Jaiprakash Associates*.

Placing reliance on the nine-Judge Bench decision in *Jindal Stainless Ltd.,* the Appellants asserted that the impugned differentiation reflected intentional and unfavourable bias in favour of locally manufactured goods, which squarely attracted the prohibition under Article 304(a). They also distinguished *Video Electronics*, arguing that unlike the limited and time-bound exemption upheld in that case, the exemption in the present matter had been continuously extended from 2000 to 2016, covering both old and new manufacturers, without adequate justification. They submitted that the case was closer to *Shree Mahavir Oil Mills and Jaiprakash Associates*, where similar exemptions were struck down. Addressing the State's objection regarding non-challenge to earlier notifications, the Appellants relied on *Shree Mahavir Oil Mills* to contend that there could be no estoppel or acquiescence against the enforcement of constitutional rights. Finally, they challenged the State's justification that the exemption was aimed at promoting industrial development, arguing that accepting such a broad rationale would effectively dilute the constitutional guarantee of free trade under Chapter XIII, as States could routinely favour local goods under the guise of economic development.

The State on the other hand argued that the impugned notification was constitutionally valid and did not violate Article 304(a). Relying on *Jindal Stainless Ltd.*, it was submitted that the State's plenary taxing power was restricted only where there was discriminatory taxation, and that *Video Electronics* continued to hold the field. The State contended that the exemption amounted to permissible differentiation, as it was granted to a distinct class of industries for a limited period to promote industrialisation and environmental objectives. Support was drawn from *Digvijay Cements*, recognising the States' power to grant time-bound exemptions without affecting economic unity. It was further argued that the continued relevance of *Jaiprakash Associates* was doubtful after *Jindal Stainless Ltd*.

On facts, the State emphasised that Rajasthan had no asbestos manufacturing units prior to 2000, that fly ash was abundantly available in the State and the exemption was intended to encourage its utilisation in line with environmental policy. High transportation costs made out-of-State sourcing impractical, justifying the incentive. Finally, the State submitted that reasons for the notification need not be stated on its face and could be gathered from official records and affidavits, there being a presumption of constitutionality in favour of State action.

Decision

The Court held that the validity of the impugned notification depended on whether it could be justified within the limited exception carved out in *Video Electronics*. If the notification satisfied the parameters of permissible "differentiation" laid down in it, it could be sustained; otherwise, it would be construed as unconstitutional under Article 304(a) of the Constitution.

Relying on *Jindal Stainless Ltd.*, the Court reiterated that a tax measure does not become discriminatory merely because it differentiates, provided the differentiation is non-hostile, time-bound, applies to a distinct class, and serves a legitimate objective. Whether these conditions were satisfied was a fact-specific inquiry. The Court clarified that its analysis must consider the impugned notification in the context of the entire chain of exemption notifications issued by the State, though the final determination was confined to the validity of the notification dated March 9, 2007.

Applying these principles, the Court noted that while the exemption was ostensibly confined to a class of dealers and appeared time-bound, the cumulative effect of successive

[33] Shree Mahavir Oil Mills vs. State of J&K, (1996) Supp.9 SCR 356, State of U.P. vs. M/s Laxmi Paper Mart, (1997) 1 SCR 914, Anand Commercial Agencies vs. Commercial Tax Officer VI Circle, Hyderabad, (1998) 1 SCC 101.

notifications revealed that the benefit had effectively been extended from 2000 to 2016. The exemption was not limited to new industries nor demonstrably restricted to a short or exceptional period, thereby weakening the State's reliance on *Video Electronics*. Further, the notification was not targeted at economically backward areas, as it applied uniformly across Rajasthan.

The Court emphasised that the crucial requirement of "non-hostile" differentiation was not met. Drawing from equality jurisprudence, it held that classification becomes discriminatory when it lacks a reasonable nexus with the stated object or injuriously affects similarly situated persons. In the context of Article 304(a) of the Constitution, discrimination involves intentional and purposeful bias in favour of locally manufactured goods.

The Court found that the impugned notification disclosed no discernible objective beyond a generic reference to "public interest". Applying *Mohinder Singh Gill* and *Gordhandas Bhanji*,[34] it held that the State could not justify the notification by supplying reasons through affidavits or subsequent explanations. No industrial or environmental policy forming the basis of the exemption was shown, nor was any justification offered for repeatedly extending the benefit beyond the original cut-off dates.

Crucially, the exemption was based on the place of manufacture rather than the source of fly ash. As a result, asbestos products manufactured outside Rajasthan using fly ash were denied exemption, while products manufactured within the State using fly ash sourced from outside were favoured. This revealed a protectionist bias unrelated to the stated objective of fly ash utilisation, rendering the measure discriminatory. The Court observed that a source-based criterion applicable irrespective of the place of manufacture could have achieved the stated objective without discrimination.

Surveying precedents from *Atiabari Tea Co., Firm Mehtab Majid, Weston Electronics, Shree Mahavir Oil Mills,* and *Jaiprakash Associates*, the Court held that the present case fell squarely within the line of decisions striking down discriminatory tax measures and not within the narrow exception of *Video Electronics*, which was based on peculiar and compelling circumstances absent here. Accordingly, the Court concluded that the impugned notification violated Article 304(a) of the Constitution and was regarded as unconstitutional. The notification was quashed, the appeals were allowed, and the issue of refund of the differential tax deposited was directed to be examined separately.

Significant Takeaways

The judgment reaffirmed that tax incentives favouring locally manufactured goods must satisfy a strict, fact-based test under Article 304(a) of the Constitution. A State cannot justify differential tax treatment merely by invoking "public interest" or industrial promotion. The narrow exception in *Video Electronics* applies only where exemptions are clearly reasoned, time-bound, non-hostile, and linked to exceptional circumstances. Where an exemption is repeatedly extended, lacks an articulated policy rationale, and is based on the place of manufacture rather than the stated objective (such as resource utilisation), it amounts to protectionist discrimination and hence, should be construed as unconstitutional. The ruling underscored that States could not use fiscal incentives as indirect trade barriers, and reasons for such measures must be evident from the notification itself, not supplied later through affidavits. The Court's holding that public orders made by public authorities must be judged by the reasons mentioned in the order itself and cannot be supplemented by fresh reasons in affidavits or otherwise reinforced the principle that fiscal measures affecting inter-State trade must be transparent and grounded in manifest public purpose at the time of their issuance.

> **"Any long-term benefit extended to locally manufactured products over products procured from outside the state may not be permissible unless cogent reasons have been provided."**

[34] Mohinder Singh Gill vs. Chief Election Commissioner, (1978) 1 SCC 405, Commissioner of Police vs. Gordhandas Bhanji, AIR 1952 SC 16.

REGULATORY DIRECT TAX UPDATES

CBDT extends timelines for filing audit reports and Income Tax Returns for AY 2025–26

The CBDT, *vide* Circular No. 15/2025[35] dated October 11, 2025, extended the due dates for filing Income Tax Returns (**ITRs**) and audit reports for the AY 2025–26. This Circular extended the deadline for filing ITRs from October 31, 2025, to December 10, 2025. Consequently, the specified date for furnishing the audit report under Section 44AB of the IT Act also extended. The deadline for furnishing audit report had previously been extended from September 30, 2025, to October 31,2025. Pursuant to this Circular, it extended to the specified date under Section 44AB, i.e., to November 10, 2025, being one month prior to the due date for filing ITRs. This extension provided additional time to assessees to complete compliance obligations and was intended to ease compliance pressures for the relevant AY.

Central Government notifies arm's length price tolerance range for AY 2025–26

The Ministry of Finance (Department of Revenue), *vide* Notification No. 157 of 2025[36] dated November 6, 2025, notified the tolerance range for determining the arm's length price under the transfer pricing regulations for the AY 2025–26. As per the Notification, where the variation between the ALP determined under Section 92C of the IT Act and the price at which the international transaction or specified domestic transaction was actually undertaken did not exceed one percent of the latter in the case of wholesale trading, and three percent of the latter in all other cases, the transaction price would be deemed to be the arm's length price. The Notification also defined "wholesale trading" for this purpose as trading in goods, where the purchase cost of finished goods constituted 80 per cent or more of the total cost of such trading activities and the average monthly closing inventory of such goods did not exceed 10 per cent of the sales pertaining to such trading activities. This Notification provided certainty and clarity to taxpayers engaged in international and specified domestic transactions by prescribing the applicable tolerance margins for transfer pricing adjustments for the relevant assessment year.

Central Government amends Capital Gains Accounts Scheme to include electronic modes and Section 54GA

The Ministry of Finance (Department of Revenue), *vide* Notification No. 161 of 2025[37] dated November 19, 2025, issued the Capital Gains Accounts (Second Amendment) Scheme, 2025, further amending the Capital Gains Account Scheme, 1988. The amendment aim to incorporate transactions under Section 54GA and facilitate electronic mode of deposits and filings under the Scheme.

Key amendments include the insertion of Section 54GA references throughout the Scheme, expansion of the definition of "Deposit Office" to cover authorised banking companies, and inclusion of electronic payment modes such as credit/debit cards, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhaar Pay. Provisions were also updated to recognise electronics receipts, electronic statement of account, and electronic verification of deposits, account closures, and filing of Forms G and H.

These changes aim to modernise the Scheme, promote digital compliance, and provide assesses claiming exemption under the specified capital gains provisions with flexibility and ease in depositing capital gains and interacting with the relevant authorities electronically. The amendments came into force from the date of publication in the Official Gazette.

35 Circular No. 15/2025 dated October 11, 2025 [F. No. 225/131/2025/ITA-II].
36 Ministry of Finance Notification No. 157/2025 dated November 6, 2025 [No.157/2025/F. No. 500/1/2014-APA-II].
37 Ministry of Finance Notification No. 161/2025 dated November 19, 2025 [F. No.161/2025/F. No. 370142/23/2024-TPL].

India introduces landmark customs revision regulations to boost rrade facilitation

The CBIC, *vide* Notification No. 70/2025-Customs (N.T.)[38] dated October 30, 2025, notified the Customs (Voluntary Revision of Entries Post Clearance) Regulations, 2025, effective November 1, 2025, marking a transformative shift in India's customs framework. Framed under newly inserted Section 18A of the Customs Act, these regulations empower importers and exporters to voluntarily correct errors in Bills of Entry or Shipping Bills after goods clearance, eliminating cumbersome appeals and court interventions. Key features include application fee, automatic refund processing, and verification by designated officers.

CBIC launches risk-based system for 90 per cent provisional GST refunds to accelerate trade facilitation

The CBIC, *vide* Instruction No. 06/2025–GST,[39] dated October 3, 2025, introduced a risk-based mechanism enabling 90 per cent provisional GST refunds for zero-rated supplies and inverted duty structure claims, effective October 1, 2025. Issued via Instruction No. 06/2025-GST following the 56th GST Council meeting, the reform amends Rule 91(2) of CGST Rules, 2017, allowing system-identified "low-risk" applications to receive swift provisional sanctions without detailed scrutiny. Notably, proper officers retain discretion to conduct examinations in specific cases with recorded justification. Statutory conditions, including non-prosecution requirements and exclusions under Section 54(6) still remain applicable. As an interim measure, inverted duty structure refunds also qualify for provisional sanctions pending legislative amendments. This initiative aims to significantly reduce processing delays and enhance cash flow for compliant businesses.

DGFT streamlines IEC application process through digital integration and form consolidation

The DGFT has issued Public Notice No. 32/2025-26[40] dated November 20, 2025, amending Para 2.08 of the Handbook of Procedures 2023 with immediate effect. The reform merges ANF-1A with a revised ANF-2A form, eliminating duplicate documentation requirements. Crucially, details submitted in Importer Exporter Code (**IEC**) applications will now be validated through online integration with records maintained by relevant Ministries, Departments, Organisations, and Banks, wherever feasible. Applicants need only submit documents not specifically exempted by the system during the online application process. Additionally, guidelines for post-verification of online IECs will be issued by DGFT Headquarters periodically.

[38] CBIC Notification No. 70/2025-Customs (N.T.) dated October 30, 2025.
[39] CBIC Instruction No. 06/2025-GST, dated 03-10-2025.
[40] DGFT Public Notice No. 32/2025-26 dated 20 November 2025.

Excise duty on machine-based tobacco products and Health and National Security Cess on pan masala effective from February 2026

The Government, *vide* Notification No. 05/2025-Central Excise (N.T.)[41] dated December 31, 2025, issued the Health Security se National Security Cess Bill, 2025, and the Central Excise Amendment Bill, 2025, introducing a Health and National Security Cess to be levied specifically on *pan masala* manufacturing. Tobacco and its derivatives will instead attract an additional excise duty. To implement this, the Chewing Tobacco, Jarda-Scented Tobacco, and Gutkha-Packing Machines (Capacity Determination and Collection of Duty) Rules, 2026, have been notified. These rules specify that excise duty will be charged on products manufactured using packing machines and packed in pouches, with the number and maximum capacity of such machines in a factory serving as the basis for determining production. The rules also require manufacturers to declare the retail sale price on product packages and permit the use of CENVAT credit for excise duty paid. In line with these changes, Notification No. 01/2022-Central Excise (NT) has been amended to replace the term *"pan masala containing tobacco"* with *"Gutkha"*. Additionally, Notification No. 03/2019-Central Excise has been superseded, exempting certain excisable goods, such as unmanufactured tobacco, cigars, cheroots, cigarillos, cigarettes, *hukkah*, chewing tobacco, and *jarda*-scented tobacco from excise duty beyond the rates specified in Notification No. 3/2025-Central Excise.

41 Notification No. 05/2025-Central Excise (N.T.) dated December 31, 2025.

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AO	Learned Assessing Officer
AY	Assessment Year
CASS	Computer-Assisted Scrutiny Selection
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

GLOSSARY

ABBREVIATION	MEANING
GAAR	General Anti-Avoidance Rules
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

GLOSSARY

ABBREVIATION	MEANING
SAD	Special Additional Duty
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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