cyril amarchand mangaldas
ahead of the curve

tax scout

Tax Scout | April – June, 2026

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 on June 30, 2026.

Our cover story discusses the decision of the Hon'ble Supreme Court in the case of Tiger Global and its impact on offshore investment structures into India. It also examines the interplay and impact of subsequent CBDT Notification allowing GAAR grandfathering for investments made before April 1, 2017.

The Tax Scout also deals with other important developments in the field of taxation including an analysis of the landmark judgment by the Hon'ble Delhi High Court in the case of EY US LLP and other important 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 cam.publications@cyrilshroff.com.

Regards,

CYRIL SHROFF
Managing Partner
Cyril Amarchand Mangaldas

India's leading law firm

Index

Index

India's Post Tiger Global Tax Order: Impact on Structuring Offshore Investments

1. Introduction

The SC decision in *Authority for Advance Rulings (Income Tax) v. Tiger Global International II Holdings*[1] (**Tiger Global case**) is among the most important recent rulings on offshore investment structures into India. Its significance lies not only in the outcome but also the SC judges' approach.

The case concerned Mauritius-resident entities of the Tiger Global group that sold shares of Flipkart Private Limited, a Singapore-incorporated company, as part of Walmart's 2018 acquisition of Flipkart. Since Flipkart Singapore derived substantial value from its Indian subsidiaries, i.e., underlying Indian assets, the IRA treated the gains as taxable in India. The Mauritius entities relied on the India–Mauritius DTAA and their Tax Residency Certificates (**TRCs**) to claim exemption.

The SC ruled against the taxpayers. It held that the transaction was *prima facie* designed for tax avoidance, that a TRC was no longer conclusive after the statutory changes to Section 90 of the IT Act and the introduction of GAAR, and that treaty grandfathering under the amended India–Mauritius DTAA did not protect the indirect transfer of shares of a Singapore company.

Shortly thereafter, the CBDT issued Notification No. 54/2026 on 31 March 2026 (**the CBDT Notification**), amending Rule 10U of the IT Rules. The amendment clarified that Chapter X-A, which contains GAAR, would not apply for income arising from transfer of investments made before April 1, 2017.

This notification provides comfort to legacy investors related to one major concern on grandfathering of GAAR, but it has not removed all uncertainties created by the Tiger Global ruling. Several questions remain unaddressed on the conclusiveness of TRCs, the scope of GAAR and judicial anti-avoidance rules (**JAAR**), and the level of commercial substance required in treaty jurisdictions. These issues may create uncertainty for taxpayers, particularly those exiting old investments or negotiating cross-border acquisitions involving Indian assets.

This article explains the development of treaty-based structuring, the legal changes that reduced its importance, the SC decision in the Tiger Global case, the correction attempted through the CBDT Notification, and the implications of these developments on existing and future offshore investment structures.

The issue is important because many offshore investment structures were not created in anticipation of the present anti-abuse framework but at a time when the law, administrative circulars, and judicial decisions provided greater certainty to Mauritius-based holding structures. Consequently, the Tiger Global decision affects not only parties to the case, but also a wider class of private equity funds, venture capital funds, strategic investors, and holding companies that invested into India through intermediary jurisdictions before the position was revised.

The central question is no longer whether India can tax indirect transfers, considering indirect transfers are taxable since the introduction of amendments in 2012, provided the relevant statutory conditions are met. The pertinent question investors have is whether treaty protection and

1 [2026] 182 taxmann.com 375 (SC).

grandfathering continue to protect old investments, and if so, to what extent. The answer now depends on several interconnected factors, including the date of investment, the nature of assets transferred, the treaty invoked, the existence of substance in the offshore vehicle, and whether the same satisfies anti-avoidance provisions under GAAR, JAAR, and other treaty-specific anti-abuse rules.

2. Overview of history: Treaty-based structuring for offshore investments

For many years, treaty-based structuring was a widely accepted for channelling offshore investments into India. Mauritius emerged as the preferred investment jurisdiction because Article 13 of the India–Mauritius DTAA allocated taxing rights over capital gains to the state of residence. Since Mauritius did not tax capital gains on the sale of shares, Mauritius-resident investors could often exit an Indian investment without paying capital gains tax either in India or Mauritius.

These structures were not treated as unusual or abusive. Rather, these reflected the market norm established by the treaty itself. The CBDT also reinforced this by through Circular Nos. 682 of 1994 and 789 of 2000, which confirmed that capital gains accruing to a Mauritius resident would not be taxable in India and affirmed the supremacy and evidentiary value of TRCs.

The SC accepted this position in *Union of India v. Azadi Bachao Andolan* (**Azadi Bachao Andolan**)[2] by holding that TRC issued by a Mauritius authority is sufficient evidence for accepting tax residency. The Court also recognised that treaty shopping is not illegal merely because a resident of a third state uses India–Mauritius DTAA to claim the benefits available therefrom. The SC observed that in case India wished to deny benefits, it could have inserted a limitation of benefits clause in the treaty.

The decision in *Azadi Bachao Andolan* provided legitimacy to the structuring of investments through an intermediary vehicle in a separate country such as Mauritius. It upheld the superiority of treaty provisions against Indian domestic tax laws where the treaty was more beneficial and treated a valid TRC as sufficient proof for availing treaty benefit. This provided certainty to various funds that had invested in India through Mauritius at a time when these structures were increasingly under scrutiny and investigations from the IRA.

The SC later considered offshore holding structures in its landmark decision in *Vodafone International Holdings B.V. v. Union of India* (**Vodafone**).[3] The dispute concerned the transfer was of shares of a Cayman Islands company between two non-residents. The Court held that, as the law then stood, Section 9 of the IT Act did not contain a look-through provision for indirect transfers. Accordingly, India could not tax the transfer of shares of a foreign company merely because the foreign company indirectly held Indian assets.

Vodafone also reaffirmed the importance of legal form, genuine holding structures, and TRCs. It held that corporate structures should be evaluated holistically and not viewed on a piecemeal basis. The Court acknowledged that a valid TRC is entitled to benefits, unless the IRA is able to argue that the arrangement is a sham, lacks commercial substance, or a mere device designed to claim treaty benefits. *Vodafone* also did not say that TRCs can never be questioned but recognised that where a Mauritius entity is interposed only as a device without commercial substance, the IRA may examine the real transaction.

The historical comfort was also supported by Section 90 of the IT Act, which allows India to enter into tax treaties and agrees to the supremacy of the treaty provisions over domestic law where they are more beneficial to the taxpayer. As a result, investors focused on ensuring the Mauritius entity had valid incorporation, held a TRC, complied with Mauritius law, and held ownership of the Indian investment. Indian tax diligence at the time often concentrated on documentary proof of residence rather than a detailed enquiry into day-to-day management, expenditure, employees, or investment decision-making in Mauritius.

Consequently, before subsequent legislative and treaty amendments, the broad position was taxpayer friendly. Treaty-based structuring was accepted as legitimate, indirect transfers were not taxable under the then Section 9, and TRCs carried significant evidentiary value.

3. Revision of treaty provisions: Introduction of GAAR, the 2016 Protocol, and the Multilateral Instrument (MLI)

As the Indian economy expanded and became increasingly confident of interacting with global economic superpowers, the government adopted a more assertive tax position. Following the SC's adversarial decision in *Vodafone*, it chose

[2] [2003] 132 Taxman 373 (SC).
[3] [2012] 17 taxmann.com 202 (SC).

to significantly overhaul India's position pertaining to taxation and overrule the SC decision with absolute clarity and confidence. India amended its domestic taxation provisions bringing within its purview tax situations which foreign investors had been avoiding through multi-layered investment arrangements. The country's assertiveness on taxation was also reflected in several significant changes introduced through the budget of 2012, including but not limited to, the scope of Indian tax, widening the scope of royalty, the introduction of GAAR and APAs, the reduction of the long-term capital gains tax rate on unlisted securities from 20 per cent to 10 per cent, etc.

These changes came as a surprise to the business community and foreign investors who were accustomed to interacting with accommodating tax administrators whereas they now had to confront confident and bullish tax administrators. What began in 2012, evolved into a more assertive and aggressive tax policy with each successive subsequent budget. India also renegotiated its DTAAs with friendly jurisdictions such as Mauritius, Singapore, and Cyprus in 2016. Subsequently, GST was introduced in July 2017, replacing a host of indirect taxes applicable on various goods and services across the country, and long term capital gains arising from the sale of listed securities, which was earlier exempt, became taxable from 2018 onwards.

The amendments introduced in 2012 were particularly significant because they altered the domestic law position the SC had accepted in *Vodafone*. The amendments treated shares or interests in a foreign company as situated in India if they derived substantial value from Indian assets. This allowed India to tax gains from offshore transfers where the real economic value was linked to India. These also expanded the withholding risk for buyers because payments between two non-residents could still be chargeable in India if the underlying gain was taxable in India.

The same period also saw the introduction of GAAR, although its application was deferred and became effective only from April 1, 2017. GAAR allows the IRA to deny tax benefits, including treaty benefits, where an arrangement constitutes an impermissible avoidance arrangement. Section 90(2A) of the IT Act was also inserted subsequently to clarify that treaty benefits would be subject to GAAR. The provision did not merely create a anti-avoidance charging mechanism, it gave the IRA a framework to deny a tax benefit where the main purpose of an arrangement was to obtain a tax benefit and the arrangement lacked commercial substance, misused the law, created non-arm's length rights or obligations, or was not carried out in a *bona fide* manner. It also allowed the authorities to disregard, combine, recharacterise, or look through steps in an arrangement.

The next major change came in 2016 through the renegotiation of the DTAA provisions with Mauritius, Singapore, and Cyprus. Pursuant to the Protocol to the India-Mauritius DTAA (**Protocol**), India obtained source-based taxing rights over gains from the alienation of shares of an Indian company acquired on or after April 1, 2017. This effectively removed the key capital gains advantage that had made Mauritius the default route for new offshore investments in India.

However, the Protocol also protected earlier investments. Investments made before April 1, 2017, were grandfathered, meaning that the earlier treaty provisions would continue to apply to them. Rule 10U(1)(d) of the IT Rules also protected income from the transfer of investments made before April 1, 2017, from GAAR.

The MLI added another layer by introducing Principal Purpose Test (**PPT**) in the DTAAs. Under the PPT, treaty benefits can be denied where one of the principal purposes of an arrangement is to obtain tax benefit. Accordingly, taxpayers could avail treaty benefit if they could prove that the transaction or arrangement has a business purpose consistent with the object and purpose of the treaty. This made substance, purpose, and documentation more important than mere residence. Hence, the MLI and the PPT further reduced the relevance of treaty-only structuring.

After these changes, treaty-based structuring declined in importance because treaties no longer offered the same capital gains benefits to new investors and for new investments. Nevertheless, the principles in *Azadi Bachao Andolan* and *Vodafone* continued to remain relevant for genuine legacy investments, particularly on the importance of TRCs, legal form, and the need for the IRA to show abuse before disregarding a structure. The Tiger Global case tested the limits of those principles in the changed statutory environment.

4. The Tiger Global ruling: Judicial history and decision

The Tiger Global entities were incorporated in Mauritius and held valid TRCs. They had acquired shares of Flipkart Singapore between 2011 and 2015. Flipkart Singapore, in turn, held Indian subsidiaries and derived substantial value from assets located in India. In 2018, the Tiger Global entities sold their Flipkart Singapore shares to a Luxembourg purchaser as part of Walmart's acquisition of Flipkart.

The taxpayers approached the AAR, seeking an advanced ruling on whether the gains were taxable in India under the IT Act read with the India Mauritius DTAA. The AAR rejected the applications at the threshold under Section 245R(2) of the IT Act, holding that the transaction was *prima facie* designed for income tax avoidance. The AAR observed that real control and management were not in Mauritius, that the entities had no meaningful investment activity other than their investment in Flipkart, and that the structure was designed to claim treaty benefits.

However, on being approached by Tiger Global, the Delhi HC took a completely different view and reversed the AAR's decision. The Delhi HC held that the entities had been in existence for a considerable period of time, possessed valid TRCs, and that the structure had exhibited commercial substance. Since the IRA had not established sham or fraud, the Delhi HC grandfathered the pre-2017 investments, while relying heavily on *Azadi Bachao Andolan* and *Vodafone*.

When the matter ultimately reached the SC, the Court had a completely different view. Upon reviewing the facts and the statutory framework, the SC was of the view that the AAR's *prima facie* jurisdictional bar was relevant. The SC gave weight to the words "*prima facie*" in Section 245R(2) of the IT Act, which meant that the AAR does not need to finally prove tax avoidance before refusing to entertain an application. If the material before it supports a view that the transaction has been designed for income tax avoidance, the AAR may reject the application at the threshold.

The SC was also of the view that following the insertion of Sections 90(2A), 90(4) and 90(5), and GAAR, a TRC continues to be a necessary document for claiming treaty benefits, but it is no longer regarded as a conclusive proof of residence and commercial substance. The IRA may examine and investigate whether the entity claiming treaty benefit is a genuine tax resident and whether it has a real commercial substance. This is the point on which the Tiger Global case departs from the earlier understanding of *Azadi Bachao Andolan*.

The SC treated Section 90(4) as imposing an eligibility condition, not as creating conclusive proof. This represents a significant shift in emphasis. A TRC remains the starting point for a treaty claim, and without it, treaty relief will generally not be available. But after the Tiger Global case, the presence of a TRC does not end the enquiry if the IRA is able to establish that the entity is a conduit, lacks substance, or is effectively controlled from outside the treaty jurisdiction.

The SC also held that the transfer was domestically taxable under Section 9(1)(I) because the shares of Flipkart Singapore derived substantial value from assets located in India. This conclusion was possible because of the 2012 amendments introduced after *Vodafone*. Therefore, the Tiger Global case does not overrule *Vodafone* on the earlier law. Instead, it applies the amended law.

Treaty grandfathering under Article 13(3A) of the Indian–Mauritius DTAA applied only to direct transfers of shares of Indian companies and not to indirect transfers of shares of a foreign company. Since Tiger Global had transferred shares of Flipkart Singapore, a foreign company deriving substantial value from Indian assets, the SC concluded the transaction fell outside the grandfathering protection available under Article 13(3A). treated.

The SC observed that as per Rule 10U(2) of the IT Rules, as it existed at the relevant time, GAAR could be applied to any arrangement where the tax benefit arose on or after April 1, 2017, even if the investment was made before that date. Since the exit occurred in 2018, the SC held that the arrangement could be tested under GAAR.

The SC's reasoning proceeded in a three-step sequence: (i) The SC first examined domestic taxability under Section 9(1)(I), including the indirect transfer deeming fiction; (ii) after establishing taxability under domestic laws, it examined whether any beneficial provision under the relevant treaty was applicable; and (iii) for applying such treaty benefit, it considered whether anti-abuse principles, including GAAR and JAAR, could prevent the taxpayers from availing such benefit.

The decision also reflects a wider policy theme of tax sovereignty. The SC emphasised that tax treaties are bargains between States and that the purpose of a DTAA is to prevent double taxation, not to enable double non-taxation or treaty abuse. While the Court did not suggest that every case of non-taxation is abusive, it nevertheless implied that courts may now be more willing to interpret treaty provisions in light of the post-GAAR anti-abuse environment.

Hence, while the Tiger Global case does not fully overrule *Azadi Bachao Andolan* or *Vodafone*, it narrows their practical effect in the post-2012 and post-GAAR regime. The earlier cases still matter for genuine structures and for the proposition that tax planning is permissible if it is within the law. However, after the statutory changes, the IRA has greater power to examine substance, indirect transfers, and treaty abuse.

5. The CBDT Notification: The grandfathering correction and its limits

Before the CBDT Notification, Rule 10U(1)(d) of the IT Rules provided that GAAR would not apply to income from transfer of investments preceding April 1, 2017. Rule 10U(2), however, said that GAAR would apply to any arrangement, irrespective of the date of entry, if the tax benefit was obtained on or after April 1, 2017. The SC relied on this point of difference and held that Rule 10U(2) diluted the protection under Rule 10U(1)(d) where the exit occurred after April 1, 2017, and consequently the tax benefit was obtained after such date.

The CBDT Notification corrected this position. It amended Rule 10U(1)(d) to protect income from the transfer of such investments made before April 1, 2017. It also substituted Rule 10U(2) to clarify that Chapter X-A applies to tax benefits obtained from arrangements on or after April 1, 2017, except for income arising from transfer of the pre-2017 investments. The explanatory memorandum states that Chapter X-A shall not be invoked from the date of publication of the rules where income arises from transfer of investments made before April 1, 2017.

The CBDT Notification provides significant relief to investors still holding legacy investments. Post this notification, for relevant investment made before April 1, 2017, income from its transfer should no longer be tested under GAAR. This amendment aligns the rules with the policy expectation that pre-GAAR investments should be grandfathered.

The change made by CBDT Notification is, therefore, best understood as a targeted correction. It does not rewrite the treaty and overrule or disregard the parts of the Tiger Global case relating to taxation or treaty interpretation. Instead, it addresses the specific concern that the old wording of Rule 10U(2) could misinterpreted to expose even pre-2017 investments to GAAR merely because the exit happened after April 1, 2017.

For taxpayers, the key benefit is that the notification restores the intended difference between investments and arrangements in a more balanced manner. A genuine investment made before April 1, 2017, should not lose GAAR grandfathering simply because the transfer or monetisation occurs later. This is consistent with the policy statements made when GAAR was deferred and investors were assured that pre-2017 investments would be protected.

However, the notification has its own limits. While it protects income from the transfer of such investments from the applicability of GAAR, it does not clarify whether assets transferred qualify for grandfathering or not, neither does it clarify whether the place of effective management is within or outside Mauritius nor whether the structure can be challenged under ordinary principles of substance over form. Understandably, these issues remain fact-dependent and will be determined on a case-by-case basis. The Notification merely clarifies that in case of investments made prior to April 1, 2017, the GAAR cannot be invoked.

6. Practical implications: Risk for existing structures and impact on future structures

For existing structures, the main concern is whether the investment was made before April 1, 2017. If yes, the CBDT Notification now gives a strong argument that GAAR should not apply to income from its transfer. However, investors must preserve clear documentary evidence establishing the acquisition date and nature of the original investment, including the identity of the investor, share certificates or investment instruments, and records of any subsequent actions such as conversions, splits, bonus issuances, or reorganisations to substantiate eligibility for grandfathering protection.

The next important issue is commercial substance. Existing Mauritius or Singapore vehicles should be reviewed for board composition, meeting location, actual decision-making, bank account authority, employees or service providers, local office arrangements, accounting records, and evidence substantiating that the key decisions were actually made by the local board after much deliberation over the arguments placed before them rather than merely ratifying decisions made elsewhere. A TRC remains an important and necessary evidence for claiming benefits, but it now needs to be supported with contemporaneous records of the functioning of a company to show that it has commercial substance.

Another practical implication relevant for existing structures will be additional factors to be kept in mind while negotiating share purchase agreements for the sale of shares deriving substantial value from Indian assets. Since the SC has clarified that a TRC shall not be construed as a conclusive proof for claiming treaty benefit, sellers of such shares seeking treaty benefits will need to substantiate their position through adequate and appropriate documentary evidence showcasing commercial substance of the holding companies and of the proposed arrangements. They will also have to consider whether they can support a no-withholding position with a reasoned tax opinion obtained from reputed Indian tax practitioners or a lower withholding certificate from Indian tax authorities that can be provided to the buyers.

Correspondingly, buyers may want comfort not only on the target company's tax profile, but also regarding the seller's treaty eligibility before deciding on whether or not to withhold the taxes. In competitive transactions, this may become an important negotiation point impacting the price and timing of the closing conditions. The buyers' diligence will now extend to the seller's holding structure and treaty claim, not only to the Indian target's tax compliance.

Yet another practical implication for sellers is that if buyers fear defaults in withholding tax obligations, then buyers may demand additional tax indemnity for the same or even the retention of relevant amounts in escrow accounts. Therefore, it shall be important for sellers claiming treaty benefits to not only have a valid TRC but also extensive documents such as financial statements, board minutes, investment committee approvals, service agreements, bank mandates, and records showing that key decisions were taken within the treaty jurisdiction.

For future structures, Mauritius route is no longer attractive because no capital gains exemption is available for acquisitions made after April 1, 2017. New investments should be structured around commercial, regulatory, investor, and operational considerations rather than tax treaty benefits alone. Tax planning is no longer relevant for structuring a new investment because no jurisdiction provides any treaty benefit for capital gains earned in India.

7. The way forward

The position emerging from the Tiger Global case and the CBDT Notification is not entirely negative for taxpayers. The CBDT Notification shows that the government is willing to respond where judicial interpretation creates wider uncertainty for genuine legacy investments.

Going forward, government policy decisions should balance two objectives. First, that India has a legitimate interest in taxing gains earned from value additions done in India and through prevention of treaty abuse, while ensuring investors' need for tax certainty rules, especially where investments were made under an earlier legal regime. Second, that a clearer administrative framework on substance, documentation, and grandfathering would reduce litigation and improve confidence.

It will also be interesting to see the evolution of evidentiary standards for substance in treaty jurisdictions. While a standard test may not be possible for such fact-specific determination, some guidance by the CBDT on documentation other than the TRC would help reduce avoidable disputes.

8. Conclusion

The SC's decision on the Tiger Global case marks a turning point in Indian international tax law. This decision does render all offshore structures invalid; instead, it signals that availing treaty benefits will require a deeper analysis. The IRA is now empowered to examine the substance of arrangements under the provisions of GAAR before extending treaty benefits. Importantly, the actual assessment and raising of tax demand in the Tiger Global case remains pending and dependent the evidences submitted before the assessing officer and subsequent authorities. It will also be interesting to see how the jurisprudence evolves in the new tax framework, wherein the

courts will have to navigate through GAAR, PPT, POEM, along with BEPS framework.

A TRC continues to be a necessary document for claiming treaty benefits, but it is no longer a conclusive proof of residence. TRCs, along with other evidentiary documents, shall have to be examined to determine whether an arrangement can be considered as an impermissible avoidance arrangement under GAAR and treaty benefits can be denied for such arrangements. The CBDT Notification is an important correction because it protects income from transfer of investments made before April 1, 2017, from GAAR, thereby providing certainty to legacy investors.

For taxpayers, the lasting lesson is that treaty planning has moved from a certificate-based to a substance-over-form approach. Existing investors must prepare for deeper review at exit, while future investors must design structures that have genuine operational substance. It will have to be seen how the taxation of cross jurisdictional investments evolves over the coming days because it is almost impossible not to deal in multiple treaty jurisdictions in today's evolving economic circumstances. Whether post Tiger Global the tax world becomes a facilitator of extremely structured and sophisticated tax optimised world or becomes a simple cross-country investment between source and resident countries, remains to be seen.

Delhi HC holds secondment reimbursements as FTS where "Make Available" test is met

Introduction

The Delhi HC, in ***Commissioner of Income Tax (International Taxation)-1, New Delhi v. Ernst and Young U.S. LLP***,[4] held that cost-to-cost reimbursements that EY US LLP (**EY US**) received from its Indian affiliated entities for the secondment of employees constitute Fees for Technical Services (**FTS**) under Article 12 of the India–United States DTAA, as the seconded employees satisfied the "make available" test by transferring technical knowledge, skill, and experience, including through training to the EY India entities and their customers. The HC clarified that the employees of EY US retained their employment lien with the company, even when working exclusively for EY India. Accordingly, they should be regarded as employees of EY US rendering services to EY India. The HC also held that ITAT's orders were *per incuriam* and perverse for not engaging with the binding precedent of the earlier HC decision in *Centrica India Offshore Pvt. Ltd. v. CIT*[5] (**Centrica**).

Facts

EY US, a limited liability partnership incorporated under the laws of the United States and a member of the global EY network, is engaged in the business of providing professional services in the fields of assurance, tax, transactions, and business advisory services to clients across the globe, including India. Three EY entities operate in India, namely, EY GBS (India) Pvt. Ltd., EY Global Delivery Services India LLP (**EYGDS India**), and Ernst & Young LLP (collectively, the **EY India entities**).

Under EY US's deputation agreement with EY India entities, certain EY US personnel were seconded to work with EY India entities. During the assignment period, the secondees were to function solely under the control, direction, and supervision of EYGDS India and in accordance with all rules, regulations, policies, guidelines, and other practices generally applicable to EYGDS India employees. For administrative convenience, EY US made salary payments to the secondees in the United States on behalf of EYGDS India and thereafter raised invoices on EYGDS India for the reimbursement of the exact amounts paid, without any mark-up.

Across various AYs, the AO proposed additions to the income of EY US on account of the secondment reimbursements, by treating such reimbursements as FTS under Article 12 of the India–US DTAA and found that a portion of EY US's receipts from professional services rendered in and from the United States did not qualify for the exemption under Article 12(5)(e) of the DTAA. The DRP rejected the Assessee's objections and upheld the additions. On further appeal, the ITAT allowed EY US's appeals and set aside the assessment orders, prompting the IRA to approach the HC in this case.

Issue

(I) *Whether employees of EY US working exclusively for and under the exclusive control and supervision of EYGDS India should be construed as employees of EY US since they retain their employment lien with EY US?*

4 CIT (International Taxation) – I v. Ernst and Young US LLP [2026] 187 taxmann.com 711 (Delhi).
5 Centrica India Offshore Private Limited v. Commissioner of Income Tax – I, New Delhi [2014] 51 taxmann.com 386 (SC).

(ii) *Whether the cost-to-cost reimbursement amounts received by EY US on account of the secondment of its employees to the EY India entities ought to be treated as FTS under the India–US DTAA, given that the "make-available" test under the DTAA is satisfied.*

(iii) *Whether the absence of mark-up on the reimbursements could negate the character of the transaction as FTS, and whether the ITAT's orders rendered in disregard of the binding precedent in Centrica were per incuriam and perverse.*

(iv) *Whether the professional service receipts received by EY US from Indian clients fell within the exemption for professional services under Article 12(5)(e) read with Article 15(2) of the India–US DTAA, and whether the ITAT's blanket finding that all such services were exempt could be sustained in the absence of analysis of the nature of services.*

Arguments

The IRA contended that the employment that EY India entities offered to the seconded employees came with a lien marked on the employment with EY US. On the completion of their tenure, the seconded employees were repatriated to EY US and were not free to move anywhere else, demonstrating that the seconded employees never ceased to be EY US employees. The revenue authority further argued that the employees working in India continued to contribute to social security benefits in the United States through EY US, corroborating that the employer–employee relationship between EY US and the secondees continued to subsist throughout the deputation. The IRA relied upon the coordinate bench decision in *Centrica* for the proposition that the mere characterisation of a payment as a "reimbursement", and the absence of a mark-up, cannot be determinative of the nature of the services rendered.

On the other hand, EY US contended that the secondees ceased to be employees of EY US during the period of deputation and became employees of EY India entities. The company contented that EY India entities discharged their TDS obligations in their capacity as employers under the relevant provisions of the IT Act, 1961. The Assessee relied upon the judgment of the SC in *AP Moller Maersk A S*[6] to argue that the principle of cost-to-cost reimbursement is conclusive that the transaction did not give rise to any taxable income, regardless of the object or purpose of the payment or the person to whom the payment was made. On the professional service receipts, it was contended that EY US's receipts were not covered under Article 12(4)(b) of the DTAA as the "make available" test was not satisfied. It was also contended that payments made for professional services as defined in Article 15 should be excluded from the scope of Article 12 by virtue of Article 12(5)(e) of the DTAA, relying upon Bio-Rad *Laboratories*,[7] *RELX Inc.*,[8] and *Aecom*.[9]

Decision

At the outset, on the basis of a detailed review of the terms and conditions entered between EY US and EY India Entities, the HC held that it was evident that the secondees had to India only for a short duration and during such period, EY continued to pay their salaries and social security contributions and they continued to hold lien over their employment with EY US. The HC also observed that EY India entities did not even have the authority to terminate the seconded employees. They could only terminate the secondment prior to the agreed period and relieve the secondees to enable them to rejoin EY US. They also had no power whatsoever to severe the relationship between the secondees and EY US, which would resume at the end of the deputation. This, the HC held, confirmed that the secondees continued to maintain their employment lien with EY US throughout the period of their deputation, that they were paid social security benefits through EY US, and that EY US retained overarching control over them. From these discussions, the HC concluded that the secondees operated in India as employees of EY US even though they operated under the exclusive control and supervision of EY India Entities.

The HC held that EY US's argument regarding the absence of any transfer of technical know-how or expertise was negated based on a critical review of the scope of service set out in the engagement letter. In this letter, the services rendered by EY US, *inter alia*, included training services imparted by the seconded EY US employees, which reflected an element of transfer of technical knowledge, experience, skill, or know-how that satisfied the "make available" test as laid down in *De Beers India*.[10] The HC found it impossible to appreciate how the ITAT could have reached a contrary conclusion without specifically contradicting AO's detailed analysis of the scope of work.

The HC further held that the instant facts were similar to those in *Centrica* and that the findings of the Coordinate Bench were

6 DIT (International Taxation) - I v. AP Moller Maersk AS [2017] 78 taxmann.com 287 (SC).
7 CIT (International Taxation) – I v. Bio-Rad Laboratories (Singapore) Pte Ltd. [2023] 155 taxmann.com 646 (Delhi).
8 CIT (International Taxation) v. RELX Inc [2024] 160 taxmann.com 109 (Delhi).
9 Aecom Technical Services Inc. v. ITO, IT [2025] 174 taxmann.com 1173 (Delhi).
10 CIT v. De Beers India Minerals Private Limited [2012] 21 taxmann.com 214 (Kar)

squarely applicable, especially observing that the SC had also upheld the *Centrica* order. Having examined the impugned ITAT orders, the HC found that the ITAT had provided no cogent reasoning for departing from the concurrent findings of the AO and the DRP and had made no reference whatsoever to the binding precedent of this Court in *Centrica* rendering the impugned orders *per incuriam* and perverse.

On the issue of professional service receipts, the HC noted that the AO had already extended the benefit of Article 12(5)(e) to certain services and had retained for taxation only those receipts falling outside the definition of "professional services" under Article 15(2). The ITAT ought to have examined the key differences between the services charged as FTS and those found to be exempt instead of providing a blanket finding that all services fell within Article 12(5)(e). The HC accordingly set aside the impugned ITAT orders, answered certain other issues as discussed earlier in favour of the IRA, and remanded the professional receipts questions back to the ITAT for reconsideration afresh with a reasoned order.

Significant Takeaways

The HC's elucidation of the relationship between the assignor and the assignee has created considerable doubt and uncertainty among the taxpayers and professional community. After the SC's observation in the case of Morgan Stanley regarding the status of secondees working in India retaining their lien with the parent organisation had resulted in a significant amount of rethinking and restructuring of secondment arrangements, especially in the case of GCCs operating in India. The issue became further complicated with the Delhi HC's decision in *Centrica (supra)*. The Delhi HC's strong and unambiguous support of its earlier decision makes the judiciary's thinking abundantly clear and warrants an urgent recalibration of the international human resource planning of the industry, especially among the GCCs.

From a taxability perspective, the HC's ruling in this case clarified the interaction between the tax treaties and the taxation of cross-border secondment arrangements, specifically affirming that the characterisation of a payment as a cost-to-cost reimbursement without a mark-up is not determinative of its true nature of such payments under the relevant tax treaty. The HC reiterated the principles established in *Centrica* and particularly addresses the application of the "make available" test to secondment arrangements where seconded personnel come to India to work with Indian clients, bring in their technical and professional skills, and implement group-wide policies, processes, and quality standards. It emphasised that once such knowledge is imbibed into the Indian entity, which it can thereafter apply independently without the aid of the overseas entity, the "make available" test is satisfied and that the absence of a mark-up over and above actual costs cannot negate that conclusion. However, while making these observations, the HC did not clarify whether the requisite skill and experiences were actually imparted to the client or to its Indian affiliates.

The HC's observation was also unclear about its conclusion that the employees retained their ability to claim compensation from EY US even though the Assessee submitted that the employment with it was suspended during the secondment. It also did not clarify whether secondees had the right to claim any compensation from EY US while working with EY India Entities.

The HC's ruling further demands taxpayers to prevent them from relying on blanket claims of professional service exemption without analysing the actual services being rendered.

> **" A secondee retaining lien over employment with the overseas parent shall continue to be regarded as an employee of the foreign parent. "**

Partner-specific DTAA analysis required for fiscally transparent UK LLPs; Legal services not FTS

Introduction

In ***Herbert Smith Freehills LLP***,[11] the Delhi ITAT held that where a foreign partnership was fiscally transparent in its jurisdiction of constitution, the treaty entitlement of each partner would be independently examined under the DTAA between India and that individual partner's country of tax residence. However, this could not be determined solely by a reference to the treaty applicable to the jurisdiction in which the partnership was registered. The Tribunal further affirmed that professional and legal services rendered by a foreign law firm were a distinct statutory category and could not be characterised as FTS under the IT Act.

Background

Herbert Smith Freehills LLP (**Assessee**) is an international law firm of solicitors registered in the United Kingdom as an LLP engaged in rendering legal services to clients worldwide through its partners, members, and employees, primarily from outside India with intermittent visits to India. As is characteristic of UK-based partnerships, the firm is a fiscally transparent entity under UK domestic law. The partnership is required to file an income tax return, but the tax liability arising from partnership income flows through and is assessed in the hands of each individual partner in proportion to their respective profit-sharing entitlement. Income attributable to partners who are not UK tax residents is not subject to taxation in the United Kingdom.

The Assessee's partnership comprises partners residents across several jurisdictions. In filing its returns of income, the Assessee had claimed that income attributable to UK-resident partners was exempt under the India–UK DTAA, as amended, to include partnership firms within the definition of "person". The income attributable to the partners resident in certain other jurisdictions was claimed as not taxable in India under the respective bilateral DTAAs between India and those countries, relying on the independent personnel services' provisions, the absence of a fixed base or PE in India, and the make-available test applicable under those treaties. Regarding partners whose applicable bilateral treaty with India did not contain a make-available clause, the Assessee voluntarily offered the corresponding share of income to tax. The AO accepted the Assessee's positions in relation to UK-resident partners and those whose income was offered to tax but treated the income attributable to the remaining all non-UK partners as FTS taxable under the IT Act, on the basis that those partners could not avail themselves of the India–UK DTAA. CIT(A) upheld the additions, and the Assessee appealed to the ITAT.

Issue

(i) *Whether Article 4(1)(b) of the India–UK DTAA, which provides that treaty benefits apply to the partnership only to the extent that its income is subject to tax in the United Kingdom bars non-UK partners from invoking the bilateral DTAAs between India and their own countries of residence?*

(ii) *Whether income received by the Assessee from Indian legal engagements constitutes FTS taxable under the IT Act?*

Arguments

The Assessee submitted that Article 4(1)(b) of the India–UK DTAA restricts the application of the treaty benefits to income actually taxed in the United Kingdom as the income of a resident. It does not, and legally cannot, deny non-UK resident partners the right to independently invoke the DTAAs between India and their own countries of residence. Every bilateral DTAA India has entered into applies to persons who are residents of one or both contracting states, and both a partnership and its constituent partners qualify as "persons" within the meaning of the respective DTAAs. Any contrary interpretation would result in an outcome where the same income is taxed in India while the remaining untaxed in the United Kingdom, which is directly contrary to the object of every DTAA.

The Assessee further submitted that UK LLPs are recognised as taxable units under the UK domestic law, and that the amended definition of "person" under the India–UK DTAA expressly includes partnership firms, making the firm eligible for treaty protection to the extent of its UK-resident partners' share. On the income from legal services, the Assessee submitted that professional services constitute a distinct category of income under the IT Act, explicitly separated from managerial, technical, or consultancy services that constitute FTS, and are excluded from the FTS definition under the applicable DTAA provisions. The independent personnel services article in the relevant bilateral treaties also precluded taxation in India, since the firm neither maintained a fixed base in India nor did its members' presence in India exceed the prescribed treaty threshold.

[11] Herbert Smith Freehills LLP v. Commissioner of Income Tax (Appeals)-43, ITA Nos. 2281/DEL/2019, 2352/DEL/2022 & 3209/DEL/2023 (ITAT Delhi, 22 June 2026.

The IRA submitted that a plain reading of Article 4(1)(b) of the India–UK DTAA makes clear that treaty benefits can be extended to the partnership firms only to the extent that its income is subject to tax in the United Kingdom. Since the income attributable to non-UK resident partners is not taxed in the United Kingdom, those partners fall entirely outside the protection of the India–UK DTAA, leaving their share of income exposed to taxation under the IT Act. The IRA further relied on a CBDT Circular to argue that this reading was consistent with the official position on the scope of the India–UK DTAA. On the question of consistency, the IRA pointed that since the Assessee had offered to tax the share of profit attributable to one group of non-UK resident partners under the applicable bilateral DTAA, there was no logical basis to treat the remaining non-UK partner groups differently. If the Assessee acknowledged taxability for one set of non-UK partners, the same position ought to be applied for the others, since the nature of the services and the character of the income were identical across all groups. On FTS, the IRA contended that to the extent no treaty shield was available, the receipts from Indian legal engagements constituted FTS under the IT Act, on the ground that the services the Assessee rendered were specialised expert advisory services rendered to Indian clients for consideration, which fell broadly within the category of managerial, technical, or consultancy services.

Decision

The Tribunal held that the phrase "to the extent" limits the scope of the India–UK DTAA but it does not override the independent treaty rights of partners who are residents of other countries. Holding otherwise would result in the same income being taxed in India while remaining untaxed in the United Kingdom in the hands of those partners, a result contrary to the object of the relevant DTAA. The Tribunal analysed the categorical distinction between professional services and FTS. Section 40(a)(I) of the IT Act, which prescribes withholding for FTS payments to non-residents, makes no mention of professional service fees. At the treaty level, the applicable DTAA provisions expressly exclude lawyers and professional firms from the applicability of FTS. On the basis of such FTS exclusion at the domestic and treaty levels, the additions were deleted accordingly.

Consequently, the ITAT allowed the appeals and deleted the additions. The taxability of each relevant partner's income was restored to the AO for fresh examination under the applicable bilateral DTAA. The Tribunal also observed that since the UK LLP was fiscally transparent, each partner's treaty entitlement must be assessed individually by reference to the DTAA applicable to their country of residence. The ITAT also frowned upon the AO's selective approach in accepting the taxes paid by the firm for certain non-UK resident partners while challenging a similar approach adopted by the other non-UK partners of the partnership.

Significant Takeaways

The decision is an addition to the growing body of jurisprudence on the taxation of fiscally transparent foreign partnerships in India. It builds on the Mumbai Tribunal's decision in *Linklaters LLP*,[12] which established the core principle that treaty protection cannot be denied in India if partnership income is liable to tax in the treaty partner jurisdiction, whether in the hands of the firm or its partners. Calcutta HC in *P&O Nedlloyd Ltd.*[13] reinforced this by holding that a UK partnership qualifies as a "person" entitled to treaty benefits, a position ultimately accepted at the sovereign level through a MAP resolution. This judgment necessitates a partner-level DTAA analysis for any fiscally transparent foreign partnership with Indian engagements. At the structuring stage, before formalising any Indian engagement, the firm must review the profit-sharing arrangement of the multi-jurisdictional partnership and check, for each partner's home country, (a) whether the relevant treaty has an independent personnel services article and what presence thresholds it sets and (b) whether that treaty includes a make-available clause. This is critical because if a particular partner's treaty does not contain a make-available clause, the income attributable to that partner can become taxable in India on its own, regardless of any exemption that might otherwise apply to professional services under other treaty provisions.

> **"Legal services are not FTS, and each partner is taxed having regard to their home-country DTAA."**

[12] Linklaters LLP v. Income Tax Officer, [2010] 40 SOT 51 (Mum. - Trib.), affirmed in [2023] 150 taxmann.com 222.
[13] P&O Nedlloyd Ltd. & Ors. v. DDIT, TS-682-HC-2014-CAL; SLP dismissed as infructuous by the SC (Petition No. 17456/2015).

Mumbai ITAT: Holding company cannot fulfil the resulting company's statutory obligation for achieving a tax neutral demerger

Introduction

In ***Sterling Holiday Resorts Limited***,[14] Mumbai ITAT held that in case of a demerger, the issuance of shares by the demerged company's holding company shall not satisfy the conditions of a tax-neutral demerger.

Background

Sterling Holiday Resorts Limited, formerly Thomas Cook Insurance Services India Ltd. (**TCISL**) (**Assessee**), which is engaged in selling vacation home and leisure hospitality services, filed a loss return for AY 2015–16.

Three entities had entered into a court-approved scheme of arrangement, sanctioned by the Bombay HC, involving (i) Sterling Holiday Resorts India Ltd. (**SHRIL**), a listed company, as the demerged/transferor company; (ii) Thomas Cook (India) Ltd. (**TCIL**), a listed company, as the transferee/resulting company; and (iii) the Assessee, a wholly owned subsidiary of TCIL, as a resulting company. The scheme of arrangement involved (a) the demerger of the resorts and time-share undertaking of SHRIL into the Assessee on a going-concern basis; and (b) the amalgamation of the residual business of SHRIL into TCIL, pursuant to which SHRIL ceased to exist.

During the assessment proceedings, the AO observed that the shares pursuant to the demerger were allotted by the holding company, TCIL, and not by the Assessee, and accordingly held that this violated the provisions of Section 2(19AA)(iv), providing the definition of the term "demerger" read with Section 2(41A) of the Act. On this basis, the AO disallowed the carry-forward and set off of the accumulated losses and unabsorbed depreciation, all under Section 72A(4) of the IT Act.

Issue

(i) Whether the issuance of shares by the holding company, TCIL, to the shareholders of the demerged company SHRIL, in consideration of the demerger, satisfies the conditions of a tax-neutral demerger under Sections 2(19AA) and 2(41A) of the Income Tax Act, 1961, on the ground that both the holding company and its wholly owned subsidiary may be considered interchangeable "resulting companies" for this purpose?

*(ii) Whether the Assessee is entitled to carry forward and set off accumulated business losses and unabsorbed depreciation aggregating to INR 2,401.50 million under Section 72A(4) of the IT Act, 1961, where the shares to the shareholders of the demerged company (**SHRIL**) were issued by the holding company (**TCIL**) and not by the Assessee that actually received the demerged undertaking?*

Arguments

The Assessee submitted that the demerged undertaking was transferred to it and TCIL (its holding company that issued the shares) both fall within the definition of "resulting company" under Section 2(41A) of the IT Act, 1961. It contended that the conditions under Section 2(19AA)(iv) were satisfied as TCIL issued shares to the shareholders of SHRIL. The Assessee further argued that the phrase "one or more companies (including wholly owned subsidiary thereof)" in Section 2(41A) means that both the holding company and the subsidiary can be interchangeably considered as a resulting company and that the IT Act considers a combination of the holding company together with its subsidiary as a resulting company.

The Assessee also contended that if only the demerged company could allot shares, then the bracketed phrase "(including a wholly owned subsidiary thereof)" in Section 2(41A) would become redundant and that an interpretation rendering part of a statute redundant must be rejected. Reliance was placed on the SC decisions in *Shri Balaganesan Metals v. M.N. Shanmugham Chetty*[15] and *Shri Illuri Subbayya Chetty & Sons*[16] on this aspect. Further, the principles of liberal construction of provisions granting deductions and incentives were also relied on.[17]

On the other hand, the IRA relied on the orders of the lower authorities, contending that the Assessee's claim was not in accordance with the express provisions of the IT Act. The IRA's position was that since the Assessee (the resulting company) did not issue any shares to the shareholders of SHRIL (demerged company), the conditions prescribed in Section 2(19AA)(iv) were not fulfilled.

[14] Sterling Holiday Resorts Limited vs. DCIT in ITA No. 843 & 941/MUM/2024 (Mumbai).
[15] Shri Balaganesan Metals v. M.N. Shanmugham Chetty (1987) 2 SCC 707
[16] Shri Illuri Subbayya Chetty & Sons v. State of Andhra ([1963] 50 ITR 93)
[17] CIT v. Gwalior Rayon Silk Mfg. Co. Ltd. ([1992] 196 ITR 149), Bajaj Tempo Ltd. v. CIT ([1992] 196 ITR 188), and CIT v. Vegetable Products Ltd. ([1973] 88 ITR 192)

Decision

The ITAT reiterated the settled law that taxation statutes must be interpreted strictly, going by their literal meaning. The ITAT noted that other tools of interpretation, contextual or purposive, cannot be applied in taxation statutes and there is no room for intendment, equity, or the drawing of any presumption. Nothing is to be read in or implied, other than essential inferences, while interpreting a taxation statute. The ITAT further relied on the judgments of SC in *M/s Dilip Kumar and Company*,[18] and *American Express Bank Ltd. and Oman International Bank*,[19] which reiterate the principle that it is impermissible for courts to add or read words into a statute on the assumption that such additions may better advance legislative intent, particularly when the language used by the statute is clear.

Accordingly, the ITAT concluded that since the provisions had no ambiguity, there was absolutely no basis for a different interpretation. The ITAT held that since the Assessee did not issue shares to the shareholders of the demerged company, it failed to satisfy the conditions laid down in the statute. The ITAT further observed that there is a substantial difference between a holding company and a subsidiary, as both have their own independent legal existence. A holding company cannot issue shares on behalf of its resulting subsidiary company, and its obligations are restricted to its own legal liabilities and obligations under the law. Accordingly, the ITAT confirmed the disallowance of set-off of brought-forward unabsorbed depreciation and subsequent carry-forward of business loss and unabsorbed depreciation.

Significant Takeaways

The conditions for a tax-neutral demerger under the IT Act, 1961, must be literally and strictly complied with. Evidently, the holding company and its subsidiary have their separate and independent legal existence, and a holding company cannot issue shares on behalf of a subsidiary company or discharge the subsidiary's statutory obligations. Although the commercial rationale of the demerger was recognised and approved by the Bombay HC, tax neutrality under the IT Act, 1961, is a separate and stricter assessment. At the time of approving the demerger, the HC left the tax issue open for the IRA to analyse later.

While the courts have not extensively analysed this issue in the past, in *Avaya Global Connect Ltd.*,[20] Mumbai ITAT had analysed whether the requirement for the resulting company to issue shares to shareholders of the demerged company could be dispensed with where the demerged company had a negative net worth. The Mumbai ITAT adopted a strict interpretation of the language of the section and held that a demerger cannot be considered as tax neutral if the condition requiring the issue of shares to shareholders of the demerged company is not satisfied. The ITAT also observed that the legislature must be deemed to have foreseen all possible contingencies and yet chose to impose the conditions for a transaction to qualify as a demerger for the purposes of Section 47(vib) of the IT Act, 1961. In addition, ITAT also noted that no presumption can be made regarding any omission by the legislature to provide for a situation where the consideration is not discharged through the allotment of shares in the resulting company to the shareholders of the demerged company.

The present judgment reiterates the strict interpretation of the requirements given in the law. Accordingly, companies contemplating restructuring should conduct a thorough analysis of the requirements to ensure compliance and minimise the risk of challenges from the IRA in the future.

> **“ Non-issue of shares by the resulting company may not be construed as tax-neutral demerger. ”**

[18] Commissioner of Customs (Import), Mumbai v. M/s Dilip Kumar and Company (AIR 2018 SC 3606)
[19] Director of Income Tax (IT)-I, Mumbai vs American Express Bank Ltd. and American Express Bank Ltd. and Oman International Bank v Oman International Bank dated February 06, 2026.
[20] Avaya Global Connect Ltd. v. Assistant Commissioner of Income-tax, Range 7(3), Mumbai [2008] 26 SOT 397 (Mumbai).

HC invokes real income theory, nixes taxation of "excess royalty" refunded basis APA

Introduction

The Bombay HC, in ***Gemological Institute of America Inc.***,[21] dismissed the IRA's appeals in their entirety and affirmed the ITAT's position that only the royalty amount ultimately retained by an assessee, i.e., the amount actually and finally "paid" as contemplated under Article 12 of the India–US DTAA constitutes its real income and is therefore liable to tax in India.

Facts

Gemological Institute of America Inc. (**Assessee**) is a US-based nonprofit entity engaged in the business of gem grading and certification. The Assessee incorporated a wholly owned subsidiary in India, GIA India Laboratory Pvt. Ltd. (**GIA India**), to provide grading services to the Indian diamond industry. The Assessee supplied GIA India with equipment, technical know-how, and expertise, for which it charged royalty. Due to capacity constraints, diamonds above a particular carat weight were forwarded by GIA India to the Assessee for grading; these inter-company grading services were transacted at an agreed arm's-length rate.

For AY 2011–12, the Assessee filed its return of income declaring total royalty income of INR 685.35 million received from GIA India and offered the same to tax. The case was selected for scrutiny, and the AO referred the matter to the TPO, who passed an order proposing a NIL TP adjustment. However, the AO held that the Assessee had established a PE in India and accordingly assessed its total income at INR 728.87 million. Aggrieved by the proposal, the Assessee filed objections before the DRP, which was not very useful. Pursuant to the DRP's directions, the AO passed a final assessment order against the Assessee, raising a demand of INR 728.87 million on the ground that GIA India was a PE of the Assessee and accordingly treated the royalty income as business income attributable to the PE, taxable at 42.23 per cent under Article 7 of the India–US DTAA.

GIA India had filed an application for an APA with the CBDT on March 22, 2013, prior to any TP reference being made to ascertain the ALP of the royalty payments. Subsequently on March 30, 2015, it files a rollback application for AYs 2010–11 to 2013–14. After prolonged negotiations, GIA India and the CBDT signed an APA on May 7, 2018, which determined the ALP of the royalty at INR 490.90 million for AY 2011–12. This required the Assessee to refund the excess royalty of INR 194.45 million to GIA India. In 2018, pursuant to an invoice raised by GIA India, the Assessee refunded this amount the same year. GIA India simultaneously filed modified returns to reflect the reduced royalty deduction as income, and the excess amount was also offered to tax in GIA India's hands. The Assessee, during the pending ITAT proceedings, raised an additional ground seeking the exclusion of the refunded amount from its income. The ITAT allowed this additional ground for AYs 2011–12 to 2016–17.

This appeal before the HC arose from the IRA's challenge to these orders.

Issue

(i) *Whether the ITAT was justified in allowing the Assessee to reduce its returned royalty income on the basis of an APA entered into by GIA India, even though the Assessee was not a party to the APA and whether this was permissible under Section 253 of the IT Act?*

(ii) *Whether the ITAT was justified in ignoring the expression "through" used in Section 9(1)(I) and Explanation 4 thereof, and in the PE definition under Articles 5 and 7 of the India–US DTAA?*

(iii) *Whether the ITAT had erred in holding that GIA India did not constitute a PE of the Assessee, given the alleged operational control, supervision, and business integration exercised by the Assessee over GIA India?*

(iv) *Whether the ITAT had erred in deleting the addition on attribution of profit and royalty as effectively connected to PE under Section 44AD of the IT Act?*

Arguments

The IRA's case proceeded on two fronts, namely, the royalty issue and the PE issue. On the royalty issue, the IRA argued that Chapter X of the IT Act constitutes a self-contained anti-avoidance code and that once royalty income had been received and offered to tax by the Assessee in the relevant AY, it became irrevocably taxable. According to the IRA, the subsequent refund pursuant to the APA was merely a voluntary repayment in a subsequent year that could not unwind a completed tax levy.

The IRA relied extensively on Section 92(3) of the IT Act to contend that TP provisions cannot operate to reduce income. It also relied on the second proviso to Section 92C(4), which

[21] Commissioner of Income-tax (International Taxation)-2, Mumbai v. Gemological Institute of America Inc., TS-473-HC-2026(BOM)-TP

expressly bars recomputations of a non-resident AE's income consequent to a TP adjustment in the hands of the Indian entity, and on Section 92CE(3), arguing that the statutory scheme proceeds entirely on the basis of upward adjustments in the hands of the Indian assessee without any mirrored downward adjustment for the counter-party.

The IRA further argued that the APA, being an exclusively agreement between GIA India and the CBDT, was binding only on GIA India and not on the Assessee by virtue of Section 92C(5), and that the real income theory was misplaced in the context of a statutory TP framework. The IRA also relied on the 2026 Finance Act amendment (substituting Section 169(1) of the Income-tax Act, 2025), which extended APA-related benefits to non-signatory AEs for the first time. Arguing that this prospective amendment showed that no such mechanism existed under the previous law, the IRA foreclosed the Assessee's claim for the AYs in question.

On the PE issue, the IRA argued that the Assessee exercised strategic, operational, and financial control over GIA India, that the degree of overlap and functional integration between the two entities was so much that GIA India constituted a fixed place, service, or agency PE of the Assessee in India.

The Assessee, on the other hand, submitted that Article 12 of the India–US DTAA allows taxation in India of only the royalty actually "paid". It argued that the word "paid" must be interpreted to mean the amount actually and finally retained by the Assessee after the *bona fide* refund made pursuant to the APA. Consequently, the Assessee argued that Section 92(3) was patently inapplicable because the prohibition on downward adjustments under that sub-section applies only to the same person in whose case the computation under Section 92(1) is undertaken, and this should not be applied across two different assessees.

Similarly, the Assessee distinguished the second proviso to Section 92C(4), relying on the *Karnataka HC ruling in EYGBS (India) (P.) Ltd.*[22] to demonstrate that the proviso is only triggered where the ALP is first determined by the AO under Section 92CC(3) and has no application where the ALP is determined under an APA. It also submitted that Section 92CE dealing with secondary adjustments applied only to GIA India, not to the Assessee, which neither maintained books of account in India nor had a PE in India.

On real income, the Assessee relied on various SC and HC precedents, including *Godhra Electricity Co. Ltd.,*[23] *Bokaro Steel Ltd.,*[24] and *H.M. Kashiparekh & Co. Ltd.,*[25] to establish that income that is *bona fide* refunded after actual receipt could not be regarded as the real income of the recipient.

On the PE issue, the Assessee contended that the ITAT's factual findings were based on a careful analysis of the risk-assumption, functional independence, and legal separation between GIA India and the Assessee are not perverse and hence does not raise any substantial question of law.

Decision

On the PE issue, the HC affirmed the ITAT's finding that GIA India did not constitute a PE of the Assessee in India under any of the limbs of Article 5 of the India–US DTAA. On the fixed-place PE issue, the HC held that GIA India operated as an independent, separate legal entity rendering grading services to its own clients within its capacity. The forwarding of higher-carat stones to the Assessee was purely a sub-contracting arrangement on account of GIA India's technological and capacity constraints, not a joint venture or integrated operation. On the agency PE test issue, the HC noted that GIA India had no authority to conclude contracts on behalf of the Assessee, did not secure orders for the Assessee in India, and was an independent entity managing its own client relationships. The HC found that the IRA's PE questions did not give rise to any substantial question of law and accordingly did not entertain them.

On the royalty issue, the HC rejected all three legs of the IRA's statutory argument under Chapter X. First, on Section 92(3), it held that the prohibition on downward TP adjustments under this sub-section is person-specific and can only apply to reduce the income of the very person in whose case the Section 92(1) computation is made. The IRA's attempt to apply Section 92(1) in GIA India's case and then invoke Section 92(3) against the Assessee was patently erroneous. Additionally, Section 92(3) has no application where the income reduction is based on the actual repayment as the Assessee had in fact refunded the differential royalty.

Second, on Section 92C(4), the HC held that the second proviso to Section 92C(4), which bars recomputation of a non-resident AE's income, consequent to the first AE's TP adjustment, only operates where the ALP is determined by the AO under Section 92C(3), and not where the ALP is governed by an APA. Once an APA is in place, the ALP determination under Section 92C(3) is entirely bypassed, making Section 92C(4) and its provisos inapplicable. The HC endorsed and extended the ratio of the Karnataka HC ruling in *EYGBS* to the second proviso.

22 PCIT v. EYGBS (India) (P) Ltd., [(2025) 180 taxmann.com 681].
23 Godhra Electricity Co. Ltd. v. Commissioner of Income-tax, [1997] 91 Taxman 351 (SC).
24 Commissioner of Income-tax v. Bokaro Steel Ltd., [1999] 102 taxman 94 (SC).
25 H.M. Kashiparekh & Co. Ltd. v. CIT, (1960) 39 ITR 706 (Bom).

Third, on Section 92CE, the HC held that the secondary adjustment obligation under Section 92CE(1) is cast on GIA India as the "assessee" who entered into the APA and has no application to the Assessee. The definition of "secondary adjustment" in Section 92CE(3) confirms that it contemplates adjustments in both the Assessee's (GIA India's) and its AE's (the Assessee's) books to reflect the actual profit allocation and does not operate to increase or maintain the Assessee's taxable income.

On the real income doctrine, the HC examined various precedents and reiterated that only real income actually earned, not hypothetical income the Assessee could have possibly earned, can be taxed. The HC also held that Article 12 of the India–US DTAA allows taxation only of royalties actually "paid" to the Assessee. The word "paid", on the facts of this case, refers to the amount actually and eventually retained by the Assessee after making the *bona fide* refund made pursuant to the APA's critical assumption requiring GIA India to raise invoices for excess royalty. Since the refunded amount was not "paid" to the Assessee in any meaningful or final sense, and since the corresponding amount had been reflected as income in GIA India's modified returns and taxed in its hands, the HC held that it would be wholly incongruous to tax the same amount again in the Assessee's hands.

Significant Takeaways

This decision is a landmark development in India's international tax and TP landscape, consolidating and extending several important legal principles that is likely to have enduring relevance for MNCs with APA arrangements and cross-border transactions.

The HC's most significant holding is that the doctrine of real income prevails over a formally accrued receipt. Hence, where a *bona fide* repayment is made pursuant to a government-sanctioned APA, the refunded amount cannot be brought to tax merely because it had initially been received and offered to tax. The Court drew a clear distinction between a voluntary commercial repayment (which may not necessarily retroactively reduce income) and a refund mandated under the critical assumptions of an APA, viewing the latter as part of the same economic event as the original royalty receipt rather than a subsequent independent act. This has significant implications for businesses operating under APA arrangements, where an APA results in the downward revision of payments.

The HC also authoritatively held that once an APA is entered into, it exclusively governs the determination of the ALP for all covered years, displacing any role for the AO in determining the ALP. This is a critical clarification that insulates APA-covered transactions from the IRA's assessments. This significantly strengthens the utility of APAs as certainty mechanisms for MNC groups.

The HC further rejected the IRA's reliance on the Finance Act, 2026, which amended Section 169(1) to explicitly permit non-signatory AEs to file modified returns within three months of an APA being signed, thereby extending APA relief beyond the signatory. The HC upheld the Assessee's relief on the grounds of real income doctrine without needing a statutory mechanism for the Assessee to file a modified return. While the amendment is applicable prospectively for APAs entered into on or after April 1, 2026, the judgment establishes that equitable taxation principles shall apply regardless of the statue confirming the same and that the tax system should not result in the same income being taxed twice. The overarching policy of India's DTAA network avoidance of double taxation must inform the interpretation of domestic TP provisions. Hence, this shall be an important precedent for entities who have entered into APAs prior to April 1, 2026.

> **"Tax applies only to real income, not amounts refunded under the APA."**

Bombay HC allows bad debt deduction under Section 36(1)(vii) during pending recovery litigation

Introduction

In ***Madhusudan Babubhai Kocha***,[26] the Bombay HC reversed the ITAT's order and held that the bad debt "virtually" written off in the P&L account, while legal proceedings were instituted for its recovery was allowable as a deduction under Section 36(1)(vii) of the IT Act. This was possible even if the amount may not have been strictly written off as per the accounting principles. The HC held that the continuation of a litigation proceeding before a competent court was itself sufficient testimony that the amount may be irrecoverable. The Court recognised that, in such circumstances, the Assessee could not have expressly written off the amount in the P&L account and ledger without conferring undue advantage on the opposing party in litigation.

Facts

Madhusudan Babubhai Kocha (**Assessee**), an individual engaged in business, had entered into a sub-contract with M/s Gannon Dunkerly & Co. Limited (**Supplier**) for the supply of a chlorination system for two gas-based combined cycle power projects at Auraiya and Kawas, which were being developed by the National Thermal Power Corporation Limited.

Disputes subsequently arose between the Assessee and the Supplier regarding delays in commissioning of the chlorination plant. Consequently, an advance paid by the Assessee was withheld by the Supplier. The Assessee instituted legal proceedings before the Bombay HC and the Delhi HC to recover the amount. Simultaneously, during AY 1990–91, the Assessee wrote off the amount in the P&L account under *"Bad Debts Allowance Provision"*, treating it as irrecoverable debt.

While filing the return for AY 1990–91, the Assessee claimed deduction of the said amount as bad debt. The AO, however, by order dated December 31, 1992, disallowed the claim, holding that the mere creation of a provision for bad debts, without it being based on an ascertained liability, was not sufficient to claim a deduction under Section 36(1)(vii). The CIT(A) reversed the AO's order, allowing the deduction on the ground that the existing litigation and the P&L and reserve account entries constituted sufficient statutory compliance for writing off the debt as irrecoverable.

The AO challenged before the ITAT. The ITAT reversed the findings of the CIT(A), holding that Explanation 1 to Section 36(1)(vii) expressly excluded a mere provision for bad and doubtful debts from the ambit of allowable deductions. Aggrieved, the Assessee preferred the instant appeal before the Bombay HC.

Issue

Whether the ITAT was justified in disallowing the Assessee's bad debt claim under Section 36(1)(vii) of the IT Act, where the amount was written off in the P&L account?

[26] ITA No. 10 of 2024, High Court of Judicature at Bombay.

Arguments

The Assessee contended that the bad debt had been written off for all practical purposes. However, since it was not in a position to guarantee that it would be recovered, it could not be expressly recorded as bad debts written off in the P&L account because it would have given undue advantage to the Supplier in the recovery proceedings pending before the Courts. The Assessee further contended that the question of law raised in the present appeal was directly covered by the decision of the SC in *Vijaya Bank v. Commissioner of Income Tax and Anr.*[27] and sought appropriate relief as claimed in the appeal accordingly.

The IRA argued that in view of the plain language of the explanation, no deduction under Section 36(1)(vii) could be claimed post April 1, 1989, unless the bad debt or any part thereof was actually written off as irrecoverable in the Assessee's accounts. The IRA further submitted that a mere provision for bad and doubtful debts was not sufficient to claim deduction for bad debts. It also sought to distinguish the *Vijaya Bank* decision on the ground that it was decided in the context of the pre-April 1, 1989, law.

Decision

The Bombay HC, on a conjoint reading of the SC's decisions in *Southern Technologies Ltd. v. Joint Commissioner of Income-Tax, Coimbatore*[28] and *Vijaya Bank (Supra)*, answered the substantial question of law in favour of the Assessee and reversed the ITAT's order.

The HC affirmed that, following the amendment introduced by the Finance Act, 2001, a mere provision for bad debt does not qualify for deduction under Section 36(1)(vii) unless written off as irrecoverable. However, where the assessee debits the amount of doubtful debt in the P&L account and is under litigation to recover the amount, it may be construed as a valid write-off, even in the absence of an express ledger closure, especially since the Assessee has also instituted recovery proceedings before a competent court.

The HC drew support from the SC's observations in *Vijaya Bank*, which squarely addressed a situation where litigation was pending for recovery of the disputed amount, and the assessee had taken the position that an express write-off in the P&L account and ledger would confer undue advantage to the defendant. In those circumstances, the SC held that the assessee was entitled to claim the deduction even without a specific write-off entry. Applying the same reasoning, the Bombay HC held that the Assessee's institution of recovery proceedings indicated the probability of irrecoverability of the amount. It further observed that if the Assessee succeeded in obtaining a decree and recovered the amount in the future, it would be liable to tax for the relevant assessment year, thereby negating any concern regarding escapement of income.

Accordingly, the HC set aside the ITAT's order and allowed the Assessee's claim for deduction of bad debts.

Significant Takeaways

The Bombay HC's ruling provides important clarity on the write-off requirement under Section 36(1)(vii), particularly where debts are simultaneously the subject of ongoing recovery proceedings. The HC held that a debit to the P&L account, coupled with a corresponding reduction in the sundry debtors account, constitutes a valid write-off, even in the absence of a formal closure of the debtor's ledger account.

Significantly, HC recognised that the institution of legal proceedings for recovery is itself compelling evidence of the debt being doubtful of being recovered. It also observed that a taxpayer should not be disadvantaged for avoiding an express write-off that could prejudice its position in a pending litigation. The decision also states that any subsequent recovery of the debt pursuant to a judicial decree would be taxable in the year of recovery, thereby ensuring that the allowance of the deduction does not result in any permanent loss of revenue.

> **“Pending litigation is itself testimony that the debt may not be recoverable.”**

[27] (2010) 323 ITR 166 (SC).
[28] (2010) 2 Supreme Court Cases 548.

Share buy-back constitutes capital reduction, not acquisition of assets; Section 56(2)(x) does not apply

Introduction

In ***Globe Capital Market Ltd,***[29] the Delhi HC held that a company's buy-back of its own shares constitutes a reduction of capital and not the acquisition of an asset. Accordingly, the provisions of Section 56(2)(x) of the IT Act, read with Rule 11UA of the IT Rules, are not attracted. The HC held that the AO's treatment of the buy-back of shares as a transaction leading to profit generation or deemed profit is flawed and untenable in the eyes of law.

Facts

Globe Capital Market Ltd (**Assessee**), a company engaged in share broking and trade clearing activities, had in the FY 2007–08 raised an amount of INR 164 crore from Citi Group Venture Capital, Mauritius, through a preferential issue of equity shares and compulsorily convertible preference shares (**CCPS**). The CCPS were subsequently converted into equity shares, and bonus shares were issued in the ratio of 20:1, resulting in the Assessee having a total holding of 65,62,500 equity shares. The Board of Directors approved the buy-back of 28,62,500 fully paid-up equity shares at a price of INR 313.40 per share out of free reserves and securities premium. The buy-back, approved by the shareholders, was completed in AY 2018–19. The Assessee also paid tax of INR 20.69 crore on distributed income under Section 115QA of the IT Act.

During assessment proceedings for AY 2018–19, the AO found that the Fair Market Value (**FMV**) of each share under Rule 11UA of the IT Rules was INR 370.46, whereas the buy-back price was fixed at INR 313.40 per share. Consequently, the AO held that the buy-back of shares constituted acquisition of property attracting Section 56(2)(x) of the IT Act and accordingly added the difference of INR 16,33,34,250 as the Assessee's income.

Aggrieved, the Assessee preferred an appeal before the CIT(A). Allowing the appeal, the CIT(A) held that the transaction was not a purchase of shares simpliciter but a purchase of own shares under a buy-back offer, which amounts to a reduction in share capital rather than the purchase of a capital asset. Consequently, the ITAT rejected the IRA's appeal, relying on the decision of the Hyderabad Bench in *VITP Private Limited*.[30] It held that since the Assessee had purchased its own shares and not the shares of another company, the provisions of Section 56(2)(viia) of the IT Act were inapplicable. The HC later noted that the ITAT's reliance on this decision was misplaced because the present case involved Section 56(2)(x), although such reliance was only incidental. The IRA then filed an appeal before the HC.

Issue

Whether the buy-back of shares by a company at a price lower than the FMV determined under Rule 11UA of the IT Rules constitutes acquisition of property attracting the provisions of Section 56(2)(x) of the IT Act?

Arguments

The IRA contended that the Assessee had purchased its own shares at INR 313.40 per share, whereas the FMV was INR 370.46 per share. It also contended that the definition of "property" under Section 56(2)(x)(c) does distinguish between the shares of the assessee company and that of any other company. It argued that the provisions of Section 56(2)(x) become applicable if shares, which are considered property under the definition clause, are purchased at a rate lower than the FMV. Hence, the AO had committed no error of law in making the addition. The IRA also contended that the ITAT had erroneously relied upon the judgment of the Hyderabad Bench, which had dealt with Section 56(2)(viia). However, in the present case, the AO had resorted to Section 56(2)(x) of the IT Act, which is considerably wider in scope. The IRA also drew the HC's attention to the explanatory note of the Finance Bill, 2017, to submit that the amendment was introduced to widen the scope of income from other sources.

The Assessee contended that the CIT(A) and the ITAT had rightly dealt with the facts of the case in light of the applicable statutory provisions and had correctly held that the company's buy-back of shares does not amount to the purchase of any asset or property. It further argued that the buy-back offer was made in accordance with Section 68 of the Companies Act, 2013 (**Companies Act**), after following due process, and it would be incorrect to assume that the Assessee had adopted any ploy to generate undisclosed income or income out of books. The Assessee maintained that, as a matter of fact and law, the purchase of its own shares does not constitute the purchase of property within the meaning of Section 56(2)(x) of the IT Act.

[29] Globe Capital Market Limited [TS-529-HC-2026(DEL)]
[30] VITP (P.) Ltd. v. Deputy Commissioner of Income Tax (DCIT) (2022) 197 ITD 395 (Hyd.) (Trib.)

Decision

The HC, upon perusal of Section 68 of the Companies Act, observed that a buy-back of shares essentially means a reduction of the company's capital, which is otherwise impermissible if it does not take recourse to Section 68 of the Companies Act. The HC noted that but for Section 68 and the procedure provided thereunder, a company cannot buy its own shares, because buying of own shares is otherwise alien to the concept of corporate entity and the provisions of the Companies Act. The HC also observed that in the hands of a corporate entity, the securities or shares of a company can be property. However, for the issuing company, it is a certificate issued to its members in lieu of their contribution towards the capital or for subscribing to the shares.

The HC placed significant reliance on sub-section (7) of Section 68 of the Companies Act, which mandates that after buy-back completion, the company shall extinguish and physically destroy the shares or securities bought back. The HC held that the Assessee must have mutilated or destroyed the shares or so-called property that the AO had sought to tax. It also held that a person cannot be taxed for so-called deemed profit from property (shares) that accrues to it consequent to the destruction of that property. The HC observed that once the shares are bought back, the purported property extinguishes or vanishes; hence, the very hypothesis that the Assessee had acquired an asset at a rate lesser than the FMV has no legs to stand on. The HC categorically held that the buy-back of own shares is antithetical to buying an asset.

The HC observed that the IRA's interpretation of Section 56(2)(x) of the IT Act at first blush appears to be attractive, but when testing the same on the anvil of the principles of the Companies Act, common prudence, and provisions of the IT Act, it holds no water. The HC accepted the IRA's contention that the ITAT's reliance upon the judgment of the Hyderabad Bench was misplaced, because the applicable provision therein was Section 56(2)(viia) and not Section 56(2)(x) of the IT Act. However, the HC noted that such reliance was only incidental, and the ITAT had otherwise deliberated upon the issue and affirmed the well-reasoned order of the CIT(A).

Accordingly, the HC held that the CIT(A) was perfectly justified in allowing the appeal. The HC concluded that the AO's treatment of the buy-back of the company's shares as a transaction leading to the generation of profit or deemed profit is clearly flawed and untenable in the eye of law. Hence, the HC dismissed the IRA's appeal.

Significant Takeaways

The judgment clarifies that a company's buy-back of its shares under Section 68 of the Companies Act constitutes a reduction of share capital and not the acquisition of a capital asset. The provisions of Section 56(2)(x) of the IT Act read with Rule 11UA of the IT Rules are not attracted in the buy-back of own shares, as the shares are mandatorily required to be extinguished and physically destroyed upon buy-back completion. The HC has drawn a clear distinction between acquisition of property, including shares in a given case, and the issuing company's buy-back of own shares, holding that the latter is antithetical to buying an asset.

This judgment reinforces the principle that taxing provisions must be interpreted in consonance with the broader legal framework, including the Companies Act. It also reiterates that an interpretation that appears attractive on a literal reading of a provision may not sustain scrutiny when tested against established corporate law principles. The IRA should exercise caution before invoking Section 56(2)(x) of the IT Act in cases of buy-back of own shares, as the HC has unequivocally held that such transactions do not constitute the acquisition of property giving rise to deemed income.

This decision is welcome because it paves the way for many deserving entities to undertake legitimate corporate structuring transactions without worrying about taxation.

> **“ Buy-back of own shares by a company does not give rise to any income under section 56(2)(x) of the IT Act. ”**

Reopening upheld on fresh tangible material absent AO's prior opinion

Introduction

In ***Sanand Properties P. Ltd. v. Joint Commissioner of Income Tax***,[31] the SC upheld the reopening of completed assessments relying on fresh tangible material discovered during a survey. It held that where the AO had formed no earlier opinion on the specific nature of income, there is no "change of opinion" to bar reassessment.

Facts

Sanand Properties P. Ltd. (**Assessee**) and M/s. Raviraj Kothari & Co formed an Association of Persons (**AOP**) called "Fortaleza Developers" under an agreement to develop a residential housing project. After the completion of the Assessee's scrutiny assessments for AY 2007–08 and AY 2008–09, a survey led the IRA to reopen both assessment years under Section 148 of the IT Act, on the basis that the Assessee's receipts were actually 35 per cent of the gross sale receipts (i.e., revenue receipts) and not exempt as "share of profit" from the AOP. Following the ITAT's rejection of its objections to reopening, the Assessee filed a writ petition before the Bombay HC. The Bombay HC quashed the reopening for AY 2007–08 but upheld it for AY 2008–09. Although the ITAT and the High Court in parallel AOP proceedings, treated 35 per cent as a profit-share, the dispute ultimately reached the SC by way of civil appeals preferred by both the Assessee and the IRA.

Issue

(i) Whether the reopening of the assessments of Assessee for AY 2007–08 and AY 2008–09, respectively, were valid?

(ii) Whether the amount accrued to the Assessee from the AOP, based on Clause 7 of the AOP Agreement dated April 29, 2003, is liable to be taxed in the hands of SPPL for AY 2008–09 and AY 2009–10, respectively?

Arguments

The Assessee argued that the reopening of assessment was on the basis of a mere change of opinion by the AO and was not supported by any new tangible material. It contended that it had already disclosed the existence of the AOP and furnished the AOP Agreement and related accounts during the original scrutiny assessments. Therefore, the reassessment proceedings, founded on the allegation that income the Assessee received from the AOP was not exempt as a share of profits, were based on material already available with the AO, and therefore, amounted to an impermissible review. On merits, the Assessee relied upon prior decisions that treated the 35 per cent receipt as a profit-share and claimed that such income could not be taxed again in its own hands in view of Sections 86, 67A, and 167B(2) of the IT Act.

On the issue of the validity of the reopening of assessment proceedings, the IRA contended that the reassessment proceedings opening were valid because the AO had neither considered tangible material in the form of the AOP Agreement

[31] Sanand Properties P. Ltd. v. Joint Commissioner of Income Tax, [TS-675-SC-2026].

during the original scrutiny proceedings nor formed any opinion on such material. Hence, the discovery of the AOP Agreement and its relevant clauses suggesting income escaping assessment during the survey constituted new tangible material that could be considered by the AO for reopening of prior assessments.

The IRA further argued that Clause 7 of the AOP Agreement entitled the Assessee to 35 per cent of the gross sale receipts upfront, which is a revenue share, with only the remaining 65 per cent going towards meeting expenses. Accordingly, the Assessee's receipt was taxable as a revenue receipt and not an exempt share of profits. The IRA further argued that substance prevails over form and that the substance of the payment to the Assessee was a share of gross receipts rather than a share of profits. Therefore, the IRA further submitted that Section 86 of the IT Act, which excludes from taxation income received from an AOP in the total income of its members, where such income has already been taxed at the AOP level, would not bar taxation in the Assessee's hands because the amount in question had effectively escaped taxation at the AOP level on account of the deduction available under Section 80IB(10) of the IT Act.

Decision

The SC reiterated that reopening under Sections 147 and 148 of the IT Act requires "reason to believe" to be founded on tangible material and cannot be based on a mere review or a change of opinion. Crucially, if no opinion was formed on an issue during the original assessment, i.e., there was no conscious application of mind, reopening cannot be barred on the ground of "change of opinion". Mere production of documents does not amount to "true and full disclosure" unless the Assessee specifically draws the AO's attention to the relevant parts and the primary facts.

The SC further held that the Assessee's entitlement under Clause 7 of the AOP Agreement to 35 per cent of gross sale receipts upfront demonstrates revenue-sharing and creates a diversion of income at source by overriding title. Applying the well-settled judicial principles on diversion of income by overriding title, the 35 per cent is not a share of profit because it is insulated from expenses of the AOP, and such a payment to the Assessee is a revenue receipt. The SC accordingly held that the 35 per cent is taxable in the Assessee's hands as a business receipt, and that reopening for both AY 2007–08 and AY 2008–09 was valid.

Significant Takeaways

This judgment establishes that reopening and reassessment will be valid where subsequent tangible material made available to the AO from any new source (such as survey findings) that reveals the true nature of a transaction, and the AO had formed no earlier opinion on that specific issue during the original proceedings. Mere filing of documents or making a generic disclosure during scrutiny assessments may not be sufficient to prevent future reopening. A targeted, conscious disclosure of all primary facts on the specific issue is necessary.

The ruling also clarifies that challenges to reopening must be anchored in the recorded reasons and must demonstrate actual formation of opinion in the original assessment on the specific issue sought to be reopened. Existence of documents on the record alone is insufficient if the AO's order does not reflect conscious adjudication of the issue.

The judgment also serves as a precedent for cases of diversion of income by overriding title. A clause granting a member an upfront, expense-insulated share of gross sale receipts will be treated as a diversion of revenue by overriding title and taxed as the recipient's business receipt, not as an exempt share of AOP profits under Section 86 of the IT Act. The "profit-share" label is not determinative; what matters is the substance and mechanism of the entitlement.

Hence, parties seeking "profit-share" characterisation in joint venture/AOP arrangements must ensure that the relevant clause is genuinely net-of-expense and not gross-receipt-linked. Any clause that guarantees an upfront percentage of gross receipts, irrespective of actual profits or expenses, risks being recharacterised as a revenue receipt in the hands of the recipient.

Further, by characterising the interpretation of Clause 7 of the AOP Agreement as a question of law and therefore not as a finding of fact binding on the SC from the lower adjudicatory forums, the SC has reserved to itself the power to independently interpret any contractual provision that forms the foundation of a party's tax rights. This is consistent with the principle in *Sir Chunilal V. Mehta*,[32] but its application in the present context means that even where the ITAT and HC have definitively interpreted a commercial arrangement in an assessee's favour, the SC may revisit the interpretation de novo. This should put taxpayers on notice that factual findings at the ITAT level on the interpretation of transaction documents are not necessarily immune from challenge on appeal.

The ruling carries systemic implications for the large volume of pending reassessment litigation across Indian courts and tribunals. Assessees who have relied upon the "change of opinion" doctrine to challenge reopening notices on the basis that the underlying documents were already available during the original assessment may find that their challenge is now much harder to sustain, particularly if the original assessment order does not contain a conscious application of mind on the specific question at issue. Conversely, the ruling should motivate the Revenue to ensure that assessment orders are comprehensive and specifically address each material issue raised by the assessee, since a specific finding recorded in the original order will effectively prevent reopening on that issue.

> **"To constitute a 'change of opinion', for invalidating the reopening of assessment, there must first be a conscious application of mind and a formation of an opinion during the original assessment proceedings."**

32 Sir Chunilal V. Mehta and Sons Ltd. v. Century Spinning. & Manufacturing Co. Ltd. [AIR 1962 SC 1314].

DTVSV Scheme settlement does not bar reopening of assessment on unrelated matters

Introduction

In ***Bhima Jewellery***,[33] the Kerala HC dismissed a writ petition challenging the validity of a notice under Section 148A(b) and the consequent order under Section 148A(d) for reopening the assessment, primarily on the ground that it had already settled the tax dispute for that year by complying with the provisions of the Direct Tax Vivad Se Vishwas Act, 2020 (**DTVSV Act**), and that settlement operated as a full and final resolution barring any further proceedings. The HC rejected this contention and held that the DTVSV Act settles only the "disputed tax" that was the subject of pending appeal or revision proceedings. Its protective effect does not extend to matters that were never part of the original assessment or the settlement, making the judgment directly relevant to the large body of taxpayers who have availed the benefits available under the DTVSV Act.

Facts

Bhima Jewellery (**Assessee**), a partnership firm in the jewellery trade, filed its return for AY 2017–18, which was assessed under Section 143(3) of the IT Act. Certain heads of the assessment were challenged by the Assessee before the CIT(A).

While the appeal was pending, the Central Government introduced the DTVSV Act. Availing this opportunity, the Assessee filed a declaration, and the designated authority determined the amount payable at INR 72,83,610, which was duly remitted. The designated authority then issued Form No. 5, certifying full and final settlement of tax arrears for AY 2017–18.

Subsequent to the settlement, the AO issued a notice dated July 18, 2023 under Section 148A(b) proposing to reopen the assessment for AY 2017–18 on two grounds entirely unrelated to the matters covered in the original assessment: (i) an alleged computational shortfall in disallowance of interest expenditure and (ii) a proposed disallowance of belated contributions to the Provident Fund (**PF**) account, which had not been dealt with in the original assessment order.

The Assessee filed objections under Section 148A(b), asserting that the AO could not revive the concluded settlement in the absence of grounds for rejection under Section 4(7) of the DTVSV Act. The AO rejected these objections and passed the impugned order under Section 148A(d), directing the reopening of the assessment. The Assessee then challenged this order before the Kerala HC, seeking a declaration that the reopening was ultra vires the DTVSV Act.

Issue

(i) Whether the settlement arrived at between the parties under the DTVSV Act in respect of AY 2017–18 operates as an absolute bar against the initiation of reassessment proceedings under Section 148A of the IT Act for the same AY, even in respect of matters that were not covered in the original assessment order or the settlement?

(ii) Whether the reopening of an assessment under Section 148A(d) of the IT Act is permissible in respect of issues (such as interest disallowance and belated PF contributions) that are wholly unrelated to the disputes covered and settled under the DTVSV Act?

Arguments

The Assessee argued that once its application under the DTVSV is accepted and Form No. 5 is issued, the assessment itself stood settled and there was no surviving assessment to serve as the foundation for Section 148A proceedings. Relying on the finance minister's Budget Speech of February 1, 2020, the Assessee contended that the scheme was a comprehensive settlement mechanism conferring year-wide finality. The Assessee also relied on SC decisions in *Killick Nixon Ltd. v. DCIT*[34] and *Brij Lal v. CIT*[35] and other HC decisions to support the submission that once the declaration was accepted, the assessment for the relevant AY was extinguished.

The IRA countered this argument by clarifying that the DTVSV Act is a mechanism for settling "disputed tax" (tax in dispute in pending appeals, revisions, or assessment proceedings) and nothing more. It also argued that the two grounds for reopening, interest disallowance and PF contributions, were entirely unrelated to the matters covered in the original assessment and the settlement, and that the DTVSV settlement accordingly neither barred reassessment on those grounds nor extinguished the underlying assessment order.

33 Bhima Jewellery v. Union of India, TS-966-HC-2026(KER).
34 (2003) 1 SCC 145.
35 (2011) 1 SCC 1.

Decision

The Kerala HC dismissed the writ petition, upholding the Section 148A(d) order by observing that reopening of assessment proceedings on matters unrelated to the DTVSV settlement are not prohibited under the DTVSV Act.

The HC undertook a detailed examination of the DTVSV Act's statutory architecture, focussing on the definitions of "disputed tax" (under Section 2(1)(j)) and "tax arrear" (under Section 2(1)(o)), and under Sections 3, 4, and 5 of the DTVSV Act. It observed that the DTVSV Act's heading, namely, *"an Act to provide for resolution of disputed tax and for matters connected therewith or incidental thereto"*, itself limits the scheme's scope to the resolution of disputed amounts, not the entirety of an assessment year.

The HC noted that the definition of "disputed tax" under Section 2(1)(j) computes the amount with specific reference to the amount pending in dispute in appeal, assessment, or revision proceedings yet to attain finality. Section 5(3) of the DTVSV Act renders the designated authority's determination conclusive only *"as to the matters stated therein,"* and no matter *"covered by such order"* may be reopened. This conclusiveness is, therefore, confined to the specific issues forming the subject of the settlement, not to the assessment year as a whole.

On this basis, the HC concluded that the DTVSV settlement covers only the finality of amounts covered by assessment orders pending in dispute and does not extend to matters not covered by such orders. The protection is confined to the specific matters dealt with under the settled assessment, and the order of assessment does not cease to exist merely because the payment was made.

The HC distinguished the precedents the Assessee had relied upon. Regarding *Killick Nixon*, the HC noted that the KVSS defined "disputed tax" broadly as total tax determined and payable reduced by tax paid, whereas the DTVSV Act employs a far more specific computation tied to the amount in dispute in pending proceedings. Further, in *Killick Nixon*, the reopening matters were to, some extent, related to the original assessment unlike the present case where the grounds are completely unrelated. The HC similarly distinguished Chapter XIX-A Settlement Commission decisions, noting that the Commission had adjudicatory powers over assessments on merits, conferring a broader finality than the DTVSV Act's purely monetary settlement. The HC also relied on *Hemalatha Gargya v. CIT*[36] to reiterate that assessees claiming statutory benefits must comply strictly with the conditions, with no room for equitable considerations.

Significant Takeaways

The Kerala HC's ruling is a calibrated and textually grounded interpretation of the DTVSV Act with wide-ranging practical implications.

The judgment firmly establishes that the DTVSV Act is an instrument of financial settlement rather than comprehensive legal extinguishment. The finality conferred under the scheme is targeted for protecting only the specific issues and amounts that were the subject of the DTVSV settlement. The scheme was

[36] (2003) 9 SCC 510.

designed to reduce litigation over disputed demands pending in appeal or revision, not to create a year-wide amnesty shielding all aspects of the assessment from future scrutiny. Taxpayers must, therefore, appreciate that the immunity secured under the DTVSV Act is strictly co-extensive with the scope of the disputed amounts settled, and cannot serve as a defence against reassessment on grounds never forming part of the original assessment or settlement.

The ruling clarifies the interface between the DTVSV Act and the reassessment regime under Sections 147 and 148A of the IT Act. The HC reinforces that the DTVSV Act's monetary settlement carries only a narrower preclusive effect.

In practical terms, taxpayers across sectors, particularly in high-transaction trades, should not treat a DTVSV settlement as a blanket closure for the assessment year. The IRA retains full authority under Section 148A of the IT Act to initiate reassessment for escaped income on issues not forming part of the original assessment, subject to compliance with the conditions, time-limits, and procedural requirements under Sections 148, 148A, 149, and 151 of the IT Act. This compliance caveat is an important tool for the taxpayers to test the validity of post-settlement reassessment notices.

The decision also underscores the importance of careful documentation in DTVSV filings. Declarations and accompanying forms should precisely and comprehensively identify all issues covered by the disputed assessment, to leave no ambiguity for the IRA to exploit later and characterise a particular matter as falling outside the scope of the settlement.

Going forward, the ruling will be relevant to the large body of taxpayers facing reassessment notices for issues not covered under DTVSV settlements. It arms the IRA with legal authority to proceed with such reassessment where the procedural requirements are met, while simultaneously clarifying the legal grounds on which taxpayers can contest the validity of notices that do not satisfy those requirements.

Importantly, the ratio is likely to carry persuasive weight in proceedings under the DTVSV Act, 2024, the successor scheme introduced by the Finance (No. 2) Act, 2024, given that its structural framework and definitions of "disputed tax" and "tax arrears" are conceptually aligned with those under the 2020 Act.

> **"The scheme of settlement under Vivad Se Vishwas is confined to the settlement of the demands based on the findings in the assessment order alone and such settlement does not indemnify the taxpayers against any future proceedings on other unrelated matters."**

Resorting to adjustment u/s 143(1)(a) on highly debatable issue held to be unjustified

Introduction

In ***M/s Varsha Construction***,[37] the Chhattisgarh HC held that *prima facie* adjustments under Section 143(1)(a) of the IT Act are confined strictly to apparent and non-controversial errors. It also held that contentious or debatable legal claims must be examined through the regular scrutiny route under Section 143(3) of the IT Act.

Facts

M/s Varsha Construction (**Assessee**), a firm engaged in the construction business, filed its return of income for AY 2019–20, which was processed by the CPC, Bengaluru. Following this, an intimation order issued under Section 143(1)(a) of the IT Act disallowed the Assessee's claim for deduction for an amount, being employees' share of contribution towards ESI and EPF under Section 36(1)(va) read with Section 2(24)(x) of the IT Act, on the ground that such contributions were deposited after the due dates prescribed under the EPF Act, 1952, and the ESI Act, 1948.

Aggrieved by the intimation order, the Assessee filed an appeal before the CIT(A). While the appeal was pending, the SC delivered its authoritative ruling in ***Checkmate Services Pvt. Ltd v. CIT.,***[38] holding that to claim a deduction under Section 36(1)(va), employees' contributions must be deposited on or before the due dates specified under the respective employee welfare enactments. The CIT(A) dismissed the Assessee's appeal by relying upon the SC's judgment in *Checkmate Services*. The Assessee, thereupon, preferred a further appeal before the ITAT, which was also dismissed.

Aggrieved, the Assessee preferred the present appeal before the Chhattisgarh HC.

Issue

(I) Whether CIT(A) and the ITAT were justified in dismissing the appeals holding that the AO has rightly processed the return of the Assessee under Section 143(1)(a) of the IT Act ignoring the fact that in light of conflicting judgments on the issue of the due date, the AO was required to resort to the provisions contained in Section 143(3)/Section 147 of the IT Act, by recording a finding which is perverse to the record?

(ii) Whether the SC's judgment in Checkmate Services Pvt. Ltd. (which settled the legal position on October 12, 2022) can be applied retrospectively so as to validate an adjustment made under Section 143(1)(a) in January 2021 when that judgment was not there?

Arguments

The Assessee contended that on the date of issuance of the intimation order, the question of whether employees' contributions to ESI and EPF had to be deposited strictly on or before the respective due dates under the welfare statutes or whether the benefit of Section 43B of the IT Act (which permits deductions upon payment before the due date of filing the return) was available, was a matter of intense judicial controversy. The Assessee pointed out that the HCs of Bombay, Himachal Pradesh, Calcutta, Guwahati, and Delhi had favoured its position, while the HCs of Kerala and Gujarat had favoured the IRA. The issue was pending for final determination before the SC in *Checkmate Services Pvt. Ltd.*

The Assessee submitted that the power under Section 143(1)(a) is summary in nature and permits only *prima facie* adjustments that are apparent from the return, such as correction of arithmetical errors or disallowance of clearly inadmissible claims, and does not extend to the adjudication of debatable or contentious legal questions. The Assessee placed reliance on the SC's decisions in *Kvaverner John Brown Engg. (India) Pvt. Ltd.*[39] and *Rajesh Jhaveri Stock Brokers Pvt. Ltd.*[40] which held that the AO had no authority to make adjustments to or adjudicate upon debatable issues under Section 143(1)(a) of the IT Act.

The IRA contended that the adjustment disallowing the delayed employees' contributions was within the AO's powers under Section 143(1)(a), as it involved a *prima facie* adjustment apparent from the tax audit report. The IRA submitted that the legal position on the issue had now been settled authoritatively by the SC in *Checkmate Services* and that the Assessee had admittedly deposited the employees' contributions beyond the due dates prescribed under the relevant welfare statutes. It further argued that the SC's judgment in *Checkmate Services*, being clarificatory, in nature would have retrospective effect. The IRA contended that the earlier judgments relied upon by the Assessee were clearly distinguishable on facts.

[37] M/s Varsha Construction v. Assistant Commissioner of Income Tax, [TS-550-HC-2026(CHAT)].
[38] (2023) 6 SCC 451.
[39] Kvaverner John Brown Engg. (India) Pvt. Ltd. v. ACIT [(2008) 305 ITR 103 (SC)].
[40] ACIT v. Rajesh Jhaveri Stock Brokers Pvt. Ltd. [(2008) 14 SCC 208].

Decision

The HC allowed the appeal in favour of the Assessee and answered the substantial question of law against the IRA. The HC affirmed that the power under Section 143(1)(a) of the IT Act is summary in nature and is designed to cause adjustments apparent from the return itself. It contrasted this with the power under Sections 143(2) and 143(3), which involve a deeper probe and scrutiny for the correct determination of tax liability. Relying on *Vodafone Idea Limited*,[41] the HC reiterated that the scope of Section 143(1)(a) is confined to patent and clear errors and not contentious legal questions.

The HC found, as a matter of fact, that on the date of issuance of the intimation order under Section 143(1)(a), the question whether delayed employees' contributions to ESI and EPF could be held as income under Section 36(1)(va) read with Section 2(24)(x), or whether the benefit of Section 43B was available, was a highly debatable and contentious issue. The SC's judgment in *Checkmate Services*, which authoritatively settled the law, was rendered nearly two years after the intimation order. The HC also noted that as on the date of the intimation order, there existed a division of judicial opinion among the HCs of Bombay, Himachal Pradesh, Calcutta, Guwahati, and Delhi (favouring assessees) versus the HCs of Kerala and Gujarat (favouring the IRA), making the issue undoubtedly debatable.

Following the principles laid down in *Kvaverner John Brown Engg. (India) Pvt. Ltd.* and *Rajesh Jhaveri Stock Brokers Pvt. Ltd.*, the HC held that the AO had no authority to make adjustments to or adjudicate upon any debatable issues under Section 143(1)(a). The HC specifically held that since the issue was highly debatable as on date of the notice, the AO should instead have resorted to the provisions of Section 143(3) of the IT Act to scrutinise the return and adjudicate the question.

The HC rejected the IRA's argument that the retrospective effect of the SC's judgment in *Checkmate Services* validated the summary disallowance. The HC clearly distinguished the two issues, holding that the retrospective applicability of *Checkmate Services* was not the question before it. The question was a narrow jurisdictional one: whether Section 143(1)(a) could be invoked when the issue was highly debatable on the date of the intimation. That question had to be answered with reference to the legal landscape at the time of the intimation, and not by importing the subsequently settled legal position.

Hence the HC set aside the *prima facie* disallowance made under Section 143(1)(a) by the AO's order and consequently set aside the orders of the CIT(A) and the ITAT. However, liberty was expressly reserved in favour of the IRA to proceed in accordance with law (i.e., through scrutiny proceedings under Section 143(3)), leaving the question of substantive deductibility under Section 36(1)(va) open for determination in appropriate proceedings.

Significant Takeaways

This judgment is a significant contribution to the evolving jurisprudence on the jurisdictional boundaries of summary proceeding under Section 143(1)(a) of the IT Act and has wide-ranging implications for assessees, practitioners, and the tax administration alike.

The judgment provides a definitive affirmation of a legal principle that had, until now, been primarily articulated at the tribunal level across multiple benches: that the AO/CPC lacks the jurisdiction to make *prima facie* adjustments under Section 143(1)(a) on any issue that is legally debatable or involves a contested question of law. This principle, long recognised in the decisions of the SC in *Kvaverner John Brown Engg.* and *Rajesh Jhaveri Stock Brokers*, has now been applied with considerable force by the Chhattisgarh HC in the specific context of delayed ESI/EPF contributions.

One of the most practically significant aspects of the judgment is the HC's clear articulation that whether an issue is "debatable" for the purpose of Section 143(1)(a) must be assessed with reference to the legal landscape prevailing at the time the intimation order is issued, and not with the benefit of hindsight derived from subsequent judicial developments. The ruling provides a strong and coherent legal foundation for assessees to challenge large volumes of pre-Checkmate intimations that are currently under dispute at various levels of the appellate hierarchy.

> **"Provisions of Section 143(1)(a) of the IT Act cannot be resorted to when the subject issue was highly debatable as on the date of issuance of intimation order."**

[41] Vodafone Idea Limited v. ACIT [(2020) 19 SCC 12].

CASE LAW UPDATES - INDIRECT TAX ROUTINE

SC upholds 28 per cent GST on the full-face value of bets and deposits for online money gaming

Introduction

In ***Directorate General of GST Intelligence (HQs) & Ors. v. Gameskraft Technologies Pvt. Ltd. & Ors.,***[42] the SC confronted what is arguably the most consequential fiscal dispute to emerge from India's online gaming industry, a cluster of challenges involving demands exceeding INR 21,000 crore and raising several fundamental questions concerning the levy of GST on online gaming, fantasy sports, and casino gaming platforms.

In a pronouncement that dismantles the industry's longstanding structural defence, the SC held that online gaming, fantasy sports, and casino transactions involving money or money's worth staked on an uncertain outcome constitute "betting and gambling" for GST purposes, irrespective of the digital medium, or the skill-versus-chance characterisation, once monetary stakes are involved, unless a statute expressly protects skill games from the consequences of monetary stakes. The critical and determinative feature, the Court held, was the act of dealing with an uncertain outcome, not the nature of the underlying activity. The distinction between skill and chance, which had animated years of litigation across multiple HCs, was declared legally irrelevant to the GST classification inquiry.

Facts

Gameskraft Technologies Pvt. Ltd. (**the Respondent**) operates an online gaming platform offering various games, including rummy, in which players stake money on the outcome of their participation. The Directorate General of GST Intelligence (**the IRA**) issued show cause notices under Section 74(1) of the CGST Act to the Respondent and other similarly placed online gaming companies, proposing recovery of allegedly short-paid or unpaid GST of approximately INR 21,000 crore (inclusive of interest and penalty), demanding GST on the full value paid by the players (i.e., total stakes pooled by them) at 28 per cent on the full value of funds deposited by them, relying upon Rule 31A(3) of the CGST Rules. The Respondent challenged the notices before the Karnataka HC, contending that the games were games of skill, that prize pool contributions constituted actionable claims excluded from the levy of GST under Schedule III to the CGST Act, that the platform merely charged a platform fee, and that GST was payable only on that fee. The Respondent further contended that the prize pool was held in escrow and distributed entirely to the winners and could not be characterised as consideration received by the operator. The Karnataka HC allowed the writ petitions and quashed the notices, holding that rummy is a game of skill, that prize pool contributions are excluded actionable claims, and that Rule 31A(3) is *ultra vires* to the extent it levies GST on the full-face value in the context of skill-based gaming. The IRA challenged this judgment before the SC. Several connected writ petitions, transferred cases from various HCs, and appeals arising from similar disputes were heard together by a common judgment.

[42] Directorate General of GST Intelligence (HQs) & Ors. v. Gameskraft Technologies Pvt. Ltd. & Ors., 2026 INSC 595.

Issue

The case presented the SC with various questions, each capable of reshaping the fiscal architecture of India's online gaming industry:

(i) Whether staked online gaming, fantasy sports, and casino play constitutes "betting and gambling" for GST purposes?

(ii) Whether actionable claims arising therefrom are taxable goods?

(iii) Whether the stake amount is "consideration"?

(iv) Whether Rules 31A, 31B, and 31C are valid valuation rules?

(v) Whether the 2023 amendments to the CGST Act are clarificatory and retrospective in operation?

Arguments

The IRA contended that once money or money's worth is dependent on an uncertain outcome, the activity becomes gambling for GST purposes regardless of whether the underlying game is one of skill or chance. It also argued that betting and gambling are cognate expressions under the GST framework and cannot be narrowed by any theory distinguishing skill from chance, and that State law exemptions for skilled games with stakes only protect against criminal prosecution and do not alter the intrinsic character of the activity as gambling.

On taxable goods, the IRA submitted that online gaming companies create actionable claims in favour of players through the staking mechanism, that such actionable claims are goods within Section 2(52) of the CGST Act, and the GST is levied on the supply of such actionable claims rather than as a freestanding tax on gambling as an activity in the abstract. The IRA also argued that when stakes are placed, each player acquires a conditional beneficial interest in the pooled money, satisfying all ingredients of an actionable claim, and relied upon the decision in *Sunrise Associates*[43] in support of the proposition that betting and gambling transactions give rise to actionable claims capable of being taxed as goods.

On taxable goods, the IRA submitted that online gaming companies create actionable claims in favour of players through the staking mechanism, that such actionable claims are goods within Section 2(52) of the CGST Act, and that GST is levied on the supply of those actionable claims rather than as a freestanding tax on gambling as an activity in the abstract.

On the 2023 amendments to the CGST Act, the IRA's position was that they did not create any fresh levy but were clarificatory and explanatory in nature, inserted to remove doubts and provide greater specificity in the valuation and collection mechanisms and, therefore, operated retrospectively to confirm what the law had always required. The IRA's overall stance, which ultimately prevailed before the HC, was that online gaming, fantasy sports, and casino play with monetary stakes had always constituted betting and gambling for the purposes of GST. Actionable claims arising from these were taxable goods, the stake amount was consideration, the valuation rules were valid, and the 2023 amendments merely made explicitly clear what was already implicit in the pre-amendment regime.

The Respondents on the other hand argued that games such as rummy and fantasy sports are games of predominant skill and the essential attribute of betting and gambling is predominance of chance over skill; hence, the mere involvement of money or stakes cannot transform the genus of a skill game into gambling. They relied on the line of authority running through *RMDC*[44] and *K R Lakshmanan*[45] to submit that the character of an activity is determined by its dominant element and not by a peripheral act. They also maintained that they were intermediary platform providers who did not themselves participate in the games, so that any wagering or claims, if they existed at all, were *inter se* between the players themselves.

They further contended that actionable claims require enforceable rights. They argued that if the arrangement is characterised as a wagering contract, Section 30 of the Contract Act renders it void and unenforceable. Consequently, no actionable claim would exist that could qualify as "goods" for GST purposes. In any event, the operator does not transfer any actionable claim to a player; hence, there is no supply of goods by the platform at all. The Respondents also relied on the introduction of Rules 31B and 31C and the 2023 amendments deeming fiction in Section 2(105), which treats online gaming platforms as suppliers of actionable claims, as a positive legislative confirmation that pre-amendment law did not treat them as suppliers of actionable claims. Accordingly, they argued that this legislative development challenges the IRA's contention that the pre-2023 position was the same as the post-2023 regime.

On consideration and valuation, the Respondents argued that only the platform fee or commission retained by the operator could constitute consideration for any supply made by the platform. They contended that taxing the entire stake or prize

43 Sunrise Associates v. Govt. of NCT of Delhi & Ors., 2006 (4) TMI 118.
44 State of Bombay v. R.M.D. Chamarbaugwala, 1957 SCR 870.
45 K.R. Lakshmanan v. State of Tamil Nadu and another, 1996 (2) SCC 226.

pool was a colourable attempt to tax the betting activity itself rather than the value of any identified supply, which violates Section 15. The section requires that the transaction value be the price actually paid or payable for the relevant supply. They further argued that since the operator holds the prize-pool portion of the stake as a deposit or entrusted amount that does not accrue to the operator at all and, therefore, falls outside the definition of consideration under Section 2(31) of the CGST Act since it is never applied as consideration by the supplier and simply passes through the platform to the winning players.

The Respondents also challenged the validity of the valuation rules by arguing that Section 15(5) requires a prior notification designating the specified supplies in respect of which alternative valuation rules may be prescribed. According to them, no such notification was issued for actionable claims or online gaming before October 1, 2023, and Rule 31A, therefore, could not validly override Section 15(1) or operate for online gaming during the pre-amendment period. On retrospectivity, the Respondents argued that the 2023 amendments, which were substantive and prospective in character, newly classified online money gaming within the category of specified actionable claims and introduced a new regime of 28 per cent on full deposits. As a result, these amendments could not be treated as merely clarificatory of a pre-existing position nor can they have any retrospective operation to cover transactions completed before being brought into force.

Decision

The SC held that whenever money or money's worth is staked on an uncertain outcome, the activity constitutes "betting and gambling" for GST purposes. This legal character applies irrespective of whether the underlying game is predominantly one of skill or chance, or whether it is played online or offline. The Court observed that once monetary stakes are placed, the skill-versus-chance distinction loses its legal relevance unless an express statutory protection specifically insulates skill-based play from the consequences of such staking. Since no such protection exists under the CGST Act or any allied statute, the Court rejected the industry's central submission that platforms offering games of skill could not be treated as facilitating "betting and gambling" for GST classification purposes.

On constitutional validity, the Court held that GST is sourced in Article 246A and is a tax on the "supply" of actionable claims arising from betting and gambling arrangements. It upheld the Parliament's inclusion of actionable claims within the definition of "goods" under Section 2(52) of the CGST Act was upheld, as Article 366(12) is inclusive and not exhaustive. Entry 6 of Schedule III was read as excluding actionable claims, generally from the levy of GST but preserving the taxability for actionable claims arising from "lottery, betting, and gambling". With effect from October 1, 2023, the same treatment also extends to "specified actionable claims" arising from online gaming and casino transactions. Constitutional challenges under Articles 14, 19(1)(g), 21, and 265 were rejected.[46]

Replying on the definition of "actionable claim" under Section 3 of the Transfer of Property Act, 1882, the Court held that once a participant stakes money on an uncertain outcome, a contingent beneficial interest capable of maturing into an enforceable claim arises at the point of participation. The taxable event is located at the stage when participation yields this contingent actionable-claim interest, not at the stage of payout. The subsequent discharge of that interest upon the outcome does not negate the earlier taxable supply. The definition of "supply" under Section 7 of the GST Act is broad and extends to situations where the organised gaming framework itself generates taxable interest upon participation.

On consideration and valuation, the Court held that the entire bet amount constitutes "consideration" within Section 2(31) of the CGST Act. It rejected the platform fee or commission-only approach, holding that valuation under Section 15 is not confined to the net revenue retained by the operator. On this basis, the Court upheld Rules 31A, 31B, and 31C of the CGST Rules as valid valuation provisions, traceable to the rule-making power conferred under Sections 15 and 164 of the CGST Act. It also rejected the contention that these Rules were *ultra vires* or confined solely to horse racing transactions.

The Court further confirmed that the contest entry amount, i.e., the face value of the stake or total deposit, is the appropriate valuation base. It held that the 2023 amendments to the CGST Act and the IGST Act were clarificatory and explanatory in character and were introduced to remove doubts and provide greater specificity to the valuation and collection mechanisms; hence, these operate retrospectively. The Court accepted in full the IRA's position that the legal framework for taxing staked online gaming at 28 per cent on the full-contest entry amount had always been in place.

Procedurally, the Court dismissed all writ petitions and transferred cases challenging the levy, valuation, and show

46 The challenge under Article 14 was rejected on the ground that the classification between actionable claims arising from lottery, betting and gambling on the one hand, and other actionable claims on the other, rests on an intelligible differentia having a rational nexus with the object of the GST framework. Since activities in the nature of betting and gambling constitute res extra commercium, no fundamental right to carry on trade or business under Article 19(1)(g) can ordinarily be claimed in respect of such activities. Article 21 was held to have no application in the present fiscal context. The levy was found to be supported by statutory authority traceable to Sections 7, 9, and 15 of the CGST Act read with Schedule III and the relevant Rules framed thereunder, thereby satisfying the requirement of Article 265 that no tax shall be levied or collected except by authority of law.

cause notices. It allowed the IRA's civil appeals in their entirety and set aside the Karnataka HC judgment. The show cause notices were restored for adjudication before the relevant authorities. As a result, GST liability on online gaming, fantasy sports, and casino operations at 28 per cent on the total amount deposited by the players concerned stands constitutionally and statutorily validated. The Court also observed that the 2023 amendments operate retrospectively to cover all transactions since the inception of GST in July 2017. Consequently, the industry's pending disputes were redirected to the adjudicatory stage for quantification and determination of individual liability.

Significant Takeaway

This judgment is the most consequential indirect tax ruling in the online gaming sector since the introduction of GST. Its implications for tax planning and commercial structuring are severe and, in several respects, irreversible.

The Court's categorical rejection of the skill-versus-chance distinction as a basis for GST classification eliminates the industry's primary structural defence. Platforms had historically structured their operations around the characterisation of their games as skill-based. As a result, organisers' attempt to treat the prize pool as a pass-through amount held in fiduciary capacity and limit GST exposure to the platform fee or gross gaming revenue has fallen flat. Any restructuring that attempts to revive a fee-only GST base, whether through escrow arrangements, nominee structures, or contractual re-characterisation of the prize pool, will face the Court's holding that the entire contest entry amount has a direct and inseparable nexus with the supply and constitutes consideration. Please note that no structural arrangement can severe the prize pool from the taxable supply without an express statutory protection, which does not exist currently.

The retrospective operation of the 2023 amendments is equally consequential for planning purposes. The judgment means that GST demands for all periods from July 2017 till date are now live, and the industry cannot rely on the absence of specific legislative provisions prior to October 2023 as a defence to pre-amendment demands. For companies that have not provisioned for this liability, the financial exposure is astronomical and, in many cases, may become existential. Going forward, any acquisition, merger, or investment in the online gaming space must be preceded by a thorough GST due diligence exercise covering the full period from inception, with appropriate representations, warranties, and indemnities in transaction documents.

The judgment must also be read alongside the Promotion and Regulation of Online Gaming Act, 2025, which imposes a complete prohibition on online money games, including skill-based games with monetary stakes, fantasy sports with cash rewards, and card games such as poker and rummy. Read together, the SC judgment and the 2025 legislation may be construed to have represented a comprehensive regulatory and fiscal closure of the online money gaming industry as it existed prior to October 2023. The combined effect is that the industry faces not only retrospective GST demands but also a prospective prohibition on the very activities that generated those demands.

The Court has not determined the merits of individual demands. Consequently, some scope remains to contest the application of the extended limitation period under Section 74 (which pre-supposes existence of suppression or fraud) for periods where the industry's position was openly litigated and publicly known. The argument that should be pressed vigorously at the adjudication stage is that there was no suppression or wilful misstatement where the platform's GST treatment was the subject of active judicial proceedings across multiple Hcs.

> **"Where money or money's worth is staked on an uncertain outcome, the activity is 'betting and gambling' for GST purposes."**

SC rules UP cannot levy VAT on RIL's natural gas supplies from KG-D6

Introduction

In ***State of Uttar Pradesh & Ors. v. Reliance Industries Ltd. & Ors.,***[47] the State of Uttar Pradesh (**UP**) filed a civil appeal against a Allahabad HC (Lucknow Bench) judgment that had quashed a VAT assessment order the UP commercial tax authorities HAD raised against Reliance Industries Ltd. (**RIL**). The SC clarified a crucial aspect of state taxation powers regarding the inter-State movement of natural gas under Section 3 of the Central Sales Tax Act, 1956 (**CST Act**). It held that the supply of natural gas by RIL from the KG-D6 basin in Andhra Pradesh (**AP**) to buyers in UP constitutes an inter-State sale, and that the destination State lacks the legislative competence to levy VAT on such transactions. The judgment is significant not only as a precedent in the field of inter-State sales taxation under the CST Act, but also for its broader affirmation of fiscal federalism and the constitutional exclusivity of Union taxation over inter-State trade.

Facts

Under the New Exploration and Licensing Policy (**NELP**), RIL formed a consortium with Niko Ltd. and BP Exploration (Alpha) Ltd. (**Consortium**), which was awarded block KG-DWN-98-3 (**KG-D6**), a deep-water offshore block off the coast of Andhra Pradesh. The Government of India and the Consortium entered into a production sharing contract (**PSC**) permitting the extraction and sale of natural gas from the KG basin, subject to allocation under the gas utilisation policy (**GUP**).

Pursuant to GUP allocations, RIL entered into gas sales and purchase agreements (**GSPAs**) with buyers in various States, including UP. The GSPA defined the "Delivery Point" as the outlet flange of RIL's delivery facilities at Gadimoga near Kakinada, AP, interconnected to RGTIL's gas transportation facilities. Under Clause 7, title and risk passed from RIL to the buyer at Gadimoga, with RIL's role as seller concluding at that point.

The gas was transported from Gadimoga (AP) to Hazira (Gujarat) through RGTIL's pipeline, and further to Auraiya District in UP through GAIL's pipelines. The buyers themselves had separately entered into Gas Transportation Agreements (**GTAs**) with RGTIL and GAIL for the transportation from the delivery point to their plants in UP. RIL was not involved in the transportation leg.

RIL was registered with the AP commercial tax authorities, and it deposited CST in AP on these transactions. The UP authorities nevertheless treated the transactions as intra-State sales and passed an assessment order levying VAT at 21 per cent on RIL for April to November 2009, after successive rounds of adjudication and remand.

RIL challenged the assessment before the Allahabad HC (Lucknow Bench), which quashed the order, holding that the delivery point was unambiguously at Gadimoga in AP, that co-mingling in a common carrier pipeline did not affect the inter-State character of the transaction. Accordingly, it directed refund of the tax realised. The State of UP filed an appeal before the SC.

Notably, the State of UP itself had acknowledged the transactions as inter-State sales by issuing Form-C to the buyers under Rule 12 of the CST Rules read with Section 8(4) of the CST Act, a declaration specifically required for inter-State trade. Therefore, the State had approbated the very character it now sought to reprobate.

Issue

Whether the sale of natural gas by RIL to purchasers located in UP was in the nature of an "inter-State sale" attracting the CST Act or an "intra-State sale" subject to the levy of UP VAT under the UP VAT Act, 2008?

Arguments

The State of UP ("**the Appellant**") submitted that the gas extracted from KG-D6 in AP was transported through RGTIL and GAIL pipelines to Pata, in Auraiya district, UP, where it underwent processing before being channelled to buyers' factories. It contended that RIL acts as an agent of the Union of India and that the natural resource vests in the Union, held in public trust.

The Appellant further argued that metering occurred only at purchasers' premises in UP and that gas transported through the common carrier pipeline in co-mingled form could not be individually identified until actual delivery. Accordingly, it contended that the ascertainment and appropriation occurred only in UP at which stage the sale took place.

The Appellant also submitted that the GSPA was executed before extraction, when the goods were neither in existence nor were in a saleable form. Hence, the arrangement was merely an agreement for the sale of future and unascertained goods. It

[47] State of Uttar Pradesh & Ors. v. Reliance Industries Limited & Ors. 2026 INSC 491.

urged that Article 265 mandates the point of taxation be determined by statute, not contractual stipulations, and that Section 4 of the CST Act applied since appropriation occurred in UP. Additionally, it argued that Explanation 3 to Section 3, inserted in 2016, was applicable only prospectively.

RIL (**the Respondents**), on the other hand, submitted that the sales constituted inter-State sales under Section 3(a) of the CST Act, that Explanation 3 to Section 3 was clarificatory of the pre-existing position, and that Section 4 of the CST Act, being expressly subject to Section 3, had no application once the conditions of inter-State trade were satisfied.

The Respondents argued that for a sale to be inter-State under Section 3(a), three essentials must be satisfied: (i) the existence of a sale; (ii) the actual movement of goods from one State to another; and (iii) a direct nexus between the sale and such movement. All three were satisfied: the GSPA was a concluded contract obligating delivery at Gadimoga, AP, where title and risk passed to the buyer, and the buyers had separately entered into GTAs for carrying the gas to UP.

The Respondents further submitted that co-mingling during transportation occurred only after identification and metering at Gadimoga and did not affect the inter-State character of the transaction. Re-metering at Auraiya was legally irrelevant since the sale had already been concluded. The Respondents also pointed out that UP itself had acknowledged the transactions as inter-State sales by issuing Form-C and could not approbate and reprobate.

Decision

Upholding the Allahabad HC, The SC dismissed the civil appeals filed by the State of UP. It affirmed that the Constitution maintains an exclusive allocation of taxing powers between Parliament and State legislatures. Under Article 269(1), the Union alone has the competence to levy tax on sales in the course of inter-State trade or commerce, and Article 286(1) prohibits a State from imposing tax on the supply of goods where such supply takes place outside the State.

The Court held that the inter-State character of a sale is determined under Section 3 of the CST Act, requiring three conditions, including (i) a contract of sale incorporating a stipulation regarding inter-State movement of goods; (ii) the actual movement of goods from one State to another pursuant to such contract; and (iii) the sale being the proximate cause of such movement.

The SC agreed that the delivery point was unambiguously at Gadimoga in AP, where title and risk passed to the buyers. A plain reading of Clauses 2 and 7 of the GSPA confirmed that RIL's role as seller ended with the handing over of the natural gas to RGTIL at Gadimoga, thereby concluding the sale in AP, not in UP.

The Court held that the co-mingling of gas in the common carrier pipeline was a statutory obligation under the PNGRB Act, 2006. It also held that re-metering at Auraiya was a mere incident of transportation attendant upon a sale already completed in another State, incapable of creating a fresh occasion for VAT levy. The Court further held that upon the movement of goods from one State to another pursuant to a contract of sale under Section 3(a) of the CST Act, the nature of the goods (whether ascertained or unascertained) is irrelevant, and Section 4 has no application.

Section 7 of the UP VAT Act, 2008, was held to be a legislative acknowledgment of constitutional boundaries, not an independent source of limitation. To the extent a transaction falls within the CST Act, the State's VAT jurisdiction has no independent operation.

Significant Takeaways

The SC's decision establishes that where a contract of sale clearly provides for the inter-State movement of goods and expressly fixes the delivery point at which title and risk pass, the transaction will qualify as an inter-State sale under Section 3of the CST Act. Subsequent physical or commercial events in the destination State, including transportation through long-distance pipeline or common-carrier infrastructure or re-metering of goods, do not alter the character of the transaction or relocate the taxable event in favour of the destination State. This principle provides critical certainty to commercially structured arrangements in the energy sector, commodities trade, and any industry that relies on long-distance pipeline or common-carrier infrastructure.

From a transaction–structuring perspective, the judgment highlights the importance of clearly documenting the delivery point and transfer of title and risk in commercial agreements For energy sector participants, this means that the GSPA and GTA structure adopted by RIL, with delivery fixed at the wellhead or processing terminal in the producing State, and transportation arranged separately by the buyer is a legally sound and tax-efficient structure that will be respected by the courts. Businesses entering into new gas supply arrangements, or renegotiating existing ones, should ensure that their contracts clearly fix the delivery point, specify the transfer of title and risk at that point, and provide for separate transportation arrangements by the buyer to preserve the inter-State character of the transaction and avoid destination–State VAT exposure.

The judgment is also relevant to the structuring of cross-State commodity supply arrangements more broadly. The Court's holding that the nature of the goods (whether ascertained or unascertained) is irrelevant for the purposes of Section 3(a) of the CST Act, once there is movement of goods from one State to another pursuant to a contract of sale, removes a significant source of uncertainty in the structuring of bulk commodity supply arrangements involving fungible goods transported through common infrastructure. Parties who had previously been advised to avoid common-carrier transportation arrangements for fear of losing the inter-State character of their transactions may now revisit that advice in light of this ruling.

The ruling that Explanation 3 to Section 3 of the CST Act is clarificatory and, therefore, is retrospective in nature has profound practical implications for the pre-GST era. It means that taxpayers who faced destination-State VAT demands on inter-State gas transactions during the period prior to the Finance Act, 2016, may pursue refund or abatement claims. This retrospective protective cover is of direct relevance to players in the natural gas, petroleum, and energy sectors who had similar transactions during the pre-GST era. Practitioners advising such clients should assess whether refund claims are available and, if so, whether the applicable limitation periods have been preserved. The judgment also has implications for the resolution of legacy disputes that were stayed or deferred pending the outcome of this litigation.

> **"State of Uttar Pradesh does not have the power to levy sales tax on sale of gas concluded in the state of Andhra Pradesh."**

AIFTA origin verification is facilitative; does not bar statutory scrutiny of preferential duty claims

Introduction

In ***Rajasthan Metals & Ors. v. Union of India & Ors.,***[48] the Delhi HC addressed a batch of writ petitions challenging show cause notices (**SCNs**) issued by customs authorities rejecting preferential duty claims on copper tubes and pipes imported from Vietnam under the ASEAN–India Free Trade Agreement (**AIFTA**), on the ground that the imported goods did not satisfy the Regional Value Content (**RVC**) requirement of 35 per cent. The Court also addressed whether AIFTA's treaty-based origin verification mechanism was a mandatory pre-condition before customs authorities could issue SCNs denying preferential tariff treatment. It held that writ petitions challenging SCNs were premature in the absence of any jurisdictional error or violation of natural justice. It also held that the treaty-based verification mechanism under the AIFTA, employing the word "may", was facilitative in nature and did not curtail the statutory power of customs authorities under domestic law to scrutinise preferential tariff claims.

Facts

The IRA's investigation revealed that import of copper tubes and pipes from Vietnam had rapidly increased and that Vietnam's domestic copper production was wholly insufficient to support such exports. Intelligence indicated that copper cathodes were being sourced from Hong Kong and China and routed through Vietnam for re-export to India, with non-ASEAN origin content ranging between 48 per cent and 75 per cent of FOB value across 2019 to 2023. The IRA issued SCNs proposing to deny preferential duty and directed that all such imports be cleared provisionally upon furnishing of bank guarantee without extending AIFTA benefits.

The Petitioners challenged the SCNs before the HC, contending that the notices were issued without jurisdiction and in violation of the mandatory verification procedure under the AIFTA. The Vietnamese issuing authority had confirmed that the COOs were genuine and satisfied the RVC criterion.

Issue

Whether customs authorities could issue SCNs and examine the claim for preferential tariff treatment under the AIFTA without first completing treaty-based origin verification through a retroactive check as prescribed under Articles 16 and 17 of the AIFTA ROO, and whether the treaty-based verification mechanism constitutes a binding precondition that ousts the customs authorities' jurisdiction under domestic law?

Arguments

The Petitioners contended that the AIFTA read with the ROO constitutes a complete code governing preferential tariff treatment and that COOs issued by the Vietnamese issuing authority and confirmed as genuine are binding on customs authorities. They argued that the IRA did not follow the AIFTA-mandated two-step verification procedure, a retroactive check followed by a physical verification visit, before issuing the SCNs. The Petitioners further submitted that the word "may" in Articles 16 and 17 of the AIFTA should be read as "shall". They also contended that the IRA had applied an unauthorised RVC computation formula unknown to the ROO, that the extended limitation period under Section 28(4) was wrongly invoked in the absence of fraud or suppression, and that the continuation of the bank guarantee arrangement beyond one year was contrary to the treaty.

The IRA contended that the AIFTA does not divest India of its sovereign right to investigate and reject unjustified preferential tariff claims. It also emphasised that the word "may" in the OCP indicates a facilitative mechanism, not a mandatory precondition. The IRA submitted that an independent investigation revealed that for major Vietnamese exporters, non-ASEAN origin content ranged between 60 and 75 per cent of FOB value, which far exceeded the permissible threshold. It also contended that the exporters had failed to furnish verifiable ERP ledger records or production batch details. The IRA further argued that a COO is only *prima facie* evidence of origin under Section 28DA(2) of the Act, that the treaty's dispute settlement mechanism does not create private enforceable rights for importers, and that Section 28 of the Act confers ample investigatory powers not displaced by the AIFTA's OCP.

Decision

The Court held that the word "may" in the AIFTA's verification provisions is indicative of a facilitative mechanism, not a mandatory precondition, and rejected the Petitioners' argument that Articles 16 and 17 create a jurisdictional precondition before SCNs can be issued. The Court distinguished earlier decisions treating verification as mandatory. It held that those decisions

[48] Rajasthan Metals & Ors. v. Union of India & Ors., 2026:DHC:3557-DB.

preceded the 2020 amendments that introduced Section 28DA into the Act, which enables customs authorities to scrutinise origin claims and deny preferential treatment without completing the treaty's inter-governmental verification mechanism. It placed reliance on analogous HC decisions, holding that non-observance of the AIFTA's OCP does not invalidate action taken under the Customs Act.

The Court further held that a COO is only *prima facie* evidence of origin and does not create a conclusive entitlement to preferential tariff treatment, and that Section 28DA(2) places the burden of establishing compliance squarely on the importer. The Court noted that the exporters had been unable to produce detailed ERP ledger records and batch-wise inventory documents to demonstrate RVC compliance. All writ petitions were dismissed, and the Petitioners were directed to raise all pleas before the adjudicating authority.

Significant Takeaways

The judgment consolidates a growing line of HC authority holding that the AIFTA's OCP does not operate as a jurisdictional lock on the customs authorities' powers under domestic law, and that the treaty-based verification mechanism is a facilitative tool rather than a mandatory gateway through which all origin disputes must pass before SCNs can be issued. The ruling is practically significant for the HVAC and refrigeration sectors, which have been at the centre of large-scale investigations into suspected origin falsification and third-country routing through Vietnam. It also forecloses the procedural objection that SCNs issued without formal retroactive checks are nullities.

From a tax planning and structuring perspective, the judgment has many implications for importers who rely on FTA benefits as a core element of their supply chain economics. The Court held that a COO and Form-I declaration, even when confirmed as genuine by the issuing authority, does not discharge the importer's burden of establishing compliance with the origin criteria under Section 28DA(2) of the Act. This ruling fundamentally changes the risk calculus for FTA-based duty planning, in that importers can no longer treat the procurement of a COO from the designated issuing authority as a complete answer to a customs challenge. The judgment signals that the IRA is entitled to look behind the COO and examine the underlying production and procurement records. It also signals that the importer bears the burden of substantiating its origin claim through complete and verifiable inventory records, including batch-wise ERP data, stock movement documents, and production issue slips.

For supply chain structuring purposes, this means that importers who rely on FTA benefits must ensure that their foreign suppliers maintain complete auditable procurement and production records, including batch-wise inventory management data, purchase documentation from ASEAN-origin suppliers, and segregated stock accounts. The absence of such records at the adjudication stage may prove fatal to preferential duty claims, regardless of the existence of a valid and unrevoked COO. Importers should consider building contractual obligations on their foreign suppliers to maintain and produce such records as a condition of the supply arrangement to ensure that the evidentiary foundation for their FTA claims is robust.

Equally important is the Court's treatment of the evidentiary burden on importers claiming preferential tariff treatment. The judgment reinforces that where the customs authorities identify, through independent investigation, material revealing that the RVC composition of the goods is substantially below the prescribed threshold, the importer must substantiate its claim through complete and verifiable inventory records.

For importers relying on FTA benefits, the judgment is a clear signal that the IRA's scrutiny of RVC claims is permissible under the post-2020 statutory framework regardless of whether the treaty's inter-governmental verification mechanism was invoked. The judgment highlights that the adjudicatory proceedings before the customs authorities will be the primary battleground for resolving origin disputes.

> **"Post introduction of Section 28DA, obligation to satisfy the eligibility under the preferential claims rests with the importers who claim FTA benefits."**

Foreign exporters cannot be subjected to customs penal proceedings for pre-amendment conduct

Introduction

In ***Karl Mayer STOLL Textilmaschinenfabrik GmbH & Anr. v. Union of India & Ors.,***[49] the Bombay HC addressed whether SCNs could be issued to a foreign exporter for alleged customs contraventions relating to imports into India for a period prior to the Finance Act, 2018, amendment inserting Section 1(2) into the Customs Act, 1962 (the Act). It also addressed whether penalties under Sections 112 and 114AA of the Act could be sustained against such a foreign exporter in the absence of any legally established role in the alleged misdeclaration by the Indian importers. The Court held that the extraterritorial applicability of the Act was introduced only through the 2018 amendment and operates prospectively from March 29, 2018. It also held that the responsibility for compliance and declaration post importation rests with the importer and not the foreign exporter and that the SCNs and all consequential recovery action against the Petitioners were without jurisdiction and liable to be quashed.

Facts

The Petitioners in this batch of three writ petitions are two entities forming part of the Karl Mayer Group. The first Petitioner, Karl Mayer STOLL Textilmaschinenfabrik GmbH (**the German Exporter**), a company incorporated under the laws of Germany, is engaged in the manufacture and sale of textile machinery internationally, including in India. The second Petitioner, Karl Mayer India Private Limited (**the Indian Entity**), is a private limited company incorporated under the Companies Act, 1956, engaged in providing technical and support services to the Karl Mayer Group in relation to installation, start-up, and warranty cover for machines delivered to India and also assembling creels for warping machines at its production facility in Ahmedabad.

During the period June 2014 to May 2017, the German Exporter sold warp knitting machines to certain Indian importers. The Directorate of Revenue Intelligence, Ludhiana (**DRI-L**) initiated an investigation on the basis of intelligence that certain importers in India were mis-declaring these machines as "fully fashioned high-speed knitting machines" instead of "high speed warp knitting machines". These importers were thereby claiming the benefit of exemption notifications under the Central Excise regime. The DRI-L carried out inquiries against several Indian importers, recorded statements of their authorised representatives, and also visited the Ahmedabad and Mumbai offices of the Indian Entity. The Petitioners received more than 100 SCNs on similar grounds. Further SCNs under Section 124 read with Section 28 of the Act were issued, alleging that the Petitioners had aided and abetted the Indian importers in perpetuating the alleged import fraud and proposing penalties under Sections 112 and 114AA of the Act.

Earlier Orders-in-Original dated December 30, 2020, December 31, 2020, and March 5, 2021, had been passed in respect of nine Indian importers, wherein the SCNs against the Petitioners were dropped on the ground that there was no jurisdiction to impose penalties against the Petitioners as foreign entities. Those orders were, however, subsequently appealed by the IRA before the Tribunal, and were pending adjudication at the time of the present petitions.

Issue

(i) *Whether show cause notices could be issued to a foreign exporter for alleged customs contraventions relating to imports into India for a period prior to March 29, 2018, given that the extraterritorial reach of the Customs Act, 1962, was introduced only by the Finance Act, 2018?*

(ii) *Whether penalties under Sections 112 and 114AA of the Act could be imposed on such a foreign exporter in the absence of any legally established role in the alleged misdeclaration by the Indian importers?*

Arguments

The Petitioners contended that the SCNs were without jurisdiction as the Act did not confer extraterritorial jurisdiction prior to the amendment to Section 1(2) effective March 29, 2018. They urged that the 2018 amendment operated only prospectively, that penal provisions must be strictly construed, and that Article 20(1) prohibits imposition of penalty under an ex post facto law.

The Petitioners further submitted that obligations for declaration, self-assessment, and compliance post importation are cast entirely on the importer under Sections 17, 46, and 111(m) of the Act and that the German Exporter's responsibility ended upon shipment. No evidence of active participation in the alleged misdeclaration had been established, and the Revenue's reliance on a Single Member Bench decision was untenable, given a subsequent Division Bench ruling holding that the 2018 amendment operated only prospectively.

[49] Karl Mayer STOLL Textilmaschinenfabrik GmbH & Anr. v. Union of India & Ors., 2026:BHC-AS:17564-DB.

The Revenue contended that the German Exporter had aided and abetted the Indian importers by knowingly changing the description of machines at the importers' request, as deposed in the statement of the managing director of the Indian Entity recorded under Section 108. It submitted that this conduct fell within Section 112, and that since the Indian Entity as agent had provided documents to importers for filing before customs authorities, the acts in furtherance of the offence were committed in India.

Decision

The Court held that a foreign exporter cannot be made liable for the wrongs of the importer, since the exporter's privity with respect to the goods ends on shipment. All post-importation compliance obligations rest entirely with the importer. On extraterritorial jurisdiction, the Court held that prior to the 2018 amendment to Section 1(2), the Act did not extend outside India, and the amendment operated only prospectively. Since the alleged misdeclaration occurred between June 2014 and May 2017, the SCNs against the German Exporter were without jurisdiction.

Reading Sections 17, 46, and 111(m) conjointly, the Court held that responsibility post importation rests with the importer and the foreign exporter cannot be made liable for violations in respect thereof. No material evidence established that the German Exporter committed any act rendering goods liable to confiscation under Section 111, and the charge of abetment was not established. Penalties under Sections 112 and 114AA were accordingly unsustainable.

The Court held that the IRA's reliance on a Single-Member Bench decision was misplaced, as a Division Bench of co-ordinate jurisdiction had subsequently held that the 2018 amendment operated only prospectively. The Court quashed the impugned SCNs in all three writ petitions and made absolute the rule, also quashing any recovery notices issued in pursuance thereof.

Significant Takeaways

The judgment has significant implications for the manner in which foreign manufacturers and exporters structure their commercial relationships with Indian importers and their Indian subsidiaries or affiliates. The Court's holding that the foreign exporter's privity with respect to the goods ends upon shipment, and that all compliance obligations post importation rest exclusively with the importer, establishes a clear legal boundary between the exporter's role and the importer's role. Foreign exporters should ensure that their commercial arrangements with Indian importers clearly delineate this boundary and that the exporter's involvement in the Indian import process is limited to the supply of goods and the provision of accurate export documentation.

The judgment also has implications for the structuring of agency and distribution arrangements in India. The IRA's case rested in part on the role of the Indian Entity as the German Exporter's agent in India and on the allegation that the Indian Entity had facilitated the provision of documents to the Indian importers for filing before customs authorities. Foreign exporters who appoint Indian entities as agents, distributors, or service providers should review the scope of those arrangements to ensure that the Indian entity's role does not extend to involvement in the import compliance process.

The Court's conjoint reading of Sections 17, 46, and 111(m) of the Act to hold that the scheme of the legislation places compliance obligations exclusively on the importer is equally important for planning purposes. This analysis establishes that the foreign exporter's responsibility with respect to the goods ends upon shipment and that the importer bears sole responsibility for correct declaration and assessment at the port of entry. The IRA cannot short-circuit this allocation of responsibility by fastening derivative liability on a foreign exporter merely on the basis that the Indian importers, to whom it sold goods, have been found to have misdeclared those goods in their bills of entry.

> **“ Prior to the amendment introduced in 2018, the responsibility post importation of goods in India rested with the importer and the foreign exporter could not have been made liable for the violation in respect thereof. ”**

CBDT notifies MoU with Japan on Assistance in Collection of Taxes under Article 26A of the India-Japan DTAA

The CBDT, *vide* Notification No. 56/2026[50] dated April 2, 2026, notified the Memorandum of Understanding (**MoU**) for Assistance in Collection of Taxes, being the agreed mode of application of Article 26A of the India–Japan DTAA. The MoU was signed at Tokyo on June 30, 2025, and at New Delhi on July 8, 2025.

This notification does not amend, repeal or overrule any prior circular, notification, or statutory provision. Instead, it gives operational effect, for the first time, to the MoU concluded between the competent authorities of India and Japan under Article 26A of the DTAA, which itself is an existing treaty provision for mutual assistance in the collection of taxes between the two countries.

The notification records that Paragraph 21 of the MoU provides that its provisions shall apply to any request for tax collection made after the later of the dates on which the MoU was signed by the competent authorities of the two countries. Since the MoU was signed in India on July 8, 2025, which is later than that signed in Japan, the MoU entered into effect for requests for tax collection made after July 8, 2025.

By notifying the MoU under Section 90(1) of the IT Act, the CBDT has formally operationalised the treaty-based mechanism for cross-border assistance in tax collection under Article 26A of the India–Japan DTAA, which until now existed only as a treaty provision without a notified implementing arrangement. The notification clarifies the procedural framework under which the tax authorities of India and Japan may now request each other's assistance in collecting outstanding tax dues, thereby strengthening reciprocal enforcement of tax claims between the two jurisdictions.

[50] CBDT Notification No. 56/2026 dated April 2, 2026 [F. No. 500/22/2022-FT&TR-V].

GSTAT's Principal Bench empowered as National Appellate Authority for Advance Ruling

The Ministry of Finance, *vide* Notification No. 02/2026-Central Tax dated May 7, 2026,[51] empowered the Principal Bench of the GST Appellate Tribunal at New Delhi to function as the National Appellate Authority for Advance Ruling under Section 101A of the CGST Act, as introduced by the FA, 2026 with effect from April 1, 2026. The notification was subsequently corrected by a corrigendum issued on May 8, 2026. Before this amendment, state-level Authorities for Advance Ruling issued Advance Rulings. In cases where Appellate Authorities in two or more states issued conflicting rulings on the same question, businesses operating across multiple states across multiple states had no superior mechanism within the GST framework to resolve the conflict. This often resulted in contradictory GST treatment for the same activity in different jurisdictions, creating significant uncertainty in planning and compliance.

Section 101A empowers the Central Government to designate an authority as the National Appellate Authority for Advance Ruling. Section 101B provides that appeals may be filed before this Authority where conflicting advance rulings have been issued by the Appellate Authorities for Advance Ruling of two or more states on the same question. The notification deems the Principal Bench to have assumed this function from April 1, 2026, aligning it with the Finance Act, 2026, amendment date. The ruling of the National Appellate Authority for Advance Ruling will bind all states and cannot be displaced by any subsequent state-level ruling on the same question, thereby providing nationwide consistency. A structural milestone for multi-state businesses and tax practitioners, this step removes one of the most persistent sources of jurisdictional inconsistency within the GST dispute resolution framework.

CBIC notifies amendments to HSNS Cess Rules, 2026

The CBIC, *vide* Notification No. 03/2026-HSNS CESS dated May 20, 2026,[52] amended the Health Security se National Security Cess Rules, 2026, with immediate effect from May 20, 2026. The amendments are focused on streamlining the approval and accounting framework for the Health Security se National Security Cess, which was introduced as a dedicated levy to fund health security infrastructure and national security expenditure.

Three specific provisions have been introduced within Rule 35. First, the amendment has completely omitted Rule 35(3), which had imposed a specific procedural requirement in the transfer and accounting of cess revenue. Its removal eliminates that procedural layer, reducing the administrative burden on departments responsible for handling cess funds. Second, Rule 35(5) has been modified to eliminate the requirement for mandatory prior consultation with the Budget Division of the Department of Economic Affairs before the approval of certain fund transfers or disbursements under the cess framework. Removing this inter-departmental consultation requirement accelerates the processing of cess-related fund transfers and allows more responsive utilisation of cess revenue for its designated purposes. Third, Rule 35(6) has also been modified by consolidating the authority references governing approvals

[51] Notification No. 02/2026-Central Tax dated 7 May 2026.
[52] Notification No. 03/2026-HSNS CESS dated 20 May 2026.

for accounting and settlement functions. This amendment replaces the earlier requirement for approvals involving both the Principal Chief Controller of Accounts of CBIC and the Comptroller and Auditor General of India with a single reference to the Chief Controller of Accounts under the Ministry of Finance, thereby shortening the approval chain considerably.

DGFT mandates electronic issuance of Certificates of Origin

The DGFT, *vide* Public Notice No. 01/2026-27 dated April 7, 2026,[53] formalised a complete transition to digital trade documentation by amending Para 2.90 of the *Handbook of Procedures 2023* to mandate that all authorised agencies must process and issue Certificates of Origin exclusively through the designated electronic platform at trade.gov.in or such other DGFT-designated portals. The notice explicitly prohibits manual issuance of Certificates of Origin outside the official online system. Authorised agencies listed across Appendices 2B through 2E of the *Handbook of Procedures* must comply with this requirement or risk revocation of their authorisation to issue these trade instruments.

A Certificate of Origin certifies the country of origin of a shipment and is required by importing countries to extend preferential tariff treatment under free trade agreements, as well as for general import duty determination. Historically, many authorised agencies in India relied on partially manual or hybrid processes for issuance. The transition to an exclusively electronic process through trade.gov.in ensures that the entire lifecycle of the document, from application and processing to issuance and verification by importing country customs authorities, is digitalised and traceable. The electronic platform enables real-time automated verification by importing country customs, which is critical in the context of India's expanding free trade agreement network. Delays or discrepancies in traditional paper-based Certificates of Origin have previously led to the denial of preferential tariff treatment and commercial losses for exporters. Exporters must now file all applications through the designated portal only. Authorised agencies continuing to issue Certificates of Origin manually after the effective date risk losing their designated status.

DGFT introduces automated verification and self-certification rules for Certificates of Origin

The DGFT, *vide* Notification No. 05/2026-27 dated April 7, 2026,[54] amended Para 2.62 of the FTP 2023 to introduce two reforms relating to the issuance and verification of Certificates of Origin. These measures seek to enhance the reliability of origin documentation and create a pathway for qualified exporters to self-certify their products as originating from India, which is of direct commercial value for preferential tariff claims under free trade agreements.

The first reform mandates that all Import Export Code holders use identical invoice numbers across both their Certificates of Origin and corresponding Shipping Bills. This creates a direct and auditable linkage between the Certificate of Origin, the Shipping Bill, and the actual export transaction, enabling seamless automated cross-verification by DGFT and Customs authorities. It also prevents a single Certificate of Origin from being used across multiple shipments or invoices, which had been a compliance vulnerability under earlier documentation frameworks. The second reform introduces the Approved Exporter Scheme, which allows manufacturers recognised as Status Holders under the FTP 2023 to self-certify their manufactured goods as originating from India for the purpose of claiming preferential tariff treatment in partner countries. Self-certification removes the need for an agency-issued Certificate of Origin for each individual shipment, reducing administrative time and cost significantly for eligible exporters.

[53] Public Notice No. 01/2026-27 dated 7 April 2026.
[54] Notification No. 05/2026-27 dated 7 April 2026.

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
CST Act	Central Sales Tax, 1956
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
DTA	Domestic Tariff Area
DTAA	Double Taxation Avoidance Agreement
EPCG	Export Promotion Capital Goods
ESOP	Employee Stock Options
EXIM	Export Import
FA	Finance Act
FAO	Faceless Assessment Officer
FMV	Fair Market Value
FTP	Foreign Trade Policy

ABBREVIATION	MEANING
FTS	Fees for technical services
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GST	Goods and Services Tax
GSTAT	Goods and Services Tax Appellate Tribunal
GSTR	Goods and Services Tax Return
HC	Hon'ble High Court
HUF	Hindu Undivided Family
IBC	Insolvency and Bankruptcy Code, 2016
IEC	Import Export Code
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

ABBREVIATION	MEANING
PCCIT	Learned Principal Chief Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
RBI	Reserve Bank of India
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

List of Contributors

SR Patnaik
Partner (Head – Taxation)

Kunal Savani
Partner (Taxation)

Thangadurai V. P.
Director (Taxation)

Bipluv Jhingan
Principal Associate

Shivam Garg
Principal Associate

Reema Arya
Consultant

Vaibhav Zaveri
Consultant

Hansujja Padhy
Associate

DR Shashank
Associate

Navya Bhandari
Associate

Abhinaya Ranganathan
Associate

Cyril Amarchand Mangaldas
Advocates & Solicitors

100+ years of legacy | **1450** Lawyers | **230** Partners

Peninsula Chambers, Peninsula Corporate Park, GK Marg, Lower Parel, Mumbai – 400 013, India
T +91 22 6660 4455 **F** +91 22 2496 3666 **E** cam.mumbai@cyrilshroff.com **W** www.cyrilshroff.com
Presence in Delhi-NCR | Bengaluru | Ahmedabad | Hyderabad | Chennai | GIFT City | Singapore | Abu Dhabi