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From the President

CA Jayant Gokhale

Dear Members,

The start of the new financial year ushers in the busy period cycle for professionals—bank branch audits, appeals, filings, and other compliance deadlines. This period also coincides with school examinations and summer holidays, adding to the need for greater domestic participation. Naturally, academic activity at the Chamber slows down during this period. Yet, I may reassure members that the Managing Council and office bearers are working diligently on more ambitious programmes befitting our Centenary year.

Centenary Finale

Plans for a grand Centenary Finale Event- which would bring down the curtains on this historic centenary year; are under finalisation. You may **save the date of 20th June 2026** and block this Saturday morning for CTC. This finale event will provide a feast for members, literally and academically. The event will be our expression of gratitude to members for decades of loyalty to CTC. A Centenary comes only once in a lifetime—make sure you are part of this memorable occasion. Announcements will follow shortly.

Upcoming Programmes & Initiatives

The **19th International Tax RRC** will be held at Marriott, Udaipur from 11th–14th June. A full-day **Transfer Pricing programme** is scheduled for **9th May 2026** at India Habitat Centre, New Delhi. These programmes will feature the top names in the respective fields and enrolment is fast filling up. In case you are still thinking of attending; act now to avoid disappointment!

The Delhi programme will also mark the formal inauguration of the **CTC Delhi Branch**. Delhi has been a functional Chapter over the last two decades, and has now been recognised as a Branch of CTC. Recognising the Centenary as the right time to expand nationally, the Council has approved in March, branches at **New Delhi**, **Pune** and **Nagpur (Vidarbha)**, which already have a the requisite membership strength. Some more Branches are in the pipeline. This expansion strengthens CTC's pan-India footprint.

Legislative & Regulatory Changes

April has brought sweeping changes: the entire Income Tax Rules have been replaced, and fresh guidances has been issued by NFRA, RBI, and IRDAI. We are studying these changes closely and designing technical programmes to help members and clients successfully navigate the impact.

Nurturing the Next Generation

Parallely, CTC has also taken care to address issues relevant to the next generation of professionals. A recent free programme for new entrants to the profession featured senior members who provided excellent guidance about career choices across industry, practice, and other options such as investment, equity markets, start-ups, and consulting. We also hosted an inter-firm cricket competition (which attracted maximum possible entries). This event too provided a platform for the young and the young at heart, to spend an evening together, enjoying the camaraderie and spirit of friendly competition that pervaded.

The focus on addressing matters relevant to the younger generation is showing very positive results. We are greatly encouraged by the increased participation from younger members as they are the future of CTC who will carry our legacy forward.

Reasonable and Fair Application of Law

I am also delighted to inform, that the favourable order of the Bombay High Court allowing the Writ Petition filed by CTC (along with other professional bodies and trusts) has been received. The judgement while allowing the relief sought, also made one extremely significant observation. This obiter will be extremely relevant for numerous compliances which nowadays require online submission of applications. In dealing with a form provided in the system, which was not getting uploaded at all unless one answers in a certain manner (which effectively prevented the applicant from stating the correct position) and thereafter the Department proceeded to treat such information as false information furnished; the court observed: "*To penalise an assessee for a situation created by a utility designed by the Department itself is in violation of all legal principles. A procedural form cannot be used as a tool to coerce applicants into making declarations that are then used to their detriment.*"

Although this was not the main issue in contention, I believe that the Chamber has achieved something significant in ensuring that taxpayers are not subjected to Kafkaesque procedures under the guise of systems and forms. We believe in being compliant with the law, but in turn, the law has to be interpreted and applied reasonably and rationally. CTC will be happy to make necessary representations in this regard.

The Court's observation is especially relevant given the new **Income Tax Rules 2025**, where prescribed forms often result in impossible positions (e.g., Form 146, formerly Form 15CB). As a responsible professional body, CTC would be glad to collaborate with tax authorities to resolve such issues and prevent unintended hardship. Software developers may not always grasp ground realities, but our members' experience can help bridge that gap. We extend our hand of cooperation to ensure that such teething troubles are sorted out and better tax administration facilitated. We seek a fair and equitable application of law and are eager to support every such endeavour since a better tax administration serves the national interest. We hope authorities respond positively to our offer and our representations.

On this optimistic note, I wish all members a productive season of audits and compliance. May we continue to uphold the values of professionalism, fairness, and service that define CTC.

CA Jayant Gokhale
President



From The Editor's Desk

CA Anish M. Thacker

My Brothers and Sisters,

"We do the impossible immediately.
The miraculous takes a little longer."

These words inscribed on a plaque on the desk of my Guru, Shri Maganlal Thacker, who left this world for his heavenly abode on 14th March 2026, have stayed with me ever since I began my articleship. At first, I thought that these were boastful claims. As I grew in age and in professional experience, I go t to understand that these were what client service stands for. A true professional offers not only advice, but solutions to a client. He should not only be competent, but empathetic, an active listener and a good human being. These are some of the lessons my Guru taught me, which I have tried to imbibe into my professional life to date. Though he is not physically with me today, his words and his teachings, just by observing him throughout the 15 years I spent with him, are invaluable as I look back upon my journey both personal and professional. I will miss his sage advice on many things, including how to deal with conflict. I pray to the Almighty to grant eternal peace to his soul. Maganbhai, as he was known, was a senior and respected member of the profession and many stalwart Chartered Accountants, well placed in the profession, have passed from his office and become highly successful professionals. He will be missed but his guidance and teachings will remain with us forever.

The invasion of Artificial intelligence into our daily lives is increasing at a pace which is at times frightening. I would like to share two recent instances of this. On Sunday, 5th April, the Mumbai Mirror carried an article on how Indian authors are using artificial intelligence in coming out with their works of fiction and how, in contrast the western authors are eschewing these tools as in their view, AI does not bring out the emotions of the author and is as they call it, 'flat'. There is a school of thought on the other hand, which feels that embellishment of prose with AI is just like improving a photograph or an image, something which is done as a matter of course, and does not compromise on creativity at all. Another instance is a recent notification dated 6th April by the Punjab and Haryana High Court which warns judges about the use of AI tools in drafting their judgements and cautions that the use of AI may affect judicial integrity. These instances leave us in deep thought as should we use AI in the manner brought out above? The dilemma is real and there appears to be no right or wrong answer. We will have to wait and watch as to how the use of AI unfolds in the future. All that one can caution is that like every other tool, overdependence on AI will be detrimental. One hopes the checks and balances that mankind will put on itself for the efficient use of AI will be thought through and balanced.

This month's issue of the Journal deals with tax aspects of Shareholder distributions, a topic that is contemporary, controversial and full of twists and turns. CA Ameya Kunte, Chairman Journal Committee and his team, particularly CA Binoy Parikh, CA Vinita

Krishnan and Advocate Ritu Punjabi have put in a lot of hard work in conceptualizing the design, selecting learned authors and coming out with a good solid issue on this subject. I thank them from the bottom of my heart and express deep gratitude to all the learned authors, who have given excellent and crisp articles for this issue.

The team of Assistant Editors CA Chirag Wadhwa, Adv. Dharan Gandhi, Adv. Fenil Bhatt, CA Haresh Chheda, CA Nikhil Tiwari, CA Rakesh Upadhyay, CA Sachin Sastakar, CA Siddharth Parekh, CA Vikram Mehta, CA Yatin Vyavaharkar deserve special praise and kudos for their efficient yet silent contributions every month in upholding the style and the quality of the articles of the Journal. Also, the editorial board Mr. Kishor D Vanjara, CA Mahendra B Sanghvi, CA Manoj Shah, CA Pradip N Kapasi, CA Vipul K Choksi, CA Yatin Desai have always been there to guide and mentor me as the editor. I would also like to express my deep gratitude to each one of them. And the Journal Committee is as usual, rocking always. A shout out to each one of the members of the committee and the Chairman, Ameya for the brilliant work.

CA Sunil Gabhawala, my good friend and Editor of the Bombay Chartered Accountant Journal, has written a brilliant and thought provoking Editorial in the March issue of the BCA Journal titled "Increased Life Expectancy: When Life Outruns Professional Career" where he speaks of how, we professionals, are still physically and mentally active as we age, because of increased life expectancy and how we need to, unlike our predecessors, who retired at a particular age, evolve into roles that are mentoring more that controlling. I would urge everyone to go through and reflect upon this beautifully written and thought-provoking editorial. We need to be bold and be different in our approach once we reach the age of "gracefully letting go!"

"Do not be too timid and squeamish
about your actions.
All life is an experiment."

– Ralph Waldo Emerson

Jai Hind!

CA Anish M. Thacker
Editor



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Glimpses of the CTC NextGen Connect - Corporate Climb or Practice Prime? held on Friday, 27th March 2026 at IMC, Mumbai - 400 020



CA Jayant Gokhale, President of The Chamber of Tax Consultants welcoming the Students

CA Vishal Shah, Chairman, Members' Development & Outreach Committee giving brief about the session





***Panel Discussion** - Sitting (L-R) CA Sonakshi Jhunjhunwala, CA Dhimant Shah (Panelist), Adv. Nitesh Joshi (Panelist), CA Anish Thacker (Panelist), CA Hrudyesh Pankhania (Moderator) & CA Vishal Shah*



Group Photo

Glimpses of the 49th Residential Refresher Course on Direct Taxes held from 5th - 8th March 2026 at Sheraton Grand Bengaluru Whitefield Hotel & Convention Center, Bengaluru



Mr. Kishor Vanjara (Advisor) lighting the lamp along with CA Jayant Gokhale (President), CA Neha Gada (Vice President) and other dignitaries.

Glimpses of the 49th Residential Refresher Course on Direct Taxes held from 5th - 8th March 2026 at Sheraton Grand Bengaluru Whitefield Hotel & Convention Center, Bengaluru



Inauguration - Group Photo



CA Jayant Gokhale, (President) giving his opening remarks. Stitting (L-R) CA Pratik Doshi, Mr. Kishor Vanjara, CA Darshak Shah, CA Bandish Hemani.



CA Darshak Shah, Chairman RRC Committee giving his welcome address



***Session of Management & Taxation of Family Properties through HUF, Family Arrangements and Trusts** - Sitting (L-R) CA Dhiraj Dandgaval, CA Pratik Doshi, Adv. Dharan Gandhi (Speaker) CA Jayant Gokhale, Adv. Vipul Joshi (Chairman of the session), CA Ankit Nandu*



***Panel Discussion on Beyond Borders Conundrum: Domestic, International Tax, FEMA & Black Money Act** - Sitting (L-R) CA Sailee Gujarathi, CA Milin Mehta (Panelist), CA Manoj Shah (Moderator), CA Srinivasan PV (Panelist), CA Bandish Hemani, CA Pramod Shingte*



***Session on Case Studies in Direct Taxes -** Sitting (L-R) CA Harshil Shah, CA Mehul Sheth, CA Niraj Sheth (Speaker), CA Neha Gada, CA Ankit Kothari*



***Session on New Era in Direct Taxes: Implications of the New Act for Stakeholders** - Sitting (L-R) CA Vitang Shah, CA Geeta Jani (Speaker), Mr. Kishor Vanjara, CA Chetan Shah*



***Panel Discussion on Anatomy of a Transaction: Convergence of Sections 68-69D, Section 115BBE, The Benami Act, PMLA** - Sitting (L-R) CA Khyati Vasani, CA Vishal Shah, Sr. Adv. Saurabh Soparkar (Panelist), CA Jagdish Punjabi (Moderator), Sr. Adv. Chythanya K. K. (Panelist), CA Shailesh Bandi*



***Brains' Trust session -** Sitting (L-R) CA Neelesh Vithlani, CA Gautam Doshi (Trustee),CA Kishor Phadke (Moderator), CA H Padamchand Khincha (Trustee), Adv. Prakash Sinha*

Glimpses of the 49th Residential Refresher Course on Direct Taxes held from 5th - 8th March 2026 at Sheraton Grand Bengaluru Whitefield Hotel & Convention Center, Bengaluru



Closing Session *- Sitting (L-R) CA Parth Sanghvi, CA Bandish Hemani, CA Darshak Shah, CA Jayant Gokhale, Mr. Kishor Vanjara, CA Pratik Doshi, CA Dhiraj Dandgaval*



Group Photo

Glimpses of the CTC Premier League (CPL) 2026 held on 28th March, 2026 at Dr Antonio D'Silva School, S. K. Bole Road, Opp. Kabutar Khana, Dadar (West), Mumbai-400 028



Winning Team (Boys) - Gokhale & Sathe, CAs

Glimpses of the CTC Premier League (CPL) 2026 held on 28th March, 2026 at Dr Antonio D'Silva School, S. K. Bole Road, Opp. Kabutar Khana, Dadar (West), Mumbai-400 028



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Best Fielder (Boys)
Mr. Jimit Devani - Deloitte Shared Services India



Best Player of the Series (Boys)
Mr. Manan Soni, Deloitte Shared Services India



Best Player of the Match (Final) (Boys)
Mr. Prathamesh Surve - Gokhale & Sathe, CAs



Best Batter (Girls)
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Best Bowler (Girls)
Ms. Pari Nandu - GBCA & Associates LLP

THE TAXONOMY OF COMPANY PAYOUTS — A CONCEPTUAL AND LEGISLATIVE OVERVIEW





Suraj Malik *Anant Jain* *Khyati Aggarwal*

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* See Disclaimer on page 4

Overview

Company payouts are a critical aspect of translating business performance into shareholder value. Multiple mechanisms; such as dividends, buybacks, capital reduction, redemption, and liquidation; are available, each with distinct legal and tax implications. Selecting the appropriate route requires careful evaluation of the payout objective, shareholder profile, funding source, regulatory constraints, and impact on the capital structure of the company.

A fundamental distinction lies between distributions out of profits and those out of capital, as this determines both the corporate law framework and tax treatment. While corporate law governs the process and permissibility of payouts, tax law focuses on the economic substance of transactions rather than their legal form.

The evolving tax regime reflects a clear intent to prevent tax arbitrage and ensure that all forms of value distribution are appropriately taxed. Provisions such as deemed dividend and changes in the taxation of buybacks highlight a shift toward substance-over-form principles, bringing even indirect distributions within the tax net.

Different payout mechanisms can lead to significantly varied tax outcomes despite similar economic results. Therefore, structuring payouts requires balancing regulatory compliance, tax efficiency, and business objectives, with a focus on ensuring that transactions are commercially robust and defensible.

Building a business and delivering returns to shareholders are two sides of the same coin. Operational excellence must ultimately translate into shareholder value and a Company's management is judged not just by how well they run the business but also how well that translates into shareholder returns.

Management must navigate corporate and tax nuances with precision to ensure that payouts distributions are not only compliant with law but result in optimal tax outcomes and are implemented efficiently.



While dividends are one of the most commonly followed modes of company payout, companies have options and multiple avenues to make shareholder payout including returning capital via share buybacks, capital reduction, share redemptions and asset distributions and liquidation each with distinct regulatory and tax implications. Choosing the appropriate payout mechanism is a circumstance and fact specific exercise to achieve specific objectives and requires careful planning of the tax impact on the company and shareholder.

Key questions to consider while deciding the mode of payout are:

- *What is the objective of the payout; is it just income for shareholders or returning excess capital or an exit or restructuring or unlocking value by distribution of assets*
- *Who are the shareholders and what is their tax profile since same payout can have very different post tax outcomes depending on the shareholder entity structure, residential status etc*
- *How will the payout affect the company's current financial position, reserves and capital structure?*
- *Source of funding the payout – is it out of profits or capital or debt?*
- *What are the regulatory and compliance constraints impacting quantum, timing and approvals?*
- *What is the impact of the payout on control and shareholding?*
- *What is the desired timing horizon for the payout?*
- *What are the tax implications for the company and its shareholders?*
- *What are the other costs of execution of the payout?*

Decisions about payout to shareholders involve assessment of all these factors to arrive at the most efficient path to convert corporate value into shareholder wealth.

Understanding the tax and regulatory framework for each payout mechanism is one of the essential aspects while arriving at the optimal solution and the sequencing of steps in structuring the desired outcome.

Conceptual Foundation: Profit versus Capital

One of the key distinctions on the type of payout is the source of funds. Whether a distribution is made out of profits, capital or underlying assets fundamentally determines its tax treatment, regulatory pathway and impact on shareholder value and cap table.

We briefly discuss the corporate law aspects of company payouts before delving into taxation.

Importantly, paying a dividend does not change the company's capital structure: the number of shares and the core issued capital base remain intact. Dividend may sound simple but are generally not as straightforward to implement from a regulatory standpoint.

Corporate Law Architecture of Payouts

The Companies Act, 2013 prescribes the conditions governing the ability to make payout to shareholders, with emphasis on governance, creditor protection and corporate transparency. The three main modes are dividend, share buyback or redemptions and capital reduction.

Dividend

Dividends are the traditional form of shareholder payout, representing a distribution of profits from current earnings or accumulated free reserves. They can be declared as interim dividends during the year or as final dividends post year-end, with each route governed by distinct approval thresholds, limits on distributable surplus and prudential safeguards. While seemingly straightforward, dividends also operate within a tightly governed framework making thoughtful planning essential.

Importantly, paying a dividend does not change the company's capital structure: the number of shares and the core issued capital base remain intact. Dividend may sound simple but are generally not as straightforward to implement from a regulatory standpoint.

Share Buyback or Redemption

A buyback is a capital allocation tool through which a company returns surplus cash by repurchasing its own shares, effectively optimizing capital structure and enhancing per-share metrics. Share buyback involves the company repurchasing its own shares from shareholders. This results in reducing the number of shares outstanding and alters the capital structure. There are many guardrails imposed by corporate law (and SEBI regulations in case of listed entities) on the source and quantum of buyback and secretarial approvals and disclosure requirements. Further, in case shares are redeemable (like preference shares), the law permits the company to make a redemption out of profits or fresh capital.

Although buybacks are an effective mechanism for returning substantial capital, they involve many regulatory constraints beyond dividends, along with structural considerations and strategic implications, all of which make it far from a plug-and-play substitute for dividends.

Capital Reduction

The is one of the most direct mechanisms for returning capital or large sums to shareholders but also involves the most elaborate procedure for implementation. It allows a company to decrease its stated share capital and/or cancel shares, giving cash or other value back to shareholders. Companies reduce capital by cancelling uncalled liabilities on partly paid shares, cancelling shares, returning excess capital to shareholders or without any payout by cancelling share capital to adjust the accumulated losses to right size the balance sheet.

The company must obtain approval from the National Company Law Tribunal and creditors are given proper notice with an opportunity to object the releasing of funds or assets to shareholders, by the company.

The underlying objective of corporate law is not to restrict payouts, but to discipline them. It ensures that distributions are made transparently, equitably and without impairing the company's solvency or prejudicing creditor interests.

Capital reduction offers maximum flexibility, for instance, it can return capital even when no distributable profits exist but the strict procedures and time involved in execution makes it relevant only in special situations, including restructuring or providing exit to select shareholders.

Other Mechanisms

Beyond these primary routes, some of the other mechanisms to distribute assets to shareholders are:

The company must obtain approval from the National Company Law Tribunal and creditors are given proper notice with an opportunity to object the releasing of funds or assets to shareholders, by the company.

- **Loans to shareholders/related parties**: Corporate law severely restricts this to prevent disguised capital return that could prejudice creditors, which often necessitate the use of more structured and compliant instruments while adhering to related party transaction guardrails.

- **In-kind distributions**: A company may distribute assets (instead of cash) directly to shareholders. This is common only in certain circumstances (for example, a company winding up may distribute its assets in specie). Such distributions require robust valuation, appropriate approvals and adherence to prudential norms, including protection of creditor interests and maintenance of solvency.

The underlying objective of corporate law is not to restrict payouts, but to discipline them. It ensures that distributions are made transparently, equitably and without impairing the company's solvency or prejudicing creditor interests. The procedural requirements ensure governance and fairness and protect interest of creditors and other stakeholders so that companies cannot arbitrarily make payouts that compromise solvency or benefit select shareholders.

Taxation of Company Payouts

While Corporate law dictates how payouts can be made by a company; tax law governs how

such payout is characterized for tax purposes and who bears the tax incidence on the same. The evolving tax framework for dividends and share buybacks underscores a consistent legislative intent to tighten anti-avoidance measures by closing structural gaps, discouraging aggressive tax planning and preventing the undue exploitation of tax treaty benefits. Aggressive structuring to extract tax advantage from payout mechanisms is increasingly high-risk and litigation prone.

Taxonomy of Dividend payout

Under the current law, following the abolition of Dividend Distribution Tax (DDT) by the Finance Act, 2020, Dividends are taxed in the hands of shareholders.

Company paying a dividend does not need to bear any taxes on distribution, however it has to withhold tax on dividend payments to shareholders. Companies need to withhold tax (TDS) at the rate of 10% when distributing dividend above ₹ 5,000 to any resident shareholder. For non-resident shareholders, dividend withholding tax is subject to applicable tax treaty rate that the shareholder is eligible to claim benefit of. Further Non-resident shareholders may be eligible to claim tax credit of taxes withheld by the Indian company in their home jurisdiction as per applicable tax treaty and laws of their home country.

In a multi-layered corporate structure, to avoid cascading effect, deduction is allowed to the extent dividend is further distributed, within prescribed timelines, by the receiving entity to its shareholders.

"Deemed dividend" rules ensure that any hidden transfer of value to owners, when backed by accumulated profit, is taxed as if it were a declared dividend.

In summary, dividends are now directly taxed in the hands of shareholders, with the distributing company bearing a withholding obligation rather than a tax incidence. This creates differentiated post-tax outcomes across shareholder classes making dividend distribution inherently non-neutral from a tax efficiency perspective. This also provides some planning opportunities in the use of holding companies, GIFT structures and treaty jurisdictions with adequate substance. Given recent judicial precedents, access to lower treaty rates or other benefits under the tax treaty is no longer automatic and must be defensible.

Payout characterized as Deemed Dividend

Deemed dividend provisions are aimed to catch hidden distributions of profit and bring them under the tax net. The term "dividend" under the tax law has been defined expansively to include certain transactions that effectively confer economic benefit to shareholders or result in release of funds or assets to them, even if not formally declared or paid as a dividend under the corporate law. Typical examples include loans or advances by closely held companies to certain shareholders (or their affiliates) or payments made by the company on behalf of or for the benefit of any shareholder. The definition of dividend also covers certain non-cash or restructuring-related distributions, such as issue of bonus shares to the preference shareholders and any distribution in a capital reduction or liquidation to the extent of accumulated profits.

These back-and-forth changes reflect a consistent policy theme and legislative intent to encourage genuine capital allocation and payout flexibility, but discourage tax-driven structuring especially by controlling shareholders.

If a shareholder is able to enjoy company profits without a formal dividend, the law steps in and taxes it as dividend ignoring the form. The core principle is to prevent companies or shareholders from distributing profits indirectly and evading taxation. "Deemed dividend" rules ensure that any hidden transfer of value to owners, when backed by accumulated profit, is taxed as if it were a declared dividend.

Share Buyback

The tax treatment of share buyback has undergone significant changes in recent years. For many years until 2013, a share buyback was treated like any other sale of shares and tax implications were in the hands of shareholder under capital gains.

In 2013, new provisions were introduced to first cover unlisted companies which was extended to listed companies as well in 2019, to curb a perceived tax avoidance where shareholders enjoyed tax treaty exemptions or lower rate of taxation on capital gains vis-à-vis dividends.

Until recently, company itself had to pay a tax (@20% plus surcharge and cess) on the buyback proceeds reduced by the amount received by the company against those shares at the time of its issue, somewhat analogous to DDT. This effectively meant companies paid tax at buyback and shareholders did not have to pay a tax.

Then came the Finance Act, 2024 that revised the rules to provide that the entire buyback proceeds by listed and unlisted companies to its shareholders were deemed as dividend and taxed as ordinary income in the hands of shareholders. The cost of purchase of shares were allowed to be claimed as capital loss depending upon period of holding. This regime significantly increased the tax burden for many shareholders particularly resident individuals in higher tax brackets while also introducing complexity in loss recognition.

The Finance Act, 2026 recalibrated this approach by moving back toward a capital gains-based framework for taxation of buybacks, while simultaneously introducing targeted anti-arbitrage measures. An additional tax incidence for promoters has been introduced to curb arbitrage vis-à-vis dividend taxation. For non-promoters, this improves post-tax yield and makes buybacks attractive again as a payout mechanism

These back-and-forth changes reflect a consistent policy theme and legislative intent to encourage genuine capital allocation and payout flexibility, but discourage tax-driven structuring especially by controlling shareholders.

Other Payout Mechanisms

The taxation in case of other modes of distribution is based on their economic substance and not the form.

- Capital reduction: In a capital reduction, the tax treatment requires splitting the receipt into the portion attributable to accumulated profits and the remaining amount. This makes tax outcomes less intuitive and planning-sensitive and

applies even if the payout is structured under a scheme of arrangement.

- **Share redemption**: Redemption is when a company repays the capital invested by way of preference shares to shareholders (usually at face value or with a premium), as per terms of issue under the Companies Act, 2013. Unlike buyback, redemption does not have a separate dedicated tax regime and the source of funding matters in determining the tax outcome which is similar to a capital reduction. To the extent the redemption of preference shares is funded out of accumulated profits, the amount is characterized as dividend and the balance amount is liable to capital gains.

The choice of payout method must consider both corporate law procedures and tax consequences.

- **Liquidation**: In liquidation, the tax treatment follows a similar principle. Liquidation distributions are partly taxed as dividend and partly as capital gains. The portion of the distribution attributable to accumulated profits is taxed as dividend for shareholders. Any excess is treated as consideration for transfer and taxed as capital gains. For computing capital gains, the amount or value of assets received is reduced by the portion already taxed as dividend.

Conclusion

In a company's lifecycle, distributing value to shareholders is as important as creating it. The choice of payout method must consider both corporate law procedures and tax consequences. From a pure finance lens Dividend payouts signal stability and predictability that attract long-term, income-oriented investors. Buybacks or Capital Reduction signal capital discipline and improve per-share metrics (EPS, ROE). The decision is pick one over the other no longer binary or purely based on tax.

Designing shareholder payouts requires navigating two parallel frameworks, corporate law and income tax. Crucially, tax treatment does not always align with the legal form of a transaction. While corporate law governs how a distribution is structured (dividend, buyback, capital reduction, etc.), tax law evaluates what the transaction effectively achieves in economic terms. Ultimately, it is the substance of the transaction that determines its treatment under the tax law.

Over time, the tax regime has evolved to reinforce this principle. Through a combination of Expansive definitions, Deeming provisions and Anti-avoidance rules all of which seek to ensure that disguised or indirect distributions of profits do not escape taxation merely by adopting alternative legal forms.

Similar economic outcomes, can lead to very different tax consequences and transactions that appear benign under corporate law, may still trigger adverse tax recharacterization. In an increasingly substance-driven tax regime, the durability of any payout tax strategy lies not just in its structure but in its economic integrity.

■

DEEMED DIVIDEND UNDER SECTION 2(22)(e) — LOANS, ADVANCES, AND THE LITIGATION LANDSCAPE




Devendra Jain *Shashank Mehta*

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Overview

This article provides a comprehensive analysis of the deemed dividend provisions under Section 2(22)(e) of the Income-tax Act, 1961 which serves as an anti-abuse measure designed to prevent shareholders of closely held companies from extracting accumulated profits as tax-free loans or advances, thereby circumventing the tax incidence that a formal dividend declaration would attract.

Certain vital key areas of litigation are discussed in depth; especially- the strict construction mandate for deeming provisions; the unresolved question of whether deemed dividend is taxable in the hands of the shareholder or the recipient concern; the exclusion of trade advances and security deposits from the scope; the computation of accumulated profits including the treatment of depreciation, share premium, and capital gains; the effect of loan repayment within the same year; and the complexities arising from holding-subsidiary and intra-group fund flows.

The article has also touched upon the interplay of section 2(22)(e) with the Dividend Distribution Tax and concludes by noting that the new Income-Tax Act, 2025 carries forward this provision as Section 2(40)(e), ensuring its continued relevance as a safeguard against the siphoning of corporate profits through the loan route.

I. Introduction: The Legislative Intent and Historical Genesis

The structure of the closely held companies has long served as a vehicle for the concentration of economic power within a small group of individuals. When accumulated profits are retained within such companies and the controlling shareholders extract them under the garb of loans and advances, the economy suffers a direct erosion of its tax base. Such shareholder enjoys the economic benefit of the company's distributable surplus without bearing the tax incidence that a formal dividend declaration would attract.

It is this mischief—the disguised distribution of profits through the loan route—that sub-clause (e) of clause (22) of section 2 of the Income-tax Act, 1961 ("the Act") was designed to address.

This anti-abusive provision was first inserted in clause (e) to section 2(6A) of the Indian Income-tax Act, 1922, and was subsequently carried forward—with significant modifications—into section 2(22)(e) of the 1961 Act. The constitutional validity of the predecessor provision was upheld by the Supreme Court in ***Navnit Lal C. Javeri vs. K.K. Sen, AAC (1965) 56 ITR 198 (SC)***, which recognised that the provision was enacted to prevent a group of shareholders who held a substantial interest in a private company from diverting the company's profits to themselves in the form of tax-free loans.

II. The Statutory Architecture of Section 2(22)(e):

Hon'ble Apex Court in the case of ***CIT vs. Nalin Behari Lall Singha [1969] 74 ITR 849 (SC)*** held that 'Dividend', in its ordinary connotation, means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum distributed.

However, section 2(22) of the Act provides an inclusive definition of the term "dividend" that extends beyond its ordinary commercial understanding.

Sub-clause (e) of section 2(22) deems certain payments made by closely held companies as dividends, even though no formal dividend is declared.

The provision covers three categories of payments:

(i) any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend) holding not less than ten per cent of the voting power;

Sub-clause (e) of section 2(22) deems certain payments made by closely held companies as dividends, even though no formal dividend is declared.

(ii) any such payment to any **concern** in which such shareholder is a member or partner and has a **substantial interest**; and

(iii) any payment on behalf of, or for the individual benefit of, such shareholder.

Further, the quantum of such deemed dividend is restricted to the extent to which the company possesses accumulated profits.

However, the proviso carves out a critical exception viz. advances or loans made in the ordinary course of business where money-lending is a substantial part of the company's business.

Further, Explanation 3 to section 2(22) defines "concern". It means an HUF, firm, AOP, BOI or a company.

Further, it provides that a person shall be deemed to have substantial interest in the above referred concerns if he holds the following:

- Where the concern is HUF, Firm, AOP, BOI: he is beneficially entitled to atleast 20% of the income.
- Where the concern is a company: he is the beneficial owner of shares, carrying atleast 20% of the voting power [section 2(32)].

In a significant amendment vide the Finance Act, 2018; Explanation 2A was inserted widening "accumulated profits" for amalgamated companies to include the amalgamating company's profits on the date of amalgamation—it was a measure aimed at curbing abusive arrangements that exploited the amalgamation route to reduce capital.

III. Intricacies leading to litigation and Judicial Interpretations

A. The Mandate of Strict Construction

Since section 2(22)(e) creates a deeming fiction and the Hon'ble Supreme Court has consistently held that it must receive strict interpretation; reference can be drawn from the decision in the case of ***CIT vs. C. P. Sarathy Mudaliar [1972] 83 ITR 170 (SC) [12-10-1971]***. Further, in ***Gopal And Sons (HUF) vs. CIT [2017] 391 ITR 1 (SC) [04-01-2017]***, the apex court reiterated the foundational principle in the context of section 2(22)(e) itself that deeming provisions must be strictly interpreted and should not be given a wider meaning than what they purport to achieve. It was held that unless all the conditions contained in the provision are fulfilled, the receipt cannot be deemed as dividend. Moreover, the Hon'ble Court also specifically held that in cases of doubt or where two views are possible, the benefit must accrue to the assessee.

This dual safeguard viz. strict construction coupled with the benefit-of-doubt to assessee—forms the interpretive bedrock of the entire jurisprudence surrounding this provision.

B. Taxability: In Whose Hands?

One of the most litigated aspects of section 2(22)(e) is the interpretation of the word "shareholder." Under the 1922 Act, the position was settled by Hon'ble Apex Court in the case of ***C.P. Sarathy Mudaliar (supra)*** wherein it was held that the word 'shareholder' in section 2(22)(e) refers to the registered shareholder and not to the beneficial owner. However, the amendment made vide the Finance Act, 1987 fundamentally altered the statutory language by introducing the expression '*a person who is the beneficial owner of shares*'.

View 1: Deemed dividend taxable in the hands of recipient concern:

The CBDT Circular No. 495 dated 22 September 1987 suggested that it would be taxable in the hands of the recipient concern.

In the case of ***Gopal And Sons (HUF) vs. CIT [2017] 391 ITR 1 (SC)[04-01-2017]*** certain amounts were received by the Assessee HUF from a company where the karta of the Assessee HUF had substantial interest. It was held that provisions of section 2(22)(e) were attracted and it is not necessary to determine as to whether HUF can, in law, be beneficial shareholder or registered shareholder in a company. In substance, deemed dividend would be taxable **in the hands of the recipient concern** even if it is not shareholder in the lending company.

View 2: Deemed dividend taxable in the hands of shareholder:

The Hon'ble High Court of Delhi in the case of ***CIT vs. Ankitech (P.) Ltd. [2011] 242 CTR 129 (Delhi) [11-05-2011]*** *inter-alia* held that the deeming legal fiction created under section 2(22)(e) enlarges definition of dividend only; the legal fiction cannot be extended for broadening concept of 'shareholders'. It was held that when the Assessee received 'loans & advance' which were covered within the ambit of section 2(22)(e) on account of common substantial shareholding between the

Assessee Company and the lender company; such deemed dividend cannot be taxed in the hands of the recipient assessee because the Assessee was never the shareholder of the lender company.

Further, Hon'ble Supreme Court in the case of ***CIT vs. Madhur Housing & Development Co. [2018] 401 ITR 152 (SC) [05-10-2017]*** affirmed the view of the Hon'ble Delhi High Court in CIT vs. Ankitech (P.) Ltd. (supra) to hold that the taxation of **deemed dividend would be in the hands of the shareholder, and not in the hands of the recipient concern**.

The present status of the above litigation:

In further development; the Hon'ble Apex Court in the case of ***National Travel Services vs. CIT [2018] 89 taxmann.com 332/253 Taxman 243 (SC)*** declined to accept the view taken by the coordinate bench in the case of ***CIT vs. Madhur Housing & Development Co. (supra)*** and held that the issue required further consideration and placed the appeals before the Hon'ble Chief Justice of India in order to constitute an appropriate bench of three learned Judges in order to have a relook at the entire question. The same is still pending for adjudication.

C. Beneficial shareholder vs. Registered beneficial shareholder:

An interesting case came up before the Hon'ble High Court of Bombay in the case of ***Dattaprasad Kamat vs. ACIT [2023] 458 ITR 201 (Bombay) [18-08-2023]*** wherein the Assessee was married to his spouse in terms of the provisions of the Portuguese Civil Code and provisions of section 5A of the Act were applicable; according to which the income (except salary) was to be apportioned equally between the husband and the wife. Assessee (being shareholder of a closely held company) received certain payments which were deemed as dividend in terms of section 2(22)(e). The Assessee pleaded that such dividend income cannot be assessed solely and entirely in his hands; as 50% of such income should have been apportioned towards his spouse in terms of section 5A. Hon'ble High Court held that for the purpose of section 2(22)(e), wife married under Portuguese Civil Code, is not holder of 50% of voting rights in shares of company **registered exclusively in name of husband**; the term 'beneficial owner of shares', 'shareholder' and 'member' in company referred in section 2(22)(e), **shall only be registered shareholder or registered beneficial owner of a share whose name is found in register of members/ shareholders of company. Accordingly, it was held that the entire amount was taxable only in the hands of the Assessee (husband)**.

The word "advance" in the phrase "by way of advance or loan" has been interpreted as referring only to advances carrying an obligation of repayment akin to a loan, not to trade advances made in the course of regular commercial transactions.

D. Trade Advances and Commercial Transactions

The most prolific line of judicial development concerns the exclusion of trade advances from the scope of deemed dividend in the form of loans and advances. The word "advance" in the phrase "by way of advance or loan" has been interpreted as referring only to advances carrying an obligation of repayment akin to a loan, not to trade advances made in the course of regular commercial transactions. The Delhi High Court in ***CIT vs. Raj Kumar [2009] 181 Taxman 155/318 ITR 462*** articulated this distinction, holding that the word 'advance', which precedes the word 'loan' in section 2(22)(e), can only mean such advance which

carries with it an obligation of repayment. The trade advances, which is in nature of money transacted to give effect to a commercial transaction, cannot be treated as 'deemed dividend' falling within ambit of provisions of section 2(22)(e) of the Act.

The Calcutta High Court in ***Pradip Kumar Malhotra vs. CIT (2011) 338 ITR 538*** held that the advance given by the company to the assessee-shareholder by way of compensation for keeping his property as mortgage on behalf of company to reap benefit of loan could not be treated as deemed dividend within meaning of section 2(22)(e) of the Act. The Court drew a vital distinction viz. the advance was not gratuitous but was linked to a quid pro quo beneficial to the company.

The CBDT itself, through Circular No. 19/2017 dated 12.06.2017, acknowledged that the view of excluding trade advances from the ambit of section 2(22)(e) had "attained finality" and directed that appeals shall not be filed merely on this ground.

Most recently, Gujarat High Court in the case of ***Relitrade Stock Broking (2025) 176 taxmann.com 509*** placing reliance upon the said Circular quashed the re-assessment proceedings; thereby reaffirming this settled position that 'trade advances' cannot fall within the ambit of section 2(22)(e).

E. Deposits and Security Deposits: Distinct from Loans

A related line of jurisprudence concerns inter-corporate deposits and security deposits.

The Delhi Special Bench in ***Housing & Urban Development Corpn. Ltd. vs. Jt. CIT [2006] 5 SOT 918 (Delhi) (SB)*** held that despite similarities, the two expressions 'loans' and 'deposits' are to be taken different and the distinction can be summed up by stating that in the case of loan, the needy person approaches the lender for obtaining the loan therefrom. The loan is clearly lent at the terms stated by the lender. In the case of deposit, however, the depositor goes to the depositee for investing his money primarily with the intention of earning interest.

The Allahabad High Court in ***CIT vs. Atul Engineering Udyog [2014] 51 taxmann.com 569 (Allahabad)*** held that security deposits made by affiliates in the normal course of business cannot constitute loans within section 2(22)(e).

The Karnataka High Court in S***mt. Jamuna Vernekar vs. DCIT [IT Appeal No. 43 OF 2013, dated 10th February, 2021]*** held that amounts received towards security deposit and lease rentals for premises construction fell outside the provision of section 2(22)(e).

F. Accumulated Profits: Computation and Nuances

The provisions of section 2(22)(e) provides that the quantum of deeming the specified sum as dividend is limited only to the extent of accumulated profits possessed by the company on the date of the loan or advance.

Hon'ble Supreme Court in the case of ***CIT vs. Mukundray K. Shah [2007] 290 ITR 433 (SC)*** has obliquely explained as to why the quantum of deemed dividend should be restricted to the amount of 'accumulated profits. It was observed that the companies having accumulated profits and the companies in which substantial voting power lies in the hands of the person other than the public (controlled companies) are generally required to distribute accumulated profits as dividends to the share-holders. In such closely held companies, the controlling group does what it likes with the management of the company, its affairs and its profits. It is for this group to decide whether the

profits should be distributed as dividends or not. The declaration of dividend is entirely within the discretion of this group. Therefore, the Legislature realized that though funds were available with the company in the form of profits, the controlling group refused to distribute accumulated profits as dividends to the shareholders but adopted the device of advancing the said profits by way of loan to one of its shareholders so as to avoid payment of tax on 'accumulated profits'. This was the main reason for enacting section 2(22)(e) of the Act.

From the above, it can be inferred that if the company has no accumulated profits or has accumulated losses, the provision of section 2(22)(e) simply cannot be made applicable.

A critical issue is the method of computation of 'accumulated profit'.

The Telangana High Court in ***Babulal Jain vs. ITO (2024) 169 taxmann.com 238***, following the Bombay High Court's earlier decisions in ***Navnitlal C. Jhaveri vs. CIT (1971) 80 ITR 582*** and ***CIT vs. Jamnadas Khimji Kothari (1973) 92 ITR 105***, held that accumulated profits do not mean profits as disclosed by the company's balance sheet; depreciation at rates prescribed by the Income-tax Act must be deducted for ascertaining accumulated profits.

Where the lending company does not have reserves and surplus and has only the amounts received by way of share premium, it could not be construed as accumulated profits of the company as held by the High Court of Calcutta in the case of ***CIT vs. Shree Balaji Glass Manufacturing (P.) Ltd. [2016] 72 taxmann.com 118 (Cal.)***

Interestingly in the case of ***Manoj Murarka vs. ACIT [2016] 65 taxmann.com 255 (Kolkata - Trib.)*** it was held that the capital gains could be included for reckoning the accumulated profits only when the said capital gain has been duly subjected to tax. Explanation to section 2(22) nowhere contemplates to bring within the ambit of expression 'accumulated profits' any capital profits which are not liable to capital gains tax.

Another peculiar aspect w.r.t. section 2(22)(e) is that a comparative analysis of section 2(22)(a) to (d) reveals that the phrase "capitalised or not," is conspicuously absent from sub-clause (e). Consequently, if accumulated profits are capitalised—such as through bonus or rights shares—prior to advancing of any loan/advance, section 2(22)(e) does not apply. This contention has been upheld by Hon'ble Supreme Court in the case of ***P.K. Badiani vs. CIT [1976] 105 ITR 642 (SC)[21-09-1976]***.

Hon'ble Supreme court in the context of section 2(22)(d) in the case of ***CIT vs. G. Narasimhan [1999] 236 ITR 327 (SC)*** held that the accumulated profits get reduced by the amount deemed to be dividend under section 2(22) even where no adjustment therefor was made in books of account.

In the backdrop of this ratio laid down by Hon'ble Apex Court a peculiar computational situation may also arise even for the purpose of calculating the quantum of accumulated profits for the purpose of section 2(22)(e).

Say for example, a private company holds accumulated profits of ₹ 1 crore. Loans are advanced to one of the shareholder (say of ₹ 30 lakhs) which is admittedly deemed as dividend under section 2(22)(e). Though the accumulated profits as per the books stands as ₹ 1 crore; however, notionally there is reduction of accumulated profit on account of payout of the said deemed dividend of ₹ 30 lakhs.



If further loans of ₹ 80 lakhs are advanced to another substantial shareholder; the question arise is to what extent such loan would be taxed as deemed dividend? Following the ratio laid down by Hon'ble Apex court it can be said that the accumulated profit would be considered as only ₹ 70 lakhs (after notionally reducing the initial deemed dividend payout of ₹ 30 lakhs) in which case- the quantum of deemed dividend for the subsequent shareholder would be taxed only to the extent of ₹ 70 lakhs as against total payout of ₹ 80lakhs.

G. Loans Repaid Within the Same Year

Whether repayment of a loan within the same assessment year exempts it from section 2(22)(e) is one of the issues where divergent views persist.

The Hon'ble Supreme Court in ***Miss P. Sarda vs. CIT (1993) 229 ITR 444 (SC)*** held that advances made by company to assessee would have to be treated as deemed dividends paid on dates when such payments were made; mere subsequent repayment/squaring off on very last day of accounting year would not alter position that assessee received notional dividends on various dates.

However, the Calcutta High Court in the case of ***PCIT vs. Suprabha Industries Ltd. [2022] 136 taxmann.com 259 (Calcutta)*** held that provisions of section 2(22)(e) would not be applicable where assessee availed unsecured loan from its group company which was paid back with interest in same year. Further, the SLP filed by the revenue was dismissed in ***PCIT vs. Suprabha Industries Ltd. [2023] 154 taxmann.com 536 (SC)[25-08-2023]***. [The earlier decision of Supreme Court in the case of ***Miss P. Sarda v. CIT (supra)*** was not brought to the notice of High Court)]

H. Holding-Subsidiary Dynamics and Intra-Group Fund Flows

When a subsidiary company lends money to its holding company, the holding company's majority stake automatically satisfies the ten per cent voting power threshold, making any loan from a profitable subsidiary as deemed dividend under section 2(22)(e) in the hands of holding company.

Further, an interesting interplay arises with section 19 of the Companies Act, 2013, which prohibits a subsidiary from holding shares in its holding company except for pre-existing holdings. In such cases, the second proviso to section 19(1) explicitly denies voting rights on the pre-existing shares. Since section 2(22)(e) predicates applicability on "voting power" rather than mere equity ownership, accordingly, a subsidiary with zero voting rights in the holding company cannot trigger the provision of deemed dividend w.r.t. loan received from the holding company.

More complex situations may arise with horizontal fund flows between fellow subsidiaries. If Company ABC Pvt Ltd (subsidiary of Holding Ltd.) lends to Company XYZ Pvt. Ltd (another subsidiary), and Holding Ltd holds substantial interest in both, the provisions of section 2(22)(e) may treat this as if Company ABC Pvt. Ltd. advanced the money to Holding Ltd., making it taxable as deemed dividend even though the funds never passed through its account.

The Telangana & Andhra Pradesh High Court in the case of ***CIT vs. India Fruits Ltd. [2015] 53 taxmann.com 307(Mag.)*** held that where subsidiary company advanced money to the assessee-company to meet their business liabilities, the said amount could not be treated as deemed dividend income of the assessee-company.

IV. Interplay with Section 115-O

Prior to the amendment made vide the Finance Act, 2018; the deemed dividend under section 2(22)(e) was outside the ambit of the provisions of the Dividend Distribution Tax i.e. the tax on the said deemed dividend was to be paid by the shareholder/recipient. W.e.f. 01.04.18, the deemend dividend under section 2(22)(e) was also governed by the provisions of section 115-O whereby tax at the rate of 30% was payable by the payer company. Correspondingly the second proviso to section 10(34) provided for exemption from tax w.r.t. the deemed dividend under section 2(22)(e) for the receipt of dividend.

However, sunset clause was inserted in section 115-O vide the Finance Act, 2020 w.e.f. 01.04.2021; consequently the tax on dividend distribution shifted from the payer company to the recipient/shareholder.

V. Conclusion and the Road Ahead

Section 2(22)(e) remains one of the most intensely litigated provisions of the Income-tax Act, not because its legislative purpose is obscure—that purpose is eminently clear—but because the interplay of its constituent elements with the varied commercial realities of closely held corporate structures produces a constantly evolving intricacies of interpretive challenges. The question about the hands in which deemed dividend to be taxed, the trade advances, inter-corporate deposits, security deposits, and loans repaid within the same year continues to generate nuanced judicial responses that often turn on the specific facts of each case.

The Income-Tax Act, 2025, carries the substance of the provisions of section 2(22)(e) of the Income Tax Act, 1961 into a new legislative framework in the form of section 2(40)(e). Till the time the existing and fresh intricacies would be tested from the lens of the new Act , the jurisprudence w.r.t. provision of section 2(22)(e) serves as a necessary safeguard against the siphoning of corporate profits through the route of loan/advances and at the same time serves as yardstick to safeguard the *bona fide* commercial transactions.

■

CAPITAL REDUCTION UNDER THE COMPANIES ACT, 2013 – LEGAL ARCHITECTURE, TAX IMPLICATIONS, AND PRACTICAL CONSIDERATIONS



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Overview

Capital reduction under Section 66 of the Companies Act, 2013 read with Rule 2 of NCLT (Procedure for Reduction of Share Capital of Company) Rules, 2016 provides a mechanism enabling companies to reorganise their share capital in line with commercial and financial objectives and to rationalise company capital structure such that the balance sheet relects the true and fair position of the company. Unlike routine methods such as dividend for distributions or share buybacks, capital reduction offers a broader framework for varied purposes, including writing off accumulated losses, returning surplus funds to shareholders, rationalising capital structures, and facilitating minority exits.

The process is subject to shareholder approval and confirmation by the National Company Law Tribunal (NCLT), with a strong emphasis on the protection of creditor and stakeholder interests. Over time, the role of the NCLT has evolved beyond procedural oversight to a more substantive review of fairness, valuation and commercial rationale.

From a tax perspective, capital reduction presents a nuanced framework, wherein distributions are bifurcated between deemed dividends to the extent of accumulated profits and capital gains for the balance. This dual characterisation, coupled with considerations around cost of acquisition and tax treaty implications, makes tax analysis central to structuring such transactions.

Equally important are the valuation aspects, where an independent and defensible valuation is required to establish fairness, protect minority shareholders interest, and support regulatory submissions

The increasing use of capital reduction in start-up restructuring and promoter-led reorganisations highlights its growing relevance. However, its flexibility also invites greater regulatory and tax scrutiny, necessitating careful planning, robust documentation and a clear demonstration of commercial substance.

1. Overview: Concept and Evolution of Capital Reduction

Capital reduction under Section 66 of the Companies Act, 2013 ('the Act') represents a structured mechanism through which companies may reorganise their share capital by reducing their issued, subscribed or paid-up capital. While conceptually distinct from shareholder payout mechanisms such as dividends, buybacks or redemption of preference shares, it serves as a broader tool for recalibrating the capital base in line with the company's financial position and commercial objectives.

Historically, such reductions required approval of the High Court under the Companies Act, 1956. The transition to the National Company Law Tribunal (NCLT) exercising power over respective jurisdiction where company's registered office is situated under the current regime has introduced a more specialised and procedurally streamlined framework, with greater emphasis on transparency, stakeholder protection and regulatory oversight. At the same time, the statutory flexibility embedded in the provision—particularly the ability to effect reduction "in any manner"—has enabled companies to structure outcomes tailored to specific business needs.

Of late, the relevance of capital reduction has expanded significantly. Beyond its traditional use in writing off accumulated losses or rationalising capital structures, it is now increasingly being deployed in complex commercial contexts, including investor exits, group reorganisations and balance sheet clean-up exercises. This is evident in private equity and start-up ecosystems, where conventional mechanisms such as buybacks or dividends may be constrained.

However, this flexibility is accompanied by heightened scrutiny. Regulatory authorities and tax administrators are increasingly examining such transactions from a substance-over-form perspective. Accordingly, capital reduction today operates at the intersection of company law, tax, valuation and exchange control considerations, requiring careful structuring and a clear articulation of commercial rationale.

2. Statutory Framework of Section 66 of the Act

Section 66 of the Act provides the enabling provision for the reduction of share capital. It permits a company limited by shares or guarantee and having share capital to reduce its capital "in any manner", subject to the approval of shareholders and confirmation by the NCLT. The provision contemplates three broad modes of reduction -

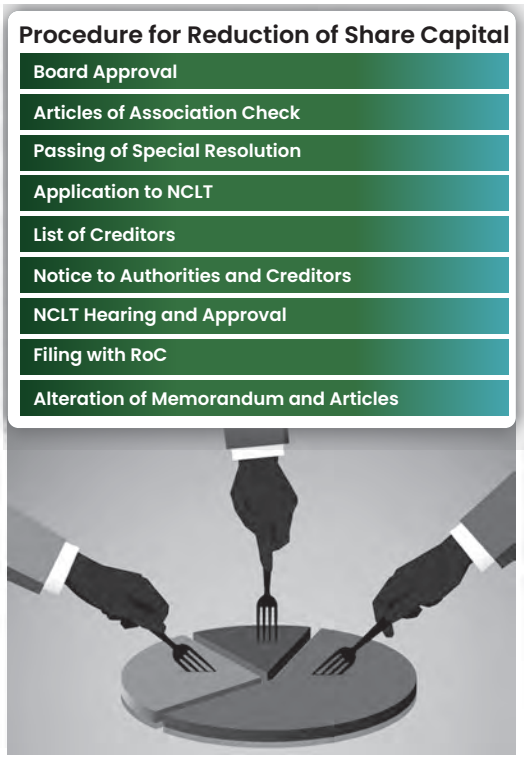
(i) Extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up

For example, if the shares are of face value of INR 100 each of which INR 75 has been paid, the company may reduce them to INR 75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of INR 25 per share); or

(ii) Cancel any paid-up share capital, which is lost, or is not represented by available assets

This may be done either with or without extinguishing or reducing liability on any

Regulatory authorities and tax administrators are increasingly examining such transactions from a substance-over-form perspective.



of its shares. For example, if the shares of face value of INR 100 each fully paid-up are represented by INR 75 worth of assets. In such a case, reduction of share capital may be affected by cancelling INR 25 per share and writing off similar amount of assets; or

(iii) Pay off the paid-up share capital, which is in excess of the needs of the company.

This may be achieved either with or without extinguishing or reducing liability on any of its shares. For example, shares of face value of INR 100 each fully paid-up can be reduced to face value of INR 75 each by paying back INR 25 per share.

The breadth of the phrase "in any manner" has been judicially recognised as conferring considerable flexibility, although such flexibility is always subject to fairness and stakeholder protection.

3. Procedure for reduction of share capital

The procedure for capital reduction is set out in Section 66 of the Act, read with the National Company Law Tribunal (Procedure for Reduction of Share Capital of Company) Rules, 2016. While the steps are well defined, their practical application requires careful attention.

Certain foundational conditions must be satisfied before undertaking capital reduction. The Articles of Association must authorise such reduction; failing which, they must first be amended.

Additionally, the company must not be in arrears in repayment of deposits or interest thereon. This condition is strictly applied and often becomes a gating factor in practice.

The process is initiated by the Board of Directors ('BOD'), followed by approval of shareholders through a special resolution. Thereafter, an application is made to the NCLT in the prescribed form, supported by a list of creditors, auditor's certificates and declarations confirming that the company is not in default in repayment of deposits.

A critical feature of the process is stakeholder protection. The Tribunal directs issuance of notices to the Central Government, RoC, Regional Director ('RD'), Securities Exchange Board of India ('SEBI') (in case of listed entities), and creditors. Public notices are also required to be published, inviting objections.

The company must demonstrate either that creditors have consented or that their interests are adequately secured. This requirement has consistently been emphasised in judicial precedents, including

the ***Elpro International (2009 4 COMP LJ 406) (Bom)*** case, where the court reiterated that creditor protection is central to the approval of capital reduction.

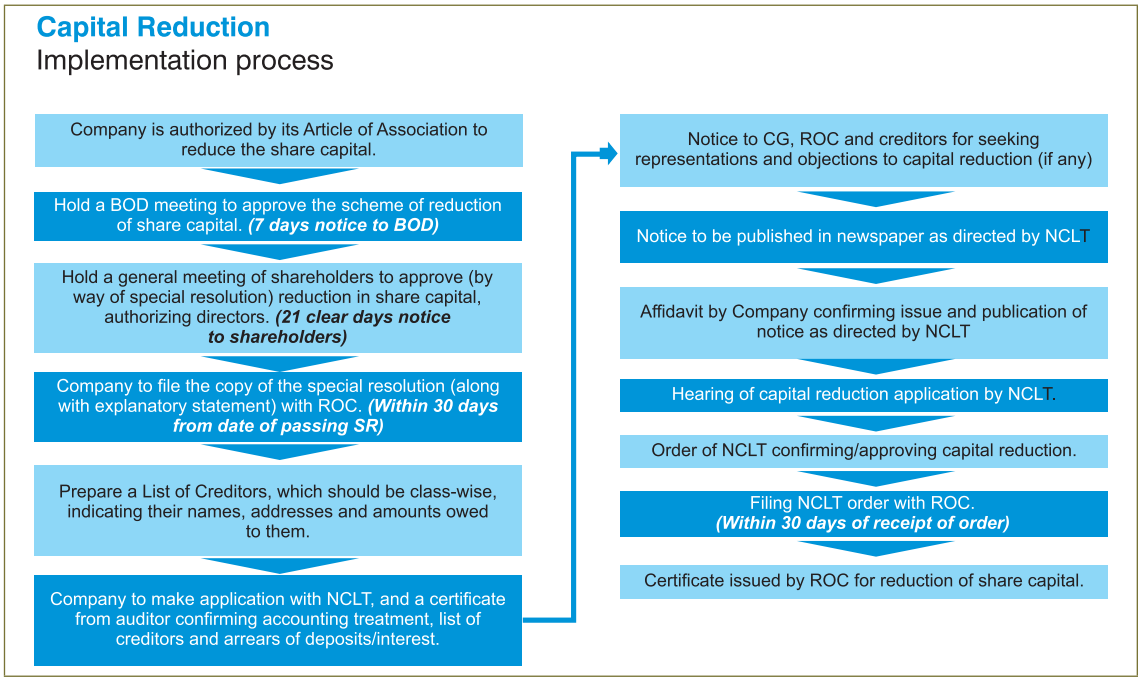
From a practical standpoint, the NCLT process, while structured, is not always linear. Queries from the RD and/or from the Income Tax Department are increasingly common. In many cases, the tribunal seeks additional clarification on valuation methodology, source of funds for payout commercial justification for the capital reduction, particularly where the reduction is undertaken primarily to facilitate cash repatriation following the transfer of the business, or where the overall commercial rationale of the transaction is not clearly demonstrated.

Upon considering representations, if any, and being satisfied that the proposal is not prejudicial to stakeholders or public interest, the NCLT confirms the reduction.

In practice, a hearing may be adjourned where responses are not sufficiently substantiated. Accordingly, while statutory timelines are prescribed, the actual completion timeline may vary depending on the complexity of the transaction and the nature of stakeholder and the regulator's responses.

In terms of section 66(5) of the Act, the effective date of the capital reduction is generally regarded as the date on which the order of the NCLT is filed with the Registrar of Companies ('RoC'). Upon such filing, the reduction becomes operative and the corresponding shares are deemed to be extinguished.

Capital reduction – Implementation process in a diagrammatic form



4. Capital Reduction – Typologies and Practical Use Cases

While the Act is enabling, practitioners typically see five patterns:

(i) Write-off of losses against reserves/share capital/securities premium

Purpose: To align the Company's capital with realizable net assets, eliminate accumulated losses or impairment, and create a clean platform for dividends/ fund-raises. This helps companies to present a healthier net worth and removes the legacy loss from the balance sheet.

Accordingly, debit the P&L debit balance to securities premium or paid up capital as permitted by the scheme.

(ii) Return of excess cash to shareholders

Purpose: Rationalize over capitalization and repatriate surplus cash to shareholders where leverage/Return on equity (ROE) considerations point to a leaner equity base.

Act reference and precedence: Section 66(1)(b)(ii) of the Act provides for return of capital "in excess of the wants of the company". Reliance may also be placed on the case of ***Ulundurpet Expressways Pvt. Ltd. vs. Regional Director [Company Appeal (AT) No. 53 of 2024, dated 6-1-2025]*** wherein the National Company Law Appellate Tribunal ('NCLAT') overturned NCLT Mumbai's decision to dismiss a petition under Section 66 of the Act. The Company had proposed to cancel certain equity shares and compensate its shareholders. The payout was designed as an unsecured loan, repayable over 5 years, subject to specific terms with a view to utilising surplus cash effectively.

The NCLT had rejected the scheme because the proposed reduction relied on projected future cash flows rather than the current surplus, which did not comply with Section 66(1)(b)(ii) of the Act and further, converting reduced capital into unsecured loans would breach the provisions under the Foreign Exchange Management Act (FEMA) and External Commercial Borrowings (ECB) regulations. The NCLAT overturned this view holding that Section 66 of the Act grants companies the power to reduce share capital 'in any manner' as long as creditors and stakeholders' interests are protected and their consent is obtained.

(iii) Reduction in face value (with or without cash pay out)

Purpose: Reset the par value to reflect asset value and normalize per share metrics. It may be purely book-entry (write-off) or accompanied by cash (partial return of capital).

Tax implications: The Supreme Court's judgement in the case of ***Kartikeya V. Sarabhai (1997)*** held that a face value reduction with cash is an extinguishment of rights and hence a 'transfer' taxable as capital gains (subject to the dividend overlay).

Selective capital reduction is used to consolidate ownership, simplify the cap table, or enable promoter/investor exit without impacting all shareholders.

(iv) Selective capital reduction (targeting a subset within a class or minority shareholders)

Purpose: Selective capital reduction is a mechanism under Section 66 of the Act that allows a company to reduce its share capital only in respect of specific shareholders, rather than all shareholders equally. A minority acquisition through selective capital reduction is a mechanism where a company reduces its share capital only with respect to specific shareholders, typically minority shareholders, by cancelling their shares and paying them fair value. It is used to consolidate ownership, simplify the cap table, or enable promoter/investor exit without impacting all shareholders.

Legal jurisprudence: NCLT/NCLAT recognize capital reduction is permissible 'in any manner' under Section 66 of the Act. Accordingly, selective reduction has legal validity as long as it is transparent and not disguised as a buy-back. Reliance may be placed on the following precedents taking contrary views:

- In the case of ***Bharat Diamond Bourse, In re [CP NO. 175 (MB) of 2021, dated 12-12-2023] - NCLT Mumbai Bench-V*** approved a petition under Section 66 of the Act for the reduction of share capital. Despite objections from the Regional Director regarding potential non-conformity of the framework of law prescribed under Section 8 of the Act and concerns over selective reduction, the Tribunal upheld that capital reduction is a domestic matter, permissible "in any manner" under Section 66 of the Act. Accordingly, selective reduction has legal validity as long as it is transparent and not disguised as a buy-back.

- In the case of ***Philip India Ltd., In re [2024] 168 taxmann.com 141 (NCLT - Kol.) - NCLT Kolkata Bench*** dismissed a petition where the said company sought to reduce its share capital by cancelling 3.87% of equity shares held by minority shareholders. The petitioner company took the decision to provide exit to the public shareholders post delisting and offered a 24% premium over the fair value of the shares. The Tribunal held that as the proposed capital reduction does not fall under the scope of Section 66(1)(a) or 66(1)(b) of the Act as it did not aim to extinguish unpaid capital or cancel any paid-up share capital lost or underrepresented by available assets. Instead, this petition has been filed predominantly for buying out the minority shareholders who are large in number compared to the promoter shareholder, with the real intention of a selective buyback governed under Section 68 of the Act. This case reiterated the legal distinction between capital reduction and buyback of shares.

- In the case of ***Pannalal Bhansali vs. Bharti Telecom Limited 2026 INSC 213 (10 March 2026)***, in the case of a minority acquistion, the Supreme court emphasized that the NCLT's function in this context is not to conduct a fresh and independent valuation exercise or to substitute the company's established approach to determining share value with its own assessment. Rather, the Tribunal's inquiry is confined to

three core questions:

1. whether a fair and reasonable value has been offered to the shareholders whose shares are being cancelled;

2. whether the reduction has been approved by the requisite majority shareholders;

3. whether the terms of the transaction are so manifestly unreasonable as to shock judicial conscience.

Unless one of these thresholds is crossed, courts and tribunals ought not to interfere with commercial decisions that have been taken by shareholders in accordance with the statute.

The Supreme Court concluded that the capital reduction complied with section 66 of the Act, and the valuation approach adopted was reasonable and consistent with accepted standards, and there was no demonstrable prejudice or oppression suffered by the minority shareholders.

Selective capital reduction inherently raises questions of fairness, particularly where minority shareholders are impacted. While courts have recognised the permissibility of such a reduction, they have also emphasized that the transaction must not be oppressive or prejudicial.

(v) Distribution in kind in case of capital reduction

Purpose: Distribution in kind (also known as in specie distribution) in the context of capital reduction refers to a process where the company returns assets other than cash to shareholders as part of reducing its share capital. Instead of paying shareholders in cash, the company transfers assets such as investments, shares of a subsidiary, property, or other non cash assets. This method is usually adopted when the company wishes to return value but prefers not to liquidate assets or when the commercial objective is to transfer specific assets directly to shareholders.

Section 66 of the Act allows capital reduction to be 'in any manner', which could be interpreted as capital reduction can be executed in cash or kind (i.e. in-specie distribution). However, section 123 of the Act appears to confine distributions strictly to profits and largely in cash, and prohibits the in-specie distribution.

While Section 66 of the Act appears to support a broader range of methods for returning capital, including non cash forms, and Section 123 of the Act limits dividends to cash, the practical overlap between a non cash return and a profit based payout means the legal position is not always as clear and this leads to room for interpretation.

The permissibility of distributing assets in specie as part of a capital reduction under Section 66 of the Act has been affirmed, although it requires careful justification. ***Vodafone India Limited (CP No. 407 of 2017, NCLT Mumbai Bench, Order dated 17 May 2018),*** NCLT approved a scheme involving the reduction of capital where consideration was discharged by transferring certain assets (investments held by the company) to the shareholder whose capital was being reduced.



5. Income tax implications on capital reduction

Capital reduction often gives rise to tax questions that are far more complex than the corporate action itself. Even a straightforward adjustment of share capital can trigger difficult issues around the nature of the payout, how the distribution should be classified for tax purposes, the impact on reserves, and the treatment across different shareholder categories or jurisdictions. These complexities mean that capital reduction frequently demands a careful tax lens.

The taxation of capital reduction is characterised by a dual framework.

Under Section 2(22)(d) of the Income Tax Act, 1961 (hereinafter referred to as 'the ITA'), distributions on capital reduction are treated as a deemed dividend to the extent of accumulated profits. The Supreme Court in ***CIT vs. G. Narasimhan*** emphasised that the character of distribution is determined by substance rather than form.

The balance distribution is treated as consideration for transfer and taxed as capital gains, consistent with the principle laid down in ***Kartikey V. Sarabhai vs. CIT. (supra)***

While retained earnings are generally included, the treatment of other reserves, such as share premium, capital reserves, revaluation gains, or past adjustments is not always clearly defined.

Illustration: Tax Characterisation in Capital Reduction

Consider a shareholder holding 1,000 shares (cost: ₹ 10,000) in a company that undertakes capital reduction and pays ₹ 15 per share (total: ₹ 15,000). Assume the company has accumulated profits of ₹ 8,000.

In such a case, the distribution is bifurcated for tax purposes. To the extent of accumulated profits (₹ 8,000), the amount is treated as deemed dividend under section 2(22)(d) of the Income Tax Act, 1961 ('the ITA'). The balance of ₹ 7,000 is regarded as consideration for transfer and taxed under the head capital gains.

Based on a cost of ₹ 10,000, this would result in a capital loss of ₹ 3,000.

This illustrates that a single capital reduction can simultaneously give rise to both taxable dividend income and capital loss, underscoring the importance of careful tax analysis in structuring such transactions.

There are a few aspects that require careful consideration

(i) What is 'accumulated profits'?

Understanding what forms part of "accumulated profits" for tax purposes in a capital reduction is not always straightforward. While retained earnings are generally included, the treatment of other reserves, such as share premium,

capital reserves, revaluation gains, or past adjustments is not always clearly defined. Depending on how these amounts arose and how they sit in the books, they may or may not fall within the scope of accumulated profits, creating a grey area where different interpretations can reasonably exist.

A combined reading of the above principles indicates that while the characterisation of distribution on capital reduction depends on the existence of accumulated profits, the relevant point in time for such determination assumes importance.

From a company law perspective, the reduction becomes effective only upon registration of the NCLT order with the Registrar of Companies, at which stage the shares stand extinguished. Accordingly, one view is that accumulated profits as on such effective date should be considered for determining the extent to which the distribution is treated as deemed dividend, with the balance being subject to capital gains. However, in the absence of specific guidance under the ITA, this position is not free from doubt, and alternative views based on the appointed date or date of distribution may also arise.

(ii) Interplay between section 50D and section 50CA

In capital reduction transactions, the boundary between Section 50CA and Section 50D of the ITA can be difficult to draw. Section 50CA of the ITA points toward Fair Market Value ('FMV') based taxation of unlisted shares, whereas Section 50D of the ITA applies when consideration cannot be clearly identified. But reductions, especially those involving selective cancellations or non cash transfers, reduction of face value often shadow the idea of what exactly is being 'received.' This makes it open to interpretation whether the case fits the specificity of Section 50CA of the ITA or falls back on the broader deeming rule of Section 50D of the ITA.

(iii) Implications where the capital reduction results in writing off of accumulated losses

When a capital reduction is used purely to write off accumulated losses, the step is generally treated as a balance sheet alignment with no real transfer of value to shareholders. In the given scenario, can section 50CA or 50DA of the ITA be triggered and consequently tax the shareholder at the minimum fair market value especially on the premise that the consideration to the shareholder is "Nil".

(iv) Treatment of capital loss in case of reduction in the face value of shares

A reduction in the face value of shares inevitably reduces a portion of the shareholder's rights, yet the absence of any consideration makes it difficult to determine whether this diminution should crystallise a capital loss at that moment or merely adjust the cost base for future computation. The statute does not expressly clarify how such partial extinguishment should be treated, and in the absence of clear guidance, the tax outcome remains open to interpretation, leaving room for differing views on whether a loss can truly be said to arise.

(v) Implications under section 56(2)(x) of the ITA for the company

Another important aspect is whether an Indian company undertaking capital reduction will be subject to the provisions of section 56(2)(x) of the ITA. To attract the provisions of Section 56(2)(x) of the ITA, the primary condition required to be satisfied is that

the person should receive property. The moot question here is whether a property is 'received' by the company on capital reduction or not.

(vi) Applicability of exemption under Section 47(iv) in case of capital reduction of a wholly owned subsidiary

A nuanced issue arises in the context of capital reduction involving a wholly owned subsidiary (WOS) and the applicability of the exemption under Section 47(iv) of the ITA, which provides tax neutrality for transfers by a parent company to its wholly owned Indian subsidiary.

In a capital reduction, shares are typically cancelled or extinguished rather than transferred to the subsidiary. However, judicial precedents recognise such extinguishment as a 'transfer' under the ITA. This raises the question of whether Section 47(iv) of the ITA can apply in the absence of an actual transfer of shares.

While one view supports the applicability of the exemption based on the intent to provide tax neutrality within a wholly owned group, the position is not free from doubt, as exemption provisions are strictly construed. Tax authorities may contend that the condition of transfer "to a subsidiary" is not satisfied.

Further, in cases involving capital loss, taxpayers may seek to recognise such loss; however, the tax authorities may invoke Section 47(iv) of the ITA to deny its recognition. Accordingly, while an exemption under Section 47(iv) of the ITA may be arguable in the context of capital reduction of a WOS, the position carries litigation risk.

(vii) Implications of capital reduction on non-resident shareholders

Capital reduction involving non-resident shareholders requires careful consideration of both tax and regulatory aspects.

From a tax perspective, the distribution is generally regarded as accruing in India and is bifurcated into deemed dividend (to the extent of accumulated profits) and capital gains for the balance. The applicability of a Double Taxation Avoidance Agreement (DTAA) is critical in determining the ultimate tax liability. While the dividend component is typically taxable in India (often at concessional treaty rates), the capital gains component may be taxable or exempt depending on the relevant treaty provisions.

From a withholding perspective, the company is required to evaluate its obligations under Section 195 of the ITA, including the applicability of treaty rates and timely compliance.

In addition, exchange control regulations under FEMA must be complied with, including adherence to pricing guidelines and reporting requirements. Procedural compliances such as filing of Form 15CA and, where applicable, obtaining Form 15CB are also required prior to remittance.

Appropriate documentation, including tax residency certificates, Form 10F and related declarations, should be maintained to support treaty positions and withholding decisions.

6. Exchange Control Implications (FEMA)

Where capital reduction involves non-resident shareholders, compliance with exchange control regulations assumes significant

Auditor certification on accounting treatment is also a critical component of the NCLT approval process.

importance. The transaction must align with the Foreign Exchange Management Act (FEMA) framework, including pricing guidelines prescribed under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

A key consideration is that any payout to non-resident shareholders must be supported by a fair valuation, typically certified by a merchant banker or chartered accountant. In selective capital reduction scenarios, this becomes particularly relevant, as differential treatment of shareholders may invite scrutiny from a regulatory perspective.

From a compliance standpoint, appropriate reporting must be undertaken within prescribed timelines. Delays or non-compliance may lead to compounding proceedings.

7. Accounting and Financial Reporting Considerations

The accounting treatment of capital reduction depends on the nature and objective of the transaction. Where the reduction involves writing off accumulated losses, the adjustment is typically effected against share capital, securities premium or a capital reduction reserve, in accordance with applicable accounting standards.

In cases involving payout to shareholders, the transaction results in a reduction of equity and recognition of a corresponding liability until settlement. The distinction between reduction of capital and distribution assumes importance in determining presentation in financial statements.

For companies following Indian Accounting Standards (Ind AS), additional emphasis is placed on disclosures. These include the nature of the transaction, impact on equity structure, and compliance with relevant standards. Auditor certification on accounting treatment is also a critical component of the NCLT approval process.

From a practical standpoint, alignment between the accounting treatment and the legal structure of the transaction is essential to avoid inconsistencies during regulatory or audit review.

8. Conclusion

Capital reduction, while conceptually straightforward, operates in a space where legal permissibility, tax efficiency, regulatory compliance and commercial intent must align. The flexibility embedded in Section 66 of the Act is both its strength and its challenge. It allows companies to tailor outcomes but also invites closer scrutiny.

Recent trends indicate a clear shift towards substance-based evaluation. Transactions that are supported by a genuine commercial rationale, robust valuation and transparent disclosures are more likely to withstand scrutiny. Conversely, structures that seek to achieve tax outcomes without adequate commercial justification may face resistance.

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INCOME-TAX IMPLICATIONS OF CAPITAL REDUCTION — TRANSFER, CAPITAL ASSET, COMPUTATION, AND SECTION 50CA





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Overview

This article examines the income-tax treatment of capital reduction under the Income-tax Act, 1961, tracing the jurisprudential evolution across four interconnected questions: whether capital reduction constitutes a "transfer" under Section 2(47), what the relevant capital asset is, how gains and losses are computed, and whether the anti-avoidance provision in Section 50CA applies.

Beginning with the Supreme Court's foundational ruling in Kartikeya Sarabhai *and moving through the Special Bench divergence in* Bennett Coleman, *the analysis tracks the judicial trajectory towards the present position as settled by the Supreme Court's observations in* Jupiter Capital *and the Mumbai ITAT's reasoning in* Carestream Health *and* Tata Sons. *The article establishes that the individual share, not the proportionate shareholding interest, is the unit of analysis for Section 2(47), that cancellation of shares constitutes a transfer even where no consideration is paid, and that capital loss is allowable in zero-payout reductions where the computation mechanism under Section 48 remains operable.*

The final sections address the interaction of Section 50CA with both payout and zero-payout reductions, the residual uncertainty around face value reductions without consideration, and the expanding commercial deployment of capital reduction across squeeze-outs, surplus distributions, and restructurings.

I. Introduction

Alteration of share capital by way of cancellation and extinguishment of shares, or reduction in face value, can be carried out by undertaking capital reduction under Section 66 or a scheme of arrangement under Section 230 of the Companies Act, 2013. The central income-tax question arising from such a reduction is whether it constitutes a "transfer" within Section 2(47) of the

The central income-tax question arising from such a reduction is whether it constitutes a "transfer" within Section 2(47) of the Income-tax Act, 1961 ("the 1961 Act"), and if so, how the resulting gain or loss should be computed.

Income-tax Act, 1961 ("the 1961 Act"), and if so, how the resulting gain or loss should be computed. This article analyses each of these limbs: first, whether and when capital reduction constitutes a "transfer"; second, the identification of the capital asset; third, the computation of gains and losses across different fact patterns; and finally, the applicability of the anti-avoidance provision in Section 50CA.

II. Statutory Framework

The chargeability of capital gains under Section 45 of the 1961 Act[1] requires three elements: the existence of a capital asset, a "transfer" of that asset, and the profits or gains (including losses) arising from such transfer. "Capital asset" is defined in Section 2(14) to include property of any kind held by an assessee[2]. Shares held by a shareholder are capital assets within this definition. "Transfer" is defined in Section 2(47) to cover, *inter alia*, the sale, exchange, or relinquishment of a capital asset, the extinguishment of any rights therein, and compulsory acquisition[3]. The computation mechanism under Section 48[4] yields the capital gain or loss as the difference between the full value of consideration received or accruing on the transfer, and the cost of acquisition and improvement of the asset. No provision of Section 47[5] exempts capital reduction from the charge of capital gains, unlike amalgamation, demerger, or conversion of bonds into shares.

Each of these elements raises distinct questions in the context of capital reduction, and several case laws have developed along each limb independently.

III. Capital Reduction as a "Transfer" Under Section 2(47)

A. Reduction of Face Value

In ***Kartikeya V. Sarabhai v. CIT***[6], the Supreme Court held that reduction of the face value of preference shares from ₹ 1,000 to ₹ 50, against payment of ₹ 950 per share, constituted a "transfer" within Section 2(47). The Court reasoned that when face value is reduced, the shareholder's right to dividends on the full capital and the right to participate in net assets upon liquidation is also proportionately reduced. This extinguishment falls within the statutory definition of transfer. The Court clarified that a sale in the conventional sense is not required; relinquishment or extinguishment of rights in a capital asset is independently sufficient.

CIT v. Grace Collis[7] reinforced this position in the context of amalgamation, holding that the extinguishment of a shareholder's rights in the transferor company constitutes a "transfer" within Section 2(47). While the case concerned amalgamation, the principle that extinguishment of rights is a species of "transfer" applies with equal force to capital reduction and has been relied upon in subsequent capital reduction decisions.

1. *Section 45, Income-tax Act, 1961; Section 67, Income-tax Act, 2025.*
2. *Section 2(14), Income-tax Act, 1961; Section 2(22), Income-tax Act, 2025.*
3. *Section 2(47)(i) to (vi), Income-tax Act, 1961. The 2025 Act carries forward substantially the same inclusive definition in Section 2(109).*
4. *Section 48, Income-tax Act, 1961; Section 72, Income-tax Act, 2025.*
5. *Section 47, Income-tax Act, 1961; Section 70, Income-tax Act, 2025.*
6. *Kartikeya V. Sarabhai v. CIT [1997] 228 ITR 163 (SC).*
7. *CIT v. Grace Collis [2001] 248 ITR 323 (SC).*

The Special Bench of the Mumbai ITAT in ***Bennett Coleman & Co. Ltd. v. ACIT***[8] departed from this position. The face value of shares in Times Guarantee Ltd. was halved from ₹ 10 to ₹ 5, and two shares of ₹ 5 each were thereafter consolidated into one share of ₹ 10, without any consideration. The Special Bench held that this did not constitute a "transfer", on two grounds. First, the assessee's proportionate shareholding, voting power, and share of net assets remained identical before and after the reduction, so there was no real extinguishment of rights. Second, since no consideration was received or receivable, the computation mechanism under Section 48 failed. It followed the B.C. Srinivasa Setty Supreme Court ruling[9], which held that if the computation provision cannot be applied and fails, capital gains cannot be assessed under Section 45.

Bennett Coleman thus introduced two propositions that ran counter to *Kartikeya Sarabhai*: proportionate shareholding, rather than the number or face value of shares held, is the relevant measure of whether rights have been extinguished; and that the absence of consideration renders the computation machinery inoperable, removing the transaction from the charge of capital gains altogether. Both propositions would be tested, and ultimately rejected, in the decisions that followed regarding cancellation of shares.

B. Cancellation of Shares

The Bangalore ITAT in ***Jupiter Capital Pvt. Ltd. v. ACIT***[10] held that cancellation of shares on capital reduction amounts to extinguishment of rights within Section 2(47). Jupiter Capital held 99.88% of ANNPL. Under a court-sanctioned reduction, Jupiter Capital's holding was reduced from 15.33 crore shares to 9,988 shares, with a consideration of approximately ₹ 3.18 crore. The Assessing Officer had disallowed the capital loss claim on the ground that proportionate shareholding was unchanged.

The Karnataka High Court upheld the ITAT and allowed the capital loss. The Supreme Court dismissed the Revenue's Special Leave Petition[11], observing that the reduction in share capital and subsequent proportionate reduction in the shareholding of the assessee is covered within the ambit of Section 2(47). In doing so, the Court reaffirmed *Kartikeya Sarabhai* and endorsed the Gujarat High Court's observation in ***CIT v. Jaykrishna Harivallabhdas***[12], that receipt of consideration is not a precondition for computation of capital gains on extinguishment of rights. The Supreme Court's observations while dismissing the petition carry significant persuasive force and, practically, settle the question for share cancellation scenarios.

IV. The Share as the Unit of Analysis

The Revenue's argument, running through from Bennett Coleman to Jupiter Capital, consistently relied on the proposition that if the shareholder's proportionate interest in the company is unchanged, no transfer has occurred. The Mumbai ITAT's decision in ***Carestream Health Inc. v. DCIT***[13] addressed

8. *Bennett Coleman & Co. Ltd. v. ACIT [2011] 12 ITR(T) 97 (Mumbai) (Special Bench).*
9. *CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294 (SC). The principle is that where the computation provisions of Section 48 cannot be applied, the charge under Section 45 does not arise.*
10. *Jupiter Capital Pvt. Ltd. v. ACIT, ITA No. 445/Bang/2018 (ITAT Bangalore, order dated November 29, 2018).*
11. *PCIT v. Jupiter Capital Pvt. Ltd. [2025] 170 taxmann.com 305 (SC), SLP No. 63 of 2025, order dated January 2, 2025.*
12. *CIT v. Jaykrishna Harivallabhdas [1998] 231 ITR 108 (Gujarat HC).*
13. *Carestream Health Inc. v. DCIT, ITA No. 826/Mum/2016 (Mumbai ITAT).*

a foundational question that cuts across both the transfer and computation enquiries: what is the relevant capital asset?

The Indian wholly-owned subsidiary of Carestream Health, a US tax resident, halved its share capital by way of capital reduction; however, Carestream Health continued to hold 100% of its share capital after the capital reduction. The Tribunal rejected the proportionate-interest test. It held that the capital asset for the purposes of Section 2(47) is the "share" itself, not the "percentage of shareholding". Each share is an independent capital asset and the cancellation of each share is an independent extinguishment event. The percentage of shareholding is a derivative measure that reflects the ratio between the shareholder's holding and the company's total issued capital; it is not the asset itself. This ruling has significant implications. It means that even where a proportionate reduction leaves the shareholder's percentage unchanged (as in Bennett Coleman and Carestream Health itself), the cancellation of individual shares constitutes a transfer of capital assets. The unit-of-analysis question is therefore resolved in favour of the individual share.

V. Computation of Capital Gains and Losses

A. Bifurcation: Deemed Dividend and Capital Gains

Where consideration is received on capital reduction, the first computational step is the bifurcation established by the Supreme Court in ***CIT v. G. Narasimhan***[14]. The Court held that to the extent the distribution is represented by accumulated profits, it constitutes deemed dividend under Section 2(22)(d)[15]; the balance, being a return of capital, is chargeable under the head "Capital Gains". The capital gain or loss under Section 48 is then computed as the full value of consideration (after carving out the deemed dividend component) less the cost of acquisition.

In partial capital reductions where only some shares are cancelled, cost apportionment becomes relevant. The 1961 Act does not contain a specific provision for this. The logical approach is per-share apportionment: if a shareholder holds 1,000 shares at a cost of ₹ 100 each and 500 shares are cancelled for a consideration of ₹ 30 per share, the capital loss on the cancelled tranche is ₹ 70 per share, aggregating to ₹ 35,000. The surviving 500 shares retain their original cost of ₹ 100 each.

B. The Zero-Payout Problem

The Mumbai ITAT in ***Tata Sons Ltd. v. PCIT***[16] addressed capital reduction without any consideration. Tata Sons held shares in TTSL, which had incurred substantial losses. Under a court-sanctioned scheme, TTSL cancelled half of the issued share capital, with the resulting amount written off against accumulated losses and share premium. No payout was made to Tata Sons against cancellation of its shareholding. The PCIT invoked revisionary jurisdiction under Section 263 to disallow the capital loss, relying on Bennett Coleman.

The Tribunal distinguished Bennett Coleman and held that: reduction of capital by cancellation of shares constitutes

14. *CIT v. G. Narasimhan [1999] 236 ITR 327 (SC).*
15. *Section 2(22)(d), Income-tax Act, 1961; Section 2(40)(d), Income-tax Act, 2025.*
16. *Tata Sons Ltd. v. PCIT [2024] 158 taxmann.com 601 (Mumbai ITAT), order dated January 23, 2024.*

Reduction of capital by cancellation of shares constitutes extinguishment of rights and therefore is a "transfer"; the resulting loss is a real capital loss, not a notional one, because the shareholder's investment has been genuinely eroded.

extinguishment of rights and therefore is a "transfer"; the resulting loss is a real capital loss, not a notional one, because the shareholder's investment has been genuinely eroded; and the principle in B.C. Srinivasa Setty has no application where the cost of acquisition and the full value of consideration are both conceivable and ascertainable, even if the latter is nil.

C. Ascertainability of Consideration

The distinction drawn by the Tribunal, in the Tata Sons case, between two categories of scenarios is analytically significant. In the first category, consideration is inherently unascertainable, as with self-generated goodwill, the subject matter of B.C. Srinivasa Setty. Here the computation mechanism genuinely fails because there is no conceivable cost of acquisition, and the charge under Section 45 cannot arise. In the second category, consideration is ascertainable but happens to be NIL. Both, the full value of consideration and the cost of acquisition, are known quantities, and the computation under Section 48 proceeds normally to yield a capital loss equal to the cost of acquisition.

The Gujarat High Court's decision in Jaykrishna Harivallabhdas had reached this conclusion earlier in the context of liquidation, allowing a capital loss under Section 46(2) read with Section 48 where no payout was received. The Supreme Court's endorsement of this decision in Jupiter Capital reinforces the position at the appellate level. The combined effect is that a shareholder whose shares are cancelled in a zero-payout capital reduction is entitled to claim a capital loss equal to the cost of acquisition of the cancelled shares.

VI. Applicability of Section 50CA

Section 50CA of the 1961 Act, inserted by the Finance Act, 2017 with effect from Assessment Year 2018-19, provides that where the consideration received or accruing as a result of the transfer of an unquoted share is less than its fair market value ("FMV"), the FMV shall be deemed to be the full value of consideration for the purposes of Section 48[17]. The provision is an anti-avoidance measure directed at the undervaluation of shares in private company transfers. Its application to capital reduction transactions raises several questions.

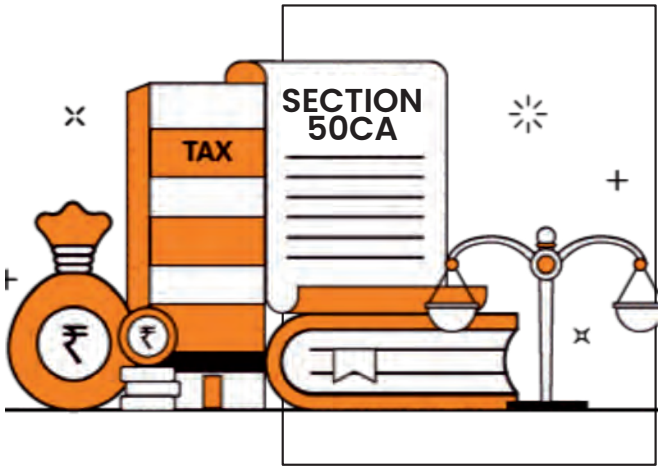
A. Capital Reduction With a Payout

Where capital reduction involves payment of consideration and the cancelled shares are unquoted, Section 50CA appears to apply on a plain reading. If the consideration paid is less than the FMV determined under Rule 11UAA (i.e., adjusted net book value for equity shares, and actual FMV for other

Where capital reduction involves payment of consideration and the cancelled shares are unquoted, Section 50CA appears to apply on a plain reading.

17. *Section 50CA, Income-tax Act, 1961; Section 79, Income-tax Act, 2025. The FMV is determined under Rule 11UAA of the Income-tax Rules, 1962.*

shares such as RPS/CCPS/OCRPS), the FMV is deemed the full value of consideration. However, this creates a difficulty where the payout is partly characterised as deemed dividend under Section 2(22)(d). The deemed consideration under Section 50CA would be the entire FMV, while the accumulated profits component has already been carved out as deemed dividend. This produces a risk of double taxation to the extent the FMV reflects accumulated profits embedded in net worth. The better view is that Section 50CA should operate only on the capital gains component, since the deemed dividend portion is not income under the head "Capital Gains" and Section 50CA operates exclusively within the computation machinery of Section 48. This interpretation awaits judicial or legislative clarification.



B. Capital Reduction Without a Payout

Where no consideration is paid, a strong argument exists that Section 50CA should not apply. The section is triggered where the "consideration received or accruing as a result of the transfer" is less than FMV. "Less than" is a comparative expression requiring a base value. Where there is no consideration at all, the comparative mechanism has nothing to operate on. This is not a case of consideration being less than FMV; it is a case of there being no consideration "received or accrued", and without the consideration variable, the trigger fails.

Where no consideration is paid, a strong argument exists that Section 50CA should not apply. The section is triggered where the "consideration received or accruing as a result of the transfer" is less than FMV.

A further structural argument reinforces this position. Section 50CA was designed for bilateral share transfers where there is a willing buyer and willing seller, and the consideration is being suppressed below FMV to avoid tax. Capital reduction is a NCLT-sanctioned corporate act, not a negotiated transfer between two parties. The mischief that Section 50CA targets, namely undervaluation in private transfers, does not arise in court-sanctioned reductions where the terms are judicially scrutinised. Moreover, Section 50CA is a deeming fiction, and deeming fictions are to be construed strictly. The "transfer" within Section 50CA need not carry the same expansive meaning as "transfer" within Section 2(47), particularly given that the former operates as a penal substitution mechanism while the latter is a definitional provision.

C. Face Value Reduction

In cases of face value reduction (as opposed to share cancellation), Section 50CA may not apply for an additional reason. The section speaks of the transfer of a "share" and the FMV determined under Rule 11UAA is the FMV of one share. When rights in a share

are partially extinguished through face value reduction, there is no transfer of a complete share, and the FMV substitution mechanism may not operate. This question remains untested in reported decisions.

VII. Residual Issues

A. The Status of Bennett Coleman

The Supreme Court's observations in Jupiter Capital settle the law for share cancellation scenarios, considering it as a "transfer". The Carestream Health ruling established that each individual share is a capital asset, and not the proportionate shareholding interest. The Tata Sons decision reinforces this at the Tribunal level, even where there is no payment of consideration against a reduction. However, the specific fact pattern of Bennett Coleman, being face value reduction followed by consolidation without any consideration, has not been directly addressed by the Supreme Court. While Kartikeya Sarabhai also involved a face value reduction, the Bennett Coleman Special Bench distinguished it on the ground that Kartikeya Sarabhai involved payment of consideration. A residual uncertainty, therefore, persists in the narrow configuration of face value reduction without payout.

B. Set-off and Carry Forward

Capital loss arising from capital reduction is governed by the general provisions of Sections 70, 71, and 74 of the 1961 Act[18]. Long-term capital loss can be set off only against long-term capital gains and carried forward for eight assessment years. In group restructurings where a holding company incurs capital loss on capital reduction of a subsidiary, the availability of long-term capital gains within the carry-forward window is a relevant structuring consideration.

C. The Broader Commercial Context

Capital reduction is no longer merely a tool for writing off accumulated losses. It has evolved into a versatile restructuring mechanism deployed across a range of corporate objectives: minority squeeze-outs (as in the Bharti Telecom transaction, where a selective capital reduction was deployed to consolidate ownership by extinguishing minority shareholdings at a determined price per share), surplus distribution as an alternative to buyback, balance sheet rehabilitation in distressed situations, and clean exits for private equity investors and joint venture partners through selective reduction of a specific class or series of shares. Each of these applications engages the tax framework analysed in this article: particularly the G. Narasimhan bifurcation, the Tata Sons zero-payout analysis, and the Section 50CA questions.

The tax framework as it now stands accommodates each of these commercial applications. The recognition of capital reduction as a "transfer", the identification of the individual share as the unit of analysis, the allowability of capital loss even in zero-payout scenarios, and the bifurcation of proceeds into deemed dividend and capital gains provide a workable, albeit incomplete, architecture. The unresolved questions around Section 50CA and face value reductions are the remaining friction points, and they are likely to be tested as the commercial use of capital reduction continues to expand.

■

18. Sections 70, 71, and 74, Income-tax Act, 1961; corresponding to Sections 108, 109, and 111 of the Income-tax Act, 2025.

HISTORY AND EVOLUTION OF BUYBACK TAXATION — FROM CAPITAL GAINS TO BBT TO DEEMED DIVIDEND AND BEYOND



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Overview

The tax treatment of buy-back has undergone changes in four stages since the time relevant provisions were inserted in the Companies Act (Cos Act) 1956 in 1999 to allow Indian companies to undertake buy-back of its own shares.

Stage 1 – 1 April 1999 to 31 May 2013

- *Buy-back of shares was subject to capital gains (CG) tax in the hands of the shareholder and consequent tax withholding by the company in case of non-resident (NR) shareholders.*

Stage 2 – 1 June 2013 to 30 September 2024

- *Companies were subject to Buyback Distribution Tax (BBT) at the rate of 20%, while the amount received by the shareholders was exempt from tax.*

Stage 3 – 1 October 2024 to 31 March 2026

- *The amount paid on buy-back was deemed as dividend and taxed in the hands of the shareholders. Such dividend was subject to TDS by the company.*
- *Further, the cost of shares bought back was allowed as capital loss to the shareholders.*

Stage 4 – 1 April 2026 and onwards

- *Buy-back is now taxed in the hands of the shareholders as CG with promoter shareholders being subject to additional tax in respect of such CG.*
- *Company undertaking buy-back is required to withhold taxes on capital gains arising to NR shareholders.*

The comparative rates of DDT and LTCG rates which influenced the four stages of buyback taxation (as discussed in detail below) are provided at Annexure A.

Detailed discussion[1]

Stage 1 - 1 April 1999 to 31 May 2013

The provisions enabling Indian companies to purchase their own shares was first introduced in Cos Act 1956 vide The Companies (Amendment) Ordinance, 1998 (subsequently enacted as the Companies (Amendment) Act, 1999) w.e.f. 7 January 1999.

The enabling provisions in relation to buy-back transactions in Cos Act 1956 gave rise to questions on the tax treatment of such transaction, specifically whether the proceeds paid on buy-back would qualify as dividend (and hence subject to Dividend Distribution Tax (DDT) in the hands of the company itself) or capital gains in the hands of the shareholder. In order to nip the controversy at its bud and to provide certainty on tax treatment of buy-back transaction, Finance Act (FA) 1999 amended Income Tax Act, 1961 (ITA 1961) to provide for following tax treatment in respect of buy-back transaction w.e.f. TY 1999-2000:

- S. 2(22)(iv) was inserted to exclude the payment made by a company on buy-back transaction from the definition of "dividend"

- S. 46A was inserted to provide that the difference between consideration received on shares or specified securities bought back and cost of acquisition would be subject to capital gains tax in the hands of the shareholder.

- "Specified securities" was defined to have the same meaning as assigned to it in the Explanation to S. 77A of Cos Act 1956.

Relevant extracts from Explanatory Memorandum (EM) to FA 1999[2] explaining the intent of the amendment are reproduced below:-

> *"The above newly introduced provisions of buy-back of shares has thrown open certain issues in relation to the existing provisions of Income-tax Act.* ***The two principal issues are whether it would give rise to deemed dividend under section 2(22) of the Income-tax Act and whether any capital gains would arise in the hands of the shareholder. The legal position on both the issues are far from clear and settled and there is apprehension that there will be unnecessary litigation unless the issues are clarified with finality.****"*

As a consequence, income arising to a shareholder on buy-back was not treated as dividend but taxed as capital gains.

During this stage, there was no tax arbitrage for resident shareholders since dividend was liable to DDT @ 10% to 15% whereas up to TY 2003-04, whereas LTCG on listed shares was taxable at 20% (with indexation benefit)/10% (without indexation benefit) and LTCG on unlisted shares was taxable 20% (with indexation).

1. *The discussion in this note is restricted to a case where shares are held by the shareholders as capital assets and not as stock in trade*
2. *Circular No 779 dated 14 September 1999*

However, NR shareholders from favorable treaty jurisdictions like Mauritius, Singapore and Cyprus could claim complete exemption from capital gains tax in India due to absence of source taxation provisions in those treaties at relevant point in time.

Stage 2 - 1 June 2013 to 30 September 2024

Despite specific tax treatment as capital gains, there arose a debate on whether buy-back arrangement could be regarded as a tax avoidant mechanism for repatriating dividend without paying any taxes in India[3], especially in cases where shareholders were from favorable treaty jurisdiction. The debate intensified with exemption for LTCG on listed shares from TY 2003-04 and reduction of LTCG on unlisted shares held by NR from 20% (with indexation benefit) to 10% (without indexation) from TY 2012-13, which created a tax arbitrage between higher DDT taxation of 15% on dividends and lower/nil capital gains on buyback.

To address this, FA 2013 introduced an additional tax called the Buy-Back distribution Tax (BBT) on the company (akin to DDT) u/s 115QA at the rate of 20%[4] on the unlisted companies on buy-back undertaken u/s 77A of the Cos Act 1956. BBT @ 20% was levied on the difference between amount paid on buy-back and amount received on issue of such shares. Simultaneously, S. 10(34A) was inserted to provide exemption to the shareholders of unlisted company on receipt of proceeds from buy-back.

The legislative intent of the amendment was explained as follows in the Circular explaining amendments to FA 2013[5].

> ***"Unlisted companies, as part of tax avoidance scheme are resorting to buy back of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholder are either not chargeable to tax or are taxable at a lower rate.***
>
> ***In order to curb such practice, a new Chapter XIIDA has been inserted in the income-tax Act to provide that the consideration paid by the company for purchase of its own unlisted shares which is in the excess of the sum received by the company at the time of issue of such shares (distributed income) will be charged to tax and the company would be liable to pay additional tax at the rate of 20% of the distributed income paid to the shareholder."***

FA 2013 amendment, resulted in differential treatment between buyback of unlisted and listed shares as follows :-

3. *AAR decision dated 22 March 2012 (2012) 20 taxmann.com 52*
4. *Approx. 23.3% with surcharge and cess*
5. *Circular No 3 of 2014 dated 24 January 2014*

Particulars	***Unlisted shares***	***Listed shares bought back through stock exchange***
Taxation in hands of shareholders	Exempt u/s. 10(34A)	LTCG exempt u/s. 10(38) till FY 2017-18 and @ 10% thereafter
Taxation in hands of company	BBT @ 20%	No tax[6]

Meanwhile Cos Act 1956 was substituted by Cos Act 2013 which continued with similar provisions for buy-back of shares as part of S. 68 of Cos Act 2013.

Subsequently following amendments were made to S. 115QA (BBT) in 2016 and 2019.

a. FA 2016 deleted the reference to S.77A of Companies Act 1956 and replaced it with the phrase "any law for the time being in force relating to companies". This was intended to curb the practice adopted by certain unlisted companies to avoid BBT by undertaking buyback under other provisions of Cos Act (including by way of payment of amount higher than permitted under s. 77A of Cos Act 1956).

b. Additionally, FA 2016 provided that for computing distributed income on which BBT is levied, the "amount received by the company for issue of shares" would be determined as per rules to be prescribed. As a consequence, Rule 40BB was introduced in the Income-Tax Rules, 1962[7] to provide for manner of determination of amount received by the company. This was intended to overcome difficulties in determining amount received by the company on issue of shares in different circumstances like merger, demerger, ESOPs, etc.

c. Thereafter Finance (No.2) Act 2019 further amended S. 115QA to levy BBT on buy-back undertaken by listed companies as well. It may be noted that the exemption u/s 10(38) on LTCG on listed shares was withdrawn w.e.f 1 April 2018 and 10% tax was levied on LTCG on listed shares for both residents and non-resident shareholders (when DDT levy was at 15%). The intent of the amendment was to curb the practice of listed companies resorting to buy-back instead of dividend and to bring parity between buy-back by listed and unlisted companies.

Following are relevant extracts of Explanatory Memorandum to FA 2019

> ***"……***
>
> ***This section was introduced as an anti-abuse provision to check the practice of unlisted companies resorting to buy-back of shares instead of payment of dividends. This practice of widespread abuse was noted, in the past, amongst unlisted companies where the taxpayers preferred it for tax avoidance, as tax rate for capitals gains was lower than the rate of Dividend Distribution Tax (DDT). However, instances of similar***

6. *Withholding obligation on buyback of shares from non-residents*
7. *Notification No. 94/2016 dated 17 October 2016.*

tax arbitrage have now come to notice in case of listed shares as well, whereby the listed companies are also indulging in such practice of resorting to buy-back of shares, instead of payment of dividends.

In order to curb such tax avoidance practice adopted by the listed companies, the existing anti abuse provision under Section 115QA of the Act, pertaining to buy-back of shares from shareholders by companies not listed on a recognised stock exchange, is proposed to be extended to all companies including companies listed on recognised stock exchange."

While the BBT regime was in place in India, some of the tax treaties of India which had favorable capital gains article such as Mauritius, Singapore and Cyprus were amended to grant source taxation rights to India in respect of capital gains arising from transfer of Indian company shares with specific carve out to grandfather the gains arising from transfer of Indian company shares acquired prior to 1 April 2017.

The levy of BBT led to a different set of difficulties for shareholders. One such difficulty was levy of BBT irrespective of gains in the hands of the shareholders. For instance, consider a case where Mr. A subscribes shares of ICo for say ₹ 10 and after certain years transfers it to B for ₹ 150. Subsequently, ICo undertakes buy-back say at ₹ 110. In this case, in terms of Rule 40BB, the BBT would be levied on difference of ₹ 110- ₹ 10, being ₹ 100, while for shareholder Mr. B the buyback would result in a non-deductible loss. Another difficulty was inability of foreign shareholders to claim foreign tax credit in respect of BBT paid by the Indian companies in India.

Stage 3 - 1 October 2024 to 31 March 2026

Incidentally, FA 2020 abolished DDT in the hands of company and restored classical system of taxation of dividends in the hands of the shareholder. However, BBT levy and consequential exemption continued in the hands of the shareholders. This gave rise to another facet of tax arbitrage. While BBT in hands of company was at 20%, dividend taxation in the hands of promoter shareholders was up to 30%

With a view to target such tax arbitrage, a new scheme of taxation of buy-back was introduced vide FA 2024 as follows:

- S. 2(22)(iv) was deleted and S. 2(22)(f) was inserted to provide that any amount received by a shareholder on buy-back of shares in accordance with S. 68 of Cos Act, 2013 was deemed as a dividend and taxed in the hands of the shareholder. The deeming fiction applied, regardless of presence or absence of accumulated profits with the company and nature of asset in the hands of shareholder (capital asset or stock in trade).

- S. 46A was amended to provide that consideration received on buyback would be deemed to be NIL and thus cost of acquisition of shares bought back would be allowed as a capital loss in the hands of the shareholder. Consequently shareholder could set off and carry forward capital losses incurred on buy-back in accordance with the applicable provisions of ITA 1961.

The legislative intent of the amendments vide Finance Act (No. 2) of 2024 was explained in the Explanatory Memorandum as follows:

> *"2. **References have been received stating that pay-outs on buy-back of shares should be taxed in hands of recipients, in line with similar regime in place for taxation of dividend.***
>
> *3. **Both dividend as well as buy-back are methods for the company to distribute accumulated reserves and thus ought to be treated similarly. In addition, there is extinguishment of rights for the shareholders who are tendering their shares in the buy-back by domestic company, to the extent of shares bought back by such company from shareholders. The cost of acquisition of such shares also needs to be accounted for in some manner.***
>
> *4. It is therefore, proposed that, the sum paid by a domestic company for purchase of its own shares shall be treated as dividend in the hands of shareholders, who received payment from such buy-back of shares and shall be charged to income-tax at applicable rates. No deduction for expenses shall be available against such dividend income while determining the income from other sources. The cost of acquisition of the shares which have been bought back would generate a capital loss in the hands of the shareholder as these assets have been extinguished."*

The new system of full dividend taxation of amount received on buyback resulted in onerous taxation in the hands of public/ minority shareholders as well as promoters making buyback an unattractive mode for return of capital. One extreme situation was even if company was incurring losses and made buyback from share premium, still, it was taxed as dividend in the hands of shareholders.

The new ITA 2025 which received Presidential Assent on 21 August 2025 and was to come into effect from 1 April 2026 continued the same provisions in ITA 1961 (viz. full dividend taxation of buyback proceeds and allowing cost as capital loss).

Stage 4 - 1 April 2026 and onwards

However, before the new Act could take effect from 1 April 2026, Finance Act 2026 reverted to capital gains taxation of buy-back by amending the provisions of ITA 2025 w.e.f. 1 April 2026 as follows:

- S. 2(40)(f) of ITA 2025 (S. 2(22)(f) of ITA 1961) which deemed the amount received on buy-back as dividend is deleted.
- Further S. 69(2) of ITA 2025 (S. 46A of ITA 1961) is amended to provide that
  - The amount received on buy-back of shares or specified securities would now be treated as full value of consideration received for computation of capital gains in the hands of the shareholders.
  - The capital gains arising on buy-back in the hands of promoters[8] (of both listed and unlisted companies) would now be subject to additional

8. *Defined in S. 69 of ITA 2025 with reference to listed and unlisted companies*



tax over and above the tax rate applicable to capital gain as per other provisions of ITA 2025.

- It may be noted that while S. 2(40)(f) of ITA 2025 has been deleted, unlike erstwhile S. 2(22)(iv) of ITA 1961, there is no specific provision in ITA 2025 to clarify that distribution on buy-back would not qualify as dividend.

The Explanatory Memorandum explaining FA 2026 reproduced below, does not provide a clear policy rationale for the amendment:

> ***"It is proposed to rationalise the taxation of share buy-backs by providing that consideration received on buy-back shall be chargeable to tax under the head "Capital gains" instead of being treated as dividend income. Further, having regard to the distinct position and influence of promoters in corporate decision-making, particularly in relation to buy-back transactions, it is proposed that, in the case of promoters, the effective tax liability on gains arising from buy-back shall be thirty per cent, comprising tax payable at the applicable rates together with an additional tax. In case of promoter companies, the effective tax liability will be 22%."***

Post amendment, the capital gains rate applicable for promoters and non-promoters on buy-back is tabulated as follows:

(i) Rate of capital gains taxation in case of non-promoters[9] under domestic law (whether resident or non-resident):

9. *Before applicable surcharge & cess*

	Nature of capital asset	*Tax rate*
1	Short term capital gains (STCG) on listed shares (STT based) covered by S. 196 of ITA 2025	20%
2	STCG other than 1 above	Applicable rate[10]
3	LTCG covered by S. 197 and 198 (i.e., whether or not liable for STT) of ITA 2025	12.5%

(ii) Rate of capital gains taxation in case of promoter[11] under domestic law:

Sr. No.	*Nature of capital asset*	*Promoter is a domestic company*			*Promoter other than domestic company*[12]		
		Base rate (BR)	*Additional rate (AR)*	*Final rate(FR)*	*BR*	*AR*	*FR*
1	STCG covered by S. 196 of ITA 2025	20%	2%	22%	20%	10%	30%
2	STCG other than 1 above	Applicable rate	NIL	Applicable rate	Applicable rate	NIL	Applicable rate
3	LTCG covered by S. 197 and 198 of ITA 2025	12.5%	9.5%	22%	12.5%	17.5%	30%

Conclusion

The changes in buyback taxation in the four stages represent Government's policy response to unique situation of buyback which involves not only return of capital to shareholders but also part of accumulated profits of the company. Each change was a response to address the tax arbitrage arising from changing policy of taxation of dividends and capital gains vis-à-vis buybacks. The current policy of capital gains taxation for public/ minority shareholders and quasi-dividend taxation for promoter shareholders is intended to address the difficulties faced by public/ minority shareholders from full dividend taxation and curb arbitrage for promoter shareholders. While it appears that the current policy may remain stable for some time, there is scope for change in hands of promoters if a better measure is found to distinguish between situations of bonafide buybacks meriting capital gains treatment vs. buybacks involving disguised dividends.

10. 30% for FIIs and specified funds covered by s. 210 of ITA 2025
11. Before applicable surcharge and cess
12. Foreign company, firm, LLP, individual, HUF, trust etc.

Annexure A
Comparative rates between Dividend Distribution Tax (DDT) and Long Term Capital Gains (LTCG) on listed & unlisted shares (before applicable surcharge and cess)

<table>
<tr><th rowspan="3">Tax years</th><th rowspan="3">DDT</th><th colspan="4">LTCG</th></tr>
<tr><th colspan="2">Resident</th><th colspan="2">Non-resident</th></tr>
<tr><th>Listed</th><th>Unlisted</th><th>Listed</th><th>Unlisted</th></tr>
<tr><td>1997-98 to 1998-99</td><td>10%#</td><td colspan="4">20% *</td></tr>
<tr><td>1999-2000</td><td>10%</td><td rowspan="4">Lower of 20%* or 10%**</td><td rowspan="10">20% *</td><td rowspan="4">Lower of 20%* or 10%**</td><td rowspan="5">20% *</td></tr>
<tr><td>2000-01</td><td>20%##</td></tr>
<tr><td>2001-02</td><td>10%###</td></tr>
<tr><td>2002-03</td><td>NIL$</td></tr>
<tr><td>2003-04</td><td rowspan="2">12.50%</td><td rowspan="3">Exempt u/s. 10(38)***</td></tr>
<tr><td>2004-05 to 2006-07</td><td rowspan="3">Exempt u/s. 10(38)***</td></tr>
<tr><td>2007-08 to 2011-12</td><td rowspan="3">15%</td></tr>
<tr><td>2012-13 to 2017-18</td><td rowspan="3">10%**####</td></tr>
<tr><td>2018-19 to 2019-20</td><td rowspan="2">10%**</td><td rowspan="2">10%**</td></tr>
<tr><td>2020-21 to 22 July 2024</td><td rowspan="2">NIL$</td></tr>
<tr><td>23 July 2024 onwards</td><td colspan="4">12.5%**</td></tr>
</table>

* with indexation
** without indexation
*** w.e.f 1 October 2004
# w.e.f 1 June 1997
w.e.f 1 June 2000
w.e.f 1 June 2001
$ Dividend taxable in hands of shareholder at applicable rates
####w.e.f 1 April 2013

■

LIQUIDATION OF AN INDIAN COMPANY AND A FOREIGN COMPANY HAVING INDIAN ASSETS — TAX IMPLICATIONS FOR THE COMPANY AND ITS SHAREHOLDERS





Jai Soni *Govind Mandhana*

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Overview

The article provides a comprehensive analysis of the tax implications arising from the liquidation of Indian companies and foreign companies holding Indian assets, within the framework of the Income-tax Act, 1961 and its successor, the Income-tax Act, 2025. It highlights that while liquidation is fundamentally a process of corporate dissolution, its tax treatment is nuanced and multi-layered.

At the company level, distributions to shareholders on liquidation are not regarded as "transfer" and hence do not attract capital gains tax; however, any pre-distribution sale of assets by the liquidator is taxable in the normal course. In contrast, shareholders are subject to a dual tax regime: distributions attributable to accumulated profits are treated as deemed dividends and taxed accordingly, while the balance is taxed as capital gains based on fair market value.

The article further examines critical judicial developments, interpretational issues and also analyses the extended applicability of these principles to foreign company liquidations, particularly in light of indirect transfer rules and evolving statutory definitions.

Additionally, the discussion covers treaty considerations, foreign tax credit availability, reporting obligations, and liquidator responsibilities. Overall, the article distils a complex regime into a coherent framework navigating cross-border and domestic liquidation scenarios.

I. Introduction

The liquidation of a company at its core deals with orderly unwinding of a legal entity. A process that crystallizes latent economic interests held by a shareholder in the company. Though from an income-tax standpoint, the event is far from straightforward.

The enactment of the Income-tax Act, 2025 (hereinafter "ITA 2025"), which comes into force from 1 April 2026, has reorganized the statutory framework while largely preserving its substantive content. This article is written primarily from the ITA 1961 perspective, but

for each key provision it also indicates the corresponding section in the ITA 2025.

II. Statutory Framework: ITA 1961 and the Corresponding ITA 2025 Provisions

Before entering the substantive analysis, it is useful to map the key provisions across the two statutes:

Sl. No.	Particulars	Section (ITA 1961)	Section (ITA 2025)
1	Charge of capital gains	45	67
2	Capital gains on distribution by company in liquidation	46	68
3	Buyback capital gains	46A	69
4	Transactions not regarded as transfer	47	70
5	Mode of computation	48	72
6	Cost with reference to certain modes of acquisition	49	73
7	Definition of capital asset	2(14)	2(22)
8	Definition of transfer	2(47)	2(109)
9	Deemed dividend on liquidation	2(22)(c)	2(40)(c)
10	Company in liquidation – liquidator obligations	178	322
11	Income deemed to accrue in India (indirect transfer)	9(1)(i)	9(2)(d) r.w.s. 9(9)

III. Tax consequences in the hands of the company being liquidated

A. Distribution of assets – No Transfer

Section 46(1) of ITA 1961 creates a statutory carve-out from the general charging provision:

> "***46.*** *(1) Notwithstanding anything contained in section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall* ***not be regarded as a transfer*** *by the company for the purposes of section 45.*"

The corresponding provision under ITA 2025 is Section 68(1), which retains this non-obstante protection in identical terms. The rationale is well-settled in law: a liquidating company distributing its assets to shareholders is merely returning capital, not transacting in the market. For the company - no extraneous consideration changes hands; the transaction is essentially a dissolution of the corporate veil.

Consequently, the company itself incurs no capital gains tax liability on pure distribution. This exemption under Section 46(1) is absolute – there is no discretion vested in the hands of the Assessing Officer to re-characterize the event as a transfer.

B. Sale of Assets by Liquidator -Transfer and Taxability

Section 46(1)/Section 68(1) protects only distributions. Where the liquidator sells the company's assets to third parties before making distribution, the transaction

constitutes a "transfer" under Section 2(47)/ Section 2(109), and capital gains are computed in the hands of the company in the normal course.

IV. Tax Consequences in the Hands of Shareholders of an Indian Company

A. The Two-Part Taxation Mechanism under Section 46(2)/Section 68(2)

The statutory text of Section 46(2) of ITA 1961 (the operative provision for shareholders) reads:

> *"(2) Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head 'Capital gains', in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of sub-clause (c) of clause (22) of section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48."*

Section 68(2) of ITA 2025 is materially identical. The provision therefore bifurcates the receipts into two distinct income streams:

Component	Head of Income
Distribution attributable to accumulated profits of the company before liquidation (whether capitalized or not)	Dividend - Income from Other Sources
Remainder (i.e., total FMV/money received minus the above deemed dividend)	Capital Gains

B. Deemed Dividend under Section 2(22)(c)

Section 2(22)(c) of ITA 1961 defines dividend to include:

> *"any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not."*

The following issues merit attention:

1. **Pre-liquidation accumulated profits:** Any profits accruing after the date of liquidation do not constitute deemed dividend under this clause.

2. **Compulsory acquisition carve-out**: Where liquidation is consequent to compulsory acquisition of an undertaking by the Government or a Government-controlled corporation, accumulated profits do not include profits of the company prior to the three successive previous years immediately preceding the year of acquisition (subject to exceptions).

3. **Dividend taxation at applicable slab rates**: Post the abolition of Dividend Distribution Tax (DDT) by Finance Act 2020, dividends — including deemed dividends under Section 2(22)(c) — are taxed in the hands of shareholders at their applicable slab rates. TDS is deducted on such deemed dividend at source u/s 194 of ITA 1961, unless the payment is to a non-resident, in which case Section 195 of ITA 1961 (Section 403 of ITA 2025) may apply.

C. Computation of Capital Gains in the Shareholder's Hands

Once the deemed dividend is carved out, the capital-gains computation proceeds as follows:

Full Value of Consideration (FVC) = Money received + FMV of assets on date of distribution minus Amount assessed as deemed dividend u/s 2(22)(c)

Cost of Acquisition (CoA) = Cost/indexed cost at which the shareholder originally acquired the shares

Capital Gain = FVC − CoA − Transfer Expenses

Illustration 1: Basic Details

Particulars	*Amount/Details*
Company	B Ltd. (wound up)
Shareholding of Mr. A	10%
Cost of acquisition	Rs. 5,00,000
FMV of assets received	Rs. 40,00,000
Accumulated profits	Rs. 60,00,000

Tax Treatment in hands of Mr. A

Particulars	*Amount*
Deemed Dividend (IFOS)	
Share of accumulated profits (10% of 60,00,000)	Rs. 6,00,000
Capital Gains	
Full Value of Consideration (FMV received)	40,00,000
Less: Deemed Dividend	(6,00,000)
Less: Cost of acquisition	(5,00,000)
Capital Gain	**Rs. 29,00,000**

D. Short-Term or Long-Term Classification

Section 2(42A) Explanation 1 of ITA 1961[section 2 (101) of ITA 2025] provides for determining whether shares in a liquidating company are short-term or long-term capital assets, the period of holding subsequent to the date on which the company goes into liquidation shall be excluded.

E. Cost of asset subsequently transferred

A recurring area of litigation concerns the cost of acquisition, in the shareholder's hands, of an asset received on liquidation that is subsequently sold. Two provisions compete:

- **Section 55(2)(b)(iii):** Where the asset was received pursuant to distribution on liquidation and the assessee has been assessed to income-tax under Section 46(2), the **cost of acquisition = FMV on the date of distribution**.

- **Section 49(1)(iii)(c):** Where the asset became the property of the assessee on distribution of a company's assets on liquidation, the **cost of acquisition = cost to the previous owner (the company)**.

The Madras High Court in a landmark 2025 decision in the case of ***T.R. Balasubramanium vs. The Asst Commissioner of Income Tax City Circle VII(2), Chennai (T.C.A.No. 438 of 2008)*** resolved this conflict. The Court held that where the shareholder has been taxed under Section 46(2) on receipt, Section 55(2)(b)(iii) governs, and the cost is the FMV on the date of distribution. Section 49(1)(iii)(c) applies only where the shareholder was not subjected to tax under Section 46(2). This decision has significant practical implications: it eliminates double-taxation and ensures that the shareholder's cost basis

for subsequent transfers is stepped up to the fair market value at which the asset entered his hands.

F. Self-contained code – Definition of Capital assets

The Supreme Court in the case of ***N. Bagavathy Ammal vs. CIT (2003) 259 ITR 678 (SC)*** held that Section 46(2) is a self-contained code. The word "assets" in Section 46(2) is broader than the term "capital assets" defined in Section 2(14) and therefore includes agricultural land even though such land is excluded from the Section 2(14) definition. The Court affirmed that Section 46(2) creates a legal fiction under which the extinguishment of shareholder rights upon liquidation is treated as a constructive transfer, and the market value of all assets received — regardless of their nature — constitutes the full value of consideration for capital-gains purposes. This fiction, once triggered, must be followed to its logical conclusion — whether the ultimate result is a gain or a loss.

G. Availability of Capital loss

The Gujarat High Court in the case of ***CIT vs. Jaykrishna Harivallabhdas [2000] 112 Taxman 683 (Gujarat)*** held that where a shareholder receives no consideration on liquidation (because the company's assets were exhausted by creditor claims), a capital loss is allowable under Section 46(2). The Court rejected Revenue's argument that Section 46(2) could only produce a gain and reaffirmed that the legal fiction of "transfer" inheres both gains and losses. This ruling has been consistently cited to support claims for capital loss set-off by shareholders receiving nil or nominal distributions on winding up.

The Court affirmed that Section 46(2) creates a legal fiction under which the extinguishment of shareholder rights upon liquidation is treated as a constructive transfer.

V. Liquidation of a foreign company

A. Section 2(17) amendment: The watershed moment

The Supreme Court in the case of ***CIT vs. R.M. Amin [1977] 106 ITR 368 (SC)*** held that, under the definition of "company" as it then stood in Section 2(17), Section 46 of ITA 1961 did not extend to a foreign company. An issue that arises often is whether the provisions of Section 46 would apply in case of liquidation of a foreign subsidiary. The Court's reasoning turned on the restricted statutory definition that prevailed in Assessment Year 1962-63, which did not encompass bodies corporate incorporated outside India.

The Finance (No. 2) Act, 1971 amended Section 2(17) of ITA 1961 to explicitly include "any body corporate incorporated by or under the laws of a country outside India" within the definition of "company". This amendment fundamentally altered the landscape. Post this amendment, the ruling in R.M. Amin no longer protects Indian shareholders receiving distributions from a foreign liquidating company. Today, Section 46(2) of ITA 1961 (Section 68(2) of ITA 2025) fully applies to the liquidation of a foreign company, provided the Indian shareholder comes within the ambit of the Act.

B. Taxation of Indian company holding shares in a foreign subsidiary

Where an Indian company holds shares in a foreign subsidiary that is liquidated, the distribution received from the foreign

subsidiary is taxable in India under Section 46(2)/Section 68(2). The Indian company would also need to consider whether foreign tax credits under Section 90/91 can be claimed on any taxes paid in the country of the foreign company's incorporation.

C. Liquidation of Foreign Company having Indian Assets : Indirect transfer provisions

The Indian taxability of an offshore liquidation is anchored in the combined operation of the following sections:

- Sections 4 and 5 (charge and scope of total income),
- Section 45 (capital gains),
- Section 2(22)(c) (income from other sources),
- Section 2(47) (definition of "transfer") and,
- Section 9(1)(i) (indirect transfer provisions).

Section 9(1)(i) deems income to accrue or arise in India if it arises, directly or indirectly, through the transfer of a capital asset situated in India. Pursuant to Explanation 5 to section 9(1)(i), a share or interest in a foreign company or entity is itself deemed to be situated in India if it derives, directly or indirectly, its value "substantially" from assets located in India.

Where a non-resident or a foreign company holds shares in a foreign entity that derives its value substantially from Indian assets, the gains on liquidation (being a "transfer" within Section 2(47)(i) or through extinguishment) are deemed to accrue or arise in India under Section 9(1)(i) read with Explanation 5.

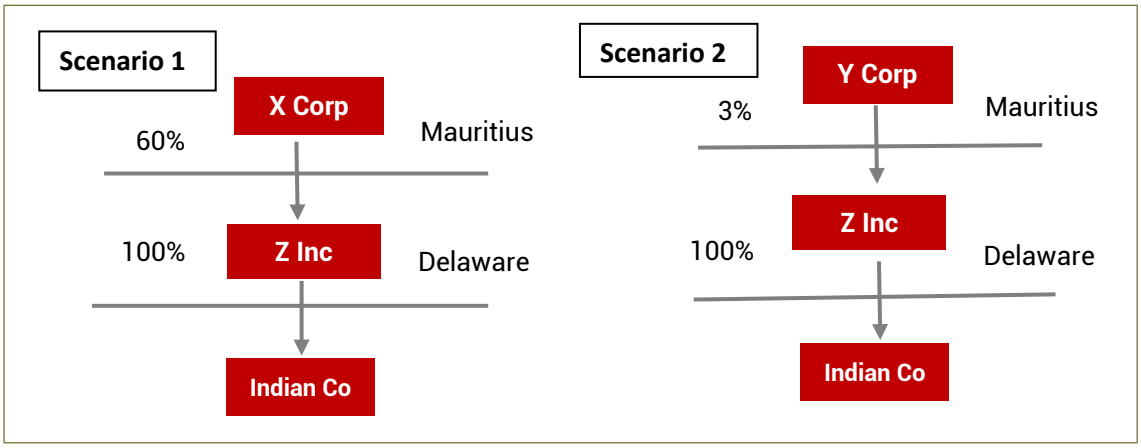
The test for "substantial value from Indian assets" [Section 9(1)(i) read with Explanation 6] is:

- The FMV of Indian assets exceeds Rs. 10 crore, and
- The FMV of Indian assets represents at least 50% of the FMV of all assets of the foreign company or entity.

The income attributable to Indian assets is computed on a proportional basis where not all assets are located in India.

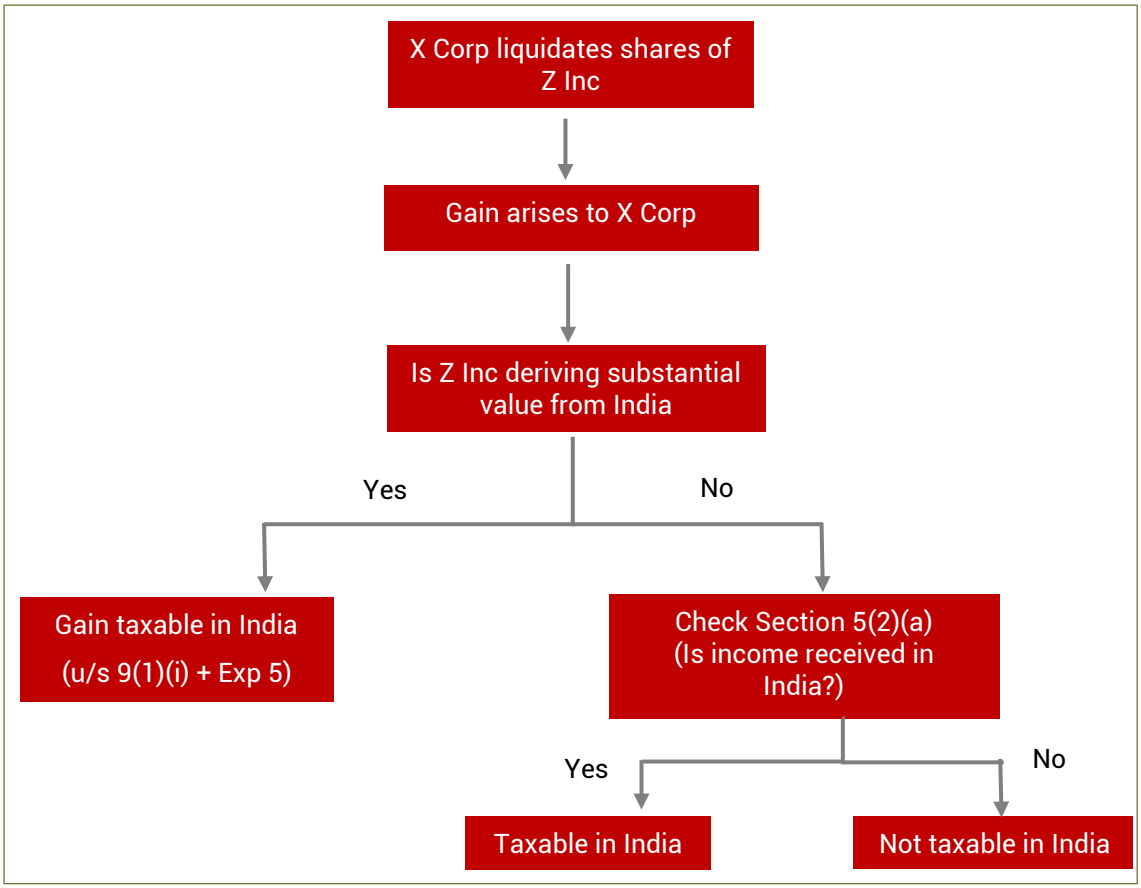
Exception for small shareholders: By virtue of Explanation 7 to Section 9(1)(i), gains arising from the transfer of a share or interest in a foreign entity are not deemed to accrue or arise in India if the transferor (individually or along with associated enterprises) neither holds the right to management or control nor holds voting power, share capital or interest exceeding 5% of the total, directly or indirectly.

Illustration 2:



Particulars	*Scenario 1 (No Exception)*	*Scenario 2 (Small Shareholder Exception Applies)*
Structure	X Corp (Mauritius) holds 60% in Z Inc (Delaware), which holds 100% in Indian Co.	Y Corp (Mauritius) holds 3% in Z Inc (Delaware), which holds 100% in Indian Co.
FMV of Indian assets	Rs. 500 crore (75% of total assets of Z Inc)	Same as Scenario 1
Event	Z Inc goes into liquidation and distributes assets	Same as Scenario 1
Applicability of Explanation 5	Applicable (Indian assets > Rs. 10 Cr and > 50%)	Same as Scenario 1
Shareholding/ control test	60% holding → exceeds 5% threshold	3% holding → within 5% threshold
Management/ control	Exists	No control
Taxability in India	**Gains deemed to accrue in India u/s 9(1)(i)**	**Not taxable in India due to Explanation 7 (small shareholder exception)**

Logical chart to check the taxability



Indirect transfer refinement in ITA 2025

Section 9(9) of ITA 2025 refines the indirect-transfer language from Explanation 5 to Section 9(1)(i) of ITA 1961. The new formulation potentially extends the net to cover "share of a company" and "interest in an entity" – configurations previously unaddressed, which could affect certain partnership, trust, or hybrid structures used in offshore holding arrangements.

D. DTAA protection for non-resident shareholders

Non-resident shareholders exiting through liquidation of an Indian company (or a foreign company with Indian assets) should carefully evaluate the applicable Double Taxation Avoidance Agreement (DTAA). Several key points apply:

1. **Capital gains article:**

   - The Capital gains article of the treaty should be examined in detail, where the foreign shareholder is eligible to claim benefits of the tax treaty.

   - In certain treaties (e.g., India–Mauritius, India–Singapore), capital gains arising from shares of Indian companies were historically exempt from Indian taxation for residents of the treaty country, subject to conditions and subsequent transition provisions introduced post-2016. Following these changes, capital gains on shares of Indian companies are, in general, taxable in India under the source rule, irrespective of the treaty jurisdiction, subject to any applicable grandfathering or specific treaty reliefs.

   - To the extent the value of such shares is derived from immovable property situated in India, the provisions of DTAA relating to taxability of shares deriving value from immovable property in India may also become relevant, allowing India to exercise taxing rights in such cases.

   - Whether cancellation of shares of a foreign company on liquidation fall within the ambit of the term 'alienation of any property' as per treaty provisions should be examined. Generally, 'alienation' inter alia means change of ownership of the property, which inherently requires the property to be in existence even after the transaction, the extinguishment of rights in the shares of a company may not be considered as 'alienation' under the tax treaty. However, specific definition should be examined.

   - Even taking a view that the 'alienation' covers cancellation of shares of F Co, pursuant to liquidation, the residuary clause may not give the taxing rights to India in certain cases. Residuary clauses of capital gains article of the relevant tax treaty to be examined.

2. **Business profits**: Where the shareholder has a Permanent Establishment (PE) in India and the shares are effectively connected with such PE, forming part of its business assets, the gains arising on liquidation may be attributable to the PE and consequently taxable in India as business profits in accordance with the treaty provisions.

3. **Dividend**: Where Section 2(22)(c) is triggered, the applicability of the Dividend Article under the DTAA needs to be examined. A view may be taken that as the dividend distributing company is neither a resident of India or the jurisdiction of Shareholder entity, hence the Dividend Article may not apply. Further, the definition of "dividend" as per the treaty should be examined.

4. **Foreign tax credits**. Indian shareholders receiving liquidation distributions from foreign companies are taxable in India under Section 46(2) of the ITA 1961. Taxes withheld in the foreign jurisdiction on such income may be available for credit in India under Sections 90 or 91, subject to the provisions of the applicable DTAA and the Foreign Tax Credit Rules.

5. **MAT exemption**. A foreign company that: (a) is a resident of a DTAA country, and (b) has no PE in India, is exempt from Minimum Alternate Tax (MAT) under Section 115JB.

E. Reporting obligations u/s 285A

Where a foreign company or entity derives substantial value from Indian assets, the Indian concern (i.e., the Indian entity in whose assets the foreign company has an interest) is obligated under Section 285A to furnish prescribed information regarding any offshore transaction modifying the ownership structure or control of the Indian entity. Failure to do so attracts a penalty under Section 271GA — either 2% of the value of the transaction or Rs. 5 lakh, whichever is applicable.

F. Amendments in IT Rules 2026 in relation to indirect transfer

Rule 10 has introduced a new definition of "foreign company or entity" to mean a "company or entity registered or incorporated outside India"

Amendments in definition of "Accountant" from whom Valuation Report is required to be obtained is made as below:

New Form	*Earlier Rules*	*New Rules*
Domestic Individuals	NA	- Certification receipts >/INR 0.5 Crore - 10-year experience
Domestic non-individuals	NA	- Certification receipts >/INR 3 Crore
Foreign Individuals	- Valuation receipts >/INR 1 Crore - 10-year experience	- Certification receipts >/INR 0.5 Crore - 10-year experience
Foreign Non-individuals	- Valuation receipts >/INR 10 Crore - Presence in > 2 countries	- Certification receipts >/INR 3 Crore - Presence in > 2 countries

VI. Obligations of the liquidator — Section 178 of ITA 1961/Section 322 of ITA 2025

The statute imposes specific obligations on persons acting as liquidators to safeguard the Revenue's interests. Section 178 provides that a liquidator must first obtain approval from the jurisdictional tax authority before distributing or disposing of company assets. Upon receiving intimation from the Assessing Officer regarding outstanding tax dues, the liquidator is required to earmark sufficient funds to meet such liabilities and cannot part with the assets until this requirement is fulfilled.

In case the liquidator does not comply with the obligation to notify the tax authorities, fails to reserve the specified amount, or improperly distributes assets, he may become personally liable for the company's tax dues. These provisions override other applicable laws, except where the Insolvency and Bankruptcy Code, 2016 applies.



IBC Carve-Out: A Critical Distinction

The proviso to Section 178(6)/Section 322(8) — the IBC exception — has generated significant litigation. Where a company undergoes liquidation under the Insolvency and Bankruptcy Code, 2016, the NCLAT in ***Om Prakash Agrawal (Liquidator: S. Kumars Nationwide Ltd.) vs. CCIT(TDS) [2021] 124 taxmann.com 305 (NCL-AT)*** affirmed that Section 178 is inapplicable, and income-tax dues rank as operational creditor claims in the distribution waterfall under Section 53 of IBC. This is a critical distinction: in IBC-driven liquidations, the Assessing Officer cannot block asset distribution by demanding a set-aside under Section 178/322; the Revenue must prove its claim before the liquidator like any other creditor.

VII. Conclusion

The taxation of company liquidation in India is a multi-layered exercise. At its simplest, it operates through a two-part mechanism — deemed dividend to the extent of accumulated profits, and capital gains on the residue — but the complexity multiplies when one introduces foreign companies, indirect-transfer rules, DTAA protection, and the interplay with the IBC waterfall.

The transition to ITA 2025, effective 1 April 2026, preserves this two-part framework (Sections 68 and 2(40)(c)) but introduces noteworthy refinements: the broadened indirect-transfer language in Section 9(9).

The views expressed in this article are those of the author in a personal capacity and are intended for academic and informational purposes. Readers are advised to seek specific professional advice before acting on any of the positions discussed herein.

■

NAVIGATING THE CLEAN SLATE: PAYOUTS, RIGHT-SIZING, AND RPS RESTRUCTURING IN DISTRESSED COMPANIES





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Overview

Acquiring a distressed company is fundamentally a balance-sheet reconstruction exercise that collides directly with the Income-tax Act. While the Insolvency and Bankruptcy Code (IBC) promises a "clean slate" free of legacy claims, the tax framework inherently seeks to tax the very mechanics of corporate rescue, ie, liability write-backs, debt conversions, and capital reductions. Navigating this collision is what determines whether a resolution plan creates value or traps it.

This article provides a practitioner's roadmap across five intersecting issues.

- ***Defending the Clean Slate**: The clean slate, while firmly anchored in Supreme Court jurisprudence, is not self-executing. The Madras HC's divergence in Dishnet Wireless creates a live jurisdictional risk that only specific Revenue-neutralising plan clauses and express NCLT directions can contain.*

- **The Timing Mismatch Trap:** *A related trap arises from timing: liabilities extinguish on NCLT approval, but accounting entries follow months later. Resolution plans must explicitly shield these implementational entries from being treated as fresh taxable events.*

- **IBC Route vs. Out-of-Court OTS**: The 2023 *expansion of Section 28(iv) has made Out-of-Court OTS structurally inferior. The IBC framework, with its NCLT exemptions and enhanced MAT loss preservation under Section 79(2)(c), remains vastly superior.*

- ***RPS Restructuring & Right-Sizing**: Converting legacy debt into Redeemable Preference Shares (RPS), while commercially elegant, demands careful structuring to neutralise tax friction on the conversion differential.*

- ***SPV Funding Under the New Act**: SPV debt structures face intense scrutiny over interest deductibility. Crucially, the Finance Bill 2026's proposed complete disallowance of interest against dividend income effectively mandates a prompt post-acquisition merger as the only viable structural response.*

Ultimately, precision in structuring is the difference between a successful turnaround and trapped value.

Distressed M&A is, at its core, a balance sheet reconstruction exercise. The Resolution Applicant (RA) acquires not a functioning business at a market multiple, but an enterprise whose liabilities exceed its assets, whose equity has eroded to zero or below, and whose operations may have been mothballed under interim management. Before a single rupee of fresh revenue can be earned, legacy liabilities must be extinguished, existing equity cancelled, the business recapitalised, and a viable capital structure established. The commercial viability of the resolution plan and the RA's return on investment turns entirely on how efficiently this reconstruction is executed.

This reconstruction inevitably collides with the Income-tax Act, 1961 (IT Act), a statute designed to tax benefits, gains, and accretions to wealth. Every liability written off generates a potential Section 41(1) or Section 28(iv) charge. Every share cancelled raises questions of deemed dividends or capital gains. Every rupee of acquisition debt invites scrutiny under Section 36(1)(iii). The Insolvency and Bankruptcy Code, 2016 (IBC), by contrast, is engineered to give the corporate debtor a clean slate. The Supreme Court's phrase in *Ghanshyam Mishra* was that the RA should not be "flung with any surprise claims."

This article navigates the collision of these two frameworks: the clean slate principle, liability write-backs, Redeemable Preference Share (RPS) restructuring, capital reduction, and SPV funding architecture. It also addresses the jurisdictional fault line introduced by the Madras High Court in *Dishnet Wireless*, which every transaction must now account for. Given that the new Income-tax Act, 2025 (effective 1 April 2026) carries no substantive changes to the 1961 Act, analysis under the existing framework remains fully applicable.

1. The Clean Slate: IBC's Override of Tax Claims

Section 31(1) of the IBC (as amended in 2019) makes an approved resolution plan binding on the corporate debtor, its creditors, including the Central Government, State Governments, and local authorities and all other stakeholders. Section 238 reinforces this with a non-obstante clause stating that the IBC prevails over any other law that is inconsistent with it.

The Supreme Court's jurisprudence has firmly consolidated this position. In ***Ghanshyam Mishra and Sons Pvt. Ltd. v. Edelweiss ARC Ltd., (2021) 9 SCC 657***, the Court held that all dues not addressed in the resolution plan stand extinguished upon approval, and no proceedings for the pre-approval period may continue thereafter. In ***Essar Steel (CoC) v. Satish Kumar Gupta, (2020) 8 SCC 531***, the Court deployed the vivid "hydra head" metaphor, that undecided claims surfacing post-approval would render any plan unworkable. ***Jaypee Kensington v. NBCC (C.A. No. 3395/2020)*** further confirmed that claims not filed in time cannot be included in the Information Memorandum[1].

This binding effect extends squarely to Revenue. The Delhi HC in ***Tata Steel v. DCIT [2023] 156 taxmann.com 104 (Delhi)*** quashed demand-recovery notices against Tata Steel (successor to Bhushan Steel), holding that Section 238 gives the IBC overriding effect over the IT Act. In ***M-Tech Developers v. National Faceless Assessment Centre [2024] 161 taxmann.com 736 (Delhi)***, Revenue's

1. *Also refer: Garden Silk Mills v. Commissioner of Central Excise and Customs, Surat-I (2023) 4 Centax 204 (Guj.); Ruchi Soya Industries Ltd. v. Union of India 2022 (380) E.L.T. 8 (SC).*

failure to lodge a claim during the Corporate Insolvency Resolution Process (CIRP) was held fatal to any subsequent proceedings. The Bombay HC in ***Murli Industries v. ACIT [2022] 441 ITR 8 (Bombay)*** went further, observing that if Revenue felt precluded, the remedy was legislative amendment, not circumvention. Notably, in ***State Tax Officer v. Rainbow Papers Ltd., (2022) 142 taxmann.com 157 (SC)***, the Supreme Court held that a State holding a statutory charge qualifies as a secured creditor under Section 53 of the IBC, a position Revenue authorities now invoke for tax dues, making proactive claim-management during CIRP essential.

1.1 The Madras HC Divergence — A Live Jurisdictional Risk

The Madras HC's ruling in ***Dishnet Wireless Ltd. v. ACIT [2022] 139 taxmann.com 493 (Madras)*** stands as the sole material outlier in an otherwise coherent jurisprudential landscape, where reassessment notices under Section 148 were issued after initiation of CIRP but prior to approval of the resolution plan, and the Court ultimately declined relief on the basis that the assessee had not ensured proper notice to the Revenue, that the Revenue's claims had not crystallised during the CIRP period, and that the resolution plan, containing only a generic withdrawal clause could not be read to curtail the Revenue's authority to complete assessment proceedings.

The ruling is factually distinguishable, the plan's silence on Revenue claims was decisive, and the "non-crystallisation" reasoning is difficult to reconcile with *Ghanshyam Mishra's* unqualified "all such claims" language. *Dishnet Wireless* essentially penalised poor drafting rather than articulating a general principle. Nevertheless, within the Madras HC's jurisdiction, the risk is live and demands specific mitigation. Every resolution plan should include:

- **Specific Revenue-neutralising clauses**: Generic withdrawal language is insufficient. Reassessment claims must be explicitly identified and extinguished.
- **Proactive notice:** Formal notice of the CIRP served on the jurisdictional Assessing Officer and Principal Commissioner.
- **Express NCLT directions**: A specific order barring reassessment or revisionary proceedings for the pre-CIRP period.

These steps should be the minimum standard practice in every resolution plan, regardless of the jurisdiction.



1.2 The Timing Mismatch Trap

A related vulnerability arises from the gap between legal extinguishment and accounting recognition. Liabilities are extinguished by operation of law on the date of NCLT approval. However, the physical accounting entries to settle and write back those liabilities, cancelling shares, and recognising capital reduction are invariably passed weeks or months later, often in a subsequent financial year. Revenue may argue that because the accounting entry was recorded post-CIRP, it constitutes a fresh taxable event outside the protective umbrella of the NCLT order.

The resolution plan must bridge this temporal gap. An explicit clause should direct that any accounting entries passed to give effect to the plan, irrespective of the financial year in which they are recorded, are ministerial implementations of the NCLT order and shall not trigger any liability under Section 41(1), Section 28(iv), or MAT under Section 115JB.

2. Liability Write-Backs: IBC Route vs Out-of-Court Settlement

In any distressed restructuring, a significant quantum of liabilities, ie, bank debt, trade creditors, and statutory dues, is written back. The tax treatment turns on two variables: the nature of the liability (trading vs capital) and the mechanism employed (IBC plan or bilateral One Time Settlement (OTS)).

Post-amendment, any loan waiver that constitutes a business benefit is potentially taxable, dramatically raising the stakes for write-backs outside the IBC framework.

The physical accounting entries to settle and write back those liabilities, cancelling shares, and recognising capital reduction are invariably passed weeks or months later, often in a subsequent financial year.

Interest waivers attract Section 41(1) where the corporate debtor previously claimed a deduction. The Supreme Court's ruling in ***Polyflex (India) (P.) Ltd. v. CIT, (2002) 257 ITR 343***, confirmed that "remission or cessation" applies to trading liabilities. Principal waivers historically attracted different treatment. In ***Commissioner v. Mahindra & Mahindra Ltd., (2018) 404 ITR 1 (SC)***, the Court held that a loan waiver is cash and therefore outside Section 28(iv) (which covered only non-cash benefits), while a capital-asset term loan is not a "trading liability" for Section 41(1) purposes. This position was followed in Tosha International, Xylon Holdings, and Essar Shipping, among others[2].

The Finance Act, 2023, changed this. Effective Assessment Year 2024-25, Section 28(iv) was substituted to expressly include cash and monetary benefits, directly overriding *Mahindra & Mahindra*. Post-amendment, any loan waiver that constitutes a business benefit is potentially taxable, dramatically raising the stakes for write-backs outside the IBC framework. Some protection survives through the Gujarat HC's analysis in ***CIT v. Chetan Chemicals [2004] 139 Taxman 301 (Guj)***, which held that waiver of loans does not yield a taxable business benefit where the assessee is not in the business of borrowing, i.e., capital-account loan waivers should remain outside Section 28(iv)'s expanded reach.

2. *[2009] 176 Taxman 187 (Delhi); [2012] 26 taxmann.com 333 (Bom.) and [2020] 117 taxmann.com 389 (Bombay).*

The structuring choice between an out-of-court OTS and an IBC resolution plan is stark – under an OTS, principal waivers are taxable under Section 28(iv), interest waivers under Section 41(1), standard MAT applies without relief, and historical tax liabilities continue. In contrast, under an IBC plan, non-admitted claims are extinguished (per *Ghanshyam Mishra*), NCLT-approved plans may ring-fence waiver taxation, MAT allows aggregate set-off of losses and depreciation, Section 79(2)(c) preserves losses despite ownership change, and Section 238 overrides conflicting provisions of the IT Act.

Companies may also sidestep MAT entirely by opting for the concessional regime under Section 115BAA (effective rate approximately 25.17%), though this requires foregoing certain deductions; the trade-off must be modelled against the quantum of accumulated losses available.

The extinguishment of debt and issuance of RPS should not, in principle, constitute a "remission".

The CBDT Circular No. 18/2022 dated 13/09/2022, which exempts OTS from TDS under Section 194R for banks, public FIs, ARCs, and certain NBFCs, applies to both routes.

3. Restructuring via Redeemable Preference Shares (RPS)

Lenders in a distressed resolution face a binary choice – accept a deep haircut on their debt claims or convert part of those claims into instruments that participate in the upside of a successful turnaround. RPS bridges this gap. Converting debt into RPS transforms a hard obligation requiring periodic interest service into an instrument that requires dividends only from distributable profits, immediately relieving the cash-flow pressure that is often the proximate cause of distress.

From the lender's perspective, RPS offers capital waterfall priority, a defined redemption timeline, and upside participation without the downside of equity. The conversion ratio, ie, debt exchanged for RPS face value, is the critical negotiation point, and any haircut embedded in that conversion (say, INR 100 crore of debt converting to INR 40 crore RPS) creates the differential that drives the tax analysis.

The extinguishment of debt and issuance of RPS should not, in principle, constitute a "remission". The lender receives RPS in exchange for its claim. Neither Section 41(1) nor Section 28(iv) should be triggered where genuine consideration flows in the form of equity instruments. However, where the issue price of RPS is materially below the debt extinguished, the conversion differential may be characterised in the corporate debtor's hands as a benefit under amended Section 28(iv).

With the abolition of Section 56(2)(viib), which previously taxed excessive premiums on the allotment of shares, the option to structure the RPS at a premium can be considered to narrow the conversion differential. This can be addressed by benchmarking the conversion ratio against an independent valuation, obtaining an NCLT direction confirming tax neutrality of the conversion, and ensuring the resolution plan expressly records that the issuance of RPS constitutes full and final settlement with no adverse inference arising from the differential, alongside structuring the RPS with an appropriate face value and redemption premium.

A further technical exposure arises under Section 269T, which requires loan repayments only through prescribed banking modes. In

CIT v. Triumph International Finance Ltd. (345 ITR 270 - Bom HC), repayment via journal entry was held to contravene Section 269T, attracting a penalty under Section 271E[3]. The ITAT Kolkata, in ***Arkit Vincom Pvt. Ltd. v. ACIT (ITA No. 2397 Kol-Tri)***, took a more nuanced position: conversion, absent any cash outflow, is not "repayment" for Section 269T purposes. However, the position remains fact-sensitive, and accurate characterisation within the resolution plan is essential.

Further, while the CBDT's relaxation[4] exempts NCLT-approved transactions under Sections 241/242 of the Companies Act from Sections 56(2)(x) and 50CA. This relief has not been extended to IBC resolutions, a distinction without a commercial difference, since both involve court-sanctioned transfers with no control over consideration, leaving resolution applicants exposed to valuation-based tax triggers.

3.1 Redemption and Capital Reduction

Once the corporate debtor stabilises post-turnaround, the RPS must be addressed. Redemption at face value from distributable profits or by fresh issue, creating a Capital Redemption Reserve, constitutes a transfer under Section 2(47) by the Supreme Court in ***Anarkali Sarabhai [1997] 90 Taxman 509 (SC)***. Alternatively, where full redemption is commercially impractical, the RPS may be subjected to capital reduction within the resolution plan itself. The RPS is cancelled at a value below its face value, resulting not in a remission of liability but in a return of capital at a reduced amount. Since the RPS is cancelled rather than transferred, Section 56(2)(x) should not be attracted, though the lender-shareholder will incur a capital or business loss depending on how the investment is classified. Further, since RPS is not a liability, the adverse implications under Section 41(1) or 28(iv) shall not arise.

4. Balance Sheet Right-Sizing: Capital Reduction and Loss Preservation

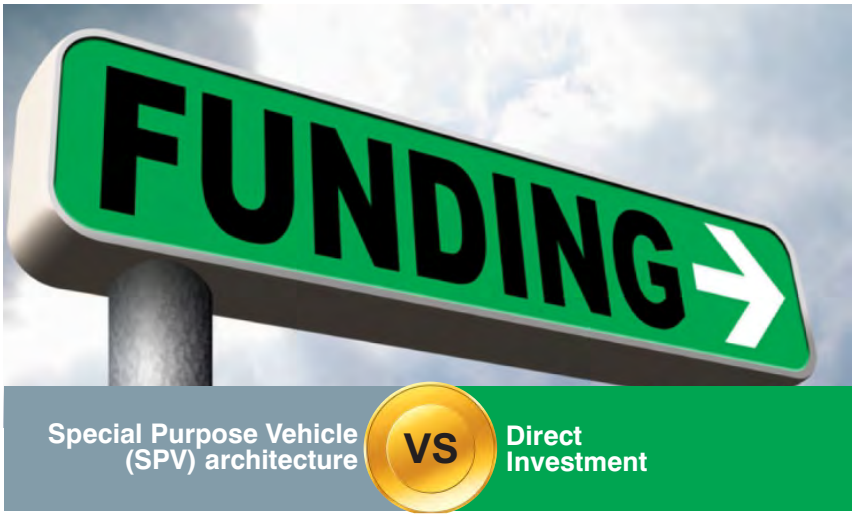
In virtually every resolution plan, existing share capital is reduced to zero. Under the IBC framework, the NCLT order itself dispenses with the Section 66 Companies Act procedure – the special resolution, the creditor notice window, are all bypassed. This compressed timeline is operationally critical. The RA must begin recapitalising and operating immediately. For the corporate debtor, no adverse tax arises from the cancellation of its own shares. Promoters whose equity is cancelled without payment suffer a capital loss, and no deemed dividend arises unless there is a payout or accumulated profits are negative.

In many distressed acquisitions, the accumulated losses of the corporate debtor, often running into hundreds of crores, are among the most commercially valuable attributes the RA is acquiring. Their preservation is critical to the plan's financial viability, as they shelter post-resolution turnaround income from tax. Section 79(1) would normally extinguish these losses upon a complete change in shareholding. Section 79(2)(c) provides the IBC carve-out: losses survive an ownership change pursuant to an IBC-approved resolution plan, provided the jurisdictional PCIT or CIT is afforded a reasonable opportunity of being heard. Unabsorbed depreciation under Section 32(2) is not subject to Section 79 at all and survives regardless.

3. *A compendium on handling Income-tax matters before NCLT – for department use only.*
4. *CBDT Notification No. 40/2020 dated June 29, 2020.*

If the corporate debtor, during the period of distress, failed to file timely returns, those losses lapse irrevocably, and Section 79(2)(c) does not cure this.

Resolution plans should explicitly invoke Section 79(2)(c) and direct the Resolution Professional to serve notice on the jurisdictional PCIT or CIT immediately after NCLT submission. One critical risk must be diligently and meticulously investigated: Section 80 requires that the return for the year of loss be filed within the due date under Section 139(1). If the corporate debtor, during the period of distress, failed to file timely returns, those losses lapse irrevocably, and Section 79(2)(c) does not cure this. The possibility of seeking a CBDT extension through jurisdictional authorities to resurrect lapsed losses can be explored, though it remains untested territory. Finally, both the Section 79(2)(c) carve-out and the enhanced Section 115JB MAT deduction are available only for companies in CIRP and not for going-concern sales in liquidation. This asymmetry is a significant factor favouring the resolution route.



5. Funding the Resolution: SPV Architecture vs Direct Investment

Route A - Acquisition SPV: Under the SPV route, the RA incorporates a fresh entity, equity and debt are raised, shares of the corporate debtor are acquired, and the resolution plan consideration is funded, with a post-acquisition merger intended to consolidate the structure.

Where the SPV borrows to acquire shares, Revenue typically argues that interest should be restricted to Section 57 (against dividend income only) or disallowed absent dividends. The Supreme Court's "commercial expediency" test in ***S.A. Builders Ltd. v. CIT(A), (2007) 288 ITR 1 (SC)***, and the holding in ***Core Health Care Ltd., (2008) 298 ITR 194 (SC)*** that Section 36(1)(iii) is attracted for business borrowings regardless of asset type provide the assessee's defence. Revenue cannot assume the armchair of a businessman to judge reasonableness (***Pr. CIT v. Reebok India Co., (2018) 98 taxmann.com 413 (SC)***).

The strongest structural response is a post-acquisition merger at the earliest opportunity, converting "investment in shares" into "acquisition of business" for Section 36(1)(iii) purposes. Contemporaneous documentation (board resolutions, valuation reports, strategic rationale memos) is essential. Two

further complications: the proviso to Section 36(1)(iii) requires capitalisation of interest until the asset is "put to use", with no settled meaning for shares, and Section 94B (thin capitalisation) caps the deduction at 30% of EBITDA where an associated enterprise is involved.

The Finance Bill, 2026, now adds a sharper edge to this analysis. It proposes to amend Section 93(2) of the Income-tax Act, 2025 (corresponding to Section 57 of the 1961 Act) to completely disallow interest on borrowings used for earning dividend income, effective 1 April 2026. Previously, such interest was deductible up to 20%. For SPV structures holding shares pending a merger, any dividend from the target will be taxable under Income from Other Sources, with a zero-interest offset. The post-acquisition merger is now not merely advisable but effectively the only viable path. Even then, it carries stamp duty, compliance with Section 72A and Section 79, and procedural costs, alongside the non-deductibility overhang in the interim.

Route B – Direct Investment: *Under the direct investment route, the RA infuses funds into the corporate debtor by way of an equity subscription or a shareholder loan. The corporate debtor itself makes creditor payouts, either as lump-sum settlements or through capital reduction of the RPS issued to lenders during CIRP. This avoids the SPV layer and the interest-deductibility complications above.*

Where the RA invests directly into the corporate debtor, and the debtor itself makes payouts, whether direct settlements or capital reduction of RPS issued to lenders, the Section 36(1)(iii) controversy is largely avoided. Funds carry a straightforward business nexus. The trade-off is structural. Direct investment does not accommodate multi-investor participation as naturally as an SPV does, and the RA bears direct balance-sheet exposure without an intermediate holding vehicle. The optimal split between direct payout and capital reduction must be determined against the specific economics of the resolution plan.

Conclusion

The restructuring of distressed companies sits at the intersection of the IBC's rehabilitative philosophy and the IT Act's taxing imperative. The legislative framework, bolstered by the Supreme Court's clean slate jurisprudence, has evolved to facilitate corporate rescue through extinguishment of historical tax claims (Sections 31 and 238, IBC), preservation of accumulated losses (Section 79(2)(c)), MAT relief through aggregate deduction of losses and depreciation (Section 115JB), and procedural fast-tracking of capital reduction.

Three risk areas demand attention. First, the 2023 amendment to Section 28(iv) has expanded the tax net for liability write-backs to include cash benefits, making explicit NCLT exemption clauses indispensable. Second, the Madras HC's divergence in Dishnet Wireless, though factually distinguishable, has created a live jurisdictional risk manageable only through specific Revenue-neutralising plan clauses and express NCLT directions barring reassessment. Third, interest deductibility on SPV acquisition debt remains perennially contestable, compounded by the Finance Bill 2026's complete disallowance of interest against dividend income, making a prompt post-acquisition merger the only reliable structural response.

Precision in structuring, ensuring that every payout, write-back, conversion, and capital action is anchored to the right statutory mechanism and shielded by the right plan clause, is the difference between a successful turnaround and trapped value.

■

INTERNATIONAL TAX IMPLICATIONS OF COMPANY PAYOUTS: TREATY CLASSIFICATION, WITHHOLDING, AND STRUCTURAL CONSIDERATIONS



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Overview

When an Indian company, or a foreign company with substantial Indian economic interests, returns value to its shareholders by way of dividend, capital reduction, or buyback, the tax characterization of the payout in the hands of non-resident investors is far from straightforward. The same economic receipt can attract treaty-rate dividend withholding, capital gains taxation, or, in certain configurations, no Indian tax at all. This article sets out the current domestic framework governing each payout form, including the significant changes introduced by the Finance (No. 2) Act, 2024 and the Finance Act, 2026, before turning to its primary focus: the cross-border implications for non-resident shareholders.

Two hypothetical scenarios, a share repurchase by a foreign holding company whose value derives substantially from Indian assets and an in-kind distribution of Indian subsidiary shares by a foreign company, are examined to illustrate how competing characterizations under domestic law and treaty provisions can produce materially divergent outcomes. The discussion highlights the divergent preferences of resident and non-resident shareholders on income classification, the compliance obligations attaching to cross-border payouts, and the structural considerations that investors must weigh in light of the rapidly evolving legislative landscape.

(I) Introduction

The mechanisms by which an Indian company, and indeed, a foreign company with substantial Indian economic interests, returns value to its shareholders have long occupied a central position in Indian tax discourse. Whether the payout takes the form of an ordinary dividend, a deemed dividend, a reduction of share capital, or a buyback of shares, each mechanism carries distinct tax consequences for the distributing company and the recipient shareholder alike. For domestic shareholders, the tax treatment, whilst not without complexity, is at least anchored in a relatively settled statutory

The characterization of a given payout form determines not merely the applicable domestic withholding tax rate, but also the availability (or otherwise) of relief under India's extensive network of Double Taxation Avoidance Agreements ("DTAAs"), the eligibility for foreign tax credits in the investor's home jurisdiction, and the compliance obligations that attach to the transaction.

framework. For non-resident shareholders, however, the position is considerably more intricate. The characterization of a given payout form determines not merely the applicable domestic withholding tax rate, but also the availability (or otherwise) of relief under India's extensive network of Double Taxation Avoidance Agreements (**"DTAAs"**), the eligibility for foreign tax credits in the investor's home jurisdiction, and the compliance obligations that attach to the transaction.

The landscape has undergone significant change in recent years. The abolition of the Dividend Distribution Tax (**"DDT"**) by the Finance Act, 2020 restored the classical system of taxing dividends in the hands of shareholders. More recently, the Finance (No. 2) Act, 2024 amended the treatment of share buybacks with effect from 1 October 2024, bringing buyback proceeds within the deemed dividend framework under the Indian income tax laws. This amendment created fresh and largely unresolved questions regarding the treaty classification of buyback proceeds received by non-resident shareholders. The Finance Act, 2026 has since reversed this characterization, restoring capital gains treatment for all shareholders whilst imposing an additional buyback tax on promoters with effect from 1 April 2026.

This article begins by setting out the domestic tax framework governing the principal forms of company payouts: dividends, deemed dividends, capital reductions, and buybacks. It then turns to the cross-border dimension, which is the primary focus of the discussion. In particular, two hypothetical scenarios are examined in detail to illustrate the interpretive challenges that arise when India's domestic rules on income characterization interact with treaty provisions and the Indirect Transfer Rule. The first scenario concerns a share repurchase by a foreign company whose value derives substantially from Indian assets, raising the question of whether such proceeds can be characterized as dividends at all under Indian law. The second scenario concerns a distribution of shares of an Indian company by a US company to its parent, testing whether the transaction should be characterized as a sale or as a dividend in specie and the consequences of each construct for the computation of consideration and withholding obligations. Together, these scenarios demonstrate that significant uncertainty persists in this area. Whether the question is the characterization of a receipt as dividend or capital gain (as in the first scenario) or the legal construct through which a transfer is effected and the resulting implications for the computation of consideration and withholding obligations (as in the second), non-resident investors and their advisers must navigate a web of competing characterizations, each with materially different tax outcomes.

(II) The Domestic Tax Framework for Company Payouts

Indian tax law recognises four principal forms of company payouts to shareholders, each governed by a distinct tax regime. *First*, dividends, following the abolition of DDT by the Finance Act, 2020, are taxable in the

resident shareholder's hands at applicable slab rates under the head "Income from Other Sources," and 20 per cent (plus applicable surcharge and cess) for non-residents, subject to a lower rate under the applicable DTAA. The abolition of DDT has restored treaty relief for non-resident shareholders. Under the earlier regime, DDT at 20 per cent (plus applicable surcharge and cess) was levied on the distributing company and was generally not creditable abroad; with its removal, non-residents can now claim concessional rates of typically 10 to 15 per cent under Article 10 of the applicable DTAA. Even during the DDT regime, a line of judicial authority held that DDT could not exceed the treaty rate on dividends. The Delhi Tribunal in ***Giesecke and Devrient (India) (P.) Ltd. vs. Addl. CIT [2020] 120 taxmann.com 338*** held that DDT, falling within the definition of "Tax" under Indian income tax laws, was subject to beneficial provisions under applicable tax treaties, and the DTAA rate must prevail; a similar view was taken in ***Indian Oil Petronas [2021] 127 taxmann.com 389***. The contrary position of the Mumbai Special Bench in ***Total Oil India [2023] 149 taxmann.com 332*** was decisively overruled by the Bombay High Court in ***Colorcon Asia (P.) Ltd. vs. Jt. CIT [2025] 181 taxmann.com 30***1, which held that DDT in excess of the treaty rate was violative of Article 265 of the Constitution, reasoning that DDT is in substance a tax on dividend income merely recovered from the distributing company. This principle has since been followed in ***Mitsui Kinzoku [2026] 183 taxmann.com 659*** and ***Sophos Technologies [2026] 183 taxmann.com 87***, affirming that treaty rates constitute a ceiling on India's right to tax dividend income.

Second, dividends are defined expansively under Indian income tax laws to encompass, among other transactions, distributions on capital reduction to the extent of the company's accumulated profits, distributions on liquidation, and loans or advances by closely held companies to substantial shareholders; any amount paid on capital reduction in excess of accumulated profits is treated as consideration for the transfer of shares and taxed as capital gains. *Third*, the taxation of share buybacks has seen three distinct phases of reform: until 30 September 2024, a company-level tax was levied under Section 115QA of the erstwhile Income-tax Act, 1961 (**"old IT Act"**) at 20 per cent (plus applicable surcharge and cess) on the distributed income, with the shareholder's receipt exempt under Section 10(34A) of the old IT Act; from 1 October 2024 to 31 March 2026, the Finance (No. 2) Act, 2024 re-characterised the entire buyback consideration as a deemed dividend under a newly inserted provision Section 2(22)(f) of the old IT Act, taxable in the shareholder's hands at slab rates with no deduction for cost of acquisition; and from 1 April 2026, the Finance Act, 2026 restores capital gains treatment, with all shareholders taxed at standard rates (12.5 per cent for long-term gains; 20 per cent for short-term gains on listed shares) and promoters bearing an additional buyback tax yielding effective rates of 22 per cent for corporate Indian promoters and 30 per cent for all other promoters.

The abolition of DDT has restored treaty relief for non-resident shareholders. Under the earlier regime, DDT at 20 per cent (plus applicable surcharge and cess) was levied on the distributing company and was generally not creditable abroad; with its removal, non-residents can now claim concessional rates of typically 10 to 15 per cent under Article 10 of the applicable DTAA.

(III) Cross-Border Dimensions: Treaty Classification and Withholding

The foregoing domestic framework must be read alongside India's extensive network of DTAAs. For non-resident shareholders, the characterization of a payout as dividend income, capital gains, or other income under the applicable treaty is critical, since each category may attract a different rate of withholding (or, in some cases, exemption) and determines whether a foreign tax credit is available in the shareholder's home country.

Where a payout is characterized as a dividend under the treaty, Article 10 of most Indian DTAAs permits the source country (India) to tax the dividend, typically at a concessional rate. Where the same payout is characterized as capital gains, Article 13 of the treaty would govern, and the taxability in India would depend on whether the treaty allocates exclusive taxing rights to the state of residence or permits source-state taxation. For payouts

Where a payout is characterized as a dividend under the treaty, Article 10 of most Indian DTAAs permits the source country (India) to tax the dividend, typically at a concessional rate.

that do not fit neatly into either the dividend or capital gains article, Article 23 ("Other Income") of certain treaties may provide that such income is taxable only in the state of residence, effectively granting a full exemption in India.

The interplay between domestic re-characterization and treaty classification is particularly complex in the context of buyback proceeds, as the two hypothetical scenarios examined below seek to illustrate.

A. Scenario I: Share Repurchase by a Foreign Holding Company

Consider a foreign holding company, **"HoldCo"**, incorporated in a tax-neutral



jurisdiction such as Sinagpore. HoldCo wholly owns an operating subsidiary in India (**"IndiaCo"**) through which substantially all of its business value is derived. A non-resident shareholder, **"InvestorCo"**, incorporated in the USA, holds shares in HoldCo. HoldCo proposes to repurchase a portion of InvestorCo's shares for cash consideration.

Under Indian income tax law, non-residents are taxed on capital gains arising from the transfer of shares of a foreign company if such shares derive, directly or indirectly, more than 50 per cent of their fair value from assets situated in India. If HoldCo's shares meet this 50 per cent threshold (as is likely given that IndiaCo represents substantially all of HoldCo's value), the indirect transfer provisions would apply. The critical question is whether the income arising from the share repurchase should be characterized as dividend income or as capital gains.

There are two competing characterizations. First, under Indian income tax laws, any distribution to shareholders on the reduction of capital is classified as dividend income to the extent of the company's accumulated profits. A share repurchase that effectively reduces the company's capital could, in principle, be regarded as analogous to a capital reduction. However, this provision has traditionally been applied in the context of Indian companies undertaking court-approved capital reductions. It is arguable that such provision for dividends under Indian income tax laws is circumscribed to Indian companies undergoing court approved reduction, and its extension to a foreign company's buyback would be incorrect. On the other hand, dividend is also defined to include any distribution by a company of accumulated profits which entails the release of assets by the company to its shareholders.

Moreover, even if the dividend characterization were to be pursued in the hands of the non-resident shareholder, the applicable treaty definition must be considered. Under the India-US DTAA, for instance, the term "dividends" is defined to mean income from shares or other rights (not being debt-claims) participating in profits, as well as income from other corporate rights which are subjected to the same taxation treatment as income from shares by the taxation laws of the state of which the company making the distribution is a resident. The definition further extends to income from arrangements, including debt obligations, carrying the right to participate in profits, to the extent so characterized under the laws of the Contracting State in which the income arises. This treaty definition ties the characterization of a payment as dividend to the tax laws of the state of residence of the distributing company and, critically, the classification as dividend would also be contingent on the availability of accumulated profits in HoldCo, since the concept of dividend, whether under domestic law or the treaty, presupposes a distribution out of profits rather than a return of capital.

If this income is classified as dividend income under the US DTAA, India may not have the right to tax such income as the taxing right lies with the country of which the company paying the dividends is a resident and with the country in which the shareholder is resident.

The second characterization is that the income constitutes capital gains under Indian income tax laws, which provides that any consideration received by a shareholder from "any company" for the purchase of its own shares shall be treated as capital gains. Unlike the dividend provisions, the capital

gains provision (Section 69 of the Indian Income-tax Act 2026) is not limited to Indian companies. Accordingly, the gains realized by InvestorCo on the repurchased shares may be computed as the difference between the buyback consideration and the cost of acquisition, and may be taxable as long-term or short-term capital gains depending on the period for which the shares were held.

The characterization question in this scenario produces a notable divergence of interest between resident and non-resident shareholders. A resident shareholder will generally prefer that buyback proceeds received from the foreign company are treated as capital gains, since the applicable long-term capital gains rate of 12.5 per cent (under the Finance Act, 2026 framework) is substantially lower than the maximum marginal slab rates that could apply if the same amount were treated as dividend income.

InvestorCo, as a non-resident shareholder holding shares in a foreign company that derives substantial value from Indian assets, may by contrast prefer the dividend characterization, given India's lack of taxing rights on dividends distributed by a foreign company under the DTAA. If, however, the same proceeds are characterized as capital gains, the indirect transfer provisions would squarely apply to the extent HoldCo's shares derive more than 50 per cent of their fair value from Indian assets, and InvestorCo would be subject to capital gains tax in India, as no benefit is available under the India-US Tax Treaty in this regard. This competing classification of the same economic receipt underscores the stakes involved: the same transaction can possibly give rise to full exemption in India (if treated as a dividend by a foreign company) or to a substantial tax liability (if treated as a capital gain subject to the indirect transfer provisions), depending entirely on how it is characterized.

Several practical consequences flow from this characterization. HoldCo, as the entity making the payout, may be required to withhold capital gains tax at the applicable rate.

B. Scenario II: Distribution of Indian Company Shares by US company to its Parent

Consider a US company, **"USCo"** which holds shares in an Indian private limited company, **"OpCo India."** USCo's parent is **"ParentCo"**, also a US corporation. USCo proposes to distribute the shares of OpCo India to ParentCo in accordance with US law. The question is whether this transaction triggers Indian capital gains tax in the hands of USCo and, if so, whether USCo is obligated to withhold such tax or whether the transaction will be classified as dividend distributed to ParentCo.

As such, there could be two competing classifications. The transaction could be regarded as a transfer of Indian shares triggering capital gains tax liability in India.

The transaction may be characterized as a transfer of OpCo India shares by USCo to ParentCo. This is straightforward: the transfer is subject to capital gains tax under Indian income tax laws, and ParentCo must withhold tax. For the purposes of computing capital gains, the consideration can be deemed to be the higher of (i) fair value under Indian transfer pricing regulations and (ii) the Tax Fair Market Value (**"Tax FMV"**) under Indian tax rules (broadly, OpCo India's net asset value adjusted for stamp duty value of immoveable properties and fair value of investments).

Alternatively, the transaction may be characterized as a dividend in kind by USCo to ParentCo, satisfied by distribution of OpCo India shares. This construct is more nuanced:

Indian companies are not permitted to pay dividends in specie except on liquidation, leaving no direct domestic precedent for such a distribution by a foreign entity. However, the definition of dividend under Indian domestic tax law recognizes in-specie distributions as dividends to the extent of accumulated profits of the distributing company. However, if a view is taken that the transaction is more akin to a dividend distribution, it may be possible to take a view that the in-specie distribution of shares not be subject to tax under Article 10 of the India-US DTAA, given that India's withholding rights is limited to distribution of dividend by an Indian Company under the said Treaty. Even then, capital gains tax could arise in USCo's hands because there is an undeniable transfer of shares of an Indian company. The contentious question is the computation of consideration in such case. USCo could argue that no consideration has been received (since it is simply distributing assets to its member) and that the Tax FMV and transfer pricing rules cannot be invoked. The characterization of the transaction and its accounting treatment under US corporate and tax laws would be pivotal to the tax analysis.

(IV) Conclusion

The two scenarios discussed above highlight a number of recurring structural issues that non-resident investors must navigate when planning cross-border payouts from Indian operations.

First, the characterization of income is the single most consequential variable. Whether a payout is treated as a dividend, deemed dividend, capital gain, or other income under domestic law and the applicable treaty will determine not only the rate of Indian withholding but also the availability and quantum of the foreign tax credit in the investor's home jurisdiction. Mischaracterization can lead to either double taxation or double non-taxation, both of which carry legal and reputational risks.

Second, the indirect transfer provisions under the Indian income tax laws cast a wide net. Any transfer of shares in a foreign company that derives more than 50 per cent of its fair value from Indian assets is within the charge of Indian tax. Investors holding shares in layered structures must therefore consider the Indian tax consequences of any corporate action at the foreign holding company level, including buybacks, capital reductions, and distributions in specie.

Third, the withholding tax obligations in cross-border payouts are onerous. The payer (whether an Indian or foreign company) is typically required to withhold tax at the applicable rate, failing which it may be treated as an "assessee in default" and held liable for the tax, interest, and penalties.

Fourth, the rapid pace of legislative change in this area, with three distinct buyback tax regimes in the space of three years, underscores the importance of structuring payouts with flexibility. Investors and their advisers should build optionality into shareholder agreements and corporate governance frameworks so that the chosen method of cash repatriation (dividend, buyback, capital reduction, or otherwise) can be adjusted in response to evolving tax rules.

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COMPANY PAYOUTS TO SHAREHOLDERS: A MULTI-REGULATORY ANALYSIS OF IMPLICATIONS UNDER FEMA, VALUATION CONSIDERATIONS, STAMP DUTY IMPLICATIONS, ETC.





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Overview

Company payouts to shareholders are a key aspect of corporate finance, enabling distribution of profits or capital while also serving broader objectives such as investor exit, balance sheet optimisation and group restructuring. This article analyses four primary payout mechanisms – dividend, buy-back, capital reduction and liquidation – from a multi-regulatory perspective, focusing on FEMA implications, valuation requirements and stamp duty considerations.

Dividend is the simplest and least regulated route, treated as a current account transaction under FEMA, with no pricing or valuation requirements and minimal compliance burden. In contrast, buy-back, capital reduction and liquidation are regarded as capital account transactions and attract stricter FEMA regulations, including pricing guidelines, reporting obligations and repatriation conditions, particularly for foreign investors.

Buy-back emerges as a widely used tool for structured exits and capital restructuring, albeit with higher compliance requirements. Capital reduction offers flexibility for selective restructuring but involves procedural complexity due to approval from the National Company Law Tribunal. Liquidation, governed inter alia by the Insolvency and Bankruptcy Code, 2016, represents a terminal process for complete exit.

The article highlights that an optimal payout strategy must balance regulatory compliance, valuation robustness and stamp duty efficiency alongside commercial objectives.

1. Introduction

Company payouts to shareholders represent a critical aspect of corporate finance, enabling distribution of accumulated profits or capital. In modern corporate structuring, shareholder payouts are increasingly being designed with multifaceted objectives—cash extraction, balance sheet optimization, exit facilitation or restructuring. While tax efficiency remains important, regulatory compliance under foreign exchange laws (in case of cross border transactions), robustness of valuation and incidence of stamp duty play a decisive role in determining the feasibility of a payout mechanism.



This article examines these non-tax dimensions across major payout mechanisms such as dividends, buybacks, capital reduction and liquidation proceeds.

2. Pay-out in the form of Dividend

A. Concept

Dividend represents distribution of a company's profits to its shareholders in proportion to their shareholding. It is one of the most common form of payouts used by companies to distribute profits. It serves as a return on investment and indicates that the company has generated sufficient distributable surplus. Under the Companies Act, 2013, the term 'dividend' is not exhaustively defined. However, it is generally understood (as per Section 2(35) of the Companies Act, 2013) to include both interim dividend (the dividend that is declared by the Board of Directors during the financial year) and final dividend (the dividend that is declared by shareholders at the Annual General Meeting).

Dividend declaration and payment are primarily governed by sections 123 to 125 of the Companies Act, 2013 read with relevant rules under the Companies (Declaration and Payment of Dividend) Rules, 2014. These provisions collectively regulate source, manner, timing and conditions of dividend distribution.

B. FEMA considerations

Dividend payments to foreign shareholders represent one of the least restrictive modes of repatriation under FEMA, being classified as current account transactions and generally free from pricing and approval constraints.

- **Inbound Investments**

Dividend payments to non-resident shareholders by Indian companies are governed by the Current Account Transaction framework under the Foreign Exchange Management Act, 1999 (FEMA).

FEMA does not prescribe a specific time limit for remittance of dividend. However, practically the company must comply with Section 127 of the Companies Act, 2013, which requires payment within 30 days of declaration.

The key regulations applicable are:

- Foreign Exchange Management (Current Account Transactions) Rules, 2000
- Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. ('NDI Rules')
- RBI Master Directions on Foreign Investment in India.

Dividend is treated as a current account transaction (i.e repatriation of income), unlike buyback or capital reduction, which are capital account transactions. Being a current account transaction, dividend payments are generally freely permitted under FEMA, subject to compliance with applicable conditions.

Indian companies are permitted to remit dividends to foreign shareholders subject to:

- The investment being compliant with FDI/NDI regulations (sectoral caps, entry route, etc.).
- Shares on which dividend is paid must have been validly issued under FEMA.
- Dividend must be declared and paid in accordance with the Companies Act, 2013.

FEMA does not prescribe a specific time limit for remittance of dividend. However, practically the company must comply with Section 127 of the Companies Act, 2013, which requires payment within 30 days of declaration. Authorized Dealer (AD) banks ensure that remittance is made promptly upon declaration and documentation. The Indian company declaring dividend must ensure that the sum is deposited in a separate bank account within 5 days of declaration.

Similarly, no pricing guidelines apply to dividend payouts, unlike capital account transactions. This is a key distinction from other company payouts such as buyback, capital reduction, share transfers. However, the quantum of dividend which can be declared by a company is subject to the conditions provided under the Companies Act, 2013. For instance, under the said Act, availability of profits is a pre-condition for declaration of dividend. Dividend can primarily be declared only out of:

1. Current year profits, after providing for depreciation; or
2. Accumulated profits (free reserves); or
3. A combination of both.

Dividend cannot be paid out of capital, except in specific situations permitted by law (e.g., as per prescribed rules in case of inadequacy of profits).

AD banks typically require:

- Board/shareholder resolution
- Auditor's certificate confirming compliance
- Form 15CA/15CB (tax compliance)

No specific RBI reporting (such as Form FC-GPR or Form FC-TRS) is required for

dividend remittance. However, AD bank filings and documentation are mandatory and in case of delays or irregularities, scrutiny may arise.

- **Outbound Investments**

Receipt of dividend from overseas investments by a person resident in India (PRII) is governed by:

- Foreign Exchange Management (Current Account Transactions) Rules, 2000,
- Foreign Exchange Management (Overseas Investment) Rules, 2022 ('OI Rules'),
- Foreign Exchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations), and
- RBI Master Directions on Overseas Investment.

Buybacks are also used to offset dilution caused by Employee Stock Option Plans (ESOPs).

Similar to the case of inbound investment, dividend received from a foreign entity by a PRII is treated as a current account transaction (income receipt).

Such income is freely receivable in India provided the investment is a bona fide and FEMA compliant investment i.e. in compliance with OI framework. Receipt of dividend by PRII may be subject to repatriation requirements depending upon whether it is received in respect of ODI (Overseas Direct Investment) or a LRS (Liberalised Remittance Scheme)/OPI (Overseas Portfolio Investment) investment.

Buy-back of shares is a corporate action in which a company uses its own cash reserves to repurchase its outstanding shares from existing shareholders.

- As per Para 9(4) of OI Regulations, where the investment is in the nature of ODI, the PRII is required to realise and repatriate to India all dues receivable from the foreign entity with respect to investment in such foreign entity (which includes even the dividend declared by the foreign entity) within 90 days from the date when such receivables fall due.
- In case of OPI/LRS investments which are not ODI, PRII is allowed to reinvest the dividend proceeds outside India for permissible purposes/investments. However, where such proceeds are not reinvested within the time specified for realisation and repatriation as per Notification No. FEMA 9(R)/2015-RB namely, Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015, the same should necessarily be repatriated to India within the given time limits on the said Regulation.

C. Needless to add, dividend payouts do not trigger any stamp duty implications.

3. Pay-out in the form of Buyback of Shares

A. Concept

Buy-back of shares is a corporate action in which a company uses its own cash reserves to repurchase its outstanding shares from existing shareholders. This form of payout is primarily used by companies to return surplus cash to shareholders coupled with optimization of company's equity. It is commonly initiated when management

believes that the company's shares are undervalued and when there are limited profitable investment opportunities available. A buyback reduces the number of outstanding shares, which in turn improves key financial metrics such as Earnings Per Share (EPS), Return on Equity (ROE), and Return on Assets (ROA), thereby making the company appear more profitable. Buybacks are also used to offset dilution caused by Employee Stock Option Plans (ESOPs). Since ESOPs increase the number of shares and dilute ownership, buybacks help neutralize this effect by maintaining a stable share count. On the other hand, in case of unlisted companies, buy-back is a common method adopted by companies to provide exit to employees who hold shares as a part of their ESOP plans.

Additionally, a buyback can serve as an exit mechanism, providing liquidity to shareholders, particularly early investors, founders or employees, without requiring a full acquisition or an Initial Public Offering (IPO). It enables investors to realize returns while allowing promoters or founders to consolidate their ownership and control in the company. For instance, in the year 2025, Infosys Ltd. undertook a buyback through the tender offer route, which enabled shareholders to tender their shares directly to the company.

The buy-back is governed primarily under:

- Companies Act, 2013 (Sections 68 to 70)
- SEBI (Buy-back of Securities) Regulations, 2018 (for listed companies); and
- Foreign Exchange Management Act, 1999 (for non-resident shareholders)

Under the Companies Act, 2013, a company may purchase its own shares or other specified securities out of –

1. free reserves; or
2. Securities premium account; or
3. The proceeds of any shares or other specified securities

Basic conditions for buy-back are as follows:

1. The buy-back must be authorised by the Articles of Association of the company.
2. The buy-back must be approved by way of a special resolution. However, where the buy-back does not exceed 10% of the total paid-up equity capital and free reserves, approval by the Board of Directors shall be sufficient.
3. The buy-back shall not exceed 25% of the aggregate of the paid-up capital and free reserves of the company.
4. Post buy-back, the ratio of the aggregate of secured and unsecured debts owed by the company shall not exceed twice the paid-up capital and free reserves.
5. All shares or other specified securities proposed to be bought back must be fully paid-up.
6. No offer of buy-back shall be made within a period of one year from the date of closure of the preceding buy-back offer, if any.

Recently, on March 23, 2026, the Government has introduced the Corporate Laws

The Bill proposes to allow up to two buy-back offers per year with a mandatory six-month gap between closure of the two offers for buy-back for certain classes of companies.

(Amendment) Bill 2026 in Lok Sabha proposing amendments to certain provisions of the Companies Act, 2013, including Section 68 dealing with buy-back. The Bill proposes to allow up to two buy-back offers per year with a mandatory six-month gap between closure of the two offers for buy-back for certain classes of companies. Further, also proposes to relax the 25% limit applicable in case of buy-backs. However, the Bill is currently at a draft stage.

The Company law does not explicitly require valuation of shares for buy-back. However, the basis of arriving at the buy-back price needs to be mentioned in the explanatory statement annexed to the notice issued for the buy-back. Hence, as best practice, unlisted companies generally obtain a valuation report from registered valuers for determining the buy-back price.

In case of listed shares, the pricing for buy-back is dependent upon the manner of buy-back i.e. whether the same is under Tender offer route or under Open Market through Book Building process. In former case, the Company fixes the buy-back price practically through a valuation report to justify the buy-back price. On the other hand, in case of book building process, there is no fixed price and the same is market driven which is determined in accordance with Regulation 22B of SEBI (Buy-back of Securities) Regulations. The said buy-back is undertaken at prevailing market price subject to maximum buy-back price determined by the company.

B. FEMA considerations

Under FEMA, buy-back transactions are considered akin to transfer of capital instruments and therefore, the regular conditions applicable to such capital account transactions under FEMA apply to such buy-back transactions.

- **Inbound Investments**

Buy-back by an Indian company from foreign shareholders is governed by

- NDI Rules;
- Relevant RBI Master Directions on Foreign Investment in India;
- Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 ('NDI Reporting Regulations')

Under FEMA, such buy-back from foreign shareholders is treated as a transfer of capital instruments from a Person Resident Outside India ('PROI') to PRII (the company buying back shares). Hence, the requirements for such transfer pertaining to pricing, reporting, sectoral compliance etc. shall apply to such buy-back. The requirements would further differ depending upon whether the Indian shares are held by the PROI on repatriable or non-repatriable basis.

Under FEMA, a repatriable investment in Indian company by PROI is regarded as a foreign investment, whereas in case of non-repatriable investments, the same is regarded as akin to domestic investments as the proceeds from said investments cannot be freely repatriated outside India. Accordingly, the restrictions and compliance requirements which are generally applicable to repatriable investments do not apply to non-repatriable investments. The same with the perspective of transfer of shares of Indian company is summarised in the following Table:

Particulars	*Repatriable Investment (FDI)*	*Non-Repatriable Investment (NRI/OCI)*
Legal Character	Foreign investment (FDI)	Treated as domestic investment
Governing law	NDI Rules	Sch IV of NDI Rules
Repatriation of Capital & Gains	Freely repatriable (subject to taxes)	Not freely repatriable (restricted)
Pricing at the time of Transfer / Exit (incl. buy-back)	Price ≤ FMV mandatory	No FEMA pricing restriction
Valuation Requirement	Mandatory	Not required under FEMA
Reporting – Transfer of Shares	Form FC-TRS (within 60 days)	Not required
Remittance of Sale/Buy-back Proceeds	Freely remittable outside India	Restricted (generally up to USD 1 million/year with conditions)
Compliance Burden	High (pricing + reporting + sectoral conditions)	Low (minimal FEMA compliance)
Regulatory Objective	Capital account regulation & forex control	Ease for NRI domestic participation
Typical investors	PE/VC funds, foreign investors	NRIs/OCIs for long-term / family investments

Under Rule 21 of the NDI Rules, in case of repatriable investments in listed Indian company, the buy-back price should not exceed the price worked out in accordance with the relevant SEBI guidelines in case of a listed Indian company. In case of unlisted Indian company, the buy-back price shall not exceed the price determined as per valuation done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with the SEBI or a practising Cost Accountant, in case of an unlisted Indian company. Further, buy-back from foreign shareholders needs to be reported by filing Form FC-TRS within sixty days of transfer of equity instruments or receipt/remittance of funds whichever is earlier. Such form would be filed by the PROI where the transfer occurs on the recognised stock exchange and in other cases, by the Indian company buying back the shares (Regulation 4 of NDI Reporting Regulations). Further, the proceeds received by non-resident shareholders are generally freely repatriable (in case of repatriable investments), subject to payment of applicable taxes and submission of requisite documentation (such as auditor's certificate and no-objection/clearance, if required).

These pricing and reporting guidelines shall not be applicable for investment in equity instruments by a PROI on a non-repatriation basis. The proceeds are subject to repatriation restrictions (typically up to USD 1 million

per financial year under general permission, subject to conditions) and the transaction is otherwise treated akin to domestic transactions, resulting in relatively lower compliance requirements.

- **Outbound Investment**

In case of outbound investment, where shares are tendered by a PRII on buy-back by foreign company, the same would be regarded as disinvestment of overseas investment by PRII and accordingly, the normal rules with respect to disinvestment under OI framework shall apply even on buy-back.

Hence, the PRII tendering shares under a buy-back by foreign company should ensure that such transfer is in accordance with Rule 17 of the OI Rules and related regulations and directions. For instance,

- The investment being transferred should be held by PRII in compliance with FEMA (Rule 17(1) and (5) of the OI Rules)

- In case the transfer is on account of buyback of foreign securities, such transfer should have the approval of the competent authority as per the applicable laws in India or the laws of the host country or host jurisdiction, as the case may be. (Rule 17(3) of the OI Rules)

- Further, where such investment is in form of ODI, and it results in full disinvestment, the PRII should have any dues outstanding for receipt, which such PRII is entitled to receive from the foreign entity as an investor in equity capital and debt. The said dues does not include trade debts. (Rule 17(4)(i) of the OI Rules read with Para 13 of OI Direction).

- Further, the PRII should have stayed invested for at least one year from the date of making ODI before such transfer can take place. (Rule 17(4)(ii) of the OI Rules).

- If PRII has an account appearing as a non-performing asset or is classified as a wilful defaulter by any bank or is under investigation by a financial service regulator or by investigative agencies in India, before undertaking disinvestment, such person needs to obtain a No Objection Certificate from the lender bank or regulatory body or investigative agency, as the case may be (Rule 10 of OI Rules and Para 6 of OI Directions).

- Such transfer should adhere to pricing guidelines, documentation and reporting requirements (Rule 17(1) of the OI Rules); i.e.

  – The disinvestment needs to be reported by the PRII within 30 days of receipt of disinvestment proceeds in Form FC (Section G). Where the disinvestment proceeds are received in tranches in accordance with the agreement, each such receipt shall be reported in Form FC. In case of OPI, a PRII (other than resident individual) needs to report such transfer in form OPI within 60 days from the end of the half-year in which such investment or transfer is made as of September or March-end. (Regulation 10 of OI Regulations read with Master

Direction on Reporting under FEMA)

– In case of ODI, the disinvestment proceeds (including buy-back proceeds) should be realised and repatriated to India within 90 days from the date of disinvestment. (Regulation 9(4) of OI Regulations). In case of OPI/ LRS investments which are not ODI, PRII is allowed to reinvest the disinvestment proceeds outside India for permissible purposes/ investments. However, where such proceeds are not reinvested within the time specified for realisation and repatriation as per Notification No. FEMA 9(R)/2015-RB namely, Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015, the same should necessarily be repatriated to India within the given time limits on the said Regulation.

– On buy-back, the buy-back price needs to be arrived at on arm's length basis. The AD bank, before facilitating a transaction shall ensure compliance with arm's length pricing taking into consideration the valuation as per any internationally accepted pricing methodology for valuation. The logic is that the price received by the PRII should not be less than the arm's length price. (Rule 16 of OI Rules read with Para 12 of OI Direction)

– Further, the AD Banker shall also require documentation to demonstrate compliance with the foregoing FEMA requirements. The types of documents to be submitted shall be decided by the AD Bank which shall be guided by their board approved policy. Where the buy-back results in write-off, further documents would need to be submitted to justify such write-off (Para 12 of OI Direction).

C. Stamp Duty on Buy-back

- Stamp duty on buy-back transactions is governed by the Indian Stamp Act, 1899, as amended by the Finance Act, 2019. The overarching principle is that the incidence of stamp duty depends on the mode through which the buy-back is undertaken, rather than the mere fact of buy-back itself. Broadly, where the transaction is regarded as a transfer of shares, stamp duty is attracted at a uniform rate of 0.015% (Article 56A of Schedule I to Indian Stamp Act, 1899).

- In the case of a buy-back through the stock exchange, the transaction is treated akin to a secondary market transfer. Accordingly, stamp duty is levied at 0.015% on the transfer of shares and is collected by the stock exchange or clearing corporation. The rate is uniform across India pursuant to the centralized mechanism introduced by the 2019 amendments. Importantly, the duty is imposed on the act of transfer of shares and not on their subsequent extinguishment by the company.

- Greater complexity arises in the context of buy-back by unlisted companies (off-market transactions). Under a conservative view, a buy-

back is regarded as a transfer of shares by the shareholder to the company, thereby attracting stamp duty at 0.015% on the consideration, in accordance with applicable stamp provisions. However, an alternative and evolving jurisprudential view posits that a buy-back results in the extinguishment of shares rather than their transfer, and therefore should not attract stamp duty. Notwithstanding this divergence in legal interpretation, in practice, many taxpayers and practitioners continue to discharge stamp duty at the aforesaid rate as a precautionary measure to mitigate potential litigation exposure.

4. Pay out in the form of Capital Reduction

A. Concept

Capital reduction is a corporate action whereby a company reduces its share capital. This typically involves extinguishment or cancellation of shares, reduction of share capital coupled with either repayment of capital to shareholders or set-off of accumulated losses/fictitious assets. Companies undertake this form of payout to restructure their balance sheet, remove accumulated losses, write-off fictitious assets or return surplus cash to shareholders. This form of payout is also used by the companies to streamline their capital structure post mergers, acquisitions or significant changes in business direction. Similar to buyback, it also reduces the number of outstanding shares, which in turn improves key financial metrics like EPS, etc. and make the company appear more profitable. Unlike buy back, it is a court/tribunal driven process requiring detailed filings, notices and approvals, making it relatively time-consuming but more flexible in scope. For instance, it is not subject to the quantitative limits (i.e. 25% cap) applicable to buy-back. Further, recently, the Hon'ble Supreme Court has affirmed in the case of ***Pannalal Bhansali vs. Bharti Telecom Ltd. [2026] 184 taxmann.com 177 (SC)[10-03-2026]*** has conclusively upheld validity of selective capital reduction. It held that where reduction of share capital involving cancellation of minority shares was approved by Board and requisite shareholder majority, with no opposition from creditors, and with disclosed valuation basis and all affected shareholders had means and opportunity to make an informed decision, such reduction met statutory requirements and involved no oppression or irregularity.

Capital reduction is governed primarily under:

- Companies Act, 2013 (Section 66);
- National Company Law Tribunal (procedural oversight and approval); and
- Foreign Exchange Management Act, 1999 (in case of non-resident shareholders)

Under the Companies Act, 2013, capital reduction may be effected in the following manner:

1. Extinguishment or reduction of liability on shares; or
2. Cancellation of paid-up share capital which is lost or unrepresented by available assets; or
3. Payment to shareholders of any paid-up share capital in excess of the company's requirements

Basic conditions for capital reduction are as follows:

1. The reduction of share capital must be authorised by the Articles of Association of the company.

2. The company must pass a special resolution approving the capital reduction.

3. The reduction must be confirmed by the National Company Law Tribunal (NCLT).

4. The company must give notice to creditors, the Central Government, Registrar of Companies and in case of listed companies, SEBI.

5. The Tribunal must be satisfied that the interests of creditors are adequately protected or that their consent has been obtained.

6. The accounting treatment proposed for such reduction must be in conformity with applicable accounting standards and certified by the statutory auditor.

Company law does not prescribe a specific methodology for valuation in case of capital reduction. However, since the transaction typically involves payout to shareholders, the company is required to justify the consideration being paid. Accordingly, as a matter of best practice, companies (especially unlisted companies) obtain a valuation report from a registered valuer to support the fairness of the reduction price. In case of listed companies, SEBI may require additional disclosures and fairness opinions depending on the structure of the transaction.

B. FEMA Considerations

Both NDI Rules and OI Framework do not specifically deal the compliance requirements applicable in case of capital reduction. However, essentially on capital reduction, there is a cancellation of shares which is akin to transfer/disinvestment under court-route[1]. Accordingly, the same requirements pertaining to pricing, reporting, sectoral compliance etc. for such transfer/disinvestment of shares as applicable in case of buy-back as discussed above shall apply even in case of capital reduction. Therefore, in case of inbound investments, the requirements of pricing, reporting, repatriation, etc. shall need to be determined depending upon whether the investment is repatriable or non-repatriable. Further, in case of outbound investment, on capital reduction, PRII should ensure that such transfer is in accordance with Rule 17 of the OI Rules and related regulations and directions as discussed above in buy-back section.

C. Stamp Duty on Capital Reduction

In case of shares/securities, generally stamp duty is governed by the Indian Stamp Act, 1899, Article 56A to Schedule I. Said Article deals with issue and transfer of securities. Unlike buy-back, capital reduction is generally

1. *Refer NCLT, Kolkata Bench order in case of Company Petition No. 14 of 2022 dealing with capital reduction scheme involving foreign shareholders.*

regarded as extinguishment of shares rather than transfer. Hence, the said Article of the Indian Stamp Act should not apply in case of simple capital reduction.

Further, even under the state stamp laws, typically there is no article in the schedule to state stamp laws specifically providing for stamp duty in case of capital reduction. For instance, in the context of Bombay Stamp Law, there are several NCLT orders wherein it is provided that in absence of any specific provision, no stamp duty is leviable in case of capital reduction[2]. Hence, generally no stamp duty should apply in case of capital reduction. However, given the evolving nature of jurisprudence and the fact-specific character of capital reduction structures, stamp duty exposure should be evaluated on a case-by-case basis.

5. Pay out in the form of Liquidation

A. Concept

Liquidation is the process of winding up a company's affairs, whereby its assets are realized, liabilities are discharged and the surplus, if any, is distributed to shareholders. Once this process is completed, the company is dissolved and no longer exists as a legal entity. Companies usually undergo liquidation when continuing the business is no longer practical. This may happen if the business is not profitable, if investors want to exit after a certain period (as in private equity or venture capital investments), if the company is inactive or no longer required, or if it is unable to meet its financial obligations.

Liquidation is a terminal process, unlike buy-back or capital reduction and results in complete closure of the entity.

Under the Companies Act, 2013, a company can be majorly liquidated in following three ways:

1. Voluntary liquidation (initiated by shareholders), which is done voluntarily by the shareholders when they decide that the company is no longer needed or has completed its purpose; or

2. Compulsory liquidation, which is done compulsorily by an order of the Tribunal, usually when the company is unable to pay its debts or there are serious issues in its functioning; or

3. Liquidation through the Insolvency and Bankruptcy Code (IBC), where a company is first taken through an insolvency resolution process and if no solution is found, it is ultimately liquidated.

Liquidation is a terminal process, unlike buy-back or capital reduction and results in complete closure of the entity. It is typically more time-consuming and compliance-intensive, particularly in cases involving multiple stakeholders or insolvency proceedings. For this reason, liquidation is generally seen as a last step, taken only when there are no better alternatives available.

2. *See for instance NCLT Mumbai order in CSA No. 108 of 2017*

It is governed primarily under:

- Companies Act, 2013 (Sections 270 to 365 – winding up provisions);
- Insolvency and Bankruptcy Code, 2016 (IBC) (for insolvency-driven liquidation); and
- Foreign Exchange Management Act, 1999 (in case of non-resident shareholders)

Basic conditions/key aspects of liquidation are as follows:

1. The company must pass a special resolution (in case of voluntary liquidation) and appoint a liquidator.
2. A declaration of solvency is required in case of voluntary liquidation (where applicable).
3. The liquidator is responsible for realisation of assets, settlement of claims and distribution of proceeds.
4. The proceeds are distributed in accordance with the statutory waterfall (priority of payments), with creditors being paid before shareholders.
5. Surplus, if any, is distributed to shareholders in proportion to their rights and shareholding.
6. The process culminates in dissolution of the company upon approval by the relevant authority.

There is no specific requirement for valuation of shares at the stage of liquidation under Company Law. However, under IBC code, valuation report from registered valuer is required under various provisions depending upon the type of liquidation. For instance, in case of voluntary liquidation, section 59 of IBC requires that the majority of directors of the company must submit a declaration that it shall be able to pay its debits in full from the proceeds of assets to be sold and such declaration should be accompanied with a report of the valuations of assets of the company prepared by registered valuer. Similarly in case of corporate insolvency resolution process, the valuation requirements under Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 needs to be followed.

B. FEMA considerations

Similar to buy-back and capital reduction, even in case of liquidation, the investment of the shareholders in the company stands cancelled which would be regarded as a case of transfer/disinvestment under FEMA. Hence, the regular requirements for such transfer pertaining to pricing, reporting, sectoral compliance etc. as applicable in case of buy-back, as discussed above shall apply even in case of liquidation of inbound investments. Needless to add, liquidation shall always result in full disinvestment and accordingly, the filing shall happen accordingly.

Similarly, the conditions as discussed above in buy-back section shall apply even in case of liquidation of outbound investment. However, it may be noted that the requirement of Rule 17(4)(i) of the OI Rules does not apply in case of liquidation i.e. the requirement that there should not be any dues outstanding in respect of the equity capital or debt at the time of disinvestment does not apply in case of liquidation.

C. Stamp Duty on Liquidation

As a general principle, distribution of assets to shareholders upon liquidation is not regarded as a transfer of shares, but rather as a distribution of residual assets to shareholders on dissolution. Accordingly, no stamp duty is typically payable on cash distribution. However, if the distribution is undertaken in kind, the same could be regarded as a case of conveyance and accordingly, stamp duty can apply accordingly depending upon the local stamp laws. Further, in case of liquidation, since all the affairs of a company are wound up which may involving settling of debts of debtors and creditors through composition deeds or transfer of assets, such steps prior to liquidation may also attract stamp duty. Hence, stamp duty may arise in certain situations, such as:

- Transfer of specific assets (e.g., immovable property) by the company to shareholders, which may attract stamp duty as per applicable state laws;
- Execution of instruments (e.g., conveyance deeds) to give effect to distribution of assets

In such cases, stamp duty would be levied based on the nature of the asset and the instrument executed, rather than on the liquidation per se.

Given the transaction-specific nuances, stamp duty exposure in liquidation scenarios should be evaluated based on the manner of distribution and nature of underlying assets.

6. Conclusion

There is no one-size-fits-all approach to shareholder payouts. Each mechanism carries a distinct regulatory footprint across Company law, FEMA, valuation and stamp duty.

- Dividend is ideal for routine, compliant profit distribution.
- Buy-back is optimal for structured exits and capital realignment.
- Capital reduction is suited for complex restructuring scenarios involving NCLT route.
- Liquidation is reserved for final exit and closure situations.

In practice, companies often evaluate these options in tandem, balancing commercial objectives with regulatory feasibility. A well-designed payout strategy must therefore integrate legal permissibility, FEMA compliance, valuation robustness and stamp duty efficiency to achieve optimal outcomes. ■

BONUS DEBENTURES AND PREFERENCE SHARES TO SHAREHOLDERS





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Overview

Bonus debentures and redeemable preference shares are increasingly being seen as an attractive option for companies looking to reward their shareholders while also retaining flexibility. This article covers the underlying commercial/corporate rationale behind the need for such instruments while highlighting important considerations from a capital allocation perspective. The authors evaluate certain key income-tax considerations associated with the issuance and redemption of such instruments, along with the interpretational ambiguities that persist. The authors then proceed to briefly touch upon the company law considerations which remain pertinent while considering issuance (sources which can be utilised for such issue) and redemption (creation of reserves for/or at the time of redemption) of such bonus instruments, while also highlighting the need to examine Indian Exchange Control implications in relation to non-resident shareholders of the issuing company. Listed companies or RBI regulated entities contemplating to issue such instruments would need to also separately factor additional considerations from a SEBI, stock exchange regulations and RBI regulations perspective.

I. Commercial rationale

There are moments in a company's life when the board is not asking whether to reward shareholders, but how to do so without disturbing the operating rhythm of the business. A surplus-rich company may have every reason to preserve liquidity for capex, working capital, or strategic flexibility, yet still wish to unlock value sitting in accumulated reserves. In that setting, the familiar dividend cheque begins to look a little blunt. The conversation then shifts to structures that can repackage surplus into instruments with a deferred payoff. **Enter**: bonus preference shares, bonus debentures, and redemption at a premium.

What makes these structures interesting is that they are not designed to create economic value out of thin air. They are designed to re-channel existing value. A well-structured bonus issue can preserve the company's cash, avoid an immediate drain on the balance sheet, and still give shareholders a monetizable claim.

For the company, the attraction lies in timing: value is distributed now, cash may go out later. For shareholders, the attraction lies in

optionality: they may hold the instrument to redemption or transfer it if the market permits. For the tax lawyer, the appeal is subtler still: the character of the receipt may change depending on whether the value is carved out as a debenture, a preference share, a redemption premium, or a secondary-market sale.

II. Taxation at the time of issue: why bonus debentures and bonus redeemable preference shares ("RPS") are not the same

While section 2(40) of the Income-tax Act, 2025 (**"ITA 2025"**) (section 2(22) of the Income-tax Act, 1961 (**"ITA 1961"**)) contains several limbs expanding the scope of "dividend", for the purposes of the present discussion, **clauses (a) and (b) are of primary relevance**. These provisions, in essence, provide as follows:

Clause (a) treats as dividend **any distribution by a company of its accumulated profits, whether capitalised or not, if such distribution entails the release of all or any part of the company's assets to its shareholders**. The emphasis here is on the **release of assets**: the provision is concerned not merely with formal declarations of dividend, but with any transaction through which shareholders are put in possession or enjoyment of the company's economic resources. The inclusion of the phrase "whether capitalised or not" ensures that even where profits are first converted into another form—such as share capital or other instruments—the distribution may still fall within the dividend net if and when it eventually results in a release of the company's assets.

Clause (b) complements this by specifically including within dividend **any distribution by a company to its shareholders of debentures, debenture-stock or deposit certificates (with or without interest), as well as any distribution of shares by way of bonus to preference shareholders**, to the extent such distributions are sourced from accumulated profits. This limb reflects a clear legislative intent to cover non-cash distributions, particularly those structured through financial instruments, so that the character of the distribution is not altered merely by interposing a different legal form.

These two clauses, read together, lay down the core statutory framework for examining the tax implications of bonus debentures and bonus preference shares.

a. Bonus debentures: tax is front-loaded

A bonus debenture issue is the easier case from the revenue's perspective. Section 2(40)(b) of the 2025 Act [section 2(22)(b) of the 1961 Act] specifically treats any distribution by a company to its shareholders of debentures as dividend to the extent of accumulated profits.

Where a company capitalises reserves into bonus debentures, the shareholder is treated as having received dividend income at the moment of issue, not at redemption. In other words, the tax event is not postponed merely because the cash payment is postponed.

A bonus debenture structure may be attractive for the company because it defers cash

Section 2(40)(b) of the 2025 Act [section 2(22)(b) of the 1961 Act] specifically treats any distribution by a company to its shareholders of debentures as dividend to the extent of accumulated profits.

In a typical bonus RPS structure, a company capitalises its accumulated profits and issues redeemable preference shares proportionately to its equity shareholders.

outflow, but it does not defer the shareholder-level tax which is on the allotment itself.

Given that the issuance of bonus debentures itself is deemed to be dividend, a corresponding withholding tax obligation arises at the time of allotment. This gives rise to a practical challenge, particularly in the case of listed companies or companies with a large number of shareholders, as the dividend is being discharged in kind rather than in cash. In such cases, a workable approach is for the company to gross up the dividend amount and issue bonus debentures only to the extent of the net amount after withholding. The portion representing the withholding tax may be treated as a cash dividend, which is directly deposited by the company with the government in discharge of its tax deduction obligations.

b. Bonus RPS: issue is usually not dividend

The position in relation to bonus RPS is more nuanced and turns on a careful reading of the dividend definition. Section 2(40)(b) of the ITA 2025 (section 2(22)(b) of the ITA 1961) brings within the ambit of "dividend" two distinct categories of non-cash distributions—(i) distribution of debentures to shareholders, and (ii) distribution of shares by way of bonus to preference shareholders. The latter limb is specifically targeted at bonus shares issued to *existing preference shareholders*, and not at a situation where preference shares are issued as bonus to equity shareholders.

In a typical bonus RPS structure, a company capitalises its accumulated profits and issues redeemable preference shares proportionately to its equity shareholders. At first glance, this involves a movement of reserves into share capital, much like a conventional bonus issue. The key question, however, is whether this transaction results in a "distribution" of accumulated profits in a manner that releases assets to shareholders, or whether it is merely a reorganisation of the shareholders' existing interest.

On a proportionate allotment, the stronger view is that no dividend arises at the stage of issuance. While there is, in a technical sense, a "distribution" insofar as accumulated profits are capitalised, such distribution does not entail any release of assets from the company to the shareholders. The company's reserves are capitalised, but no asset leaves the corporate balance sheet.

At the same time, it is important to recognise that the accumulated profits of the company at the point of such capitalisation are effectively being "distributed". Accordingly, while no tax event arises at issuance due to the absence of a release of assets, the quantum and character of accumulated profits at that stage assume significance for computing the dividend income at a later stage which may entail the release of assets by the company.

It is also pertinent to highlight that no unintended consequence of section 92(2)(m) of the ITA 2025 (section 56(2)(x) of the ITA 1961) should be attracted. This is because the shareholder does not receive anything over and above what is already embedded in their equity holding. There is no extraction of value from the company into the shareholder's hands; rather, there is a reclassification of the same economic interest—from a residual

equity claim into a partly fixed, redeemable preference entitlement. In substance, the shareholder's interest is "sliced differently", not enlarged.

The contrast with bonus debentures is instructive. In the case of debentures, the statute expressly deems the **very act of distribution** to be a dividend, irrespective of whether cash is paid. In the case of bonus RPS, there is no such explicit deeming fiction for issuance to equity shareholders, and the analysis therefore falls back on general principles of "distribution" and "receipt" — both of which are difficult to satisfy in a proportionate allotment.

That said, the absence of tax at the point of issue does not render the structure tax-neutral in its entirety. It merely indicates that, unlike bonus debentures, the tax incidence is deferred. The relevant tax event is likely to arise at the stage of redemption or secondary transfer, where the character of the receipt, whether as dividend or capital gain, will need to be examined in light of the specific facts and statutory provisions.

III. The redemption moment: where the real tax question often lies

The most important tax debate in these structures is not always about issue; it is often about redemption. Once the instrument is redeemed, the company is making an actual payout. The question then becomes whether that payout is a dividend, a capital receipt, or capital gains. The answer depends on the instrument's character and the source from which the payout is made.

a. Redemption of bonus RPS: a strong case for dividend characterisation

Unlike bonus debentures, where the statute explicitly front-loads taxation, the tax character of redemption proceeds in a bonus RPS must be determined by applying the general principles embedded in section 2(40) of the ITA 2025 (section 2(22) of the ITA 1961).

Where no fresh capital has been introduced by the shareholder, and the preference share capital itself represents a mere reclassification of accumulated profits, the eventual redemption is, in economic terms, nothing more than a release of those profits back to shareholders.

Judicial guidance has consistently leaned toward a **dividend characterisation** in cases where preference shares have been issued by capitalising accumulated profits and are subsequently redeemed. Where no fresh capital has been introduced by the shareholder, and the preference share capital itself represents a mere reclassification of accumulated profits, the eventual redemption is, in economic terms, nothing more than a release of those profits back to shareholders.

This principle finds support in authorities such as ***Shashibala Navnitlal*** **(Gujarat High Court)**[1] and the ruling in ***Briggs of Burton (India) (P.) Ltd.*** **(AAR)**[1], where it was recognised that redemption of preference shares, particularly those traceable to accumulated profits, can assume the character of dividend.

1. 54 ITR 478

From a statutory perspective, this aligns closely with section 2(40)(a), which treats as dividend any distribution of accumulated profits that entails a release of assets. While the issuance of bonus RPS may not involve such a release, the redemption does. At that point, the company parts with cash or other assets in satisfaction of an instrument that was itself created out of accumulated profits.

Importantly, the accumulated profits relevant for this analysis should be those available at the time of capitalisation (i.e., issuance of the bonus RPS), since it is at that stage that profits are effectively converted into share capital. The subsequent redemption can be viewed as a realisation or release of those very profits in another form.

On this basis, the more robust view is that to the extent the bonus RPS can be traced to accumulated profits at the time of issuance, the amount paid to shareholders on redemption would be taxable as dividend.

That said, the position is not entirely one-dimensional. There exists an alternative line of reasoning — emanating from decisions such as ***Anarkali Sarabhai vs. Commissioner of Income Tax*** **(Supreme Court)**[3] — that redemption of preference shares may constitute a **"transfer" involving extinguishment of rights**, thereby giving rise to **capital gains**. This line of argument, however, is generally more persuasive in cases involving **subscription-funded preference shares**, where the shareholder has invested capital and the redemption represents a return on that investment. In the specific context of bonus RPS, where the instrument itself is a product of capitalised profits, the dividend analysis typically carries greater weight.

Once a portion of the redemption proceeds is characterised and taxed as dividend, it ought not to be brought to tax again as capital gains.

A nuanced situation may arise where the redemption payout exceeds the accumulated profits available with the company at the time of redemption. This can occur, for instance, because under company law, preference shares may be redeemed not only out of profits but also out of securities premium. In such cases, while the portion of the redemption that can be attributed to accumulated profits would retain its dividend character, the excess i.e., the amount not backed by accumulated profits, would need to be evaluated separately.

To this extent, such excess may fall to be taxed under the capital gains regime, particularly if the redemption is viewed as involving an extinguishment of rights in a capital asset. In this context, it is relevant to note that the cost of acquisition of bonus shares (including bonus preference shares) is deemed to be nil under section 90(6) of the ITA 2025 (section 55(2)(aa) of the ITA 1961). Consequently, any portion of the redemption proceeds not taxed as dividend could, in principle, be subject to capital gains tax with a nil cost base.

Finally, it is important to bear in mind that the same receipt cannot be taxed twice under different heads. Once a portion of the redemption proceeds is characterised and

2. *274 ITR 595*
3. *224 ITR 422*

taxed as dividend, it ought not to be brought to tax again as capital gains. This principle, recognised in decisions such as ***Surat Cotton Spg. & Wvg. Mills (P.) Ltd.***[4], serves as an important safeguard in ensuring that the same income is not taxed twice.

Secondary transfer of bonus RPS: capital gains character

Where the holder transfers the bonus RPS to a third party prior to redemption, the transaction is purely an inter se transfer between shareholders. At this stage, there is no release of assets by the company, and therefore the essential condition for dividend under section 2(40) of the ITA 2025 (section 2(22) of the ITA 1961) is not met.

Accordingly, the receipt on such transfer is not in the nature of dividend but is taxable under the capital gains framework.

It is, however, important to note that this characterisation is stage-specific. While the secondary transfer gives rise to capital gains, the instrument itself continues to represent capitalised accumulated profits. Consequently, at the point of redemption, in the hands of the then holder, there would be a release of assets by the company, and the receipt would assume the character of dividend (to the extent of accumulated profits).

b. Redemption of bonus debentures

The dividend character in the case of bonus debentures is front-loaded at the stage of issue under section 2(40)(b) of the ITA 2025 (section 2(22)(b) of the ITA 1961). Consequently, at the time of redemption, the payment is, in substance, a repayment of debt rather than a fresh distribution of accumulated profits.

Accordingly, redemption is generally tested under the capital gains framework. To the extent the debentures are redeemed at face value, no further tax should arise, since the amount has already been subjected to tax as dividend at the time of issuance and would, therefore, be regarded as forming the cost of acquisition of the debenture.

IV. Premium on redemption: separate the company's liability from the holder's tax character

a. Premium on redemption of bonus RPS

As discussed above, at the time of redemption of the bonus RPS, there is an actual release of assets in favour of the shareholder, which triggers the tax event. While the amount received up to the face value may be regarded as distribution of the accumulated profits capitalised at the time of issuance, the treatment of any premium on redemption may not necessarily be governed by Section 2(40) given that it does not represent a "distribution" of accumulated profits or even capitalised accumulated profits.

Accordingly, the taxability of the premium may need to be examined under the capital gains framework. Such premium would form part of the overall consideration received on redemption and not being in the nature of a distribution, ought to be characterised as consideration for transfer rather than as dividend income.

4. *186 ITR 375*

In this regard, the decision of the Supreme Court in *Anarkali Sarabhai (Supra)* is instructive. The Court held that redemption of preference shares is not a mere return of capital but involves a **"sale, exchange or relinquishment"** of a capital asset within the meaning of section 2(47). It was observed that, in order to receive the redemption proceeds, the shareholder necessarily gives up, abandons or surrenders the shares, and such surrender constitutes a relinquishment of rights in the capital asset. The Court further recognised that, in substance, redemption is akin to a company purchasing its own shares, thereby reinforcing the characterisation of the transaction as a transfer.

Applying this principle to the present context, on redemption of the bonus RPS, the shareholder relinquishes the bundle of rights attached to such shares in consideration for the redemption proceeds. To the extent of the premium received, such amount may not be said to represent distribution of the originally capitalised profits and is more appropriately regarded as consideration received on **relinquishment of a capital asset**.

Once characterised as a transfer, the computation provisions assume significance. Given that the RPS have been issued by way of bonus, section 90 of ITA 2025 (section 55(2)(aa) of ITA 1961) would apply, pursuant to which the **cost basis available to the shareholder would be nil**.

Accordingly, the premium received on redemption—being consideration for relinquishment of the shares—would be chargeable to tax as capital gains, with the entire amount of such premium effectively being taxable in the absence of any cost base. However, the lower rate of long-term capital gains would be available where the RPS have been held for more than 12 months (listed) or 24 months (unlisted), as the case may be.

That said, one may also evaluate a potential argument for application of section 2(22)(a) of the ITA 1961 (now section 2(40)(a) of the ITA 2025) to the premium component. This provision is intended to cover situations where a company distributes accumulated profits to shareholders in their capacity as shareholders, typically without any alteration or extinguishment of their underlying shareholding rights. In substance, it targets payments which are in the nature of a return on shareholding rather than consideration for any transfer or extinguishment of rights.

In the present case, however, the redemption of RPS results in the shares themselves ceasing to exist, and the shareholder correspondingly relinquishes all rights attached to such instruments. The payment is therefore intrinsically linked to the extinguishment of the capital asset, rather than being a standalone distribution to shareholders. Further, unlike a dividend—which is ordinarily declared at the discretion of the board as an appropriation of profits—the redemption payment arises from a pre-existing contractual obligation embedded in the terms of issuance of the RPS. In that sense, it bears closer resemblance to a discharge of a financial liability by the company than to a distribution of accumulated profits.

On this reasoning, there may be a defensible position that the premium on redemption should not fall within the ambit of section 2(22)(a)/section 2(40)(a).

b. Premium on redemption of bonus debentures

Similar to bonus RPS, in the case of bonus debentures, because the dividend event is already exhausted at the stage of issue under section 2(40)(b), the redemption, including any premium, must therefore be analysed independently of that earlier characterisation.

The Supreme Court in *Anarkali Sarabhai (Supra)* recognised that redemption of such instruments involves an extinguishment of rights in the capital asset, which constitutes a "transfer" for tax purposes. On that reasoning, the consideration received on redemption, including any premium, is to be analysed under the capital gains framework. Further, in light of section 50AA of ITA 1961 (now section 76 of ITA 2025), gains on redemption of debentures are deemed to be short-term and taxed at the rates applicable to ordinary income. Limited exceptions apply for instruments such as listed debentures (not being market-linked debentures), where the lower long-term capital gains treatment is available, subject to the period of holding being more than 12 months.

For this purpose, it may be argued that the face value of bonus debentures should be regarded as the shareholder's cost base, both because that amount has effectively already been taxed as dividend at the time of issuance and because the instrument is, in substance, issued through a constructive subscription mechanism.

At the outset, it is relevant to note that the scope of section 90 of the ITA 2025 (corresponding to section 55(2)(aa) of the ITA 1961) is sufficiently broadly worded to cover a bonus issue of "debentures" and accordingly deem its cost as nil. On a literal application of this provision, debentures issued without an explicit outflow from the shareholder may be regarded as having no acquisition cost.

However, such a view may not fully capture the economic substance of a bonus debenture issuance structured through a dividend route. In commercial terms, the transaction is not one where the shareholder receives an asset for no consideration. Rather, it is akin to a two-step process: first, a distribution of accumulated profits to the shareholder in the form of a deemed dividend, and second, an immediate application of such funds by the shareholder towards subscription of debentures of the company.

Viewed in this manner, the shareholder is effectively placed in the same position as if cash had been received and contemporaneously reinvested. The debentures, therefore, cannot be said to have been acquired without consideration. Instead, the amount representing the dividend—which has already suffered tax—constitutes the economic cost incurred by the shareholder to acquire the debentures. To disregard this and adopt a nil cost would lead to a distortion whereby the same economic accretion is subjected to tax twice: once as dividend and again as capital gains on transfer of the debentures. This approach also finds judicial support in the decision of the Mumbai ITAT in ***JP Morgan Funds vs. DCIT***[5].

5. *[2022] 140 taxmann.com 210 (Mumbai - Trib.)*

On the company side, such premium should be deductible as a revenue expenditure, albeit with an important timing nuance. The Supreme Court in ***Madras Industrial Investment Corporation vs. Commissioner of Income Tax***[6] recognised that where a liability is incurred upfront but the benefit of the borrowing runs over a number of years, the expenditure may appropriately be spread over the tenure of the instrument. This principle has been applied by the Delhi High Court in ***Commissioner of Income tax vs. Jagatjit Industries***[7] and the Delhi Tribunal in ***ACIT vs. Cleta Real Estate***[8], wherein both proceed on the footing that the liability to pay the premium arises at the time of issuance of the debentures and can be allowed on a proportionate basis over their life.

Section 63 is framed in the context of bonus shares, and hence it is sufficiently broad in practice to accommodate bonus preference shares, provided the instrument otherwise complies with the act.

There are decisions such as ***Raymond Ltd. vs. CIT (Bombay HC)***[9] and ***Nitesh Housing Developers vs. DCIT (Karnataka HC)***[10] where the deduction has been allowed in the year of redemption, but the subject matter in those cases was affirming the allowability of the expenditure itself, rather than conclusively settling the question of timing. On a principled view, given the nature of the instrument and the matching of cost with the period of borrowing, spreading the deduction over the tenure of the debentures remains the more coherent approach.

V. Overview of applicable regulatory framework

The structuring of bonus RPS or debentures is fundamentally anchored in the Companies Act, 2013, and the statutory route chosen has a direct bearing on both feasibility and execution.

At the outset, section 63 specifically governs bonus issues and does, in fact, contemplate shareholder involvement. A bonus issue requires (i) authorisation in the articles, (ii) a recommendation of the board, and (iii) approval of shareholders in general meeting. The statute also clarifies that such capitalisation can be made not only out of free reserves but also out of the securities premium account and capital redemption reserve, subject to prescribed conditions. Section 63 is framed in the context of **bonus shares**, and hence it is sufficiently broad in practice to accommodate bonus preference shares, provided the instrument otherwise complies with the act.

However, section 63 does not extend to debentures. As a result, any structure involving bonus debentures necessarily has to be implemented through the scheme of arrangement route under section 230. This provision is designed as a residuary restructuring mechanism and allows companies to undertake more tailored capital

6. *225 ITR 802*
7. *287 ITR 46*
8. *ITA No. 5312/Del/2019*
9. *482 ITR 400*
10. *454 ITR 770*



reorganisations that fall outside the strict contours of section 63 or any other provision. A scheme under section 230 requires approval by the prescribed majority of shareholders (and creditors, where applicable), followed by sanction of the National Company Law Tribunal, making it a more process-intensive but also more flexible route.

Even for bonus RPS, while a section 63 route is ordinarily available, companies often opt for a section 230 scheme in more complex situations—particularly where there are non-resident shareholders. This is because the scheme route provides a court-approved framework that sits more comfortably within the regulatory expectations under the Foreign Exchange Management Act, 1999 and the debt instrument regulations.

In addition to the mechanics of issuance, the redemption side of the instrument brings into play the requirements relating to creation of a capital redemption reserve ("CRR") and, in the case of debentures, a debenture redemption reserve ("DRR"). Under section 55 of the Companies Act, 2013, where preference shares are redeemed otherwise than out of the proceeds of a fresh issue, an amount equal to the nominal value of the shares redeemed is required to be transferred out of profits to the CRR. This reserve is treated as a notional extension of share capital and is intended to ensure that the company's capital base is not eroded upon redemption.

Similarly, section 71 read with the applicable rules contemplates the creation of a DRR in respect of debentures, as a measure to ring-fence resources for repayment. While the quantum and applicability of DRR have been relaxed for certain classes of companies, the underlying principle remains that a portion of profits may need to be appropriated towards a reserve to secure redemption obligations.

In the context of bonus instruments, however, the application of these requirements throws up an interesting interpretational question. In a typical bonus issuance, there is no inflow of fresh funds; rather, accumulated profits are first capitalised into share capital (or a debt-like instrument) and subsequently, upon redemption, the statutory framework appears to require a further appropriation of profits towards CRR or DRR. This gives rise to a seeming "double charge" on reserves—once at the stage of capitalisation and again at the stage of redemption.

This raises the question whether, on a purposive and substance-based reading, the requirement to create a CRR (or DRR) ought to be relaxed in such cases, given that the company's capital base is already formed out of the company's reserves itself. Whether such an interpretation can be sustained, or whether a literal compliance with the reserve creation requirements remains unavoidable, is an area that merits closer evaluation.

■

SUPREME COURT



Keshav B. Bhujle
Advocate

1 CIT VS. DEUTSCHE BANK A.G. (2026) 494 ITR 47 (SC): 2008 SCC ONLINE SC 2030: DATED 26/08/2008

A. Appeal to Supreme Court — Department could not be permitted to revise question of law other than those referred to High Court — Department not filing appeal against decision of High Court followed by Tribunal to hold in favour of the assessee on ground revenue involved was meagre — Original file not produced to show that Department took conscious decision not to file appeal in the case — Assumption that Department had accepted ratio of the case — Question regarding applicability of S. 44C to be answered against Department and in favour of assessee

B. Banking company — Business expenditure — Salaries and perquisites — Disallowance — Disallowance to be restricted to expenditure apportioned under head "Profits and gains of business and profession" and not applied to expenditure apportioned under head "Interest on securities": Ss. 20(1)(i), 36, 37, 40A(5), 44C and 260A of ITA, 1961: A. Ys. 1982-83 to 1985-86

The assessee is a foreign bank. For the A.Ys. 1982-83 to 1985-86, the assessee claimed deduction of the full amount of head office expenses on the ground that section 44C of the Income-tax Act, 1961 was not applicable as one of the three parameters mentioned in clauses (a), (b) and (c) of section 44C was not attracted. According to the assessee, when one of the three parameters failed, the entire section 44C could not be applied. That, when one of the three parameters failed, the entire computation of deduction would collapse and, therefore, the ceiling on expenditure contemplated by section 44C would not be attracted, and therefore, the assessee was entitled to debit total head office expenditure to the profit and loss account u/s. 37(1) of the Act. This position of the assessee was accepted by the Tribunal.

Thereafter, on a petition filed by the Department, the Tribunal referred the following two questions to the Bombay High Court for its opinion u/s. 256(1) of the Act, said to be arising from the order of the Tribunal:

"1. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that each portion of salary and perquisite as is allowable under the head 'Interest on securities' u/s. 20 of the Act should be reduced from the computation of disallowance u/s. 40A(5) of the Act?

2. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the whole of the head office expenditure of ₹ 21,07,796 is allowable u/s. 37(1) as provisions of section 44C of the Income-tax Act, 1961 are not applicable in the assessee's case ?"

The High Court answered the questions against the Department. [***CIT vs. Deutsche Bank A.G.: (2006) 284 ITR 463 (Bom): 2003 SCC OnLine Bom 1286***]

On appeal to the Supreme Court, the Department sought to raise different questions, not raised before the High Court. The Supreme Court dismissed the appeal filed by the Department and held as under:

"i) The Department cannot be permitted to revise the questions of law other than those that were referred to the High Court. The Court would proceed with the questions which were referred to the High Court.

ii) Insofar as question No. 1 is concerned, this question is concluded against the Revenue and in favour of the assessee by our order dated August 12, 2008, passed in Civil Appeal Nos. 1533 and 1537 of 2006 ***[CIT vs. Citi Bank N.A. (No. 2), (2024) 469 ITR 398 (SC); 2008 SCC OnLine SC 2022.]***.

iii) The Tribunal, after following the decision of the Calcutta High Court in the case of ***Rupenjuli Tea Co. Ltd. vs. CIT [(1990) 186 ITR 301 (Cal); 1989 SCC OnLine Cal 410.]***, held that section 44C was not applicable. Admittedly, the Revenue has not filed any appeal against the decision of the Calcutta High Court in the case of ***Rupenjuli Tea Co. Ltd. vs. CIT [(1990) 186 ITR 301 (Cal); 1989 SCC OnLine Cal 410.]*** because the revenue involved was meagre, i.e., a sum of ₹ 12,000.

iv) We had asked learned counsel appearing for the Revenue to produce the original file to show that the Revenue has taken a conscious decision not to file the appeal as the revenue involved was meagre. In response to our query, Mr. Tripathi has placed a letter stating that the original file is not traceable for the reasons that the case is quite old, pertaining to the years 1974-1977. In the absence of the original file showing that the Revenue did not file any appeal by taking a conscious decision against the decision of the Calcutta High Court in the case of ***Rupenjuli Tea Co. Ltd. vs. CIT [(1990) 186 ITR 301 (Cal); 1989 SCC OnLine Cal 410.],*** we assume that the Revenue had accepted the ratio of the aforesaid case in ***Rupenjuli Tea Co. Ltd. vs. CIT [(1990) 186 ITR 301 (Cal); 1989 SCC OnLine Cal 410.]*** and accordingly answer the question regarding the applicability of section 44C of the Act against the Revenue and in favour of the assessee.

v) Learned counsel appearing for the Revenue does not challenge that in the absence of applicability of section 44C of the Act, section 37(1) would

apply. Accordingly, we answer question No. 2 as well against the Revenue and in favour of the assessee regarding the applicability of section 44C of the Act, as well as allow the head office expenditure u/s. 37(1) of the Act. The appeals are dismissed accordingly."

2 CIT (INTERNATIONAL TAXATION) VS. QUALCOMM INCORPORATED (2026) 485 ITR 347 (SC): 2025 SCC ONLINE SC 3129: DATED 03/11/2025

Assessment – Limitation – Commencement of period of limitation – AO passing order on 31/10/2017 giving effect to direction of Tribunal on 12/03/2015 – Limitation for assessment to be reckoned from that date – High Court holding assessment barred by limitation – Supreme Court dismissed the special leave petition filed by the Department: Ss. 143(3) and 153(2A) of ITA, 1961: A. Ys. 2005-06 and 2006-07

On 03/04/2007, the assessee filed its return of income. On 31/12/2007, the assessing officer passed an assessment order u/s. 143(3) of the Income-tax Act, 1961, determining the total taxable income of the respondent at INR 1,38,83,40,893. The Commissioner (Appeals) confirmed the order. By an order dated 12/03/2015, the Tribunal deleted the addition and remanded the matter to the Assessing Officer.

Pursuant to the order of remit, the Assessing Officer on 27/12/2016 drew up a draft assessment order. Asserting that the order had been passed beyond the period of limitation prescribed in section 153(2A), the assessee filed its objections before the Dispute Resolution Panel. Those objections were rejected by the Dispute Resolution Panel, which rejected the objections of the assessee and confirmed the draft assessment order. Thereafter, the Assessing Officer passed the final assessment order on 31/10/2017.

The Tribunal held that the order was barred by limitation.

On appeals by the Revenue, the Delhi High Court framed the following question of law for our consideration:

"(i) Whether on the facts and in the circumstances of the case the Income Tax Appellate Tribunal has erred in holding that the draft assessment order and final assessment order passed by the assessing officer are barred by limitation under Section 153(2-A) of the Income Tax Act, 1961?"

The High Court dismissed the appeal filed by the Revenue and held as under:

"i) While examining the issue of limitation, one would have to pose the question of when the Department became aware of the order and not when the Commissioner concerned or Principal Commissioner may have been served or had derived knowledge. Once a responsible officer of the Department becomes aware of the order, the period of limitation would commence from that point in time.

ii) It was submitted that a plain reading of the order dated 12/03/2015 would establish that the assessing officer had full knowledge of the order dated 20/02/2015 in ***Qualcomm Incorporated vs. CIT [Qualcomm Incorporated vs. CIT, 2015 SCC OnLine ITAT 1700]***, passed by the Income Tax Appellate Tribunal and consequently the period of limitation as prescribed in Section 153(2-A) would have to be computed accordingly.

iii) Mr Pardiwalla laid stress on the aforesaid order, acknowledging the judgment rendered by the Income Tax Appellate Tribunal on 20-2-2015 in ***Qualcomm Incorporated vs. CIT [Qualcomm Incorporated vs. CIT, 2015 SCC OnLine ITAT 1700]*** and the same embodying the intent of the assessing officer to give effect to the same. In view of the above, he submitted that the view as taken by the Income Tax Appellate Tribunal merits no interference.

iv) The order of the Tribunal dated 20/02/2015 had been given effect by the Assessing Officer. In view thereof, the period for drawing up a draft and a final assessment order would have to be computed from that date. Hence, the draft as well as final assessment order framed by the Assessing Officer for A. Ys. 2005-06 and 2006-07 would be barred by limitation."

[CIT vs. Qualcomm Incorporated: (2024) 3 HCC (Del) 408: (2024) 470 ITR 5908 (Del): 2024 SCC OnLine Del 3298:]

The Supreme Court dismissed the special leave petition filed by the Department and held as under:

"i) Delay condoned.

ii) After having heard Mr. Udit Dedhiya, learned counsel appearing for the petitioner, we are not inclined to entertain this special leave petition. The special leave petition is, accordingly, dismissed."

3 PRINCIPAL CIT VS. MONTECARLO LTD. (2026) 485 ITR 1 (SC): 2026 SCC ONLINE SC 312: DATED 09/01/2026

Industrial undertaking – Contractor or developer of infrastructure facility – Special deduction u/s. 80-IA(4) – Tribunal finding assessee eligible for deduction – High Court dismissing Department's appeal, following its own decision in assessee's case for earlier assessment year – Effect of earlier decision of Court that assessee was not a contractor but a developer of infrastructure facilities and was eligible for deduction u/s. 80-IA(4) – Supreme Court dismissed the special leave petition filed by the Department on the ground of delay, and on the ground decision relied upon had attained finality: S. 80-IA(4) of ITA, 1961: A. Y. 2017-18

For the A. Y. 2017-18, the assessee had claimed a deduction of ₹ 86,52,24,043 u/s. 80-IA(4) of the Income-tax Act, 1961. The

Assessing Officer disallowed the claim, holding that the assessee is a contractor and not a developer of infrastructure facilities.

The Tribunal deleted the disallowance, holding that the assessee is not a contractor but a developer of infrastructure facilities and is eligible for deduction u/s. 80-IA(4) of the Act.

The Gujarat High Court dismissed the appeal filed by the Revenue and held as under:

"i) Learned advocates for both sides submitted that the issue with regard to considering the respondent as a developer of the infrastructure facility so as to become eligible for deduction u/s. 80-IA(4) is no more res integra in view of the order passed by this court dated December 19, 2023, in Tax Appeal No. 786 of 2023 for the A. Y. 2008-2009 ***(Pr. CIT vs. Montecarlo Construction Ltd.),*** whereby the appeal filed by the Revenue is dismissed on the same question of law.

ii) Considering the above concurrent finding of facts, this court dismissed Tax Appeal No. 786 of 2023 dated December 19, 2023 ***(Pr. CIT vs. Montecarlo Construction Ltd.)*** and, therefore, this tax appeal is also dismissed as no question of law can be said to have arisen out of the impugned order passed by the Tribunal."

[***CIT vs. Montecarlo Ltd.: (2025) 475 ITR 143 (Guj): 2024 SCC OnLine Guj 4360***]

The Supreme Court dismissed the special leave petition filed by the Department and held as under:

"i) There is a delay of 358 days in filing the special leave petition, which has not been explained satisfactorily.

ii) Moreover, the relied upon judgment on the basis of which the impugned order has been passed, has not been appealed against and has attained finality.

iii) In view of the above, the special leave petition is dismissed both on the ground of delay as well as on merits." ■

" Don't look back—forward, infinite energy, infinite enthusiasm, infinite daring, and infinite patience—then alone can great deeds be accomplished. "

Swami Vivekananda

HIGH COURT



Jitendra Singh
Advocate



Radha Halbe
Advocate



Harsh Shah
Advocate

1 AECOM INTERCONTINENTAL HOLDINGS UK LTD. VS. ACIT [2026] 183 TAXMANN.COM 692 (DELHI)

Deduction of tax at source - section 197 of the Income Tax Act 1961 - Certificate for deduction at lower rate - High Court directing the authorities to grant certificate for nil rate withholding certificate in earlier year - authorities are bound by the order of High Court for issuance of nil rate withholding certificate - filing of SLP is no ground for disobeying the High Court order

Facts

The Assessee during the relevant period provided corporate and management support services such as legal, tax, treasury, finance, IT, HR, enterprise risk management, etc., to its Associated Enterprise (AE). The assessee also provided identical services to its AE in the earlier year. The assessee in the earlier year had applied for nil withholding tax which was rejected by AO. The assessee challenged the same before the Hon'ble Delhi High Court and the High Court directed the AO to issue nil rate certificate to the assessee. The assessee has also applied for nil withholding tax certificate. However, the AO instead of following the order passed by the Hon'ble High Court and granting nil withholding tax certificate issued a certificate that required TDS at the rate of 15%. The Authority justified this approach of deviating from the High Court order stating that the department had decided to file an SLP against the High Court order.

The assessee, being aggrieved by the order of AO, approached the Hon'ble Delhi High Court challenging the order passed under section 197 of the Act.

Ruling of the High Court

Hon'ble Delhi High Court allowed the Writ Petition filed by the assessee on the ground that the Authority never questioned the nature or taxability of the assessee's transaction with its AE. The Court further observed that the reason given by the AO for not following the earlier binding order of Hon'ble High Court was that the Department intended to file an SLP, is an unjustified ground. The Court also criticized the Competent Authority for causing serious and avoidable prejudice to the assessee by observing that although the assessee had applied for a nil-rate TDS certificate under section 197 on 12 March 2025, the Authority neither decided the application within the statutory one-month period (i.e., by

12 April 2025) nor acted promptly thereafter, instead, it rejected the application only on 19 August 2025, by which time 15% tax had been deducted for nearly 11 out of 12 months on payments that were potentially not taxable. The Court held that this delay defeated the very purpose of section 197, which is designed to prevent unnecessary cash-flow blockage and avoidable refund situations, and to ensure the Revenue is not saddled with statutory interest liability. Accordingly, the Court set aside the 15% certificate and directed issuance of a nil-rate certificate within 15 days.

2 BAJAJ ELECTRICALS LTD. VS. ACIT [2026] 183 TAXMANN.COM 637 (BOMBAY)

Business reorganisation – Section 170A of the Income Tax Act 1961 – during the course of assessment proceedings modified return was filed after order passed by NCLT approving scheme of amalgamation – assessment was completed as per modified return – issuing of fresh notice under section 143(2) to assess the modified return is unjustified

Facts

The assessee filed its original return for AY 2023–24 which was revised by the assessee to give effect to scheme of demerger duly approved by NCLT. The revised return filed by the assessee was selected for scrutiny assessment by issuing the statutory notices under section 143(2) of the Act. Pending the scrutiny proceedings, the assessee filed a modified return under section 170A of the Act to give effect to the scheme of amalgamation of a company with the assessee which was duly approved by NCLT. During scrutiny, the assessee informed the AO about the modified return and also requested him to complete the assessment after examining the modified return. The AO also examined amalgamation-related issues and passed an assessment order under section 143(3) of the Act, but mistakenly computed income as declared in the revised return instead of the modified return. AO issued fresh notices under Sections 143(2) and 142(1) to scrutinize the modified return filed under the provisions of section 170A of the Act.

The assessee being aggrieved by the fresh notice issued under section 143(2) of the Act challenged the same before the Hon'ble Bombay High Court.

Ruling of the High Court

Hon'ble High Court was pleased to allow the writ petition filed by the assessee by observing that assessee had filed modified return pursuant to an NCLT-approved amalgamation, and since assessment proceedings were pending at that time, Section 170A(2)(b) required the AO to pass a single assessment order incorporating the modified return. The AO had, in fact, considered the amalgamation and the modified return while passing the assessment order under section 143(3) of the Act. Thus, subsequent notices issued under Sections 143(2) and 142(1) amounted to a second scrutiny of the same modified return, which is impermissible under the Act.

3 SAPPHIRE FOODS INDIA LTD. VS. ACIT (OSD) [2026] 183 TAXMANN.COM 506 (DELHI)

Reassessment – Section 147 of the Income Tax Act 1961 - audit objection cannot review concluded assessment where all material earlier disclosed - notice issued beyond four years from the end of relevant assessment year is barred by first proviso to section 149 of the Act

Facts

The assessee filed its return for AY 2016-17 declaring a loss. During scrutiny proceedings, the AO examined in detail the large payments made to the Managing Director (₹ 8.90 crore) and to a shareholder (₹ 90.81 lakh), and the assessee submitted the relevant agreements. Although the AO had all this information when completing the assessment under Section 143(3) in 2018, he did not make any specific disallowance. Subsequently, the AO issued a notice under Section 148A(b) dated on 22.03.2023 based on local audit objections alleging escaped income relating to (i) share premium, and (ii) the same expenditure on remuneration and consultancy. After considering the assessee's reply, the AO dropped the share-premium issue but relied on the audit objection regarding expenses and passed an order under Section 148A(d), followed by a notice dated 31.03.2023 under Section 148 of the Act.

The assessee being aggrieved by the order passed under section 148A(d) and notice issued under section 148, challenged the same before the Hon'ble Delhi High Court under Article 226 of Constitution of India.

Ruling of the High Court

Hon'ble Delhi High Court allowed the Writ Petition filed by the assessee by observing that the reassessment was invalid because the AO already had all relevant details and documents regarding the large payments to the Managing Director and shareholder during the original scrutiny assessment. The assessee had fully disclosed the Employment Agreement and Consulting Agreement in response to the AO's queries, so the AO's failure to make any disallowance at that time meant the issue had already been subjected to assessment.

Reopening the case later based solely on an audit objection amounted to an impermissible review of a concluded assessment. The Court emphasized the distinction between:

- cases where the assessee hides information (where reopening may be justified), and
- cases where all material was already disclosed and examined (where reopening is a change of opinion, which the law does not permit).

Although audit objections can sometimes constitute "information" for reopening, they cannot override the rule that a concluded assessment cannot be reviewed simply because an audit party disagrees with the AO's earlier judgment. Since the AO had full knowledge of the transactions at the time of the original assessment, the audit objection did not constitute valid new information.

4 CHAMBER OF TAX CONSULTANTS VS. COMMISSIONER OF INCOME-TAX (EXEMPTIONS) [2026] 184 TAXMANN.COM 374 (BOMBAY)

Registration – section 12A of the Income Tax Act 1961 - Charitable trusts registered under MPT Act, 1950 - denial of renewal under section 12AB on the ground that trust deeds lacked explicit irrevocability and dissolution clauses - unjustified

Facts

The assessee before the Hon'ble Bombay High Court was an association of tax practitioners and public charitable trusts duly registered under the Maharashtra Public Trusts Act, 1950. The assessee had been granted registration under Sections 12A/12AB of the Income-tax Act, 1961. The assessee in pursuant to the new registration regime effective from 1 April 2021, filed an application for renewal of registration under Section 12AB in Form No. 10AB.

The Commissioner (Exemption) rejected the applications for renewal primarily on the ground that the respective trust deeds did not contain an explicit clause declaring the trust to be irrevocable and/or prescribing the manner of dissolution of the trust. It was further alleged that the assessee had furnished false or incorrect information by answering "Yes" to the question in Form No. 10AB relating to irrevocability of the trust, despite the absence of an express clause in the trust deed. On this basis, the Commissioner (Exemption) treated the same as a "specified violation" within the meaning of Section 12AB(4) and consequently denied renewal of registration.

The assessee being aggrieved by the rejection of its applications and the interpretation adopted by the Commissioner (Exemption), challenged the order passed by Commissioner (Exemption) before the Hon'ble Bombay High Court under Article 226 of Constitution of India.

Ruling of the High Court

Hon'ble Bombay High Court was please to allow the Writ Petition filed by the assessee by observing that the impugned action of the Commissioner (Exemption) in rejecting the application for registration is contrary to the plain language and scheme of Section 12AB of the Act, which requires satisfaction only with respect to the objects of the trust, the genuineness of its activities, and compliance with applicable laws. The statute does not mandate the existence of an express irrevocability clause in the trust deed as a precondition for grant or renewal of registration, and such a requirement cannot be read into the provision by implication. Hon'ble Court further observed that the interpretation adopted by the Commissioner (Exemption) is further inconsistent with the legal framework governing public trusts under the Maharashtra Public Trusts Act, 1950. Under the said enactment, once property is dedicated to a public charitable purpose, the settlor is divested of all rights, title, and interest therein, and such property cannot revert to the settlor. Even in cases of revocation, the statutory mechanism ensures that the trust property is applied for charitable purposes or vested in the statutory fund, thereby ruling out any possibility of reversion to the settlor. Thus, denial of renewal under section 12AB of the Act is without any basis.

5 MANJULABEN MAFATLAL SHAH VS. TAX RECOVERY OFFICER-3, AHMEDABAD [2026] 183 TAXMANN.COM 746 (BOMBAY)

Collection and recovery of taxes – Section 226 of the Income Tax Act -Attachment of bank account of wife pursuant to the outstanding tax demand of a company where her husband is a director – Company's outstanding tax demands cannot be recovered from director's wife - attachment invalid

Facts

The assessee before the Hon'ble Bombay High Court is the wife of a director of Shri Ram Tubes Private Limited. The Income Tax Department issued a notice under Section 226(3) of the Act to the assessee's bank, directing it to remit the funds lying in the assessee's individual bank account towards recovery of the company's outstanding tax dues, thereby attaching the said account.

The assessee being aggrieved by the said attachment challenged the same by way of a writ petition, contending that she had no association with the company in any capacity neither as a director, shareholder, nor employee. It was further emphasized that the bank account in question was held solely in her name and had no connection with the company.

Ruling of the High Court

Hon'ble Bombay High Court was pleased to allow the Writ Petition filed by the assessee by observing that the assessee was never a director of the company and no tax liability had arisen in her name. In such circumstances, the Court held that the Income Tax Department had no authority to attach the assessee's personal bank account merely because she was married to a director of the company. While the Department may have recourse against the husband under Section 179 of the Act, such provisions had no applicability to the assessee. On this basis alone, the writ petition was allowed. The impugned notice issued under Section 226(3) was quashed, and the attachment was directed to be lifted, with instructions to release and de-freeze the petitioner's bank account forthwith.

■

" We have to bear the result of
our own actions because
we attach ourselves to them. "

Swami Vivekananda

TRIBUNAL





CA Nikhil Mutha *CA Viraj Mehta* *CA Kinjal Bhuta*
Advocate

1 TATA STEEL LTD. VS. DCIT-2(3)(1), MUMBAI [I.T.A. NO. 3555 & 3294/MUM/2016 DATED 20/02/2026] [AY 2008-09]

Section 36(1)(iii) – Interest on borrowed capital utilized for acquiring an overseas subsidiary in the same line of business for global expansion is allowable as business expenditure

Facts of the case

The AO reopened the assessment and, interalia, disallowed interest expenditure of INR 518.75 crore claimed by the Assessee under Section 36(1)(iii) of the Act. The interest was paid on funds borrowed to acquire the UK-based Corus Group plc via wholly owned step-down subsidiaries using a leverage financing structure. The Ld. AO contended that the investment was solely to acquire a controlling interest in a foreign subsidiary and the amount invested was disclosed as 'investments' in books of accounts. The Ld. AO also denied the Assessee's alternate claim under Section 57(iii), stating the primary motive was not to earn dividends, relying on the decision of the Hon'ble Bombay HC in the case of *Amritaben R. Shah [1999] (238 ITR 777)*. The Ld. CIT(A) upheld the interest disallowance. Consequently, the Assessee filed an appeal before the Hon'ble ITAT on this issue.

Held

The Hon'ble ITAT analyzed the Assessee's Board minutes, presentations, and public announcements made during the loan syndication and basis the same observed that the dominant purpose of acquiring Corus was out of commercial expediency at achieving inorganic growth since the said entity was in the identical line of business (steel manufacturing). The acquisition was intended to expand the Assessee's existing business globally, achieve economies of scale, access mature markets, and leverage superior technology and R&D. The Hon'ble ITAT distinguished the Assessee, a manufacturing enterprise, from Tata Sons Ltd., an investment company, noting that choosing to expand a business via the acquisition of a foreign subsidiary is a valid business decision. The Hon'ble ITAT further emphasized that as long as the borrowing is for commercial expediency and extending the business, it satisfies the "for the purpose of business" test, regardless of the

fact that it involved acquiring a controlling interest. The Hon'ble ITAT primarily relied upon the decision of the Hon'ble Bombay HC in the case of ***Concentrix Services (P) Ltd (2019) (111 Taxmann.com 269)***. Consequently, the interest of disallowance of INR 518.75 crore was deleted, rendering the alternate claim under Section 57(iii) infructuous. Since the appeal was allowed on merits, the legal grounds challenging the jurisdictional aspects were left open. Thus, the assessee's appeal was allowed.

2 ITO-19(3)(1), MUMBAI VS. VARUN JAISINGH ASHER [ITA NO. 8251/MUM/2025 (MUMBAI TRIB)] (AY:2020-21)

Transaction of surrender of tenancy rights resulted in transfer of capital asset, receipt of flat on redevelopment was taxable under the head capital gains and could not be brought to tax under section 56(2)(x); exemption under section 54F allowed

Facts

The assessee filed his return of income for AY 2020-21 declaring income of ₹ 4.87 lakh and claimed exemption under section 54F amounting to ₹ 11.68 crore in respect of flat received on surrender of tenancy rights. The case of assessee was selected for scrutiny to verify the claim of capital gain deduction. The assessee along with his brother started occupying the premises by paying monthly rent of ₹ 5,000. A tenancy agreement was later registered on 05.08.2014. Subsequently, the said property was redeveloped and under the redevelopment scheme and the assessee entered into Permanent Alternate Accommodation Agreement and surrendered his tenancy rights. In lieu of surrender of tenancy rights, the assessee received possession of residential flat and claimed deduction under section 54F. The AO considered the tenancy agreement as a sham and held that assessee had no genuine rights. He treated the flat received as a gratuitous receipt and taxed the stamp duty value of ₹ 11.68 crore under section 56(2)(x) of the Act as 'Income from other sources' and denied deduction under section 54F of the Act. Aggrieved, the assessee filed an appeal before CIT (A). The CIT (A) deleted the addition while allowing deduction under Section 54F. Aggrieved, the revenue filed an appeal before the ITAT.

Held

Before the Hon'ble Tribunal, the AR submitted that the assessee had furnished various documents including rent receipts, electricity bills, registered tenancy agreement and records of MHADA to establish continuous tenancy rights from 01.04.2013 till surrender of tenancy. It was further submitted that even a substantial stamp duty of ₹ 35 lakh was paid on registration of tenancy agreement and therefore the tenancy could not be treated as sham. On the other hand, the DR supported the order of AO and submitted that tenancy agreement and all supporting documents were merely a colourable device adopted to avoid tax.

The Hon'ble Tribunal held that assessee had produced substantial documentary evidence such as rent receipts, electricity bills, registered tenancy agreement, MHADA verification records, Permanent Alternate Accommodation Agreement establishing continuous tenancy from 01.04.2013 till

surrender of tenancy rights. It was held that tenancy rights constitute a capital asset and surrender thereof amounts to transfer and the flat received on redevelopment represented consideration for such surrender and could not be taxed under section 56(2)(x). Reliance was placed on the decision in Vasant Nagorao Barbade holding that income assessable under the head capital gains cannot be taxed under Income from other sources. The Hon'ble Tribunal also noted the decision of Hon'ble Bombay High Court in the case of assessee's brother and Co-tenant Vivek Jaisingh Asher wherein allegations of colourable device were rejected in the absence of cogent material and proper show cause notice specifying the applicable statutory provision. Hence, it was held that the assessee's claim of exemption under section 54F was correctly allowed by CIT(A).

3 MANOJ RAJARAM SHARMA VS. ITO (42)(3)(4), MUMBAI [ITA NO. 8313/MUM/2025 (MUMBAI TRIB)] (AY:2020-21)

Section 44AD vs Section 44ADA- Business Correspondent – Estimation of Income at 50% by applying provisions applicable to professionals - Not justified

Facts

The assessee filed his return of income for AY 2020-21 on 17.10.2020, declaring total income of ₹ 4.92 lakh. Subsequently, based on information available with the department, it was noticed that large credits were reflected in the assessee's bank account, and therefore reassessment proceedings were initiated. During the reassessment proceedings, the AO obtained bank details u/s. 133(6) and noticed total credits of about ₹ 4.63 crore in the bank account. The assessee explained that he was working as a Business Correspondent (BC) with Fino Payments Bank Ltd and that bank account was a BC Merchant Account through which customer transactions were routed. He further explained that the deposits did not belong to him and that he earned only commission income on such transactions.

The AO initially proposed to estimate income at 8% of total credits amounting to ₹ 37.10 lakh but later changed the basis and treated the turnover declared by the assessee at ₹ 14.86 lakh as gross receipts. The AO held that the assessee should have declared income at 50% of receipts similar to provisions applicable to professionals under section 44ADA, and accordingly computed income at ₹ 7.07 lakh making an addition of ₹ 2.15 lakh. The reassessment order was passed on 20.02.2025 under section 147 read with sections 144 and 144B. Aggrieved, the assessee filed an appeal before the CIT (A). The CIT(A) vide order dated 17.10.2025 held that the assessee had failed to comply with notices issued during assessment proceedings and had provided only limited details at later stage and thus upheld the addition made by the AO. Aggrieved, the assessee filed an appeal before ITAT.

Held

Before the Hon'ble Tribunal, the AR challenged the addition and reiterated that the assessee was engaged as a Business Correspondent (BC) with Fino Payments Bank Ltd and the bank account was a BC Merchant Account used for routing customer transactions. He contended

that the assessee earned only commission income and had correctly declared income under section 44AD. He further contended that the AO had wrongly applied 50% profit rate which is applicable only to professionals under section 44ADA, whereas the assessee was engaged in business. On the other hand the DR relied upon the assessment order wherein it was noted that the assessee had declared income at about 35% of gross receipts whereas the income ought to have been declared at 50% of receipts and thus the AO was justified in making the addition and it ought to be sustained.

The Hon'ble Tribunal held that the activity of a Business Correspondent (BC) is a business activity and not a profession covered under section 44ADA. It was observed that the profit rate applicable to professionals could not be applied to business income. Since the assessee had declared income at a rate higher than that prescribed under section 44AD and no defect was pointed out in the receipts, the AO was not justified in applying a 50% profit rate. Thus, the addition of ₹ 2.15 lakh was deleted.

4 THIPPAREDDY GOVINDAREDDY MALLI REDDY VS. DCIT, CENTRAL CIRCLE 2(3), BANGALORE [ITA NO. 685/BANG/2025 DATED 20/02/2026] [AY 2017-18]

Section 69A – Addition for unexplained cash loan confirmed where assessee's admission during search was corroborated by seized material and delayed retraction lacked credible evidence

Facts of the case

The assessee, an individual engaged in finance and real estate, was subjected to search proceedings under Section 132 on 10.09.2018. During the search, the assessee attempted to destroy certain loose sheets by throwing them away, but the documents were recovered by the search party. One of the seized sheets contained notations regarding a transaction of ₹ 2 crore with one Mr. Vasudev. In his statement recorded under Section 132(4), the assessee explicitly admitted that he had advanced a cash loan of ₹ 2 crore to Mr. Vasudev in June 2016 at 12% interest out of his unaccounted income. He detailed that after demonetization, Mr. Vasudev failed to pay interest, leading them to negotiate a land deal for ₹ 7.8 crore against which this loan, along with cheque payments, was to be adjusted, though the deal was later dropped due to title issues. Consequently, the assessee voluntarily offered the ₹ 2 crore as undisclosed income for AY 2017-18. However, while filing the return under Section 153C, this sum was not offered. During assessment, the Ld. AO summoned Mr. Vasudev, who denied receiving any cash loan. The assessee then claimed the document was merely an estimate, asserting that the ₹ 2 crore actually referred to accounted cheque loans given in the previous year (FY 2015-16) that were subsequently repaid, and that his initial statement was erroneous due to mental trauma. Rejecting these explanations, the Ld. AO made an addition of ₹ 2 crore under Section 69A based on the Section 132(4) statement. The Ld. CIT(A) upheld the addition, observing that the statement was not retracted promptly, the seized material contained composite notings of cash and banking transactions, and the Assessee produced no corroborative evidence

to support his subsequent retraction. The Assessee appealed to the Hon'ble ITAT.

Held

The Hon'ble ITAT held that a statement recorded under Section 132(4) carries significant evidentiary value, especially when it is directly linked to and corroborated by incriminating material found and seized during a search. The Hon'ble ITAT noted the Assessee's deliberate attempt to destroy the documents, which highlighted their incriminating nature. Furthermore, the Assessee's admission during the search was not a bare confession but a highly detailed narrative specifying the source of funds, interest rates, the impact of demonetization, and subsequent land deal negotiations.

The ITAT observed that the assessee did not retract this statement for nearly three years, only doing so during the assessment proceedings in February 2021. Upon examining the ledger account produced by the assessee to establish that the transactions were via cheque, the Hon'ble ITAT found that the cheque loans had already been substantially repaid and cleared by August 2016, leaving a nil balance on the date of the search. This documentary evidence of cheque repayments had no correlation with the distinct cash loan transaction admitted to have occurred in June 2016. The Hon'ble ITAT established the principle that where a detailed admission is corroborated by tangible seized evidence, the burden shifts entirely to the assessee to rebut the presumption of its truthfulness with credible, corroborative evidence. Since the assessee failed to adduce such evidence and the delayed retraction was a mere afterthought, the addition of ₹ 2 crore under Section 69A was held to be legally sound. Accordingly, the orders of the lower authorities were upheld, and the appeal of the assessee was dismissed.

PS: In CTC Journal (March, 2026), in Tribunal Decisions update, we have dealt with a decision in the case of ***Tata Chemicals Ltd. vs. DCIT [ITA NO. 7912/MUM/2019] (Page No. 143)*** *– In the header, we had erroneously mentioned as 'allowable' instead of 'not allowable'. We request readers to take note of the same.*

5 LIC HOUSING FINANCE LTD. VS. ACIT, CIRCLE 2(2)(1), MUMBAI [I.T.A. NO. 6972, 6973 & 6974/MUM/2024, 12/02/2026] [AY 2005-06, 2006-07 & 2007-08]

Section 244A – Interest on delayed refund determined under Direct Tax Vivad Se Vishwas (DTVSV) Act allowable

Facts of the case

The Assessee, LIC Housing Finance Ltd., filed an application under the Direct Tax Vivad Se Vishwas (DTVSV) Act, 2020. The Principal CIT accepted the application and issued Form No. 5, determining a tax refund for the Assessee. However, the Order Giving Effect (OGE) and the actual issuance of the refund were significantly delayed by the Revenue department, with the refund for AY 2005-06 being issued after a delay of 20 months. Consequently, the Assessee filed an application under Section 154 of the Act claiming interest at 6% on the delayed refund under Section 244A(1)(b) of the Act. The Ld.

AO rejected the claim, reasoning that no interest is allowable on refunds arising out of the DTVSV scheme. The Ld. CIT(A) upheld the AO's rejection, observing that the refund became due under a relief scheme rather than the normal provisions of the Income Tax Act, thereby making Section 244A inapplicable. The Assessee appealed to the Hon'ble Mumbai ITAT.

Held

The Hon'ble ITAT held that the Assessee is legally entitled to interest on the delayed refund. The Hon'ble ITAT observed that the Explanation to Section 7 of the DTVSV Act, which bars the payment of interest on excess amounts, pertains exclusively to the period prior to the filing of the declaration. It does not prohibit the payment of interest for the period after the entitlement to a refund has been conclusively established via the issuance of Form No. 5. Relying primarily on the Hon'ble Supreme Court's ruling in ***Union of India vs. Tata Chemicals Ltd.***, the Hon'ble ITAT noted that when the State retains money without a legal right, it is bound to make the party good, and the obligation to refund carries with it an implicit right to interest as compensation for undue retention. Since the DTVSV Act does not explicitly deny interest for post-settlement delays, the provisions of Section 244A of the Act become applicable once the refund becomes due. Accordingly, the Hon'ble ITAT directed the AO to allow interest under Section 244A of the Act on the delayed refunds. The appeals of the Assessee were allowed.

6 RAVI SELLAPPAN VS. DCIT- 7, PUNE [MISCELLANEOUS APPLICATION NO.150/PUN/2023 (PUNE TRIB)] (AY: 2008-09)

Miscellaneous application u/s. 254(2) – Conditional non-pressing of grounds cannot be treated as unconditional withdrawal and failure to consider relevant submissions constitutes a mistake apparent from record warranting recall under section 254(2)

Facts

The assessee was subjected to reassessment proceedings initiated under Sections 147 and 148 of the Income-tax Act for AY 2008–09. The AO, on 25.02.2016, passed an order under Section 147 read with Section 143(3) of the Act, making an addition of ₹ 6.56 crore. The addition was made on the ground that the assessee had carried out civil contract work for M/s Samcon Infrastructure Corporation, Pune, but had failed to disclose certain receivables arising from such work. Aggrieved, the assessee filed an appeal before the CIT(A), raising several grounds, including grounds challenging the validity of reopening as well as grounds on merits relating to the addition. During the proceedings before the CIT(A), the assessee did not press certain legal grounds relating to the validity of reassessment. However, vide letter dated 19.12.2016, the assessee had stated that he was not pressing certain grounds, subject to relief being granted on other grounds on merits. Ultimately, the CIT(A) vide order dated 22.12.2016 allowed the appeal in favour of the assessee on merits and granted relief against the addition. Against this, the Revenue preferred an appeal before the ITAT.

The Tribunal observed that the assessee had not pressed the grounds challenging the reopening of assessment before the CIT(A). On

that basis, the Tribunal held that the assessee could not raise such grounds again before the Tribunal. Consequently, the Revenue's appeal was allowed by the Tribunal vide order dated 05.01.2023.

Aggrieved, the assessee filed a Miscellaneous Application under Section 254(2) of the Act seeking rectification of the Tribunal's order. However, the Tribunal vide order dated 25.10.2023 dismissed the Miscellaneous Application. Thereafter, the assessee filed a writ petition before the Hon'ble Bombay High Court. The Hon'ble High Court held that the assessee had made out a prima facie case. Accordingly, the Hon'ble High Court vide order dated 07.05.2024 quashed and set aside the Tribunal's order and remanded the matter to the Tribunal for fresh adjudication of the Miscellaneous Application.

Held

Before the Hon'ble Tribunal the AR submitted that the Tribunal, in its earlier order, wrongly held that the assessee had not pressed the grounds relating to reopening of assessment before the CIT(A), without considering the assessee's fundamental submission on this issue. It was argued that the assessee had only conditionally not pressed such grounds, i.e. subject to relief being granted on merits, and therefore the same could not be treated as an unconditional withdrawal. The AR relied upon the letter dated 19.12.2016 filed before the CIT(A), which clearly stated that the non-pressing of grounds was conditional. It was contended that the Tribunal had overlooked this letter, which was already on record, and had instead relied only on the findings of the CIT(A). The AR emphasized that conditional non-pressing is different from withdrawal, and the principle of preclusion would apply only if the assessee had unconditionally withdrawn the grounds or unconditionally not pressed the same. It was further submitted that where an assessee does not press certain grounds because relief has been granted on other grounds and if such relief is subsequently denied, the assessee should be permitted to raise those earlier grounds before the Tribunal. The AR also relied on Rule 27 of the ITAT Rules to submit that the assessee is entitled to support the order of the CIT(A) on all grounds, including those not decided in his favour. The AR further contended that the failure of the Tribunal to consider these submissions and material on record amounted to a mistake apparent from the record under section 254(2), and therefore the earlier order should be recalled for fresh adjudication. On the other hand, the DR submitted that as per the order sheet of the CIT(A), the assessee had not pressed certain grounds and there was no explicit mention of any conditional withdrawal. However, upon verification of the appellate records, the DR admitted that the letter dated 19.12.2016 was indeed filed before the CIT(A) and formed part of the record.

The Hon'ble Tribunal held that the non-pressing of grounds by the assessee was conditional and not absolute, as evidenced from the letter dated 19.12.2016. The Hon'ble Tribunal observed that such fact had not been considered in its earlier order, and further noted that while dismissing the assessee's cross appeal and cross objection as withdrawn, the assessee had been granted liberty to raise all legal and factual grounds in the Revenue's appeal; however, such grounds were not adjudicated. Accordingly, the Tribunal held that there was a mistake apparent on record. The earlier order dated 05.01.2023 was therefore recalled, and the matter was directed to be heard afresh by way of de novo adjudication.

■

CASE LAW UPDATE



Dr. CA Sunil Moti Lala
Advocate

I. RESIDENT

US LLC

1 GE ENGINE SERVICES LLC VS. ACIT [2026] 184 TAXMANN.COM 238 (DELHI - TRIB.) [11-03-2026] ITA NO. 3700 (DELHI) OF 2023 [A.Y. 2021-22] : TS-347-ITAT-2026 (DEL)

Where assessee, a US-incorporated single-member LLC engaged in aircraft engine repair and offshore supply to Indian airlines, was fiscally transparent and its income was taxable in hands of its sole member, a US corporation holding valid tax residency certification, assessee was entitled to India-USA DTAA benefit as being 'liable to tax' under article 4 despite absence of direct US tax liability [India – U.S.A DTAA]

Assessee, a US-incorporated single-member LLC engaged in offshore aircraft engine repair/overhaul services and offshore supply of spare parts to Indian airline customers, filed return declaring income of about ₹ 37.72 lakhs and claimed applicability of India-USA DTAA u/s 90(2).During assessment, AO following earlier year, treated receipts as taxable and, without prejudice, held that assessee, being an LLC fiscally transparent under US law and not itself liable to tax in USA, was not a resident under article 4 of India-USA DTAA and therefore not entitled to treaty benefits. DRP upheld the said view. On appeal, assessee furnished Tax Residency Certificate showing allotment of US Tax Identification Number and certification by US tax authorities that assessee LLC was a branch, division or business unit of a U.S. corporation resident in USA for U.S. taxation purposes and contended that liability to tax was a legal status independent of actual tax payment. The Tribunal held that assessee, being an LLC, was entitled to benefit of India-USA DTAA. [***Wild West Domains, LLC vs. ACIT IT Appeal No.1774 (Delhi) of 2022, dated 29-7-2024 and Go Daddy. Com LLC vs. Dy. CIT IT Appeal No. 8085 (Delhi) of 2018, dated 23-9-2022 followed***]

TIE-BREAKER

2 PRADEEP NARASIMHAN VS. ITO [2026] 184 TAXMANN.COM 442 (BANGALORE – TRIB.) [25-02-2026] ITA NO. 1414 (BANG) OF 2025 [A.Y. 2018-19]

Where assessee, after completing India assignment, shifted to Kazakhstan and exercised employment with closer personal and economic ties to Kazakhstan, he was to be regarded as a tax resident of Kazakhstan under Article 4(2) , so salary for overlapping period was taxable only in Kazakhstan and not in India. [India – Kazakhstan DTAA]

Assessee, a New Zealand national, was on assignment in India from 01-8-2007 to 06-8-2017. Post completion of his assignment in India, assessee was sent on assignment to Kazakhstan from 07-8-2017. Assessee filed his original return of income as a 'Resident' offering to tax in India his global income. Subsequently, assessee filed a revised return of income wherein he did not offer salary for 01-1-2018 to 31-3-2018 (Overlapping Period) on the ground that he was a resident of Kazakhstan for that period under Article 4(2) of India-Kazakhstan DTAA and that employment was exercised in Kazakhstan during that overlapping period. AO rejected claim of assessee, held assessee to be resident in India and brought to tax salary for overlapping period. Tribunal noted that (a) assessee did not have permanent home in India thereafter, (b) was residing in Kazakhstan and on assignment to Kazakhstan, (c) his payroll was also shifted to Kazakhstan, (d) assessee had closer personal and economic ties with Kazakhstan at the time of exercise of employment. Consequently, it held that as per Article 4(2)(a)/(b) of the DTAA, assessee would be regarded tax resident of Kazakhstan and the salary for the overlapping period was taxable in Kazakhstan only.

Note **: Also see case no 1 under INCOME FROM HOUSE PROPERTY, case no. 1 under DIVIDEND & case no. 1 under INTEREST.**

II. INCOME FROM IMMOVABLE PROPERTY

PROPERTY IN UK

1 PRADEEP NARASIMHAN VS. ITO [2026] 184 TAXMANN.COM 442 (BANGALORE – TRIB.) [25-02-2026] ITA NO. 1414 (BANG) OF 2025 [A.Y. 2018-19]

Where rental income was derived from an immovable property situated in United Kingdom, such income was not taxable in India by virtue of Article 6, as same was taxable only in country where property was situated [India-UK DTAA]

Assessee, an individual, was a New Zealand national, who moved from an Indian assignment (up to August 2017) to a Kazakhstan assignment from 07/08/2017. For AY 2018-19, he filed a revised return claiming that for 01-01-2018 to 31-03-2018 he was also a resident of Kazakhstan and offered

to tax rental income from said house property located in London for the period 01-04-2017 to 31-12-2017 and income from House Property for Overlapping Period was not offered to tax. AO treated assessee as resident in India and taxed rental income for 01-01-2018 to 31-03-2018 under head Income from House Property. Tribunal held that since rental income had been earned from immovable property located in London, United Kingdom, as per Article 6(1) of India-UK DTAA, income from immovable property was to be taxed in source state where immovable property was located (which was United Kingdom in present case). Therefore, even if assessee was considered to be tax resident of India, rental income arising from immovable property would not be taxable in India.

***Note* : Also see case no 2 under RESIDENT, case no. 1 under DIVIDEND & case no. 1 under INTEREST.**

III. PERMANENT ESTABLISHMENT

SUBSIDIARY/DAPE/FIXED PLACE PE

1 ORACLE SYSTEMS CORPORATION VS. ADIT [2026] 184 TAXMANN.COM 34 (DELHI - TRIB.) [02-03-2026] ITA NOS. 5671 (DEL) OF 2011 AND OTHERS [A.Y. 2006-07 TO 2012-13]

Where assessee, a US company, had a wholly owned Indian subsidiary carrying out software development activities, but assessee had no control or right of disposal over subsidiary's premises and subsidiary was remunerated at arm's length, neither fixed place PE nor agency PE existed in India and no business profits were taxable in assessee's hands [India – U.S.A DTAA]

Assessee, a US company, was engaged in business of developing and licensing software products. It had a wholly owned Indian subsidiary, OIPL, carrying out software development activities in India. Revenue alleged that OIPL constituted assessee's Permanent Establishment (PE) in India under India–USA DTAA in respect of these software development activities. Tribunal noted that premises in Bangalore and Hyderabad were leased by OIPL and machinery/equipment were owned and operated by OIPL for its own business and it was OIPL which claimed depreciation u/s 32 on premises and equipment. Since neither AO nor Commissioner (Appeals) had demonstrated that any specific part of OIPL's premises at Bangalore or Hyderabad was available to or under control of assessee for carrying on its business, crucial 'disposal test' for constituting fixed place PE was not satisfied and, thus, there was no fixed place PE under article 5(1) of India-USA DTAA. Further since OIPL did not act on behalf of assessee and OIPL's transactions with assessee had been remunerated at arm's length, OIPL could not be held as Agency PE. Thus, since there was no PE of assessee in India, no business profits could be attributable to said PE and brought to tax in India in hands of assessee.

***Note* : Also see case no. 2 under ROYALTY-Software, case no. 1 under ROYALTY – Surcharge & Health/Education cess & case no. 1 under OTHERS- Interest u/s 234B.**

Reference may be made *Oracle Systems Corporation vs. Additional Director of Income-tax, International Taxation [2026] 184 taxmann.com 147 (Delhi - Trib.) [02-03-2026]* wherein a similar view has been taken.

DAPE

2 MILESTONE SYSTEMS A/S. VS. ACIT, INTERNATIONAL TAXATION [2026] 184 TAXMANN.COM 194 (DELHI - TRIB.) [06-03-2026] ITA NO. 1897 (DELHI) OF 2025 [A.Y. 2022-23]

Where assessee, a Denmark based company, sold licensed software in India through non-exclusive distributors on principal-to-principal basis and distributors neither concluded contracts nor maintained stock or secured orders on behalf of assessee, assessee had no DAPE in India and its business profits from such sales were not taxable in India

Assessee, a Denmark based company, was engaged in business of providing IP video management software and other video surveillance related products. It sold licensed software to its distributors in India and earned revenue .Assessee claimed that said revenue was not taxable in India as it had no PE in India. AO held that software was customized to needs of end users and assessee exercised comprehensive control over operations of distributors, including fixation of prices and distributor was not at liberty to select resellers. Thus, AO concluded that assessee had a DAPE in India and, accordingly, attributed 50 per cent of such profits to alleged DAPE of assessee in India. Tribunal noted that assessee only restricted 'maximum resale price' at which product could be sold but did not restrict distributor in any manner to fix resale price of product. Further, distributors did not conclude contracts on behalf of assessee, nor did they maintain stock of goods or merchandise from which regular deliveries were made on behalf of assessee. It held that since distributors purchased and sold products in their own name and for their own account, risk and cost, assessee had no DAPE in India and, thus, business profits from sale of software licenses were not taxable in India. Once it was held that assessee had no PE/ DAPE in India, question of attribution of profits to alleged PE did not arise.

IV. BUSINESS PROFITS

HEAD OFFICE EXPENDITURE

1 DDIT (IT)-L(L) VS. BANK OF AMERICA N.A [2026] 184 TAXMANN.COM 431 (MUMBAI- TRIB.) [18-03-2026] ITA NO. 4090 AND 4154 (MUM) OF 2004 – A.Y. 2000-01 : TS-383-ITAT-2026 (MUM)

Where assessee, a commercial bank, claimed deduction for expenses incurred by overseas branches towards NRI Desk activities supporting Indian operations,

such expenditure constituted 'Head Office Expenditure' within meaning of Explanation to section 44C and was therefore subject to the deduction restriction u/s 44C, not section 37(1)

Assessee, a commercial bank, claimed deduction of about ₹ 1.16 crores for expenses incurred overseas (allocated by Head Office/ overseas branches) towards NRI Desks set up to support Indian operations, asserting these were directly attributable to Indian branch and fully allowable u/s 37(1), and contending that section 44C limit did not apply, including with reference to Article 7(3) of DTAA. The Tribunal held that expenses incurred by overseas branches towards NRI Desk activities for Indian operations were in nature of 'Head Office Expenditure' (executive and general administration) within Explanation to Section 44C, thereby restricting deduction u/s 44C. ***[DIT (IT) vs. American Express Bank Ltd. [2025] 181 taxmann.com 433 (SC)/[2026] 308 Taxman 246 (SC)/[2025] 484 ITR 137 (SC) Followed; Inspecting Assistant Commissioner v. Goodricke Group Ltd. [1985] 12 ITD 1 (Calcutta) (SB) [distinguished]***

2 DDIT (IT)-L(L) VS. BANK OF AMERICA N.A [2026] 184 TAXMANN.COM 431 (MUMBAI - TRIB.) [18-03-2026] ITA NO. 4090 AND 4154 (MUM) OF 2004 – A.Y. 2000-01 : TS-383-ITAT-2026 (MUM)

Where assessee claimed deduction for head office expenditure u/s 44C and deduction for provision for bad and doubtful debts u/s 36(1)(viia), deduction u/s 36(1)(viia) must be computed before applying restrictive limit for deduction of head office expenditure u/s 44C as per the definition of 'adjusted total income'

The Tribunal held that from the plain reading of the provisions of section 44C, it is evident that while computing the income chargeable under the head "profits and gains of business or profession", the deduction of Head Office Expenditure is restricted either to an amount equal to 5% of the adjusted total income or the amount of Head Office Expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India, whichever is less. The term "adjusted total income" has been defined in the Explanation to section 44C as follows: "(i) "adjusted total income" means the total income computed in accordance with the provisions of this Act, without giving effect to the allowance referred to in this section or in sub-section (2) of section 32 or the deduction referred to in section 32A or section 33 or section 33A or the first proviso to clause (ix) of sub-section (1) of section 36 or any loss carried forward under sub-section (1) of section 72 or sub-section (2) of section 73 or sub-section (1) 55 [or sub-section (3)] of section 74 or sub-section (3) of section 74A or the deductions under Chapter VI-A;". From the plain reading of the above Explanation, it is evident that "adjusted total income" would mean total income without giving effect to the specified deductions as mentioned in the Explanation. It is found that deduction u/s 36(1)(viia) has not been expressly excluded for computation of "adjusted total income" as per the Explanation to section 44C. Thus, the effect of the deduction u/s 36(1)(viia) has to be given prior to computation of deduction u/s 44C. Accordingly, no infirmity was found in the findings of the CIT(A) on this issue, and the same are upheld.

3 BANK OF TOKYO-MITSUBISHI UFJ LTD. VS. DCIT INTERNATIONAL TAXATION [2026] 184 TAXMANN.COM 323 (DELHI - TRIB.) [13-03-2026] ITA NO. 7212 (DELHI) OF 2017 [A.Y. 2013-14] : TS-360-ITAT-2026 (DEL)

Where assessee, a Japanese company, received ECB interest taxed in India on a gross basis under Article 11(2) of India–Japan DTAA at 10 percent, it could not simultaneously claim deduction u/s 44C for such interest income since DTAA taxation regime and domestic law benefits cannot be mixed, making no deduction admissible from income taxed on gross basis under DTAA [India – Japan DTAA]

Assessee, a foreign company, filed its original return declaring income of about ₹ 499.28 crores and later filed a revised return declaring total income of about ₹ 1167.35 crores after including about ₹ 668.07 crores representing interest received by its head office/overseas branches on External Commercial Borrowings (ECBs) from India. During assessment, assessee claimed that ECB interest should be excluded as not taxable in India and, without prejudice, sought that if taxed, deduction u/s 44C be computed considering such interest in 'adjusted total income'. AO framed a draft assessment taxing ECB interest of about ₹ 668.07 crores in India under Article 11(2) of the DTAA on a gross basis and rejected assessee's claim for deduction u/s 44C on ground that no deduction could be allowed from income taxed on a gross basis. The Tribunal noted that since income of assessee was taxed under article 11(2) of India-Japan DTAA on gross basis at rate of 10 per cent and it was option of assessee to be governed by provisions of domestic tax laws or the DTAA, whichever was more beneficial to assessee. It held that since there was no mandate that assessee could opt for lower taxes as per DTAA and claim expenses as per domestic tax laws, no deduction u/s 44C was admissible on ECB interest taxed in India on gross basis under Article 11(2) of India–Japan DTAA. [***MUFG Bank Ltd vs. ACIT (International Taxation) [2021] 126 taxmann.com 304 (Delhi - Trib.) Followed***]

***Note*: See Case No 3 under INTEREST and case no. 1 under OTHERS – TDS on Interest Income from ECB loan.**

V. DIVIDENDS

RELEVANT DTAA IS THAT OF SOURCE COUNTRY

1 PRADEEP NARASIMHAN VS. ITO [2026] 184 TAXMANN.COM 442 (BANGALORE – TRIB.) [25-02-2026] ITA NO. 1414 (BANG) OF 2025 [A.Y. 2018-19]

Where assessee, an individual, received dividend income from Netherlands during his transition from Indian to Kazakhstan assignment and claimed foreign tax credit for Netherlands and Kazakhstan, since dividend source was Netherlands and assessee was resident only in India for DTAA purposes and not in Netherlands,

India–Netherlands DTAA applied and FTC was limited to taxes paid in Netherlands, with matter remanded for fresh adjudication [India – Netherlands DTAA]

Assessee was an individual, a New Zealand national, who moved from an Indian assignment (up to August 2017) to a Kazakhstan assignment from 07/08/2017. For AY 2018-19, he received dividend income in respect of shares held in Netherlands and in revised return, he offered dividend relatable to 01-4-2017 to 31-12-2017 and did not offer dividend for 01-1-2018 to 31-3-2018, claiming residency in Kazakhstan for overlapping period under Article 4(2) of India-Kazakhstan DTAA and that such dividend was not taxable in India. AO treated assessee as resident in India and brought to tax dividend from 1-1-2018 to 31-3-2018, while granting FTC under India-Netherlands DTAA and denying balance FTC claimed. Tribunal held that since source country for dividend income was Netherlands, relevant DTAA would be India-Netherlands DTAA. Since relevant facts for adjudication of Article of DTAA between India and Netherlands were not before Tribunal, issue relating to taxation of dividend income in hands of assessee was restored back to file of AO for de novo adjudication.

Note **: Also see case no 2 under RESIDENT, case no. 1 under INCOME FROM IMMOVABLE PROPERTY & case no. 1 under INTEREST.**

VI. INTEREST

BENEFICIAL RATE UNDER ARTICLE 11 VS. NORMAL SLAB RATES

1 PRADEEP NARASIMHAN VS. ITO [2026] 184 TAXMANN.COM 442 (BANGALORE – TRIB.) [25-02-2026] ITA NO. 1414 (BANG) OF 2025 [A.Y. 2018-19]

Where assessee, treated as resident of Kazakhstan for overlapping period, earned interest income in India and offered it to tax at 10 percent under DTAA, taxability must be restricted to beneficial rate as per Article 11, not normal slab rates, on such interest income [India-Kazakhstan DTAA]

Assessee, an individual, a New Zealand national, moved from an Indian assignment to a Kazakhstan assignment from 07-08-2017. For Assessment year 2018-19, he claimed Kazakhstan residency for 01-01-2018 to 31-03-2018 for treaty purposes and offered Indian-sourced interest income at 10% under Article 11 of the DTAA. AO, while computing income, clubbed dividend and interest under Income from Other Sources, thereby taxing interest at normal slab rates. Tribunal held that since assessee would be treated as resident of Kazakhstan during overlapping period, interest income arising in India would be taxable in India at beneficial rate of 10% in terms of Article 11(1) read with 11(2) of DTAA between India and Kazakhstan.

Note **: Also see case no 2 under RESIDENT, case no. 1 under INCOME FROM IMMOVABLE PROPERTY & case no. 1 under DIVIDEND.**

DISALLOWANCE U/S 94B

1 VESTAS WIND TECHNOLOGY INDIA (P.) LTD. VS. ITO, CORPORATE CIRCLE 3(1) [2026] 184 TAXMANN.COM 579 (CHENNAI - TRIB) [09-03-2026] ITA NO. 320 (CHNY) OF 2025 [A.Y. 2018-19] : TS-377-ITAT-2026 (CHNY)

Where assessee paid interest on ECB to non-resident AE and *suo motu* disallowed the same partially u/s 94B, TPO's higher disallowance by recomputing EBITDA using net depreciation (after netting subvention income) and including non-deductible items (capitalised interest) was unjustified, as only deductible interest should be considered and EBITDA must be computed with actual depreciation

Assessee-company paid interest on ECB borrowed from its non-resident AE and made a suo motu disallowance u/s 94B. In scrutiny, TPO recomputed section 94B disallowance at a higher amount by recomputing EBITDA using net depreciation rather than assessee's claimed gross depreciation and by including items assessee said were already disallowed or not paid or payable. Tribunal held that EBITDA must be computed using actual depreciation without netting subvention income. Only deductible interest can enter section 94B computation and notional Ind AS unwinding and capitalized interest already disallowed could not be again considered.

***Note* : Also see case no 1 under NON – DISCRIMINATION.**

ARTILCE 11(2) VS SEC. 44C

1 BANK OF TOKYO-MITSUBISHI UFJ LTD. VS. DCIT, INTERNATIONAL TAXATION [2026] 184 TAXMANN.COM 323 (DELHI - TRIB.) [13-03-2026] ITA NO. 7212 (DELHI) OF 2017 [A.Y. 2013-14] : TS-360-ITAT-2026 (DEL)

Where assessee, a Japanese company, received ECB interest taxed in India on a gross basis under Article 11(2) of India–Japan DTAA at 10 percent, it could not simultaneously claim deduction u/s 44C for such interest income since DTAA taxation regime and domestic law benefits cannot be mixed, making no deduction admissible from income taxed on gross basis under DTAA [India – Japan DTAA]

***Note* : See Case No 3 under BUSINESS PROFIT and case no. 1 under OTHERS – TDS on Interest Income from ECB loan.**

VII. ROYALTY

DESIGN SUPPORT SERVICES

1 INTERNATIONAL BRIDGE TECHNOLOGIES MIDDLE EAST DMCC VS. DCIT, (IT) [2026] 184 TAXMANN.COM 593 (DELHI - TRIB) [13-03-2026] ITA NO. 1584 (DELHI) OF 2025 [A.Y. 2018-19] : TS-393-ITAT-2026 (DEL)

Where assessee, a UAE resident company, provided design support services for a sea link project under an agreement transferring complete ownership of all project-specific designs and drawings to Systra India for a lump-sum professional fee, such consideration was for outright transfer of title, not for use or right to use any design, and thus did not constitute royalty under Article 12(3) of India–UAE DTAA and was not taxable in India [India – UAE DTAA]

Assessee, a UAE resident company, was engaged in designing of bridges - It entered into a Sub-Consultancy Agreement with Systra India for Versova–Bandra Sea Link project to provide design support services, including preparation of tender design and drawings, for which it received professional fees. AO held that professional fees received for design support services were in nature of royalty taxable in India u/s 9(1)(vi) as well as under Article 12 of India–UAE DTAA. Tribunal noted that agreement provided that all project-specific documents, reports, data and other deliverables prepared by assessee would be owned by Systra India, and consideration was payable as a lump-sum professional fee. It held that since there was complete transfer of ownership in designs and drawings to Systra India, consideration received by assessee was for outright transfer of title in designs and not for use or right to use any design, and thus, did not fall within definition of 'royalty' under Article 12(3) of India–UAE DTAA. Therefore, consideration received by assessee was not chargeable to tax in India.

TELECOMMUNICATION SERVICES

1 VERIZON COMMUNICATIONS INDIA P. LTD. VS. ACIT [2026] 183 TAXMANN.COM 700 (DELHI TRIB.) [25-02-2026] ITA NO. 442 (DEL) OF 2017 [A.Y. 2012-13]

Where assessee made payments to US entities for telecommunication services rendered outside India, since such data transmission services did not qualify as royalty per earlier Tribunal's decision in assessee's own case, related disallowance u/s 40(a)(i) for non-deduction u/s 195 was not sustainable

Assessee, engaged in providing telecommunication services in India and overseas, made payments to MCI Communications Services Inc. (MCICS) and MCI International Inc. (MCII) towards telecommunication services rendered outside India. AO held payments to be royalty u/s 9(1)(vi) and disallowed u/s 40(a)(i) for

non-deduction u/s 195. In view of decision of Tribunal in assessee's own case, it was held that telecom charges paid by assessee-company to non-resident telecom operators did not constitute 'royalty' within meaning of Explanation 2 to section 9(1)(vi) and, thus, disallowance made u/s 40(a)(i) was not valid. [***Radhasoami Satsang vs. CIT [1992] 60 Taxman 248 (SC)/[1992] 193 ITR 321 (SC) followed***]

SOFTWARE/MAINTENANCE/SOFTWARE SUPPORT

1 COMPUTER MODELLING GROUP LTD. VS. ACIT (IT) [2026] 184 TAXMANN.COM 71 (DELHI-TRIB.) [27-02-2026] ITA NO. 1978 (DELHI) OF 2025 [A.Y. 2022-23] : TS-270-ITAT-2026 (DEL)

Where assessee, a Canadian company selling software licences and providing maintenance services in India, had no permanent establishment in India as held in prior years and revenue failed to establish otherwise for relevant year, receipts from software licences and related services, being business income, were not taxable in India under India–Canada DTAA and impugned order was liable to be set aside

Assessee, a Canadian company engaged in sale of reservoir simulation software used in oil and gas exploration industry and in providing software maintenance/support services, granted software licenses to Indian customers. It claimed that receipts from software licenses and maintenance services were exempt in India under India-Canada DTAA. AO treated software license receipts as royalty and software maintenance fees as fee for included services, while DRP held in addition that assessee had a PE in India and entire receipts were taxable u/s 44BB. Before the Tribunal, the Revenue placed reliance on the judgment rendered in the case of ***Paradigm Geophysical Pty. Ltd. vs. CIT [2020] 115 taxmann.com 254/424 ITR 521 (Delhi)***. Tribunal held that the said judgment was distinguishable on facts. In the said case, the assessee was providing customized software solutions and annual maintenance services used by oil and gas exploration industry. The assessee itself offered the receipts from sale of software and annual maintenance services to tax u/s 44BB. Thus, in the said case the assessee therein had opted to offer the receipts from sale of customized software and annual maintenance services under presumptive basis. In the instant case, the software license provided by the assessee was off the shelf software and not the customized software. Further, the case of the assessee herein was that it had no PE in India. The revenue has also not been able to establish that the assessee has PE in India. Thus, the facts in the case of assessee were distinguishable. Further, it was noted that in preceding assessment years Tribunal had held that assessee had no PE in India and identical receipts were not taxable in India - Since revenue failed to establish existence of PE in India, impugned order taxing receipts under article 12 or section 44BB was set aside. [***Computer Modelling Group Ltd. vs. ACIT (IT) [2024] 162 taxmann.com 437 (Delhi - Trib.) followed; Paradigm Geophysical Pty. Ltd. vs. CIT [2020] 115 taxmann.com 254/424 ITR 521 (Delhi) distinguished***.]

2 ORACLE SYSTEMS CORPORATION VS. ADIT [2026] 184 TAXMANN.COM 34 (DELHI – TRIB.) [02-03-2026] ITA NOS. 5671 (DEL) OF 2011 AND OTHERS [A.Y. 2006-07 TO 2012-13]

Where assessee offered to tax only 56 per cent of revenue transfers received from its Indian subsidiary as royalty under software support agreement and Assessing Officer sought to tax entire compensation including global deal revenue as royalty, only contractually receivable sums could be taxed as royalty and addition of notional royalty on global deals was unsustainable [India – U.S.A DTAA]

Assessee entered into a Software Support Services Agreement (SSSA) with its 100 per cent Indian subsidiary, Oracle India Private Limited (OIPL), under which assessee received 56 per cent of revenue transfers received by OIPL and offered that portion to tax as royalty. Assessee did not offer to tax any amount on revenue transfers relatable to training, education and consultancy under SSSA. AO treated 100 per cent of compensation for services under SSSA received by OIPL as royalty payable to assessee u/s 9(1)(vi) and/or article 12, as against 56 per cent offered by assessee. Tribunal held that revenue transfer on global deal could not be taxed as royalty under article 12 of India-USA DTAA since under SSSA, OIPL was only granted license to use software and provide support services. Held, yes. Since assessee was neither entitled to receive nor had acquired any right to receive royalty on global deals, AO's action of determining royalty on global deals had no legal basis and same was deleted. [*Oracle Systems Corporation vs. ADIT, International Taxation [2026] 182 taxmann.com 238 (Delhi - Trib.), Radhasoami Satsang vs. CIT [1992] 60 Taxman 248/193 ITR 321 (SC) followed*]

***Note* : Also see case no.1 under PERMANENT ESTABLISHMENT - Subsidiary/DAPE/Fixed Place PE, case no. 1 under ROYALTY- Surcharge/Health & Education Cess & case no 1 under OTHERS – Interest u/s 234B.**

Reference may be made *Oracle Systems Corporation vs. Additional Director of Income-tax, International Taxation [2026] 184 taxmann.com 147 (Delhi - Trib.) [02-03-2026]* wherein a similar view has been taken.

SURCHARGE/HEALTH & EDUCATION CESS

1 ORACLE SYSTEMS CORPORATION VS. ADIT [2026] 184 TAXMANN.COM 34 (DELHI – TRIB.) [02-03-2026] ITA NOS. 5671 (DEL) OF 2011 AND OTHERS [A.Y. 2006-07 TO 2012-13]

Where assessee, a US company, received royalty income from its wholly owned Indian subsidiary and offered same to tax at 15 per cent under article 12(2) of India-USA DTAA, tax on royalty could not exceed 15 per cent of gross amount and thus surcharge/ health and education cess could not be further added to said rate under DTAA

The Tribunal held as above by following *JC Decaux S.A. vs. ACIT/DCIT [IT Appeal No. 1630/Del/2015, dated 20-3-2020]*

***Note* : Also see case no. 1 under PERMANENT ESTABLISHMENT - Subsidiary/DAPE/Fixed Place PE, case no. 2 under ROYALTY- Software & case no 1 under OTHERS – Interest u/s 234B.**

Reference may be made *Oracle Systems Corporation vs. Additional Director of Income-tax, International Taxation [2026] 184 taxmann.com 147 (Delhi - Trib.) [02-03-2026]* wherein a similar view has been taken.

VIII. FEES FOR TECHNICAL SERVICES

REIMBURSEMENT

1 DCIT VS. MAKE MY TRIP INDIA (P.) LTD. [2026] 184 TAXMANN.COM 562 (DELHI – TRIB) [25-03-2026] ITA NOS. 5095 (DELHI) OF 2014 & 989 & 1387 (DELHI) OF 2017 AND OTHERS [A.Y.S 2009-10, 2011-12, 2012-13, 2013-14, 2014-15 & 2015-16]

Where assessee remitted ticket cost to its AE on cost-to-cost basis for onward payment to airlines, such payment being mere reimbursement without any income element and not constituting fees for technical services/fees for included services, was not chargeable to tax in India and no tax was deductible u/s 195, and consequently no disallowance u/s 40(a)(i) was warranted

Assessee purchased international air tickets through its US group entity (MMT US) for onward sale to customers and remitted ticket cost to MMT US on a cost-to-cost basis, while separately paying service fee. AO treated such remittances as fees for technical services chargeable to tax in India and disallowed same u/s 40(a)(i) for non-deduction of tax u/s 195. The Tribunal held that since payments represented mere purchase cost/reimbursement without any income element and not constituting fees for technical services/fees for included services. Further, amounts were not chargeable to tax in India as MMT US had no PE in India. Consequently, section 195 was inapplicable and disallowances u/s 40(a)(i) were to be deleted.

AIRCRAFT ENGINE REPAIR AND OVERHAUL SERVICES

2 GE ENGINE SERVICES LLC VS. ACIT [2026] 184 TAXMANN.COM 238 (DELHI - TRIB.) ITA NO. 3700 (DELHI) OF 2023 [A.Y. 2021-22] : TS-347-ITAT-2026 (DEL)

Where assessee, a US LLC, rendered offshore aircraft engine repair and overhaul services to Indian customers, with title and risk passing outside India, and no technical knowledge, skill or know-how was made available to customers, receipts were not taxable in India as fees for technical services under India-USA DTAA [India – U.S.A DTAA]

Assessee, a US LLC, provided aircraft engine repair/overhaul services at offshore

facilities; Indian customers shipped engines/ parts abroad, assessee inspected, replaced/ refurbished parts, assembled and tested them, and shipped back repaired components, with title and risk passing outside India. Assessee received about ₹ 471.64 crores from Indian airline customers and claimed receipts were not taxable in India u/s 9(1)(vii) and, invoking section 90(2), under article 12(4)(b) of India-USA DTAA since services did not make available technical knowledge, skill, know-how or technical plan/design. The Tribunal held that since technical knowledge and skill employed by assessee did not remain with customers after completion of contract and customers continued to depend upon assessee for such offshore work in subsequent years, requirement of make available clause under article 12(4)(b) was not satisfied. Therefore, receipts from repair and overhaul services were not taxable in India either as FTS u/s 9(1)(vii) or as FIS under article 12(4)(b). [***Pratt & Whitney Canada Corp. vs. Dy. CIT, International Taxation [2025] 179 taxmann.com 278 (Delhi-Trib) and Rockwell Collins Southeast Asia Pte Ltd vs. Dy. CIT IT Appeal No. 2409 (Delhi) of 2023, dated 14-11-2024 followed***]

IX. CAPITAL GAINS

BUY – BACK OF SHARES

1 HUNTSMAN INVESTMENT [NETHERLANDS] BV VS. A.D.I.T, (IT) [2026] 184 TAXMANN.COM 602 (DELHI TRIB.) [25-03-2026] ITA NO. 764 (DELHI) OF 2014 [A.Y. 2009-10] : TS-417-ITAT-2026 (DEL)

Where assessee, a Netherlands company, derived capital gains arising from buy-back of shares by its Indian subsidiary, such transaction being transfer of shares within same corporate group constituting corporate reorganisation, such gains were taxable only in Netherlands under Article 13(5) of India–Netherlands DTAA and hence not taxable in India [India – Netherlands DTAA]

Assessee, a Netherlands resident, held 99.98 per cent of shares in an Indian company, HIIPL. During relevant year, HIIPL offered a buy-back under which assessee sold 2.14 crore equity shares (about 24 per cent) at ₹ 23.10 per share for about ₹ 49.43 crores. Assessee initially offered long-term capital gains of about ₹ 6.17 crores to tax in its return. TPO determined ALP at ₹ 80.77 per share and proposed an upward adjustment of about ₹ 123.41 crores by adopting sale consideration at about ₹ 172.85 crores instead of ₹ 49.43 crores. Assessee raised an additional ground that buy-back was not taxable in India under article 13(5) of India–Netherlands DTAA on the ground that gains were realised in course of a 'corporate organisation, re-organisation, amalgamation, division or similar transaction' and were taxable only in Netherlands. The Tribunal (majority view) accepted the plea of the assessee. It relied on the Bombay High Court judgment in ***SEBI vs. Sterlite Industries (India) Limited [2003] 53 CLA 41 (Bombay)*** wherein it has been held that: 'a company could buy back its own shares as a part of reorganization scheme u/s 391 read with sections 100 to 104 of the Companies Act 1956.' Similar view was taken by the ***Andhra Pradesh High Court in the case of***

Shareholders of TCI Industries Ltd. vs. TCI Industries Ltd. 60 CLA 382. These decisions of the High Court show that the scheme of buy-back of shares by a company has been recognized as a scheme of reorganization. Tribunal further referred to P. Ramanatha Aiyar's Major Law Lexicon which defines the term 'Re-organisation of a company' to mean amalgamation or readjustment when one company acquires another by way of merger or a single company divides into two or more entities or a company makes a substantial change in its capital structure. Also, the guidance issued by ICAI to its fellow members, states that the definition of 'Capital and Financial Restructuring' includes buy-back of shares. Similarly, the guidance issued by the Institute of Company Secretaries of India (ICSI) for its fellow also provides that buy back is a part of corporate restructuring of a company. In view of the above, the intention of the contracting parties i.e., India and the Netherlands with respect to Article 13(5) of the India-Netherlands DTAA is to provide taxation rights to the home country in relation to gains arising in the course of a corporate reorganization wherein there is a transfer of shares within the same corporate group. In the present case as well, since the transaction of buy back by HIIPL from the assessee resulted in transfer of shares within the same corporate group, this transaction of buy back qualified as a corporate re-organisation that was eligible to claim the benefit of Article 13(5) of the India Netherlands DTAAA.

STOCK DERIVATIVES

2 ESTEE INDIA FUND VS. ACIT [2026] 184 TAXMANN.COM 416 (DELHI - TRIB.) [12-03-2026] ITA NO. 1955 (DEL) OF 2025 [A.Y. 2022-23]

Where assessee, a Mauritius based Foreign Portfolio Investor (FPI), earned gains from stock derivatives, AO taxed same as share-based gains under Article 13(3A), since derivatives were distinct from shares and said clause applied only to shares, gain from trading of derivatives were covered under Article 13(4) and taxable in country of residence [India – Mauritius DTAA]

Assessee, a tax resident of Mauritius, was a registered Foreign Portfolio Investor (FPI) with SEBI. During relevant assessment year, it traded in F&O in currency derivatives and stock derivatives. Assessee claimed gains from these transactions were not taxable in India under India-Mauritius DTAA. AO held that gains from stock derivatives were taxable in India under Article 13(3A) as share-based capital gains. The Tribunal held that a bare reading of clause 3A of Article 13 would show that it only refers to "shares" and Clause 4 provided that any other property not mentioned in Clause 3A would be taxable in State of residence. Since shares and derivatives were two distinct assets and even though underlying asset might be shares, same could not be treated as gain from trading in shares. Thus, provisions of Article 13(3A) would not get attracted and gain from trading of derivatives would be covered by Clause 4 of Article 13, hence, taxable in country of residence. [***Vanguard Funds Public Ltd. vs. Asstt. CIT (International Taxation) [2025] 173 taxmann.com 321 (Mumbai - Trib.) and Sigma Global Fund vs. ACIT [2025] 176 taxmann.com 708 (Mumbai - Trib.) followed***]

X. DEPENDENT PERSONAL SERVICES

SERVICES PARTLY RENDERED IN INDIA AND PARTLY ABROAD

1 MRIGESH GAURAV VS. ITO [2026] 184 TAXMANN.COM 251 (MUMBAI - TRIB) [05-03-2026] ITA NO. 7988 (MUM) OF 2025 [A.Y. 2018-19] : TS-366-ITAT-2026 (MUM)

Where assessee, an Indian employee deputed to USA, claimed portion of salary for services rendered abroad as not taxable in India but entire salary was taxed and partial TDS credit was allowed based on Indian payroll records, since verification of salary taxation in USA was lacking, matter was remanded for limited factual verification regarding salary income taxation [India – U.S.A. DTAA]

Assessee, an individual salaried employee of an Indian company, was deputed on a short-term international assignment to USA during relevant period and claimed to be a non-resident for year. Salary was processed through Indian payroll. In return, he computed salary at about ₹ 81.80 lakhs, reduced salary attributable to services rendered outside India of about ₹ 76.73 lakhs, and offered net taxable salary of about ₹ 5.07 lakhs - TDS of about ₹ 24.76 lakhs was deducted by employer and reflected in Form 26AS - On processing u/s 143(1), CPC allowed TDS credit of about ₹ 1.62 lakhs against claim of about ₹ 24.76 lakhs, resulting in short grant of about ₹ 23.14 lakhs .Commissioner (Appeals) examined taxability of entire salary, held it taxable in India, and directed Assessing Officer to tax entire salary as per Form 16 and grant TDS credit accordingly, thereby effectively enhancing income beyond scope of section 143(1) adjustment. Tribunal held that since Commissioner (Appeals) had not issued any specific show-cause notice proposing enhancement of income of assessee before directing AO to tax entire salary receipts, in absence of such notice, direction issued by Commissioner (Appeals) could not be sustained to extent it amounted to enhancement of income without complying with mandatory requirement of section 251(2). Further, since factual aspect regarding taxation of impugned salary income in United States had not been properly verified by lower authorities, matter was to be remanded to AO for limited verification.

XI. NON-DISCRIMINATION

DISALLOWANCE U/S SECTION 94B

1 VESTAS WIND TECHNOLOGY INDIA (P.) LTD. VS. ITO, CORPORATE CIRCLE 3(1) [2026] 184 TAXMANN.COM 579 (CHENNAI - TRIB) [09-03-2026] ITA NO. 320 (CHNY) OF 2025 [A.Y. 2018-19] [INDIA – DENMARK DTAA] : TS-377-ITAT-2026 (CHNY)

Where assessee, a subsidiary of a Danish entity, availed ECBs from its non-resident AE and suffered disallowance u/s 94B despite TPO accepting arm's length interest (*qua* article 12(7)), such disallowance was discriminatory since thin capitalization rules applied only to non-resident borrowings and violated non-discrimination under Article 24(4) of India-Denmark DTAA, rendering the disallowance unsustainable

Assessee, a wholly owned subsidiary of a Danish group entity, availed ECBs from its non-resident AE and incurred interest of ₹ 55.83 crores. It made a suo motu disallowance of ₹ 9.34 crores u/s 94B. TPO accepted arm's length nature of interest (qua article 12(7)) but recomputed disallowance u/s 94B at ₹ 18.47 crores (by recomputing EBITDA). CIT(A) upheld disallowance and held that non-discrimination under Article 24(4) of India–Denmark DTAA was unavailable in view of Article 12(7). Tribunal held that Article 24(4) clearly mandates parity in deductibility of interest paid to residents and non-residents, except where Article 12(7) applies. Since Section 94B applies only when debt is from a non-resident AE and no corresponding restriction exists for resident AE borrowings, prima facie, differential treatment arises based on residence. Since TPO had accepted arm's length nature of interest and no TP adjustment was made, Article 12(7) was not attracted. In absence of specific treaty carve-out, thin capitalization rules that apply exclusively to non-residents violate Article 24(4). Accordingly, disallowance u/s 94B in present case was discriminatory and could not be sustained in view of Article 24(4) read with section 90(2).

NOTE **: Also see case no. 2 under INTEREST.**

XII. FOREIGN TAX CREDIT (FTC)

DELAY IN FILING FORM 67

1 AMITH VISHNAV GUDIMELLA VS. ITO [2026] 184 TAXMANN.COM 204 (HYDERABAD TRIB.) [06-03-2026] ITA NO. 1705 (HYD.) OF 2025 [A.Y. 2020-21]

Where assessee, a non-resident employed in USA, earned salary there, paid US taxes, and subsequently reported global salary in India along with claim for Foreign Tax Credit, denial of credit merely due to delayed filing of Form 67 was not justified as the limitation in Rule 128(9) is directory, hence claim for FTC must be considered on basis of Form 67 already filed

Assessee was a non-resident during relevant period and was employed in USA - He earned salary income in USA, paid US taxes there, subsequently returned to India and was employed in India - He reported aggregate salary under head 'Income from Salaries' in his Indian return and claimed Foreign Tax Credit (FTC) under India–USA DTAA - For claiming FTC, he furnished Form 67 on 07.04.2021 - CPC processed return u/s 143(1) on 03.08.2022 and denied FTC claim. Assessee thereafter furnished proof of US taxes paid and sought rectification u/s 154, which CPC rejected on 03.03.2023. Tribunal held that claim of FTC could not be denied merely on ground of delay in filing Form-67 as limitation provided under Rule 128(9) is a directory condition .Accordingly, the matter was remanded to AO for considering claim of assessee for grant of FTC on basis of Form-67 already filed by assessee. [***Smt. Sonali Verma vs. ITO [IT Appeal No. 778(Hyd.) of 2025, dated 30-07-2025] followed***]

2 RELIANCE RETAIL LTD. VS. ACIT [2026] 184 TAXMANN.COM 280 (MUMBAI - TRIB.) [10-03-2026] ITA NO. 3510 AND 4244 (MUM) OF 2025 - A.Y. 2019-20

Where assessee filed Form 67 belatedly but before completion of assessment/appellate proceedings and necessary details of foreign taxes paid were available on record, delay being procedural in nature could not defeat substantive claim of foreign tax credit, though same remained subject to verification by AO [India – China DTAA]

Assessee paid taxes in China and claimed foreign tax credit - Form No. 67 was filed after due date u/s 139(1) but before completion of appellate proceedings. Commissioner (Appeals) denied credit solely on ground of delay in filing Form 67. The Tribunal held that requirement of filing Form 67 is procedural in nature and delay therein cannot defeat substantive claim of foreign tax credit when necessary details are available on record. Foreign tax credit could not be denied merely for delay in filing Form 67. Matter was restored to AO for verification of claim. [***Duraiswamy Kumaraswamy vs. PCIT [2023] 156 taxmann.com 445/[2024] 296 Taxman 502/ [2023] 460 ITR 615 (Madras) followed***]

GENERAL

1 HITACHI ENERGY TECHNOLOGY SERVICES (P.) LTD. VS. DCIT [2026] 184 TAXMANN.COM 275 (BANGALORE – TRIB.) [05-03-2026] IT(TP)A NO. 2565 (BANG) OF 2024 [A.Y. 2021-22]

Where assessee, a captive ITeS/IT support service provider, sought foreign tax credit for taxes withheld outside India and alternatively deduction of uncredited foreign tax u/s 37(1), AO was to verify claim, recompute admissible credit if assessed income changed, and examine allowability of deduction in accordance with law

The Tribunal followed *Reliance Infrastructure Ltd. vs. CIT [2016] 76 taxmann. com 257/390 ITR 271 (Bombay).*

2 AMIT SATPATHY VS. DCIT [2026] 184 TAXMANN.COM 68 (MUMBAI - TRIB.) [27-02-2026] ITA NO. 5930 (MUM) OF 2025 [A.Y. 2017-18]

Where assessee, an individual, received salary in India for services rendered in UK and claimed foreign tax credit for taxes paid in UK, matter was to be restored to AO for examination of such entitlement under article 24 of for relevant financial year [India-UK DTAA]

Since the matter was restored to the file of the AO, the assessee was directed by Tribunal to furnish any other information as may be sought by the AO for examining the claim of the assessee as per law.

XIII. OTHERS

REVISION U/S 263 – EXEMPTION UNDER ARTICLE 13(4) [INDIA – MAURITIUS DTAA]

1 SANDSTONE INVESTMENT PARTNERS-I VS. DCIT (IT) [2026] 183 TAXMANN.COM 699 (DELHI - TRIB.) [25-02-2026] ITA NO. 1158 (DELHI) OF 2022 [A.Y. 2017-18]

Where assessee, a Mauritius based company, holding valid TRC and having no PE in India, earned long-term capital gains on sale of listed shares through recognised stock exchange and paid STT and AO accepted claim of exemption u/s 10(38) and Article 13(4) of India–Mauritius DTAA after detailed enquiry and necessary verification, Commissioner was not justified in invoking section 263 alleging lack of enquiry, treaty shopping etc. [India – Mauritius DTAA]

Assessee, a Mauritius-resident company engaged in holding investments in equity shares, held valid Tax Residency Certificate (TRC) for relevant year and had no permanent establishment (PE) in India. During relevant year, it sold listed shares of an Indian company through recognised stock exchange, paid securities transaction tax (STT), earned long-term capital gains (LTCG), claimed exemption under Article 13(4) of India–Mauritius DTAA and u/s 10(38), and filed return declaring NIL income - AO examined all these facts and accepted returned income. Subsequently, Commissioner invoked section 263 holding that AO had not made proper enquiries and that assessee was not entitled to treaty benefits on grounds of treaty shopping, lack of beneficial ownership and commercial rationale, and further held that LTCG was taxable under Act including u/s 115JB. Tribunal held that since necessary verification/enquiries were made by AO during scrutiny assessment proceedings and assessee had furnished relevant documents and information and AO after having examined documents furnished by assessee accepted returned income, it could not be said that necessary verification/enquiries were not made by AO during scrutiny assessment proceedings. Further, in view of Explanation 4 to section 115JB, provisions of section 115JB were not applicable to a foreign company being resident of a DTAA country and having no PE in India, and LTCG arising from sale

of listed shares on which STT was paid was exempt u/s 10(38). Therefore, twin conditions prescribed u/s 263 were not satisfied and impugned revisional order was set aside. [***Malabar Industries Co. Ltd. vs. CIT [C.A. No. 3646 of 1993, dated 10-2-2000] followed***]

INTEREST U/S 234B FOR NON-RESIDENT

1 ORACLE SYSTEMS CORPORATION VS. ADIT [2026] 184 TAXMANN.COM 34 (DELHI – TRIB.) [02-02-2026] ITA NOS. 5671 (DEL) OF 2011 AND OTHERS [A.Y. 2006-07 TO 2012-13]

Where assessee, a non-resident, claimed its income was subject to TDS by Indian payers, interest u/s 234B was to be recomputed considering that, prior to financial year 2012-13, assessee was entitled to reduce tax deductible at source while computing advance tax liability

Tribunal directed the AO to recompute interest u/s 234B in accordance with law keeping in view Supreme Court decision in ***Director of Income-tax vs. Mitsubishi Corporation [2021] 130 taxmann.com 276 (SC)***, wherein it was held that prior to financial year 2012-13, tax deductible or collectible at source had to be reduced while computing advance tax liability.

Note **: Also see case no.1 under PERMANENT ESTABLISHMENT - Subsidiary/DAPE/Fixed Place PE, case no. 2 under ROYALTY- Software & case no 1 under ROYALTY – Surcharge/Health & Education cess.**

Reference may be made ***Oracle Systems Corporation vs. Additional Director of Income-tax, International Taxation [2026] 184 taxmann.com 147 (Delhi - Trib.) [02-03-2026]*** **wherein a similar view has been taken.**

TDS ON INTEREST INCOME FROM ECB LOAN

1 BANK OF TOKYO-MITSUBISHI UFJ LTD. VS. DCIT (IT) [2026] 184 TAXMANN.COM 323 (DELHI - TRIB.) [13-03-2026] IT APPEAL NO. 7212 (DELHI) OF 2017 (A.Y. 2013-14)] : TS-360-ITAT-2026 (DEL)

Where assessee was liable to tax in India on interest income from ECB loan and tax was deducted at source, assessee was entitled to credit for such tax deducted, subject to verification and allowance by AO

Accordingly, the matter was remanded by the Tribunal.

Note**: Also see case no. 3 under BUSINESS PROFIT & case no. 3 under INTEREST.**

■

GST





CA Naresh Sheth *CA Jinesh Shah*

A. DECISIONS BY HIGH COURT

1 RELIANCE JIO INFOCOMM LTD. VS. UNION OF INDIA [2026] 184 TAXMANN.COM 103 (MADRAS) – MADRAS HIGH COURT

Facts and issues involved

Petitioner is a company engaged in providing telecommunication services with separate GST registrations across various States and Union Territories, each treated as a distinct person under the GST law. To manage common ITC across its 36 registrations, the petitioner operates as an Input Service Distributor (ISD) to distribute credit pro rata based on the turnover of individual units.

The dispute arose from the mandatory requirement in Rule 39(1)(a) of the CGST Rules which stipulates that the input tax credit available for distribution in a month shall be distributed in the same month. For the period prior to 01.04.2025, the petitioner challenged this rule as ultra vires Section 20 of the CGST Act, which at the time did not explicitly empower the government to prescribe a time limit for distribution.

Show cause notices (SCN), including SCN No. 216/2025-AUDI dated 27.06.2025 and SCN No. 185/2025-AUDIT dated 26.06.2025, were issued to the petitioner alleging contravention of these rules. Specifically, one notice alleged the taxpayer declared IGST credit of ₹ 51,55,243/- for distribution based on inward supply invoices that were not distributed in the same month as their receipt, leading to a demand for recovery of allegedly wrongly availed ITC.

Petitioner's submissions

The petitioner contended that Rule 39(1)(a) is manifestly arbitrary and violative of Article 14 of the Constitution because the requirement to distribute ITC in the same month as the invoice is practically impossible to fulfil. It was argued that before distribution, an ISD must verify eligibility conditions under Section 16(2) of the Act, including whether the service was received and whether the supplier reported the tax, which is a time-consuming exercise that cannot be completed forthwith. The petitioner further argued that unamended Section 20 did not grant the power to

prescribe time limits, and the amendment effective 01.04.2025, which introduced the phrase within such time and subject to such restrictions and conditions as may be prescribed should be applied prospectively rather than retrospectively. Citing the precedent of ***Sales Tax Officer Ponkunnam vs. K.I. Abraham***, the petitioner asserted that a rule prescribing a time limit where the parent statute does not is ultra vires. Furthermore, they claimed that imposing adverse consequences like interest and penalty for failing an impossible timeline violates Article 19(1)(g).

Respondent's submissions

Respondents maintained that Rule 39(1)(a) was validly framed under the general rule-making power of Section 164 read with Section 20 of the Act, which allows the government to prescribe the manner of distribution. They characterized the 01.04.2025 amendment to Section 20(2) as a clarificatory amendment that merely made explicit what was always implicit in the power to manage the ISD mechanism. The Department argued that ISD distribution is merely an internal accounting adjustment or book entry and is distinct from the actual availment of credit by a recipient unit under Section 16. They relied on ***Union of India v. VKC Footsteps India Pvt Ltd*** and ***Jayam & Co. vs. Assistant Commissioner*** to argue that ITC is a statutory benefit, not an absolute right, and can be subject to reasonable procedural conditions to prevent revenue leakage and manipulation. The Respondents asserted that the same-month distribution requirement serves legitimate legislative objects, such as maintaining audit trail integrity and facilitating destination-based taxation.

Discussions by and Observations of High Court

The pivotal issue arising for consideration is whether the statutory mandate engrafted in Rule 39(1)(a) of the CGST Rules is *ultra vires* the enabling Act and whether the legal requirement of distribution of credit by the distributor in the same month of receipt of invoice is manifestly arbitrary and violative of Article 14 of the Constitution of India.

On a bare reading of the provisions contained in Section 16(2) of the Act, it is clear that no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him, unless the conditions prescribed in Clauses (a), (aa), (b), (ba), (c) and (d) are fulfilled. Importantly, receipt of notice [invoice] is only the first step which necessarily has to follow fulfillment of other conditions. Relying on Supreme Court precedents (***ALD Automotive Pvt Ltd. and Jayam & Co.***), the Court observed that the input credit is in the nature of benefit/ concession extended to the dealer under the statutory scheme. The concession can be received by the beneficiary only as per the scheme of the statute. It is thus clear that unless all the conditions stipulated in Section 16(2) of the CGST Act are fulfilled as required under the law, a registered person is not entitled to take ITC. A conjoint reading of the provisions contained in Section 16 of the CGST Act and the Rules would reveal that mere receipt of invoice does not entitle the registered dealer to claim to be entitled to ITC without fulfillment of other conditions enumerated therein. Various conditions incorporated therein alone would finally lead to a situation where ITC can be said to be availed legally and in accordance with the

statutory scheme of CGST Act and the Rules made thereunder, not otherwise.

The expression "*the Input Service Distributor shall distribute the credit of central tax or integrated tax charged on invoices received by him*" has to be interpreted keeping in view the other provisions contained not only in Section 20 of the CGST Act, but also Section 16 of the CGST Act and not in isolation. The use of the expression that distribution of credit shall be upon receipt of invoices does not mean that distribution has to take place even before the registered person is entitled to ITC under Section 16 of the Act. Such an interpretation will create absurdity and anomaly. There is no discernible guiding principle or rationale reflected from the scheme of the CGST Act as to what purpose would be served in providing for distribution without fulfillment of conditions for taking ITC as provided under Section 16 of the CGST Act.

The language of Section 20 of the CGST Act does not talk of distribution of "invoice", but of "credit". Merely because the expression used is distribution of credit upon receipt of "invoice", it cannot be taken to mean that the legislative intention is to mandate distribution of credit indicated in the advice even before the registered person is entitled to claim ITC. Rule 39(1)(b) of the CGST Rules which uses the expression "credit available for distribution", therefore, has to be interpreted in consonance with principles of harmonious construction of Sections 16 and 20 of the CGST Act to mean that the "credit" which has become available in accordance with law provided under Section 16 of the CGST Act. This is so because, unless the conditions prescribed in Section 16(2) of the CGST Act are fulfilled, the registered person is not entitled to credit of input tax in respect of any supply of goods or services or both to him. What is mandated to distribute is "ITC". The distribution, therefore, is triggered only upon fulfillment of conditions incorporated in Section 16(2) of the CGST Act and not otherwise. It is clear that what is available for distribution is not the tax invoice, but the ITC. The registered person becomes entitled to the same upon fulfillment of conditions incorporated in Section 16(2) of the CGST Act and not before that.

The said provision, if interpreted in the manner as has been argued by learned counsel for the respondents that what is required to be distributed in terms of provision contained in Section 20 of the CGST Act read with Rule 39 of the Rules is credit as stated in the tax invoice, even without fulfillment of conditions incorporated under Section 16(2) of the CGST Act, will be liable to be struck down as ultra vires Section 16(2) read with Section 20 of the enabling Act. The said Rule only incorporates the expression "the input tax credit available for distribution". It does not, in turn, say that upon receipt of tax invoice, distribution mechanism shall be operated without fulfillment of the conditions of Section 16(2) of the CGST Act. Therefore, the rule is required to be interpreted in the manner that saves its constitutionality.

Decision of the High Court

The provision contained in Sections 16 and 20 of the CGST Act read with Rule 39 of the CGST Rules are required to be applied as above. It is not a case where Rule 39(1)(a) of the Rules is required to be declared *ultra vires* the enabling Act.

2 SMURTI WAGHDHARE VS. JOINT DIRECTOR, DGGSTI, MUMBAI ZONAL UNIT [2026-TIOL-437-HC-MUM-GST] – BOMBAY HIGH COURT

Facts and issues involved

Petitioner is the proprietor of M/s. Platinum International, a registered entity under the Goods and Services Tax Act engaged in the trading of ferrous and non-ferrous metals and scrap. On June 27 and 28, 2023, the Directorate General of GST Intelligence (DGGI) conducted searches at various premises owned by the Petitioner, including her registered principal place of business, another office referred to as Premises No. 19 and the residence of her parents. Pursuant to these searches, the respondents issued two seizure orders in Form GST INS-02, seizing cash amounting to INR 60 Lakhs from Premises No. 19 and INR 40 Lakhs from the residence of the Petitioner's parents, totalling INR 1 Crore. These actions were part of an investigation into an alleged fake Input Tax Credit (ITC) nexus involving one Mr. Hitesh Chheda, a friend of the Petitioner, who was arrested under Section 132(1) of the CGST Act.

Petitioner subsequently filed a writ petition under Article 226 of the Constitution of India seeking the quashing of these seizure orders and the release of the cash with interest.

Petitioner's submissions

Petitioner contended that the seizure of cash was "patently illegal" and not authorized by any provision of the CGST Act. It was argued that Section 67(2) of the Act only authorizes a proper officer to seize "goods, documents, books or things" that are useful or relevant to proceedings and have been secreted at any place. The Petitioner asserted that cash is not something which a proper officer can seize under the provisions of Section 67(2) and that Indian currency is explicitly excluded from the definition of "goods," falling instead under the definition of "money". Furthermore, the Petitioner argued that the Respondents failed to establish any "reason to believe" that the cash was useful for proceedings, a requirement that forms the "undisputed core of search proceedings". It was also submitted that the Respondents violated Section 67(7) of the CGST Act by failing to issue a notice within six months of the seizure, thereby mandating the return of the seized items. Finally, the Petitioner stated the cash was intended for the urgent medical treatment of her mother's heart ailment.

Respondent's submissions

Respondents justified the seizure as necessary to unearth a huge racket operated by the Petitioner and Mr. Hitesh Chheda to claim fake ITC, involving approximately 155 bogus firms and a revenue implication exceeding INR 312.8 Crores. They contended that the Petitioner admitted to providing Premises No. 19 to Mr. Chheda for his use and lacked knowledge of the incriminating documents and data found therein. Relying on the precedent of ***Smt. Kanishka Matta vs. Union of India***, the Respondents argued that the term "thing" in Section 67(2) can include "money" and therefore cash is subject to seizure if it is relevant to tax evasion proceedings. They further alleged that the cash was ill gotten money from the evasion of Goods and Services Tax by fraudulent means and that the Petitioner had no locus to file

the petition as the source of the money was unaccounted for.

Discussions by and Observations of High Court

Court observed that the action of the Respondents was perverse, arbitrary and without the authority of law. It emphasized that Section 67(2) requires the proper officer to have "reason to believe" that goods liable to confiscation or things useful for proceedings are secreted in a place. Bench noted that the respondents gave a go-by to the expression 'reason to believe' which forms the bedrock to initiate proceedings under section 67(2). Referencing the Supreme Court decision in ***ITO vs. Lakhmani Meval Das***, the Court clarified that reason to believe does not mean a purely subjective satisfaction and must have a rational connection rather than being a mere pretence or reason to suspect. Critically, the Court held that the provisions of Section 67(2) do not mandate the seizure of any cash and thus there was no power under which the Respondents could seize the cash. Court also found a violation of Section 67(7), as no notice was issued within six months. Furthermore, the Bench expressed utter shock and dismay regarding the respondents' decision to handover the seized cash to the Income Tax Department, stating they were at pains to understand as to from where the Respondents have sourced the power under the CGST Act for such an action.

Decision of the High Court

High Court quashed and set aside the impugned seizure orders dated June 27, 2023, and June 28, 2023. Court held that the seizure was without any authority of law. Consequently, the Court directed respondent to forthwith release INR 1 Crore and pay the same directly into the petitioner's bank account along with the applicable interest.

3 SOUTH INDIAN BANK LTD VS. JOINT DIRECTOR, DGGSTI [2026-TIOL-427-HC-KERALA-GST] – KERALA HIGH COURT

Facts and issues involved

The banking companies have approached the Court challenging show cause notices issued under Section 74 of the CGST Act. In W.P.(C) No. 23546/2024, the challenge is raised against the Order-in-Original passed under Section 73 of the CGST Act. In all these cases, a common issue that arises relates to the entitlement of the input tax credit in respect of a portion of the tax component on which the petitioners have claimed depreciation under the provisions of the Income Tax Act.

The proceedings were initiated by issuing show cause notice, based on the information received by the officers of DGGSTI that most of the banking companies are availing Input Tax Credit on the capital goods in contravention of Section 16(3) and 17(4) of the CGST Act, 2017. The petitioner therein, for the purpose of availing the input tax credit, opted for Section 17(4) of the CGST Act, and availed 50% of the eligible input tax credit, and the remaining 50% of the same, was lapsed as per the said provision. As far as the 50% of input tax credit lapsed as above

is concerned, the same is capitalized to the respective assets and depreciation is claimed on the gross-block assets under the Income Tax Act, 1961. Thus, as far as the challenge raised in these cases are concerned, the same is confined to the question of alleged wrongful availment of input tax credit in respect of the tax component, to which the petitioners have claimed depreciation under the provisions of the Income Tax Act.

Petitioner's submissions

As far as option available to a banking company under Section 17(4) is concerned, the same enables them to claim Input Tax Credit up to 50% of the eligible Input Tax Credit, in lieu of the normal procedure contemplated under subsection (2) of Section 17. While availing Input Tax Credit up to 50% of the actual entitlement, by virtue of Rule 38, the remaining 50% in respect of which the credit is not claimed, shall be reversed in FORM GSTR-3B. Thus, according to the petitioner, as far as the non-availed portion of the tax component is concerned, the same cannot be subjected to the restriction contemplated under Section 16(3). The sole purpose behind the prohibition contained in Section 16(3) in availing the depreciation benefits, is to avoid the double benefit being availed by the taxpayer – Input Tax Credit under the provisions of the CGST Act and the benefits of depreciation under the provisions of the Income Tax, 1961.

Discussions by and Observations of High Court

The prohibition contemplated is in respect of the tax component for which depreciation is claimed and does not extend to the other portion of the tax component. The expression 'the said tax component' mentioned in the last portion of sub-section (3) of section 16, gives a clear indication to that effect. It is not in dispute that, the purpose of sub-section (3) of Section 16 is to avoid double benefit being availed by the taxpayer. In fact, a prohibition in claiming the input tax credit would be applicable only to the portion of the tax component for which depreciation was claimed and the portion of the tax component for which, no depreciation was claimed, cannot be subjected to the prohibition from availing input tax credit.

Sub-section (4) of Section 17 is a special provision envisaged for the banking and financial institutions, taking note of the peculiar nature of the business they are engaged in. Thus, 50% has been fixed as the eligible input tax credit, instead of bifurcating the taxable supplies and exempted supplies. A fiction has been created to the effect that the remaining 50% is intended to cover the exempt supplies to which input tax credit is not attributable as provided in sub-section (2) of Section 17. The 50% of the input tax, for which no credit is available was treated at par with the value of the exempt supplies contemplated under sub-section (2) of Section 17. Therefore, when the depreciation claimed for the exempt supplies does not attract the prohibition contemplated under Section 16(3), then imposing such a restriction, in respect of the un-availed portion of the input tax credit by opting for sub-section (4) of section 17, would be an unreasonable classification.

If an institution under Section 17(4) avails its 50% eligible Input Tax Credit, the rest shall become lapsed. This means that the unveiled Input Tax Credit cannot have the nature of a tax component, for the purpose of taking credit. Since the unavailed credit under Section 17(4) becomes lapsed, it will not attract the prohibition under Section 16(3), particularly because depreciation has to be claimed upon the tax component of the

cost of capital goods. Therefore, there is no sustainable grounds to uphold the reason based on which the show cause notices and the order were issued to the petitioners as the same are beyond the scope of Section 16(3) of the CGST Act.

Decision of the High Court

Show cause notices and Order-in-Original is quashed to the extent the prohibition is imposed under Section 16(3) of the CGST Act in respect of the 50% of the tax component, for which the petitioners did not avail the depreciation.

4 BIRLANU LTD. VS. UNION OF INDIA [2026] 182 TAXMANN.COM 297 (TELANGANA) – TELANGANA HIGH COURT

Facts and issues involved

Petitioner is registered as an Input Service Distributor (ISD) under the CGST Act. During the audit for the financial years 2017-2018 and 2018-2019, respondent Nos. 2 to 4 observed that the petitioner had accumulated ITC during each financial year and distributed the accumulated ITC in the last month (March 2018-2019) instead of distributing it month wise. This, according to the respondent authorities, is contrary to Rule 39(1)(a) of the CGST Rules, which mandates that the credit available for distribution in a month 'shall be distributed in the same month'. Consequently, a Spot Memo dated 07.12.2023 was issued, followed by additional Spot Memo and Final Audit Report. A show-cause notice dated 30.01.2024 proposing a penalty of ₹ 8,38,67,332/- was issued without granting the petitioner adequate opportunity to respond. The present Writ Petition is filed challenging the constitutional validity of Rule 39(1)(a) of the CGST Rules 2017, the Final Audit Report dated 22.01.2024 and the consequential show-cause notice dated 30.01.2024.

Petitioner's submissions

Rule 39(1)(a) of the CGST Rules, insofar as it mandates distribution of ITC within the same month, is ultra vires Section 20 of the CGST Act as it introduces a mandatory time limitation, not contemplated by the parent statute. The eligibility to ITC is governed exclusively by Sections 16 and 17 of the Act, and once validly availed, such credit constitutes a vested and indefeasible right. Procedural provisions relating to distribution by an ISD cannot operate to extinguish or invalidate such substantive entitlement. Even if Rule 39(1)(a) of the CGST Rules is taken, as it obtains today, it is required to be read as directory and not mandatory. The subsequent amendment to Section 20(2) by the Finance Act, 2024, expressly empowering prescription of time limits with effect from 01.04.2025, clearly demonstrates that no such delegation existed during the relevant period, rendering Rule 39(1)(a), to that extent, unsustainable. The invocation of extended limitation and penalty provisions is wholly unjustified in the absence of any suppression, misstatement, or fraud. All relevant returns and disclosures were made on the common portal and were within the knowledge of the Department.

Respondent's submissions

Section 20 of the CGST Act and Rule 39 of the CGST Rules constitute a composite statutory scheme governing Input Service Distributors and must be read harmoniously.

The amendment to Section 20 of the CGST Act introduced by the Finance Act, 2024 operates prospectively with effect from 01.04.2025 and does not render Rule 39(1)(a) invalid or ultra vires for the earlier period. The Rule 39(1)(a) lawfully operationalizes the statutory mandate contained in Section 20(1) and does not travel beyond the scope of delegated legislation. The impugned proceedings are within jurisdiction and in accordance with law, and that interference at the threshold would seriously prejudice the Revenue.

Discussions by and Observations of High Court

It is pertinent to note that Section 20 of the CGST Act lays down the statutory framework governing the distribution of Input Tax Credit by an ISD and does not stipulate any time limit within which such distribution is required to be effected. It is to be noted that the Rule 39(1)(a) travels beyond the scope of the parent provision, by introducing a mandatory time limit for distribution, which is not contemplated under Section 20 of the Act. In the absence of any express or implied statutory mandate authorizing the prescription of a limitation period, the rulemaking authority cannot, under the guise of prescribing the 'manner', introduce a substantive restriction which has the effect of extinguishing a vested statutory entitlement.

It is well settled that a rule framed 'for carrying out the purposes of the Act' constitutes a general delegation of power, which cannot be exercised to create substantive obligations, disabilities, or conditions not contemplated by the Legislature. By mandating distribution of credit within the same month, Rule 39(1)(a) imposes an inflexible condition which has the effect of denying or forfeiting legitimately accrued Input tax credit, thereby defeating the fundamental objective of the GST regime, namely, the elimination of cascading of taxes. The denial of an identical benefit solely on the ground that the credit is routed through an ISD results in hostile discrimination and is manifestly arbitrary and violation of Articles 14 and 300-A of the Constitution of India. Further, once ITC is lawfully availed in terms of the Act, it crystallizes into a vested statutory right. Any curtailment thereof through delegated legislation, bereft of express legislative sanction and unsupported by a rational nexus to the statutory objective, cannot be sustained.

It is evident that the audit objections were finalized and the matter was also placed before the Monthly Monitoring Committee Meeting (MMCM) without prior notice to the petitioner and without affording an opportunity of being heard. This action is in clear derogation of the fundamental principles of natural justice. The respondents have sought to invoke the extended period of limitation under Section 74 of the CGST Act on the allegation of 'suppression'. However, such invocation does not appear to be sustainable, inasmuch as the record indicates that the particulars of distribution of ITC were duly disclosed by the petitioner in its periodical returns in Form GSTR-6 and were available to the department on the common GST portal. In circumstances where the relevant facts are within the knowledge of the tax authorities, the allegation of 'suppression' is legally untenable. It is settled law that the existence of an alternative statutory remedy does not operate as an absolute bar to the exercise of writ jurisdiction under Article 226 of the Constitution of India, particularly in cases where the vires of a statutory provision is under challenge.

Decision of the High Court

Writ Petition is allowed with the following terms:

- Rule 39(1)(a) of the CGST Rules, 2017, to the extent it mandates that Input Tax Credit available for distribution in a month shall be distributed in the same month, is declared ultra vires Section 20 of the CGST Act, 2017, and is hereby struck down.
- Final Audit Report dated 22.01.2024 and the Show cause notice dated 30.01.2024, along with all consequential proceedings are hereby quashed and set aside.

B. RULINGS BY ADVANCE RULING AUTHORITY

1 PONNUSAMY THANGARAJ (2026) 40 CENTAX 70 (A.A.R.-GST-T.N.) – TAMIL NADU AAR

Facts and issues involved

Applicant is a proprietary concern engaged in business activities and is registered under GST. The proprietor had purchased a new car in April 2025 for personal use, which was subsequently capitalized in the books of accounts of the business. Applicant has not claimed Input Tax Credit (ITC) on the purchase of the car. Further, no depreciation was claimed on the said car for the financial year 2025–26.

Subsequently, the applicant decided to sell the said car as a used vehicle and sought an advance ruling on the question as to whether GST is payable on the full sale value or only on the margin (profit) in terms of applicable provisions.

Applicant relied upon Notification No. 8/2018–Central Tax (Rate) and provisions relating to margin scheme, contending that GST should be levied only on the margin.

Discussion by and Observations of AAR

Before going into the question of value on which GST needs to be paid, it would be beneficial to discuss whether the transaction in question, i.e. sale of car as a used vehicle, is a 'Supply' as envisaged in the CGST Act". On a combined reading of various provisions under GST, sale of used car is an outward supply of goods as the car is a movable property which is being sold for a consideration in the course of the applicant's business. Applicant has capitalized the car in its business account. Therefore, though the transaction effected by the applicant happens to be a single transaction, nevertheless it is a business transaction and therefore becomes taxable under GST.

Now, once it is clear that the said transaction of sale of used vehicle attracts GST, the next obvious step is to arrive at the value of the transaction on which such GST is payable. In the instant case, the applicant claims that they have neither taken input tax credit on the purchase of the new vehicle, nor availed

any depreciation on the capitalization of the said vehicle. It is observed that non-claiming of depreciation by the applicant is on account of the fact that the financial year involved herein, i.e., 2025-26 is yet to come to a close, as the car is reportedly purchased during April 2025. Notwithstanding the same, the entire scheme of valuation based on margin applies to cases where a taxable supply is provided by a person dealing in buying and selling of secondhand goods. Whereas, in the instant case, applicant is neither dealing in secondhand goods or old and used goods, nor they deal in buying and selling of such goods in the normal course of business. Further, though the applicant attempts to sell a 'used' car, the same was reportedly purchased as a 'new' car originally, and therefore, the applicant is not dealing in 'secondhand goods'". Accordingly, the method/manner of valuation of supply representing the margin of the supplier, as laid down under Rule 32 of the CGST Rules, 2017, read with Notification No. 8/2018-Central Tax (Rate) dated 25.01.2018, is effectively ruled out in the instant case, and that the said option is not available to the applicant.

Once the said method of valuation stands ruled out, the applicant by default becomes liable to assessment based on the transaction value, i.e., the price actually paid or payable for the said supply of goods or services or both where the supplier and recipient of the supply are not related and the price is the sole consideration for the supply, as stipulated under Section 15(1)". Applicant is liable to pay taxes on full value, i.e., consideration received by applicant towards sale of car.

Ruling of AAR

Applicant's proposed transaction of sale of used car is liable for tax under GST, as applicable and the tax is liable to be paid on the entire sale value of the used car by the applicant in the instant case, and not on the profit/margin.

2 BOARD OF SECONDARY EDUCATION RAJASTHAN [2026] 184 TAXMANN.COM 50 – RAJASTHAN AAR

Facts and issues involved

Applicant, a government authority, is engaged in supplying services to students in relation to conducting examination. The appellant receives various services from suppliers namely:-

1. Services of providing printing of Answer Sheets, Question papers, OMR sheets, Graphs, Certificates, Mark-sheets etc.
2. Services provided by way of online examination form filling.
3. Service provided by way of annual maintenance of the computers exclusively used for examination purposes.
4. Service of operator provided by supplier for operating computer system.
5. Services provided by way of processing of result through marks allotted in examination".

The main issue for consideration is whether the above referred services received by the applicant, M/s Board of Secondary Education, Rajasthan (RBSE), from various suppliers in connection with the conduct of examinations, are exempt from GST under Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, as amended, read with Circular No. 151/07/2021-GST dated 17.06.2021.

Applicant's submissions

RBSE is an Educational Institution as explained in Notification No. 14/2018 read with paragraph 3 explanation of Notification No. 12/2017, who receives above mentioned services as per its own specifications for conducting examinations. Applicant falls under the definition Educational Institution by virtue of Notification No. 12/2017 which clearly exempts services provided to an Educational Institution in relation to conduct of examination. RBSE qualifies as an Educational Institution for the limited purpose of conducting examinations. All services listed are directly and exclusively related to the conduct of examinations. As per Notification No. 12/2017 (read with amendments), such services are exempt from GST.

Discussion by and Observations of AAR

Authority noted that the AAAR, Jaipur vide order dated 20.02.2024 have remanded back the matter to AAR, Jaipur to decide the application afresh after considering the judgement dated 21.04.2023 of Hon'ble High Court, Calcutta delivered in the case M/s Anmol Industries Ltd. Furthermore, the Supreme Court on the question of maintainability of an application for advance ruling, has held that the definition of 'advance ruling' under Section 95(a) of the CGST Act does not restrict the scope of the applicant to suppliers only. The Court observed that even a person liable to pay tax under reverse charge, or otherwise a recipient of service, may seek an advance ruling.

On the merits, entry No. 66(b)(iv) of Notification No. 12/2017-CT (Rate) exempts services 'to an educational institution, by way of services relating to admission to, or conduct of examination by, such institution.' Further, Explanation (iv) to paragraph 3 explicitly treats Central and State Educational Boards as educational institutions for the limited purpose of conducting examinations. Thus, RBSE qualifies as an educational institution for the limited purpose of conducting examinations. Consequently, services provided to RBSE which are integral and directly connected with the conduct of examinations are only eligible for exemption under Entry No. 66(b)(iv).

Accordingly, all the services mentioned in the application dated 9.2.2022 by the applicant are found to be in relation to the conduct of examination and hence are covered under the exemption available vide Entry No. 66(b)(iv) of Notification No. 12/2017-CT (Rate), as amended.

Ruling of AAR

All services received by applicant is exempted as per Notification No. 12/2017-CT(Rate) read with explanation in paragraph 3 clause (iv) and read with Circular No. 151/07/2021-GST.

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SERVICE TAX





CA Rajiv Luthia

Keval Shah
Advocate

1 M/S. RADIANT ADVERTISING AND MARKETING (INDIA) PVT. LTD. VS. THE COMMISSIONER OF CGST & CENTRAL EXCISE, KOLKATA 2026 (4) TMI 4 - CESTAT KOLKATA

Backgrounds and facts of the case

- The appellants are engaged in the business of Marketing and Advertising in Print/Electronic and Other Media. They were raising bills and paying Service Tax @ 15% of the Total amount charged.
- The impugned proceedings were initiated invoking Extended Period of Limitation on 2 major issues which are as under:
  - Non-Payment of Service Tax amounting to ₹ 1,83,666/- on the ADVANCE RECEIVED during the Financial Years 2008-09, 2009-10, 2010-11 & 2011-12; and
  - Excess Availment of CENVAT Credit of ₹ 4,06,138/- on the Input Services.
- The Ld. Adjudicating Authority and Ld. Appellate Authority has upheld the Service Tax demand amounting to ₹ 6,25,706/- along with consequential Interest and Penalty by passing Order-in-Original and Order-in-Appeal respectively.

Arguments by Appellant Assessee

- The Appellants submitted that the amount of Advance taken was ₹ 10,98,587/- and they demonstrated that these advances received were not purely Taxable Receipts under Finance Act, 1994 but were adjusted through various means:
  - Execution of Work: Advances were adjusted against Services subsequently rendered;
  - Supply of Goods: In some instances, goods were supplied instead of Services, and VAT on such Sale of Goods was paid accordingly
  - Refund & Write-offs: Some amount of the Advances were either refunded to the Clients or amounts which could not be refunded were written-off in the Books of Accounts in FY 2011-12.

- Further, the Appellants submitted and agreed that they are at the most liable to pay service tax @ 15% on the amount of Advance which was written-off by relying on the decision in their own case having Final Order 76704/2024 dated 20th August, 2024.

- Regarding the wrongful/excess availment of CENVAT Credit, the appellants contended that they have not availed any excess Credit and in support of the same submitted the CENVAT Credit Reconciliation Chart.

- The Appellants also stated that the extended period cannot be invoked in the instant case, since the demand has been emanated from scrutiny of Financial Statements, ST-3 Returns and other records of the Appellants by the Ld. CEO and hence in such circumstances suppression of facts with an intent to evade Payment of Service Tax cannot be alleged. The appellants further contested that Demand is Barred by Limitation as some period is even beyond a period of 5 years. The Appellants relied on various Judicial Precedents in this regard.

Arguments by Department

- The Ld. AR for the revenue reiterated the findings of the Ld. Commissioner (Appeals).

Decision of the Hon'ble Tribunal

- The Hon'ble Tribunal observed that the Appellants have adjusted the Advances received as stated by them and also paid Service Tax later. The small amount of Advance was written off by the Appellants. The Hon'ble Tribunal agreed with the contention of the appellant that they are at the most liable to pay service tax only on amount written-off i.e. Service Tax @ 15% is payable on Written off amount and hence set aside the demand upheld in the impugned Order-in-Appeal.

- The Hon'ble Tribunal has gone through the Reconciliation Chart submitted by the Appellants to substantiate their claim that there is no excess availment of CENVAT Credit. The Tribunal further observed that the Closing Balance as on 30th September, 2007 was ₹ 1,71,372/- and in the intervening period has received some invoices and amount of CENVAT Credit taken was shown in Opening Balance. The Hon'ble Tribunal agreed that there is no excess availment of CENVAT Credit and had set aside the demand on this ground.

- The Hon'ble Tribunal also agreed that the demand cannot be sustained as the same has been confirmed by invoking extended period of limitation and demand is also set aside taking this ground into account.

- Consequently, the impugned order is set aside both on Merits as well as technical grounds and the appeal is allowed with consequential relief, as per law.

2 RR KABEL LTD VS. COMMISSIONER OF C.E. & S.T., DAMAN, GUJARAT 2025 (10) TMI 621 – CESTAT AHMEDABAD

Backgrounds and facts of the case

- The Appellant had availed various services such as GTA Service, Manpower Recruitment Agency Service, Legal Services, Security Services and Renting of Immovable Property Service, etc. for its business requirements and was liable to discharge the Service tax under Reverse Charge Mechanism.

- During CERA Audit conducted by the Service Tax Department, it was observed that the Appellant had not paid Service Tax under RCM basis on GTA Service, Manpower Recruitment Agency Service and Renting of Immovable Property Service. During the Audit they paid the applicable Service tax on the above services. Subsequently, they filed 3 Refund Claims for Refund of above amount of Service tax so paid on which they were eligible to claim CENVAT Credit on the ground that they would not be entitled to CENVAT Credit as the Provisions of Chapter-V of the Finance Act, 1994 had LAPSED and GST Provisions came into force with effect from 1st July, 2017.

- The Department issued 3 Show-cause Notices denying the Refund Claims filed alleging that there is no provision for refund of Service tax paid in respect of GTA Services and Manpower Recruitment Agency Service either in Previous regime or under GST.

- The Ld. Adjudicating Authority and Ld. Appellate Authority has rejected the Refund Claimed of the Appellant on the ground that the Appellant is not eligible for refund in terms of existing law and that the new law does not allow them to transit the payment of these taxes into GST regime either by way of Input Tax Credit in terms of Section 16 or under Section 140/142 of the CGST Act, 2017 by passing the impugned Order-in-Original and Order-in-Appeal respectively.

Arguments by Appellant Assessee

- The Ld. Counsel for the Appellants took the following grounds:

  – Repeal of any existing law does not affect the right accrued to the appellant under the said existing Law; hence they have correctly filed 3 refund claims u/s 142(3) read with Section 142(8)(b) of the CGST Act, 2017.

  – Right to claim refund of taxes paid under earlier law is provided by the transitional provisions of GST Act and not by Section 11B of the Central Excise Act, 1944 or Rule 5 of the CENVAT Credit Rules, 2004. They placed reliance on Judicial Precedent in case of Sudarshan Chemical Industries Ltd.

  – Refund has been sanctioned in their own case, on the ground that w.e.f. 1st July, 2017 GST came into existence and CENVAT Credit Rules, 2004 ceased to exist and hence, the claimant is not in a

position to avail CENVAT Credit of such duty paid by them.

- CENVAT Credit is a vested Right and any Law cannot restrict to exercise such right.

- Suppression of Facts stated by the Ld. Commissioner (Appeals) on the ground that only during the course of Audit, non-payment of Service Tax under RCM basis by the Appellant came to the knowledge of the Department is not justified as the entire transaction is Revenue Neutral i.e., they would have paid tax and taken the CENVAT Credit of the same. He relied on various Judicial Precedents.

Arguments by the Department

- The Ld. Authorized Representative of the Revenue relied on the findings of the Lower Authority. He referred to various paras of the impugned OIA to ensure that the Provisions of Section 148(2)(b) of the CGST Act, 2017 are not applicable in this case. He further stated that provisions of Section 11B is also not applicable in the instant case.

Decision of the Hon'ble CESTAT AHMEDABAD

- The Hon'ble Tribunal after hearing both the sides and material on record and after examining the provisions of Section 142(3) of the CGST Act, 2017 dealing with Miscellaneous Transitional Provisions came to conclusion that refund claims by the Appellant merit consideration. The Hon'ble Tribunal stated and relied on the decision of Hon'ble CESTAT Mumbai in case of M/s NSSL Private Limited involving similar facts. The Tribunal reproduced the provisions of Section 142(3) of the CGST Act, 2017 and relevant paras of the decision.

- Further, the Hon'ble Tribunal referred to the decision of Hon'ble CESTAT Chennai in the case of ***Gigamon Solutions Private Limited vs. Commissioner of GST & Central Excise, Chennai reported at 2025(26) CENTAX 170*** under the similar facts and circumstances the appellants filed a refund claim and was allowed by the Hon'ble CESTAT Chennai in favour of the Appellants. The Tribunal reproduced the relevant paras of the said Judicial Precedent.

- Therefore, the Hon'ble CESTAT Ahmedabad held that the issue involved is covered by the above decisions and is no more Res-integra. Thus, agreeing with the finding of the Tribunals in the above cases, the Hon'ble CESTAT Ahmedabad ALLOWED the refund of Service Tax paid under RCM basis whose CENVAT Credit could not be availed by the Appellants for the reasons stated above.

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CASE LAW UPDATE



CS Makarand Joshi

SEBI

BLUE COAST HOTELS LIMITED

In the matter of Blue Coast Hotels Limited Before the Adjudicating Officer, Securities and Exchange Board of India (SEBI) Order dated 11 March 2025

I. Facts of the Case

- SEBI received an examination report from the National Stock Exchange (NSE) regarding irregularities in the financial statements of Blue Coast Hotels Limited (the "Company") for the financial years (FY) 2018-19 to 2021-22. A detailed investigation by SEBI followed for this period (the "Investigation Period" or "IP").

- Mr. Amit Kumar Singhal, who served as the **Chief Financial Officer (CFO)** of the Company during the investigation period, is the **Noticee** in this matter.

- In 2010, the Company qualified for a five-star hotel project at Aerocity, Delhi (Delhi Hotel Project). It incorporated a Special Purpose Vehicle (SPV), **Silver Resort Hotel India Private Limited (SRHIPL)**, to execute the project.

- Due to defaults in license fees and other dues, Delhi International Airport Limited (DIAL) took over possession of the project from SRHIPL on July 16, 2015. Following a representative suit **by multiple individual buyers who had invested in the Delhi Hotel Project** Hon'ble Delhi High Court ordered a refund of ₹ **318.95 crore** to these buyers. Even though the primary liability was on other entities, Blue Coast Hotels agreed to pay this massive amount if the others defaulted, making it a critical financial obligation for the following reasons: The Company specifically agreed to pay this substantial amount if the primary entities defaulted This agreement transformed the refund into a "critical financial obligation" for the Company Under accounting standards (Ind AS 37), because the liability became "probable" and "measurable" following the order of the Hon'ble Delhi High Court, the Company was required to disclose it as a contingent liability.

- The **Noticee (CFO)** was found at fault because, despite the primary liability

technically resting elsewhere, the Company's commitment to pay upon a default created a significant financial risk that was not transparently reported to investors for four consecutive years.

- Despite the **Hon'ble Delhi High Court** order and its agreement to the refund liability, the Company failed to record this ₹ 318.95 crore as a **contingent liability** in its financial statements from FY19 to FY22. It only recorded this in FY23 upon the advice of a new auditor. Beyond the non-disclosure of the primary court-ordered liability, SEBI's investigation into the Company's books (FY19–FY22) revealed a pattern of deeper accounting irregularities. These lapses specifically involved the mischaracterization of project losses and inter-corporate fund transfers, as detailed below:

1. Misclassification of Project Loss: Delhi Hotel Project (FY 2020-21)

- During the Financial Year 2020-21, the Company incurred a substantial loss amounting to **₹ 8.82 crore** specifically related to its Delhi Hotel Project. **The Accounting Violation (Ind AS 1)**: Under **Indian Accounting Standard (Ind AS) 1** (*Presentation of Financial Statements*), items of income or expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the entity for the period must be disclosed separately as **"Exceptional Items."**

  The Company recorded this ₹ 8.82 crore loss under the head of **"Miscellaneous Expenses"** within the "Other Expenses" category. By burying a project-specific loss of this magnitude within general administrative expenses, the Company failed to highlight the significant impact of the project's failure on its net profit. This treatment prevented stakeholders from distinguishing between routine operational costs and one-time significant losses.

2. Inaccurate Classification of Inter-Corporate Payment (FY 2021-22)

- In the Financial Year 2021-22, the Company made a payment of **₹ 2.49 crore** to its Special Purpose Vehicle (SPV), **Silver Resort Hotel India Private Limited (SRHIPL)**. This transaction was recorded in the Company's books of accounts and financial statements as an **"Advance to Supplier."**

- The investigation conducted by SEBI established that this payment was not a commercial advance for the procurement of goods or services in the ordinary course of business. Instead, the nature of the transaction was a disbursement of funds to a group entity, which should have been classified as a **"Loan."**

3. Failure to disclose Related Party Transaction (RPT)

The Company entered into significant financial arrangements with entities defined as "Related Parties" under Section 2(76) of the Companies Act, 2013 and Regulation 2(1)(zb) of the SEBI (LODR) Regulations, 2015, without following the mandatory oversight protocols.

a. Non-Approval of Material RPT: Investment Sale to Silverring Drinks Private Limited

During the period under investigation, the Company

executed a sale of its investment in **Joy Hotel** to an entity named **Silverring Drinks Private Limited**. The total value of this transaction was recorded at ₹ **10.48 crore**. Under Regulation 23 of the SEBI (LODR) Regulations, a transaction with a related party is considered "material" if it exceeds 10% of the annual consolidated turnover of the listed entity (or a specific threshold defined by the Board). Material RPTs require **prior approval from shareholders** through a resolution.

Investigation found that Silverring Drinks was a related party to Blue Coast Hotels. However, the Company failed to place this ₹ 10.48 crore transaction before the shareholders for approval. By bypassing the shareholders, the Company deprived investors of their right to scrutinize a transaction that significantly impacted the Company's asset base.

b. Failure of Prior Approval: Transactions with Zios Medical

The Company engaged in business dealings with **Zios Medical** amounting to ₹ **2.88 crore**. Regulation 23(2) of the SEBI (LODR) Regulations mandates that **all** Related Party Transactions (regardless of whether they are "material" or not) must receive **prior approval from the Audit Committee**. This serves as a primary check to ensure the transaction is at "arm's length" and not prejudicial to the interests of the Company.

The investigation established that Zios Medical was a related party. The Company, however, proceeded with the ₹ 2.88 crore transaction without obtaining the requisite prior approval from its Audit Committee.

By signing on the financial statements and providing CFO certifications without ensuring these approvals were in place, the Noticee/CFO was held to have failed in his fiduciary duty to ensure regulatory compliance.

II. Contentions of SEBI AO

i. **Non-Disclosure of Contingent Liability:** SEBI **alleged** that the Company failed to disclose a massive liability of ₹ **318.95 crore** related to the 2018 **Hon'ble Delhi High Court** refund order in its balance sheets for FY19 to FY22. This was alleged to be violation of **Ind AS 37**.

ii. **Misclassification of Expenses:** SEBI **alleged** that in FY21, a loss of ₹ **8.82 crore** specifically related to the **Delhi Hotel Project** (a failed five-star venture at Aerocity) was buried under "Miscellaneous Expenses". SEBI contended that under **Ind AS 1**, this should have been transparently disclosed as an **"Exceptional Item"**.

iii. ***Advance vs. Loan Treatment*:** SEBI **alleged** that a ₹ **2.49 crore** payment to the SPV (SRHIPL) in FY22 was wrongly classified as an "advance to supplier". SEBI contended that the nature of the transaction was a disbursement to a group entity, which should have been classified as a **"Loan"**. Classifying a loan as an "advance" misleads the

users of financial statements regarding the liquidity and the nature of the Company's receivables. Loans to related parties carry different risk profiles and disclosure requirements (such as interest rates and repayment terms) compared to trade advances. By mislabeling this as a supplier advance, the Company bypassed the transparency required for inter-corporate financial support.

iv. **Related Party Transactions (RPT):** SEBI alleged that the Company executed significant financial arrangements with related entities without following mandatory oversight protocols. These included a ₹ **10.48 crore** sale of investment in Joy Hotel to **Silverring Drinks Private Limited**, which lacked the required prior approval from shareholders, Additionally, the Company engaged in business dealings worth ₹ **2.88 crore** with **Zios Medical** without obtaining the mandatory prior approval from the Audit Committee. By providing certifications for these financial statements, the **Noticee (CFO)** was found to have failed in his fiduciary duty to ensure these transactions followed the regulatory roadmap, especially given the concurrent non-disclosure of a massive liability mandated by the **Hon'ble Delhi High Court.**

v. **CFO Certification (Reg 17(8)):** SEBI **alleged** that this certificate falsely stated that the financials were giving a "true and fair" view despite the Noticee's (CFO's) awareness of the unrecorded ₹ 318.95 crore liability and other misstatements. By certifying these financial statements as "true and fair" under **Regulation 17(8) of the SEBI (LODR) Regulations**, the Noticee (CFO) endorsed these misclassifications. The Adjudicating Officer held that these were not mere technical errors but significant lapses that obscured the true financial position of the Company from the investing public.

III. Held

The Noticee (CFO) filed no written reply to the Show Cause Notice (SCN) and did not attend the personal hearing scheduled for January 21, 2026. There was no rebuttal provided for the accounting treatments, certifications, or RPT violations.

The Adjudicating Officer (AO) proceeded based on the evidence available on record and concluded that:

i. The liability was "probable" and "measurable" following the 2018 **Hon'ble Delhi High Court**. Failure to record it as a contingent liability resulted in misstated financials for four consecutive years.

ii. The Noticee (CFO) guilty of providing **false certifications**. As CFO, he had a fiduciary duty to ensure the integrity of financial reporting which he failed to uphold

iii. This was a deliberate attempt to hide the impact of the project loss on the operational performance of the Company.

iv. The classification was inaccurate and violated accounting principles regarding the nature of inter-corporate transactions.

v. The violations of **Regulation 23 of LODR**, noting that the CFO failed

to ensure that these transactions followed the mandatory regulatory approval roadmap.

IV. Charges levied and Penalty

- The Noticee (CFO) was responsible for the "lapses and omissions" in the financial statements. His certifications were found to be misleading to both the Board and the investors. He has been found to have violated Section 21 of the SCRA read with **Regulations 4(1), 17(8), and 33 of the SEBI (LODR) Regulations, 2015**, as well as relevant Indian Accounting Standards (Ind AS).

- Taking into account the factors under Section 15J of the SEBI Act (nature of default and impact on investors), the AO imposed a **monetary penalty of ₹ 5,00,000/- (Rupees Five Lakh)** on the CFO under Section 15HB of the SEBI Act.

- The Noticee(CFO) was directed to pay the penalty within 45 days through the SEBI online portal.

IBC

SHRI ARVIND KUMAR - APPELLANT VS. BEACON TRUSTEESHIP LTD. AND OTHERS - RESPONDENT

In the matter of *Shri Arvind Kumar - Appellant vs. Beacon Trusteeship Ltd and Others - Respondent* at National Company Law Appellate Tribunal (NCLAT) New Delhi dated 25 February 2026

Facts of the Case

- Arcturus Developers Private Limited - the Corporate Debtor (CD), a real-estate company, issued 50,00,000 Optionally Convertible Debentures (OCDs) of ₹ 1,000 each, with a tenure of 60 months from the date of allotment i.e., 12 June 2019.

- A Debenture Trust Deed (DTD) was executed on 29 July 2019 with Beacon Trusteeship Limited as Debenture Trustee (Financial Creditor/Respondent - FC). Amendments to the DTD were made on 17 January 2020 and 16 January 2024, including revision of redemption provisions and extension of tenure to 108 months.

- First conversion notice was issued by the Debenture Holder on 6 January 2021, calling for conversion of OCDs into equity shares/CCDs within 36 months; a second conversion notice on 5 January 2024 extended this period to 54 months (up to 5 July 2025).

- Due to expiry of the original 60-month tenure, the ISIN expired. Its expiry in this case meant that the OCDs could no longer be electronically processed or converted into new instruments through standard depository corporate actions. The CD used this as a defence claiming conversion was impossible without an active ISIN.

- The CD passed Board and Shareholder's Resolutions on 28 December 2024 to convert OCDs into CCDs.
- On 7 January 2025, the FC exercised the put option demanding payment of approx., ₹ 1,258 Cr within seven days.
- The CD replied on 24 January 2025, asserting its right to convert OCDs until 6 July 2025 and contending that conversion could not occur without an active ISIN, which had expired.
- No payment was made by the CD. The FC filed a Section 7 of Insolvency and Bankruptcy Code, 2016 (IBC/the Code), petition on 17 March 2025.
- The National Company Law Tribunal (NCLT) admitted the petition, holding that in the absence of actual allotment and completion of corporate actions, the right to issue put notice was not lost and default was established.
- Aggrieved by the order of NCLT –the appeal was filed by a suspended director of the CD challenging the NCLT's admission order dated 20 January 2026.

Arguments of the Appellant (CD)

- Debenture Holder, having elected to exercise the conversion option, could not exercise the put option.
- Upon issuance of conversion notice, instruments were automatically deemed equity shares per Clause 6(b) of Schedule 1 of the DTD.
- The 54-month period for conversion (ending 05 July 2025) was available for procedural compliance; put option could not be exercised during this period.
- Conversion could not occur without active ISIN, which expired; Debenture Holder did not provide consent for reactivation
- NCLT failed to consider the deeming provision in Clause 6(b) of DTD and relied only on ministerial acts.
- Debentures having been converted, there was no financial debt to support a Section 7 of IBC petition.
- The Board and Shareholder's Resolutions and balance sheet reflected conversion.

Arguments of the Respondent (Debenture holder/FC)

- CD never converted OCDs into equity instruments; admitted in reply that conversion did not occur due to inactive ISIN.
- The Board and Shareholder's Resolutions and balance sheet were not part of NCLT record and have no effect without actual conversion.
- No statutory filings or register entries show Debenture Holder as equity shareholder.
- Also contended that Clause 6(b) of Schedule I of the DTD merely fixes (or 'pegs') the effective date of conversion retrospectively, subject to completion of all requisite corporate and statutory actions. It does not, by itself, effect an automatic conversion of 'debt' into 'equity', nor does it dispense with mandatory statutory filings.
- The put option may be exercised after 60 months; failure to effect conversion constitutes an event of default under

Clause 11.1 of the DTD, thereby entitling the holder to exercise remedies, including the put option.

- CD neither allotted equity shares nor paid outstanding amount; default established, justifying Section 7 admission.

NCLAT held

- The CD argued that under Clause 6(b) of Schedule I of the DTD, conversion becomes effective from the date of the conversion notice and debentures should be treated as equity from that date. The Respondent stated that Clause 6(b) must be read with Clause 6(c), and conversion is complete only after all statutory requirements are fulfilled. Clause 6(b) only fixes the conversion date after completion.

- Clause 6(a) of DTD imposed a mandatory duty on the CD to convert debentures within seven days of receiving a conversion notice. Clause 6(b) clarified that conversion is effective from the date of notice, but also required issuance of equity shares and immediate recording in statutory registers. Clause 6(c) required all statutory actions and filings to effect conversion.

- NCLAT held that unless all statutory actions are taken, the deemed date of conversion in Clause 6(b) is meaningless. In the present case, the CD admitted that conversion did not occur due to expired ISIN and lack of statutory compliance. Reliance on Clause 6(b) for deemed conversion was rejected.

- NCLAT further noted that if conversion was deemed complete upon the first notice (6 January 2021), there would have been no occasion for a second notice (5 January 2024). The CD's own reply relied on the extended period for conversion, not on automatic conversion.

- Since the debentures were not converted and the Debenture Holder continued to remain a debenture holder, there was no restriction on exercising the put option.

- NCLAT found that in the absence of actual allotment, completion of corporate actions, activation of ISIN, credit of securities, and statutory filings, the beneficiary remained a debenture holder/FC and retained the right to issue put notice**.** Default was established upon non-redemption.

- The NCLAT agreed with these findings and held that there was no actual conversion of OCDs into CCDs, and the Debenture Holder was entitled to exercise the put option.

- The NCLAT also held that the Financial Creditor had established default on the part of the CD. As both debt and default were proved, the NCLT rightly admitted the Section 7 petition, and no interference with its order was warranted.

Companies Act

MADHUKAR ANANTRAO PATHAK VS. MPTA LTD. AND ORS.

In the Matter of *Madhukar Anantrao Pathak vs. MPTA Ltd. and Ors.* - NCLAT Principal Bench, Order dated 9 March 2026

Facts of the Case

- Mr. Madhukar Anantrao Pathak (hereinafter called as "appellant") was a minority shareholder of the respondent company, MPTA Ltd. (hereinafter called as "company"). The said company was managed by the majority shareholders.
- The appellant had already filed a petition alleging acts of oppression and mismanagement, which was pending before the NCLT.
- During the pendency of the said petition, the company sold a property known as "Saakar Bungalow Property" situated at Bhamburda, Pune.
- Pursuant to the sale of the said property, the appellant filed a petition before the NCLT, alleging that the said property was sold in gross violation of Section 180(1)(a) of the Companies Act, 2013 (the Act).
- The appellant argued that the property constituted more than 20% of the undertaking of the company and yet was sold without obtaining approval of shareholders by special resolution.
- However, the NCLT dismissed the said application seeking cancellation of sale; hence, the appellant has filed an appeal before the NCLAT.

Appellant's Arguments

The appellant argued that:

- The net worth of the company was **₹ 20.89 crore**, and the property was sold for **₹ 9.50 crore**.
- This amount was more than 20% of the net worth, thereby falling within the statutory threshold provided under Section 180(1)(a).
- Therefore, the sale of the property violated Section 180(1)(a) of the Act which requires shareholders' approval by special resolution for the sale of the whole or substantially the whole of the undertaking.
- Further, the property was sold at an undervalued price, and the purchaser had knowledge of the ongoing litigation.
- Hence, the purchaser could not be treated as a bona fide purchaser in good faith under Section 180(3).
- The NCLT incorrectly relied on judicial precedents under the Companies Act, 1956, while interpreting the term "undertaking".

Respondents' Arguments

The respondents argued that:

- The property sold was merely an individual asset and not an "undertaking" of the company.

- An undertaking refers to a **business activity or business unit**, not merely an asset of the company.
- Reference was made to the following judgments to support this contention:
  - ***Sree Yellamma Cotton, Woollen and Silk Mills Co.*** **(Madras High Court).**
  - ***P.S. Offshore Inter Land Services Pvt. Ltd. vs. Bombay Offshore Suppliers Ltd.*** **(Bombay High Court).**
- The property had neither generated any revenue since its acquisition nor was it used for business purposes; therefore, it could not be treated as an undertaking u/s 180.
- The company had defaulted on loans from Axis Bank, and the account had been declared NPA.
- Consequently, the sale of the property was carried out to repay the outstanding loan under pressure of SARFAESI.

Held

- The NCLAT upheld the findings of the NCLT and dismissed the appeal for the following reasons:
- 'Undertaking' means a running business, not individual assets; assets are only tools of the business. Sale of a single mortgaged property does not amount to sale of an undertaking.
- Section 180(1)(a) applies only when an 'undertaking' or substantially the whole of it is disposed, not in case of isolated assets. The 20% threshold under Section 180 applies only after the subject qualifies as an undertaking.
- Saakar Bungalow was a non-operational, non-revenue asset, hence its sale was only disposal of an asset, not an undertaking. Therefore, no special resolution under Section 180 was required.
- A legally valid sale cannot be set aside merely because the price is lower than market value.

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FEMA – UPDATES AND ANALYSIS





CA Hardik Mehta *CA Tanvi Vora*

In this article, we have discussed recent amendments made in FEMA through Notifications, Circulars, Master Directions, Press Notes & Press Releases.

A. Update through Circulars and Notifications

1. Reporting under Foreign Exchange Management Act, 1999 – Returns pertaining to External Commercial Borrowing (ECB)

Form ECB 1 and Revised Form ECB 1 (known as Form ECB and Revised Form ECB respectively prior to amendment) shall be treated as returns which do not capture flows. Therefore, Late Submission Fee (LSF) for delayed submission of these forms shall be as follows:

Sr. No.	*Type of Reporting delays*	*LSF Amount (INR)*
1	Form ODI Part-II/APR, FCGPR (B), FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7500

Since LSF amount is per return, each delayed submission of Form ECB 2 return under a Loan Registration Number (LRN) shall be treated as a separate instance for computation of the fixed component of LSF. Therefore, LSF for delayed submission of this form shall be as follows:

2	FC-GPR, FCTRS, Form ESOP, Form LLP(I), Form LLP(II), Form CN, Form DI, Form InVi, Form ODI-Part I, Form ODI-Part III, Form FC, Form ECB, Form ECB-2, Revised Form ECB or any other return which captures flows or returns which capture reporting of non-fund transactions or any other transactional reporting	[7500 + (0.025% x A x n)]

The AD bank shall submit the return (complete in all aspects) received from the eligible borrower, along with due certification, to the Reserve Bank within seven calendar days from the date of its receipt.

A.P. (DIR Series) Circular No. 25 dated 30th March 2026

(Comments: RBI has rightly updated the applicability of LSF to the ECB forms by clarifying 2 aspects – (1) ECB 1 to fall under the "return which does not capture flows" category, thereby having a fixed LSF amount and (2) ECB 2 to fall under the "return that captures flows" category, thereby having a variable LSF amount.

It should however be noted that drawdown of ECB before allotment of Loan Registration Number would be subject to compounding and not LSF since it pertains to a non reporting contravention.)

2. Reporting under Foreign Exchange Management Act, 1999 – Returns pertaining to Foreign Exchange Management (Guarantees) Regulations, 2026

The FEM Guarantee Regulations were notified by RBI in January 2026 wherein reporting requirements were provided. RBI has now provided excel format for the forms pertaining to guarantee transactions as follows:

- Form GRN Issue – For reporting issuance of Guarantee
- Form GRN Modification – For reporting any subsequent change in guarantee terms, namely - guarantee amount, extension of period or pre-closure
- Form GRN Invocation – For reporting invocation of guarantee

These forms are to be submitted:

- by **the surety** where he is a person resident in India; or
- by **the principal debtor** who has arranged the guarantee and where the surety is a person resident outside India; or
- by **the creditor** where the surety and the principal debtor both are persons resident outside India or where the creditor has arranged the guarantee.

The person is required to file the form with the AD Bank on a quarterly basis within 15 calendar days from the end of the respective quarter. Thereafter, AD Bank shall submit the returns to the RBI within 30 calendar days from the end of the respective quarter through CIMS.

For each guarantee issuance, reported through 'Form GRN Issue', the AD bank is required to provide a unique Guarantee Transaction Number before submission of the return to the RBI as per the operational guidelines.

For the purpose of computation of LSF for delayed reporting of 'Form GRN Invocation', the amount involved in the delayed reporting 'A' shall be the amount of liability created towards the surety on invocation.

However, for delayed reporting of 'Form GRN Issue' and 'Form GRN Modification', 'A' shall be considered to be 'Nil' since these returns do not capture flows. LSF shall be calculated using the formula: ₹ 7500 + 0.025% x A x n. ["n" is the number of years of delay in submission, rounded-upwards to the nearest month and expressed up to 2 decimal points; and 'A' is the amount involved in the delayed reporting in INR.]

A.P. (DIR Series) Circular No. 1 dated 1st April 2026

(Comments: The New Regulations were notified in January 2026 but reporting

procedures were yet not operationalised. Through this circular, the RBI has now notified the procedure and provided excel formats of the forms. As the regulation now reads, the first due date of reporting shall be 15th April 2026 for the quarter ended 31st March 2026)

3. Overseas Investment – Submission of References to the Reserve Bank

Currently references pertaining to Overseas Investment received from Persons Resident in India through AD banks are processed centrally at Foreign Exchange Department, Central Office of the RBI.

Sr. No.	*UIN with prefix*	*Regional Office of RBI to which the reference is to be sent to*
1.	AH	Ahmedabad
2.	BG	Bengaluru
3.	BL or BY or PJ	Mumbai
4.	BN or CA or GA or GH	Kolkata
5.	CG or JM or JR or KA or ND or PT or WR	New Delhi
6.	HY	Hyderabad
7.	IKO or MA	Chennai

RBI has now decided that references shall be processed at seven Regional Offices of the RBI with effect from 1st April 2026. AD banks, which were hitherto forwarding such references to the Central Office of the RBI, are now required to submit the same to the designated Regional Offices through PRAVAAH portal of the Reserve Bank as per the UIN (Unique Identification Number of the foreign entity) mapping given below:

A.P. (DIR Series) Circular No. 2 dated 1st April 2026.

(Comments: The processing of applications/ references to RBI by the AD banks have been decentralised to the respective regional offices of the RBI. This move should ensure faster processing of applications and remove any bottlenecks causing delays in applications. It is also most likely that in the future RBI may also decentralise the compounding of Overseas Investment applications.)

B. Issuance of Press Notes by DPIIT

The Government of India reviewed Para 3.1.1 of the Consolidated FDI Policy Circular of 2020 dated 15.10.2020 (famously known as PN3 amendment) on investments from countries sharing land border with India as notified vide Press Note 3 (2020) dated 17.04.2020.

Upon review, Para 3.1.1 of the FDI Policy is amended to provide as follows:

- An entity or citizen of a land border country (LBC), or where a beneficial owner of an investment into India is a citizen of a LBC requires government

approval. The earlier restriction of 'situated in' has been liberalised.

- Clear standarised definition of beneficial owner aligned with Prevention of Money Laundering Rules, 2005.

- Non controlling beneficial ownership upto 10% from LBC is now permitted subject to sectoral caps and DPIIT reporting.

- Mandatorily, the majority shareholding and control of the Indian entity should remain with resident citizens or entities at all times.

Proposals for LBC investments in specified sectors/activities of manufacturing in the following sectors shall be processed and decided within 60 days:

- capital goods
- electronic capital goods
- electronic components
- polysilicon
- ingot-wafer
- solar cells

Committee of Secretaries (CoS) under the Cabinet Secretary may also revise the list of specified sectors.

DPIIT F. No. 5(5)/2020-FDI Policy (Pt-1) dated 15.03.2026 | Cabinet Meeting Press Release dated 10.03.2026 (Release ID: 2237806) Press Information Bureau

(Comments: The amendment shall enable Indian entities to enter in JVs and access critical new technology from global partners more efficiently. Unintended barriers to capital are now removed, e.g. global PE/VC funds with minor LBC investors were forced to approach DPIIT for approval causing delays and hindering the ease of doing business in India. This was adversely affecting FDI investments in Indian start-ups. The increased FDI inflow should hopefully boost the Atmanirbhar Bharat by supplementing domestic capital, accelerating manufacturing growth and economic competitiveness.)

C. Amendment to FAQs

The FAQs on Annual Return on Foreign Liabilities and Assets (FLA) under FEMA, 1999 have been updated by the RBI and can be access at https://rbi.org.in/scripts/FS_FAQs.aspx?Id=95&fn=5 and https://rbi.org.in/scripts/FS_FAQs.aspx?Id=176&fn=5.

The changes are summarised as follows:

- NIC Code list (National Industrial Classification) has been updated to NIC 2025 from the old NIC 2008
- New FAQ inserted in relation to change of residential status of shareholder to NR. RBI specifies that FLA is required to be filed if the shares are held on repatriation basis and not required to be filed if shares are held by such NR on non-repatriation basis
- New FAQ clarifies that the Indian entity needs to revise their FLA data after taking RBI approval irrespective of any amount/percentage variation once the

audited numbers are ready in case the FLA was filed on provisional/unaudited basis

- Entity registered under International Financial Services Centre Authority (IFSCA) and operating from GIFT City is also required to file FLA return
- IFSC entity having investment from a foreign entity is required to submit FLA return
- When an Indian entity invests in an IFSC entity, both entities are required to file FLA return
- In case of large variance in due to applicability of accounting policy/Ind AS, the RBI has suggested to ignore the variation report
- In case of change in email id/authorised person details/head of institution details/entity name/entity address, the account would need to be de-activated (by email to flareturn@rbi.org.in) an registration of new account on the portal with the new details If CIN/LLPIN/UIN are same, the previously filed data will be updated on the new account
- In case of change of CIN after the reporting year (March 31st), the FLA needs to be filed with the old CIN
- Sales/Domestic Sales has been specially explained to include only sales/earnings which is generated as part of the regular business activity/purpose only, i.e., revenue from operations (i.e., sale of goods and services). However, if the primary revenue of the reporting entity is from interest/commission/foreign exchange or revaluation gain, example for hiring/leasing/money changing entities, etc., they need to be reported, being the primary revenue from operations
- Similarly, expenses/purchases done as part of regular business operations are only required to be included in the FLA
- Prepaid expenses do not need to be included in 'Total Purchases'
- Sales and Purchases may be reported based on the income/expenditure incurred for conducting the regular business operations. Even if there is no trading, the primary income/expense is to be reported

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" The idea is, when a man receives
a gift from another, his heart becomes impure,
he becomes low, he loses his independence,
he becomes bound and attached. "

Swami Vivekananda

BEST OF THE REST





Rahul Hakani
Advocate

Niyati Mankad
Advocate

1 S. RAJENDRAN VS. THE DEPUTY COMMISSIONER OF INCOME TAX (BENAMI PROHIBITION) & ORS – JUDGMENT DATED 24 FEBRUARY, 2026 PASSED IN CIVIL APPEAL NO. 7140 OF 2022 [2026 INSC 187]

IBC, 2016 — Ss. 14, 32A, 60(5), 238 — Benami Transactions (Prohibition) Act, 1988 — Ss. 24–27, 45, 46, 67 — Jurisdiction of NCLT/NCLAT — Challenge to provisional attachment under Benami Act — Held, Benami Act is a complete code providing exclusive adjudicatory mechanism; orders of attachment/confiscation thereunder cannot be questioned before NCLT/NCLAT under IBC — Proceedings under Benami Act are sovereign, in rem and dehors insolvency — Moratorium u/s 14 IBC does not bar such proceedings — NCLT's residuary jurisdiction u/s 60(5) does not extend to reviewing actions under independent public law statutes — Remedy lies only under Benami Act

Facts

The case arose from attachment proceedings under the Benami Act against properties of corporate debtors, including M/s Padmaadevi Sugars Ltd. Investigation revealed that 100% shareholding was transferred through a benami arrangement for ₹ 450 crores paid in demonetised currency, with V. K. Sasikala as beneficial owner. Proceedings under Section 24 of the Benami Act culminated in provisional attachment of properties. Meanwhile, CIRP was initiated under the IBC, followed by liquidation. The liquidators challenged the attachment before NCLT, contending that the assets formed part of the liquidation estate and were protected by moratorium. NCLT and NCLAT rejected the challenge, holding lack of jurisdiction, leading to appeals before the Supreme Court.

Issues Involved

a) Whether the legality and validity of provisional attachment orders passed under the Benami Act can be challenged before NCLT/NCLAT under the IBC?

b) Whether Section 14 moratorium bars proceedings under the Benami Act?

c) Whether Section 60(5) confers jurisdiction on NCLT to adjudicate such disputes;

d) Whether attached properties form part of the liquidation estate under Section 36 of IBC.

Held

The Supreme Court upheld the concurrent findings of NCLT and NCLAT and dismissed the appeals. It held that the Benami Act is a self-contained code governing identification, attachment, adjudication and confiscation of benami property (Ss. 24–27, 45, 46, 67). The IBC, though a complete code for insolvency (Ss. 14, 60(5), 238), operates in a distinct field and cannot be invoked to challenge sovereign actions under public law statutes. Proceedings under the Benami Act are not recovery proceedings but penal, in rem actions leading to confiscation and vesting in the State; hence, Section 14 moratorium does not apply. The residuary jurisdiction under Section 60(5) is limited to matters arising out of or in relation to insolvency and does not extend to disputes dehors insolvency, such as determination of benami nature of property. Applying principles of harmonious construction and precedents including ***Innoventive Industries Ltd. vs. ICICI Bank (2018) 1 SCC 407, Swiss Ribbons vs. Union of India 8(2019) 4 SCC 17, Embassy Property Developments V. vs. State of Karnataka (2020) 13 SCC 308, Gujarat Urja Vikas Nigam Ltd. vs. Amit Gupta (2021) 7 SCC 209***, and ***State Bank of India vs. Union of India 2026 INSC 153***, the Court held that jurisdiction to adjudicate attachment lies exclusively with authorities under the Benami Act. Consequently, such attached property does not automatically form part of the liquidation estate, and the appropriate remedy is to challenge the attachment within the statutory framework of the Benami Act.

2 SANT ROHIDAS LEATHER INDUSTRIES AND CHARMAKAR DEVELOPMENT CORPORATION LTD. VS. VIJAYA BANK – JUDGMENT DATED MARCH 19, 2026 PASSED IN CIVIL APPEAL NO. 4841 OF 2023 [2026 INSC 264]

Consumer Protection Act, 1986 — Ss. 2(1)(d), 2(1)(o), 2(1)(g) — "Consumer" — "Commercial purpose" — Determination — Dominant purpose test — Mere deposit of funds in bank earning interest does not ipso facto constitute commercial purpose — However, where deposit is linked to or leveraged for availing credit facilities for business, it may acquire commercial character — Burden to prove commercial purpose lies on service provider — Complaints involving serious allegations of fraud/forgery and disputed pledge of FDR not amenable to summary jurisdiction under Act — Such disputes require adjudication in civil/criminal proceedings — Complaint not maintainable

Facts

The appellant-company invested ₹ 9 crores in a fixed deposit with the respondent bank. Subsequently, the bank informed that an overdraft facility of ₹ 8.10 crores had been sanctioned against the said FDR. Alleging fraud and unauthorized pledge of the FDR, the appellant lodged complaints with authorities and sought reversal of entries. The bank later adjusted the maturity proceeds

of the FDR against the overdraft dues and remitted the balance. Aggrieved, the appellant filed a consumer complaint seeking refund of the entire amount with interest. The NCDRC dismissed the complaint holding that the appellant was not a "consumer" as the transaction was for a commercial purpose.

Issues Involved

(i) Whether the appellant, a body corporate, while availing services of the Bank to deposit its surplus funds in an interest bearing term deposit, such as an FDR, could be considered a consumer as defined in Section 2(1)(d) of the 1986 Act?

(ii) Whether the nature of allegations made in the complaint were such that they took the claim outside the purview of proceedings under the 1986 Act?

Held

The Supreme Court held that under Sections 2(1)(d), 2(1)(o) and 2(1)(g) of the Consumer Protection Act, 1986, determination of "commercial purpose" depends on the dominant intention of the transaction. Mere placement of funds in a bank, even if interest-bearing, does not automatically imply a commercial purpose, as deposits may be for safekeeping or statutory compliance. However, where such deposits are used to leverage credit facilities or augment business, they may acquire a commercial character. The Court relied on ***Lilavati Kirtilal Mehta Medical Trust [(2020) 2 SCC 265], Karnataka Power Transmission Corpn. [(2009) 3 SCC 240, paragraph 21], Harsolia Motors [(2023) 8 SCC 362], Poly Medicure Ltd. [2025 SCC OnLine SC 2443]*** and ***Shriram Chits [(2024) 9 SCC 509]*** to reiterate that (i) dominant purpose test applies, (ii) identity of the entity is not decisive, and (iii) burden to prove commercial purpose lies on the respondent. On facts, there existed a serious dispute regarding whether the FDR was pledged for overdraft, which directly impacted the nature of the transaction. Further, relying on Ravneet Singh Bagga and City Union Bank Ltd., the Court held that allegations of fraud, forgery and disputed contractual arrangements cannot be adjudicated in summary proceedings under the Act, as they involve complex factual and possibly criminal issues. Therefore, the complaint was not maintainable under the Act. Accordingly, while the reasoning of NCDRC on "commercial purpose" was not entirely correct, the dismissal of the complaint was upheld on the ground of non-maintainability, with liberty to the appellant to pursue appropriate civil/criminal remedies.

3 CATALYST TRUSTEESHIP LTD. VS. ECSTASY REALTY PVT. LTD. - JUDGMENT DATED FEBRUARY 24, 2026 PASSED IN CIVIL APPEAL NO. 7424 OF 2025 [2026 INSC 186]

IBC – Section 7 – Admission – Scope – Adjudicating authority is only to ascertain existence of financial debt and default – Alleged restructuring/moratorium not binding absent compliance with contractual mechanism under Debenture Trust Deed – No novation/waiver without written consent of all debenture holders

as per DTD – Unilateral negotiations with one debenture holder do not bind others – "Pre-existing dispute" irrelevant in Section 7 proceedings – NCLT/NCLAT erred in inferring moratorium and rejecting CIRP – Application ought to be admitted

Facts

The respondent company issued non-convertible debentures worth ₹ 850 crore under a Debenture Trust Deed (DTD), of which ₹ 600 crore (Series A) was subscribed and disbursed. The appellant, acting as debenture trustee, later claimed default in repayment and issued demand and recall notices. Meanwhile, the respondent had engaged in restructuring discussions with one debenture holder (ECL Finance Ltd.), seeking moratorium and other concessions, without informing or obtaining consent of the trustee or other debenture holders. The restructuring proposal was ultimately rejected by 94.84% of debenture holders. The appellant filed a Section 7 application under the IBC, which was dismissed by the NCLT and upheld by the NCLAT on the premise that a moratorium/restructuring existed.

Issues Involved

Whether a valid restructuring or moratorium existed so as to negate "default" under Section 7 of the IBC.

Whether unilateral negotiations with one debenture holder could bind all debenture holders and the debenture trustee.

Whether NCLT/NCLAT erred in refusing admission of CIRP by treating the matter as involving dispute or restructuring.

Held

The Supreme Court held that for admission under Section 7 of the IBC, the adjudicating authority is only required to be satisfied about the existence of a financial debt and default, as laid down in ***Innoventive Industries Ltd. vs. ICICI Bank***; the concept of "pre-existing dispute" is irrelevant. The alleged restructuring was not binding as it did not comply with the mandatory procedure under the DTD, which required approval of debenture holders by special resolution and written modification. No novation under Section 62 of the Contract Act occurred, as all parties had not consented. Unilateral communications with one debenture holder could not bind others in the absence of authorization. The Bombay High Court had also refused interim relief on similar grounds. The findings of the NCLT and NCLAT—inferring moratorium, waiver, legitimate expectation, and collusion—were perverse and contrary to the DTD. Consequently, default stood established, and the Section 7 application ought to have been admitted. The impugned orders were set aside and CIRP directed to be admitted.

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THE CHAMBER NEWS



CA Mehul Sheth
Hon. Jt. Secretary



CA Ankit Sanghavi
Hon. Jt. Secretary

Important events and happenings that took place online/physical between **March 1, 2026 to March 31, 2026** are being reported as under:

I. ADMISSION OF NEW MEMBERS

The details of new members who were admitted in the Managing Council Meeting held on March 14, 2026 are as under:

Type of Membership

Life Member	Ordinary Member	Half yearly - Ordinary	Digital Membership
8	16	0	0

Student Member	Associate Member	Total Members
0	0	24

II. PAST PROGRAMMES

RESIDENTIAL REFRESHER COURSE

5.3.2026 to 8.3.2026
Topic: **49th Residential Refresher Course (RRC) on Direct Taxes** on Sheraton Grand Bengaluru Whitefield Hotel & Convention Center

a Management & Taxation of family properties through HUF, Family arrangement and Trusts
Chairman: Mr. Vipul Joshi, Adv.
Speaker: Mr. Dharan Gandhi, Adv.

b Case Studies in Direct Taxes
Speaker: ***Mr. Niraj Sheth, Adv.***

c Beyond Borders Conundrum: Domestic, International Tax, FEMA & Black Money Act (Compliances and Tax issues faced by stakeholders
Panellist's: CA Srinivasan PV
CA Milin Mehta
Moderator: CA Manoj Shah

d Anatomy of a Transaction: Convergence of Sections 68-69D, Section 115BBE, The Benami Act, PMLA
Panellist's: Mr. Saurabh Soparkar, Sr. Adv.; Mr. Chythanya K K, Sr. Adv.
Moderator: CA Jagdish Punjabi

e New Era in Direct Taxes: Implications of the New Act for Stakeholders
Speaker: ***CA Geeta Jani***

f Brains' Trust
Trustees: CA Gautam Doshi
CA Padamchand Khincha
Moderator: CA Kishor Phadke

INTERNATIONAL TAXATION

11.3.2026
Topic: **FEMA SC - Overview of External Commercial Borrowings** (including recent changes)
Speaker: ***CA Harshita Dhariwal***

13.3.2026
Topic: **Study Circle - Colorcon Judgment: Key Takeaways and Practical Implications**
Speaker: ***CA Heena Khajanchi***

27.3.2026
Topic: **Study Circle - International Taxation and Transfer Pricing – Budget 2026 Amendments and Their Implications**
Speaker: ***CA Naman Shrimal***

30.3.2026
Topic: **Recently Notified Income tax Rules, 2026 & New Forms with Focus on International Taxation & Transfer Pricing**
Speaker: ***CA Nilesh Modi***

DIRECT TAXES

Topic: **Webinar Series on "Decoding Appeals, Stay Petitions & Penalty Proceedings"**

a **16.3.2026**
Managing Stay and Recovery Actions
Speaker: ***Adv. Ragini Handa***

b **20.3.2026**
Approach towards Penalties and Efficient Handling of Penal Consequences
Speaker: ***CA Namrata Dedhia***

c **21.3.2026**
Handling Appeals including faceless manner – Drafting Grounds & Submissions – Taxpayers Duties, Do's and Don'ts
Speaker: ***Adv. Priyanka Jain***

COMMERCIAL & ALLIED LAWS

20.3.2026
Topic: **Webinar on Alternative Investment Funds (AIF): Unplugged**
Speaker: ***Adv. Aditya Khandelwal***

INDIRECT TAXES

25.3.2026
Topic: **Classification of Goods and Services under GST**
Group Leader: CA Payal Shah
Chairman: CA S. S. Gupta

MEMBERS' OUTREACH & DEVELOPMENT

27.3.2026
Topic: **CTC NextGen Connect - Corporate Climb or Practice Prime?**
Panelist: CA Anish Thacker, Adv. Nitesh Joshi
Moderator: CA Hrudyesh Pankhania

28.3.2026
Topic: **Chamber Premier League (CPL) Cricket Tournament**
Speaker:

ACCOUNTING & AUDITING

30.3.2026
Topic: **Lecture meeting on Not the Client, But You: Handling Notices Served on CA Firm**
Speaker: ***CA Padmashree Crasto***


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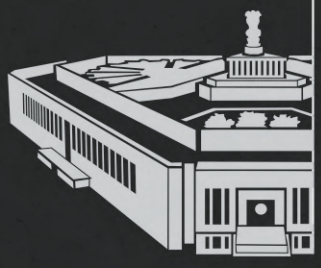



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