MY LORDS

Key Recent Supreme Court and ITAT Special Bench Decisions

6TH EDITION

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A BETWEEN US PUBLICATION

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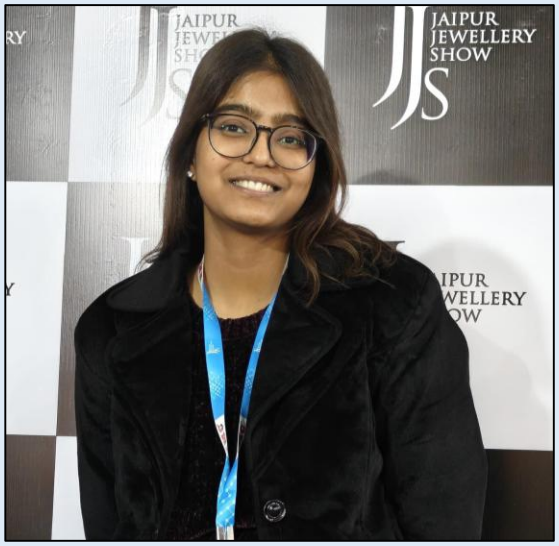

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From the Editors' Desk

Dear Readers,

The legal landscape is currently undergoing a period of profound transformation, where the ability to navigate legal complexities is the hallmark of a true professional. It is with a sense of esteemed purpose that we introduce the **6th Edition of *My Lords*—a publication by *Between Us*.**

As we move further into this decade, the realm of **Direct Tax Laws** has been redefined by a series of high-stakes legal interpretations. This edition moves beyond traditional summaries to offer a rigorous analysis of **Supreme Court** and **Special Bench ITAT** rulings delivered across the year **2025**. These decisions are not merely case law, they are the architectural blueprints currently reshaping India's fiscal jurisprudence. Whether you are an **aspiring Chartered Accountant** mastering the core tenets of the law or a **veteran practitioner** managing sophisticated tax litigation, this edition is designed to be your intellectual anchor in a sea of volatility.

Our gratitude goes out to our mentors, whose seasoned wisdom guided the way for this project. Most importantly, we acknowledge the intellectual rigor of **all the authors whose articles grace this journal.** Their diverse insights and commitment to the "pursuit of veracity" have elevated this edition from a simple compilation to a profound academic inquiry.

We invite you to delve into these pages not just for information, but for inspiration. Let us foster an environment of **intellectual curiosity and professional synergy**, working together toward a tax regime that balances efficiency with equity. Ultimately, our progress as a fraternity is defined not just by the precedents we follow, but by **our collective capacity to think critically and innovate** within the frameworks of justice.

Warm regards,

Vedansh, Rakshita & Bharat

The Editorial Team, 6th Edition of *My Lords*—A *Between Us* Publication

R Sogani & Associates

TABLE OF CONTENTS

❖ Cases reviewed by Adv. Ruchika Sogani

❖Design and layout by Rakshita Gupta

Interpretation and application of procedural provisions under the Income Tax Act, 1961, particularly in relation to revised returns.

M/s Shriram Investments

vs.

Commissioner of Income Tax III, Chennai.

CIVIL APPEAL NO. 6274 OF 2013

4th October 2024

Author: Ritika Saini

Bench:

Justice Abhay S. Oka

Justice Augustine George Masih

Brief Facts:

The assessee filed its original return of income for the Assessment Year 1989–90 on 19 November 1989 in accordance with the provisions of the Income Tax Act, 1961. Thereafter, a revised return was filed on 31 October 1990 within the permissible statutory period. Subsequently, the assessee filed another revised return on 29 October 1991 claiming deduction of deferred revenue expenditure. The Assessing Officer declined to consider this revised return on the ground that it was barred by limitation under Section 139(5) of the Act. The Commissioner of Income Tax (Appeals) affirmed this view. On further appeal, the Income Tax Appellate Tribunal remanded the matter to the Assessing Officer to examine the claim on merits. However, the High Court of Madras set aside the Tribunal's order, which led to the present appeal before the Supreme Court.

Issues Involved:

The primary issue involved in the case was whether the Assessing Officer has the jurisdiction to consider a claim made by an assessee through a revised return filed beyond the statutory time limit prescribed under Section 139(5) of the Income Tax Act, 1961.

Sections Involved:

Section 139(5) of the Income Tax Act, 1961 permits an assessee to file a revised return to correct any omission or wrong statement in the original return, subject to compliance with the time limits prescribed therein. The provision is procedural in nature but mandatory in its application. Section 254 empowers the Income Tax Appellate Tribunal to pass such orders as it thinks fit after hearing the parties, thereby granting it wide appellate jurisdiction.

What the AO Held:

The Assessing Officer held that the revised return filed on 29 October 1991 was time-barred under Section 139(5) of the Act. As a result, the Assessing Officer refused to take cognizance of the claims made therein, stating that the return had no legal validity and could not be considered during the assessment proceedings.

What the CIT(A) Held:

The Commissioner of Income Tax (Appeals) upheld the order of the Assessing Officer. It was observed that once a revised return is filed beyond the prescribed limitation period, the Assessing Officer is statutorily barred from considering the claims made therein. Accordingly, the appeal filed by the assessee was dismissed.

What the ITAT Held:

The Income Tax Appellate Tribunal partly allowed the appeal and remanded the matter to the Assessing Officer with directions to examine the assessee's claim relating to deferred revenue expenditure. The Tribunal exercised its appellate powers under Section 254 to ensure that the substantive claim of the assessee was examined.

What the High Court Held:

The High Court of Madras set aside the order of the Income Tax Appellate Tribunal. The Court held that once the revised return was barred by limitation under Section 139(5), there was no statutory provision that permitted the Assessing Officer to consider the claim. The High Court emphasized strict compliance with procedural provisions of the Act.

What the Supreme Court Held (Ratio and Contentions):

The Supreme Court dismissed the appeal and affirmed the view taken by the High Court. It held that the Assessing Officer does not have jurisdiction to entertain a claim made through a revised return filed beyond the statutory limitation prescribed under Section 139(5). The Court relied on the decision in Goetze (India) Ltd.*[2006] 157 Taxman 1 (SC)* and clarified that although appellate authorities such as the ITAT possess wide powers under Section 254, such powers do not extend to the Assessing Officer. The Court further observed that procedural compliance under the Act is mandatory and cannot be relaxed at the assessment stage.

My Analysis:

This judgment reinforces the fundamental principle that statutory timelines prescribed under the Income Tax Act, 1961 are mandatory in nature and must be strictly complied with by the Assessing Officer. The Supreme Court has clearly emphasized that procedural requirements under tax law are not mere technicalities but form an essential part of the statutory framework governing assessments. By denying the Assessing Officer the power to entertain claims made through a time-barred revised return, the Court has upheld the rule of law and legislative intent behind Section 139(5).

The decision also draws a well-defined distinction between the powers of assessment authorities and appellate forums. While appellate authorities such as the Income Tax Appellate Tribunal are vested with wider discretionary powers under Section 254 to admit additional claims in the interest of substantive justice, such flexibility is consciously not extended to the Assessing Officer. This demarcation ensures that the assessment stage remains confined within statutory boundaries, while appellate stages function as corrective mechanisms.

Furthermore, the ruling promotes certainty, predictability, and procedural discipline in tax administration. Allowing belated claims at the assessment stage could lead to arbitrariness and undermine the finality of proceedings. By reaffirming strict adherence to procedural timelines, the judgment strikes a balance between administrative efficiency and taxpayer rights, thereby strengthening the integrity and uniform application of the income tax regime.

Strategic Oversight Creating Fixed Place PE in India: Supreme Court Reaffirms Substance-over-Form Test under India–UAE DTAA

Hyatt International Southwest Asia Ltd.

vs.

Additional Director of Income-tax

478 ITR 238(SC)

24 July 2025

Author: Bharat Ganglani

Bench:

Hon'ble Justice J.B. Pardiwala

Hon'ble Justice R. Mahadevan

Brief Facts:

The assessee, Hyatt International Southwest Asia Ltd., is a company incorporated in the Dubai International Financial Centre, United Arab Emirates, and is a tax resident of the UAE. The assessee is engaged in providing strategic planning, brand oversight and know-how services to hotels operating under the Hyatt brand.

On 4 September 2008, the assessee entered into two Strategic Oversight Services Agreements (SOSA) with Asian Hotels Limited (subsequently Asian Hotels (North) Limited), India—one in respect of a hotel at Delhi and the other at Mumbai. Under the SOSA, the assessee agreed to provide strategic planning, operational policies, branding, marketing, financial oversight and human resource related services to ensure that the hotels were developed and operated in accordance with Hyatt's international standards.

For the Assessment Years 2009-10 to 2017-18, the assessee filed returns declaring nil income in India, contending that it did not have any Permanent Establishment (PE) in India under the India–UAE Double Taxation Avoidance Agreement (DTAA). The Assessing Officer, however, held that the assessee had a fixed place Permanent Establishment in India under Article 5(1) of the DTAA and taxed the income received under the SOSA in India.

The assessee's objections were rejected by the Dispute Resolution Panel (DRP). Appeals before the Income Tax Appellate Tribunal (ITAT) and the Delhi High Court were dismissed insofar as the existence of PE was concerned. Aggrieved by the High Court's decision, the assessee approached the Supreme Court.

Issues Involved:

1. Whether the assessee had a Permanent Establishment in India in the form of a fixed place of business under Article 5(1) of the India–UAE DTAA.
2. Whether the hotel premises in India could be regarded as being "at the disposal" of the assessee.
3. Whether the income received by the assessee under the Strategic Oversight Services Agreement was attributable to such Permanent Establishment and taxable in India under Article 7 of the DTAA.

Sections Involved –

Section 9(1)(i) of the Income-tax Act, 1961- This section provides that income accruing or arising, whether directly or indirectly, through or from any business connection in India shall be deemed to accrue or arise in India.

Section 92F(iii-a) of the Income-tax Act, 1961- This section defines "permanent establishment" to include a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Article 5(1) of the India–UAE DTAA- Article 5(1) defines Permanent Establishment as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Article 7 of the India–UAE DTAA- Article 7 provides that the business profits of an enterprise shall be taxable only in the State of residence unless the enterprise carries on business in the other Contracting State through a Permanent Establishment situated therein. In such cases, only profits attributable to the PE may be taxed in the source State.

What the Assessing Officer (AO) Held

The Assessing Officer held that the assessee had a Permanent Establishment in India in the form of a fixed place of business under Article 5(1) of the India–UAE DTAA. The AO observed that under the SOSA, the assessee exercised pervasive control over the strategic, operational and financial aspects of the hotels in India. The AO further held that the assessee's activities constituted a business connection in India under Section 9(1)(i) of the Act and that the income earned under the SOSA was taxable in India.

What the CIT(A) Held

Not applicable, as the matter was governed by the Dispute Resolution Panel (DRP) mechanism. The DRP upheld the findings of the Assessing Officer and confirmed that the assessee had a Permanent Establishment in India.

What the ITAT Held

The ITAT upheld the order of the Assessing Officer and held that the assessee had a fixed place Permanent Establishment in India. Relying heavily on the decision of the Supreme Court in Formula One World Championship Ltd. v. CIT, the ITAT observed that the hotel premises were effectively at the disposal of the assessee and that the assessee carried on its core business activities through such premises. Accordingly, the income was held to be taxable in India

What the High Court Held

The Delhi High Court affirmed the findings of the ITAT and held that the assessee had a Permanent Establishment in India under Article 5(1) of the India–UAE DTAA. The Court observed that the assessee's role went far beyond mere advisory or preparatory functions and extended to substantive operational control over the hotels. The High Court held that the hotel premises constituted a fixed place of business of the assessee in India.

What the Supreme Court Held (Ratio + Contentions of Both Parties)

Contentions of the Assessee –

The assessee contended that it merely provided strategic and advisory services from Dubai and did not have any fixed place of business in India. It was argued that there was no exclusive or designated space at the hotel premises placed at the disposal of the assessee. The assessee further contended that day-to-day operations were carried out by an Indian group entity under a separate agreement and that occasional visits by employees could not result in a Permanent Establishment.

Contentions of the Revenue –

The Revenue contended that the SOSA conferred extensive and enforceable rights upon the assessee, including control over staffing, operations, branding, pricing and financial matters. It was argued that the assessee's employees made frequent and regular visits to India and carried on core business activities through the hotel premises, which were effectively at the disposal of the assessee. Hence, a fixed place PE existed in India.

Ratio Laid Down by the Supreme Court-

The Supreme Court upheld the findings of the High Court and held that the assessee had a fixed place Permanent Establishment in India under Article 5(1) of the India–UAE DTAA. The Court held that exclusive possession of premises is not a prerequisite for constitution of a PE and that temporary or shared use of space is sufficient if the business of the enterprise is carried on through such space.

The Court emphasized that the long duration of the SOSA (20 years), the continuous and functional presence of the assessee, and the pervasive control exercised over strategic, operational and financial aspects of the hotels satisfied the tests of stability, productivity and dependence. The hotel premises were therefore held to be at the disposal of the assessee. Consequently, the income received under the SOSA was attributable to such PE and taxable in India under Article 7 of the DTAA.

My Analysis-

This judgment significantly reinforces the expansive interpretation of a fixed place Permanent Establishment under Indian tax jurisprudence. The Supreme Court has reiterated that economic substance and functional control prevail over formal legal arrangements while determining the existence of a PE.

The decision clarifies that in service-oriented and management-driven business models, the absence of exclusive physical space or ownership of premises does not negate the existence of a PE. What is crucial is the degree of control, continuity of presence, and integration of activities with the core business operations carried out in India.

From an international taxation perspective, this ruling signals heightened PE risks for multinational groups engaged in long-term strategic, management or oversight arrangements with Indian entities. The judgment underscores the need for careful structuring of cross-border service agreements and robust evaluation of PE exposure, particularly where revenue is linked to operational performance in India.

Overall, the ruling aligns Indian jurisprudence with global PE principles laid down in OECD and UN Model Conventions while adopting a fact-intensive and substance-driven approach.

A Critical Analysis of Reduction of Share Capital as a 'Transfer' under Section 2(47)

Principal Commissioner of Income-tax

vs.

Jupiter Capital (P.) Ltd.

SLP NO. 63 OF 2025

2nd January, 2025

Author: Prerna Vyas

Bench:

Justice J.B. Pardiwala

Justice R. Mahadevan

Brief Facts:

M/s Jupiter Capital Pvt. Ltd. ("Assessee") is a company engaged in investing in shares, leasing, financing, and money-lending. It held 15,33,40,900 equity shares of Asianet News Network Pvt. Ltd. (ANNPL) representing 99.88% of the total equity.

Due to significant losses, ANNPL's net worth was eroded. Consequently, ANNPL obtained an order of the Bombay High Court under the Companies Act permitting reduction of its share capital to set off losses against paid-up capital. As a result:

- ANNPL's total shares were reduced from 15,35,05,750 to 10,000.
- The Assessee's holding proportionately reduced from 15,33,40,900 shares to 9,988 shares.
- The face value per share remained ₹10.
- ANNPL paid ₹3,17,83,474 as consideration to Jupiter Capital under the capital reduction scheme.

On these facts, the Assessee claimed a long-term capital loss of ₹164,48,55,840 under the Income-tax Act, 1961 ("IT Act").

Issues Involved:

Whether the reduction in share capital of a subsidiary, leading to proportional reduction in the shareholder's shareholding (without change in face value or percentage holding), constitutes a "transfer" under Section 2(47) of the Income-tax Act, thereby entitling the shareholder i.e., Jupiter Capital to claim capital loss under Section 45?

Sections Involved:

The following sections of the **Income Tax Act, 1961** are central to the case:

1. Section 2(47) – Definition of "Transfer":

'transfer' in relation to a capital asset, includes,

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in trade or a business carried on by him, such conversion or treatment; or

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53-A of the Transfer of Property Act, 1882 (4 of 1882); or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a cooperative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

2. Section 45 of IT Act:

Section 45 provides that any profits or gains arising from the transfer of a capital asset in the previous year are chargeable to tax as capital gains and shall be deemed to be the income of the previous year in which the transfer took place.

What the AO Held:

The Assessing Officer (AO) disallowed Jupiter Capital's claim for capital loss on the basis that there was no "transfer" within the meaning of Section 2(47) because:

- The face value per share remained ₹10 both before and after reduction.
- There was no change in percentage of shareholding which remained 99.88% leading to no change in voting power.
- No conventional sale or exchange of shares occurred.

Therefore, according to the AO, the reduction in share capital did not trigger capital gains/loss.

What the CIT(A) Held:

The Commissioner of Income-tax (Appeals) agreed with the AO's view and upheld the disallowance of capital loss. CIT(A) held that since the percentage holding of the Assessee remained unchanged and there was no extinguishment of rights in a meaningful sense merely because share count reduced.

Accordingly, CIT(A) ruled that Section 2(47) was not attracted.

What the ITAT Held:

On second appeal by the assesse to the Income-tax Appellate Tribunal (ITAT), Bangalore, the Tribunal reversed the AO and CIT(A) decisions and held:

Reduction in share capital resulting in a proportionate reduction in number of shares constitutes a transfer within Section 2(47).

Even though Jupiter Capital continued as shareholder and held the same proportion of shares, the reduction resulted in **extinguishment of a bundle of rights** attached to shares including rights to dividend, rights in assets on liquidation, etc.

Reliance was placed on Kartikeya V. Sarabhai v. CIT (1997) 94 Taxman 164/228 ITR 163 (SC) where the Supreme Court held that the percentage of shareholding before and after reduction is irrelevant, and what is material is the extinguishment of rights for considering it as transfer of capital asset. Since the facts of the present case are covered by this judgment, the assessee's claim of capital loss due to reduction of share capital in ANNPL is allowable.

Accordingly, the ITAT allowed the Assessee's claim for capital loss.

What the High Court Held:

The Karnataka High Court affirmed the ITAT's order:

The High Court rejected the Revenue's argument that there was no extinguishment because the face value and shareholding percentage remained unchanged.

It held that the reduction extinguished part of the Assessee's rights in its shareholding and that the Tribunal was correct in holding that such extinguishment amounted to transfer under Section 2(47).

Therefore, the Assessee was entitled to treat the transaction as giving rise to a capital loss.

What the Supreme Court Held:

The Supreme Court of India dismissed the **Special Leave Petition** filed by the Principal Commissioner of Income-tax, thereby *affirming the High Court and ITAT decisions.*

Ratio Laid Down By SC:

- **Inclusive nature of Section 2(47):** Section 2(47) includes **extinguishment or relinquishment of rights** in a capital asset within the definition of transfer.
- **Extinguishment of rights due to capital reduction:** Reduction in share capital of ANNPL, even without change in face value or proportionate holding, resulted in extinguishment of part of Jupiter Capital's rights in its shares (e.g., right to dividend, liquidation rights, etc.).
- **Real effect over form:** Substance of the transaction that is extinguishment of rights and receipt of consideration, must be evaluated rather than formalistic observations that says same face value or percentage holding.
- **Application of precedent:** The Supreme Court restated its earlier ruling in Kartikeya V. Sarabhai vs. CIT (1997) 94 Taxman 164/228 ITR 163 (SC) that reduction of rights attached to shares constitutes transfer under Section 2(47).

- **Capital loss claim allowable:** Since a transfer occurred, Jupiter Capital was entitled to claim capital loss under Section 45.

Accordingly, the SLP was dismissed.

Contentions:

- **Assessee's Argument:**
    - The capital reduction scheme resulted in extinguishment and relinquishment of rights in respect of shares that were cancelled.
    - The company paid consideration and part of the shareholding was formally relinquished and rights extinguished by operation of scheme.
    - As per earlier Supreme Court precedents, extinguishment of rights in a capital asset constitutes transfer under Section 2(47).
- **Revenue's Argument:**
    - There was no extinguishment of rights with respect to shares just because share count was reduced.
    - Percentage holding and face value remaining constant negated the existence of transfer under Section 2(47).
    - Therefore, capital loss claimed by Jupiter Capital should not have been allowed.

My Analysis:

This judgment clearly explains that reduction of share capital is not a mere accounting adjustment, but a real legal event that affects a shareholder's rights. Even if the shareholder continues to hold the same percentage of shares and the face value of shares remains unchanged, the cancellation of shares results in loss of rights, such as rights to dividends and assets on liquidation.

Additionally, between the two concepts under Section 2(47) i.e.,

- Relinquishment of the asset
- Extinguishment of any rights

"Extinguishment of rights" fits this case better than "relinquishment of asset." As, relinquishment of asset is a voluntary act and the assessee did not voluntarily give up the shares; instead, its rights in those cancelled shares were automatically extinguished due to the capital reduction. This loss of rights is sufficient to treat the transaction as a transfer.

This case settles an important doubt and makes it clear that **substance is more important than form**. Tax authorities cannot deny capital loss merely because there is no sale of shares or because shareholding percentage remains the same. The ruling strengthens legal certainty and helps taxpayers understand that capital reduction can have direct tax consequences.

A Critical Analysis of Revisionary Jurisdiction under Section 263: The Distinction between 'No Inquiry' and 'Wrong Conclusion'

Principal Commissioner of Income-tax

vs.

NYA International

[2025] 173 taxmann.com 103 (SC)

17th February, 2025

Author: Rakshita Gupta

Bench

Hon'ble Chief Justice Sanjiv Khanna

Hon'ble Justice Sanjay Kumar

Brief Facts of the Case

NYA International, a partnership firm, filed its return of income for **A.Y. 2012-13** on **16.08.2012** declaring **total income as nil.** The case was selected for scrutiny and an assessment order was passed under **Section 143(3)** on **25.03.2015**.Subsequently, information was received from DDIT (Investigation) Unit-7(2) Mumbai that the assessee was maintaining a bank account with **ING Vysya Bank** with substantial credit entries of **Rs.70,13,43,319**, which was not disclosed in the return of income.

Additionally, during the year, the assessee had claimed exemption under **Section 10AA** of **Rs.87,21,44,414,** which was disallowed by the AO in subsequent assessment years (2013-14 and 2014-15).Based on these reasons, the case was reopened under **Section 147** by issuing a notice under **Section 148**. The AO passed a reassessment order on **31.12.2019**, making a disallowance of **Rs.87,21,44,414** (relating to Section 10AA deduction).

However, **no addition was made** regarding the credit entries of **Rs.70,13,43,319** in the ING Vysya Bank account. **The Principal Commissioner of Income Tax (PCIT), Surat,** exercising powers under **Section 263**, noted that the assessee was maintaining **three bank accounts** (two with Allahabad Bank and one with ING Vysya Bank) which were not disclosed in the ITR.

The PCIT held that the AO had not made any inquiry regarding these credit entries, making the order **erroneous and prejudicial to revenue**. A show cause notice was issued, and the **reassessment order dated 31.12.2019 was set aside on 18.02.2022 with directions to reframe the assessment.**

The assessee challenged the PCIT's order before the ITAT, which set aside the revisionary order, holding that the **AO had conducted sufficient inquiry** and the order could not be termed erroneous and prejudicial to revenue. The Gujarat High Court upheld the ITAT's decision on **18.09.2023**. The Revenue filed an SLP before the Supreme Court.

Issues Involved

a) Whether the PCIT was justified in exercising revisionary jurisdiction under Section 263 when the AO had conducted inquiry into credit entries during reassessment proceedings, even though no addition was made?

b) Whether this was a case of 'no inquiry' or 'inadequate inquiry'?

c) The distinction between 'no enquiry' and 'wrong conclusion'?

d) Whether the PCIT could substitute the AO's opinion?

Sections Involved

A. Section 263 - Revision of Orders Prejudicial to Revenue

a) As per Section 263(1):

"The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including:

a) An order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment."

b) Conditions Required:

i. The order must be "erroneous"
ii. The order must be "prejudicial to the interests of revenue"

Both conditions must be satisfied cumulatively.

c) Critical Consideration - Explanation 2 to Section 263

Explanation 2 was inserted by Finance Act, 2015 with effect from June 1, 2015:

"For the purposes of this section, it is hereby declared that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner -

(a) the order is passed without making inquiries or verification which should have been made;

(b) the order is passed allowing any relief without inquiring into the claim;

(c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or

(d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person."

d) Application to Present Case:

Since the A.Y. is 2012-13, Explanation 2 did NOT apply. The case was governed by the pre-amendment judicial interpretation.

Before 2015, Section 263's scope was determined entirely by judicial interpretation:

i. **Malabar Industrial Co. Ltd. v. CIT [2000] 243 ITR 83 (SC):** Section 263 cannot be invoked to correct every error. If the AO adopted a permissible course after inquiry, even if resulting in revenue loss, the order is not erroneous unless the view is unsustainable in law.

ii. **CIT v. Max India Ltd. [2007] 295 ITR 282 (SC):** When the AO makes detailed inquiries and assesses after considering materials, there is no 'no inquiry' or 'inadequate inquiry.'

B. <u>Section 147 - Income Escaping Assessment</u>

"If any income chargeable to tax, in the case of an assessee, has escaped assessment for any assessment year, the Assessing Officer may, subject to the provisions of sections 148 to 153, assess or reassess such income or recompute the loss or the depreciation allowance or any other allowance or deduction for such assessment year"

C. <u>Section 148 - Issue of notice where income has escaped assessment</u>

"Before making the assessment, reassessment or recomputation under section 147, the Assessing Officer shall subject to the provisions of section 148A, issue a notice to the assessee, along with a copy of the order passed under sub-section (3) of section 148A, requiring him to furnish, within such period as may be specified in the notice, not exceeding three months from the end of the month in which such notice is issued, a return of his income or income of any other person in respect of whom he is assessable under this Act during the previous year corresponding to the relevant assessment year"

The first proviso to section 148 states that *"Provided that no notice under this section shall be issued unless there is information with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment in the case of the assessee for the relevant assessment year"*

D. Section 10AA - Special provisions in respect of newly established Units in Special Economic Zones

This section provides for deduction in respect of units located in Special Economic Zones (SEZ). The assessee had claimed deduction under this section, which was one of the two reasons for reopening the assessment. The AO disallowed this deduction during the reassessment proceedings, indicating that he had actively examined and formed an opinion on this issue.

What the Assessing Officer Held?

The reassessment order under Section 148 reflected:

a) Examination of Credit Entries: The AO examined the bank statements and credit entries. After inquiry, no addition was made, implicitly accepting the explanation or finding credits did not represent undisclosed income.

b) Disallowance of Section 10AA: The deduction was disallowed by the Assessing Officer pursuant to an active examination undertaken by him.

What the ITAT Held?

The ITAT, after examining the facts and the legal position, held in favor of the assessee and set aside the PCIT's revisionary order under Section 263. The key findings of the ITAT were:

a) Inquiry Was Conducted: The ITAT specifically noted that the Assessing Officer had examined both issues raised in the reopening notice under Section 147, namely:
   i. The credit entries in the bank account maintained with ING Vysya Bank
   ii. The claim of deduction under Section 10AA

b) Not a Case of 'No Inquiry': The Tribunal found that the entries in the bank statement were duly examined by the AO during the reassessment proceedings. The fact that the AO did not make an addition after such examination did not mean that no inquiry was conducted.

c) Distinction Between 'No Inquiry' and 'No Addition': The ITAT recognized the crucial distinction between a situation where no inquiry is conducted (which would justify Section 263 proceedings) and a situation where inquiry is conducted but the AO forms a view that no addition is warranted (which would not justify Section 263 proceedings).

d) Setting Aside of Revisionary Order: On the basis of these findings, the ITAT set aside the PCIT's order passed under Section 263, holding that the revisionary jurisdiction was not properly invoked in the facts and circumstances of the case.

What the High Court Held?

The High Court of Gujarat, upheld the ITAT's decision and dismissed the Revenue's appeal. The High Court's judgment contained several significant observations:

a) **Sufficient Inquiry Conducted:** The High Court categorically held that the Assessing Officer had conducted sufficient inquiry into the matters raised in the reopening notice, including the credit entries in the bank account.

b) **Not a Case of 'No Inquiry' or 'Lack of Inquiry':** The Court emphasized that this was not a case where the AO had failed to conduct inquiry or had conducted inadequate inquiry. The AO had examined the relevant materials and formed an opinion.

c) **Exclusive Domain of the Assessing Officer:** The High Court observed that when an opinion is formed by the AO as a result of proper inquiries, such opinion formation falls within the exclusive domain of the Assessing Officer. **The revisional authority cannot substitute its own opinion merely because it would have reached a different conclusion.**

d) **Assessment Order Not Erroneous:** Given that proper inquiry was conducted and the AO had applied his mind to the issues, the assessment order could not be characterized as "erroneous" merely because the PCIT disagreed with the conclusion reached by the AO.

What the Supreme Court Held?

The Supreme Court, at the very outset, characterized the Revenue's Special Leave Petition as **"misconceived and completely contrary to the law"** pertaining to Section 263 of the Income-tax Act, 1961. This strong language indicates the Court's view that the Revenue's position was fundamentally flawed both on facts and law.

Factual Findings

The Supreme Court meticulously examined the factual matrix and made the following specific findings:

a) **Two Reasons for Reopening:** The Court acknowledged that the notice under Section 148 referred to two distinct reasons as discussed earlier.

b) **Reassessment Order Passed:** The Court accepted that a reassessment order under Section 148 read with Section 143(3) was indeed passed by the AO.

c) **No Addition for First Reason:** Critically, the Court noted that addition was not made for the first reason (i.e., the credit entries in the bank account).

Ratio Laid Down

The Supreme Court laid down several important principles:

a) **Revenue's Assertion Ex Facie Incorrect:** The Court held that in the given facts, the Revenue's assertion that inquiry and verification regarding the bank account was not made was ex-facie incorrect. This finding was based on the fact that:

i. The issue was specifically raised in the reopening notice
ii. A reassessment order was passed under Section 148 read with Section 143(3)
iii. The AO had examined the matter before completing the reassessment

b) Critical Distinction: 'Failure to Investigate' vs. 'Wrong Conclusion'" The Supreme Court drew a crucial distinction that forms the cornerstone of this judgment:

"This being the position, this is not a case of failure to investigate, but as no addition was made, the Revenue can argue that it is a case of wrong conclusion and decision in the reassessment proceedings."

This distinction is fundamental to understanding the scope and limitations of Section 263:

i. Failure to Investigate (No Inquiry): Where the AO has not conducted any inquiry at all, or the inquiry is so perfunctory that it amounts to no inquiry, Section 263 can be validly invoked on the ground that the assessment order is erroneous due to lack of proper verification.

ii. Wrong Conclusion: Where the AO has conducted proper inquiry and examined the relevant materials but has reached a conclusion that the Revenue disputes, this represents a difference of opinion. In such cases, Section 263 cannot be invoked merely because the Commissioner would have reached a different conclusion.

iii. Requirements for Valid Exercise of Section 263 in Cases of Wrong Conclusion: The Supreme Court laid down that when the Revenue's case is not one of 'no inquiry' but of 'wrong conclusion,' the procedure under Section 263 must be fundamentally different:

"Therefore, to exercise jurisdiction under Section 263 of the 1961 Act, the Commissioner of Income Tax should have examined the merits and only on reaching a finding that the reassessment order was erroneous and prejudicial to the interest of the Revenue made an addition."

This means that:

✓ The Commissioner cannot simply conclude that the AO failed to inquire.
✓ The Commissioner must examine the merits of the case on facts and law.
✓ The Commissioner must demonstrate, after such examination, how the AO's conclusion was erroneous.
✓ Only after establishing the erroneous nature of the conclusion can the Commissioner proceed to make an addition or direct the AO to do so.

Contentions of the Parties

A. Revenue's Contentions

a) The AO had not conducted adequate inquiry regarding substantial credit entries.
b) Credit entries remained unexplained and warranted addition.
c) Failure to make addition was prejudicial to Revenue.
d) PCIT was justified in invoking Section 263.

B. Assessee's Contentions

a) AO had conducted proper inquiry as evidenced by reopening notice and reassessment order.
b) Not a case of 'no inquiry' but inquiry followed by opinion that no addition was warranted.
c) Mere difference of opinion does not justify Section 263.
d) Case fell under 'wrong conclusion after investigation,' not 'failure to investigate'.
e) ITAT and High Court had concurrent findings in favor of assesse.

Final Determination

Based on this legal analysis, the Supreme Court:

1. **Upheld the High Court's Decision:** The Court held that "the High Court was right in dismissing the appeal preferred by the Revenue."

2. **Dismissed the SLP:** The Special Leave Petition filed by the Revenue was dismissed.

3. **Disposed of Pending Applications:** All pending applications, if any, were disposed of.

My Analysis

A. Significance of the Judgment

This judgment clears the jurisprudence on Section 263 by providing a clear, practical framework for distinguishing between cases where revisionary powers can be straightforwardly invoked ('failure to investigate') and cases where substantive merit examination is mandatory ('wrong conclusion').

The Supreme Court's language, calling the Revenue's petition **"misconceived and completely contrary to law"** signals strong judicial disapproval of attempts to misuse Section 263 as a routine tool for reassessing completed assessments.

Practical Implications and Impact

For tax administrators, the judgment clarifies that Section 263 can be used only after properly identifying the nature of the issue. If there was **no inquiry at all**, the Commissioner may set aside the assessment and order fresh inquiry. However, if the Assessing Officer (AO) conducted an inquiry and reached a **wrong conclusion**, the Commissioner must examine the merits, clearly point out the specific error, and show how it caused revenue loss. Merely stating that more inquiry was possible is not sufficient.

For taxpayers, the judgment strengthens their defense. If the AO has made inquiries—even if the final decision favors the taxpayer—Section 263 cannot be invoked casually. Taxpayers can challenge such revision orders by showing that inquiries were actually conducted and that the case does not fall under “no inquiry.”

In reassessment cases, the impact is significant. When an assessment is reopened under Sections 147–148 and the AO conducts fresh inquiry, the Commissioner cannot invoke Section 263 simply because no addition was made. Allowing this would lead to endless layers of scrutiny. The judgment rightly recognizes that reassessment itself involves detailed examination, preventing unnecessary and unfair revision proceedings.

Conclusion

The Supreme Court's decision in NYA International brings much-needed clarity to the scope of Section 263. It firmly limits arbitrary revision by requiring the Commissioner to clearly establish whether the case involves a complete lack of inquiry or an erroneous conclusion reached after inquiry, and to follow the appropriate legal standard for each.

By striking a careful balance between the revenue's power to correct genuine errors, the judgment ensures that Section 263 functions as a corrective provision and not as a substitute for appeal. Going forward, assessments where the AO has conducted inquiry and applied his mind will stand unless the Commissioner can, through substantive and reasoned analysis, demonstrate both error and prejudice to the Revenue.

Whether time taken for the DRP process under Section 144C is to be subsumed within the limitation period prescribed under Section 153 ?

ACIT (International Taxation)

vs.

Shelf Drilling Ron Tappmeyer Ltd.

[2025] 177 taxmann.com 262 (SC)

8th August, 2025

Author: Vedansh Gupta

Bench:

Hon'ble Justice B.V. Nagarathna

Hon'ble Justice Satish Chandra Sharma

Brief Facts of the Case:

In the present case, the respondent, Shelf Drilling Ron Tappmeyer Ltd., is a non-resident foreign company engaged in shallow water drilling services for clients in the oil and gas industry and had the option to compute the income on presumptive basis as per Sec 44BB of the Act. Being a non-resident foreign company, it qualifies as an 'eligible assessee' under Section 144C(15) of the Income Tax Act, 1961.

Assessment Year 2014-15:

The respondent filed its Return of Income on November 29, 2014, declaring a total loss of Rs. 120.18 crores, having opted out of presumptive taxation under Section 44BB. The assessee's case was selected for scrutiny and a Draft Assessment Order under Section 144C(1) was passed on December 26, 2016, rejecting the books furnished by the assessee and computing income at Rs. 4.34 crores against the declared loss. The assessee filed its objections before the Dispute Resolution Panel (DRP) and the final Assessment Order was passed on October 30, 2017 in favour of the revenue.

Aggrieved by the order, the Respondent appealed to the Income Tax Appellate Tribunal (ITAT), which on October 4, 2019, allowed the appeal and remanded the matter back to the AO for fresh assessment, holding that the rejection of books was unjustified.

Now, after the remand back, on September 23, 2021, a show cause notice was issued and a fresh Draft Assessment Order was passed on September 28, 2021, just two days before the extended limitation period (under TOLA) i.e. September 30, 2021.

The respondent contended that no final order could be passed now as the time period of limitation expired on 30th September, 2021.

Assessment Year 2018-19:

Similar facts were applied. The Return was filed on November 30, 2018. The Draft Assessment Order under Section 144C was passed on September 28, 2021, just before the extended limitation deadline.

The controversy arose because only the Draft Orders were passed before the limitation period expired, and no Final Orders could be passed within the prescribed time.

Key Issues Involved:

The primary issue before the Supreme Court was:

Whether the time taken for the Dispute Resolution Panel (DRP) process under Section 144C is to be subsumed within the limitation period prescribed under Section 153 for completing an assessment, OR whether it is additional to the Section 153 timeline?

Other subsidiary issues involved:

(a) Interpretation of non-obstante clauses in Section 144C(1), (4), and (13),

(b) Whether Section 144C is a 'complete code' operating independently of Section 153,

(c) Harmonious construction of Sections 144C and 153.

Law Involved:

A. Section 144C - Reference to Dispute Resolution Panel:

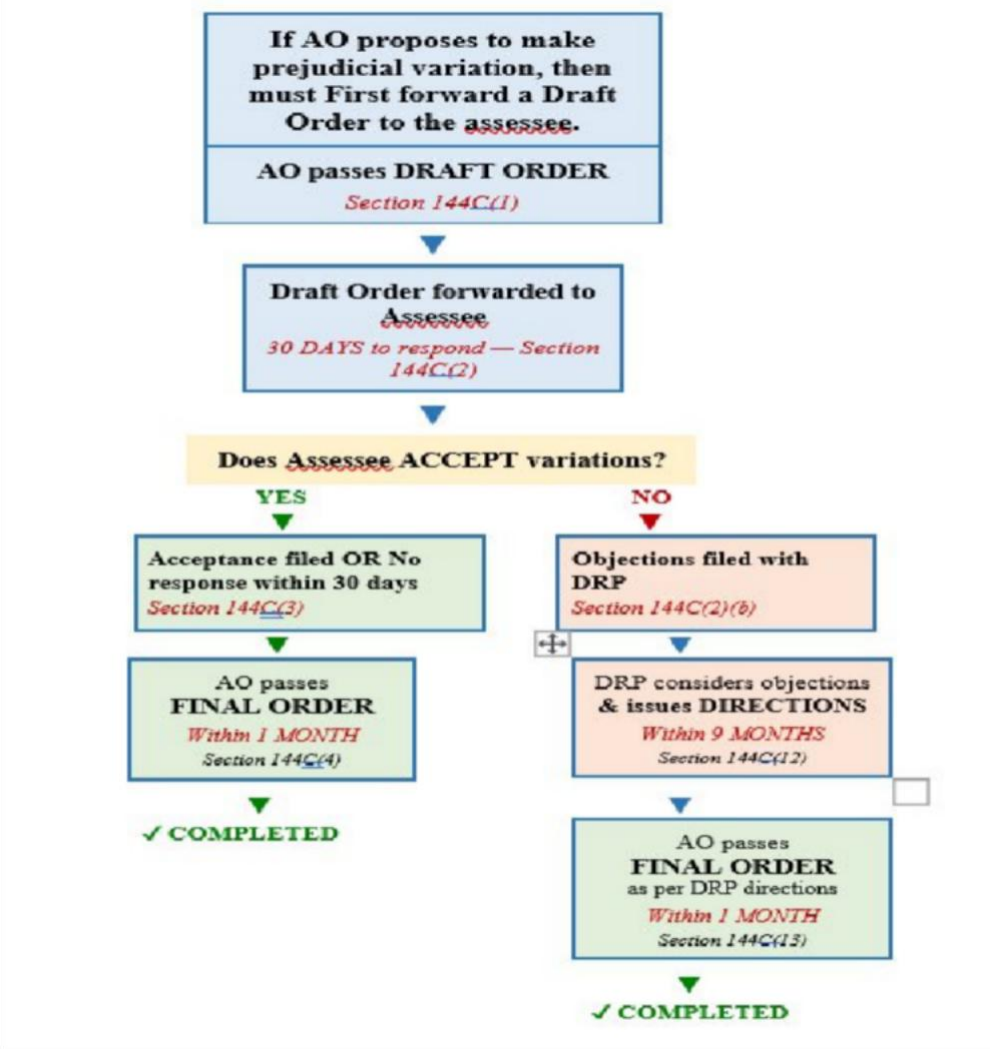
Introduced by Finance (No.2) Act, 2009, this section provides a special assessment procedure for "eligible assessees".

Section 144C(15) defines "eligible assessee" as:

- Persons with Transfer Pricing adjustments under Section 92CA(3); OR
- Non-residents or foreign companies

In this case: Shelf Drilling Ron Tappmeyer Ltd. is a foreign company, hence an "eligible assessee" under Section 144C(15)(b).

Procedure and Timelines:



B. Section 153 - Time limit for completion of assessment, reassessment and recomputation:

Section 153 prescribes the **limitation periods** within which assessment proceedings must be completed.

a) Section 153(1) - Original Assessment Time Limit

This sub-section prescribes the time limit for making an order of assessment u/s 143 (regular assessment) or u/s 144 (best judgment assessment).

Basic Rule: Assessment must be made within **21 months** from the end of the assessment year.

Provisos Added by Finance Act, 2017:

✓ **First Proviso:** For AY 2018-19, the time limit is **18 months**

✓ **Second Proviso:** For AY 2019-20 and onwards, the time limit is **12 months**

b) Section 153(3) - Fresh Assessment After Tribunal Remand

Basic Rule: 9 months from end of FY in which ITAT order was received

Proviso: 12 months in case of orders passed on or after 1st April, 2019 (applicable for our case)

C. <u>TOLA, 2020</u>:

The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, enacted due to COVID-19, extended statutory deadlines. In the present case, the original limitation period under Section 153(3) for completing the fresh assessment after ITAT remand was March 31, 2021 (12 months from end of FY 2019-20). This deadline stood extended to September 30, 2021 under TOLA, which became the operative limitation date for both AY 2014-15 and AY 2018-19.

<u>What the Assessing Officer (AO) Held?</u>

In the first round of assessment (AY 2014-15), the AO rejected the books of account maintained by the Respondent and computed income at Rs. 4.34 crores against the declared loss of Rs. 120.18 crores. The AO passed a Draft Order on December 26, 2016, making variations which were prejudicial to the assessee. Thereafter, the objections were filed to the Dispute Resolution Panel (DRP) and after receiving the directions of DRP, a Final Assessment Order was passed on October 30, 2017.

In the second round of assessment (post-remand), the respondent was called upon to produce certain details to substantiate the loss incurred. Subsequently, several notices were issued, followed by a Draft Assessment Order passed on September 28, 2021, just two days before the limitation deadline expired.

The assessee contended that since the limit for completion of assessment which was 30.09.2021 (31.03.2021+ TOLA Extension = 31.09.2021) had expired and a final order could not be passed, therefore the assessment proceedings are time barred and are invalid in law.

<u>What the CIT(A) Held?</u>

Orders passed pursuant to DRP directions under Section 144C are not appealable before the Commissioner (Appeals). Such orders are directly appealable to the Income Tax Appellate Tribunal under Section 253(1)(d).

<u>What the ITAT Held?</u>

The Income Tax Appellate Tribunal, by order dated October 4, 2019, allowed the Respondent's appeal against the Final Assessment Order dated October 30, 2017. The Tribunal held that:

a) The revenue authorities were not justified in rejecting the books of account furnished by the Respondent;

b) The matter was remanded back to the Assessing Officer for fresh adjudication. This remand order triggered the limitation period under Section 153(3) of the Act, which stated that the assessment order need to be passed within 12 months from the end of the year in which order was passed, which was further extended to September 30, 2021 due to enactment of TOLA.

What the High Court Held?

The Bombay High Court, by judgment dated August 4, 2023, allowed the writ petitions filed by the Respondent. Following the Madras High Court's decision in *CIT v. Roca Bathroom Products (P.) Ltd. [2022] 140 taxmann.com 304 (Mad.),* the Court held that:

a) The entire Section 144C procedure must be completed within the Section 153 timelines;

b) Sections 144C and 153 are not mutually exclusive and that no exception has been carved out for Section 144C of the Income Tax Act in any of the sub-sections of Section 153 of the Act. It clears that Section 144C proceedings must necessarily conclude within the time period prescribed under Section 153 of the Income Tax Act.

c) Regarding the non-obstante clause in Section 144C(13) "*The Assessing Officer shall, notwithstanding anything to the contrary contained in Section 153, pass an assessment order in conformity with the directions issued by the Dispute Resolution Panel under sub-section (5), within one month from the end of the month in which such direction is received.*", the Court examined, that these non-obstante clauses do not grant additional time beyond Section 153. Rather, they mandate that despite Section 153 permitting a longer period (up to 12 months), AO must pass the final order within the **shorter period of one month**.

d) Since the Draft Assessment Order was passed on September 28, 2021 and no Final Assessment Order could be passed by September 30, 2021 (extended deadline), the proceedings were time-barred.

What the Supreme Court Held?

The Supreme Court delivered a split verdict, with both judges expressing divergent opinions, resulting in reference to a larger bench.

Contentions of the Revenue (Appellant):

(i) Section 144C is a 'complete code' with distinct procedures for eligible assessees, operating independently of Section 153;

(ii) The non-obstante clauses in Section 144C(1), (4), and (13) indicate that Section 144C timelines are additional to Section 153;

(iii) Section 153 time limits apply only to the Draft Assessment Order under Section 144C(1); thereafter, Section 144C provides additional time; (iv) If the entire Section 144C process must fit within Section 153, it would be 'unworkable'.

Contentions of the Assessee (Respondent):

(i) Section 153 prescribes overall limitation; no exception is carved out for Section 144C proceedings;

(ii) Explanation 1 to Section 153 specifically lists out the excluded periods and Section 144C procedure is not mentioned, indicating Parliament's intent;

(iii) Section 144C was introduced for 'speedy disposal' of disputes therefore, extending the timelines defeats this purpose;

(iv) The non-obstante clause in Section 144C(1) relates to the special procedure (draft order vs. final order) in the case of eligible assesses and not to limitation periods

Justice B.V. Nagarathna's Opinion (For Assessee):

Her Ladyship held that the Section 144C procedure must be completed within the limitation period prescribed under Section 153, thereby upholding the Bombay High Court's judgment. In arriving at this conclusion, Justice Nagarathna undertook a comprehensive analysis of the statutory provisions, legislative history, and principles of interpretation.

❖ **On the Interpretation of Non-Obstante Clauses**:

Her Ladyship held that the three non-obstante clauses in Section 144C serve distinct purposes. The expression in Section 144C(1) "notwithstanding anything to the contrary contained in this Act", is purely procedural requiring issuance of a Draft Assessment Order for eligible assessees and does not affect limitation.

In contrast, the clauses in Sections 144C(4) and (13) "notwithstanding anything contained in Section 153" prescribe a stricter timeline, mandating that the final assessment order be passed within one month, overriding the longer period otherwise available under Section 153. These clauses thus impose a shorter, not extended, limitation period.

❖ **Harmonious Construction**

The cumulative timeline under Section 144C which is about 11 months (30 days for the assessee's response, 9 months for DRP directions, and 1 month for the final order)—fits well within the 12-month limitation under Section 153(3). Therefore, no additional time shall be allowed for the completion of 144C procedure.

❖ **Legislative Intent**

Referring to the Finance Minister's Budget Speech of July 6, 2009, it can be noted that Section 144C was introduced to *"facilitate expeditious resolution of tax disputes faced by foreign companies"* and to create a *"speedier dispute resolution mechanism."* Interpreting Section 144C to extend limitation periods beyond Section 153 would defeat this express legislative purpose.

❖ **Significance of Explanation 1 to Section 153:**

Explanation 1 specifically lists out the periods excluded from the limitation periods such as time under court stays, valuation proceedings, receipt of foreign information, and prosecution. Notably, the time consumed u/s 144C/DRP proceedings is absent from this list. This omission is deliberate, signifying a clear legislative intent that the time u/s 144C is to be included within the limitation prescribed u/s 153.

Conclusion: High Court was correct; Revenue's appeals dismissed.

Justice Satish Chandra Sharma's Opinion (For Revenue):

His Lordship took a divergent view, holding that Section 153 applies only to the Draft Assessment Order, while Section 144C provides additional time for the subsequent procedural steps.

❖ **Section 144C as a "Complete Code"**

Justice Sharma held that Section 144C constitutes a self-contained and complete code prescribing a distinct procedural regime for eligible assessees. The provision has its own internal structure, timelines, and mechanisms, including the DRP directions and final order which operates independently of Section 153.

❖ **Interpretation of Non-Obstante Clauses**

His Lordship interpreted the non-obstante clauses in Sections 144C(4) and (13) *"notwithstanding anything contained in Section 153"* as **expressly excluding** Section 153. Held that, after the draft assessment order is passed, Section 153 no longer applies and the timelines under Section 144C take over. The non-obstante clauses clearly give Section 144C priority, otherwise those clauses would have no meaning.

❖ **Comparison with Section 153(4)**

Section 153(4) expressly extends limitation by 12 months for cases involving TPO reference. This demonstrates Parliament's recognition that special procedures require additional time. The same logic applies to Section 144C, where the non-obstante clauses achieve a similar extension to provide adequate time for specialized procedures.

❖ **Practical Workability and Avoidance of Absurdity**

If the entire Section 144C procedure must fit within Section 153 limit, the Assessing Officer would be left with **negligible time** and would render the scheme unworkable and lead to absurd results, leaving the AO with negligible time. Courts must prefer an interpretation that makes the statute workable.

Conclusion: High Court's order set aside; Revenue's appeals allowed.

Final Order:

Due to the divergent opinions, the matter was directed to be placed before the Chief Justice of India for constitution of a larger bench to consider the issues afresh.

My Analysis:

This case presents a classic conflict between textual interpretation and practical workability in tax law. Having analyzed both judicial opinions, I find merit in elements of both views, though I lean towards Justice Nagarathna's interpretation.

The foundation of my view lies in the legislative intent behind Section 144C. The Finance Minister's Budget Speech (2009) and the Memorandum Explaining the Finance Bill clearly stated that Section 144C was introduced to *"facilitate expeditious resolution of disputes"* for foreign companies, as foreign investment is *"extremely sensitive to prolonged uncertainty in tax matters."* The clear purpose was to speed up the assessment process, not to make it longer. Therefore, giving additional time for passing the final orders beyond the Section 153 limitation period would contradict what the Parliament intended.

Justice Sharma's concerns regarding workability are understandable and have practical relevance. However, when the provisions are read in a harmonious manner, the statutory time limit of twelve months prescribed under Section 153(3) is sufficient to accommodate the maximum procedural timeline of approximately eleven months under Section 144C, provided the revenue authorities act with due promptness.

The larger bench should consider that expanding limitation periods through judicial interpretation may encourage administrative lethargy. If the Parliament believes that the current timelines are inadequate, Section 144C proceedings can be expressly excluded by amending Section 153.

Whether income from cancelled sale agreements can be taxed despite not having accrued in real what is a valid revised return u/s 139(5)

Commissioner of Income-tax

vs.

Lok Housing and Construction Ltd.

[2025] 175 taxmann.com 848 (SC)

24th April, 2025

Author: Tanishka Gupta

Bench:

Justice J.B. Pardiwala

Justice R. Mahadevan

Brief Facts of the Case

Lok Housing & Constructions Ltd. ("the Assessee") is a listed public company engaged in the business of real estate development and construction. The relevant assessment year is 2007-08, corresponding to the financial year 2006-07.

A. The Survey and Its Aftermath:

A survey under Section 133A of the Income Tax Act was conducted at the Assessee's premises on 11.09.2008. During the survey, audited financial statements for FY 2006-07 were found, showing profit before taxation of Rs. 142.45 crores. The computation revealed tax payable of approximately Rs. 52.55 crores including interest under Sections 234A, 234B, and 234C.

During the survey, the statement of Shri Lalit C. Gandhi, Chairman and Managing Director of the Assessee company, was recorded. He admitted that the tax liability could not be discharged due to severe financial constraints, and consequently, the return of income had not been filed despite the due date of 30.11.2007 having elapsed.

B. The Original Return:

Following the survey, a notice under Section 142(1) was issued on 18.09.2008. In response, the Assessee filed its return of income on 23.09.2008, declaring total income of Rs. 135.47 crores. No payment of tax was made along with this return. The return was processed under Section 143(1) on 22.10.2008.

C. The Five Transactions:

The income declared in the original return primarily arose from five transactions involving sale/development rights of immovable properties to parties who were either sister concerns or associated entities. These transactions, being agreements to sale of immovable

properties under construction, involved aggregate turnover of approximately Rs. 194 crores. In each transaction, only token advances of approximately Rs. 3 crores each were received, with the balance consideration remaining unpaid. No conveyance deeds were executed, no possession was transferred, and no development work was undertaken.

D. The Accounting Policy:

The Assessee's accounting policy stated: "Revenue recognition in respect of property sale transactions is on the basis of agreement of sale and are subject to execution of conveyance and compliance of applicable legal formalities." The Assessee later claimed the original return was based on the first limb (recognition on agreement), while the revised return was based on the second limb (subject to conveyance execution).

E. Cancellation and Revised Return:

Due to the downturn in the real estate market, all five agreements were cancelled between November and December 2008 by mutual consent. There was no termination clause in the original agreements, yet cancellations were effected without any arbitration, penalty, or interest. The properties reverted to the Assessee and continued as stock-in-trade in its balance sheet.

Consequent to the cancellation, the Assessee filed a revised return on 01.01.2009, declaring NIL income. Along with the revised return, revised annual accounts were submitted. Notably, the statutory auditors qualified their report on the revision of accounts, stating that a listed company could not reopen and revise accounts already adopted at its annual general meeting.

Sections Involved as relevant to AY 2007-08

A. Section 139(5) of the Income Tax Act, 1961 – Revised Return:

This section permits an assessee who has furnished a return under Section 139(1) or in pursuance of a notice issued under Section 142(1), upon discovering any omission or wrong statement therein, to furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

The provision acts as a remedial mechanism, allowing taxpayers to correct genuine errors or omissions. Three conditions must be satisfied for a valid revised return:

i. The original return must have been filed under Section 139(1) or pursuant to notice under Section 142(1);

ii. The assessee must discover any omission or wrong statement in the original return; and

iii. The revised return must be filed before assessment completion or within the prescribed time limit.

Note on Amendment: *As per Finance Act 2016 (w.e.f. AY 2017-18), Section 139(5) has been amended. The current provision permits revision only of returns filed under Section 139(1) or Section 139(4), and the time limit has been changed to "before the end of the relevant assessment year or before the completion of the assessment, whichever is earlier." Significantly, the reference to returns filed pursuant to Section 142(1) notice has been omitted from the amended provision.*

However, the present case relates to AY 2007-08, and hence, the law as it existed at the relevant time is applicable.

B. Section 5 of the Income Tax Act, 1961 – Scope of Total Income:

This section defines the scope of total income and provides that income shall be chargeable to tax if it is received or deemed to be received in India, or if it accrues or arises or is deemed to accrue or arise in India during the previous year. For an assessee following the mercantile system of accounting, income is taxable on accrual basis, meaning it becomes taxable when the right to receive such income becomes vested, irrespective of actual receipt. This distinction between accrual and receipt forms the foundation of the dispute in the present case.

C. Section 2(47) of the Income Tax Act, 1961 – Definition of "Transfer":

This section defines "transfer" in relation to a capital asset, including sale, exchange, relinquishment, or extinguishment of rights. Importantly, clause (v) includes any transaction which has the effect of transferring or enabling enjoyment of immovable property under Section 53A of the Transfer of Property Act. However, as held in this case, this extended definition applies only to capital assets and does not extend to stock-in-trade transactions.

D. Section 54 of the Transfer of Property Act, 1882:

This provision governs the sale of immovable property and provides that transfer of tangible immovable property worth Rs. 100 or more can only be made by a registered instrument. A mere agreement of sale does not of itself create any interest in or charge on the property.

Issues Involved

1. **Validity of Revised Return:** Whether the revised return filed under Section 139(5) was valid, particularly whether cancellation of sale agreements constituted "discovery of omission or wrong statement."
2. **Accrual of Income:** Whether income from the five transactions actually accrued to the Assessee, or whether it was merely hypothetical income that could not be brought to tax.

What the Assessing Officer Held?

The Assessing Officer rejected the revised return and completed assessment under Section 143(3) on 29.12.2009, determining total income at Rs. 135.56 crores based on the original return. The key grounds were:

- ❖ The CMD had admitted during survey that tax was payable on the income reflected in audited accounts. This admission was binding.
- ❖ Section 139(5) permits revision only upon discovery of "omission or wrong statement." Since income was correctly recognised per consistently followed accounting policy, there was no wrong statement.
- ❖ All agreements were with sister concerns or entities under Assessee's influence, suggesting collusive transactions.

- ❖ No termination clause existed, yet cancellation after two years without penalty or interest was commercially implausible unless pre-planned.
- ❖ Share price appreciation (Rs. 35 to Rs. 351) during this period was allegedly exploited by sister concerns.

What the CIT(A) Held?

The CIT(A) upheld the AO's order vide order dated 31.10.2011. The key findings were:

- ❖ The word "discovers" in Section 139(5) connotes discovery of something unknown at the time of filing original return. The Assessee was fully aware of all transactions.
- ❖ Relying on Morvi Industries Ltd. v. CIT [1971] 82 ITR 835 (SC), income accrued when agreements were signed; subsequent termination could not affect such accrual.
- ❖ The revised return was filed (January 2009) before books were revised (March 2009), creating doubts about bona fides.
- ❖ The CIT(A) declared the revised return as "non-est" (legally non-existent).

What the ITAT Held?

The ITAT Mumbai Bench 'A', vide order dated 23.10.2012, allowed the Assessee's appeal. The detailed reasoning covered:

A. On Book Entries:

Relying on Sutlej Cotton Mills Ltd. v. CIT [1979] 116 ITR 1 (SC) and Kedarnath Jute Mfg. Co. Ltd. v. CIT [1971] 82 ITR 363 (SC), the Tribunal held that entries in books are not determinative of taxability. An assessee may make entries not conforming to proper accounting principles, but such entries cannot be conclusive. What matters is the true nature of the transaction.

B. On Real Income Theory:

Relying on CIT v. Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC), the Tribunal held: "Income-tax is a levy on income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about hypothetical income which does not materialise." Further relying on Godhra Electricity Co. Ltd. v. CIT [1997] 225 ITR 746 (SC) and CIT v. Birla Gwalior (P.) Ltd. [1973] 89 ITR 266 (SC), where income can be said not to have resulted at all, there is neither accrual nor receipt.

C. On Section 2(47):

Section 2(47) defining "transfer" applies only to capital assets, not stock-in-trade. For immovable property held as stock-in-trade, the Transfer of Property Act governs, and mere agreement without registered conveyance doesn't constitute transfer. Since no conveyance was executed and no title passed, there was no sale.

D. On Revised Return:

All conditions under Section 139(5) were satisfied. The declaration of income that never accrued was a "wrong statement" discovered upon cancellation.

E. On Survey Statement:

Statement under Section 133A is not on oath and lacks binding evidentiary value. Reliance was placed on CIT v. S. Khader Khan Son [2008] 300 ITR 157 (Mad.).

What the High Court Held?

The Bombay High Court (13.04.2015) dismissed Revenue's appeal, affirming the Tribunal's order.

A. Revenue's Contentions:

Returns filed pursuant to Section 142(1) notice could not be revised; Section 139(5) requirements were not fulfilled; transactions were sham designed to manipulate share prices.

B. Assessee's Contentions:

Section 139(5) expressly permits revision of returns filed pursuant to Section 142(1) notice; cancellation was genuine as properties reverted; book entries are not conclusive.

C. The Court's Analysis:

There is no legal bar on revising returns filed pursuant to Section 142(1) notice. The Tribunal's findings that income had not really accrued were findings of fact, neither perverse nor vitiated by error of law. The Court observed: "Once income had not accrued to the assessee in the real sense, then the original return represents wrong statement which was corrected by filing a revised return. Therefore, no hypothetical income could have been brought to tax."

What the Supreme Court Held?

The Supreme Court (24.04.2025) dismissed Revenue's Civil Appeal No. 277 of 2016.

A. Revenue's Contentions:

Mr. Arijit Prasad, Senior Advocate, reiterated contentions raised before lower forums and urged interference.

B. Assessee's Contentions:

Ms. Anjali Sharma, Advocate, supported the concurrent findings, contending no substantial question of law arose.

C. The Court's Order:

"Having heard Mr. Arijit Prasad, the learned Senior counsel appearing for the appellant - Revenue and having gone through the materials on record, we find no good reason to interfere with the impugned order dated 13.04.2015 passed by the High Court of Judicature at Bombay." This affirmed: (1) validity of revised return; (2) no real income accrued; (3) hypothetical income cannot be taxed.

Cases Relied Upon

- ❖ *CIT v. Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC)*
- ❖ *Godhra Electricity Co. Ltd. v. CIT [1997] 225 ITR 746 (SC)*
- ❖ *CIT v. Birla Gwalior (P.) Ltd. [1973] 89 ITR 266 (SC)*
- ❖ *Sutlej Cotton Mills Ltd. v. CIT [1979] 116 ITR 1 (SC)*
- ❖ *India United Mills Ltd. v. CEPT [1955] 27 ITR 20 (SC)*

Critical Analysis

While the concurrent findings have been affirmed by the Supreme Court and will serve as binding precedent, a deeper examination reveals fundamental questions that, in considered view, deserve critical scrutiny. The decision, though providing relief to the assessee, raises significant concerns from both legal and accounting perspectives.

1. Was There a Valid Right of Revision Under Section 139(5)?

A. The Legal Framework:

Section 139(5) permits revision upon "discovering any omission or wrong statement." Three conditions must be satisfied: (i) original return filed under Section 139(1) or pursuant to Section 142(1) notice; (ii) discovery of omission or wrong statement; (iii) filing within prescribed time. The crux lies in interpreting "discovers."

B. The Meaning of "Discovers":

The Oxford English Dictionary defines "discover" as "the finding out or bringing to light that which was previously unknown." The literal meaning suggests uncovering something hidden, concealed, or unknown. In Addl. CIT v. Radhey Shyam [1979] 1 Taxman 29 (All.), the Allahabad High Court held that "wrong statement" includes within its scope a statement which is not false to the knowledge of the person making it. This means a statement can be found wrong when evaluated against facts already in existence OR facts subsequently coming into existence.

C. The Distinction Between "Omission" and "Wrong Statement":

The Legislature deliberately used two distinct terms. "Omission" connotes an unintentional act or neglect to perform what law requires - it can only be discovered based on facts already in existence at the time of filing. "Wrong statement" was traditionally understood as an incorrect declaration of existing facts. The scope of "omission" is inherently limited to pre-existing facts; extending "wrong statement" to cover subsequent events stretches the provision beyond its intended purpose.

D. My Analysis – The Original Return Was Correct When Filed:

In my considered view, the original return was CORRECT at the time of filing. The Assessee was following its consistently adopted accounting policy of recognizing revenue on execution of agreements. The agreements were valid and subsisting. Income was correctly recognized as per the mercantile system. There was no omission, no wrong statement, and nothing to "discover" at that point.

The cancellation happened AFTER the original return was filed – in November-December 2008, while the original return was filed in September 2008. This is a subsequent event that changed the factual position. A statement cannot be called "wrong" merely because circumstances changed subsequently. If this interpretation is accepted, any subsequent event affecting earlier income could justify revision, creating enormous uncertainty and opening doors for manipulation.

2. The Core Question: "No Real Income" vs. "Income Accrued and Subsequently Lost"

This is the most fundamental question that was not adequately addressed. There is a crucial distinction between two scenarios:

A. Scenario A – What Courts Held (No Real Income):

Income never really accrued. Since agreements were cancelled, no conveyance executed, no possession given, properties remained with assessee – the income was hypothetical and never materialized.

B. **Scenario B – The Challenge (Income Accrued and Subsequently Lost):**

Income DID accrue in Year 1 when agreements were executed. The cancellation in Year 2 is a separate transaction that resulted in loss/reversal. These are two independent transactions – income in Year 1, and loss on cancellation in Year 2.

C. **The Sale Return Analogy:**

Consider this example: In Year 1, goods costing Rs. 100 are sold for Rs. 150, generating profit of Rs. 50. In Year 2, the customer returns the goods (sales return). What is the correct treatment?

Standard accounting and tax treatment would be:

- **Year 1 –** record sale of Rs. 150, cost Rs. 100, profit Rs. 50 (taxable in Year 1).
- **Year 2 –** record sales return of Rs. 150, goods back in stock at Rs. 100, loss Rs. 50 (deductible in Year 2). We do NOT revise Year 1 accounts to nullify the original sale. The sale and return are treated as two independent transactions in their respective years. This is standard accounting practice consistent with the yearly nature of income tax assessment.

Why Lok Housing Should Be Treated Similarly: In my analysis, the Lok Housing case should be treated as "income accrued and subsequently lost," not "no real income," for the following reasons:

1. **The Assessee's own accounting policy** recognized revenue on agreement execution. If the Assessee believed income accrued on agreement execution (which is why it booked the income), then income DID accrue.
2. **The agreements were valid contracts** creating legally enforceable rights and obligations. Under mercantile system, income accrues when the right to receive arises - which happened when agreements were signed.
3. **Cancellation extinguished those rights** - but this extinguishment happened in FY 2008-09, not FY 2006-07. The cancellation is a Year 2 event creating loss in Year 2.

4. **Taxation is a yearly exercise.** Each assessment year is a separate unit. What happens in AY 2009-10 should not alter the income of AY 2007-08.

The Shoorji Vallabhdas Distinction: The Courts relied heavily on CIT v. Shoorji Vallabhdas & Co *(supra)*. However, there is a crucial factual distinction. In Shoorji Vallabhdas, the commission agent's entitlement was renegotiated BEFORE crystallization – income NEVER resulted at all. In Lok Housing, income HAD accrued (as evidenced by Assessee's own accounting entries following its stated policy), and was later reversed due to subsequent cancellation. The real income doctrine applies where income never materializes at all - not where income accrues and is later lost due to subsequent events.

3. Hypothetical Income vs. Real Income Subsequently Lost – A Fundamental Distinction

The Courts treated this as a case of "hypothetical income". Let's understand the distinction:

A. Characteristics of Hypothetical Income:

- ❖ Income that is merely anticipated or expected
- ❖ No legal right to receive has crystallized
- ❖ Subject to conditions that may or may not be fulfilled
- ❖ Example: Contingent income, income subject to future approval

B. Characteristics of Real Income Subsequently Lost:

- ❖ Legal right to receive had crystallized at time of transaction
- ❖ Income was correctly recognized as per accounting standards
- ❖ Subsequent events caused loss or reversal
- ❖ Example: Bad debts (sale was real, but amount became irrecoverable later)

In my analysis, Lok Housing falls in the second category. The income was real when agreements were signed - the Assessee's own accounting treatment proves this. The cancellation due to changed market conditions is a subsequent event that caused loss. The income became "hypothetical" only with the benefit of hindsight - a perspective not available on the balance sheet date.

4. Events After Balance Sheet Date – The AS-4 Analysis

This accounting dimension was not adequately examined. Accounting Standard 4 (AS-4) issued by ICAI deals specifically with "Contingencies and Events Occurring After Balance Sheet Date." It classifies such events into:

1. **Adjusting Events:** Events providing additional evidence of conditions that EXISTED at balance sheet date – require adjustment.
2. **Non-Adjusting Events:** Events indicative of conditions that AROSE AFTER balance sheet date - no adjustment, only disclosure.

Application to Lok Housing: Balance sheet date was 31.03.2007. Cancellation happened in November-December 2008 – more than 18 months later. Reason for cancellation was real estate market downturn - a condition that arose AFTER the balance sheet date.

Critical Question: Was there any condition on 31.03.2007 indicating agreements would be cancelled?

The answer is NO. On that date: agreements were valid and subsisting; token advances had been received; there was no indication of cancellation; the market had not crashed; all parties proceeded assuming transactions would complete.

Therefore, under AS-4, the cancellation is a NON-ADJUSTING EVENT. Financial statements for FY 2006-07 should NOT have been adjusted. The impact should have been given in FY 2008-09 when cancellation actually occurred. The revision of accounts was not in accordance with generally accepted accounting principles.

5. The Two-Limbed Accounting Policy: A Smoke Screen?

The Assessee's accounting policy stated: "Revenue recognition in respect of property sale transactions is on the basis of agreement of sale and are subject to execution of conveyance and compliance of applicable legal formalities." The Assessee claimed original return was based on the first limb; revised return on the second limb.

In my view, this two-limbed policy was essentially a smoke screen to prepone or postpone income recognition at will. When convenient, invoke the first limb and recognize income on agreement; when not convenient, invoke the second limb and reverse. This defeats the very purpose of having an accounting policy - consistency and comparability.

Evidence showed that in earlier years (2002-03 to 2005-06), the Assessee had consistently recognized cancellations in the year of cancellation by reducing that year's sales figure - not by altering earlier years' figures. Why was this year different? This departure from consistent practice was not adequately explained.

Furthermore, AS-9 (Revenue Recognition) requires:

(i) price determinable;

(ii) transfer of significant risks and rewards;

(iii) no significant uncertainty regarding realization.

The two-limbed policy did not clearly establish when these conditions were satisfied - the vagueness allowed selective application depending on the Assessee's tax position.

6. What Should Have Been the Correct Treatment?

Option A – What Was Done (Revise Year 1 Return):

- AY 2007-08: NIL income (after revision)
- Effect: Income of Rs. 135+ crores completely wiped out
- **Problem:** Violates AS-4 (non-adjusting event), disturbs finality of assessment year, creates precedent for manipulation

Option B – What Should Have Been Done (Give Effect in Year of Cancellation):

- AY 2007-08: Income of Rs. 135+ crores – taxable
- AY 2009-10: Loss on cancellation of Rs. 135+ crores – deductible (subject to set-off and carry forward provisions)
- **Effect:** Consistent with AS-4, preserves yearly nature of assessment, doesn't disturb finality

The end result in terms of total tax over both years may have been similar, but the methodology would have been legally and conceptually sound.

Conclusion

Based on my analysis of the legal and accounting principles involved, I conclude:

1. **Right of Revision:** The revision was legally questionable. The original return was correct when filed. Subsequent events should not constitute "discovery of wrong statement" for purposes of Section 139(5).
2. **Accrual vs. Reversal:** This is a case of income accrued and subsequently lost, NOT a case of no real income. The agreements were valid contracts creating enforceable rights. Cancellation was a subsequent event.
3. **Hypothetical vs. Real Income:** The income was real when recognized (as evidenced by Assessee's own entries and policy). It became "hypothetical" only with the benefit of hindsight. Under AS-4, the cancellation is a non-adjusting event.
4. **Correct Treatment:** The income should have been taxed in AY 2007-08, and loss allowed in AY 2009-10. This maintains consistency with accounting standards and yearly nature of assessment.

While the ITAT, High Court, and Supreme Court applied the Real Income Doctrine, they arguably overlooked the distinction between "income never accrued" (the Shoorji Vallabhdas situation) and "income accrued but subsequently reversed" (the Lok Housing situation). The former attracts the real income doctrine; the latter does not.

The decision may set a problematic precedent. It could encourage manipulation through strategic use of related party transactions - show profits, benefit from share price appreciation, then cancel with related parties and claim "no real income".

The sequence in this case - profits shown, share prices rose dramatically, sister concerns allegedly benefited, then cancellation without penalty - raises legitimate concerns not adequately addressed. That said, the judgment being affirmed by the Supreme Court will serve as binding precedent.

Binding Nature of the Judgment and Scope for Review

Article 141 of the Constitution of India states: *"The law declared by the Supreme Court shall be binding on all courts within the territory of India."* This provision establishes the doctrine of precedent within the Indian legal system, mandating that all subordinate courts, i.e.

High Courts, Tribunals, and other authorities must follow the legal principles laid down by the Hon'ble Supreme Court. Consequently, the judgment in Lok Housing and Construction Ltd. *(supra)*, having been pronounced by the apex court, becomes the law of the land and is binding on all courts and tribunals across India.

While the Hon'ble Supreme Court's order is final and cannot be appealed to any higher forum, the Constitution provides a limited remedy for reconsideration. Article 137 states: *"Subject to the provisions of any law made by Parliament or any rules made under article 145, the Supreme Court shall have power to review any judgment pronounced or order made by it."* A review petition must ordinarily be filed within 30 days of the judgment. The Hon'ble Supreme Court judgment in the present case was delivered on 24th April 2025. More than eight months have since elapsed, and the Revenue in order to review the order of Hon'ble Supreme Court would have filed any review petition within 30 days. However, whether this option was explored and not pursued, or simply not considered, remains unclear.

It may be noted that the Hon'ble Supreme Court does exercise its review jurisdiction in appropriate cases. A recent example is the Aravalli Hills case (Issues Relating to Definition of Aravalli Hills and Ranges), where on 20th November 2025, a Bench accepted certain recommendations regarding mining in Aravalli ranges. Following widespread concerns, the Hon'ble Supreme Court, vide order dated 29th December 2025, stayed its own earlier judgment and kept the recommendations in abeyance.

Another significant instance is the Bhushan Power and Steel Ltd. case (Kalyani Transco v. Bhushan Power & Steel Ltd.). On 2nd May 2025, the Hon'ble Supreme Court rejected JSW Steel's Rs. 19,700 crores resolution plan for Bhushan Power and Steel Ltd. (BPSL) and directed liquidation of the company, holding that the resolution plan violated Sections 30(2) and 31(2) of the IBC, 2016. JSW Steel, Punjab National Bank, and other creditors filed review petitions. On 29th July 2025, a bench allowed open court hearing of the review petitions. Thereafter, on 31st July 2025, the Hon'ble Supreme Court recalled its judgment dated 2nd May 2025, holding that there were "errors apparent on the face of the record". The matter was thereafter heard afresh, and on 30th September 2025, the Hon'ble Supreme Court upheld JSW Steel's resolution plan for BPSL. These cases demonstrate that where concerns arise or errors are pointed out, the Court may reconsider its pronouncements. Nevertheless, in the absence of any review petition by the Revenue, the Lok Housing judgment now operates as binding precedent.

A Critical Examination of the Prospective Application of the 2022 Amendment to Section 80DD under the Income Tax Act

Ravi Agrawal

vs.

Union of India

[2024] 168 taxmann.com 320 (SC)

20, AUGUST, 2024

Author: Nandini Gupta

Bench:

Justice B.V. Nagarathna

Justice Nongmeikapam Kotiswar Singh

Brief Facts of the Case:

In this case, the petitioner, Ravi Agrawal, filed a writ petition under Article 32 of the Constitution of India seeking that the amendment made by the Finance Act, 2022 to Section 80DD of the Income Tax Act, 1961 be given retrospective effect.

Before the amendment, Section 80DD granted a **deduction** to taxpayers who incurred expenses or paid insurance premiums for the benefit of a **disabled dependent**, but the benefit under such insurance schemes was **available only after the death of the subscriber**. The law did not permit the caregiver to withdraw or use the accumulated funds during their lifetime, even after reaching old age.

After the amendment, which came into effect from **1 April 2023**, subscribers who had attained **60 years of age or more** were allowed to **discontinue the policy** and **utilize the accumulated funds during their lifetime** for the welfare of the disabled dependent.

The petitioner argued that this amendment should apply to policies taken before 2014, whereas the Union of India contended that retrospective application would disturb existing contractual terms of the insurance policies.

Issue Involved:

In this case, the issue is whether the amendment introduced by the Finance Act, 2022 to Section 80DD of the Income Tax Act, 1961, which allows withdrawal of benefits after attaining sixty years of age, can be applied retrospectively to cover insurance policies taken prior to 2014.

Section Involved:

- **Section 80DD of the Income-tax Act, 1961 ("IT Act")**

  This section provides deduction to an individual or Hindu Undivided Family (HUF) resident in India who bears the cost of maintaining a dependent with disability.

  The section allows deduction where the assessee-
  (a) incurs expenditure on the medical treatment, training, or rehabilitation of the dependent, or
  (b) pays premium under an approved insurance scheme such as LIC's Jeevan Aadhar Policy for the dependent's benefit.

  Before the Finance Act, 2022, the benefit under such schemes was available only after the subscriber's death. The amendment, effective 1 April 2023, now permits withdrawal of the accumulated amount after attaining sixty years of age for the dependent's welfare.

Supreme Court:

Assessee's Contention

- The assessee argued that the amendment to Section 80DD, brought in by the Finance Act, 2022, was enacted in the interest of disabled persons, and therefore should be applied retrospectively to all existing policies, including those issued prior to 2014.

- Such retrospective application would allow caregivers, on attaining 60 years of age, to utilize the accumulated funds during their lifetime, thereby providing immediate financial support to the disabled dependent.

- Since the amendment is a social welfare measure, it deserves a liberal interpretation to advance the legislative intent of promoting the welfare of persons with disabilities.

Revenue's Contention:

- The Revenue contended that the amendment to Section 80DD is **prospective** and **cannot be applied retrospectively** to alter pre-existing insurance contracts.

- The insurance policies are commercial in nature, and retrospective application would disturb their contractual terms and sanctity.

- The object of Section 80DD is to provide financial security to the disabled dependent after the subscriber's death, and allowing early withdrawal would defeat this objective.

Judgement:

- The Court observed that the purpose of Section 80DD is to provide financial protection to the disabled dependent after the death of the caregiver. Allowing the subscriber to withdraw or use the policy amount during their lifetime would go against the very intent of the provision.

- It was further noted that if such early withdrawal was permitted in earlier policies, it could defeat the long-term security of the dependent and disturb the basic structure of the insurance arrangement meant to safeguard them.

- The Court emphasized that insurance policies are commercial contracts with fixed terms and conditions. Hence, their core terms cannot be changed retrospectively, as doing so would interfere with the contractual balance between the insurer and the insured.

  Hence, the Supreme Court rejected the petitioner's plea for retrospective application of the amendment and held that the change made by the Finance Act, 2022 would **apply only prospectively from 1 April 2023**.

My Analysis:

The judgment maintains a balance between legal certainty and social welfare. The Supreme Court rightly emphasized that Section 80DD was framed to secure the future of the disabled dependent after the caregiver's death, and any retrospective change could weaken that protection.

While the petitioner's demand was socially motivated, the Court prioritized the sanctity of contractual terms and the legislative intent behind the provision. The decision thus reinforces that beneficial amendments, though well-intentioned, cannot override existing legal or contractual frameworks unless expressly stated by law.

Allowability of Business Expenditure and Depreciation during Temporary Inactivity under the Income-tax Act

Pride Foramer S.A.
vs.
Commissioner of Income-tax
[2025] 179 Taxmann.com 464 (SC)
OCTOBER 17, 2025

Author: Manvee Porwal

Bench:

Justice Manoj Misra

Justice Joymalya Bagchi

Brief Facts:

Pride Foramer S.A. was a non-resident company incorporated in France, engaged in the business of offshore oil drilling. It had earlier executed a **10-year drilling contract with ONGC** for offshore Mumbai, which expired in the year 1993. After the expiry of this contract, the assessee did not have any active drilling operations in India for several subsequent years. During this intervening period:

- The assessee continued to **maintain its corporate existence** in India.
- **Incurred routine expenditure** including administrative charges, audit fees etc.
- Carried on **business correspondences with ONGC** and had also submitted a bid for oil exploration in 1996.

During the relevant assessment year, although no drilling income was earned, the assessee claimed certain business expenditure, which was disallowed by the Assessing Officer on the ground that the assessee was not carrying on any business activity in India during the relevant assessment years.

Issues Involved:

Whether the assessee, a non-resident company, could be **regarded as "carrying on business"** in India during the relevant assessment years, so as to be **entitled to deduction of business expenditure** under Section 37(1) read with Section 71 of the Income-tax Act, 1961, and to carry forward and set off unabsorbed depreciation under Section 32(2) of the Act, **despite the absence of active business operations** in India during those years?

Law Involved:

- **Section 37(1) of the Income-tax Act, 1961 – Allowability of Business Expenditure**
  Section 37(1) provides that any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being capital or personal expenditure), laid out or expended wholly and exclusively for the purposes of the business or profession, shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

  For allowance under this section, it is essential that:
  - The assessee is carrying on a business, and
  - The expenditure is incurred in the course of such business.

- **Section 71 of the Income-tax Act, 1961 – Set-off of Losses**
  Section 71 permits set-off of loss from one head of income against income from another head, subject to conditions prescribed therein.
  In the context of business income, the provision operates only if there exists a valid business loss, which presupposes that the business is in existence during the relevant assessment year.

- **Section 32(2) of the Income-tax Act, 1961 – Carry Forward and Set-off of Unabsorbed Depreciation**
  Section 32(2) allows unabsorbed depreciation to be carried forward to subsequent years, and treated as depreciation of the following year. However, judicial interpretation has consistently held that the business need not generate income, but the assessee must be carrying on business in the relevant year for the benefit of set-off to be available.

Assessing Officer ("AO"):

The Assessing Officer took the view that since **no business activity was carried** on during the relevant year and **no income was earned**, the assessee's business had come to an end. According to the AO, the expenditure claimed could not be regarded as incurred wholly and exclusively for the purposes of business, as the business itself was no longer in existence. On this reasoning, the **AO disallowed the expenditure** claimed by the assessee.

CIT (A):

The Commissioner of Income-tax (Appeals) **affirmed the order of the Assessing Officer** and held that the **mere intention to resume** business at some future point was **insufficient to establish continuity of business**. The CIT (A) observed that in the absence of any commercial operations during the year, the assessee could not be said to be carrying on business, and

therefore, the expenditure incurred during the period of inactivity was not allowable as business expenditure.

ITAT:

The Tribunal however, **reversed the findings of the CIT (A)** and held that a **temporary lull in the business cannot be termed as cessation** of business. The tribunal noted that correspondence with ONGC in 1996 and the submission of a tender in September 1996 demonstrated that the assessee continued to pursue fresh drilling contracts even after completion of the earlier contract in 1993. The Tribunal applied the principle laid down by the **Bombay High Court in Hindustan Chemical Works Ltd. v. CIT (124 ITR 561)**, which draws a clear distinction between a "lull in business" and "going out of business", and held that the assessee's case fell within the former category.

Accordingly, the Tribunal concluded that the assessee was carrying on business during the relevant assessment years and **allowed the assessee's claim for deduction** of business expenditure and allied benefits under the Act.

High Court:

The High Court, while hearing the Department's appeals, **reversed the orders of the ITAT**. Although the Court accepted the legal proposition that a **mere lull in business does not necessarily amount to cessation of business**, it disagreed with the ITAT's application of that principle to the facts of the case.

The High Court held that during the relevant assessment years the assessee did not have any permanent or other office in India, and no drilling contract was in execution. In the absence of any ongoing business activity or business establishment in India, the Court concluded that the assessee **could not be regarded as carrying on business in India**.

Accordingly, the High Court held that the assessee was not entitled to the set-off claimed under Section 71 of the Act, and reversed the ITAT's findings.

Supreme Court Held:

The Supreme Court **set aside the judgment of the High Court** and **restored the orders of the ITAT**, holding that the High Court had erred in concluding that the assessee was not carrying on business in India during the relevant assessment years.

Ratio Laid Down by the Supreme Court:

- **Temporary lull is not cessation**: Mere absence of income or suspension of operations for a limited period cannot, by itself, lead to the conclusion that the business has been discontinued.

- **Readiness to resume business is crucial**: So long as the assessee demonstrates an intention to continue business and undertakes activities directed towards securing business, it cannot be said that the business has ceased.

- **Commercial reality over technical interpretation**: The nature of the offshore drilling industry, which inherently involves intervals between contracts, must be taken into account while determining whether the business was being carried on.

Accordingly, the business expenditure claimed by the assessee was held to be allowable.

Revenue's Contention:

- ➢ No active drilling activity was undertaken during the year
- ➢ No income was earned
- ➢ The assessee's business had effectively come to an end

Therefore, expenditure claimed could not be allowed as business expenditure.

Assessee's Contention:

- The business was never closed or abandoned
- The drilling rig was continuously maintained
- Employees were retained and statutory obligations were complied with
- The lull was temporary and dictated by the nature of the business

My Analysis:

This judgment clearly explains the distinction between "temporary lull" and "cessation of business." The Supreme Court rightly recognised that **business continuity cannot be judged merely by the absence of income** in a particular year.

In Pride Foramer's case, several factual indicators strongly negated the theory of cessation:

- ➢ The core business asset (drilling rig) was not sold, dismantled, or abandoned
- ➢ The rig was maintained in operational readiness, which involves substantial cost and technical compliance
- ➢ Employees and technical crew were retained, indicating an intention to continue business
- ➢ The lull arose due to non-availability of immediate contracts, a commercial reality inherent in offshore drilling

These facts collectively demonstrate that the business infrastructure remained fully intact. There was **no winding up of operations**, no closure decision, and no diversion of assets for non-business purposes. What existed was **merely a pause between two business cycles**, not a termination of business itself.

The ruling reinforces that **cessation of business is a matter of intention**, not a mechanical consequence of temporary inactivity. Where the assessee continues to preserve its business apparatus and remains ready to resume operations, the business must be regarded as continuing.

This judgment is particularly significant for capital-intensive industries, where gaps between revenue-generating activities are common. It ensures that genuine business expenditure incurred during such intervening periods is not unfairly disallowed on a narrow or overly technical understanding of "cessation of business."

Pre-Plan income-tax demands not filed during CIRP cannot be enforced under Section 31(1) IBC.

Vaibhav Goel & Another
v.
DCIT & Another
Civil Appeal No. 49 of 2022
20th March 2025

Author: Sanya Khandelwal

Bench:
Justice **Abhay S. Oka**
Justice **Ujjal Bhuyan**

Brief Facts:
1. Corporate Insolvency Resolution Process (CIRP) was initiated against M/s Tehri Iron and Steel Casting Ltd. (Corporate Debtor).

2. The appellants, Vaibhav Goel & Anr., submitted a Resolution Plan dated 21 January 2019.

3. The National Company Law Tribunal (NCLT) approved the Resolution Plan on 21 May 2019 under Section 31(1) of the Insolvency and Bankruptcy Code, 2016 (IBC).

4. The Resolution Plan accounted for certain tax liabilities but no claim was filed by the Income Tax Department for Assessment Years (AY) 2012-13 and 2013-14 during the CIRP.

5. After approval of the Resolution Plan, the Income Tax Department issued demand notices in December 2019 for the said assessment years.

6. The Monitoring Professional challenged these demands before the NCLT, contending that such claims stood extinguished upon approval of the Resolution Plan.

7. The NCLT and subsequently the NCLAT rejected the challenge, leading to the present appeal before the Supreme Court.

Issues Involved:
Whether **income-tax demands for periods prior to approval of a Resolution Plan**, for which **no claim was filed during CIRP**, can be enforced after the Resolution Plan has been approved under **Section 31(1) of the IBC**.

Sections Involved:
Section 31(1), Insolvency and Bankruptcy Code, 2016
This provision states that once a Resolution Plan is approved by the Adjudicating Authority (NCLT), it becomes **binding on the corporate debtor, its employees, members, creditors, guarantors, and all statutory authorities**.

The legislative intent is to provide **finality and certainty**, ensuring that all claims not included in the Resolution Plan stand **extinguished**.

Income Tax Act, 1961 (Contextual Reference)

The Income Tax Department sought to recover tax dues for prior assessment years, treating them as statutory dues payable notwithstanding the approved Resolution Plan.

What the AO Held:

No detailed Assessing Officer's order is discussed in the judgment. The controversy arose from **post-resolution tax demand notices** issued by the Income Tax Department rather than from appellate proceedings under the Income Tax Act.

What the CIT(A) Held:

The dispute did not arise out of an assessment order passed under the Income Tax Act, 1961, nor was it challenged through the statutory appellate mechanism provided therein. The controversy concerned the **enforceability of income-tax demands after approval of a Resolution Plan under the IBC**, which falls outside the jurisdiction of the Commissioner of Income Tax (Appeals). Consequently, no appellate proceedings before the CIT(A) were initiated or required.

What the ITAT Held

The issue involved was not the correctness or validity of the tax assessment or demand under the Income Tax Act, but whether such demands **survived in law after approval of a Resolution Plan under Section 31(1) of the IBC**. As the question related to the overriding effect of the IBC and the binding nature of an approved Resolution Plan, jurisdiction lay exclusively with the **NCLT/NCLAT as the Adjudicating Authorities under the IBC**, and not with the Income Tax Appellate Tribunal.

What the High Court Held

No High Court judgment was involved. The appeal before the Supreme Court arose directly from the **NCLAT's order**.

What the NCLT Held

The NCLT dismissed the application filed by the Monitoring Professional, holding that the challenge to the tax demands was **not maintainable**, and refused to declare the demands invalid.

What the NCLAT Held

The NCLAT upheld the NCLT's decision, affirming that the Income Tax Department could proceed with the recovery of tax dues despite approval of the Resolution Plan.

Contentions:

Contentions of the Appellants

- Once a Resolution Plan is approved under Section 31(1) of the IBC, **all claims not submitted during CIRP stand extinguished**.
- The Income Tax Department failed to lodge its claims for AY 2012-13 and 2013-14 before the Resolution Professional.
- Reliance was placed on **Ghanashyam Mishra & Sons Pvt. Ltd. v. Edelweiss ARC Ltd.**, Civil Appeal No. 8129 of 2019, which held that statutory dues not part of the approved Resolution Plan cannot be enforced later.

Contentions of the Respondents (Income Tax Department)

- Statutory tax dues cannot be waived unless expressly dealt with in the Resolution Plan.
- The approval order of the NCLT preserved the right of statutory authorities to determine and recover lawful dues.

Supreme Court's Decision / Ratio

- The Supreme Court **allowed the appeal** and set aside the orders of the NCLT and NCLAT.
- It held that **once a Resolution Plan is approved, all claims which are not part of the plan stand permanently extinguished**, including statutory dues payable to the Central Government.
- Tax demands raised for periods **prior to the approval of the Resolution Plan**, without filing claims during CIRP, are **unenforceable in law**.
- The Court reaffirmed the binding nature of Section 31(1) IBC and reiterated that **no authority can initiate or continue proceedings for past claims not included in the Resolution Plan**.

Own Analysis:

This judgment reinforces the foundational principle of the Insolvency and Bankruptcy Code — finality of resolution. By extinguishing all unclaimed liabilities upon approval of the Resolution Plan, the Supreme Court ensures commercial certainty and protects the sanctity of the insolvency resolution process.

The ruling places a clear obligation on statutory authorities, including tax departments, to participate actively in CIRP by filing claims within prescribed timelines. Failure to do so results in forfeiture of recovery rights.

From a policy perspective, the decision strengthens investor confidence by guaranteeing a "clean slate" to successful resolution applicants. It also aligns with the IBC's objectives of value maximisation, time-bound resolution, and avoidance of endless litigation.

Overall, the judgment harmonises insolvency law with tax law by clarifying that IBC has overriding effect, thereby preventing post-resolution revival of dormant statutory claims.

A Critical Analysis of Taxability of Sales Tax Subsidy under the Income-tax Act

Principal Commissioner of Income-tax

v.

Sunbeam Auto (P.) Ltd.

[2024] 463 ITR 3 (SC)

30th January, 2024

Author: Kanav Agarwal

Bench:

Justice B. V. Nagarathna
Justice Augustine George Masih

Brief Facts:

The assessee, Sunbeam Auto (P.) Ltd., received **sales tax subsidy** under a State Government industrial incentive scheme from AY 2006-07 to AY 2010-11 The object of the scheme was to promote industrial development by encouraging the setting up and operation of industrial units in designated areas.

The subsidy was quantified with reference to sales tax collected and retained by the assessee for a specified period. The assessee treated the subsidy as a **capital receipt**, contending that it was granted to promote industrial growth and capital investment and not to supplement its business profits.

The Assessing Officer, however, proposed to treat the sales tax subsidy as a **revenue receipt**, taxable under the Income-tax Act, 1961. The matter travelled through various appellate stages and ultimately reached the Supreme Court.

Issues Involved:

Whether **sales tax subsidy received by the assessee-company under a State Government incentive scheme** constitutes a **capital receipt** or a **revenue receipt** for the purposes of taxation under the Income-tax Act, 1961.

Sections Involved:

Section 4 – Charging Section

Section 4 is the charging provision under the Income-tax Act and provides that income-tax shall be charged on the **total income** of an assessee. If a receipt does not qualify as "income", it falls outside the charging mechanism.

Section 2(24) – Definition of Income

Section 2(24) provides an inclusive definition of "income". While the definition is wide, judicial precedents have consistently held that **capital receipts are not taxable**, unless specifically included by statute.

The controversy in the present case revolved around whether sales tax subsidy could be brought within the scope of "income" under these provisions.

What the Assessing Officer (AO) Held:

The Assessing Officer held that:

- The sales tax subsidy was received during the course of business operations.
- The subsidy had a direct nexus with sales turnover.
- It effectively increased the profitability of the assessee.

Accordingly, the AO treated the subsidy as a **revenue receipt**, taxable as business income under the Act.

What the CIT(A) Held:

The Commissioner of Income-tax (Appeals) ruled in favour of the assessee, holding that:

- The purpose of the subsidy scheme was industrial promotion.
- The subsidy was not granted to meet operational expenditure or trading losses.

Accordingly, the subsidy was held to be a **capital receipt**, not chargeable to tax.

What the ITAT Held:

The Income Tax Appellate Tribunal affirmed the view taken by the CIT(A) and held that:

- The decisive factor is the **object of the subsidy scheme**, and not the method of its computation or disbursement.
- Since the subsidy was intended to encourage industrial development, it constituted a **capital receipt**.

What the High Court Held:

The High Court upheld the findings of the appellate authorities and held that:

- Sales tax subsidy received under an industrial incentive scheme aimed at promoting industrial growth is capital in nature.
- Such subsidy cannot be brought to tax merely because it is quantified with reference to sales tax or turnover.

The High Court ruled in favour of the assessee.

What the Supreme Court Held:

Contentions of the Revenue

The Revenue contended that:

- The subsidy was linked to sales tax collection and arose during the course of business.
- It resulted in an increase in business profits.
- Therefore, it should be treated as a **revenue receipt**, taxable under the Income-tax Act.

Contentions of the Assessee

The assessee argued that:

- The subsidy was granted with the object of encouraging industrial development.
- It was not intended to supplement business profits or meet revenue expenditure.
- The **purpose test**, as laid down by earlier Supreme Court judgments, clearly establishes the subsidy as capital in nature.

Ratio Laid Down by the Supreme Court

The Supreme Court dismissed the Revenue's appeal and held that:

- The **purpose for which the subsidy is granted** is the determining factor in deciding its nature.
- If the object of the subsidy is to promote industrial growth or capital investment, the subsidy constitutes a **capital receipt**, irrespective of the mode of payment or computation.
- Once a receipt is held to be capital in nature, the **natural consequences must follow**, and such receipt cannot be brought to tax under the Income-tax Act.

The ruling was delivered **in favour of the assessee**.

My Analysis:

The judgment in *PCIT v. Sunbeam Auto (P.) Ltd.* reinforces the settled position of law on the tax treatment of government subsidies. The Supreme Court has once again clarified that the **purpose for which a subsidy is granted is more important than the form in which it is received**.

By holding that sales tax incentives given for industrial promotion are capital in nature, the Court has removed ambiguity in an area that has seen repeated litigation despite clear judicial guidance. The decision restricts the tendency of the tax authorities to treat such incentives as taxable merely because they are linked to sales or turnover.

From a practical perspective, the ruling provides confidence to taxpayers who receive incentives under State industrial policies and ensures consistency in tax treatment. It also highlights the need for tax authorities to follow settled legal principles, which will help reduce unnecessary disputes and promote certainty in tax administration.

Post-2016 Legal Position and Impact of Section 2(24)(xviii)

Section 2(24)(xviii) was inserted by the Finance Act, 2015 with effect from Assessment Year 2016-17, whereby assistance in the form of subsidy, grant, incentive, concession or reimbursement received from the Central or State Government was specifically included within the definition of "income". The introduction of this provision has widened the scope of the term "income" in relation to government subsidies.

However, the said amendment does not expressly do away with the settled distinction between capital and revenue receipts, nor does it provide for taxation of capital subsidies per se. Judicial principles laid down by the Supreme Court continue to hold that inclusion within the definition of income does not automatically result in taxability unless the receipt is also chargeable under section 4 of the Act.

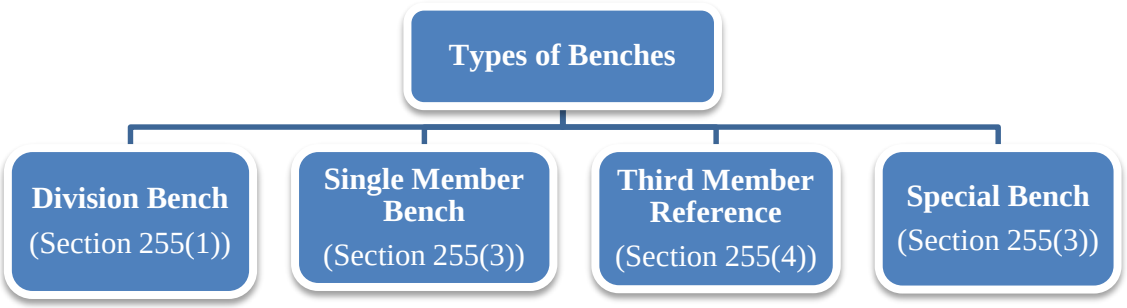
Accordingly, even in the post-2016 regime, the nature of subsidy must be determined by applying the **purpose test**. Where the object of the subsidy is to promote industrial growth, encourage capital investment or facilitate setting up or expansion of industrial units, such subsidy would retain its character as a capital receipt and would not be chargeable to tax in the absence of a specific charging provision. Conversely, subsidies granted to supplement business profits or to meet revenue expenditure would be taxable.

Although the decision of the Supreme Court in *PCIT v. Sunbeam Auto (P.) Ltd.* relates to assessment years prior to the insertion of section 2(24)(xviii), the principles reaffirmed therein continue to provide interpretative guidance for determining the taxability of government subsidies even in the post-amendment period.

ITAT (INCOME-TAX APPELLATE TRIBUNAL)

Types of Benches:

1. Division Bench (Section 255(1))
2. Single Member Bench (Section 255(3))
3. Special Bench (Section 255(3))
4. Third Member Reference (Section 255(4))



Note on Special Bench

The power to constitute a Special Bench is vested in the President of the ITAT under Section 255(3) of the Income-tax Act, 1961, which provides:

"The President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more Members, one of whom shall necessarily be a Judicial Member and one an Accountant Member."

While the statute itself does not enumerate an exhaustive list of circumstances for the constitution of a Special Bench, judicial practice has consistently recognized that such power is exercised in situations involving conflicting decisions of coordinate Benches, issues of substantial importance, or matters requiring authoritative resolution.

A Special Bench may be constituted by the President *suo motu* in exercise of his discretion; however, such constitution may also be made upon a request by either the assessee or the Assessing Officer. Thus, both the assessee and the Department are entitled to request the President for constitution of a Special Bench.

In this context, reference may also be made to the CBDT publication titled **"Appeals and Procedure for Filing Appeals"** (Tax Payers Information Series -42, August 2018), which explains that where divergent interpretations arise among coordinate Benches of the ITAT, the President is empowered to constitute a Special Bench. The said publication being purely explanatory and procedural in nature, the reference thereto is only corroborative of the statutory framework under Section 255(3) of the Income-tax Act, 1961 and the Income-tax (Appellate Tribunal) Rules, 1963.

Special Bench is normally constituted on legal issues, so that a similar viewpoint may be taken across Benches. For fact-driven issues, a Special Bench is not constituted.

The decision of a Special Bench has binding force on the various Benches of the ITAT.

An appeal against a Special Bench decision would lie before the High Court having jurisdiction over the Bench at which the Special Bench is constituted.

Since a Special Bench combines cases listed before various Benches across the country having similar issues involved, a notice is displayed on the notice board of all the Benches, informing the general public and counsels of the constitution of the Special Bench and the question referred to it. The counsels of different assessees facing similar issues, and whose matters are pending for hearing before different Benches, can join the hearing and present their arguments, acting as interlocutors.

Surcharge rates for private discretionary trusts taxed at the Maximum Marginal Rate

Araadhya Jain Trust

vs.

Income-tax Officer

[2025] 126 ITR(T) 1 (Mumbai - Trib.) (SB)

9th April, 2025

Author: Shivika Sarraf

Bench:

Justice C.V. Bhadang, President

Shri Saktijit Dey, Vice President

Shri B.R. Baskaran, Accountant Member

Brief Facts:

The assessee, Araadhya Jain Trust, is a Private Discretionary Trust. For the 2023-24 assessment year, it reported an income of approximately Rs. 4,85,290. Because it is a discretionary trust, it is required by law to pay tax at the "Maximum Marginal Rate" (MMR).

The dispute began when the Centralized Processing Centre (CPC) processed the tax return. While the trust correctly applied the 30% tax rate, the CPC also added the highest possible surcharge rate (which is 37%) to that tax. The Trust argued that since its income was only Rs. 4.85 lakhs-well below the Rs. 50 lakh threshold where surcharges usually begin—it should not have to pay any surcharge at all.

Surcharge Rate for Trusts (as per Individual/AOP rates):

Total Income	Surcharge Rate
Up to Rs. 50 lakhs	Nil
More than Rs. 50 lakhs up to Rs.1 crore	10% of tax
More than Rs.1 crore up to Rs. 2 crores	15% of tax
More than Rs. 2 crores up to Rs. 5 crores	25% of tax
More than Rs. 5 crores	37% of tax

Note: In case where the total income includes any income by way of dividend or income under the provisions of section 111A, section 112 and section 112A of the Income-tax Act, the rate of surcharge on the amount of income-tax computed in respect of that part of income shall not exceed fifteen per cent. The matter ultimately reached the Income-tax Appellate Tribunal, where due to conflicting Tribunal views, a Special Bench was constituted to decide the issue.

Issues Involved:

The core question before the Special Bench was:

In the case of **private discretionary** trusts taxed at the **Maximum Marginal Rate** (MMR), should the surcharge also be charged at the highest possible rate (37%), or should it follow the standard income-based slab rates (starting only if income exceeds Rs. 50 lakhs)?

Sections Involved:

Section 164 of the Income-tax Act:

This section deals with how to tax "discretionary trusts" where the beneficiaries or their shares are not fixed. It mandates that such income must be taxed at the Maximum Marginal Rate (MMR) to prevent people from using trusts to split income and avoid higher tax brackets.

Section 167B of the Income-tax Act:

This section applies similar principles to Associations of Persons (AOPs) or Bodies of Individuals (BOIs) where members' shares are indeterminate. It reinforces the concept of taxing such income at the **maximum marginal rate**.

Section 2(29C) of the Income-tax Act:

This defines "Maximum Marginal Rate. "Maximum marginal rate" means the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, association of persons or, as the case may be, body of individuals as specified in the Finance Act of the relevant year;

Section 2 of the Finance Act, 2023:

This is the "annual law" that actually sets the tax rates and surcharge percentages for the year.

What the Assessing Officer (AO) Held:

The Assessing Officer (via the CPC's automated processing) held that since, the trust is taxable at the maximum marginal rate, and Section 2(29C) includes surcharge within the definition of maximum marginal rate, Surcharge must be applied at the highest possible rate, irrespective of the actual income of the trust. Therefore, they applied the maximum surcharge rate of 37% regardless of the trust's actual income.

What the CIT(A) Held:

The Commissioner of Income-tax (Appeals) upheld the AO's decision. The CIT(A) focused on the phrase "if any" in the definition of MMR, interpreting it to mean that if a surcharge exists in the Finance Act at all, the highest rate of that surcharge must be applied to these trusts.

Reason for Reference to the Special Bench:

Initially, a regular division of the Tribunal had ruled against the Trust for a previous year, stating the highest surcharge should apply. However, other divisions of the Tribunal had given the opposite ruling in similar cases. Because of these conflicting views between different benches of the same Tribunal, a "Special Bench" was formed to provide a final, authoritative decision.

What the Special Bench Held:

Final decision: The Special Bench ruled in favor of the Assessee (the Trust). Stating that, in case of Private Discretionary Trusts, whose income is chargeable to tax at maximum marginal rate, surcharge has to be computed on the income tax having reference to the slab rates prescribed in the Finance Act under the heading 'surcharge on income tax' appearing in Paragraph A, Part 1, First Schedule, applicable to the relevant assessment year

Ratio Laid Down:

The Bench held that for Private Discretionary Trusts, while the tax rate is fixed at the MMR (30%), the surcharge must still follow the income-based slabs provided in the Finance Act. Since the Trust's income was below the Rs. 50 lakh threshold, **no surcharge was applicable**.

Contentions of the Parties:

The Trust (Assessee): Argued that "surcharge" and "rate of tax" are two different things under the Constitution and the Law. Surcharges are intended to tax those with very high incomes (the "super-rich"). Applying a 37% surcharge to a trust earning only Rs. 4 lakhs would be absurd and discriminatory.

The Revenue (Income Tax Dept): Argued that the definition of MMR is a "package deal" that includes both the 30% tax and the highest surcharge (37%). They claimed the phrase "including surcharge... if any" meant the surcharge is part of the rate itself.

Final Reasoning:

The Bench noted that if the Department's view were accepted, it would make several parts of the tax law "meaningless" and "absurd". For example, the law provides a lower surcharge cap for dividend income; the Department's view would ignore such specific protections. Ignoring income thresholds would make the entire surcharge structure meaningless. They concluded that MMR determines the rate of basic tax, but the surcharge must be calculated based on the actual quantum of income.

My Analysis:

This judgment is a victory for common sense in tax law. It prevents a "mechanical" reading of definitions from creating unfair results. The Special Bench has rightly separated **tax rate determination, and Surcharge computation**. The MMR rule was created to ensure trusts pay tax at the highest rate (30%) so they aren't used for tax evasion. However, "surcharge" is a separate tool used by the government to collect extra money from high-income earners. Applying surcharge to a small trust with only Rs. 4 lakhs of income would go against the very purpose of the surcharge law. By ruling that surcharge must follow income slabs, the Special Bench has ensured that tax remains progressive and fair.

A Critical Analysis of Transfer Pricing Applicability in Tax-Exempt Units under Section 10A.

M/s Doshi Accounting Services Pvt. Ltd.

vs.

DCIT, Baroda

ITA No. 1352/Ahd/2011

24th October 2019

Author: Rituraj Jain

Bench:

Justice P.P. Bhatt, President

Shri Rajpal Yadav, Judicial Member

Shri Waseem Ahmed, Accountant Member

Brief Facts:

M/s Doshi Accounting Services Pvt. Ltd. (the assessee) is a private limited company engaged in providing business process outsourcing (BPO) services, primarily in the areas of accounting, taxation, bookkeeping, VAT returns, payroll, management accounting, and audit services. The company is a 99.99% subsidiary of **Doshi & Co.**, a UK-based firm. The primary business of the company is to provide services to **Associated Enterprises (AEs)**, including its parent company (Doshi & Co.).

The assessee operates from a **Special Economic Zone (SEZ)** unit in Baroda, which is eligible for tax benefits under **Section 10A of the Income Tax Act**, granting it a 100% tax exemption on profits derived from its export activities. The assessee's international transactions, particularly with its AEs, are at the heart of this case, with a focus on whether the provisions of **Transfer Pricing** (Section 92) can be invoked in cases where the income is exempt under Section 10A.

The primary issue arose when the **Assessing Officer (AO)** referred the case to the **Transfer Pricing Officer (TPO)** for determining the arm's length price (ALP) of transactions between the assessee and its AEs. The assessee argued that since it was exempt under Section 10A, it had no tax avoidance motive and hence the transfer pricing provisions should not apply.

Issues Involved:

The key issues involved in this case were:

1. **Whether transfer pricing provisions under Section 92 can apply when the assessee's income is exempt under Section 10A** of the Income Tax Act (i.e., no taxable income is derived from the international transactions with AEs).
2. **Whether tax avoidance is a necessary condition for invoking transfer pricing provisions** in cases where the transactions between AEs are at arm's length but the assessee's income is exempt.

Sections Involved:

The following sections of the **Income Tax Act, 1961** are central to the case:

1. Section 92A - Associated Enterprises (AEs):

Section 92A defines "associated enterprises," which are two or more enterprises that are related to each other through common control or ownership, among other criteria. This section is vital for determining whether transactions between entities are covered under **transfer pricing provisions**. Since M/s Doshi Accounting Services Pvt. Ltd. is a subsidiary of Doshi & Co., a UK-based firm, the transactions between them are considered international transactions under Section 92A and hence come within the scope of transfer pricing.

2. Section 10A - Exemption on Profits from SEZ Units:

Section 10A provides **tax exemptions** to enterprises operating in **Special Economic Zones (SEZs)**, allowing them to claim 100% deduction on profits derived from their business activities. The assessee, being an SEZ unit, claimed the exemption for its export-related income. This exemption is at the heart of the case because the assessee argued that, since it was already exempt from tax under Section 10A, there was no incentive to shift profits out of India.

3. Section 92C - Determination of Arm's Length Price (ALP):

Section 92C outlines the method to determine the arm's length price for international transactions between associated enterprises. The section provides various methods, such as:

- **Comparable Uncontrolled Price (CUP) method**
- **Resale Price method**
- **Cost Plus method**
- **Profit Split method**
- **Transactional Net Margin Method (TNMM)**

In the case, the assessee used the **CUP method** to benchmark the transactions with its AE, claiming that the rates charged to the AE were within arm's length. However, the TPO rejected this method, arguing that the transactions involved were not comparable enough and instead used the **TNMM**.

4. Section 92 - General Provisions Relating to Transfer Pricing:

This section governs the transfer pricing provisions, which are meant to prevent tax avoidance by ensuring that the prices charged between related parties are consistent with what would have been charged between unrelated parties (i.e., at arm's length). It also gives the TPO the authority to assess and make adjustments to the prices for international transactions.

5. Section 92C(4) - Impact on Exemption under Section 10A:

Section 92C(4) is significant as it prohibits the deduction under Section 10A in cases where the ALP has been adjusted upward, thus reducing the exemption available under Section 10A. This creates a conflict between the provisions of Section 92 and the exemption available under Section 10A.

What the AO Held:

The **Assessing Officer (AO)** referred the case to the **Transfer Pricing Officer (TPO)** to determine the arm's length price of the transactions between the assessee and its associated enterprise (Doshi & Co.). The AO disagreed with the assessee's claim that transfer pricing provisions should not apply due to the tax exemption under Section 10A. The AO argued that transfer pricing regulations aim to ensure fair and reasonable profits, regardless of tax exemptions.

What the CIT(A) Held:

The **Commissioner of Income Tax (Appeals)** upheld the AO's reference to the TPO and dismissed the assessee's argument that there was no need to invoke transfer pricing provisions due to the tax exemption under Section 10A. The CIT(A) cited previous judgments, including **Aztec Software & Technology Services Ltd.** (107 ITD 141) to support the application of transfer pricing rules even in cases where income is exempt under Section 10A.

Reason for Reference to the Special Bench:

The case was referred to the **Special Bench** because of contradictory decisions by various benches regarding whether transfer pricing provisions apply when the income is exempt under Section 10A. The issue of tax avoidance, particularly whether it is necessary to prove a tax avoidance motive before invoking transfer pricing provisions, needed clarity. The **Special Bench** was constituted to resolve this legal question.

What the Special Bench Held (Ratio laid down + Contentions of both the parties):

The **Special Bench** ruled that **transfer pricing provisions under Section 92** can be invoked even when the assessee's income is exempt under **Section 10A**. The Bench clarified that the purpose of the transfer pricing provisions is to ensure that profits are reported at arm's length, irrespective of whether those profits are taxable in India. This ruling emphasized that the objective of the provisions is to prevent profit shifting and tax avoidance, even in cases where the income is exempt.

Contentions:

- **Assessee's Argument:**
    - The assessee argued that there was no incentive to shift profits out of India because its income was fully exempt under Section 10A.
    - It contended that the provisions of Chapter X (transfer pricing) should not be applicable since the motive to avoid tax did not exist in this scenario.
    - The assessee cited various case laws, including **Vodafone India Services Pvt. Ltd.** (361 ITR 531), to argue that transfer pricing provisions should not apply in the absence of tax avoidance motive.
- **Revenue's Argument:**
    - The Revenue contended that the **transfer pricing provisions** should apply to ensure that international transactions between related parties are at arm's length.
    - The Revenue argued that there is no requirement for proving tax avoidance motive for invoking transfer pricing provisions.
    - It also pointed to the **proviso to Section 92C(4)**, which states that no deduction under Section 10A would be allowed if the ALP is adjusted upward.

My Analysis:

In this case, the **Special Bench** clarified an important issue regarding the applicability of **transfer pricing** provisions in situations where income is exempt under **Section 10A**. While the assessee argued that there was no incentive to shift profits due to the exemption, the ruling emphasized that the **purpose of transfer pricing provisions** is to determine whether the transactions between related parties are conducted at arm's length, regardless of tax exemptions.

This case also highlights the **conflict** between the **transfer pricing provisions** and **tax exemptions** provided under Section 10A. The proviso to Section 92C(4), which disallows deductions under Section 10A when ALP is adjusted, creates an inherent tension. The **Special Bench's ruling** supports the view that the **transfer pricing regulations** aim to **protect India's tax base** and are not contingent upon the existence of a tax avoidance motive. This ruling sets a crucial precedent for future cases involving international transactions and tax exemptions.

In light of this, it is evident that tax exemptions provided under Section 10A cannot provide an automatic defense against the invocation of transfer pricing provisions. The decision underscores the need for **consistent application** of transfer pricing rules to ensure fair reporting and prevent profit shifting, irrespective of tax exemptions.

An Analytical Review of Transfer Pricing Provisions in the Context of Foreign Enterprises Operating through Indian Permanent Establishments

M/s. TBEA Shenyang Transformer

Group Company Limited

vs.

DCIT (International Taxation)

ITA No. 581/Ahd/2017

11th November, 2024

Author: Saloni Arora

Bench:

Shri George George K. (Vice-President)

Smt. Annapurna Gupta (Accountant Member)

Smt. Suchitra R. Kamble (Judicial Member)

Brief Facts

The taxpayer, M/s. TBEA Shenyang Transformer Group Co. Ltd., is a company incorporated in China. It was awarded a large "turnkey" contract by the Power Grid Corporation of India Ltd. (PGCIL) to set up sub-stations in India.

Because the project involved work on Indian soil (onshore services and supply), the Chinese company set up a Project Office (PO) in India. Under tax treaties and Indian law, this Project Office is considered a Permanent Establishment (PE) of the foreign company operating within India.

The dispute arose because of how the money flowed. While the Indian Project Office was doing the actual work, many payments from PGCIL were received directly by the Head Office (HO) in China. Similarly, many expenses and payments to subcontractors were paid by the Chinese HO. The Project Office in India reported significant losses, claiming that the costs it incurred (or were attributed to it) were higher than the revenue it earned.

Issues Involved

"Can an arrangement or transaction between a foreign company's Head Office and its own branch (Permanent Establishment) in India be legally treated as an 'International Transaction'?"

In simpler terms: Can the tax department apply Transfer Pricing rules to a situation where a company is essentially "dealing with itself"?

Sections Involved -

Section 92:

Any income arising from an international transaction shall be computed having regard to the arm's length price.

Section 92B:

A transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises.

Section 92F(iii):

Enterprise' means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents... or the provision of services of any kind

Chapter X of the Income-tax Act, 1961, titled "Special Provisions Relating to Avoidance of Tax," contains the core statutory framework for Transfer Pricing in India.

Its primary objective is to ensure that profits taxable in India are not understated (or losses overstated) by multinational enterprises through price manipulation in transactions with related parties.

What the Assessing Officer (AO) / TPO Held

The Transfer Pricing Officer (TPO) looked at the losses in the Indian Project Office and became suspicious. The TPO argued that if the Project Office were an independent Indian company, it wouldn't have agreed to do this work for such a low price that it resulted in a loss.

The TPO concluded that the Chinese Head Office was "underpaying" its Indian branch for the

services provided. Therefore, the TPO treated the arrangement as an international transaction and "adjusted" the income, effectively saying: "We are going to tax you as if you had earned a fair profit in India, regardless of what your internal books say."

What the CIT (A) Held

The Commissioner of Income Tax (Appeals) agreed with the TPO. They held that the Indian tax law specifically allows the department to treat a branch and a head office as separate entities for Transfer Pricing purposes to ensure India gets its fair share of tax.

Reason for Reference to the Special Bench

There was a major disagreement between different benches of the ITAT (Tribunal). One view (in the Aithent Technologies case) was that a person cannot "transact with himself," so a branch and head office are one entity and cannot have an "international transaction". However, another view was that for a foreign company, the Indian branch is a separate "enterprise" under Section 92F(iii) to ensure Indian profits are taxed fairly. The Special Bench was formed to settle this once and for all.

What the Special Bench Held

Final Decision: The Special Bench ruled in favor of the Tax Department (Revenue). It held that transactions between a foreign head office and its Indian PE are international transactions subject to Transfer Pricing.

Ratio Laid Down (The Legal Reason):

Specific Definition: While a branch and HO are one legal entity, Section 92F(iii) specifically includes a "Permanent Establishment" in the definition of an enterprise.

Protecting the Tax Base: If Transfer Pricing didn't apply, a foreign company could easily shift profits out of its Indian branch to its home country by charging unfair prices, thus avoiding Indian taxes.

Arm's Length Principle: Even if they are legally one, they must be treated as "independent actors" for tax purposes to ensure the profit shown in India is what an independent business would have earned

Contentions of the Parties:

The Company's Argument: "We are one legal entity. How can I contract with myself? How can I profit from myself? If there is no contract, there is no 'transaction' under Section 92B."

The Revenue's Argument: "The tax law is specific. It says a PE is an enterprise. If a foreign HO and its Indian PE engage in activities that affect profit, it must be tested against the Arm's Length Price to ensure the Indian profit is not artificially suppressed."

My Analysis:

The issue in the present case turns on the scope of Chapter X, which operates on the concept of an "enterprise" rather than the legal identity of a "person", as is evident from section 92F(iii) which expressly includes a Permanent Establishment within the definition of an enterprise.

While a PE is not a separate juridical person, the statute creates a deeming fiction for transfer pricing purposes. A clear distinction exists between an Indian company having a foreign branch and a foreign company having an Indian branch.

In the former case, the Indian company is taxable in India on its global income under section 5(1), rendering transactions with its foreign branch revenue neutral.

In contrast, where a foreign company operates through an Indian branch, only Indian-source income is taxable under section 5(2), and arrangements between the Head Office and the Indian PE are capable of influencing the Indian tax base.

This distinction explains the shift in approach in the third Aithent Technologies decision, where the Tribunal acknowledged that the deeming fiction under section 92F(iii) becomes relevant in cases involving a foreign enterprise and its Indian PE.

Further, the requirement under section 92B(1) that at least one party to the transaction be a non-resident stands fulfilled in the present case, thereby bringing such arrangements within the ambit of international transactions.

Viewed in this context, the Special Bench decision provides doctrinal clarity by aligning statutory interpretation with the anti-avoidance objective of Chapter X and settles the jurisprudence on the applicability of transfer pricing provisions to foreign enterprises operating through Indian Permanent Establishments.

Allocation of head office expenses under Article 7(3) of the India-UAE DTAA

Mashreq Bank Psc

vs.

DCIT (IT)-3(2), Mumbai

ITA No. 1342/Mum/2006

6th February, 2025

Author: Rachit Gupta

Bench:

Justice (Retd.) C. V. Bhadang, President

Shri Saktijit Dey, Vice President

Ms. Padmavathy S, Accountant Member

Brief Facts of the Case:

In this case, Mashreq Bank, (assessee) a non-resident banking company incorporated in UAE, operates in India through Mumbai and New Delhi branches. The assessee claimed deductions for head office expenses allocated to Indian branches and for certain expenses incurred outside India exclusively for Indian operations.

The AO restricted the deduction under Section 44C and disallowed expenses of Rs. 1,78,07,340 expenses allocated to Indian branches and expenses of Rs.3,58,421 holding that domestic law limitations apply. The CIT(A) upheld these disallowances. The assessee appealed, invoking Article 7(3) of the India-UAE DTAA, arguing that the treaty allows full deduction of expenses attributable to the Permanent Establishment (PE) in India.

Issue Involved:

The key issues in this case are whether head office expenses allocated to the Indian branches of Mashreq Bank are fully deductible under Article 7(3) of the India-UAE DTAA, thereby overriding the restrictions of Section 44C of the Income Tax Act, and whether certain expenses incurred outside India exclusively for the Indian branches can be claimed as deductions under Section 37 without being subject to the limitations imposed by Section 44C.

Section Involved:

- **Section 44C of the Income-tax Act, 1961 ("IT Act")**
  This section limits the deduction of head office expenses for a non-resident's Indian branch to **5% of average adjusted total income**, ensuring only a reasonable portion of global overheads is allowed.

- **Section 37 of the Income-tax Act, 1961 ("IT Act")**
  Allows deduction of business expenses wholly and exclusively for the business, not covered elsewhere, including those incurred outside India if attributable to Indian operations.

- **Article 7(3), India-UAE DTAA (Before 01 April 2008):**
  Provides that expenses of the Permanent Establishment (PE), including executive and administrative costs, incurred in India or abroad, are fully deductible in computing PE profits, effectively overriding domestic restrictions like Section 44C

Assessing Officer (AO):

The deduction of head office expenses was restricted to 5% of the average adjusted total income under Section 44C. Consequently, expenses incurred outside India, amounting to Rs. 3,58,421, were disallowed by the Assessing Officer, as they were treated within the ambit of Section 44C and subject to its prescribed limitation.

CIT(A):

The CIT(A) confirmed the Assessing Officer's disallowance for both the head office expenses and the specific foreign-incurred expenses. While Section 44C limits head office deductions to 5% of the Indian branches' income, the CIT(A) upheld the AO's treatment of the foreign expenses under the same restriction, denying their deduction.

Reason for Reference to the Special Bench:

In the assessee's prior years (1996-97, 1998-99, and 2001-02), conflicting decisions on the same legal issue arose regarding the deductibility of head office expenses, with some rulings allowing full deduction under the DTAA and others restricting it under domestic law (Section 44C). This inconsistency highlighted the need for a clear resolution on whether treaty provisions could override statutory limitations on branch expenses.

ITAT:

Assessee's contention

- The assessee contended that Article 7(3) of the India-UAE DTAA allows full deduction of all expenses related to the Indian Permanent Establishment (PE), whether incurred in India or abroad, and that the limitations under Section 44C of domestic law cannot restrict such deductions.

- The assessee further argued that changes made to Article 7(3) in 2008 were meant to clarify how deductions should be treated, but these changes do not apply to earlier years, so the rules before 2008 should still apply.

- The assessee also argued that any expenses spent outside India for the Indian branches are clearly for the Indian operations (the Permanent Establishment), and therefore, these expenses should be fully allowed as deductions under the treaty.

Revenue's Contention:

The Revenue contended that Article 25(1) of the DTAA provides that domestic law governs the computation of income unless expressly overridden by the treaty. Since Article 7(3) does not explicitly exclude the application of Section 44C, the deduction of head office and foreign-incurred expenses must comply with the limitations prescribed under domestic law.

Judgement:

- The Tribunal ultimately ruled in Favor of the assessee, Mashreq Bank, holding that the deductions claimed for expenses attributable to its Indian Permanent Establishment (PE) were fully allowable under Article 7(3) of the India-UAE DTAA. This included not only expenses incurred in India but also those incurred outside India specifically for the Indian branches, as they were wholly and exclusively related to the PE's operations.

- The Tribunal clarified that Section 44C of the Income Tax Act, which limits head office expenses, could not override the provisions of the treaty, since the treaty explicitly allows such deductions.

- Additionally, the Tribunal noted that the Protocol amending Article 7(3) in 2008 was prospective and therefore had no effect on assessments for prior years. In essence, the decision reinforced that expenses genuinely attributable to a PE must be allowed in computing its profits, and domestic law restrictions cannot be imported where the treaty is silent, upholding the principle of taxing PE profits on a net basis.

My Analysis:

The Special Bench examined Article 7(3) of the India-UAE DTAA before and after the 2008 Protocol to see if domestic law limits, like Section 44C, could apply.

The Relevant Extract of Article 7(3) India-UAE DTAA is as below:

"In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the tax laws of that State."

Before the amendment, Article 7(3) allowed all expenses of a permanent establishment—including head-office and administrative costs incurred abroad—to be fully deductible. It made no reference to domestic law, implying a clear, independent right to claim these deductions. After the 2008 Protocol, the article was amended to make such deductions "subject to the limitations of the tax laws of that State," introducing Section 44C's 5% ceiling for Indian branches of foreign banks.

The Tribunal held that this change was prospective. For the 2002-03 assessment year, Mashreq Bank was entitled to claim full head-office expenses, as the restriction could not apply retroactively.

The decision underscores an important principle in treaty interpretation: amendments to a treaty cannot be applied retrospectively unless explicitly stated. It also highlights that pre-2008 Article 7(3) gave foreign banks an unconditional right to deduct PE expenses, reflecting a policy that prioritized the economic reality of the PE over domestic statutory limits. This ensures predictability and fairness for taxpayers operating across borders.

Imposition of penalty under section 43 for non-disclosure of foreign assets is discretionary or mandatory?

Vinil Venugopal

vs.

DDIT (Inv.)

[2025] 179 taxmann.com 618 (Mumbai - Trib.)

October 14, 2025

Author: Rashi Jain

Bench:

Justice C.V. Bhadang (President)

Saktijit Dey (Vice President)

Smt. Renu Jauhri (Accountant Member)

Sections Involved

- **Section 2 (11) of the BM Act, 2015:**

"undisclosed asset located outside India" means an asset (including financial interest in any entity) located outside India, held by the assessee in his name or in respect of which he is a beneficial owner, and he has no explanation about the source of investment in such asset or the explanation given by him is in the opinion of the Assessing Officer unsatisfactory;

- **Section 4(1)(a) of the BM Act, 2015:**

Subject to the provisions of this Act, the total undisclosed foreign income and asset of any previous year of an assessee shall be - the income from a source located outside India, which has not been disclosed in the return of income furnished within the time specified in *Explanation 2* to sub-section (1) or under sub-section (4) or sub-section (5) of section 139 of the Income-tax Act;

- **Section 43 of the BM Act, 2015: Penalty for failure to furnish in return of income, an information or furnish inaccurate particulars about an asset (including financial interest in any entity) located outside India.**

If any person, being a resident other than not ordinarily resident in India within the meaning of clause (*6*) of section 6 of the Income-tax Act, who has furnished the return of income for any previous year under sub-section (*1*) or sub-section (*4*) or sub-section (*5*) of section 139 of the said Act, fails to furnish any information or furnishes inaccurate particulars in such return relating to any asset (including financial interest in any entity) located outside India, held by him as a beneficial owner or otherwise, or in respect of which he was a beneficiary, or relating to any income from a source located outside India, at any time during such previous year, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ten lakh rupees:

[Provided *that this section shall not apply in respect of an asset or assets (other than immovable property), where the aggregate value of such asset or assets does not exceed twenty lakh rupees*.**]**

Explanation - The value equivalent in rupees shall be determined in the manner provided in the *Explanation* to section 42.

❖ **Section 46 of the BM Act, 2015:**

46(1) The tax authority shall, for the purposes of imposing any penalty under this Chapter, issue a notice to an assessee requiring him to show cause why the penalty should not be imposed on him.

46(3) No order imposing a penalty under this Chapter shall be made unless the assessee has been given an opportunity of being heard.

This procedural safeguard was crucial to the interpretation adopted by the Special Bench.

Brief Facts:

The appellants, Vinil Venugopal and his wife (a resident husband and wife), were subjected to penalty orders of Rs. 10 lakhs each under Section 43 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ('BM Act') for A.Y. 2020-21. The penalties were imposed by the DDIT/ADIT (Inv.)-4(1), FAIU (Foreign Assets Investigation Unit), Mumbai on June 1, 2023, for failure to disclose their foreign investment in Avestar Global Opportunities SPC (Cayman Islands) in Schedule FA (Foreign Assets Schedule) of their Return of Income.

The requirement to report foreign assets in Schedule FA has existed since A.Y. 2012-13, introduced by the Finance Act, 2012, to track foreign assets and income generated thereon by Indian residents. The assessees admitted the investment pursuant to a show cause notice issued u/s 46 of the BM Act dated March 21, 2023. They contended that the investment was made from tax-paid income through banking channels under the RBI's Liberalized Remittance Scheme (LRS) and hence was not an 'undisclosed asset' within the meaning of Section 4 read with Section 2(11) of the BM Act.

The assessees further stated that the same investment had been duly disclosed in their returns for Assessment Years 2021-22 and 2022-23 prior to receiving the show cause notice, and the non-reporting for Assessment Year 2020-21 was merely an oversight.

Issues Involved

The core issue before the Special Bench was: "Whether the use of word 'may' in Section 43 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 should be construed as 'shall'.

In other words, whether the imposition of penalty is mandatory once the requirements of Section 43 of the said Act are satisfied or there is a discretion of the Assessing Officer to impose the penalty or otherwise?"

What the Assessing Officer Held

The AO held that penalty u/s 43 of the BM Act is attracted for non-disclosure of foreign assets held by a resident at any point of time during the previous year.

The AO observed that since the assessees had failed to disclose their foreign assets in Schedule FA prior to issuance of summons, they were liable for imposition of penalty. Relying on:

CBDT Circular No. 13 of 2015 dated July 6, 2015

Q. No. 18: **A person holds certain foreign assets which are fully explained and acquired out of tax paid income. However, he has not reported these assets in Schedule FA of the Income-tax Return in the past. Should he declare such assets under Chapter VI of the Act?**

Answer: Since, these assets are fully explained they are not treated as undisclosed foreign assets and should not be declared under Chapter VI of the Act. However, if these assets are not reported in Schedule FA of the Income-tax Return for assessment year 2016-17 (relating to previous year 2015-16) or any subsequent assessment year by a person, being a resident (other than not ordinarily resident), then he shall be liable for penalty of Rs. 10 lakhs under section 43 of the Act. The penalty is, however, not applicable in respect of an asset being one or more foreign bank accounts having an aggregate balance not exceeding an amount equivalent to Rs. 5 lakhs at any time during the previous year.

The AO was of the opinion that **once non-disclosure in Schedule FA is established, the penalty automatically follows**. The AO accordingly imposed a penalty of Rs. 10 lakhs on each of the assessees.

What the CIT(A) Held

The Commissioner of Income Tax (Appeals) confirmed the penalty orders passed by the AO, upholding the imposition of penalty u/s 43.

Reason for Reference to Special Bench

When the matter came before the Division Bench of the ITAT Mumbai on January 22, 2024, the Bench noticed **conflicting decisions of coordinate Benches on the interpretation of Section 43 of the BM Act**, particularly regarding whether the word **'may' used in the section is discretionary or mandatory**.

Some decisions favored the assessee by holding that the imposition of penalty is discretionary, while others favored the Revenue by holding that it is mandatory/automatic upon non-disclosure.

Given this conflict, the Division Bench, vide order dated April 17, 2025, referred the matter to a Special Bench. The President, in his discretion, constituted the Special Bench vide order dated August 1, 2025, to resolve this interpretational conflict.

What the Special Bench Held

❖ **Contentions of the Assessee:**

(a) the investment was made out of tax paid income through banking channel under the Liberalized Remittance Scheme (LRS) of RBI. It was pointed out that the amount was transferred from the bank account of the assessees and as such, cannot be said to be an **'undisclosed asset'** within the meaning of Section 4 r.w.s. 2(11) of the BM Act.

(b) the investment has been disclosed/declared in the subsequent income tax return for assessment years 2021-22 and 2022-23 much before the show cause notice was received. It was pointed out that for the assessment year in question **the disclosure was missed out of oversight.**

(c) Imposition of penalty u/s 43 is **not mandatory merely on account of non-disclosure of foreign assets in Schedule FA**;

(d) The use of the word **'may'** in Section 43 coupled with the requirement of issuance of a show cause notice under Section 46 indicates that in appropriate cases **involving bona fide oversight/mistake/inadvertence or venial breach, AO has discretion to impose the penalty or otherwise.**

(e) Charging/penal provisions of a taxing statute must be construed strictly;

(f) The legislature **consciously used 'may' for the decision to impose penalty** while using **'shall' for the quantum**, indicating clear legislative intent.

❖ **Contentions of the Revenue:**

(a) The BM Act was enacted with specific legislative intent to ensure full and accurate disclosure of foreign income and assets;

(b) Section 43 mandates imposition of penalty for any failure to disclose such assets, which is a strict liability provision with deterrent effect;

(c) **Mere omission leads to automatic imposition of penalty** and the bona fides or inadvertence of the assessee are not relevant considerations;

(d) Relying on *Union of India v. Dharamendra Textile Processors [2008] 174 Taxman 571 (SC)*, the Revenue argued that penalty provisions are **compensatory and not penal in nature**, hence strict interpretation is not warranted.

(e) the assessees being high networth individuals, had the benefit of tax advisers and cannot be expected to have missed the disclosure of the foreign assets in Schedule FA out of oversight or inadvertence.

❖ **Ratio Decidendi:**

The Special Bench, after elaborate consideration, held in **favor of the assessee** on the following **grounds:**

1. the Bench applied the well-established principle that charging/penal provisions of a taxing statute must be construed strictly. Words must be given their plain and ordinary meaning unless it leads to absurd results. The use of the word 'may' in Section 43 clearly indicates that the imposition of penalty is discretionary in nature. Significantly, the concluding part of Section 43 employs both 'may' (for decision to impose penalty) and 'shall' (for quantum of Rs. 10 lakhs), demonstrating that the legislature consciously chose different words for different purposes.

2. Section 46(3) of the BM Act mandates that no order imposing penalty shall be made unless the assessee has been given an opportunity of being heard. This requirement cannot be treated as an empty formality. If penalty were automatic upon non-disclosure, the provision for hearing would be rendered redundant or superfluous. It is a fundamental principle of interpretation that the legislature cannot be attributed with such redundancy.

3. the Bench relied on *Hindustan Steel Ltd. v. State of Orissa [1972] 83 ITR 26 (SC)*, wherein the Supreme Court held that even where minimum penalty is prescribed, the competent authority is justified in refusing to impose penalty when there is a technical or venial breach of provisions.

4. the Bench relied on *ACST v. Ankit International [2011] 46 VST 1 (Bom)* and *Nitco Paints Ltd. v. State of Maharashtra [2011] 42 VST 71 (Bom)*, where the Bombay High Court held that the use of 'may' combined with the requirement of opportunity of hearing is indicative of penalty being discretionary.

5. the Bench distinguished the Revenue's reliance on earlier Division Bench decisions in *Nirmal Bhanwarlal Jain v. CIT(A)* and *Ms. Shobha Harish Thawani v. JCIT*, observing that both cases turned on their own facts where the assessee's claim of bona fide mistake was found unsubstantiated, and neither decision considered the implications of Section 46(3) on interpretation of Section 43.

6. the Bench applied the settled principle that if two views regarding interpretation of a taxing provision are possible, the construction favoring the assessee should be adopted.

Conclusion:

The Special Bench **answered the issue in the negative**, holding that the word **'may' in Section 43 must be given its plain meaning as being directory in nature and cannot be construed as 'shall'. The imposition of penalty is not mandatory/automatic.** The Assessing Officer has discretion to impose the penalty or otherwise depending upon the facts and circumstances of each case. The appeals were remanded to the Division Bench for disposal on merits in accordance with law.

Cases Relied Upon

Hindustan Steel Ltd. v. State of Orissa [1972] 83 ITR 26 (SC);

ACST v. Ankit International [2011] 46 VST 1 (Bom);

Nitco Paints Ltd. v. State of Maharashtra [2011] 42 VST 71 (Bombay).

CIT v. Ask Enterprises [1998] 230 ITR 48 (Bombay);

Vidarbha Industries Power Ltd. v. Axis Bank Ltd. [2022] 140 taxmann.com 252 (SC);

Cases Distinguished

Nirmal Bhanwarlal Jain v. CIT(A) [BMA Nos. 13 to 15 (Mum.) of 2023, dated 31-7-2023];

Ms. Shobha Harish Thawani v. JCIT [BMA Nos. 1 to 3 (Mum.) of 2023, dated 9-8-2023].

My Analysis

This Special Bench decision provides much-needed clarity on the interpretation of Section 43 of the BM Act. The Bench's approach of giving plain meaning to the word 'may' is sound, especially when the legislature deliberately used both 'may' and 'shall' in the same provision indicating a conscious distinction between discretionary penalty imposition and mandatory quantum.

The harmonious reading of Section 43 with Section 46(3) is particularly significant. If penalty were automatic, the statutory requirement of opportunity of hearing would be rendered meaningless an interpretation that attributes redundancy to the legislature and must be avoided.

Importantly, this decision does not grant blanket immunity. Deliberate concealment will still attract penalty. The judgment merely ensures that the Assessing Officer exercises judicious discretion, distinguishing between willful evaders and honest taxpayers who commit technical defaults. This balanced approach upholds both the legislative objective of combating black money and the principles of natural justice.

The decision of the Special Bench is not new on this issue. There are a number of judicial precedents available where the word "may" has been emphasized for discretion of imposing penalty. One such instance is of Old Section 158BFA (2) of the Income-tax Act, 1961 (relating to block assessments in search cases), which uses identical phraseology *"may direct that a person shall pay by way of penalty."*

The interpretation of this provision across various judicial precedents also provides support to the decision of Special Bench:

- CIT v. Becharbhai P. Parmar [2012] 341 ITR 499 (Gujarat)
- DCIT v. Suresh Kumar [2005] 97 ITD 527 (Kolkata - Trib.)
- ITO v. Smt. Pramila Pratap Shah [2006] 100 ITD 160 (Mumbai - Trib.)

A Critical Analysis of Tax Treatment of Depreciable Assets under Section 50

SKF India Ltd.

vs.

Deputy Commissioner of Income-tax

IT APPEAL NO. 7544 (MUM.) OF 2011

3rd October 2024

Author: Yashika Mittal

Bench:

Shri Amit Shukla, Judicial Member

Shri Vikas Awasthy, Judicial Member

Shri Om Prakash Kant, Accountant Member

Brief Facts:

During the Assessment Year 2000-01, the Assessee, **SKF India Ltd.,** transferred immovable properties (three residential flats) that were part of a "block of assets" on which depreciation had been claimed. Although these assets had been held for a period exceeding 36 months, the Assessee computed the resulting gain as Short-Term Capital Gain (STCG) in its return of income as mandated by Section 50 of the Income-tax Act. However, the Assessee applied a tax rate of 20%, arguing that the assets remained "long-term capital assets" by virtue of their holding period, thus qualifying for the concessional rate under Section 112.

Issues Involved:

The core issue for the Special Bench was whether capital gains arising under Section 50 from the sale of a depreciable asset held for more than 36 months is chargeable at the normal rate applicable to short-term capital gains (30%) or the concessional rate of 20% applicable to long-term capital assets under Section 112.

Sections Involved:

- **Section 2(42A) – Definition of "short-term capital asset":** This section defines a short-term capital asset as a capital asset held for not more than the specified period immediately preceding the date of its transfer. In the case of immovable property, the prescribed holding period at the relevant time was thirty-six months. Assets held beyond this period qualify as long-term capital assets.

- **Section 112 – Tax on long-term capital gains:**
  This section prescribes a concessional rate of tax on income arising from the transfer of a long-term capital asset. In the case of a domestic company, the applicable rate is twenty per cent, subject to surcharge and cess. The provision applies where income chargeable under the head "Capital Gains" arises from the transfer of a long-term capital asset.
- **Section 50 – Special provision for computation of capital gains in case of depreciableassets:**
  This section lays down a special mechanism for computing capital gains arising from the transfer of depreciable assets forming part of a block of assets. It introduces a legal fiction whereby the gains are deemed to be short-term capital gains, irrespective of the actual period of holding. This deeming fiction is primarily intended to modify the computation provisions contained in Sections 48 and 49, particularly by denying benefits such as indexation.

What the Assessing Officer ("AO") Held:

The Assessing Officer held that because the assets were depreciable and covered by Section 50(1), the gains arising from their transfer had to be treated as short-term capital gains and taxed at the normal corporate rate of thirty per cent. The Assessing Officer rejected the Assessee's reliance on the decision in **CIT v. Ace Builders Pvt. Ltd [2005]**, stating that the facts of that case were different. According to the Assessing Officer, the legal fiction created under Section 50 did not apply only to the computation of capital gains but also changed the nature of the gains for all purposes, including the applicable rate of tax.

What the CIT(A) Held:

The **Commissioner of Income-tax (Appeals)** confirmed the order of the Assessing Officer. While doing so, the Commissioner mainly relied on the decisions of the Income-tax Appellate Tribunal in the Assessee's own case for previous assessment years (2001-02 and 2002-03, where the same issue relating to the applicability of the concessional rate on capital gains computed under Section 50 had been decided **against the Assessee**. Since the facts for the year under appeal were identical and there was no change in the legal position, the Commissioner of Income-tax (Appeals) followed the earlier Tribunal decisions and upheld the assessment.

Reason for Reference to the Special Bench:

The reference was made due to conflicting decisions among various benches of the Tribunal. While one bench had ruled against the Assessee in its own case for earlier years, another bench in Smita Conductors Ltd. had ruled in favor of the taxpayer, relying on the jurisdictional Bombay High Court's rationale that the fiction of Section 50 is restricted to computation.

What the Special Bench Held:

Majority View (Amit Shukla & Vikas Awasthy, JJ.M.):

The majority ruled **in favor of the Assessee**, establishing the following ratio:

- **Restricted Fiction:** The legal fiction in Section 50 is limited to the computation of capital gains (modifying Sections 48 and 49) and does not convert a "long-term capital asset" into a "short-term capital asset" for other purposes of the Act.
- **Nature of the Asset:** An asset held for more than 36 months remains a "long-term capital asset" as a matter of fact. Section 50 only deems the gain to be short-term, not the asset itself.
- **Applicability of Section 112:** Since Section 112 applies to income arising from the transfer of a "long-term capital asset," and the assets here met the 36-month holding requirement, the 20% rate is applicable.
- **Precedents:** The bench followed the Bombay High Court in CIT v. Ace Builders (P.) Ltd. and the Supreme Court in CIT v. V.S. Dempo Company Ltd., which held that Section 50 does not override exemption provisions (like Section 54E) or the character of the asset.

  In simple terms, these judgments say that Section 50 cannot be used to take away benefits available to long-term capital assets, because it only changes how the gain is calculated, not what type of asset it is.

Contentions of the Parties:

- **Assessee:** The Assessee argued that Section 50 applies only to the method of calculating capital gains. Its non-obstante clause overrides only Sections 48 and 49, which deal with computation. It does not override the definition sections or provisions dealing with the rate of tax. Therefore, even though the gain is calculated as short-term under Section 50, the asset itself continues to be a long-term capital asset based on its holding period. Since Section 112 applies whenever income arises from the transfer of a long-term capital asset, the concessional tax rate should apply.
- **Revenue:** The Departmental Representative argued that once capital gains are deemed to be short-term under Section 50, such deeming fiction must apply for all purposes of the Act, including the applicable rate of tax. It is stated that short-term capital gain and long-term capital asset are mutually exclusive concepts, and therefore the Assessee cannot claim the benefit of Section 112 once Section 50 applies. The Revenue further contended that allowing the concessional rate under Section 112 would render Section 50 otiose or ineffective, as the very object of Section 50 is to ensure that gains arising from depreciable assets are taxed at the normal rate applicable to short-term capital gains.

Minority View (Om Prakash Kant, A.M.):

The Accountant Member dissented, arguing:

- **Character of Income:** Once the gain is admittedly part of "total income" as STCG, Section 112 (exclusive to LTCG) cannot apply.
- **Legislative Intent:** Section 50 was intended to deny multiple benefits (depreciation as a revenue expense and concessional rates on sale) to owners of depreciable assets.

My Analysis:

This decision is an important win for taxpayers. It confirms that legal fictions created by the law must be applied only for the specific purpose for which they are introduced and should not be extended beyond that.

The majority clearly explained that Section 50 deals only with how capital gains are calculated, while Section 112 deals with the tax rate based on the nature of the asset. Even if Section 50 treats the gain as short-term for calculation purposes, the asset can still be treated as long-term when deciding the applicable tax rate.

The ruling also supports the principle that a taxpayer should not lose genuine benefits, such as a lower tax rate, which arise from holding an asset for a long period, unless the law clearly says so.

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