# ACCOUNTING, REGULATORY & TAX NEWSLETTER

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## ACCOUNTING UPDATES

### Institute Of Chartered Accountants of India (ICAI)

#### Expert Advisory Committee ('EAC') Opinion: Accounting treatment of non-construction fee under the Ind AS framework

The EAC examined the appropriateness of the accounting treatment of non-construction/ extension fees levied by the Greater Mohali Area Development Authority (GMADA) on the Company over the land allotted and acquired by the Company vide conveyance deed for the construction of an office building. The company, with the capital commitment later, failed to initiate and complete the construction of the office building within the stipulated timelines under the terms of allotment due to financial crunch. In between, GMADA levied 'non-construction fees' on a quarterly and annual basis for failure to complete the office building by the stipulated date. The Company recognised these demands of construction extension fees by GMADA in Capital Work-in-Progress (CWIP) relating to the proposed office building project. The C&AG raised an audit query stating the levied non-construction fees are in the nature of a penalty for non-adherence of conditions of allotment order and sale deed and therefore should not be capitalised as such cost as per para 16(b) of INDAS 16 are not cost directly attributable to brining the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The C&AG concluded the 'non-construction fees' should have been charged off as an expenditure.

The EAC, considering the para 16 of 'Ind AS 16 – Property, Plant and Equipment (PPE)', which comprises about cost of an item of PPE stated only costs that are directly attributable to bringing an asset to the location and condition necessary for it to operate in the manner intended by management should be capitalised as part of the asset's cost. The Committee further noted that directly attributable costs generally include expenditures such as site preparation, installation, testing, and professional fees that are necessary for the construction or development of the asset. Non-construction fees imposed by GMADA on the Company of it failing to commence or complete construction and not adhering to the conditions of allotment order and sale deed cannot necessarily be included under the construction activity or for bringing any asset (land or building) to the location and condition necessary for it to be capable of operating; rather, such expenditure is cost of holding the land without any construction or during construction, similar to administration costs incurred during construction. Therefore, it cannot be considered as a cost directly attributable to bringing the land or building to the location and condition necessary for it to be capable of operating in the manner intended by management, as per the requirements of Ind AS 16.

Accordingly, the EAC opined that the issue of non-construction fee, which relates to delay in construction or non-compliance with the initial condition of construction within the stipulated timelines under the terms of allotment, should be expensed by way of charge to the statement of profit and loss with appropriate disclosure instead of inclusion under CWIP.

## REGULATORY UPDATES

### Ministry of Corporate Affairs (MCA)

#### Companies Compliance Facilitation Scheme, 2026

MCA Vide circular dated 24 February 2026, has introduced the Companies Compliance Facilitation Scheme, 2026, to give a one-time opportunity to allow companies to file their documents related to Annual Returns and Financial statements in the MCA -21 Registry or to file for dormancy or closure by paying lesser fees.

The one-time compliance window of 90-day of period, from 15 April 2026, to 15 July 2026, allows companies to regularise delayed annual returns and financial statements by paying only 10% of the additional fees. Further, the Scheme enables companies to declare as 'dormant company' by paying fifty per cent of the normal fee payable under the rules, and the companies struck off by paying twenty-five per cent of the filing fees.

The Scheme also grants immunity from penalty if filings under sections 92 and 137 of the Act were made prior to issuance of, or within 30 days of issuance of notice by the adjudicating authority. In respect of certain other E-forms - ADT-1, FC-3, FC-4, Form 20B, Form 21A, Form 23AC & 23ACA, Form 66 and 23B — immunity from penalty shall be granted against prospective penal action for delayed filing of such forms, provided filing has been regularised vide the Scheme and no adjudicating proceedings/ prosecution have been initiated.

### Ministry of Finance

#### FAQs on Budget, 2026

The CBDT has released the FAQs on the Budget Proposal 2026-27. The publication classifies proposals into seven buckets: Ease of Living, Rationalising penalty & prosecution, Cooperatives, Supporting IT sector, Attracting global business & investment, corporate tax regime changes, and Other direct tax provisions.

#### Draft Income Tax Rules 2026 & Draft Income Tax Forms 2026

The CBDT has issued the draft Income-tax Rules, 2026, along with the corresponding Forms, for public consultation. To facilitate stakeholder understanding, two navigators have been provided—one mapping the existing Rules to the draft Rules, and another mapping the existing Forms to the draft Forms. The draft Rules and Forms will remain available in the public domain for comments.

### Institute Of Chartered Accountants of India (ICAI)

#### Exposure Draft of Guidance Note on Audit of Banks (2026 Edition)

The Auditing and Assurance Standards Board of ICAI has issued the Exposure Draft of the revised edition of the Guidance Note on Audit of Banks (2026 Edition). This publication is released annually to provide detailed guidance to auditors on the statutory audit of banks and their branches, incorporating recent changes in RBI Directions.

#### Updates from Research Committee of ICAI

The Research Committee of ICAI has published reports on the following topics:

- Liquidation Accounting
- Corporate Reporting Practices of Listed Companies in India
- Revitalising India's Legal Landscape: Addressing Obsolete Economic and Commercial Laws for Vikasit Bharat @2047.
- REITs and their Emerging Significance in India: A Regulatory, Market and Professional Perspective
- Mahua Flowers: Regulatory, Economic and Social Opportunities.
- Reprioritising Environmental Claims Under the Insolvency and Bankruptcy Code

#### Practitioner's Guide on Drafting of Modified Opinions in Independent Auditor's Reports

The AAASB of ICAI has released "Practitioner's Guide on Drafting of Modified Opinions in Independent Auditors' Reports". The Guide contains an overview of the concept and types of modified opinions, guidance on presentation and headings in the auditor's report when an opinion is modified. Further, the publication also covers certain illustrations of certain commonly encountered audit areas and circumstances when an auditor is giving a qualified opinion in the audit report.

#### Guidance on New Labour Codes

The AAASB of ICAI has released the Guidance on New Labour Codes to assist auditors in understanding and addressing the implications of the new Labour Codes while planning and performing audit engagements.

This publication provides specific audit procedures and audit focus required particularly around payroll-related expenses, employee benefit obligations, statutory dues, compliance with applicable labour laws and regulations, and related recognition, measurement, and disclosure requirements in the financial statements. The guide also contains FAQs on key accounting implications arising from the New Labour Code.

### The Standard on Auditing for Audits of Financial Statements of Less Complex Entities

The Auditing and Assurance Standards Board, in an attempt to simplify the audit framework for entities with relatively less complex structures and operations have published the aforementioned exposure draft. As per the draft, specific prohibitions from application of this exposure draft have been included to exclude listed entities, banking entities, insurance companies—with main function as insurance to public, entities governed by special statute, holding, subsidiary or associate of any other entity and entity reporting using the financial information of one or more components included in the financial information of that entity.

In addition, qualitative criteria have been prescribed in the draft. The proposed standard would be applied to entities where the paid-up share capital does not exceed INR 10 crore, turnover does not exceed INR 50 crore, borrowings, including public deposits, do not exceed INR 25 crore, grants and/or donations do not exceed INR 25 crore and the number of employees of the auditee entity does not exceed 100 during the accounting year. Apart from this, qualitative criteria have been fixed — exemption from Section 143(3)(i) of the Companies Act reporting, entities with simplicity in business activities, operations and related transactions and events relevant to the preparation of the financial statements and absence of complexity in entities' ownership, corporate governance, policies, procedures and processes established.

By prescribing these eligibility criteria, the proposed standard seeks to specifically address the needs of smaller and less complex entities, while ensuring that the audit process remains proportionate, practical, and aligned with the scale and complexity of such entities.

## Securities and Exchange Board of India (SEBI)

### Master Circular for Issue of Capital and Disclosure Requirements.

SEBI has updated the aforesaid Master Circular dated 11 November 2024, to include all relevant circulars that were issued till 31 December 2025, and changes, wherever considered relevant. This change is carried out to reflect the provisions which are currently in force.

## Reserve Bank of India (RBI)

### Reserve Bank of India (Rural Co-operative Banks - Income Recognition, Asset Classification and Provisioning) Amendment Directions, 2026.

RBI has issued the Rural Co-operative Banks – Income Recognition, Asset Classification and Provisioning (Amendment) Directions, 2026, amending the 2025 Directions to streamline income recognition practices for Rural Co-operative Banks.

**Key Highlights:**

- Banks may now recognise interest, fees, commission, and other income on Standard advances on an accrual basis without creating matching provisions.
- Income from non-Standard advances will continue to be recognised only on an actual receipt (cash) basis.
- If any facility is classified as non-performing, previously accrued income shall be reversed.

The amendment is effective immediately.

### Reserve Bank of India (Non-Banking Financial Companies - Credit Facilities) Amendment Directions, 2026

RBI has issued the aforesaid amended directions 2026 to amend the existing directions to align the asset classification and provisioning requirements of individual loan assets with the RBI (Non-Banking Financial Companies – Income Recognition, Asset Classification and Provisioning) Directions, 2025, as amended. The amendment is effective immediately.

### Reserve Bank of India (Non-Banking Financial Companies - Income Recognition, Asset Classification and Provisioning) Amendment Directions, 2026.

RBI, through a circular, has clarified the treatment of Default Loss Guarantee (DLG) arrangements for NBFCs in determining Expected Credit Loss (ECL) provisioning. NBFCs may consider DLG arrangements while calculating ECL across all stages, subject to compliance with applicable Ind AS requirements. NBFCs must make relevant disclosures under Ind AS 1, ensuring transparency in financial reporting. ECL should be recalculated upon invocation of the DLG cover to reflect the updated credit loss exposure. Related amendments have been made to the NBFC Credit Facilities Directions, 2025 to align with DLG provisions. The amendment is effective immediately.

### Reserve Bank of India (Small Finance Banks / Commercial Banks - Prudential Norms on Capital Adequacy) Second / Third Amendment Directions, 2026

RBI has issued amended the existing directions for Small Finance Banks (‘SFBs’) / Commercial Banks (‘CBs’) in prudential norms on capital adequacy to clarify the treatment of irrevocable payment commitments issued by banks to clearing corporations on behalf of clients.

**Key Highlights:**

- Irrevocable payment commitments by SFBs or CBs shall be treated as financial guarantees with 100% credit conversion factor.
- SFBs and CBs to maintain capital only on the portion identified as Capital Market Exposure (CME), in line with the Directions, instead of applying capital to the entire guaranteed amount.
- The capital market exposure portion continues to attract 125% risk weight for capital adequacy computation, consistent with earlier provisions.

The amendment will come into force from the date a bank implements the amended directions of 2026 or 1 April 2026, whichever is earlier.

### Reserve Bank of India (Commercial Banks & Small Finance Banks - Financial Statements: Presentation and Disclosures) - Third Amendment Directions, 2026

RBI has issued the Commercial Banks – Financial Statements: Presentation and Disclosures (Third Amendment) Directions, 2026 and Small Finance Banks – Financial Statements: Presentation and Disclosures (Second Amendment) Directions, 2026, amending the respective 2025 Directions to revise disclosure requirements on capital market exposures.

The amendments pertain to Disclosure in financial statements-Notes to Accounts, wherein earlier banks were required to disclose exposure to the capital market. The amended version includes Equity-oriented mutual funds replaced with non-debt mutual fund schemes, explicit inclusion of REITs, InvITs and AIFs, preference shares included the venture capital funds category that has been removed and subsumed under AIFs. Capital market exposures are to be computed in accordance with the respective Concentration Risk Management Directions, 2025 and Credit Facilities Directions, 2025.

The amendments are effective from the earlier implementation of the respective Credit Facilities (Amendment) Directions, 2026 or 1 April 2026.

### RBI Updates on External Commercial Borrowings (ECB) and Related Regulations

RBI has issued Foreign Exchange Management (Borrowing and Lending) (First Amendment) Regulations, 2026, dated 9 February 2026, amending the similar Regulations, 2018. The amended regulations shall be followed while facilitating borrowing and lending transactions.

Certain provisions of the ECB contained in the Master Direction – ECB, Trade Credits and Structured Obligations and certain related provisions pertaining to borrowing in INR by resident Indians contained in the Master Direction- Borrowing and lending transactions in INR between persons resident in India and NRI / Person of Indian origin have been reviewed and regulations consolidated.

#### Key Highlights

- Form ECB 1 (Annex I), Revised Form ECB-1(Annex I), Form ECB-2 (Annex II), and Form TC published via Master Direction- Reporting circular dated 18 February 2026, which amends earlier Part V Annex I & II and Form TC (Annex III) and Statement on Guarantee (Annex IV).
- Form GRN included in the Master Direction- Reporting circular for the reporting requirements as per FEMA Guarantees Regulations 2026.
- Borrowed funds end use restricted and prohibited from utilisation in Chit funds, Nidhi Companies, Real estate, Agriculture, Plantation, transaction related to listed and unlisted securities subject to exceptions.
- Adherence to Minimum Average Maturity Period, borrowing limits and cost of borrowing norms is mandatory.

## OTHER REGULATORY MATTERS

### Ministry of Labour and Employment (ML&E)

### Compliance Handbook for Employers Under the Four Labour Codes

The Ministry of Labour and Employment has released ‘Compliance Handbook for Employers Under the Four Labour Codes’ (Central Government Sphere) to guide organisations through statutory obligations under the new labour regime.

The publication provides an overview of compliance requirements under each of the four Labour Codes, with the objective of making regulatory compliance simpler, faster, and more accessible for employers. It also explains the rationale behind the labour law reforms and highlights the key changes introduced by the Labour Codes compared to the earlier labour legislations.

In addition, the handbook outlines the specific compliance obligations for employers and includes practical guidance in the form of ready-to-use compliance checklists. These checklists categorise obligations based on day-one requirements, periodic (monthly and annual) compliances, and event-based compliances, thereby serving as a practical reference tool for organisations in managing their labour law compliance effectively.

### Institute of Actuaries of India

### Advisory on New Labour Code- Institute of Actuaries of India (‘IAI’)

The IAI has released an Advisory on the New Labour Code dated 27 January 2026. The publication provides a background of the changes in the subject matter, the impact of change and the accounting treatment of change. The publication provides technical guidance on measurement, reporting, data requirements and assumptions needed for actuarial valuations after implementation of the new Codes.

In light of the impact of the change and its accounting treatment, the IAI, in its measurement and reporting guidance, has advised actuaries to separately identify and measure the impact of such changes in the current reporting period. Considering that the labour codes have become effective from 21 November 2025, the actuaries may, where appropriate, prepare financial information in two parts: (a) from the beginning of the financial year to 21 November 2025, based on the pre-Code benefit structure; and (b) from 21 November 2025 to the reporting date, based on the revised benefit structure. In part (a), past service cost should reflect the change in the present value of obligation arising from the revised wage definition and the inclusion of fixed-term employees, if any, and in part (b), current service cost and interest shall be determined using the revised benefit structure.

### Updated definition of Startup India - Ministry of Commerce and Industry

The Ministry of Commerce and Industry vide notification dated 4 February 2026, has updated the definition of startups. Under the updated framework, the scope of eligible entities has been broadened to include Multi-State Cooperative Societies registered with the Central Registrar of Cooperative Societies and Cooperative Societies registered under State or Union Territory Cooperative Societies Acts. The notification also enhances the turnover threshold for recognition as a startup from INR 100 crore to INR 200 crore, thereby allowing a larger number of growing entities to qualify under the startup framework.

A new category, "Deep Tech Startups", is also being introduced. These kinds of entities will benefit from extended recognition of up to 20 years and a higher turnover threshold of INR 300 crore, reflecting the longer gestation period.

## Insurance Regulatory Development Authority of India (IRDAI)

### Clarifications on provisions with respect to investment in Alternative Investment Funds (AIFs)

IRDAI has issued a circular providing clarifications on investments by insurers in AIFs with "Excusal Rights" under Section 27E of the Insurance Act, 1938, including investee limits for direct and indirect exposure through Fund of Funds.

**Key Highlights:**

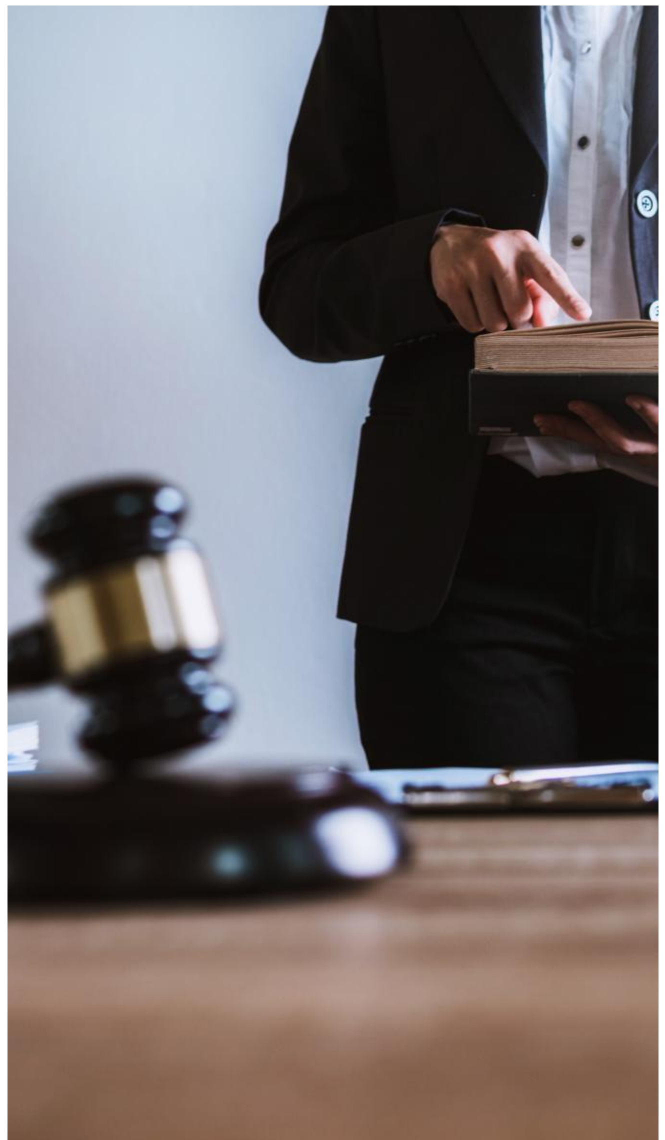
- Statutory Auditors of AIFs to annually confirm that the capital of the insurer is not invested outside India.
- Concurrent/Internal Auditors of insurers must certify quarterly compliance with excusal rights for investments in AIFs having overseas exposure.
- Auditors to review AIF cashflows, drawdowns, and investment schedules to ensure that insurers have not directly or indirectly invested in overseas assets.
- AIFs to maintain dual ledger accounting and segregated accounting systems to track insurer investments for accurate attribution of profits and losses.
- AIFs to provide a certificate confirming that overseas investments have been disclosed to the insurer, excusal rights have been applied where relevant, and no costs related to overseas assets were charged to the insurer.

Insurers and professionals should align with these requirements to ensure compliance with statutory provisions related to overseas investments in AIFs.

## BSE Ltd. (BSE)

### Update on Single Filing System through API based integration between Stock Exchanges

BSE Ltd. has announced a single filing system through API-based integration between the stock exchanges. This system has been extended, effective from 21 February 2026, to cover XBRL filings related to specified events under Regulation 30 of SEBI LODR Regulations. This phase covers listed equity entities as well as listed equity and debt entities. Regulation 30 single filing disclosures, XBRL events to a limited extent as mentioned in the circular, are only covered in this phase, and all the other events not included in the circular, the listed entities would be required to make submissions on the respective stock exchanges separately.



# REGULATORY UPDATES

## REGULATORY UPDATES:

### Consultation Paper issued by Securities and Exchange Board of India ("SEBI") on flexibility to Alternative Investment Funds (AIFs) in winding up the Scheme/ Surrendering the Registration

With an objective to streamline the processes pertaining to winding up of the AIF schemes and surrender of AIF registrations, the SEBI has issued a consultation paper dated 5 February 2026, inviting public comments on proposals that facilitate a clear, predictable and operationally efficient regulatory framework for exit where an entity seeks to discontinue its activities.

#### Background

As per Regulation 29(7) of SEBI (Alternative Investment Fund) Regulations, 2012 ("AIF Regulations"):

*Within the liquidation period[1], the assets shall be liquidated, and the proceeds accruing to investors in the AIF or the scheme of the AIF shall be distributed to them after satisfying all liabilities.*

Further, in terms of operational guidelines for surrender, an applicant filing for surrender of registration is required to submit various documents/declarations, including the Fund's bank statement evidencing a nil balance to SEBI.

It is observed that certain AIFs or schemes of AIF continue to retain proceeds of liquidated assets beyond the liquidation period or dissolution period ("permissible fund life"), for the following reasons:

- Amounts retained on account of pending litigation or tax demand;
- Amounts retained on account of anticipated litigation or tax demand; and
- Amounts retained for meeting operational liabilities.

Consequently, AIFs or schemes of AIFs that have completed their tenure but continue to retain funds on account of the above circumstances face constraints in surrendering their registration due to non-compliance with the requirement specified under Regulation 29(7) of AIF Regulations.

Further, it is also observed that certain AIFs do not carry out any active fund management activity and continue to exist solely on account of the anticipation of a favourable resolution of a litigation(s).

In view of the above, SEBI is issuing this consultation paper to seek public comments on the review of Regulation 29(7) of the AIF Regulations.

#### Proposed amendments to Regulation 29(7) of the AIF Regulations:

*Within the liquidation period, the assets shall be liquidated, and the proceeds accruing to investors in the Alternative Investment Fund or the scheme of the Alternative Investment Fund shall be distributed to them after satisfying all liabilities, **subject to conditions as may be specified by the Board from time to time**.*

#### Issuance of a circular:

It is proposed that the following modalities may be specified by way of a circular:

- AIF schemes may be permitted to retain funds beyond permissible fund life, subject to the following conditions:
  - Demonstrable receipt of litigation or demand notice from tax authorities or any other regulatory authority/ law enforcement agency;
  - Consent from at least 75% of the investors by value in case of anticipated liabilities arising due to litigation or tax demand; and
  - Substantiation of retained amounts towards operational expenses through invoices, supporting documents or comparable expenses incurred in previous years.

[1]Regulation 2(1) (pb) of AIF Regulations defines Liquidation Period as a period of one year following expiry of tenure or extended tenure of the scheme of a Fund.

- Money retained by such AIFs shall be bound by investment conditions as specified under Regulation 15(f) of AIF Regulations.
- AIFs intending to surrender registration and having one or more such schemes may be tagged as inoperative and may apply for surrender only after all liabilities are settled, and a Nil bank balance is achieved.
- AIFs that have not retained monies beyond permissible fund life may also apply for 'inoperative' status.
- The regulatory framework for inoperative funds shall inter alia include:
  - Rationalised compliances – discontinuation of PPM audit report, CTR report and quarterly filing to SEBI;
  - AIFs to intimate annual status report of retained money to SEBI and investors;
  - Prohibition on launch of new schemes & charging management fees;
  - Retention period of 3 years (max.) for amounts retained towards operational expenses.

## Consultation paper on proposed amendment to Schedule II of Securities & Exchange Board of India (Intermediaries) Regulations, 2008 ("Intermediaries Regulations") – 'Fit and Proper Person' Criteria

With the objective to appropriately balance the ease of compliance by market participants and the regulatory objective of ensuring that only participants having integrity, honesty, ethical behaviour, reputation, fairness and character operate in the securities market, the SEBI has issued a consultation paper dated 4 February 2026, inviting inputs from the public on proposed amendments to Intermediaries Regulations.

### Background

In terms of the extant provisions of the Intermediaries Regulations, the SEBI may, at the time of considering any application for registration and while reviewing the registered status of an intermediary, apply both the 'principle-based criteria' and the 'rule-based criteria', in determining the 'fit and proper person' status.

Based on learnings from the experience gained in enforcement of the extant 'fit and proper person' criteria in the last 5 years and the best practices being followed internationally, including the broad principles of 'International Organisation of Securities Commissions' ("IOSCO"), as well as domestic regulators, it was examined whether there is a need to review the provisions of Schedule II to reflect such learnings.

SEBI has also received representations seeking review of the 'fit and proper person' criteria, highlighting onerous compliance provisions under Schedule II, in particular, certain provisions under Clause 3(b). Concerns have also been expressed in respect of issues arising from divestment in terms of the second proviso to Clause 6 of Schedule II, stating that the same leads to irreparable damage and cannot be reversed if the person is later acquitted or not found guilty in the proceedings pursuant to which the disqualification was incurred.

### Review of Schedule II of the Intermediaries Regulations

1. ***Review of Clause 3(b)(i), 3(b)(ii) and 3(b)(v)***

   Under Clause 3(b)(i) and Clause 3(b)(ii) of Schedule II, the applicant/ intermediary, KMPs and Persons in Control incur a disqualification if there is a pending criminal complaint or FIR filed by SEBI or a pending charge sheet concerning economic offences by an enforcement agency.

   It is proposed that a rule-based formula for matters falling under Clause 3(b)(i) and Clause 3(b)(ii) may be onerous and not appropriate as it could lead to unintended consequences such as putting a person at a disadvantageous position at a preliminary stage of pending criminal complaint/ charge sheet, which could later result in acquittal or discharge. This may also be counterproductive to the objective of promoting ease of doing business. Hence, Clause 3(b)(i) and 3(b)(ii) of Schedule II may be omitted.

   Moreover, Clause 3(b)(v), which provides for disqualification on order of conviction by a court for any offence involving moral turpitude may be extended to also include conviction by a court for any economic offence or any offence under securities laws in alignment with the provisions of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 ("SECC Regulations") and Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 ("DP Regulations").

2. ***Review of Clause 3(b)(iv)***

   Under this provision, any legal entity, such as a body corporate (companies, LLPs, etc.) listed under Clause 2 of Schedule II, shall incur the disqualification upon initiation of winding up proceedings.

   It may be noted that under regulation 20 of SECC Regulations and regulation 23 of the DP Regulations, the disqualification is incurred only if an order for winding up has been passed against such persons/ entities and not at the stage of initiation of winding up proceedings.

   Thus, it is felt that the thresholds of incurring disqualification across the aforesaid regulations may be aligned by amending the Intermediaries Regulations such that the disqualification for the legal entities listed under Clause 2 of Schedule II may only be attracted in cases where an order of winding up has been passed against such entity to facilitate ease of compliance for intermediaries.

3. ***Review of clause 4***

   Under Clause 4, if a person has been declared as not a 'fit and proper person' by an order of SEBI, such a person is not eligible to apply for any registration during the period provided in the order. If no such time period is specified in the order, the said prohibition applies for a period of 5 years from the date of effect of the order.

   The deeming provision of imposing a default 5-year prohibition operates automatically and could lead to inflexibility even in cases where SEBI has consciously refrained from specifying a time period.

Accordingly, it is proposed that the default time period of 5 years, where no period is specified in the order, may be removed from Clause 4.

4. ***Review of clause 5***

In terms of Clause 5, at the time of filing of an application for registration as an intermediary, if any notice to show cause has been issued for proceedings under the Intermediaries Regulations or section 11(4) / 11B of the SEBI Act against an applicant or any KMPs / Persons in Control, such an application shall not be considered for a period of 1 year from the date of issuance of such notice or until the conclusion of the proceedings, whichever is earlier.

The above time period of 1 year may be reduced to 6 months to rule out the uncertainty of outcome for potential applicants and to ensure that access to registration is not unduly deferred where the proceedings are prolonged without the fault of the applicant.

5. ***Review of clause 6 (2nd proviso)***

As per 2nd proviso to clause 6, if any person as referred in sub-clause (c) of clause (2) *(includes promoters or person holding controlling interest etc.)* fails to satisfy the 'fit and proper person' criteria, the intermediary shall ensure that such person does not exercise any voting rights and that such person divests their holding within six months from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against such intermediary."

It is proposed that, upon being **declared** as not a 'fit and proper person', only the voting rights of the Person in Control will be restricted, and such person shall not be required to divest such holdings.

### Voluntary Retention Route (VRR) - Imparting predictability and increasing ease of doing business

The VRR was introduced by the Reserve Bank of India ("RBI") in March 2019 to provide an additional channel for investments by Foreign Portfolio Investors (FPIs) with long-term investment interest in the Indian debt markets.

Over the years, the Bank has been recalibrating this Route to improve operational flexibility and ease of doing business. The VRR has been witnessing active investment by FPIs, and over 80% of the current investment limit of INR 2.5 lakh crore has been utilised.

With a view to ensuring predictability about the availability of investment limits under the VRR and to further increase ease of doing business, the RBI in its statement on developmental and regulatory policies dated 6 February 2026, read with notification[2] decided to make the following changes to the regulatory framework governing investments under the VRR:

- Investment limits under the VRR shall be subsumed under the investment limit for FPI investments under the General Route. Accordingly, all investments through VRR in Central Government securities (including Treasury Bills), State Government Securities and corporate debt securities shall be reckoned under the investment limit for the respective securities under the General Route; and
- FPIs that have availed retention periods longer than the minimum retention period stipulated in the Directions[3] shall have the option of liquidating their portfolio, fully or partly, and exiting the VRR after the end of the minimum retention period.

The above directions shall come into force with effect from 1 April 2026. All existing investments under VRR on 1 April 2026 shall be transferred to the respective investment limits under the General Route.

### Ease of Doing Investment (EoDI) - Disclosure of registered name and registration number by SEBI-regulated entities and their agents on Social Media Platforms (SMPs)

In order to strengthen the conduct of regulated entities (***inter alia includes Investment Advisers, Infrastructure Investment Trusts (InvITs), Real Estate Investment Trusts (REITs), Portfolio Managers (PMs), Alternative Investment Funds (AIFs) etc.***), increase transparency and strengthen investor protection in the securities market, SEBI vide circular[4] dated 26 February, 2026, decided that the regulated entities and their agents shall ensure compliance with the following, with respect to uploading/posting content on SMPs:

#### A. Regulated entities:

1. ***Entity having a single registration with SEBI:***

SEBI registered name and registration number shall be stated on the home page near the name of the social media handle on the SMP, which is being used for hosting/broadcasting/ publishing/ uploading/posting contents (related to the securities market), as well as at the beginning of each video/shorts/content, etc. uploaded by them on their handles.

2. ***Entity having multiple registrations with SEBI:***

- On the home page of their handles: Weblink directing to the website of the registered intermediary listing all the SEBI-registered names and registration numbers shall be provided.
- In the beginning of each video/ content uploaded by the entity: SEBI registered name and registration number of the entity in the capacity in which it is hosting/ broadcasting/ publishing/ uploading/posting the video/ contents, is required to be disclosed.

#### B. Agents of Regulated entities (authorised participants, mutual fund distributors, distributors of portfolio management services etc.)

1. ***Agents of regulated entities having a single registration as an agent (related to the securities market):***

SEBI registration name and registration number of the principal entity, followed by the agent's own registered name and registered number, shall be stated on the home page near the name of the social media handle, as well as at the beginning of each video/ content uploaded by it.

[2] RBI Notification No. RBI/2025-26/205 A.P. (DIR Series) Circular No. 21 dated 6 February 2026
[3] Master Direction - Reserve Bank of India (Non-resident Investment in Debt Instruments) Directions, 2025
[4] SEBI Circular HO/(79)2026-MIRSD-PODMMC dated 26 February 2026

2. ***Agents of regulated entities having a single registration as an agent (related to the securities market):***

    - On the home page of their handles: Weblink directing to the website of the agent listing the SEBI registration names and registration number(s) of the principal entities, followed by its own registered names, registration numbers and the capacities in which it is registered shall be provided.
    - At the beginning of each video/ content uploaded by the agent, the SEBI-registered name and registration number of the principal entity to whom the content relates, followed by its own registered name and registration number, shall be disclosed.

The provisions of this circular shall come into effect from May 1, 2026, for all contents uploaded on/after the effective date.

### Revised Norms for appointment of an independent third-party reviewer/certifier for green debt security

In order to align the requirements for appointment of an independent third-party reviewer/ certifier for green debt securities with those specified for social bonds/ sustainability bonds[5], SEBI vide circular[6] dated 27 February 2026, decided to modify chapter IX of the Master Circular for issue and listing of Non-convertible Securities, Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper ("**NCS Master Circular**") dealing with Green Debt Securities.

#### A. Omission of para 1.8 of Chapter IX of NCS Master Circular

As per the above said para 1.8, the issuer shall appoint an independent third-party reviewer/ certifier, on a 'comply or explain' basis, for a period of 2 years for reviewing/certifying the processes, including project evaluation and selection criteria, project categories eligible for financing by green debt securities, etc. Aforesaid para stands deleted.

#### B. Insertion of new para 5 "Independent third-party reviewer/ certifier" in Chapter IX of NCS Master Circular

- Issuer shall appoint an independent third-party reviewer/ certifier to ascertain that the issuance of green debt securities is in accordance with the definition specified under Regulation 2(1)(q) of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, including review/ certification of the processes, project categories eligible for financing by green debt security, etc., in compliance with the following conditions:
    - Reviewer shall be independent of the issuer, its directors, senior management and key managerial personnel;
    - Reviewer shall be remunerated in a way that prevents any conflicts of interest; and
    - Reviewer shall have expertise in assessing ESG debt securities.
- Scope of the review(s) conducted by the independent third-party reviewer/ certifier shall be specified in the offer document.
- Independent third-party review may take one or more of the following forms recommended by the International Capital Market Association:
    - Second Party Opinion;
    - Verification, including the cases where proceeds are to be utilised for the purpose of refinancing;
    - Certification;
    - Scoring / Rating.

The provisions of this circular shall be applicable with immediate effect.

[5] SEBI vide Circular SEBI/HO/DDHS/DDHS-POD-1/P/CIR/2025/84 dated 5 June 2025 prescribed framework for Environmental, Social and Governance (ESG) Debt Securities (other than green debt securities)
[6] SEBI Circular HO/17/11/24(1)2026-DDHS-POD1/I/5967/2026 dated 27 February 2026

# DIRECT TAX

## Circulars / Notifications / Press Release

### CBDT issued draft Income-tax Rules, 2026, along with draft Income-tax Forms, 2026

The Income-tax Act, 2025 (IT Act, 2025), which received the President's assent in August 2025, is set to come into force from 1 April 2026. In this regard, the Central Board of Direct Taxes (CBDT) has issued a Press Release placing the draft Income-tax Rules, 2026 (IT Rules) along with the draft Income-tax Forms, 2026 in the public domain for consultation to encourage stakeholder participation. Further, stakeholders were invited to submit their suggestions on the draft rules and forms on the e-filing portal by 22 February 2026. The draft IT Rules and the related forms follow the same guiding philosophy as the IT Act, 2025, with a strong focus on simplification and usability. The key drafting principles include:

- Simplification of language;
- Incorporation of formulas and tables, wherever required, to improve clarity;
- Logical structuring of provisions to enhance readability;
- Elimination of redundant provisions

The draft IT Rules aim to simplify and consolidate existing provisions, resulting in a significant reduction in volume and a more streamlined framework. Further, the income-tax Forms are simplified to a large extent to make them more taxpayer-friendly. The redesigned forms are intended to facilitate automated reconciliation, support prefilling of data, and make compliance more intuitive and less error-prone. These changes aim to reduce the compliance burden on taxpayers and improve the overall filing experience.

***[Press Releases dated 7 February 2026 and 8 February 2026]***

### Finance Minister introduced the Finance Bill 2026

The Hon'ble Finance Minister presented the Finance Bill, 2026, on 1 February 2026. The Hon'ble Finance Minister proposed amendments to provide clarity and predictability for foreign investment, including safe-harbour margins for Information Technology (IT)/ Information Technology Enabled Services (ITES) and data centre structures, greater clarity on the tax treatment of electronics contract manufacturing, and faster Advance Pricing Agreement (APA) mechanisms. To read our detailed analysis on the Finance Bill 2026, please go to: https://www.bdo.in/getmedia/311da163-93bb-42a8-91f3-b7d4c375a179/India-Union-Budget-2026_BDO-India.pdf

### Governments of India and France have signed the amending protocol to amend the India-France DTAA

The CBDT has issued a press release on 23 February 2026 announcing the signing of the protocol to amend the India-France Double Taxation Avoidance Agreement ('DTAA' or 'the treaty') signed on 29 September 1992. The protocol will make the following amendments to the treaty:

1. **Capital Gains on sale of shares** - Taxation rights in respect of capital gains arising from sale of shares of a company to be granted to the country of residence of such company. Accordingly, source country shall have full taxing rights on gains on sale of shares without any threshold requirement. This amendment aligns with the UN model tax treaty and is on similar lines to the amendments made to the India-Mauritius and India-Singapore treaties in 2016, which granted the source state the right to tax capital gains income.
2. **Dividend** - Dividend shall now be taxable at the split rates of 5% for shareholders holding at least 10% of capital and 15% in all other cases, replacing the earlier single rate of10%.

3. **Fees for Technical Services - Definition of FTS to be modified to align with the definition provided in the** India-US tax treaty. Hence, make available clause shall now be introduced.
4. **Permanent establishment** - The scope of permanent establishment to be expanded to include Service PE.
5. **Articles on Exchange of Information and Collection of Taxes** - To strengthen tax cooperation between India and France, new article on assistance in collection of taxes to be introduced.
6. The Most Favoured Nation clause has been deleted.
7. The relevant articles of MLI based on the respective MLI positions of India and France have been appropriately incorporated in the treaty.

***[Press Releases dated 23 February 2026]***

## Judicial Updates

### Delhi High Court directs issuance of a lower TDS certificate while affirming full deduction of distribution commission from PE-attributed revenue

The taxpayer, a non-resident corporate entity incorporated in and tax resident of the United Kingdom, is engaged in providing electronic global distribution services to the travel industry globally through an automated computer reservation system. The taxpayer provides such services to various airlines and earns booking fees for each completed booking. The taxpayer received some commission in India and applied for a lower withholding certificate under section 197[1] of the Income-tax Act, 1961 (the Act). The tax authorities disposed of the application by directing the payer to deduct tax at source (TDS) at 1.6%, and the corresponding certificate issued pursuant thereto was challenged. Further, the taxpayer claimed that the Delhi tax tribunal, in its own case, had held that only 15% of its receipts constituted revenue attributable to its Permanent Establishment (PE) in India, which was further upheld by the Supreme Court[2]. Additionally, 68% commission paid to its Indian distribution agents was required to be deducted from such attributed revenue to compute the profit taxable in India.

However, the tax authorities restricted the deduction of commission expenditure to 15% (i.e., 15% of 68%) instead of allowing deduction of the entire commission amount. Furthermore, the tax authorities contended that revenue arising from non-Indian point of sale (POS) transactions where bookings were made outside India but passengers travelled to India was taxable in India. Aggrieved, the taxpayer filed a writ petition before the Delhi High Court, which made the following observations while ruling in favour of the taxpayer:

- It is settled position that the revenue attributable to the taxpayer's Indian PE is to be taken as 15% of its total receipts as held by the Supreme Court in taxpayer's own case (supra), wherein the Court held that 15% represents revenue attributable to the PE in India based on the Functions performed, Assets used and Risks undertaken analysis, and does not operate as a limit on allowability of expenditure.
- Further, the Supreme Court affirmed that once 15% of the total revenue was attributed to India, the entire commission paid to distribution agents was liable to be deducted therefrom and since such commission exceeded the attributed revenue, no further income was taxable in India.
- Accordingly, the tax authorities were required to deduct the entire commission expenditure of 68% from the 15% revenue attributed to the Indian PE. Once the full commission is set off against such attributed revenue, the resulting income attributable to the PE would be nil or negative in the taxpayer's case.
- In respect of revenue from non-India POS transactions, the issue is pending before the appellate authorities and demands were raised in earlier years. Therefore, without expressing a conclusive view on taxability, it is held that the withholding certificate be issued proportionately with reference to such non-India POS receipts (approximately one-fifth of total revenue). Accordingly, the tax authorities are directed to issue a fresh withholding certificate prescribing TDS at 0.5% (1/5 of 1.6%).

***[Travelport International Operations Limited v. DCIT, W.P.(C) 7633/2025, CM APPEAL NO.34030/2025 (Delhi High Court)]***

### Mumbai Tax Tribunal extends the existing tax exemption available for AIFs to its schemes in spite of having separate PAN at scheme level

The taxpayer, a scheme of Edelweiss Alternative Investment Opportunities Trust (Trust), is registered as a Category II Alternate Investment Fund (AIF) under SEBI (AIF) Regulations, 2012. The taxpayer filed a nil return for fiscal year (FY) 2022-23, claiming exemption for income distributed to investors under the Permanent Account Number (PAN) of the taxpayer. However, the tax authorities denied the exemption under section 10(23FBA)[3] read with section 115UB[4] of the Act on the grounds that the registration under the SEBI (AIF) Regulations was granted to the Trust and not to the taxpayer. The tax authorities claimed that the taxpayer had a separate PAN and distinct legal identity, hence, it was not itself registered as a Category I or Category II AIF under the SEBI (AIF) Regulations, 2012. The taxpayer contended that, being a scheme of an SEBI-registered AIF, it is inextricably linked with the trust and, therefore, the exemption available to the Trust under the Act should extend to the taxpayer.

Aggrieved, the taxpayer filed an appeal before the First Appellate authority, which was dismissed on the ground that the taxpayer is not registered as an AIF and hence, does not qualify as an 'investment fund' under section 115UB of the Act. Further aggrieved, the taxpayer preferred an appeal before the Mumbai Tax Tribunal. The Mumbai Tax Tribunal, while allowing the exemption to the taxpayer, made the following observations:

- PAN is merely an administrative identifier and does not create a new AIF requiring registration under SEBI AIF Regulations. AIF schemes are part of the parent trust, and the law recognises 'a scheme of an investment fund' in the context of section 115UB of the Act.

[1] Section 197 of the Act provides for issuance of a certificate for deduction of tax at source at a lower or nil rate.
[2] DIT v. Travelport Inc., 398 ITR 593 [2017] (Supreme Court)
[3] Section 10(23FBA) of the Act exempts any income (other than business income) of an investment fund.
[4] Section 115UB of the Act provides for taxation of income of investment funds and its unit holders.

- Further, as per Explanation 1 to section 115UB of the Act, 'unit' means beneficial interest of an investor in the investment fund or a scheme of the investment fund. This statutory recognition of a 'scheme of the investment fund' indicates that the Act expressly contemplates schemes operating under an investment fund framework and does not require each scheme to obtain an independent AIF registration.
- Reliance is placed on the Private Placement Memorandum, SEBI registration certificate, and trust documentation, all of which state that the taxpayer scheme is a scheme floated under the SEBI-registered trust.
- Further, taxpayer's reliance on the decision of coordinate bench in the case of UTI India Fund Unit Scheme 1986[5], wherein it was held that a scheme need not have separate registration when it is part of the registered fund and a separate PAN and separate books were treated as procedural/administrative and not determinative, is tenable. Although the decision pertained to section 10(23D)[6] of the Act, and the statutory framework is not identical, the principle for which the taxpayer relied is limited and relevant.
- Accordingly, the exemption under section 10(23FBA) of the Act cannot be denied solely because the scheme has a separate PAN while the SEBI registration is of the Trust, when the scheme is stated to be floated under the SEBI registered Category II AIF trust and the statute itself recognises 'scheme of the investment fund' in the context of section 115UB of the Act.

***[Edelweiss Crossover Opportunities Fund v. ITO, I.T.A No. 7439/Mum/2025 (Mumbai Tax Tribunal)]***

### Ahmedabad Tax Tribunal holds that salary received in NRE account is not taxable in India if it pertains to employment outside India

The taxpayer, a non-resident individual, earned salary income from his employment outside India, and the said salary was received in India in his Non-Resident External (NRE) account. The tax officer, in accordance with the direction of the Dispute Resolution Panel (DRP) under section 147[7] with respect to section 144C(13)[8] of the Act passed an order making an addition towards the salary income received by the taxpayer in his bank account with Indian Branch.

Aggrieved by the order, taxpayer filed an appeal before Ahmedabad Tax Tribunal, which made the following observations while ruling in favour of the taxpayer:

- Reliance is placed on the decision of the Agra Tax Tribunal in the case of Arvind Singh Chauhan[9] wherein an identical issue was there, and the term 'income received in India' in section 5(2)(a)[10] of the Act was interpreted to mean the first occasion when the taxpayer gets the money in his own control, real or constructive. Further, it was held that the constructive receipt of salary took place at the place of rendering employment, and the deposit of the same in the NRE bank account in India was only an application of the salary received outside India.
- In this case, the salary amount is received in India, but the salary income is earned outside India owing to rendering of services outside India at his place of employment. The ITAT noted that the assessee was in lawful right to receive this money, as an employee, at the place of employment. Accordingly, the ITAT held that the constructive receipt of salary took place at the place of rendering employment, and the deposit of the same in the NRE bank account in India was only an application of the salary received outside India. In view of the same, the salary received by the taxpayer in his NRE Account does not tantamount to receipt of salary income and is therefore not liable to tax in India by virtue of Section 5(2)(a) of the Act.

***[Kaushal Ganpatbhai Patel v. ITO, I.T.A. No. 434/Ahd/2025]***

### Delhi Tax Tribunal relies on Tiger Global and denies treaty benefit by holding that capital gains on sale of shares are taxable in India

The taxpayer, a private limited company incorporated in Singapore in April 2015, was a tax resident of Singapore. The taxpayer's principal activity was to make investments in companies involved in the production, sales and trading of power. It was a wholly-owned subsidiary of Hareon Solar Co. Ltd., Hong Kong, which, in turn, was a wholly-owned subsidiary of Hareon Solar Technology Co. Ltd., China. In July 2015, the taxpayer invested in 40,92,941 equity shares and 14,89,180 Compulsorily Convertible Debentures (CCDs) of Renew Solar Energy (Karnataka) Pvt. Ltd. Subsequently, in June 2019, the taxpayer disposed of these investments to Renew Solar Power Pvt. Ltd., resulting in long-term capital gains of INR 17.67 crores. Significantly, the ultimate parent company in China was engaged in supplying photovoltaic (PV) modules to the same Indian investee company for its 60MW solar power project.

The taxpayer claimed exemption from capital gains tax in India under Articles 13(4A) and 13(5) of the India-Singapore DTAA, asserting that as a Singapore tax resident, the gains were taxable only in Singapore, where no capital gains tax exists. The tax officer passed the draft order denying the treaty benefits by holding that the taxpayer company was set up purely to secure the treaty benefits and there was no commercial substance. Aggrieved by the same, the taxpayer filed objections before DRP. The DRP rejected the taxpayer's objections and upheld the draft order passed by the tax officer.

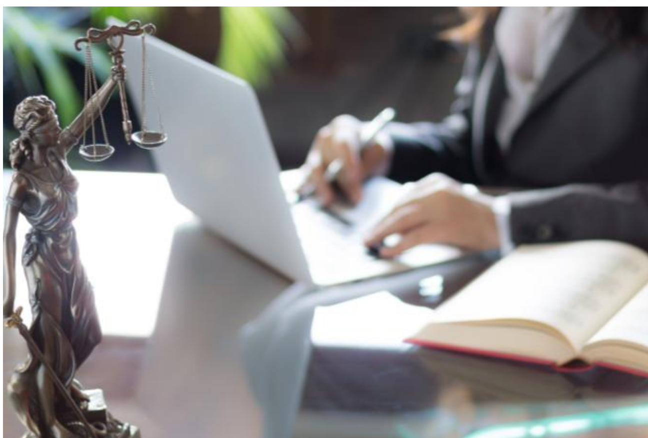
Aggrieved by the same, the taxpayer preferred an appeal before Delhi Tax Tribunal. The Delhi Tax Tribunal, while holding that the taxpayer was merely an investment vehicle and a conduit entity, made the following observations:

- Article 24A of the India-Singapore DTAA contains LOB provisions which stipulates that treaty benefits shall not be available when i) Affairs of a resident company are designed to take treaty advantage; ii) The company has negligible or nil business operations or no real and continuous business activities; iii) presumably a company is shell entity if annual operational expenditure is less than SG$ 200,000. All the said conditions were satisfied in this case.

[5] DCIT v. M/s. UTI India Fund Unit Scheme 1986, I.T.A. Nos. 1859 to 1862/Mum/2023 and C.O. No. 92/Mum/2023 (Mumbai Tax Tribunal)
[6] Section 10(23D) of the Act exempts income of a mutual fund registered under the SEBI Act, 1992, or a specified public sector mutual fund, subject to the conditions prescribed therein.
[7] Section 147 of the Act empowers the tax officer to reassess income if he has reason to believe that any income chargeable to tax has escaped assessment, subject to fulfillment of prescribed conditions and safeguards.
[8] Section 144(13) of the Act empowers the Assessing Officer to reassess income if he has reason to believe that any income chargeable to tax has escaped assessment, subject to fulfillment of prescribed conditions and safeguards.
[9] Arvind Singh Chauhan vs. Income Tax Officer 42 taxmann.com 285 (Agra Tribunal),
[10] Section 5(2)(a) of the Act specifies that in the case of a non-resident, income received or deemed to be received in India during the relevant previous year is taxable in India.

- The taxpayer company had no independent business activities apart from holding a few investments and is dependent on its holding company for funding. Rather, the taxpayer company was interposed for routing investment in Renew Solar Energy (Karnataka) Limited, India.
- The ultimate parent company had entered into a supply contract for supplying PV modules to Renew Solar Energy (Karnataka) Ltd. Nothing prevented it from making direct investments in that company rather than routing it through the taxpayer company.
- Further, there were no employees employed by the taxpayer. The taxpayer has not incurred any operating expenses to run its business, such as internet, electricity, communication, travel, or entertainment. Even the office space was taken on lease as and when required. The taxpayer had negligible fixed assets, and no expenses related to the director's salary or other expenses were booked into the books of accounts.
- The Place of effective Management constituted outside Singapore as –
  i. Three of four directors resided outside Singapore;
  ii. No evidence of physical meetings held in Singapore was produced;
  iii. Bank accounts were handled by residents outside India;
  iv. Key investment decisions were not taken independently by Singapore-based management.
- The Tax Residency Certificate issued by Singapore's Inland Revenue Authority was issued based on the taxpayer's self-declaration that control and management would be exercised in Singapore for the entire year, which was contradicted by factual evidence.
- Further, reliance is placed on the recent Supreme Court Ruling in case of Tiger Global International Holdings[11] wherein principle of substance over form was emphasised. Considering the same, capital gains arising on sale of equity shares and CCDs shall be taxable in India based on source rule and the taxpayer shall not be eligible and entitled to avail treaty benefit under the India-Singapore DTAA.

***[Hareon Solar Singapore Pvt Ltd; ITA No.2226/Del/2024 (Delhi Tax Tribunal)]***



### Pune Tax Tribunal denies depreciation on the goodwill created on the amalgamation of two subsidiaries, holding it as a colourable device

Aptara Inc. USA has two wholly owned subsidiary companies in India, i.e. Aptara Technologies Pvt Ltd (ATPL or 'the taxpayer') and Maximise Learning Pvt. Ltd. (MLPL). The taxpayer was engaged in the business of publishing services entailing digitalisation of content for third parties, and MLPL was into providing e-learning services solely to its parent company. In order to combine the marketing expertise of the taxpayer and the technical expertise of MLPL together, during the FY 2014-15, it was decided to merge the taxpayer with MTPL. The Bombay High Court approved the scheme of amalgamation in September 2014. On account of amalgamation, the taxpayer took over MLPL's assets and liabilities at book value; however, the excess of purchase consideration above the net assets payable to MLPL's shareholders was recorded as INR 6.07 crore. On the asset side, the taxpayer created a new intangible asset - goodwill worth INR 5.97 crore. Instead of paying cash through banking channels, the taxpayer simply issued 60.72 new equity shares for every 1 MLPL share held by shareholders (with only INR 10 lakh face value share capital). The taxpayer recorded goodwill of INR 5.97 crore in its books and claimed 25% depreciation of INR 1.49 crore on the same as a tax deduction. The taxpayer then bought back 12,72,200 shares at INR 39.27. The distributable income was calculated at -0.49 per share, being the difference between the rate at which equity shares were issued in amalgamation and the buy-back price. Hence, the buy-back tax on the same was NIL. The tax officer alleged that both the transactions, i.e., recording of goodwill on amalgamation and buy-back of shares, are interrelated and are colourable devices to claim depreciation and incur zero tax liability on buy-back.

The Pune Tax Tribunal held that creation of goodwill on amalgamation is merely a colourable transaction carried out between the holding company and the subsidiary company and made the following observations:

- The facts in the given case are peculiar, and the parties involved are not independent. The owner remains the same, and the amalgamation is between two subsidiaries.
- It is a case where the owner himself is claiming that one of its subsidiary companies has purchased the business of another subsidiary company at a higher amount, and such higher amount is basically goodwill, and there is no banking transaction except the issue of fresh equity shares in lieu of the goodwill.
- Further, post amalgamation, no sales were affected by the Holding Company, which implies that the business of the amalgamating company prior to amalgamation has been discontinued, no new business has been added, and profitability has also not increased.
- Creation of goodwill was merely a colourable transaction carried out between subsidiaries so as to create an intangible asset in the books, to inflate the value of shares and evade taxes by claiming depreciation on such fictitious asset.
- Hence, it was an artificial creation of an intangible asset and a classic case of lifting the corporate veil.
- Consequential to the above, the distributable income is to be recalculated without considering the goodwill and accordingly, the buy-back tax is to be recomputed.

***[Aptara Technologies Private Limited; ITA No.63/PUN/2020 (Pune Tax Tribunal)]***

[11] AAR & Ors. V. Tiger Global International II Holdings in Civil Appeal No. 262 of 2026(Arising out of SLP(C) No. 2640 of 2025.

# INDIRECT TAX

## Union Budget 2026

The Finance Bill, 2026 was introduced on 1 February 2026. Our detailed analysis of the budget proposals from an indirect tax perspective is available here.

## Customs

### CBIC extends deferred payment of Customs Duty benefits to Eligible Manufacturer Importer

CBIC has operationalised the deferred duty payment scheme for Eligible Manufacturer Importers ('EMIs') as announced in the Union Budget 2026-27 and introduced by customs notification no. 12/2026-Customs (N.T.) dated 1 February 2026. In this regard, CBIC has also issued Circular No. 08/2026-Customs ('Circular') and a Press Release summarising the salient features of the EMI scheme. The EMI scheme is available between 1 April 2026 and 31 March 2028.

- **Eligibility**: The key conditions prescribing eligibility under the EMI scheme are summarised hereunder:
  - The applicant must be an importer and a manufacturer. Alternatively, the applicant can be an importer who sends inputs/capital goods, without payment of tax, to a job worker under the GST law.
  - The applicant must have a valid Importer-Exporter Code and must have filed at least 25 EXIM documents (Bills of Entry/Shipping Bills) in the previous financial year preceding the date of application (10 EXIM documents in case of MSME applicant).
  - The applicant must have at least one active GST registration with the nature of business activity mentioned in Form GST REG-01 as '***factory/manufacturing***'. In case the applicant is not a manufacturer but sends inputs/capital goods to a job worker, at least one of its active GSTINs must have filed the last two half-yearly Form GST ITC-04 and the job worker must also have at least one active GSTIN wherein the nature of its business in Form GST REG-01 is declared as '***factory/manufacturing***'.
  - The applicant must have filed all pending Form GSTR-3B returns in respect of all active GSTINs. The applicant's annual aggregate turnover of all GSTINs having same PAN must exceed INR 50mn in the last financial year. Further, the applicant must have business activities for at least two financial years preceding the date of application.
  - There must not be any instance of tax/duty collected but not deposited with the Government under the Indirect Tax laws (GST law as well as Pre-GST regime).
  - The applicant or its proprietor/partner(s) or any of its Board of Directors/Directors must not have been arrested/convicted for an offence under the Indirect Tax laws, including the Customs Act, 1962.
  - There must be no pending prosecution proceedings against the applicant or its proprietor/partner(s) or any of its Board of Director/Directors under the aforesaid law(s).
  - The applicant's earlier application for grant of approval as EMI must not have been rejected for the reason that an information/declaration in the said application was found to be false, or a document submitted in the said application was found to be forged. Further, the applicant's status as EMI must not have been suspended on the aforesaid grounds.

- **Application process**
  - Applicants can register and submit applications from 1 March 2026 electronically[1] under the tab "*Eligible Manufacturer Importer*" in the prescribed form (appended as Appendix-I to the Circular). The said application must be accompanied by uploading the documents specified in Appendix-II and the Chartered Account's certificate (annexed as Appendix-III).
  - Based on the uploaded documents, the designated officer of Directorate of International Customs ('DIC') shall approve the application and update the details in the Customs Automated System to enable the facility of deferred payment of duty.
- **Due date:** The due date for payment of customs duty under the EMI scheme is as under:
  - For goods corresponding to Bills of Entry returned for payment between 1*st* day to last day of any month (other than March) – Duty shall be paid by the 1*st* day of the following month; and
  - For goods corresponding to Bills of Entry returned for payment between 1*st* day to last day of March – Duty shall be paid by 31*st* March.

**[***Source: Notification No. 12/2026-Customs (N.T.) dated 1 February 2026; Circular No. 08/2026-Customs dated 28 February 2026 and Press Release – ID No. 2234116***]**

## Foreign Trade Policy

### Draft of Digital Trade Facilitation Bill, 2026 issued

Directorate General of Foreign Trade (DGFT) has invited comments on the draft '***Digital Trade Facilitation Bill, 2026***' which seeks to provide legal recognition, validity and enforceability to the electronic trade documents and to regulate the use, management and cross-border recognition of digital identity and trust services and for matters connected therewith or incidental thereto. Inputs in this regard must be submitted within 30 days *via* email to tradefinance-dgft@gov.in.

[*Source: Trade Notice No. 24 /2025-26 dated 9 February 2026*]

### Introduction of export promotion schemes to facilitate Micro, Small and Medium Enterprises

DGFT has announced the launch of the following export promotion schemes to facilitate Micro, Small and Medium Enterprises ('MSMEs'):

1. Support for Alternative Trade Instruments under Export Promotion Mission ('EPM') – NIRYAT PROTSAHAN is implemented to strengthen access to export finance for MSMEs (involved in international value chains) through structured support for alternative trade finance mechanisms, to supplement bank-based export credit with an initial focus on export factoring. The scheme is operationalised on a pilot basis for feedback, institutional learning and data-driven refinements.
2. Support for Trade Regulations, Accreditation & Compliance Enablement ('TRACE') under EPM – NIRYAT DISHA is implemented to strengthen India's quality and technical compliance ecosystem and to facilitate MSMEs (involved in international value chains) in meeting importing-country regulatory requirements. The support under TRACE shall be limited to partial reimbursement of eligible expenditure incurred by MSMEs towards testing, inspection, certification, audits, traceability systems and other conformity-assessment requirements that are mandated vide regulations required for market access or necessary to demonstrate compliance with internationally recognised standards. The scheme is operationalised on a pilot basis for feedback, institutional learning and data-driven refinements.
3. Support for Integrated Support for Trade Intelligence & Facilitation (INSIGHT) intervention under the EPM – NIRYAT DISHA is implemented to strengthen exporter preparedness and institutional support systems by addressing information asymmetries, procedural frictions and capacity gaps faced by exporters and manufacturers, particularly MSMEs. The scheme is operationalised on a pilot basis for feedback, institutional learning and data-driven refinements.
4. Support for Facilitating Logistics, Overseas Warehousing & Fulfilment (FLOW) under EPM – NIRYAT DISHA is implemented to mitigate logistics-related constraints faced by MSMEs (involved in international value chains) in accessing overseas markets, and to facilitate improved delivery efficiency, reduced logistics costs and enhanced market responsiveness. The scheme is operationalised on a pilot basis for feedback, institutional learning and data-driven refinements.
5. Support for Logistics Interventions for Freight & Transport ('LIFT') under EPM – NIRYAT DISHA is implemented to address geographical disadvantages and logistics gaps affecting MSMEs in low export intensity areas. Under LIFT, the proposed support focuses on lowering freight and logistics costs stemming from the locational challenges faced by MSMEs in these regions. The scheme is operationalised on a pilot basis for feedback, institutional learning and data-driven refinements.

[*Source: Trade Notice Nos. 25 to 29/2025-26 dated 20 February 2026*]

[1] www.aeoindia.gov.in

## Special Economic Zone

### Execution of Bond-cum-Legal Undertaking ('BLUT') by SEZ Developers/units

The BLUT required to be furnished by SEZ Developers/units may be executed as an electronic Bond-cum-Legal Undertaking (e-BLUT), including through e-stamp or other digital mechanisms, in alignment with the electronic systems in operation, such as ICEGATE, where electronic bonds are accepted. Accordingly, the requirement of execution of the BLUT on non-judicial stamp paper and notarisation by a Notary public has been dispensed with.

[*Source: Instruction No. 123 dated 23 February 2026*]

## Judicial Precedents

### Penalty under section 122(1A) can be levied only on taxable persons; applicable prospectively from 1 January 2021

### Amit Manilal Haria and Ors. Vs. Joint Commissioner of CGST & CE and Ors. [TS-105-HC(BOM)-2026-GST]

The Joint Managing Director, Chief Executive Officer and Chief Financial Officer ('Petitioners') are employees/officers of M/s. Shemaroo Entertainment Ltd. ('SEL'). A search was initiated under section 67(2) of Central Goods and Services Tax Act, 2017 ('CGST Act') pursuant to which, the Petitioners were arrested for allegedly committing offences under sections 132(1)(b) and 132(1)(c) of CGST Act. Later, the Petitioners were granted bail by Additional Chief Metropolitan Magistrate.

Consequently, a show cause notice ('SCN') was issued in Form GST DRC-01 for FY 2017-18 to FY 2021-22 to SEL *inter alia* alleging that it had availed and passed on ineligible ITC by issuing fake invoices without undertaking actual supply and thereby violating Section 16(2)(b) of the CGST Act and attracting penalties under section 122. SCN was also separately issued to the Petitioners proposing imposition of penalty under section 122(1A) of the CGST Act.

The SCN was confirmed *vide* the Impugned Order *inter alia* confirming the imposition of penalties on the Petitioners. Aggrieved, the Petitioners approached the Bombay High Court *vide* the writ petition. The Bombay High Court, while ruling in favour of the Petitioners, *inter alia* held as under:

- On perusal of section 122(1) of the CGST Act, it is observed that the said provision categorically uses the expression '***taxable person***' as defined in section 2(107) of the CGST Act, to whom the said provision would apply. The definition of '***taxable person***' provides that the said term means a person who is registered or liable to be registered under section 22 or 24 of the CGST Act. Thus, penalty under section 122(1) is imposable on a taxable person who is registered or is liable to be registered under the GST law.
- Section 122(1A) envisages a two-fold requirement for imposing penalty as:
  - Any **<u>person</u>** who retains the benefit of a transaction covered under clauses (i), (ii), (vii) or (ix) of section 122(1) of CGST Act; and
  - At such person's instance, the said transaction is being conducted.

  Unless the aforesaid two-fold requirements are satisfied, it would not be possible to recognise any jurisdiction being available to invoke the said provision.
- There is another facet of section 122(1A) of CGST Act, namely that it is applicable in the circumstances falling under clauses (i), (ii), (vii) or (ix) of section 122(1) i.e., necessarily to a '***taxable person***'. These violations are purely attributable to a '***taxable person***' and hence, there is substance in Petitioner's contentions as to how in the absence of the Petitioners being taxable persons *qua* the business of SEL, the Petitioners can be held liable for any penalty under section 122(1A) of CGST Act.
- The legislative intent of section 122(1A) of CGST Act is quite clear and must be read in conjunction with section 122(1)(i), (ii), (vii) and (ix) of CGST Act. Hence, the phrase '***any person***' used in section 122(1A) must be understood in the context of a '***taxable person***' as section 122(1) itself applies to a taxable person.
- In the present case, an action was initiated against SEL. The Petitioners, being employees of SEL could not be held liable for a penalty under section 122(1A). The Supreme Court ruling in ***Shantanu Sanjay Hundekari***[2] would become squarely applicable.
- The Petitioners cannot be held liable for penalty in the absence of any material stating that they are taxable persons who have retained the benefits of the transactions covered under section 122(1)(i), (ii), (vii) or (ix) of CGST Act. No such finding was recorded in the Impugned Order or Reply affidavit and none of these documents sets out the manner in which the basic ingredients of section 122(1A) of CGST Act were attracted/present.
- Section 122(1A) of CGST Act which was introduced prospectively with effect from 1 January 2021 cannot be applied for prior periods based on the following:
  - Section 122 was to be incorporated in the CGST Act with effect from 1 January 2021. However, the relevant period which is the subject matter of the SCN is from July 2017. As per Article 20 of the Constitution of India, a person cannot be penalised under a law/provision which was not in force for the period in which such alleged acts are stated to have been committed.
  - Accordingly, Section 122(1A) could not have been applied retrospectively in issuing the impugned show cause notice for the period July 2017 to 1 January 2021. For such reason also, the Impugned Order, insofar as such period is concerned, cannot be sustained.
- In view of the above, the SCN and the consequent Impugned Order were held as illegal and without jurisdiction.

[2] 2024(89) G.S.T.L. 62 (Bom.) affirmed in (2025) 27 Centax 14 (S.C.). Our alert on the Bombay High Court ruling may be accessed by clicking here.

### Proper officer can impose penalty under section 122 after issuance of Circular conferring jurisdiction

#### Alokadci Holdings Pvt. Ltd. Vs. Commissioner of Central Tax and Ors. [TS-108-HC(TEL)-2026-GST]

Alokadci Holdings Pvt. Ltd. ('Taxpayer') was issued a show cause notice ('SCN') under section 74 of CGST Act by Joint Commissioner of Central Tax ('tax authority') alleging fraudulent availment and passing of ITC on fake invoices without the actual supply of goods. The SCN also proposed to impose penalty under section 122(1)(ii) and (vii) of CGST Act. The allegations in the SCN were confirmed *vide* the Impugned Order (dated 28 October 2025) and consequently, penalty was imposed on the Taxpayer under sections 122(1)(ii) and 122(1)(vii) of CGST Act for the period from May 2018 to June 2019.

On 27 October 2025, CBIC issued Circular No. 254/11/2025-GST ('Circular') conferring jurisdiction upon the officers enumerated therein to pass orders under sections 74A, 75(2) and 122 of CGST Act.

Aggrieved by the above, the Taxpayer filed a Writ Petition before the Telangana High Court to challenge the jurisdiction of tax authority to initiate the Impugned proceedings. The Telangana High Court, while ruling in favour of the tax authority, held as under:

- The Impugned Order was passed after the issuance of the Circular and hence, on the date of passing the Impugned Order, the tax authority had the jurisdiction to impose penalty under sections 122(1)(ii) and 122(1)(vii) of CGST Act.
- As per section 160(2) of CGST Act, service of any notice, order or communication shall not be questioned, if the said document has already been acted upon by the person to whom it is issued or where such service has not been questioned at or in the earlier proceedings commenced, continued or finalised pursuant to such notice, order or communication.
- In the instant case, the Taxpayer did not file a reply or participate in the personal hearings and did not question the issuance of the show cause notice on lack of jurisdiction. Such notice was acted upon, leading to the issuance of the Impugned Order.
- The point of jurisdiction raised by the Taxpayer is not tenable in law and on facts. Hence, the present Writ Petition was dismissed. However, the Taxpayer was granted the liberty to file an appeal before the appellate authority with a direction that the appellate authority shall exclude the period during which the Taxpayer was pursuing the writ remedy for computing limitation.

### Mushroom growing apparatus is not agricultural machinery

#### Commissioner of Customs (Import) Vs. M/s. Welkin Foods [TS-2-SC-2026-CUST]

M/s. Welkin Foods ('Importer') *inter alia* imported aluminium shelves, floor drains and automatic watering systems for mushroom cultivation. The Importer classified these goods under HSN 8436 9900 as '***parts of agricultural machinery***' attracting NIL rate of customs duty. During audit, the Commissioner of Customs (Import) ('Customs Authority') alleged that aluminium shelves ('subject goods') constituted an aluminium structure and not as '***parts of agricultural machinery***'. Hence, the same is classifiable under HSN 7610 9010 attracting Basic Customs Duty @ 10%, Countervailing Duty @ 12.5%, Cess @ 3% and Additional Customs Duty @ 4%.

Consequently, a show cause notice ('SCN') was issued under section 28(1) of Customs Act, 1962 ('Customs Act') *inter alia* seeking to demand differential customs duty along with interest. After considering the reply filed by Importer, the Customs Authority confirmed the demand alleged in the SCN. In the said order, the Customs Authority applied rule 1 of General Rules of Interpretation ('GRI') provided under First Schedule to the Customs Tariff Act, 1975 ('CT Act') and *inter alia* observed that:

- HSN 7610 does not exclude aluminium structures based on their end use;
- The subject goods lacked characteristics of agricultural/horticultural machinery for classification under HSN 8436; and
- HSN 8436 does not encompass every individual component essential for mushroom cultivation.

Against this, the Importer appealed before the First Appellate Authority ('FAA'). However, the FAA affirmed the order passed by the Customs Authority. Hence, the Importer filed an appeal with CESTAT which allowed[3] the appeal and *vide* the 'Impugned Order', the CESTAT *inter alia* held as follows:

- Since the subject goods were imported from a supplier exclusively dealing in mushroom cultivation structures and are specifically designed to integrate with other mushroom cultivation machinery, they are known as mushroom growing racks in common trade parlance;
- Chapter 76 covers all aluminium structures generally whereas chapter 84 pertains to any machine or device made of metal and used for agricultural purposes;
- The subject goods merit classification under chapter 84 as '***parts of agricultural machinery***'.

Against this, the Customs Authorities filed an appeal before the **Supreme Court**. The Supreme Court, while allowing the appeal and ruling in favour of Customs Authorities held as under:

- **GRI and HSN Explanatory Notes**
  - The GRI's primary purpose is establishing mandatory boundaries for ensuring a structured, uniform and predictable approach to classification. GRIs must be construed as a legal framework dictating a precise and sequential methodology for classifying goods. The key principles for interpreting GRIs are:
    - GRI 1 is the non-negotiable starting point.

[3] M/s. Welkin Foods Vs. Commissioner of Customs (Import), New Delhi [2024 (4) TMI 830 - CESTAT New Delhi]

    - GRI 2 acts as an extension of GRI 1 by deeming headings to include incomplete/ unassembled goods or mixtures or combinations of a material or substance.
    - GRI 3 exists only as a tiebreaker, invoked only when applying GRI 1 and/or GRI 2 results in the good being *prima facie* classifiable under two or more competing headings.
    - GRI 4 is the rule of last resort and is mutually exclusive to GRI 3. It is invoked only if GRI 1 and 2 fail to find even one heading for the good.
  - Explanatory notes published by World Customs Organisation ('WCO') form the foundation for interpreting HSN. When domestic tariff entries (as per First Schedule of CT Act) are aligned with the corresponding HSN entries published by WCO, with no explicit deviation or contrary legislative intent, as in the instant case, such Explanatory Notes are binding guidance for resolving classification disputes.
- **Applicability of Common Parlance Test ('CPT')**[4]
  - CPT must be applied restrictively as its function is limited to finding common or commercial meaning of a term within a tariff heading or its defining criterion. CPT can only be invoked when all these conditions are satisfied:
    - No explicit definition or criteria exists in the Governing statute, tariff heading, Section/Chapter Notes or HSN Explanatory Notes;
    - Tariff heading excludes use of scientific/technical terms or such terms are not used in a specialised, technical context;
    - Application of CPT must not contradict the overall statutory framework/mandate of law.
  - It cannot be used as a first resort and must be applied only in absence of statutory guidance and the party relying on it must present satisfactory evidence. When a tariff item is specific to a particular industry, it must be understood to be used within that industry/trade circle.
- **Consideration of 'Use' (i.e., End-use) in classification**
  - 'Use' can be considered as a relevant factor only if the tariff heading allows such consideration, either explicitly or implicitly, when the following conditions are satisfied –
    - Tariff heading explicitly references use or adaptation;
    - Section/Chapter Notes provide a legal definition/criterion which includes reference to use or adaptation;
    - Use or adaptation is inherent in the wording of the tariff entry;
    - The heading is an *eo nomine* term without statutory definition;
    - Court concludes the common/commercial meaning includes 'use' or 'adaptation' as a defining aspect of its identity.
  - Unless a contrary statutory intention is proven, importers cannot classify goods based on its actual use. To classify goods based on 'intended use', following conditions must be fulfilled:
    - The tariff heading allows consideration of 'use' as a relevant factor;
    - The 'use' mentioned in tariff heading and 'intended use' claimed by the importer are consistent;
    - The 'intended use' claimed is inherent in the goods and is discernible from its objective characteristics and properties, conforming to the standard of use established for that entry.
  - When a tariff heading contains both an *eo nomine* component and a use component, both criteria must be satisfied.
- **Subject goods can be more appropriately classified under HSN 7610 9010**
  - To be classified under HSN 7610 9010, the subject goods need to fulfil a two-part criterion:
    - They must be made of aluminium, and
    - They must be a structure or part of such a structure.
  - HSN 7610 is purely an *eo nomine* provision and makes no implicit/explicit reference to 'use'. Hence, HSN 7610 covers all forms of aluminium structures except prefabricated buildings of HSN 9406. Explanatory Note to HSN 7308 (*mutatis mutandis* applicable to HSN 7610) provides a broad criterion for recognising '***structures***' viz., generally, a 'structure' remains in same position once assembled and is usually composed of various prepared components joined by riveting, bolting, welding, etc.
  - The subject goods fulfil the aforesaid characteristics and hence, fall within the category of '***structures***'. Even in common parlance, the subject goods would be referred as '***structures***' and hence, are classifiable under HSN 7610 9010. Both Section Note 1(f) to Section XV and Explanatory Note to HSN 7610 substantiate the following:
    - Goods classifiable under Section XVI are excluded from being classified under Section XV;
    - Assemblies identifiable as parts of articles of Chapters 84 to 88 are excluded from being classified under the heading 7610.
- **Subject goods cannot be classified as '*Parts of Agriculture Machinery*' under HSN 8436 9900**
  - HSN 8436 does not refer to a single specific article or machine but rather *inter alia* includes all agricultural and horticultural machinery not specifically listed in other headings of Chapter 84. Hence, scope of classification under HSN 8436 is quite broad.

[4] CPT is known as Common / Trade Parlance Test

- HSN 8436 is an *eo nomine* provision referring to goods by name - '***agricultural machinery***' – which inherently refers to 'use' criteria i.e., items primarily used in agricultural processes. Explanatory Notes to HSN 8436 provide that the heading belongs to a category of headings that group machinery by the field of industry in which it is used, regardless of its specific function. Hence, in common parlance, the term '***agricultural machinery***' means a machinery whose principal use is in agricultural processes.
- The subject goods are not understood as 'machinery' in common parlance and are mere structures (like an iron or steel shelf). To classify static, non-moving assemblies as '***machinery***' would defy common sense and be patently absurd.
- If a specific heading viz., HSN 8436 solely refers to '***machinery***', its scope is limited to '***machinery***' and cannot encompass other types of goods like '***plant***'. An item can only be classified as '***plant***' if the relevant heading explicitly includes that term.
- The subject goods do not qualify as a composite machine (as different machines are not meant to be fitted together permanently) and a functional unit (as all machines do not appear to work together towards a single function). Instead, each machine performs its independent tasks and the only common element is that they are all part of mushroom cultivation process.
- All the individual machines are already complete and fully operational on their own, i.e., their mechanical and electrical functions do not rely on the aluminium shelves. These shelves do not contribute to their operation but merely serve as a surface for the devices to perform their functions. A surface supports an object but does not become a part of it. Hence, the subject goods cannot be classified under HSN 8436.

- Considering the above, the appeal was allowed and Impugned Order was set aside.

### Compensation for idle capacity received from Parent company qualifies as declared service but cannot be treated to be a service in relation to immovable property

#### Commissioner of Central GST and Central Excise-Vadodara-II Vs. Lanxess India Pvt. Ltd. [TS-42-CESTAT-2026-ST]

Lanxess India Pvt. Ltd. ('Taxpayer') is a subsidiary of Lanxess Deutschland GmbH ('LXD') and is engaged in the manufacturing excisable goods of Chapter 29 and 38. The Taxpayer entered into a contract manufacturing agreement with LXD to manufacture specified products at its site in Jhagadia, as per the instructions and specifications of LXD. In turn, LXD agreed to off-take the products and pay the agreed remuneration i.e., '***manufacturing fee per unit***' based on the number of units produced. The agreement also mandates LXD to pay '***idle cost compensation***' ('ICC') for under-utilisation of the Taxpayer's manufacturing capacity.

During the course of Audit by Service Tax authorities, it was observed that during the period July 2012 to March 2016, the Taxpayer received ICC of INR 675.39mn which was disclosed as Export of Services on which Service tax was not paid. Hence, a Show Cause Notice ('SCN') was issued proposing to demand Service tax under proviso to Section 73(1) of the Finance Act, 1994 ('FA 1994') by –

- Treating ICC as a consideration for '***declared service***' under Section 66E(e) of FA 1994;
- Classifying the said service to be in relation to an immovable property, having place of supply as the location of immovable property i.e., in India, as per rule 5 of Place of Provision of Services Rules, 2012 ('POPS Rules').

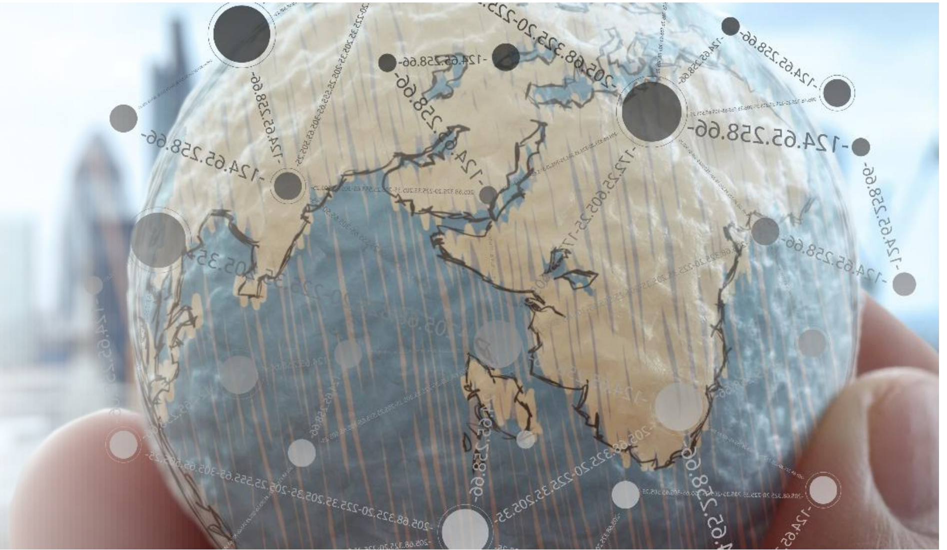
The Commissioner of Central GST and Central Excise-Vadodara-II ('tax authority') adjudicated the matter and issued the Impugned Order, dropping the entire demand. Against this, the tax authorities filed the present appeal before CESTAT. After hearing both the sides, the CESTAT ruled the case in Taxpayer's favour, affirming the Impugned Order and *inter alia* holding that –

- **ICC falls within the scope of 'declared service' under section 66E(e) of FA 1994**
  - The definition of '***services***' under Section 65B(44) of FA 1994 indicates that the said term can include any activity carried by a person for another for a consideration and also includes a '***declared service***'. The expression '***consideration***' must exist even if the service falls within the scope of "***declared service***" under section 66E(e) of FA 1994. Thus, the declared service under 66E(e) of FA 1994 viz., '***agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act***' requires existence of consideration.
  - Since the term '***consideration***' is not defined in FA 1994, reference was made to its definition in section 2(d) of Indian Contract Act, 1872 ('Contract Act') which provides that damages are a consequence of breach and not a part of '***consideration***' for a promise.
  - Damages/liquidated damages as well as penalties, even if they are provided for in the contract but are consequence of an undesired act or an unanticipated situation, cannot be considered as a '***service***' because of lack of element of '***consideration***' which is essential both for '***service***' as well as the '***declared service***'.
  - In the present case, there was no breach or discharge of agreement and ICC is duly invoiced as a part of consideration for the Taxpayer acting on behalf of LXD and the agreement is allowed to continue and is from quarter to quarter. This distinguishes it from a breached contract, as breach leads to discharge of the contract, resulting in the requirement for entering into a fresh contract.

- The principle is not of compensation for damages as the capacity installation was undertaken by the Taxpayer at the behest of LXD and was a consideration as the act was done as per the desire of the promiser (i.e. LXD). Therefore, even as per Section 2(d) of Contract Act, such act of creation of stipulated capacity is very much consideration for the promise.
- There is a subtle difference between 'remuneration' and 'compensation'. Compensation, on one hand, is generally to make good a loss, injury or inconvenience or deprivation and is often remedial to put a person in a position it would have been, but for the loss. On the other hand, remuneration is a contractual or statutory entitlement arising from performance.
- The possibility of variance in quantum of remuneration cannot be equated with an uncertainty of an event leading to consequence of damages. ICC was only made dependent on the quantum of unutilised capacity, and thus, is a consideration.
- In the present case, there is –
  - An obligation undertaken by the Taxpayer to earmark a particular capacity for LXD;
  - LXD is obligated to pay, if there is some capacity which remains unutilised;
  - Both Taxpayer and LXD are aware of such obligation on the part of each other;
  - The respective obligations exist even without breach of contract (unlike the clauses for damages and liquidated damages) and are part of the '***consideration***' as remuneration.
- It is a case of pre-determined 'remuneration' and not of 'compensation' post breach of contract, despite both expressions 'remuneration' and 'compensation' are used in contract.
- Further, the mark-up clause apart from various cost elements is allocated to the idle capacity to arrive at ICC to ensure that the Taxpayer receives a '***fair and adequate compensation*** *for the functions performed, assets employed and risks assumed under the agreement*'.
- Thus, earmarked capacity must be placed at LXD's disposal by Taxpayer. Hence, the remuneration includes a manufacturing fee plus ICC which is pre-determined in case there is an unutilised capacity.
- What has been essentially provided is a '***declared service***' and the same is distinguishable from liquidated damages and must be treated as such. The use of expression '***compensation***' cannot prevent a close scrutiny of the terms of contract and nature thereof or whether the same was a consideration for agreeing to an obligation to do or not to do an act.

- **The declared service qualifies as export of service and not as a service in relation to immovable property**
  - The Impugned Order has correctly held that the:
    - Taxpayer and LXD are distinct incorporated entities and are not merely establishments of distinct persons;
    - ICC cannot be considered as a service in relation to an immovable property and hence, the place of provision of service must be determined as per the general rule i.e., rule 3 of POPS Rules which provides that the place of provision of service shall be the location of the recipient of service;
    - In view of the above, in respect of ICC services, all the conditions for export of services are duly satisfied and hence, the same qualifies as an export.
  - The payment as per contractual obligation undertaken to allocate a particular capacity for LXD cannot be taken to be an agreement for the use of an immovable property. The reasoning adopted in the Impugned Order about why the remuneration received for non-utilised capacity cannot be treated as the use of an immovable property is well founded and deserves to be accepted, but for the reason that service is a deemed service (i.e., declared service under section 66E(e) of FA 1994).
  - The location of recipient of the said service is not covered by clauses 2(i)(b)(i),(ii),(iii) of POPS Rules but is covered under sub-clause (iv) of rule 2(i)(b) of POPS Rules.
  - The place of provision of service cannot be determined under rule 5 which states that the place of provision of services in relation to immovable property shall be the location of the said property.
  - In the absence of a dedicated provision for 'declared service' and its placement in POPS Rules, 2012, the residuary and general rule emanating from 'destination principle' of location of service recipient, applies. Accordingly, the place of provision of service in consideration shall be determined in terms of clause 2(i)(b)(iv) read with Rule 3 of POPS, 2012, as being outside India. Since all the conditions for export of services are satisfied, the service under consideration would be covered within the scope of '***export of services***'.
- In view of the above, the appeal filed by Service tax authorities cannot be allowed and is therefore dismissed.

# TRANSFER PRICING



## Judicial Updates

### Madras High Court holds TP adjustment based on ALP estimation cannot by itself trigger ‘misreporting’ penalty under section 270A of the Act unless it involves deliberate concealment

The taxpayer, a corporate entity, filed its return of income for fiscal year (FY) 2019-20 and benchmarked its international transactions using the Transactional Net Margin method and Comparable Uncontrolled Price (CUP) method as per Rule 10B[1] of the Income-tax Rules, 1961 (IT Rules). During the assessment proceedings, a reference was made to the Transfer Pricing Officer (TPO) under section 92CA(1)[2] of the Income-tax Act, 1961 (the Act). The TPO rejected certain comparables adopted under the CUP method, and conducted an independent search under section 92C[3](1) and (2) of the Act and concluded that the taxpayer’s margin was outside the permissible range, resulting in an upward transfer pricing (TP) adjustment in the software development, testing and support services segment. In relation to the said TP adjustment, the tax officer initiated penalty proceedings for misreporting of income under section 270A[4] of the Act.

Thereafter, the taxpayer filed an application seeking immunity under section 270AA of the Act. However, the tax officer rejected the application for waiver of penalty on the grounds that immunity under section 270AA of the Act is available only where the assessment does not involve misreporting of income. Aggrieved, the taxpayer filed a writ petition before the Madras High Court, which made the following observations while ruling in favour of the taxpayer:

- The immunity under section 270AA[5] of the Act is available only in cases of ‘under-reporting of income’ simpliciter and is barred where such under-reporting is in consequence of ‘misreporting of income’ as contemplated under section 270A(8) and (9) of the Act.
- Misreporting represents an aggravated form of under-reporting, involving deliberate misrepresentation, suppression, or falsification falling within the ingredients enumerated in section 270A(9) of the Act. In the case of taxpayers, there is no scope to infer an aggravated form of under-reporting that is characterised by a deliberate and wilful attempt to evade tax.
- The penalty proceedings were founded solely on the transfer pricing adjustment proposed in the draft assessment order, which by its nature involves estimation and determination of ALP and cannot be equated with concealment or misrepresentation so as to attract section 270A(9)(a) of the Act.
- Further, the taxpayer maintained prescribed documentation under section 92D[6] of the Act, disclosed all international transactions under Chapter X[7] of the Act, and complied with statutory requirements. The ingredients necessary to establish ‘under-reporting of income as a consequence of misreporting of income’ are absent.
- Therefore, the taxpayer’s case squarely falls within the exception carved out under section 270A(6)(d) of the Act, which expressly excludes such cases from the ambit of under-reporting.
- Unless there are clear and categorial incriminating facts to infer deliberate and conscious concealment or furnishing of false particulars, it cannot be said that there was “under-reporting of income as a consequence of misreporting of income” which is completely absent in the present case

[1] Rule 10B of the IT Rules prescribes the manner of determination of the ALP under different transfer pricing methods.
[2] Section 92CA of the Act empowers the tax officer to refer the determination of ALP of international transactions to the TPO.
[3] Section 92C of the Act provides the methods for computation of ALP in relation to international transactions or specified domestic transactions.
[4] Section 270A of the Act provides for levy of penalty for under-reporting and misreporting of income.
[5] Section 270AA of the Act provides immunity from imposition of penalty subject to specified conditions.
[6] Section 92D of the Act requires maintenance and furnishing of prescribed documentation and information relating to international transactions.
[7] Chapter X of the Act outlines provisions aimed at preventing tax avoidance through international transactions.

- Income under-reported was represented by an addition made in conformity with the arm's length price determined by the Transfer Pricing Officer. In addition, the taxpayer had maintained information and documents prescribed under Section 92D and had declared the international transaction under Chapter X and disclosed all the material facts relating to the international transaction. Therefore, the petitioner was entitled to immunity under section 270AA of the Act.

***[Verizon Data Services India Private Limited v. DCIT, W.P.No.18377 of 2024 and W.M.P.Nos.20189 & 20190 of 2024 (Madras High Court)]***

### Chennai Tax Tribunal holds that market study expenses paid to AE for business expansion cannot be disallowed by determining ALP at Nil.

The taxpayer is a company engaged in the business of manufacturing and selling tractors, engineering plastic components, and batteries, and trading in related parts and attachments. The taxpayer made a payment to its Associated Enterprise (AE) in Turkey for a market study to expand operations and sales in Turkey. The tax officer referred the international transactions to the TPO to determine ALP. The TPO disallowed the amount paid to AE for the market study, stating that the information was generic and publicly available. The tax officer incorporated TPO's adjustment in the final assessment order. Aggrieved, the taxpayer filed an appeal before the First Appellate Authority, which upheld TPO's adjustment. Aggrieved by the same, the taxpayer filed an appeal before the Chennai Tax Tribunal.

The Chennai Tax Tribunal, while ruling in favour of the taxpayer, made the following observations:

- Reliance is placed on the Delhi High Court's decision in the case of EKL Appliances Ltd.[8] where it is held that it is not necessary for the taxpayer to show that any legitimate expenditure incurred by him was also incurred out of necessity or for the purpose of business carried on by him, has resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred 'wholly and exclusively' for the purpose of business and nothing more.
- Payments were made as part of business expansion in Turkey, and there was a subsequent increase in investment and sales of tractors, which substantiates the benefit arising from the payments made towards market study.
- ALP determination should focus on methodology and comparables, not prudence or necessity of expense. TPO was not justified in determining ALP at Nil for market study expenses without independent benchmarking.
- Hence, commercial prudence cannot be a basis for disallowance under provisions of Chapter X of the Act, read with Rules 10A to 10E[9]. Accordingly, TPO's adjustment for market study expenses is reversed.

***[Tractors and Farm Equipment Ltd. v. ITO, I.T.A. No. 2054/Chny/2025 (Chennai Tax Tribunal)]***

[8] CIT vs. EKL Appliances Ltd. [2012] 24 taxmann.com 199 (Delhi High Court)
[9] Rules 10A to 10E of the IT Rules prescribe the definitions, methods (including comparability analysis), and procedural framework for computation of the ALP.

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