India Tax Konnect

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a. Decisions – International tax

Retrospective application of an amendment cannot fasten TDS liability on the payer; HC reads down 2010 amendment in FTS provisions as prospectively applicable: Karnataka High Court[1]

Facts of the case

During the FYs 1995-96 to 1997-98, the Indian company made payment to a foreign entity, *inter alia*, for the provision of services.

The dispute arose whether the payment, which was in nature of fees for technical services ('FTS'), to the foreign entity for services rendered outside India and utilised in India was subject to the tax deduction at source ('TDS') by the Indian company.

Both the Commissioner of Income-tax (Appeals) and the Tribunal held that such payment was chargeable to tax in India and thus, liable to TDS by the Indian company.

The Indian company filed an appeal before the Karnataka High Court.

During the pendency of the appeal before the High Court, the Supreme Court in the case of *Ishikawajima*[2] held that FTS income of the non-resident would be taxable in India under the Income-tax Act, 1961 ('the 1961 Act') only if the services were both rendered and utilised in India ('the twin conditions'). Accordingly, the High Court granted the relief from the TDS obligations in respect of the services rendered outside India.

[1] ITA No. 3025/2005; Writ Petition No. 192 of 2011 (T-IT)
[2] *Ishikawajma-Harima Heavy Industries Ltd.* v. *DIT* [2007] 288 ITR 408 (SC)

A Special Leave Petition was filed before the Supreme Court.

During the pendency of the matter before the Supreme Court, the Finance Act, 2010 ('FA 2010') amended section 9 retrospectively by providing that the FTS income of a non-resident shall be deemed to accrue or arise in India even if the services were not rendered in India ('the 2010 amendment').

In view of this amendment, the Supreme Court permitted the Revenue to seek review of the Karnataka High Court's decision.

The Revenue filed the review petition,[3] which was allowed and the appeals were restored.

The Indian company also filed a writ petition challenging the constitutional validity of the retrospective amendment introduced by the FA 2010.

The issues before the High Court were (a) whether its earlier order needed to be reversed/ modified in light of the 2010 amendment? (b) whether the retrospective application of the 2010 amendment was unconstitutional and bad in law?

Relevant provisions

Section 9(1)(vii) provides that FTS paid by a resident to a non-resident is deemed to accrue or arise in India, unless the services are utilised in a business carried on by such resident outside India or for earning income from a source outside India.

The FA 2010 amended the Explanation to section 9(2), with retrospective effect from 1 June 1976, to clarify that FTS income of a non-resident will be deemed to

[3] R.P. Nos. 317 to 319 of 2010

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accrue or arise in India, whether or not the non-resident has rendered services in India.

Revenue's contentions

The charge under section 9(1)(vii) was always there and was not altered. The 2010 amendment merely clarified that the 'source rule' applied in the main provision did not impose the twin conditions.

Relied on the Supreme Court decision in *GVK Industries,*[4] which interpreted the 'source rule', and held that payments made by an Indian entity to a non-resident for services rendered outside India for the purposes of business carried on in India, were liable to tax in India. The Supreme Court further affirmed the legislature's power and competence to enact law with respect to extra-territorial aspects in case of nexus with India.

The twin conditions laid down in *Ishikawajima* were not the true intention of the legislature. Reliance was placed on the explanatory notes to the FA 2010, whereby it was clarified that the intention of the legislature to use the 'source rule' was to tax the income deemed to accrue or arise in India on the basis of the place of utilisation of such service and not the place of rendition of such service.

[4] *GVK Industries Ltd*. v. *Income-tax Officer* [2015] 371 ITR 453 (SC)

High Court's decision

The Karnataka High Court held that the 2010 amendment, though framed as a clarificatory amendment, substantially widened the scope of taxation under section 9(1)(vii) and therefore the said amendment is to be read down as prospectively applicable and not retrospectively applicable from 1 June 1976.

Accordingly, the High Court allowed the writ petition and dismissed the Revenue's review petition.

Key observations of the High Court included:[5]

<u>Withdrawal of CBDT Circulars could not operate retrospectively</u>

The Indian company had relied on CBDT Circulars No. 23 dated 23 July 1969 and 786 dated 7 February 2000, which provided relief from tax in certain cases involving non-residents. The circulars were subsequently withdrawn *vide* another circular released in 2009.[6]

The High Court observed that a beneficial circular is to be given retrospective effect, while an oppressive circular is to be given prospective effect.

The 2009 Circular withdrawing Circular Nos. 23 and 786 was oppressive to the non-resident taxpayers as it widened the scope of taxability to include previously exempted taxpayers, thereby subjecting them to tax. Accordingly, the 2009 Circular was to be applied prospectively and not retrospectively.[7]

[5] The High Court's observations on the maintainability of the writ petition have not been covered in this note.
[6] CBDT Circular No. 7 of 2009
[7] *CIT* v. *Gujarat Reclaim & Rubber Products Ltd* [2016] 383 ITR 236 (Bombay); *CIT* v. *Angelique International Ltd* [2013] 359 ITR 9 (Delhi); *DCIT* v. *Sanjiv Gupta* [2011] 135 TTJ 641 (Lucknow); Satellite Television Asia Region advertising Sales BV v. ADIT (ITA No. 1840/Mum/04) (Mumbai Tribunal)

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Direct Tax

The 2010 amendment effectively widened the charging provision

The 2010 amendment provided that FTS income would be deemed to accrue in India whether or not the non-resident rendered services in India. In substance, the amendment removed one of the twin conditions laid down in *Ishikawajima* and sought to tax FTS on the basis of utilisation in India.

A clarificatory provision using the phrase 'for the removal of doubts' needs to be read prospectively, when in effect it alters or broadens the scope of the taxing statute.[8]

The 2010 amendment, under the garb of being clarificatory amendment, effectively created a fresh tax liability with retrospective effect which is contrary to the settled principles of law. A charging provision cannot be expanded or its scope enlarged under the guise of a clarificatory amendment with retrospective effect. Any such enlargement would, in substance, amount to the introduction of a new charging provision.

India-USA tax treaty supported the Indian company's tax position

Article 12(4) of the India-USA tax treaty ('the US Treaty') defines fees for included services to mean payments for rendering technical or consultancy services. Thus, the article covers consideration for the services rendered and not utilised.

Even if the 2010 amendment was assumed to have validly altered the position under the 1961 Act, the more beneficial interpretation under the US Treaty would prevail.

The widened scope of taxability under the 2010 amendment was contrary to the provisions of the US Treaty and the settled principles of law.

[8] *M.M. Aqua Technologies Ltd.* v. *CIT* [2021] 436 ITR 582 (SC); *Sedco Forex International Drill Inc.* v. *CIT* [2005] 279 ITR 310 (SC)

Re-opening/ review of settled matters not permissible

A mere change of law is not a sufficient reason for the court to re-open and review matters which have already been decided on the basis of the law as it stood before the amendment.

In the instant case, the Indian company rightly contended that the change in law *vide* the amendments was not sufficient ground for this Court to review its earlier order.

Foreign cruise operator eligible for presumptive taxation; Onboard hospitality and entertainment incidental to passenger carriage: Supreme Court[9]

Facts of the case

A foreign entity ('FCo') was operating a cruise ship in India. An Indian company was acting as its agent in India and was responsible for conducting the cruise and collecting revenue from the sale of cruise packages and shore excursions in India.

The issue arose around the applicability of section 44B of the 1961 Act for the purposes of TDS. The section provides a presumptive taxation scheme for non-residents engaged in shipping business – 7.5 per cent of income from carriage of passengers, goods, etc. shipped at any port in India is deemed to be taxable income.

The Revenue alleged that section 44B applies only where there is carriage of passengers or goods from one place to another place. Since the cruise started and ended at Mumbai port and primarily offered hospitality and entertainment during the

[9] *DIT* v. *Star Cruises (India) P. Ltd.* (Civil Appeal No(s) 3334-3336 of 2012)

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voyage, the activity could not be regarded as “carriage” within the meaning of section 44B.

Both the Tribunal and the High Court upheld the applicability of section 44B, and the Revenue filed an appeal before the Supreme Court.

The issues before the Supreme Court were (a) whether FCo was engaged in the business of operation of ships and was entitled to be assessed under section 44B; and (b) whether the primary business activity of FCo was of providing hospitality and entertainment onboard the cruise ship and not mere transportation of passengers.

Supreme Court’s decision

The Supreme Court held that FCo was eligible for presumptive taxation regime as per section 44B.

FCo’s activities did not fall outside the expression “carriage” and the provision of ancillary services on a voyage did not take away FCo’s activities outside the meaning of “carriage” as per section 44B.

The Court rejected the Revenue’s narrow interpretation of the term “carriage”, i.e. to attract the meaning of the word “carriage”, the movement should be from place ‘A’ to place ‘B’.

Earlier, the Tribunal had observed that:

- A round-trip voyage constitutes two separate acts of carriage i.e., from station A to station B and back to station A.
- FCo also offered one-way cruises, and passengers booking round-trip cruises were entitled to disembark at intermediate ports without being compelled to return to Mumbai.
- Booking slips establish that the primary fees collected from passengers were for cabin and transport fares. Any on-board entertainment, whether included or paid for separately, was incidental to the main business of operating ships.
- CBDT circulars[10] clarify that carriage payments include handling charges and that section 44B of the 1961 Act was designed to simplify the computation of taxable profits for foreign shipping enterprises.

The Supreme Court also observed that it is not defining the term “carriage” but merely examining its application to the facts of the case.

Non-discrimination clause should result in parity in disallowance due to TDS default on payment to resident and non-resident: Delhi Tribunal[11]

Facts of the case

During the relevant FYs, the taxpayer made certain payments to non-resident entities without deducting TDS as per the 1961 Act.

In its income-tax return, the taxpayer made a disallowance for such expenditure due to default in TDS obligation. However, instead of disallowing the entire amount, the taxpayer restricted the disallowance to 30 per cent, relying upon the non-discrimination clause (‘NDC’) contained in the applicable tax treaties (i.e., India-USA and India-China tax treaties).

[10] Circular No. 763 dated 18 February 1996 and Circular No. 169 dated 23 June 1975
[11] *GE India Industrial Private Limited* v. *ACIT* (ITA No. 3019 and 3020/Del/2022)

Contd….

Direct Tax

The tax officer increased the disallowance from 30 per cent to 100 per cent.

***Relevant provisions*[12]**

In case of default in TDS obligation, section 40(a)(i) of the 1961 Act provided for disallowance of expenditure payable to a non-resident. Section 40(a)(ia) similarly provided for disallowance of expenditure payable to a resident, though the disallowance was restricted to 30 per cent of such expenditure.

Article 26(3) of the India-USA tax treaty contained NDC and provided that the payment made by an Indian resident to a US resident shall, for the purposes of determining the taxable profits of the Indian resident, be deductible under the same conditions as if they had been paid to an Indian resident. A similar provision is contained in Article 24(5) of the India-China tax treaty.

Taxpayer's contentions

Under the domestic law provisions applicable to payments to residents, the corresponding disallowance was restricted to 30 per cent. Accordingly, imposing a 100 per cent disallowance would create discriminatory treatment solely because the payee was a non-resident.

The additional disallowance under section 40(a)(i) was violative of the NCD contained in the applicable tax treaties.

In this regard, reliance was placed on the decision of the coordinate Bench of the Tribunal in the case of *LinkedIn Technology*[13] wherein the same issue was addressed.

[12] As applicable for the years under consideration i.e., FY 2016-17 and 2017-18
[13] *LinkedIn Technology Information (P.) Ltd.* v. *PCIT* [2026] 182 taxmann.com 472 (Delhi Tribunal)

Tribunal decision

Accepting the taxpayer's contention and relying on the decision in the case of *LinkedIn Technology*, the Delhi Bench of the Tribunal ruled in favour of the taxpayer.

In *LinkedIn Technology* decision, the Tribunal rejected the Revenue's contention that the non-discrimination provision was limited merely to the differential treatment of expenses incurred by residents and non-residents and held that the provision also extended to the quantum of expenditure disallowed. The Tribunal, in turn, had relied on the Delhi High Court's decision in the case of *Herbalife India*.[14]

Forward contracts for hedging foreign exchange exposure linked to debt investment constitute capital asset: Mumbai Tribunal[15]

Facts of the case

The taxpayer was a tax resident of Singapore and a registered Category-I Foreign Portfolio Investor ('FPI') under the SEBI Regulations.[16] It was engaged in making investments in permissible debt securities issued by the Government of India and listed Indian companies. As part of its investment activities in India, it also entered into forward contracts for the purpose of hedging the foreign exchange exposure arising from such debt investments.

During FY 2022-23, the taxpayer earned gains from the cancellation or early settlement of forward foreign exchange contracts.

[14] *CIT* v. *Herbalife International India (P.) Ltd.* [2016] 384 ITR 276 (Delhi)
[15] *Citicorp Investment Bank (Singapore) Limited* v. *ACIT* (ITA No. 9147/Mum/2025)
[16] SEBI Regulations (Foreign Portfolio Investors) Regulations, 2019

Contd.…

The taxpayer contended that the gains arising from cancellation/ early settlement of such forward contracts were in the nature of capital gains. Considering the beneficial provisions of Article 13(5) of the India-Singapore tax treaty,[17] the said capital gains were not taxable in India.

The Revenue rejected the taxpayer's claim and alleged that the taxpayer failed to establish that the forward foreign exchange contracts were inextricably linked with the underlying debt investments. Accordingly, the Revenue held that the gains arising on cancellation of the forward contracts were taxable as income from other sources rather than as capital gains.

Taxpayer's contentions

The definition of "capital asset" under the 1961 Act[18] includes securities held by foreign institutional investor in accordance with the applicable SEBI regulations. In this regard, the expression "securities" has the meaning assigned to it under the Securities Contracts (Regulations) Act, 1956 ('SCRA') which includes derivatives. A forward foreign exchange contract is a derivative instrument whose value is derived from changes in foreign exchange rates and thus, such contracts qualify as capital assets under the 1961 Act.

Cancellation or early settlement of the forward contracts results in extinguishment of the rights and obligations embodied in the contract, thereby constituting transfer of a capital asset under the 1961 Act.

Under the RBI[19] framework, the FPIs are permitted to hedge foreign exchange exposure only to the extent such exposure arises from the underlying securities, and the notional amount and tenor of the derivative contract cannot exceed those of the underlying investment. Once the underlying debt security is sold, the corresponding forward contract cannot continue independently and must necessarily be cancelled or unwound. Accordingly, the forward contracts are not independent speculative transactions but are intrinsically linked to the underlying debt investments. In this regard, the taxpayer submitted various documentary evidence.

Where a secondary transaction is inextricably linked to the primary transaction, the character of the receipt from the secondary transaction must follow the character of the underlying asset/ transaction. In the instant case, since the forward contracts were entered into only as a hedging mechanism in respect of the underlying debt securities held as capital assets, the gain or loss arising on cancellation of such contracts would be taxable as capital gains.

Tribunal's decision

Accepting the taxpayer's arguments, the Mumbai Bench of the Tribunal held that the gains arising on cancellation / early settlement of forward foreign exchange contracts entered into for hedging the foreign exchange risk associated with the underlying debt investments were capital gains in nature and not income from other sources.

Key observations of the Tribunal included:

It was evident from the material available on record that the forward contracts in the instant case were inextricably linked with the underlying debt investments. Thus,

[17] Article 13 contains provisions relating to capital gains. Article 13(5) provides that gains from the alienation of any property (other than immovable property, movable business property, ship or aircraft, company shares acquired on or after 1 April 2017 as referred to in paragraphs 1, 2, 3, 4A and 4B of this Article) shall be taxable only in the country of which the alienator is a tax resident.

[18] Section 2(14) of the 1961 Act read with Section 2(h) of the Securities Contracts (Regulations) Act, 1956

[19] Reserve Bank of India

Contd.…

the character of the gain arising on cancellation of such contracts ought to be determined having regard to the character of the underlying asset/ transaction. The mere fact that the contracts were cancelled or settled prior to maturity did not alter their intrinsic character or severe their nexus with the underlying debt securities.

No material brought on record by the Revenue to show that the taxpayer was independently trading in foreign exchange or entering into forward contracts *de hors* the underlying investments.

The RBI framework governing FPIs and foreign exchange hedging shows that forward contracts entered into for hedging foreign exchange exposure are not independent speculative transactions but serve solely as a protective mechanism against the foreign exchange exposure attached to the underlying debt investments.

The forward contracts in the instant case constituted capital assets and the cancellation thereof resulted in "transfer" of a capital asset under the 1961 Act.

b. Decisions – Domestic tax

Partnership interest in LLP constitutes capital asset; Valuation essential for capital gains computation in case of related-party transfer: Ahmedabad Tribunal[20]

Facts of the case[21]

The taxpayer, an Indian company, had made a significant capital contribution of INR 263.74 crores in an Indian Limited Liability Partnership ('LLP1') which in turn held equity investment in an Indian company ('ICo1').

Pursuant to the court-approved scheme of arrangement, ICo1 was amalgamated with another Indian company ('ICo2').

Pursuant to amalgamation, the shares of ICo1 held by LLP1 were cancelled; however, no corresponding shares of ICo2 were issued to LLP1 (being the shareholder of the amalgamating company ICo1).

Accordingly, the book value of the investment in LLP1 was recorded as 'nil' in the taxpayer's books of account.

During FY 2015-16, the taxpayer transferred its entire partnership interest in LLP1 to another Indian LLP ('the buyer') for a consideration of INR 5 lakhs.

Based on the difference between the original capital contribution and the sale consideration, the taxpayer claimed a short-term capital loss ('STCL') under the 1961 Act.[22]

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[20] ITA No. 1733/Ahd/2024
[21] Other grounds of appeal have not been covered in this note.
[22] Sections 45 and 48

Contd.…

The Revenue, however, alleged that the entire arrangement was a colourable device designed to generate an artificial capital loss as all the entities involved in the transaction, i.e. LLP1, its partners (including the taxpayer), the buyer and ICo2, were under the direct or indirect control of the same promoter group. The taxpayer's investment in ICo1's shares through LLP1 was made with the knowledge of the impending amalgamation of ICo1 with ICo2. Neither the taxpayer nor LLP1 raised any objection to the cancellation of ICo1's shares upon amalgamation without the issuance of ICo2's shares as consideration. Accordingly, the Revenue disallowed the STCL claimed by the taxpayer. The Revenue argued that, alternatively, since the investment in the books of the taxpayer had already become *nil* after cancellation of the ICo1's shares, the cost of acquisition of the partnership interest in LLP1 also ought to be regarded as *nil*.

Taxpayer's contention

The asset transferred was the taxpayer's partnership interest in LLP1, which constituted a "capital asset" under the 1961 Act.[23]

Section 42 of the Limited Liability Partnership Act, 2008 expressly recognises the transferability of a partner's rights and section 49(2AAA) of the 1961 Act (which deals with cost of acquisition of partner's right in LLP acquired on conversion of a company into LLP) recognises such rights as capital assets. Once the partnership interest was transferred through a valid assignment deed for valuable consideration, the capital gains provisions were applicable.

The taxpayer's capital contribution to LLP1 constituted the cost of acquisition of the partnership interest,[24] which should be deducted from the sale consideration for computing capital gains under the 1961 Act. The statute nowhere authorises substitution of the cost of acquisition merely because the value of the investment had diminished in the books of account – book entries cannot override the statutory computation mechanism prescribed under the 1961 Act.

The investment made by the taxpayer in LLP1 was real, genuine and substantial. The subsequent cancellation of ICo1 shares under the court-approved scheme led to complete erosion of the value of LLP1, which drastically reduced the value of the taxpayer's partnership interest and resulted in genuine commercial loss on the transfer of such interest.

The Revenue incorrectly adopted a "look-through" approach by treating ICo2, the taxpayer and LLP1 as a single economic entity. Each entity was a separate juristic person recognised under law and their corporate identities could not be ignored in the absence of any statutory provision authorising such an approach.[25]

The Revenue's allegation that the buyer belonged to the same group was factually incorrect, as it was neither a subsidiary nor a related party of the taxpayer and was not disclosed as a related party in the financial statements. Even otherwise, merely because parties may be related could not by itself lead to the conclusion that a genuine transaction was a 'sham'.

Tribunal decision

The Ahmedabad Bench of the Tribunal held that partnership rights in an LLP constituted a "capital asset", being "property of any kind", and that the assignment of such rights resulted in "transfer" under the 1961 Act.

With regard to the Revenue's allegation that the loss arose as a result of cancellation of shares on account of the merger, the Tribunal observed that

[23] Section 2(14)
[24] *New Kamlesh Jewellers* v. *ITO* [2011] 9 taxmann.com 204 (Mumbai)
[25] *Vodafone International Holdings BV* v. *Union of India* [2012] 17 taxmann.com 202 (SC)

Contd.…

the Scheme was approved by the High Court after receiving approvals from SEBI, the creditors, the shareholders and competition commission of India and all other regulatory authorities and therefore, the transaction of cancellation of shares as a result of the merger was a consequential effect and process of law.

Considering the Revenue's doubt regarding the sale of interest in LLP1 as a transaction between related entities, the Tribunal held that the valuation of interest in LLP1 as on the date of transfer assumed greater significance. However, it was noted that the taxpayer had not obtained any valuation report, while the Revenue had also failed to apply any recognised valuation methodology when alleging that the transaction lacked commercial substance.

In view of the incomplete factual record, the Tribunal remanded the matter to the tax officer for fresh examination, with clear directions to:

- Examine the pre-merger and post-merger financial statements of the amalgamating, and amalgamated companies to understand the accounting treatment given as a result of the merger; and
- Obtain the accounts of LLP1 as on the date of transfer of partnership interest.

The Tribunal also directed the taxpayer to submit valuation report valuation report from authorised person valuing the interest in LLP1 as on the date of transfer, for the purposes of computing capital gains.

Amortisation of IPO-related expenses restricted to companies; REITs not eligible to claim benefit: Bangalore Tribunal[26]

Facts of the case

The taxpayer was a Real Estate Investment Trust ('REIT') constituted as an irrevocable trust[27] and registered under the SEBI Regulations.[28]

In the tax return filed for FY 2020-21, the taxpayer claimed deduction under section 35D(2)(c) of the 1961 Act for the expenditure incurred towards its initial public offer ('IPO'), public subscription, and listing of its units on the recognised stock exchange.

However, the Revenue rejected the taxpayer's claim alleging that the taxpayer, being a trust assessed as an association of persons or body of Individuals and not as a company, was not eligible for deduction under section 35D(2)(c).

Relevant provisions

Section 35D of the 1961 Act allows an Indian resident (including an Indian company) to amortise certain preliminary expenses over a period of five consecutive FYs.

However, as per section 35D(2)(c)(iv), expenditure incurred in connection with the issue, for public subscription, of shares in or debentures of a company is allowed to be amortised but is allowable only to a company.

[26] ITA No. 221/Bang/2025
[27] Under the Indian Trusts Act, 1882
[28] Regulation 6 of the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014

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Taxpayer's contentions

Although the relevant provision expressly refers to a company, the same benefit should also be extended to the taxpayer, which is REIT, as provisions allowing incentive-based deduction and having a beneficial object should receive a liberal construction.

The provision was enacted at a time when entities such as REITs were not in existence or trusts were not eligible to list their units on stock exchanges. Since REITs were subsequently permitted to raise funds through public subscription of units in a manner comparable to companies, section 35D(2)(c) should be interpreted in harmony with its object and purpose.[29]

The public issue of units by a REIT is, in economic and functional terms, indistinguishable from a public issue of shares by a company. A REIT files an offer document with SEBI, complies with disclosure norms substantially similar to those applicable to companies, incurs IPO-related expenses and lists its units on a recognised stock exchange, denying the deduction merely because a REIT issues units instead of shares would defeat the object of section 35D.

Tribunal's decision

The Bangalore Bench of the Tribunal ruled against the taxpayer and upheld the disallowance of deduction claimed under section 35D(2)(c). Key observations of the Tribunal included:

No ambiguity in the statutory language

The language of the section is clear and unambiguous. Although section 35D(1) extends to Indian companies and resident non-corporate taxpayers, clause (c) of section 35D(2) expressly begins with the words "where the assessee is a company", thereby restricting the deduction for expenditure incurred in connection with public subscription exclusively to companies. The deduction expressly confined to a company cannot be extended, by judicial interpretation, to a non-corporate taxpayer.

An exemption or deduction must be construed strictly, and in case of ambiguity, the interpretation favouring the Revenue must be adopted.[30]

The legislative history of section 35D, introduced with effect from 1 April 1971, draws a clear distinction between specified expenses incurred by resident taxpayers, as covered by clauses (a) and (b) of section 35D(2), and expenses that are inherently corporate in nature, as covered under clause (c) of the section. The legislature was conscious that only a company could issue shares or debentures; accordingly, clause (c) specifically refers to "shares or debentures of the company" and does not extend to units or securities generally.

REIT is not a company

The taxpayer was a REIT constituted as a trust and did not fall within the definition of "company" provided under the 1961 Act.[31]

Further, the 1961 Act separately recognises REITs as business trusts[32] and provides a distinct taxation regime under Chapter XII-FA which confirms that, for the purposes of the 1961 Act, a REIT is neither a company nor treated as one.

Unlike a company which suffers tax on its income and whose shareholders are taxed when dividend is distributed, a trust is a pass-through entity—and therefore no parity can be drawn between the two types of entities.

[29] *K.P. Varghese* v. *ITO* [1981] 131 ITR 597 (SC); *CIT* v. *J.H. Gotla* [1985] 156 ITR 323 (SC); *K.S. Vaidyanathan* v. *CIT* [1985] 153 ITR 11 (Madras)

[30] *Customs* v. *Dilip Kumar and Company* [2018] 95 taxmann 327 (SC)
[31] Section 2(17)
[32] Section 2(13A)

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The partnership firms, LLPs and trusts may also raise funds for their activities; however, they are not eligible for deduction under section 35D(2)(c) as the provision is specifically restricted to companies. Applying the same principle, a REIT cannot claim the deduction merely because it raises funds through the issuance of units.

REIT units are not shares or debentures

REIT units are neither shares nor debentures, but a distinct class of security recognised under the SEBI Regulations and the SCRA. The fact that REIT units are treated as securities for the purposes of the SCRA does not *ipso facto* convert them into shares or debentures for the purposes of section 35D(2)(c).

While there are regulations[33] which classify REIT units as equity instruments for mutual fund investment purposes, however, such classification is regulatory and context-specific and does not alter the legal character of a REIT unit as a distinct security from a share.

The 1961 Act itself draws a deliberate distinction between shares and units of a business trust in multiple provisions, including sections 2(42A), 47(xvii), 112A, 10(23FC), and 115UA.

[33] SEBI (Mutual Funds) Regulations, 1996; SEBI (Mutual Funds) Amendment Regulations, 2024 and the Master Circular for Mutual Funds

No disallowance due to TDS default where the payee reported loss and no tax was legally payable: Bangalore Tribunal[34]

Facts of the case

During FY 2013-14, the taxpayer (an Indian company) purchased goods from the Indian branch office of a US company.

The Revenue observed that the payment for these purchases had been made without deduction of TDS[35] and accordingly, the deduction for purchase expenditure claimed by the taxpayer was disallowed.

The taxpayer contended that the recipient branch had filed its return of income in India, included the receipts in its tax computation and satisfied the prescribed conditions and accordingly, the relief under the second proviso to section 40(a)(i) was available.

Relevant provisions

Section 40(a)(i) of the 1961 Act disallows deduction of payments made to non-residents where there is a failure to comply with applicable tax deduction obligations. However, the second proviso[36] – inserted by the Finance (No. 2) Act, 2019 w.e.f. 1 April 2020 – provides relief from disallowance where the payee:

- has furnished a return of income;
- has taken the relevant amount into account while computing income;
- has paid the tax due on the income declared; and

[34] *Cyberstar Infocom LLP* v. *ITO* (ITA No. 1926/Bang/2025)
[35] Under section 195
[36] Read with the first proviso to section 201(1) inserted by the Finance Act, 2012

Contd.…

Direct Tax

- furnishes an accountant's certificate in the prescribed form (i.e., Form 26A)

Revenue's contentions

The prescribed conditions remained unsatisfied, and the taxpayer was not eligible to claim the relief on the following grounds:

- The taxpayer had only furnished acknowledgment of branch’s tax return and Annexure A to Form 26A. It had not placed the complete Form 26A on record.
- The recipient branch had filed a *nil* return (due to tax losses) and paid no tax on the sum received from the taxpayer.

Tribunal’s decision

The Bangalore Bench of the Tribunal deleted the disallowance on the ground that the prescribed conditions were satisfied.

‘*Paid the tax due’ does not require tax payment where no tax is legally payable*

The phrase used in the statute is ‘paid the tax due’. Accordingly, tax payment is required only where tax is due as per the law.

The recipient branch had filed its return under section 139(1) and reported tax losses. Consequently, no tax was payable. Compelling tax payment despite absence of tax liability would be inconsistent with Article 265 of the Constitution and contrary to the statutory scheme governing business losses and carry-forward provisions.

Second proviso, being curative, is retrospective in effect

Second proviso to section 40(a)(i) was declaratory and curative in nature and was retrospective in operation. Accordingly, it was applicable to the year under consideration.[37]

Other observations

Annexure A to Form 26A contained the accountant's certification required for claiming relief under the second proviso the section 40(a)(i) The certificate was duly signed and included all prescribed particulars. Form 26A largely contained information already available with the Revenue and that its absence was merely a technical defect which could not defeat the substantive relief.

In the TDS proceedings, the Revenue had accepted that the recipient had filed its return and discharged applicable tax liability, and therefore only interest had been imposed.[38]

[37] *Celltick Mobile Media (India) P. Ltd* v. *DCIT* [2021] 127 taxmann.com 598 (Mumbai Tribunal)
[38] Under section 201(1A) of the 1961 Act

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Capital gains exemption available on full reinvestment of actual sale proceeds despite higher stamp duty valuation: Chennai Tribunal[39]

Facts of the case

During FY 2016-17, the taxpayer sold five properties and earned long-term capital gains ('LTCG'). He invested the sales consideration in the purchase of land and the construction of a new residential house thereon.

In his tax return, he claimed that the entire amount of LTCG was exempt under section 54F of the 1961 Act since the amount of investment made in the new residential house exceeded the actual sale consideration received from these transfers.

The Revenue observed that the stamp duty value of the properties sold was substantially higher than the sale consideration disclosed in the sale deeds. Accordingly, applying section 50C of the 1961 Act, the Revenue substituted the actual sale consideration with the stamp duty value, and re-computed LTCG (which were higher than the amount computed by the taxpayer).

The Revenue further concluded that as the investment in the new residential house was lower than the stamp duty value, which was deemed as sales consideration, only proportionate exemption under section 54F was available to the taxpayer.

Relevant provisions

Section 50C provides that where the consideration received or accruing as a result of transfer of land, building, or both is less than the stamp duty value, then such value is deemed to be the *full value of consideration* for computing capital gains under section 48 of the 1961 Act ('deemed consideration').

Section 54F(1) provides that where an individual transfers a long-term capital asset (not being a residential house) and purchases or constructs one residential house in India within the prescribed period, the capital gain is eligible for exemption as follows:

- If the cost of the new residential house is not less than the net consideration from the transfer, the whole of such capital gain is exempt.
- However, if the cost of the new house is less than the *net consideration*, the exemption is restricted proportionately.

Explanation to section 54F(1) defines the term "net consideration" as the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

Tribunal's decision

The Chennai Bench of the Tribunal ruled in favour of the taxpayer and held that the whole of the LTCG was eligible for exemption under section 54F even if such LTCG was computed based on the deemed consideration under section 50C.

[39] *T Srikanth* v. *DCIT* (ITA No. 3792/Chny/2025) – The appellant was the legal heir/son of deceased Shri Skandhakumar Tellakulla (the taxpayer)

Contd.…

Key observations of the Tribunal included:

The term “net consideration” used in section 54F is contra distinct to the term deemed “full value of consideration” referred to in section 50C, which is only for the purpose of computing capital gains.[40]

It is a settled principle of law that in construing deeming fiction, it is not to be extended beyond the purpose for which it is created, or beyond the language of the section by which it is created.[41] Hence, the deeming fiction as provided in section 50C in respect of the expression “full value of consideration” cannot be applied to the expression “full value of consideration” mentioned in other provisions of the 1961 Act (including section 54F).

The natural meaning of the expression “full value of consideration” refers to the consideration specified in the sale deed. Accordingly, except for the purposes of computing capital gains, the expression, wherever mentioned in different provisions of the 1961 Act, should be interpreted as the consideration specified in the sale deed.[42]

In the instant case, the taxpayer invested the entire sale consideration for construction of new residential house. Once the entire sale consideration had been fully applied, then the deemed consideration could not be imported into or read into the provisions of section 54F.

[40] Under section 48
[41] *Mancheri P Ahmed* v. *Kuthiravattam Estate Receiver* [1996] 6 SCC 185 (SC)
[42] *Gyan Chand Batra* v. *ITO* [2010] 8 taxmann.com 22 (Jaipur Tribunal)

Fresh allotment of shares is not ‘receipt’ of property; No tax on shares allotted below FMV as per prescribed valuation rules: Visakhapatnam Tribunal[43]

Facts of the case

During FY 2013-14, the taxpayer, an individual, was issued equity shares by an Indian company at face value.

The Revenue alleged that the issue price of the shares was substantially lower than the fair market value (‘FMV’) of the shares determined as per the prescribed valuation rules,[44] and therefore proposed to tax the difference between the issue price and the FMV as income from other sources under section 56(2)(vii)(c) of the 1961 Act.

The taxpayer contended that a fresh allotment of shares is distinct from the transfer of existing shares. Since, in case of fresh allotment, the shares come into existence only upon allotment and no pre-existing property is transferred from one person to another, the essential condition for applying that section, namely the receipt of property from another person, is not satisfied in the instant case. To support its contentions, the taxpayer relied on the Supreme Court ruling in *Khoday Distilleries* and other judicial precedents.[45]

However, the Revenue rejected the taxpayer’s contentions and held that once the taxpayer had obtained property for inadequate consideration, the manner in which the property came into existence was not relevant for the purposes of the charging provision.

[43] *ACIT* v. *Ramesh Chandra Yarlagadda* (ITA 642/Viz/2025) – Multiple appeals and cross appeals
[44] Rules 11U and 11UA of the Income-tax Rules,1962
[45] Khoday Distilleries Ltd. v. CIT [2008] 307 ITR 312 (SC); Jigar Jashwantlal Shah v. PCIT (2024) 468 ITR 628 (Gujarat); Thermodyne Dynamics (P.) Ltd. v. ITO [2025] 176 taxmann.com 485 (Hyderabad)

Contd.…

Relevant provisions

Section 56(2)(vii)(c) of the 1961 Act provides that where an individual receives (before 1 April 2017), from any person or persons, any property (other than immovable property) for a consideration which is less than the aggregate FMV of the property, the difference between the aggregate FMV of such property and the consideration paid will be chargeable to tax as income from other sources.

The term "property" has been defined to include, *inter alia*, shares and securities.

Tribunal's decision

The Visakhapatnam Bench of the Tribunal ruled in favour of the taxpayer and held that the provisions of section 56(2)(vii)(c) were not attracted to the impugned transaction of fresh allotment of shares in the instant case.

Key observations of the Tribunal included:

The legislature has used the expression "receives" property from another person in section 56(2)(vii)(c), rather than expressions such as "is allotted" or "is issued" shares. Therefore, the provision necessarily presupposes the prior existence of the property which is received. In a fresh allotment, what comes into existence is a new property, and such creation of property could not be equated with receipt of property from another person.

As per the well-settled principles of the company law, allotment of shares involves the company's appropriation of a portion of its unissued share capital, whereas transfer involves the passing of an already existing share from one holder to another.

<u>Judicial precedents</u>

- In *Khoday Distilleries*, the Supreme Court recognized the distinction between allotment of shares and transfer of shares and held that allotment is creation of shares, not transfer of existing shares.
- In *Jigar Jashwantlal Shah*, the Gujarat High Court had examined the applicability of section 56(2)(vii)(c) to a fresh issue of shares and observed that the charging provision could not be extended to a transaction that falls outside the statutory expression employed by the Parliament.
- In *Thermodyne Dynamics*, the Hyderabad Bench of the Tribunal held that fresh allotment of shares falls outside the scope of the expression "received" as used in section 56(2)(vii)/(viia) of the 1961 Act. The Tribunal observed that the deeming fiction under section 56 applies only when an existing property is received from another person, and not when the company creates new shares upon allotment.

Indirect Tax

Supreme Court cases

Input Tax Credit available only if supplier paid GST to the Government[46]

Section 16(2)(c) of the CGST Act, 2017 provides that a registered person is entitled to avail Input Tax Credit ('ITC') only where the tax charged on the supply has actually been paid to the government by the supplier. The constitutional validity of this provision was challenged before the Gujarat High Court.

The petitioners contended that denial of ITC to a bona fide purchaser solely because of the supplier's failure to deposit tax was arbitrary and unconstitutional. In the alternative, they sought reading down of Section 16(2)(c) of the CGST Act, 2017 so that ITC would not be denied where the recipient had complied with all statutory requirements and the default lay entirely with the supplier.

By judgment dated 1 May 2026, the Gujarat High Court upheld the constitutional validity of section 16(2)(c) and rejected the constitutional challenge in its entirety. The Court held that payment of tax by the supplier is a substantive statutory condition for availment of ITC and that the Goods and Services Tax framework is materially different from the erstwhile Value Added Tax regime. The Court also rejected the alternative prayer to read down section 16(2)(c). While reaching this conclusion, the Court placed significant reliance on the amended Section 41 of the CGST Act, 2017 read with rule 37A of the CGST Rules, 2017, which provides a statutory mechanism for reversal of ITC where the supplier defaults and for the restoration of ITC once the supplier subsequently discharges the tax liability.

Aggrieved by the judgement, the petitioners preferred a Special Leave Petition ('SLP') before the Supreme Court.

[46] *Bhandari Scrap Traders* – [TS-538-SC-2026-GST]

The Supreme Court referred to the pending SLP arising from the Tripura High Court's judgment in *Sahil Enterprises*, in which Tripura High Court had held that though Section 16(2)(c) is not violative of Constitution of India, it should be read down and applied only where the transaction is found either not to be bona fide or to be collusive or fraudulent.

The Supreme Court observed that the exercise undertaken by the Gujarat High Court had not been undertaken by the Tripura High Court. The Gujarat High Court had undertaken a detailed analysis distinguishing the provisions of the Delhi VAT Act, 2004 from those of the CGST Act, 2017 after examining the statutory scheme governing availment of ITC under the CGST Act.

The Supreme Court held that the Gujarat High Court had rightly considered the statutory framework under Sections 41, 73 and 74 of the CGST Act, 2017 under which a recipient whose ITC is reversed due to supplier default is entitled to re-avail such credit once the supplier subsequently discharges the tax liability. The Gujarat High Court was fully justified in refusing to declare section 16(2)(c) of the CGST Act, 2017 unconstitutional or to read down the provision.

The Supreme Court expressly recorded that it was in 'complete and respectful agreement' with the views expressed by the Gujarat High Court and dismissed the SLP.

Contd.…

High Court cases

Levy of GST on corporate guarantees upheld but deemed 1 per cent valuation under rule 28(2) read down[47]

The petitioners being holding companies, had furnished corporate guarantees in favor of their subsidiaries, primarily to facilitate the subsidiaries’ financing arrangements with banks/financial institutions. The guarantees were furnished without consideration. The petitioners challenged the levy of GST on such corporate guarantees under rule 28(2) of the CGST Rules, 2017. The said rule was introduced with effect from 26 October 2023 and prescribed the value of the supply by way of a corporate guarantee at 1 per cent of the amount of the guarantee offered per annum or the actual consideration, whichever is higher.

The petitioners contended that furnishing a corporate guarantee without consideration does not constitute a taxable supply under section 7 of the CGST Act, 2017. It was submitted that Entry 5(e) under schedule II to the CGST Act, 2017 does not apply to corporate guarantees given by a holding company to its subsidiary. It was further submitted that the execution of corporate guarantee constitutes an actionable claim and hence was non-taxable. The petitioners also argued that the corporate guarantee is furnished as a shareholder/intra-group arrangement and does not constitute an activity undertaken in the course or furtherance of business. The petitioners further challenged rule 28(2) of CGST Rules, 2017, on the ground that being a valuation provision, it cannot independently create a taxable event where no taxable supply exists. Therefore, the petitioners submitted that the prescribed 1 per cent valuation has no legal or commercial nexus with the actual value of a corporate guarantee and was therefore challenged as arbitrary. The petitioners also contended that the circulars could not create or expand the scope of the levy beyond the provisions of the CGST Act, 2017 and CGST Rules, 2017.

The government on the other hand contended that Section 7(1)(c) read with Schedule I of the CGST Act, 2017, specifically provides for taxation of certain supplies even without consideration. It contended that a holding company and its subsidiary are related persons and, accordingly, a corporate guarantee furnished by the holding company falls within Entry 2 of schedule I. It submitted that the corporate guarantee constitutes a supply of service, with schedule II being relevant for classification. It further contended that the subsidiary is the recipient of the service since the guarantee is furnished at its request and ultimately benefits the subsidiary. It was also argued that furnishing a corporate guarantee is an activity in the course or furtherance of business, even where it is not the principal business activity of the holding company. The government also submitted that corporate guarantee does not constitute an actionable claim, as the guarantor does not itself hold a claim to the underlying debt. The government therefore submitted that rule 28(2) validly prescribes the value of the related-party supply at 1 per cent of the guaranteed amount per annum or the actual consideration, whichever is higher and that the impugned Circulars merely clarify and facilitate implementation of rule 28(2) and do not travel beyond the statute.

The High Court held that corporate guarantee constitutes a ‘supply of service’ under section 7 read with schedule I (Article 2). It observed that a holding company and its subsidiary are ‘related persons’ under explanation to section 15 of CGST Act, 2017, making the guarantee fall under section 7(1)(c) of CGST Act, 2017 read with schedule I to CGST Act, 2017 The Court also held that corporate guarantee is in ‘course or furtherance of business’ even if not the main business, it is incidental/

[47] *Torrent Power Limited* – [2026] 45 Centax 217 (Guj.)

Contd.…

ancillary to the holding company's business interest. The Court also held that the subsidiary qualifies as a ‘recipient’ under section 2(93) of the CGST Act, 2017, as the service ultimately accrues to and benefits the subsidiary.

The Court also held that a corporate guarantee is not an actionable claim under section 3 of the Transfer of Property Act, 1882 and the definition of ‘debt’ under Article 366(8) of the Constitution cannot be imported for this purpose.

The Court observed that the doctrine of shareholder activity cannot be applied stricto sensu to the GST regime, and it depends on the nature of execution of corporate guarantee and that the agreement of pledging of shares along with the corporate guarantee is a supply of services attracting levy of 1 per cent of valuation under rule 28(2) of CGST Rules, 2017. The Court also held that Rule 28(2) of the CGST Rules is *intra vires* but read down the expression ‘whichever is higher’ in rule 28(2) as arbitrary, because it does not confer any option to pay GST on actual commission/charge.

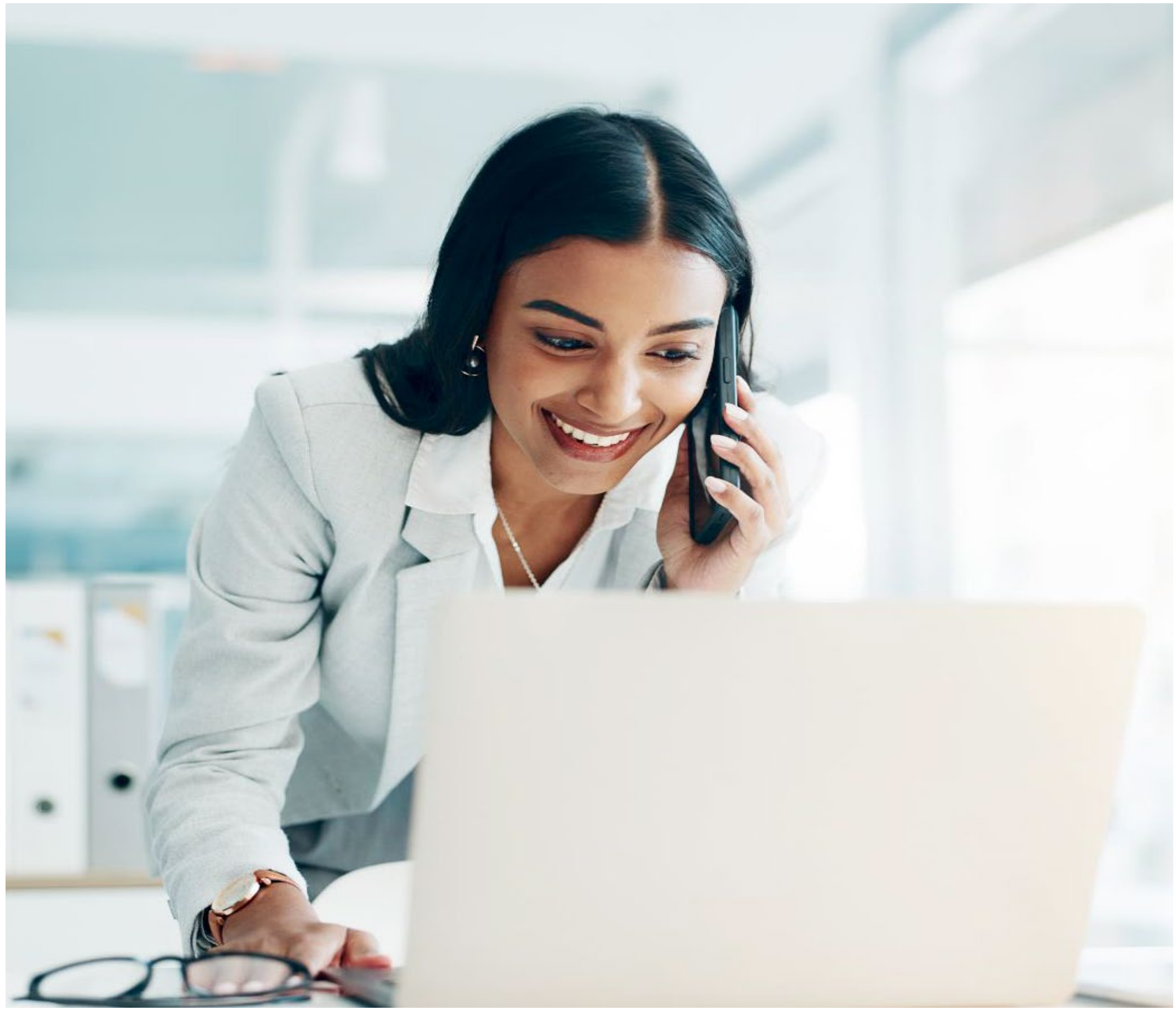
The Court held that levy of GST on corporate guarantees furnished prior to 26 October 2023 under rule 28(2) of CGST Rules, 2017 was violative of Articles 14 and 19(1)(g) of the Constitution, but levy gets attracted from 26 October 2023 onwards if the guarantees continue. The Court observed that the time of supply is determined under section 13(2)(c) of the CGST Act, 2017 i.e., ., the date on which the subsidiary reflects the guarantee in its books of accounts; for continuing guarantees, the taxable event occurs each year based on the outstanding debt reflected. It was also held that corporate guarantee does not fall within ‘continuous supply of services’ under section 2(33), as the periodic payment obligation is absent when the guarantee is without consideration.

The Court held that impugned circulars dated 27 October 2023 and 11 July 2024 were to be set aside to the extent that they run contrary to the Court's observations; The court directed that revenue may issue fresh circulars consistent with this judgment. The Court also held that impugned actions under section 74 were to be quashed as mere non-payment due to dispute in interpretation of law did not constitute ‘suppression of facts or wilful evasion’. The High Court held that section 15(4) of the CGST Act, 2017 is *intra vires* and that excess GST deposited shall be refunded to petitioners or parties may also adjust such amounts if desired. Therefore, the writ petitions were allowed partly.

Foreign Exchange Management Act, 1999

The Government of India introduces an inventory-based cross-border e-commerce facilitation framework under the Foreign Trade Policy, 2023

The Ministry of Commerce and Industry on 5 August 2026[48] amended the Foreign Trade Policy, 2023. The new Directorate General of Foreign Trade (‘DGFT’) framework enables registered Exporters-on-Record (‘EORs’) to procure Indian goods against confirmed overseas orders and manage end-to-end export operations, helping MSMEs and manufacturers expand their global e-commerce presence.



The Reserve Bank of India has updated FAQs in relation with the Special Rupee Vostro Account

The RBI on 30 July 2026 updated the frequently asked questions (‘FAQs’) in relation with the Special Rupee Vostro Account (‘SRVA’) under FEMA, 1999.

[48] S.O. 4335(E), DGFT Notification No. 27/2026-27 dated 5 August 2026

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