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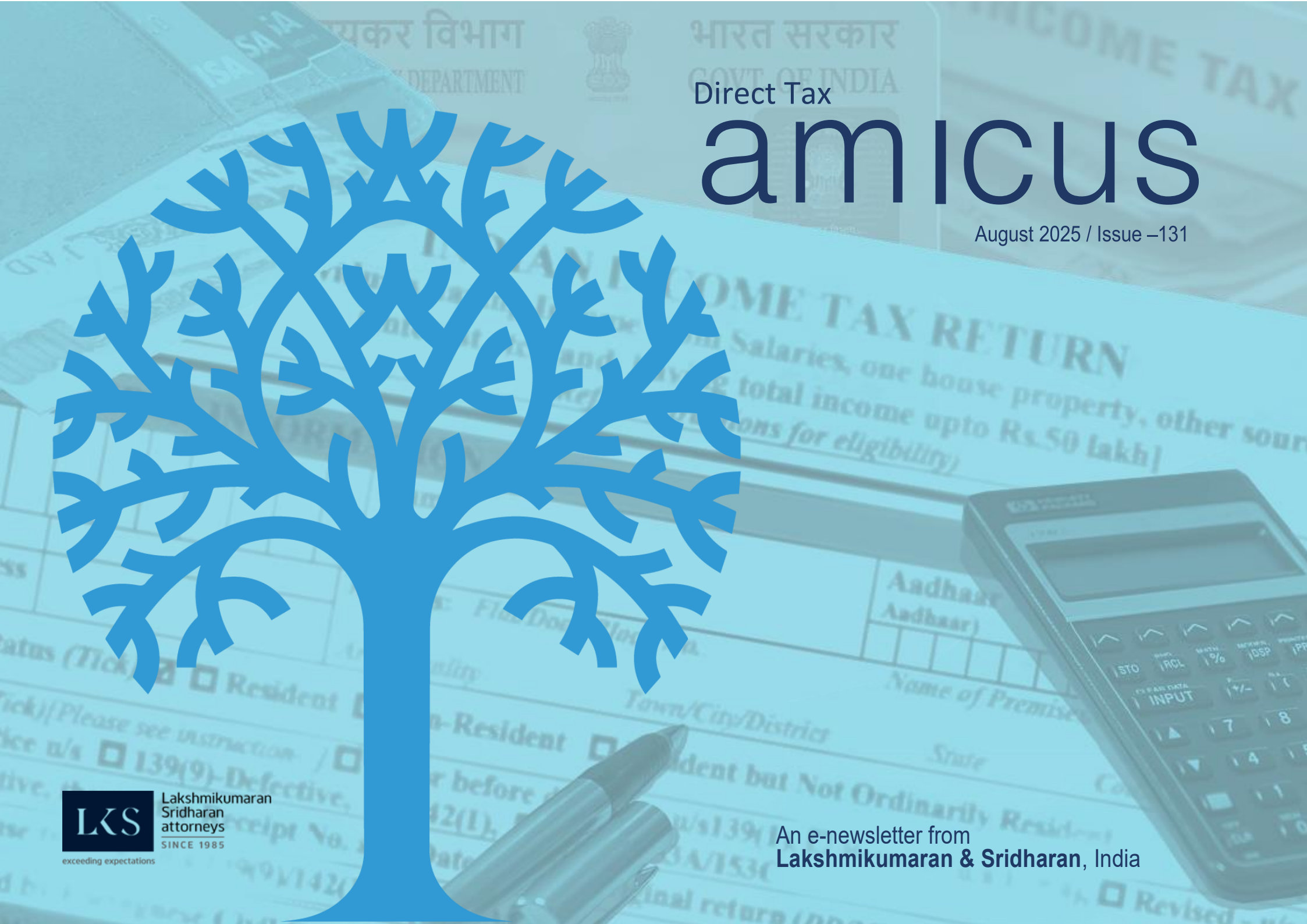

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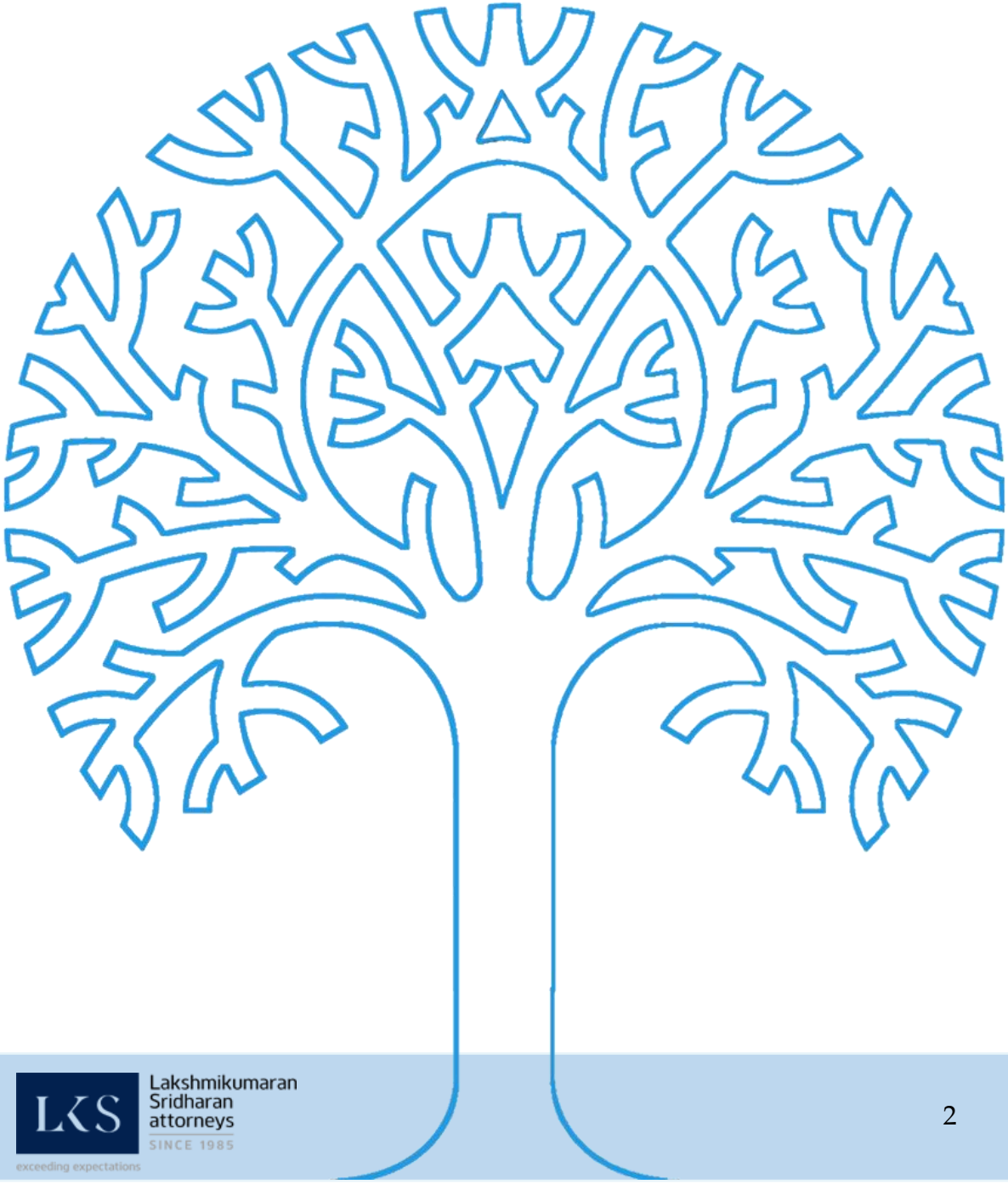

Article

Dy/Dx – Differentiating the contours of taxation of derivatives

By **Siddhesh Khandalkar and Sudin Sabnis**

The article in this issue of Direct Tax Amicus discusses a recent ITAT decision wherein the Tribunal was called upon to adjudicate a question as to whether a Venn Diagram of two sets of items – meaning of derivatives as it is normally understood and its tax treatment equating it with shares, would have any intersection or not. By distinguishing derivatives from shares, the ITAT has affirmed that derivatives, despite deriving their value from underlying assets like shares, are distinct financial instruments, i.e., the derivatives are not subject to the same taxation rules as shares under the India-Mauritius DTAA. According to the authors, the judgment underscores the importance of understanding the legislative intent behind treaty provisions and adhering to the principle of treaty override.

Dy/Dx – Differentiating the contours of taxation of derivatives

By Siddhesh Khandalkar and Sudin Sabnis.

Introduction

When classical mathematicians (Bhaskar Acharya, Leibniz, Issac Newton) were codifying the laws and nature of derivatives, they could not have fathomed that tax authorities one day would contend that a *'derivative'* is the same as the underlying item, from which it derives its value.

The term 'derivative', by its very meaning, connotes something which is a little bit of something else[1].

In the financial world, a derivative denotes an instrument which derives its value from another instrument, for example shares, bonds, commodities, etc. The Black-Scholes model for option pricing, which is a standard model for pricing of all freely traded derivatives, contains the *'price of the underlying asset'* as one of the components of the option pricing formula. Again, driving home the point that a derivative is different from the underlying instrument from which it derives its value.

Be that as it may, the Hon'ble Mumbai ITAT, in a recent judgement[2], was called upon to adjudicate a question as to whether a Venn Diagram of two sets of items, i.e., the meaning of derivatives as it is normally understood and its tax treatment equating it with shares thereof, would have any intersection or not.

Issue under deliberation before the Tribunal

Whether income from sale of derivatives by a Mauritius resident can be made subject to tax in India, in terms of Article 13(4) of the India-Mauritius DTAA?

Taxation of capital gains under the India-Mauritius DTAA

Section 90(2) of the Income-tax Act, 1961 ('**IT Act**') provides for the proverbial 'treaty override[3]', i.e., an option to the taxpayer to be either governed by the provisions of the IT Act or the applicable tax treaty, to the extent whichever would be beneficial to them.

Article 13(1), (2) and (3) of the DTAA provides for taxation of capital gains arising from alienation of immovable property situated in a source state, property forming part of a permanent

[1] Calculus Made Easy by Silvanus P. Thompson
[2] *3 Sigma Global Fund* [TS-928-ITAT-2025(Mum)]
[3] *UOI* v. *Azadi Bachao Andolan* [2003] 263 ITR 706 (SC)

establishment in a source state and gains from alienation of ships and aircraft respectively.

Article 13(3A) provides that gains from alienation of shares in a company which is a resident of a contracting state may be taxed in such state.

Further, in terms of Article 13(4) gains from alienation of any property other than those mentioned in Article 13(1),(2),(3) and (3A) are made exigible to tax only in the state in which the alienator is a resident.

Thus, the only question for adjudication before the Hon'ble ITAT, essentially, was whether a derivative could be considered to be a 'share' in terms of Article 13(3A) of the DTAA, so as to allocate the taxing rights thereof to the source state.

Decoding the undefined – finding context within subtext

The term 'derivative' remains undefined in the DTAA. It is trite law that in finding meaning for words which remain undefined in a treaty, recourse may be made to, firstly the domestic tax laws of the-source state, secondly if such an exercise yields no results, then to other laws of the source state.

Thus, traversing the relevant domestic laws, which could provide a *context specific definition* of the term derivatives, the Hon'ble ITAT noted that the provisions of Section 2(84) of the Companies Act, 2013 ('**CA, 2013**') define a 'share' to mean a share in the share capital of a company and includes stock. It also noted that term 'derivative' is not defined the CA, 2013, however the same is included within the meaning of the term 'securities', as contained in Section 2(81) of the CA, 2013, which, by making a circular reference to the definition provided therefor in terms of the Section 2(h) of the Securities Contracts (Regulations) Act, 1956 ('**SCRA**'), includes the term 'derivatives' within its ambit.

Further, to gather the relevant context within which the provisions of paragraph 3A of Article 13 were amended by the Central Government in 2015, the Hon'ble ITAT relied on its own decision in the undernoted case[4], wherein the interview given by the then Revenue Secretary to a media house, clarifying the Government's intentions while making the amendments to the Article 13 of the DTAA, was used as an external aid of interpretation.

[4] *Vanguard Emerging Markets Stock Index Fund* v. *ACIT*, [2025] 172 Taxmann.com 515 (Mumbai – Trib)

Relying on the said piece of external aid of interpretation, the Hon'ble ITAT noted that it was not the intention of the Government to introduce the provision of paragraph 3A to Article 13 was to restrict source based taxation of 'shares' of companies resident in India and that the residence based taxation of financial instruments other than, such as derivatives and other forms of securities like compulsorily convertible debentures (CCDs) and optionally convertible debentures (OCDs) would continue to be governed by the provisions of the DTAA which existed prior to its amendment.

It is also noteworthy that, though the term derivative has not been defined in the IT Act or in the CA, 2013, the same has been defined in the provisions of Section 2(ac) of the SCRA to include:

1. A security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
2. a contract which derives its value from the prices, or index of prices, of underlying securities;
3. commodity derivatives; and
4. such other instruments as may be declared by the Central Government to be derivatives;

Thus, even without a reference to external aid of interpretation, the Hon'ble ITAT could have arrived at the same conclusion, by following the hierarchy of interpretation as contained in Article 3(2) of the DTAA.

Nature of Derivatives

The Hon'ble ITAT also observed that derivative contracts are essentially entered into by parties to mitigate the risks of price fluctuations of the underlying assets / instruments. Upon nature derivatives the Hon'ble ITAT expounded on the following key features:

1. That derivates are a financial contract different from the underlying asset
2. That the underlying asset can be anything and not only shares
3. That in order to trade in derivatives, the investor need not own the underlying asset
4. That the derivative contract being a separate financial instrument can be traded as it is without buying or selling the underlying asset

Thus, based on the nature of the derivatives as well, the Hon'ble ITAT held that derivatives cannot be equated to shares in a company.

Concluding remarks

The judgment by the Hon'ble Mumbai ITAT provides crucial clarity on the taxation of derivatives under the Indo-Mauritius DTAA. By distinguishing derivatives from shares, the ITAT has affirmed that derivatives, despite deriving their value from underlying assets like shares, are distinct financial instruments. This ensures that derivatives are not subject to the same taxation rules as shares, aligning with their inherent characteristics and providing relief to international investors engaged in derivative transactions.

Furthermore, the legal principle enunciated in the judgment can be appropriately invoked to support taxpayers in matters concerning the taxation of income arising from the sale of units of mutual funds, business trusts, venture capital funds, and investment funds – where analogous issues are encountered, akin to those observed in the taxation of income from derivatives.

Furthermore, the judgment underscores the importance of understanding the legislative intent behind treaty provisions and adhering to the principle of treaty override. By considering both domestic laws and external aids of interpretation, ITAT has demonstrated a comprehensive approach to resolving tax disputes. This decision not only supports a fair and predictable tax environment but also promotes cross-border investments, contributing to a more robust and transparent international tax framework.

[The authors are Senior Associate and Partner, respectively, in Direct Tax practice at Lakshmikumaran & Sridharan Attorneys]

Notifications & Circulars

- Section 54EC — IREDA bonds (5 year lock in) treated as 'long term specified asset'
- Section 10(23FE) — Eligibility window extended to 31 March 2030
- Rule 21AK amended to include OTC derivatives and recognise IFSC FPI units for Section 10(4E)
- PAN-AADHAR non-linking – No liability to deduct/collect at higher rates in certain circumstances
- CPC may re-process invalidated income tax returns filed up to 31 March 2024, and issue intimations by 31 March 2026

Section 54EC — IREDA bonds (5-year lock-in) treated as 'long-term specified asset'

Vide Notification No. 73 of 2025 dated 9 July 2025, the CBDT, invoking clause (ba) of the Explanation to Section 54EC of the Income-tax Act, 1961 ('**Act**'), has notified that bonds redeemable after five years and issued on or after the date of this notification by the Indian Renewable Energy Development Agency ('**IREDA**') qualify as 'long-term specified asset' for the purposes of Section 54EC of the Act.

IREDA must deploy the bond proceeds only in renewable projects that can service their debt from project revenues themselves, i.e., without relying on State Government support for repayment.

Under Section 54EC of the Act, long-term capital gains from land/building are exempt if you invest the gain (max INR 50 lakh per FY) in notified 'long-term specified asset' bonds within 6 months. The bonds carry a 5-year lock-in and an early transfer claw back of the exemption. IREDA's 5-year bonds now join the approved list, giving taxpayers another avenue to park gains while the Government channels that money into renewable projects.

Section 10(23FE) — Eligibility window extended to 31 March 2030

Vide Notifications No. 74 of 2025 to 113 of 2025 dated 11 July 2025, the CBDT has extended the eligibility window to claim benefits under Section 10(23FE) of the Act to 31 March 2030.

Section 10(23FE) exempts certain income (typically interest, dividends and long-term capital gains) earned by specified investors—like sovereign wealth funds, foreign pension funds, or any other class the Government notifies—when they invest in notified infrastructure/eligible entities in India and meet prescribed conditions (lock-in, no loans/borrowings, etc.).

Previously, the cut-off date for qualifying investments/payments under Section 10(23FE) was 31 March 2025. This amendment substitutes that terminal date with 31 March 2030, extending the eligibility window by five years.

Rule 21AK amended to include OTC derivatives and recognise IFSC FPI units for Section 10(4E)

Vide Notification G.S.R. 503(E) [No. 126/2025/F. NO. 370142/26/2025-TPL] dated 28 July 2025, the CBDT has introduced the Income-tax (Twentieth Amendment) Rules, 2025 to amend Rule 21AK of the Income Tax Rules, 1962.

Rule 21AK prescribes the conditions for claiming an exemption under Section 10(4E) of the Act for income of a non-resident from specified derivative transactions routed through an International Financial Services Centre ('**IFSC**'). In essence, the rule requires that the qualifying contract/instrument be entered into by the non-resident with an offshore banking unit ('OBU') in an IFSC holding IFSCA registration, and that the transaction is not entered into through or on behalf of the non-resident's permanent establishment in India.

The Notification amends Rule 21AK to (i) widen the scope to include exemption *qua* distribution of income on 'over-the-counter ('**OTC**') derivatives'; (ii) broaden the set of eligible counterparties to include a Foreign Portfolio Investor ('**FPI**') that is a unit of an IFSC alongside IFSCA-regulated offshore banking units; and (iii) define FPI by reference to a person registered under the SEBI (Foreign Portfolio Investors) Regulations, 2019 (made under the SEBI Act, 1992).

The amendment in Rule 21AK aligns it with the amendments made in Section 10(4E) *vide* Finance Act, 2025 by (i) explicitly covering distribution of income on OTC derivatives, and (ii) recognising FPIs being units of an IFSC as eligible counterparties. This broadens the availability of the Section 10(4E) exemption for qualifying non-resident transactions routed through IFSCs.

PAN-AADHAR non-linking – No liability to deduct/collect at higher rates in certain circumstances

Vide Circular No. 09 of 2025 dated 21 July 2025, the CBDT has partially modified and continued Circular No. 3/2023 (28 March 2023) and the interim relief of Circular No. 6/2024 (23 April 2024). While Rule 114AAA renders an unlinked PAN 'inoperative' with higher TDS/TCS under Section 206AA/206CC from 1 July 2023, numerous deductors/collectors received 'short-deduction/collection' intimations during statement processing under Section 200A/206CB because they had applied normal rates when their payees' PANs were inoperative.

To redress this grievance, the CBDT stipulates that no liability to deduct/collect at the higher rates under Section 206AA/206CC shall arise (a) where amounts were paid/credited between 1 April 2024 and 31 July 2025 and the PAN is made operative (*via* Aadhaar linkage) on or before 30 September 2025; and (b) where amounts are paid/credited on or after 1 August 2025 and the PAN is made operative within

two months from the end of the month of such payment/credit. In these situations, only the rates prescribed elsewhere in Chapters XVII-B/XVII-BB will apply.

Consequently, demands already raised for short-deduction/collection in the above fact patterns are unsustainable and must be ignored/withdrawn upon PAN activation within the prescribed windows. Deductors/collectors should secure evidence of PAN operability and, where necessary, file correction statements so that processing reflects the regular rates rather than the punitive higher rates.

CPC may re-process invalidated income tax returns filed up to 31 March 2024, and issue intimations by 31 March 2026

Section 143(1) of the Act governs the initial, computer-assisted processing of a return filed under Section 139 (or in response to Section 142(1)). At this stage, the system computes total income after making limited, mechanical adjustments; determines the tax, interest and fee; adjusts prepaid taxes/TDS/TCS; and issues an 'intimation' showing any demand or refund. The second proviso to Section 143(1) states that an intimation cannot be sent after nine months from the end of the financial year in which the return was filed.

Vide Circular No. 10 of 2025 dated 28 July 2025, the CBDT has relaxed the time bar in the second proviso to Section 143(1) of the Act to allow CPC to validate and process electronically filed returns that were wrongly treated as 'invalid' due to technical reasons. The relaxation covers returns filed up to 31 March 2024 and directs that Section 143(1) intimations be issued by 31 March 2026. Refunds (with Section 244A interest, as applicable) will follow on processing. However, no refund is to be released where the PAN remains inoperative for want of PAN–Aadhaar linkage, consistent with CBDT Circular No. 03 of 2023.

Ratio Decidendi

- Strategic oversight fees taxable in India: Supreme Court upholds existence of a fixed place PE – *Supreme Court*
- Corporate guarantee fee paid by an Indian subsidiary to its Korean parent is taxable only in Korea under Article 22 ('Other income') of the India-Korea DTAA – *ITAT Bengaluru*
- Fees received from Indian airlines for the use of software are not 'royalty' – Indian tax not attracted in absence of a permanent establishment – *ITAT New Delhi*
- Buyback of shares – Section 56(2)(viia) is inapplicable as a company's own shares do not constitute 'property' in its hands – *ITAT Mumbai*
- IBC moratorium bars income tax assessment proceedings as well – *Bombay High Court*
- Provision for disputed liability which is pending adjudication does not crystallise into taxable income under Section 41(1) – *Madras High Court*
- Estate of a deceased assessed through multiple executors is to be taxed at the slab rates applicable to an individual – *ITAT Mumbai*

Strategic-oversight fees taxable in India: Supreme Court upholds existence of a fixed-place PE

The Assessee, a company incorporated and tax-resident in the UAE, entered into two twenty-year Strategic Oversight Services Agreements ('**SOSAs**') with the owners of Hyatt-branded hotels in Delhi and Mumbai. Under these contracts, the Assessee posted expatriate personnel to on-site 'oversight offices' inside the hotels and was empowered to appoint and supervise the general manager and other senior staff, approve annual budgets, set pricing and marketing strategy, enforce brand-standard manuals and control key bank accounts. In consideration, it received a fee linked to each hotel's gross operating revenue. The Indian tax authorities treated the arrangement as giving rise to a fixed-place permanent establishment ('**PE**') in India under Article 5(1) of India-UAE DTAA and assessed the corresponding income as business income under Article 7 of the India–UAE DTAA.

The Assessee contended that the Indian hotels were independently owned and operated; it merely provided high-level advisory services and did not maintain any premises 'at its disposal'. Its employees' visits were sporadic and fell short of the nine-month threshold for a service-PE under Article 5(2)(i). In the absence of any PE, the disputed fees constituted ordinary business profits taxable only in the UAE. The Assessee further argued that, even if a PE were to be assumed, no profit could be attributed to it because the group as a whole had booked global losses for the relevant years.

The Department contended that the SOSAs conferred pervasive and enforceable control over the hotels' day-to-day operations. The Assessee could hire and fire key personnel, dictate procurement policies, veto budgets, impose brand standards and station its own staff in dedicated office space within the hotel premises. This level of authority, exercised on a continuous basis over many years, placed the hotels themselves 'at the disposal' of the Assessee and satisfied the stability, productivity and business-disposal tests for a fixed-place PE. Once a PE existed, the source State (India) was entitled to attribute profit to it irrespective of the parent company's global losses.

The Bench affirmed the decision of the Delhi High Court, holding that a fixed-place PE requires (i) the foreign enterprise's right of disposal over premises in the source country and (ii) the conduct of core business functions from that location. On the facts, the hotels satisfied both limbs: The Assessee's contractual

powers went far beyond episodic consultancy and amounted to 'pervasive operational control' over staffing, finance and brand implementation. The Court emphasised that a 'place of business' under Article 5(1) can exist within a third-party's premises if the foreign enterprise habitually conducts business there; physical ownership or a formal lease is not necessary. Relying on *Formula One* and distinguishing *e-Funds*, it concluded that the oversight offices and, in substance, the hotel premises constituted a fixed-place PE. It also rejected the argument that worldwide losses bar attribution, reiterating that PE profits must be computed on an arm's-length basis as if the PE were an independent enterprise.

The Court thus concluded that the Assessee maintained a fixed-place PE in India under Article 5(1) of the India–UAE DTAA. The strategic-oversight fees were therefore taxable in India as business profits attributable to that PE. Global losses of the UAE parent did not erase the Indian tax base.

[*Hyatt International Southwest Asia Ltd.* v. *ADIT* – Decision dated 24 July 2025 in Civil Appeal No. 9277 of 2024, Supreme Court]

Corporate guarantee fee paid by an Indian subsidiary to its Korean parent is taxable only in Korea under Article 22 ('Other income') of the India-Korea DTAA

The Assessee, a resident of South Korea, furnished a corporate guarantee that enabled its wholly-owned Indian subsidiary, Kia India Pvt Ltd, to obtain bank finance. For this support the subsidiary remitted a guarantee fee of INR 9.74 crore to its parent. The Assessee contended that the fee received must be classified as 'other income' within Article 22 of the India–Korea DTAA which allocates sole taxing rights to the state of residence, i.e. Korea. This is because it is not covered by other articles (business profits, interest, FTS, etc.) of the DTAA. The Department contended that the guarantee facilitated borrowing used in India, so the fee had an Indian source and was deemed to accrue or arise in India under Section 5(2) and 9(1)(i) of the Act. Article 22 of the DTAA did not override domestic source-based taxation in such circumstances.

The Tribunal noted the Income Tax Officer's own finding that the receipt was neither business profit nor interest, leaving it to be tested only under Article 22 of the DTAA. Article 22(1) of the India–Korea DTAA provides that *'items of income of a resident of a*

Contracting State, wherever arising, shall be ***taxable only*** *in that State if not dealt with in the foregoing Articles.'* The phrase *'taxable only'* confers exclusive taxing rights to the state of residence. The Tribunal contrasted this wording with the India–UK DTAA considered in *Johnson Matthey* (which uses the language *'may be taxed'*) and held the Delhi High Court ratio inapposite.

Further, paragraph 4 of the OECD Commentary on Article 21 (the model counterpart of Article 22) states that a state of source loses the right to tax such income once the clause is applied. Tribunals have consistently followed this interpretation in *Capgemini SA* (India-France), *Draegerwerk AG* (India-Germany) and *Daechang Seat Co.* (India-Korea), all of which were cited and relied upon. Following *Daechang Seat*, the Bench held that an isolated, shareholder-centric guarantee is neither a technical/managerial service (to invoke FTS) nor a core business operation (to attract Article 7). Hence, it is rightly covered under Article 22 of the DTAA.

The Bench also clarified that even if the guaranteed fee received could be said to 'arise' in India under Section 5(2) or Section 9(1)(i) of the Act, Section 90(2) mandates that treaty provisions prevail where more beneficial to the taxpayer.

[*Kia Corporation* v. *ACIT* – Order dated 30 June 2025 in IT(IT)A No. 644/Bang/2025, Bangalore – Tribunal]

Fees received from Indian airlines for the use of software are not 'royalty' – Indian tax not attracted in absence of a permanent establishment

The Assessee, a Spanish resident, provides its cloud-based inventory-management and host-reservation platform (the Altea suite) to Indian airline carriers. For AY 2022-23, it earned booking and hosting-fees from those airlines. The Income Tax Officer treated the receipts as 'royalty' under Section 9(1)(vi) of the Act and Article 13 of the India–Spain tax treaty.

The Assessee contended that Indian airlines simply log in to its platform hosted on servers outside India and get no ownership or license rights in the software. Therefore, the fees are its regular business income, and the Department can tax them only if the Assessee has a permanent establishment ('**PE**') in India. The Department argued that the airlines 'use' or 'right to use' the software embedded in the Altea suite, attracting Explanation 4 to Section 9(1)(vi). Alternatively, the payments made are for 'processes' and hence royalty is attracted under both domestic law and Article 13 of the DTAA.

The Tribunal noted that the Supreme Court in *Engineering Analysis* treats a payment as royalty **only** when the payer acquires copyright or an equivalent proprietary interest. Mere

remote access to software-enabled services does not suffice. Here the entire infrastructure, including core code, databases and servers, remains outside India, and airlines obtain no ability to commercially exploit or modify the program. The Altea platform therefore constitutes a 'standard facility', its fees being consideration for services rendered abroad. Because neither the Spanish parent nor its Indian liaison office performed core revenue-generating functions in India, the Revenue failed to establish a fixed-place or dependent-agent PE. The receipts, though business profits under Article 7, were exempt from Indian tax absent a PE.

[*Amadeus IT Group SA* v. *DCIT* – Order dated 4 July 2025 in ITA No. 1494/Del/2025, Delhi-Tribunal]

Buyback of shares – Section 56(2)(viia) is inapplicable as a company's own shares do not constitute 'property' in its hands

The Assessee bought back 1,90,097 of its own unlisted equity shares for INR 19,00,970 (at the rate of INR 10 per share). The Assessing Officer, applying Rule 11UA, computed the fair-market value (FMV) at INR 1,836 per share and added the differential amount of INR 34.71 crore to tax under Section 56(2)(viia) of the Income Tax Act.

The Assessee submitted that a buy-back is governed exclusively by Sections 46A and 115QA of the Act. Once a company acquires its own shares, the shares are statutorily extinguished and never become a capital asset or 'property' in its hands. Hence, Section 52(2)(viia), being an anti-abuse provision aimed at undervalued transfers *between distinct entities*, does not apply. The Department, however, maintained that the Assessee had in substance received shares for an inadequate consideration and the differential amount ought to be taxed under Section 56(2)(viia) of the Act, notwithstanding the separate levy under Section 115QA.

Relying on the Mumbai Bench ruling in *Vora Financial Services P. Ltd.* and *Sudhir Menon HUF*, the Tribunal held that the provision targets transfers where the recipient comes to **own** the shares as a capital asset. It does not extend to a company purchasing its own shares, which are statutorily cancelled on buy-back. The legislative intent, reflected in the Finance-Bill Memoranda for 1999 (with respect to Sections 46A and 2(22)(iv)) and 2010 (with respect to Section 56(2)(viia)), was to deter undervalued transfers of unlisted shares between distinct entities, not to super-tax a buy-back already subjected to distributed-income levy under Section 115QA. Since the twin conditions of 'receipt' and 'property' were unsatisfied, the FMV differential could not

be assessed to tax under Section 56(2)(viia) of the Act.

Section 56(2)(viia) of the Act is confined to cases where a firm or closely-held company acquires, for inadequate consideration, shares of another company that thereafter remain its property. It cannot be invoked where the Assessee buys back and extinguishes its own shares. The addition of INR 34.71 crore was therefore deleted.

[*Lupin Investments Pvt. Ltd.* v. *DCIT* – Order dated 9 July 2025 in ITA No. 4635/Mum/2024, Mumbai - Tribunal]

IBC moratorium bars income-tax assessment proceedings as well

The Petitioner, which was undergoing corporate-insolvency resolution ('**CIRP**') since 6 May 2022, received a notice under Section 143(2) of the Income Tax Act and a draft assessment order for AY 2019-20 during the moratorium period declared under Section 14(1)(a) of the Insolvency and Bankruptcy Code, 2016 ('**IBC**'). Acting through its Resolution Professional, the Petitioner invoked writ jurisdiction to quash the assessment steps as *non-est*.

The Petitioner contended that Section 14(1)(a) of IBC creates an all-embracing moratorium against 'any proceeding' for or against the corporate debtor. Therefore, the impugned notices/draft assessment order lack jurisdiction *ab initio*. Relying on the Supreme Court's judgment in *ABG Shipyard Ltd.* (2023) 1 SCC 472, the Department argued that Section 14 of IBC merely suspends coercive recovery and not assessment. Hence, continuing the enquiry would cause no prejudice to the Petitioner because any demand would still await CIRP outcome.

Interpreting the text of Section 14(1)(a) of IBC, the Division Bench of the Bombay High Court held that the moratorium is designed to preserve the debtor's estate until resolution. Every proceeding intrinsically linked to the eventual extraction of value, including assessment, therefore stands suspended. An income-tax assessment is not a neutral fact-finding exercise, it is the statutory precursor to a binding tax liability that may thereafter be enforced. The Court found the Revenue's reliance on *ABG Shipyard* misplaced due to following reason:

Firstly, the Court noted that the said decision was not passed under the IT Act but under the Customs Act, 1962. Secondly, the Court found the Supreme Court in *ABG Shipyard* relied on another decision of the Hon'ble Supreme Court in the case of *S V. Kandaskar* v. *V. N. Deshpande* [(1972) 1 SCC 438] to come to the conclusion that the Customs Department could initiate assessment or reassessment of duties and other levies but could not initiate recovery in violation of Section 14 or 33 (5) of the IBC,

2016. However, the Court found that the decision in the case of *V. N. Deshpande* (*supra*) was considered by an earlier Coordinate Bench of the Hon'ble Supreme Court in the case of *P Mohanraj & Others* v. *Shah Brothers Ispat* [(2021) 6 SCC 258]. In that decision also, the decision in *V. N. Deshpande's* (*supra*) case was pressed into service but was distinguished by the Hon'ble Supreme Court. The Supreme Court in *P Mohanraj* distinguished *V.N. Deshpande* on the ground that the term 'proceeding' as used in Section 446 of the Companies Act, 1956 which was subject matter of dispute was used in limited sense due to following reason: The winding-up court under Section 446(2) is to take up all matters which the company court itself can conveniently dispose of rather than exposing a company which is under winding up to expensive litigation in other courts. This being the object of Section 446(2), the expression 'proceeding' was given a limited meaning as it is obvious that a company court cannot dispose of an assessment proceeding in income tax or a criminal proceeding. However, such limited meaning of the term 'proceeding' cannot be applied for IBC. The Bombay High Court further observed that without noticing the decision passed by the Hon'ble Supreme Court in *P. Mohanraj & Others* (*supra*), the Hon'ble Supreme Court, in *ABG Shipyard* (*supra*), had relied upon the case of *V. N. Deshpande* (*supra*) which was not correct.

Thus, the Court held that while the moratorium is operative, the Income-tax Department lacks jurisdiction to issue or pursue assessment notices or draft orders. Such actions are *void ab initio*.

[*Smaaash Entertainment (P) Ltd.* v. *ACIT* – Order dated 18 July 2025 in W.P. No. 3273 of 2024, Bombay High Court]

Provision for disputed liability which is pending adjudication does not crystallise into taxable income under Section 41(1)

The Income Tax Officer treated INR 15.04 crore standing in the books of accounts of the Respondent-Assessee as a provision against claims raised as a 'cessation of liability' under Section 41(1) of the Act. The Department contended that the provision had remained unadjusted for more than three years, with no write-off or payment. Hence, the liability had effectively ceased and the amount had become the Respondent's profit under Section 41(1). The Respondent-Assessee submitted that liability was actively disputed in a civil suit filed against SICAL and until the suit is decided, no remission or cessation can be inferred.

The Bench held that Section 41(1) is attracted only when a trading liability is remitted or has ceased in law or in fact. A liability under contest in judicial proceedings remains in

suspense and cannot be presumed to have ceased. Since the Respondent-Assessee's suit against SICAL for recovery of counter-dues was pending, the mutual claims had not crystallised.

The Court thus held that where the very existence or quantum of a liability is sub-judice, there can be no 'remission or cessation' within the meaning of Section 41(1) and any book provision maintained, pending litigation, cannot be taxed as income.

[*CIT* v. *Anand Transport* – Order dated 3 July 2205 in TCA No. 944 of 2009, Madras High Court]

Estate of a deceased assessed through multiple executors is to be taxed at the slab rates applicable to an individual

The estate of the Assessee was administered by three executors under a probated will. The return of income was filed in the status 'Association of Persons ('AOP') (Estate of Deceased)' but tax was self-computed at individual slab rates. In processing the return u/s 143(1)(a) of the Act, the CPC taxed the total income at the maximum-marginal rate and also levied surcharge, treating the estate as an ordinary AOP.

The Assessee submitted that Section 168 of the Act, consistent with the interpretation in *CIT* v. *G.B.J. Seth* [133 ITR 192 (MP)], treats the executor(s) as a statutory representative of the deceased and the assessment is, in substance, that of the deceased individual. Even where there is more than one executor, the 'AOP' label is merely procedural, and the income must still be charged at the slab rates applicable to an individual. Thus, the CPC had exceeded its limited powers under Section 143(1)(a) of the Act by re-computing tax at the maximum-marginal rate and by imposing surcharge even when the total income was below INR 50 lakh. The Revenue contended that the presence of multiple executors justified taxation of the estate as an AOP at the higher rate.

The Tribunal held that under Section 168 of the Act, the income of a deceased person's estate, even where is administered by multiple executors, is chargeable at the slab rates applicable to an individual. The 'AOP' status assigned in the return is purely statistical and does not permit departure from individual slab rates. Further, an adjustment to the rate of tax lies beyond the scope of Section 143(1)(a) of the Act, which is confined to the specific mismatches listed in clauses (i)-(vi) of the Section.

[*Estate of Satibai Tahilram Chellaram* v. *ITO* – Order dated 7 July 2025 in ITA No. 4757/Mum/2024, Mumbai-Tribunal]

NEW DELHI
7th Floor, Tower E, World Trade Centre, Nauroji Nagar, Delhi – 110029
Phone : +91-11-41299800, +91-11-46063300
---
5 Link Road, Jangpura Extension, Opp. Jangpura Metro Station, New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : Lsdel@lakshmisri.com , lprdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing, Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-30567800/30567801
E-mail : lsbom@lakshmisri.com

CHENNAI
Door No.27, Tank Bund Road, Nungambakkam, Chennai 600034.
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center, Brigade Gateway Campus, 26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Phone : +91-80-49331800 Fax:+91-80-49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road, Opp. Methodist Church, Nampally, Hyderabad - 500 001
Phone : +91-40-2323 4924 E-mail :lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII, Nehru Bridge Corner, Ashram Road, Ahmedabad - 380 009
Phone : +91-79-4001 4500 E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road, Camp, Pune-411 001.
Phone : +91-20-6680 1900 E-mail : lspune@lakshmisri.com

KOLKATA
6A, Middleton Street, Chhabildas Towers, 7th Floor, Kolkata – 700 071
Phone : +91 (33) 4005 5570 E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59, Sector 26, Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURUGRAM
OS2 & OS3, 5th floor, Corporate Office Tower, Ambience Island, Sector 25-A,
Gurugram-122001
phone: +91-0124 - 477 1300 Email: lsgurgaon@lakshmisri.com

PRAYAGRAJ (ALLAHABAD)
3/1A/3, (opposite Auto Sales), Colvin Road, (Lohia Marg), Allahabad -211001 (U.P.)
Phone : +91-532-2421037, 2420359
E-mail : lsallahabad@lakshmisri.com

KOCHI
First floor, PDR Bhavan, Palliyil Lane, Foreshore Road, Ernakulam Kochi-682016
Phone : +91-484 4869018; 4867852
E-mail : lskochi@laskhmisri.com

JAIPUR
2nd Floor (Front side), Unique Destination, Tonk Road, Near Laxmi Mandir Cinema Crossing, Jaipur - 302 015
Phone : +91-141-456 1200 E-mail : lsjaipur@lakshmisri.com

NAGPUR
First Floor, HRM Design Space, 90-A, Next to Ram Mandir, Ramnagar,
Nagpur - 440033
Phone: +91-712-2959038/2959048 E-mail : lsnagpur@lakshmisri.com

Lakshmikumaran Sridharan attorneys
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