Direct Tax

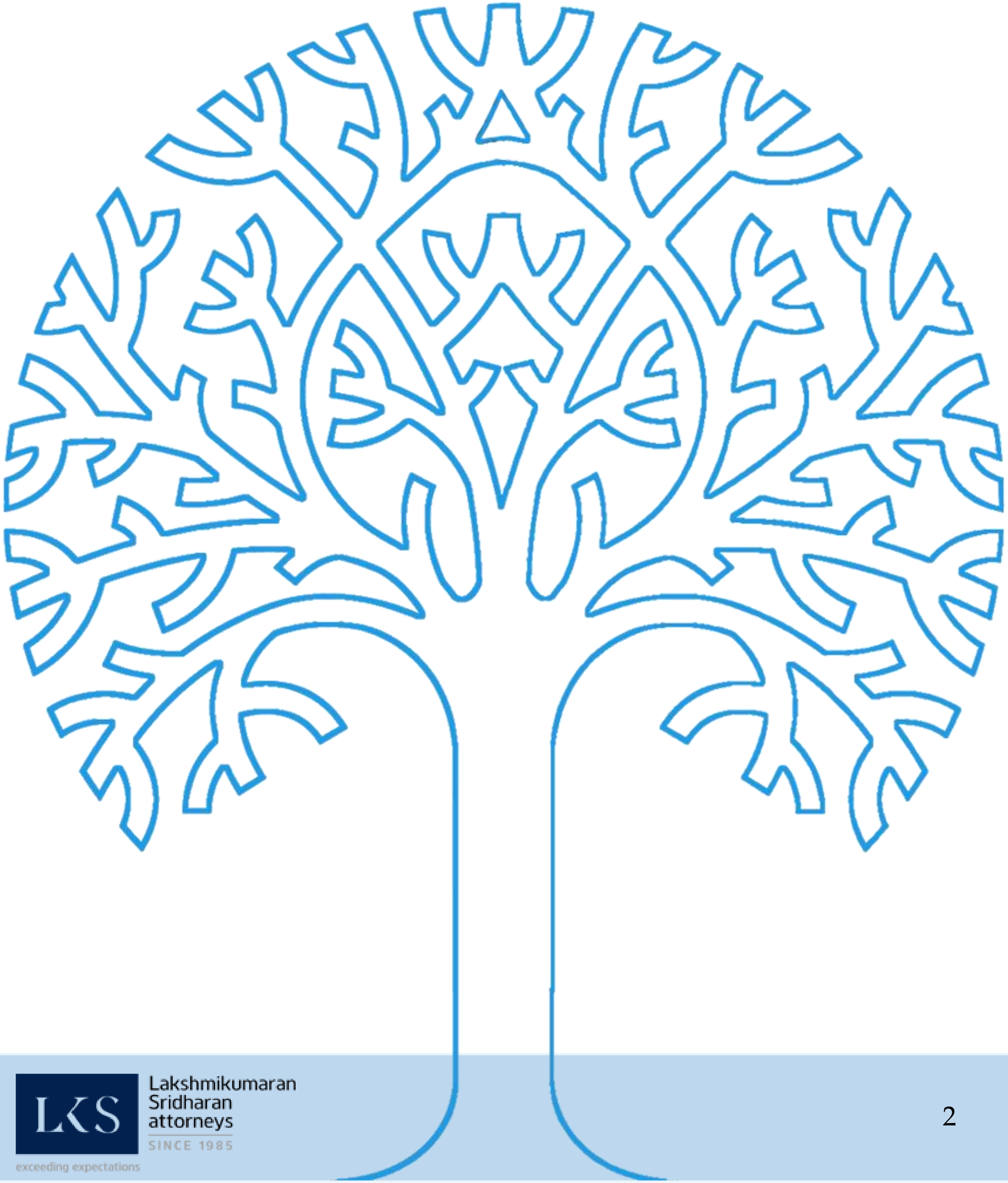
amicus

June 2025 / Issue –129

Lakshmikumaran Sridharan attorneys
SINCE 1985
exceeding expectations

An e-newsletter from
Lakshmikumaran & Sridharan, India

Table of Contents



Article

Navigating fair value adjustments in income tax computations

By **Bharathi Krishnaprasad, Venkat Ramanan and Bhavana Kulluru**

The article in this issue of Direct Tax Amicus examines the implications of fair value accounting advocated by the Accounting Standards issued by the ICAI. It delves into the question as to whether the computation of income for the purposes of the Income Tax Act can be made with reference to the fair value accounting carried out in books of accounts. Considering various examples, the authors also explore the potential challenges and the supporting arguments in this regard. According to them, with evolving Accounting Standards and incongruence persisting between the tax laws and such standards, doubts and disputes surrounding taxability and claim of deductions are bound to arise. Observing that deliberations on this front would dilute if tax laws explicitly recognise or deviate from the treatment adopted in books of accounts, the authors note that till such clarity expressly emerges, it would not be incorrect for the assessees to mirror an accounting treatment for tax computation as well, provided such an act is not expressly prohibited under the IT Act.

Navigating fair value adjustments in income tax computations

By Bharathi Krishnaprasad, Venkat Ramanan and Bhavana Kulluru.

It is codified in Section 145(1) of the Income-tax Act, 1961 (‘**IT Act**’), that income under the head ‘Profits or Gains from Business or Profession’ (‘**PGBP**’) and ‘Income from Other Sources’ (‘**IOS**’) is to be computed, in accordance with cash or mercantile system of accounting regularly employed by an Assessee. In most cases, Taxpayers follow the accrual basis of accounting to determine profit or loss in respect of every accounting year. The accrual basis of accounting recognises income and expenses as they are incurred, as opposed to actual cash inflow or outflow taking place.

Key considerations in income computation

While recognition is accorded to the method of accounting regularly followed by an Assessee in computing taxable income under the aforementioned heads, the following additional aspects must also be complied with by the taxpayer:

a. The profits so determined should be in accordance with the provisions of Income Computation and Disclosure Standards (‘**ICDS**’) notified by the Central Government in exercise of powers conferred under Section 145(2).

b. The taxable profits would additionally be subject to the specific provisions of the IT Act that restrict the claim of any deductions, notwithstanding the fact that it may otherwise constitute an expense under the IT Act. For instance, a provision made in the books of accounts towards gratuity liability of employees, even if based on actuarial valuation, would not be allowed as a tax deduction unless the amount of gratuity is actually paid, by virtue of Section 40A(9) of the IT Act.

As far as ICDS is concerned, these are specific standards formulated for the purpose of computing income under the head PGBP and IOS. Where conflicts arise between ICDS and the IT Act, it is clarified in the preamble of ICDS that the provisions of the IT Act shall prevail. A fundamental question that merits consideration is where (i) no express treatment is provided in ICDS and (ii) no express bar is contained in IT Act, would treatment permitted otherwise under the Accounting Standards issued by the Institute of Chartered Accountants of India (’**ICAI**’), and regularly followed by an Assessee in preparing its books of accounts, be accepted as a basis for claim of deduction under the IT Act.

Harmonizing accounting practices with tax law: A judicial perspective

It would, at this juncture, be relevant to note that judicial precedents in the past have upheld the validity of following the principles enunciated under the Accounting Standards to compute income for the purposes of the IT Act. In the judgment of *Woodward Governor India Pvt. Ltd.*[1], the Hon'ble Supreme Court recognized that genuine losses arising from the ordinary course of business, even if arising from accounting adjustments, should be allowed as deductions, if there is no specific provision in the tax law barring such claim. The Court emphasized that, in the absence of a contrary tax provision, accounting principles can be relied upon to determine the true income. The ratio of this judgment was followed by various High Courts and Tribunals.

Although these precedents were rendered prior to ICDS being made an embedded part of Legislature, the principle laid down in these decisions will still be valid for the reason that, introduction of ICDS has not in any way altered the parent provision of sub-section (1) of Section 145, which mandates the taxpayer to continue to compute income under the head PGBP by following the regularly employed method of accounting.

Fair Value Accounting: Implications on income tax computation

Having stated thus, we now proceed to examine the implications of fair value accounting advocated by the Accounting Standards and whether the computation of income for the purposes of IT Act can be made with reference to the fair value accounting carried out in books of accounts.

Fair value accounting is a concept recognised in the Accounting Standards issued by the ICAI. This essentially involves recognising an asset or a liability at their respective realisable values as on the date of drawing up the financial statements, as opposed to recognising the same at their historical costs or future values.

Illustrative example in the context of Fixed Assets:

An example for historical cost would be a scenario where a fixed asset is purchased at a historical cost of INR 10 crores and

[1] *Commissioner of Income-tax, Delhi* v. *Woodward Governor India (P.) Ltd.* – (2009) 179 Taxman 326 (SC)

has a depreciated cost of INR 8 crores as on the balance sheet date, is compared with its realisable value. Assuming such realisable value is INR 7 crores, the asset would be recognised in the books of account at INR 7 crores and the difference is accounted for as a loss in value, debited to profit and loss account. From an income tax perspective, this loss in value would not be allowable as a deduction for the reason that manner of computing depreciation and written down value are clearly enshrined in the IT Act itself, and no departure therein would be permissible.

Illustrative example in the context of Revenue Recognition:

Another example is a scenario where for a revenue transaction of sale, the settlement is agreed to be received in 4 equal annual instalments. Assume that the value of the revenue transaction is INR 10 crores, with INR 2.5 crores being eligible to be received annually. In this case, absent a separate interest component to compensate for the loss in time value of money, it is considered that the agreed upon consideration of INR 10 crores embeds the interest component and hence, the transaction is to be recorded not at INR 10 crores but at the value that excludes the interest component, if such interest component is significant in the transaction. Such recognition is permitted in Ind AS 115 read with Ind AS 109 which deals with recognition of revenue and accounting for financial instruments respectively. Assuming in the present case, the cash selling price is INR 7 crores, the revenue is recognised at INR 7 crores. The balance is recognised as interest income over the tenor of the payment duration.

The question that arises is whether for the purposes of computation of income under IT Act, should one recognise the revenue at INR 10 crores or INR 7 crores as is permitted under the Ind AS.

The ICDS notified under the IT Act contains a separate standard to deal with revenue recognition in ICDS IV. The said standard does not specifically contain a guideline similar to that contained in Ind AS 115/109. However, the standard does recognise that interest income is to be recognised on accrual and on time basis. Further, it is also relevant to note that the IT Act does not expressly bar dissecting a transaction to reflect their actual nature and accordingly offer income for tax purposes. In a transaction where there is a significant time period involved in cash settlement and therefore, a natural inference of significant finance costs being embedded therein, bifurcation of the transaction into two parts and recognising the interest element separately is certainly reasonable.

Considering that there is no express bar and considering that the bifurcation is only a mechanism to reflect the true nature of the transaction, the recognition of revenue adopted for Ind AS must equally apply for the purposes of computing income under the IT Act as well.

Impact of deferred payment terms on existing contracts:

A modification to the example discussed above would be a scenario where the transaction of sale is agreed at INR 10 crores, however subsequently, the parties have agreed for deferred payment terms to settle the transaction at the same value of INR 10 crores over equal instalments across 4 years. In such a scenario, recognition of receivable is once again to be carried out on a fair value basis in terms of Ind AS 115 read with 109. This is a scenario akin to:

a. A discount granted on the sale value earlier recorded.

b. Subsequent recovery of the agreed upon value along with interest.

In such a scenario, while recording the transaction at fair value, the difference is recognised as a loss in the financial statements. The question that arises here is whether such a loss can be claimed as a deduction for computing income under the IT Act.

The loss in the present transaction arises on account of the modification of the contractual terms between parties as regards payment of consideration. The Authors believe that it may be possible to contend, placing reliance on the principles enunciated in judicial precedents discussed above and in the absence of a specific provision either in IT Act or under ICDS barring claim of deduction, that adjustments arising on application of Ind AS should be allowable as a deduction. The loss recognised in books, it can be contended, is not an estimated future loss but a recognized reduction in the value of an existing asset due to a change in payment terms.

Potential challenges and supporting arguments

It is certainly possible that the Revenue may deny claim of the loss for the reason that the said loss is notional and therefore, cannot be eligible for deduction. However, as already stated, the modification in terms of payment has in effect resulted in (i) waiver of a portion of the principal receivable, which is under law allowable as claim for bad debts and (ii) compensation in the form of interest for the finally agreed upon principal which will be offered to tax on par with payment terms. Further, the fact that such treatment is mandated under the Accounting Standards, under strength of which deduction can be claimed, such a principle being recognised and upheld by the judiciary. At this point it is pertinent to note that like in the case of fixed assets, Ind AS for the first time has introduced the concept of depreciation in the context of receivables so as to reflect their fair value. Though in cases like these, there is indeed a loss suffered by the companies, until the introduction of Ind AS, companies did not recognize the same in the books; with the implementation of Ind AS, recognition for such loss is being made by the companies. Further, the Supreme Court in the decision of *Badridas Daga* v. *CIT*[2] held that while computing profits and gains from a business or profession, an assessee shall always be allowed a deduction in respect of incidental losses that are directly emanating from the carrying on of the business. This school of thought will be even more relevant in the present case; the reason being, trade receivables are directly linked to the core activities of any business and any loss arising on such receivables shall also be treated as a loss under the charging section of PGBP i.e., Section 28.

Conclusion: Bridging the gap between accounting and tax laws

To conclude, with evolving Accounting Standards and incongruence persisting between the tax laws and such standards, doubts and disputes surrounding taxability and claim of deductions are bound to arise. Deliberations on this front would dilute if tax laws explicitly recognise or deviate from the treatment adopted in books of accounts. Till such clarity expressly emerges, it would not be incorrect for Assessees to mirror an accounting treatment for tax computation as well, provided such an act is not expressly prohibited under the IT Act.

[The first two authors are Associate Directors while the third author is an Associate in Direct Tax practice at Lakshmikumaran & Sridharan Attorneys, Chennai]

[2] *Badridas Daga* v. *Commissioner of Income-tax* – (1958) 34 ITR 10 (SC)

Notifications & Circulars

- Due date for furnishing Return of Income for AY 2025-26 extended
- ITR Form 6 substituted – Highlights of changes
- ITR Form 7 substituted – Highlights of changes
- Zero Coupon Bonds notified
- Form ITR-U substituted

Due date for furnishing Return of Income for AY 2025-26 extended

Section 139(1) of the Income-tax Act, 1961 ('**IT Act**') provides that every person being a company or firm or a person other than a company or firm, if his total income exceeds the maximum amount of income which is not chargeable to tax during the previous year, shall on or before the due date, furnish return of income in the previous year.

Explanation 1 to Section 139(1) provides for the 'due date' as follows:

Clause	Applicability	Due Date
(a)	Where an Assessee (other than mentioned in (aa)) is a company or a person or a partner of a firm whose accounts are required to be audited	31 October 2025
(aa)	An Assessee including partners of the firm or the spouse of such a partner, who is required to furnish a report referred to in Section 92E of the IT Act	30 November 2025
(b)	A person other than a company referred to in first proviso to Section 139(1) – (applicable only up to AY 2003-04)	31 October
(c)	Any other Assessee	31 July 2025

Vide Circular No. 06/2025 dated 27 May 2025, the due date for Assessee's covered under clause (c) Explanation 1 to Section 139(1) of the IT Act to furnish his/her Return of Income has been extended from 31 July 2025 to 15 September 2025.

ITR Form 6 substituted – Highlights of changes

Vide Notification No.44/2025 dated 6 May 2025, ITR Form 6 has been substituted to incorporate the amendments brought out by the Finance (No.2) Act, 2024 and Finance Act, 2025. Form ITR-6 is used by companies other than those claiming exemption under Section 11 for filing their Return of Income (ROI) for the relevant Assessment Years (AY). The following key changes are made to Form ITR 6:

1. Necessary modifications to facilitate disclosure for assessee's being covered under the newly inserted Section 44BBC.
2. Changes to reflect the amended scheme of taxation of capital gains.
3. Amendments to reflect change in buyback taxation, consequent to abolish of Section 115QA.
4. Requirement to additional information in respect of loans taken for claim of deduction qua interest under the head income from house property.

5. Insertion of new field in TDS to enter section numbers, to facilitate reconciliation with 26AS.

ITR Form 7 substituted – Highlights of changes

In order to incorporate the amendments made by Finance (No.2) Act, 2024 and Finance Act, 2025, the following changes are included in ITR Form 7 *vide* Notification No. 46/2025 dated 9 May 2025. Form 7 is used by persons including companies required to furnish return under Section 139(4A)/(4B)/(4C)/(4D).

1. Changes to reflect the amended scheme of taxation of capital gains.
2. Amendments to reflect change in buyback taxation, consequent to abolish of Section 115QA.
3. Requirement to additional information in respect of loans taken for claim of deduction *qua* interest under the head income from house property.
4. Insertion of new field in TDS to enter section numbers, to facilitate reconciliation with 26AS.

Zero Coupon Bonds notified

Section 2(48) of the IT Act defines Zero Coupon Bond. Section 2(48)(c) empowers the Central Government to notify certain bonds as Zero Coupon Bond for the purpose of this section. In the exercise of such power, the Central Government has notified the following bonds as Zero Coupon Bond with certain mandatory features, *vide* Notification No. 48/2025 dated 14 May 2025 and Notification No. 52/2025 dated 30 May 2025:

SN	Particulars	Bond with features	Bond with features
A	Name of the bond	Ten-Year Zero-Coupon Bond of *Indian Railway Finance Corporation Ltd*	Ten-Year Zero-Coupon Bond of *REC (Rural Electrification Corporation) Ltd*
B	Term	10 years	10 years 6 months
C	Time period within which it should be issued	on or before the 31 March 2027	on or before the 31 March 2027
D	The amount to be paid upon maturity or redemption	INR 10,000 crores	INR 5,000 crores
E	Discount on bond	INR 4916.51 crores	INR 2,200 crores
F	Number of Bonds to be issued	10 lakhs	5 lakhs

Form ITR-U substituted

Vide Finance Act, 2025, Section 139(8A) has been amended to extend the time limit for filing an updated return from 24 months to 48 months from the end of the relevant assessment year. This amendment was made effective from 1 April 2025. Consequential amendment has been made under Section 140B with respect to tax payable on filing such updated return,

Vide Notification No. 49/2025 dated 19 May 2025, the Central Board of Direct Taxes has amended the Form ITR-U (form to file the updated return) to incorporate the aforementioned amendments.

Ratio Decidendi

- Income from other sources – Section 56(2)(x) applies to any immovable property including agricultural land, from buyer's perspective, irrespective of its classification as a 'capital asset' under Section 2(14) for the seller – *ITAT Ahmedabad*
- Deductions can be claimed under Section 80-HHC and 80-IA conjointly, provided the aggregate deductions do not exceed the gross total income – *Larger Bench of Supreme Court*
- Short-term capital loss on which STT was paid can be set off against short-term capital gain on which STT was not paid – *ITAT Mumbai*
- Delay in share sale being 'depravation' of capital, escrow a/c interest is non-taxable – *ITAT Mumbai*
- Sales tax subsidy claim disallowed in search assessment sans declaration in original or Section 153A return – *ITAT New Delhi*

Income from other sources – Section 56(2)(x) applies to any immovable property including agricultural land, from buyer's perspective, irrespective of its classification as a 'capital asset' under Section 2(14) for the seller

The issue involved in this case refers to the applicability of Section 56(2)(x) of the Income Tax Act, 1961 ('**IT Act**'), in case of the purchase of agricultural land at a value lower than its stamp duty value and the mandatory referral to the Departmental Valuation Officer ('**DVO'**) when the property's stamp duty value is disputed.

The assessee filed an income tax return declaring loss for the Assessment Year ('**AY'**) 2018-19. Subsequently, the case was selected for 'limited scrutiny' through CASS to examine whether the purchase value of property was less than its Stamp Duty Value (SDV) under Section 56(2)(x) of the IT Act. During the relevant AY, the assessee purchased rural agricultural land for INR 42.72 lakhs while the SDV was INR 1.15 crores. The Assessing Officer invoked the provisions of Section 56(2)(x) of the IT Act and proposed to tax the difference of INR 72.90 lakhs as 'Income from Other Sources'. The assessee contended the addition on the ground that the property was agricultural land at the time of purchase and therefore, not a capital asset under Section 2(14) of the IT Act, thereby making Section 56(2)(x) of the IT Act inapplicable. The AO relied on the judgement of Hon'ble Supreme Court in case of *Sarifabibi Mohamed Ibrahim* v. *CIT* [3], wherein it was held that agricultural status depends on actual use, intention and not merely on the classification in revenue records. The AO held that the assessee's intention was to use the land for non-agricultural purposes as evidenced by the early application and subsequent conversion into non-agricultural purpose and thus, the difference between consideration paid and SDV will be taxable under Section 56(2)(x) of the IT Act. The assessee challenged the Order passed by the AO before the Commissioner of Income Tax (Appeals) ('**CIT(A)**'). The assessee also requested for a reference to the DVO due to the reason that the SDV is higher than the Fair Maker Value ('**FMV'**). The CIT(A) upon noting the fact that the District Collector's certificate mentions that the land was purchased for *bona fide* industrial purposes and permissions were granted for non-agricultural use, upheld the order passed by the AO. Further, CIT (A) denied reference to DVO beside the specific request made by the

[3] [1993] 204 ITR 631

assessee in this regard. Aggrieved by the Order passed by the CIT(A) the assessee preferred this appeal before the Income Tax Appellate Tribunal (‘**ITAT**’).

The Hon’ble ITAT addressed two primary issues as follows:

a. Applicability of Section 56(2)(x) to agricultural land

The ITAT observed that while Section 56(2)(x) uses the term ‘any immovable property’, it does not provide the definition for the same, hence the term has to be interpreted in general parlance. In terms of the general understanding agricultural land will squarely fall within the ambit of the term immovable property. Further, the Tribunal highlighted that while Section 2(14) of the IT Act specifically excludes rural agricultural land from the definition of ‘capital asset’, Section 56(2)(x) of the IT Act uses the term ‘immovable property’ and not ‘capital asset’, hence, the definition of the latter cannot be applied for interpreting Section 56(2)(x) of the IT Act. Thus, the Hon’ble ITAT held that the rural agricultural land cannot be taken outside the purview of Section 56(2)(x) of the IT Act.

b. Mandatory reference to DVO

The Tribunal found merit in the assessee’s contention that where SDV of the property is disputed, the AO may make a reference to the DVO for valuation of such property. The ITAT referred to the provisions of third proviso to Section 56(2)(x) and relied on its own ruling in the case of *Dilip Manibhai Prajapati* v. *ITO*[4] to establish that if the assessee disputes the SDV, a reference to the DVO becomes mandatory.

Thus, ITAT remanded the matter back to Ld. AO with a direction to refer the matter to the DVO and allowed the assessee’s appeal for statistical purposes. [*Clayking Minerals LLP* v. *ITO* – 2025 174 taxmann.com 111 (Ahmedabad – Tribunal)]

Deductions can be claimed under Section 80-HHC and 80-IA conjointly, provided the aggregate deductions do not exceed the gross total income

Appellant filed its Return of Income for AY 2002-03 and claimed deductions under Section 80-IA and Section 80-HHC of the Income Tax Act. The Income Tax Department initiated re-assessment proceedings and invoked Section 80-IA(9) of the IT Act which provides that where any amount of profits and gains of an undertaking or of an enterprise is claimed and allowed under Section 80-IA, deduction to the extent of such profits and gains shall not be allowed under any other provisions of Chapter

[4] [2024] 164 Taxmann.com 224

VI-A and shall in no case exceed the profits and gains of such eligible business or undertaking or enterprise.

The Income Tax Department disallowed the deductions claimed by the Appellant on the ground that the Appellant cannot claim deduction under both Section 80IA as well as Section 80HHC of the IT Act as double deductions cannot be allowed as per Section 80IA(9) of the IT Act. The view of the Income tax Department was upheld by the Commissioner of Income Tax (Appeals), Income Tax Appellate Tribunal and the Hon'ble High Court of Punjab and Haryana. Aggrieved by the decision of the High Court, the Appellant preferred an appeal before the Hon'ble Supreme Court.

A batch of appeals on the same question of law as that of the present case were tagged and heard together by the Hon'ble SC. The Division Bench *vide* decision in *Assistant Commissioner of Income Tax* v. *Micro Labs Limited* [5] being the lead case rendered divergent views.

One view was that if an Assessee has gross total income and claims any deduction under Section 80-IA / 80-IB of the IT Act, then the gross total income of the Assessee must be decreased basis the amount of deduction claimed under Section 80-IA and on the decreased gross total income, the deduction should be claimed under Section 80-HHC of the IT Act.

The other view, ascribed to the decision rendered by the Bombay High Court on similar facts in *Associated Capsules (P) Ltd.* v. *CIT*[6] wherein it was held that Section 80-IA(9) of the IT Act does not affect the computability of deduction of various provisions under Chapter VI-A, but that it affects the allowability of deductions computed under the provisions under Chapter VI-A so that the aggregate deduction under Section 80-IA and other provisions of Chapter VI-A do not exceed 100% of the profits of the business of the Assessee. The High Court also illustrated the same vide an example- If INR 100 is the profits of the business of the undertaking, INR 30 is the profits allowed as deduction under Section 80-IA (1) and the deduction computed as per Section 80-HHC is INR 80, then in view of Section 80-IA(9), deduction under Section 80-HHC would be restricted to INR 70, so that the aggregate deduction does not exceed the profits of the business. Thus, it was held that Section 80-IA (9) has been enacted to prevent cascading effect of deductions under Section 80-IA and 80-HHC.

[5] (2015) 17 SCC 96

[6] (2011) 332 ITR 42 (Bom)

It was further held that Section 80-IA (9) stipulates that in no case, deduction shall exceed profits and gains of such eligible business of undertaking or enterprise. Therefore, the said provision only refers to profits and gains and does not make a mention of 'gross total income'.

In view of the divergent views rendered by the division bench, a reference was made to a three-judge bench. The three judge bench taking Shital Fibres Limited as the lead case upheld the view that Section 80-IA does not alter the computation of deductions, but only provides that when the deductions are aggregated, they should not exceed the profits and gains of the enterprise or undertaking thus, aligning with the view of the Bombay High Court in *Associated Capsules*. [*Shital Fibres Limited* v. *Commissioner of Income* Tax – Judgement dated 20 May 2025 in Civil Appeal No. 14318 of 2015, Supreme Court, Larger Bench]

Short-term capital loss on which STT was paid can be set off against short-term capital gain on which STT was not paid

Assessee is a Foreign Portfolio Investor in India registered with SEBI. The Assessee filed its return of income for AY 2022–23, declaring short-term capital gains ('**STCG**') taxable at two different rates—15% under Section 111A of the IT Act for gains on which Securities Transaction Tax ('**STT**') was paid, and 30% under Section 115AD for gains on which STT was not paid. The Assessee also reported a short-term capital loss ('**STCL**') on listed equity shares on which STT was paid and adjusted the same first, against the STCG taxable at higher rate of 30% on which STT was not paid and thereafter, set off the balance loss against the STCG taxable at lower rate of 15% on which STT was paid. The case of the Assessee was subject to scrutiny. During assessment, the AO rejected the method of set-off adopted and held that the STCL arising on sale of listed equity shares on which STT was paid could only be set off against STT-paid STCG (i.e., taxed at 15%). Accordingly, the income was re-computed. The Assessee preferred objections before the DRP and the DRP upheld the action of the AO. Aggrieved, the Assessee preferred an appeal before the Hon'ble ITAT.

Before the ITAT, the Assessee argued that Section 70(2) of the IT Act which deals with set-off of STCL allows STCL to be set off against any STCG computed under Sections 48 to 55 of the IT Act, and that the said provision does not make any further classification between the transactions where STT was paid and the transactions where STT was not paid. The Hon'ble ITAT in this regard observed that while deciding on a similar issue the Hon'ble Mumbai ITAT in the case of *iShares MSCI EM UCITS ETF USD ACC* v. *DCIT*[7] by placing reliance on the Calcutta High Court decision in *CIT* v. *Rungamatee Trexim (P.) Ltd.*[8] held that there is no provision in the IT Act which compels the assessee to first set off STT-paid STCG against STT-paid STCL and then allow it to set off against non-STT paid STCG. Therefore, the Hon'ble ITAT in the present case by placing reliance on the above-mentioned decisions held that the Assessee' s method of adjusting STT-paid STCL first against non-STT paid STCG taxable at higher rate of 30% and then against STT-paid STCG taxable at the lower rate of 15%, is valid under Section 70(2) of the IT Act. [*Eastspring Investments India Equity Open Ltd.* v. *Deputy Commissioner* – [2025] 174 taxmann.com 445 (Mumbai - Trib.)]

Delay in share sale being 'depravation' of capital, escrow a/c interest is non-taxable

The Assessee is an Indian company engaged in various business sectors. It entered into a Share Purchase Agreement ('**SPA**') to sell its shares in a company. The sale proceeds were placed in an offshore escrow account and the parties agreed for the sale consideration to be released only after parties fulfil certain obligations before the actual transfer of shares. During the interim period between placing sale consideration in escrow account and subsequent transfer of shares, interest accrued on the escrow account, which was offered to tax. However, before the AO the Assessee claimed that the interest income is capital receipt, forming part of the sale consideration and therefore, the interest income will be capital in nature and not exigible to tax. The AO refused the claim of the Assessee and treated the interest earned as revenue receipt. Aggrieved, the Assessee preferred an appeal before the CIT(A). The CIT(A) relied on the decision of the Hon'ble Mumbai ITAT in the case of *Narang Overseas P. Ltd.* v. *ACIT*[9], wherein the Hon'ble ITAT had dealt with an issue of whether mesne profits received for deprivation of use and occupation of the property will constitute a capital receipt or revenue receipt and held that such mesne profits being akin to compensation for deprivation of capital is a capital receipt and hence, not taxable as income under the IT Act thereby allowing Assessee's appeal.

[7] [2024] 164 taxmann.com 56 (Mumbai - Trib.)
[8] IT Appeal number 812 of 2008
[9] 300 ITR (AT) 1-Mum.

The Department preferred an appeal before the ITAT. The Department argued that the delay in the sale of shares caused by the buyer's failure to meet certain conditions resulted in compensatory interest paid to the assessee, which is taxable as revenue receipt. In this regard the Tribunal placed reliance on the case of *Fujitsu Ltd.* v. *ACIT*[10] wherein the Hon'ble Delhi ITAT dealt with an issue of whether the interest accrued on an arbitral award received by an Assessee, a Japan resident will be treated as business income or income from other sources. The ITAT in *Fujitsu Ltd.* (*supra*) placed reliance on the Hon'ble Apex Court decision in *CIT* v. *Govinda Choudhary & Sons*[11] wherein the Apex Court held that interest received on arbitral award will partake the same character as the arbitral award itself. The Hon'ble ITAT in *Fujitsu Ltd.* (*supra*) therefore, held that in light of the Apex Court decision in *Govinda Choudhary & Sons* (*supra*), the interest on arbitral award will be business income as well and since in that case there was no PE for the non-resident such income was not exigible to tax in India as per the India-Japan DTAA.

In the present case the ITAT placed reliance on *Fujitsu Ltd.* (*supra*) and held that interest/compensation will partake the same character as that of the principal amount itself. Further, the ITAT accepted the Assessee's reliance on *Narang Overseas* (*supra*) to say that interest received on the deposits in escrow account on account of delay in fulfilling obligations will be treated as capital receipt on account of depriving the Assessee of receiving the compensation on sale of shares and therefore, not exigible to income tax. Therefore, the Hon'ble ITAT upheld the action of the CIT(A) in deleting the addition of the interest as income. [*Grasim Industries Ltd.* v. *Assistant CIT* – TS-657-ITAT-2025(Mum)]

Sales tax subsidy claim disallowed in search assessment sans declaration in original or Section 153A return

Assessee is a company engaged in the business of manufacturing and trading of photo sensitized goods. The Assessee was subjected to a search under Section 132 of the IT Act, pursuant to which assessments were initiated under Section 153A of the IT Act for AYs 2006-07 to AY 2014-15. During the course of Section 153A proceedings, the Assessee made a fresh claim seeking exemption of sales tax subsidy, contending that the said subsidy was a capital receipt and hence not taxable.

Category I cases: AYs 2006–07 to 2008–09, wherein the assessments had already attained finality under Section 143(1) or 143(3) prior to the date of search (unabated AYs). For these years,

[10] ITA No. 2607/Del/2022

[11] 203 ITR 881 (SC)

the Assessee had not claimed the sales tax subsidy in the original tax returns, and claim was made for the first time during the course of assessment under Section 153A of the IT Act.

Category II cases: AYs 2009–10, 2010–11 and 2011–12, the regular assessments merged with the search assessment (abated AYs). For the said AYs the claim of sales tax subsidy was not made in the revised return u/s. 139(5) or in pursuance to the notice issued under Section 153A of the IT Act but was made by way of filing a revised computation of total income, for the first time during the proceedings u/s. 153A of the IT Act.

Category III cases: AYs 2012–13 to 2014–15, were abated assessments. For AY 2012-13, the Assessee made the claim for sales tax subsidy in the revised return u/s. 139(5) of the IT Act. For AY 2013-14 and 2014-15 the Assessee made the claim for sales tax subsidy in the original return filed u/s. 139(1) itself.

The AO in Category I and II cases rejected the claim of the Assessee citing absence of any incriminating material found during the search to justify a fresh claim in Section 153A proceedings for abated years. In category III cases, the AO rejected the claim of the Assessee on merits stating that sales tax subsidy is revenue receipt and therefore, exigible to income tax.

The CIT(A) concurred with the view of the AO. Aggrieved the Assessee preferred an appeal before the ITAT.

While deciding the issue with respect to Category I cases, the ITAT observed that in the case of *PCIT* v. *Abhisar Buildwell (P.) Ltd.* the Apex Court while dealing with the issue of scope of assessment under Section 153A of the IT Act held that in cases where the assessments for the relevant years have not abated, the AO cannot make additions in the absence of any incriminating material found during the course of search. Placing reliance on the Apex Court decision, the ITAT held that for un-abated AYs, a fresh claim of exemption cannot be made during the proceedings under Section 153A of the IT Act.

In respect of Category II cases, the Hon'ble ITAT placed reliance in the case of *DCIT* v. *Sew Infrastructure Limited*[12] wherein the Hon'ble ITAT after relying upon the Apex Court judgment of *Abhisar Buildwell* (*supra*) and Hon'ble High Court decision in *Jai Steel (India), Jodhpur* v. *ACIT* [13] held that in cases of abated assessments, any legitimate claim of exemption would be open for the Assessee to make only through the process of filing return of income u/s. 153A. The Hon'ble ITAT in the present case held that since, the Assessee did not file any return in response to the

[12] ITAT Hyderabad (Special Bench) dated 07.10.2024.

[13] [2013] 36 taxmann.com 523 (Rajasthan High Court).

Notice u/s. 153A therefore, the claim of the Assessee cannot succeed.

In respect of the Category III cases, the Tribunal observed that since, the exemption of sales tax subsidy from income tax has been made by the Assessee in the return itself therefore, the matter has to be decided on merits. In this regard, the ITAT observed that the Apex Court in *Sahney Steel and Press Works* v. *CIT*[14] and *CIT* v. *Ponni Sugar and Chemicals Ltd*[15] laid down the purpose test in terms of which if the object of the subsidy scheme enables the Assessee to run the business profitable it is a revenue receipt and where the scheme enables the Assessee to set up or expand its business it is a capital receipt. In the present case, the Hon'ble ITAT observed that the sales tax subsidy merely provided exemption from sales tax on sale of goods manufactured for a period of 15 years from the date of first sale or first consignment/branch transfer and there was no mention that the objectives of the subsidy scheme was for industrialization, employment generation, repayment of loans, or asset creation. Therefore, the Hon'ble ITAT held that the subsidy granted to support the assessee in the course of its business operations was a revenue receipt and therefore, exigible to income tax.

Therefore, in all Category cases the Hon'ble ITAT upheld the order of the Ld. CIT(A). [*Jindal Photo Limited v. ACIT* – TS-673-ITAT-2025(DEL)]

[14] CIT 228 ITR 253

[15] 306 ITR 392

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

www.lakshmisri.com **www.gst.lakshmisri.com** **www.addb.lakshmisri.com**

Lakshmikumaran Sridharan attorneys SINCE 1985

exceeding expectations

LKS
Lakshmikumaran
Sridharan
attorneys
SINCE 1985
exceeding expectations