ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

RECENT DEVELOPMENTS IN DIRECT & INDIRECT TAX

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DIRECT TAX - RECENT CASE LAWS

Delhi High Court[1] rules that the Buy-back of own shares is a capital reduction, not acquisition of property, shielded from Deemed Income Tax under Section 56(2)(x) of the Income tax Act, 1961 (ITA)

FACTS OF THE CASE

- The assessee-company, engaged in share broking and clearing activities, undertook buy-back of its own equity shares and discharged tax on distributed income under section 115QA of the ITA.
- During assessment proceedings, the Assessing Officer compared the buy-back price with the fair market value determined under Rule 11UA of the Income Tax Rules, 1962 (**the Rules**) and treated the differential as income under section 56(2)(x) of the ITA, alleging that the transaction resulted in the receipt of property for inadequate consideration.
- Commissioner of Income Tax appeals ['CIT(A)'] deleted the addition, holding that buy-back is a transaction of share cancellation and not acquisition of property. This view was upheld by the Income Tax Appellate Tribunal (**ITAT**), as well against which the Revenue filed an appeal before the High Court (**HC**).

ASSESSEE'S STAND

- The assessee contended that the buy-back of its own shares under section 68 of the Companies Act, 2013, is a transaction of capital reduction and not an acquisition of property. It was submitted that a company's own shares do not constitute an independent asset but merely represent shareholders' contribution, which stands extinguished upon buy-back; hence, there is no "receipt" of property to trigger section 56(2)(x) of the ITA.
- It was further contended that tax on distributed income has already been duly paid under section 115QA of the ITA, and the statutory framework does not envisage any additional taxation on a notional basis under section 56(2)(x) of the ITA.

REVENUE'S STAND

- The Revenue contended that shares fall within the definition of "property" under section 56(2)(x) of the ITA, without any distinction between a company's own shares and shares of another company.
- It was argued that by undertaking the buy-back at a value lower than fair market value, the assessee had effectively acquired property for inadequate consideration, and the differential amount was liable to be taxed as deemed income under section 56(2)(x) of the ITA.
- The Revenue further submitted that no exception exists for buy-back of own shares under section 56(2)(x) of the ITA, and therefore, the distinction drawn by the CIT(A) was incorrect. It also contended that reliance on judicial precedents under different provisions was misplaced, as such rulings did not deal with section 56(2)(x) of the ITA.

HIGH COURT'S DECISION

- The Hon'ble High Court examined whether buy-back of a company's own shares could be treated as acquisition of property giving rise to deemed income under section 56(2)(x) of the ITA. It was undisputed that the assessee-company had undertaken the buy-back in accordance with section 68 of the Companies Act, 2013, pursuant to duly approved corporate actions and in compliance with the prescribed framework.
- The Hon'ble High Court observed that, absent the enabling provisions of section 68 of the Companies Act, a company cannot otherwise purchase its own shares. It noted that shares may constitute property in the hands of shareholders; however, for the issuing company, they merely represent capital contributions. A buy-back,

[1] *Principal Commissioner of Income-tax vs. Globe Capital Market Ltd.* (Delhi) IT Appeal No. 364 of 2024.

therefore, amounts to a reduction of share capital, reinforced by the statutory mandate requiring extinguishment and destruction of the shares so bought back.

- On this basis, the Hon'ble High Court held that no property is acquired by the company upon buy-back, as the shares stand extinguished. Consequently, the assumption that the company has acquired an asset at a value lower than fair market value is misconceived. The deeming provisions of section 56(2)(x) of the ITA were held to be inapplicable to such transactions.
- Hon'ble High Court concluded that the Assessing Officer's attempt to tax a notional gain on buy-back was untenable in law, and accordingly, the deletion of the addition was sustained, and the Revenue's appeal was dismissed.

ELP Comments

While in the past there have been Tribunal rulings, including the Mumbai Income Tax Appellate Tribunal ruling in the case of Vora Financial Services, the judgement from the Delhi High Court provides a much-needed reinforcement on this very sensitive issue of applying deemed gift tax implications in the hands of the Company on buyback of shares. This judgement provides an affirmation that a regulatory compliant buy-back of shares is, in law, a cancellation of capital of the Company and not an acquisition of "property", thereby placing such transactions outside the garb of section 56(2)(x) of the Income-tax Act, 1961, i.e. section 92(2)(m) of the Income Tax Act, 2025.

ITAT Delhi[2] held that the index-based derivatives do not qualify as "shares" under the India-Mauritius tax treaty, and that gains arising from such instruments are taxable only in the state of residence

FACTS OF THE CASE

- The assessee, a company incorporated in Mauritius and registered with SEBI as a Foreign Portfolio Investor, earned short-term capital gains (STCG) from trading in index-based derivatives during the relevant year.
- In the return of income, the Assessee claimed such STCG to be taxable only in Mauritius under Article 13(4) of the India-Mauritius tax treaty (**the Tax Treaty**) and therefore not taxable in India.
- The Assessing Officer, following directions of the Dispute Resolution Panel (**DRP**), taxed the gains in India by invoking Article 13(3A) of the Tax Treaty, treating the gains from index-based derivatives as gains from alienation of shares. Aggrieved by this position, the Assessee preferred an appeal before the Hon'ble ITAT.

ASSESSEE'S STAND

- It was contended that index-based derivatives are distinct from shares and cannot be equated for the purposes of the Tax Treaty. Shares represent ownership in a company, whereas derivatives are financial instruments deriving value from underlying assets, a distinction also recognised under domestic law, including the Income-tax Act, 1961.
- Accordingly, it was submitted that Article 13(3A) of the Tax Treaty applies only to gains arising from the alienation of shares and does not extend to derivative transactions. Gains from index-based derivatives would therefore fall within the residuary Article 13(4) of the Tax Treaty and be taxable only in the State of residence, i.e., Mauritius.

REVENUE'S STAND

- The Revenue contended that the term "derivatives" is not defined in the applicable tax treaty and, therefore, should not be confined to narrow domestic law meanings. It was argued that the relevant article of the Tax Treaty should be interpreted purposively, in line with its objective of preventing fiscal evasion.
- It was further submitted that drawing a strict distinction between shares and derivatives could enable taxpayers to circumvent taxation by using derivative instruments in place of direct share transfers. Since derivatives derive their value from underlying shares or indices, gains arising from such instruments should, in substance, be treated akin to gains from shares.
- The Revenue also argued that the concept of "alienation" should extend beyond mere legal ownership to include transfer of economic or beneficial ownership. Accordingly, derivative transactions, which effectively transfer risks and rewards associated with shares, should be regarded as equivalent to share alienation, warranting a substance-over-form interpretation of the Tax Treaty.

TRIBUNAL DECISION

- The Hon'ble ITAT held that index-based derivatives constitute a distinct asset class and cannot be equated with "shares" for the purposes of the Tax Treaty. It relied on the statutory framework, including the Securities Contracts (Regulation) Act, 1956 and section 43(5) of the ITA, which clearly differentiates between shares and derivatives.
- The Hon'ble ITAT rejected the Revenue's purposive interpretation and held that mere economic linkage to underlying shares or indices does not amount to "alienation of shares." It emphasised that derivative transactions cannot be recharacterized as share transfers in the absence of explicit treaty language.
- Accordingly, the Hon'ble ITAT held that Article 13(3A) of the Tax Treaty applies only to gains from alienation of shares and does not extend to derivative transactions. Gains from index-based derivatives were therefore held

[2] *M/S Em Delta One Versus ACIT*, I. T. (IT)A No. 84/Del/2025 And Stay Appl. No. 29/Del/2026

to fall under the residuary Article 13(4) of the Tax Treaty.

- Relying on the coordinate bench ruling in the case of Estee India Fund[3], The Hon'ble ITAT held that such gains are taxable only in the State of residence and not in India, and accordingly deleted the addition made by the Assessing Officer.

ELP Comments

The ruling provides a reaffirmation that index-based derivatives are a distinct asset class and cannot be read into the term "shares" for purposes of Article 13(3A) of the India-Mauritius tax treaty, supporting a more predictable tax position. By affirming exclusive residence-state taxation under Article 13(4), the Tribunal enhances certainty for overseas investors investing in derivatives and claiming treaty benefits under the Capital Gains Article of treaties like India-Mauritius, India-Singapore, etc.

[3] ITA 1955/Del/2025

INDIRECT TAX - RECENT CASE LAWS

Bombay High Court holds amendment to Rule 89(5) is clarificatory; the Circular cannot restrict the retrospective benefit of refund

FACTS OF THE CASE

- ***CHEC-TPL Line 4 Joint Venture***[4] (the **Petitioner**), engaged in metro rail construction, filed refund claims of accumulated input tax credit (**ITC**) under Section 54(3) of the Central Goods and Services Tax Act, 2017 (**CGST Act**) on account of inverted duty structure.
- Under the pre-amended Rule 89(5) of the CGST Rules, the refund formula excluded input services, resulting in restricted refund entitlement.
- In ***Union of India vs VKC Footsteps India Pvt. Ltd.***, the Supreme Court upheld the validity of Rule 89(5), but acknowledged the anomaly in the formula, particularly the exclusion of input services, and urged the GST Council to address the issue.
- Pursuant thereto, ***Notification No. 14/2022-Central Tax dated 05.07.2022*** amended Rule 89(5) to include input services in the refund computation.
- Subsequently, ***Circular No. 181/13/2022-GST dated \10.11.2022*** clarified that the amendment would apply prospectively, i.e., to refund applications filed after 05.07.2022.
- The Petitioner's refund claims pertaining to earlier periods were rejected by relying on the Circular and denying the benefit of input services in computation.
- The Petitioner challenged such rejection on the ground that the amendment was clarificatory and intended to remove an anomaly and therefore ought to apply retrospectively.

RULING OF BOMBAY HC

- The Bombay HC held that the amendment to Rule 89(5), introduced vide Notification dated 05.07.2022, was intended to cure the anomaly in the refund formula as noted in ***VKC Footsteps***.
- The Court observed that such an amendment is clarificatory in nature, as it seeks to align the formula with the underlying scheme of Section 54(3).
- Relying on the Gujarat High Court decision in ***Ascent Meditech Limited vs Union of India***, the Court held that an amendment introduced to remove an anomaly must be given retrospective effect.
- The Court further noted that the decision in *Ascent Meditech* has attained finality, as the challenge before the Supreme Court was dismissed.
- It was held that ***Circular No. 181/13/2022-GST***, to the extent it restricts the applicability of the amendment prospectively, is contrary to the statutory provision and cannot be relied upon to deny refund.
- The Court reiterated that a circular cannot override or curtail the scope of a statutory rule, particularly where the amendment expands eligibility.
- Accordingly, the Court set aside the rejection orders and held that the Petitioner is entitled to a refund under Section 54(3) by applying the amended Rule 89(5), including input services.

[4] *2026 (4) TMI 1649 – BOMBAY HIGH COURT*

ELP Comments

This ruling is significant as it clearly establishes that amendments introduced to cure structural anomalies in GST provisions must be interpreted in a manner that gives full effect to their purpose. The Bombay High Court has, in line with the Gujarat High Court's ruling in Ascent Meditech, affirmed that such amendments are clarificatory and retrospective, particularly where they expand the scope of benefits and correct unintended restrictions in the statutory framework.

Equally important is the Court's reaffirmation of the principle that administrative circulars cannot override statutory provisions. By setting aside the restrictive interpretation in Circular No. 181/13/2022-GST, the Court has reinforced that delegated legislation and executive instructions must yield to the intent and scope of the rule as amended.

Andhra Pradesh High Court clarifies distinction between deposit and discharge of GST liability

FACTS OF THE CASE

- Sona Enterprises[5] (the **Petitioner**), is engaged in the trading of ferrous waste & scrap and accordingly purchased scrap from Indian Railways, where GST was payable by the purchaser under the reverse charge mechanism (**RCM**).
- For FY 2017-18 and FY 2018-19, the Petitioner deposited, in cash, the GST payable under RCM into its electronic cash ledger within the prescribed time but failed to debit the ledger to appropriate the amounts to the Government account.
- Despite non-appropriation to the Government, the Petitioner availed input tax credit (**ITC**) on the basis of such cash deposits in the electronic ledger.
- An audit for the said periods detected that although sufficient cash stood deposited, no corresponding debit had been made towards payment of tax and ITC had been availed without actual payment of tax to the Government.
- After the audit pointed out the discrepancy, the Petitioner made the necessary debit entries in the electronic ledger and appropriated the amounts to the Government.
- The Department issued a composite show cause notice covering both years and passed an order under section 74 of the CGST Act, demanding tax, interest and penalty, and also treating the ITC as wrongly availed.

RULING OF ANDHRA PRADESH HC

- The Court held, based on section 49(1) of the CGST Act read with rule 87(6) and (7) of the CGST Rules and relying on the Jharkhand High Court ruling in ***RSB Transmission (India) Ltd.***[6] That mere deposit of cash into the electronic ledger does not amount to payment of tax; tax is paid only upon appropriation to the Government through a debit in the ledger.
- Accordingly, a mere cash deposit could not by itself be treated as a discharge of GST liability under RCM. However, once the Petitioner later debited the ledger and appropriated the amount, the GST liability on the railway scrap purchases stood discharged.
- Since such appropriation occurred belatedly, beyond the statutorily prescribed time, the Petitioner was held liable to pay interest for the period of delay between the due date and the actual date of appropriation.
- On ITC, the Court accepted that ITC could not properly have been availed until the underlying tax was actually appropriated to the Government; however, once the subsequent debit was made, the Department could not simultaneously recover the ITC in addition to appropriating the tax amount.
- The Court disagreed with the Department's approach of treating the already appropriated tax as unpaid and again recovering the same by labelling the ITC as wrongful availment, holding this part of the order to be unsustainable.
- The question of whether the lapse amounted to suppression or bonafide error was held to be a question of fact requiring reconsideration. The impugned order was set aside, and the matter remanded, also noting that composite orders covering multiple periods were not sustainable.

[5] TS-301-HC(AP)-2026-GST

[6] W.P(T).No.23 of 2022

ELP Comments

This judgment settles a recurring ambiguity under GST by drawing a strict line between deposit and discharge of liability. The High Court held that mere parking of funds in the electronic ledger is not sufficient; tax payment is recognized only upon actual debit and appropriation to the Government. This interpretation reinforces the statutory framework under Section 49 and is likely to be actively relied upon by the Department in cases involving delayed set-off.

However, this position is not entirely free from judicial divergence. The Gujarat High Court in Arya Cotton Industries[7] *has taken a materially different view, holding that once the amount is deposited in the electronic cash ledger, it is credited to the Government and assumes the character of "tax paid", with subsequent debit being a mere accounting formality. On this reasoning, the Court restricted interest liability only up to the date of deposit and rejected interest for the intervening period till return filing.*

A noteworthy aspect of the present ruling is its treatment of ITC. While the Court acknowledged that availment of ITC prior to appropriation was technically irregular, it nevertheless held that once the underlying tax is ultimately paid (through subsequent debit), recovery of such ITC may not be justified. In effect, the Court has recognized that procedural timing mismatches should not result in substantive denial or double recovery, provided the tax has actually reached the Government.

However, instead of remanding the issue, the Court could have held that fraud or suppression was not established, given that the amounts were already deposited and lying unutilized in the electronic cash ledger, indicating a bona fide lapse rather than any intent to evade tax.

[7] SCA No. 8871 of 2022

Orissa HC sets aside Section 74 proceedings where ITC reversed prior to SCN; mechanical reliance on DGGI alert notice held unsustainable

FACTS OF THE CASE

- M/s Manoj Kumar Naik[8] (**Petitioner**), a registered taxpayer, had availed input tax credit (**ITC**) on purchases from a supplier, which was later alleged by the Department to be a non-existent/fake entity based on investigation inputs (DGGI alert notice).
- Based on such inputs, proceedings were initiated, and a Show Cause Notice dated 26.07.2024 was issued under Section 74 of the CGST Act proposing recovery of ITC along with interest and penalty.
- Prior to issuance of the SCN, the Petitioner had voluntarily reversed the ITC, as reflected in its returns and electronic credit ledger.
- Despite such a reversal, the Department passed Order-in-Original confirming demand of tax, interest and penalty under Section 74 of the CGST Act, primarily relying on the investigation report/alert without independent verification. Aggrieved, the Petitioner challenged the Order before the Orissa HC.
- The Petitioner contended the following:
  - Invocation of Section 74 was without jurisdiction, in the absence of any material evidencing fraud, wilful misstatement, or suppression of facts.
  - Proceedings were initiated solely on the basis of a DGGI alert/investigation report, without independent application of mind or verification by the adjudicating authority.
  - The entire ITC had been reversed prior to issuance of the SCN; hence, the demand of tax, interest, and penalty was unsustainable.
  - Interest under Section 50 is not payable where ITC is reversed before utilisation, and penalty under Section 74 cannot be imposed in the absence of intent to evade tax.
- The Department contended that ITC was fraudulently availed on invoices from a non-existent supplier, warranting invocation of Section 74 of the CGST Act and subsequent reversal of ITC after detection does not extinguish liability, interest and penalty were rightly imposed.

RULING OF ORISSA HC

- The HC held that proceedings under Section 74 cannot be invoked mechanically merely on the basis of investigation alerts without independent verification or application of mind by the adjudicating authority.
- The HC observed that the invocation of Section 74 requires clear and cogent material evidencing fraud, wilful misstatement, or suppression of facts and inter alia held that:
  - reliance solely on DGGI alert notice, without independent inquiry or verification, is insufficient;
  - voluntary reversal of ITC prior to SCN does not, by itself, justify invocation of fraud provisions;
  - mechanical invocation of Section 74, without verification or application of mind, vitiates the proceedings;
  - fraud, wilful misstatement or suppression must be established with tangible evidence, and cannot be presumed merely because the supplier is alleged to be non-existent;
  - initiation of proceedings under Section 74, after the limitation under Section 73 has lapsed, without

[8] 2026-TIOL-560-HC-ORISSA-GST

establishing fraud or suppression, is impermissible;

- once ITC is reversed prior to SCN, the same amount cannot be demanded again, as it would amount to double taxation.

- The HC further held that in the absence of fraud or suppression, interest and penalty cannot be imposed under Section 50 and Section 74, respectively.
- Accordingly, the HC set aside the Order-in-Original and quashed the impugned proceedings.

ELP Comments

This ruling reinforces that Section 74 cannot be invoked mechanically without cogent and independent evidence establishing fraud, wilful misstatement or suppression of facts.

It is in line with various rulings, including Neeyamo Enterprise Solutions Private Limited[9], wherein it was inter alia held that the extended period under Section 74 cannot be invoked in the absence of specific allegations and evidence of fraud, wilful misstatement or suppression of facts. The HC also observed that the use of the expression "determined" indicated a pre-determined approach rather than a genuine proposal.

This position also aligns with the clarification[10] issued by the CBIC, which provides that extended limitation can be invoked only where investigations produce material evidence of fraud, wilful misstatement or suppression of facts with intent to evade tax. Mere non-payment is insufficient, and such evidence must be clearly set out in the show cause notice.

Further, mere reliance on investigation alerts, without independent verification or application of mind, is insufficient to sustain proceedings under Section 74. This is particularly relevant in the context of increasing departmental action in fake ITC cases, where proceedings are often initiated based on third-party reports.

[9] 2025 (11) TMI 847- Madras High Court

[10] Instruction No. 05/2023-GST dated 13.12.2023

Madras High Court holds Section 76 cannot be invoked where GST collected is already paid through another registration

FACTS OF THE CASE

- M/s. GAIL (India) Limited[11] (**Petitioner**) was engaged in the sale of natural gas and provision of transmission services and operated through two GST registrations within the same State—trading and transmission verticals.
- While the sale of natural gas was outside GST and subject to VAT, transmission services were liable to GST, which was duly discharged by the transmission vertical.
- In its transactions with customers, gas was supplied on a delivered basis, and the price included transmission charges. The trading vertical recovered from customers an amount representing the GST component on such transmission charges as part of the overall consideration.
- The GST on transmission services was fully paid to the Government by the transmission vertical, and the amount recovered from customers corresponded entirely with the tax so paid, with no discrepancy.
- However, despite recording this position, the Department issued a show cause notice under Section 76, alleging that the trading vertical had collected tax but failed to remit the same to the Government.

RULING OF MADRAS HC

- The High Court examined the show cause notice and noted that the Department's own records clearly acknowledged that the amount recovered from customers matched the GST paid to the Government by the transmission vertical, with no shortfall.
- On this basis, the Court first observed that Section 76 applies only where an amount is collected as tax and not paid to the Government. Since the tax had already been remitted, the basic requirement for invoking Section 76 was not satisfied.
- The Court then considered the Department's reliance on the concept of distinct persons due to separate registrations. While accepting that the trading and transmission verticals are distinct persons under the GST law, it held that such a distinction cannot be applied to disregard actual payment of tax to the Government.
- It further held that a payment made through another registration within the same State, when duly accounted for, cannot be ignored for the purpose of invoking Section 76.
- The Court noted that despite recording the fact of payment, the show cause notice proceeded to raise a demand by disregarding it, reflecting non-application of mind.
- Accordingly, the Court held that the invocation of Section 76 in such circumstances would result in double taxation, which is impermissible, and therefore quashed the show cause notice.

ELP Comments

This ruling clarifies that Section 76 applies only where tax collected is not paid to the Government.

Where the tax has already been paid by another vertical, the invocation against another registration within the same State is not warranted.

The judgment also highlights that while GST treats multiple registrations as distinct persons, this legal position cannot override actual discharge of tax where there is no loss to the revenue.

[11] [TS-260-HC(MAD)-2026-GST]

Overall, the decision provides useful guidance against mechanical invocation of Section 76 and indicates that the provision is not intended to create duplicative demands where tax has already been paid.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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