ACUITY LAW

2025

TAX YEARLY REWIND

This Rewind consolidates key judgements and notable regulatory developments in the Tax and FEMA landscape in the year 2025.

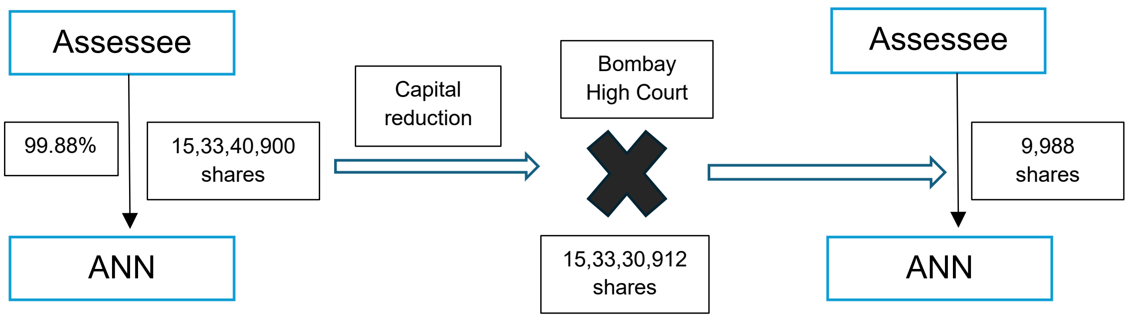
TABLE OF CONTENTS

DIRECT TAX

A. PROPORTIONATE REDUCTION AS 'TRANSFER': PRINCIPAL COMMISSIONER OF INCOME TAX v. JUPITER CAPITAL

Brief Facts:

The Assessee is a company engaged in the business of investing in shares, financing and money lending. It held 15,33,40,900 shares at a face value of Rs. 10 each which constituted 99.88% of the total number of shares in Asianet News Network Private Limited ("**ANN**"). ANN incurred heavy losses resulting in the loss of networth. ANN filed a petition in the Bombay High Court ("**High Court**") for reduction of its share capital to set off its losses against the paid-up equity share capital. The High Court sanctioned ANN's share capital reduction from 15,35,05,750 to 10,000 shares, proportionately cutting the Assessee's holding from 15,33,40,900 to 9,988 shares (face value unchanged at Rs. 10), with Rs. 3,17,83,474 paid as consideration.



The Assessee claimed long-term capital loss accrued to the reduction in share capital from the sale of shares in ANN. The Assessing Officer ("**AO**") rejected the capital loss claim, ruling no "transfer" under Section 2(47) of Income Tax Act, 1961 occurred despite reduced share numbers, as face value and holding percentage (99.88%) stayed unchanged. Commissioner of Income Tax (Appeals) upheld this, distinguishing the judgement of *Kartikeya V. Sarabhai*[1] ("**Kartikeya**") by requiring sale/relinquishment to a third party. The Income Tax Appellate Tribunal ("**ITAT**") reversed the judgement of CIT and applied the Kartikeya judgement squarely to recognize rights extinguishment in cancelled shares. The High Court of Karnataka dismissed Revenue's appeal and affirmed the decision of ITAT.

Issue for consideration:

The Department of Revenue sought leave to appeal before the Supreme Court of India ("**Supreme Court**"). The issue for consideration before the Supreme Court was whether the ITAT was correct in allowing the assessee's claim of long-term capital loss of Rs. 164.48 crore, finding an extinguishment of rights in 15,33,40,900 shares under Section 2(47), even without any reduction in the shares' face value?

Judgement:

The Supreme Court, in its order dated 2 January 2025, dismissed the Revenue's SLP, holding that the proportionate reduction in Jupiter Capital's shareholding constituted a "transfer" under Section 2(47) of the Income Tax Act, 1961. Relying on *Kartikeya V. Sarabhai v. CIT*, the Court clarified that Section 2(47)'s inclusive definition encompasses relinquishment or extinguishment of rights in capital assets, beyond mere sale. Here, the Assessee extinguished rights in 15,33,40,900 shares of ANN, receiving 9,988 shares plus Rs. 3.18 crore consideration thereby triggering long-term capital loss computation under Section 45, irrespective of unchanged face value (Rs. 10) or shareholding percentage (99.88%).

[1] AIR 1997 SC 3794

The bench emphasized that capital reduction under Section 66 of the Companies Act erodes shareholder rights to dividends and liquidation proceeds proportionally, qualifying as transfer. Precedents like *Anarkali Sarabhai v. CIT*[2] reinforced that redemption or reduction equates to the company buying back shares, with no need for third-party involvement or percentage dilution. No error of law arose in the High Court/ITAT affirming the loss, distinguishing from cases lacking consideration or rights extinguishment.

<u>Our thoughts</u>

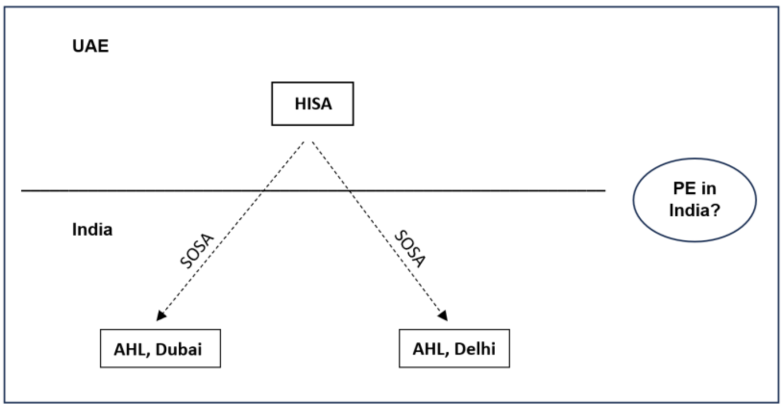
This Supreme Court ruling provides welcome relief for taxpayers seeking to claim capital losses from a company's share capital reduction, resolving years of conflicting judicial stances that bred uncertainty. The Mumbai ITAT Special Bench in *Bennett Coleman & Co. Ltd v. ACIT*[3] ruled that share substitution via reduction without consideration does not constitute a 'transfer,' disallowing resultant capital losses. This was later overridden by the Mumbai ITAT in *Tata Sons Limited v. CIT*[4], permitting such losses even absent consideration. The Supreme Court drew on the Gujarat High Court's *CIT v. Jaykrishna Harivallabhdas*[5], affirming that consideration is not essential for computing capital gains on rights extinguishment, potentially extending guidance to no-payout scenarios. Given the grey areas involved in such a capital reduction transaction not involving transfer or conversion, it would be worthwhile to have an amendment in the Income Tax Act to facilitate such loss upon capital reduction as capital loss.

[2] AIR 1997 SC 1677
[3] (2011) 12 ITR (T) 97 (Mum)
[4] ITA No. 3468/Mum/2016
[5] (1998) 231 ITR

B. SUBSTANCE OVER FORM WHILE DETERMINING PERMANENT ESTABLISHMENT: HYATT INTERNATIONAL SOUTHWEST ASIA LTD. v. ADDITIONAL DIRECTOR OF INCOME TAX

Brief Facts:

Hyatt International Southwest Asia Ltd ("**Appellant")** is a company incorporated in the United Arab Emirates ("**UAE**") and is a tax resident UAE under Article 4 of the Agreement between the Government of India and the UAE for the avoidance of Double Taxation ("**India-UAE DTAA**"). In 2008, two Strategic Oversight Services Agreements ("**SOSA**") were entered into by the Appellant with Asian Hotels Limited, India ("**AHL**"), one for Asian Hotels Limited, Delhi and the other for Asian Hotels Limited, Mumbai. The SOSA was entered into for provision of strategic planning services and know-how by the Appellant to ensure the operation and development of Asian Hotels Limited into an efficient and high-quality international full-service hotel.



For the Assessment Year 2009-10, the Appellant filed its return of income declaring 'Nil' income. Upon the issuance of notice by an Assessing Officer under Section 142(1) and 143(3) of the Income Tax Act, 1961, the Appellant submitted a reply stating that its income is not taxable as:

- There is no specific article under the India-UAE DTAA referring to Fees for Technical Services.
- The Appellant did not have any fixed place of business, office, or branch in India.
- Presence of its employees in India did not exceed nine months as specified under Article 5(2) of the India-UAE DTAA.

The Assessing Officer held that the activities of the Appellant constitute a permanent establishment ("**PE**"**)** under Article 5 of the India-UAE DTAA. The Appellant filed objections before the Dispute Resolution Panel which rejected the same. The Appellant filed appeals before the Income Tax Appellate Tribunal ("**ITAT**"). The ITAT, relying of the decision of the court in *Formula One World Championship Limited v. Commissioner of Income Tax, International Taxation-3, Delhi & Anr*.[6] ("**Formula One judgement**"), held that the Appellant has a fixed place of business in India qualifying as a PE under Article 5 of the India-UAE DTAA.

The Appellant filed an appeal before the High Court. The High Court dealt with the essential question of "*Whether the Appellant has PE in India within the meaning of the Double Taxation Avoidance Agreement?"* The High Court held that despite being a company incorporated in Dubai and a tax resident of the UAE, the Appellant had a PE in India. The said judgement of the High Court was appealed to the Supreme Court of India.

[6] (2017) 15 SCC 622

Arguments before the Supreme Court of India:

The Appellant contended before the Apex Court that the SOSA explicitly stipulates that the Appellant shall render its services from Dubai and is not obligated to send or station any employee in India. Further, the income of the Appellant is not taxable as there is no specific article in India-UAE DTAA enabling taxation of Fees for Technical Services. The Appellant further stated that it doesn't maintain a fixed place of business, office or branch in India nor was there any specifically reserved place at the disposal of the Appellant.

The Revenue Authority contended that the SOSA which was entered into for a period of 20 years and under the same, the premises of AHL were under the full and unconditional disposal of the Appellant. The Respondents referred to various clauses of the SOSA and submitted that the role of the Appellant was training staff, monitoring operations, exercising financial oversight, and influencing procurement and operational decisions.

Decision of the Supreme Court:

The Supreme Court formulated the principal issue for consideration as whether the Appellant has a PE in India under Article 5(1) of the India-UAE DTAA and consequently, whether its income derives under SOSA is taxable in India.

Prior to delving further into the reasoning, the Apex Court analyzed the relevant clauses of DTAA and the SOSA. Article of 5 of the India-UAE DTAA defines PE as "*a fixed place of business through which the business of an enterprise is wholly or partly carried on*". Article 7 of the India-UAE DTAA deals with taxation of business profits which are attributable to a PE. Article 7(1) states that profit of an enterprise shall be taxable only in the State of its residence unless the enterprises carry on business in the other contracting state through a PE.

The relevant provisions of the SOSA examined by the Supreme Court of India include:

Relevant Article of SOSA	Provision
Section 4 of Article I	'Title of the hotel' - If AHL desires to obtain financial assistance for the construction of the hotel or if the hotel is to be used as collateral for any borrowing unrelated to hotel business, the owner of AHL is required to obtain a non-disturbance and attornment agreement from the lender, which must also be acceptable to the Appellant.
Article II	The term is for twenty years with a possibility of extension by ten years through mutual agreement.
Section 1 of Article III	AHL shall be operated with standards comparable to international hotels operated by the Appellant.
Section 2 of Article III	The Appellant had c**omplete control and discretion in formulating and establishing the strategic plan for all aspects** of AHL including **branding, marketing, product development, and daily operations.**
Section 3 of Article III	The Appellant assigned employees to India without prior approval from hotel owner or management.
Section 4 of Article III	The Appellant had the **powers to formulate policies governing the bank accounts of AHL.**
Section 1(a) and 1(b) of Article V	"Strategic Fees" for the Appellant had been set out as a calculation of percentage of room revenue and other revenues and income.

Subsequent to analyzing the above-mentioned provisions of the SOSA, the role of the Appellant was held to not be confined to mere policy formation. The degree of control and supervision vested in the Appellant for a Fixed Place PE under Article 5(1) of the India-UAE DTAA. The Supreme Court relied on the Formula One judgement to state that the two essential tests include

- The place must be **“at the disposal”** of the enterprise
- The business of the enterprise **must be carried on through that place**

Further, the three core attributes of a PE must be **stability, productivity, and degree of independence.** The “disposal test” was held to be important as a test. The Appellant held control over the hotel’s strategic, operational, and financial dimensions. The functions performed by the Appellant are to be performed over a period of twenty years and include revenue sharing. **Thus, the Supreme Court held economic substance over legal form in determining PE status**.

<u>Our thoughts:</u>

The Supreme Court's July 24, 2025 judgment in *Hyatt International Southwest Asia Ltd. v. CIT* significantly expands the "fixed place PE" threshold under Article 5(1) of the India-UAE DTAA, ruling that a UAE-based Hyatt entity created a PE in India through substantive operational control including policy enforcement, HR oversight, staff deployment, and profit-linked fees from an Indian hotel despite lacking ownership or exclusive possession of premises, thereby prioritising economic substance over contractual form. This lowers the bar to be considered as a PE for foreign entities in hospitality, consulting, and tech sectors providing managerial services, potentially taxing business profits under Article 7 even without physical offices or extended stays, while exposing intra-group oversight models to Indian tax attribution and prompting structural reassessments like relocations or enhanced withholding.

C. TRANSFER PRICING AND CHARACTERIZATION OF AN ENTITY: NETFLIX ENTERTAINMENT SERVICES INDIA LLP v. DEPUTY COMMISSIONER OF INCOME TAX

Brief Background:

About Netflix -

Netflix Inc (Netflix USA) operates on a subscription model where users gain access to a curated video-on demand content. There are certain agreements that were entered into by Netflix USA, Netflix International B.V. and Netflix Netherlands. They can be stated as follows:

Date	Description
Upto 31 December 2020	Netflix USA granted a license to Netflix International B.V. (Netflix Netherlands), a company in Netherlands. Netflix Netherlands was authorized to use, exhibit, distribute, sub-distribute and premiere the contents. Netflix Netherlands had rights to copy, reproduce, publicly perform and broadcast the Netflix service in all media outside the United States.
12 April 2017	Netflix Entertainment Services India LLP (Netflix India) was incorporated on 12 April 2017 with the primary business of **distribution of access** to global Netflix service comprising a video-on-demand streaming subscription that enables subscribers to watch global content available on Netflix' digital platform
5 September 2017	Netflix Netherlands entered into a distribution agreement with Netflix India.
1 January 2021	Netflix India entered into a distribution agreement with Netflix USA directly.

The role of Netflix India was contractually confined to **distributing access** to the "Netflix Service," defined as a global, internet-streamed video-on-demand service for personal use, **with no transfer of content, technology, or other IP rights**. Netflix India's functions were limited to marketing, customer acquisition and support, invoicing/collection, liaising with telecom operators, and routine operational support, earning a low, fixed-margin distribution fee on Indian subscription revenue while its entire cost base was reimbursed. Its assets were only routine tangibles (no intangibles developed or owned), and it bore limited operational/regulatory risk, for which it applied the Transactional Net Margin Method ("**TNMM**") with Operational Profit/Operational Revenue as the profit level indicator, positioning itself as a limited-risk distributor.

The Revenue Authorities recast Netflix India as a full-fledged entrepreneurial content/technology provider rather than a limited-risk distributor, pointing to clauses making it responsible for making the service available in India, marketing and pricing, issuing gift subscriptions and discounts, contracting directly with Indian subscribers, providing customer support, obtaining local licences and infrastructure, and receiving subscription fees in India. On this basis, the Transfer Pricing Officer and Dispute Resolution Panel ("**DRP**") treated the model as a complex content-and-technology distribution business akin to media/entertainment providers, contending (i) that there was a transfer or use of intellectual property giving rise to royalty, (ii) that TNMM was not the appropriate method, and (iii) that an "other method" under Rule 10AB, factoring in royalty on content/technology sourced from Netflix US and Netherlands, was the correct approach.

Decision of Income Tax Appellate Tribunal:

The ITAT examined the distribution agreement and held that **Netflix India never received any licence to use, reproduce, alter, or sub-license Netflix content, and that the DRP had overstated the clauses to wrongly treat it as a content provider**. Netflix India held no digital content stock; Open Connect Appliances only cached transient copies for bandwidth optimisation, without customer data, algorithms, playback, or recommendation logic, all of which remained with Netflix entities abroad. The Tribunal accepted the assessee's FAR analysis, noting that no Netflix India employee handled content acquisition, tech design, or platform development, and rejected the Revenue's "other method" computation as inconsistent with transfer pricing principles.

On method selection, the ITAT reiterated that the **most appropriate method must be driven by the nature of the controlled transaction and reliable functional comparables, not by generic sectoral labelling such as "media and entertainment."** It endorsed prior rulings treating software distributors as suitable analogues for digital content distributors and held that the "other method" under Rule 10AB is not a licence for ad hoc profit attribution, but must still rest on comparable uncontrolled transactions and be used sparingly. Applying a DEMPE lens, it found all development, enhancement, maintenance, protection, and exploitation of IP occurred in the US/Netherlands, with no such functions in India, and emphasized that Section 92C read with Rule 10B provides an exhaustive transfer pricing framework leaving no room for hybrid methods. Relying on *WarnerMedia India*[7], *Star Den Media Services*[8], and *Turner International India*[9], the ITAT characterized Netflix India as a limited-risk distributor remunerated on a TNMM basis and deleted the entire transfer pricing adjustment.

<u>Our Thoughts:</u>

The ITAT ruling prioritizes functional analysis over physical presence, clarifying that infrastructure or personnel alone does not create value and further, technological presence cannot be conflated with economic ownership, offering critical guidance for digital models. Entities claiming entrepreneurial returns must demonstrate substantive Development, Enhancement, Maintenance, Protection, and Exploitation of intangible assets functions (also known as DEMPE functions), as routine marketing and compliance activities fall short. Rule 10AB's "Other Method" cannot override viable traditional approaches and requires functionally comparable uncontrolled transactions, rejecting arbitrary profit grids. Origin Cache Appliances and similar tools serve purely logistical roles akin to warehousing, not core asset ownership for streaming operations while full cost-plus-fixed-markup structures confirm limited-risk profiles despite ancillary duties. Functional comparability extends across industries, enabling analogous benchmarks when direct comparables are unavailable.

[7] 167 taxmann 307
[8] 118 taxmann 662
[9] 95 taxmann 285

D. LEASE AIRCRAFTS AND THEIR TAXABILITY IN INDIA: SUNFLOWER AIRCRAFT LEASING LIMITED v. ASSISTANT COMMISSIONER OF INCOME TAX

Brief Background:

The decision of the Mumbai Bench of the Income Tax Appellate Tribunal ("ITAT") in Sunflower Aircraft Leasing Limited v. Assistant Commissioner of Income Tax addresses an important issue concerning the taxation of cross-border aircraft leasing arrangements and the scope of India's taxing rights under the India–Ireland Double Taxation Avoidance Agreement ("India- Ireland DTAA"). The Appellant, Sunflower Aircraft Leasing Limited ("Sunflower"), is a company incorporated in Ireland and forms part of the AerCap Group, one of the world's largest aircraft leasing enterprises. Sunflower is engaged in the business of leasing aircraft globally.

Sunflower entered into aircraft lease agreements with InterGlobe Aviation Limited ("IndiGo"), India's largest airline. Under the Aircraft lease agreements (dry operating leases), Sunflower leased two aircraft to IndiGo for use in India. While **Sunflower retained legal ownership of the aircraft, the possession, operational control, commercial wisdom and maintenance of the aircrafts were contractually transferred to IndiGo**. The aircraft were integrated into IndiGo's fleet and used interchangeably on domestic and international routes.

Indian tax authorities contended that the continuous physical presence of the leased aircraft in India constituted a fixed place permanent establishment ("PE") of Sunflower in India. On this basis, they sought to tax the lease rentals in India. The Dispute Resolution Panel ("DRP"), while relying on the Formula One World Championship Ltd. case, applied the 'at the disposal of' test and held that since such high-value, income-earning assets were continuously present in India, with Sunflower having the right to inspect and repossess the aircrafts, it would constitute fixed place PE. The authorities attributed 25% of the gross lease rentals to India. The DRP also rejected Sunflower's reliance on the Article 8 (1) of the India-Ireland DTAA, which exempted profits from the operation of ships and aircrafts in international traffic from being taxed in the country to which the enterprise is not a resident. The rejection was made stating that the leased aircrafts were primarily utilised for domestic use and that the occasional usage of the leased aircrafts in international sectors did not qualify it as operating in "international traffic."

Issue for Consideration:

The principal issue was on the taxability of profits derived from aircraft leasing arrangements in India i.e. whether the mere presence of leased aircraft in India, without personnel or operational infrastructure of the lessor, could constitute a fixed place PE of Sunflower under Article 5(1)[10] of the India–Ireland DTAA.

Judgement :

The ITAT ruled decisively in favour of Sunflower. On the issue of permanent establishment, the Tribunal reiterated that Article 5(1) of the DTAA requires not merely a fixed place of business, but that such place must be at the disposal of the foreign enterprise and used for carrying on its business. Applying the "disposal test" laid down by the Supreme Court in the Formula One case, the Tribunal examined the terms of the aircraft lease agreements in detail. It noted that IndiGo had exclusive possession and commercial control

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[10] *"For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on."*

over the aircraft, bore responsibility for maintenance and all airworthiness directives in India, and deployed the aircraft entirely at its own discretion.

The Tribunal held that Sunflower's limited rights of inspection (once a year) and repossession were merely protective rights incidental to ownership and did not amount to operational control. There was no presence of Sunflower's personnel or business infrastructure in India, nor any involvement in the day-to-day operations of the aircraft. The Tribunal also relied on the decision in the Hyatt case, which emphasised that mere ownership of assets does not give rise to a PE unless accompanied by effective strategic or day to day operational control. Accordingly, it concluded that no fixed place PE existed in India.

On Article 8(1) of the DTAA, the Tribunal rejected the Indian tax authority's narrow interpretation. It observed that the treaty expressly covers profits derived from the "operation or rental" of aircraft in international traffic. Referring to the definition of "international traffic" under Article 3(1)(f) of the DTAA, the Tribunal found that the definition of international traffic excludes only those operations where the ship or aircraft is operated solely in the other Contracting State. This means that the moment the operation is not exclusively domestic, it satisfies the definition. Since IndiGo is an international carrier and the leased aircraft formed part of its integrated fleet operating on both domestic and limited international routes, the requirement of international traffic was satisfied.

<u>Our Thoughts:</u>

This ruling reinforces the consistent judicial position that the existence of a permanent establishment cannot be inferred merely from the physical presence of high-value assets in India. The Tribunal's analysis appropriately focuses on the concept of "disposal" and effective control, thereby aligning Indian jurisprudence with internationally accepted principles on permanent establishment. The decision provides clarity to the aircraft leasing industry, where dry lease arrangements typically involve transfer of possession and operational control to airlines, with the lessor retaining only ownership and protective rights. Further, the rejection of an overly restrictive reading of "international traffic" is significant for the Indian aviation industry and understanding specific treaty definitions.

E. DETERMINING REIMBURSEMENT OR FTS FOR SECONDMENT OF EMPLOYEES: TOSHIBA CORPORATION v. DCIT

Brief Facts:

Toshiba Corporation ("**the Assessee**"), a Japanese tax resident engaged in manufacturing and marketing communications systems, electronic components, heavy electrical equipment etc., received Rs. 10.76 crore in reimbursements for salaries paid in Japan to employees of its Indian subsidiaries (Toshiba India Pvt. Ltd., Toshiba JS Power Systems Pvt. Ltd., Toshiba Transmission and Distribution Systems India Pvt. Ltd., and Toshiba Software India Pvt. Ltd.). These payments were made on behalf of the Indian entities for administrative convenience, with reimbursements received without markup and after TDS compliance. To prove the employees were seconded but remained under the Indian entities' control and supervision, the Assessee submitted certain documents which included payroll agency agreements, sample employment contracts and appointment letters from Indian entities, Form 16s, and Form 15CA/15CB certificates from a chartered accountant verifying the remittances. The Assessing Officer held that the appointment letters and contracts indicated short-term, assignment-based secondment of employees to Indian entities at their request, with the assessee retaining ultimate lien, and the employees reverting post-temporary period under Indian control. On this basis, the AO treated salary reimbursements from Indian entities as fee for technical services (FTS).

Issue for consideration:

Whether the payments made by the Indian entities to the Assessee in respect of salaries paid to the seconded employees in Japan are in the nature of reimbursement of the salary for the services rendered in India or are in the nature of Fees for Technical Services?

Judgement:

The Income Tax Appellate Tribunal ("**ITAT**"), placed reliance on the documents submitted by the Assessee, to ascertain the employee-employer relationship between the Indian entity and the seconded employees. The appointment letter of the seconded employees showed the payment of salaries by the Indian entity and further, the exercise of control and right to terminate services exercised by the Indian entity was highlighted by the ITAT. Form 16s issued by Indian companies to the seconded employees confirm salary payments were subject to TDS, with tax duly deducted at source by those employers. The ITAT further analysed the judgement of PCIT vs. Boeing India (P.) Ltd. and Article 12(4) of the Double Taxation Avoidance Agreement between India and Japan ("**DTAA**"). Article 12(4) of the DTAA excludes salary payments to employees from FTS, covering only non-employee payments. With salaries substantiated as reimbursed for India services (evidenced by Form 16s with TDS), reimbursements fell outside FTS scope. Thus, the ITAT ruled that the payment was not in the nature of FTS and rejected the assessment by the Department of Revenue.

Our Thoughts:

This judgement provides clarity on the tax treatment for seconded employees especially for group companies. This decision delivers significant relief for multinational enterprises seconding personnel, confirming pure reimbursements do not trigger FTS taxation when Indian entities retain substantive control, supervision, and termination rights as evidenced by contracts and payroll records. It aligns with *PCIT vs. Boeing India*[11], reinforcing that administrative conveniences do not trigger service fees if economic

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[11] (2023)457 ITR 84/146

substance reflects employment costs. This judgement reinforces the need for requisite and clear documentation in terms of secondment to make clear the terms of employment and existence of control.

F. PE LOSS SET OFF AGAINST ECB INTEREST ALLOWED: ABU DHABI COMMERCIAL BANK v. DCIT

Brief Facts:

Abu Dhabi Commercial Bank ("**Assessee**") is a UAE -headquartered bank and UAE tax resident with a Permanent Establishment ("**PE**") in India, extended External Commercial Borrowings ("**ECBs"**) directly from its head office to Indian customers during AY 2019-20. These loans were not routed through the PE, generating interest income of INR 138.48 crore which was classified as "income from other sources" by the Assessee. Meanwhile, the Assese's PE reported current-year business losses. The Assessee set off these PE losses of Rs 75.33 crores against ECB interest of Rs 138.48 crores, offering net income of INR 63.15 crore, taxable at a concessional 5% rate under Article 11(2) of the India-UAE Double Taxation Avoidance Agreement ("**India-UAE DTAA**") that is applicable to interest on bank loans, when the recipient is the beneficial owner of the interest. The Assessee contended that the interest earned on ECB loans advanced directly by its UAE head office to Indian borrowers was taxable at the rate of 5% under Article 11(2) of the India–UAE DTAA.[12], and that the expression "gross amount of interest" in Article 11(2) is left undefined within the DTAA and per common parlance such shall only be referred only to interest without deduction of expenses, not as interest without deduction of business losses. Therefore, PE losses in India could be set off against such interest income in accordance with domestic law before applying the treaty rate as Article 11(2) itself provides that interest is to be taxed "according to the laws" of the source Contracting Party (i.e India).Relying on Section 90(2) of the Income Tax Act, 1961 ("**IT Act**"), the Assessee also argued that it could apply domestic law for computation and the India- UAE DTAA treaty for the concessional rate, and rate and also pointed out that the return form permitted such inter-head adjustments

The Assessee also claimed concessional taxation at rate of 5% under Section 115A(1)(a)(iiaa)[13] read with Section 194LC[14] against the Dispute Resolution Panels ('**DRP**')

The Revenue, on the other hand, argued that once the Assessee opted for the route provided under Article 11(2), interest earned had to be taxed on a gross basis without any deduction or set-off permitted. This entailed that the Assessee cannot set-off their PE's losses as Article 11(2) only permitted calculation upon "gross" amount including PE losses, since the treaty. It was also averred that the DTAA did not contemplate inter-head adjustments and the term "gross" meant the full amount of interest. The Revenue further relied on CBDT Circular No. 333 dated 02 April 1982 and judicial precedents to contend that a hybrid approach using treaty provisions for rate while invoking domestic law for computation was impermissible. The DRP additionally reasoned that, being a banking entity, the ECB lending activity formed part of business operations and the interest constituted business income taxable under domestic provisions at higher rates; even assuming Section 115A applied, it would fall under Section 115A(1)(a)(ii) at 20% and not under Section 115A(1)(a)(iiaa).

Issue for consideration:

Whether PE business losses could set off against non-attributable ECB interest income before applying DTAA's 5% on the amount of interest?

ITAT Ruling and Reasoning:

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[12] Article 11(2) of the India-UAE DTAA states that interest paid from one contracting state to a resident of the other can be taxed in the recipient's state. However, the source state may also tax it under its domestic laws, subject to caps if the recipient is the beneficial owner: 5% on gross interest for loans from bona fide banks or similar financial institutions, and 12.5% in all other scenarios.

[13] Section 115A(1)(a)(iia) of the IT Act

[14] Section 194LC of the IT Act

The ITAT ruled in favour of the Assessee, holding that PE losses were allowable to be set off against ECB interest income before applying the 5% rate under Article 11(2). It reasoned that Article 11(2) operates in two stages—first, the computation and taxability of interest must be determined “according to the laws” of the source State, meaning the Income-tax Act (including Chapter VI provisions permitting inter-head set-off under Section 71), and only thereafter is the treaty-specified rate applied.

The Tribunal also examined the meaning of “gross amount of interest” and, relying on the OECD Commentary (2017), held that **“gross” refers to interest without deduction of *expenses* incurred to earn it, and does not prohibit set-off of losses where the treaty itself directs computation under domestic law; since the Assessee had not claimed any expenditure deduction, its computation was consistent with Article 11(2)**. On the alternative plea, the ITAT further held that the interest qualified for concessional taxation at 5% under Section 115A(1)(a)(iiaa), noting the CBDT press release dated 21 September 2012 clarification that separate Central Government approval was not necessary where ECB borrowings complied with RBI guidelines.

Our thoughts:

The Mumbai ITAT ruling delivers crucial clarity for non-resident banks under the India-UAE DTAA where current-year losses from Indian PEs can offset head-office interest income (such as from direct ECB lending), with treaty rates under Article 11(2) applied only after computing total income per IT Act provisions like Section 71 set-off—overriding Assessing Officers' gross-basis taxation attempts. Key takeaways include:

(i) the mandatory sequence of domestic loss adjustments before treaty benefits,
(ii) eligibility of routine PE operational losses against protected interest streams, and
(iii) harmonious integration of DTAA with statutory mechanics.

Multinationals with Indian PEs gain confidence in direct lending structures, enhancing tax efficiency and cash flows, provided they maintain robust segregated profit/loss records to substantiate audit defenses.

G. ANTI-FRAGMENTATION RULE AND BUSINESS ACTIVITIES OF A FOREIGN ENTERPRISE IN INDIA: RGA SERVICES INTERNATIONAL REINSURANCE COMPANY v. DCIT

Brief Facts:

RGA International Reinsurance Company DAC, an Ireland-based life reinsurer entered into reinsurance arrangements with Indian insurers and received reinsurance premiums for assuming risk overseas. The taxpayer had no office, employees, or physical presence in India, and all core functions such as underwriting approval, risk assumption, capital deployment, and contract execution took place outside India. An Indian group entity, RGA India, provided underwriting support, actuarial assistance, risk analysis inputs, market research, customer relationship coordination, and administrative back-office support. These services were rendered on a cost-plus arm's-length basis, and RGA India also serviced other group entities. The taxpayer contended that RGA India's activities were preparatory and auxiliary in nature and therefore did not trigger a Permanent Establishment ("**PE**") under the India–Ireland treaty.

Issue under consideration:

The Revenue alleged that RGA India constituted both a fixed place PE and a Dependent Agent PE ("**DAPE**"), arguing that the support functions were integral to the taxpayer's business model. Further, relying on the MLI anti-fragmentation rule, the Revenue asserted that the activities of the taxpayer and RGA India formed complementary parts of a cohesive business operation in India, thereby nullifying the preparatory-and-auxiliary exemption. The core question before the Tribunal was whether the Indian support entity's functions crossed the threshold from auxiliary assistance to core business activity, and whether the anti-fragmentation rule could expand PE exposure in such a structure.

ITAT Ruling:

The Tribunal undertook a detailed functional and factual analysis and reaffirmed that the taxpayer's reinsurance business was not carried on in or from India. It emphasized that the core income-generating activity in reinsurance is the assumption of risk, which was undertaken exclusively by the taxpayer outside India using overseas infrastructure, personnel, and capital. Reinsurance contracts were executed offshore, premiums were received abroad, and no part of the key decision-making chain was situated in India. Consequently, RGA India's premises could not be regarded as a fixed place at the disposal of the taxpayer, which is a threshold condition for a fixed place PE under Article 5.

On the nature of services, the Tribunal observed that RGA India only performed administrative, analytical, and coordination-level support functions such as information collation and proposal evaluation support. These functions did not involve risk assumption, pricing authority, capital deployment, or binding decision-making, and were therefore correctly categorized as 'preparatory and auxiliary'.

Further, RGA India was remunerated on an arm's-length cost-plus basis and serviced multiple group entities, reinforcing its independent operational character rather than functioning as an extension of the taxpayer's business in India.

With respect to DAPE, the Tribunal held that RGA India neither negotiated nor concluded contracts, nor did it habitually secure orders for the taxpayer, and in the absence of IRDAI authorization, it was not legally competent to enter into reinsurance contracts — a decisive factor negating agency authority. The Tribunal reiterated that the DAPE test requires substantive contractual authority or principal-like conduct, neither of which was present.

Turning to the MLI anti-fragmentation rule, the Tribunal clarified that the rule applies only where both entities carry on complementary business activities forming a cohesive business operation in the same country. Since the taxpayer's core functions were performed offshore and the Indian entity's role was limited to support activities, the rule could not be invoked to expand PE exposure. Finally, the Tribunal held that the Revenue's profit attribution exercise was unsustainable in the absence of a PE and consistent with earlier years, concluded that the reinsurance premium was not taxable in India, with the preparatory-and-auxiliary characterization remaining intact.

Our thoughts:

This judgment brings much-needed clarity by drawing a clear line between core business activities and support functions. The Tribunal rightly recognized that in a reinsurance business, income is generated where risk is assumed and capital and underwriting decisions are made, all of which happened outside India in this case. Indian support services, even if detailed and technical, were correctly treated as back-end assistance and not as carrying on the business itself. The ruling also limits the use of the anti-fragmentation rule, making it clear that it cannot be used to create a PE where the foreign company does not actually operate in India. Overall, the decision offers relief to foreign reinsurers that routinely support arrangements in India, when properly structured and paid at arm's length, will not by themselves lead to tax exposure, while also reminding businesses to keep decision-making and risk assumption clearly offshore.

INDIRECT TAX

A. GST 2.0 REFORMS

The 56th Goods and Services Tax Council ("**GST Council**") meeting unveiled GST 2.0 reforms with the aim of making the tax structure more citizen-friendly and further improvise agriculture, health and manufacturing. The reforms were related to (1) GST rate reduction and (2) Process reforms for facilitation of trade including a simplified two-tier slab system (merit rate of 5% and standard rate of 18%) with a demerit rate of 40% for select foods and services.

(*A detailed understanding of the GST 2.0 reforms can be found here*.)

B. ISSUANCE OF SUMMONS NOT CONSIDERED 'INITIATION OF PROCEEDINGS': ARMOUR SECURITY (INDIA) LTD. v. COMMISSIONER, CGST

Brief Facts and Background:

The Petitioner, engaged in the business of providing security services, was issued a Show Cause Notice ("**SCN**") by the State GST Department constituted under the State Goods and Services Tax Act ("**SGSTA**") on 18 November 2024. The said show cause notice was served on the ground that –

(i) net tax under declared due to non-reconciliation of turnovers in other returns and e-way bill information;
(ii) excess claim of ITC.

Subsequently, the Commissioner, CGST, Delhi East Commissionerate issued summons on 23 January 2025 under Section 70 of the Central Goods and Services Tax Act, 2017 ("**CGST Act**"), requiring the directors of the Petitioner to produce various documents.

Aggrieved by the initiation of parallel proceedings by both the State and Central GST authorities, the Petitioner filed a writ petition before the Hon'ble High Court of Delhi ("**High Court**"), contending that the issues raised by the Central Authorities had already been examined by the State GST Department. It was further submitted that, considering Section 6(2)(b) of the CGST Act, the Central GST authorities lacked jurisdiction to conduct a separate investigation into the same matter. The High Court dismissed the writ petition and declined to interfere with the summons issued to the Petitioner, holding that **the expression "any proceeding" under Section 6(2)(b) of the CGST Act cannot be interpreted to include a search or investigation. It observed that a summons or investigation following a search serves merely as a precursor to formal proceedings and is distinct from assessment proceedings, being primarily intended to collect information. The Court clarified that the statutory bar against parallel proceedings applies only to assessment-related actions, such as those under Sections 73 and 74 of the CGST Act, and not to preliminary investigative steps undertaken to gather facts.**

Aggrieved by the order of the Delhi High Court, the petitioner preferred a Special Leave Petition before the Supreme Court.

Issue for consideration:

The issue for consideration before the Apex Court was whether issuance of summons can be construed as 'initiation of proceedings' in respect of the 'same subject matter' within the meaning of Section 6(2)(b) of the CGST Act.

Judgement:

The Apex Court first observed that the framework of the GST regime is founded on two central and interrelated concepts: (i) the principle of a "single interface" and (ii) the concept of "cross-empowerment."

Whether summons amount to 'initiation of proceedings' under Section 6(2)(b)?

The Supreme Court of India observed that various High Courts have adopted divergent views on the scope of the term "proceedings" in this context. Some courts have held that proceedings extend to audits, inquiries, or investigations for instance, in *R.P. Buildcon*[15] and *Vivek Narsiya*[16], whereas others, such as in *G.K.*

[15] M.A.T. No.1595 of 2022
[16] W.P(T) NO. 4491 of 2023

Trading[17], and *Anurag Suri*[18], have confined “proceedings” to those commencing with a show cause notice, reasoning that summons under Section 70 are merely steps in aid of an inquiry and do not, by themselves, constitute proceedings.

Referring to the ninth GST Council meeting held on January 16, 2017, and Circulars dated October 5, 2018, and June 22, 2020, the GST framework strikes a balance between the principle of a single interface where one authority manages routine taxpayer compliance and cross-empowerment, which equips both Centre and States for intelligence-driven enforcement actions. Section 6 of the CGST Act formalizes this cross-empowerment by permitting officers from either department to function as ‘proper officers’ under the other’s law, while prohibiting duplicate proceedings on identical matters. For administrative efficiency, taxpayers are allocated between Centre and States, yet either authority may independently initiate intelligence-based enforcement.

A summons constitutes merely a preliminary step in an investigation or inquiry, aimed at gathering information rather than serving as a final action. While tax liability may emerge from audits, scrutiny, or investigations, Sections 73, 74, and 76 of the CGST Act mandate issuance of a show cause notice before any demand or recovery can be enforced. Although "proceedings" remain undefined in the CGST Act, it commences only with the show cause notice.

Meaning of ‘subject matter’ under Section 6(2)(b) of the CGST Act:

One of the claims of the Petitioner was that both the investigations centered on the same subject matter. However, the phrase "subject matter" under Section 6(2)(b), though undefined in GST law, has been judicially construed to denote the cause of action for which proceedings are launched, ensuring only one authority (Central or State) pursues a single cause to prevent duplication. This subject matter crystallizes upon issuance of the show cause notice, which delineates allegations, period, invoked provisions, and proposed demand, thereby inaugurating formal proceedings. The statutory bar under Section 6(2)(b) applies solely when proceedings involve identical liabilities or overlapping obligations; distinct violations remain pursuable by separate authorities, with the Apex Court stipulating two conditions for "sameness": (i) the proceedings must concern the same liability or offence based on identical facts, and (ii) the sought demand, penalty, or relief must match.

Thus, the Supreme Court conclusively held that the issuance of summons or initiation of search/investigation does not amount to ‘initiation of proceedings’ for the purposes of Section 6(2)(b) of the CGST Act.

Our thoughts:

The Supreme Court’s judgment reinforces that the statutory bar under Section 6(2)(b) of the CGST Act applies exclusively to parallel assessment or adjudicatory actions concerning the identical subject matter such as tax demands, penalties, or recoveries under Sections 73, 74, or 76 and does not extend to simultaneous investigations or summons issued under Section 70 for information-gathering. To operationalize this principle and prevent harassment, the Court issued pragmatic guidelines for authorities: (i) they must proactively communicate with counterpart agencies upon detecting potential overlaps in the same subject matter; (ii) overlapping show cause notices must be quashed or withdrawn by the second

[17] WRIT TAX No. - 666 of 2020
[18] W. P.(C) No. 158 of 2020

authority; and (iii) taxpayers remain obligated to fully cooperate with summons, producing documents as required during preliminary inquiries.

This balanced approach fortifies the GST regime's foundational tenets of a "single interface" for routine compliance and "cross-empowerment" for intelligence-driven enforcement, while advocating real-time data-sharing mechanisms between Central and State authorities to foster efficient, duplication-free tax administration and safeguard taxpayers from protracted multiplicity of proceedings.

C. RECTIFICATION OF ERRORS IN RETURNS: CBIC v. ABERDARE TECHNOLOGIES

Brief Facts:

Aberdare Technologies (P.) Ltd. ("**Assessee**") is a registered person under the Central Goods and Services Tax Act, 2017 ("**CGST Act**"). For the tax periods July 2021, November 2021, and January 2022, the Assessee duly furnished its GST returns, including Form GSTR-1 and Form GSTR-3B, within the prescribed timelines. In December 2023, the Assessee discovered certain errors and incorrect particulars in the returns already filed for financial year 2021-22.

Section 39(9) of the CGST Act permits rectification of omissions or incorrect particulars only up to 30 November following the end of the relevant financial year, or the date of furnishing of the annual return, whichever is earlier. As the statutory cut-off date had elapsed, the Assessee submitted written representations to the jurisdictional GST authorities seeking permission to rectify the errors, either electronically or manually. The authorities rejected the request solely on the ground that the time limit prescribed under Section 39(9) had expired, notwithstanding the absence of any allegation of revenue loss or mala fide conduct. Aggrieved, the Assessee filed a writ petition before the Bombay High Court, challenging the refusal to permit rectification.

Issue for Consideration:

Whether rectification of GST returns can be denied solely on the ground that the statutory time limit prescribed under Section 39(9) of the CGST Act has expired, even where the errors are bona fide, inadvertent, and cause no loss of revenue to the tax authorities.

Decision of the Bombay HC:

The Bombay High Court allowed the writ petition and directed the tax authorities to permit the Assessee to amend and rectify its GST returns. The Court undertook a detailed examination of Sections 37, 38, and 39 of the CGST Act, which collectively govern the furnishing of outward supply details, inward supply details, and returns. **The Court held that these provisions must be read harmoniously and purposively, rather than in a strictly literal or mechanical manner. The High Court observed that the GST regime is a technology-driven compliance framework and that inadvertent human errors are inevitable. Treating such errors as irrevocable merely because a procedural deadline has elapsed would result in incorrect data being perpetuated within the GST system, leading to cascading adverse consequences.**

The Court placed reliance on its earlier decision in *Star Engineers (I) Pvt. Ltd. v. Union of India* [19] and noted that where there is no loss of revenue, denial of rectification on purely technical grounds defeats the object of the statute. The proviso to Section 39(9), according to the Court, cannot be interpreted so as to nullify the substantive right to correct bona fide errors. Accordingly, the respondents were directed to open the GST portal to enable rectification, failing which, the Assessee was permitted to carry out rectification through manual filing, subject to procedural safeguards, including prior notice and an opportunity of hearing.

[19] Star Engineers (I) (P.) Ltd. v. Union of India [2023] 157 taxmann.com 285

<u>Appeal before the Supreme Court of India</u>:

The Revenue challenged the Bombay High Court's decision by filing a Special Leave Petition before the Supreme Court of India. **The Supreme Court dismissed the Special Leave Petition and affirmed the reasoning of the High Court. The Apex Court observed that human errors and clerical or arithmetical mistakes are a normal incident of compliance, and such errors are not confined to assessees alone.** The Court held that the right to correct *bona fide* clerical or arithmetical errors flows from the right to carry on business and cannot be denied unless there exists a clear and reasonable justification.

The Supreme Court further held that limitations on software or portals cannot constitute a valid basis for denying rectification, as technology is intended to facilitate compliance, not obstruct it. The Court expressly declined to interfere with the impugned judgment and dismissed the SLP.

<u>Our Thoughts</u>:

This decision adopts a practical and taxpayer-friendly approach by recognising that the GST system should prioritise accuracy and fairness over rigid procedural formalism. By allowing the rectification of genuine clerical or arithmetical errors even beyond statutory timelines where no revenue loss is caused, the Court acknowledges the realities of a technology-driven compliance regime that is still evolving. The judgment rightly rejects the use of portal limitations as a blanket justification to deny correction of bona fide mistakes and affirms that compliance mechanisms must facilitate, rather than frustrate, lawful business activity. From a broader perspective, the ruling strikes a fair balance between administrative discipline and commercial reality and sends a clear message that procedural rules under GST cannot be enforced in a manner that undermines substantive rights and accurate tax reporting.

D. DOCTRINE OF MUTUALITY AND GST: INDIAN MEDICAL ASSOCIATION v. UNION OF INDIA

Brief Facts:

The Indian Medical Association, Kerala State Branch ("**IMA Kerala**" or "**Petitioner**") is a registered society and the State unit of the Indian Medical Association. The Petitioner operates multiple schemes exclusively for the benefit of its member-doctors, including social security schemes, disability support schemes, professional protection schemes, hospital protection schemes, health schemes, etc. Under these schemes, members contribute admission fees, annual subscriptions, and other scheme-specific contributions, which are pooled and utilised to provide financial assistance, legal support, health-related benefits, pensionary benefits, or aid in the event of death, disability, illness, or litigation. Each scheme is administered separately, has independent accounts, and is governed by its own bye-laws and managing committee.

The Petitioner had obtained GST registration and was subject to coercive action by the tax authorities, including recovery proceedings, pursuant to a summons issued by the Directorate General of GST Intelligence seeking details of its GST registration, audited accounts, and financial records for the period 2017-18 to 2021-22. The apprehended tax demand related to services allegedly rendered by the Petitioner to its members under the aforesaid schemes.

Under the GST regime as initially enacted, transactions between a club or association and its members were outside the scope of GST on the basis of the mutuality principle, as recognised by judicial precedent. This position was altered by the Finance Act, 2021, which retrospectively amended the CGST Act and the Kerala SGST Act with effect from 1 July 2017 by inserting Section 7(1) (aa) along with an Explanation and amending Section 2(17)(e). **The amendments introduced deeming provisions treating activities or transactions between a club or association and its members, for consideration, as taxable supplies for the purposes of the levy of GST.** After the introduction of these amendments and the initiation of proceedings, the constitutional validity of the amended provisions, and whether the amendments impermissibly sought to tax transactions that did not constitute "supply" under the Constitution with retrospective operation, were examined before the Kerala High Court.

A learned Single Judge of the Kerala High Court partly allowed the writ petition by striking down the retrospective operation of the amendments, while upholding their substantive validity. Aggrieved by the decision, both the Petitioner and the tax authorities filed writ appeals before the Division Bench.

Issues for Consideration:

1. Whether the amendments introduced by the Finance Act, 2021, to Section 2(17)(e) and Section 7(1)(aa) of the CGST Act and KGST Act, deeming supplies by clubs or associations to their members as taxable supplies, are constitutionally valid?

2. Whether, under the constitutional framework governing GST, the concept of "supply" permits taxation of transactions between a club or association and its members, notwithstanding the principle of mutuality?

3. Whether the retrospective operation of the impugned amendments with effect from 1 July 2017 is constitutionally permissible?

Judgement:

The Division Bench of the Kerala High Court allowed the Petitioner's writ appeals and dismissed the appeals filed by the tax authorities, holding that the impugned amendments were unconstitutional in their entirety. The Court held that GST, as envisaged under Article 246A read with Article 366(12A) of the Constitution, is a tax on the supply of goods or services or both, and that the **concepts of "supply" and "service" inherently require the existence of two distinct persons, namely a supplier and a recipient. Transactions involving self-supply or self-service are not contemplated under the constitutional scheme.** The Court noted that while the 46th Constitutional Amendment had introduced a deeming fiction under Article 366(29A) to treat certain transactions as "sales" for the purposes of sales tax, no corresponding constitutional amendment had been enacted in the context of GST to deem supplies between clubs and their members as taxable supplies.

The impugned amendments, according to the Court, merely sought to expand the statutory definition of "supply" without amending the constitutional definition of GST or the concept of "service". In the absence of a constitutional deeming provision, **Parliament could not, by way of a statutory amendment, enlarge the scope of "supply" to include transactions that constitutionally do not amount to a supply. The Court relied heavily on the doctrine of mutuality, as recognised and affirmed by the Supreme Court in *State of West Bengal v. Calcutta Club Ltd.*[2], and held that the principle continued to apply even after the introduction of GST. Since the identity between the club and its members remained intact, there could be no taxable supply of services between them.**

On this basis, the Court held that Section 2(17)(e) and Section 7(1) (aa) of the CGST Act and KGST Act, along with the Explanation thereto, failed the test of constitutional validity and were ultra vires Articles 246A, 366(12A), and 265 of the Constitution of India. In view of this conclusion, the Court did not find it necessary to separately sustain the amendments, even prospectively, and held them unconstitutional and arbitrary. The judgment of the Division Bench of the Kerala High Court has since been carried in appeal, and the issues arising from the decision are currently pending consideration before the Supreme Court of India.

Our Thoughts:

This ruling is a strong reaffirmation of the constitutional limits of the GST framework and the continued relevance of the principle of mutuality. By holding that GST can operate only where there is a supply between two distinct persons, the Court correctly rejected attempts to tax transactions that are, in substance, internal to an association and its members. The judgment emphasises that Parliament cannot use statutory deeming provisions to override constitutional concepts, and that any departure from the mutuality principle must be rooted in a constitutional amendment rather than ordinary legislation. From a practical standpoint, the decision provides certainty and relief to clubs, associations, and professional bodies such as the Indian Medical Association, while also signalling that foundational changes to the GST regime must respect constitutional boundaries.

FOREIGN EXCHANGE MANAGEMENT ACT

A. SABKA BIMA SABKI RAKSHA (AMENDMENT OF INSURANCE LAWS) ACT, 2025

The Sabka Bima Sabki Raksha (Amendment of Insurance Laws) Bill, 2025, introduced in Lok Sabha on December 16, 2025, and swiftly passed by Rajya Sabha the next day, represents a landmark liberalization of India's insurance sector. The Bill received Presidential assent on 20 December 2025 and thereby Sabka Bima Sabki Raksha (Amendment of Insurance Laws) Act, 2025 ("**Act**") was published for general information in the Gazette of India on 21 December 2025.

The Act amends the following existing legislations

1. Chapter II of Insurance Act, 1938;
2. Chapter III of Life Insurance Corporation Act, 1956;
3. Chapter IV of Insurance Regulatory and Development Authority Act, 1999.

Key Aspects of the Act:

Major Liberalizations: Foreign direct investment ("**FDI**") in insurers rises to 100% of the paid-up capital under the automatic route, up from 74%. Subsequent to the notification of the Act, the Ministry of Finance has notified amendments to the Companies (Foreign Investment) Rules, 2015 to effect this change in FDI limit. Along with the change in FDI, the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2025 (FI Rules") published by the Ministry of Finance, modifies the governance norms for insurers by mandating that at least one among the Chief Executive Officer ("**CEO**"), Managing Director ("**MD**") or Chairperson of the board must be a resident Indian citizen. The earlier requirement was that the majority of the board must be resident directors or key managerial persons.

Net-own funds for foreign reinsurers: Section 6 of the Insurance Act, 1938 was amended to state that for the registration of an Insurer it shall have net owned funds of not less than Rs. 1,000 crores. Prior to the amendment, the net-owned fund requirement was Rs. 5,000 crores.

Registration of transfer of shares: Previously, an approval was required from Insurance Regulatory and Development Authority of India ("**IRDAI**") for registration of transfer of shares exceeding 1% of a public company in the insurance business was required. The Act increased the threshold for the same from 1% to 5%.

Merger and Amalgamations: Post-enactment of the Act, insurance businesses may be transferred or amalgamated with non-insurance companies upon obtaining IRDAI approval. This represents a notable shift from the earlier framework, which restricted such schemes to insurers alone, subject to IRDAI approval.

Increase in powers of IRDAI: The Act empowers IRDAI to supersede the Board of Directors of an insurer to appoint an Administrator when it has reason to believe that an insurer carrying on insurance business is acting in a manner likely to be prejudicial to the interest of its policyholders. Further, IRDAI has been empowered to prescribe the cap or specific limits and modalities for commissions, remuneration and rewards to agents and intermediaries.

Insurance Intermediary: Subsequent to the amendment, intermediaries will now receive registrations that remain valid until suspended or cancelled, which previously were valid only for a period of 3 years from the date of registration.

Provisions focusing on Consumer and Governance interests:

The amendment empowers the government to set up a dedicated Policyholders' Education and Protection Fund. This fund is intended to promote insurance literacy and strengthen consumer education ensuring informed consumers and policyholders.

Our Thoughts:

The Amending Act marks a decisive step toward the Government's long-term goal of "Insurance for All by 2047." Relaxing regulatory norms and permitting 100% FDI enhances consumer options by fostering robust competition among existing insurers. This shift also creates new channels for securing foreign investment, bolstering companies' growth prospects and financial resilience. Although consumer safeguards remain firmly in place, the bolstered regulatory structure demonstrates a thoughtful equilibrium between liberalization and oversight. Simplified governance norms grant insurance firms greater operational flexibility, streamlining compliance and spurring efficiency.

B. <u>AMENDMENT TO COMPOUNDING RULES</u>

Brief Background:

Under Section 15 of the Foreign Exchange Management Act, 1999 ("**FEMA**"), the compounding mechanism enables individuals and companies to voluntarily acknowledge breaches of FEMA provisions and settle them by paying a penalty, thereby avoiding protracted enforcement proceedings. Building on the earlier analysis of the Foreign Exchange (Compounding Proceedings) Rules, 2024 ("**Compounding Rules**"), along with the Master Directions on Compounding of Contraventions under FEMA ("**Compounding Directions**"), this piece reviews the most recent amendments to the compounding framework. The Reserve Bank of India ("**RBI**") introduced these changes via A.P. (DIR Series) Circulars dated April 22, 2025, and April 24, 2025 ("**April Amendments**").

Key Amendments introduced:

Introduction of a cap on maximum compounding amount

Through the April Amendments, the RBI introduced paragraph 5.4.II.vi in the Compounding Directions, capping the compounding amount at INR 2,00,000 per contravention for miscellaneous non-reporting violations listed in Row 5 of the 'Guidance note on computation matrix'. This cap applies, subject to factors like the nature of contravention, exceptional circumstances, case-specific facts, and public interest. Previously, amounts for these non-reporting contraventions under FEMA lacked any upper limit, following a formula of 'INR 50,000 fixed plus a percentage of the contravened amount', which created ambiguity as authorities had no explicit ceiling to follow.

Deletion of paragraph 5.4.ii.v – fresh applications without linking to previous compounding order

The RBI deleted paragraph 5.4.II.v of the Compounding Directions. Previously, this clause automatically increased compounding amounts by 50% for applicants who had received an earlier compounding order for the same contravention but failed to pay the stipulated amount before re-applying. This deletion now decouples fresh compounding applications from prior ones concerning the same subject matter, eliminating any enhanced penalty for previous non-payment of the compounding amount under FEMA.

New procedural requirements for payment submission

Through the April Amendments, the RBI modified Part B of Annexure I to the Compounding Directions. Following payment of the compounding application fee or amount, applicants must now email the RBI additional details, including:

(i) mobile number;
(ii) specific RBI office where payment was made; and
(iii) payment mode details. The enhanced requirements improve payment tracking, expedite record updates, and streamline overall compounding administration.

Our Thoughts:

The amendments to compounding regulations deliver tangible economic benefits by capping or rationalizing amounts for minor and procedural contraventions, alleviating fears of disproportionate penalties and fostering ease of doing business, while clearer differentiation between penalties and compounding amounts enhances taxpayer predictability in deciding whether to pursue regularization. On the behavioral front, the predictable framework incentivizes early voluntary compounding over protracted litigation, elevating overall compliance culture, yet maintains robust deterrence by keeping serious or willful breaches non-compoundable or subject to stringent scrutiny.

C. AMENDMENTS TO FOREIGN EXCHANGE REGULATIONS

The Reserve Bank of India introduced certain amendments to the (i) Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instrument) Regulations, 2019 ("**Mode of Payment Regulations**"), (ii) Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2015 ("**Currency Accounts Regulations"**), and (iii) the Foreign Exchange Management (Deposit) Regulations, 2016 ("**Deposit Regulations"**). These amendments were all aimed to encourage the use of Indian Rupee in cross border transactions.

(*A detailed understanding of the reforms can be found here.*)

D. DRAFT ECB REFORMS

On October 3, 2025, the Reserve Bank of India (RBI) issued the draft *Foreign Exchange Management (Borrowing and Lending) (Fourth Amendment) Regulations, 2025* (“Draft Amendment”). The Draft Amendment seeks to revise and comprehensively reform the *Foreign Exchange Management (Borrowing and Lending) Regulations, 2018* (“Current ECB Regime”). Among other changes, the Draft Amendment proposes to:

(i) increase the borrowing limits;
(ii) broaden the categories of eligible borrowers and recognized lenders;
(iii) simplify reporting requirements; and
(iv) rationalize the list of permissible end-uses under the Current ECB Regime.

E. CLARITY ON REQUIREMENT OF RBI APPROVAL FOR PAYMENTS AGAINST FOREIGN ARBITRAL AWARDS: GPE (INDIA) LTD. v. TWARIT CONSULTANCY SERVICES PVT. LTD.

Brief Facts:

The petitioners, GPE (India) Limited ("**GPE")** were Mauritius-based investors and shareholders who had invested approximately INR 125 crore in Haldia Coke and Chemicals Private Limited in 2010 **("Haldia Coke**"). The investment by way of purchase of securities was governed by two Share Subscription and Shareholders' Agreements ("**SSHAs**") dated 31.05.2010. The SSHAs provided numerous exit options to the petitioners, i.e. IPO, strategic sale, and the exercise of a put option. In 2015, the promoters of Haldia Coke, i.e. Twarit Consultancy and its affiliates agreed to purchase the petitioners' securities for a total consideration of INR 200 crore in fourteen tranches. This arrangement was formalised through three Share Purchase Agreements ("**SPAs**"). However, the promoters paid only INR 5 crore against the purchase of these shares and defaulted on all remaining tranches, leading to purchaser payment breach. The petitioners thus invoked arbitration under the Singapore International Arbitration Centre ("**SIAC**") Rules in December 2017.

Findings of the Arbitral Tribunal constituted under the SIAC Rules:

The arbitral tribunal constituted under the SIAC Rules ("**Tribunal")** held that the promoters had breached the SPAs and awarded damages of INR 195 crores to the investors. The investors (petitioners herein) had initially claimed INR 401 crore, being internal rate of return of 24% on INR 125 crore ("**IRR")** on exercise of the put option (IRR was provided under the SSHAs). The Tribunal rejected this claim, holding that such a guaranteed return was a penalty barred by Section 74 of the Indian Contract Act. Instead, relying on Section 73 of the Act, the Tribunal calculated damages on the standard principle, i.e. Damages = Agreed price − Market value on the date of breach. The date of breach was fixed as 11 July 2017. On the evidence, Haldia Coke was found to be commercially defunct and its shares were worth zero. Accordingly, the Tribunal awarded INR 195 crore (Damages= INR 200 crore minus the INR 5 crore already paid). The Tribunal noted that this was not a guaranteed return but compensation for a failed sale of shares.

Proceedings in the High Court

This foreign award was sought to be enforced by the petitioners in Madras High Court ("**HC**") under Sections 47 and 49 of the Arbitration and Conciliation Act, 1996. However, the respondents cited violation of public policy as a ground to deny enforcement of the arbitral award. This was based on Foreign Exchange Management Act, 19991("**FEMA**") and RBI pricing rules. They argued that the exit structure guaranteed the investors a 24% IRR, which is impermissible. Under FEMA, foreign equity investment is treated as risk capital, not debt, and non-residents must exit at fair market value and not at a certain agreed price. Thus, a contractual arrangement to pay INR 200 crore in exchange of securities, irrespective of the company's value, is violative of this framework. Consequently, the SPAs were alleged to be illegal.

In January 2023, the HC enforced the award, holding that refusal of enforcement is permitted only for fraud, violation of fundamental policy of Indian law, or basic morality and justice. FEMA breaches do not meet this threshold. Drawing on *Vijay Karia and Others v. Prysmian Cavie Sistemi SRL*[20], the HC held that FEMA is regulatory in nature and violations do not render contracts void.

[20] Civil Appeal No. 1544 of 2020

The HC also noted that since no shares were transferred, no foreign exchange moved out of India. The SSHAs' put options were never exercised, so they never triggered FEMA. The SPAs resulted only in a failed share sale and breach of contract and therefore Tribunal awarded the damages. However, the HC held that although the payment is labelled as "damages", in economic substance it is identical to paying the full share price and therefore is a capital account transaction. Therefore, RBI approval would be required before remittance abroad. The award was thus enforceable, subject to RBI clearance.

Issue for Consideration:

GPE challenged the requirement of RBI-approval before the Supreme Court ("**SC**"). The SC had to decide whether RBI approval was needed before remitting the awarded damages outside India.

Ruling of the SC:

RBI filed an affidavit before the SC stating that payment of compensatory damages pursuant to an arbitral award is a current account transaction under Section 5 of FEMA read with the Current Account Transaction Rules, 2000. Since no equity instruments were being transferred, no capital account transaction was involved, and therefore no RBI approval was required. In effect, entire unpaid consideration under SPAs was directed to be paid as damages by HC. It is important to note that this is in the nature of damages and not the sale price of shares. In essence, the quantum mirrors a capital account transaction, yet its legal character is that of a current account payment for breach of contract.

The SC dismissed Twarit's review petition on 29 October 2025, effectively endorsing this position.

Our Thoughts:

This judgment is doctrinally significant. Although the damages arose from breach of what would have been a capital account transaction (a share sale), the payment itself was treated as a current account transaction because it involved no transfer of securities. The same amount of ₹195 crore became legally permissible requiring no RBI approval simply because it was paid as compensation rather than consideration.

The SC did not clarify or substantiate on the principle distinguishing outbound payments arising out of underlying capital account transactions and ordinary current account remittances. Currently, the same bench of SC in the matter of *Nine Rivers Capital Limited v. Gokul Patnaik*[21] has sought RBI affidavit on whether investors seeking specific performance of put option rather than seeking damages is a current or a capital account transaction. The matter is listed for hearing on 26 February 2026.

GPE v. Twarit is a pivotal pro-enforcement and pro-investment judgment. The policy logic underlying this classification is that current account transactions are generally permitted unless expressly prohibited; channeling such payments through this framework avoids unnecessary regulatory friction that would otherwise impede enforcement of foreign arbitral awards. This directly advances ease of doing business for foreign investors.

[21] SLP(C) No. 21109/2025 XIV

F. UNDERSTANDING THE SCOPE OF 'UNDUE HARDSHIP': DEPUTY DIRECTOR v. GOOGLE INDIA

Brief Facts:

Google India Pvt. Ltd. ("**GIPL**") owed Rs.3.64 crore to Google Ireland Ltd. as distributor fees under the 'Ad Words Program' for marketing online advertising space to Indian advertisers, outstanding for over four years as of May 2014. In FY 2007, GIPL also owed INR 1.09 mn to its holding company Google Inc. USA, for fixed assets purchased in FY 2007-08, outstanding for over seven years as of January 2014. The Adjudicating Authority imposed penalties of Rs.5 crores on GIPL, Rs.20 lakhs of each of the Foreign Directors Mr. Kent Walker and Mr.Lloyd Hartley Martin, and Rs.5 lakhs on the Indian director Mr. Hari Raju Mahadevu (later substituted by Mr.Vivek Chhabra), for contravening Section 6(3)(d) of Foreign Exchange Management Act ("**FEMA**") read with Regulations 3, 5(3), 6(3) and Schedule III of FEM (Borrowing/Lending in Foreign Exchange) Regulations, 2000, viewing delays in the above stated amounts payable to Google Ireland Ltd. and Google Inc. USA as supplier's credit akin to External Commercial Borrowings("**ECB**") without RBI ("**Reserve Bank of India**") / government approval.

GIPL secured post-facto RBI permissions via its AD bank (Citibank) on 27 May, 2014, after verifying no interest, no pecuniary gain, and genuine delay reasons, allowing remittances under FEMA for current account transactions per Master Circular on Imports. The Appellate Tribunal on January 11, 2019, granted full stay on penalties pending appeals, finding *prima facie* merit, balance of convenience, and undue hardship absent pre-deposit.

Issue for Consideration:

The key issue was whether the Tribunal correctly waived pre-deposit under the proviso of Section 19(1) of FEMA without imposing conditions to safeguard the Revenue's interests, or if it failed to balance undue hardship against revenue protection as mandated by preceding Supreme Court judgements. The Directorate argued RBI permissions to AD banks did not regularize GIPL's contraventions, no undue hardship existed, and full stay on pre-deposit led to prejudiced recovery. GIPL contended the transactions at hand were not ECBs as it lacked loan terms/interest/gain and further, the RBI permissions post-facto validated delays under Para B.5 of the Master Circular on Imports for Goods and Services. GIPL submitted that there has been no prima facie violation and further, the pre-deposit would create undue hardships.

Judgement:

The Division Bench of the Karnataka High Court set aside the Appellate Tribunal's unconditional stay of penalties under FEMA Section 19, directing respondents to furnish bank guarantees for 50% of the levied penalties (₹5 crores on GIPL, ₹20 lakhs each on foreign directors Kent Walker and Lloyd Hartley Martin, ₹5 lakhs on Indian director Hari Raju Mahadevu) within two weeks to the Assistant Director balance the statutory pre-deposit mandate with revenue safeguards. Emphasizing the Appellate Tribunal's failure to apply Supreme Court precedents, **the High Court Court held that "undue hardship" under the provisio of Section 19 demands claimant-specific evidence of disproportionate economic burden exceeding circumstances warranted and not mere assertion or prima facie merit alone. While mandating proactive conditions to secure penalty realization even if partially waived, rejecting blanket hardship absent disproportionality proof despite GIPL's scale implying financial capacity.**

Drawing directly from *Benara Valves Ltd. v. Commissioner of Central Excise*[22] , the twin tests require: (1) evidential establishment of excessive hardship unwarranted by conduct (beyond ordinary strain); and (2)

[22] AIRONLINE 2006 SC 339

Tribunal-imposed protections (e.g., partial guarantees) safeguarding revenue, as complete waiver risks non-recovery given substantial dues.

Our Thoughts:

The Karnataka High Court's ruling in *Deputy Director v. Google India* reinforces the judiciary's calibrated approach to FEMA penalty stays under Section 19(1), **striking a pragmatic balance between taxpayer relief and revenue protection by mandating 50% bank guarantees rather than unconditional waivers**. This is seen as a timely course-correction against Appellate Tribunals' over-reliance on prima facie merit, emphasizing claimant-specific evidence of "undue hardship" that transcends mere assertions particularly, for financially robust entities like GIPL where capacity to pay negates blanket exemptions. Drawing from Supreme Court precedents like *Benara Valves*, the decision underscores twin imperatives: rigorous hardship substantiation beyond ordinary strain, and proactive safeguards like partial guarantees to mitigate non-recovery risks on substantial dues.