KHAITAN & CO
ADVOCATES SINCE 1911

Navigating Tax Disputes & Related Developments in India

JULY - AUGUST 2026

Tax Rulings

Reimbursement for cross-border secondments taxable as FTS

The Hon'ble Delhi High Court, in Ernst and Young U.S. LLP (EY US) held that cost-to-cost reimbursements of seconded employees made by the Indian entity to its US affiliate constitutes fees for technical services/fees for included services (FTS) under the Income-tax Act, 1961 (IT Act) read with the India-USA Tax Treaty. In holding so, the Court concluded that such payments are not non-taxable reimbursements as argued by the taxpayer.

The Court held that the arrangement was, in substance, a deputation by EY US of its personnel to make available their technical knowledge, skills and know-how to EY's Indian entities. In reaching this conclusion, it attached particular significance to the secondees' continuing employment lien with EY US, their continued entitlement to overseas social-security and other employment benefits, and the fact that the Indian entities could terminate the assignment but could not sever the secondees' underlying employment relationship with EY US. Secondly, observing that the secondees transferred group culture, global processes and institutional know-how to the Indian entity enabling it to independently apply such knowledge going forward, the Court held that the 'make available' test under Article 12(4)(b) of the India-USA Tax Treaty was satisfied. The Court further held that the absence of a mark-up does not, by itself, negate taxability where the arrangement, in substance, involves provision of services through personnel.

The tax treatment of payments under secondment arrangements remains an unsettled issue. This ruling gives greater weight to the secondee's continuing employment relationship with the overseas entity than to the extent of the Indian entity's day-to-day supervision and control. Multinational groups should therefore carry out a detailed review of their secondment arrangements, payroll processes and operational control structures in light of this development.

Irrespective of ESOPs taxed in India, the 'cost of acquisition' is available at FMV

The Hon'ble Tax Tribunal, Mumbai in Rajesh R. Hemrajani, examined the cost of acquisition of shares acquired through exercise of stock options for computing capital gains. The taxpayer, a non-resident employed with the UK branch of L&T Infotech Ltd., was granted ESOPs in the Indian company and acquired 1,540 equity shares at an exercise price of INR 1 per share, which were subsequently sold. The tax officer denied benefit under section 49(2AA) of the IT Act, which provides for the adoption of the fair market value (on date of exercise) of underlying shares as the cost of acquisition, and accordingly adopted the actual exercise price as the cost of acquisition. Rationale for the same was that the resultant perquisite was not chargeable to tax in India under the India-UK Tax Treaty.

The Tax Tribunal ruled in the taxpayer's favour, holding that section 49(2AA) of IT Act merely requires the fair market value to have been 'taken into account' for purposes of section 17(2)(vi), and does not additionally require that the resultant perquisite actually be brought to tax in India. Applying the settled principle that courts cannot read additional words into an unambiguous statutory provision, the Tax Tribunal held that the applicability of section 49(2AA) of the IT Act cannot be determined on the jurisdiction in which the perquisite was taxed.

This ruling provides significant relief for international employees, particularly those who exercise ESOPs while working outside India and whose perquisite income is consequently taxed overseas rather than in India. It confirms that such employees are not disadvantaged when computing capital gains on subsequent sale of the underlying shares, preventing an artificially inflated capital gains liability. The employers should ensure ESOP documentation and valuation records maintained are robust, as these form the basis to compute the cost of acquisition regardless of the taxpayer's residential status at the time of exercise of such ESOPs.

Defects in section 143(2) notice format held to be curable, validity of tax scrutiny assessments upheld

A Special Bench of the Hon'ble Tax Tribunal, Bangalore in M D Sons & Ors, held that a tax scrutiny notice under section 143(2) of the IT Act, which is the first step in a tax scrutiny and marks the initiation of a detailed assessment, is not rendered invalid merely because it does not conform to the format prescribed under Central Board for Direct Taxes' (CBDT) Instruction dated 23 June 2017. CBDT in its aforesaid instruction laid down three formats for issuing section 143(2) notice namely, limited scrutiny, complete scrutiny and compulsory manual scrutiny. The contention of the taxpayer was that such non-conformity was a jurisdictional defect that renders the assessment proceedings and consequential assessment order invalid.

The Special Bench held that a notice issued under Section 143(2) informing a taxpayer that the return has been selected for scrutiny is valid if it conveys that the return has been selected for scrutiny and is issued within limitation. The Special Bench noted the conflicting views of the various Tax Tribunals on the issue and followed the Delhi High Court's view in Bharat Bansal vs National Faceless Assessment Centre that the CBDT

circulars are administrative instructions meant for internal departmental guidance regulating the manner and categories of cases to be selected for scrutiny and the extent of such scrutiny. The High Court also held that a notice under Section 143(2) is only an intimation that a taxpayer's case has been selected for scrutiny. The Special Bench further observed that since the taxpayer participated in the scrutiny proceedings without demonstrating prejudice, the alleged defect is procedural in nature and does not vitiate the consequential assessment proceedings.

This ruling authoritatively resolves a long-standing and widespread conflict across various benches of the Tax Tribunal, where numerous taxpayers had successfully obtained favourable rulings setting aside the assessments on this technical ground. The ruling is likely to be relied upon extensively by the revenue to defend pending and future challenges premised on notice-format defects, materially narrowing this extensively relied upon technical defence. Taxpayers with pending appeals raising this issue should reassess their litigation strategy.

Buy-back of own shares is not taxable acquisition under Section 56(2)(x)

The Hon'ble Delhi High Court in M/s Global Capital Market Limited , held that a company's buy-back of its own shares at a price lower than their tax fair market value does not attract Section 56(2)(x) of the IT Act. The tax officer had treated the difference between the tax fair market value of the shares and the buy-back price as taxable income in the hands of the taxpayer (ie issuer company), on the basis that the taxpayer had acquired property for inadequate consideration.

The High Court observed that while shares may constitute 'property' in the hands of a shareholder or another corporate acquirer, they do not assume the same character for the issuing company when it repurchases them. Under buy-back, a company is required to cancel, mutilate or destroy the bought-back shares, thus it cannot be regarded as having acquired an asset from which a deemed benefit can arise. Taxing the taxpayer on the alleged accretion arising from such shares would consequently be untenable, since the shares cease to exist following the buy-back.

The ruling provides support for the position that Section 56(2)(x) should not apply to an issuing company merely because the buy-back price is below the prescribed tax fair market value. This ruling is particularly relevant where a buy-back is commercially undertaken at a negotiated price and the tax authorities seek to characterise the transaction as an acquisition of property by the company.

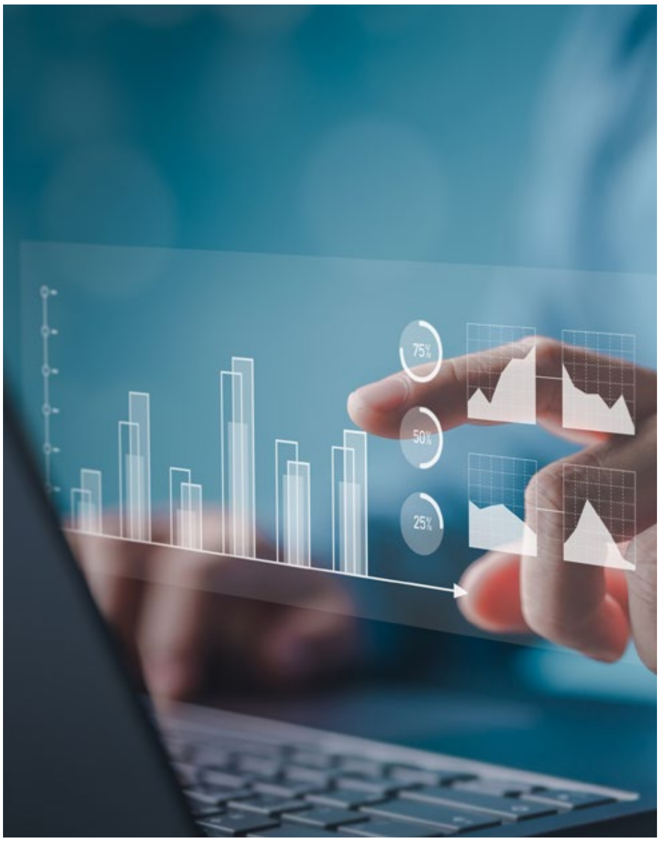
PE profit attribution – MAP resolution not automatically binding on subsequent years

The Hon'ble Tax Tribunal, Delhi in BBC Global News Limited held that profit attribution rate followed in earlier years pursuant to a mutual agreement procedure (MAP) resolution could not be automatically applied to subsequent years, if the underlying facts and activities of the Indian dependent agency permanent establishment (DAPE) had changed.

For the years under consideration, the tax officer had increased the attribution to 15% (from 8.75% agreed under MAP) based on material found during a survey, which indicated that the Indian DAPE was performing functions beyond those disclosed in the transfer pricing study. These included promoting and facilitating advertisement sales, business development, identifying market opportunities, marketing and research activities, and collection of advertisement revenue. The Tax Tribunal agreed that these additional activities justified a higher attribution than 8.75% but found the tax officer's 15% attribution to be excessive. It therefore restricted the attribution to 12% of advertisement revenue for the concerned years.

The Tax Tribunal also rejected the argument that no further profits could be attributed to the DAPE since it had already been remunerated at arm's length. Relying on the Hon'ble Supreme Court's decision in DIT v. Morgan Stanley & Co., the Tax Tribunal observed that further attribution may still be required where the transfer pricing analysis does not adequately capture the functions performed and risks assumed by the PE.

Overall, the ruling is significant affirming that an attribution rate agreed under a MAP may be followed in subsequent years where the facts remain unchanged, but a change in the functions and activities of the PE can justify a fresh attribution.



Other Key Updates

India–Mauritius Tax Treaty Protocol: PPT on Horizon

On 7 March 2024, India and Mauritius signed an amending protocol (Protocol) to incorporate the BEPS minimum-standard anti-abuse measures. The Protocol firstly replaces the treaty preamble to clarify that the elimination of double taxation is not intended to create opportunities for non-taxation or reduced taxation through tax evasion, avoidance or treaty shopping; and secondly introduces a new 'Entitlement to Benefits' article containing the Principal Purpose Test (PPT) which permits either country to deny tax treaty benefits where obtaining a tax benefit is one of the principal purposes of an investment or transaction, unless granting the benefits would be in accordance with the object and purpose of the relevant treaty provisions.

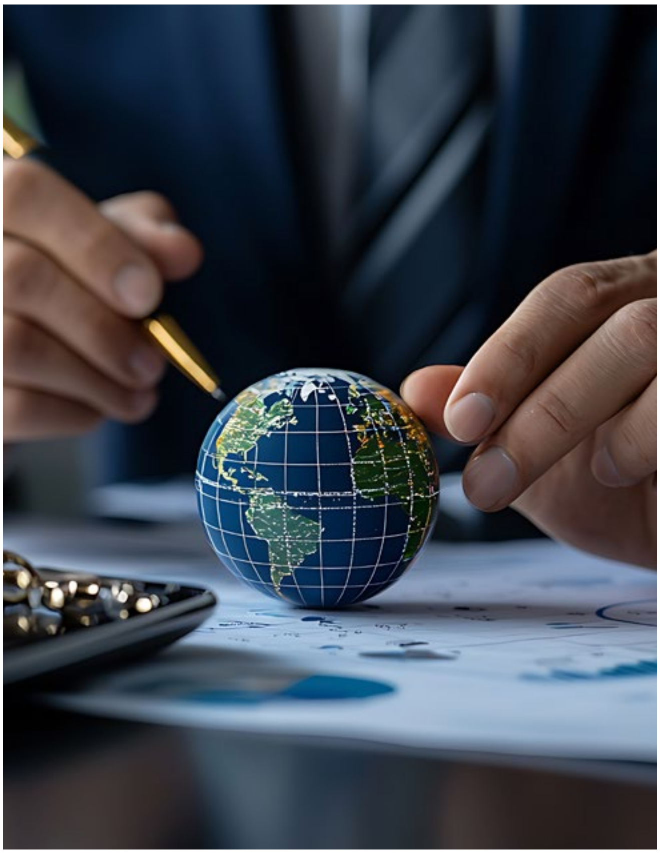
Mauritius had deferred ratification of the Protocol following stakeholder and investor concerns in Mauritius and India regarding its possible effect on existing treaty benefits, including the scope and temporal application of the PPT. The highlights of the Mauritian Cabinet's meeting on 17 July 2026 records that India had assured Mauritius that it would not take action undermining Mauritius' benefits under the India-Mauritius Tax Treaty and that the Indian authorities' subsequent clarification was favourable to Mauritius.

This is an important step towards ratification, but the effective date remains contingent on completion and exchange of those notifications. For the tax authorities, the Protocol supplies a broad treaty-based anti-abuse tool, whereas for the taxpayers, it heightens the need to demonstrate that treaty claim is consistent with the purpose of the relevant tax treaty provision and is not driven principally by the tax benefit.

India APA Annual Report for FY 2025-26

CBDT released its eighth Annual Advance Pricing Agreement (APA) Report for financial year (FY) 2025-26, recording one of the highest number of APA signings in any financial year, with 220 APAs signed (136 unilateral and 84 bilateral), taking the cumulative total of 1,035 APAs signed since the programme's inception in 2012. Bilateral APAs (BAPAs) also hit a record, with India signing its first-ever bilateral agreements with France, Indonesia, Ireland and Sweden.

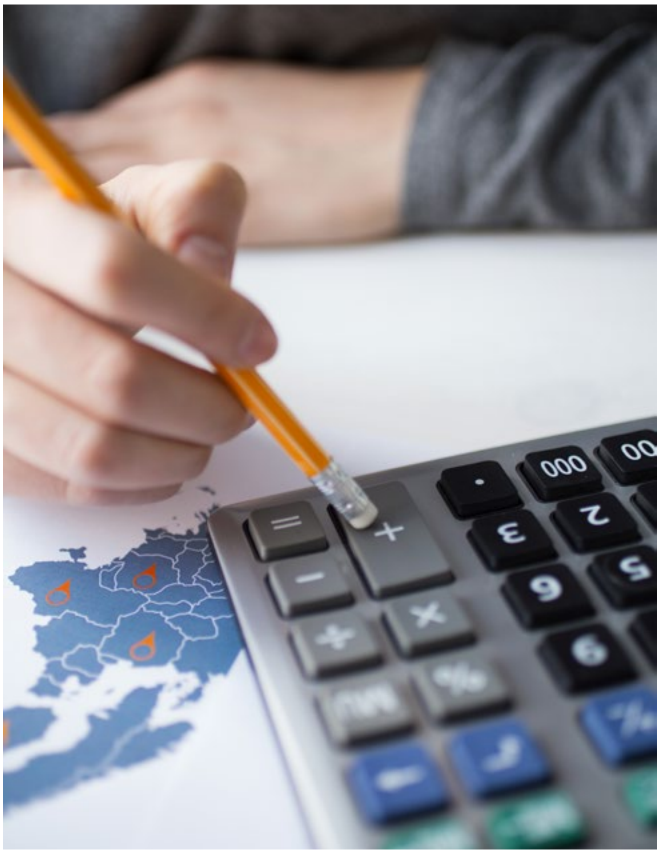
The new APA reforms undertaken in Income-tax Act, 2025 and Income-tax Rules, 2026, include new standardised forms, a flat filing fee of INR 20 Lakhs (replacing the slab-based system), a two-year timeline for IT services unilateral APAs



and expanded Safe Harbour turnover threshold of INR 2,000 Crores, with a unified 15.5% profit margin for IT services.

Separately, the Mutual Agreement Procedure (MAP) programme showed a declining case inventory, down to 365 cases by end of year 2025 from 947 in 2020, with India recognised by the OECD for 'Best Co-operation in Transfer Pricing MAP Cases' with Japan for year 2024.

Collectively, these developments reinforce India's continuing shift toward a more predictable, taxpayer-friendly transfer pricing and dispute resolution framework, reducing litigation and strengthening investor confidence. The statistics highlighted in the annual report are a testament to the success of the APA regime. It shows a significant departure from the 'wait and watch' approach to a 'tax-certainty' approach.



Transfer Pricing Non-Reference: A New Basis for Reassessment

Lately tax authorities have initiated reassessment proceedings in cases where, during the original tax assessment / tax audit, the tax officer did not refer the taxpayer's case to Transfer Pricing Officer (TPO) to determine whether 'international transactions' undertaken with 'associated enterprises' (ie related parties) were at arm's length or not. In certain cases, the absence of such a reference is being cited as a basis for initiating reassessment proceedings.

This development has created uncertainty for taxpayers, particularly where transfer pricing disclosures and supporting documentation had already been furnished during the original assessment. While the validity of any such reassessment proceedings will depend on the facts and circumstances of each case, including the nature and extent of disclosures made by the taxpayer during original tax assessment / tax audit, businesses should ensure that all international transactions undertaken with associated enterprises are supported by a robust and contemporaneous benchmarking study report, together with adequate documentation substantiating the arm's length nature of such transactions.

Adjustments made while processing income tax returns: Timely responses can prevent avoidable appeals

An increasing number of appeals are being filed against adjustments made while processing income-tax returns under section 143(1) of the IT Act. In many cases, these adjustments arise because taxpayers are not served with a notice proposing the adjustment, or because the intimation is processed before the expiry of the deadline provided for responding to the proposed adjustment notice. Further, there is no mechanism for taxpayers to ascertain whether their response to the proposed adjustment notice has been accepted or rejected by the Centralised Processing Centre (CPC) of the Income-tax Department, which processes income-tax returns. The resulting intimation leads to an additional tax demand, which then needs to be challenged through the appellate process.

Taxpayers should, therefore, closely monitor notices and communications issued through the income-tax portal and respond to proposed adjustments promptly, with detailed explanations. Early engagement can help resolve routine issues before an adjustment is finalised, reducing avoidable demands and subsequent litigation.

End Notes

CIT (IT)-1 vs. Ernst and Young U.S. LLP [2026] 187 taxmann.com 711 (Delhi).
Rajesh R Hemrajani vs. ITO [2026] 189 taxmann.com 183 (Mumbai-Trib).
M D Sons & Ors vs. ITO, TS-1089-ITAT-2026(Bang)].
TS-216-HC-2026(DEL) (Order dated 17.2.2026).
PCIT vs. M/s Global Capital Market Limited 2026:DHC:3051-DB.
BBC Global News Limited vs. DCIT Circle Intl Tax 1(1)(2), [2026] 189 taxmann.com 436 (Delhi-Trib).
[2007] 292 ITR 416 (SC)

ABOUT KHAITAN & CO

Khaitan & Co is a top tier and full-service law firm with 1300+ legal professionals, including 340+ leaders and presence in India and Singapore. With more than a century of experience in practicing law, we offer end-to-end legal solutions in diverse practice areas to our clients across the world. We have a team of highly motivated and dynamic professionals delivering outstanding client service and expert legal advice across a wide gamut of sectors and industries.

To know more, visit www.khaitanco.com

For any queries regarding the newsletter, please email us at directtax.lit@khaitanco.com

Disclaimer

This document has been created for informational purposes only. Neither Khaitan & Co nor any of its partners, associates or allied professionals shall be liable for any interpretation or accuracy of the information contained herein, including any errors or incompleteness. This document is intended for non-commercial use and for the general consumption of the reader, and should not be considered as legal advice or legal opinion of any form and may not be relied upon by any person for such purpose. It may not be quoted or referred to in any public document, or shown to, or filed with any government authority, agency or other official body.

Ahmedabad ▪ Bengaluru ▪ Chennai ▪ Delhi ▪ GIFT City ▪ Gurugram ▪ Hyderabad
Kolkata ▪ Mumbai ▪ Noida ▪ Pune ▪ Singapore