KATALYST ADVISORS

Katalyst Kaleidoscope

January 2026: Tax and Regulatory Insights

SUMMARY OF CONTENTS

A. Income Tax Highlights

1. SC: Taxability of shares received on amalgamation when held as stock-in-trade[1]

The assessee companies received shares of the amalgamated company pursuant to a court-sanctioned scheme of amalgamation in substitution of shares held in the amalgamating company as stock-in-trade. The Assessing Officer treated the receipt as taxable business income under section 28, while the assessee contended that mere substitution of shares did not result in accrual of real income.

The Supreme Court examined whether allotment of shares on amalgamation could give rise to taxable business income, independent of the concept of "transfer" applicable to capital gains. The Court held that section 28 is a wide charging provision and does not require a conventional sale, transfer or exchange. Business income may arise in kind, and receipt of shares in lieu of trading stock may constitute a receipt of consideration.

However, the Court clarified that taxability under section 28 depends on commercial realisability. The receipt must result in a real and presently realisable commercial benefit. Taxability would arise only where the substituted shares are freely tradable and capable of definite monetary valuation, such that the original stock-in-trade is replaced by an asset of ascertainable market value.

The Court held that where these conditions are satisfied, business income may arise at the time of allotment of shares. Conversely, where the shares are subject to restrictions, lack marketability or do not yield a realisable benefit, taxation may be deferred. The determination is fact-specific and the burden lies on the Revenue to establish real income.

***Katalyst comment**:*

This judgement is likely to create significant uncertainty in certain cases and also has potential of significant confusion because aggressive positions by the tax department based on this judgement can unsettle a settled position in law. The reality is that a very large majority of shares held by the shareholders of the amalgamating company are capital assets such as those held by promoters, FPIs, DIIs, and indeed, most investors. There could be a very small portion held as stock in trade where the issue will arise, but it also has the potential of litigation and confusion where shares are held as investments for many years, but are sold shortly after amalgamation.

[1]M/S Jindal Equipment Leasing Consultancy Services Ltd v. CIT-Delhi-II, New Delhi [Civil Appeal No. 152 of 2026] dated January 9, 2026

2. SC: Interest on borrowed funds used to acquire controlling interest allowable as business expenditure[2]

The assessee had borrowed funds on which interest was paid and utilised such funds for investment in a company with the objective of obtaining controlling interest, pursuant to which the investee company became its subsidiary. The Assessing Officer disallowed the interest under section 36(1)(iii), holding that acquisition of shares for control purposes did not constitute use of borrowed capital for the purposes of business.

The Tribunal allowed the interest deduction on the ground that the investment was made out of commercial expediency, and the High Court affirmed this view, holding that acquisition of controlling interest in a subsidiary was a business decision and not a passive investment.

The Supreme Court upheld the findings and reiterated that the test under section 36(1)(iii) is whether the borrowing is for commercial expediency and not whether it directly results in income. It was held that investment in a subsidiary to acquire controlling interest constitutes business purpose, and interest on borrowed funds used for such investment is allowable. The Court further held that advances made to sister concerns and their directors would also be covered by the principle of commercial expediency, subject to facts. Accordingly, the disallowance of interest was set aside.

3. SC: DTAA does not shield indirect share transfers from GAAR[3]

The grandfathering dispute arose from the exit of a private equity investor (Tiger Global International Holdings) from an Indian e-commerce company in 2018 pursuant to Walmart Inc.'s acquisition of a controlling stake in Flipkart, where investments in the Indian company had been made between 2011 and 2015 through Mauritius-based entities holding shares in a Singapore holding company. The assessee claimed exemption from Indian capital gains tax under Article 13 of the India–Mauritius DTAA, relying on valid tax residency certificates and the grandfathering protection available for investments made prior to the treaty amendment effective from 1 April 2017.

Upon the assessee seeking a nil withholding certificate, the Indian tax authorities rejected the claim, alleging that the Mauritius entities were conduit structures and that effective management and control rested outside Mauritius. The Authority for Advance Rulings rejected the applications as non-maintainable under section 245R(2), holding that the transaction was prima facie designed for tax avoidance. The High Court quashed the AAR's decision and upheld treaty entitlement, but the Supreme Court reversed the High Court and restored the Revenue's position.

[2] Sharp Business System v. CIT [2025] 181 taxmann.com 657 (SC) dated December 19, 2025
[3] The Authority for Advance Rulings (Income Tax) and others v. Tiger Global International II Holdings dated January 15, 2026

The Supreme Court held that possession of a tax residency certificate or reliance on CBDT Circular No. 789 does not create an irrebuttable presumption of treaty entitlement. It was held that tax authorities are entitled to examine effective management and control, commercial substance, and whether the arrangement constitutes an impermissible avoidance arrangement. The Court clarified that its earlier decision in Azadi Bachao Andolan[4] does not preclude such examination and reaffirmed the continued relevance of the substance-over-form doctrine as recognised in McDowell & Co.[5]

On the issue of grandfathering, the Court held that the cut-off date of 1 April 2017 is not determinative where a tax benefit is obtained on or after that date. It was held that GAAR can be invoked even in respect of pre-2017 investments if the subsequent transfer forms part of an impermissible arrangement. The Court clarified that the duration of the arrangement or the date of original investment is irrelevant once a tax benefit is derived post cut-off.

The Court further held that under section 96(2), once GAAR is invoked, the burden shifts to the taxpayer to rebut the presumption of tax avoidance, and found that the assessees had failed to discharge this burden. It also noted that seeking exemption simultaneously under Indian and Mauritian law ran contrary to the object of the DTAA.

Interpreting Article 13 of the India–Mauritius DTAA, the Court held that treaty protection applies only to direct transfer of shares held by a Mauritian resident and does not automatically extend to indirect transfers of shares of foreign companies deriving value from Indian assets. An indirect transfer, at the threshold, was held to fall outside treaty protection.

The judgment marks a decisive shift towards a substance-based approach in treaty interpretation, substantially diluting the certainty previously associated with grandfathering provisions, tax residency certificates and long-standing administrative circulars. The ruling is expected to have far-reaching implications for foreign investors, particularly private equity and venture capital funds that have historically structured Indian investments through Mauritius.

Katalyst Comment:

The India–Mauritius capital gains exemption as per the tax treaty has, unfortunately, been a controversial issue for several years, despite the clear intent with which the treaty was crafted i.e. to attract foreign investment into India at a time when the country had virtually no foreign exchange reserves. The CBDT circular clearly communicated that possession of a Tax Residency Certificate (TRC) would be sufficient to claim the exemption; in a manner of speaking, the TRC itself was "deemed substance".

In 2016, the treaty was amended in relation to shares acquired on or after 1 April 2017, while earlier acquisitions were grandfathered. Very unfortunately, this grandfathering which effectively represents a sovereign commitment has now been overturned by the Supreme Court. This

[4] Union of India v. Azadi Bachao Andolan [(2004) 10 SCC 1]
[5] McDowell & Company Ltd v. Commercial Tax Officer [(1985) 3 SCC 230]

judgement will undoubtedly have wide-ranging ramifications for foreign investment into India, which is already under challenge due to a variety of reasons, and, in that sense, both the judgment and its timing are particularly unfortunate. It is also unfortunate that the Government itself chose to litigate against its own commitment of grandfathering.

4. Delhi ITAT: Loan to concern not taxable as deemed dividend where recipient is not shareholder[6]

The assessee company had received an unsecured loan from another closely held company in which a common individual held substantial shareholding. The Assessing Officer treated the loan as deemed dividend under section 2(22)(e) on the ground that the common individual was a beneficial shareholder having substantial interest in both the lender and the assessee company.

The Tribunal examined whether a loan or advance could be taxed as deemed dividend in the hands of a concern which is not a shareholder of the lender company. It was noted that although the common individual was the beneficial shareholder in both entities, the assessee company itself did not hold any shares in the lender company.

Relying on settled judicial principles, the Tribunal held that section 2(22)(e) applies only where the recipient of the loan is a shareholder of the lender company. A concern cannot be treated as a shareholder merely because a common shareholder has substantial interest in both entities. Accordingly, the unsecured loan received by the assessee could not be regarded as deemed dividend, and the addition was deleted.

5. Bangalore ITAT: Residential status and treaty benefits denied despite overseas employment and relocation[7]

The assessee, an individual and co-founder of an Indian e-commerce group, claimed non-resident status for the relevant assessment year on the ground that he had resigned from his Indian employment, relocated to Singapore, and taken up employment with Singapore entities. During the same year, between August 2019 and November 2019, the assessee sold shares of a Singapore holding company deriving value from Indian assets and claimed exemption from capital gains tax under the India–Singapore DTAA, contending that he was a tax resident of Singapore and entitled to treaty protection.

The Assessing Officer rejected the claim and treated the assessee as a resident under section 6(1)(c), noting that the assessee had been resident in India in all preceding years, had stayed in India for more than 60 days during the relevant year, and had been present in India for more than 365 days in the preceding four years. The benefit of Explanation 1(b) extending the stay threshold from 60 days to 182 days was denied on the ground that the provision applies only to non-

[6] BSST India Private Limited v. CIT [TS-1749-ITAT-2025(DEL)] dated January 7, 2026
[7] Binny Bansal v. DCIT [TS-18-ITAT-2026(Bang)] dated January 10, 2026

residents and not to residents visiting India. The Assessing Officer further held that even under the India–Singapore DTAA, the assessee's centre of vital interests, permanent home and habitual abode were in India, and consequently denied treaty benefits.

Before the Tribunal, the assessee contended that the expression "being outside India" in Explanation 1(b) is distinct from "non-resident" and that the relaxation applies even where the individual was resident in preceding years. It was also argued that the assessee had a permanent home in Singapore, his family had relocated there, and his personal and economic relations were closer to Singapore, thereby satisfying the treaty tie-breaker tests.

The Tribunal rejected these contentions and held that Explanation 1(b) is intended to prevent hardship only in the year in which an individual who is already a non-resident has left India, and cannot be extended to residents who continue to have substantial presence in India and merely visit India after overseas employment. The Tribunal observed that accepting the assessee's interpretation would defeat the purpose of the residential status provisions, as it would enable an individual who had been resident in India for several years to continue claiming non-resident status merely by taking up overseas employment while maintaining substantial presence in India.

On the treaty issue, the Tribunal held that the centre of vital interests must be examined for the entire year and not selectively from the date of relocation. On facts, it was found that the assessee's major economic interests, investments and immovable properties were located in India, that the Singapore employment and accommodation lacked permanence, and that the assessee's habitual abode remained India. Accordingly, the assessee was held to be a resident of India both under domestic law and under the India–Singapore DTAA, and the claim for treaty exemption on capital gains was denied.

6. Mumbai ITAT: Negative capital balance alone insufficient to disallow interest under section 36(1)(iii)[8]

Section 36(1)(iii) permits deduction of interest on capital borrowed for the purposes of business. Disallowance under this provision generally arises where borrowed funds are alleged to have been diverted for non-business purposes, and the onus lies on the Revenue to establish a nexus between the borrowing and such diversion.

The assessee firm had claimed deduction of interest on borrowed funds, while also having interest-free advances outstanding and a negative capital balance. The Assessing Officer disallowed interest under section 36(1)(iii) on the presumption that borrowed funds had been diverted for non-business purposes. The CIT(A), while accepting that the assessee had sufficient interest-free funds and that no direct nexus between borrowings and advances was established, nevertheless sustained a partial disallowance based solely on the negative capital balance.

[8] M/s. Ashapura Developers v. ACIT Circle -1, Thane [TS-26-ITAT-2026(Mum)] dated January 13, 2026

The Tribunal held that a negative capital account by itself does not automatically lead to the conclusion that borrowed funds have been diverted for non-business purposes. It was emphasised that, in the absence of a fund-flow analysis or identification of specific diversion of borrowed funds, disallowance cannot rest on presumptions. The Tribunal further noted that the assessee had charged and recovered interest from partners on their debit balances, which neutralised any allegation of diversion. Accordingly, the Tribunal held that once availability of interest-free funds and absence of nexus are accepted, no disallowance under section 36(1)(iii) can survive, and the residual disallowance was deleted.

B. Corporate Law Highlights

1. Gauhati HC: Scope of Company Court's jurisdiction in schemes of amalgamation[9]

The assessee company, being a transferor company, had filed a petition seeking sanction of a scheme of amalgamation under section 394 of the Companies Act, 1956, (being a pre-NCLT matter), which had already been approved by the shareholders of both the transferor and transferee companies. A minority shareholder objected to the scheme, primarily on the ground that the share exchange ratio was unfair and prejudicial, and that proper notice of the shareholders' meeting had not been received.

The matter was examined by the Company Judge, who expressed reservations on the share exchange ratio and issued directions for re-evaluation by the Registrar of Companies. Both the assessee company and the objector challenged these directions before the High Court, contending that once the scheme was approved by shareholders based on commercial wisdom, the Company Court could not substitute its own view or direct a re-determination of the exchange ratio.

The High Court held that the Company Court does not sit as an appellate authority over a scheme of amalgamation and cannot replace the commercial wisdom of shareholders with its own views, though it retains the power to refuse sanction if the scheme is illegal, fraudulent or against public interest. Considering that the impugned directions were interim in nature and both parties agreed that re-evaluation directions were unnecessary, the matter was remitted back to the Company Judge to decide the sanction of the scheme independently, without being influenced by the earlier observations.

2. New Delhi NCLT: Capital reduction involving payout to shareholders rejected for lack of excess capital and procedural non-compliance[10]

[9] Buragohain Tea Company Ltd. v. Union of India [2025] 180 taxmann.com 50 (Gauhati) dated October 29,2025
[10] Tictok Skill Games Private Limited, New Delhi NCLT [CP-83/ND/2021], dated December 18,2025

The assessee company filed a petition under section 66 of the Companies Act, 2013 seeking confirmation of reduction of its paid-up equity share capital by paying off excess capital to equity shareholders, pursuant to a special resolution passed by shareholders. The reduction was proposed as a return of excess paid-up capital without altering the shareholding pattern.

The petition was examined by the New Delhi Bench of the NCLT, where the Regional Director objected to the scheme on the ground that the financial statements did not demonstrate availability of surplus capital or free reserves to justify payment to shareholders under section 66(1)(b)(ii). It was further pointed out that the financial position relevant for evaluating the reduction must exist at the time the scheme was conceived and approved.

The Tribunal observed that reduction of capital involving payout requires strict compliance with statutory conditions and adequate safeguarding of creditors' interests. It noted deficiencies in proof of service of notices to all unsecured creditors and held that compliance with section 66(2) is mandatory. The Tribunal further observed that multiple changes in shareholding and capital structure during the pendency of the petition undermined the stability of the scheme.

In the absence of clear evidence of excess capital, conclusive proof of notice to creditors and a stable capital structure, the NCLT held that the proposed reduction did not satisfy the requirements of section 66 and accordingly dismissed the petition.

C. SEBI and Other Highlights

1. SEBI: Amendment of (Share Based Employee Benefits and Sweat Equity) Regulations- Valuation framework aligned with Companies Act[11]

SEBI has notified the Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) (Second Amendment) Regulations, 2025, amending the valuation framework applicable to employee stock options, other share-based employee benefits and sweat equity. Under the earlier framework, valuation was required to be carried out by a merchant banker and the term "valuer" was defined independently under the SEBI regulations; the amended regulations now align the definition of "valuer" with section 247 of the Companies Act, 2013 and mandate that valuation be carried out by an independent registered valuer. The amendment also provides a transitional arrangement permitting merchant bankers to complete valuation assignments already undertaken prior to the amendment coming into force within a prescribed transition period.

[11] Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) (Second Amendment) Regulations, 2025, vide notification dated December 3, 2025.

2. Karnataka HC: Capital reduction approval not barred by pending minimum public shareholding non-compliance proceedings[12]

The respondent company, a listed entity, failed to maintain minimum public shareholding (MPS) as prescribed under Rule 19A of the Securities Contracts (Regulation) Rules, 1957 and the SEBI framework, and subsequently opted for voluntary delisting of its equity shares. Thereafter, the company sought confirmation of reduction of share capital under sections 100–104 of the Companies Act, 1956.

The Company Judge sanctioned the reduction and directed fixation of a record date. The stock exchange and SEBI challenged the order on the ground that reduction of capital and fixation of record date could not be permitted while proceedings relating to MPS violations were pending under securities laws.

The Karnataka High Court held that proceedings for enforcement of MPS norms under securities laws and proceedings for reduction of share capital under the Companies Act operate in distinct statutory spheres. It was held that non-compliance with MPS requirements does not curtail the jurisdiction of the Company Court to sanction reduction of capital where statutory conditions are otherwise satisfied.

3. SC: Scope of section 5 of Limitation Act and limits on condonation of delay[13]

Section 5 of the Limitation Act, 1963 enables courts to admit an appeal or application filed beyond the prescribed limitation period if the applicant demonstrates "sufficient cause" for not filing it within such period. The present case arose from an order of the High Court condoning a substantial delay in filing an appeal by invoking this provision.

The Supreme Court examined the scope of the expression "within such period" and clarified that an applicant seeking condonation must explain not only the delay after expiry of limitation but also why the proceedings could not be instituted within the original limitation period itself. It was held that the expression covers the entire duration commencing from the start of limitation up to the actual date of filing, and not merely the post-limitation delay.

The Court further held that condonation of delay is a discretionary relief and cannot be granted as a matter of course, particularly where the delay results from negligence, inaction or lack of bona fides. It was emphasised that State authorities are not entitled to special indulgence on the ground of administrative inefficiency. On facts, the High Court was held to be unjustified in condoning the delay, and the order granting condonation was set aside.

[12] BSE Ltd v. Khoday India Ltd [2025] 181 taxmann.com 260 (Karnataka) dated November 21, 2025
[13] Shivamma (Dead) by LRs v. Karnataka Housing Board & Ors. [2025 INSC 1104 (SC)] dated September 12, 2025

4. Delhi HC: Gift by senior citizen revocable on denial of basic amenities[14]

The respondent, a senior citizen, had executed a registered gift deed in favour of her daughter-in-law in respect of a residential property, out of love and affection and with the expectation of care and support. After execution of the gift deed, disputes arose between the parties, and the respondent alleged that she was subjected to neglect, harassment and denial of basic amenities, compelling her to approach the Maintenance Tribunal under section 23 of the Maintenance and Welfare of Parents and Senior Citizens Act, 2007 seeking cancellation of the gift deed.

The Maintenance Tribunal initially rejected the application on the ground that the gift deed did not contain an express condition requiring the transferee to maintain the transferor. On appeal, the District Magistrate reversed the Tribunal's order and directed cancellation of the gift deed, holding that the conduct of the transferee amounted to failure to provide basic amenities. The order was upheld by the Single Judge of the High Court.

Before the Division Bench, the appellant contended that section 23 could be invoked only where the transfer was expressly subject to a condition of maintenance, relying on the Supreme Court decision in Sudesh Chhikara[15]. The Court rejected this contention and held that the absence of an express clause is not determinative, it was held that transfers by senior citizens are ordinarily made with an implied expectation of care and protection, and denial of basic amenities after such transfer would attract section 23.

The Court further held that the Tribunal is entitled to examine pleadings, surrounding circumstances and evidence to ascertain whether the transfer was induced by an expectation of care. On facts, sufficient material was found to establish neglect of the senior citizen, and the cancellation of the gift deed was upheld.

[14] Smt Varinder Kaur v. Smt. Daljit Kaur & Ors 2025 SCC Online Del 6212 dated September 26, 2025
[15] Sudesh Chhikara v. Ramti Devi, (2024) 14 SCC 225: 2022 SCC Online SC 1684

D. GST Highlights

1. Karnataka HC: Clinical trial services rendered to overseas entities are classified as 'export of services'[16]

Karnataka HC has set aside the adjudication and appellate order and held that clinical trial services/ R&D services provided to overseas entities constitute "export of services," since the place of supply, by virtue of the Notification[17] read with Section 13(2) of the IGST Act, is the location of the recipient outside India. Further, the HC also clarified that all amendments which are beneficial in nature, which are elucidatory and clarificatory would operate retrospectively and hence, there is no demand for pre-notification periods.

2. Kerala HC: GST exemption is not applicable to premium paid for group insurance policies[18]

The Kerala HC has held that GST exemption[19] on premiums is applicable to 'individual health/life policies' alone (including family floater policies and policies for senior citizens), and not to 'group insurance policies'. Consequently, GST is leviable on premiums paid by retired bank employees towards group health insurance policies.

3. Tamil Nadu AAAR: No ITC of electrical installations/fittings at the factory is available[20]

Tamil Nadu AAAR upholds the AAR ruling which held that ITC of electrical installation work carried out for expansion of factory is not available as they become the part of immovable property after integration and fall under the category of "blocked credit." The AAAR also clarified that post integration, such installations don't qualify as 'Plant and machinery' which would otherwise be eligible for ITC. The AAAR emphasized that the object behind their installation is clearly to assist and enable the operation of cranes and other machineries, and as a result, these installations are basically meant for the permanent beneficial enjoyment of the land, and is to be considered as immovable and hence, ITC of such installations is not available.

[16] Iprocess Clinical Marketing Pvt Ltd Vs Asst. Commissioner of Commercial Taxes [TS-1047-HC(KAR)-2025-GST] dated January 5, 2026
[17] Notification No. 04/2019–Integrated Tax dated September 30, 2019
[18] E P Gopakumar vs Union of India [TS-04-HC(KER)-2026-GST] dated January 9, 2026
[19] Notification No. 16/2025–Central Tax (Rate) dated September 17, 2025
[20] In the matter of Shibaura Machine India Private Limited [TS-1059-AAAR(TN)-2025-GST] dated January 19, 2026