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NEWS LETTER

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DIRECT TAX UPDATE

I. Supreme Court Decision

Withdrawal of Income from AOP- Diversion of Income & not Share in Profit
Sanand Properties (P.) Ltd. v. JCIT [2026] 186 taxmann.com 535 (SC)

Facts of the Case:

The assessee-company (SPPL) joined with RKC to form an AOP namely Fortaleza Developers, for development of a residential housing project. Under Clause 7 of AOP agreement, all sale receipts were to be collected by AOP. Assessee was entitled to withdraw 35 per cent of gross sale receipts; and all project expenses were to be met from remaining 65 percent, with balance constituting share of RKC. The assessee claimed that withdrawal of Rs.14.19 Crores being thirty-five percent of gross sale from AOP represented exempt share of profit under section 86 r.w. sections 67A and 167B. Assessing Officer made addition of said amount holding that said amount represented share of revenue and not share of profits.

Decision:

The Supreme Court held that a correct interpretation of clause 7 of the AOP agreement is crucial in order to determine whether the income accrued to the SPPL from the AOP is a share of its profit or revenue.

Upon a plain reading of clause 7 of the AOP Agreement, it is clear that the SPPL was entitled to withdraw a share of 35 per cent of the gross sale proceeds right away, even before the expenses were deducted from the gross sale proceeds. It is from the remaining 65 per cent that 'all required and relevant expenditure for the purpose of the business of the AOP' was to be met with and the net balance that remained, were to be the share of revenue/income of RKC. This clearly indicates that the 35 per cent received by SPPL was an income in the hands of the SPPL and a diversion for the AOP due to overriding title on the said 35 per cent, created by clause 7 of the AOP Agreement as held by this Court in Sitaldas Tirathdas.

Upon analysing clause 7 of the AOP Agreement, accrual of the SPPL's share, i.e. 35 per cent of gross sale receipts of the AOP, was not contingent on the AOP's profit and the SPPL could withdraw such amount immediately. The entitlement of the SPPL is embedded in the very framework of the arrangement of clause 7 of the AOP Agreement and attaches to the gross receipts at the point of their accrual, leaving no discretion with the AOP in the matter. To that extent, the AOP neither acquires nor retains any control over such portion of the receipts but merely holds and disburses the same on behalf of the SPPL. This is not a case of the AOP applying its income in discharge of an obligation. Rather, it is a case where, by reason of a pre-existing and enforceable right created by the overriding title under clause 7 of the AOP Agreement, the gross sale receipts to the extent of 35 per cent is intercepted and diverted towards the SPPL before it could have even assumed the character of income in the hands of the AOP. Consequently, within the meaning of the principle enunciated in Sitaldas Tirathdas, the subject 35 per cent share attributable to SPPL has to be taxed at the hands of the SPPL itself, and not the AOP, since it is an income in the hands of the SPPL and a diversion for the AOP.

The Court also observed that even the words used in the clause itself are 'share of revenue/income', and not 'share of profit'. Hence, it would defy logic to say that the SPPL's income from the AOP is a share of its profit and not merely a share of its revenue. It is a well-settled principle of accounting and law that profit is the surplus that remains after all the expenses have been deducted from the gross receipts. Since the SPPL's share remained insulated from the expenses of the AOP, the amount received by it lacks the essential characteristics of 'profit' and is, in pith & substance, a business receipt arising from the surrender of development rights or a share of gross revenue. Therefore, since the amount received by the SPPL from the AOP is not a share of its profit but a share of revenue, taxable in the hands of SPPL.

Our Comments:

This being a landmark adjudication of Hon'ble Supreme Court based on interpretation of clauses of the AOP Agreement. Therefore, joint development agreement (JDA) should be drafted in clear terms to avoid implications of diversion of income.

II. High Court Decisions

Section 50C - Applicable to Leasehold Property
Vidarbha Veneere Industries Ltd. v. ITO [2026] 484 ITR 132 (Bom)

Facts of the Case:

The assessee company was assigned lease rights in a property from VVI , the lessee , by way of assignment deed ON 30.08.2004. VVI was the original holder of lease rights which were transferred by MIDC, Nagpur by way of a lease deed dated 31.03.1979. The assessee claimed that section 50C was not applicable to a property held in leasehold right and thus, tax would not be payable on sale consideration. The Assessing Officer add difference between the stamp authority value and agreement value as income under section 50C.

Decision:

The Bombay High Court, Nagpur Bench, decided the appeal against the assessee company overruling the decisions of Bombay High Court in the case of CIT v. Greenfield Hotels & Estates (P.) Ltd. [2016] 389 ITR 68 and Mumbai Tribunal decision in the case of Atul G. Puranik v. ITO [2011] 11 taxmann.com 92/132.

The High Court has held that the expression used in Section 50C of the IT Act is 'consideration received or accruing as a result of transfer of a capital asset, being land or building or both'. 'Capital asset' is defined in Section 2(14) of the IT Act, which includes property of any kind, "held by an assessee". What is material to note is, that the expression is "held by an assessee" and not owned by an assessee. In so far as the immovable property, i.e. land or building is concerned, there are number of ways, in which it can be held. The holding can be either as an owner, lessee, sub-lessee, allottee, tenant, licensee, gratuitous licensee or any other mode, permissible or recognized by law. The expression "held by an assessee" therefore does not restrict the manner in which the land or building can be held. The holding of land, is merely a method in which rights to the land, can be held or acquired, by a person. That cannot be in any manner equated with land or building, but rather, would be a species of the right to hold it, which as indicated above, are of multiple nature.

The Court held that, therefore, merely because the land was originally allotted by the MIDC by way of a lease to the predecessor of the appellant, who in turn has received the same by way of an assignment, that being one of the modes of transfer, of land or building, the mere use of a particular mode of transfer, cannot create any exception vis-a-vis the holding of the land or building by the Assessee. The word 'transfer' as used in Section 50C(1) of the IT Act, also cannot be used in a restricted sense and will have to be given widest amplitude, considering the nature and purpose of the section and thus would include all modes and methods of transfer as are permissible and recognizable in law.

The Court further held that in the case of Atul Puranik (supra) , the effect and import of Section 2(14)(a) in conjunction with the language used in section 50C of the IT Act was not considered, and merely was held that since the land is held in a leasehold right, it cannot be equated with land or building, which does not address the issue altogether, neither does it consider the position, that mode of holding of property, cannot be equated with the property itself, as against which what Section 50C read with Section2(14) of the IT Act speaks about, is the property.

Our Comments:

The decision of the Bombay High Court, Nagpur Bench, shall have far reaching implications on transactions of transfer of lease rights as the Court has reversed the decision of the Mumbai Tribunal in the case of Atul Puranik which was followed by all the judicatures till now.

III. Tribunal Decisions

Section 28(iv)/Section 41(1) - Waiver of Working Capital Loan is not taxable
Mukat Pipes Ltd v. ACIT [2026] 185 taxmann.com 1000 (Mum - Trib.)

Facts of the Case:

The assessee company had credited Rs. 11.03 crores towards waiver of principal amount of working capital loan from bank in its profit and loss account but had excluded the same from taxable income. The Assessing Officer made addition under section 41(1)/28(iv) holding that waiver of working capital loan was taxable as business income.

Decision:

The Mumbai Tribunal decided the issue in favour of the assessee, following the judgment of the Supreme Court in Commissioner v. Mahindra and Mahindra Ltd. [2018] 255 Taxman 305. In the case of Mahindra, the Supreme Court held, that for invoking section 28(iv), fulfilment of two test is required. The first, the benefit or perquisite must be in a form other than money, and loan waiver, resulting in cash/money benefit. Secondly, section 41(1) applies only where an allowance or deduction has been granted in respect of a loss, expenditure or trading liability, and waiver of loan does not amount to cessation of trading liability. The Supreme Court drew a clear distinction between “trading liability” and “other liability” and held that waiver of loan falls in the latter category. This ratio is the governing law.

The Tribunal held that in the case of the assessee company, the principal amount of loan waived is not chargeable to tax either under section 28(iv) or under section 41(1). The reason is two fold. First, the benefit on waiver is in the nature of money and therefore falls outside section 28(iv). Second, principal loan liability does not amount to trading liability and there is no finding of prior allowance or deduction in respect of the principal amount so as to attract section 41(1). The distinction attempted by the revenue between capital loan and working capital loan does not alter this legal position, at least for the purposes of section 28(iv), in view of I.G. Petrochemicals, and does not convert the principal borrowing into a trading liability for section 41(1), in view of Mahindra and Mahindra and SICOM.

ACCOUNTING UPDATE

EAC Opinions

1. Capitalisation of Dry Dock Expenditure on Dredgers (Ind AS 16)

- Context: A dredging company continues to operate dredgers beyond their estimated useful life (25 years) and incurs significant dry dock (major inspection/repair) costs to maintain their seaworthiness.
- Issue: Whether these dry dock expenditures can be capitalised as separate components and depreciated, even after the main asset's useful life has expired.
- Opinion:
  - → Ind AS 16 allows capitalisation of major inspection costs as separate components if they meet recognition criteria (probable future economic benefits and reliable measurement).
  - → Each cost must be individually assessed; not all dry dock expenses qualify for capitalisation (e.g., routine repairs should be expensed).
  - → If the expenditure extends the useful life of the dredger, the useful life should be reviewed and extended accordingly, and the cost can be capitalised and depreciated over the new period.
  - → Ind AS 16 does not prohibit capitalisation after the original useful life, provided recognition criteria are met.

2. Accounting for Government Grants/Subsidies (Ind AS 20)

- Context: A paper manufacturing company receives a structured package of incentives from the Tamil Nadu Government, initially as VAT reimbursement, later as a capital subsidy linked to investment and operational performance (production, employment).
- Issue: Whether the grant should be treated as a capital grant (related to assets) or a revenue grant (related to income).
- Opinion:
  - → The substance of the grant, not its name, determines its accounting treatment.
  - → Since the grant is contingent on ongoing operational and employment conditions (not just asset acquisition), it is a revenue grant (grant related to income), not a capital grant.
  - → The company's practice of recognising the grant as income over the period in which related costs are incurred is appropriate under Ind AS 20.

3. **Capitalisation of Payments for Road Connectivity (Ind AS 16)**
   - Context: A public sector company developing an Exhibition-cum-Convention Centre (ECC) pays the National Highways Authority of India (NHAI) for road connectivity to the project.
   - Issue: Whether the payment to NHAI should be capitalised as part of the ECC project cost or expensed.
   - Opinion:
     - → Only costs directly attributable to bringing the asset to the location and condition necessary for its intended operation can be capitalised.
     - → The road connectivity, while beneficial, is not essential for the ECC's construction or operation as intended by management.
     - → Therefore, the payment should be expensed in the Statement of Profit and Loss, not capitalised as part of Property, Plant, and Equipment (PPE).

   Link for Opinions:

   https://resource.cdn.icai.org/92505cajournal-june2026-27.pdf

COMPANY LAW UPDATE

Allowing CSR via Zero Coupon Zero Principal Instruments listed on Social Stock Exchange.

The Ministry of Corporate Affairs (MCA), by notifications G.S.R. 415(E) and G.S.R. 416(E) dated 27 May 2026, has amended Schedule VII of the Companies Act, 2013 and the Companies (Corporate Social Responsibility Policy) Rules, 2014.

The amendments insert a new item (xiii) permitting companies to discharge CSR obligations by subscribing to Zero Coupon Zero Principal instruments listed on the Social Stock Exchange, and prescribe the framework, limits and compliance requirements for doing so in lieu of direct donations to NGOs.

IFSCA UPDATE

A. Framework for preferential issues and qualified institutions placement under the International Financial Services Centres Authority (Listing) Regulations, 2024:

The International Financial Services Centres Authority (IFSCA), vide Circular No. IFSCA PLNP/16/2024 Capital Markets dated April 22, 2026, has issued framework for raising capital via preferential issues and qualified institutions placement (QIP) by IFSC listed entities. The provisions shall not apply to issuers having a secondary listing on such recognized stock exchange(s).

The Circular can be accessed at:

https://ifsca.gov.in/CommonDirect/GetFileView?id=d575554ec59b09e7fde503d3a8de0b46&fileName=Framework_for_preferential_issues_and_QIP_under_the_IFSCA__Listing__Regulations_2024_20260422_0607.pdf&TitleName=Legal

B. Framework for rights issue under the International Financial Services Centres Authority (Listing) Regulations, 2024.

The International Financial Services Centres Authority (IFSCA), vide Circular No. IFSCA PLNP/16/2024 Capital Markets dated April 22, 2026, has issued framework for raising capital via right issue by IFSC listed entities. The provisions shall not apply to issuers having a secondary listing on such recognized stock exchange(s).

The circular can be accessed at:

https://ifsca.gov.in/CommonDirect/GetFileView?id=d575554ec59b09e7fde503d3a8ddff35&fileName=Framework_for_rights_issue_under_the_IFSCA__Listing__Regulations__2024_20260422_0605.pdf&TitleName=Legal

C. Guidelines on Cyber Security and Cyber Resilience for Market Infrastructure Institutions (MIIs) in IFSC

The International Financial Services Centres Authority (IFSCA) issued circular No. IFSCA-CSD/MSC/2/2026-DCS dated April 20, 2026. As per the circular, IFSCA has prescribing a minimum baseline framework for cyber security applicable to all Regulated Entities (REs) operating within GIFT IFSC.

The circular can be accessed at:

https://ifsca.gov.in/CommonDirect/GetFileView?id=d575554ec59b09e7fde503d3a8d614a8&fileName=Circular_Guidelines_CSCR_MIIs_20042026_20260420_0617.pdf&TitleName=Legal

D. Prior requirements for Payment Service Providers entering into Rupee Drawing Arrangement (RDA)

The International Financial Services Centres Authority (IFSCA) issued circular No. IFSCA-FMPP0BR/3/2023-Banking 2026-27/01 dated April 10, 2026. As per the circular, requires Payment Service Providers to obtain prior approval of the Authority to participate in Rupee Drawing Arrangement (RDA) scheme, as a non-resident Exchange House, in accordance with the Master Direction titled “Opening and Maintenance of Rupee/Foreign Currency Vostro Accounts of Non-resident Exchange Houses” dated January 1,2016, issued by the Reserve Bank of India

The circular can be accessed at:

https://ifsca.gov.in/CommonDirect/GetFileView?id=d575554ec59b09e7fde503d3a8bb6026&fileName=Requirements_for_Payment_Service_Providers_entering_into_RDA_20260410_0757.pdf&TitleName=Legal

E. Issued new Reporting norms for Capital Market Intermediaries in IFSC

The International Financial Services Centres Authority (IFSCA) issued revised circular No. F.No.1/IFSCA/CMI Supervision/2023-24 dated April 08, 2026. The Circular prescribes updated quarterly reporting norms and formats for all Capital Market Intermediaries (CMIs) in IFSC pursuant to the 2025 CMI Regulations.

The circular can be accessed at:

https://ifsca.gov.in/CommonDirect/GetFileView?id=d575554ec59b09e7fde503d3a8b10bd3&fileName=Circular_CMI_reporting_final_pdf_20260409_1010.pdf&TitleName=Legal

F. Specification of Certification Course for Key Managerial Personnels (KMPs)/Employees under the International Financial Services Centres Authority (Fund Management) Regulations, 2025.

The International Financial Services Centres Authority (IFSCA), vide Circular F. No. IFSCA PLNP/80/2024 Capital Markets dated April 02, 2026, has specified mandatory certification course for key personnel and core-business employees of all Capital Market Intermediaries (CMIs) in IFSC to be completed on or before September 30, 2026.

The circular can be accessed at:

https://ifsca.gov.in/CommonDirect/GetFileView?id=d575554ec59b09e7fde503d3a89be802&fileName=Specification_of_Certification_Course_for_KMPs_and_other_employees_of_Capital_Market_Intermediaries_under_the_IFSCA__Capital_Market_Intermediaries__Regulations__2025_20260402_0517.pdf&TitleName=Legal

SEBI UPDATE

A. Identification of 'Significant Indices' under SEBI Regulations.

SEBI has, vide circular HO/47/17/12(8)2025 MRD POD2 dated May 05, 2026, specified the criteria for identification of 'Significant Indices' under SEBI (Index Providers) Regulations, 2024.

An index shall be treated as 'Significant' if it is tracked by mutual funds with cumulative Assets under Management(AUM) exceeding ₹20,000 crore and SEBI has prescribed registration and compliance requirements for their providers.

The Circular can be accessed at:
https://www.sebi.gov.in/legal/circulars/may-2026/-significant-indices-under-sebi-index-providers-regulations-2024_101271.html

B. Permitted Use of Borrowings by Infrastructure Investment Trusts (InvITs).

SEBI has, vide circular SEBI/HO/DDHS/DDHS PoD 2/I/11700/2026 dated May 15, 2026, specified the permitted use of borrowings by InvITs where net borrowings exceed 49% of asset value.

The circular lays down the specific purposes and conditions for utilization of higher borrowings.

The Circular can be accessed at:
https://www.sebi.gov.in/legal/circulars/may-2026/permitted-use-of-fresh-borrowings-for-invits-where-net-borrowings-exceeds-forty-nine-percent-of-the-value-of-invit-assets_101465.html

C. Revision of Monthly Cumulative Report (MCR) Format.

SEBI has, vide circular HO/24/11/24(62)2026 IMD RAC4/I/11872/2026 dated May 19, 2026, revised the format of Monthly Cumulative Report (MCR) for mutual funds.

The revised format shall be applicable from June 2026 onwards.

The Circular can be accessed at:
https://www.sebi.gov.in/legal/circulars/may-2026/revision-of-monthly-cumulative-report-mcr-format_101522.html

D. Modified Norms for Nomination in Demat Accounts and Mutual Fund Folios.

SEBI has, vide circular SEBI/HO/OIAE/OIAE_IAD-3/P/CIR/2026/12676 dated May 29, 2026, issued modified norms for nomination in demat accounts and mutual fund folios.

Under this circular, nomination has been made mandatory for single-holder accounts (unless opted out), and investors can appoint up to three nominees.

The provisions shall come into effect from September 01, 2026

The Circular can be accessed at:

https://www.sebi.gov.in/legal/circulars/may-2026/ease-of-doing-investments-modified-norms-for-nomination-in-demat-accounts-and-mutual-fund-folios_101703.html

FEMA UPDATE

A. Case Law

I. Reporting Non submission of Bills of Entry for Foreign Remittances: Penalty Upheld under FERA

1. **Summary**
   - → The SAFEMA Appellate Tribunal has upheld the levy of penalty for failure to submit Bills of Entry as proof of import against foreign remittances routed through an Authorised Dealer, in contravention of Section 8 of the Foreign Exchange Regulation Act, 1973 (FERA).
   - → While the contravention was sustained based on confirmations from the RBI and lack of evidence of customs duty payment, the Tribunal reduced the penalty in the interest of justice, treating the breach as procedural.
2. **Background**
   - → The appellant made three foreign remittances aggregating USD 71,439.88 towards import of teak logs.
   - → RBI confirmed that Bills of Entry were not submitted to the Authorised Dealer in respect of the said remittances.
   - → The appellant claimed that the goods were sold on a high-seas basis and that the Bill of Entry was filed by the buyer with Customs.
   - → The Enforcement Directorate imposed a penalty of ₹10 lakhs for contravention of Sections 8(3) and 8(4) of FERA.
3. **Key Issues Considered**
   - → Whether the appellant had discharged its obligation to submit Bills of Entry as proof of import to the Authorised Dealer.
   - → Whether a Bill of Entry filed by a third party under high-seas sale could be considered adequate compliance.
   - → Whether absence of evidence of customs duty payment vitiated the appellant's explanation.
   - → Whether the penalty imposed was proportionate.
4. **Tribunal's Findings**
   - → Non submission Established: RBI categorically confirmed that Bills of Entry were not submitted to the Authorised Dealer for the impugned remittances.
   - → High-Seas Sale Argument Rejected: The Tribunal noted that the Bill of Entry relied upon was filed by a third party and no conclusive evidence linked it to the specific remittances made by the appellant.
   - → Customs Duty Evidence Lacking: Even assuming the remittances were covered by the cited Bill of Entry, no proof of customs duty payment corresponding to the remittance amount was produced.
   - → Contravention Sustained: In absence of documentary evidence and in light of RBI confirmation, the penalty for contravention of Section 8 of FERA was held to be legally sustainable.
   - → Penalty Rationalisation: Considering the facts and circumstances, the Tribunal reduced the penalty from ₹10 lakhs to ₹2.5 lakhs, holding that the ends of justice would be met by moderation of quantum.

5. **Key Takeaways**
   → Submission of Bills of Entry to the Authorised Dealer is a critical compliance requirement linked to foreign remittances.
   → Reliance on high-seas sale arrangements does not dilute the remitter's statutory obligations under exchange control laws.
   → RBI confirmations carry significant evidentiary weight in FEMA/FERA adjudications.
   → Absence of customs duty linkage may weaken defences even where imports are claimed to be genuine.
   → Procedural lapses can still attract penalties, though penalty quantum may be moderated based on facts.

Case Law:
Yasha Overseas v. Special Director, Directorate of Enforcement

B. Updates

1. Government amends FEM (Non-debt Instruments) Rules; hikes FDI limit in insurance sector to 100% under automatic route

- The Central Government has amended Schedule I of the FEMA (Non-Debt Instruments) Rules, 2019, revising the regulatory framework for foreign investment in the insurance sector.
- The Key Highlights are as follows :

1. **Revised FDI Limits & Entry Routes**

Sector / Activity	Sectoral Cap	Entry Route
Insurance Company	100%	Automatic
Life Insurance Corporation of India (LIC)	20%	Automatic
Insurance Intermediaries (including brokers, re-insurance brokers, insurance consultants, corporate agents, TPAs, surveyors, loss assessors, managing general agents, insurance repositories, etc.)	100%	Automatic

2. **Key Conditions for Insurance Companies & Intermediaries**

- Full foreign ownership (up to 100%) allowed subject to IRDAI approval/verification.
- Must comply with:
  → Insurance Act, 1938
  → IRDAI regulations & licensing requirements
- Management requirement: At least one of Chairperson/MD/CEO must be a resident Indian citizen.
- Pricing guidelines and FDI rules must be followed for any increase in foreign investment.
- Foreign Portfolio Investment (FPI) governed by existing FEMA & SEBI regulations.

3. **Additional Conditions for Intermediaries with Majority Foreign Ownership**

- Must be incorporated as a company under the Companies Act, 2013
- Must :
  → Appoint at least one resident Indian in key leadership roles
  → Bring in technology and managerial expertise
  → Disclose related-party payments to regulators

4. **Special Provisions**

- Bank-promoted insurance entities: Must also comply with banking sector FDI conditions.
- Entities with mixed business (e.g., banks acting as intermediaries):
  → Insurance-related foreign investment caps apply
  → Non-insurance revenue must remain above 50% of total revenue

5. **LIC-Specific Conditions**

- Foreign investment subject to:
  - → LIC Act, 1956
  - → Relevant provisions of the Insurance Act, 1938
- Certain FEMA provisions (FPI, pricing) made applicable to LIC as well.
  - → This amendment streamlines and consolidates the foreign investment framework for the insurance sector, reinforces 100% FDI under automatic route for most entities, and ensures strong regulatory oversight by IRDAI, while keeping LIC FDI capped at 20%.

Notification:

https://www.taxmann.com/research/fema-banking-insurance/top-story/104010000000115750/govt-amends-fem-non-debt-instruments-rules-hikes-fdi-limit-in-insurance-sector-to-100-under-automatic-route-circulars-notifications

II. Government amends FEM (NDI) Rules, 2019; mandates prior govt. approval for change in beneficial ownership & prescribes reporting norms

- The Central Government has amended Rules 2 and 6 of the FEMA (Non-Debt Instruments) Rules, 2019 to strengthen provisions relating to foreign investment and beneficial ownership.
- The Key Highlights are as follows :

1. **Minor Technical Change**
   - → In Rule 2, the term "government approval" has been standardized to "Government approval".

2. **Pakistan-Specific Restriction**
   - → Investments by Pakistani citizens/entities are permitted only under the Government route, excluding prohibited sectors.

3. **Beneficial Ownership Clarified:**
   - → Investments by Pakistani citizens/entities are permitted only under the Government route, excluding prohibited sectors.

4. **Multilateral Institutions Exempted:**
   - → Investments by multilateral banks/funds (where India is a member) are excluded from country-specific restrictions.

5. **New Reporting Requirement:**
   - → Certain investments with border-country linkage but not requiring approval will still require RBI reporting.

6. **Oil & Gas Sector Update:**
   - → Transfer of participating interests/rights in oil fields to non-residents will be treated as foreign investment.

Notification:

https://www.taxmann.com/research/fema-banking-insurance/top-story/104010000000115741/govt-amends-fem-ndi-rules-2019-mandates-prior-govt-approval-for-change-in-beneficial-ownership-prescribes-reporting-norms-circulars-notifications

GST UPDATE

TRANSIT STATE INTERCEPTION OF GOODS IN MOVEMENT:

A penalty demanded by an intermediate State on your transiting goods is — in most cases — legally unsustainable.

I. The Problem Taxpayers Face

1. Under Article 301 of the Constitution, free trade and commerce throughout India is a guaranteed right. Yet, **traders engaged in inter-State movement of goods routinely face detention and unjustified penalties** imposed by transit States — States through which goods merely pass and which have no tax stake in the transaction whatsoever.
2. A large number of taxpayers face this situation regularly. Their truck — carrying valid documents and the correct goods — is stopped by GST enforcement authorities of a transit State. The grounds cited are invariably trivial. The most common triggers we encounter are: **GSTIN of the recipient not printed on the e-Way Bill or invoice**; the **e-Way Bill having expired** by a few hours; **certain digits of the vehicle number in the e-Way Bill not matching** the actual registration plate; or a **minor mismatch between the e-Way Bill and the invoice** — a digit in the document number or a spelling variant in a party name. None of these are substantive deficiencies, and none have any tax consequence in the transit State.
3. Despite this, the transit-State authority detains the vehicle, issues a Show Cause Notice under Section 129(3), and demands penalty of 200% of Tax. Faced with business disruption and mounting freight costs, most traders pay — **without realising that this payment has no basis in law.**
4. There is a further injustice: the transit State **retains the entire penalty amount for itself**, even though every rupee of tax on that transaction rightfully belongs to the Centre and the destination State. The transit State profits from penalising a transaction that is none of its fiscal concern.

II. The Existing Process — Circular No. 41/15/2018-GST

5. To bring uniformity to the interception process, the CBIC issued **Circular No. 41/15/2018-GST** prescribing a step-by-step procedure: interception → statement of driver in **Form GST MOV-01** → physical verification order in **Form GST MOV-02** → verification report in **Form GST EWB-03/MOV-04** → if satisfactory, release in **Form GST MOV-05**; if not, detention in **Form GST MOV-06** → notice under Section 129(3) → explanation or payment → speaking penalty order in **Form GST MOV-09** → release.
6. This procedure was framed without accounting for the transit-State scenario. It prescribes what the officer must do when a deficiency is found, but provides no mechanism to **communicate the deficiency to the origin or destination State and release the goods in the meantime.** This is the **missing link** in the adjudication chain — filled by judicial direction, but not yet by the Circular itself.

III. What the Law Actually Permits

7. Under the IGST Act, tax on an inter-State transaction accrues to the Union and is shared with the **destination State.** The transit State has **no tax incidence and no share in IGST** on a consignment that merely passes through it.

8. Section 129 of the CGST Act / State GST Acts computes penalty as a **percentage of 'tax payable on such goods'**. Where the transit State has zero tax incidence, 'tax payable' is zero, and the penalty — being a percentage of zero — is **also zero**. The computation mandated by Section 129 simply cannot be performed in a State with no tax stake in the transaction.

9. The transit-State officer may **stop the vehicle, inspect documents, and verify goods** — lawful under Section 68 read with Rules 138A, 138B, and 138C. Upon finding a deficiency, the officer must r**ecord it and communicate it to the origin or destination State** for appropriate action. Beyond this — detention, seizure, penalty — the transit State has **no jurisdiction.**

10. The department frequently invokes **'cross-empowerment'** under Section 6 of the CGST Act and Section 4 of the IGST Act for the said issue. This argument has been rejected by the courts. Cross-empowerment operates between Central GST and State GST authorities **within the same jurisdictional State** — it does not confer upon one State's officers any authority over taxpayers of another State, or over transactions with no tax nexus in that State.

IV. What the Courts Have Held

11. In a batch of cases decided in May 2026, the Allahabad High Court (Maruti Enterprises v. State of U.P.) dealt with precisely this situation — inter-State consignments penalised by U.P. GST authorities while passing through Uttar Pradesh. The Court held:

a. Transit interception and verification are permissible as a reasonable regulatory measure. That is where the transit-State authority's power ends.
b. Detention and penalty under Section 129 require tax incidence within the State. Where goods originate in State A and are destined for State C, no tax arises in State B — and therefore no penalty can be imposed.
c. Cross-empowerment does not extend between the GST authorities of different States. The transit State has no jurisdiction over taxpayers of the origin or destination State.
d. The correct course upon finding a deficiency is to record it and report it to the origin/destination State authorities — not to detain or penalise.
e. Permitting transit States to levy penalties freely would be a gross violation of Article 301 of the Constitution — the freedom of inter-State trade and commerce.

12. The Andhra Pradesh High Court in 2026 took an identical view — confirming a consistent judicial position that Section 129 powers cannot be exercised over inter-State transactions that originate and culminate outside the transit State.

V. When Can the Transit State Legitimately Act?

13. The transit-State authority is fully justified in acting where: (a) the goods differ from what the documents describe; (b) the documents are bogus; (c) the transit State is actually the origin or destination; or (d) there is a significant shortfall in quantity. Where goods match documents, documents are genuine, and the transit State has no tax connection, no penalty can be imposed — regardless of minor or technical deficiencies.

VI. What You Must Do — Practical Guidance

14. Before despatch: Verify that the e-Way Bill is valid for the full route, matches the invoice in all material particulars, and carries the correct vehicle number and GSTINs. Brief your transporter that no payment is to be made at any checkpost without first informing you.

15. On interception: Cooperate fully with the inspection. Document the officer's name, designation, time, location, and the specific deficiency cited. Do not pay penalty without legal advice. Contact us immediately — a prompt reply to the SCN citing the correct legal position often halts the proceedings before any penalty order is passed.

16. If payment cannot be avoided: Insist on Form GST MOV-09 (the speaking penalty order) and confirm that Form GST DRC-07 is uploaded by the officer before you pay. The Supreme Court has held these mandatory even on voluntary payment for release of goods. Without them, your right of appeal under Section 107 is extinguished.

17. After the order: File a strong reply to the SCN. If a penalty order is issued, appeal under Section 107. For large penalties or prolonged detention, a writ petition before the High Court is the most direct and effective remedy — courts have been granting relief consistently. Past transit-State payments in similar situations may also be eligible for refund; consult us.

VII. The Missing Link — What Needs to Change

18. While the judiciary has clarified the jurisdictional limits of transit-State authorities, **Circular No. 41/15/2018-GST has not yet been amended** to reflect this position. The Circular contains no provision for the transit-State officer to communicate a deficiency to the origin or destination State and release the goods in the meantime. In the absence of a prescribed procedure, officers on the ground continue to detain and penalise — because that is the only process the Circular currently authorises.

19. **CBIC must amend Circular No. 41/15/2018-GST** to incorporate a transit-State procedure: upon finding a deficiency in a transiting consignment, the officer must (a) record the deficiency, (b) communicate it electronically to the jurisdictional authorities of the origin and destination States, and (c) r**elease the goods and vehicle forthwith.** Until this amendment is made, traders will continue to struggle for relief on the ground — even when the law and the courts are firmly on their side.

VIII. Summary — What Every Trader Must Know

1. A transit State can stop and inspect — it cannot detain or penalise unless there is a substantive allegation: different goods, bogus documents, or actual tax incidence within that State.
2. Section 129 penalty is a percentage of 'tax payable'. Where the transit State has zero tax incidence, the penalty is legally and mathematically zero.
3. Minor deficiencies — expired e-Way Bill, digit mismatch in vehicle number, missing GSTIN of recipient, minor invoice–e-Way Bill variance — do not justify a transit-State penalty.
4. Cross-empowerment under Section 6 CGST Act / Section 4 IGST Act does not authorise one State's officers to penalise taxpayers of another State.
5. Paying a transit-State penalty without challenge is a voluntary surrender of money the law does not permit the authority to collect. These are highly winnable cases.
6. Always insist on Form GST MOV-09 and Form GST DRC-07 before any payment — without these, the right of statutory appeal under Section 107 is lost.
7. Circular No. 41/15/2018-GST needs to be amended by CBIC to incorporate a communication-and-release procedure for transit-State interceptions — the missing link in the adjudication chain.

20. GST was conceived to create one unified national market free from inter-State barriers. The transit-State penalty practice is precisely the abuse it was meant to end. The courts have now said so clearly. **What is needed is a corrected Circular from CBIC — and, until then, traders who know their rights and assert them.**

21. If you or any of your associates are facing a transit-State interception or a penalty notice from an intermediate State, **please reach out to us before taking any further step.** A timely and well-drafted reply can, in most cases, prevent the penalty altogether.

DUE DATES

Due dates of various compliances falling in the month of June 2026

Due Date	Act/Authority	Compliance Description
07-06-26	Income Tax	TDS and TCS Payment for deduction during the month of May - 2026
10-06-26	GST	Return (GSTR-7) to be furnished by the registered persons who are required to deduct tax at source for the month of May - 2026.
10-06-26	GST	Return (GSTR-8) to be furnished by the registered electronic commerce operators who are required to collect tax at source on the net value of taxable supplies made through it for the month of May - 2026
11-06-26	GST	Statement of outward supplies (GSTR-1) by the taxpayers having an aggregate turnover of more than Rs. 5 crore or the taxpayers who have opted for monthly return filing for the month of May - 2026.
13-06-26	GST	Statement of outward supplies (IFF) by the taxpayers having an aggregate turnover of upto Rs. 5 crore and who have opted for QRMP scheme for the month of May - 2026.
13-06-26	GST	Return (GSTR-5) to be furnished by the non-resident taxable persons containing details of outward supplies and inward supplies for the month of May - 2026.
13-06-26	GST	Return (GSTR-6) to be furnished by every Input Service Distributor (ISD) containing details of the input tax credit received and its distribution for the month of May - 2026.
15-06-26	Income Tax	First installment of advance tax for the Tax Year 2026-27
15-06-26	PF/ESIC	Payment of PF / ESIC for the month of May - 2026
20-06-26	GST	Return (GSTR-5A) to be furnished by Online Information and Data base Access or Retrieval (OIDAR) services provider for providing services from a place outside India to non-taxable online recipient (as defined in Integrated Goods and Services Tax Act, 2017) and to registered persons in India and details of supplies of online money gaming by a person outside India to a person in India for the month of May - 2026.
20-06-26	GST	Return (GSTR-3B) to be furnished by all the taxpayers other than who have opted for QRMP scheme comprising consolidated summary of outward and inward supplies for the month of May - 2026.

25-06-26	GST	Payment of GST for a Taxpayer with aggregate turnover upto Rs. 5 crores during the previous year and who has opted for filing of return under QRMP scheme for the month of May-2026.
29-06-26	Income Tax	Due date for e-filing of a statement in Form No. 3CEK (Income-tax Rules, 1962) by an eligible investment fund under section 9A (Income-tax Act 1961) in respect of its activities in the financial year 2025-26.
30-06-26	Income Tax	Deposit of Tax Deducted at source (TDS) during the month of May - 2026 For transaction mentioned in table nos. 2(i), 3(i), 6(ii), 8(vi) as specified under section 393(1) of the Income tax Act 2025 [Section 194-IA, Section 194-IB, Section 194-IC and Section 194-ID of ITA 1961].
30-06-26	Income Tax	Quarterly return of non-deduction of tax at source by a banking company from interest on time deposit in respect of the quarter ending March 31, 2026.
30-06-26	Companies Act	Form DPT-03 -by all companies who have any outstanding loans / advances / receipts of money which are not treated as deposits as on 31st March 2026.

THE ONLY THING STANDING BETWEEN YOU AND YOUR GOAL IS THE STORY YOU KEEP TELLING YOURSELF AS TO WHY YOU CAN'T ACHIEVE IT

Manubhai & Shah LLP

Chartered Accountants

CORPORATE OFFICE

4th Floor, Capital One, Opp. Ashok Vatika BRTS Stop, Ambli Bopal Road,
Ahmedabad - 380058, Gujarat, India.
Phone : +91 79 2647 0000, 79 4107 0800 | Email : info@msglobal.co.in

MUMBAI OFFICE

3C Maker Bhavan No 2, 18, New Marine Lines, Mumbai - 400 020, Maharashtra, India.
Phone : +91 22 6633 3668/59/60 | Fax : +91 22 6633 3561 |
Email : infomumbai@msglobal.co.in

Unit No.- 502,
5th Floor, Modi House, Bajaj Cross Road, Kandivali (West), Mumbai - 400 067,
Maharashtra, India.
Phone : +91 224 960 6695/ 96

PUNE OFFICE

405-407, Suyog Center, Girdhar Bhawan Chowk, Maharshinagar, Pune - 411037.
Phone : +91 9028094428 | Email : pune@msglobal.co.in

BRANCHES

NEW DELHI | RAJKOT | JAMNAGAR | BARODA | SURAT | GIFT CITY- GANDHINAGAR
UDAIPUR | INDORE

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