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Tax Digest

- Recent case laws

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Direct Tax Newsletter

District Legal Service Authority, Panchkula Notified Under Section 11

[Notification No. 113/2026 dated August 11, 2026]

The Central Government has notified 'District Legal Service Authority, Panchkula' (PAN: AAAGC0054R) for tax exemption under Schedule III [Table: Sl. No. 36] read with Section 11 of the Income-tax Act, 2025, for Tax Year 2026-27. The exemption covers specified incomes, including grants from the National, Haryana State, or Punjab & Haryana High Court legal services authorities, government grants or donations, court-ordered receipts, recruitment application fees, and interest on bank deposits. The exemption is subject to the conditions that the Authority shall not engage in commercial activities, must file its return of income under Section 263(9)(c)(xiii), and its activities and income streams remain unchanged. Non-compliance will result in withdrawal of the exemption and initiation of proceedings under the Act.

1. Market Research Expenditure Allowable as Revenue Expenditure

In the instant case[1], the assessee had incurred market research expenditure and claimed the same as revenue expenditure. The Assessing Officer treated the expenditure as capital in nature on the ground that market research activities contributed towards brand building, increased brand awareness and provided enduring benefits to the business. The Commissioner of Income-tax (Appeals) upheld the action of the Assessing Officer.

Aggrieved by the same, the assessee preferred an appeal before the Hon'ble Income-tax Appellate Tribunal (ITAT). The Hon'ble ITAT held that the expenditure had been incurred in the ordinary course of business to understand consumer behaviour, obtain product feedback and improve marketing strategy. It was further observed that similar expenditure had consistently been allowed as revenue expenditure in earlier years. Accordingly, the Hon'ble ITAT held the expenditure to be revenue in nature.

Aggrieved by the order of the Hon'ble ITAT, the Revenue preferred an appeal before the Hon'ble Bombay High Court.

The Hon'ble High Court observed that the expenditure was incurred in the normal course of business and was aimed at understanding consumers, their habits, reactions and feedback on products through various market research activities. It was further observed that such expenditure assisted the assessee in improving its marketing strategy and increasing sales and profitability. The Hon'ble High Court also observed that the expenditure was recurring in nature and had consistently been accepted as revenue expenditure in earlier assessment years.

Accordingly, the Hon'ble High Court held that market research expenditure incurred by the assessee was revenue in nature and could not be treated as capital expenditure merely on the ground that it resulted in an enduring business benefit. Consequently, the appeal filed by the Revenue was dismissed.

2. Addition Under Section 68 Unsustainable Where Penny Stock Allegation Based Solely on Investigation Wing Report

In the instant case[2], the assessee had claimed exempt long-term capital gains arising from transactions in shares of Safal Herbs Ltd. The Assessing Officer reopened the assessment and treated the transactions as non-genuine penny stock transactions. Accordingly, the long-term capital gains were held to be bogus and an addition was made under section 68 of the Act. The Commissioner of Income-tax (Appeals) deleted the addition, which was subsequently affirmed by the Hon'ble Income-tax Appellate Tribunal (ITAT).

Aggrieved by the order of the Hon'ble ITAT, the Revenue preferred an appeal before the Hon'ble Madhya Pradesh High Court.

The Hon'ble High Court observed that the findings of the Assessing Officer were based solely on information received from the Investigation Wing and were not supported by any independent enquiry. It was further observed that the assessee had discharged the onus cast upon him under

[1] Principal Commissioner of Income-tax-12 v. Marico Ltd. [2026] 189 taxmann.com 74 (High Court of Bombay)

[2] Principal Commissioner of Income-tax v. Aditya Agrawal [2026] 189 taxmann.com 71 (High Court of Madhya Pradesh)

section 68 by substantiating the share transactions through banking channels and DEMAT records. The Hon'ble High Court further observed that the Revenue had failed to place any material on record establishing the assessee's involvement in the alleged accommodation entry arrangement.

Accordingly, the Hon'ble High Court held that the addition made under section 68 in respect of the alleged penny stock transactions was unsustainable. Consequently, the appeal filed by the Revenue was dismissed.

3. Consideration Received on Repurchase of Unexercised ESOPs Taxable as Capital Gains and Not as Salary

In the instant case[3], the assessee, an employee of Flipkart India Private Limited, was granted stock options under the Flipkart Stock Option Scheme, 2012 by Flipkart Private Limited, Singapore. During the relevant assessment year, certain vested stock options held by the assessee were repurchased by the grantor company. Since the stock options had not been exercised and no shares were allotted to the assessee, the consideration received on such repurchase was offered to tax as Long-Term Capital Gains. However, the Assessing Officer treated the amount as a perquisite taxable under the head "Salaries" under section 17(2)(vi) of the Act, which was upheld by the Commissioner of Income-tax (Appeals).

Aggrieved by the same, the assessee preferred an appeal before the Hon'ble Income-tax Appellate Tribunal (ITAT).

The Hon'ble ITAT observed that section 17(2)(vi) applies only where a specified security or sweat equity shares are allotted or transferred to an employee upon exercise of the option. It was further observed that in the present case, the stock options were never exercised and no shares were ever allotted to the assessee. Accordingly, the consideration received on repurchase of the vested options could not be brought to tax as a salary perquisite.

The Hon'ble ITAT further observed that a vested stock option represents a valuable and enforceable right capable of being transferred and, therefore, constitutes a capital asset. Since the repurchase of the vested options resulted in relinquishment of such right, the transaction amounted to a transfer of a capital asset and the resultant gains were chargeable to tax under the head "Capital Gains".

Accordingly, the Hon'ble ITAT held that the consideration received by the assessee on repurchase of vested but unexercised stock options was chargeable to tax under the head "Capital Gains" and could not be assessed as a perquisite under the head "Salaries". Consequently, the addition made by the Assessing Officer under the head "Salaries" was deleted.

4. Section 264 Cannot Be Invoked as a Substitute for Filing a Revised Return

In the instant case[4], the assessee filed its return of income without claiming the benefit of the tolerance limit prescribed under section 43CA of the Act. The return was processed under section 143(1) and a demand was raised pursuant to the intimation issued by the Centralised Processing

[3] Pramod Kumar Jain v. Deputy Commissioner of Income-tax [2026] 189 taxmann.com 66 (Bangalore - Trib.)

[4] Deputy Commissioner of Income-tax, CPC v. Om Siddhakala Associates [2026] 189 taxmann.com 305 (SC)

Centre (CPC). Thereafter, instead of filing a revised return within the time prescribed under the Act, the assessee invoked the revisionary jurisdiction of the Principal Commissioner of Income-tax under section 264 seeking the benefit of the tolerance limit under section 43CA. The revision application was rejected.

Aggrieved by the same, the assessee filed a writ petition before the Hon'ble Bombay High Court, which remanded the matter for fresh consideration. Pursuant to such remand, reassessment proceedings were also undertaken. Aggrieved by the order of the Hon'ble High Court, the Revenue preferred an appeal before the Hon'ble Supreme Court.

The Hon'ble Supreme Court observed that the issue relating to the tolerance limit under section 43CA had neither been raised in the original return nor through a revised return within the time prescribed under the Act. It was further observed that where an assessee fails to revise the return within the statutory time limit, a claim omitted from the original return cannot subsequently be introduced by invoking section 264. The Hon'ble Supreme Court held that permitting such a course would amount to allowing revision of the return under the guise of revision proceedings.

Accordingly, the Hon'ble Supreme Court held that the Hon'ble High Court was not justified in remanding the matter for fresh consideration. Consequently, the order of the Hon'ble High Court was set aside, the reassessment proceedings undertaken pursuant to such remand were rendered ineffective, and the assessee was held liable to pay tax in accordance with the return originally filed and the demand raised thereon.