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## Tax Digest

- Recent case laws

October 26, 2026

### CBDT Notifies Income-tax (Seventh Amendment) Rules, 2026

[Notification No. 137/2026 dated October 19, 2026]

The Central Board of Direct Taxes (CBDT) has issued the *Income-tax (Seventh Amendment) Rules, 2026*, coming into force immediately from the date of their publication in the Official Gazette. The amendment inserts new Rule 281A into the Income-tax Rules, 2026, mandating assessee to furnish information in newly introduced Form No. 173A when claiming exemptions on interest and capital gains derived from Government securities under Schedule IV (Table: Sl. Nos. 13D and 13E). Form No. 173A requires comprehensive disclosures, including basic taxpayer particulars such as PAN, TIN, and SEBI registration numbers for FPIs and FIIs, alongside detailed transactional data regarding treasury bills, fixed and floating rate bonds, and State Development Loans (SDLs), as well as gross interest received and capital gains earned during the tax year.

### 1. Penalty deleted due to defective notice and absence of undisclosed income

In the instant case<sup>1</sup>, the assessee, a company engaged in film production, declared additional income following a search, on which the Assessing Officer levied penalty under section 270A for under-reporting of income. In a separate issue, the Assessing Officer treated cash expenditure recorded in kaccha books but not in the regular books as undisclosed income and levied penalty under section 271AAB.

The Commissioner (Appeals) confirmed the penalties levied by the Assessing Officer. Aggrieved by the order of the Commissioner (Appeals), the assessee preferred appeals before the Hon'ble Bangalore ITAT.

The Hon'ble Tribunal observed that the notices issued under sections 270A and 271AAB did not specify the particular clauses under which the penalties were proposed to be levied. It held that the notices failed to communicate the precise charges to the assessee, rendering the penalty proceedings unsustainable.

With regard to section 271AAB, the Hon'ble Tribunal further observed that the cash expenditure recorded in kaccha books during an ongoing financial year was subsequently incorporated into the regular books before filing the return of income. It held that such expenditure could not be treated as undisclosed income merely because it had not been recorded in the regular books on the date of search.

Accordingly, the Hon'ble Tribunal deleted the penalties, holding that penalty notices must specify the precise charge and that expenditure recorded in kaccha books during an ongoing financial year does not, by itself, constitute undisclosed income under section 271AAB.

### 2. ESOP expenditure allowable under section 37(1)

In the instant case<sup>2</sup>, the assessee-company claimed expenditure of ₹4.83 crore towards Employee Stock Option Plan (ESOP) under section 37(1) of the Income-tax Act, 1961. The expenditure was disclosed in the audited financial statements and claimed as employee-compensation cost. The Assessing Officer completed the assessment without making any disallowance in respect of the said expenditure.

Subsequently, the Principal Commissioner of Income-tax (PCIT) invoked section 263, holding that the ESOP expenditure was notional and that the Assessing Officer had failed to make adequate enquiries. Accordingly, the assessment was set aside on this issue, with a direction to frame the assessment afresh.

Aggrieved by the order of the PCIT, the assessee preferred an appeal before the Hon'ble Mumbai ITAT.

The Hon'ble Tribunal observed that ESOP expenditure represents employee-compensation cost incurred for business purposes and does not become notional merely because it is not paid immediately in cash. It further held that mere inadequacy of enquiry or a different view taken by

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<sup>1</sup> Rockline Entertainments (P.) Ltd. v. Deputy Commissioner of Income-tax [2026] 191 taxmann.com 87 (Bangalore - Trib.)

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<sup>2</sup> JSW Jaigarh Port Ltd. v. Principal Commissioner of Income-tax [2026] 190 taxmann.com 1184 (Mumbai - Trib.)

the PCIT could not justify revision under section 263 unless the assessment order was both erroneous and prejudicial to the interests of the Revenue.

Accordingly, the Hon'ble Tribunal quashed the revision order passed under section 263 and restored the assessment order, allowing the appeal filed by the assessee.

### 3. Personal Hearing Mandatory Before Passing Order under Section 148A

In the instant case<sup>3</sup>, the assessee held shares in two companies that were restructured under a Scheme of Arrangement approved by the National Company Law Tribunal. The assessee disclosed the shares in his return of income at their cost of acquisition, whereas the companies reported them at the value adopted under the Scheme. This difference in reporting led the Assessing Officer to initiate reassessment proceedings under section 148A of the Income-tax Act, 1961, on the ground that income had escaped assessment.

The assessee filed a detailed reply explaining the Scheme of Arrangement, the computation of the cost of acquisition and the difference in reporting. He also specifically requested an opportunity of personal hearing. However, the Assessing Officer passed an order under section 148A(3), holding that the case was fit for issuance of notice under section 148, without granting the requested hearing.

The Hon'ble Rajasthan High Court observed that section 148A requires the Assessing Officer to provide the assessee an opportunity of being heard before deciding whether it is a fit case for issuance of notice under section 148. The Court held that

merely considering the assessee's written reply does not fulfil the requirement of personal hearing when such an opportunity has been specifically requested.

Accordingly, the Hon'ble High Court set aside the impugned order for violation of the principles of natural justice. However, it clarified that the Assessing Officer could initiate the proceedings afresh after granting the assessee an opportunity of personal hearing.

### 4. Disallowance under Section 14A Not Sustainable in Absence of Exempt Income

In the instant case<sup>4</sup>, the assessee's assessment for Assessment Year 2014-15 was reopened, during which the Assessing Officer made a disallowance of expenditure under section 14A read with Rule 8D of the Income-tax Rules, 1962. The assessee contended that no exempt income had been earned during the relevant previous year and, therefore, no disallowance under section 14A was warranted.

The Commissioner (Appeals) upheld the disallowance by relying on the Explanation inserted in section 14A by the Finance Act, 2022, which clarified that the provision could apply even where no exempt income had accrued, arisen or been received during the relevant year. The Commissioner (Appeals) treated the amendment as retrospective and applicable to the assessment year under consideration.

The Hon'ble Mumbai Tribunal observed that the Explanation inserted by the Finance Act, 2022, with effect from 1 April 2022, could not be applied retrospectively to Assessment Year 2014-15. The Tribunal noted that the amendment was applicable

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<sup>3</sup> Purshotam Kumar Hissaria v. Assistant Commissioner of Income-tax [2026] 191 taxmann.com 196 (High Court of Rajasthan)

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<sup>4</sup> Thomson Reuters International Services (P.) Ltd. v. Commissioner of Income-tax (Appeals) [2026] 191 taxmann.com 699 (Mumbai - Trib.)

from Assessment Year 2022-23 onwards and that the assessee had not earned any exempt income during the relevant previous year.

Accordingly, the Hon'ble Tribunal held that the disallowance under section 14A read with Rule 8D could not be sustained. It set aside the finding of the Commissioner (Appeals), deleted the disallowance and allowed the assessee's appeal.

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