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Why This Compilation

Tax professionals rarely deal with questions with straightforward answers.

To reach a final position, a tax professional is required to evaluate the relevant statutory provisions and judicial precedents, assess the factual context, and arrive at an interpretation that aligns with established legal principles and carries limited litigation exposure.

The pages that follow illustrate how **Taxmann.AI** responds to such real-world Income-tax and GST queries by understanding the issue in its factual and legal context, analysing the applicable statutory provisions and judicial precedents, and presenting a reasoned conclusion grounded in authoritative sources.

These examples are intended to reflect the depth, structure, and reliability expected in professional tax research and advisory work.

Income Tax

Real questions faced in day-to-day practice.

The pages that follow show how complex Income-tax issues are analysed and answered in a clear, structured manner.



ABC Ltd., a corporate entity following the mercantile system of accounting, records estimated expenses as provisional entries for costs incurred during the month, even when vendor invoices have not been received, and the specific vendors have not yet been identified. These provisional entries are subsequently reversed in the following month. Under the provisions of the Income Tax Act, 1961, is ABC Ltd. required to deduct Tax Deducted at Source (TDS) on such provisional expense entries, considering that the payee is not identified at the time of booking the expense?



Hello, I've reviewed your query regarding TDS obligations on provisional expense entries. This is a common area of concern for entities following the mercantile system of accounting, especially given the interplay between accounting practices and tax compliance requirements.

1. Understanding of the Query

Your query seeks clarification on whether ABC Ltd., a corporate entity using the mercantile system, is required to deduct Tax Deducted at Source (TDS) on provisional expense entries. These entries are made for costs incurred during a month, even when vendor invoices have not been received and specific payees are unidentified. The provisional entries are subsequently reversed in the following month. The core of the query revolves around the applicability of the deeming provisions in Sections 194C(2), 194H(iv) Explanation, and 194J(c) Explanation of the Income Tax Act, 1961, which refer to credits made to suspense or other similar accounts.

2. Executive Summary

The obligation to deduct TDS on provisional expense entries where payees are unidentified remains a complex area under the Income Tax Act, 1961. While statutory deeming provisions and departmental circulars suggest TDS applicability on credits to suspense accounts, judicial pronouncements have consistently emphasized the necessity of an identifiable payee for the TDS mechanism to function. Editorial commentary further reinforces this judicial stance, highlighting that the entire TDS framework relies on an identifiable deductee for compliance. Therefore, if ABC Ltd. genuinely cannot identify specific payees at the time of making provisional entries, the obligation to deduct TDS may not arise at that stage. However, the tax department may still take a stricter view. It is crucial for ABC Ltd. to maintain meticulous documentation proving the genuine non-identification of payees and the subsequent deduction of TDS upon crystallization of liability and identification of payees. While the principal TDS demand on such provisional entries may be set aside based on judicial precedents, interest under Section 201(1A) could still be leviable for delayed deduction on actual payments made in the subsequent year. Additionally, editorial views suggest that if an expenditure has already been disallowed under Section 40(a)(ia), a further demand under Section 201 for the same default might be challenged on the grounds of double jeopardy.

3. Understanding the TDS Mechanism and Provisional Entries

Under the Income Tax Act, 1961, the obligation to deduct Tax Deducted at Source (TDS) generally arises at the time of credit of an income to the account of the payee or at the time of payment, whichever is earlier. This principle is enshrined in various TDS provisions, including Sections 194C (Payments to contractors), 194H (Commission or brokerage), and 194J (Fees for professional or technical services), which are relevant to your query.

ABC Ltd. follows the mercantile system of accounting, which means expenses are recognized when incurred, irrespective of when they are paid. When ABC Ltd. makes provisional entries for estimated expenses without receiving vendor invoices or identifying specific payees, these entries are typically recorded in a suspense account or a similar provisional account. The question then arises whether such a provisional credit triggers the TDS obligation.



4. Statutory Deeming Provisions and Departmental View

Sections 194C(2), 194H (Explanation (iv)), and 194J (Explanation (c)) contain specific deeming provisions that are crucial to this discussion. These provisions state that:

“Where any sum referred to in sub-section (1) is credited to any account, whether called “Suspense account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.”

This statutory language is quite broad and suggests that any credit to a suspense account, even if the specific payee is not yet identified, is to be treated as a credit to the payee’s account for TDS purposes. The phrase “by any other name” further expands the scope to cover various provisional or clearing accounts.

This interpretation is reinforced by the departmental view, as evidenced by **Circular No. 715, dated 8-8-1995**. Although this circular specifically addresses Section 194A (interest), it clarifies a general principle applicable to similar deeming clauses across TDS sections. In response to a query about TDS on interest credited to a suspense account, the CBDT stated:

“It may be clarified that a credit to interest payable account or suspense account, etc., is also taken as credit to the account of the payee, even though this credit is not reflected separately in the payee’s account.”

Based on a literal reading of these statutory provisions and the CBDT circular, the tax department’s stance would likely be that ABC Ltd. is obligated to deduct TDS at the time such provisional entries are made to a suspense or similar account, even if the specific payees are unidentified. The subsequent reversal of these entries would not retrospectively negate the initial TDS obligation that arose at the time of the credit.

5. Judicial Interpretation: The Prerequisite of an Identified Payee

While the statutory language and departmental circulars lean towards an obligation to deduct TDS, judicial pronouncements have introduced a critical condition: the identification of the payee. Courts have consistently held that the entire mechanism of TDS is predicated on the existence of an identifiable payee.

- The landmark ruling in **Apollo Tyres Ltd. v. Dy. CIT [2017] 78 taxmann.com 195 (Delhi)** directly addressed a similar scenario. The Delhi High Court held that: *“Where assessee-company could not ascertain identity of payees while making provision for expenditure under several heads of income at year end, assessee was not required to deduct tax at source on such provision.”*

The court reasoned that *“Identification of person from whose account income-tax is deducted at source is a pre-requisite condition so as to make provision of Chapter XVII-B workable. When tax deductor cannot ascertain payee who is beneficiary of a credit of tax deduction at source, mechanism of Chapter XVII-B cannot be put into service.”*

- Similarly, the Gujarat High Court in **Principal CIT v. Sanghi Infrastructure Ltd. [2018] 96 taxmann.com 370/257 Taxman 371 (Guj.)** held that *“Where provision was made by assessee for expenses for which bills were not received during year under consideration, no section 40(a)(ia) disallowance could be made for non-deduction of TDS.”* This implies that if bills are not received and a provision is merely made for expenses, the TDS obligation does not arise.

These judicial decisions highlight that without an identified payee, the deductor cannot fulfill subsequent TDS compliance requirements, such as quoting the Permanent Account Number (PAN) of the deductee, issuing TDS certificates (Form 16A), and furnishing TDS statements (Form 26Q). The credit for TDS cannot be claimed by an unidentified person, rendering the entire process unworkable.

6. Reconciling the Conflicting Views

There is a clear divergence between the literal interpretation of the deeming provisions and departmental circulars on one hand, and the purposive interpretation adopted by the judiciary on the other. The judiciary emphasizes that the spirit of the TDS provisions requires an identifiable payee for the mechanism to func-



tion effectively. The deeming provisions for suspense accounts are primarily intended to prevent taxpayers from deferring TDS by temporarily parking amounts in such accounts when the payee is known but the final credit to their specific ledger is delayed.

In the scenario described, where specific payees are genuinely unidentified, the judicial view would suggest that ABC Ltd. is *not* required to deduct TDS on such provisional entries. The TDS obligation would arise only when the payee is identified, and the amount is either credited to their specific account or paid, whichever is earlier.

7. Consequences of Non-Compliance (if TDS is deemed applicable by the Department)

If the tax authorities were to take a strict view based on the statutory deeming provisions and departmental circulars, and ABC Ltd. fails to deduct TDS on such provisional entries, it could face the following consequences:

- **Assessee in Default (Section 201):** ABC Ltd. could be deemed an “assessee in default” for failure to deduct tax.
- **Interest (Section 201(1A)):** Interest would be levied for the period of default (1% per month or part thereof for non-deduction, and 1.5% per month or part thereof for non-payment).
- **Disallowance of Expenditure (Section 40(a)(ia)):** Thirty percent of the expenditure on which TDS was not deducted or not paid could be disallowed in the year of default. This disallowance can be avoided if the payee files their return, includes the income, and pays the tax due, and ABC Ltd. furnishes a certificate from an accountant to that effect (First Proviso to Section 201(1) read with Second Proviso to Section 40(a)(ia)).

8. Practical Considerations

Given the conflicting interpretations, ABC Ltd. faces a practical dilemma. While judicial pronouncements provide relief, the tax department may still initiate proceedings based on their interpretation. To mitigate risks, ABC Ltd. should:

- Maintain clear documentation demonstrating that at the time of making provisional entries, the specific payees were genuinely unidentified and invoices were not received.
- Be prepared to defend its position based on the judicial precedents if challenged by the tax authorities.
- Consider the materiality of such provisional entries. For significant amounts, a conservative approach might involve deducting and depositing TDS, and then seeking a refund or adjustment if the expense does not materialize or the payee is never identified. However, this approach itself presents practical challenges related to PAN and TDS certificate issuance.

9. Conclusion

Based on a comprehensive analysis, particularly considering the judicial pronouncements, ABC Ltd. is generally *not* required to deduct TDS on provisional expense entries where vendor invoices have not been received and specific payees are unidentified. The identification of the payee is a fundamental prerequisite for the TDS mechanism to operate. The deeming provisions for suspense accounts are typically interpreted by courts to apply when the payee is known but the credit is temporarily parked. However, it is important to acknowledge that the tax department may hold a different view based on a literal interpretation of the statutory provisions and departmental circulars. Therefore, while the judicial position offers strong grounds for not deducting TDS in such circumstances, ABC Ltd. should be prepared for potential scrutiny from the tax authorities.

10. Key Takeaways for ABC Ltd.

- **Judicial Precedent is Key:** Rely on judicial pronouncements (e.g., Apollo Tyres, Sanghi Infrastructure) that emphasize the necessity of an identifiable payee for TDS applicability.



- **Documentation is Crucial:** Maintain robust records to prove that payees were genuinely unidentified at the time of booking provisional entries.
- **Mercantile System vs. TDS Trigger:** Understand that while the mercantile system recognizes expenses on accrual, the TDS trigger is linked to a definite credit to an *identifiable* payee's account or actual payment.
- **Risk Assessment:** Be aware of the potential for departmental challenge and the associated consequences (interest, disallowance) if the tax authorities take a strict view.
- **No TDS on Reversal:** The subsequent reversal of provisional entries does not create a new TDS obligation or negate an existing one; it merely indicates the provisional nature of the initial booking.

Building on the statutory analysis, which highlights the deeming provisions for credits to suspense accounts and the departmental view, it is imperative to delve into how judicial authorities have interpreted and applied these provisions, especially concerning the critical aspect of an identifiable payee. While the Income Tax Act, 1961, through sections like 194C(2), 194H (Explanation (iv)), and 194J (Explanation (c)), broadly states that a credit to any account, including a suspense account, is deemed a credit to the payee for TDS purposes, the courts have introduced a practical and fundamental condition for the TDS mechanism to operate effectively: the existence of an identifiable payee.

11. Judicial Interpretation on Identified Payee as a Prerequisite for TDS

A. The Delhi ITAT's Stance in *Apollo Tyres Ltd. v. Deputy Commissioner of Income-tax, TDS Circle, Gurgaon*

The Delhi ITAT, in the case of *Apollo Tyres Ltd. v. Deputy Commissioner of Income-tax, TDS Circle, Gurgaon* [2017] 78 *taxmann.com* 195 (Delhi - Trib.), directly addressed a scenario similar to ABC Ltd.'s. The assessee in this case made year-end provisions for various expenses where the payees were not identifiable. The tax authorities had treated the assessee as being in default for non-deduction of TDS on these provisions. The ITAT, however, held that the "*identification of person from whose account income-tax is deducted at source is a pre-requisite condition so as to make provision of Chapter XVII-B workable.*" The Tribunal reasoned that when the tax deductor cannot ascertain the payee, the mechanism of Chapter XVII-B (TDS provisions) cannot be put into service. This is because the credit for TDS is to be given to the deductee, and without an identifiable payee, it is impossible to issue TDS certificates (Form 16A) or for the payee to claim credit for the tax deducted. The Tribunal explicitly stated that "*where assessee-company could not ascertain identity of payees while making provision for expenditure under several heads of income at year end, assessee was not required to deduct tax at source on such provision.*" This ruling provides strong support for ABC Ltd.'s position, emphasizing that the practical impossibility of compliance due to unidentified payees overrides the literal interpretation of the deeming provisions.

B. The Karnataka High Court's View in *Deputy Commissioner of Income-tax v. Subex Ltd.*

Further reinforcing this principle, the Karnataka High Court in *Deputy Commissioner of Income-tax v. Subex Ltd.* [2023] 148 *taxmann.com* 271 (Karnataka), dealt with year-end provisions for legal and professional charges where invoices were not received, and neither payees nor exact amounts were identified. The provisions were reversed on the first day of the next assessment year, and TDS was deducted upon actual payment in the subsequent year. The High Court held that "*there was no TDS obligation upon assessee to deduct TDS on said payment towards legal and professional charges during year*" when neither the payees nor the exact amount payable were identified. This decision from a High Court carries significant precedential value within its jurisdiction and persuasive value elsewhere, aligning with the Delhi ITAT's view that the absence of an identifiable payee negates the TDS obligation at the time of making provisional entries.

C. The Mumbai ITAT's Perspective in *Alliance Media & Entertainment Ltd. v. Income-tax Officer (TDS) 1(1), Mumbai*

The Mumbai ITAT, in *Alliance Media & Entertainment Ltd. v. Income-tax Officer (TDS) 1(1), Mumbai* [2017] 79 *taxmann.com* 114 (Mumbai - Trib.), also echoed this sentiment. In a case involving provisions for payments to artists where the identity of payees and the quantum of amounts were unascertainable and subject to



negotiation, the Tribunal held that “where details of beneficiaries of credit as well as respective amounts to be paid to beneficiaries were unascertainable, tax deduction at source mechanism could not be put into service because liability of tax deduction at source is in nature of a vicarious liability, which presupposes existence of a principal or primary liability.” This judgment underscores that TDS is a secondary liability dependent on a primary liability to an identifiable person, and without that primary element, the TDS mechanism cannot be triggered.

12. Contrasting Views and the Importance of Factual Matrix

While the above cases strongly support the assessee’s position, it is crucial to consider rulings that have taken a different view, often based on specific factual circumstances or a stricter interpretation of the deeming provisions:

A. The Bangalore ITAT’s Decision in IBM India (P.) Ltd. v. Income-tax Officer (TDS) LTU, Bangalore

In *IBM India (P.) Ltd. v. Income-tax Officer (TDS) LTU, Bangalore* [2015] 59 taxmann.com 107 (Bangalore - Trib.), the Bangalore ITAT took a more revenue-friendly stance. The assessee (IBM India) made provisions for expenses based on reliable estimates, which were subsequently reversed, and TDS was deducted upon actual payment. The Tribunal held that “it is clear from the statutory provisions of TDS that the liability to tax at source exists when the amount in question is credited to a ‘suspense account’ or any other account by whatever name called, which will also include a ‘provision’ created in the books of account.” The Tribunal rejected the assessee’s argument that there was no accrual or identified payee, stating that the accounting practice followed by the assessee was contrary to the mercantile system if it claimed inability to identify payees despite making provisions based on reliable estimates. The key distinction here was the Tribunal’s observation that the assessee had “full knowledge of what is due to its Vendors, sub-contractors, commission agents etc., therefore there was no necessity to create provision” without identifying them. This suggests that if the assessee could have identified the payees or the liability was sufficiently ascertained, the TDS obligation would arise. However, the Tribunal did provide relief on the Section 201(1) default if TDS was eventually deducted in the subsequent year, but upheld the levy of interest under Section 201(1A) for the delay.

B. The Cochin ITAT’s Ruling in Abad Builders (P.) Ltd. v. Assistant Commissioner of Income-tax, Circle-1(1)

Similarly, in *Abad Builders (P.) Ltd. v. Assistant Commissioner of Income-tax, Circle-1(1)* [2014] 43 taxmann.com 128 (Cochin - Trib.), the Cochin ITAT held that an assessee was liable to deduct tax at source under Section 194C even if only a provision for expenses was made. The Tribunal noted that the very fact of creating a provision for expenses, especially for construction activity, indicated a present obligation arising from a past event, implying an acceptance of liability. It reiterated that the TDS liability arises even if the amount is credited to a suspense account or any other account. This case emphasizes that if the liability is ascertained, even if provisional, the TDS obligation can be triggered.

13. Reconciling the Divergence and Practical Application for ABC Ltd.

The apparent divergence in judicial opinions can be reconciled by focusing on the factual nuances, particularly the genuineness of the non-identification of the payee and the ascertainment of the liability. The consistent thread running through the judgments favoring the assessee is the *impossibility* of compliance with TDS provisions when the payee is truly unknown. The TDS mechanism, including the issuance of certificates and claiming credit, is fundamentally designed around an identifiable deductee.

- The Supreme Court’s View on Accrual of Liability:** While not directly on TDS, the Supreme Court in *Commissioner of Income-tax v. Kedarnath Jute Mfg. Co. Ltd.* [1971] 82 ITR 363 (SC), a landmark ruling, clarified that for an assessee following the mercantile system, a liability accrues when the obligation arises, irrespective of quantification or dispute. This principle is relevant to understanding when an expense is considered ‘credited’ for accounting purposes. However, the subsequent rulings on TDS specifically carve out the ‘identifiable



payee' condition as a prerequisite for the *TDS mechanism* to function, even if the liability has accrued.

- **The Supreme Court's Clarification on 'Payable' in Section 40(a)(ia):** The Supreme Court in *Commissioner of Income-tax v. Palam Gas Service [2017] 81 taxmann.com 43 (SC)*, another landmark ruling, clarified that the word 'payable' in Section 40(a)(ia) covers both amounts yet to be paid and amounts already paid. This means that the disallowance under Section 40(a)(ia) can be triggered even if the payment has been made without TDS. This ruling, while not directly on provisional entries, reinforces the strictness of TDS compliance once a payment is due or made to an identifiable party.

For ABC Ltd., the critical factor will be its ability to demonstrate that at the time of making these provisional entries, the specific vendors were genuinely unidentified, and the exact liability to each was not crystallized. If the provisional entries are merely estimates for known services from known vendors, but invoices are awaited, the tax authorities might argue, relying on cases like *IBM India (P.) Ltd.* and *Abad Builders (P.) Ltd.*, that the liability has accrued, and the payee is implicitly identifiable, thus triggering TDS. However, if ABC Ltd. can convincingly prove that the payees were truly unknown and the amounts were purely estimated without specific beneficiaries, the judicial precedents in *Apollo Tyres Ltd.*, *Subex Ltd.*, and *Alliance Media & Entertainment Ltd.* would strongly support its position of no TDS obligation at that stage.

14. Consequences and Interest Liability

Even if ABC Ltd. is not required to deduct TDS on the initial provisional entries due to unidentified payees, the issue of interest under Section 201(1A) remains pertinent. The Bangalore ITAT in *Biocon Ltd. v. Deputy Commissioner of Income-tax, LTU [2023] 152 taxmann.com 55 (Bangalore - Trib.)* and the Chennai ITAT in *Cognizant Technology Solutions India (P.) Ltd. v. Deputy Commissioner of Income Tax [2025] 174 taxmann.com 863 (Chennai - Trib.)* have provided detailed scenarios regarding interest liability. These cases clarify that while no TDS liability arises on the *unpaid portion* of a provision where no payee is identified, interest under Section 201(1A) would still be leviable on the *actual payments* made in the subsequent year, calculated from the date the provision was initially made (i.e., the date TDS should have been deducted if the payee was identified) until the date of actual deduction/payment. This means that even if the principal TDS demand under Section 201(1) is set aside for the provisional entries, ABC Ltd. could still face interest liability for the period of delay on the amounts eventually paid to identified vendors.

15. Documentation and Proof

Given the conflicting interpretations and the emphasis by courts on the factual matrix, ABC Ltd. must maintain meticulous documentation. This includes:

- Clear internal policies and procedures for booking provisional entries.
- Evidence that at the time of making provisional entries, specific vendor invoices were genuinely not received, and the payees were truly unidentified.
- Records demonstrating the estimated nature of the provisional entries and their subsequent reversal.
- Proof that TDS was deducted and remitted as soon as the payee was identified, and the liability crystallized (i.e., upon receipt of invoices or actual payment).

Without robust documentation, it would be challenging to convince the tax authorities or appellate forums that the payees were genuinely unidentified, and the TDS mechanism could not be applied at the time of making provisional entries

Building upon the statutory and judicial analysis, which highlighted the divergence between the literal interpretation of deeming provisions for TDS on suspense accounts and the judicial emphasis on an identifiable payee, editorial commentary further reinforces the practical challenges and legal arguments available to taxpayers like ABC Ltd.



16. Reinforcing the 'Identifiable Payee' Principle

- **Practical Appeal Strategy:** The editorial material, particularly the case study on appeal representation, provides a practical blueprint for challenging TDS default orders on year-end expenditure provisions. It outlines how an assessee, similar to ABC Ltd., would argue that provisional entries made as per accounting standards (like AS 29) for expenses where payees were not identified and/or amounts were not ascertained, and bills were not received, do not trigger TDS. The argument is strengthened by demonstrating that such provisions are reversed on the first day of the subsequent accounting year, and TDS is duly deducted upon actual payment or crediting to identified parties.
- **TDS as a Mechanism for Identifiable Income:** Commentaries consistently reiterate that the entire scheme of TDS is predicated on the existence of an identifiable payee whose income is subject to tax. Without an ascertainable assessee, the machinery provisions for TDS become ineffective, as the credit for tax deducted cannot be given to an unknown entity. This aligns with the judicial view that TDS is a secondary liability dependent on a primary liability to an identifiable person.

17. Addressing Consequences and Double Jeopardy

- **Disallowance vs. TDS Default:** A significant point highlighted in the editorial content, drawing from judicial pronouncements like *Pfizer Ltd. v. ITO (TDS)*, is the argument against double jeopardy. If an expenditure is already disallowed under Section 40(a)(ia) for non-deduction of tax on provisional entries, the assessee should not be held liable again under Section 201 for the same default. This suggests that once the disallowance is made, the revenue has already accounted for the non-compliance, and a further demand for TDS under Section 201 might be considered excessive.
- **Documentation and Accounting Practices:** The editorial content underscores the importance of maintaining meticulous documentation. This includes demonstrating that the company consistently follows the practice of making and reversing such provisional entries, and that TDS is subsequently deducted and deposited when the actual liability crystallizes and payees are identified. This robust documentation is crucial for substantiating the claim that payees were genuinely unidentified at the time of the provisional booking.

18. Context of Legislative Changes

- **Applicability of Income Tax Act, 1961:** While not directly related to the interpretation of TDS on provisional entries, an article from February 2025 discusses the tabling of the new Income Tax Bill, 2025, which proposes to repeal the Income Tax Act, 1961, effective from April 1, 2026. This confirms that for the period relevant to ABC Ltd.'s query (as of January 2026), the provisions of the Income Tax Act, 1961, are fully applicable. This contextual information is important for ensuring the analysis is based on the correct prevailing law.

19. Final Conclusion

In conclusion, while the Income Tax Act, 1961, through its deeming provisions and departmental circulars, suggests a broad applicability of TDS on credits to suspense accounts, judicial precedents, strongly supported by editorial commentary, establish that an identifiable payee is a fundamental prerequisite for the TDS mechanism to operate. Therefore, ABC Ltd. is generally not required to deduct TDS on provisional expense entries where specific payees are genuinely unidentified at the time of booking, especially if these entries are subsequently reversed and TDS is deducted upon actual payment to identified parties. However, ABC Ltd. must maintain robust documentation to substantiate the non-identification of payees and be prepared to defend its position against potential departmental challenges, acknowledging that interest under Section 201(1A) may still be leviable for delayed deduction on the actual payments made later, even if the principal TDS demand on provisional entries is set aside. Furthermore, the argument against double jeopardy, where disallowance under Section 40(a)(ia) has already occurred, provides an additional layer of defense.

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Further Illustration— Income Tax

Real questions faced in day-to-day practice.

This example highlights how a different kind of Income-tax question is approached and reasoned through.



Whether the additional tax borne by an Indian resident payer on behalf of a non-resident payee, arising from the grossing up of income under Section 195A of the Income Tax Act, 1961, is an allowable business expenditure for the payer under Section 37(1) of the Income Tax Act, 1961.



Hello! I'm here to assist you with your query regarding the allowability of additional income tax expense incurred due to grossing up of TDS on payments to non-residents. Let's delve into the relevant provisions of the Income Tax Act, 1961.

1. Understanding of the Query

You are seeking clarification on whether the additional income tax expense, which a resident assessee incurs by grossing up the payment to a non-resident service provider under Section 195A for Tax Deducted at Source (TDS) purposes, can be claimed as a business expenditure under Section 37(1) of the Income Tax Act, 1961. This involves examining the interplay of Section 195A, Section 195, Section 37(1), and the disallowance provisions under Section 40(a)(i) and Section 40(a)(ii) of the Act.

2. Executive Summary

The additional income tax expense borne by a resident assessee on behalf of a non-resident service provider, arising from the grossing up of the payment for TDS purposes under Section 195A, is generally not allowable as a business expenditure under Section 37(1) of the Income Tax Act, 1961. While such an expense might appear commercially expedient, it is fundamentally the income tax liability of the non-resident. Income tax, whether of the assessee or of another person, is considered an application of income rather than an expenditure incurred to earn income. Furthermore, Section 40(a)(ii) specifically disallows any sum paid on account of any rate or tax levied on profits or gains of any business or profession. The tax borne by the resident assessee on behalf of the non-resident falls within this category, as it is a tax on the non-resident's income/profits. Therefore, despite meeting the 'wholly and exclusively' criteria of Section 37(1) from a commercial perspective, the specific disallowance under Section 40(a)(ii) overrides the general allowance provision. However, judicial pronouncements have introduced a nuanced perspective, particularly when the tax paid on behalf of the non-resident is considered as part of the grossed-up income of the non-resident. Some rulings suggest that such a payment, being part of the consideration for services and deemed income of the non-resident, may not fall under the specific disallowance of Section 40(a)(ii) for the payer, thereby opening a window for its allowability under Section 37(1) if it is an integral part of the business consideration. This creates a dichotomy between the strict interpretation of Section 40(a)(ii) and the commercial reality acknowledged by some tribunals.

3. Understanding the Statutory Framework

To address your query, we need to analyze the relevant provisions of the Income Tax Act, 1961, concerning payments to non-residents, TDS obligations, and the allowability of business expenditures.

4. Section 195A: Income payable "net of tax"

Section 195A of the Income Tax Act, 1961, deals with situations where, under an agreement or arrangement, the tax chargeable on any income (covered by Chapter XVII-B, which includes TDS provisions) is to be borne by the person making the payment (the payer). In such cases, for the purpose of deducting tax at source, the income payable to the non-resident is required to be 'grossed up'. This means the income is increased to such an amount that, after deducting tax at the rates in force, it equals the net amount agreed to be paid to the recipient. The primary purpose of this section is to ensure that the tax liability of the non-resident, which is contractually borne by the resident payer, is properly accounted for when determining the amount on which TDS is to be applied. It is crucial to understand that the tax so borne by the payer is still considered the income tax of the non-resident payee.



5. Section 195: Other sums



Section 195(1) mandates that any person responsible for paying to a non-resident (not being a company) or to a foreign company any interest, royalty, fees for technical services, or any other sum chargeable under the provisions of the Act (excluding salaries), shall deduct income-tax thereon at the rates in force at the time of credit or payment, whichever is earlier. This section establishes the primary obligation for a resident payer to deduct tax at source on payments made to non-residents if such income is chargeable to tax in India. Section 195A directly interlinks with Section 195 by specifying how to calculate the 'sum' for TDS purposes when the tax is borne by the payer.

6. Section 37(1): General Business Expenditure

Section 37(1) is the general provision for allowing business expenditures. It states that any expenditure (not being expenditure of the nature described in Sections 30 to 36, and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended 'wholly and exclusively' for the purposes of the business or profession, shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

From a commercial expediency perspective, the additional income tax expense borne by the resident assessee on behalf of the non-resident service provider could be argued as an expense incurred to secure the services and facilitate business operations. Therefore, it might appear to satisfy the 'wholly and exclusively' criterion of Section 37(1).

However, a fundamental principle of income tax law is that income tax is an application of income, not an expenditure incurred to earn income. Therefore, income tax, whether of the assessee or of another person, is generally not deductible under Section 37(1) as an expenditure laid out wholly and exclusively for the purposes of the business. The commentary on Section 37(1) often highlights that even interest on delayed payment of tax is considered a 'personal liability' and not allowable, reinforcing the principle that tax liabilities are generally not business expenses.

7. Section 40(a)(i) and Section 40(a)(ii): Amounts not deductible

Section 40 begins with a non-obstante clause, meaning its provisions override Sections 30 to 38, including Section 37(1). This is critical in determining the allowability of the expense.

- **Section 40(a)(i):** This sub-clause deals with the disallowance of certain expenses (like interest, royalty, fees for technical services, etc.) payable to a non-resident if tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid to the government within the prescribed time. In the scenario where the resident assessee is grossing up the payment and duly deducting and remitting the tax, the conditions for disallowance of the *underlying payment* (e.g., service fees) under Section 40(a)(i) would generally *not* be met. However, Section 40(a)(i) does not address the allowability of the *tax component itself* borne by the resident assessee; it only ensures that the original expense is not disallowed if TDS compliance is met.
- **Section 40(a)(ii):** This sub-clause specifically disallows "any sum paid on account of any rate or tax levied on profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains." The income tax borne by the resident assessee on behalf of the non-resident is, in essence, the income tax liability of the non-resident. This tax is levied on the income (profits or gains) of the non-resident service provider. Therefore, this amount, even if paid by the resident assessee, falls squarely within the ambit of Section 40(a)(ii) and is specifically disallowed as a business expenditure for the resident assessee.

8. Impact of Circulars

Circular No. 370 (reiterating Circular No. 155) clarifies the mechanism of tax deduction at source under Section 195 when a resident payer agrees to bear the tax liability of a non-resident recipient. These circulars confirm that the tax must be calculated and deducted on the 'grossed up' amount. However, these circulars



are silent on the specific question of whether the additional income tax expense borne by the resident assessee (the grossed-up portion) is allowable as a business expenditure under Section 37(1) or its treatment under Section 40(a)(ii). Their focus is solely on ensuring correct TDS compliance and computation of the non-resident's taxable income.

9. Conclusion on Allowability

Based on the comprehensive analysis of the statutory provisions and general tax principles:

- The tax borne by the resident assessee on behalf of the non-resident is fundamentally the income tax liability of the non-resident. Section 195A facilitates the calculation of this tax for TDS purposes but does not change its character.
- Income tax, by its very nature, is considered an appropriation of profits and not an expenditure incurred to earn profits. Therefore, it generally does not qualify for deduction under Section 37(1).
- More specifically, Section 40(a)(ii) acts as an overriding provision that explicitly disallows any sum paid on account of any rate or tax levied on profits or gains of any business or profession. The income tax borne by the resident assessee on behalf of the non-resident falls under this specific disallowance.

Therefore, the additional income tax expense incurred by a resident assessee due to grossing up of TDS under Section 195A on payments made to a non-resident service provider is **not allowable as a business expenditure** under Section 37(1) of the Income Tax Act, 1961, primarily due to the specific disallowance provision of Section 40(a)(ii).

Building on the statutory analysis, which highlights that income tax is generally an application of income and Section 40(a)(ii) specifically disallows taxes on profits, we must now delve into how judicial precedents have interpreted these provisions, particularly in the context of tax borne by a resident assessee on behalf of a non-resident.

10. Judicial Interpretation of Allowability of Tax Borne on Behalf of Non-Residents

- **The Principle of Tax as an Application of Income vs. Business Expenditure:** The Hon'ble Supreme Court, in the landmark case of **Commissioner of Income-tax vs. Indian Aluminium Co. Ltd., [1971] 79 ITR 514 (SC)**, laid down a crucial principle regarding the allowability of tax paid on behalf of another. In this case, the assessee company failed to deduct tax at source from retainer fees paid to a foreign company and was subsequently treated as an assessee in default. The assessee then sought to claim the amount of tax it had to pay (which the foreign company refused to reimburse) as a business expenditure. The Supreme Court held that this payment could not be regarded as a bad debt or an expenditure laid out wholly and exclusively for the purpose of business under Section 10(2)(xv) of the 1922 Act (corresponding to Section 37(1) of the 1961 Act). The Court observed that the debt arose out of non-compliance with the provisions of the Act and was *"more a matter of commercial expediency and proceeded out of motives of business relationship because the assessee was anxious not to annoy or offend the Montreal company so as to avail of its continued technical assistance and advice."* However, the Court emphasized that *"a payment made under a statutory obligation, because the assessee was in default, could not constitute expenditure laid out for the purpose of the assessee's business."* This ruling strongly supports the view that tax paid due to a statutory default, even if commercially expedient, is not an allowable business expense for the payer. Similarly, in **Commissioner of Income-tax vs. Flour & Food Ltd., [1983] 12 Taxman 19 (Madhya Pradesh)**, the High Court, relying on the *Indian Aluminium Co. Ltd.* case, held that tax paid by an assessee on behalf of its employee (a foreign technician) due to a guarantee given by the assessee was not an allowable business expenditure. The Court noted that it was not the business of the assessee to give guarantees for income-tax payments of its employees, and the payment was not laid out wholly and exclusively for business purposes. This reinforces the principle that a payment of another's



tax liability, even if arising from a business context, may not qualify as a business expenditure under Section 37(1). However, a different perspective emerges from the ITAT Delhi Bench in **Italian Thai Development Public Co. Ltd. vs. Assistant Director of Income-tax, Circle 1(2), New Delhi, [2012] 17 taxmann.com 172 (Delhi)**. In this case, a foreign company (assessee) obtained a loan and paid an upfront fee to a bank, which was net of taxes. The assessee paid the income tax on behalf of the bank as part of the agreement. The Assessing Officer allowed the net upfront fee but disallowed the tax component. The ITAT held that the tax deducted at source and paid to the Government on behalf of the bank was an *“integral part of the consideration paid by the assessee towards upfront fees.”* Since the net upfront fee was allowed as a revenue deduction, the tax component, being part of the same consideration, should also be eligible for deduction. The ITAT reasoned that *“There is no logical reason for not treating the income-tax deducted at source and paid by the assessee for and on behalf of Standard Chartered Bank, Bangkok in terms of the agreement as part of the upfront fees payable...”* This decision was later affirmed by the Delhi High Court in **Director of Income-tax vs. Italian Thai Development Co. Ltd., [2014] 45 taxmann.com 61 (Delhi)**, lending significant weight to this interpretation. This suggests that if the tax component is contractually agreed upon as part of the overall consideration for services, and the underlying service payment is allowable, then the tax component may also be allowable as an integral part of that business expenditure.

- **Interpretation of Section 40(a)(ii) - Tax on Profits or Gains:** The statutory analysis highlights Section 40(a)(ii) as a key disallowance provision. However, the ITAT Mumbai Bench in **Deputy Commissioner of Income-tax vs. Circle 31 vs. Mumbai vs. Karan Johar, [2011] 11 taxmann.com 268 (Mumbai)**, provided a crucial interpretation. In this case, the assessee reimbursed withholding tax borne by a sub-contractor on payments to a non-resident. The Assessing Officer disallowed this under Section 40(a)(ii), arguing it was tax paid on behalf of another. The ITAT held that *“the tax of the non-resident recipient borne by the Indian payer is nothing but deemed income of the non-resident. Whenever payer bears the withholding tax, such amount is deemed to be the income of the assessee and the tax to be paid is grossed up.”* The Tribunal concluded that *“what the Indian payer deposits to the Government cannot be construed as tax of the Non-resident being borne by the Indian Resident Payer, but the amount paid is only out of the deemed income of the recipient.”* Therefore, the amount reimbursed could not be disallowed under Section 40(a)(ii). This ruling is highly significant as it distinguishes between tax paid as tax on profits and tax paid as part of the grossed-up income of the recipient. It suggests that if the tax component is treated as part of the non-resident's income (due to grossing up), then for the payer, it is merely an additional cost of acquiring the service, not a tax on its own profits, and thus not hit by Section 40(a)(ii). This view is further supported by the ITAT Kolkata in **Deputy Commissioner of Income-tax vs. Welkin Telecom Infra (P.) Ltd., [2022] 142 taxmann.com 146 (Kolkata - Trib.)**, a landmark ruling. While primarily dealing with interest on delayed TDS, the Tribunal explicitly stated that *“TDS paid by assessee is not in nature of ‘income-tax’ of assessee or ‘tax levied on its profits and gains of business’ and, therefore, TDS component paid on expenditure is not disallowable under section 40(a)(ii).”* The Tribunal reasoned that *“the withholding tax/TDS is not in the nature of ‘income-tax’ as defined for the purposes of section 40(a)(ii). Instead the TDS deducted and paid on the business expenditure and is thus a deductible item under section 37.”* This landmark decision directly challenges the conventional understanding of Section 40(a)(ii) in the context of TDS borne by the payer, asserting that such a payment is not a tax on the payer's profits but part of the business expenditure. However, it is important to note the context of **Commissioner of Income-tax vs. Dashmesh Transport Co. (P.) Ltd., [1974] 93 ITR 275 (Punjab & Haryana)**. Here, the assessee company paid the outstanding tax liability of a transferor company as part of an acquisition. The High Court allowed this as a business expenditure, stating that *“Section 40 prevents tax as a deduction when it has been levied on the profits and gains of the assessee's business. The payment made by the assessee in instant case did not fall within this category. It was payment of the liability to tax of another assessee.”* While this case also deals with tax of another assessee, its factual matrix



(acquisition of a company and its liabilities) is distinct from the ongoing service payment scenario. The principle that Section 40(a)(ii) applies to tax on *the assessee's own profits* is consistent, but the interpretation of whether grossed-up TDS is 'tax on the assessee's profits' or 'part of the service cost' is where the nuance lies.

- **Grossing Up under Section 195A and its Effect on Allowability:** The Madras High Court in **Income-tax Officer vs. International Taxation-II vs. Chennai vs. TVS Motor Co. Ltd., [2018] 96 taxmann.com 567 (Madras)**, affirmed the principle of grossing up under Section 195A. The Court held that where an assessee agrees to bear Indian taxes on technical services provided by a UK university, the obligation to pay tax is on the university, and since the assessee agreed to pay it, *"the same has to be necessarily added to the income of the U.K. University and therefore, the principle of grossing up has to be applied."* This decision, later dismissed as withdrawn by the Supreme Court in **Income-tax Officer vs. (International Taxation) vs. Tvs Motor Company Ltd., [2024] 161 taxmann.com 211 (SC)** (meaning the High Court's reasoning stands as persuasive authority, though not affirmed on merits by SC), confirms that the tax borne by the payer becomes part of the non-resident's income. While this case primarily deals with the obligation to gross up for TDS purposes, it implicitly supports the idea that this tax component is part of the overall consideration for the service, which aligns with the *Karan Johar* and *Italian Thai Development* rulings regarding allowability. The ITAT Delhi in **Deputy Commissioner of Income-tax vs. O.N.G.C., [2000] 74 ITD 180 (Delhi)**, while dealing with Section 44BB, clarified that Section 195A is applicable *"only for the purpose of determining the amount of tax deductible at source. Its scope could not be elongated any further."* This suggests that while Section 195A dictates how to calculate TDS, it doesn't automatically determine the allowability of that tax component for the payer under other sections. However, the same ruling also states that the expression *"amount paid or payable' in section 44BB comprises tax liability of the assessee, which is agreed to be paid by the Indian concern pursuant to an agreement and as such, only single point grossing can be done."* This indicates that the tax component, when contractually borne, is considered part of the overall 'amount paid or payable' for the service, which is a business expense.
- **Distinction between Payer's Tax and Payee's Tax:** The Supreme Court in **Commissioner of Income-tax vs. Emil Webber, [1993] 67 Taxman 532 (SC)**, held that tax paid by a company on behalf of an expatriate employee (as per agreement) was income in the hands of the employee. The Court noted that the payment was *"for and on behalf of the assessee. It was not a gratuitous payment. But for the said agreement and but for the said payment, the said tax amount would have been paid by the assessee himself."* This reinforces that the tax borne by the payer is fundamentally the payee's tax liability, but it becomes part of the payee's income. This characterization as the payee's income is crucial for the argument that it is not a tax on the payer's profits under Section 40(a)(ii). The Supreme Court in **Commissioner of Income-tax vs. GE India Technology Cen. (P.) Ltd., [2010] 7 taxmann.com 18 (SC)**, a landmark ruling, emphasized that the obligation to deduct TDS arises only when there is a *"sum chargeable under the provisions of the Act."* While this case primarily deals with the obligation to deduct TDS, it underscores that the tax is on the *income of the non-resident*. If the tax is on the non-resident's income, and the payer agrees to bear it as part of the consideration for services, then for the payer, it transforms into an expense related to acquiring those services, rather than a tax on its own profits.

11. Reconciling the Views

The statutory position, particularly Section 40(a)(ii), appears to disallow any tax on profits or gains. However, judicial pronouncements, especially the ITAT Mumbai in *Karan Johar* and ITAT Kolkata in *Welkin Telecom Infra (P.) Ltd.* (a landmark ruling), have carved out an important distinction. They argue that when a resident payer bears the withholding tax of a non-resident, especially under a gross-up arrangement, this tax component is considered part of the *deemed income* of the non-resident. For the resident payer, this is not a tax on its *own* profits but an additional cost incurred to secure the services, forming an integral part of the overall consideration. Therefore, it is argued that such a payment does not fall within the ambit of Section



40(a)(ii) as a tax on the payer's profits. Instead, it is seen as a business expenditure allowable under Section 37(1), provided the underlying service payment is itself allowable.



The Delhi High Court's affirmation in *Italian Thai Development Co. Ltd.* further strengthens the position that if the tax component is an integral part of the consideration for services, and the net payment is allowed as a revenue deduction, then the tax component should also be allowed. The key is to establish that the tax borne is part of the contractual consideration for the services, effectively increasing the cost of services, rather than a separate tax liability of the payer.

Therefore, while the general principle is that income tax is not an allowable expense, the specific context of grossed-up TDS under Section 195A, where the tax is contractually borne by the payer as part of the non-resident's income, has been interpreted by some judicial forums as an allowable business expenditure for the payer under Section 37(1), and not subject to disallowance under Section 40(a)(ii). This interpretation hinges on the characterization of the tax component as part of the service consideration and the deemed income of the non-resident, rather than a tax on the payer's own profits. This is a nuanced area, and the specific facts of the agreement and the nature of the payment will be critical.

12. Final Conclusion

In conclusion, while the Income Tax Act, 1961, through Section 40(a)(ii), generally disallows any tax levied on profits or gains as a business expenditure, judicial precedents have introduced a significant distinction concerning the additional income tax expense incurred by a resident assessee due to grossing up of TDS under Section 195A on payments to a non-resident service provider. The prevailing judicial view, as seen in cases like *Deputy Commissioner of Income-tax vs. Circle 31 vs. Mumbai vs. Karan Johar* and the landmark ruling in *Deputy Commissioner of Income-tax vs. Welkin Telecom Infra (P.) Ltd.*, suggests that such a tax component, when contractually borne by the Indian payer, is considered part of the *deemed income* of the non-resident recipient. For the resident assessee, this payment transforms into an integral part of the cost of acquiring the services, rather than a tax on its own profits. Consequently, it is argued that this amount does not fall within the specific disallowance under Section 40(a)(ii) and can be allowable as a business expenditure under Section 37(1), provided the underlying service payment itself is allowable and commercially expedient. The affirmation by the Delhi High Court in *Director of Income-tax vs. Italian Thai Development Co. Ltd.* further supports this position, emphasizing that if the tax is an integral part of the consideration for services, it should be treated as such for allowability. Therefore, the allowability hinges on demonstrating that the tax borne is part of the contractual consideration for the services, effectively increasing the cost of services, and not a separate tax liability of the payer. Given the differing interpretations and the specific factual nuances that can influence the outcome, this remains an area where careful consideration of the contractual terms and the nature of the payment is paramount.

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GST

Real questions faced in day-to-day practice.

The following pages demonstrate how GST issues involving classification and judicial views are examined.

What are the Goods and Services Tax (GST) implications on the transfer or assignment of leasehold rights in India, considering whether such transactions constitute a 'supply of goods' or 'supply of services' under the Central Goods and Services Tax (CGST) Act, and the judicial pronouncements classifying them as akin to the sale of land, which is outside the purview of GST?

  Edit

Hello! I understand you have a query regarding the Goods and Services Tax (GST) implications on the transfer or assignment of leasehold rights in India. This is a critical area, especially given the interplay between the statutory provisions and various judicial interpretations. I will provide a comprehensive analysis based on the available legal framework and pronouncements.

1. Understanding of the Query

Your query seeks clarity on whether the transfer or assignment of leasehold rights in India constitutes a 'supply of goods' or 'supply of services' under the Central Goods and Services Tax (CGST) Act, 2017. You have also highlighted the relevance of judicial pronouncements that classify such transactions as akin to the sale of land, which is typically outside the purview of GST. The core challenge lies in reconciling the specific classification under Schedule II of the CGST Act with the exclusion provided in Schedule III for the sale of land, and the differing judicial views on the nature of assignment of leasehold rights.

2. Executive Summary

The transfer or assignment of leasehold rights in India continues to be a complex area under GST. While the statutory framework and departmental stance, supported by Advance Ruling Authorities, generally classify these transactions as a 'supply of services' subject to GST, the Gujarat High Court has taken a divergent view, considering the assignment of long-term leasehold rights as akin to the transfer of benefits arising out of 'immovable property,' thus placing it outside the GST ambit. Editorial commentaries further elaborate on this conflict, emphasizing that such assignments are fundamentally transfers of immovable property, drawing parallels with pre-GST jurisprudence and the broader definitions of immovable property in other statutes. This creates a significant interpretational challenge, as the consistent application of core GST definitions like 'taxable supply' is also debated. Taxpayers must navigate this uncertain environment by carefully assessing their specific facts, jurisdictional implications, and the potential for litigation, while closely monitoring any further judicial pronouncements, particularly from the Supreme Court, for a definitive resolution.

3. GST Implications on Transfer or Assignment of Leasehold Rights in India

The Goods and Services Tax (GST) framework in India is predicated on the concept of 'supply'. Understanding whether a transaction involving the transfer or assignment of leasehold rights falls within the definition of 'supply' and, if so, how it is classified (as goods or services), is crucial for determining its taxability. This analysis will delve into the relevant statutory provisions, departmental clarifications, and judicial pronouncements.

A. The GST Framework: Scope of Supply

- **Section 7(1) of the CGST Act, 2017**, broadly defines 'supply' to include all forms of supply of goods or services or both, such as sale, transfer, barter, exchange, licence, rental, lease, or disposal, made or agreed to be made for a consideration by a person in the course or furtherance of business. This wide definition prima facie covers transactions involving leasehold rights.
- **Section 7(1A)** further clarifies that where activities or transactions constitute a supply under sub-section (1), their classification as either a supply of goods or a supply of services shall be as referred to in **Schedule II**.



- **Section 7(2)** provides an exception, stating that activities or transactions specified in **Schedule III** shall be treated neither as a supply of goods nor a supply of services, effectively placing them outside the GST net.

B. Classification of Leasehold Rights: Supply of Services

Schedule II of the CGST Act plays a pivotal role in classifying certain transactions. Specifically, **Entry 2(a) of Schedule II**, under the heading 'Land and Building', explicitly states that "*any lease, tenancy, easement, licence to occupy land is a supply of services.*"

This provision directly addresses the nature of a lease of land, classifying it as a supply of services. Consequently, the initial grant of leasehold rights, or the act of letting out land, is unequivocally treated as a supply of services under GST. By extension, the transfer or assignment of such leasehold rights, which are derived from or are an extension of the original lease, would generally follow this classification and be treated as a supply of services.

This classification applies irrespective of the lease period, even for long durations like 99 or 999 years. Several Advance Ruling Authority (AAR) decisions, such as *HazariBagh Builders (P.) Ltd.* and *Kedaram Trade Centre*, have confirmed that a 99-year lease of land is subject to GST and is classified under SAC 9972, leviable to tax at 18%. The Supreme Court, in *Builders Association of Navi Mumbai v. UOI*, has also confirmed that leasing of land is a 'supply' and taxable under GST.

C. Exclusion of Sale of Land: Schedule III

Schedule III of the CGST Act lists activities or transactions that are explicitly excluded from the definition of 'supply'. One such entry in Schedule III is the "*sale of land and, subject to paragraph 5(b) of Schedule II, sale of building.*" This means that the outright sale of land is outside the purview of GST.

It is important to note the distinction: while the *sale of land* is excluded, the *lease, tenancy, easement, or licence to occupy land* is specifically classified as a supply of services under Schedule II. This statutory distinction is fundamental to the GST treatment of these transactions.

D. Departmental View: CBIC Clarifications

The Central Board of Indirect Taxes and Customs (CBIC) has issued clarifications to address the taxability of transfer of tenancy rights, particularly in the context of tenancy premium (often referred to as the 'pagadi system').

- **Circular No. 44/18/2018-GST, dated 02-05-2018**, explicitly clarifies that the activity of transfer of tenancy rights is a form of lease or renting of property and is specifically declared to be a service in Schedule II. This means that any consideration, such as tenancy premium, for such activity is liable to GST.
- The circular further clarifies that the transfer of tenancy rights **cannot be treated as a sale of land or building** as per Schedule III of the CGST Act. The argument that the levy of stamp duty and registration charges on such transfers should exempt them from GST (similar to the sale of land) is explicitly rejected. The circulars clarify that merely because a transaction involves execution of documents requiring registration and payment of stamp duty, it does not preclude it from the scope of supply of goods and services and from payment of GST.
- An important exception is noted: the grant of tenancy rights in a residential dwelling for use as a residence (against tenancy premium or periodic rent or both) is exempt from GST under Sl. No. 12 of Notification No. 12/2017-State Tax (Rate) (or corresponding Central Notification).
- Services provided by an outgoing tenant by way of surrendering tenancy rights against consideration (e.g., a portion of the tenancy premium) are also liable to GST.

This departmental stance clearly distinguishes the transfer or assignment of leasehold rights from the outright sale of land, affirming its classification as a supply of services.



E. Judicial Pronouncements: Conflicting Interpretations

The user's query highlights that such transfers are "judicially considered akin to the sale of land." This argument has indeed been a subject of judicial scrutiny, leading to conflicting interpretations:

- **Advance Ruling Authorities (AARs):** Generally, AARs have upheld the departmental view. For instance, in *Enfield Apparels Ltd., In re* [2020] 118 taxmann.com 339 (AAR - West Bengal), the AAR examined the GST implications on the assignment of leasehold rights. The applicant argued that it was akin to the sale of land and thus exempt. However, the AAR concluded that the assignment of leasehold rights is a **supply of service**, not a transfer of immovable property, and classified it under 'Other miscellaneous service'. It was held that GST paid on such transfer fee is admissible as input tax credit. Another AAR ruling in *India Pistons Ltd.* similarly held that "Agreeing to part with leasehold rights to other person is taxable @ 18% under heading 9997". These rulings reinforce the position that for GST purposes, the specific provisions of Schedule II prevail over general interpretations from other statutes.
- **Gujarat High Court Decision:** In contrast, the Gujarat High Court (DB) in *Gujarat Chamber of Commerce and Industry v. UOI* held that "GST is not leviable on assignment of leasehold rights of plot of land allotted on lease by lessee or its successor (assignor) to a third party (assignee) on payment of lump-sum as such an assignment by sale and transfer of leasehold rights of plot for a consideration would be assignment/sale/transfer of benefits arising out of 'immovable property' by lessee-assignor in favour of third party-assignee and hence would not be 'supply'." This ruling aligns the assignment of leasehold rights with the 'sale of land', which is excluded from GST under Schedule III, emphasizing the nature of the underlying asset (immovable property) and the comprehensive transfer of rights akin to ownership.

F. Reconciliation and Practical Implications

The divergence between the Gujarat High Court decision and the AAR rulings creates a significant interpretive complexity. While a High Court ruling carries substantial weight and is binding within its jurisdiction, the departmental view, supported by AARs, maintains that the assignment of leasehold rights is a taxable supply of services. The commentary also flags the Gujarat High Court decision as an "arguable issue" and advises that "relying on this may be risky. It may be safe and hence advisable to pay GST and avail ITC."

This cautionary note indicates that the judicial interpretation is evolving and could be subject to further scrutiny or clarification from higher courts or the tax authorities. The department's consistent stance, as reflected in circulars and AARs, is that the specific classification under Schedule II (as a service) takes precedence over analogies drawn from other statutes or judicial interpretations for different tax regimes.

G. Conclusion

Based on the statutory provisions, departmental clarifications, and the prevailing judicial landscape, the transfer or assignment of leasehold rights in India is generally considered a **supply of services** under Paragraph 2(a) of Schedule II of the CGST Act, 2017, and is therefore subject to GST. The exclusion under Schedule III applies to the outright 'sale of land', which is distinct from the transfer or assignment of leasehold rights. While there is a High Court pronouncement suggesting otherwise for assignment of leasehold rights, the departmental view and several AARs classify it as a taxable service. Given this conflict, taxpayers should carefully evaluate their position and consider the potential risks involved. It is often prudent to adopt a position that aligns with the departmental view to avoid litigation, especially when Input Tax Credit (ITC) can be availed on the GST paid.

Building on the statutory analysis, which clearly delineates the GST framework for 'supply' under Section 7 of the CGST Act, 2017, and the classification of lease of land as a 'supply of services' under Entry 2(a) of Schedule II, while excluding the 'sale of land' under Schedule III, we now delve into how judicial pronouncements have interpreted and applied these provisions. The user's query specifically highlights a perceived judicial view that such transfers are "akin to the sale of land," which necessitates a thorough examination of the conflicting interpretations from various judicial forums.



4. Judicial Interpretation: Navigating the Divergence



The statutory provisions, particularly Schedule II, Entry 2(a), unequivocally classify any lease, tenancy, easement, or licence to occupy land as a supply of services. This position is consistently upheld by the Central Board of Indirect Taxes and Customs (CBIC) through its circulars, which explicitly state that the transfer of tenancy rights cannot be treated as a sale of land or building. However, the judicial landscape presents a nuanced picture, with Advance Ruling Authorities (AARs) generally aligning with the departmental view, while certain High Court pronouncements have offered a contrasting interpretation.

A. Advance Ruling Authorities (AARs) and Appellate Advance Ruling Authorities (AAARs): Upholding 'Supply of Service'

The Advance Ruling Authorities (AARs) and Appellate Advance Ruling Authorities (AAARs) have consistently interpreted the transfer or assignment of leasehold rights as a 'supply of service' under the GST regime. Their reasoning primarily hinges on the distinction between the transfer of ownership (sale of land) and the transfer of a right to use or occupy land for a specified period (lease or assignment of leasehold rights).

- **Kobelco Construction Equipment India (P.) Ltd., In re [2025] 180 taxmann.com 432 (AAR - ANDHRA PRADESH):**
 - **Facts:** The applicant held a 99-year lease over land and proposed to assign the unexpired leasehold interest of 89 years to a transferee for consideration, with a transfer fee payable to the lessor.
 - **Reasoning and Ratio Decidendi:** The AAR ruled that the assignment or transfer of leasehold rights constitutes a *supply of service* under Schedule II. The core principle here is that such an assignment *only confers a right to use for a fixed term and not ownership*. Therefore, it cannot be considered a sale of land under Schedule III. The AAR also clarified that separate recoveries for infrastructural development works (roads, drains, etc.) would amount to a taxable supply of service, and the transfer fee paid to the lessor for permitting the transfer of leasehold interest is also a taxable service, classifiable under 'Other miscellaneous service' (SAC 999794), for which Input Tax Credit (ITC) is admissible.
 - **Application to User Query:** This ruling directly addresses the user's query, affirming that the assignment of leasehold rights, even for long durations, is a service because it does not transfer ownership but merely the right to use.
- **Fena (P.) Ltd., In re [2024] 159 taxmann.com 541 (AAR - UTTAR PRADESH) and Remarkable Industries (P.) Ltd., In re [2024] 160 taxmann.com 150 (AAR - UTTAR PRADESH):**
 - **Facts:** In both these cases, the applicants, holding 99-year leases from industrial development authorities, transferred their leasehold rights to third-party assignees with the lessor's approval, receiving consideration.
 - **Reasoning and Ratio Decidendi:** The AARs reiterated that the transfer of leasehold rights falls within the ambit of 'supply of service' under Paragraph 2 of Schedule II. They emphasized that the applicant's interest in the demised premises is limited to sub-leasing or transferring leasehold rights, and *there is no transfer of any immovable property in the context of the GST Act*. The activity is akin to compensation for agreeing to transfer one's leasehold rights and is classified under 'other services' (SAC 9997 92), taxable at 18%. The rulings explicitly state that 'benefits arising out of land' are not 'land' itself for the purpose of Schedule III exclusion.
 - **Application to User Query:** These rulings reinforce the AAR position that the transfer of leasehold rights, even for long terms, is a service and not a sale of land, thereby attracting GST. The distinction between 'land' and 'benefits arising out of land' is crucial here.



- **Vilas Chandanmal Gandhi, In re [2020] 120 taxmann.com 83 (AAAR-MAHARASHTRA):**
 - **Facts:** This case involved the transfer of Transferable Development Rights (TDRs) received by an appellant for surrendering rights in land to a municipal corporation. The question was whether the sale of TDR/FSI was a taxable supply or a sale of land.
 - **Reasoning and Ratio Decidendi:** The AAAR held that TDR is an *immovable property* but its transfer is covered under the definition of *service* because the definition of service is very wide. Crucially, the AAAR clarified that Schedule III, Entry 5, which excludes the 'sale of land', must be *strictly interpreted*. The term 'land' in Schedule III cannot be extended to include 'benefits arising out of land' like TDR. Therefore, TDR, being a benefit arising out of land and not land itself, is liable to GST as a service. The AAAR also noted that legislative intent, as evidenced by various notifications, was to tax transactions involving TDR/FSI under GST.
 - **Application to User Query:** While this case specifically deals with TDRs, its underlying principle is highly relevant. It establishes that even if a right is considered an 'immovable property' (like leasehold rights or TDRs), its transfer may still be a 'service' for GST purposes if it doesn't amount to an outright 'sale of land' as strictly defined in Schedule III. This strengthens the argument that leasehold rights, being benefits arising out of land, are services.
- **Sanjeev Sharma vs. In re [2018] 93 taxmann.com 494 (AAR - New Delhi):**
 - **Facts:** This ruling concerned the GST applicability on the sale of an undivided share in land and superstructure in a residential project.
 - **Reasoning and Ratio Decidendi:** The AAR reiterated that the *sale of land* is outside the scope of supply under GST as per Schedule III. However, the *construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer*, is a supply of services under Schedule II, Entry 5(b). The ruling also discussed the mechanism for valuing the service component by excluding the value of land.
 - **Application to User Query:** This case, while not directly on leasehold rights, reinforces the fundamental distinction: outright sale of land is exempt, but activities *in relation to* land, such as construction or granting rights to use, are services.
- **NBCC (India) Ltd. vs. In re [2018] 98 taxmann.com 333 (AAR - New Delhi) (affirmed by NBCC (India) Ltd., In re [2023] 149 taxmann.com 84 (AAAR-Delhi)):**
 - **Facts:** The applicant, an implementing agency for redevelopment projects, sought a ruling on GST liability on the sale of commercial built-up area on behalf of the Ministry of Housing and Urban Affairs.
 - **Reasoning and Ratio Decidendi:** The AAR held that the sale of commercial built-up units is a 'supply of service' under Schedule II, Entry 5(b). The AAAR affirmed this, reinforcing that activities related to the development and transfer of rights in immovable property, even if they involve a component of land, are treated as services under GST.
 - **Application to User Query:** This further supports the view that transactions involving immovable property, other than the outright sale of bare land, are generally considered services for GST purposes.

B. Supreme Court's Stance on Leasing of Land

The Supreme Court has also weighed in on the taxability of land-related transactions, particularly the initial leasing of land.



- **Builders Association of Navi Mumbai vs. Union of India [2024] 162 taxmann.com 610 (SC):**
 - **Facts:** This case involved a challenge to the High Court's decision that one-time lease rent paid as consideration by a builders' association to a government agency (CIDCO) for the lease of land for residential/commercial purposes amounted to a supply of services under GST.
 - **Reasoning and Ratio Decidendi:** The Supreme Court upheld the High Court's view, stating that there was "no good ground and reason to take a different view than taken by High Court." This confirms that the *leasing of land* by a government agency against consideration (including one-time lease rent) is a *supply of service* and leviable to GST. The Court, however, left open questions regarding specific exemptions and the full scope of "licence to occupy land is supply of service" under Schedule II, Entry 2(a).
 - **Application to User Query:** This landmark ruling from the Supreme Court solidifies the position that the initial act of leasing land is a taxable service. While it doesn't directly address the *assignment* of leasehold rights, it sets the foundational principle that transactions involving the right to use land, rather than outright ownership transfer, fall under the ambit of 'service'.

C. Conflicting High Court Pronouncement: The Gujarat High Court View

In contrast to the consistent stance of AARs/AAARs and the Supreme Court's affirmation on initial leasing, the Gujarat High Court has taken a different view regarding the assignment of leasehold rights.

- **Gujarat Chamber of Commerce and Industry v. Union of India [2025] 170 taxmann.com 251 (Gujarat):**
 - **Facts:** This case involved the assignment of 99-year leasehold rights of industrial plots allotted by the Gujarat Industrial Development Corporation (GIDC) to a third party for consideration. The GIDC lease deed permitted such assignments.
 - **Reasoning and Ratio Decidendi:** The Gujarat High Court held that such an assignment by sale and transfer of leasehold rights of a plot of land for consideration would be an *assignment/sale/transfer of benefits arising out of 'immovable property'* by the lessee-assignor in favour of the third-party assignee. The Court concluded that in such circumstances, the provisions of Section 7(1)(a) read with Schedule II, Entry 5(b) (construction services) or Schedule III, Entry 5 (sale of land) would *not be applicable*, and therefore, the transaction would *not be subject to levy of GST* under Section 9. The Court reasoned that the transfer of leasehold rights, especially for long durations, effectively transfers a bundle of rights akin to ownership, making it a transfer of immovable property.
 - **Application to User Query:** This is the crucial judgment that aligns with the user's observation that such transfers are "judicially considered akin to the sale of land." The Gujarat High Court's view is that a comprehensive transfer of leasehold rights, particularly long-term ones, is essentially a transfer of an interest in immovable property, which should be outside the scope of GST, similar to the sale of land.
- **Life Sciences Chemicals vs. Union of India [2025] 175 taxmann.com 540 (Gujarat), Quilon Real Industries (P.) Ltd. vs. Union of India [2025] 176 taxmann.com 320 (Gujarat), and Siemens Ltd. vs. Union of India [2025] 181 taxmann.com 212 (Gujarat):**
 - **Facts:** These subsequent Gujarat High Court decisions involved similar factual matrices where industrial plots were allotted on long-term lease by GIDC, and the leasehold rights were later assigned to third parties.
 - **Reasoning and Ratio Decidendi:** These rulings consistently followed the precedent set in *Gujarat Chamber of Commerce and Industry v. Union of India*, reiterating that the assignment of leasehold rights in such scenarios constitutes a transfer of benefits arising out of 'immovable property' and is therefore not subject to GST. They explicitly stated that



Section 7(1)(a) read with Schedule II, Entry 5(b) and Schedule III, Entry 5 would not apply to such transactions.

- o **Application to User Query:** These cases solidify the Gujarat High Court's position, creating a strong precedent within its jurisdiction that the assignment of long-term leasehold rights is not a taxable supply under GST.

D. Pre-GST Regime Jurisprudence: Insights into 'Right to Use' and 'Sale'

While the GST regime has its own specific definitions, understanding the pre-GST jurisprudence on 'right to use' and 'sale' can provide valuable context, especially when distinguishing between a service and a deemed sale.

- **Commissioner of Central Excise vs. Customs & Service Tax vs. Hyderabad-1 vs. Power Mak Industries [2018] 91 taxmann.com 316 (Hyderabad - CESTAT):**
 - o **Facts:** This case involved the supply of Diesel Generator (DG) sets on a hire basis, with the hirer having the legal right of possession and effective control.
 - o **Reasoning and Ratio Decidendi:** The CESTAT held that if a transaction involves the transfer of possession and effective control of goods to the user, it is considered a 'deemed sale of goods' (under Article 366(29A) of the Constitution) and would attract sales tax/VAT, not service tax. Conversely, if the supply does not extend to the transfer of possession and effective control, it would be a service. The key test is whether the hirer has the legal right to use the goods and effective control over them.
 - o **Application to User Query:** This case, though about movable goods, highlights the principle that a transfer of the *right to use* with effective control can be akin to a sale for tax purposes. The Gujarat High Court's reasoning on leasehold rights draws a similar analogy, suggesting that a comprehensive transfer of leasehold rights grants such extensive control that it resembles a sale of immovable property.
- **Commissioner of Central Excise vs. Noida vs. Greater Noida Industrial Development Authority [2014] 44 taxmann.com 271 (New Delhi - CESTAT):**
 - o **Facts:** This case dealt with the service tax liability on one-time lease charges and annual lease charges collected by an industrial development authority for long-term leases (90 years) of vacant land.
 - o **Reasoning and Ratio Decidendi:** The CESTAT observed that the difference between "sale" and "renting" is blurring. It held that "renting" would not ordinarily cover long-term leasing where a property is given with rights to transfer, assign, and mortgage, as *such transfers are more akin to sale and less to renting of property*. The CESTAT distinguished between 'premium' (price for obtaining lease, akin to capital income) and 'rent' (periodical payments for continuous enjoyment, akin to revenue receipt). Service tax was leviable only on the 'rent' element, not on the 'premium' for transfer of interest.
 - o **Application to User Query:** This pre-GST ruling directly supports the argument that long-term leases, especially those with extensive rights like transfer and assignment, bear a strong resemblance to a sale. This judicial thought process from the service tax era appears to have influenced the Gujarat High Court's interpretation under GST.

5. Reconciliation and Practical Implications

The analysis reveals a clear conflict between the departmental view (supported by AARs/AAARs and the Supreme Court's ruling on initial leasing) and the Gujarat High Court's pronouncements regarding the assignment of long-term leasehold rights.

- **Departmental View and AARs:** The consistent position is that the transfer or assignment of leasehold rights, irrespective of duration, is a 'supply of service' under Schedule II, Entry 2(a), and therefore taxable under GST. They strictly interpret 'sale of land' in Schedule III to



mean an outright transfer of ownership of bare land, not a transfer of rights to use or benefits arising from land.

- **Gujarat High Court View:** The Gujarat High Court has taken a broader view, considering the assignment of long-term leasehold rights (e.g., 99 years) as akin to a 'sale of immovable property' or 'benefits arising out of immovable property'. This interpretation places such transactions outside the scope of 'supply' for GST purposes, similar to the exclusion for the sale of land.
- **Hierarchy of Courts:** It is crucial to remember that a High Court ruling is binding within its territorial jurisdiction. Therefore, within Gujarat, the decisions of the Gujarat High Court would prevail. However, AAR rulings are binding only on the applicant and the jurisdictional officer who sought the ruling. The Supreme Court's decision in *Builders Association of Navi Mumbai* confirms that the *initial leasing* of land is a service, but it did not specifically address the *assignment* of leasehold rights in the context of it being akin to a sale of land.
- **Risk and Prudence:** Given this divergence, taxpayers outside the jurisdiction of the Gujarat High Court face uncertainty. Relying solely on the Gujarat High Court's view might be risky, as the departmental stance, backed by AARs and the Supreme Court's general affirmation of leasing as a service, remains strong. The tax authorities may continue to demand GST on such assignments, potentially leading to litigation.

Therefore, while the Gujarat High Court has provided a favourable interpretation for taxpayers within its jurisdiction, the broader national perspective, especially considering the Supreme Court's general stance on leasing as a service and the strict interpretation of Schedule III by AARs, suggests that the transfer or assignment of leasehold rights is generally considered a taxable supply of services under GST. Taxpayers should carefully assess their specific facts, the jurisdiction, and the potential for litigation when determining their GST liability on such transactions.

Building upon the statutory and judicial analysis, which highlighted the conflicting interpretations regarding the GST implications on the transfer or assignment of leasehold rights, editorial commentaries offer further insights into the rationale behind these divergent views, particularly emphasizing the Gujarat High Court's position.

6. Editorial Perspectives on Transfer of Leasehold Rights

- **Nature of Assignment as Immovable Property:** Several commentators, such as Dr. Sanjiv Agarwal and Ramesh Chandra Jena, in their articles from 2025, strongly support the view that the assignment of long-term leasehold rights, especially those granted by industrial development corporations (like GIDC), constitutes a transfer of "benefits arising out of immovable property." They argue that such a transfer is akin to a sale of immovable property and therefore falls outside the ambit of 'supply' under GST, aligning with the exclusion of 'sale of land' in Schedule III of the CGST Act, 2017. The articles reference the *Gujarat Chamber of Commerce and Industry v. Union of India* judgment, noting that the court considered the assigned leasehold rights as encompassing incorporeal ownership rights, such as the right to possess, enjoy income from, and alienate, which are characteristic of immovable property.
- **Distinction between Initial Allotment and Subsequent Assignment:** The editorial content draws a crucial distinction between the initial grant of a long-term lease by a development authority and the subsequent assignment of those leasehold rights by the lessee. While the initial allotment of land on a 99-year lease by GIDC (or similar authorities) for a one-time upfront premium is acknowledged as a 'supply of service' (renting of immovable property under Schedule II, 5(a)), it is often exempt from GST under Entry No. 41 of Notification No. 12/2017-Central Tax (Rate). However, the subsequent transaction where the lessee/assignor transfers these leasehold rights to a third-party assignee is argued to be a transfer of an interest in immovable property, not a service. This is because the lessee/assignor divests all absolute rights in the property, making it an alienation akin to a sale.



- **Pre-GST Jurisprudence and Legislative Intent:** Authors like Ramesh Chandra Jena refer to the pre-GST service tax regime, where there was a specific exclusion for the transfer of title in immovable property from the definition of “service.” This historical context is used to argue that the legislative intent has consistently been not to impose tax on the transfer of immovable property. The articles also highlight that the GST Council, in its initial meetings, decided not to introduce GST on land and building, further supporting the interpretation that such transfers should remain outside the GST net.
- **Definition of Immovable Property:** The commentaries delve into the definitions of “immovable property” from other statutes, such as Section 3(26) of the General Clauses Act, 1897, and Section 2(6) of the Registration Act, 1908, which explicitly include “benefits to arise out of land.” This broad definition is used to bolster the argument that leasehold rights, being benefits arising from land, are indeed immovable property. The fact that such assignments are subject to stamp duty, often at rates similar to conveyance for sale of immovable property, further reinforces this position.
- **Critique of Inconsistent Application of ‘Taxable Supply’:** An article by Veer Singh Verma and CA Rajesh Kumar Khandelwal, while not directly on leasehold rights, points out a broader issue within the GST Act: the inconsistent application of the definition of “taxable supply” as provided in Section 2(108). They argue that this inconsistency creates confusion and ambiguity, potentially leading to litigation. This general observation underscores the interpretational challenges faced by taxpayers and courts when dealing with complex transactions like the assignment of leasehold rights, where the core definitions themselves might be applied differently across various sections of the Act.

These editorial views provide a deeper understanding of the arguments favoring the non-taxability of assignment of leasehold rights, particularly by emphasizing the nature of the transaction as a transfer of immovable property rather than a supply of service.

7. Final Conclusion

While statutory provisions and departmental clarifications, supported by various AARs and the Supreme Court’s stance on initial leasing, generally classify the transfer or assignment of leasehold rights as a ‘supply of services’ liable to GST, editorial commentaries, aligning with the Gujarat High Court’s pronouncements, strongly argue that such assignments, especially for long durations, constitute a transfer of ‘benefits arising out of immovable property’ akin to a sale of land, thereby falling outside the scope of GST. This persistent conflict between the departmental view and the High Court’s interpretation, further elaborated by expert opinions on legislative intent and the definition of immovable property, underscores the ongoing uncertainty for taxpayers, necessitating careful consideration of jurisdictional precedents and potential litigation risks until a definitive Supreme Court ruling clarifies the matter.

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Further Illustration— GST

Real questions faced in day-to-day practice.

This example reflects how GST questions with differing views are analysed step by step.

What is the eligibility of Input Tax Credit (ITC) under the Goods and Services Tax (GST) regime on telecommunication towers, considering the provisions of Section 17(5) of the Central Goods and Services Tax (CGST) Act, 2017, and recent judicial pronouncements classifying them as movable property?

  Edit

Hello, I understand you have a query regarding the eligibility of Input Tax Credit (ITC) on telecommunication towers under the Goods and Services Tax (GST) regime, particularly in light of Section 17(5) of the CGST Act, 2017, recent judicial pronouncements, and the Finance Act, 2025 amendments. This is a critical area with significant implications for the telecommunication sector, and I will provide a comprehensive analysis based on the latest legal provisions.

1. Understanding of the Query

The query seeks clarification on the eligibility of Input Tax Credit (ITC) for telecommunication towers under the Central Goods and Services Tax (CGST) Act, 2017. The core of the issue revolves around the interpretation and application of Section 17(5) of the CGST Act, which deals with blocked credits. Specifically, the user is interested in understanding the interplay between the statutory definition of 'plant and machinery' (and its exclusions), judicial pronouncements classifying telecommunication towers as movable property, and the impact of retrospective amendments introduced by the Finance Act, 2025. The complexity arises from the potential conflict between judicial interpretations and specific legislative intent as expressed through statutory definitions and subsequent amendments.

2. Executive Summary

Input Tax Credit (ITC) on telecommunication towers is generally **not available** under the GST regime. This position is primarily driven by the explicit exclusion of 'telecommunication towers' from the definition of 'plant and machinery' in the Explanation to Section 17(5) of the CGST Act, 2017. While judicial pronouncements, notably the Supreme Court in the context of erstwhile CENVAT law, have classified telecommunication towers as movable property and eligible for credit, and some High Courts initially followed this view under GST, the legislative amendments introduced by the Finance Act, 2025, specifically aim to reinforce the statutory position. These amendments, particularly the insertion of Explanation 2 to Section 17(5) with retrospective effect, clarify that the legislative intent is to block ITC on such structures, overriding any contrary judicial interpretations. Editorial commentaries further elaborate on the judicial reasoning that classified towers as movable based on 'functionality' and 'object of annexation' tests, a perspective that the retrospective legislative changes were designed to counter. These commentaries also discuss the broader policy implications of such legislative overrides, highlighting the legislature's prerogative in tax policy and the ongoing debate regarding the fairness and certainty of retrospective amendments. Therefore, despite their potential classification as movable property in other contexts, for GST ITC purposes, the specific legislative framework ensures that ITC on telecommunication towers remains unavailable. However, ITC may still be claimed on other movable components of the telecommunication infrastructure, such as BTS, shelters, and electronic equipment, provided they are not considered part of the immovable tower structure and meet other ITC eligibility conditions.

3. Eligibility of Input Tax Credit on Telecommunication Towers under GST

The eligibility of Input Tax Credit (ITC) on telecommunication towers under the Goods and Services Tax (GST) regime is a matter that has seen considerable debate and legislative clarification. The analysis hinges on the interpretation of Section 17(5) of the Central Goods and Services Tax (CGST) Act, 2017, its associated Explanation, and recent amendments.

4. General Principles of ITC Eligibility

Section 16 of the CGST Act, 2017, lays down the general eligibility criteria for claiming ITC. It states that every registered person is entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business, subject to certain conditions and restrictions. However, Section 17(5) acts as a specific blocking provision, restricting ITC on certain goods and services, even if they are used for business purposes.



5. Blocking Provisions under Section 17(5)



Two clauses within Section 17(5) are particularly relevant to the discussion of telecommunication towers:

- **Section 17(5)(c):** This clause blocks ITC on “works contract services when supplied for construction of an immovable property (other than plant and machinery) except where it is an input service for further supply of works contract service.”
- **Section 17(5)(d):** This clause blocks ITC on “goods or services or both received by a taxable person for construction of an immovable property (other than plant and machinery) on his own account, including when such goods or services or both are used in the course or furtherance of business.”

These provisions essentially block ITC on inputs used for the construction of immovable property, with a crucial exception for ‘plant and machinery’. The determination of whether telecommunication towers fall under this exception is key.

6. Statutory Definition of ‘Plant and Machinery’ and Exclusion of Telecommunication Towers

The Explanation to Section 17(5) of the CGST Act, 2017, provides a specific definition for ‘plant and machinery’ for the purposes of these blocking provisions. It defines ‘plant and machinery’ as:

“apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes:

- (i) land, building or any other civil structures;*
- (ii) telecommunication towers; and*
- (iii) pipelines laid outside the factory premises.”*

The explicit exclusion of “telecommunication towers” from the definition of ‘plant and machinery’ is a critical aspect. This statutory exclusion means that for the purpose of Section 17(5)(c) and 17(5)(d), telecommunication towers are *not* considered ‘plant and machinery’. Consequently, they do not qualify for the exception to the blocking provisions, and ITC on works contract services, goods, or services used for their construction is blocked.

This position has been consistently reiterated in official communications. For instance, **Circular No. 219/13/2024-GST, dated 26-6-2024**, while clarifying ITC eligibility for ducts and manholes, explicitly quotes and relies on this statutory exclusion to differentiate between eligible and ineligible items. The circular aligns with the literal reading of the Explanation to Section 17(5), confirming that telecommunication towers are excluded from ‘plant and machinery’ for ITC purposes.

7. Impact of Judicial Pronouncements

The user’s query rightly points to recent judicial pronouncements classifying telecommunication towers as movable property. Notable judgments include:

- **Supreme Court Ruling in *Bharti Airtel Ltd. vs. Commissioner of Central Excise (2024)*:** In a case under the erstwhile CENVAT Credit Rules, 2004, the Supreme Court held that telecommunication towers and prefabricated buildings are movable property and qualify as ‘inputs’ for providing mobile telecommunication services. The Court applied various tests to conclude that these items can be dismantled and relocated without causing damage.
- **Delhi High Court Ruling in *Bharti Airtel Ltd. vs. Commissioner, CGST Appeals-1 (2024)*:** Following the Supreme Court’s decision, the Delhi High Court specifically addressed the GST context. It ruled that telecommunication towers, being dismantlable and relocatable, fail the test of permanency and are therefore classified as movable property. Crucially, the Delhi High Court held that the specific exclusion of telecommunication towers from the definition of ‘plant and machinery’ in the Explanation to Section 17(5) of the CGST Act **does not**



automatically render them immovable property. The Court emphasized that for Section 17(5)(d) to apply, the property must first qualify as immovable property. Since telecommunication towers were deemed movable, they would fall outside the scope of the blocking provisions of Section 17(5)(d).

These judicial pronouncements, if considered in isolation, would suggest that ITC should be available, as the blocking provisions of Section 17(5)(c) and (d) apply to *immovable property*. However, the legislative intent, as expressed through the specific statutory exclusion, takes precedence, especially with subsequent amendments.

8. Retrospective Amendments by Finance Act, 2025

The Finance Act, 2025, has introduced significant retrospective amendments to Section 17(5) that directly address the interpretation of 'plant and machinery' and aim to override judicial pronouncements. As of January 2026, these amendments are in effect:

- **Substitution of "plant or machinery" with "plant and machinery":** The phrase "plant or machinery" in clauses (c) and (d) of Section 17(5) has been substituted with "plant and machinery" with retrospective effect from 1st July, 2017. This is a clarificatory amendment to ensure consistency in terminology.
- **Insertion of new Explanation 2:** A new Explanation 2 has been inserted for the purposes of clause (d) of Section 17(5), effective from 1st October, 2025. This Explanation clarifies that *"notwithstanding anything to the contrary contained in any judgment, decree or order of any court, tribunal, or other authority, any reference to 'plant or machinery' shall be construed and shall always be deemed to have been construed as a reference to 'plant and machinery'."*

This new Explanation 2 is particularly crucial. It explicitly aims to override any judicial pronouncements that might have interpreted 'plant or machinery' differently or classified telecommunication towers as movable property to circumvent the blocking provisions. By stating that the reference to 'plant or machinery' (now 'plant and machinery') must be construed as per the statutory definition, the amendment reinforces the legislative intent to block ITC on items explicitly excluded from that definition, such as telecommunication towers.

9. Conclusion on ITC Eligibility

Considering the explicit statutory exclusion of telecommunication towers from the definition of 'plant and machinery' in the Explanation to Section 17(5) of the CGST Act, coupled with the retrospective amendments introduced by the Finance Act, 2025, ITC on telecommunication towers is **not eligible**. The legislative intent, as clarified by these amendments, is to ensure that ITC is blocked on such structures, irrespective of any judicial classification of them as movable property. The amendments effectively nullify the impact of judicial pronouncements that sought to allow ITC by classifying towers as movable property and thus outside the scope of Section 17(5)(d).

10. ITC on Other Components of Telecommunication Infrastructure

It is important to distinguish between the telecommunication tower itself and other components of the telecommunication infrastructure. While ITC is blocked on the tower, credit may still be available for other movable goods and services used in the infrastructure, provided they are not permanently affixed to the earth and are not specifically excluded. Examples of such items, as per various commentaries and advance rulings, include:

- Pre-fabricated shelters (if movable)
- Electronic Panels
- Base Transceiver Stations (BTS) and other radio transmission and reception equipment
- Diesel generator sets
- Hollow steel galvanized pipes (if easily removable)

These items, if considered 'goods' and not part of the immovable property (telecommunication tower), would generally be eligible for ITC, subject to other conditions of Section 16 and not falling under any other blocking provisions of Section 17(5).

Building on the statutory framework, which explicitly excludes telecommunication towers from the definition of 'plant and machinery' under Section 17(5) of the CGST Act, 2017, it is crucial to examine how judicial pronouncements have interpreted this aspect, especially in light of the retrospective amendments. The user's query highlights the classification of telecommunication towers as movable property by courts, which, if applied without considering the specific GST exclusions, could lead to a different conclusion regarding ITC eligibility.

11. Judicial Interpretation of Movability vs. Statutory Exclusion

A. The Supreme Court's Stance on Movability (Pre-GST Era):

The Supreme Court, in the case of *Bharti Airtel Ltd. vs. Commissioner of Central Excise vs. Pune*, (2024) 24 Centax 266 (S.C.)/2025 (391) E.L.T. 3 (S.C.), while dealing with the erstwhile CENVAT Credit Rules, 2004, provided a significant interpretation regarding telecommunication towers and prefabricated buildings (PFBs). The core issue was whether these items qualified as 'inputs' or 'capital goods' for claiming CENVAT credit. The Department argued that these were immovable properties, hence not 'goods' and ineligible for credit. However, the Supreme Court held that:

- Towers and PFBs are **'goods' and not immovable property**. The Court reasoned that while an antenna may theoretically receive and transmit signals without a tower, *practically, it is not feasible*. The tower is an *essential accessory* for keeping the antenna at a proper height and in a stable position for effective signal transmission and wider coverage. Thus, the link between the antenna and the tower is *almost inseparable* for providing mobile telecommunication services, and their nexus is *quite proximate and inseparable*.
- PFBs, which house electrical cables, equipment related to antennas, Base Transceiver Stations (BTS), and generators, *enhance the efficacy and functioning* of mobile antennas and BTS. Therefore, PFBs can also be considered *accessories* to antennas and BTS.
- These items (towers and PFBs) are covered by the definition of 'capital goods' under Rule 2(a)(A)(iii) read with Rule 2(a)(A)(i) of the CENVAT Rules. Since they are used for providing output services (mobile services), they qualify as 'inputs' under Rule 2(k) for CENVAT credit purposes.

This landmark ruling established that telecommunication towers and PFBs are movable goods and are integral to the provision of telecommunication services, thereby making them eligible for CENVAT credit. This decision was a significant victory for telecom service providers under the previous indirect tax regime.

B. Conflicting High Court Views (Pre-GST and Early GST Era):

Prior to the Supreme Court's definitive ruling, there were conflicting views among High Courts. For instance, the Bombay High Court in *Bharti Airtel Ltd. vs. Commissioner of Central Excise vs. Pune-III*, 2014 (35) S.T.R. 865 (Bom.), and subsequently affirmed in *Commissioner of Central Excise vs. Mumbai-II vs. Vodafone India Ltd.*, 2015 (40) S.T.R. 422 (Bom.) and 2015 (324) E.L.T. 434 (Bom.), had taken a contrary view. The Bombay High Court held that:

- Towers and parts thereof are *fastened and fixed to the earth* and after erection become *immovable*, and therefore, cannot be considered 'goods'.
- They do not fall under the definition of 'capital goods' or 'inputs' under the CENVAT Credit Rules, as they are not directly used for output services and are non-marketable and non-excisable.
- The argument that towers are accessories to antennas was rejected, stating that an accessory must go into the composition of another article, which towers do not.



However, the Delhi High Court in *Commissioner vs. Vodafone Mobile Services Ltd.*, 2017 (47) S.T.R. J114 (All.), expressly dissented from the Bombay High Court's decision in *Bharti Airtel*, holding that credit of taxes paid on telecom towers was eligible. The Delhi High Court observed that the Bombay High Court's decision went against the law laid down by the Supreme Court in *Solid and Correct Engineering Works* (a case cited in the *Bharti Airtel* Bombay High Court judgment itself, but distinguished). This highlights the judicial debate on the nature of these structures.

C. Advance Rulings under GST:

The Advance Ruling Authority in *P.K. Mahapatra*, 2020 (39) G.S.T.L. 459 (App.A.A.R. - GST) [03-09-2019], while dealing with lighting towers for a steel plant (not telecom towers, but similar in principle of being civil structures), affirmed the AAR's finding that such structures were civil structures with foundations and were immovable in nature. Crucially, it emphasized that the project for lighting could not be said to be used for making outward supply of goods or services, which is an essential ingredient for being termed as 'Plant and Machinery' under the GST definition. The ruling also noted that the definition of 'plant and machinery' specifically excludes telecom towers and pipelines. This ruling, though not directly on telecom towers, reinforces the strict interpretation of the 'plant and machinery' definition under GST, particularly the 'used for making outward supply' condition and the explicit exclusions. Another Advance Ruling in *Vindhya Telelinks Ltd.*, 2018 (17) G.S.T.L. 649 (A.A.R. - GST) [28-08-2018], considered poles used for stringing fibre (not containing antennas or electronic equipment). The AAR held that if such infrastructure could be moved easily without damage, it could be classified as 'goods' and ITC could be availed. This ruling, however, pertains to a different type of infrastructure and does not directly contradict the specific exclusion of 'telecommunication towers'. The cases of *In re : KEI Industries Ltd.*, (2025) 29 Centax 324 (A.A.R. - GST - Guj.) [21-03-2025] and (2025) 33 Centax 371 (App. A.A.R. - GST - Guj.) [31-07-2025], though concerning concrete structures for VCV manufacturing lines, illustrate the application of the 'plant and machinery' definition. The initial AAR denied ITC, stating the construction was for immovable property and not 'plant or machinery' as the applicant could not prove it was not for its own account. However, the Appellate AAR allowed ITC, emphasizing that the definition of 'plant and machinery' specifically includes foundation and structural support if used for making outward supply. This highlights that even if a structure is immovable, if it forms part of 'plant and machinery' as defined, ITC is available, unless specifically excluded.

12. Impact of Retrospective Amendments and Overriding Judicial Pronouncements

As discussed in the statutory analysis, the Finance Act, 2025, introduced retrospective amendments to Section 17(5) of the CGST Act, 2017. The insertion of a new Explanation 2 explicitly states that "notwithstanding anything to the contrary contained in any judgment, decree or order of any court, tribunal, or other authority, any reference to 'plant or machinery' shall be construed and shall always be deemed to have been construed as a reference to 'plant and machinery'." This amendment is a legislative override, specifically designed to nullify the effect of judicial pronouncements that might have allowed ITC on telecommunication towers by classifying them as movable property or by interpreting 'plant and machinery' broadly.

While the Supreme Court's decision in *Bharti Airtel Ltd. vs. Commissioner of Central Excise vs. Pune*, (2024) 24 Centax 266 (S.C.)/2025 (391) E.L.T. 3 (S.C.), was a significant precedent under the CENVAT regime, classifying towers as movable goods and eligible for credit, its applicability to the GST regime is now directly curtailed by the retrospective amendment. The GST law, through the Explanation to Section 17(5), specifically excludes telecommunication towers from the definition of 'plant and machinery'. This statutory exclusion, coupled with the legislative override, means that even if a court classifies telecommunication towers as movable property, for the purpose of ITC under GST, they are treated as if they are not 'plant and machinery' and thus fall under the blocking provisions of Section 17(5)(c) and (d).

13. Constitutional Validity of Blocking Provisions

It is also pertinent to note the Supreme Court's view on the constitutional validity of such blocking provisions. In *Chief Commissioner of Central Goods and Service Tax vs. Safari Retreats Pvt. Ltd.*, (2024) 23 Centax 62 (S.C.), the Supreme Court upheld the constitutional validity of clauses (c) and (d) of Section 17(5) of the CGST Act, 2017. The Court clarified that the right to ITC is a creation of a statute, and the Legislature can always carve out exceptions to the entitlement of ITC. No one can claim ITC as a matter of right unless



it is expressly provided in the statute. The Court stated that immovable property and immovable goods for GST purposes constitute a class by themselves, and clauses (c) and (d) apply only to this class of cases. This ruling reinforces the legislative power to restrict ITC, even if it appears to go against the general principle of seamless credit flow.

Therefore, despite the judicial pronouncements classifying telecommunication towers as movable property, the specific and explicit exclusion of 'telecommunication towers' from the definition of 'plant and machinery' in the Explanation to Section 17(5) of the CGST Act, 2017, combined with the retrospective legislative override, ensures that ITC on such towers remains blocked. The legislative intent is clear: to deny ITC on telecommunication towers, irrespective of their classification as movable or immovable property in other contexts or under previous tax laws

Building upon the statutory and judicial analysis, which established the explicit exclusion of telecommunication towers from the definition of 'plant and machinery' under Section 17(5) of the CGST Act, 2017, and the subsequent legislative override through the Finance Act, 2025, the editorial commentary offers insights into the judicial thought process that the amendments aimed to address.

A. Judicial Interpretation of Movability and its Conflict with Statutory Exclusion

- Pre-Amendment Judicial Stance:** The article by Ramesh Chandra Jena, titled "Telecommunication Towers Are Movable Property and Not Fall Within Ambit of Section 17(5) (d); ITC Admissible - Supreme Court" [(2025) 34 Centax 170 (Article)], provides a detailed account of the judicial perspective that telecommunication towers are movable property. It highlights the Supreme Court's decision in *Commissioner CGST, (Appeal-1), Delhi v. Bharati Airtel Ltd.*, (Civil Appeal No. 35416 of 2025, decided on 08-8-2025), which upheld the Delhi High Court's ruling. The core argument was that the specific exclusion of telecommunication towers from the definition of 'plant and machinery' in the Explanation to Section 17(5) does not automatically render them immovable property. For Section 17(5)(d) to apply, the property must first qualify as immovable. The courts applied the 'functionality test' and 'object of annexation' test, drawing from precedents like *Commissioner of Central Excise, Ahmedabad v. Solid and Correct Engineering Works & Others* and *Sirpur Paper Mills Ltd.*, to conclude that towers are erected for operational stability and can be dismantled and moved, thus retaining their movable character. This judicial view, prior to the Finance Act, 2025 amendments, suggested that ITC on telecommunication towers should be admissible as they would fall outside the blocking provisions applicable to immovable property.

B. Legislative Override and Policy Considerations

- Policy vs. Legal Interpretation:** The article by Manoj Mishra and Shilpa Verma, titled "[2025] 170 taxmann.com 156 (Article)", discusses the broader implications of the Supreme Court's ruling in *Safari Retreats* (which upheld the constitutional validity of blocking provisions) and the subsequent retrospective amendment to Section 17(5)(d). It emphasizes that tax policy decisions, such as defining taxable items and determining exclusions, fall within the legislature's domain. The authors note that the Supreme Court reinforced the legislature's prerogative to limit ITC in specific contexts, prioritizing revenue protection. This aligns with the long-standing policy intent, even under pre-GST regimes, to restrict ITC for immovable properties. The article suggests that the ITC debate is often more about policy considerations than legal interpretation, advocating for proactive engagement with policymakers.
- Retrospective Amendments and Challenges:** The article by Mishra and Verma also touches upon the potential challenges to retrospective amendments. While acknowledging the legislature's power to amend laws retrospectively to align with policy objectives (citing instances like *Eicher Motors* and *Canon India*), it raises concerns about fairness and legislative overreach. It highlights that retrospective amendments must meet the test of reasonableness and should not unduly prejudice taxpayers, especially when altering tax obligations for past transactions. This perspective underscores the ongoing tension between legislative intent to clarify or override judicial pronouncements and the principles of legal certainty and fairness for taxpayers.



C. Temporal Application of Amendments

- **Prospective vs. Retrospective Application:** The article by CA R Raghunathan, titled “[2025] 179 taxmann.com 593 (Article)”, provides a comprehensive analysis of the judicial approach to the temporal application of tax amendments. While not directly on telecommunication towers, it establishes a key principle: an amendment that withdraws or curtails a benefit (like ITC) is generally presumed to apply prospectively, unless expressly or by necessary implication made retrospective. This principle is founded on protecting taxpayers from unforeseen liabilities. The article cites foundational judgments like *CIT (Central) I v. Vatika Township (P.) Ltd.* and *Jayam & Co. v. Assistant Commissioner*. This general principle is crucial when evaluating the Finance Act, 2025’s retrospective amendments, as they explicitly aim to apply retrospectively to block ITC on telecommunication towers, overriding previous judicial interpretations that might have allowed it.

14. Final Conclusion

In summary, while judicial pronouncements, particularly the Supreme Court’s decision in *Bharti Airtel Ltd. vs. Commissioner of Central Excise vs. Pune* (2024) and the Delhi High Court’s subsequent ruling in *Bharti Airtel Ltd. vs. Commissioner, CGST Appeals-1* (2024), classified telecommunication towers as movable property and suggested ITC eligibility by applying the ‘functionality test’ and ‘object of annexation’ tests, the legislative intent, as clarified by the explicit statutory exclusion of telecommunication towers from ‘plant and machinery’ in Section 17(5) of the CGST Act, 2017, and reinforced by the retrospective amendments of the Finance Act, 2025, definitively blocks ITC on such structures. The Supreme Court’s affirmation of the constitutional validity of Section 17(5)(c) and (d) in *Chief Commissioner of Central Goods and Service Tax vs. Safari Retreats Pvt. Ltd.* (2024) further solidifies the legislature’s power to restrict ITC, effectively overriding any contrary judicial interpretations regarding movability for GST purposes. Editorial commentaries highlight this tension between judicial interpretation and legislative policy, acknowledging the legislature’s prerogative to shape tax policy and introduce retrospective amendments, even while noting potential debates on fairness and legal certainty. Therefore, despite their potential classification as movable property in other contexts, for GST ITC purposes, the specific legislative framework ensures that ITC on telecommunication towers remains unavailable. However, ITC may still be claimed on other movable components of the telecommunication infrastructure, such as BTS, shelters, and electronic equipment, provided they are not considered part of the immovable tower structure and meet other ITC eligibility conditions.

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What These Answers Demonstrate

These examples reflect how Taxmann.AI approaches complex tax questions:

- Begins with a clear understanding of the issue
- Interprets statutory provisions in their proper context
- Recognises conflicting judicial views instead of oversimplifying
- Delivers structured, professional-grade conclusions backed by authority

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