

EY Tax Alert

**CBDT notifies laws under which
settlement would be
disallowable expenditure**

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

Executive summary

This Tax Alert explains Notification No. 38/2025 dated 23 April 2025¹ (Notification) along with related FAQs issued by the Central Board of Direct Taxes (CBDT)², notifying certain laws in respect of which any expenditure incurred towards settlement of initiated proceedings for contraventions, would be disallowable for tax purposes. The laws as notified are: (i.) the Securities and Exchange Board of India (SEBI) Act, 1992. (ii.) the Securities Contracts (Regulation) Act (SCRA), 1956. (iii.) the Depositories Act, 1996. (iv.) the Competition Act, 2002.

The Notification has come into force from the date of its publication in the official gazette i.e., 23 April 2025.

¹ [F. No. 38/2025/F. No 370142/11/2025-TPL]

² The apex body for administration of direct taxes in India



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Background

- ▶ Generally, expenses incurred wholly and exclusively for the purpose of business are allowed as deduction under Section 37 of the Indian Tax Laws (ITL) while computing business income.
- ▶ However, expenditure incurred towards any purpose which is an offense or which is prohibited by any law, is not allowed as a deduction. Finance Act, 2022³ further amended Section 37 to clarify that such disallowable expenditure would also include expenditure incurred:
 - ▶ For any purpose which is an offense or which is prohibited, either under Indian or foreign law; or
 - ▶ To provide any benefit or perquisite to any person, where acceptance of such benefit or perquisite is in contravention of any law, rule, regulation or guideline regulating the conduct of such person; or
 - ▶ To compound an offence under any Indian or foreign law.
- ▶ Against this legislative backdrop, an issue arose as to whether payments made to settle proceedings initiated against a taxpayer in relation to infraction of any law, without admittance of guilt, would also be subject to disallowance.
- ▶ This issue gained prominence in various Income Tax Appellate Tribunal rulings which took contrary views on deduction of expenditure incurred on settlement of proceedings under securities law, without admitting or denying guilt⁴.
- ▶ Considering this, Finance (No. 2) Act, 2024, with effect from 1 April 2025 (i.e., tax year 2024-25), introduced an amendment to clarify the position. As per the said amendment, expenditure incurred by a taxpayer to settle proceedings which are

initiated in relation to a contravention under any law for the time being in force as may be notified by the central government in the official gazette, will also be disallowed⁵.

CBDT notifies laws

- ▶ Against the above backdrop, the CBDT has now issued the Notification notifying the laws under which any expenditure for settlement of initiated proceedings for contravention are disallowable.
- ▶ The notified laws are:
 - ▶ the SEBI Act, 1992 (15 of 1992).
 - ▶ the SCRA, 1956 (42 of 1956).
 - ▶ the Depositories Act, 1996 (22 of 1996).
 - ▶ the Competition Act, 2002 (12 of 2003).

Effective date

The Notification states that it shall come into force on the date of its publication in the official gazette i.e., 23 April 2025.

FAQs 5 & 6 issued by CBDT seek to clarify that the amendment will apply from tax year 2024-25 [assessment year (AY) 2025-26] onwards and that tax audit report in Form 3CD has also been amended by earlier CBDT Notification No. 23/2025 dated 28 March 2025 to capture details pertaining to such expenses as well.

³ Refer EY Alerts in the "Budget Connect 2022" series dated 1 February 2022

⁴ For instance, refer Reliance Share and Stock Brokers (P) Ltd. [TS-664-ITAT-2014(Mum)] where the Mumbai Tribunal took a view in favor of deduction of settlement fees, and Monal Y. Thakkar [(2016) 69 taxmann.com 349] and Shri Anil Dhirajlal

Ambani [TS-291-ITAT-2018(Mum)] where the Ahmedabad Tribunal without noticing the earlier Mumbai Tribunal ruling, took a contrary view to deny deduction of settlement fees.

⁵ Refer EY alert titled "Tax Alert - Key announcements of Union Budget 2024" dated 23 July 2024

Comments

The Notification provides welcome clarity on the notified laws to which the disallowance of expenditure for settlement of contravention proceedings may apply. Importantly, it keeps out of scope, expenses incurred on settlement of contraventions under any other Indian or foreign law. But taxpayers may note that the central government can expand the scope by notifying any other laws in the future.

In view of the notified laws, a contentious issue may arise on distinction between expenditure incurred: (a.) To “compound” an offense under any Indian or foreign law. (b.) To “settle” proceedings initiated in relation to contravention under the notified laws. The former category covers any Indian or foreign law, without the need to be notified by the central government. On the other hand, the latter category covers only those Indian or foreign laws which are notified by the central government. Hence, taxpayers may need to carefully evaluate the category under which a particular settlement expenditure may fall before claiming any deduction.

Another issue is the effective date of expanded scope of disallowance. The FAQs issued by CBDT along with the Notification state that such settlement expenditure cannot be claimed as a deduction or allowance from tax year 2024-25 [corresponding to AY 2025-26] onwards. As against this, a well settled position under the ITL is that the law as it stands on first day of the AY applies to the whole of the tax year (called “previous year”). Given this, it may be argued that the Notification, which has come into force on 23 April 2025, will apply only from the current tax year 2025-26 onwards i.e. AY 2026-27 onwards. The clarification provided in the FAQ may thus result in retroactive application for tax year 2024-25.

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