

# 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 2025<sup>1</sup> (Notification) along with related FAQs issued by the Central Board of Direct Taxes (CBDT)<sup>2</sup>, 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.

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

<sup>2</sup> 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, 2022<sup>3</sup> 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 guilt<sup>4</sup>.
- 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 disallowed<sup>5</sup>.

## 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.

<sup>3</sup> Refer EY Alerts in the "Budget Connect 2022" series dated 1 February 2022

<sup>4</sup> 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.

<sup>5</sup> 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.

# Our offices

## Ahmedabad

22<sup>nd</sup> Floor, B Wing, Privilon  
Ambli BRT Road, Behind Iskcon Temple  
Off SG Highway  
Ahmedabad - 380 059  
Tel: + 91 79 6608 3800

8<sup>th</sup> Floor, Building No. 14A  
Block 14, Zone 1  
Brigade International Financial Centre  
GIFT City SEZ  
Gandhinagar - 382355, Gujarat  
Tel +91 79 6608 3800

## Bengaluru

12<sup>th</sup> & 13<sup>th</sup> Floor  
"UB City", Canberra Block  
No.24 Vittal Mallya Road  
Bengaluru - 560 001  
Tel: + 91 80 6727 5000

Ground & 1<sup>st</sup> Floor  
# 11, 'A' wing  
Divyasree Chambers  
Langford Town  
Bengaluru - 560 025  
Tel: + 91 80 6727 5000

3<sup>rd</sup> & 4<sup>th</sup> Floor  
MARKSQUARE  
#61, St. Mark's Road  
Shantala Nagar  
Bengaluru - 560 001  
Tel: + 91 80 6727 5000

1<sup>st</sup> & 8<sup>th</sup> Floor, Tower A  
Prestige Shantiniketan  
Mahadevapura Post  
Whitefield,  
Bengaluru - 560 048  
Tel: + 91 80 6727 5000

## Bhubaneswar

8<sup>th</sup> Floor, O-Hub, Tower A  
Chandaka SEZ, Bhubaneswar  
Odisha - 751024  
Tel: + 91 674 274 4490

## Chandigarh

Elante offices, Unit No. B-613 & 614  
6th Floor, Plot No- 178-178A  
Industrial & Business Park, Phase-I  
Chandigarh - 160 002  
Tel: + 91 172 6717800

## Chennai

6<sup>th</sup> & 7<sup>th</sup> Floor, A Block,  
Tidel Park, No.4, Rajiv Gandhi Salai  
Taramani, Chennai - 600 113  
Tel: + 91 44 6654 8100

## Delhi NCR

Aikyam  
Ground Floor  
67, Institutional Area  
Sector 44, Gurugram - 122 003  
Haryana  
Tel: +91 124 443 4000

3<sup>rd</sup> & 6<sup>th</sup> Floor, Worldmark-1  
IGI Airport Hospitality District  
AeroCity, New Delhi - 110 037  
Tel: + 91 11 4731 8000

4<sup>th</sup> & 5<sup>th</sup> Floor, Plot No 2B  
Tower 2, Sector 126  
Gautam Budh Nagar, U.P.  
Noida - 201 304  
Tel: + 91 120 671 7000

## Hyderabad

THE SKYVIEW 10  
18<sup>th</sup> Floor, "SOUTH LOBBY"  
Survey No 83/1, Raidurgam  
Hyderabad - 500 032  
Tel: + 91 40 6736 2000

## Jaipur

9<sup>th</sup> floor, Jewel of India  
Horizon Tower, JLN Marg  
Opp Jaipur Stock Exchange  
Jaipur, Rajasthan - 302018

## Kochi

9<sup>th</sup> Floor, ABAD Nucleus  
NH-49, Maradu PO  
Kochi - 682 304  
Tel: + 91 484 433 4000

## Kolkata

22 Camac Street  
3rd Floor, Block 'C'  
Kolkata - 700 016  
Tel: + 91 33 6615 3400

## Mumbai

14<sup>th</sup> Floor, The Ruby  
29 Senapati Bapat Marg  
Dadar (W), Mumbai - 400 028  
Tel: + 91 22 6192 0000

5<sup>th</sup> Floor, Block B-2  
Nirlon Knowledge Park  
Off. Western Express Highway  
Goregaon (E)  
Mumbai - 400 063  
Tel: + 91 22 6192 0000

3<sup>rd</sup> Floor, Unit No 301  
Building No. 1  
Mindspace Airoli West (Gigaplex)  
Located at Plot No. IT-5  
MIDC Knowledge Corridor  
Airoli (West)  
Navi Mumbai - 400708  
Tel: + 91 22 6192 0003

Altimus, 18<sup>th</sup> Floor  
Pandurang Budhkar Marg  
Worli, Mumbai - 400 018  
Tel: +91 22 6192 0503

## Pune

C-401, 4<sup>th</sup> Floor  
Panchshil Tech Park, Yerwada  
(Near Don Bosco School)  
Pune - 411 006  
Tel: + 91 20 4912 6000

10<sup>th</sup> Floor, Smartworks  
M-Agile, Pan Card Club Road  
Baner, Taluka Haveli  
Pune - 411 045  
Tel: + 91 20 4912 6800

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