

EY Tax Alert

Karnataka HC holds that denial of excess FTC without variation in total income cannot result in levy of penalty

Executive summary

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.

This Tax Alert summarizes a recent decision of the Karnataka High Court (HC) in the case of Mr. Srinivasa Gandhi Sampath (Taxpayer) v. ACIT¹, wherein the HC quashed a penalty order and held that penalty for under-reporting or misreporting of income cannot be imposed merely because the Taxpayer made an excess claim of foreign tax credit (FTC).

In this case, the Taxpayer's returned income was accepted in the assessment without any variation. However, while computing tax liability, the tax authority disallowed part of FTC made in the return in respect of which tax authority initiated and imposed penalty of under-reported income.

The HC held that the penalty for under-reported income requires variation in total income as returned by the Taxpayer. Absent such variation, penalty cannot be invoked merely on account of reduction in grant of credit for FTC in computing tax liability of the Taxpayer.

¹ WP No. 22802 of 2022 dated 21 November 2025



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Background

- ▶ Under the Income-tax laws² (ITL), when a resident taxpayer earns income in a foreign jurisdiction and pays tax thereon in foreign country, the foreign tax so paid is allowed to be claimed as credit against the taxes payable in India (this is popularly known as FTC credit) in accordance with the relevant tax treaty as well as the provisions of the ITL, subject to certain conditions.
- ▶ Separately, ITL provides for levy of penalty if there is under-reporting or misreporting of income by virtue of variation to total income assessed by compared to returned income by the taxpayer. Penalty for underreported income is 50% of tax payable on under-reported income and penalty for misreported income is 200% of such tax payable.

Facts:

- ▶ The Taxpayer was an employee of an Indian company of a MNC group and worked in India as also abroad. The Taxpayer, an Indian resident, during the relevant tax year, filed a return of income declaring salary income received from Indian employer and claimed a credit of taxes paid outside India amounting to INR 6.8 million.³
- ▶ In the scrutiny assessment the tax authority did not make any variation to the total income declared in the tax return. However, in computation of tax liability, it reduced the FTC claim to INR 2.2 million. The Taxpayer did not dispute the same.
- ▶ Subsequently, tax authority passed a penalty order levying penalty on the Taxpayer on the grounds that the Taxpayer had under-reported its income.⁴ According to tax authority, the Taxpayer had claimed excess FTC with the intent to evade income tax resulting in under-reporting of total income in India.
- ▶ Aggrieved, the Taxpayer has filed a writ petition before the Karnataka High Court challenging the penalty order.

Taxpayer's contentions:

- ▶ The penalty under the ITL can be imposed only in cases of underreporting of income and misreporting of income which necessarily requires variation in total income as compared to returned income.
- ▶ The tax authority accepted the income declared in the return of income by the Taxpayer without any variation to such total income. There is, therefore, no under-reporting of income involved therein.
- ▶ Errors in the claim of FTC relief while computing tax liability does not amount to underreporting or

misreporting of income, absent any variation in total income. Penal provision of the ITL does not trigger at all.

Tax authority contentions:

- ▶ The writ is not maintainable since taxpayers have efficacious and alternative remedy available in the form of an appeal.

HC ruling:

The HC quashed the penalty order and held that penalty can only be invoked in case under-reporting of income and not to the case of availing excess FTC relief without variation in income:

- ▶ Penalty provisions under the ITL have to be strictly construed and such provisions can be invoked and initiated only in the event of the taxpayer being guilty of under-reporting of income.
- ▶ Excess claim of FTC relief does not result in under-reporting of income and, hence, the essential requirements to invoke penalty proceedings is absent in the facts of the case.
- ▶ The HC relied on the Gujarat HC decision in the case of Prafulbhai Vallabhadas Fuletra⁵ in support of the proposition that in absence of variation to the returned income, there would be no under-reporting of income and consequently there can be no levy of penalty under the ITL.
- ▶ Reliance was placed also on the Supreme Court (SC) decision in the case of Reliance Petroproducts⁶ to hold that mere making of a claim which is not sustainable in law by itself would not amount to furnishing inaccurate particulars or concealment of income. The SC, in this case, was concerned with the erstwhile penalty provisions of the ITL which applied in case of concealment of income by furnishing inaccurate particulars.
- ▶ Further, rejecting tax authority's contention, the HC held that the existence of an alternative remedy does not take away HC's jurisdiction under Article 226 of the Constitution of India. Hence the writ petition was held to be maintainable.

² Income-tax Act, 1961 read with Income-tax Rules, 1962

³ The decision does not elaborate why the salary income was taxable outside India.

⁴ There was no allegation of misreporting of income.

⁵ [(2023) 157 Taxmann.Com 754 (Gujrat)]

⁶ [(2010) 11 SCC 762]

Comments

The present HC ruling affirms the well-settled legal position that underreported of income presupposes upward variation to total return income. Absent variation, penal provisions of the ITL does not trigger. Consequently, denial of FTC while computing tax liability does not result under-reporting of income so as to trigger penal consequences.

The principles of rulings may also be extended to cases involving mismatch or variation in allowance of credits for tax credit or collected at source or minimum alternate tax (MAT)/alternate minimum tax (AMT) credit entitlement or claim for tax rebate.

Our offices

Ahmedabad

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

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

Bengaluru

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

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

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

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

Bhubaneswar

8th 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

6th & 7th 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

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

4th & 5th 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
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur

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

Kochi

9th 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

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

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

3rd 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, 18th Floor
Pandurang Budhkar Marg
Worli, Mumbai - 400 018
Tel: +91 22 6192 0503

Pune

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

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

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