JANUARY 2026

TAX EDGE

YOUR MONTHLY GUIDE TO STAYING AHEAD

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Two-Year Safe Harbour Window & Transfer Pricing Applicability

Strategic Planning for AY 2026-27

With Safe Harbour provisions extended up to AY 2026-27, taxpayers now have a critical two-year window to revisit their transfer pricing (TP) models. However, Safe Harbour is relevant only after TP provisions are triggered. Understanding when TP applies and how Safe Harbour fits into the broader TP framework is essential for informed tax planning.

Transfer Pricing Provisions Applicability

An assessee is required to comply with Chapter X of the Income-tax Act in any of the following cases:

1. **International Transactions**
   - Transactions with an Associated Enterprise (AE) located outside India
   - Applicable irrespective of transaction value
2. **Transactions with Notified Jurisdictional Areas (NJA)**
   - TP provisions apply even without an AE relationship
   - Focused on preventing profit shifting to low-tax jurisdictions
3. **Specified Domestic Transactions (SDTs)**
   - Domestic transactions notified under Section 92BA
   - Applicable only if aggregate SDTs exceed ₹20 crore in a financial year

Key Message:

Safe Harbour and other TP options (APA / benchmarking) become relevant only after these conditions are met.

Safe Harbour Rule

Safe Harbour Rules (Rule 10TD read with Rule 10TC) allow eligible taxpayers to declare transfer prices at prescribed margins / rates, which are automatically accepted by tax authorities—provided conditions are met.

- No comparability analysis.
- No TP adjustments once accepted.
- Reduced audit and litigation exposure

Two-Year Safe Harbour Window & Transfer Pricing Applicability

Transfer Pricing Applicability – International vs Domestic Transactions:

Key Parameter	International Transactions (ITs)	Specified Domestic Transactions (SDTs)
Threshold	Applicable irrespective of value	Applicable only if ₹20 crore exceeded
Relevant Provisions	Sections 92–92F (excluding 92BA) and Section 94B	Sections 92, 92BA, 92C, 92CA, 92D, 92E, 92F
Secondary Adjustment (Sec 92CE)	Applicable	Not applicable
Advance Pricing Agreements (APA)	Available	Not available
TPO Powers	Wide powers, including unreported transactions	Limited to SDTs referred by AO
Non-filing of Form 3CEB	Income deemed to have escaped assessment	No deeming provision
Inter-party Loans	Covered; ALP interest required	Resident-to-resident loans excluded
Thin Capitalisation (Sec 94B)	Applicable	Not applicable

Two-Year Safe Harbour Window & Transfer Pricing Applicability

Eligible Transactions & Indicative Thresholds

Service Transactions

- Software Development / ITES: 17%–22% margin (value-linked)
- KPO: 18%–25% margin (employee cost linked)
- Contract R&D (Software / Pharma): 24%–30%

Financial Transactions

- Intra-group Loans (INR): SBI MCLR + 175–625 bps (credit rating based)
- Intra-group Loans (Foreign Currency): SOFR / EURIBOR / SONIA / SORA + spread
- Corporate Guarantees: 1%–2% per annum

Manufacturing & Others

- Core Auto Components: ⩾12%
- Non-core Auto Components: ⩾8.5%
- Low Value-Adding Services: Cost + ⩽5% (₹10 crore cap)

Safe Harbour Applicability Period

- Safe Harbour under Rule 10TD(2A) applicable for AY 2020-21 to AY 2026-27

Key Takeways

- Trigger check first: Safe Harbour applies only after TP provisions are triggered; eligibility assessment is the starting point.
- Certainty vs cost: Lock in margins for AYs up to 2026-27, weighing prescribed margins against reduced audit and litigation risk.
- Compliance not diluted: TP documentation and Form 3CEB under Sections 92D and 92E remain mandatory even under Safe Harbour.

Conclusion

- With Safe Harbour available only up to AY 2026-27, taxpayers should transition to a regular transfer pricing study thereafter.
- A robust benchmarking analysis will be critical post-AY 2026-27 to support arm's length pricing and manage litigation risk.

ESOP Taxation in India – At a Glance

Employee Stock Option Plans (ESOPs have steadily become an integral part of employee compensation, particularly in startups and fast-growing companies. By offering a stake in the organisation, ESOPs allow employees to participate in the company's growth journey and foster a strong sense of ownership.

That said, ESOP taxation under Indian income-tax law is complex and often misunderstood. Without a clear understanding of the applicable rules, employees may face unexpected tax outflows and cash-flow challenges. This newsletter aims to simplify ESOP taxation and explain the key provisions in a clear and practical manner.

Employee Stock Option Plan

An Employee Stock Option Plan (ESOP) is a scheme under which a company grants its employees the option to purchase shares of the company at a predetermined price (known as the exercise price) after a specified period (vesting period). Essentially, it allows employees to benefit from the growth in the company's value.

Overview of ESOP Taxation in India

Under Indian tax law, ESOPs are taxed at two distinct stages:

1. At the time of exercise / allotment of shares - taxed as a perquisite under the head "Income from Salary"
2. At the time of transfer / sale of shares - taxed under the head "Capital Gains"

Importantly, no tax is levied at the time of grant or vesting of ESOPs.

ESOP Exercise – Perquisite Tax Implications

As per Section 17(2)(vi) of the Income-tax Act, 1961 read with Rule 3 of the Income-tax Rules, 1962, when an employee exercises ESOPs and shares are allotted, the difference between the Fair Market Value (FMV) of the shares on the date of exercise and the exercise price paid by the employee is treated as a taxable perquisite. This perquisite is taxed as salary income in the year in which the shares are allotted.

Perquisite Valuation Formula

Perquisite Value = FMV on date of exercise – Amount paid by employee

The FMV as on the date of exercise is the relevant value for taxation purposes. The FMV on the date of grant or vesting is not relevant. As a result, the tax liability arises in the year of allotment, even though the employee may not have realised any cash benefit at that stage.

ESOP Taxation in India – At a Glance

Special Relief for Employees of Eligible Start-ups

Recognising the cash-flow challenges faced by startup employees, the Income-tax Act provides a deferment of TDS and tax payment on ESOP perquisites for employees of eligible start-ups referred to in Section 80-IAC.

Tax/TDS becomes payable within 14 days from the earliest of:

1. Expiry of 48 months from the end of the relevant assessment year
2. Date of sale of ESOP shares
3. Date of cessation of employment

It is important to note that this provision offers only a deferment and not an exemption. The tax liability remains intact. Employees are still required to disclose the perquisite value in their return of income for the year in which the shares are allotted, even though the actual payment of tax is deferred.

Capital Gains Tax on ESOP Share Sale

When ESOP shares are sold, the gains arising from such transfer are taxable under the head "Capital Gains" in accordance with Section 45 of the Income-tax Act. For the purpose of computing capital gains, Section 49(2AA) provides that the FMV considered earlier for perquisite taxation shall be treated as the cost of acquisition.

Period of Holding

The period of holding is computed from the date of allotment of shares, and not the exercise date.

Type of Shares	Short-Term	Long-Term
Listed Shares	⩽ 12 months	> 12 months
Unlisted Shares	⩽ 24 months	> 24 months
Listed Shares	⩽ 12 months	> 12 months

Conclusion

ESOPs are a powerful long-term wealth-creation and retention tool, but their taxation requires careful planning and informed decision-making. With evolving regulations and Finance Act amendments, both employers and employees must remain compliant while optimising tax outcomes.

Waiver of Interest on Delayed Deposit of TDS/TCS

Late Deposit Interest TDS

This provision deals with interest liability when TDS is deducted but not deposited on time with the Central Government.It applies where:

- Tax has been deducted at source (TDS), but
- Such TDS is not paid to the Government within the prescribed due date
  Interest is payable at 1.5% per month or part of month thereof

Late Deposit Interest – TCS

This subsection deals with interest liability when a person who is required to collect tax at source (TCS) fails to do so or fails to deposit it on time.It applies if the seller/collector:

- Fails to collect TCS, or
- Collects TCS but does not deposit it with the Central Government within the due date
  Interest is payable at 1% per month or part of the month thereof

CBDT Circular for Interest Waivers on TDS and TCS

The CBDT has issued Circular No. 05/2025 dated 28th March 2025, providing relief from interest levied under Section 201(1A) (ii) (TDS) and Section 206C (7) (TCS).

Interest for delayed deposit of TDS/TCS will be waived in cases where:

- The payment was initiated and debited from the bank account of the deductor/collector on or before the due date, and
- The amount was credited to the Central Government after the due date due to technical glitches

Where delay in credit is beyond the control of the deductor/collector and the funds were timely debited, interest shall not be levied.

Time Period for filing Application.

An application for waiver of interest under section 201(1A) (ii) or section 206C (7) can be considered if it is filed within one year from the end of the financial year to which the interest relates.

Section 194R: Taxing Business Benefits and Perquisites

Introduction

Section 194R brings a new dimension to TDS by targeting non-cash benefits and perquisites provided in the course of business or profession.
The section applies when:

- A resident receives a benefit or perquisite,
- The benefit arises from business or professional activities, and
- The benefit is provided by a person carrying on business or profession.

The form of the benefit is irrelevant—it may be cash, kind, or a combination of both.

Rate of TDS and Threshold

TDS under Section 194R is required to be deducted at a flat rate of 10% of the value of the benefit or perquisite.
However, the obligation arises only when the aggregate value of benefits provided to a recipient exceeds ₹20,000 during a financial year. This limit is calculated on a yearly, recipient-wise basis, not per transaction.
Once this threshold is crossed, tax is deductible on the entire value of benefits provided during the year.

Persons Responsible to Deduct TDS

Section 194R places the responsibility to deduct tax on the provider of the benefit or perquisite.

- All entities such as companies, firms, LLPs, trusts, AOPs and BOIs, irrespective of turnover.
- Individuals and Hindu Undivided Families (HUFs) are covered only if their business turnover exceeded ₹1 crore in the preceding financial year.
- In case of professionals, the obligation applies where professional receipts exceeded ₹50 lakh in the preceding financial year.
- Individuals and HUFs below these thresholds are not required to deduct TDS under Section 194R.

This ensures that large and mid-sized businesses comply, while small taxpayers remain outside the administrative burden.

Section 194R: Taxing Business Benefits and Perquisites

Meaning of Benefit or Perquisite

The term "benefit or perquisite" has been intentionally kept broad. It covers any advantage, incentive, or facility provided in connection with business dealings.
Common examples include:

- Free or discounted products retained by distributors
- Gifts, gadgets, or vehicles given as performance incentives
- Sponsored travel, accommodation, or event passes
- Free training programs or memberships provided to professionals

At the same time, normal business discounts, such as trade discounts, rebates, and cash discounts that are directly linked to sales transactions, are not treated as benefits or perquisites for the purpose of this section.

Exclusions from Applicability

Section 194R does not apply in certain situations, including:

- Benefits provided to employees (covered under salary TDS provisions)
- Benefits provided to non-residents
- Benefits not arising from business or professional activity
- Cases where the annual benefit value does not exceed ₹20,000

These exclusions help maintain a clear boundary between different TDS provisions and prevent overlapping taxation.

Conclusion

- Section 194R brings non-cash business benefits and perks within the TDS net.
- The provider of the benefit is responsible for deducting tax.
- TDS applies only if benefits to a recipient exceed ₹20,000 annually.

UPDATED RETURN UNDER THE INCOME TAX ACT, 1961

Introduction

The Finance Act, 2022 introduced the concept of Updated Return under Section 139(8A) of the Income-tax Act, 1961. This allows taxpayers to voluntarily disclose additional income or correct omissions even after the time limit for filing original, belated, or revised returns has expired. The main goal is to promote voluntary compliance and transparency in the tax system.

Meaning of Updated Return

An Updated Return is a return filed to update income details where:

- No return was filed earlier, or
- A return was filed but certain income was omitted or under-reported.

It is filed in Form ITR-U, after paying tax, interest, and additional tax as prescribed.

Recent Amendments

1. The due period to file an updated return has been extended from 24 months to 48 months (4 years) from the end of the relevant assessment year.
2. Additional tax slabs for later periods (up to 70%) introduced.
3. The ITR-U form has been updated to reflect these changes.

Additional Tax Payable (Section 140B)

- With the extension of the filing window, the additional tax structure has also changed:

Filing period from end of AY	Additional Tax
Within 12 months	25%
12–24 months	50%
24–36 months	60%
36–48 months	70%

Conclusion

- Up to 31 March: Income corrections must be made by filing an Updated Return (ITR-U) within the applicable deadline.
- After 31 March: No filing or revision is permitted beyond the cut-off, unless specifically allowed under the Act.

Tax Position on Write-Back of Capital Items and Export Bad Debts

Capital Write-Backs – Income-Tax Position

A write-back of amounts earlier written off or provided for (such as capital liabilities, capital advances, or Capital Work-in-Progress) is not chargeable to tax where:

- the original item was capital in nature,
- no deduction or allowance was claimed or permitted in earlier years, and
- the write-back represents a mere reversal of a capital item and does not result in operational surplus.

Taxability is determined by the intrinsic nature of the original transaction and not by the subsequent accounting entry.

Accounting vs Income-Tax Treatment

Under AS / Ind AS, capital write-backs may be routed through the Profit and Loss Account for disclosure purposes. However, accounting presentation does not govern taxability. For income-tax purposes, such write-backs retain their character as capital receipts and are not taxable.

Non-Applicability of Section 41(1)

Section 41(1) applies only where a deduction or allowance was granted in an earlier year and there is a subsequent remission or cessation of that liability. Since capital items do not involve any prior deduction, Section 41(1) has no application. Taxing a capital write-back would amount to taxation of non-existent income, contrary to settled legal principles.

Export Bad Debts – Income-Tax and FEMA Perspective

Income-Tax Treatment

Under Section 36(1)(vii) read with Section 36(2) of the Income-tax Act, export receivables are allowable as bad debts where the export income was offered to tax in earlier years and the amount is written off as irrecoverable in the books. Judicial precedents consistently hold that mere write-off in the books is sufficient and that proof of impossibility of recovery is not required.

FEMA Update and Practical Alignment

The export realisation period under FEMA/RBI has been extended from nine months to fifteen months, recognising global trade delays. While FEMA and Income-tax laws operate independently, a FEMA-compliant write-off strengthens the evidentiary basis for claiming bad debt deductions by demonstrating genuineness of transactions and bona fide recovery efforts.

Rule 31D – CGST Rules, 2017

Valuation of supply in case of Online Gaming

Rule 31D was inserted to prescribe a special valuation mechanism for online gaming, in line with the amendments made effective from 1 October 2023.

What Rule 31D provides :

For online gaming (including games of skill and chance), the value of supply shall be:

- The amount paid or payable to the supplier by the player
  (i.e., the total amount deposited / staked by the player)

Note : Not just platform fees, commission, or margins, but the entire amount deposited is treated as the value of supply

Key implications

- GST is leviable on the full face value of the bet / deposit
- GST rate: 28%
- Applies irrespective of whether the game is of skill or chance
- Winnings paid out to players do not reduce the taxable value.

Example

If a player deposits ₹1,000 on an online gaming platform:

- Value of supply (Rule 31D): ₹1,000
- GST @ 28%: ₹280
- GST payable even if platform fee is only ₹100

Particulars	Before Rule 31D	After Rule 31D
Basis of valuation	Platform fee / commission	Entire amount deposited by player
GST rate	18%	28%
Value on which GST applied	Net revenue	Gross face value
Treatment of winnings	Excluded from tax	Not deductible
Skill vs chance distinction	Relevant	Irrelevant

Rule 86B of GST

The Central Board of Indirect Taxes and Customs (CBIC) has introduced new rule 86B vide notification number 94/2020 dated 22nd December, 2020. Rule 86B is made effective from 1st January 2021.

What is the restriction imposed under Rule 86B

Rule 86B limits the use of input tax credit (ITC) available in the electronic credit ledger for discharging the output tax liability. This rule has an overriding impact on all the other CGST Rules.

Applicability:

This rule is applicable to registered persons having taxable value of supply (other than exempt supply and zero-rated supply) in a month which is more than Rs.50 lakh. The limit has to be checked every month before filing each return.

Restriction imposed:

For eligible taxpayers, more than 99% of the liability for output tax cannot be discharged with input tax credit. This compels businesses to pay at least 1% of the tax liability in cash from their electronic cash ledger.

Exceptions to the Rule:

- Income Tax Obligations: In case the taxpayer or key managerial persons, including the proprietor, karta, managing director, or partners, have paid more than Rs. 1 lakh in income tax under the Income Tax Act of 1961 in last two financial years for which the time limit to file the income tax return under Section 139(1) of the said Act has expired:

- Refund related to exports or inverted tax structure: The restriction shall not apply to taxpayers who have received a refund exceeding ₹1 lakh in the preceding financial year on account of:
  - Exports made under a Letter of Undertaking (LUT), or
  - Accumulation of input tax credit due to an inverted duty structure.

- Cash Settlement in Earlier Months: A taxpayer shall be exempt from the 1% cash payment restriction if more than 1% of the total output tax liability has already been discharged in cash during earlier months of the same financial year.

- Government Organisations: The Act is not applicable to the government bodies, public sector undertakings, local authorities, and statutory organizations.

Keeping Credit Notes 'Pending' in IMS – When and Why It Matters

Treatment of Credit Notes Marked Pending in IMS

IMS (Invoice Management System) under GST allows recipients to take action on invoices and credit notes uploaded by suppliers. Marking a Credit Note as "Pending" means you are deferring its acceptance or rejection for the current tax period.

When should a Credit Note be kept Pending?

- When the goods/services are under dispute or not fully agreed.
- When the credit note details need verification (value, GST amount, reference invoice).
- When the commercial settlement is not finalized.
- When the credit note should be adjusted in a future return period, not the current one.

Relevance for Tax Compliance

- Prevents automatic reduction of ITC in the current tax period.
- Helps avoid reconciliation mismatches between GSTR-2B and books.
- Gives time for internal approval or clarification with the supplier.
- Ensures accurate ITC reporting and compliance.

Note: A credit note marked as Pending does not impact ITC immediately, but it must be acted upon later to stay compliant.

GST Treatment of Credit Notes for Exports and Zero-Rated Supplies

Introduction

- Exports of goods or services and supplies made to SEZ units or SEZ developers are treated as zero-rated supplies under Section 16 of the IGST Act, 2017.
- Zero-rated supplies ensure that GST does not become a cost to exporters while allowing refund of taxes paid or input tax credit.
- In commercial practice, situations such as post-sale discounts, price revisions, return of goods, or deficiencies in services often require issuance of credit notes.

Zero-Rated Supplies

- Zero-rated supplies include export of goods, export of services, and supplies made to SEZ units or SEZ developers.
- These supplies are taxable supplies but taxed at a rate of zero percent.
- Full input tax credit is available in respect of such supplies, unlike exempt supplies.

Modes of Making Zero-Rated Supplies

- Zero-rated supplies may be made on payment of IGST, followed by a claim of refund of the IGST paid.
- Alternatively, supplies may be made without payment of IGST under a Letter of Undertaking (LUT) or Bond, followed by a refund of unutilised input tax credit.
- The option chosen directly impacts the manner in which credit notes affect refund eligibility.

Legal Provision for Issuance of Credit Notes

- Section 34 of the CGST Act, 2017 permits a registered person to issue a credit note.
- Credit notes may be issued where taxable value exceeds actual value, excess tax is charged, goods are returned, or services are found to be deficient.
- The credit note must be linked to the original tax invoice and contain prescribed particulars.

Time Limit for Issuing Credit Notes:

- Credit notes must be declared on or before 30th November following the end of the financial year in which the original supply was made.
- Alternatively, they must be declared before filing of the annual return, whichever is earlier.
- Credit notes issued beyond the prescribed time limit do not allow adjustment of tax liability or refund claims.

GST Treatment of Credit Notes for Exports and Zero-Rated Supplies

Credit Notes for Exports with Payment of IGST

- Where exports are made on payment of IGST, credit notes may be issued for reduction in taxable value or tax amount.
- Such credit notes must be reported in GSTR-1 and the corresponding adjustment must be reflected in GSTR-3B.
- If refund of IGST has already been claimed or sanctioned, issuance of a credit note may result in excess refund.
- Excess refund becomes recoverable along with applicable interest under GST law.

Credit Notes for Exports under LUT or Bond

- In cases where exports are made without payment of IGST, credit notes are issued only for value adjustment.
- Since no tax is charged on the export invoice, there is no output tax adjustment.
- However, credit notes reduce the turnover of zero-rated supplies, which directly impacts the refund of unutilised input tax credit.

Impact on Refund of Unutilised ITC:

- Refund of unutilised ITC is calculated based on turnover of zero-rated supplies.
- Non-adjustment of credit notes while computing refund may result in excess refund.
- Excess refund is liable to recovery during audit or assessment proceedings.

Credit Notes for Supplies to SEZ Units or Developers

- Supplies to SEZ units or developers are treated as zero-rated supplies subject to authorised operations.
- Credit notes may be issued for price revisions, discounts, or return of goods or services.
- Such credit notes must be properly reported and considered while recalculating refund eligibility.

Conclusion:

- Issuance of credit notes in exports and zero-rated supplies is legally permissible under GST law.
- However, due to their direct impact on refund eligibility, exporters must exercise caution.
- Timely issuance, proper reporting, and accurate refund computation are essential to ensure compliance and avoid disputes.

Place of Supply for Services Across Locations

Introduction

Under the Goods and Services Tax (GST) law, the concept of Place of Supply (POS) plays a crucial role in determining whether a transaction qualifies as intra-state or inter-state supply, and consequently whether CGST & SGST or IGST is applicable.
For supply of services, determining the place of supply becomes complex when services are provided through a Head Office, Branch Office, or directly at the Client's location. Correct identification of the place of supply ensures proper tax compliance and avoids disputes

Importance of Place of Supply for Services

The place of supply helps in:

- Determining the nature of tax (CGST + SGST or IGST)
- Identifying the state entitled to tax revenue
- Avoiding double taxation or non-taxation

Legal Provisions Governing Place of Supply

The place of supply of services is governed by:

- Section 12 of the IGST Act, 2017 – where supplier and recipient are in India
- Section 13 of the IGST Act, 2017 – where either supplier or recipient is outside India

This assignment focuses mainly on Section 12, as it involves Head Office, Branch, and Client locations within India.

Place of Supply Based on Location of Supplier and Recipient

General Rule – Section 12(2)

Situation	Place of Supply
Recipient is registered	Location of recipient
Recipient is unregistered	Location of recipient if address exists, otherwise

Companies Amendment Rules, 2025

Threshold Limit for Small Companies

Before the Amendment

Under Section 2(85) of the Companies Act, 2013 (as per the Rules before Dec 1 2025):
A Small Company meant a private company (not a public company) with both:

- Paid-up share capital not exceeding ₹4 crore
- Turnover not exceeding ₹40 crore

Also excluded:

- Holding or subsidiary companies
- Section 8 companies (non-profit)
- Companies governed by any special Act

After the Amendment (effective 1 December 2025)

With the Companies (Specification of Definition Details) Amendment Rules, 2025:
A Small Company now means a private company (not a public company) with both:

- Paid-up share capital not exceeding ₹10 crore
- Turnover not exceeding ₹100 crore

The same exclusions remain

- Holding or subsidiary companies
- Section 8 companies (non-profit)
- Companies governed by any special Act

Criteria	Before Amendment (till 30 Nov 2025)	After Amendment (from 1 Dec 2025)
Paid-up Share Capital	⩽ ₹4 crore	⩽ ₹10 crore
Turnover (preceding FY)	⩽ ₹40 crore	⩽ ₹100 crore
Exclusions	Yes (holding/subsidiary/Section 8/special Act)	Yes (holding/subsidiary/Section 8/special Act)

Overview of RBI Circulars and Banking Incentives for MSMEs

The key banking and credit-related benefits available to Micro, Small and Medium Enterprises (MSMEs) under various Reserve Bank of India (RBI) circulars, guidelines, and regulatory norms. These measures are intended to improve credit flow, reduce borrowing costs, and strengthen financial resilience of MSMEs

1. Priority Sector Lending (PSL) Benefits

As per RBI's Priority Sector Lending Guidelines, bank credit to MSMEs qualifies as Priority Sector Lending, subject to prescribed limits.

Key Benefits

- Banks are mandated to lend to MSMEs to meet PSL targets
- Improved credit availability at competitive rates
- Greater willingness of banks to extend working capital and term loans

Practical Impact

MSMEs enjoy preferential treatment in loan sanctioning compared to non-PSL borrowers.

2. External Benchmark Linked Lending (EBLR) for MSMEs

RBI has directed banks to link MSME loans to external benchmarks such as the Repo Rate.

Key Benefits

- Transparent interest rate mechanism
- Faster transmission of rate cuts to MSME borrowers
- Mandatory interest rate reset at least once in 3 months

Action Point for MSMEs

- Existing borrowers may request migration to benchmark-linked loans to reduce interest cost.

3. Collateral-Free Lending & Credit Guarantee Schemes

Under RBI-recognized frameworks and Government-backed schemes (e.g., CGTMSE):

Benefits

- Loans available without collateral (subject to limits)
- Reduced risk for banks encourages MSME lending
- Faster credit approvals for eligible entities

Particularly beneficial for micro and small enterprises with limited asset base.

Overview of RBI Circulars and Banking Incentives for MSMEs

4. Cash-Flow Based Lending Framework

RBI has encouraged banks to shift from asset-based to cash-flow based lending, especially for MSMEs.

Benefits

- Loan eligibility assessed based on business cash flows
- Reduced dependency on collateral and net worth
- Improved access to finance for growing enterprises

Digital data (GST returns, bank statements, TReDS data) play a key role in credit assessment.

5. Trade Receivables Discounting System (TReDS)

RBI promotes TReDS platforms to ease MSME working capital constraints.

Key Benefits

- Transparent interest rate mechanism
- Faster transmission of rate cuts to MSME borrowers
- Mandatory interest rate reset at least once in 3 months

Existing borrowers may request migration to benchmark-linked loans to reduce interest cost.

6. Restructuring & Relief Measures for MSMEs

RBI permits special restructuring frameworks for MSMEs facing financial stress, without asset classification downgrade, subject to conditions.

Benefits

- Temporary relief in repayment obligations
- Preservation of credit rating
- Continued access to banking facilities

7. Protection under RBI Banking Ombudsman Scheme

MSMEs are covered under RBI's Integrated Ombudsman Scheme.

Benefits

- Enhanced grievance redressal mechanism
- Compensation for deficiency in banking services (up to prescribed limits)
- Greater accountability of banks

Overview of RBI Circulars and Banking Incentives for MSMEs

8. Overall Impact of RBI MSME-Friendly Norms

Area	Benefit to MSMEs
Credit availability	Improved & assured
Interest cost	Lower & transparent
Collateral requirement	Reduced
Working capital	Faster access
Regulatory protection	Strengthened

9. Conclusion & Advisory

RBI's regulatory framework demonstrates a strong policy intent to support MSMEs through improved access to finance, reduced cost of borrowing, and enhanced banking protections. MSMEs are advised to:

- Actively engage with banks citing RBI MSME norms
- Explore benchmark-linked loans and TReDS
- Ensure MSME registration (Udyam) is updated to avail benefits

This note is issued for general guidance and does not constitute a legal opinion.

RBI Guidelines on Digital Lending – Key Highlights

Applicability of the Guidelines

These guidelines apply to digital lending undertaken by:

- All Commercial Banks
- Primary (Urban), State and District Central Co-operative Banks
- Non-Banking Financial Companies (including Housing Finance Companies)

Compliance Requirements:

- Comply with RBI digital lending guidelines if you are a Commercial Bank, Co-operative Bank, or NBFC (including HFCs).
- Ensure loan disbursals and repayments are made directly between the borrower and the Regulated Entity's bank account.
- Disburse loans only to the borrower's bank account, except where permitted under statutory or regulatory mandates.
- Pay all LSP(Lending Service Provider) fees directly by the RE (Regulated entities: The entities to whom this circular is applicable), and not through the borrower.
- Disclose the all-inclusive APR upfront and include it in the Key Fact Statement (KFS).
- Provide a standardized KFS before loan execution, containing APR, recovery mechanism, grievance redressal details, and cooling-off period.
- Share digitally signed loan documents (KFS, sanction letter, terms and conditions, account statements, privacy policy, etc.) with borrowers via registered email/SMS.
- Publish the list of DLAs and LSPs engaged, along with their roles, on the RE's website.
- Display product features, loan limits, and costs clearly at the onboarding stage on DLAs.
- Inform borrowers about authorised recovery agents, including any change in recovery responsibility.
- Provide an accessible grievance redressal mechanism, including a designated nodal officer for digital lending complaints.
- Resolve borrower grievances within the stipulated timeframe and guide borrowers to RBI's Ombudsman where applicable.
- Assess borrower creditworthiness by capturing economic profile details such as age, income, and occupation.
- Offer a cooling-off / look-up period allowing borrowers to exit the loan without penalty within the prescribed timelines.

RBI Guidelines on Digital Lending – Key Highlights

- Conduct enhanced due diligence on LSPs and carry out periodic reviews of their conduct.
- Collect borrower data only on a need-basis, with explicit and auditable consent.
- Provide borrowers the option to grant, restrict, revoke consent, and request deletion of personal data.
- Store borrower data only on servers located in India, in compliance with RBI guidelines.
- Maintain and disclose a comprehensive privacy policy covering data usage, storage, and sharing.
- Comply with RBI-prescribed cybersecurity and technology standards.
- Report all digital lending transactions to Credit Information Companies (CICs), irrespective of loan nature or tenure.
- Follow RBI securitisation guidelines for loss-sharing or FLDG arrangements.

Compliance Restrictions

- Do not route loan disbursals or repayments through LSPs, DLAs, or any third-party accounts.
- Do not disburse loans to third-party accounts, except as expressly permitted by regulation.
- Do not allow LSPs to charge borrowers directly for any fees or services.
- Do not levy fees, charges, or penal interest that are not disclosed in the KFS.
- Do not impose penal charges without disclosing them upfront on an annualised basis.
- Do not access borrower mobile data such as contact lists, call logs, files, or media.
- Do not collect or store biometric data, unless permitted under applicable laws.
- Do not share borrower data with third parties without explicit borrower consent, except where legally required.
- Do not retain borrower data beyond the period permitted under policy or regulation.
- Do not increase credit limits automatically without explicit borrower consent.
- Do not deny borrowers the cooling-off / look-up period provided under RBI guidelines.
- Do not restrict prepayment rights beyond what is permitted under extant RBI norms..
- Do not engage LSPs without proper due diligence and oversight.
- Do not fail to report digital loans to CICs, regardless of loan size or duration

Loan vs Capital vs Advance – Tax & Banking Perspective

Understanding the difference between Loans, Capital, and Advances is critical for accurate accounting, tax compliance, and avoiding regulatory scrutiny. While they may look similar in cash flow, their legal intent, tax treatment, and balance-sheet impact are very different.

1. Loan

Accounting & Banking Implications

- Recorded as a liability
- Classified as:
  - Short-term loan (repayable within 12 months)
  - Long-term loan (repayable after 12 months)
- Interest is recorded separately as an expense

Understanding Tax Consequences

- Loan principal received → Not taxable
- Interest paid → Generally tax-deductible (if business-related)
- Interest earned → Taxable income

Common Types of Loans

- Bank loans
- Director or shareholder loans
- Inter-company borrowings

2. Capital

Accounting & Banking Implications

- Shown under Equity
- No repayment obligation
- Returns through dividends or capital appreciation

Understanding Tax Consequences

- Capital introduced → Not taxable
- Dividends paid → Not tax-deductible for the company
- Dividends received → Usually taxable (often at concessional rates)
- Capital gains on exit → Taxable (rules vary by jurisdiction)

Loan vs Capital vs Advance – Tax & Banking Perspective

Common type of Capital

- Share capital
- Partner's capital in a partnership
- Additional capital contributions

3. Advance

An advance is money paid before goods or services are delivered and is meant to be adjusted against a future transaction.

Accounting & Banking Implications

- Advance paid → Recorded as an Asset
- Advance received → Recorded as a Liability (unearned income)

Understanding Tax Consequences

- Advance received
  - Generally not taxable until income is earned (accrual basis)
  - May be taxable immediately under cash-based systems
- Advance paid
  - Not an expense until goods/services are actually received

Common type of Advances

- Customer advances
- Advances to suppliers
- Salary advances to employees

Loan vs Capital vs Advance – Tax & Banking Perspective

Comparison Summary

Feature	Loan	Capital	Advance
Repayment obligation	Yes	No	Adjustable
Balance sheet impact	Liability	Equity	Asset / Liability
Interest involved	Usually	No	No
Taxable on receipt	No	No	Usually No
Tax-deductible cost	Interest	No	When expense arises
Ownership dilution	No	Yes	No

Structuring External Commercial Borrowings (ECBs):

External Commercial Borrowings (ECBs) remain an attractive source of overseas funding for Indian companies—but compliance with RBI regulations is critical to avoid penalties and delays. Below is a quick guide on how clients can structure ECBs responsibly and efficiently.

Check Eligibility Upfront

Ensure the borrower qualifies under RBI norms and the lender is a recognised lender from a FATF/IOSCO-compliant jurisdiction. Early validation helps avoid structural rework later.

Check Eligibility Upfront

- Automatic Route: Faster and simpler, provided all conditions are met
- Approval Route: Required if any parameter falls outside prescribed limits (USD $750M for most corporates, USD $ 200M for Service Sector)

Wherever possible, structure ECBs to fall under the automatic route.

Align End-Use with RBI Guidelines

ECB proceeds must be used only for permitted purposes. Activities on the negative list (such as real estate or equity investment, where prohibited) should be strictly avoided. Clear end-use documentation is essential.

Meet Minimum Average Maturity Period (MAMP)

ECB tenors must comply with the prescribed minimum maturity, which varies based on the purpose of borrowing. Loan terms should not include options that indirectly breach MAMP.

Price and Hedge Prudently

Interest, fees, and other costs must be commercially justifiable and acceptable to the Authorised Dealer (AD) bank. Where ECBs are denominated in foreign currency, appropriate hedging should be evaluated to manage forex risk.

Complete Reporting Without Gaps

- Obtain the Loan Registration Number (LRN) before drawdown
- File monthly ECB returns (ECB-2) on time
- Maintain robust records of utilisation, repayments, and hedging

RBI's Seventh Amendment to FEMA Regulations -Foreign Currency Accounts.

Overview of the Amendment:

The Reserve Bank of India has notified the Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) (Seventh Amendment) Regulations, 2025, amending the 2015 regulations. The amendment formally integrates International Financial Services Centres (IFSCs) into the FEMA framework and provides greater flexibility to exporters in managing foreign currency export proceeds.

Key highlights:

Statutory recognition of IFSCs:

IFSCs are now expressly defined under FEMA, aligned with the IFSC Authority Act, 2019, removing long-standing ambiguity regarding their treatment.

Revised rules for exporters' foreign currency accounts:

Exporters may continue to open and maintain foreign currency accounts abroad (including IFSCs) for realisation of export proceeds and receipt of advances. Funds may be used for import payments or repatriated to India

Extended retention period for IFSC accounts:

Export proceeds may be retained:

- Up to 3 months in accounts maintained with banks in IFSCs; and
- Up to the end of the succeeding month for accounts in other overseas jurisdictions. (Earlier, a uniform one-month limit applied.)

Explicit clarification on IFSC treatment:

Accounts in IFSCs are deemed to be maintained "outside India" for FEMA purposes, despite their physical location in India.

Regulatory intent:

The amendment supports India's strategy to strengthen IFSCs—particularly GIFT City—by encouraging exporters to use onshore IFSC banking channels while improving liquidity and cash-flow flexibility. It also aligns FEMA more closely with global trade practices.

In summary, the Seventh Amendment enhances legal clarity, promotes ease of doing business for exporters, and reinforces the IFSC ecosystem without diluting foreign exchange controls.

RBI Introduces Reforms to Foreign Currency Account Framework

The Reserve Bank of India (RBI) has notified the Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) (Seventh Amendment) Regulations, 2025, marking a significant step towards simplifying foreign currency account operations for Indian exporters.

The amendment, notified on 6 October 2025, introduces greater flexibility, regulatory clarity, and stronger recognition of International Financial Services Centres (IFSCs).

Overview of the Regulatory Framework:

Under FEMA, persons resident in India have traditionally faced strict controls on opening and maintaining foreign currency accounts abroad. Over time, RBI has gradually liberalised these rules to support exporters and businesses engaged in cross-border trade.

The Seventh Amendment continues this trend by addressing practical challenges faced in managing export proceeds.

IFSC

- An International Financial Services Centre (IFSC) is a designated financial zone established in India to provide international financial services to customers outside the domestic economy.
- Although physically located in India, IFSCs are treated as offshore jurisdictions for regulatory purposes. They enable international banking, foreign currency transactions, fund management, capital markets and other cross-border financial operations.
- India's first IFSC is GIFT City in Gujarat.

Amendment Overview

1.Formal Inclusion of IFSC in FEMA Regulations

- The amendment inserts a definition for International Financial Services Centre aligned with the IFSC Authority Act, 2019 into the principal FEMA regulations.
- This explicitly recognises IFSCs within the framework governing foreign currency accounts for residents.

2.Flexibility for Exporters to Open Foreign Currency Accounts

- Under the revised Regulation 5(CA), a person resident in India who is an exporter may now open, hold and maintain a foreign currency account with a bank outside India, including a bank in an IFSC.
- These accounts can be used for receiving export proceeds and advance remittances related to export of goods or services

RBI Introduces Reforms to Foreign Currency Account Framework

3.Extended Retention Period for Export Proceeds

- Export proceeds credited to foreign currency accounts maintained with banks in IFSCs may now be retained for up to three months after receipt.
- This provides exporters with greater time to manage foreign exchange exposure and meet cross-border obligations.

4.Clarifying Treatment of IFSC Accounts.

- The amendment clarifies that foreign currency accounts permitted to be opened "outside India/abroad" include those in IFSCs, thereby strengthening the operational equivalence of IFSC-based banks with overseas banks

Highlights of the Amendment Benefits

- Enables exporters to open and maintain foreign currency accounts with banks in IFSCs, treated at par with overseas banks
- Improves cash-flow management by allowing retention of export proceeds in foreign currency for a longer period
- Helps exporters manage foreign exchange risk more efficiently and plan currency conversions strategically.
- Reduces transaction and compliance friction in cross-border trade.
- Strengthens the role of IFSCs, particularly GIFT City, as international financial hubs
- Supports ease of doing business and aligns India's foreign exchange framework with global practices.

Conclusion

- Reinforces IFSCs as credible offshore banking hubs within India's regulatory framework.
- Enhances operational and foreign exchange management flexibility for Indian exporters, including an extended timeline for retention of export proceeds.
- Supports ease of doing business by aligning FEMA regulations with global trade practices.

Administrative Expenses under FCRA, 2010:

FCRA Guidelines on Administrative Expenses (Rule 5, 2011)

Under the FCRA framework, administrative expenses are those incurred by an organization for general administration and management. These include salaries, wages, or any remuneration paid to members of the Executive Committee, office bearers, and employees.

Key Components:

- Salaries & Remuneration: Includes basic pay and related benefits such as travel, training, and medical insurance.
- Office Establishment Expenses: Rent, repairs, utilities (electricity, water, telephone, internet), and office consumables.
- Communication & Professional Charges: Postal/courier costs, legal and audit fees, consultancy, and other professional services.
- Vehicle & Conveyance: Purchase, running, fuel, maintenance, and insurance of vehicles used for administrative purposes.
- General Management Costs: Expenses related to overall supervision, management, and administration not directly linked to specific projects.

Statutory Ceiling:

Administrative expenses must not exceed 20% of foreign contributions received in a financial year.

Compliance Insight:

Only expenses directly attributable to project implementation may be excluded from administrative costs. Such expenses must be clearly identifiable and properly documented to ensure compliance with FCRA rules.

Clarification on timely renewal application under FCRA, 2010:

As per Public Notice Issued by Ministry of Home Affairs as on 30-Sept-2025, the following are the key guidelines observed,

1. Renewal of FCRA Registration – Important Guidelines

All associations registered under the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010) are informed about the provisions of Section 16 of the Act and Rule 12 of the Foreign Contribution (Regulation) Rules, 2011 (FCRR, 2011) regarding renewal of FCRA registration.

2. Requirement to Apply for Renewal (Section 16(1) of FCRA, 2010)

Every association that has been granted an FCRA registration certificate under Section 12 must apply for its renewal within six months before the expiry of the certificate.

3. Time Limit for Processing Renewal Applications (Section 16(3) of FCRA, 2010)

As per Section 16(3), the Central Government generally renews the registration within 90 days from the date of receiving the renewal application.

4. Mode of Submission of Application (Rule 12(2) of FCRR, 2011)

The renewal application must be submitted online in Form FC-3C, along with the required affidavits in Proforma 'AA'.

5. Issues Due to Late Submission of Applications

It has been noticed that many associations are submitting renewal applications less than 90 days before the expiry of their registration. Such late submission does not provide enough time for proper examination and for obtaining inputs from security agencies. As a result, the FCRA registration expires while the renewal application is still pending.

6. Consequences of Delay (Rule 12(5) of FCRR, 2011)

In cases where the certificate expires before renewal is granted, the registration is treated as ceased, and under Rule 12(5), the association cannot receive or use foreign contribution until the renewal is approved. This may affect the association's ongoing work.

7. Advisory for Timely Submission

Associations are therefore strongly advised to submit their renewal applications well in advance, and at least four months before the expiry of their FCRA certificate. Timely submission will help ensure smooth processing and prevent disruption of activities.

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