



Tax alert: SC rules CBDT administrative circulars do not bind courts

29 September 2026

The Supreme Court (SC) of India has held that premium earned from transfer of export quota cannot be treated as export incentive eligible for deduction under section 80HHC of the Income-tax Act, 1961. Further, it held that the Central Board of Direct Taxes (CBDT) Office Memorandum is binding only on the tax authorities and not on the courts.

In a nutshell



The CBDT O.M. is not binding on the courts. They merely represent the executive's understanding of a statutory provision and are never binding on the HC or the SC.

If a circular were binding on courts, the judiciary would have to follow an administrative memo even when it directly violates a Parliament enactment. Further, if the Revenue were permanently barred by its own circular from questioning a legal interpretation in court, the Department could never appeal an erroneous ITAT ruling.



The CBDT O.M. creates a legal fiction by equating the export quota premium with the items mentioned in section 28(iia) to (iic) of the ITA. The application of a legal fiction contrary to the explicit statutory position is impermissible in law.

Income from the sale of a quota generates horizontal revenue for the taxpayer but does not earn foreign exchange. The requisite for any of the revenues covered by section 28(iia) to (iic) of the ITA is not present in the sale of the quota. Therefore, on a plain reading of section 28, the sale of quota cannot be treated as business income.



If a court were compelled to treat an administrative CBDT circular as binding on itself, it would undermine the entire constitutional and statutory framework governing income tax liability, including the standard of "income derived," the strict construction of legitimate deductions, and the classification of permissible expenses.



Scroll down to read the detailed alert

Background:

- The taxpayer¹ declared proceeds from the sale of export quota and interest earned on the margin money deposit in its return of income for the relevant year. The taxpayer claimed a deduction under section 80HHC of the Income-tax Act, 1961 (ITA) [deduction in respect of profits retained for export business]
- During the course of audit proceedings, the Assessing Officer (AO) rejected the claim under section 80HHC of the ITA, *inter-alia*, on the following basis:
 - On sale of export quota: The deduction provisions apply strictly to profits and gains “derived by” an industrial undertaking from the export of articles or things. The export quota entitlements were granted under the Garment Export Entitlement Policy, based on past export performance. Monetising such quotas by selling them to third parties did not constitute export activity of the industrial undertaking.
 - On interest on margin money: The interest earned on fixed deposits pledged with banks to secure credit facilities had no direct nexus to the undertaking's manufacturing and export activities.
- Aggrieved, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) allowed the taxpayer's appeal holding that quota-sale proceeds were deductible and allowed both claims in full.
- The Revenue authorities filed an appeal before the Income-tax Appellate Tribunal (ITAT), which dismissed the Revenue's appeal.

Aggrieved the Revenue filed an appeal before the Delhi High Court (HC), which relying on certain earlier rulings² ruled in favour of the Revenue.

- Aggrieved, the taxpayer filed an appeal before the Supreme Court of India (SC).
- The taxpayer argued that CBDT O.M.³ provides that a quota sale is treated as profit on the sale of an import licence, cash assistance, and duty drawback, as per the items in section 28(iia), (iib) and (iic) of the ITA [section 26 of the Income-tax Act 2025].

As per section 28(iia), (iib) and (iic) of the ITA:

“The following income shall be chargeable to income-tax under the head “Profits and gains of business or profession”-

...

(iia) profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 (18 of 1947);

(iib) cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;

(iic) any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;...”

- The taxpayer transferred the available surplus quota and realised a premium. By operation of the CBDT O.M., the premium was treated as eligible for deduction under section 80HHC of the ITA in accordance with the description in section 28(iia) to (iic). The CBDT O.M. binds the Revenue department. The CIT(A) and ITAT appreciated the binding nature of the CBDT O.M. and allowed a deduction under section 80HHC of the ITA in favour of the taxpayer.

¹ Samtex Fashions Ltd. vs. Commissioner of Income-tax [2026] 190 taxmann.com 645 (SC)

² CIT v. Nagesh Knitwears P. Ltd., (2012) 22 taxmann.com 309 (Delhi), CIT, Delhi XIII vs. Mereena Creations [2010] 189 Taxman 71 (Delhi) and CIT, Delhi vs. Shri Ram Honda Power Equip [2007] 158 Taxman 474 (Delhi)

³ The Central Board of Direct Taxes-Office Memorandum

Relevant provisions of the ITA

Section 80HHC

“(1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction to the extent of profits, referred to in sub-section (1B), derived by the assessee from the export of such goods or merchandise:.....”

Decision of the SC:

The SC acknowledged that the issue for consideration was whether the availability of deduction under section 80HHC of the ITA would depend on the meaning the court would attach to the CBDT O.M. for technically equating it with sections 28(iia) to 28(iic) of the ITA.

- The SC, in an earlier ruling⁴, laid down the following principles on the scope and binding nature of the CBDT circulars:
 - Departmental Circulars and instructions issued by the Central Board of Excise and Customs (CBEC) are binding on the subordinate authorities functioning under the respective statutes. However, once the SC or a HC declares the law on a question arising for consideration, it is impermissible for any court or Tribunal to direct that the executive circular be given effect in preference to the view expressed by the Constitutional Court.
 - Administrative circulars and clarifications issued by the Central or state governments merely reflect the executive's understanding of statutory provisions. Such circulars are not binding on the courts. **Under the constitutional framework, only the judiciary can interpret statutory provisions.** The executive does not have this power.
 - **Any administrative circular or clarification that runs contrary to statutory provisions or to the judicial declaration thereof has no force in the eyes of the law.**
 - **Accepting the contention that if the Revenue is precluded from challenging an interpretation contrary to its circulars, it would extinguish the Revenue's valuable right of appeal.** Because a taxpayer who benefits from a circular will not appeal; precluding the Revenue from appealing would prevent the HCs and the SC from ever adjudicating the question. Such an outcome would directly undermine the law declared by the SC and compromise its binding force under Article 141 of the Constitution of India.
- The CBDT O.M. is not binding on the courts. The taxpayer's argument, for the reasons given in an earlier HC ruling⁵ does not merit further consideration. A Constitution Bench of the SC⁶ held that circulars issued by the CBDT bind only the administrative departmental authorities. They merely represent the executive's understanding of a statutory provision and are never binding on the HC or the SC. When the HC or SC interprets a statutory provision, a conflicting administrative circular has no legal existence before the court.
- If a circular were binding on courts, the judiciary would have to follow an administrative memo even when it directly violates a Parliament enactment. Further, if the Revenue were permanently barred by its own circular from questioning a legal interpretation in court, the Department could never appeal an erroneous ITAT ruling. Since a taxpayer benefiting from a circular would never appeal, the true statutory meaning could never be adjudicated by the HCs or the SC.

⁴ CCE v. Ratan Melting & Wire Industries, (2008) 13 SCC 1

⁵ CIT v. Nagesh Knitwears P. Ltd. [2012] 22 taxmann.com 309 (Delhi)

⁶ CCE v. Ratan Melting & Wire Industries, (2008) 13 SCC 1

- The CBDT O.M. creates a legal fiction by equating the export quota premium with the items mentioned in section 28(iia) to (iic) of the ITA. The application of a legal fiction contrary to the explicit statutory position is impermissible in law. Further, the scope for limiting legal fiction is well established in tax matters. Income from the sale of a quota generates horizontal revenue for the taxpayer but does not earn foreign exchange. The requisite for any of the revenues covered by section 28(iia) to (iic) of the ITA is not present in the sale of the quota. Therefore, on a plain reading of section 28, the sale of quota cannot be treated as business income.
- It is difficult to equate something as “business income” unless the basic traits of the transaction, namely receipt of foreign exchange, etc., are satisfied.
- If a court were compelled to treat an administrative CBDT circular as binding on itself, it would undermine the entire constitutional and statutory framework governing income tax liability, including the standard of “income derived,” the strict construction of legitimate deductions, and the classification of permissible expenses.

In view of the above, the SC rejected taxpayer’s argument to give effect to the CBDT O.M.

Comments:

While export quotas are commercially valuable rights that can be sold for consideration, disputes could arise regarding the nature of income generated from such transfers and their eligibility for deductions designed for export-related profits. Courts have also examined whether administrative clarifications issued by CBDT can broaden the ambit of statutory deductions beyond what is expressly contemplated by the provisions of the tax laws.

The SC, in this ruling, while examining the issue of whether the premium earned on the transfer of export quotas could be treated as income akin to export incentives covered under sections 28(iia) to 28(iic) and consequently qualify for deduction under section 80HHC, also considered the binding nature of CBDT O.M specially on courts.

The SC, in this ruling, has held as follows:

- The CBDT O.M. is not binding on the courts. They merely represent the executive's understanding of a statutory provision and is never binding on the HC or the SC.

If a circular were binding on courts, the judiciary would have to follow an administrative memo even when it directly violates a Parliament enactment. Further, if the Revenue were permanently barred by its own circular from questioning a legal interpretation in court, the Department could never appeal an erroneous ITAT ruling.
- The CBDT O.M. creates a legal fiction by equating the export quota premium with the items mentioned in section 28(iia) to (iic) of the ITA. The application of a legal fiction contrary to the explicit statutory position is impermissible in law.
Income from the sale of a quota generates horizontal revenue for the taxpayer but does not earn foreign exchange. The requisite for any of the revenues covered by section 28(iia) to (iic) of the ITA is not present in the sale of the quota. Therefore, on a plain reading of section 28, the sale of quota cannot be treated as business income.
- If a court were compelled to treat an administrative CBDT circular as binding on itself, it would undermine the entire constitutional and statutory framework governing income tax liability, including the standard of “income derived,” the strict construction of legitimate deductions, and the classification of permissible expenses.

Recently, the SC also rendered a decision in case of another taxpayer⁷, involving identical facts. In this case, the AO had initially allowed Section 80HHC deduction on premium earned from the sale of export quotas; the Commissioner, exercising revisionary powers under Section 263 of the ITA [Section 377 of the Income-tax Act 2025], subsequently withdrew the benefit.

The SC held that the Commissioner had validly invoked the provision, reiterating that an order can be revised where it is both erroneous and prejudicial to the interests of the Revenue. An order becomes 'erroneous' where it rests on an incorrect assumption of facts, misapplies the law, violates principles of natural justice, or is passed without proper application of mind. If an AO's erroneous order results in the Revenue losing tax that is lawfully payable, it is considered prejudicial to its interests.

The SC also held that the CBDT circular could not bind the courts where its interpretation was inconsistent with the ITA and that premium from the sale of export quotas does not fall within Section 28 and is therefore ineligible for deduction under Section 80HHC.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

⁷ Orient Crafts Ltd. vs. Commissioner of Income-tax [2026] 190 taxmann.com 629 (SC)



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities (collectively, the “Deloitte organization”). DTTL (also referred to as “Deloitte Global”) and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see <http://www.deloitte.com/about> to learn more.

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which is a separate and independent legal entity, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Bengaluru, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Mumbai, New Delhi, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

This communication contains general information only, and none of DTTL, its global network of member firms or their related entities is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication.