

## Budget 2026: Assessment Procedures and Penalty - Bringing About Confidence and Certainty

Feb 07, 2026



### Sneha Pai

Senior Director, Direct Tax, Nexdigm



### Ekta Gala

Manager, Direct Tax, Nexdigm

The Union Budget 2026 marks a decisive step towards restructuring India's tax administration framework by addressing long-standing concerns related to assessments, penalties, appeals, and immunity provisions. Over the years, the income-tax system has been criticised for excessive litigation, procedural rigidity, and a punitive approach even for minor or technical defaults. Recognising these issues, the Budget 2026 introduces targeted amendments aimed at simplifying procedures, reducing disputes, and encouraging voluntary compliance, while still safeguarding revenue interests.

### Key Amendments Introduced in Union Budget 2026

#### **A. Retrospective Amendments**

Three retrospective amendments have been proposed in the Budget 2026. These amendments seek to clarify the tax position for various assessment procedure related appeals that are pending upto the Supreme Court.

##### i. Time Limit for completion of assessment under section 144C:

The interpretation of Section 144C vs Sections 153/153B has been a source of prolonged litigation for years with many assessment orders held as invalid.

The conflict revolves around - whether the Dispute Resolution Panel (DRP) procedure creates an independent, self-contained timeline that overrides the general limitation periods in Section 153, or if it must be completed within the outer limits of Section 153.

The Revenue has consistently argued that Section 144C is a "self-contained code" with non-obstante clauses that override the general limitation under Section 153. Various Courts have upheld that Section 144C does not override the limitation period under Section 153. It

has interpreted the non-obstante clause ("notwithstanding anything to the contrary contained in Section 153") to be limited. It means that even if the 12/24-month limit has not expired, the final order must be passed within one month of receiving Dispute Resolution Panel (DRP) directions, but it does not mean the Revenue gets an extension beyond the 12/24-month limit if DRP directions are delayed. The Apex Court has not delivered a fully settled position, with a split verdict reflecting one member favoring strict 153/153B adherence and the other member upholding the 144C carve-out for finalization of assessment.

To settle the conflict a clarification is respect to completion of assessment u/s section 144C is brought in where it is clarified that section 144C timelines govern finalization and 153/153B timelines govern draft order stage only. The amendment applies notwithstanding any judgment, order, or decree, making it a legislative override.

Department and taxpayers will have no ambiguity over deadlines for finalizing assessments after draft orders or DRP directions. Clear timelines reduce disputes and prevent repeated appeals solely on procedural grounds which helps in shifting focus to merits of assessment rather than procedural validity.

#### ii. Validity of Notices with DIN

CBDT Circular No. 19/2019, effective October 1, 2019, mandates that all income tax communications must have a computer-generated DIN. If not, they are invalid unless they fall under specific, documented exceptions. Taxpayers have challenged the validity of tax notices and orders issued without a Document Identification Number (DIN), that such communications are generally deemed invalid and non-est (deemed to have never been issued) if they do not comply with circulars.

Some courts agreed with taxpayers, invalidating otherwise correct orders, while others held that as long as a valid DIN existed and could be traced to the order, minor defects should not void it. This split in judicial interpretation created uncertainty - The department faced repeated litigation on technical DIN defects rather than substantive tax issues, administrative efficiency suffered because courts had to repeatedly adjudicate DIN compliance instead of focusing on the merits of assessment

To address this Budget 2026 introduced a clarificatory amendment which states that assessment order or notice will not be treated as invalid merely due to a mistake, defect, or omission in quoting the DIN, as long as the communication is otherwise identifiable or traceable through the DIN.

The DIN amendment reflects a broader Budget 2026 objective: simplify tax procedures, reduce litigation, and make compliance less burdensome for both taxpayers and authorities. By prioritizing substance over form, it helps avoid unnecessary legal challenges based on minor procedural mistakes.

#### iii. Jurisdiction to issue notice u/s 148 and 148A by NaFAC or the Assessment Units in NaFAC:

Post introduction of faceless assessment schemes, many taxpayers challenged the 148/148A notices issued by Jurisdictional Assessing Officer (JAOs) instead of the National Faceless Assessment Centre (NaFAC), arguing that Section 151A mandated a faceless process.

The matter went to court where divergent rulings meant that many reassessment notices were challenged and quashed in some jurisdictions, invalidating assessments even before merits were examined; leading to full reassessment orders and consequent appeals. This inconsistent jurisprudence caused delays and litigation across multiple courts and tribunals and confusion about the validity of notices

To resolve this dispute and reduce litigation, the Finance Bill 2026 introduced a retrospective effect from 1<sup>st</sup> April 2021 clarificatory amendment to the Income-tax Act. It explicitly states that for issuance of reassessment notices and pre-reassessment inquiry, the term "Assessing Officer" includes the Jurisdictional Assessing Officer (JAO), and does not restrict such powers exclusively to the National Faceless Assessment Centre (NFAC) or its units. By clarifying that JAOs can issue Section 148 and 148A notices, the amendment likely eliminates a major jurisdictional ground of challenge in reassessment litigation, reducing appeals on this point.

## **B. Assessment Proceedings:**

### i. Integrated Proceedings:

Budget 2026 proposes an integration of assessment and penalty proceedings where Tax Officers will now issue one unified order for both, eliminating separate, protracted proceedings.

Historically, India's tax assessment process followed a fragmented structure. Assessment proceedings and penalty proceedings were conducted separately, often leading to multiple notices, prolonged timelines, and overlapping litigation.

After the assessment, the AO initiated a separate penalty proceeding and after considering the taxpayer's response and any appellate proceedings, a separate penalty order was passed. This led to multiplicity of proceedings and prolonged the resolution process. Taxpayers remained unsure about total liability until both assessment and penalty proceedings were completed, often stretching over multiple years. Also, processing multiple notices, responses, and approvals led to higher administrative costs and delays. Similarly, the appeal mechanism required substantial pre-deposit of disputed tax, making access to justice costly, particularly for small and medium taxpayers.

The proposed amendment of integrating the penalty proceedings with assessment proceedings is expected to reduce the 'multiplicity of proceedings which was identified as a hindrance for tax settlement process and simplify enforcement for taxpayers. The total tax and penalty liability will be known at once, reducing prolonged uncertainty. The section has also been amended to include a show cause notice for levy of penalty.

The levy of penalty post along with assessment may raise questions on the principle of natural justice if the orders are passed arbitrarily without considering the merits of the case. Further, we will need to see the implementation mechanism especially with regard to principles of natural justice and opportunity of being heard provided to assessee's in absence of which a new string of litigation will likely follow.

### ii. Interest levy on disputed penalty demand

Budget 2026 proposes that interest on penalty demands will now be charged only after appellate orders are concluded — either by CIT(A) or ITAT, as applicable for appeal against

DRP. This ensures that interest does not accrue during the pendency of appeals or dispute resolution, offering temporary relief to taxpayers

iii. Immunity Extended to Misreporting:

The concept of immunity from penalty and prosecution under the Income-tax Act has long been part of India's effort to encourage voluntary compliance. Historically, taxpayers who fully cooperated with the tax authorities — paying due tax and interest on time and refraining from filing appeals — could seek relief from penalties and prosecution.

Under existing provisions, Immunity was granted only in cases of under-reporting of income, not in cases where under-reporting arose due to misreporting or intentional misstatement. The policy rationale was clear: provide an incentive for honest taxpayers to settle disputes early, reduce litigation, and promote voluntary compliance. However, taxpayers who under-reported due to misreporting or had discrepancies like unexplained credits, assets, or investments were excluded, forcing prolonged litigation and compliance burden.

Budget 2026 amendments seek to broaden the scope of immunity and simplify compliance. Tax payers may now seek immunity for penalty levied on misreporting as well. As per the proposed provisions, taxpayers whose under-reporting arises due to misreporting (intentional or otherwise) can now also apply for immunity and will be required to pay 100% of the tax as additional tax in lieu of the penalty. Additionally where penalty is levied for unexplained credits, investments, or assets, immunity shall be granted if the taxpayer pays 120% of the tax payable on such income in lieu of penalty.

This is a welcome amendment helping in reduction of litigation and giving genuine tax payers and opportunity to settle disputes on paying a smaller sum. The amendment reflects the government's intent to promote early settlement of disputes. The additional tax payment is often less punitive than prolonged litigation and penalties, encouraging taxpayers to come forward proactively.

iv. Penalties termed as a fee :

Failures or delays such as non-compliance with the prescribed timelines for furnishing tax audit reports, non-submission of mandated transfer pricing reports within the stipulated period, and delays in filing statements of financial transactions are now reclassified as defaults attracting a specified fee, instead of being treated as penal offences. The introduction of a fee-based mechanism is intended to encourage timely compliance by taxpayers and adherence to statutory timelines, thereby avoiding such levies.

Further, characterising these charges as fees makes their payment automatic and mandatory upon the occurrence of a default, unlike the earlier penalty regime which required the initiation of separate proceedings and provided the taxpayer with an opportunity of being heard before any levy was imposed.

v. Updated Returns post- issue of notice of Reassessment:

Under Indian income-tax law, filing of return of income has always been the foundation of the assessment mechanism. taxpayers were allowed to file original, belated and revised return, however once proceedings such as assessment or reassessment were initiated, the scope for voluntary correction by the taxpayer significantly narrowed. The concept of an

updated return was introduced to promote voluntary compliance by allowing taxpayers to declare omitted income even after expiry of the time limits for belated and revised returns to encourage self correction and reduce litigation. Despite its progressive intent, the updated return mechanism was subject to strict prohibitions. One key restriction was that an updated return could not be filed if reassessment proceedings had been initiated which diluted the effectiveness of the updated return framework.

Budget 2026 has now allowed the taxpayer to file an updated return of income after reassessment proceedings have begun by paying an additional 10% on the tax. Further till now even after paying additional tax on updated returns, the income disclosed could still be exposed to penalty proceedings, particularly in reassessment cases. Budget has now amended that income on which additional income-tax (including the extra 10%) is paid shall not form the basis for penalty.

This provides a last-mover opportunity to correct errors without protracted disputes. And a path for taking immunity from penalty proceedings.

### **C. Prosecution: Ensuring Fairness in Compliance**

#### vi. Reducing Severity: In case of Search and Seizures

The provisions for imprisonment in tax contraventions have been liberalised to adopt a more taxpayer-friendly approach. Rigorous imprisonment of up to 2 years (with a fine) has been replaced by simple imprisonment of up to 2 years and a fine, while minor or procedural defaults are now subject to simple imprisonment of up to 6 months and/or a fine. Additionally, for second and subsequent offences, rigorous imprisonment ranging from 6 months to 7 years (with a fine) has been reduced to simple imprisonment of 6 months to 3 years and a fine in certain cases.

This shift reduces the severity of punishment, maintains deterrence for serious offences, and reflects a more proportionate and balanced approach, easing the punitive burden on taxpayers while continuing to discourage non-compliance.

#### vii. Reducing Severity: Rigorous implementation replaced Simple Imprisonment

In following cases where, rigorous imprisonment 6 months to 7 years was leviable for Tax > Rs. 25 lakh and in other cases 3 months to 2 years is now replaced with introduction of a threshold-based relaxation of Rs. 10 lakh / Rs. 50 lakh with simple imprisonment or fine is brought in to encourage voluntary payment.

- Tax collected/deducted at source but not credited to the account of Central Government
- Evasion of any tax, penalty, or interest chargeable or imposable, or under-reporting of income
- Failure to furnish original return or by issuance of any notice as prescribed
- Providing false statement or delivering an account which is false.
- Offence of abatement of false return wherein person makes or delivers an account or statement relating to any income which is false.

#### viii. Relief Measures for Tax Deductors.

Previously, failure to pay TDS on winnings from lotteries, crossword puzzles, online games,

or consideration from virtual digital assets attracted rigorous imprisonment ranging from 3 months to 7 years along with fines.

Under the revised proposed framework, these provisions have been decriminalized or removed, providing significant relief to tax deductor and substantially reducing their criminal exposure.

These reforms promote faster dispute resolution, lower compliance costs, and improved ease of doing business, while continuing to safeguard revenue interests

#### **D. Conclusion:**

The Union Budget 2026 amendments mark a clear move toward a more balanced and rational enforcement framework in matters of penalty, prosecution, immunity, and appeal. By refining penalty provisions and clarifying prosecution thresholds, the amendments seek to ensure that punitive measures are applied proportionately and judiciously, focusing on deliberate non-compliance rather than procedural lapses.

At the same time, expanded immunity provisions and simplified appeal mechanisms reflect an intent to encourage voluntary compliance and timely dispute resolution, while upholding principles of natural justice. Overall, these changes indicate a shift from a purely punitive approach to one that emphasizes fairness, certainty, and administrative efficiency, strengthening both taxpayer confidence and the credibility of the regulatory system.