Updated ITRs: Costly compliance or smart move post-budget 2025?

ITR filing window is now extended to four years, but taxpayers must tread carefully as penalties escalate steeply

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Can updating ITR cost you more than a reassessment?

Reassessment (Sec 148)*
Maximum penalty on tax due for underreported income: 50%

- If unreported income is less than ₹50 lakh, case can be reopened for up to **3 years**
- If unreported income exceeds ₹50 lakh, case can be reopened for up to **5 years**

Updated return (Sec 139 (8A))*
Penalty on tax due plus interest

Filed	Penalty
Filed within 1 year	25%
2nd year	50%
3rd year	60%
4th year	70%

Penalty in the 3rd year is far higher than the reassessment penalty, which may discourage taxpayers from updating ITR in the 3rd or 4th year, and instead, wait for scrutiny.

Example: For FY23...

Income	Tax due on underreported income
₹40 lakh	**₹10 lakh**

In third year (FY27), if...

	Updated ITR filed	Reassessment opened
Interest	₹4.8 lakh (Calculated from 1 Apr 2023 to 31 Mar 2027 (4 years at **1%** interest per month))	₹7.2 lakh (Calculated from April 1, 2023, to March 31, 2029 (6 years at **1%** interest per month, assuming the order is passed by March 2029—the final date for reassessment closure))
Due tax + interest	₹14.8 lakh	₹17.2 lakh
Penalty	₹8.88 lakh (**60%** of due tax + interest)	₹5 lakh (**50%** of due tax)
Total liability	**₹23.68 lakh**	**₹22.2 lakh**

Under reassessment, the taxpayer pays a lower tax and penalty. If underreported income escapes scrutiny completely within 3 years, reassessment is time-barred and no tax or penalty to be paid

*Sections of the Income Tax Act, 1961

*Compiled by Laxmi Ahirwar, chartered accountant and director, P.R. Bhuta & Co.

Tax gamble? Experts warn of steep penalties

- Foreign income must be disclosed in the updated ITR, as reassessment triggers Black Money Act scrutiny
- Black Money Act penalty: ₹10 lakh
- Reassessment risks a 200% penalty if income is deemed misreported
- The distinction between underreported and misreported income is unclear and subject to interpretation
- No waiver for misreported income penalties; appeals can be lengthy
- Misreported income may also lead to prosecution

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The Budget for 2025 has extended the window for filing updated income tax returns (ITRs) from two to four years. So, after you file an ITR, you get four years from the end of the assessment year to include any additional income in the updated ITR that you have missed reporting in the original tax return.

Sounds like a good deal for voluntary compliance? It is, but only until you realise that there is no free lunch and it comes with a steep 25-70% tax penalty.

The highest penal tax is 70% of the aggregate of tax dues, and interest, when the updated ITR is filed in the fourth year. In the third year, the penal tax is 60%.

Here's another catch—the cost of voluntary compliance by filing an updated return in the third or fourth year is significantly higher than getting a reassessment notice from the tax department.

When a case is reassessed for underreported income and a penalty order is passed, 50% of the tax due is to be paid as a penalty. Take note, this penalty is levied only on the tax due, unlike an updated ITR, where the penalty is calculated on the tax due plus the interest payable on it.

Therefore, in many cases, the penalty under reassessment may turn out to be lower than what you would pay by voluntarily filing an updated ITR.

Even after extending the window by two more years for filing updated returns, the Budget has left a loophole that may encourage some taxpayers to skip filing updated ITRs in the third or fourth year to avoid steep penalties.

The loophole in timelines

Under Section 148, past income tax returns can be reopened for assessment for up to three years from the end of the assessment year if the unreported income is below ₹50 lakh.

For amounts exceeding the threshold the reassessment window extends to five years, allowing tax authorities more time to scrutinize higher-value cases. For example, ITRs that were filed for assessment year 2024-25 with unreported income below ₹50 lakh can be reopened until 31 March 2028. If the unreported income exceeds ₹50 lakh, the reassessment period extends up to 31 March 2030, increasing the risk of scrutiny for larger sums.

In cases where the unreported income is below ₹50 lakh, this loophole may prompt assessees to avoid updating ITRs after two years, as waiting for a tax notice under Section 148 means paying only a 50% penalty—lower than the 60% penalty incurred for filing updated ITRs in the third year.

If the unreported income escapes scrutiny for three years, they are completely safe as the case cannot be reopened for assessment after that.

Experts said the central government must relook at the high amount of additional tax imposed in the third and fourth years for updated returns so that the taxpayers are not deterred from updating ITRs beyond two years. "The Union government should consider reducing the additional tax for all updated ITRs," said Bengaluru-based chartered accountant (CA) Prakash Hegde.

Costly tax mistake

Experts cautioned against exploiting this loophole to avoid updating returns for missed income, as the consequences can be severe and financially burdensome.

Delaying updated ITR filing, and instead, waiting for reassessment to avoid high penalties comes with its own risks

Foremost, the 50% penalty in reassessment applies to underreported income, whereas misreported incomes attract a whopping 200% of the tax due as penalty, significantly increasing cost of non-compliance. There's a key difference between the two, said Harsh Bhuta, partner, Bhuta Shah & Co.

"When it's an honest mistake of reporting income lower than the actual income earned or received for a financial year, it's a case of underreporting income. For example, reporting of lower revenue due to accounting errors or failure to include complete revenue. Or interest income from a joint bank account is not reported, which is not offered by other joint holders either," said Bhuta. "Misreported income, on the other hand, is when there is intentional misrepresentation of facts. Say, claiming expenditure without any supporting evidence," he added.

Though the income tax law defines scenarios to distinguish between under-reporting and misreporting of income, it may be subject to interpretation, said Parizad Sirwalla, partner and head, global mobility services, tax, KPMG in India.

"What the taxpayer may consider as only underreporting, the authorities, based on a detailed review of the documents and the intent, may consider the same as misreporting, considering the intent, explanations and documents provided by the taxpayer," Sirwalla said.

Therefore, if you get a tax order wherein the assessing officer (AO) treats your case as one of misreported income, you will then have to pay double the tax due as a penalty, significantly increasing your tax liability. Hegde pointed out that in the case of misreported income, taxpayers don't even get the option of immunity from penalty, unlike for underreported income, making it a much costlier mistake.

"When passing the reassessment order, the AO doesn't straightaway levy the penalty. He first issues initiation of notice for penalty proceedings. If it's a notice for underreported income, the taxpayer can submit Form 68 to request immunity from penalty and that he will pay the due tax, interest payable and not appeal against the reassessment order. In majority cases, AOs accept such requests and waive the penalty. But this option is not available in cases of notice for misreported income," Hegde said.

Of course, the taxpayer can challenge the order against misreported income by filing an appeal, but the case can slip into prolonged litigation, and interest on the tax due will keep building up throughout the duration of the appeal, adding to the financial burden.

Not to mention, the tax authorities can recover the due tax even when the case is pending, making it crucial to act promptly. The only way to get a stay on the recovery is by depositing 20% of the tax dues as well as penalty amount, which can be significant. However, a better course of action is to update the tax return as soon as you discover that you have missed reporting income, as delaying it increases the risk of it being assessed as a case of misreporting, leading to severe penalties under Section 270A of I-T Act.

In extreme cases, reassessment orders can also lead to prosecution. This is applicable to misreporting of domestic income and assets too along with that of foreign incomes. "The Income-tax Act, 1961, empowers the IT department to initiate prosecution proceedings for various offences apart from levy of fine," said Bhuta.

He outlined some such cases along with imprisonment duration: a) tax evasion under Sec 276C(1)—wilful attempt to evade taxes. If evasion exceeds ₹25 lakh: prison term is six months to seven years (non-cognisable), whereas in other cases it's three months to two years (non-cognizable); b) evasion of tax payment under Sec 276C(2)—three months to three years (non-cognizable); c) false statements or accounts under Sec 277. If evasion exceeds ₹25 lakh, six months to seven years, while in other cases duration is three months to two years (non-cognizable); d) falsification of books under Sec 277A—three months to two years (cognizable).

Report it or risk it

Sudhakar Sethuraman, partner at Deloitte India, emphasised the importance of filing updated returns, especially when taxpayers have overlooked reporting foreign income.

"Report foreign income voluntarily by filing updated returns as these are scrutinised under the Black Money Act. If a tax officer reopens unreported foreign income under Section 148, they will also initiate black money penalty, which is at least ₹10 lakh," he warned.

However, an updated return cannot be used solely to report missed foreign assets under Schedule FA, as the conditions for filing an updated return do not permit it.

A taxpayer can file an updated return only if there is an additional tax liability. Therefore, it cannot be filed solely for foreign asset disclosure, explained Bhuta.

That said, FA disclosures can be made if there is other income to report alongside them.

"In case the taxpayer also has any additional income to offer in the updated tax return, then the same can be filed along with reporting of foreign assets, subject to payment of additional taxes and applicable penalties," Sirwalla said.

F&O losses? Report now

The other crucial use case of updated returns is for traders to report losses from futures & options (F&O) or intra-day trades, which many don't report, thinking there are no profits to show.

But the condition is that the updated return should not result in a total loss, said Vishwas Panjiar, partner, Nangia Andersen LLP.

"There is no restriction on filing an updated return if a loss exists under a particular head of income, provided the overall total income remains positive. Losses from F&O transactions and intra-day trades are business losses, the assessee can report these losses in an updated return. However, the total income in the updated return must be equal to or greater than the total income declared in the original return, ensuring that the tax liability does not decrease," he said.

"If claiming these losses does not lead to a reduction in tax liability, the normal provisions of set-off of losses under the Income Tax Act, 1961, will apply," he added.

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