HC sets aside ruling of AAR treating damages received by shareholder of ADR on alleged fraud as taxable receipts

Summary – The High Court of Delhi in a recent case of Bernstein Litowitz Berger And Grossmann LLP., (the Assessee) held that where Authority of Advance ruling determined that a settlement fund received by foreign-petitioner was taxable in India, based upon wrong premise that petitioner had accepted said receipts to be in nature of revenue receipts, ruling was to be set aside.

Facts

- Certain shareholders of American Depository shares had filed suits against 'S' (Indian company) as well as against 'P' and 'P' LLP, USA claiming damages on account of the alleged admitted fraud in the representations to the Authority governing the Stock exchange under the Securities Exchange Act, 1934 and the Securities Act of 1933 (both USA Acts).
- In those suits, a settlement was arrived at whereby said companies was required to pay damages to said shareholders. Shortly, after the settlement was arrived at as a condition of the settlement, an Advance Ruling was invited from the Authority for Advance Rulings with regard to the taxes to be with held in respect of the transfer of funds from India to USA.
- While the matter was pending before the Authority for Advance Rulings, the entire funds available in the Segregated Account were transferred to the Initial Escrow Account in New York. However, thereafter the Authority for Advance Rulings determined that the said amount was taxable in India and, therefore, tax was to be deducted at source prior to the payment to the beneficiaries. Consequently, 30 per cent of the funds which had been transferred from the Segregated Account to the Initial Escrow Account were returned to India and they continue to be deposited with the revenue authorities.
- On writ :

Held

- The primary question which was there before the Authority for Advance Rulings was whether the amount of the settlement funds which had been transferred from India to USA were chargeable to tax in India. In order to answer this question a primary issue that arose was whether the receipts in the hands of the beneficiaries were in the nature of capital receipts or revenue receipts. The Authority for Advance Rulings had proceeded on the basis that they were revenue receipts and it had so observed on the basis of an alleged submission to this effect made on behalf of the petitioner. That is not the correct position inasmuch as from the impugned Ruling itself it would be evident that the stand of the petitioner was that they were not revenue receipts but capital receipts not chargeable to tax. It was the further case of the petitioner that the settlement amounts would only go towards reducing the cost of acquisition of the American Depository Shares.

- The Authority for Advance Rulings has rendered its ruling based upon the wrong premise that the petitioner had accepted the receipts to be in the nature of revenue receipts. Thus, the Ruling cannot stand. Consequently, the Ruling is set aside and remit the matter to the Authority for Advance Rulings to examine the position, first of all, in the light of whether the receipts were in the nature of capital receipts or revenue receipts and thereafter to determine as to whether those receipts were chargeable to income tax in India.