

# Compensation received for a transaction declared void ab initio is a capital receipt not chargeable to tax

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## In brief

In a recent decision, the Chandigarh bench of the Income-tax Appellate Tribunal (Tribunal) has held that as the transaction of sale of an industrial plot was set aside by the Supreme Court (SC), the taxpayer **M/s Winsome Yarns Limited** (Winsome or the taxpayer) was deprived of making future profits on the industrial plot and therefore, the compensation received against such surrender was a capital receipt not chargeable to tax.

## In detail

### Facts

- M/s Punjab Wireless Systems Limited (the Liquidated Company) was in the process of being wound up. The taxpayer<sup>1</sup>, through an auction process, won a bid to obtain an industrial plot on lease along with certain other assets of the Liquidated Company. Accordingly, *vide* an order of the Company Judge, a 'No objection Certificate' (NoC) was granted in December 2004 to Winsome for transfer of the lease deed in the industrial plot in its favour, and for the sale of certain other assets, for a price of INR 33.6 million.

- Subsequently, Sun Group made an offer to take over all the assets of the Liquidated Company on a going concern basis. The Company Judge allowed the application of Sun Group and set aside his earlier order, and directed Winsome to deliver back the industrial plot and other assets to the Official Liquidator, and also held that the taxpayer would be entitled to a refund.
- The Company Judge's order was challenged by Winsome before the High Court of Punjab and Haryana, which allowed the appeal and confirmed the sale to Winsome. Aggrieved, Sun Group and the Employees Union appealed before the SC. The SC, keeping in view the larger interests of all the parties, exercised its powers conferred by Article

142 (Enforcement of decrees and orders of SC) of the Constitution of India. Winsome accepted the settlement and Sun Group agreed to pay a sum of INR 63.6 million towards refund of the sale price and as compensation for depriving Winsome from the enduring benefit of the industrial plot and other capital assets.

- Thereafter, during the assessment proceedings for assessment year 2007-08, the tax officer (TO) sought to tax an amount of INR 27 million in the hands of Winsome as short-term capital gains arising on extinguishment of rights in the industrial plot. However, on appeal before the Commissioner of Income-tax (Appeals) (CIT (A)), the CIT (A) allowed the appeal of Winsome by treating the receipt as a

<sup>1</sup> DCIT v. Winsome Yarns Limited [TS-546-ITAT-2014(Chandigarh)]

capital receipt not chargeable to tax.

- Aggrieved, the TO preferred an appeal before the Tribunal.

### **Issue before the Tribunal**

Whether the CIT (A) erred in not taxing the amount of INR 27 million as short-term capital gains in the hands of Winsome on extinguishment of rights in the industrial plot?

### **Revenue's contentions**

- The Revenue contended that the surrender of the lease amounted to transfer<sup>2</sup>, as the lease deed of the industrial plot was transferred to the name of the taxpayer, and the taxpayer was the complete owner of the industrial plot. If this property were to go out of existence in view of certain legal operations, then this would result in extinguishment of rights. Therefore, as there was extinguishment of rights in the industrial plot by the taxpayer, the taxpayer was liable to pay tax on short-term capital gains of INR 27 million.
- Alternatively, if the gain of INR 27 million could not be treated as short-term capital gain, then it should be taxed as interest income, being compensation by way of interest given to the taxpayer by the SC towards deprivation of rights in the industrial plot.

### **Taxpayer's contentions**

- When the auction sale was ultimately set aside by the

SC<sup>3</sup>, there was no transfer of assets as the sale itself was void *ab initio*. Therefore, the amount received could not be treated as consideration received for extinguishment of rights in any capital asset leading to capital gains.

- The taxpayer wanted to set up a manufacturing unit by purchasing the industrial plot. Therefore, any compensation received against the surrender of the capital asset could not be treated as interest income or a revenue receipt<sup>4</sup>.

### **Tribunal's ruling:**

*On whether the taxpayer acquired any right in the industrial plot when the sale was set aside by the SC:*

- The decision of the SC clearly stated that the sale in favour of Winsome should be set aside, and that the industrial plot thereon would be confirmed in favour of Sun Group. Based on Black Law's dictionary "set aside" among other things included "vacate", "cancel", "annul" and therefore, in the present case the SC had cancelled the original sale made to the taxpayer. The SC had directed the Official Liquidator to issue a fresh NoC so that Sun Group could obtain the lease in its favour. This showed that the sale in favour of Winsome was cancelled.

- Furthermore, relying on an identical issue before the Karnataka High Court<sup>3</sup> the Tribunal concluded that as the sale in itself was set aside, the taxpayer never acquired any interest in the property.

*On extinguishment of rights as contemplated under section 2(47) of the Income-tax Act, 1961:*

- There was no extinguishment of rights as the property purchased through auction by the taxpayer never came into existence because of the SC's order setting aside the sale.
- Reliance placed on the judicial precedents by the Revenue in the case of Pramia Engineering Private Limited and Smt Anand Bala Bhushan<sup>2</sup> were distinguished as the lease agreements in those cases were never set aside by any authority.

*On taxability of the amount received as compensation:*

On setting aside of the sale by the SC, the taxpayer was deprived of making future profits by surrendering the capital asset being an industrial plot. Therefore, the compensation received against such surrender was a capital receipt, and could not be brought to tax as a revenue receipt. In this regard, reliance was placed on the decision of the SC in the case of Kettlewell Bullen and Company Limited, Oberoi Hotel Private Limited and Saurashtra Cement Limited<sup>4</sup>.

### **The takeaway**

This ruling supports the taxpayer's contention that there can be no income from a transaction which is held as void *ab initio*.

<sup>2</sup> Reliance was placed on the Calcutta High Court ruling in the case of CIT v. Pramia Engineering Private Limited [1993] 202 ITR 298 (Calcutta) and also the Allahabad High Court ruling in the case of Smt Anand Bala Bhushan v. CIT [1996] 217 ITR 144 (Allahabad).

<sup>3</sup> Reliance was placed on the Karnataka High Court ruling in the case of Smt C. Kamala v. CIT [1978] 114 ITR 159 (Karnataka)

<sup>4</sup> Reliance was placed on the Supreme Court decisions in CIT v. Saurashtra Cement Limited [2010] 325 ITR 422 (SC), Kettlewell Bullen and Company Limited v. CIT [1964] 53 ITR 261 (SC) and Oberoi Hotel Private Limited v. CIT [1999] 236 ITR 903 (SC)

## Let's talk

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