BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX)
NEW DELHI

19th Day of January, 2016

A.A.R. No 1364 , 1370 & 1433 of 2012

PRESENT

Justice V.S. Sirpurkar (Chairman)
A.K. Tewary, Member (Revenue)

Name & address of the applicant	Aberdeen Claims Administration Inc., 1735 Market Street, 32nd Floor Philadelphia, PA 19103 United States of America. & Aberdeen Asset Management Plc., 10 Queen's Terrace, Aberdeen, AB10 1YG, United Kingdom
Present for the applicant	Mr. Rajesh Simhan, Advocate Mr. Prateek Bagharia, Advocate
Present for the Department	Mr. G.C.Srivastava, Advocate Mr. P. Satya Prasanth, DCIT Mr. Saurabh Srivastava, FCA Mr. Daksh S. Bhardwaj, Advocate

RULING

(by A.K Tewary)

These are three applications – Aberdeen Claimants Administration Inc., USA (Aberdeen US) has filed application Nos. 1364 & 1370 and

Aberdeen Asset Management PLC, UK (Aberdeen UK) has filed one application No. 1433. The issues involved in all three applications relate to taxability of the settlement amount received from Satyam Computers Services Limited (Satyam) and Price Water House Coopers (PWC) under the provisions of the Income-tax Act, 1961. Therefore, all three applications have been taken together for hearing and a common order is being passed.

Facts

2. The facts related to Aberdeen US and Aberdeen UK are summarized below:-

(i) Twelve mutual funds, namely, (i) Aberdeen EAFE plus Sri Fund, a series of Aberdeen Delaware Business Trust, United States; (ii) Aberdeen EAFE plus Ethical Fund, a series of Aberdeen Claims Trust, United States; (iii) City of Albany Employees Pension Trust, United States; (iv) Franciscan Sister of Chicago, United States; (v) the City of New York deferred compensation plan, United States; (vi) Thrivent Partners Emerging Markets Portfolio, a serious Trivent Series Fund, Inc. United States; (vii) Aberdeen Global – Responsible World Equity Fund, Luxembourg; (viii) Aberdeen IICVC – Ethical World Fund, Scotland; (ix) Mackenzie Financial Corporation – Mackenzie Universal Sustainable Opportunities Capital Class, Canada; (x) Aberdeen Canada – Socially Responsible International Fund, Canada; (xi) Aberdeen Canada – Socially Responsible Global Fund, United States; (xii) NCB Capital Company, Bahrain; Raiffeisen Kapitalangage – Gessellsc mbg R 77 – Fonds Segment B, Austria were all holders of American Depository

Shares (“ADS”) (collective “ADS Holders”) of Satyam Computer Services Ltd.(“Satyam”)

(ii) Seven mutual funds, namely, (i) First Trust/Aberdeen Emerging Opportunity Fund; (ii) Aberdeen Emerging Markets Fund Institutional Funds, a series of Aberdeen Funds, United States; (iii) Aberdeen Emerging Markets Fund Institutional Funds, a series of Aberdeen Funds; (iv) Aberdeen Asia Pacific excluding Japan Fund a series of Aberdeen Delawre business Trust , United States; (v) Halliburton Company Employee Benefit Master Trust; United States and (vi) Thrivent Partners Worldwide Allocation Fund, a series of Thrivent Mutual Funds, United States and (vii) Aberdeen Asia Pacific including Japan Fund, a series of Aberdeen Delaware Business Trust, United States were all holders of ordinary equity shares (“Equity Holders”) of Satyam.

(iii) On January 7, 2009, Ramalinga Raju, the then Chief Executive Officer of Satyam confessed that Satyam’s financial results had been manipulated and inflated over a period of years. PricewaterhouseCoopers (“PwC”) played a key role in preparing and auditing Satyam’s financial statements as well as Securities Exchange Commission (SEC) filings. PwC possessed the documents that showed Satyam’s true financial condition, and its active participation in the fraud was thus essential and apparent.

(iv) As a result of the public disclosure of the contents of the letter, the value of ordinary equity shares and ADS of Satyam dropped precipitously, forcing the ADS and Equity Holders (collectively,

"Aberdeen Investors") to dispose of their entire shareholding by two transactions dated January 7, 2009 and January 9, 2009.

(v) This actionable conduct of Satyam and its directors, gave rise to legal claims by the Aberdeen Investors against inter alia Satyam and PwC ("Legal Claims"). The Aberdeen Investors thus decided to establish two Trusts, namely, Aberdeen Claims Trust and Aberdeen Claims Trust (II) (together referred to as 'claims trust') and granted, assigned, conveyed and transferred the aforesaid Legal Claims to the trust ("Assigned Claims"), while retaining all beneficial interest in the Trust. The Aberdeen Investors also appointed Aberdeen claims Administration Inc. (Aberdeen US) as the Trustee of Claim Trusts in order to evaluate/prosecute, and/or settle the aforesaid claims and to distribute the funds collected or received in resolution of the Assigned Claim, if any, to the Aberdeen Investors, after payment of certain litigation costs, all in accordance with the terms of Recovery Agreement.

(vi) Aberdeen US, as a trustee of the Claim Trusts, initiated a civil action against inter alia Satyam and PwC in Aberdeen Claims Admin. Inc. v. Satyam Computers Ltd, 2:09-CV-5453-NS ("Aberdeen Civil Action"), filed in United States District Court of the Eastern District of Pennsylvania ("Pennsylvania Court"), seeking unliquidated damages caused on account of inter alia Satyam's and PwC's wrongdoing. Aberdeen US estimated that the total of Aberdeen Investor's losses for which recovery was sought would exceed US $68 Million.

(vii) On November 17, 2009 the Aberdeen Civil Action was transferred to the United States District Court for the Southern District of New York (“New York Court”) for pre-trial consolidation and coordination with In re Satyam Computers Services, Securities Litigation in the New York Court (“US Class Action Litigation”), a class action initiated by other investors of Satyam before the court in New York, asserting claims under Section 10 (b) and 20 (a) of the Securities Exchange Act of 1934 (the US Exchange Act) and Rule 10b-5 promulgated there under.

(viii) Subsequently, the Aberdeen Civil Action was consolidated with the US Class Action Litigation and on May 12, 2011, the New York Court entered an order preliminarily (“Preliminary Approval Order") certifying a class for settlement purpose in connection with the US Class Acton Litigation (“Settlement Class”). In the preliminary Approval Order, the Court preliminary found the settlement to be fair, reasonable and adequate.

On August 15, 2011, Aberdeen US timely filed a request for exclusion from the Settlement Class. Satyam challenged the validity of, and objected to, Aberdeen’s request for exclusion.

On September 13, 2011 this New York Court entered final orders and judgments with respect to the settlement , certifying the Settlement Class and approving the Settlement (“Class Action Settlement”). The New York Court in the aforesaid orders and judgments, reserved decision as to the validity of Applicant’s request for exclusion, and instructed Aberdeen US and Satyam to engage in discovery and briefing in connection

with Satyam's objection to the validity of Aberdeen US's request for exclusion.

(ix) While the aforementioned proceedings were ongoing in the New York Court, conscious of the time, efforts and cost involved in the litigation, Aberdeen US and PwC and Aberdeen US and Satyam entered into two separate Settlement Agreements dated July 18, 2012 and July 27, 2012 respectively.

(x) Under the terms of the Aberdeen US-Satyam Settlement Agreement:

(a) Satyam entered into the Settlement to, without limitation, enhance its credibility and business opportunities in the United States market, and eliminated the burden expenses, uncertainty and distraction of further litigation with its attendant risk of monetary damages and reputational harm to Satyam in United States.

(b) Satyam agreed to pay a total principal settlement amount of US$ 12,000,000 to Aberdeen US ("Primary Settlement Amount").

(c) The Aberdeen-US fully, finally and forever waived, released, discharged and dismissed each and every of their Legal Claims against Satyam and agreed to be forever barred and enjoined from commencing, instituting, prosecuting or maintaining the Legal Claims. This was also agreed vice-versa. Both Satyam and the Aberdeen Investors extinguished their mutual legal claims.

(xi) The ADS Holders were deemed members of the Settlement Class and were bound by the terms of the Class Action Settlement. However in the event ADS holders recovered less than US$ 6,000,000 from the Class Action Settlement, Satyam remains obligated to pay the Aberdeen US, net of any transfer taxes, the difference between the Aggregate Aberdeen ADS Recovery and US$ 6,00,000, provided however such payment is capped at US$ 1,500,000 (‘”Supplemental Consideration”).

The Equity Holders were excluded from the Settlement Class with respect to the claims that were assigned to Aberdeen US.

Satyam transferred a sum of Primary Settlement Account to an Escrow Account, maintained with Citibank N.A at New York (“Escrow”). It was agreed between the parties these Escrowed Funds remained the property of Satyam.

Aberdeen US agreed to file the present application to seek an advance ruling regarding taxability of the Primary Settlement Amount and if occasioned, the Supplemental Consideration (“Satyam Settlement Account”).

(xii) Under the terms of the Aberdeen US-PwC Settlement Agreement:

(a) PwC entered into the Settlement to, without limitation, eliminate burden, expenses, uncertainty and distraction of further litigation with its attendant risk of monetary damages.

(b) PwC agreed to pay a total principal settlement amount of US$ 2,000,000 to Aberdeen US (“PwC Settlement Account “).

(c) The Aberdeen US fully, finally and forever waived, released, discharged and dismissed each and every of their Legal Claims against PwC and agreed to be forever barred and enjoined from commencing, instituting, prosecuting or maintaining the Legal Claims. This was also agreed vice-versa. Both PwC and the Aberdeen investors extinguished their mutual legal claims.

3. Aberdeen UK is a listed UK company which manages and/or advice certain investment funds (Aberdeen investors) that had invested in Satyam Shares. After the confession of manipulation of accounts of Satyam by the then CEO Sri Raju, legal action was initiated by the Aberdeen investors against Satyam and finally Aberdeen investors entered into a Settlement Agreement with Satyam. Under the terms of the Settlement Agreement:

(a) An amount of US$ 68,000,000 (approximately INR 420 crores) (“Settlement Amount”) is to be paid by Satyam to the Applicant for further distribution to the Aberdeen Investors to settle and resolve the Aberdeen Investors’ claims against Satyam.

(b) The Settlement Amount was deposited in an escrow account (“Escrow Account”) which shall remain the property of Satyam until disbursed from the Escrow Account. The Escrow Account is governed in terms of an escrow agreement entered into between the Applicant, Satyam and the escrow agent, Citibank N.A. (London Branch) dated February 7, 2013 (“Escrow

Agreement").

(c) The Settlement Agreement provided for a full, final and complete resolution of all claims asserted or which could have been asserted by the Applicant/Aberdeen Investors with respect to the "Released Claims".

4. For the sake of convenience the chronology of events in the case of Aberdeen US (Application No. 1364/2012) is mentioned below:-

LIST OF DATES

Date	Event
2003-2009	Investment funds managed by Aberdeen or its affiliates ("Aberdeen Investors") purchased shares of Satyam Computer Services Limited ("Satyam") listed on Bombay Stock Exchange/National Stock Exchange ("Common Stock") and Satyam's American Depository Receipts ("ASRs") listed on the New York Stock Exchange.
January 7, 2009	Ramalinga Raju, the then Chief Executive Officer of Satyam submitted his resignation letter to Satyam's board wherein he accepted that Satyam's financial results were manipulated over a period of years.
January 7, 2009	The Aberdeen Investors disposed of Satyam Common Stock and ADRs.
January 9, 2009	Further disposal of Satyam Common Stock and ADRs by Aberdeen Investors.
September	Aberdeen Claims Trust and Aberdeen Claims Trust II ("Claim

1, 2009	Trusts") were formed under laws of Pennsylvania, having the Applicant as trustee of both Claim Trusts to investigate and prosecute the claims of various Aberdeen Investors against Satyam
November 17, 2009	The Applicant , as trustee of the Claim Trusts initiated legal action against Satyam in Aberdeen Claims Administration Inc. vs Satyam Computer Services Limited et al., No.09-cv-5453, in the United States District Court for the Eastern District of Pennsylvania ("Aberdeen Complaint") Thereafter, the Aberdeen Complaint was transferred for consolidation (for pre-trial purposes) with the class action, in a multi-district litigation created in the United States District Court for the Southern District of New York ("New York Court") to consolidate pending lawsuits filed against Satyam, in Satyam Computer Services Limited Securities Litigation, No.09-md-2027 ("Class Action").
February 16, 2011	Satyam executed and entered into an Agreement of Settlement ("Class Action Settlement Agreement") with the lead plaintiffs of the Class Action including the applicant.
February 18, 2011	The Applicant filed the Second Amended Complaint in the New York Court detailing the claims of the Applicant/Aberdeen Investors against Satyam.
March 21, 2011	The New York Court entered an order preliminarily certifying a class for settlement purposes ("Settlement Class") in connection with the Class Action. The New York Court also set forth procedures and deadlines for class members to request exclusion from the Class Action Settlement

	Agreement.
August 15, 2011	The Applicant filed a request for opt out/exclusion from the Settlement Class before the New York Court.
September 13, 2011	The New York Court passed final orders and judgments certifying the Settlement Class and approved the Class Action Settlement.
July 27, 2012	The Applicant entered into a settlement agreement with inter alia Satyam Computer Services Limited ("Aberdeen Settlement Agreement") in relation to settlement amount of US$ 12,000,000 and Supplemental consideration of USD 1,500.000 ('Aberdeen Settlement Amount").
July 30, 2012	The New York Court passed a consent order stating that the Applicant's request for exclusion from the Settlement Class is valid and exclusive with respect to the Aberdeen Common Stock investors.
August 24, 2012	Applicant filed an application for advance ruling (Application No.1364/2012) in respect of the taxability of the Aberdeen Settlement Amount under the Income Tax Act, 1961
October 19, 2012	The Applicant along with Satyam and Citibank N.A. , as escrow agent entered into an escrow agreement for the transfer of the Aberdeen Settlement Amount to an escrow.

5. As the events leading to settlement are similar, if not identical, in the case of Aberdeen UK also, it is not necessary to repeat the chronology of events in the case of Aberdeen UK.

6. Questions for Ruling in Application No.1364

Q.1 Whether, on the facts and circumstance of the case, the Settlement Amount to be received by Aberdeen US as trustee for the Claims trusts from Satyam in accordance with the terms of the Settlement Agreement entered into between Aberdeen US and Satyam on July 27, 2012 is taxable under the provisions of the Income-tax Act, 1961?

Q.2 If answer to question number 1 is in the affirmative, what would be the basis and method of determination of taxable income, applicable tax rate, applicable rate of deduction of tax at source thereon and at what stage (i.e. on remittance to Escrow Account or on remittance from Escrow Account to Aberdeen US) is such tax required to be deducted?

Q.3 Without prejudice to the arguments advanced in the Application, whether the Settlement Amount (if held to be taxable in India) shall attract Indian taxes under the Income Tax Act, 1961 at the time of deposit of the Settlement Amount by Satyam Amount by Satyam in the Escrow Account?

Questions for Ruling in Application No.1370

Q.1 Whether , on fact and circumstances of the case, the consideration to be received by Aberdeen US, as trustee for the Claim Trusts from PwC in accordance with the terms of the Settlement Agreement entered between the Applicant and PwC on July 18, 2012 is not taxable under the provisions of the Income tax Act, 961?

Q.2 If answer to question number 1 is in the affirmative, what would be the basis and method of determination of taxable income, applicable tax rate, and applicable rate of deduction of tax at source thereon?

Questions for Ruling in Application No.1433

Q.1 Whether, on the facts and circumstances of the case, the settlement amount to be received by Aberdeen Asset Management PLC ("Aberdeen" or "Applicant") on behalf of the Claimants form Satyam Computer Services Ltd. ("Satyam") in accordance with the terms of the settlement agreement entered into between the Applicant and Satyam on December 12, 2012 ("Settlement Agreement") is taxable under the provisions of the Income Tax Act, 1961 (ITA" or "Act")

Q.2 If answer to Question number 1 is in the affirmative, what would be the basis and method of determination of taxable income, applicable tax rate, applicable rate of deduction of tax at source thereon and at what stage (i.e. on remittance to Escrow Account or on remittance from Escrow Account to the Applicant) is such tax required to be deducted?

Applicants' Submissions

7. The stand of the applicants in all three applications is common. The main points of submissions of the applicants are summarized below:-

(a) Section 4 of the Income-tax Act (ITA), which stipulates the basis of charge of income tax, provides that the 'total income' of a person shall be subject to tax in India. As per Section 5 of the ITA, residents are taxable in India on their worldwide income, whereas non-residents are taxed only on income which is sourced in India, i.e. income received or deemed to be received

in India, income that accrues or arises to them in India or is deemed to accrue or arise in India.

(b) The Impugned Settlement Amounts would not qualify as "income" for the purposes of the ITA. The Impugned Settlement Amounts are neither received in the ordinary course of business of the Applicant, nor is the Applicant engaged in the business of suing and seeking settlement from third parties. The Impugned Settlement Amounts cannot be said to be deemed to accrue or arise in India in terms of section 9 which refers to only specific streams of income. Further, the impugned Settlement Amounts are not sourced in India, being linked to a law suit that arose outside India and not the underlying shares of Satyam and hence the territorial nexus principle is not fulfilled in that respect. This can be established by the fact that the Aberdeen Investors had sold the shares prior to initiation of the action and the suit was linked to allegation of fraud/negligence. Therefore, the Impugned Settlement Amounts cannot be brought to tax under Section 9 read with Section 4 and Section 5 of the ITA. This is on the basis that the Impugned Settlement Amounts are not connected with the Applicant's business in India but for release of claims of Aberdeen Investors against Satyam/PwC under the Aberdeen Civil Action initiated in United States, and to end reputational harm caused to Satyam/PwC in United States. Therefore, the Impugned Settlement Amounts have no territorial nexus with India. The applicant has relied on the decision of the Privy Council in Commissioner of Income-tax, Bengal vs Shaw Wallace & Company (ILR 59 Cal 1343 At P. 1352).

(d) The Impugned Settlement Amounts are capital receipt in the books of Aberdeen US which does not fall for consideration under section 45 of the ITA for the following reasons:

a The Impugned Settlement Amounts are received on account of destruction of capital assets (i.e. the right to sue Satyam/PwC) and do not fall for consideration under Section 45 of the ITA.

b. Even if the Impugned Settlement Amounts fall for consideration under Section 45 of the ITA no Capital Gains arise owing to failure of computation mechanism under Section 48 of the ITA and Section 48 of the ITA and Section 55 (3) of the ITA.

c. Without prejudice to (a) and (b), the Impugned Settlement Amounts are received by Aberdeen US as compensation for the injury inflicted on capital asset of the trading (Equity and ADS shares held by Aberdeen Investors) and do not fall for consideration under Section 45 of the ITA.

(d) A 'right to sue' is property and thus Capital Asset as defined under Section 2 (14) of the ITA and inherently a 'right to sue' is not transferable as a matter of public policy. Thus, there cannot be any transfer of a right to sue under Indian law and any capital receipt arising from a right to sue cannot thus be considered capital gains under Section 45 of the ITA. The Gujarat High Court has accepted this in Baroda Cement and Chemicals vs C.I.T. (158 ITR 636) while examining the treatment of capital receipt from settlement and extinguishment of right to sue as

Capital gains. The relevant portion of the Gujarat High Court's decision is reproduced below:

> *"The amendment of clause (e) of section 6 by the deletion of the italicized words has brought into sharp focus the distinction between property and a mere right to sue. Before the amendment, only the right to sue for damages arising out of a tortuous act fell within the ambit of the said clause. The right to sue arising ex-contractual, therefore, did not fall within the mischief of the clause even if it were a mere right to sue. After the amendment a mere right to sue, whether arising out of tortuous act or ex-contractual, is not transferable."*

(e) The Hon'ble Supreme Court in Vania Silk Mills Pvt. Ltd. v. C.I.T. (191 ITR 647) has laid down that receipt on account of destruction of capital assets is not subject to capital gains.

(f) The destruction of the right to sue i.e. the capital asset cannot be equated with the extinguishment of any right in a capital asset, as it would amount to extinguishment of the capital asset itself. Section 2(47) defines transfer in relation to a capital asset to include "(i) the sale, exchange or relinquishment of the asset; or (ii) the extinguishment of any rights therein". The legislature in its wisdom has specifically distinguished sale, exchange and relinquishment of the asset from extinguishment of rights in a capital asset. Thus while in the former, the provision speaks of sale, exchange and relinquishment of the asset itself, the later explicitly speaks of extinguishment of any rights in the capital assets. The later provision contemplates that the asset will

continue to exist, even if the rights in such asset are extinguished. The applicants have relied on the verdict of the Apex Court in CIT vs Mrs Grace Collis and others (AIR 2001 SC 1133). However, the impact of this verdict will be discussed later in subsequent paragraphs as the applicants have not quoted the relevant portion.

(g) The cost of acquisition and cost of improvement of a right to sue cannot be computed. In such a situation the mechanism for computation of Capital Gains under Section 48 of the ITA would fail in the present situation. The applicants have relied on the decision of the Supreme Court in CIT vs B.C. Srinivasa Setty (128 ITR 294)

(h) Satyam equity shares and ADS held by the Aberdeen Investors were in the nature of capital assets. At the time of investments in Satyam equity shares, Aberdeen Investors were registered as Foreign Institutional Investors ("FIIs") and/or sub-account of FIIs under the erstwhile SEBI (Foreign Institutional Investor) Regulations, 1995 ("FII Regulations") with the Securities Exchange Board of India (SEBI). The investments made by FII entities/sub accounts are in the nature of capital assets and trading assets. The applicants have relied on the rulings given by this authority in case of Fidelity Northstar Fund [2007] 288 ITR 641 (AAR), wherein it was held as under:-

> *23. The circumstances and the framework of the plethora of legislative provisions unmistakably point out that a FII is not registered for carrying on trade in securities; it can only invest in securities for the purpose of earning income by*

way of dividends and interest and realizing capital gains on their transfer."

(i) The applicants have further relied on circular No.4 of 2007 issued by CBDT setting out various tests for determination of whether shares are held as investment or stock-in-trade. The applicants have also relied on the case of Bombay Burmah Trading Corporation Ltd v CIT (Bombay High Court) [1971] 81 ITR 777 (Bom) wherein the High Court held that where the payment in question was made as compensation for the injury inflicted on a capital asset, such payment was in the nature of capital receipt.

(j) The Primary Settlement Amount is not actually or constructively received by the Applicant in India under section 5 and/or of the ITA upon deposit in the Escrow. Clause 11 of the Aberdeen US-Satyam Settlement Agreement provides that the Primary Settlement Amount when in the Escrow shall remain to be the property of Satyam. Clause 12 further provides that the Primary Settlement Amount shall be transferred to the Applicant only under limited circumstances upon receipt of (a) a joint instruction letter by Satyam and the Applicant, (b) a consent order by the relevant US court and (c) a copy of the ruling of the Hon'ble Authority in the above application.

Revenue's Submissions

8. The Revenue has objected to the submissions of the applicants and the response of the Revenue is also common in all three applications. The main points in the response of the Revenue are summarized below:-

(a) These Aberdeen Funds which are the recipients of the respective amounts of compensation from Satyam (the applicant being only a pass-through entity) are in the business of trading in securities and thereby earning profits. The mode of sharing of profit between the fund and the participants depends on the scheme of the fund and would not be a relevant factor to decide the nature of the activity.

(b) The loss was incurred by the Aberdeen Funds in the course of their business activities of dealing in securities.

(c) The recipients of the settlement amounts are the Aberdeen funds (and not participating investors) who are in the business of purchase and sale of securities.

(d) The Mutual Funds (like Aberdeen Funds) invest their funds after a careful research of the market. The investment decisions are not taken based on the expected dividends from and the expected appreciation in the value of a particular security. Rather, these decisions are taken on the potential upside in the market price of a share/security. Unlike an investor, Mutual Funds change their portfolios frequently and sometimes prefer even booking losses. Whenever their research tells them that a particular security has reached its optimum price and the risk of losing was more than a chance gaining, they exit the security. These are characteristics of a trader and not of an investor. For example, the FIIs take

decisions to move out a market on local as well as international factors. The buying and selling of shares is done very regularly and frequently except in case of some securities where the analyst is not able to suggest a decision to exit. The FIIs are in the business of trading in shares in Indian markets. It is quite another matter that the Government in order to attract investments, has decided to treat the gains of FIIs as capital gains. That does not alter the basic character of the activity. That only changes the matter of taxability.

(e) The fact that the payment has been made through an award of a law suit or through a settlement with or without giving up the right to sue, cannot be determinative of the character of the receipt. For example, if the professional fee of a lawyer is paid to him only after a suit of recovery is filed or after the settlement is arrived at on the quantum of fee it would not make the receipt capital in nature. One has to look at it from the point of view of the lawyer – what was he trying to recover?

(f) If the sum paid or payable is for destruction of the profit making apparatus or crippling of the recipient's profit-making apparatus, it would be a capital receipt. However, when the structure of the recipient's business is so fashioned as to absorb the shock as one of the normal incidents to be looked for and where it appears that the compensation received is no more than a surrogatum for the future profits surrendered – the compensation

received is to be treated as a revenue receipt and not a capital receipt.

(g) Firstly, the treatment given in the accounts is not determinative of the nature of a particular receipt. Secondly, the tax treatment of the income for sale and purchase of shares by US tax authorities would not be relevant as the taxability of the amounts paid by Satyam is to be seen under Indian Tax laws. The nature of the income (whether from business of capital gains) is to be determined in the light of the tests laid down by Indian Courts. The Revenue has also relied upon circular No.4 of 2007 issued by CBDT and decision of the ITAT in the case of Binay Mittal ITA 1172 of 2011.

(h) The amount of the compensation was received in the course of business of the Aberdeen Funds. Hence, it would constitute a business receipt and would be part of their business profits.

(i) No asset was destroyed in this case. Any fall in price of share cannot be regarded as destruction of asset. In fact, in the case of business of a mutual fund, rise and fall in prices of securities, be it for one reason or the other, is a normal business incidence and neither the rise in price creates an asset nor the fall in price destroys an asset.

(j) The amount paid by Satyam is not for relinquishment or extinguishment of the right to sue but as a compensation

for the loss of potential income suffered by Aberdeen Funds in the course of their business operations.

(k) The Revenue has relied on the judgment of Allahabad High Court in CIT vs Smt Shanti Meattle 1973 90 ITR 385 and decision in the case of CIT vs GR Karthikeyan 201 ITR 866 (SC).

Inferences

9. We have carefully considered the submissions and counter submissions of applicants and Revenue respectively. Similar question was involved in application No. 1060 & 1070 of 2010 wherein we had analyzed various arguments relating to taxability of Settlement amount received from Satyam and PwC in similar circumstances, i.e., receipt of settlement amount as a result of settlement agreement and approval by the US Court after the complaints were filed in respect of fraud committed by Satyam/PwC. In that case we have held as under:-

"28. The term income has been defined in section 2(24) of the Act. The Privy Council in CIT vs Shaw Wallace & Co (ILR 59 Cal 1343) defined income as under:-

> *"Income, their Lordships think, in the Indian Income-tax Act, connotes a periodical monetary return 'coming in' with some sort of regularity, or expected regularity from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return excluding anything in the nature of a mere windfall."*

The settlement account received as per the Court Order is not a periodical monetary return. As it is against surrender of 'right to

sue', it is not linked with income generating apparatus, i.e. shares of Satyam. It can also not be said that it relates to any sort of business activity carried on by the QSF. In the circumstances the settlement amount has to be characterized as capital receipt. Once the character of receipt is capital in nature, it goes outside the scope of income chargeable to tax unless it is specifically brought within the ambit of income by way of specific provisions of the Income-tax Act.

29. We also notice that the most important point here is that we have to consider the nature of receipt in the hands of QSF which is not doing any activity to earn such receipt which may qualify as income. QSF is not in the business of suing and seeking settlement amount. Surrender of 'right to sue' has also been made by investors and not by QSF. Under no circumstances the theory of loss of future income would apply to QSF as neither is it owner of ADS nor it is doing any business relating to ADS. We are required to give ruling whether settlement amount in the hands of QSF is chargeable to tax. We are not considering whether investors were doing any business of purchase and sell of shares. In any case the settlement award to investors also has been given only because they have agreed not to pursue the complaint. QSF is only custodian of this amount till it is finally disbursed.

30. Now we may also consider whether the settlement amount can be treated as capital gains in the hands of QSF. Section 2(24) of the Act specifically includes "(vi) any capital gains chargeable under section 45" within the ambit of income. Thus a capital receipts would be chargeable to tax only if it falls under

section 45 of the Act (as capital gains) though capital receipt as such is not taxable. This principle was described by the Income Tax Appellate Tribunal (Mumbai) in Dhruv N. Shah v. Commissioner of Income Tax 88 ITD [2004] 118 as follows:

"Further, all receipts are not taxable under the Income Tax Act. Section 2(24) defines "income". It is no doubt that this is an inclusive definition. However, a capital receipt is not income under section 2(24) unless it is chargeable to tax as capital gain under section 45. It is for that reason that under section 2(24) (vi), the Legislature has expressly stated, inter alia, that income shall include capital gain chargeable under section 45. Under section 2(24) (vi), the Legislature has not included all capital gains as income. It is only capital gain chargeable under section 45 which has been treated as income under section 2(24). Further under section 2(24)(vi), the Legislature has not stopped with the words "any capital gains". On the contrary it is obviously stated that only capital gains which are taxable under section 45 could be treated as "income". In other words, capital gains not chargeable to tax under section 45 fall outside the definition of "income" in section 2(24). Therefore, the words "chargeable under section 45" are very important. So, whenever an amount which is otherwise a capital receipt is to be charged under section 2(24), and when specifically so provides for not charging to capital gain for any reason under section 45, the same cannot be brought to tax as income by applying the general connotation under section 2(24)……"

31. In this case it is to be considered whether right to sue is property and a capital asset as defined u/s 2(14) of the Act and whether it is chargeable to tax. Section 2(14) defines Capital Asset to mean "property of any kind held by an assessee, whether or not connected with his business or profession". Section 6 of the Transfer of Property Act states that "property of any kind may be transferred, except as otherwise provided by this Act or by any other law for the time being in force." Section 6 (e) notes that "a mere right to sue cannot be transferred".

Therefore, a 'right to sue' is property and thus Capital Asset as defined under section 2(14) of the Act but is not transferable. There cannot be any transfer of a right to sue under Indian law and any capital receipt arising from a right to sue cannot thus be considered capital gains under section 45. While examining the treatment of capital receipt from settlement and extinguishment of right to sue as Capital gains the Gujarat High Court in Baroda Cement and Chemicals v. CIT (158 ITR 636) held as under:

"The amendment of clause (e) of section 6 by the deletion of the italicized words has brought into sharp focus the distinction between property and a mere right to sue. Before the amendment, only the right to sue for damages arising out of a tortuous act fell within the ambit of the said clause. The right to sue arising ex-contractual, therefore, did not fall within the mischief of the clause even if it were a mere right to sue. After the amendment a mere right to sue, whether arising out of tortuous act or ex- contractual is not transferable."

"Chagla C.J. had an occasion to consider this aspect of the law in Iron & Hardware Co. v. Shamlal & Bros., AIR 1954 Bom 423. The learned Chief justice observed as under (at p. 425):

"It is well settled that when there is a breach of contract, the only right that accrues to the person who complains of the breach is the right to file a suit for recovering damages. The breach of contract does not give rise to any debt and, therefore, it has been held that a right to recover damages is not assignable because it is not a chose-in-action. An actionable claim can be assigned but in order that there should be an actionable claim, there must be a debt in the sense of an existing obligation. But inasmuch as a breach of contract does not result in any existing

obligation on the part of the person who commits the breach, the right to recover damages is not an actionable claim and cannot be assigned.

In my opinion, it would not be true to say that a person who commits a breach of the contract incurs any pecuniary liability, nor would it be true to say that the other party to the contract who complains of the breach has any amount due to him from the other party.

As already stated, the only right which he has is the right to go to court of law and recover damages. Now, damages are the compensation which a court of law gives to a party for the injury which he has sustained. But, and this is most important to note, he does not get damages or compensation by reason of any existing obligation on the part of the person who has committed the breach. He gets compensation as a result of the fiat of the court. Therefore, no pecuniary liability arises till the court has determined that the party complaining of the breach is entitled to damages. Therefore, when damages are assessed, it would not be true to say that what the court is doing is ascertaining a pecuniary liability which already existed. The court in the first place must decide that the defendant is liable and then it proceeds to assess what that liability is. But till that determination, there is no liability at all upon the defendant. "

Further, the Supreme Court in Union of India v. Raman Iron Foundry, AIR 1974 SC 265 held as under:

“When there is a breach of contract, the party who commits the breach does not eo instanti incur any pecuniary obligation, nor

does the party complaining of the breach become entitled to a debt due from the other party. The only right which the party aggrieved by the breach of the contract has is the right to sue for damages. That is not an actionable claim and this position is made amply clear by the amendment in section 6(e) of the Transfer of Property Act, which provides that a mere right to sue for damages cannot be transferred. "

The Supreme Court endorsed the views of J. Chagla "This statement in our view represents the correct legal position and has our full concurrence." If right to sue cannot be transferred and it has no cost of acquisition, the question of considering the same for the purpose of capital gains u/s 45 of the Act would not arise.

Having said as above, it will have to be considered whether surrender of right to sue is covered under the provisions of section 2(47)(ii) i.e., the extinguishment of any rights therein and, if so, whether the extinguishment of rights is independent of transfer. This question had come up before the Apex Court in the case of CIT vs Mrs Grace Collis and other 2001 248 ITR 323 wherein it was held as under:

> *"We have given careful thought to the definition of transfer in Section 2(47) and to the decision of this court in Vanias case. In our view, the definition clearly contemplates the extinguishment of rights in a capital asset distinct and independent of such extinguishment consequent upon the transfer thereof. We do not approve, respectfully, of the limitation of the expression extinguishment of any rights*

therein to such extinguishment on account of transfers or to the view that the expression extinguishment of any rights therein cannot be extended to mean the extinguishment of rights independent of or otherwise than on account of transfer. To so read the expression is to render it ineffective and its use meaningless. As we read it, therefore, the expression does include the extinguishment of rights in a capital asset independent of and otherwise than on account of transfer."

In view of above, the right to sue can be considered for the purpose of capital gains. This has been further clarified by explanation 2 of Section 2(47) inserted by Finance Act, 2012 but effective from 1.4.1962. This explanation reads as under:-

"Explanation 2 – For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of right has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

So right to sue may be considered for the purpose of capital gains within the terms of section 45 of the IT Act which is a charging section. However the charging section and the computation provisions under section 48 must go together. The Apex Court in the case of CIT vs B.C. Srinivasa

Setty (1981 128 ITR 294) had considered this issue and held that the "Charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section". The Apex Court also held that "none of the provisions pertaining to the head 'capital gains' suggests that they include an asset in the acquisition of which no cost of acquisition at all can be conceived". It is clear that if right to sue is considered as a capital asset covered under the definition of transfer within the meaning of section 2(47) of the IT Act, its cost of acquisition cannot be determined. In the absence of such cost of acquisition, the computation provisions failed and capital gains cannot be calculated. Therefore, right to sue cannot be subjected to income tax under the head 'capital gains'.

The Revenue also agrees that settlement amount is not paid in consideration for any capital asset and cannot be characterized as capital gains. It is only as an alternative argument that they have brought the issue of capital gains."

In this case also we reiterate our views expressed in above-mentioned judgment as relevant facts are almost identical.

10. The nature of settlement agreement in the case of Aberdeen US and Aberdeen UK is same and we take the same view in this case also that the nature of settlement amount is of capital receipt and it cannot be categorized as income. Further this amount has been received against surrender of right to sue which cannot be considered for the purpose of capital gains under section 45 of the Income-tax Act.

11 The Revenue has raised certain additional points in this case which are required to be addressed. In this case the Revenue has taken a different stand to establish that the settlement amount received is income of the applicant. According to the Revenue the settlement amount received by the applicants is a part of their business receipt because these applicants are representing mutual funds which invest their funds after careful research of the market on the basis of expectation of potential upside in the market price of share and unlike an investment, mutual funds book their profits frequently and sometimes prefer even booking loses. According to the Revenue these are characteristics of a trader and not of an investor. As regards the treatment of income of such mutual funds as FIIs as capital gains the revenue has submitted that the Government has done so in order to attract investors but that does not alter the basic character of the activities of FII and it only changes the manner of taxability. The Revenue has relied on the principle of surrogatum saying that the settlement amount has been received for the future profits surrendered. The issues raised as above by the Revenue have to be examined first against the factual position in this case and then in the light of legal position. There is no doubt that according to the surrogatum principle the character of receipt of an award of damages or of an amount received in settlement of a claim as capital or revenue depends on what such amount was intended to replace. If the replaced amount would not have been otherwise taxable, the settlement amount may also be not taxable. However, the surrogatum principle does not apply to amounts received pursuant to a fraud. Further, in this case two important facts are noted. One, there is no dispute that at the time of the investments in the shares of Satyam, Aberdeen investors were registered as FIIs under FII regulations with the securities Exchange Board of India (SEBI). FIIs are not carrying out any trade in securities and this position was settled by this

authority in the case Fidelity Northstar fund, 2007 288 ITR 641. The Authority held as follows:-

"22. It may be seen that clause (a) of sub-section (1) of section 115AD of the Act, speaks of income received in respect of securities; from the operation of such income is excluded the income by way of dividends referred to in section 115O and from the operation of securities is excluded unit referred to in section 115AB. The expression "income receipt of securities" in clause (a) connotes the income therefrom when the securities held by a FII are intact, e.g. dividends, interest etc. like fruits from a tree or a rent from an immovable property. The term 'income' employed therein, having regard to the context, can, by no stretch of imagination, be assumed as income arising from the transfer of such securities for the simple reason that such type of income is referred to in clause (b) where the income is specified as being by way of short-term and long term capital gains arising from the transfer of such securities. Clause (a) of sub-section (2) is called in aid to support the contention that income in clause (a sub-section (1) includes business income also, and it is argued that there is no reason why sections 28 to 44C of the Act, the provisions relating to computation of 'profits and gains of business', should be excluded. We are not persuaded to accede to the contention of the learned counsel. We have pointed out above that income in respect of securities, referred to in clause (a)of sub-section (1) of section 115AD, refers to income in the nature of dividends, interest income of debenture and the like. For the purpose of realizing such income, an investor/a FII would naturally engage staff and incur expenditure by way of salaries of the staff etc. incur expenditure in

obtaining loan, pay interest thereon, or incur expenditure of like nature. In our view it is against such deductions that the Parliament guarded against by providing in clause (a) of sub-section(2) of section 115AD of the Act stating that no deduction shall be allowed in computing income in respect of securities referred to in clause(a) of sub-section (1). If we read section 115AD in conjunction with the regulations 12(3) of SEBI Regulations whereunder a sub-account of FII is registered as FII for the limited purpose of deriving the benefit under section 115AD, it becomes clear that this is for the purpose of deriving the benefit of reduced rates of tax.

23. The circumstances and the framework of the plethora of legislative provisions unmistakably point out that a FII is not registered for carrying on trade in securities; it can only invest in securities for the purpose of earning income by way of dividends and interest and realizing capital gains on their transfer."

Therefore, the settled legal position is that FIIs are not engaged in trading business. The facts of the present three cases also show that the shares were purchased as investors and not as traders. In their books of accounts also they have treated this as capital investment.

12. The Circular No.4 of 2007 issued by the CBDT quotes three principles laid down by this Authority in the case of Fidelity Group 288 ITR 641 in order to determine whether shares held are investment or stock-in-trade. First principle is how the shares were valued in the books of accounts, i.e., whether they were valued as stock-in-trade or held as investment. In this case the books of accounts show that the shares were held as investment.

The second principle is to verify whether there are substantial transactions, their magnitude etc, maintenance of books of accounts and finding the ratio between purchases and sales. In this case the shares of Satyam were purchased, held as investment and sold only after the fraud became public. The third principle suggests that ordinarily purchases and sales of shares with the motive of realizing profit would lead to inference of trade/adventure in the nature of trade; where the object of the investment in shares of companies is to derive income by way of dividends etc, the transactions of purchases and sales of share would yield capital gains and not business profits. This principle also suggests that in this case the object of the investment is not to have business profit because the shares of Satyam were not being purchased and sold at regular interval. In the light of this even CBDT Circular No.4 of 2007 does not support the stand of Revenue that Aberdeen investors were engaged in trading business.

13. The next point to be considered is whether the settlement amount was received to compensate part of the business receipt as claimed by the Revenue or it was received because a fraud was committed by Satyam and PwC as a result of which the claims in deceit and fraudulent misrepresentation in respect of losses suffered by the Aberdeen investors in relation to Satyam shares was received. There is no doubt that the settlement amount is relatable to Satyam shares, i.e., if shares would not have been purchased the question of class action or right to sue would not have arisen. However, this does not mean that the settlement arrived with the approval of the US Court is to compensate business receipt of Aberdeen investors. The fact remains that the Aberdeen investors entered into a settlement agreement with Satyam considering the time, effort and costs involved in litigation and the agreement provided for a full, final and

complete resolution of all claims asserted or which could have been asserted with respect to the released claims. The Aberdeen investors fully, finally and forever waived, released, discharged and dismissed each and every of their legal claims against Satyam and PwC. This was also agreed vice versa. It is clear, therefore, that the settlement amounts have been received not as part of business profit or to compensate the future income but as a result of surrender of the claim against Satyam and PwC. Surely, even in accordance with the principle of surrogatum such amount is not assessable as income because it does not replace any business income.

14. In the light of above it is concluded that the settlement amount received by Aberdeen investors is not taxable under the provisions of the Income-tax Act and question No.1 of all three applications is answered accordingly. In view of this ruling of question No.1 of all three applications, there is no need to answer other consequential questions.

The Ruling is accordingly given and pronounced on this day of 19th January, 2016.

(V.S. Sirpurkar)
Chairman

(A.K. Tewary)
Member