AMRG & ASSOCIATES
CHARTERED ACCOUNTANTS

ITAT: Compensation for giving up the "right to sue" is not considered a taxable capital gain

Virendra Bhavanji Gala [TS-505-ITAT-2023(Mum)]
Sep 11, 2023


CA Om Rajpurohit & Adv. Sakshi Bhardwaj
-AMRG & ASSOCIATES

Facts of the case

The assessee received compensation due to a breach of contract by a builder. The dispute centered around whether this compensation should be subject to capital gains tax or not.

Assessee's contention

The assessee argued that the compensation received for the breach of contract should not be considered a capital receipt but rather as a capital asset. This argument was based on the specific circumstances of the case, where specific performance of the contract was not possible due to the project being aborted. The assessee contended that the compensation was not for the right to sue but rather for the loss incurred due to the breach.

Revenue's contention

The revenue, represented by the Principal Commissioner of Income Tax (PCIT), contended that the compensation constituted consideration for the right to sue and should be treated as taxable capital gains. The PCIT relied on the judgment of M/s. Vijay Flexible Containers to support this position, emphasizing that the compensation was essentially for the right to initiate legal proceedings.

Held

The court held that the compensation received by the assessee for the breach of contract should not be subject to capital gains tax. The judgment considered the specific circumstances of the case and the legal arguments presented. It emphasized that the compensation was not

not in exchange for the right to sue but rather for the loss incurred due to the breach of contract. The court also cited various High Court judgments, including CIT vs. Dalmia and Baroda Cement & Chemicals Ltd. vs. CIT, to support the position that damages received for the right to sue for damages are capital receipts and not taxable under capital gains. The PCIT's order invoking Section 263 was set aside, and the AO's assessment order was upheld. Consequently, the appeal of the assessee was allowed.

AMRG Take

This case highlights the importance of considering the specific circumstances and legal arguments when determining the taxability of compensation for contract breaches. It clarifies that compensation for the right to sue for damages may not be treated as taxable capital gains, especially when specific performance of the contract is not feasible. The case also underscores the relevance of past High Court judgments in shaping tax liability decisions.

NEW DELHI
AMRG Tower, 23,
Paschim Vihar Ext.,
Main Rohtak Road,
New Delhi-110063

Rajat Mohan
Senior Partner
rajat@amrg.in

Priyanka Sachdeva
Partner - GST
priyanka@amrg.in

MUMBAI
304,Green Meadows C
H S Ltd, Lokhandwala
Township, Kandivali,
East Mumbai,400101

Madhu Mohan
Founding Partner
amrg@amrg.in

Kiran Awasthi Raghavendra
Partner - Assurance and Compliance
amrg@amrg.in

DEHRADUN
Villa No. 12, Upper Crest Avenue,
Jakhan, Rajpur Road, Dehradun,
Uttarakhand, India, 248001

Swati Ghoshal
Partner - Risk Advisory and compliance
swati@amrg.in

GURUGRAM,
204, 2nd Fllor, Time Center, Golf
Course Road, Sector 54, Gurugram,
Haryana 122002

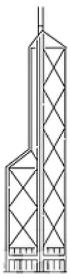
Gaurav Mohan
CEO
gaurav@amrg.in

INTERNATIONAL BRANCH -
AUSTRALIA
Unit 9, 14-15 Junia Avenue,
Toongabbie NSW 2146,
Sydney, Australia

Megha Gandhi
Director- Australia
amrg@amrg.in

INTERNATIONAL DESK - USA
Wiener & Garg LLC,
6000 Executive Boulevard,
Suite 520 | Rockville,
MD 20852T: 301.881.4244
D: 240.833.4002

Subhash Garg
Wiener & Garg LLC
amrg@amrg.in



INTERNATIONAL BRANCH
HONG KONG
Hong Kong Address - Flat B,
Floor 1, Tower - 7, Yee Mei Court,
South Horizons, ap lei chau,
Hongkong

Divya Malhotra
Director - Hong Kong
amrg@amrg.in