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Damages received by Swiss company in India is not taxable under Article 22 of the India-Swiss DTAA

Compensation received by Swiss company for breach of contract in India, was not in the nature of a 'windfall gain' under Article 22 of the India-Swiss DTAA

The Delhi High Court vide order dated 31 July 2019 in Xstrata Coal Marketing AG (decree holder) vs Dalmia Bharat (Cement) Ltd. (judgement debtor) (EX.P. 334/2014), has held that the compensation received by the decree holder towards damages for breach of contract in India, was not in the nature of a 'windfall gain' and hence not taxable as 'Other income' under Article 22 of the India-Switzerland DTAA.

Facts of the case

Xstrata Coal Marketing AG (decree holder), a company and a tax resident of Switzerland, filed an execution petition before the Delhi High Court seeking execution of two foreign awards - award of compensation towards damages for breach of contract and award of cost of arbitration, legal costs respectively.

The Dalmia Bharat (Cement) Ltd. (judgment debtor) had filed objections before Delhi High Court against the above award of decree holder which were dismissed *vide* judgment dated 07 November 2016. Further, a special leave petition filed by the judgment debtor before the Supreme Court, was also dismissed.

Pursuant to the order passed by the High Court, the judgement debtor had deposited the amount. However only part of the amount was released and the remaining was retained to ascertain with income-tax department on whether withholding tax is required be done on the above awards paid to the decree holder.

The Income-tax department in the affidavit submitted, has prima facie taken the following view on the awards, which was also relied upon during the High Court proceedings, subject to final assessment proceedings of the decree holder:

- **Compensation towards damages for breach of contract:** This is income of decree holder from a source in India and taxable as 'income from other sources' in absence of Permanent Establishment (PE) in India. As per Article 22 of the Double Tax Avoidance Agreement between India and Swiss Confederation (DTAA) such income from other sources is not taxable in India unless it is in the nature of income from lottery, card games, puzzles etc. The income received by the decree holder is in the nature of windfall gains and so is taxable in India as per Article 22(3) of the DTAA. So tax should be deducted at source at the rate of 42.024 percent.
- **Cost of arbitration proceedings and Legal Costs:** This portion of the award is incurred on engaging professional experts like lawyers etc. for the purposes of arbitration and so taxable as Fee for Technical Services from which tax should be deducted at least at the rate of 10 percent per DTAA.
- **Interest on above award payments:** Interest income should be taxable in India and so tax should be deducted at the rate of 10 percent as per the DTAA.

Decision of Delhi High Court

The High Court held that amount received by the decree holder as compensation towards breach of contract should not fall within the ambit of Article 22(3) of the DTAA. The language of Article 22(3) of the DTAA is unambiguous and only income received from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting of any nature only can be taxed, if at all, in India. Therefore, the stand of the income tax department was not accepted.

The High Court also rejected the stand taken by the income-tax department with respect to the award towards arbitration and legal costs as 'fees for technical services', being completely erroneous as the same cannot be the income of the decree holder. With respect to taxability of interest on the above awards, the court held that it cannot be taxed under article 22(3) of the DTAA.

The Delhi High Court also held that assessment proceedings, if any, can only commence against the judgment debtor and not against the decree holder.

The Delhi High Court referred to the judgements[1] relied by the Decree holder, and noted that these judgments do enunciate the principle, which is, that once a claim merges into a decree of the court it transcends into a judgment-debt and, therefore, only those adjustments and deductions can be made which are permissible under the Code of Civil Procedure, 1908. The judgments encapsulate the theme that a decree should be executed according to its tenor, unless modified by a statute such as the 1961 Act.

Accordingly, the Registry was directed to release the remaining amount available with it along with accrued interest to the decree holder without deducting any sum towards withholding tax.

Comment

The Courts generally have taken the view that once a claim merges into a decree of the court it transcends into judgement debt, and so the amount of judgemental debt should be capital receipt not taxable in India.

The Authority for Advance Ruling in AAR/1060 & 1078/2010 in a re-hearing pursuant to court decision, vide its order dated 12 January 2015 had reversed its earlier ruling, and ruled that "The settlement amount payable/paid by Satyam under the stipulation to the QSF pursuant to the judgment and final approval of the US Court, cannot be regarded as sum chargeable under the provisions of the Act in the hands of QSF".

However, the Delhi High Court has not discussed in detail why the interest on the delayed payment of compensation should not be taxable in India and has commented on Article 22 of the DTAA but not referred to Article 11 (relating to Interest) of the DTAA. There are conflicting decisions on whether interest received on delayed payments of judgemental debt is income taxable in India.

Further the Delhi High Court has not commented on whether the decree holder had withheld tax on the legal/arbitration cost, sought reimbursement from the judgemental debtor, which may not be arising from this appeal. The tax official had raised the point on flow through - that the payment by judgment debtor to decree holder appears to be a reimbursement. However

[1] All India Reporter v. Ramachandra D. Datar, (1961) 2 SCR 773; V.K. Dewan v. DDA, execution Petition No. 194/2005, Delhi High Court. Sino Ocean Limited v. Salvi Chemical Industries Limited, Chamber Summons No. 76/ 2013 in Execution Application (Lodg.) No. 263/2012. American Home Products Corporation v. MAC Laboratories Pvt. Ltd. and Anr., (1986) 1 SCC 465. Islamic Investment Company v. Union of India (UOI) and Anr.,2002 (4) BOMCR 685; S.S. Miranda Ltd. v. ShyamBahadur Singh, (1985) 154 ITR 849.

the money is to flow from judgment debtor to decree holder and from decree holder to legal/technical experts.

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