

16th September 2022

TAXABILITY OF ARBITRATION AWARD UNDER SECTION 56(1) OF THE INCOME TAX ACT, 1961 - CASE STUDY OF THE ITAT DECISION IN RAMONA PINTO

Sambhav Choudhary
Associate, MCO Legals,
LLM (Dispute Resolution), Queen Mary University of London
Expertise: Commercial Litigation

Amit Singhal
Research Partner
LL.M. and B.A .LL.B. (Hons), National Law Institute University

1. INTRODUCTION

- 1.1 With increasing pendency in the traditional courts owing to a rise in commercial disputes, the Arbitration and Conciliation Act was enacted in the year 1996 in a bid to further solidify India's status as an arbitration friendly country, in the widest sense. Various nuanced judgments have since arrived to bolster the legal jurisprudence vis-à-vis arbitration in India and its related implications.
- 1.2 A recent judgment of the Mumbai Bench of the Income Tax Appellate Tribunal ["ITAT"] has shed light on the issue of taxability of arbitral award in India. The ITAT in *Assistant Commissioner of Income Tax, Mumbai v. Ramona Pinto*¹, while affirming the decision of the Commissioner of Income-Tax (Appeals) ["CIT (A)"] and the Income Tax Tribunal ["Tribunal"], has held that an arbitration award stemming from settlement terms between the parties is taxable under the heading "Income from other sources" as per Section 56(1) of the Income Tax Act, 1961 ["the Act"].
- 1.3 The aforesaid judgment, herein, has been examined through the lens of "taxability of an arbitration award" and also deliberates whether the ITAT was correct in its decision of upholding the abovementioned decision of the Tribunal.

2. BACKGROUND OF THE CASE

- 2.1 Ramona Pinto ["the Assessee"] was a partner in a partnership firm ["the Firm"], wherein pursuant to a fresh partnership deed executed in the year 1997 the name of the Assessee was excluded from the partnership without her consent, giving rise to a dispute.
- 2.2 The dispute was contested vide arbitration proceedings whereby the Assessee was awarded a sum of INR 28 crores ["Award/ Income"], part of which having already been paid to the Assessee by the Firm.
- 2.3 The Award made no mention of her retirement from the Firm. Hence, it is unclear whether the Award was in lieu of retirement of Assessee from the firm.

- 2.4 Notably, however, the Award was made pursuant to mutually agreed Consent Terms, which recorded, amongst others, withdrawal of the Assessee's rights and interests in the Firm and its assets as well as withdrawal of all lawsuits against the Firm and the existing partners.
- 2.5 A Show Cause Notice was issued by the Assessing Officer ["AO"] to the Assessee pursuant to which, an amount of Rs. 28 crores was added to the income of the Assessee and the same was deemed "Income from business" under Section 28(iv) of the Act. The Assessee contested the aforesaid assessment before the CIT (A).
- 2.6 The CIT (A) although concurred that the Award was taxable, deemed the same as "Income from other sources" under Section 56(1) of the Act instead of "Income from business".
- 2.7 Both the Assessee and the Revenue filed appeals against the decision of the CIT (A) before the Tribunal, which upheld the decision of the CIT (A).
- 2.8 The aforesaid judgment of the Tribunal was further challenged by the Revenue before the ITAT in the instant matter.

3. THE ISSUE BEFORE ITAT

- 3.1 The only issue before the ITAT was whether the Award was correctly assessed by CIT (A) under the heading 'income from other sources' under Section 56(1) of the Act?

4. FINDINGS

- 4.1 The ITAT held that the Tribunals' judgment, which upheld the decision of the CIT (A), had already covered the major issue at hand.
- 4.2 The following observations were made in the Tribunals' judgment:-
 - 4.2.1 The settlement amount of Rs. 28 crores, as recorded in the Consent Terms, was in lieu of specific conditions which had no connection whatsoever to the interest of the Assessee in the Firm or its assets.

¹ I.T.A. No. 582/Mum/2018

- 4.2.2 There was no determination or calculation, in the Consent Terms or the arbitral award, regarding the share of the Assessee in the Firm, suggesting that the Award was not in lieu of her retirement from the Firm.
- 4.2.3 There was no positive balance of the Assessee in her account with the Firm, hence, the same could not possibly be returned back to the Assessee.
- 4.2.4 As standard practice upon retirement from a partnership firm, the share in the firm is determined by drawing of accounts in the manner prescribed by the relevant provision of law. However, no such determination made in the instant scenario.
- 4.2.5 Retirement of a partner from the firm has to be evident rather than to be indirectly inferred or to be guessed in substance.
- 4.2.6 Therefore, the Award could not be said to have been given on account of her retirement from the firm.
- 4.2.7 Furthermore, it was judicially settled principle that special income must be considered in its wider sense, since the definition of income is an inclusive one having a wide amplitude.

5. ANALYSIS

5.1 Arbitral Award as a Judgment-Debt and its Taxability

- 5.1.1 Section 36 of the Arbitration and Conciliation Act, 1996 as amended, for the purpose of enforcement, deems an arbitral award “as if it were a decree of a court”.
- 5.1.2 In *Glencore International AG vs. Dalmia Cement (Bharat) Limited*², the Hon’ble Delhi High Court, as *obiter dicta*, observed that once a claim acquires the status of decree of the Court, the same gets converted to a judgment-debt.
- 5.1.3 Applying the relevant laws to the facts herein, the Award can be deemed a judgment-debt against the Firm and the Assessee can be deemed the Decree-Holder³ vis-à-vis the Award.
- 5.1.4 The Hon’ble Bombay High Court in *Emil Webber vs. Commissioner of Income-Tax*⁴ has observed that the definition of “income” as per Section 2(24) of the Act is an inclusive definition and not an exhaustive one.
- 5.1.5 In the case of *FGP Ltd. Vs. Commissioner of Income-Tax*⁵, the Hon’ble Bombay High Court held that test in order to determine if an income can be taxed is whether there was a real accrual of income. The Hon’ble High Court further stated that only upon the arbitration award being passed and the income thereof being received by the assessee, will the same be liable to be assessed.
- 5.1.6 As recorded in the instant judgment, a part of the Award was already paid to the Assessee by the Firm and the same would be treated as actual accrual. Therefore, only the balance Award that still remained to be a judgment-debt was not liable to be assessed. Contrastingly, the amount that actually accrued can be treated as “income” for the purpose of assessment.
- 5.1.7 Further, the general rule is that all amounts are taxable unless the assessee shows that the amount is exempted under the laws relating to taxation in India.

5.2 Taxability of the Award under Section 56(1) of the Act:

- 5.2.1 An arbitration award is taxable if there has been a real or actual accrual of income.
- 5.2.2 As noted in the instant judgment, the accepted practice upon retirement from a firm is that the share in the partnership is worked out by drawing of accounts in the manner prescribed by the relevant laws.
- 5.2.3 However, in the present fact scenario, the Assessee had not been able to provide any explanations or calculation in respect of her share in the asset of the firm and had instead made a general statement that the same was based on the market value of the asset of the firm.
- 5.2.4 Even before the CIT (A), the Assessee merely submitted a valuation report of the assets, the same being inconclusive about her share in the firm. The Assessee failed to produce any evidence which would help effectively deduce the nature of the Income for the purpose of assessment under the suitable heading.
- 5.2.5 As also observed by the ITAT, the Award was in the nature of settlement since the Assessee received the money in lieu of surrendering her rights and interests in assets that had no connection with her interest in the firm as well as withdrawing lawsuits against the existing partners.
- 5.2.6 In order to deal with residuary incomes, the wordings of Section 56(1) of the Act has been kept wide enough to include any amount received by way of arbitral award under the head ‘Income from other sources’, if the same is not assessable under any other heads of income as stipulated in Section 14 (items A to E) of the Act.

- 5.2.7 Hence, the ITAT rightly upheld the decision of the Tribunal and the CIT (A), that the amount/ income received by the Assessee was taxable under the head ‘Income from other sources’ under Section 56(1) of the Act.

6. CONCLUSION

- 6.1 The taxability of an arbitral award depends on the nature of the award⁶. However, due to limited ground, the taxability of the Award herein requires little deliberation since the Assessee was not able to justify exemption of the income received vide the Award from assessment. Moreover, the Assessee also could not produce any evidence to help ascertain the correct nature of the income. In the absence of the aforesaid, the CIT (A) was correct to decide that the Award was taxable under Section 56(1) of the Act. Besides, Section 56(1) provides sufficiently wide interpretation of the term “income” to virtually encompass income of every kind, especially in absence of unambiguous evidence proving the correct nomenclature to be that of “Income from business” as per Section 28(iv) of the Act. The decision of the CIT (A) and the Tribunal, thereafter, was legally sound considering as well that a part of the Award had already actually accrued when the same was paid by the Firm to the Assessee.

A copy of the judgment is annexed hereto at **page 3 to 10**.

² 2019 SCC OnLine Del 9634

³ “Decree-Holder” defined in Section 2; Sub-section (3) of the Code of Civil Procedure, 1908.

⁴ 1978 SCC OnLine Bom 224

⁵ 2008 SCC OnLine Bom 1505

⁶ In *ITO v. Ganeshsagar Infrastructure Pvt. Ltd.* [I.T.A. No. 1535/Ahd/2018], the ITAT held that arbitral award received for release of right to sue due to breach of contract is not capital receipt and hence, not taxable as such.

IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY (JUDICIAL MEMBER)
AND
SHRI RAJESH KUMAR (ACCOUNTANT MEMBER)

I.T.A. No.582/Mum/2018
(Assessment Year : 2010-11)

Assistant Commissioner of Income-tax-23(3), Mumbai	vs	Mrs. Ramona Pinto Flat No.52, Ivorick, St. Cyrills Road Bandra (W), Mumbai-400 050 PAN : AGIPP7514N
APPELLANT		RESPONDENT

Appellant by	Smt. R.M. Madhavi, CIT(DR)
Respondent by	Shri Nitesh Joshi, AR

Date of hearing	01-09-2021
Date of pronouncement	13-09-2021

ORDER

Per : Saktijit Dey (JM)

This is an appeal by the revenue against the order dated 03-02-2017 of learned Commissioner of Income Tax (Appeals)-34, Mumbai for the assessment years 2010-11.

2. At the outset, we must observe, registry has pointed out a delay of 254 days in filing the appeal. Vide letter dated 31-01-2018, revenue has explained the cause of delay, as under:-

*"To,
The Sr. Registrar,
Income Tax Appellate Tribunal,*

Mumbai.

Sir,

Sub: Request for condonation of delay in filing Appeal U/s before ITAT in the case of Mrs. Ramona Pinto for A.Y. 2010-11.

Kindly refer to the above.

2. In the instant case, the order of the CIT(A) vide order No. CIT(A)-34/DCIT 23{3}/IT-91/15-16 dated 03.02.2017 was received in this office on 23rd March 2017. In the order, the Assessee's appeal was dismissed. Thus the appeal, if any, was to be filed before the ITAT on or before 23rd May 2017, the time barring date.

3. It is humbly submitted that, in the instant case, due to oversight and also the fact that the CIT(A) has dismissed the appeal of the assessee, the Appeal could not be filed in time. However, on verification of records, it was found that the Ld. CIT(A) has erred in deciding that the consideration received by the assessee should be assessed u/s 56(1) whereas the Assessing officer had rightly added the amount u/s 28(iv) as the said arbitration award was in nature of one time compensation and was squarely covered u/s 28(iv).

4. Therefore, as the decision of the CIT(A) was erroneous and appeal should have been filed before the ITAT within prescribed time limit which was not filed due to oversight. It is requested that the delay of 254 days in filing the appeal before the ITAT against the order of the CIT(A) may kindly be condoned and this office may be allowed to file appeal before the ITAT in the instant case."

3. After perusing the contents of the condonation application and considering the submissions of the parties, we are satisfied that the delay in filing the appeal is due to a reasonable cause. Hence, we condone the delay and admit the appeal for adjudication on merit.

4. The effective ground raised by the revenue reads as under:-

"1. "On the facts and circumstances of the case and in law, the Ld. CIT(A) has erred in deciding that the consideration received by the assessee should be assessed U/s 56(1) whereas the Assessing Officer had rightly added the amount U/s 28(iv) as the arbitration award was in the nature of one time compensation and was completely covered U/s 28(iv)."

5. Briefly the facts are, the assessee is an individual. For the assessment year under dispute, assessee had filed her return of income on 16-07-2010 declaring total income of Rs.18,91,589/-. Subsequently, the assessing officer received information from the assessing officer having jurisdiction over another assessee, viz. M/s P.N. Writer & Co that the assessee has been awarded an amount of Rs.28 crores as settlement through an arbitration award and a part of that award has been received by the assessee in the impugned assessment year. After issuing a show cause notice to the assessee to explain why the amount awarded by the Arbitrator should not be treated as income and considering assessee's explanation, the assessing officer added back an amount of Rs.28 crores to the income of the assessee by treating it as income from business. Assessee contested the aforesaid addition before learned Commissioner (Appeals). After considering the submissions of the assessee and examining the facts on record in the light of decisions relied upon, learned Commissioner (Appeals), though, agreed that the amount awarded by the Arbitrator is taxable in the impugned assessment year; however, he was of the view that it cannot be treated as income from business under section 28(iv) of the Act. On the contrary, he held that the amount of Rs.28 crores is taxable as "Income from other sources" under section 56(1) of the Act. Against the decision of learned Commissioner (Appeals), both the assessee and revenue filed appeals before the Tribunal.

6. At the outset, learned counsel for the assessee submitted, while deciding assessee's appeal on identical issue, the Tribunal has upheld the decision of learned Commissioner (Appeals) in holding that the amount received by virtue of arbitration award is taxable under the head "Income from other sources" under

section 56(1) of the Act. Thus, he submitted, the issue is squarely covered by the decision of the Tribunal.

7. The learned departmental representative, though, agreed that the issue is covered by the decision of the Tribunal; however, she relied upon the observations of the assessing officer.

8. We have considered rival submissions and perused materials on record. Pertinently, against the decision of the learned Commissioner (Appeals) holding that the amount of Rs.28 crores awarded by the Arbitrator is taxable as "Income from other sources" under section 56(1) of the Act, both, the assessee and the revenue filed appeals in the Tribunal. While deciding assessee's appeal in ITA No.3523/Mum/2017 dated 02-04-2018, the Tribunal upheld the decision of learned Commissioner (Appeals) with the following observations:-

"20. As regards the merits of the case, we find that the assessee has received an arbitration award for Rs.28 crores, upon relinquishment of her rights in the partnership of M/s. P. N. Writer & Co. Here it may be gainful to recount the brief history of the case which leads to the arbitration award. The assessee was a partner in M/s P.N.Writer & Co. A fresh partnership deed was executed in 1997 wherein the name of the assessee was excluded from the partnership firm. However, as claimed by the assessee, this new partnership deed was prepared without her consent and she was shown as retired from the said firm without her knowledge. The assessee, therefore, filed various suits against the partners, firm and various entities held by the partnership firm. Ultimately, the assessee was granted arbitration award of Rs.28,00,00,000/- on 25.09.2009 by the Arbitrator appointed by the Hon'ble Supreme Court as per mutually agreed Consent Terms for relinquishment of all her rights and benefits in the firm and for withdrawal of all claims against the partners, firm and entities held by partners, The arbitration award, however, made no mention of whether the assessee was actually retired from the firm in 1997.

21. In this regard, it may also be gainful to refer to certain points of the consent term which read as under:

(i) The Consent Terms did not speak anything about retirement of Mrs. Ramona Pinto from the partnership firm M/s P.N. Writer & Company.

(ii) It was nowhere mentioned in Consent Terms that the arbitration amount of Rs. 28 crores was an amount awarded to Mrs. Ramona Pinto for her retirement from M/s P.N. Writer & Company.

(iii) The amount awarded to the appellant was also for withdrawal of her rights and bequests made to her under the Will dated 16.09.1990 of her late father Shri Charles D'Souza.

(iv) The arbitration award was given not only for withdrawal of Suit against partners and partnership firm but it was also granted for withdrawing all the Suits against entities owned and controlled by the partners.

(v) Condition No.9 of Consent Terms stated that the appellant and her husband Etienne Pinto had no interest in properties listed in clause 9 and they would ensure execution of necessary documents for transfer of properties which presently stood in their names in favour of existing partners. This condition had no reference with the retirement of the appellant from the partnership firm.

(vi) As per condition no.12, the appellant's husband was also required to sign the Consent Terms in acceptance of his obligations as set out in the Consent Terms. Though her husband had no relation to M/s P.N.Writer & Co., it was agreed that the husband shall also sign Consent Terms and shall also transfer back assets mentioned in condition no.9 which was in the name of the appellant as well as in the name of her husband.

22. When the above facts are viewed in the light of the fact that there are no positive balance of the capital account of the assessee with M/s. P. N. Writer & Co., the question of the balance in her capital account being returned back to her certainly does not arise. The above facts clearly indicate that the arbitration award was received by the assessee not for retirement from partnership firm but was in lieu of relinquishment of all her rights, claim and demand of any nature whatsoever against the partnership firm M/s P.N.Writer & Co. and all other entities owned and controlled by the firm and partners and for withdrawing all the Suits against all the entities. It is further to be noted here that as per para 9 of the concerned terms, the assessee and her husband who had nothing to do with the said firm in any capacity are to execute all necessary documents to facilitate transfer of properties (listed at a. to f. under para 9 of Consent Terms) presently standing in their names either to the other partners of the firm and/or to persons nominated by them. The Id. Commissioner of Income Tax (Appeals) has further found that this property and assets included the following :

i. 55 equity shares of Rs.1,000 each fully paid up in Ocean air Transport and Investment Company Pvt. Ltd. held in the name of the appellant which has no connection with her interest in the firm or the assets of the firm.

ii. 2001 equity shares of Rs. 1,000 each fully paid up in JOSCO International Shipping Agency Pvt. Ltd. held in the name of Mr. Etienne Pinto, husband of the appellant, which has no connection with her interest in the firm or the assets of the firm.

23. From the above, we agree with the Id. Commissioner of Income Tax (Appeals) that when the arbitration award was given in consideration of the assessee giving certain rights and interests in assets which included rights and interests in assets which have not even a remote connection with her interest in the firm or the assets of the firm, the Arbitration Award cannot be said to be given on account of her retirement from the firm. Further, as rightly observed by the authorities below, the accepted practices upon retirement from the firm is that the share in the partnership ship is worked out by drawing of accounts in the manner prescribed by the relevant provision of the partnership law. His/her share in net partnership asset after deduction of liabilities and prior charges is determined and the same is given to him. In the present case, no such determination regarding the share of the assessee in the partnership firm has been done. The assessee despite request made in this regard by the Assessing Officer has not been able to provide the working of the share in the net asset of the firm and has generally stated that it was based on the market value of the asset of the firm. Before the Id. Commissioner of Income Tax (Appeals) also no detail working has been given except for submitting the valuation report of the assets by way of additional evidence.

24. Thus from the above, it is clear that neither the Arbitration award nor the concerned terms made any mention or a declaration or a decision for a finding that the assessee retired from the firm in the year 1997. Neither does the Arbitration Award or Consent Terms anywhere specify that the sum of Rs.28 crores represents the payment to the assessee for her retirement from P.N.Writer & Co. As a matter of fact, the basis of the Arbitration Award was never given. As rightly observed by the Id. Commissioner of Income Tax (Appeals) that the retirement of a partner from the firm has to be an evident fact and is not required to be indirectly inferred or to be guessed in substance. The assessee has received a consideration in lieu of a composite bundle of conditions which included giving up her rights and interests in assets which have no connection with her interest in the firm or its assets and also for withdrawal of all suits/legal proceedings filed by her against the other persons and against firms and entities owned or controlled by them.

25. As rightly held by the Id. Commissioner of Income Tax (Appeals) since the Arbitration Award is in cash on the touch stone of the Hon'ble jurisdictional High Court decision in

the case of Mahindra & Mahindra Limited v CIT 261 ITR 501, section 28(iv) cannot be invoked. However, the Id. Commissioner of Income Tax (Appeals) is very correct in holding that the same is taxable u/s. 56(1) as income from other sources. The fact remains that the assessee has received benefit of Arbitration Award for conditions, which included giving up her rights and interests in assets which have no connection with her interest in the firm or its assets and also for withdrawal of all suits/legal proceedings filed by her against the respondents (other partners) and against firms and entities owned or controlled by them. This should also be viewed in light of the fact that there is no positive balance of her in the partnership account.

26. Hence, we agree with the Id. Commissioner of Income Tax (Appeals) that it is judicially settled that the special income must be considered in its wider sense. The definition of income is an inclusive one having a wide amplitude. Section 56(1) provides that income of every kind which is not to be excluded from the total income in this Act shall be chargeable to tax income under the head 'income from other sources' if it is not chargeable to income tax under any of the head as specified in section 14. Accordingly, in the background of the aforesaid discussion and precedent, we uphold the order of the Id. Commissioner of Income Tax (Appeals)."

9. Since, while deciding assessee's appeal, the Tribunal has upheld the decision of learned Commissioner (Appeals) that the arbitration award is taxable as "Income from other sources" under section 56(1) of the Act, the issue is squarely covered insofar as the present appeal is concerned and nothing survives to be decided. Therefore, respectfully following the decision of the co-ordinate bench (supra), we uphold the decision of learned Commissioner (Appeals) by dismissing the ground raised.

10. In the result, appeal is dismissed.

Order pronounced on 13/09/2021.

Sd/-

sd/-

(RAJESH KUMAR)	(SAKTIJIT DEY)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Mumbai, Dt : 13/09/2021

Pavanoan

Copy to :

1. Appellant
 2. Respondent
 3. The CIT concerned
 4. The CIT(A)
 5. The DR, ITAT, Mumbai
 6. Guard File
- /True copy/

By Order

Asstt. Registrar, ITAT, Mumbai