Guffic Chem P.Ltd vs C.I.T,Belgaum & Anr on 16 March, 2011

Equivalent citations: 2011 AIR SCW 2580, 2011 (2) AIR KANT HCR 763, AIR 2011 SC (SUPP) 153, (2011) 332 ITR 602, (2011) 3 KCCR 261, (2011) 3 SCALE 595, 2011 (4) SCC 254

Author: S.H. Kapadia

Bench: Swatanter Kumar, K.S. Panicker Radhakrishnan, S. H. Kapadia

REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.2522 OF 2011

(arising out of S.L.P. (C) No. 6081 of 2010)

Guffic Chem P. Ltd. ...

Appellant(s)

versus

C.I.T., Belgaum & Anr. ...

Respondent(s)

WITH

Civil Appeal No.2523 of 2011 (arising out of S.L.P. (C) No. 222 of 2011)

J U D G M E N T

S.H. KAPADIA, CJI Leave granted.

2. Whether a payment under an agreement not to compete (negative covenant agreement) is a capital receipt or a revenue receipt is the question which arises for determination in this case?

FACTS

3. During the assessment year 1997-98 the assessee received `50,00,000/- (Rupees Fifty Lakhs only) from Ranbaxy as non-competition fee. The said amount was paid by Ranbaxy under an agreement dated 31.3.1997. Assessee is a part of Gufic Group. Assessee agreed to transfer its trademarks to Ranbaxy and in consideration of such transfer assessee agreed that it shall not carry on directly or indirectly the business hitherto carried on by it on the terms and conditions appearing in the agreement. Assessee was carrying on business of manufacturing, selling and distribution of pharmaceutical and medicinal preparations including products mentioned in the list in Schedule-A to the agreement. The agreement defined the period, i.e., a period of 20 years commencing from the date of the agreement. The agreement defined the territory as territory of India and rest of the world. In short, the agreement contained prohibitive/restrictive covenant in consideration of which a non-competition fee of `50 lakhs was received by the assessee from Ranbaxy. The agreement further showed that the payment made to the assessee was in consideration of the restrictive covenant undertaken by the assessee for a loss of source of income.

4. On perusal of the said agreement, the CIT (A) while overruling the decision of AO observed that the AO had not disputed the fact that `50 lakhs received by the assessee from Ranbaxy was towards non-competition fee; that under the said agreement the assessee agreed not to manufacture, itself or through its associate, any of the products enlisted in the Schedule to the agreement for 20 years within India and the rest of the world; that the assessee and Ranbaxy were both engaged in the business of pharmaceuticals and to ward off competition in manufacture of certain drugs, Ranbaxy had entered into an agreement with the assessee restricting the assessee from manufacturing the drugs mentioned in the Schedule and consequently the CIT(A) held that the said sum of `50 lakhs received by the assessee from Ranbaxy was a capital receipt not taxable under the Income Tax Act, 1961 (hereinafter for short `the 1961 Act') during the relevant assessment year. This decision was affirmed by the Tribunal. However, the High Court reversed the decision of the Tribunal by placing reliance on the judgment of the Supreme Court in the case of Gillanders Arbuthnot and Co. Ltd. v. CIT, Calcutta 53 ITR 283. Against the said decision of the High Court assessee has come to this Court by way of petition for special leave to appeal, hence this civil appeal. DECISION

5. The position in law is clear and well settled. There is a dichotomy between receipt of compensation by an assessee for the loss of agency and receipt of compensation attributable to the negative/restrictive covenant. The compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capital receipt.

6. The above dichotomy is clearly spelt out in the judgment of this Court in Gillanders' case (supra) in which the facts were as follows. The assessee in that case carried on business in diverse fields besides acting as managing agents, shipping agents, purchasing agents and secretaries. The assessee also acted as importers and distributors on behalf of foreign principals and bought and sold on its own account. Under an agreement which was terminable at will assessee acted as a sole agent of explosives manufactured by Imperial Chemical Industries (Export) Ltd. That agency was terminated and by way of compensation the Imperial Chemical Industries (Export) Ltd. paid for first three years after the termination of the agency two-fifths of the commission accrued on its sales in the territory of the agency of the appellant and in addition in the third year full commission was paid for the sales in that year. The Imperial Chemical Industries (Export) Ltd. took a formal undertaking from the assessee to refrain from selling or accepting any agency for explosives.

7. Two questions arose for determination, namely, whether the amounts received by the appellant for loss of agency was in normal course of business and therefore whether they constituted revenue receipt? The second question which arose before this Court was whether the amount received by the assessee (compensation) on the condition not to carry on a competitive business was in the nature of capital receipt? It was held that the compensation received by the assessee for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capital receipt. This dichotomy has not been appreciated by the High Court in its impugned judgment. The High Court has misinterpreted the judgment of this Court in Gillanders' case (supra). In the present case, the Department has not impugned the genuineness of the transaction. In the present case, we are of the view that the High Court has erred in interfering with the concurrent findings of fact recorded by the CIT(A) and the Tribunal. One more aspect needs to be highlighted. Payment received as non-competition fee under a negative covenant was always treated as a capital receipt till the assessment year 2003-04. It is only vide Finance Act, 2002 with effect from 1.4.2003 that the said capital receipt is now made taxable [See: Section 28(va)]. The Finance Act, 2002 itself indicates that during the relevant assessment year compensation received by the assessee under non- competition agreement was a capital receipt, not taxable under the 1961 Act. It became taxable only with effect from 1.4.2003. It is well settled that a liability cannot be created retrospectively. In the present case, compensation received under Non-Competition Agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide Section 28(va) and that too with effect from 1.4.2003. Hence, the said Section 28(va) is amendatory and not clarificatory. Lastly, in Commissioner of Income-Tax, Nagpur v. Rai Bahadur Jairam Valji reported in 35 ITR 148 it was held by this Court that if a contract is entered into in the ordinary course of business, any compensation received for its termination (loss of agency) would be a revenue receipt. In the present case, both CIT (A) as well as the Tribunal, came to the conclusion that the agreement entered into by the assessee with Ranbaxy led to loss of source of business; that payment was received under the negative covenant and therefore the receipt of `50 lakhs by the assessee from Ranbaxy was in the nature of capital receipt. In fact, in order to put an end to the litigation, Parliament stepped in to specifically tax such receipts under non-competition agreement with effect from 1.4.2003.

8. For the above reasons, we set aside the impugned judgment of the Karnataka High Court dated 29.10.2009 and restore the order of the Tribunal. Consequently, the civil appeal filed by the assessee

is allowed with no order as to the costs.

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9. For the reasons given hereinabove, we affirm the judgment of the Delhi High Court in CIT Vs. Mandalay Investment Pvt. Ltd. decided on 29.07.2009 in ITA No. 728/2009. Consequently, we dismiss the civil appeal filed by the Department against the decision of the Delhi High Court dated 29.07.09 with no order as to the costs.

.....CJI (S. H. Kapadia) .....J. (K.S. Panicker Radhakrishnan) .....J. (Swatanter Kumar) New Delhi;

March 16, 2011