

Shiv Raj Gupta vs Commissioner Of Income-Tax, Delhi Iv on 22 July, 2020

Equivalent citations: AIR 2020 SUPREME COURT 3556, AIR ONLINE 2020 SC 646

Author: R.F. Nariman

Bench: B.R. Gavai, Navin Sinha, R. F. Nariman

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION
CIVIL APPEAL NO. 12044 OF 2016

SHIV RAJ GUPTA

...Appellant

Versus

COMMISSIONER OF INCOME-TAX,
DELHI-IV

...Respondent

JUDGMENT

R.F. Nariman, J.

1. The present appeal relating to assessment year 1995-96 is by one Shri Shiv Raj Gupta, who was the Chairman and Managing Director of M/s Central Distillery and Breweries Ltd. (hereinafter referred to as “CDBL”), which had a unit in Meerut manufacturing beer and Indian Made Foreign Liquor (hereinafter referred to as “IMFL”). The facts leading to an appreciation of the issues raised in this appeal are as follows.

2. By a Memorandum of Understanding (hereinafter referred to as “MoU”) dated 13.04.1994, made between the appellant and three group to as “SWC group”), the appellant, his wife, son, daughter-in-law and two daughters were the registered holders of 1,86,109 equity shares of INR 10 each constituting 57.29% of the paid-up equity share capital of CDBL listed in the Bombay and Delhi Stock Exchanges. The break-up of the shares held by the family members of the appellant and the appellant himself are as follows:

Name of the Shareholder Number of Shares held in CDBL Shiv Raj Gupta (Appellant) 38,999 Jayant Gupta (Appellant’s Son) 44,658 Roopa Gupta (Appellant’s 53,911 Daughter-in-law) Pushpa Gupta (Appellant’s 3,303 Wife) Avanti Pandit (Appellant’s

5,541 Daughter) Arti Kirloskar (Appellant's 2,760 Daughter) Total 1,86,109

3. The said MoU recites that the company employed in its factory 350 employees and around 25 staff and other officers in its other offices. The MoU then refers to a direction of the Supreme Court, which was made by an Order dated 11.03.1994, which made it clear that the company's manufacturing activity at the plant at Meerut was suspended until a secondary effluent treatment plant is installed and made operative by the company. This led to the sale of this controlling block of shares, which was sold at the price of INR 30 per share (when the listed market price of the share was only INR 3 per share). It is stated in the said MoU that the entire sale consideration of Rs.55,83,270/- has since been paid by the SWC group to Shri Gupta, as a result of which Shri Gupta has irrevocably handed over physical possession, management and control of the said brewery and distillery of CDBL to a representative of the SWC group on 10.02.1994. Among the things to be done under the MoU, it was made clear that the nominees of the SWC group would be put in the saddle i.e. be made directors on or before 13.04.1994, so that they will constitute an absolute majority on the board of the company. Importantly, both Shri Shiv Raj Gupta and his son Shri Jayant Gupta (who, together with his wife, is the major shareholder of the family) will resign as Chairman and Managing Director and as Joint Managing Director respectively of CDBL by 13.04.1994. Under Clause 7 of the said MoU, personal guarantees given by the appellant and his son to UCO Bank, IFCI, ICICI and IREDA for loans amounting to INR 8.44 crores will be indemnified against all claims, actions, etc. in respect thereof.

4. By a Deed of Covenant dated 13.04.1994, the MoU signed on the same day was reiterated, and it was then stated in recitals 3 and 4 as follows:

“(3) Over the past years, Mr. Shivraj Gupta has acquired considerable knowledge, skill, expertise and specialization in liquor business.

(4) In furtherance of the purchase of the said shares, SWC have requested Mr. Shivraj Gupta to give a restrictive covenant to and in favour of SWC for not carrying on directly or indirectly any manufacturing or marketing activities, whatsoever, relating to Indian Made Foreign Liquor (IMFL) or Beer for a period of 10 years from the date hereof which Mr. Gupta has agreed to give for the consideration of a non-competition fee of Rs. 6,60,00,00 (Rupees Six crores and sixty lacs only) to be paid by SWC to Mr. Gupta.” The Deed of Covenant is a short document containing two clauses, which are set out as follows:

“1. In consideration of the sum of Rs. 6,00,00,000 (Rupees Six crores only) paid by SWC to Mr. Gupta as an advance against the aforesaid non-competition fee of Rs. 6,60,00,000 (the receipt whereof, Mr. Gupta hereby admits and acknowledges), Mr. Gupta hereby irrevocably agrees, covenants and undertakes that with effect from the date of these presents, Mr. Gupta will not start or engage himself directly or indirectly or provide any service, assistance or support of any nature, whatsoever, to or in relation to the manufacturing, dealing and supplying or marketing of Indian Made Foreign Liquor (IMFL) and/or Beer. The balance amount of Rs. 60,00,000

(Rupees sixty lacs only) will be paid by SWC to Mr. Gupta on 31st October, 1994.

2. This covenant shall remain in full force and effect for a period of 10 years from the date of these presents and this covenant will be absolutely and irrevocably binding on Mr. Gupta.”

5. The bone of contention in this appeal is whether the said Deed of Covenant can be said to contain a restrictive covenant as a result of which payment is made to the appellant, or whether it is in fact part of a sham transaction which, in the guise of being a separate Deed of Covenant, is really in the nature of payment received by the appellant as compensation for terminating his management of CDBL, in which case it would be taxable under Section 28(ii)(a) of the Income Tax Act, 1961. Section 28(ii)(a) reads as follows:

“28. Profits and gains of business or profession. The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession", -

xxx xxx xxx

(ii) any compensation or other payment due to or received by,-

(a) any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;”

6. By an order dated 31.03.1998, the Assessing Officer held that despite the fact that the appellant owned a concern, namely, one M/s Maltings Ltd., which also manufactured IMFL, being a loss making concern, no real competition could be envisaged between a giant, namely, the SWC group and this loss making dwarf, as a result of which the huge amount paid under the Deed of Covenant cannot be said to be an amount paid in respect of a restrictive covenant as to non-competition. It was further held that the son of the appellant was not paid any such non-compete fee or amount despite the fact that he also resigned from his position as Joint Managing Director. It was also held that this was a lump sum payment with no reason as to why such a huge amount of INR 6.6 crores was being paid. It was also found that there was no penalty clause to enforce the performance of obligations under the aforesaid Deed of Covenant, as a result of which, applying the judgment in McDowell & Co. Ltd. v. CTO (1985) 3 SCC 230, the Deed of Covenant was held to be a colourable device to evade tax that is payable under Section 28(ii)(a) of the Income Tax Act, 1961. As a result thereof, this amount was then brought to tax under the aforesaid provision.

7. An appeal from the Assessing Officer to the learned Commissioner of Income Tax (Appeals) was dismissed. When it came before the Income Tax Appellate Tribunal (hereinafter referred to as “Appellate Tribunal”) the learned Accountant Member differed with the learned Judicial Member. The learned Accountant Member held that the two deeds would have to be read separately and that revenue cannot challenge the business perception of the assessee. Further, it was held that there was no colourable device involved, and that, as a result, non-compete fee payable under the Deed of

Covenant was not taxable under Section 28(ii)(a) or any other provision of the Income Tax Act, 1961. The learned Judicial Member on the other hand substantially agreed with the Assessing Officer, as a result of which he decided in favour of the revenue. A reference was then made to a third Member, who was also a Judicial Member. The learned third Member emphasised the fact that a share worth INR 3 was sold for INR 30 under the MoU as a result of transfer of control of the CDBL. It cannot be said that these shares have been undervalued, neither can it be said that there was any collusion or other sham transaction, as a result of which the amount of INR 6.6 crores has escaped income tax. He pointed out that by a letter dated 02.04.1994, a “penalty clause” was provided for in that, out of the amount received by the assessee an amount of INR 3 crore was to be deposited with the SWC group for two years under a public deposit scheme, it being made clear that in case there is any breach of the terms of the MoU resulting in loss, the amount of such loss will be deducted from this deposit. The result, therefore, was that the appeal stood allowed by a majority of 2:1 in the Appellate Tribunal.

8. The revenue preferred an appeal under Section 260-A of the Income Tax Act, 1961 to the High Court. In its grounds of appeal, the revenue framed the substantial questions of law that arose in the matter as follows:

“A) Whether the ITAT has correctly interpreted the provisions of Section 28(ii) of the Income Tax Act, 1961?

B) Whether the Ld. ITAT was correct in holding that receipt of Rs.6.6 crores by the respondent/assessee as non-competitive fee was a capital receipt u/s 28(iv) income tax act and not a revenue receipt as envisaged in Section 28(ii) of I.T. Act?

C) Whether the Ld. ITAT failed to distinguish between nature of capital and nature of benefit in commercial sense in respect of amount of Rs. 6.6 crores received in view of restrictive covenant of deed dated 13.04.1994?

D) Whether Ld. Judicial Member of ITAT was correct in recording his difference of opinion that receipt of Rs. 6.6 crores by respondent/assessee was actually a colourable exercise to evade tax and same was held to be taxable under Section 28(ii) of the Income Tax Act?”

9. By the impugned judgment of the Division Bench of the Delhi High Court dated 22.12.2014, the Division Bench framed the following substantial question of law:

“Whether, on the facts and in the circumstances of the case, the amount of Rs. 6.6 crores received by the assessee from SWC is on account of handing over management and control of CDBL (which were earlier under the management and control of the assessee) to SWC as terminal benefit and is taxable u/s 28(ii) of the Income-tax Act or same is exempt as capital receipt being non-competition fee by executing deed of covenant” After going through the MoU and the Deed of Covenant, both dated 13.04.1994, and copiously referring to the order of the Assessing Officer dated 31.03.1998, the High Court agreed with the Assessing Officer and the first Judicial

Member of the Appellate Tribunal, stating that the Deed of Covenant could not be read as a separate document and was not in its real avatar a non-compete fee at all. However, in its ultimate conclusion, disagreeing with the learned Assessing Officer and the minority judgment of the Tribunal, the High Court went on to state that the said sum of INR 6.6 crores could not be brought to tax under Section 28(ii)(a), but would have to be treated as a taxable capital gain in the hands of the appellant, being part of the full value of the sale consideration paid for transfer of shares.

10. Shri Arvind Datar and Shri Ajay Vohra, learned senior advocates appearing on behalf of the appellant, have taken us through the orders of the Income Tax Authorities, the Appellate Tribunal and the impugned judgment of the High Court. They raised as a preliminary submission the fact that under Section 260-A, it is only the substantial question of law that is framed that can be answered and no other. If some other question is to be answered, the Court must first give notice of the same to both sides, hear them, pronounce a reasoned order and thereafter frame another substantial question of law, which it may then answer. This procedure has not been followed in the present case as it is clear that the substantial question of law framed did not contain within it the question as to whether the assessee can be taxed outside the provisions of Section 28(ii)(a). The entire judgment is, therefore, vitiated and must be set aside on this ground alone. They relied on several judgments to buttress this contention. They then relied upon the judgment of the learned Accountant Member and of the third Member in favour of the assessee and the reasoning therein, which according to them is unexceptionable and should have been followed by the High Court. They also cited judgments to show that prior to 01.04.2003, i.e. before the introduction of Section 28(va) by Finance Act 20 of 2002 with effect from the aforesaid date, any sum received under an agreement for not carrying out any activity in relation to any business was taxed, for the first time, under this provision and the provision not being retrospective would not apply to the facts of the present case.

11. Shri Arijit Prasad, learned senior advocate appearing on behalf of the revenue, read the order of the Assessing Officer and the order of the first learned Judicial Member and adopted the reasoning contained therein. According to him, the High Court judgment correctly applied both McDowell (supra) and Vodafone International Holdings BV v. Union of India (2012) 6 SCC 613 to arrive at the result which it arrived at as it was clear that the amount of INR 6.6 crores that was received by the assessee was really in the nature of payment for the sale of shares. He also argued as an alternative that in any event it would fall under Section 28 (ii)(a) as was correctly held by the learned Assessing Officer and the minority judgment of the Appellate Tribunal.

12. Having heard learned counsel for both parties, we are of the view that the appeal needs to succeed first on the preliminary ground raised by the learned counsel for the appellant. Section 260-A of the Income Tax Act, 1961 reads as follows:

“260-A. Appeal to High Court.

(1) An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal before the date of establishment of the National Tax Tribunal, if the High Court is satisfied that the case involves a substantial question of law. (2) The

Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court and such appeal under this sub-section shall be—

(a) filed within one hundred and twenty days from the date on which the order appealed against is received by the assessee or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner;

(b) [***]

(c) in the form of a memorandum of appeal precisely stating therein the substantial question of law involved. (2A) The High Court may admit an appeal after the expiry of the period of one hundred and twenty days referred to in clause (a) of sub-section (2), if it is satisfied that there was sufficient cause for not filing the same within that period.

(3) Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.

(4) The appeal shall be heard only on the question so formulated, and the respondents shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question :

Provided that nothing in this sub-section shall be deemed to take away or abridge the power of the court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

(5) The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit. (6) The High Court may determine any issue which—

(a) has not been determined by the Appellate Tribunal; or

(b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in sub-section (1). (7) Save as otherwise provided in this Act, the provisions of the Code of Civil Procedure, 1908 (5 of 1908), relating to appeals to the High Court shall, as far as may be, apply in the case of appeals under this section.” This provision, being modelled on a similar provision that is contained in Section 100 of the Code of Civil Procedure, makes it clear that the High Court’s jurisdiction depends upon a substantial question of law being involved in the appeal before it. First and foremost, it shall formulate that question and on the

question so formulated, the High Court may then pronounce judgement, either by answering the question in the affirmative or negative or by stating that the case at hand does not involve any such question. If the High Court wishes to hear the appeal on any other substantial question of law not formulated by it, it may, for reasons to be recorded, formulate and hear such questions if it is satisfied that the case involves such question – See section 260-A (4). Under sub-section (6), the High Court may also determine any issue which, though raised, has not been determined by the Appellate Tribunal or has been wrongly determined by the Appellate Tribunal by reason of a decision on a substantial question of law raised.

13. In *Kshitish Chandra Purkait v. Santosh Kumar Purkait* (1997) 5 SCC 438, this Court referred to Section 100 of the Code of Civil Procedure and then stated:

“10. We would only add that (a) it is the duty cast upon the High Court to formulate the substantial question of law involved in the case even at the initial stage; and (b) that in (exceptional) cases, at a later point of time, when the Court exercises its jurisdiction under the proviso to sub-section (5) of Section 100 CPC in formulating the substantial question of law, the opposite party should be put on notice thereon and should be given a fair or proper opportunity to meet the point. Proceeding to hear the appeal without formulating the substantial question of law involved in the appeal is illegal and is an abnegation or abdication of the duty cast on court; and even after the formulation of the substantial question of law, if a fair or proper opportunity is not afforded to the opposite side, it will amount to denial of natural justice. The above parameters within which the High Court has to exercise its jurisdiction under Section 100 CPC should always be borne in mind. We are sorry to state that the above aspects are seldom borne in mind in many cases and second appeals are entertained and/or disposed of, without conforming to the above discipline.” This statement of the law was followed in *Dnyanoba Bhaurao Shemade v. Maroti Bhaurao Marnor* (1999) 2 SCC 471 (See paragraph 10). A recent decision of this Court in *Biswanath Ghosh v.*

Gobinda Ghosh (2014) 11 SCC 605 has reiterated these principles in paragraph 16 as follows:

“16. Section 100 of the Code lays down the provision with regard to the second appeal which reads as under: “100.Second appeal.—(1) Save as otherwise expressly provided in the body of this Code or by any other law for the time being in force, an appeal shall lie to the High Court from every decree passed in appeal by any court subordinate to the High Court, if the High Court is satisfied that the case involves a substantial question of law.

(2) An appeal may lie under this section from an appellate decree passed ex parte.

(3) In an appeal under this section, the memorandum of appeal shall precisely state the substantial question of law involved in the appeal.

(4) Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.

(5) The appeal shall be heard on the question so formulated and the respondent shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question:

Provided that nothing in this sub-section shall be deemed to take away or abridge the power of the Court to hear, for reasons to be recorded, the appeal on any other substantial question of law, not formulated by it, if it is satisfied that the case involves such question.” From a bare reading of the aforesaid provision it is manifestly clear that an appeal shall lie to the High Court from an appellate decree only if the High Court is satisfied that the case involves a substantial question of law. It further mandates that the memorandum of appeal precisely states the substantial question of law involved in the appeal. If such an appeal is filed, the High Court while admitting or entertaining the appeal must record its satisfaction and formulate the substantial question of law involved in the appeal. The appeal shall then be heard on the questions so formulated and the respondent shall be allowed to argue only on those substantial questions of law.

However, proviso to this section empowers the court to hear on any substantial question of law not formulated after recording reasons”

14. It can be seen that the substantial question of law that was raised by the High Court did not contain any question as to whether the non-compete fee could be taxed under any provision other than Section 28(ii)(a) of the Income Tax Act, 1961. Without giving an opportunity to the parties followed by reasons for framing any other substantial question of law as to the taxability of such amount as a capital receipt in the hands of the assessee, the High Court answered the substantial question of law raised as follows:

“63. In view of the aforesaid discussion, we deem it appropriate and proper to treat Rs. 6.60 crores as consideration paid for sale of shares, rather than a payment under Section 28(ii)(a) of the Act. xxx xxx xxx

65. The substantial question of law is accordingly answered in favour of the appellant-Revenue and against the respondent-assessee but holding that Rs.6.60 crores was taxable as capital gains in the hands of the respondent-assessee being a part of the full value sale consideration paid for transfer of shares.

The appellant-Revenue will be entitled to costs as per the Delhi High Court Rules.” Clearly, without any recorded reasons and without framing any substantial question of law on whether the said

amount could be taxed under any other provision of the Income Tax Act, the High Court went ahead and held that the amount of INR 6.6 crores received by the assessee was received as part of the full value of sale consideration paid for transfer of shares – and not for handing over management and control of CDBL and is consequently not taxable under Section 28(ii)(a) of the Income Tax Act. Nor is it exempt as a capital receipt being non- compete fee, as it is taxable as a capital gain in the hands of the respondent-assessee as part of the full value of sale consideration paid for transfer of shares. This finding would clearly be in the teeth of Section 260-A (4), requiring the judgment to be set aside on this score.

15. Coming to the merits, the High Court found:

“22. ...No doubt, market price of each share was only Rs.3/- per share and the purchase price under the MOU was Rs.30/-, but the total consideration received was merely about Rs.56 lacs. What was allegedly paid as non-compete fee was ten times more, i.e. Rs.6.60 crores. The figure per se does not appear to be a realistic payment made on account of non-compete fee, dehors and without reference to sale of shares, loss of management and control of CDBL. The assessee had attributed an astronomical sum as payment toward non-compete fee, unconnected with the sale of shares and hence not taxable. Noticeably, the price received for sale of shares, it is accepted was taxable as capital gain. The contention that quoted price of each share was mere Rs. 3 only, viz. price as declared of Rs. 30/- is fallacious and off beam. The argument of the assessee suffers from a basic and fundamental flaw which is conspicuous and evident.” This finding flies in the face of settled law. A catena of judgments has held that commercial expediency has to be adjudged from the point of view of the assessee and that the Income Tax Department cannot enter into the thicket of reasonableness of amounts paid by the assessee.

This Court in CIT v. Walchand & Co. (1967) 3 SCR 214 stated as follows:

“It is open to the Tribunal to come to a conclusion either that the alleged payment is not real or that it is not incurred by the assessee in the character of a trader or that it is not laid out wholly and exclusively for the purpose of the business of the assessee and to disallow it. But it is not the function of the Tribunal to determine the remuneration which in their view should be paid to in employee of the assessee. When a claim for allowance under Section 10(2)(xv) of the Income Tax Act is made, the Income Tax Authorities have to decide whether the expenditure claimed as an allowance was incurred voluntarily and on grounds of commercial expediency. In applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of the business, reasonableness of the expenditure has to be adjudged from the point of view of the businessman and not of the Revenue.” [at page 217] The aforesaid judgment was followed by this Court in J.K. Woollen Manufacturers v. CIT (1969) 1 SCR 525 where the Court held:

“As pointed out by this Court in CIT v. Walchand & Co. Private Ltd. [(1967) 65 ITR 381 : (AIR 1967 SC 1435)] in applying the test of commercial expediency for determining whether an expenditure was wholly and exclusively laid out for the purpose of the business, reasonableness of the expenditure has to be adjudged from the point of view of the businessman and not of the Income Tax Department. It is, of course, open to the Appellate Tribunal to come to a conclusion either that the alleged payment is not real or that it is not incurred by the assessee in the character of a trader or it is not laid out wholly and exclusively for the purpose of the business of the assessee and to disallow it. But it is not the function of the Tribunal to determine the remuneration which in their view should be paid to an employee of the assessee.” [at page 529-530] This Court in CIT v. Panipat Woollen & General Mills Co. Ltd. (1976) 2 SCC 5 stated as follows:

“6. Before coming to the facts it may be necessary to mention that there can be no dispute with respect to the two important propositions:

“(1) that in order to fall within Section 10(2)(xv) of the Act the deduction claimed must amount to an expenditure which was laid out or expended wholly and exclusively for the purpose of the business, profession or vocation. This will naturally depend upon the facts of each case, (2) that in order to determine the question of reasonableness of the expenditure, the test of commercial expediency would have to be adjudged from the point of view of the businessman and not of the Income tax Department.” Further, this Court in Shahzada Nand & Sons v. CIT (1977) 3 SCC 432 reiterated this principle as follows:

“4. ...But it is well settled that these factors are to be considered from the point of view of a normal, prudent businessman. The reasonableness of the payment with reference to these factors has to be judged not on any subjective standard of the assessing authority but from the point of view of commercial expediency... ...What is the requirement of commercial expediency must be judged not in the light of the 19th Century laissez- faire doctrine which regarded man as an economic being concerned only to protect and advance his self- interest but in the context of current socio-economic thinking which places the general interest of the community above the personal interest of the individual and believes that a business or undertaking is the product of the combined efforts of the employer and the employees and where there is sufficiently large profit, after providing for the salary or remuneration of the employer and the employees and other prior charges such as interest on capital, depreciation, reserves etc., a part of it should in all fairness go to the employees.” Also, this Court in S.A. Builders Ltd. v. CIT (2007) 1 SCC 781 held as follows:

“36. We agree with the view taken by the Delhi High Court in CIT v. Dalmia Cement (B) Ltd. [(2002) 254 ITR 377 (Del)] that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put

itself in the armchair of the businessman or in the position of the Board of Directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximise its profit.

The Income Tax Authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own viewpoint but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.” The same principle has also been cited with approval by a recent judgment of this Court in *Hero Cycles (P) Ltd. v. CIT* (2015) 16 SCC 359 where the Court held as follows:

“11. Insofar as loans to the sister concern/subsidiary company are concerned, the law in this behalf is recapitulated by this Court in *S.A. Builders Ltd. v. CIT* [*S.A. Builders Ltd. v. CIT*, (2007) 1 SCC 781]. After taking note of and discussing on the scope of commercial expediency, the Court summed up the legal position in the following manner: (SCC pp. 787-88, paras 27-31) xxx xxx xxx

31. It has been repeatedly held by this Court that the expression ‘for the purpose of business’ is wider in scope than the expression ‘for the purpose of earning profits’ vide *CIT v. Malayalam Plantation Ltd.* [*CIT v. Malayalam Plantation Ltd.*, (1964) 53 ITR 140 (SC)] , *CIT v. Birla Cotton Spg. & Wvg. Mills Ltd.* [*CIT v. Birla Cotton Spg. & Wvg. Mills Ltd.*, (1971) 3 SCC 344] , etc.”

12. In the process, the Court also agreed that the view taken by the Delhi High Court in *CIT v. Dalmia Cement (B.) Ltd.* [*CIT v. Dalmia Cement (B.) Ltd.*, 2001 SCC OnLine Del 1447 : (2002) 254 ITR 377] wherein the High Court had held that (SCC OnLine Del para 8) once it is established that there is nexus between the expenditure and the purpose of business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the Board of Directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. It further held that no businessman can be compelled to maximise his profit and that the Income Tax Authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own viewpoint but that of a prudent businessman.”

16. The High Court’s next finding based on the judgment in *Vodafone* (supra) is as follows:

“56. In view of the aforesaid discussion and our findings on the true and real nature of the transaction camouflaged as ‘non-compete fee’, we have no hesitation and reservation that the respondent- assessee had indulged in abusive tax avoidance.”

17. We may only reiterate as correctly found by the majority judgments of the Appellate Tribunal, that:

(i) A share of the face value of INR 10 and market value of INR 3 was sold for INR 30 as a result of control premium having to be paid.

(ii) It is important to note that each member of the family was paid for his/her shares in the company, the lion's share being paid to the assessee's son and wife as they held the most number of shares within the said family.

(iii) The non-compete fee of INR 6.6 crores was paid only to the assessee. This was for the reason stated in the Deed of Covenant, namely, that Shri Shiv Raj Gupta had acquired considerable knowledge, skill, expertise and specialisation in the liquor business. There is no doubt that on facts he has been Chairman and Managing Director of CDBL for a period of about 35 years; that he also owned a concern, namely M/s Maltings Ltd., which manufactured and sold IMFL and beer and that he was the President of All India Distilleries Association and H.P. Distilleries Association.

(iv) It is further recorded in the judgment of the Accounting Member that the amount of INR 6.6 crores was arrived at as a result of negotiations between the SWC group and the appellant.

(v) That the restrictive covenant for a period of 10 years resulted in the payment of INR 66 lakhs per year so that the appellant "...will not start or engage himself, directly or indirectly, or provide any service, assistance or support of any nature, whatsoever, to or in relation to the manufacturing, dealing and supplying or marketing of IMFL and/or Beer." Given the personal expertise of the assessee, the perception of the SWC group was that Shri Gupta could either start a rival business or engage himself in a rival business, which would include manufacturing and marketing of IMFL and Beer at which he was an old hand, having experience of 35 years.

(vi) As was correctly held by the second Judicial Member, it was also clear that the withholding of INR 3 crores out of INR 6.6 crores for a period of two years by way of a public deposit with the SWC group for the purpose of deduction of any loss on account of any breach of the MoU, was akin to a penalty clause, making it clear thereby that there was no colourable device involved in having two separate agreements for two entirely separate and distinct purposes.

18. The reasons given by the learned Assessing Officer and the minority judgment of the Appellate Tribunal are all reasons which transgress the lines drawn by the judgments cited, which state that the revenue has no business to second guess commercial or business expediency of what parties at arms-length decide for each other. For example, stating that there was no rationale behind the payment of INR 6.6 crores and that the assessee was not a probable or perceptible threat or competitor to the SWC group is the perception of the Assessing Officer, which cannot take the place of business reality from the point of view of the assessee, as has been pointed out by us hereinabove. The fact that M/s Maltings Ltd. had incurred a loss in the previous year is again neither here nor there. It may in future be a direct threat to the SWC group and may turn around and make profits in future years. Besides, M/s Maltings Ltd. is only one concern of the assessee – it is the assessee's

expertise in this field on all counts that was the threat perception of the SWC group which cannot be second guessed by the revenue. Equally the fact that there was no penalty clause for violation of the Deed of Covenant, has been found by us to be incorrect given the letter dated 02.04.1994. The fact that the respondent-assessee in his letter dated 26.03.1998 in reply to the show cause notice had stated that the SWC group had gained substantial commercial advantage by the purchase of shares in CDBL as the turnover increased from INR 9.79 crores in the accounting period ending 31.03.1991 to INR 45.17 crores in the accounting period ending 31.03.1997 is again neither here nor there. As a matter of fact, the SWC group, due to its own advertisement and marketing efforts, may well have reached this figure after a period of six years (the date 30.09.1995 is wrongly recorded by the High Court in paragraph 19 – the correct date as per the letter dated 26.03.1998 is 31.03.1991, as has been pointed out by us hereinabove).

19. It only remains for us to point out the judgment in *Guffic Chem (P) Ltd. v. CIT* (2011) 4 SCC 254. In this case, the question set out by the Court is as follows:

“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?” Here, the Court was dealing with an amount of INR 50 lakhs received by the appellant-assessee from Ranbaxy as a non-compete fee under an agreement dated 31.03.1997. This Court in negating the application of Section 28(ii)(a) to such receipt, held as follows:

“Decision

4. 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.

5. The above dichotomy is clearly spelt out in the judgment of this Court in *Gillanders* case [(1964) 53 ITR 283 (SC)] , 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 the assessee acted as a sole agent of explosives manufactured by Imperial Chemical Industries (Export) Ltd. That agency was terminated and by way of compensation 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.

Imperial Chemical Industries (Export) Ltd. took a formal undertaking from the assessee to refrain from selling or accepting any agency for explosives.

6. Two questions arose for determination in Gillanders case [(1964) 53 ITR 283 (SC)] , 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.

7. 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 [(1964) 53 ITR 283 (SC)] . 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 CIT (A) and the Tribunal.

8. One more aspect needs to be highlighted. The payment received as non-competition fee under a negative covenant was always treated as a capital receipt till Assessment Year 2003-2004. It is only vide the Finance Act, 2002 with effect from 1-4-2003 that the said capital receipt is now made taxable [see Section 28(v-a)]. 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 the non-competition agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide Section 28(v-a) and that too with effect from 1-4-2003. Hence, the said Section 28(v-a) is amendatory and not clarificatory.

9. Lastly, in CIT v. Rai Bahadur Jairam Valji [(1959) 35 ITR 148 (SC)] 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 Rs. 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 the non-competition agreement with effect from 1-4-2003.”

20. Respectfully following the aforesaid decision, we allow the appeal and set aside the impugned judgment for all the reasons given by us above. All pending applications, if any, stand disposed of in terms of the judgment.

.....J. (R. F. Nariman)J. (Navin Sinha)
.....J. (B.R. Gavai) New Delhi 22nd July, 2020.