Sri. M.G. Mohan Kumar , Bangalore vs Assessee on 22 July, 2016

IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH ' B '

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER AND
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

I.T. A. No.981/Bang/2010
(Assessment Year : 2007-08)

Shri M. G. Mohan Kumar,
Flat No.15,
Sri Ranga Apartments,
30, Temple Road, Malleshwaram,
Bangalore-560 003. .... Appellant.
PAN ADVPM 5755E

Vs.

Dy. Commissioner of Income Tax,
Circle 5(1), Bangalore. ..... Respondent.

Appellant By : Shri S. Venkatesan, C.A.
Respondent By : Shri A.R.V. Srinivasan, JCIT (D.R.)

Date of Hearing : 08.06.2016.
Date of Pronouncement : 22.7.2016.

O R D E R

Per Shri Vijay Pal Rao, J.M. :

This appeal by the assessee is directed against the order dt.29.3.2010 of Commissioner of Income Tax (Appeals) for the Assessment Year 2007-08.

2. The assessee has raised the following grounds :

> " 1. The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of evidence, probabilities, facts and circumstances of the case.
>
> 2.1 The learned CIT[A] is not justified in upholding the assessment of a sum of Rs.2,50,OO,OOOI- made by the learned A.O. invoking the provisions of u/s. 28(va) of the Act, considering the amount received by the appellant, which is discursively described as Non- compete fee, by observing that the same was taxable instead u/s. 17[3][iii] of the Act as profit in lieu of Salary and not u/s. 28[va] of the Act as done by

the learned A 0, under the facts and in the circumstances of the appellant's case .

2.2 The learned CIT[A] ought to have appreciated that the so-called non- compete agreement is invalid in terms of Section 19[1] [g] of the Constitution and Section 27 of the Contract Act is un-enforceable as being invalid and void in restraint of trade and therefore, invocation of Section 28[va] of the Act and sec. 17[3][iii] of the Act both are misconceived and he ought to have deleted the addition even on the alternate view taken by him by considering the same under provisions of Sec. 17[3][iii] A at all.

2.3 ° not invoked by the learned

Without prejudice to the above, the provisions of Sec. 17[3][iii] is not applicable at all as the entitlement and the payment was made after the

cessation of the employment and is not pursuant to and part of any valid contract of employment earlier to be considered as profit in lieu of salary for applying the provisions of Sec. 17[1][iii].

2.4 Without prejudice to the above, the learned CIT[A] having held that the sum is not liable to tax under 28(1)(ii) could not and was not justified in sustaining the same under the different head not processed by the learned A O.

3. Without prejudice to the right to seek waiver with the Hon'ble CCIT/D.G, the appellant denies himself liable to be charged to interest u/s. 234-D of the Act, which under the facts and in the circumstances of the appellant's case deserves to be cancelled.

4. For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs."

3. The only issue arises in the appeal is regarding the amount of Rs.2.5 Crores received under non-compete fees agreement was held to be assessed to tax under Section 17(3)(iii) of the Income Tax Act, 1961 (in short 'the Act'). The assessee is an individual and was Financial Director in Deccan Aviation Ltd. The assessee filed his return of income for the Assessment Year under consideration on 31.10.2007 declaring a total income ofRs.29,00,170. In scrutiny assessment the Assessing Officer observed that the assessee left the company during the year and he has received an amount of Rs.2.5 Crores as non-compete fees from the employer Deccan Aviation Ltd. (DAL). While filing the return of income the assessee claimed the same as non-taxable being capital receipt. The Assessing Officer held that the receipt of non-compete fees is taxable as per the provisions of section 28(va) of the

Income Tax Act, 1961 (in short 'the Act'). Accordingly, the said amount of Rs.2.5 Crores was brought to tax under the head "Business or Profession" while completing the assessment under Section 143(3) of the Act. The assessee challenged the action of the Assessing Officer before the CIT (Appeals) and contended that the assessee was a professional being a Chartered Accountant and was appointed as Executive/Financial Director in the DAL. After the cessation of the employment with the DAL the assessee received the said amount under the said non-compete fees agreement and therefore it cannot be assessed as business income under Section 28(va) of the Act. It was also contended that the so called non-compete fees is invalid in terms of Article 19(1)(g) of Constitution of India and Section 27 of the Contract Act and therefore the said agreement is unenforceable as being invalid and void in restrain of trade. The CIT (Appeals) held that this payment is covered under the provisions of section 17(3)(iii) of the Act as profit in lieu of salary. Thus the CIT (Appeals) rejected the contention of the assessee by giving a different reasoning and holding that the said amount is assessed to tax as salary or payment as profit in lieu of salary under section 17(3)(iii) instead of income from "Business or Profession"

under Section 28(va) of the Act held by the Assessing Officer.

4. Before us, the learned Authorised Representative of the assessee has submitted that the assessee is an individual and is carrying on profession of C.A. and had never carried any business in the past to derive any business income. In March, 2005, the assessee was employed as an Executive by DAL vide Agreement dt.1.3.2005. During the year under consideration the assessee was working as Director (Finance) when the assessee resigned on 24.1.2007 which was accepted by DAL vide Board Resolution dt.25.1.2007. The learned Authorised Representative has referred to the terms and conditions of the employment agreement as well as the terms of the termination of the employment. The assessee resigned on 24.1.2007 which was accepted by the company on 25.1.2007 vide Board Resolution therefore the amount received by the assessee under the Agreement dt.1.2.2007 is a post employment settlement and as such is a capital receipt not chargeable to tax. The company has also not treated it as compensation in lieu of salary and accordingly not deducted TDS before making the payment. The assessee was already ceased to be an employee of DAL and therefore, the payment is to the assessee cannot be treated as compensation lieu of the salary or employment. He has further contended that Section 28(va) of the Act is not applicable as this provision is otherwise applicable only in the case of restrictive agreement for business and not for employment. The assessee never did any business and would not have business in future being a CA therefore the payment in question has no connection of doing or not doing any business neither it is received in lieu of loss caused due to cessation of employment but to restrain the assessee from sharing the secret information and knowledge of the business of the company with others. The learned Authorised Representative has relied upon the following decisions :

(i) Satya Sheel Khosla Vs ITO (2016) 129 DTR (Del) (Trib) 19.

(ii) CIT Vs. Pritam Das Narang 381 ITR 416 (Del).

Relying upon the above decisions, the learned Authorised Representative has submitted that the existence of employment is a pre condition of invoking the provisions of section 17(3)(iii) of the Act.

He has referred to the letter dt.24.1.2007 and Form 32 filed by the DAL with the Registrar of Companies intimating the change in the appointment of Director. The learned Authorised Representative has submitted that the company had already filed the requisite information of cessation of the employment of the assessee vide Resolution dt.25.1.2007 and therefore the amount received by the assessee has no connection with the employment but it is a capital receipt for not sharing the knowledge, information and business secrets with the competitors. Accordingly, the said amount is not chargeable to tax.

5. On the other hand, the learned Departmental Representative has submitted that the assessee was a retiring Director of DAL as mentioned in the agreement in question. The confidential information is connected with the employment therefore the payment is on account of cessation of the employment. He has relied upon the order of the CIT (Appeals).

6. We have considered the rival submissions as well as the relevant material on record. Before proceeding to examine and analyse the facts as well as the rival contentions of the parties we make it clear that the Assessing Officer assessed the amount of Rs.2.5 Crores received by the assessee under non-compete fees agreement as business income under Section 28(va) of the Act however, the CIT (Appeals) held that the said amount is taxable under Section 17(3)(iii) and not 28(va) of the Act in para 3.11 and 3.12 as under :

> "3.11 However, in my opinion, the Act covers suchpayments as profit in lieu of salary and to make it only abundant clear and to plug possible leakage of revenue clause (iii) was inserted under Section 17(3) of the Act with effect from 1.4.2002, which reads as under :
>
> "[(iii) any amount due to or received, whether in lump sum or otherwise, by any assessee from any person (A) Before his joining any employment with that person; or (B) After cessation of his employment with that person.]"

3.12 From a perusal of section 17(3)(iii), it is evident that this clause (iii) to section 17(3) was applicable for such payment for the assessment year 2002-03. Thus, I find that the amount of Rs.2,50,00,000 received by the appellant from DAL as non-compete fee is taxable under clause (iii) of section 17(3) and not under Section 28(va) of the I.T.Act." The revenue has not challenged the order of the CIT (Appeals) and therefore the order of the Assessing Officer has merged with the impugned order of the CIT (Appeals). Accordingly, the only dispute before us in the present appeal is the taxability of the amount in question received by the assessee under Section 17(3)(iii) of the Act. Undisputedly the assessee is a C.A. by profession and joined DAL in March, 2005. The assessee resigned vide letter dt.24.1.2007 which was accepted by DAL vide Board Resolution dt.25.1.2007. Though the resignation of the assessee from employment was w.e.f. 31.1.2007 however the assessee decided to resign vide letter dt.24.1.2007 which was accepted by DAL vide Board Resolution dt.25.1.2007. Thereafter the assessee and DAL entered into an agreement dt.1.2.2007 whereby the parties agreed upon that the assessee would not share the secrets of the trade/business etc with any third party and particularly with the competitors. It is pertinent to note that there is a confidential clause 6(b) in the employment agreement dt.1.3.2005 which reads as under :

" 6 Noncompetition : Confidentiality : Non-Solicitation and Ownership of Developments.

6(a) .....

6(b) Confidentiality. Without the prior written consent of the Board, except to the extent required by law, rule, regulation or court order, Executive shall not disclose any trade secrets, customer lists, drawings, designs, information regarding product development, marketing plans, sales plans, manufacturing plans, management organization information (including data and other information relating to members of the Board or management), operating policies or manuals, business plans, financial records, packaging design or other financial, commercial, business or technical information relating to the company or any of its subsidiaries or information designated as confidential or proprietary that the company or any of its subsidiaries may received belonging to suppliers, customers or others who do business with the company or any of its subsidiaries (collectively, "Confidential Information") to any third person unless such Confidential Information has been previously disclosed to the public by the Company or is in the public domain [other than by reason or Executive's breach of this section 6(b)]"

Therefore during the course of employment the interest of the company was protected by this clause of employment agreement. However post cesassion of employment this clause cannot be invoked being not unforceable after termination of employment. Therefore in order to protect the interest of DAL the parties entered into an agreement dt.1.2.2007 called Non-compete Agreement. Clauses 2 & 3 of the said agreement dt.1.2.2007 reads as under :

"2. That for consideration stated herein, the Retiring Officer hereby agree and consent that for a period of next three years from the date hereof :

(a) Shall not accept any employment on fulltime or part time basis relating to Airline Business.

(b) Shall not accept holding of any office in the Board of Directors of any body corporate engaged in or propose to engage in the Airline Business;

(c) Shall not provide any consultancy, advisory services or retainership to any person engaged or proposed to be engaged in the Airline Business;

(d) Shall not get associated any form with any person to promote, setup, get interested in Airline Business.

3. DAL shall pay a sum of Rs.;2,50,00,000 (Rupees Two Crores Fifty lakhs only) Mr. S.N.Ladhani, one of the director of the company to hold it in trust and pay to Mr. M.G. Mohan Kumar immediately upon execution of this Agreement."

It is clear from the plain reading of the above clauses that the assessee aggreed to the restrictive covenant of not accepting any employment including holding of office in the Board of Directors of anybody/company engaged in the airline business as well as providing any consultancy, advisory services to anybody or person engaged in the airline business or to aid or associate with anybody to promote, set up, get interest in airline business. The substance of the restrictive covenents of the agreement is to restrict the assessee to associate in any manner whatsoever with anybody or person engaged or proposed to engage in the airline business. Therefore this agreement in its plain reading cannot constitute to be related to termination of employment or to compensate the loss of salary due to termination of employment. The payment made under this agreement clearly not in the nature of compensation for loss of the employment of the assessee with DAL but it is all about the future engagement of the assessee to provide its services of knowledge in the airlines business to third party and particularly to the competitor or prospective competitor. The Hon'ble Delhi High Court in the case of Pritam Das Narang (supra) while analyzing the provisions of section 17(3)(iii) of the Act has observed in paras 13 to 15 as under :

> " 13. This Court is unable to agree with the above submissions on behalf of the Revenue. The Employment Agreement itself mentions that the employment shall commence 'latest by 1st July, 2007'. Although it further states that the employee "shall endeavour to join the company as early as possible", the intention and expectation of the parties was that the employment would commence not earlier than 1st July 2007. This becomes evident from a reading of the letter dated 1st May 2007 written by ACEE to the Assessee in which it stated that that it would not be possible to take the Assessee "on board from 1st July, 2007 as per employment contract." That the employment did not commence from the date of the Employment Agreement is further evident from the fact that ACEE stated in its letter dated 25th August 2007 that it was making the payment of Rs. 1.95 crores as "a one-time payment to you for non-commencement of employment as proposed."

14. The Court is unable to accept the interpretation sought to be placed on the plain language of Section 17 (3) (iii) of the Act by the Revenue. The words "from any person" occurring therein have to be read together with the following words in sub-clause (A): "before his joining any employment with that person". In other words, Section 17 (3) (iii) (A) pre-supposes the existence of an employment, i.e., a relationship of employee and employer between the Assessee and the person who makes the payment of "any amount" in terms of Section 17 (3)

(iii) of the Act. Likewise, Section 17 (3) (iii) (B) also pre-supposes the existence of the relationship of employer and employee between the person who makes the payment of the amount and the Assessee. It envisages the amount being received by the Assessee "after cessation of his employment". Therefore, the words in Section 17 (3) (iii) cannot be read disjunctively to overlook the essential facet of the provision, viz., the existence of 'employment' i.e. a relationship of employer and employee between the person who makes the payment of the amount and the Assessee.

15. The Court accordingly concurs with the concurrent view of the CIT (A) and the ITAT that this was a case where there was no commencement of the employment and that the offer by ACEE to the

Assessee was withdrawn even prior to the commencement of such employment. The amount received by the Assessee was a capital receipt and could not be taxed under the head 'profits in lieu of salary'."

The Hon'ble High Court has held that Section 17(3)(iii)(b) of the Act pre- suppose the existence of relationship of employer and employee between the assessee and the person who makes the payment of "any amount" in terms of sectin 17(3)(iii) of the Act. The amount received by the assessee after cessation of the employment therefore was held as capital receipt and could not be taxed under the head "Profits in lieu of salary". As it is clear from the surrounding fact as well as the terms and conditions of the agreement that the payment in question was made by DAL to the assessee for not sharing the assessee's knowledge of the business of airlines and particularly the secrets of the trade with third party in the business of airlines as well as any party who is going to set up the business of airlines. From the so called non-competent agreement dt.1.2.2007 it cannot be inferred that the said agreement in any way intended to compensate the assessee for loss of employment or in lieu of salary. Therefore in the absence of any contrary facts or material either brought on record by the Assessing Officer or by the CIT (Appeals) it cannot be held that the payment received by the assessee under the agreement dt.1.2.2007 is a profit in lieu of salary in terms of section 17(3)(iii) of the Act. A similar view has been taken by the co-ordinate bench of this Tribunal in the case of Satya Sheel Khosla (supra) in paras 15 & 16 as under :

> " 15. We have considered the arguments given by the I.T.O. in his assessment order and by the learned CIT (A) in his appellate order; the Opinion of Shri Bhardwaj; and the submissions made, and Synopsis provided, by the learned Senior Advocate; the arguments advanced in his reply by the Departmental Representative; and Shri Aggarwal's rejoinder. Two main issues need to be considered. The first and the principal issue is whether the sum of Rs. 1,32,00,000 received by the appellant from Suzuki India is taxable as "profits in lieu of salary"

under section 17(3) of the Act. The second issue is that, if the answer to the first issue is in the negative, whether the said sum is taxable under section 28(va) of the Act. The question whether the sum of Rs. 1,32,00,000 is taxable as "profits in lieu of salary" hinges on the status of the appellant. Was the appellant an employee of Suzuki India or not? We hold that the appellant was a joint venture partner in that company, and not an employee of the company.

16.In Ram Prashad v. Commissioner of Income-tax, New Delhi (1972) 86 ITR 122, the Supreme Court has observed at page 126 that:

> "A servant acts under the direct control and supervision of his master. An agent, on the other hand, in the exercise of his work, is not subject to the direct control or supervision of the principal, though he is bound to exercise his authority in accordance with all lawful orders and instructions which may be given to him from time to time by his principal."

In the course of the assessment proceedings, the Assessing Officer had asked Suzuki India as to "What were the duties assigned to Mr. Satya Sheel Khosla as a Managing Director and what type of work he was looking after" to which Suzuki India replied that he was assigned the following duties:-

> "a. Managing all affairs of the company.
>
> b. Evolving business strategies and development. c. Advising management on various issues in relation to business of the company.
>
> d. Overlook the management of the company."

The wide amplitude of the role assigned to the appellant clearly show that he was not subject to the direct control or supervision of Suzuki India, but was managing all affairs of the company; evolving business strategies; and advising the company. His role was clearly that of a joint venture partner in Suzuki India and not that of an employee of the company. In view of the foregoing and the submissions made by Shri Aggarwal, summarized in paragraphs 4 to 7 above, we are of Opinion that the appellant was not an employee of Suzuki India and, as such, the sum of Rs. 1,32,00,000 received by him from the company cannot be taxed as "profits in lieu of salary" under section 17(3) of the Act." In view of the facts and circumstances of the case discussed above as well as the decisions cited above, we hold that the amount of Rs.2.5 Crores received by the assessee under the agreement dt.1.2.2007 cannot be assessed to tax being profit in lieu of salary under Section 17(3)(iii) of the Act. Accordingly, we set aside the impugned order of the CIT (Appeals) and delete the addition on this account. The appeal of the assessee is allowed.

7. In the result, the assessee's appeal is allowed.

Order pronounced in the open court on the 22nd day of July, 2016.

Sd/-	Sd/-
(INTURI RAMA RAO)	(VIJAY PAL RAO)
Accountant Member	Judicial Member

*Reddy gp

Copy to :

1. Appellant
2. Respondent
3. C.I.T.
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard File.

By Order

Asst. Registrar, ITAT, Bangalore