In Re: Anurag Jain vs Unknown on 30 March, 2005

Equivalent citations: (2005)195CTR(AAR)117, [2005]277ITR1(AAR)

RULINGS

AAR No. 643 of 2004

Decided On: 30.03.2005

Appellants: In Re: Anurag Jain
Vs.
Respondent:

Hon'ble Judges:
Syed Shah Mohammed Quadri, J. (Chairman), K.D. Singh and A.S. Narang, Members

Counsels:
For Appellant/Petitioner/Plaintiff: Joseph Vellapally, P. Srinivasan, Advs.

For CIT: K. Ramalingam, Adv.

Subject: Direct Taxation

Acts/Rules/Orders:
Income Tax Act, 1961 - Sections 10, 15, 16, 17, 17(1), 17(3), 28, 45, 45(1), 45(5), 48,

Cases Referred:
CIT and Anr. v. George Henderson & Co. Ltd, (1967) 66 ITR 622 (SC); CIT v. Gillanders

Disposition:
Petition allowed

Head Note:

INCOME TAX

Head of income--Business income or income from salaryContingent payments towards perform
Held: Contingent payments towards employment and non-competition part of share purchas

Income Tax Act, 1961 s.14

Income Tax Act, 1961 s.17(1)(iv)

Income Tax Act, 1961 s.17(3)

Capital gains--COMPUTATIONFull value of considerationThe Indian company and shareholders

Held: On facts of the case, closing payment of $ 2.3 million alone will represent full

Income Tax Act, 1961 s.45;

Income Tax Act, 1961, s.48

JUDGMENT

Syed Shah Mohammed Quadri, J. (Chairman)

1. This application under Section 245Q(1) of the IT Act, 1961 (for short the 'Act'), is by a non-resident who holds 15,000 shares of M/s Vision Health Resources India (P) Ltd. (for short the "Indian company"), incorporated under the Companies Act, 1956. The Indian company carries on business in information technology enabled services involving processing of medical billing and medical insurance claims. The authorised capital of the Indian company is Rs. 10,00,000 which is divided into 1,00,000 equity shares of Rs. 10 each. The entire share capital is held by five individuals including the applicant. Of the five shareholders two are non-residents--applicant and his wife Mrs. Gunjan Jain--and the remaining three shareholders are residents. M/s Vision Healthsource Inc. at Delaware USA, is a non-resident US company (referred to as the "American company"). The applicant, Mrs. Gunjan Jain and Mr. Vishal Gupta held 6,75,000 shares in the American company. They entered into an agreement (styled as stock purchase agreement) for the transfer of entire 6,75,000 shares of the American company in favour of Perot System Corporation, a Delaware Corporation, USA (referred to as "PSC") and PS BP Services LLC; a Delaware Corporation Limited Company and a subsidiary of PSC (referred to as "PSBV"). It is noteworthy that under the stock purchase agreement there is no element of contingent payment, the entire consideration is to be paid by the closing date. At the same time the Indian company and all its shareholders entered into another agreement to transfer its entire business and share capital in favour of : (1) M/s Perot Systems Investments BV, Netherlands (PSIBV) (taking 99,999 shares); and (2) M/s Perot Systems BV, Netherlands (PSBV) (taking 1 share) for consideration of $ 93,00,000 on 15th April, 2003 (referred to as the "purchase agreement"). We are mainly concerned here with the purchase agreement. The Reserve Bank of India, Exchange Control Department, granted permission and issued no objection certificate for the foreign equity participation in the equity capital of the Indian company by the aforementioned purchasers. The sale consideration under the share purchase agreement for the transfer of shares of the Indian company is said to comprise of two components--(1) fixed amount of $1 23,00,000 payable in lumpsum (referred to as the closing

payment) and (2) the payer and the provider contingent payments payable in single instalment by 31st March, 2004, 31st March, 2005 and 31st March, 2006 as per the Ex.-A1 (referred to as 'contingent payments'). However, the contingent payments are not to be made unless aggregate earnings before interest, tax, depreciation allowance (EBITDA) of the business for the applicable period equals or exceeds the contingent cumulative threshold EBITDA; if the aggregate EBITDA exceeds the applicable cumulative threshold EBITDA, the applicable payment will be determined in the manner indicated in Ex. A of share purchase agreement, referred to above. Two expressions, the "payer business" and the "provider business", used therein, need to be clarified. The payer business is the portion of the operation which is focused on persons that provide finance or pay the cost of medical care including a health insurance issuer, a group health plan, employee welfare benefit plan, etc. The providers business is the portion of an operation, which is focussed on service providers of medical, and health services and any other person who furnishes bills or is paid for health care in the normal course of the business.

2. On the aforementioned facts, the applicant set out three questions in this application for seeking advance ruling of the Authority. As the questions were vague and ambiguous, the applicant was asked to reframe the questions. The reframed questions are as under :

> "1. Whether the gains arising from the transfer of 15,000 equity shares in Vision Health Source India (P) Ltd. covered by the share purchase agreement dt. 15th April, 2003 read with Ex. "A" and "B" thereto is chargeable to capital gains tax or not, either wholly or in part ?
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> 2. If the aforesaid gains arising from the above transfer is liable to be charged to capital gains tax, either wholly or in part, in which year of assessment does the liability to pay capital gains tax arise for the following amount received/receivable as consideration for the transfer of the shares aforesaid, which in aggregate amounts upto US $ 9,300,000 termed as purchase price as per Clause 1 of the aforesaid share purchase agreement dt. 15th April, 2003 ?
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> (i) Initial lumpsum payment equal to US $ 2,300,000 (referred to in the aforesaid share purchase agreement as the closing payment) received on 1st July, 2003 in the previous year relevant to the asst. yr. 2004-05.
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> (ii) Contingent payments as per Clause 1 of the share purchase agreement dt. 15th April, 2003 (referred to in Ex. A therein) receivable for each of the three years as noted below having regard to the fact that these amounts, contingent on the existence of EBITDA, can be determined only when the EBITDA as per Clause 1 of the said share purchase agreement dt. 15th April, 2003 relating to the three contingent payments as defined in Clause 1 therein, is computed.

By whom paid and nature of payment	Year in which to be paid	Where defined
Payer and provider first year contingent payment	For year ended 31.3.2004	Exhibit A

Payer and provider second year contingent payment	For year ended 31.3.2005	Exhibit A
Payer and provider third year contingent payment	For year ended on 31.3.2006	Exhibit A

3. If the gains arising from transfer of shares aforesaid is not to be charged as capital gains, either wholly or in part, under what head of income the contingent payments made to/received by the applicant towards transfer of shares covered by the aforesaid share purchase agreement dt. 16th April, 2003 read with the Exhibit attached thereto, are taxable and in which year of assessment ?

4. Whether any relief or concession in respect of income charged as capital gains or as other income under any other head is available under applicable provisions of Double Taxation Avoidance Agreement between India and US and India and Netherlands ? and if so, to what extent ?"

3. The Director of IT (International Taxation), Chennai (hereinafter referred to as the "CIT") forwarded the return of income filed by the applicant for the asst. yr. 2003-04 together with connected records and submitted the following comments to the application. It is stated that the applicant is a non-resident assessee and the relevant assessment year for the transaction is 2004-05. The applicant, Mrs. Gunjan Jain and Mr. Vishal Gupta own 6,75,000 shares of the American company, which is engaged in the activities of business process outsourcing in the "Neche Market of processing medical billing and medical insurance claims". The applicant and other shareholders of the Indian company agreed to transfer all the 1,00,000 shares of the company in favour of PSIBV and PSBV for the aggregate consideration of $ 93,00,000 by agreement dt. 15th April, 2003 and simultaneously entered into another agreement, called, stock purchase agreement. Under the share purchase agreement of 15th April, 2003, PSIBV undertook to purchase 99,999 shares and PSBV agreed to purchase 1 share from the said shareholders. The purchase price mentioned in Clause 1.3 of that agreement is as follows :

"PSI and PSN will pay an aggregate amount of up to US $ 93,00,000 which consists of the following :

(i) an amount equal to US $ 23,00,000 (closing payment)

(ii) the payer and the provider first year contingent payments (each as defined in Ex. A), if any.

(iii) The payer and the provider second year contingent payments (each as defined in Ex. A), if any, and

(iv) The payer and the provider third year contingent payment (each as defined in Ex. A), if any.

The consideration to be paid by PSN for one share will be 1/1,00,000 of the purchase price and the consideration to be paid by PSI for 99,999 shares will be 1/99,999 (sic) of the purchase price." [It would read 99,999/1,00,000] It is not disputed that the transfer of 1,00,000 equity shares has been approved by the Reserve Bank of India stating that the seller applicant and the other four shareholders are entitled to additional sale consideration equivalent to $ 7 million over the next 4 years on a pro rata basis subject to the term of meeting revenue targets as agreed to by the sellers and purchasers and that the sale consideration payable to the applicant and Mrs. Gunjan Jain shall be credited to their NRI accounts in India. It is clarified that the actual inflow of FDI in the transaction would be $ 2.3 million. The applicant has also entered into a non-competition agreement under which he would receive a portion of the purchase price in respect of his ownership interest and will also receive substantial direct and indirect benefits from the transaction contemplated under the agreement which is for 5 years employment as C.E.O. Similar agreements are entered into by the other shareholders also.

It is stated that under the Act, capital gain arose to the applicant in the year in which the transfer was complete, which would be the previous year 2003-04. The consideration including additional consideration (contingent payments), as approved by the RBI became due on account of transfer of the shares, hence the gain arising therefrom is the deemed income of the previous year in which the transfer took place and is chargeable to tax under the head capital gains. The additional consideration was stipulated by the parties by taking into account all the relevant factors, viz., net growth of Indian company, its past performance, goodwill of the company and a trend analysis with projection into future. The receipt of additional consideration in instalments by way of contingent payments, is designed with a view to postpone tax liability. On analysis of the balance sheet of the company as on 31st March, 2003, the value per share comes to $ 8, however, the applicant is paid $ 23 per share and a further consideration $ 70 per share is payable over a period of 4 years. It is also noted that the company's profits jumped to 3.85 crore for the year ended 31st March, 2003 from 1.41 crore in the preceding year. The transaction, it is submitted, defies general commercial expediency. From the three competition agreements, it is noticed that the recipients who include the applicant will receive a portion of the purchase price in respect of ownership interest in the Indian company and will also receive direct and indirect benefits from the transaction contemplated by the share purchase agreement. Such direct and indirect benefits are nothing but non-competition fees payable over a period of 5 years, therefore, the same is liable to be taxed under Section 28(va) of the Act. By linking capital gains with non-competition fees, the applicant has attempted to claim the benefit of lesser rate of tax. It is, however, added that the contingent payments depend upon the performance of the company and they are not in the nature of capital gains so they are taxable under the head "Profit and gains of the business". The transaction of sale of shares is designed, puma facie, to avoid taxation of non-competition fees. In supplementary comments, it is stated that in the return of income filed for the asst. yr. 2004-05, the assessee did not offer any income under the head capital gains; however, subsequently he filed the working sheet indicating "Nil" income on sale of shares of the Indian company claiming exemption under Section 54ED/54F of the Act showing investment of $ 23 million in Nabard Capital Gain Bonds. The applicant left out the amount of $ 70 million which is taxable under the head "Profit and gains of the business" under Section 28(va). In the additional comments of the CIT, filed after rejoinder of the applicant, it is submitted that the sum of $ 9.3 million represents composite consideration for transfer of shares and payment for

performance ensured non-competition agreement and goodwill. The closing payment constitutes full value of consideration as a result of transfer of shares but the contingent payments are meant for performance ensured by non-competition agreement and are not covered by the provision of Section 45. Hence they do not form part of the full consideration and do not fall within the charging section of Section 45 of the Act. In this case there is no bifurcation of the full value of the consideration. The full value of consideration as a result of transfer of shares is only to be taken for computation purposes and even though the consideration given in the agreement is $ 9.3 million (including closing payment and contingent payments), actually the closing payment alone constitutes the full value of the consideration and contingent payments upto $ 7 million represent consideration for performance ensured by non-competition. It is pleaded that proviso to Section 28(va) of the Act is not attracted because here neither the closing payment nor the contingent payments are on account of transfer of right to carry on any business; the closing payment is on account of transfer of shares and the contingent payments are on account of performance ensured by non-competition.

4. Mr. Joseph Vellapally, the learned senior counsel appearing for the applicant, has argued that the consideration for the sale of the shares in the Indian company is in two parts : (1) closing payment of $ 2.3 million and (2) contingent payments upto $ 7 million spread over 3 years, which is uncertain as they depend upon the Company's performance in exceeding the given target and therefore, capital gains arising from such a transfer cannot be ascertained, therefore, no liability under Section 45 of the Act would arise. The learned senior counsel invited our attention to Sub-section (5) of Section 45 of the Act to submit that in the case of enhancement of compensation by Court under the Land Acquisition Act, which is also an uncertain factor, the Parliament made a special provision, which would not cover the situation arising in this case. Section 54EC of the Act, submits the learned senior counsel, provides relief in respect of payment of tax on capital gains if the same is invested within the period of six months after the date of the transfer; in view of the contingent payments the capital gains, if any, arising could not be so invested and thus the applicant will be deprived of the benefit of the said provision. He has argued that the plea of the Revenue that consideration by way of contingent payments would be taxable as payment for non-competition under Section 28(va) of the Act, is untenable as the non-competition agreement is not subject to earning future profit by the company and as the applicant has been employed by the purchaser company, such non-competition agreement is a natural corollary to the employment. In any event, the contingent payments cannot be said to be received in the previous year in which the transfer took place and in view of the proviso to Section 28(va), the amount is not taxable.

5. Mr. K. Ramalingam, Director of IT (International taxation), Chennai, appearing for the CIT, has submitted that having regard to the provisions of Section 45 of the Act, the full value of consideration for transfer of shares will be taxable in the year in which the transfer took place and merely because payment of a part of the consideration is postponed to a future date, it cannot be said that no capital gains have accrued to the applicant in the previous year. It is, further, contended that to ascertain the true nature of the part of the consideration by way of contingent payments, it is necessary to look into the non-competition agreement as well as the employment agreement which would disclose that contingent payments constitute consideration for performance ensured by non-competition and are taxable as profits and gains of business and on the facts of the case the

proviso to Section 28(va) of the Act is not applicable.

6. A perusal of the reframed questions, set forth above, shows that question Nos. (1) and (2) overlap and have to be dealt with together and question No. (3) is consequential to the ruling on the said questions. Mr. Vellapally stated that the applicant is not pressing the fourth question.

Here, it would be useful to refer to Section 45(1), Section 48, Section 54EB and Section 54EC of the Act, which have a bearing on the present discussion.

> "Section 45. Capital gains.--(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections [54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H] be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place."
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> "48. Mode of computation.--The income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts namely :
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> (i) expenditure incurred wholly and exclusively in connection with such transfer;
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> (ii) the cost of acquisition of the asset and the cost of any improvement thereto:"

It may be seen that Sub-section (1) of Section 45 declares that any profits and gains arising from the transfer of a capital asset shall be (i) deemed to be the income of the previous year in which the transfer took place, and (ii) chargeable to income-tax under the head "Capital gains". The mode of computation of capital gains is laid down in Section 48. It provides that the income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration received or accruing on transfer of the capital asset, the amount representing the cost of acquisition of the asset together with the cost of improvement thereto and the expenditure incurred wholly and exclusively in connection with such transfer. Thus it is clear that irrespective of mode of payment of the consideration for the transfer of a capital asset, capital gains arising from such transfer are deemed to be the income of the previous year in which the transfer took place and are chargeable to income-tax in the assessment year relevant to the said previous year. It is important to note that for the purpose of computation of capital gains, the full value of the consideration is an important factor; it is from that amount that the aggregate of the expenditure incurred wholly and exclusively in connection with such transfer and the cost of the acquisition of the asset and the cost of any improvement thereto, are deducted.

The following provisions, among others, grant relief from payment of tax on capital gains :

> "54EB. Capital gain on transfer of long-term capital assets not to be charged in certain cases--(1) Where the capital gain arises from the transfer of a long-term capital asset [before the 1st day of April, 2000] (the capital asset so transferred being

hereafter in this section referred to as the original asset), and the assessee has, at any time within a period of six months after the date of such transfer invested the whole or any part of capital gains, in any of the assets specified by the Board in this behalf by notification in the Official Gazette (such assets hereafter in this section referred to as the long-term specified asset), the capital gain shall be dealt with in accordance with the following provisions of this section, this is to say--

(a) if the cost of the long-term specified assets is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under Section 45;

(b) if the cost of long-term specified asset is less than the capital gain arising from the transfer of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the long-term specified asset bears to the whole of the capital gain, shall not be charged under Section 45.

Explanation--"Cost" in relation to any long-term specified asset, means the amount invested in such specified asset out of capital gains received or accruing as a result of the transfer of the original asset."

54EC. Capital gain not to be charged on investment in certain bonds.--(1) Where the capital gain arises from the transfer of a long-term capital asset (the capital asset so transferred being hereafter in this section referred to as the original asset and the assessee has, at any time within a period of six months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset, the capital gain shall be dealt with in accordance with the following provisions of this section that is to say;--

(a) if the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under Section 45;

(b) if the cost of the long-term specified asset is less than the capital gain arising from the transfer of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the long-term specified asset bears to the whole of the capital gain, shall not be charged under Section 45."

A plain reading of these provisions makes it clear that the germane condition to claim the relief, provided therein, from payment of tax on capital gains, is that the assessee should invest the whole or any part of capital gains, as the case may be, in the long-term specified asset within six months after the date of transfer of the capital asset. Where the full value of the consideration is paid before or immediately on transfer of the capital asset in the previous year in which such transfer takes place, no difficulty arises. Where, however, the full value of the consideration is agreed to be paid at a future date or is paid in instalments over a period, after the previous year in which transfer of the

capital asset took place, the capital gains would, nonetheless, be treated as income of the previous year in which the transfer took place irrespective of the actual date of payment of the consideration and any hardship that may be caused to the transferor unless otherwise provided in the Act. In such a case the assessee obviously cannot avail the benefit of the aforementioned provisions. In the absence of any provision in the Act ameliorating the hardship caused in a case of payment of the full value of the consideration beyond the relevant previous year, there is nothing which this Authority can do to relieve the assessee of the hardship.

We have seen above that Section 48 of the Act speaks of the full value of the consideration which forms the basis for computation of capital gains. What then is meant by the full value of the consideration ? This expression is not defined in the Act. However, judicial pronouncements amply spelled out its import.

In CIT and Anr. v. George Henderson & Co. Ltd, (1967) 66 ITR 622 (SC), the Hon'ble Supreme Court explained the meaning of the expression "the full value of the consideration" appearing in Section 12B(2) of the Indian IT Act, 1922, thus :

> "The main part of Section 12B(2) provides that the amount of capital gain shall be computed after making certain deductions from the "full value of the consideration for which the sale, exchange or transfer of the capital asset is made." In the case of a sale, the full value of the consideration is the full sale price actually paid. The legislature had to use the words "full value of consideration" because it was dealing not merely with sale but with other types of transfers, such as exchange, where the consideration would be other than money. The expression "full value" means the whole price without any deduction whatsoever and it cannot refer to the adequacy or inadequacy of the price bargained for. Nor has it any necessary reference to the market value of the capital asset which is the subject-matter of the transfer."

The above decision was approved by a four Judge Bench of the Hon'ble Supreme Court in CIT v. Gillanders Arbuthnot & Co. (1973) 87 ITR 407 (SC). It will be useful to quote the following observation at p. 419 :

> "What exactly is the meaning of the expression "full value of the consideration for which sale is made"? Is it the consideration agreed to be paid or is it the market value of the consideration ? In the case of sale for a price, there is no question of any market value unlike in the case of an exchange. Therefore, in the cases of sales to which the first proviso to Sub-section (2) of Section 12B is not attracted, all that we have to see is what is the consideration bargained for. As mentioned earlier, to the facts of the present case, the first proviso is not attracted. As seen earlier, the price bargained for the sale of the shares and securities was only rupees seventy-five lakhs. The facts of this case squarely falls within the rule laid down by this Court in CIT v. George Henderson & Co. Ltd. (1967) 66 ITR 622 (SC)."

Chagla, C.J. illustrated the meaning of the expression in Baijnath Chaturbhuj & Anr. v. CIT (1957) 31 ITR 643 (Bom), thus :

> "It is erroneous to suggest that the full value is necessarily the value which the parties place upon a capital asset. The value must be the true value, not any artificial value, which parties for any purpose may assign to a particular capital asset."

In that case the firm of S.B. & Co. agreed to assign the managing agency and 4,736 shares of G.C. Mills to P.G & Co. for Rs. 7,51,000. Subsequently, the firm sold 65,012 shares held by it in the company together with its managing agency rights at Rs. 65 per share, though the market value of the share at that time was Rs. 46 per share. For the purpose of computing the capital gains accruing to the assessee who was the partner of the firm, the ITO adopted Rs. 65 per share as the full value of consideration of shares negativing the contention of the assessee that the full value of the consideration was the market value and that the firm had inflated the value for the shares as it parted with its managing agency also. The Division Bench of the Bombay High Court held that the consideration received by the assessee's-firm was really a composite consideration for transfer of the shares and the assignment of the managing agency, and it was not disputed that the real market value of the shares at the time of the sale was only Rs. 46 per share, therefore the full value of the consideration should be taken at Rs. 46 per share and not Rs. 65 per share because the assessee had fixed the consideration for the transfer on the basis of an inflated value for the shares without apportioning the consideration between the shares and the managing agency.

In Manubhai Bhikhabhai v. CIT (1994) 205 ITR 505 (Guj), 7,000 shares were purchased by three brothers at the rate of Rs. 50 per share from the third party. However, they were sold to S.S. at the rate of Rs. 1 per share under an agreement which disclosed that the price did not really reflect the correct value of the share. The transaction was for not only purchase and sale of shares but also for the release of the assessees from their onerous obligation as guarantors. The agreement was, therefore, a composite agreement and the sale price of share included release and discharge of the three brothers from their liabilities and obligations. The difference of Rs. 49 per share which was claimed as loss was in effect a part of the consideration for the release of their liabilities." Therefore, in reality assessees can be said to have received by way of consideration, the full amount of Rs. 50 per share and that no loss was suffered by them by selling the shares at the rate of Rs. 1 per share.

In the case of CIT v. Am Narayana Rao (1998) 233 ITR 10 (AP), the question before the Division Bench of the High Court of Andhra Pradesh was whether the amount realized by public auction for the house site which was held by the Government under mortgage, would partake of the character of 'full value of the consideration' envisaged under Section 48 of the Act. The assessee had mortgaged his house site with the State Government as security for running of 'abkari business'. A sum of Rs. 1,29,020 towards arrears and interest was found to be due by the assessee to the Government. To recover the said amount the Government sold his property in public auction and realized a sum of Rs. 5,62,980. The assessee contended that the amount of Rs. 1,29,020 which was due to the Government, ought to be deducted from Rs. 5,62,980 in computing the capital gains. This plea was rejected by both the ITO as well as CIT. However, the Tribunal accepted the contention of the assessee and took the view that the assessee held the property subject to mortgage or charge for the

amount due to the Government. On the sale of the mortgaged property the excise arrears of Rs. 1,29,020 which were due to the Government should be deducted from the sale proceeds and only the balance be paid to the assessee. On reference, the High Court affirmed the decision of the Tribunal holding that to ascertain the real value of the property sold by public auction, the accepted bid amount had to be reduced to the extent of interest that was created in favour of the Government by mortgage.

The above discussion leads to the conclusion that the full value of an asset for the purpose of Section 48 is the true value bargained for by the parties, which need not necessarily be, the market price and should not be an ersatz figure. The apparent consideration would generally represent the price bargained by the parties and therefore it would be the full value of consideration of an asset. However, the possibility of the apparent consideration being composite consideration and not depicting the full value of the consideration has also to be kept in mind. Whether the apparent consideration is the true full value of the consideration is a question of fact which has to be determined on the facts and in the circumstances of each case.

This being the position in law, we shall now turn to the facts of the case to ascertain the true nature of the consideration which the applicant would receive under the share purchase agreement; in other words the enquiry will centre around the question : what is the full value of the consideration under the share purchase agreement ? We have mentioned above that the apparent consideration noted in the share purchase agreement is in two parts. The first part consists of $ 2.3 million by way of closing payment. This is a common ground. The second part is said to comprise of contingent payments spread over 3 years after the previous year in which transfer of shares took place. The mode of determination of contingent payment is mentioned in Ex. 'A'.

Suffice it to say that the contingent payments are not to be made unless the aggregate earnings before interest, tax, depreciation allowance (EBITDA) of the business of the Indian company for the relevant period equals or exceeds the contingent cumulative threshold EBITDA. It is only when the aggregate exceeds applicable cumulative threshold EBITDA that the quantum of making contingent payments will arise and the quantum will be determined in the manner indicated in the said Ex. A. The contention of the CIT in regard to the second part of the consideration is that the value of each share as per the balance sheet comes to $ 8 and that by way of closing payment $ 23 per share were paid and that further consideration upto $ 70 per share is agreed to be paid by way of contingent payments over a period of four years and that these payments are nothing but non-competition fees falling under Clause (va) of Section 28 of the Act. The contingent payments are meant for performance ensured by the non-competition agreement and, therefore, they do not form part of the full value of the consideration. This plea necessitates a careful reading of the stock purchase agreement, associate employment agreement with the applicant (Ex. B) and the share purchase agreement which are contemporaneous because from the share purchase agreement alone, the true nature of the second part of the consideration cannot be ascertained. The employment agreement is for the period commencing from 2003 (no specific date is noted in Ex. B--the copy of the associate employment agreement) and ending on 31st Dec., 2006 which is terminable by the company for a 'cause'. The term 'cause' is defined to include, Inter alia, Clause (e)--"the failure of the sum of aggregate EBITDA for both the payer and provider business for any applicable period set forth in

annexure Ex. A to the purchase agreement to equal or exceed the sum of the Payer Cumulative Threshold EBITDA and the Provider Cumulative Threshold EBITDA for such applicable period, without regard to the allocation between Payer EBITDA or Provider EBITDA. However, where the agreement is terminated for any of the specified cause which does not include the aforementioned Clause (e), the applicant will no longer be entitled to any proceeds from future contingent payments payable under the purchase agreement including without limitation any contingent payments and if he had already received any such payment, he is obliged to pay back the amount immediately to the company. The non- competition agreement also includes a clause identical to Clause (e) in the employment agreement, quoted above. Clause (4) of the employment agreement refers to "non-competition agreement" which in turn mentions that the applicant will receive a portion of the purchase price in respect of ownership interest and substantial direct and indirect benefits from the transactions contemplated by the share purchase agreement. The non-competition agreement is linked to the employment agreement which has nexus with the purchase agreement. Indeed, it is stated that the applicant's obligations under the non-competition agreement are a material inducement and condition to the buyer's entering into purchase agreement and the share purchase agreement under which substantial direct and indirect benefits are assured. Had the contingent payments been the second part of the full value of the consideration for the sale of shares and the business of the Indian company, there is no reason why failure on the part of the applicant in regard to fulfilling his obligations under the employment agreement (which include the achieving the target mentioned above) should result not only in termination of the agreement for the specified cause but also in foregoing receipt of the second part of the consideration by way of contingent payments under the share purchase agreement and in refunding the same to the company where he has already received them. A combined reading of the employment agreement, non-competition agreement and the share purchase agreement which are contemporaneous leaves us in no doubt to conclude that contingent payments payable under the share purchase agreement, are in substance and reality payments for ensuring performance under the employment agreement to achieve the desired object in exceeding EBITDA and have no real nexus to the consideration for the sale of the shares, etc. under the purchase agreement. The second part of the consideration comprising of contingent payments is concerned, they are so arranged as to appear that they constitute a part of the consideration for sale of the shares, etc. whereas they are in truth and substance for achieving the target of EBITDA. We are, therefore, of the view that the consideration mentioned in the purchase agreement is a composite consideration and that the closing payment alone represents the full value of the consideration for the said agreement for purposes of Section 48 of the Act.

This conclusion takes us to the question of taxability of contingent payment; as to whether they are taxable under Section 28(va) of the Act. The said provision reads as under :

> "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"--
>
> (i) to (v) : xxxx (va) any sum, whether received or receivable, in cash or kind, under an agreement for--

(a) not carrying out any activity in relation to any business; or

(b) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services :

Provided that Sub-clause (a) shall not apply to--

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation--For the purposes of this clause--

(i) "agreement" includes any arrangement or understanding or action in concert,--

(A) whether or not such arrangement, understanding or action is formal or in writing; or (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

(ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging;"

The plea of the CIT is that contingent payments under the purchase agreement are covered by Clause (va) of Section 28. Mr. Vellapally, on the other hand, contends that in view of the proviso to Clause (va) of Section 28, the said clause does not apply. A perusal of Clause (va) of Section 28 shows that to be chargeable to income-tax under the head "Profits and gains of business or profession", the sum in question, whether received or receivable (in cash or kind) under an agreement must answer the description of the activity referred to in Sub-clause (a) or Sub-clause (b) of Clause (va). We are concerned here with Sub-clause (a), which refers to not carrying out any activity in relation to any business. In other words any sum received or receivable under an agreement for not carrying out any activity in relation to any business will be taxable under Section 28(va) of the Act. We have concluded above that contingent payments under the share purchase agreement have nexus with performance of the

applicant for achieving the defined target. They have no direct connection with 'not carrying out any activity in relation to any business'. Under the non-competition agreement, the remedy for violation of its terms and conditions, is to obtain an order of injunction against the applicant whereas under the employment agreement the consequence of failure of specified cause is termination of that agreement coupled with not making further contingent payments as well as refunding amounts of such payments if already received. It follows that contingent payments, referred to above, do not fall under Clause (va) of Section 28 of the Act. It is unnecessary to refer to the proviso in the light of the above discussion.

Had it not been necessary to pronounce a ruling on question No. (3), as to under what head of income the contingent payments made to or received by the applicant would be chargeable, we would have allowed the discussion to rest with the aforementioned conclusion. This aspect is however, not adverted to by the parties. We have already opined that contingent payments have a real nexus with the employment agreement and not with non-competition agreement much less with the purchase agreement as the second part of consideration thereunder. We shall only add here that the period over which contingent payments are spread over and the period of employment agreement is almost the same. Contingent payments are, in our view, nothing but in the nature of incentive remuneration for achieving the target. They would, therefore, fall under Section 17(1)(iv) which reads as follows :

Section 17. "Salary", "perquisite" and "profits in lieu of salary" defined For the purposes of Sections 15 and 16 and of this section --

(1) "salary" includes --

(i) to (iii) xxxxxxx

(iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;

(v) to (viii) xxxxxx"

Sub-section (1) of Section 17 defines salary to include, inter alia, fees, commissions, perquisites or profits in lieu, of or in addition to any salary or wages [Clause (iv)]. Under the employment agreement, the applicant is receiving a salary of $ 14583.33 per month, The contingent payments are in addition to the said salary. Sub-section (3) of Section 17 defines the expression profits in lieu of salary. Clause (ii) of Sub-section (3) of Section 17 is relevant and is reproduced here ;

"Section 17(3) "Profits in lieu of salary" includes--

(i) xxxxx

(ii) any payment (other than any payment referred to in Clause (10), Clause (10A), Clause (10B), Clause (11), Clause (12), Clause (13) or Clause (13A) of Section 10), due to or received by an assessee from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contributions by the assessee or interest on such contributions or any such received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

Explanation--For the purposes of this sub-clause, the expression "Keyman insurance policy" shall have the meaning assigned to it in Clause (10D) of Section 10. (iii) xxxxx"

A perusal of the clause quoted above, shows that it would apply when a payment is due or received by an assessee from an employer or former employer but the amount shall not consist of contribution by the assessee or interest on such contributions or any sum received under Keyman insurance policy including the sum allocated by way of bonus on such policy; further the payment must not be falling under any of the clauses of Section 10 specified therein.

From the facts discussed above, the contingent payments satisfy all the aforementioned requirements, therefore, they would, in our view, fall within the purview of salary.

It would be useful to refer to the following decision which would elucidate the point :

In VR.C.RM. Adaikkappa Chettiar v. CIT (1970) 78 ITR 285 (Mad), under the agreement of service, the assessee-employee was entitled to a fixed salary of Rs. 1,000 per month; in addition he was entitled one-fourth share of the profit earned by the employer from his partnership business. The assessee-employee received Rs. 25,233 towards the one-fourth share in the profits earned by the employer in addition to his salary. The additional amount was initially treated by the AO as business income but later proceedings were initiated under Section 154 of the Act to treat the said amount as salary. The AAC and the Tribunal declined to interfere with the proceedings under Section 154 of the Act. On reference to the High Court, the Division Bench of the Madras High Court held that the said amount of Rs. 25,233 was remuneration received under the service agreement and was assessable as salary.

In M. Krishna Murthy and Ors. v. CIT and Ors. (1985) 152 ITR 163 (AP), the Division Bench of the Andhra Pradesh High Court had to consider, inter alia, the question whether the amount received by an employee on encashment of leave will fall within the meaning of profit in lieu of salary under Section 17(3)(ii) of the Act. It was held that leave encashment satisfied all the essential ingredients of Section 17(3)(ii) and would, therefore, fall within the meaning of salary.

In the case of CIT v. B. Chinnaiah and Ors. (1995) 214 ITR 368 (AP), the question before the A.P. High Court was whether the incentive bonus received by Development

Officers of the LIC could be taxed under the head salary. Following the judgment in M. Krishna Murthy and Ors. v. CIT and Ors. (supra), the Division Bench of the High Court (of which I was then a member) held that the incentive bonus fell within the meaning of salary.

The same view was taken by the Allahabad High Court in the case of CIT v. Hind Lamps Ltd. (1980) 122 ITR 451 (All).

In the instant case the fact that contingent payments are disguised as the second part of consideration under the share purchase agreement, will not militate against those payments being remuneration within the meaning of salary under Section 17 of the Act.

For the aforementioned reasons, we rule on the questions set forth above as follows :

Question No. 1 : gains arising to the applicant from the transfer of 15,000 equity shares in Vision Health Source India (P) Ltd. covered by share purchase agreement dt. 15th April, 2003 read with Ex. A and B thereto computed by taking the closing amount of $ 2.3 million as the true value of the consideration, are chargeable to tax under the head "Capital gains";

Question No. 2 : (i) the initial lumpsum payment of $ 2.3 million (referred to in the aforesaid share purchase agreement as the closing payment) received on 1st July, 2003 in the previous year relevant to the asst. yr. 2004-05 as consideration for the transfer of shares (including 15,000 shares of the applicant) represents the full value of the consideration thereunder.

(ii) Contingent payments as would be determined at the end of the first year 31st March, 2004, the second year 31st March, 2005 and the third year 31st March, 2006 (under Ex. A) are not in truth and substance part of the consideration under the share purchase agreement so they cannot be taken into account in competing the capital gain but they would be taxable under the head "salaries".

Question No. 3 : Contingent payments received/receivable by the applicant would fall within the meaning of profits in lieu of or in addition to salary under Sub-section (3)(ii) of Section 17 of the Act.

Question No. 4 : This question is not pressed. We, therefore, decline to pronounce any ruling on it.