Ashok Behari Lal (Huf) vs Assistant Commissioner Of Income Tax on 23 September, 2005

Equivalent citations: (2006)99TTJ(DELHI)513

ORDER

N.V. Vasudevan, J.M.

1. This is an appeal by the assessee against the order dt. 11th March, 1999 of CIT(A), XII, New Delhi, relating to the asst, yr. 1994-95. The first ground of the appeal of the assessee was not pressed for adjudication at the time of hearing. Therefore, the said ground of appeal is dismissed as not pressed.

2. The second and third grounds of appeal of the assessee read as follows :

> (2) That the gross sale price of the shares of Groz Beckert Saboo Ltd. ought to have been adopted @ Rs. 358.89 per share as against the gross sale price of Rs. 400. At any rate, without prejudice, the sale price of the shares as adopted @ Rs. 400 per share is very excessive.
>
> (3) That further sale price of shares also included the price of the negative covenants given in the agreement of sale of shares and the same is claimed @ Rs. 100 per share by the appellant ought to have been treated as capital receipt not liable to capital gains tax. In other words, the sale price of the shares for purposes of capital gains tax ought to have been taken at Rs. 258.89 per share as purposes of capital gains tax ought to have been taken at Rs. 258.89 per share as against Rs. 400 adopted by the authorities below.

Various observations made by the authorities below in their respective orders while deciding the above issues are either factually incorrect or are legally untenable. Facts and the circumstances of the case and the evidence as produced before the authorities below had either been ignored or had not been appreciated properly.

3. The facts and circumstances giving rise to the aforesaid grounds of appeal are as follows. The assessee is assessed in the status of an HUF. It derives income from house property and other sources. During the previous year the assessee had sold 3,929 Nos. equity shares owned by it in a company by name M/s Groz Beckert Saboo Ltd. (hereinafter referred to as 'GBS Ltd.') and the capital gain on such transfer was declared in the return of income. The computation of long-term gain on transfer of shares declared by the assessee was as follows :

Computation of Capital Gain	Rs.
Sale proceeds received on sale of 3,929 shares @ 358.89	14,10,079
Less : Indexed Cost of shares as computed above	8,33,050

	5,77,029
Less : Capital Receipt of Rs. 100 per share for relinquishing management control of the company and accepting various negative covenants as per share purchase	3,92,900
Long-term capital gain	1,84,129

4. It will be relevant at this stage to narrate the circumstances under which the assessee had to sell the shares held by it in GBS Ltd.

5. One Shri R.K. Saboo had obtained an industrial licence for the manufacture of hosiery needles from the Government of India in the year 1959. A financial and technical collaboration agreement was entered into with M/s Theotor Groz & Sohni & Earnest Beckert Nadel Fabrik Commanded Gessls Chaft, a partnership firm in Germany. The Government of India approved the collaboration agreement vide its letter dt. 21st Nov., 1959. Shri R.K. Saboo and Groz Beckert Group entered into an agreement to form and promote in India a private limited company. That is how Groz Beckert Saboo Ltd. was incorporated which later on became a deemed public limited company under Section 43A of the Companies Act, 1956. Groz Beckert Group held 60 per cent shares and Saboo Group held 40 per cent shares. The assessee was one of the members of the Saboo Group who acquired shares in M/s GBS Ltd. The relationship between the Saboo Group and GB Group were very cordial and friendly for more than 25 years. M/s Saboo Group was managing the affairs of the company for long time. Disputes and differences arose between the GB group and Saboo Group. The Saboo Group were, therefore forced to file petition under Sections 397 and 398 of the Companies Act before the Company Law Board against GB group for mismanagement and oppression of minority shareholders. The Company Law Board, however, rejected the petition filed by the Saboo Group and directed that the Saboo Group will sell 40 per cent of its holding in M/s GBS Ltd. to the GB Group at a value to be determined by M/s S.B. Billimoria and Company, chartered accountants. The order of the Company Law Board was dt. 22nd Oct., 1992. The Saboo Group filed an appeal before the Hon'ble Delhi High Court and also obtained an order of stay of operation of the order passed by the Company Law Board. It was under these circumstances that the Saboo Group and the SB Group reached an out of Court settlement by which the shares held by the Saboo Group were purchased by the SB Group.

6. A copy of the agreement dt. 21st Jan., 1993 between the members of the Saboo Group and the GB Group, dt. 21st Jan., 1993 is placed at page Nos. 206-225 of the assessee's paper book. The main terms and conditions of the agreement are that :

> Saboo Group was to receive a consideration of Rs. 400 per share inclusive of the amount towards accepting negative covenants and conditions restricting the groups' earning capacity subject to the following conditions imposed on the Saboo Group :
>
> (1) Giving up its right to receive dividend for the year ended 31st March, 1992 and subsequent years.

(2) Sale of entire 40 per cent equity ownership to enable GB Group to take complete control without hindrance of M/s Groz Beckert Saboo Ltd.

(3) Undertaking not to engage in any business similar to or competing with GB Group.

(4) Not to engage any of the employees of GBS for 5 years.

(5) Not to induce any employee of GBS to leave its employment.

(6) Not to interfere with relationship of the supplier, customer or other business relations of GBS.

(7) Not to do any act detrimental to GBS.

(8) Not to use or disclose to any other party any confidential information relating to GBS or its business.

(9) Undertaking to withdraw the appeal in the High Court.

(10) Relinquishing the office of directorship by Sh. R.K. Saboo, Mr. Y. Saboo and Mr. O.P. Vaish as per Clause 2.1 (b)(ii) of escrow agreement.

(11) Giving up their right to enforce the provisions of the various agreements between Saboo and GB and also Saboo and the Company Saboo had many beneficial rights under various agreements such as an article of agreement dt. 1st April, 1960, between purchaser and Mr. R.K. Saboo, the representative of the Saboo Group, and all rights of Saboo group under the Memorandum of articles of association of the company, agreement of 7th Feb., 1989, and the managing directors agreement, contract or other commitment of any kind between the purchaser and the seller or between the seller and the company. The aforesaid understanding was embodied in the Share Purchase Agreement, dt. 21st Jan., 1993.

The restrictions placed on the Saboo Group under the Share Purchase Agreement are contained in Clause 1.8, 5.5, 5.6, 5.6(a)(b)(c), 5.3 and 5.9 and 6.4 thereof.

7. Under the provisions of Section 48 of the Act the computation of capital gain has to be made as follows :

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 :

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto :

8. In the present appeal the dispute is with regard to the computation of the consideration received on sale of shares. As can be seen from the computation of capital gains given in para 3 of this order, the assessee had declared only Rs. 358.89 as sale consideration received on transfer of shares as against Rs. 400 per share as mentioned in the share transfer agreement. Secondly, the assessee sought to deduct Rs. 100 per share as capital receipts for observing various negative covenants under the agreement for sale of shares and that such capital receipts were not chargeable to tax. The first plea of the assessee was that there were various restrictive covenants under the share transfer agreement dt. 21st Jan., 1993. According to the assessee, out of the total sale value of Rs. 400 per share, Rs. 100 per share will have to be allocated as consideration received by the assessee towards accepting negative covenants under the agreement of transfer of shares. In this regard, the assessee had filed the report of a chartered accountant M/s Vaish & Associates wherein they have valued the shares only at a sum of Rs. 93.12 as per the break-up value of shares as on 31st March, 1993. According to the assessee though in law he was entitled to claim the entire difference between the sale consideration and the break-up value as given by the valuation report of the chartered accountant towards compensation received for accepting various negative covenants mentioned in the share purchase agreement, yet it had apportioned only Rs. 100 as consideration received for accepting various negative covenants under the share transfer agreement. It was further submitted by the assessee that the consideration received by the assessee on transfer of shares which is allocated as consideration for accepting negative covenants would be a capital receipt not chargeable to tax.

9. While computing the capital gain the assessee had shown the full consideration received on transfer of shares at Rs. 358.89 per share. The AO noticed that as per the share transfer agreement the consideration of each share was Rs. 400 and there was no reason why the assessee had disclosed the sale value of each share only at Rs. 358.89. On this issue the reply of the assessee was that a sum of Rs. 41.11 per share was incurred towards legal expenses for conducting proceedings before the CLB as well as before the Hon'ble Delhi High Court. The contention of the assessee was that but for the litigation before the various forums the Saboo Group would not (have) got the value of Rs. 400 per share. The assessee, therefore, claimed that these expenses incurred were wholly and exclusively in connection with transfer of shares or (in) the alternative it has been considered as cost of improvement and were to be deducted from the sale consideration received on transfer of shares to arrive at the capital gain chargeable to tax.

10. The AO, however, did not agree with the contentions as were put forth by the assessee. With regard to the plea of the assessee that a sum of Rs. 100 has to be excluded from the sale consideration received on transfer of shares towards obligations of the assessee to adhere to the negative covenants in the share transfer agreement, he held that the sum of Rs. 400 was shown as sale consideration for each share inclusive of all dividend rights and that no split-up value has been given in the agreement. According to the AO the noncompetition clause in the agreement restricting the Saboo Group not to engage in any other business competing with that of the M/s GBS Ltd. was

merely a precaution taken by the purchaser. In any event, since the Saboo Group was not engaged in a competing business, the same will not have any effect. The AO also held that with the transfer of shares the right to dividend as well as voting rights ceased to exist and, therefore, the assessee cannot be said to have lost anything by transfer of shares. The AO also held that the plea of bifurcation by excluding Rs. 100 from the value of shares was nothing but a colourable device adopted by the assessee to hoodwink the Department by reducing the incidence of taxation. The AO made a reference to the decision of the Hon'ble Supreme Court in the case of McDowell & Co. Ltd. v. CTO in this regard.

11. With regard to the expenses of Rs. 41.11 claimed by the assessee on account of the legal expenses connected with the transfer of shares, the AO held that there was no evidence to show that the expenses in question had infact been incurred. The AO also referred to the fact that the litigation related to a total of 4,40,000 shares held by the Saboo Group. According to the AO, if the plea of the assessee were to be accepted, then the legal expenses of litigation would come to Rs. 2,60,08,400. In the opinion of the AO such huge expenditure for an out of Court settlement was unbelievable. The assessee filed a copy of the savings bank account in which consideration on sale of shares was actually realized only at Rs. 358.89 per share. According to the AO production of the bank account was not enough evidence regarding the claim of legal expenses. The AO also concluded that in any event the expenses cannot be said to be expenditure incurred in connection with the transfer of shares.

12. Aggrieved by the order of the AO, the assessee preferred appeal before the CIT(A). Before the CIT(A), the assessee reiterated the contentions as were put forth before the AO. The CIT(A), however, concurred with the view of the AO holding as follows :

> I have examined the contentions of the assessee's Authorised Representative. The assessee was a member of Saboo group who along with Groz Beckert formed a company known as Groz Beckert Saboo Ltd. which was incorporated in 1959. During the year 1960-61 the assessee was allotted 2,750 equity shares (c) Rs. 10 per share. During the financial year 1982-83 the assessee was allotted 1,179 bonus shares. In the meantime there arose some differences between Saboo group and Groz Beckert group on the point of management. The Saboo group filed a petition under Section 397/398 of the Companies Act to the Company Law Board against GB group for mismanagement and oppression of minority shareholders. The Company Law Board rejected the petition of the assessee group. The Saboo group moved the Delhi High Court and obtained a stay against order of the Company Law Board, In the meantime, an out of Court settlement was reached under which the Saboo group agreed to sell its shares to GB group @ Rs. 400 per share. Now as per the share purchase agreement, dt. 21st Sept., 1993, the shares were sold (c) Rs. 400 per share, the assessee was not justified in showing sale consideration at, Rs. 358.89 per share. As per Section 48(1)(a), the assessee has Co show full value of consideration received or accrued as a result of the transfer of the capital asset. In the instant case full value of the consideration accrued was Rs. 400 per share and not Rs. 358.89 per share. So far as claim of legal expenses of Rs. 41.11 per share is concerned, to my mind, it relates to

> litigation before the Company Law Board and the Delhi High Court which is prior to transfer of shares. Thus, these expenses have not been incurred wholly and exclusively in connection with the transfer of these shares and are, therefore, not allowable as per provision of Section 48(1) of the IT Act. The action of the AO on this point is confirmed. Besides, the sale consideration is inclusive of all dividend rights and does not talk of any other conditions. The AO was justified in holding that no part of the sale consideration should be treated as capital receipt. The action of the AO on this point is, therefore, confirmed.

13. Aggrieved by the order of the CIT(A), the assessee is in appeal before us. In this appeal two issues arise for consideration.

> (i) Whether sum of Rs. 100 out of the sale consideration of Rs. 400 per share as mentioned in the share transfer agreement can be said to be consideration paid by the purchasers towards the obligation to adhere to the various negative covenants set out in the aforesaid share purchase agreement ? The incidental question that will arise while deciding this question is as to whether in the absence of specific bifurcation in the agreement for transfer of shares whether the assessee can make such bifurcation ? In other words, whether consideration mentioned in the share transfer agreement was a composite consideration for transfer of shares as well as for performance of the various negative covenants set out in the said agreement ?
>
> (ii) Whether the legal expenses incurred in connection with the legal proceedings before the Company Law Board as well as the Hon'ble Delhi High Court can be said to be expenditure incurred in connection with the transfer of shares within the meaning of Section 48 or alternatively whether it can be considered as cost of improvement of the asset within the meaning of the said section.

14. We have heard the rival submissions. As far as the first question is concerned it is necessary for us to look into the various terms of the share purchase agreement dt. 21st Jan., 1993 between the GB Group and the Saboo Group. The preamble as well as Clause 1 of the agreement reads as follows :

> In consideration of the premises and respective representations, warranties, covenants, agreements and indemnities herein contained, the parties hereto agree as follows :
>
> 1. Sale and Purchase of Shares 1.1 Sate of Shares. The number of shares owned by each of the sellers are listed in Exhibit 1.1 hereto and Mr. Y. Saboo represents and warrants that the persons listed in the said exhibit are all members of the Saboo Group and are the true legal and beneficial owners of the shares. Sellers hereby agree to sell, transfer, assign and deliver to purchaser at the closing (as hereinafter defined) and purchaser hereby agrees to purchase and acquire or cause to be purchased or acquired from sellers and pay therefore at the closing, 440,000 (four hundred forty thousand) fully paid equity shares of Groz Beckert Saboo Ltd., (the "company")

having a nominal value of Rs. 10 per share (individually a "share" and collectively "shares") at the price of Rs. 400.00 (rupees four hundred) per share aggregating to Rs. 176 million. The shares constitute 40 per cent of the total issued and outstanding equity shares of the company. The sale price of the shares is inclusive of all dividend rights.

15. As can be seen from the preamble to the aforesaid agreement it makes a reference to the various representations, warranties and covenants. One of the covenants mentioned in the agreement is the one mentioned in Clause 5.5, 5.6, 5.7 and 5.8. Under Clause 5.5 for a period of 5 years none of the persons of the Saboo Group or any firms or companies or other entities owned or controlled by any of them where hrectly or indirectly engage in India in any business similar to or competing with the business of the company as now conducted. Similarly, the Saboo Group was also prohibited from hiring any employees of the GBS Ltd. They were also under an obligation not to do business with any existing suppliers, licensee, distributor customer etc. of GBS Ltd. The intellectual property rights relating to the confidential information relating to GBS Ltd. was also not to be infringed by the Saboo group.

16. In the light of the aforesaid restrictive covenants, it cannot be said that the consideration of Rs. 400 per share as fixed in the agreement is only towards the value of the shares. This fact is also further confirmed by the report of the valuers M/s Vaish & Associates, chartered accountants 'according to whom the break-up value of one share of GBS Ltd. as on' 31st March, 1993 was only Rs. 93.12. As per the audited financial accounts of GBS Ltd. as on 31st March, 1992, the value of one equity share as per Rule 1D of the WT Rules was also at Rs. 60.24 only. From the aforesaid facts it is clear that the fair value of one share of GBS Ltd., as on date of transfer was much lower than the consideration of Rs. 400 per share. In fact the fair value of one share was not even Rs. 100 per share. In those circumstances we are of the view that the assessee has on a very conservative estimate apportioned 25 per cent of the value of shares towards consideration payable for the obligations to be performed by it in the form of negative covenants under the share transfer agreement.

17. According to the learned Departmental Representative since the agreement did not mention the break up value of shares it is not possible to accept the argument on behalf of the assessee. In this regard the learned Counsel relied on the following decisions : Baijnath Chaturbhuj and Anr. v. CIT , Parry & Co. Ltd. v. Dy. CIT and Raghubar Narain Singh v. CIT .

18. It is seen from the decision of the Hon'ble Bombay High Court that from the very fact that there was no break-up of the consideration in an agreement the same was not conclusive and if in fact the consideration mentioned in the agreement was a composite consideration, apportionment of the consideration between the value of shares and other rights given up should be made. In this connection, the Bombay High Court has also taken note of the fact that in making such an apportionment the market value of the shares would be a relevant consideration. Similar proposition has been laid down by the other High Courts in the decision relied upon by the learned Counsel for the assessee. We, therefore, hold that the apportionment of consideration mentioned in the share transfer agreement has to be made and a sum of Rs. 100 has to be apportioned towards the consideration paid by the transferee to the assessee for observance of the various negative

covenants mentioned in the share transfer agreement.

19. As far as the taxability of sum received by the assessee as non-compete fee is concerned, in the following decisions such question had been considered :

(i) CIT v. Best & Co. (P) Ltd.

(ii) CIT v. Automobile Products of India Ltd.

(iii) CIT v. Saraswathi Publicities

(iv) Oberoi Hotel (P) Ltd. v. CIT

(v) Addl. CIT v. Dr. K.P. Karanth

(vi) Chelpark Co. Ltd. v. CIT .

The Supreme Court in Gillanders Arbuthnot & Co. Ltd. v. CIT held that : "Compensation paid for agreeing to refrain from carrying on competitive business in the commodities in respect of the agency terminated, or for loss of goodwill is prima facie of the nature of capital receipt". In Best & Co. (P) Ltd. 's case (supra) the Supreme Court has held that "the compensation agreed to be paid was not only in lieu of giving up the agency but also for the assessee accepting a restrictive covenant for a specified period. As far as the loss of agency was concerned, it was only a normal trading loss and the income received on that account was only a revenue receipt. But, with reference to the loss on account of the restrictive covenant, after referring to the decision in Gillanders Arbuthnot & Co. Ltd.'s case (supra), the Supreme Court reiterated that the restrictive covenant was an independent obligation undertaken by the assessee not to compute with the new agent in the same field and that part of the compensation attributable to the restrictive covenant was a capital receipt, not assessable to tax". In Saraswathi Publicities case (supra) the Madras High Court has held that "the amount of consideration referable to the restrictive covenant was a capital receipt not liable to income-tax". Similar views have been expressed in the various other decisions relied upon by the learned Counsel for the assessee. The law on this aspect is fairly well settled and suffice it to say that the claim of the assessee in this regard deserves to be accepted.

20. The Finance Act, 2002 has inserted Section 28(va) of the Act w.e.f. 1st April, 2003 which reads as follows :

> 28. The following income shall be chargeable to income-tax under the head 'Profits and gains of business or profession' :
>
> (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, trademark, license, 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 purpose 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) 'servrce' 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 above sub-section along with the proviso and Explanation comes into effect from 1st April, 2003. In other words this sub-section was introduced only prospectively and not retrospectively. Hence, upto 1st April, 2003, the amounts referred to in the sub-clause received by any assessee are not taxable under Section 28(va) of the Act.

20.1 As far as the claim of the assessee that a sum of Rs. 41.11 was expenditure incurred in connection with transfer of the shares we firstly notice that the AO has observed that there is no evidence regarding actual incurring of these expenses. The CIT(A) however, has merely held that these expenses related to litigation before the Company Law Board and Delhi High Court which took place prior to the transfer of shares and therefore, they cannot be sard to be expenditure wholly and exclusively incurred in connection with the transfer of the shares. We are of the view that the conclusions arrived at by the CIT(A) are just and proper and does not call for any interference.

21. The learned Counsel for the assessee has placed reliance on the decision in the case of CIT v. Bengal Assam Investors Ltd. (Call In the said case the expenditure in question was incurred in

connection with proceedings for obtaining restriction of voting rights of shares and suits for cancelling special resolution, etc. In the present case, there is no dispute with regard to the title of the shares held by the assessee. He also referred to two decisions, one of the Karnataka High Court in the case of CIT v. R. Ranga Setty and of the Kerala High Court in' the case of CIT v. Smt. M. Subaida Beevi . 'We have perused the said decisions and we find that those decisions relate to case of obtaining compensation on compulsory acquisition of property. The criteria in such types of cases will be different from the criteria to be adopted in the present case. In a case of compensation for compulsory acquisition of lands the legal expenses for obtaining compensation or enhanced compensation are directly related to the quantum of compensation which are likely to be awarded and, therefore, it can be said that they were expenses incurred in connection with transfer of capital asset. The same analogy cannot be applied in the case of transfer of shares where transfers are done voluntarily and where the consideration is fixed by mutual agreement between the parties. The learned Counsel also relied on the decision in the case of Godhra Electricity Company Ltd. v. CIT and the decision in the case of CIT v. Shoorji Vallabhdas & Co. and contended that mere book entries recognizing a receipt of income cannot give rise to any income. According to him in reality only a sum of Rs. 358.89 reached the hands of the assessee and only that should be taken as full value of consideration received. We are unable to accept this submission. In the present case the consideration for transfer of share was agreed at Rs. 400 per share and income to that extent should be treated as having accrued to the assessee. The fact that the assessee applied a part of this income towards meeting the expenditure in the form of legal fees was merely an application of income. Therefore, we are unable to accept this argument of the learned Counsel for the assessee. We are in agreement with the view of the CIT(A) that these expenses were incurred prior to the transfer of shares and cannot be said to be wholly and exclusively incurred in connection with the transfer of shares.

22. The alternative plea of the assessee that these expenses may be considered as cost of improvement of the capital asset cannot also be accepted. By incurring these expenses it cannot be said that the value of the capital asset increased nor was there any danger to the right of the assessee as owner of a capital asset. We, therefore, confirm the order of the CIT(A) on this ground.

23. In the result, the appeal by the assessee is partly allowed.