The Director Of Income-Tax vs M/S Sasken Communication Technologies ... on 10 June, 2020

Bench: Alok Aradhe, Hemant Chandangoudar

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IN THE HIGH COURT OF KARNATAKA AT BENGALURU R
DATED THIS THE 10TH DAY OF JUNE 2020

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE HEMANT CHANDANGOUDAR

I.T.A. NO.241 OF 2011

BETWEEN:

1. THE DIRECTOR OF INCOME-TAX
INTERNATIONAL TAXATIONRASHTROTHANA
BHAVANNRUPATHUNGA ROAD,BANGALORE

2. THE INCOME TAX OFFICER
INTERNATIONAL TAXATION,WARD 19
(2)RASHTROTHANA BHAVANNRUPATHUNGA ROAD,
BANGALORE

... APPELLANTS

(By SRI.K.V.ARAVIND, ADV.,)

AND:

M/S SASKEN COMMUNICATION
TECHNOLOGIES LTD.,
NO.139/25, AMARJYOTHI LAYOUT,
RING ROAD, BANGALORE

... RESPONDENT

(By SRI.T.SURYANARAYANA, ADV.)

THIS ITA IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 25.02.2011 PASSED IN ITA

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NOS.287 & 891/BANG/2009, FOR THE ASSESSMENT YEAR 2006-7,
PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO:

(I) FORUMLATE THE SUBSTANTIAL QUESTION OF LAW STATED THREIN.

(II) ALLOW THE APPEAL AND SET ASIDE THE ORDERS DATED 25.02.2011 PASSED IN ITAT, BANGALORE IN ITA NOS.287 & 891/BANG/2009 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE INCOME TAX OFFICER, INTERNATIONAL TAXATION, WARD-19(2), BANGALORE IN THE INTEREST OF JUSTICE AND EQUITY.

THIS ITA COMING ON FOR FINAL HEARING, THIS DAY, ALOK ARADHE J., DELIVERED THE FOLLOWING:

JUDGMENT

This appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act', for short) has been filed by the revenue. The subject matter of the appeal pertains to Assessment year 2006-07. The appeal was admitted by a Bench of this Court vide order dated 26.06.2012 on the following substantial questions of law:

a) Whether the Tribunal was correct in holding that a sum of Rs.4,93,07,540/-

paid to Mr.Madan S. Kumar & Mr.Kevin Koenig by the assessee is in the course of employment and would fall under the head 'Salary' or 'Profit in lieu of Salary' and not under the head 'Business income' as per Section 28(va) of the Act, as held by the assessing officer?

(ii) Whether the tribunal was correct in holding that payment made by the assessee of Rs.4,93,07,540/- paid to Mr.Madan S.Kumar & Mr.Kevin Koenig is income which has arisen or accrued to the recipients in USA as provided under Article 16 of the DTAA between Indian and USA?

(iii) Whether the assessing officer as well as the appellate Commissioner were correct in holding that the assessee was bound to deduct tax at source in respect of Rs.4,93,07,540/- paid to Mr.Madan S.Kumar & Mr. Kevin Koenig and having failed to do so, provisions of Section 201(1) of the Act was ordered and mandatory interest under Section 201(1A) of the Act was correctly levied, which was not appreciated by the Tribunal?

(iv) Whether the assessing officer as well as the appellate commissioner were correct in holding that the explanation and agreements stated to have been entered into between the assessee and Mr.Madan S.Kumark & Mr.Kevin Koenig were only sham transactions entered into between the parties to avoid tax, which was not appreciated by the tribunal?

FACTUAL BACKGROUND:

2. Twin issues arise for consideration in this appeal viz., (a) whether the remittance of amounts to employees under non compete agreements are chargeable to tax under Section 5(2) of the Act, (b) if so, the head of income under which it is liable for taxation under the Act and issue of its taxability under Double Taxation Avoidance Agreement (hereinafter referred to as 'the DTAA' for short) also needs to be determined. The relevant facts in order to appreciate the issues involved in the appeal are set out hereinafter:

3. Admittedly, two employees viz., M.S.Kumar and Mr.Kevin Koenig were in employment of M/s SNSL a subsidiary company of the assessee and were employed as Chief Executive Officer and Chief Operating Officer respectively with effect from 01.04.2004. The aforesaid subsidiary company merged with the assessee on 01.04.2005.

The assessee therefore offered employment to the aforesaid two persons on 31.03.2005, as they were in key strategic positions of the subsidiary company. Mr.Kumar and Mr.Kevin Koenig accepted the offers of employment with the assessee respectively on 31.03.2005 and 23.05.2005. The Non Compete Agreements were entered into on 02.05.2005 and payments under the agreements to the tune of $5,63,000/- (Rs.2,46,53,770/- each) were made to the employees on 31.05.2005. Thus, the payments were made to the aforesaid persons after they had become the employees of the assessee. Three contracts were executed between the two employees and the assessee viz., Employer Agreement, Non Disclosure Agreement and Employee Non Compete Agreement.

4. The assessee filed the C.A. Certificate with the remitter bank with the endorsement that no tax is required to be deducted at source since, remittance is towards consideration under the Non Compete Agreement and is covered by Article 16(1) of the DTAA between India and USA. The Income Tax Officer commenced an enquiry on 10.06.2005 and notice was issued to the assessee to show cause as to why it should not be treated as assessee in default under Section 201 of the Act. The assessing officer by an order dated 31.03.2006 inter alia held that agreements and the payment made thereunder to the two employees of the company was sham and created for the purposes of avoiding payment of tax in India. Therefore, it was held that amount of tax have to be deducted as quantified by taking assessee in default and interest under Section 201(1A) of the Act was levied. The aforesaid order was subject matter of challenge before the Commissioner of Income Tax (Appeals).

5. The Commissioner of Income Tax (Appeals) by an order dated 30.01.2009 inter alia held that place of execution of Non Compete Agreements is not specified for the reasons best known to the assessee. It was further held that under the agreement the employees have been prohibited from taking employment with the competitors of the assessee based in India and the prohibition from taking employment will operate in India with regard to 7 companies mentioned in Non Compete Agreement. It was also held that rights and obligations of the parties under the non compete agreement were to take effect in India. It was held that income under the Non Compete Agreement arises in India under Section 5(2) of the Act and the payments cannot be treated as arising from employment or treated as profits in lieu of salary within the meaning of Section 17(3) of the Act. The

Commissioner of Income Tax (Appeals) also held that non compete fees paid to the two employees by the assessee is taxable under Article 23(3) of DTAA and the appellant has not been able to show that the two employees have paid taxes voluntarily or otherwise to the United States Government. Accordingly, the order of the Assessing Officer on the aforesaid aspect was upheld.

6. Being aggrieved, the assessee filed appeals against the order passed under Section 201(1) and Section 201(1A) read with Section 195 of the Act before the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal' for short). The tribunal by an order dated 25.02.2011 allowed the appeals preferred by the assessee. The tribunal inter alia held that amount paid to the employees by the assessee under the Non Compete Agreements would fall under the term 'salary' or 'profit in lieu of salary'. It was further held that since, no business is being carried on by the employees in India, therefore, the same cannot be treated as business income. The income cannot fall under residuary heads as the same is covered under the head salary. It was also held that amounts paid to the employees were in the nature of salaries, which were not taxable in India and therefore, in view of Article 16 of DTAA, it was not necessary for the assessee to approach the appropriate authority under Section 195(2) of the Act. Accordingly, it was held that assessee cannot be treated to be an assessee in default under Section 201(1) of the Act. In the result, the order passed by the Assessing Officer and Commissioner of Income Tax (Appeals) was quashed and the appeals filed by the assessee were allowed. In the aforesaid factual background, the revenue is in appeal before us.

ARGUMENTS:

7. Learned counsel for the revenue submitted that since, the assessee had already executed the Non Disclosure Agreement and therefore, there was no need to separately execute Employee Non Compete Agreement. It is further submitted that clause in Non Compete Agreement creates a prohibition with regard to employment in respect of the companies situate in India and therefore, the rights and obligations of the parties under the Non Compete Agreement were to take effect in India and therefore, the amount paid to the employees under the Non Compete Agreement is covered under Section 5(2) of the Act. Learned counsel for the revenue has taken us through the order passed by the Commissioner of Income Tax (Appeals). While pointing out to the order passed by the tribunal, it is submitted that the lump sum payment made under a restrictive covenant before acceptance of payment cannot be treated as salary. It is also pointed out that the assessee has entered into sham transactions with its employees for the purposes of tax evasion. It is further submitted that the tribunal grossly erred in holding that Non Disclosure and Non Compete Agreements are different and the income ought to have been treated as income from other sources and Article 23(2) of the DTAA is applicable in the fact situation of the case. In support of aforesaid submissions, reliance has been placed on decisions of the supreme court in 'PERFORMING RIGHT SOCIETY LTD. VS. COMMISSIONER OF INCOME-TAX', (1977) 106 ITR 11 (SC) and 'PILCOM VS. CIT WEST BENGAL-VII', CIVIL APPEAL NO.5749 OF 2012.

8. On the other hand, learned counsel for the assessee submitted that the amount paid to the employees is not chargeable to tax in India under the Act. Alternatively, it is submitted that under the DTAA, the tax, if any, has to be levied in United States. In this connection, learned counsel has

invited the attention of this court to Section 5, Section 9 and Section 17 of the Act. It is further submitted that the employees have not rendered any services in India and on the basis of meticulous appreciation of evidence on record, the findings of fact have been recorded and there is neither any pleading nor any material placed on record to show that the findings recorded by the tribunal are perverse. It is argued that in fact, no substantial questions of law arise for consideration in this appeal and the matter stands concluded by findings of fact. It is further submitted that the provisions of DTAA would override the provisions of the Act in a matter of ascertainment of chargeability to income tax and ascertainment of total income to the extent of inconsistency between the two. It is also pointed out that it has rightly been held by the tribunal that Non Disclosure Agreement and Non Compete Agreement are different inasmuch as the former applies in case of an employee who is in employment whereas, the latter applies in the case where the employment ceases to exist. It is also urged that payer is bound to deduct tax at source only if the tax is assessable in India. It is also pointed out that before the Delhi High Court, the revenue itself had made a submission that non compete fee should be treated as salary and the aforesaid contention was accepted. It is also urged that the decision relied upon by the revenue in the case of PERFORMING RIGHTS SOCIETY LTD. Supra as well as PILCOM supra are distinguishable as the telecast as well as the matches took place in India. In support of aforesaid submissions, reliance has been placed on the decision in 'K.RAVINDRANATHAN NAIR VS. CIT', (2001) 114 TAXMAN 53 (SC), 'VIJAY KUMAR TALWAR VS. CIT', (2011) 196 TAXMAN 136 (SC), 'UNION OF INDIA VS. AZADI BACHAO ANDOLAN', (2003) 132 TAXMAN 373 (SC), ' GE INDIA TECHNOLOGIES CEN. (P) LTD. VS. CIT', (2010) 193 TAXMAN 234 (SC), ' CIT VS. KANWALJIT SINGH', (2012) 28 TAXMANN.COM 28 (DELHI) and 'CIT VS. D.P.SANDU BROS. CHEMBUR (P.) LTD.', (2005) 142 TAXMAN 713 (SC).

STATUTORY PROVISIONS:

> 9. We have considered the submissions made on both the sides and have perused the record. Before proceeding further, it is apposite to take note of statutory provisions.

Section 5(2) of the Act deals with income of a non resident. The relevant extract of Section 5(2) reads as under:

> 5. (2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-

resident includes all income from whatever source derived which--

(a) xxxxx

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

10. Section 9 of the Act defines the expression income deemed to accrue or arise in India. The relevant extract of clause (ii) appended to explanation 7 of Section 9(1) is reproduced below for the facility of reference:

(ii) income which falls under the head"

Salaries" if it is earned in India. Explanation.- For the removal of doubts, it is hereby declared that income of the nature referred to in this clause payable for-

(a) service rendered in India; and

(b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment,

(c) shall be regarded as income earned in India;

Thus it is evident that an income shall be treated as salary if it is earned in India and for services rendered in India.

11. Section 17 of the Act defines the expression 'salary, perquisites and salary in lieu of salary', The relevant extract of Section 17(1) of the Act reads as under:

17. " Salary"" perquisite" and"

profits in lieu of salary" defined 3For the purposes of sections 15 and 16 and of this section,-

(1) " Salary" includes-

(i) wages;

(ii) any annuity or pension;

(iii) any gratuity;

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

Thus, from perusal of aforementioned provision it is clear that definition of the expression 'salary' is inclusive and it includes any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages.

12. Section 17(3) of the Act defines the expression 'profits in lieu of salary'. The relevant extract of Section 17(3) reads as under:

17(3) " profits in lieu of salary"

includes-

> (iii) any amount due to or received, whether in lump sum or otherwise, by any assessee from any person-

before his joining any employment with that person; or after cessation of his employment with that person.

13. Thus it is evident that the expression profits in lieu of salary includes any amount lump sum or otherwise by an assessee from any person before his joining any employment from that person or after cessation of his employment with that person.

14. Admittedly, DTAA has been executed between India and United States. Article 16(1) of the DTAA reads as under:

> 16(1) Subject to the provisions of Articles 17 (Directors' Fees), 18 (Income Earned by Entertainers and Athletes), 19 (Remuneration and Pensions in respect of Government Service), 20 (Private Pensions, Annuities, Alimony and Child Support), 21 (Payments received by Students and Apprentices) and 22 (Payments received by Professors, Teachers and Research Scholars), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

LEGAL PRINCIPLES:

15. After having noticed the statutory provisions, we may take note of the well settled legal principles. It is the cardinal principle of law that tribunal is fact finding authority and a decision on facts on the tribunal can be gone into by the High Court only if a question has been referred to it, which says the finding of the tribunal is perverse. [SEE: 'SUDARSHAN SILKS & SAREES VS. CIT', 300 ITR 205 SCC @ 211 and 'MANGALORE GANESH BEEDI WORKS VS. CIT', 378 ITR 640 (SC) @ 648]. A three judge bench of the Supreme Court in 'SANTOSH HAZARI VS. PURSHOTTAM TIWARI', (2001) 3 SCC 179 while dealing with the expression 'to be a question of law involving in the case' held that 'to be a question of law involving in the case', there must be first a foundation for it laid in pleadings and the questions emerged from sustainable findings of fact arrived at by courts of fact and it must be necessary to decide that question of law for a just and proper decision of the case. It has been held that entirely a new point raised for the first time before the High Court is not a question involved in a case unless, it goes to the root of the matter. In 'HERO VINOTH (MINOR) VS. SESHAMMAL', (2006) 5 SCC 545 while dealing with the scope of Section 260A of the Act, it was held that this court will not interfere with findings of the court, unless the courts have ignored material evidence or acted on no evidence or have drawn wrong inferences from proved facts by applying the law erroneously or the decision is based on no evidence. The aforesaid decisions were referred to with approval in VIJAY KUMAR TALWAR supra as well as in 'UNION OF INDIA V. IBRAHIM UDDIN', (2012) 8 SCC 148 and has been followed by a division bench of this court in 'CIT VS. SOFT BRANDS (P.) LTD.,' (2018) 406 ITR 513. In G.E.TECHNOLOGIES supra, it has been held

that the payer is bound to deduct tax at source if the tax is assessable in India.

16. In the backdrop of aforementioned statutory provisions and the well settled legal principles, we may advert to facts of the case in hand. The tribunal in para 7.2 of its order has formulated 10 questions of fact and after detailed appreciation of material available on record has answered the same in favour of the assessee. The tribunal has noticed that admittedly, the two employees were in employment as Chief Executive Officer and Chief Operating Officers of subsidiary company with effect from 01.04.2004, which subsequently merged with the assessee on 01.04.2005. It has further been held that Non Compete Agreements were entered on 02.05.2005 and payments were made on 31.05.2005 after the aforesaid employees had accepted the employment in the assessee on 31.03.2005 and 23.05.2005 respectively. Thus, they had received the amount in question being employees of the assessee. On meticulous scrutiny of the clauses of Non Disclosure Agreement and Non Compete Agreement, the tribunal has held that Non Compete Agreement prohibits the employee from joining any competitive business entity after termination of the employment, whereas, no such clause is available in Non Disclosure Agreement. It was further held that the employees who were occupying higher positions in the subsidiary companies and were in possession of vital and confidential information were required to be retained in the interest of the assessee for carrying on its business effectively. It was further held that the terms and conditions of the Non Disclosure Agreement are not exactly the same as the Non Compete Agreement. The tribunal recorded a finding that the transactions in question were not sham transactions.

17. The tribunal further held that since, the employees were rendering services outside India i.e., U.S. and payments were also made in U.S., Article 16 of DTAA applies and the same is taxable only in U.S.A. It was held that income in the hands of the employees is salary / profit in lieu of salary and it has to be treated as such and in view of Article 16 of DTAA, the same is taxable in U.S. It was inter alia held that where the payments are in nature of salary, the payer need not approach the appropriate authority under Section 195(2) of the Act. It was further held that amount paid to the employees of the assessee being in the nature of salary is not taxable in India in view of Article 16 of DTAA between India and United States and therefore, the assessee was not under an obligation to deduct at source. The assessee, therefore, cannot be deemed to be an assessee in default under Section 201(1) of the Act. It was also held that since, the assessee has not been held to be an assessee in default, therefore, the interest under Section 201(1A) of the Act is not leviable. Accordingly, the appeal was allowed.

18. From perusal of the substantial questions of law, on which the appeal has been admitted, we find that the findings of fact recorded by the tribunal have not been assailed as perverse. It is also pertinent to mention here that even in the memo of appeal neither any grounds have been urged nor any material has been placed on record to demonstrate that findings of fact recorded by the tribunal are perverse. Therefore, the substantial questions of law as framed by a bench of this court, in fact, do not arise for consideration in this appeal, as the matter stands concluded by findings of fact. The amount paid to the employees under the non compete agreement is covered by the expression 'salary / profits in lieu of salary', which is not taxable in India in view of Article 16 of DTAA.

19. So far as reliance placed by the learned counsel for revenue on the cases in PERFORMING RIGHTS SOCIETY LTD., AND PILCOM supra is concerned, it is pertinent to mention that a non resident company in the former case was granted performing rights in western music to be broadcast by the All India Radio. Since, broadcasting had taken place in India, therefore, it was held that the income shall be deemed to be accrued or arise in India as prescribed under Section 5(2) of the Act. In the instant case, Section 5(2) of the Act has no applicability. Therefore, the aforesaid decision is not applicable in the fact situation of the case. Similarly in the case of PILCOM supra, the associations had participated in the matches, which were held in India and therefore, the income had accrued in India. For the aforementioned reason, the said decision does not apply to the fact situation of the case.

CONCLUSION:

20. In view of the preceding analysis, we find that matter stands concluded by findings of fact and the revenue has not been able to either plead or place on record material to show that findings of fact recorded by the tribunal are perverse. Thus, we hold that no substantial questions of law arise for consideration in this appeal.

In the result, the appeal is dismissed.

Sd/-

JUDGE Sd/-

JUDGE ss