Income-Tax Officer vs Anilkumar Rudra on 9 October, 1998

ORDER

M.V.R. Prasad, A.M.

1. This appeal is directed against the order of the CIT(A) dt. 3rd September, 1990, for the asst. yr. 1983-84. The ground taken reads as follows :

> "On the facts and in the circumstances of the case and in law, the learned CIT(A) erred in deleting the addition of Rs. 1,00,000 being profit in lieu of salary under s. 17(3) holding that there is no employer-employee relationship."

2. The appellant was an employee of M/s Vulcan-Laval Ltd., which was a FERA company and manufactures industrial machineries for various applications like drilling rods, mining equipment, etc. The appellant was with this company for about 27 years, from 1954 to 1981. He was an engineer and a geologist and when he retired on 22nd September, 1981, he was the head of mining and drilling division. During his service with the company he was sent abroad many times for getting trained with the parent company, i.e. M/s Alfa Laval of West Germany. He retired on superannuation on 22nd September, 1981, and the employer company entered into an agreement dt. 29th July, 1982. i.e., about 10 months after the date of superannuation, with the assessee under which the assessee was to receive an amount of Rs. 1 lakh in return for a covenant not to accept employment with any other employer. A copy of this agreement may be seen at pp. 1 to 5 of the appellant's paper book. The employer company is described as the party of the first part in the agreement and the assessee is described as the party of the second part, and the relevant portion of the agreement reads as follows :

> "And whereas the party of the second part was employed with the party of the first part as a senior executive for 27 years and has during the course of his employment acquired a corpus of knowledge, expertise, skill and experience related to the manufacture and marketing of the products of the party of the first part and has also acquired or otherwise come in possession of various secret information, know-how and trade secrets relating to the line of products of the party of the first part, in particular, in the manufacture of drilling rods and other mining equipment.
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> And whereas the party of the first part desires that the secret information, trade secrets and know-how should not be revealed or disclosed in any form or mode or manner to any outsider.
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> And whereas the parties hereto have agreed to enter into an agreement whereby the party of the first part puts reasonable restrictions on the party of the second part accepting employment with any other employer or being directly or indirectly associated with any other person, firm, company or other body engaged in the manufacture and/or dealing in the products presently manufactured and/or dealt

with by the party of the first part.

And whereas the party of the second part has agreed to be bound by the aforesaid restrictions.

And whereas the parties hereto wish to incorporate the terms and conditions of this agreement in writing.

Whereby it is agreed as follows :

1. The party of the second part shall not after retirement from employment with the party of the first part accept or be engaged in the employment of or be associated, directly or indirectly with any other person, firm, company or other body manufacturing or otherwise dealing in products identical or similar to those manufactured or dealt with by the party of the first part.

2. The party of the second part further agrees not to be engaged directly or indirectly on his own in business identical or similar to that carried on by the party of the first part for the period of the agreement.

3. The period of this agreement shall be three years with retrospective effect from 1st October, 1981.

4. In consideration of the party of the second part agreeing not to engage himself in or take-up employment with any other employer or be associated with any other person, firm, company or other body engaged in business identical or similar to the one carried on by the party of the first part, the party of the first part agrees to pay the party of the second part a sum of Rs. 1,00,000 (Rupees one lakh only, within a period of 60 days from the execution of this agreement.

5. The party of the second part shall, in case he shall accept employment or, as the case may be, engaged himself in business in contravention of cls. (1) and (2) hereof pay liquidated damages to the party of the first part in the amount of Rs. 2,00,000 (rupees two lakhs only) within a period of 30 days of a demand made on him for such damages by the party of the first part and on such payment this agreement shall be deemed to have been terminated.

6. Notwithstanding cls. 3 and 5, this agreement shall terminate forthwith on :

(i) death, or insolvency of the party of the second part or on his making any composition or arrangement with his creditors;

(ii) dissolution or winding up of the party of the first part.

7. This agreement supersedes, cancels and annuls any oral agreements representations or undertakings subsisting between the parties hereto."

3. The learned Departmental Representative pleaded that the sum of Rs. 1 lakh received by the assessee during the accounting year relevant for the present assessment year is in the nature of profits in lieu of salary and so that is rightly brought to tax under the provisions of s. 17(3)(i) of the IT Act. He has relied upon the decision of the Hon'ble Supreme Court in the case of CIT vs. G. R. Kartikeyan (1993) 201 ITR 866 (SC) and pleaded that the word "income" is of widest amplitude and would rope in within its scope all the receipts of the type in question.

4. The learned counsel for the assessee on the other hand pleaded that the assessee has received the amount of Rs. 1 lakh in question entirely by virtue of a restrictive covenant entered into by him with his former employer company, in terms of which covenant he had undertaken not to accept employment with any other employer and so the amount is received only for surrendering a potential source of income and as such the receipt is of capital nature. He has also pleaded that all receipts are not of an income nature and in this context he has relied upon the decision of the Hon'ble Bombay High Court in the case of Mehboob Productions (P) Ltd. vs. CIT (1977) 106 ITR 758 (Bom) in which it was held that all receipts by an assessee would not necessarily be deemed income of the assessee for the purpose of income-tax and the question whether any of the receipts is income or not would depend on the nature of the receipt and the true scope and effect of the relevant taxing provision. He has also pleaded that this issue is covered in favour of the assessee by the decision of the Tribunal in the case of K. S. S. Mani vs. ITO (1995) 54 ITD 76 (Mad) and the decision of the Tribunal in the case of M. R. Muchhala vs. ITO (1996) 56 TTJ (Mum) 504. He has also relied upon the decision of the Bombay High Court in the case of R. N. Agrawala vs. CIT (1960) 38 ITR 67 (Bom) in which the relevant portion of the head-note reads as follows :

> "Held, that as the assessee's employment was terminated the payment made to him was not under the terms of the agreement of employment, and not withstanding the fact that the assessee was being compensated for loss of employment and was also giving up all his claims against the company and binding himself to a covenant not to accept employment which may be detrimental to the interest of the company in a certain area, the payment was in the nature of capital and was not assessable in the hands of the assessee."

5. In response to a query from the Bench, the learned counsel clarified that the amount in question cannot even be treated as an income of a casual and non-recurring nature which enjoys only a limited exemption under the provisions of s. 10(3) of the IT Act and considered by the Hon'ble Allahabad High Court in the case of CIT vs. Gulabchand (1991) 192 ITR 495 (All). It is explained that in this case, the Hon'ble Allahabad High Court was considering the case of a surrender of tenancy and proceeded on the assumption that the capital gains arising on the surrender of tenancy was not chargeable to tax because there was no cost of acquisition for such tenancy rights in view of the decision of the apex Court in the case of CIT vs. B. C. Srinivasa Setty (1981) 128 ITR 294 (SC) and this decision is applicable only in a case where the receipt involved is of the nature of a capital gain and such capital gain is not chargeable under the provisions of s. 45. In the present case, it is

claimed that there is no transfer of a capital asset of any type and so there is no capital gain at all and the receipt of Rs. 1 lakh by the assessee represents only a capital receipt of Rs. 1 lakh by the assessee represents only a capital receipt and not a receipt of the nature of capital gains either taxable or not taxable under s. 45.

6. We are in agreement with the contentions made out by the learned counsel for the assessee. As the amount of Rs. 1 lakh has been received by the assessee after his superannuation, it has nothing to do with his employment and so it is not in the nature of compensation received by him at or in connection with the termination of his employment or the modification of the terms and conditions relating to his employment and as such cannot be treated as "profits in lieu of salary" under s. 17(3) of the IT Act. The amount is received purely in lieu of a restrictive covenant which puts fetters on the freedom of the assessee to engage in employment of his choice. The right surrendered by the assessee is only a personal right and not a proprietary right. We may refer to "Salmond on Jurisprudence" for the distinction between these two sets of rights. The learned author brings out the direction as follows (p. 43) :

> "Another important distinction is that between proprietary and personal rights. The aggregate of a man's proprietary rights constitutes his estate, his assets, or his property in one of the many senses of that most equivocal or legal terms. The sum total of a man's personal rights, on the other hand, constitutes his status or personal condition, as opposed to his estate. If he owns land, or chattels, or patent rights, or the goodwill of a business, or shares in a, company, or if debts are owing to him, all these rights pertain to his estate. But if he is a free man and a citizen, a husband and a father, the rights which he has as such pertain to his status or standing in the law.
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> The distinction lies in the fact that or proprietary rights are valuable, and personal rights are not. The former are those which are worth money; the latter are those that are worth none. The former are the elements of a man's wealth; the latter are merely elements in his well-being."

7. The extinguishment of every type of right does not give rise to a capital gain. In this context, we may refer to the decision of the jurisdictional High Court in the case of CIT vs. Bharat Forge Co. Ltd. (1993) 205 ITR 339 (Bom) wherein it was held that the right to sue for damages cannot be considered as a capital asset at all because such a right is not a property which can be transferred and the amount received by the surrender of such a right by virtue of a settlement was held not to be liable to capital gains tax. We may also refer to the decision of the apex Court in the case of Vania Silk Mills (P) Ltd. vs. CIT (1991) 191 ITR 647 (SC) wherein it was held that an amount received from an insurance company consequent to the extinguishment of an asset by fire was held not to be taxable under the head "Capital gains" because there is no transfer in favour of a different party when an asset is destroyed. In the light of these decisions, we have to hold that in the case of the assessee, the surrender of the right which is of a personal nature consequent to a restrictive covenant, does not involve the receipt of any income of the nature of capital gain and so the amount received by virtue of the covenant cannot be regarded as even a casual receipt liable to tax by virtue of the decision of the Allahabad High Court in the case of Gulab Chand cited supra. We are of the

view that the decision of the jurisdictional High Court in the case of Mehboob Productions (P) Ltd. cited supra is a clear authority for the proposition that all receipts are not of an income nature liable to tax under the IT Act. We are of the view that while "income" is of a very wide scope, as pleaded by the learned Departmental Representative, the age-old distinction between a capital receipt and a receipt of an income nature cannot be ignored. When an amount is received by virtue of a restrictive covenant or in lieu of the loss of a potential source of income, it has to be regarded only as a capital receipt, as held by the jurisdictional High Court in the case of R. N. Agrawala cited supra and the two decisions of the Tribunal cited in support of his plea by the learned counsel for the assessee. We may also mention that the CIT(A) has quoted the relevant portion of the decision of the Hon'ble Sind High Court in the case of CIT vs. The Mills Store Co. Karachi (1941) 9 ITR 642 (Sind), which reads as follows :

> "A restrictive covenant, whereby a person undertakes for consideration to abstain from doing a particular act or from following a particular course of conduct, is something quite outside an ordinary contract of employment and the word 'salary' cannot be held to include the consideration of such a contract."

8. We are entirely in agreement with the view taken by the CIT(A). We uphold his order.

9. The appeal is dismissed.