Mr.G.Raveendran vs The Commissioner Of Income Tax on 18 February, 2015

Bench: R.Sudhakar, R.Karuppiah

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATE : 18.02.2015

CORAM

THE HONOURABLE MR. JUSTICE R.SUDHAKAR
AND
THE HONOURABLE MR. JUSTICE R.KARUPPIAH

T.C.A. NO. 122 OF 2005

Mr.G.Raveendran .. Appellant

- Vs -

The Commissioner of Income Tax
Chennai. .. Respondent

Appeal filed under Section 260-A of the Income Tax Act against the order dated 19.5.2004

For Appellant : Mr. S.Sridhar

For Respondent : Mr. T.Ravikumar

JUDGMENT

(DELIVERED BY R.SUDHAKAR, J.) Aggrieved by the order of the Tribunal in dismissing the appeal filed by him, the appellant is before this Court by filing the present appeal. This Court vide order dated 3.3.2005, admitted the appeal on the following substantial question of law :-

> Whether the Income Tax Appellate Tribunal is correct in law in holding that the amount of 18,000 Pound Sterling (equivalent to Rs.9,83,385/=) received by the appellant under the non-competition agreement dated 14.12.1995 should be taxed as salary income of the appellant?

2. The brief facts, which are relevant for considering the present case, are set out as hereunder :-

The appellant is an engineer, who is experienced in the field of Industrial Drives. The appellant is a B.E. (Electrical & Electronics) Engineer from Annamalai University. He qualified in M.E. in Control Systems Engineering from PSG College of Technology, Coimbatore, in the year 1973. In 1974, it is stated that, he joined as Assistant Development Engineer with the R&D Division of M/s.Jyoti Ltd., Baroda. Between 1975 to 1982 he discharged duties as Manager (Designs) with M/s.Usha Rectifier Corporation, Faridabad. Between 1982 and 1985, the appellant functioned as Senior Manager with DEBIKAY Electronics, Calcutta. Between 1986 and 1989, the appellant was working as Senior Manager with A.B. Controls Ltd., Sahibabad (U.P.). The appellant had also underwent the following specialised trainings:-

:

Training on Drives for Rolling Mills at the Works of CGEE ALSTOM, France.

:

Training on DC/AC Drives in Allen Bradley, USA :

Training on Total Quality System in Allen Bradley, UK :

Training on High Power UPS (Uninterruptible Power Supply) Systems in Exide Electronics, USA :

Training on AC Drives in Stromberg, Finland

3. It is the further case of the appellant that he has rich experience in design, development and commissioning of Industrial Drives, power electronic equipments, such as High Power Battery Chargers and UPS Systems. He has proficiency in Design, Development and Commissioning of Drives in Core Industries such as Paper Mills, Rolling Mills, Sugar Plants, Cement Plants, etc. It is the further stand of the appellant that he also acquired proficiency in high power charging equipments to be used by Baba Atomic Research Centre, National Thermal Power Corporation, etc. Similarly, he also gained expertise and proficiency in commissioning of High Power UPS Systems in Customs Dept., Texas Instruments, Dalmia Cements, etc. The proficiency acquired by the appellant in Industrial Drives is put to use in industries where large motors are used for production purposes. Since the power of these motors vary between few kilowatts to 100's of kilowatts, for the purpose of controlling those motors, the appellant/assessee, using his expertise, designed and implemented power electronic controls to drive the motors. These Power Electronic Converters (for short 'PEC') are called Industrial Drives. The Industrial Drive System, according to the appellant, is a specialized equipment involving power system, electronic control system and automation system using Programmable Logic Controller (for short 'PLC') and application oriented software. The Industrial Drive System enhances the production efficiency and also results in energy saving. The Industrial Drives, otherwise known as Power Electronic Converters, are widely used in all varieties of industries to provide for optimum use of power and efficiency in production.

4. Based on his experience, the appellant, along with another colleague, started a Private Limited Company in the year 1990 by the name RSM Electronics Pvt. Ltd. (for short 'RSM') for manufacture of Industrial Drives, Battery Charges and UPS Systems, with reasonable success. Coming to know of the appellant's capacity in these fields, an UK based company, viz., M/s.Control Techniques PLC (for short 'CT-PLC') joined hands with the appellant in the year 1992. It is to be mentioned here that Control Techniques, PLC, UK, is a world leader in Europe in the field of Industrial Drives. The Indian company, RSM Electronics Pvt. Ltd., was engaged as sales agent for selling of products of CT-PLC by way of marketing and offering application/commissioning together with after sales service support to the clients. Additionally, RSM also bought the Drives from CT-PLC for providing complete solution to their customers.

5. In the meanwhile, in September, 1993, CT-PLC and RSM realized their joint potential in the field of industrial drives and as a result, a Joint Venture company was formed in September, 1993, by name Control Techniques India Pvt. Ltd. (for short 'CTIL') with 51% share held by CT-PLC and 49% share held by RSM. Since the expertise of the technical personnel of RSM would be the key to success of this joint venture, the Directors of RSM were asked to assume executive responsibility in the joint venture company and, accordingly, an employment contract was signed by the appellant and he became the employee of CTIL on 30.9.93. The salary of the appellant was paid by CTIL, which is a duly constituted and registered company under the laws of this country. The said company was filing returns of income for all the assessment years, including the assessment year in question, viz., 1996-1997.

6. The percentage of shareholding continued in the manner stated above upto 26.9.95. On 26.9.95, the Government of India, Ministry of Industries, Department of Industrial Policy & Promotion, Secretariat for Industrial Approvals, Foreign Collaboration-II Section, granted approval for changing the shareholding pattern, which is quoted hereunder :-

> Name and Address of Foreign Collaborator :
>
> M/s.CONTROL TECHINIQUES PLC ST. GILES, NEWTOWN POWYS SY 16 3AJ UNITED KINGDOM Item(s) of manufacture/activity covered by foreign collaborator :
>
> 1) STATIC CONVERTORS
>
> 2) BOARDS PANELS Proposed Location District State :
>
> DEVELOPED PLOT-117b ELECTRONIC ESTATE MADRAS TAMIL NADU Foreign Equity Participation : Increase from 51.00% (Rs.40.80 Lakhs) to 85.00% (Eighty five Percent) amounting to Rs.425.00 Lakhs (Four Hundred Twenty Five Lakhs) in the revised paid up capital of Rs.500.00 Lakhs, in your undertaking.

7. After obtaining approval as above, since the stakes of the UK company, viz., CT-PLC was increased from 51% to 85%, correspondingly, the shareholding of RSM came to be reduced from

49% to 15%. In order to ensure that there is no competition of any kind by the appellant consequent to reduction of the share capital in the joint venture Indian company, viz., CTIL, CT-PLC entered into a non-competition agreement with the appellant on 14.12.95. That agreement is now the bone of contention between the appellant/assessee and the respondent/Income Tax Department.

8. For better understanding of the issue involved in the present case, we are inclined to set out the non-competition agreement as such and the same is extracted hereinbelow :-

> NON COMPETITION AGREEMENT This Agreement made on this 14th Day of December, 1995 between G.Raveendran residing at B-6, Rams Maruti Flats, 111, Muthallaman Koil Street, West Mambalam, Madras 600 033, hereinafter called 'RAVEENDRAN' of the one part and Control Techniques plc, a company incorporated in UK and having its principal place of business at Newtown, Powys, Wales, United Kingdom, hereinafter called 'CT' which expression shall unless repugnant to the context of meaning whereof include its successors and assigns of the Second Party.
>
> WHEREAS A. RAVEENDRAN has been engaged in the area of Industrial Electronic Drive systems for over 20 years in various capacities and has acquired considerable expertise in design, manufacture, testing and commissioning of Industrial Drive Systems and has thorough application knowhow of these systems for industrial use for efficient production and energy saving in Industry.
>
> B. RAVEENDRAN, by virtue of the said experience gained over the last 20 years, set up a company RSM Electronics Pvt Limited ('RSM') in 1990 for design, manufacture and testing of Industrial Drive systems and market the products in India. RSM has considerable orders from reputed companies and were in direct competition with CT's competitors worldwide.
>
> C. RSM Electronics entered into a Joint Venture Agreement dated 1st day of October, 1993, with 'CT' to form Control Techniques India Pvt. Ltd., (the CIT) to take over the Business of 'RSM' and run as a going concern in India (the territory) and subject to the conditions therein specified, to take over from RSM the business of Industrial Drive systems on the terms and conditions therein.
>
> D. By the Deed of Assignment, RAVEENDRAN has irrevocably agreed to cease and desist to engage, directly or indirectly, in the Industrial Drives business save and except RAVEENDRAN's participation as a shareholder and operating executive of the 'CTI' under mutually agreed terms.
>
> E. RAVEENDRAN is desirous of giving an undertaking not to compete with CT. It is expedient to record the terms and conditions relating to the aforesaid matters in writing :

NOW THIS AGREEMENT WITNESSES AND THE PARTIES HERETO MUTUALLY AGREE AND STATE AS FOLLOWS :

1. CT recognises that RAVEENDRAN possesses the necessary expertise and has with considerable efforts, set up the Industrial Drives System business of RSM and has enjoyed a good reputation and sufficient market recognition in the territory which has constituted substantial source of income for RAVEENDRAN and that RAVEENDRAN has spent and incurred substantial expenditure in establishing the Industrial Drives business.

2. RAVEENDRAN agrees to give up, part with and cease and desist from carrying on the Industrial Drives business anywhere in the territory, and further agrees that such business shall be carried on only by the 'CTI' wherein RAVEENDRAN will be a shareholder and a partner.

3. RAVEENDRAN shall not directly or indirectly own, manage, operate, join, have an interest in, control or participate in the ownership, management, operation or control of, or be otherwise connected in any manner with any body corporate, partnership, proprietorship, trust association or other business entity in India which directly or indirectly engages as a commercial activity anywhere in the territory in the Industrial Drives business either in its production, distribution, marketing, sale or servicing whether by using the brand name RSM or any other brand or otherwise howsoever, nor shall RAVEENDRAN directly or indirectly compete in the Industrial Drives business with CT or otherwise engage itself in the Industrial Drives business for a period of 5 years commencing from the date of this agreement.

4. In consideration of the premises, CT agrees to pay RAVEENDRAN an amount of GBP 18,000 (Pound Sterling Eighteen Thousand Only) on signing the Agreement.

5. Notwithstanding anything contained in Clause 2 and 3 above RAVEENDRAN may carry on the Industrial Drives Business solely for 'CTI' and only to the limited extent of the work entrusted by 'CTI'.

6. The Agreement will be valid for a period of 5 years from the date of the Agreement.

7. Any dispute or difference between the parties arising from or relating to anything contained in the Agreement including the termination shall be settled by arbitration by two arbitrators to be nominated, one by each party and the Indian Arbitration Act shall apply.

IN WITNESS WHEREOF THE PARTIES HERETO HAVE CAUSED THIS AGREEMENT TO BE EXECUTED THE DAY AND YEAR FIRST HEREIN ABOVE WRITTEN.

9. The non-competition agreement speaks for itself. It provides for a consideration of 18,000 Pound Sterling in recognition of the appellant's expertise in industrial drives system and taking note of the business of RSM and the good reputation and market that it enjoys, which was the main source of income for the appellant. In turn, the appellant agreed to give up, part with, cease and desist from carrying on the business of industrial drives anywhere in the territory, subject to certain conditions, on receipt of consideration of 18,000 Pound Sterling. Accordingly, an agreement dated 14.12.95 was entered into between the appellant/assessee and CT-PLC and, accordingly, payment was made.

10. The appellant/assessee, in his return of income, showed this amount as capital receipt. Note-2 of the return filed for the assessment year 1996-1997, financial year ending 1996, is relevant for the present case and the same is extracted hereinbelow, for better clarity :-

> . I have received a sum of Rs.9,83,385/= from M/s.Control Techniques, England in accordance with non competition agreement entered into between the assessee and the said company. This amount is treated as a Capital Receipt in view of the legal opinion from M/s.Subaraiya Iyer Padmanabhan and Ramamani, Advocates. This is not received as cash but the equivalent shares will be issued by the Companies.

11. In the statement of income, besides this amount received from CT-PLC, the appellant/assessee has also shown salary that he received from the joint venture Indian Company, viz., CTIL. According to the assessee/appellant, this amount is a capital receipt and, hence, exempt from tax and also entitled to immunity from capital gains as the cost of acquisition is 'Nil'. The Assessing Officer took the view that non-competition agreement, which is a fall out of the formation of the joint venture company between CT-PLC and RSM with 51% share to the UK company and 49% share to the Indian company resulting in formation of CTIL, held that the business of RSM was taken over by CTIL and the new company came into operation from 1.10.93. In para-12 of the order, the Assessing Officer analyses the effect of such joint venture on the assessee. On the first premise, he holds that consequent to the merger of CT-PLC with the Indian company, viz., RSM, the assessee and two other Directors of RSM became Directors of CTIL. The assessee continued in the post and received salary, which income was shown as salary for the assessment year in question, viz., 1996-97. In para-13 of the order, the Assessing Officer holds that the appellant/assessee being an employee of CTIL from 1.10.93, he was prevented from doing anything in the line of business against the interests of CTIL, including accepting any job on that line. Therefore, the assessee became a full time Director of CTIL. The Assessing Officer further went on to observe that the company, viz., RSM was taken over by CTIL as per agreement dated 17.9.93 and all the Directors of RSM were taken as Directors of CTIL. The Assessing Officer, therefore, went on to hold that on 14.12.95, i.e., the date of non-competition agreement, neither the assessee/appellant nor his old company, viz., RSM, was in a position to compete with CTIL when the assessee/appellant undertook not to work against the interest of the business of the Indian company, viz., CTIL. For better clarity, the finding of the Assessing Officer is set out as hereunder :-

> As mentioned above, the assessee became an employee of the company CTI, as early as on 1.10.93. As per the Employment Contract (copy filed), the assessee was prevented from doing anything in the line of business against the interests of CTI,

including accepting any job in that line. So as on 1.10.93, the assessee had become a full time Director of CTI, dedicating all his expertise for the future of CTI.

Secondly, the company RSM was taken over by CTI as per agreement dt. 17.9.93 and all the Directors of RSM were taken as Directors of CTI. The IT record shows that as on 14.12.95, the assessee was continuing as Director of CTI on salary.

In view of the above, as on 14.12.95 neither the assessee nor his old company RSM was in a position to compete with CTI and there is, therefore, no sanctity for a non-competition agreement in this case. In addition to this, it has to be seen that when the assessee was taken over as Director he had agreed not to work against the business interests of CTI, and the very appointment was the reward for his non-competition.

12. The Assessing Officer, further went on to hold that there was no justification for the assessee/appellant for entering into the non-competition agreement and for better clarity, the reasons recorded by the Assessing Officer in paras 14 and 15 of the assessment order are extracted hereinbelow :-

4. Case Laws :-

In this connection, the assessee has presented two case laws for my consideration, but I find that both the case laws are not applicable to the case of the assessee.

In Saraswathi Publications 132 ITR 207 (Mad) the agreement was between two different concerns working in the same field to the effect that they will mutually refrain from overlapping in business in respect of specified clients and specified area.

In G.D. Naidu 165 ITR 63 (Mad) , the payment was between partners of a firm in a process of new partners joining and old partners quitting so that the business is ultimately handed over to the new partners.

On the one hand, these case laws have been delivered much before the relevant provisions of capital gains have been successively amended.

Secondly, the facts of these cases have no similarity with the case of the assessee, except that the assessee has also made an agreement in the style of a non-competition agreement. Where there is no scope for competition, there is no place for a non-competition agreement.

15. No Competition :-

RSM was in the company CTI with 49% share. The assessee was in the company as a full time Director on decent salary and perks. There is nothing on record to show that

> either RSM or the assessee had done anything against the interests of CTI in all the 27 months of their co-existence with CTI from 1.10.93 to 14.12.95. There is, therefore, no question of any non-competition agreement here.

13. The Assessing Officer has further given a finding that the sum of Rs.9,83,385/= is not the outcome of non-competition agreement as there was no competition as on 14.12.95. According to the authority, there was no competition on the right to carry on business, as the assessee was not doing any competing independent business on that date. According to the officer, competition ended 27 months earlier when RSM merged with CT-PLC to form CTIL and the assessee was made a Director. The Assessing Officer further held that the agreement shows the rich goodwill that the assessee had in the field of business which was transferred. It is further observed by the Assessing Officer that in a sense, the entire payment is attributable to the goodwill of the assessee and that goodwill is self-generated and as the cost is 'Nil' the provisions of Section 55 (2) (a) (ii) of the Act will get attracted and as a result, the entire receipt is taxable as capital gains.

14. The Assessing Officer, further held that the payment in this case was received from the employer on the premise that the company, CT-PLC and CTIL are one and the same stating that the UK company, viz., CT-PLC owns 51% in the Indian company. The Assessing Officer proceeds to hold that the payment is directly related to the service the assessee was rendering as any payment, whether it be salary, remuneration, commission, etc., forming part of the salary as per Section 17 (1) of the Income Tax Act, even if it is casual or non-recurring payment, Section 10 (3) does not exclude the amount from the purview of taxation, if the said payment is in addition to remuneration. The Assessing Officer, therefore, held that the above stated receipt is assessable under the head 'salary'.

15. In the alternative, the Assessing Officer concluded as under :-

> 8. Alternatives :-
>
> Whether it is assessed as Capital Gain or Salary , the entire receipt is taxable. For the sake of clarity, I am bringing the sum of Rs.9,83,385/= to assessment under the head Salary as the payment is one between the employer and the employee and also since it is essentially connected with his past, present and future services. But is is made known that this does not discount the scope of assessing it as Capital Gains on Goodwill, which will remain as an equal alternative. It is made clear that the receipt is assessable whether it is treated as Capital or Revenue.

16. In the end, the Assessing Officer held that the amount received as non-competition fee is salary and in the alternative it should be treated as goodwill and capital gains tax was sought to be levied. However, in the computation of assessment, the said amount was treated as salary.

17. Aggrieved by the above order, the assessee preferred appeal to the CIT (Appeals). On consideration of the matter, the CIT (Appeals) held as follows :-

> . …….. it would not make any difference, in legal parlance, to treat both as employer, in the opinion of the assessing officer. I agree with the stand taken by the assessing officer in the matter. The appellant's representatives have sought to build up a case to the effect that the appellant was never the employee of CT PLC (UK) therefore the receipt from that company would not constitute salary or addition to salary or payment in lieu of salary but the receipt would constitute non taxable capital receipt paid to the appellant in lieu of his foregoing his right to exercise business in Industrial Drive etc. I do not agree with this position. The appellant's representatives overlooked the fact that the UK company was closely knit to CTI wherein the appellant was employed during the relevant previous year, the former had substantial interest in the latter including influencing the policies and decision making processes of CTI and therefore the receipt in question earned from CT PLC (UK) is as good as earning from CTI. The nomenclature given to the receipt, viz., non-competition allowance is only a veil blanking the identity of payment in lieu of/addition to salary made to the appellant and in the spirit of Hon'ble Supreme Court's decision in the case of McDowell & Co., it has to be held that the so called non-competition allowance is only salary/addition to salary/payment in lieu of salary from CT PLC (UK) which is actually a foreign version of Indian employer CTI. Holding so, I affirm the assessment of Rs.9,83,385/= as salary.

18. The appellant/assessee, aggrieved over the finding rendered by the CIT (Appeals), pursued the matter before the Tribunal. The Tribunal, considering the factual matrix and the documents placed before it, held as under :-

> . Having heard the learned representatives on both sides, we also perused the material available on record. Admittedly, the assessee has received a sum of Rs.18,000 Pound Sterling which is equivalent to Indian currency Rs.9,83,385/= from the foreign company Control Techniques PLC. The only objection of the assessee is that there is no employee and employer relationship to treat the payment as salary. According to the assessee, it is a fee received for non-competition in the business. As rightly submitted by the learned D.R., if it is a non-competition fee, it has to be paid to RSM Electronics Pvt. Ltd., and not to the assessee. The assessee converted his business into Pvt. Limited company and the same Pvt. Limited company has entered into a joint venture project. Therefore, if at all anything to be paid as non-competition fee, it has to be paid to RSM Electronics Pvt. Ltd., and not to the assessee. Furthermore, RSM Electronics Pvt. Ltd., continued to do its business even after the formation of the joint venture company. The assessee himself admits in his letter dated 16.5.99 addressed to the first appellate authority. According to this letter, the entire business was not taken over by the joint venture company and even on 31.3.96, RSM Electronics Pvt. Ltd., was in existence and it appears the assessee has filed a copy of the audited accounts to show that RSM Electronics Pvt. Ltd., was in existence. It was the case of the assessee before the first Appellate authority that RSM Electronics Pvt. Ltd., was an independent company and it was not merged with Control Techniques PLC. If that is the factual situation and when the RSM

> Electronics Pvt. Ltd., continued its business even after the formation of the joint venture, where is the necessity to pay any money as non-competition fee? Admittedly, the foreign company Control Techniques PLC is having 51% of the shares in the newly formed joint venture Indian company. Therefore, to look after the business and overall interest in the joint venture company the foreign company has to nominate somebody. In this case, probably they might have nominated the assessee and as a consideration for taking care of the entire joint venture company, the assessee received the money. Therefore, it must be construed only as salary for taking care of interest of the foreign company in the newly formed joint venture company. Therefore, it is not correct to say that there is no employer and employee relationship between the assessee and the foreign company. Therefore, in our view, the amount of 18000 Pound Sterling (Rs.9,83,385/- in Indian currency) is taxable as salary.

19. Aggrieved by the said order of the Tribunal dismissing the appeal of the assessee, the assessee/appellant is before this Court by filing the present appeal on the question of law as admitted above.

20. Learned counsel appearing for the appellant/assessee submitted that the payment under the non-competition agreement dated 14.12.95 was paid to the appellant/assessee by CT-PLC as compensation for restrictive covenant on the part of the appellant/assessee not to engage in the business of industrial drive system anywhere in India for a period of five years. That being the case, the said amount received, partook the character of capital receipt. It is the further submission of the learned counsel for the appellant/assessee that the amount towards non-competition agreement was paid by the foreign company, viz., CT-PLC, while the salary towards the employment of the appellant/assessee was paid by the joint venture Indian company, viz., CTIL. Both the transactions being with two different entities, the receipt of the amount under the non-competition agreement from the foreign company cannot be construed as salary, when the appellant/assessee is not in employment under the foreign company, viz., CT-PLC. It is submitted by the learned counsel for the appellant/assessee that Section 15 of the Act deals with incomes falling under the head 'Salaries and 'Section 16 deals with deduction thereof from salaries. Section 15 clearly stipulates what salary means and what incomes should be construed as salary, which have not been construed in proper perspective by the authorities below and, therefore, the impugned order deserves to be set aside.

22. Per contra, learned standing counsel appearing for the respondent/Revenue submitted that the appellant/assessee having received the amounts while under employment with CTIL, the said amounts were rightly considered as salary by the authorities below as RSM had merged with CT-PLC to form a new company CTIL of which the appellant/assessee was made a Director and CT-PLC was holding 51% of the shares in CTIL. Thus there exists an employer-employee relationship and, therefore, any monies received thereof while in employment shall have to be construed as part of the salary. Therefore, it is submitted that no interference is called for with the order passed by the authorities below.

23. Heard Mr.Sridhar, learned counsel appearing for the appellant/assessee and Mr.Ravikumar, learned standing counsel appearing for the respondent/Revenue and perused the materials available on record as also the decisions relied on by the learned counsel for the parties and the relevant Sections under the Income Tax Act on which reliance was placed by the parties.

24. Before proceeding to analyse the matter in-depth, it is better to have a look at the legal position in regard to receipt of amount, whether it be treated as capital receipt or revenue receipt and what is the yardstick to be applied in cases of such receipt.

25. In Kettlewell Bullen & Co. - Vs Commissioner of Income Tax, Calcutta (AIR 1965 SC 65), the Supreme Court had occasion to consider payment of non-competition fee. In the said case, the Supreme Court, considering various case laws on the subject, held as under :-

> This case raises once again the question whether compensation received by an agent for premature determination of the contract of agency is a capital or a revenue receipt. The question is not capable of solution by the application of any single test: its solution must depend on a correct appraisal in their true perspective of all the relevant facts. As observed in Commissioner of Income-tax Nagpur v. Rai Bahadur Jairam Valji by Venkatarama Aiyar, J.,:
>
> "The question whether a receipt is capital or income has frequently come up for determination before the courts. Various rules have been enunciated as furnishing a key to the solution of the question, but as often observed by the highest authorities, it is not possible to lay down any single test as infallible or any single criterion as decisive in the determination of the question, which must ultimately depend on the facts of the particular case, and the authorities bearing on the question are valuable only as indicating the matters that have to be taken into account in reaching a decision. Vide, Van Den Berghs Ltd. v. Clark [(1935) 3 I.T.R. (Engl. Cas.) 17].

26. In the case of Oberoi Hotel Pvt. Ltd. v. CIT (236 ITR 903), the Supreme Court, laid down the parameters as to the heads under which the amounts received in a particular transaction should fall into. The relevant portion of the judgment of the Supreme Court is extracted hereunder for better clarity :-

> It may be broadly stated that what is received for loss of capital is a capital receipt: what is received as profit in a trading transaction is a taxable income. But the difficulty arises in ascertaining whether what is received in a given case is compensation for loss of a source of income, or profit in a trading transaction. Where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue: Where by the cancellation of an agency the trading structure of the assessee is

> impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt.

27. In a recent decision in Guffic Chem Pvt. Ltd. - Vs - C.I.T., Belgaum & Anr. (2011 (332) ITR 602 (SC)), the Supreme Court has distinguished the difference between 'capital receipt' and 'revenue receipt' and the circumstances in which the receipt would fall under the particular category. For better appreciation of this case, it is useful to extract the relevant portion of the said judgment, as hereunder :-

> . The position in law is clear and well settled. There is a dichotomy between receipt of compensation by an assessee for the loss of agency and receipt of compensation attributable to the negative/restrictive covenant. The compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capital receipt.

* * * * * * * * *

7. ..... One more aspect needs to be highlighted. Payment received as non-competition fee under a negative covenant was always treated as a capital receipt till the assessment year 2003-04. It is only vide Finance Act, 2002 with effect from 1.4.2003 that the said capital receipt is now made taxable [See: Section 28(va)]. The Finance Act, 2002 itself indicates that during the relevant assessment year compensation received by the assessee under non-competition agreement was a capital receipt, not taxable under the 1961 Act. It became taxable only with effect from 1.4.2003. It is well settled that a liability cannot be created retrospectively.

28. It is, therefore, clear from the above decisions of the Supreme Court that non-competition fee was a capital receipt till 31.3.2003 and vide Finance Act, 2002, with effect from 1.4.2003, it became taxable.

29. Keeping the above principles laid down by the Supreme Court in mind in relation to treating a particular receipt as capital or revenue, as also the amendment made to the Finance Act, 2002, let us now analyse whether the amount received by the assessee/appellant from CT-PLC would fall under the head 'capital receipt', as claimed by the assessee/appellant.

30. The non-competition agreement and the payment made consequent to the non-competition agreement dated 14.12.95, according to the appellant/assessee is a capital receipt and it is not paid by the employer and that no capital gains would arise as there was no cost incurred. This argument is repelled by the Department stating that the person, who made the payment, viz., CT-PLC, holds 51% share in CTIL and the assessee/appellant also, through the joint venture Indian company, viz., CTIL, holds 49% as Director of the company and, therefore, the amount paid pursuant to the non-competition agreement should be considered as salary.

31. To come to a conclusion as to the nature of receipt of the amount, at the first instance, it is necessary to look into the order of the Assessing Officer as to whether the reasonings given by the Assessing Officer to support his findings, that what was paid and received by the appellant/assessee is salary, is correct. The findings in para-11 of the original authority's order this business of RSM was taken over by CTIL and a new company came into operation from 1.10.1993 in relation to the non-competition agreement is stated to be erroneous, as the joint venture company, CTIL came into existence in September, 1993 with effect from 1.10.93. The company, RSM Electronics continued its other operations, viz., battery charges, UPS systems, etc. It is only in relation to Power Electronic Converters or Industrial Drives that RSM entered into a joint venture collaboration with CT-PLC to form the joint venture company. In view of the above reasoning, the finding of the original authority that the business of RSM was taken over by CTIL is not correct. No doubt, the fact that two Directors of RSM became Directors of CTIL and they were receiving salary from that assessment year from the joint venture company is not in dispute. The Original Authority, on considering the joint venture company and also the non-competition agreement has held in para-13 of the order that there was a specific clause barring the assessee/appellant from doing any business akin to the line of business of the joint venture company, including accepting any job in that line. This finding, according to the appellant/assessee, is erroneous in view of the terms of conditions, which provides for certain restrictions only. For better clarity, the same is extracted hereinbelow :-

> The foregoing term conditions are conditional on fulfilling all obligations as executive directors of the Company. The agreement will be deemed void if the Director :
>
> a) accept paid employment from any other person or organisation, or
>
> b) is charged and found guilty by any legally constituted court of any criminal act, or
>
> c) by his actions, brings discredit to, or jeopardizes the successful operation of the company.

32. On a reading of the above, it is clear that there is nothing in the above agreement to indicate that there was any restriction insofar as industrial drives is concerned. The restriction is only a general restriction to an employee not to accept paid employment from any other person or organisation and that he should discharge his duties in accordance with law and should safeguard the interests of the company. Therefore, the finding of the Assessing Officer in para-13 that the assessee/appellant was prevented from doing anything in the line of business against the interests of CTIL does not have any relevance to the non-competition agreement. On the contrary, the non-competition agreement, it appears, has been entered into subsequently on 14.12.95, i.e., after nearly two years and two months to safeguard the interests of the foreign collaborator, who increased his stakes from 51% to 85% on and from 27.9.95 in the joint venture Indian company.

33. The Assessing Officer is not right in saying that there is no sanctity for this non-competition agreement in this case, because his reasoning that the old company was not in a position to compete with the joint venture company, viz., CTIL, is not the issue, as CTIL is only in the business of

industrial drives as a joint venture company. The point in issue is whether the appellant, as an individual, can compete with the business of CTIL, if there is no restriction. To avoid any loophole in that, the non-compete agreement was signed by CT-PLC to restrain the assessee individual from embarking on any such business, which is akin to industrial drives. The finding of the Assessing Officer is merely based on surmises and conjectures and not borne by any documents.

34. The non-competition agreement should be read in relation to the language used therein and the intentment behind signing of such agreement. Employment by itself is not reason to say that it amounts to non-competition agreement. Such a finding cannot be accepted, since a person with wide knowledge, as that of the appellant, in a particular field, is a potential threat to the foreign company, viz., CT-PLC, as well as to CTIL and, therefore, to curb any such threat of any kind, the non-competition agreement appears to have been signed by CT-PLC with the appellant/assessee and by no stretch of imagination, the payment in lieu of the non-competition agreement could be called as salary.

35. The further finding of the Assessing Officer is that there was no reason to pay the amount of Rs.9,83,385/= as on 14.12.95, as there was no competition and that if there was any competition, it ended 27 months earlier when RSM merged with CT-PLC to form CTIL and the assessee was made a Director. The reasoning of the Assessing Officer could be found in para-17 of the assessment order and for better clarity, the said portion is extracted hereunder :-

> There are two possibilities of appreciating the receipt as per the agreement either as Capital or as Revenue. As mentioned earlier, the payment of Rs.9,83,385 is not an outcome of a non-competition agreement as there was no competition as on 14.12.95. It is not a compensation for the right to carry on business as the assessee was not doing any competing independent business as on that date. It at all there could be any competition it ended about 27 months back when RSM merged with CT to form CTI and when the assessee was made a Director.
>
> A reading of the agreement shows that in every sense it was only a late appreciation of the rich goodwill that the assessee had in the field of business. It is possible that the foreign company which concentrated on business was happy to get a good associate in RSM and only later they discovered the magnetism in the assessee. In that sense the entire payment is attributable to the goodwill of the assessee. As the goodwill in this case is self generated, the cost is 'Nil' as per the provisions of Sec. 55 (2) (1) (ii) which even the legal opinion had omitted to consider . Accordingly, the entire receipt is taxable as Capital Gains.
>
> There is yet another way of looking at the receipt. As on the date of payment, the assessee was an employee of the company and the payment is received from his employer. In this context, the companies CT and CTI are one and the same as the former is owning 51% share in the latter. Secondly, the payment is directly related to the services which the assessee was rendering. Why it is given is not a major issue, since any payment, whether it be salary, remuneration, commission, etc., forms part

of salary as per Sec. 17 (1). Even if it is a casual and non-recurring payment, Sec. 10 (3) does not exclude it from taxation if it is an addition to the remuneration. In view of the above, the receipt is also assessable under the head Salary .

36. It is to be kept in mind that RSM never was merged with CT-PLC to form CTIL. CTIL is a joint venture company with 51% shares being held by CT-PLC and 49% shares being held by RSM as on 1.10.93 and there appears to be no dispute on that.

37. The Assessing Officer has further held that the nature of payment, at best, could be attributed as goodwill, paid by the foreign company to the assessee and to substantiate the same, falls back on Section 55 (2) (a) (ii) and comes to the conclusion that it has to be taxed as capital gains. However, the Assessing Officer, without following the said string to its logical conclusion, further states that the payment in this case was received from his employer and, therefore, it is salary for all purposes, which is evident from the last portion of para-17, which has been extracted supra, which shows that any form of payment, viz., salary, remuneration, commission, etc., would form part of salary as per Section 17 (1) of the Act.

38. The contention of the assessee/appellant is that he has clearly shown in his return of income what his salary is, together with a note appended, showing capital receipt on the basis of the non-competition agreement. It is clear from the documents on record that the salary portion was received from CTIL, whereas the non-competition fee has been received from CT-PLC and, therefore, both the transactions are distinct entities. It is clear from the record that the payment made by the foreign company, viz., CT-PLC, consequent to the non-competition agreement is for the purpose of restraining the assessee from engaging in any form of business that will jeopardize its principal shareholding of 51%, which was later on enhanced to 85%, as the same should not be compromised on account of the wealth of knowledge and capacity of the assessee in the particular field, viz., industrial drives. The Original Authority himself has accepted that the receipt of the amount is not capital gain, but only salary. Therefore, this Court is not elaborating on the provisions of Section 55 (2) (a) (ii) of the Act. In any event, such a plea would arise if the transaction had arisen after 1.4.03, whereas the transaction in this case culminated on 14.12.95.

39. Though an alternative plea was raised in para-18 of the assessment order, the Assessing Officer clearly holds that the said amount of Rs.9,83,385/=, received as non-competition fee, pursuant to the non-competition agreement, dated 14.12.95, should be brought to tax under the head 'salary', as the transaction was between the employer and the employee. For better clarity, at the risk of repetition, para-18 of the order of the Assessing Officer, is extracted hereinbelow :-

8. Alternatives :-

Whether it is assessed as Capital Gain or Salary , the entire receipt is taxable. For the sake of clarity, I am bringing the sum of Rs.9,83,385/= to assessment under the head Salary as the payment is one between the employer and the employee and also since it is essentially connected with his past, present and future services. But is is made known that this does not discount the scope of assessing it as Capital

Gains on Goodwill, which will remain as an equal alternative. It is made clear that the receipt is assessable whether it is treated as Capital or Revenue.

40. The income chargeable under the head 'Salaries' and Deductions from Salaries fall under Sections 15 and 16 of the Income Tax Act and they fall under Chapter IV, which deals with 'Computation of Total Income'. For better appreciation, the said Sections 15 & 16 of the Act are extracted hereinbelow :-

Salaries.

15. The following income shall be chargeable to income-tax under the head Salaries

(a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid42 or not;

(b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;

(c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

[Explanation 1]. For the removal of doubts, it is hereby declared that where any salary paid in advance is included in the total income of any person for any previous year it shall not be included again in the total income of the person when the salary becomes due.

[Explanation 2. Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as salary for the purposes of this section.] Deductions from salaries.

16. The income chargeable under the head Salaries shall be computed after making the following deductions, namely :

(i) [***]

(ii) a deduction in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the assessee who is in receipt of a salary from the Government, a sum equal to one-fifth of his salary (exclusive of any allowance, benefit or other perquisite) or five thousand rupees, whichever is less;

(iii) a deduction of any sum paid by the assessee on account of a tax on employment within the meaning of clause (2) of article 276 of the Constitution, leviable by or under any law.

(iv) 50[***]

(v) 51[***]

41. Section 17 of the Income Tax Act deals with 'Salary', 'Perquisite' and 'Profits in lieu of salary'. The terms 'salary' and 'profits in lieu of salary', which are relevant for the case on hand, are extracted hereinbelow for better clarity :-

Salary , perquisite and profits in lieu of salary defined.

17. For 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;

(v) any advance of salary;

[(va) any payment received by an employee in respect of any period of leave not availed of by him;]

(vi) the annual accretion to the balance at the credit of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under rule 6 of Part A of the Fourth Schedule;

(vii) the aggregate of all sums that are comprised in the transferred balance as referred to in sub-rule (2) of rule 11 of Part A of the Fourth Schedule of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under sub-rule (4) thereof; and [(viii) the contribution made by the Central Government [or any other employer] in the previous year, to the account of an employee under a pension scheme referred to in section 80CCD;] * * * * * * * * * (3) profits in lieu of salary includes

(i) the amount of any compensation86 due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto;

(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 91[* * *], to the extent to which it does not consist of contributions by the assessee or [interest on such contributions or any sum 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) any amount due to or received, whether in lump sum or otherwise, by any assessee from any person (A) before his joining any employment with that person; or (B) after cessation of his employment with that person.]

42. A reading of the above Sections make it clear that salary due from an employer or former employer to the employee, whether paid or not, Section 17 makes it clear that for the purpose of Sections 15 and 16, 'salary' would include, salary, wages, any annuity or pension, gratuity and any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages. A conjoint reading of both Sections 15 and 17 make it clear that salary that is due from an employer or former employer alone should be taken for the purpose of computation of total income. The plea of the learned counsel for the respondent/Revenue that it will fall under Section 17 (1) (iv), that any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages would bring within its ambit the non-competition fee, is totally misconceived as the pre-condition for bringing any payment under the head 'salary' as defined under Section 17 is that it should be a salary due from an employer or former employer. In this case, CT-PLC is neither the employer nor the former employer and of the assessee and, therefore, bringing the above payment under the head 'salary' is unsustainable.

43. The CIT (Appeals) concurred with the Assessing Officer on all the issues and the Tribunal also dismissed the appeal filed by the assessee as against the order of the CIT (Appeals). The relevant portion of the reasoning of the Tribunal, which is found in para-4 of its order, has already been extracted above. From the same, it is evident that the Tribunal has to come to the conclusion that the payment received by the appellant/assessee is salary since the non-competition fee, if at all, has to be paid to RSM and not to the assessee because even as per the admission of the assessee, RSM continued to be in existence and they alone are a threat to the foreign company, viz., CT-PLC. To buttress this finding, the Tribunal records the reason that the foreign company, CT-PLC is having 51% share in the newly formed joint venture company, viz., CTIL and, therefore, to look after the business and overall interests of the joint venture Indian company, the foreign company has to nominate somebody and probably they have nominated the assessee and as a consideration to take care of the entire joint venture company, the assessee received the amount. This finding of the Tribunal is purely based on surmises and conjectures. It is purely due to misreading of the nature of business of the joint venture company and the nature of payment made under the non-competition agreement. As already stated, the joint venture company was formed for the purpose of manufacture, sales and service of Power Electronic Converters, viz., Industrial Drives as a joint venture between CT-PLC and RSM and the Directors of RSM, viz., the appellant/assessee and others, were also inducted in executive capacity as salaried persons. Therefore, there is no question of RSM being a threat to the very same joint venture company, viz., CTIL, in which RSM had 49% shareholding. On the contrary, the individual assessee is only a paid employee of the joint venture company.

44. Further, it is evident from the record that when the shareholding pattern of the Indian company, viz., RSM, was reduced from 49% to 15% in lieu of the grant of approval by the Government of India for increasing the shareholding pattern of the foreign company, viz., CT-PLC, at that stage, the

foreign collaborator thought it fit to enter into a non-competition agreement with the assessee, since the assessee had the knowledge, experience and capacity in the field of industrial drives and, therefore, to safeguard the interests of the joint venture company, in which the stakes of the foreign company was increased from 51% to 85%, the foreign company thought it fit to make the non-competition agreement with the appellant/assessee. There is no material anywhere before the Assessing Officer or the CIT (Appeals) or the Tribunal to say that to look after the business and overall interests of the joint venture company, the foreign company had nominated somebody, muchless the assessee and they paid the consideration to take care of the entire joint venture company on such payment. This fact is not supported by any document or statement.

45. The wordings of the non-competition agreement is clear and proceeds that taking note of the vast experience of the assessee gained over 20 years, and further the assessee being capable of design, manufacture and testing of industrial drives, in which the joint venture company is already there in the market and that the appellant/assessee has set up a company called RSM Electronics, which enjoys good reputation and market recognition and in order to ensure that the appellant/assessee ceases and desists from carrying on the business in industrial drives in the territory so that it could be carried on exclusively by CTIL, the foreign company thought it fit to make a lumpsum payment as a component of the non-competition agreement. If the so called amount had been paid by CTIL to the assessee, then certainly this Court could have accepted the case of the Department/Revenue that it will fall under the definition of 'salary', whereas in the present case, the consideration, as has been rightly pointed out, was received from the foreign company, viz., CT-PLC by the appellant/assessee, which foreign company has no relationship with the assessee/appellant in the nature of employment.

46. A cursory glance at the non-competition agreement would throw enough light that the compensation received from CT-PLC by the appellant/assessee cannot be regarded as profits in lieu of salary and brought to tax under the head salaries. By accepting the terms and conditions of the non-competition agreement, the assessee has restrained himself from setting up any business, joining any employment or becoming a director of some concern so as to open competition. Such restrictions have adversely affected his income earning potential by exploiting his skills, knowledge, experience, etc. The clear intention behind CT-PLC entering into the non-competition agreement with the appellant/assessee is only to ward off any competition from the appellant/assessee, as he could exploit his knowledge, skill and experience to the disadvantage of the shareholding of CT-PLC in the joint venture Indian company, which is evident from the non-competition agreement.

47. For the purpose of tax, the nature of payment in the manner as has been paid by the foreign company and received by the assessee will be the primary issue that has to be considered. This payment, under the non-competition agreement, by no stretch of imagination could be stated as salary for taking care of the interests of the foreign company in the newly formed joint venture company. The Tribunal erred in holding that the amount paid by the foreign company to the assessee/appellant is by the employer to the employee, which conclusion, on the face of it, is not correct, as there is no relationship of employer and employee between the foreign company and appellant/assessee and this conclusion arrived at by the Tribunal is a misreading of the agreement.

48. In the present case, this Court finds that the employment contract is between the joint venture Indian company, viz., CTIL and the assessee and the terms and conditions of the employment is restricted only in relation to three items, which we have already referred to in the earlier part of this order and there is nothing to show that it has any relation with the industrial drives in question and, therefore, the foreign collaborator was justified in entering into a non-competition agreement, i.e., only after 26.9.95 when the Government of India, Ministry of Industries, granted approval to increase the shareholding of the foreign company in the joint venture Indian company. There are clear indications as to why the foreign company entered into the non-competition agreement after this approval given by the Government of India, Ministry of Industries, Department of Industrial Policy and Promotion, Foreign Collaboration-II Section.

49. Insofar as the decision of this Court in Ian Peter Morris Vs Asst. Commissioner of Income Tax, Chennai (T.C.A. Nos.225 & 226 of 2006 dated 25.7.2010), relied on by the learned standing counsel appearing for the Department/respondent, that was a case of transfer of the company by four partners wherein one of the partners received certain amount. The fact remains that the take over of the company in the said case took effect from 1.4.93 based on an agreement dated 15.10.93 and the assessee in that case was taken on employment on 8.10.93 and, thereafter, in the course of employment, he also received a non-compete payment on 15.10.93 from the said company in which he was in employment. When the payment was made, the assessee was in employment and, therefore, the reasoning in the said decision that such payment will fall under Section 17 (1) (iv) of the Income Tax Act necessarily has to be accepted, which is not the case here. In this case, there is no payment in the nature provided under Section 17 (1) (iv) by the employer in the course of employment to the appellant/assessee, as the non-competition agreement was entered into between the foreign company, CT-PLC with the appellant/assessee. The facts in the present case, therefore, stands distinguished.

50. As regards the decision of the Supreme Court in Commissioner of Income Tax Vs P.Mohanakala (2007 (291) ITR) 278 (SC)), relied on by the learned standing counsel for the respondent/Revenue, that concurrent findings of fact should not be normally disturbed, there is no dispute on this proposition. In this case, what is sought to be interpreted is not only facts in the case, but the provisions of Sections 15 and 17 of the Income Tax Act, which have been misread and misinterpreted by the Assessing Officer, the CIT (Appeals) and the Tribunal. The interpretation given by the Assessing Officer, CIT (Appeals) and the Tribunal as to the nature of transaction, by putting the non-competition fee received by the assessee/appellant under the head 'salary', which is erroneous and the conclusion arrived at by the authorities below, which is based purely on conjectures and surmises, have been interpreted in its proper perspective. The interpretation given by the authorities below does not fit into the provisions of Sections 15 and 17 of the Act, as interpreted by the Tribunal, but falls within the purview of capital receipt, as held by the Supreme Court in Guffic's case (supra). Therefore, what has been considered and decided by this Court is a pure question of law relating to interpretation of a particular Section in the Act, which has been held in favour of the appellant/assessee. Therefore, the abovesaid decision stands distinguished in the facts of the present case.

51. On a plain interpretation of Section 15 read with Section 17 of the Act, we are unable to subscribe to the view of the respondent/Revenue as has been confirmed by the CIT (Appeals) and the Tribunal, that the payment received in this case is in the nature of salary. The principles, as laid down by the Supreme Court in Guffic's case (supra) is squarely applicable to the facts of the present case. In view of the aforesaid reasoning and findings, this Court holds that the payment in this case, received by the appellant/assessee, is not in the nature of a salary and it is only a capital receipt. Accordingly, the substantial question of law is answered in favour of the appellant/assessee and against the Revenue.

52. In the result, this appeal is allowed setting aside the order passed by the Tribunal. However, in the circumstances of the case, there shall be no order as to costs.

(R.S.J.) (R

18.02.2015

Index : Yes/No
Internet : Yes/No
GLN

To

1. The Commissioner of Income Tax
Chennai.

2. The Income Tax Appellate Tribunal
Chennai 'D' Bench, Chennai.

R.S

AND

R.KARUPPIAH,

GLN

T.C.A. NO. 122 OF 2005

18.02.2015