Commissioner Of Income Tax vs M/S.Wintac Ltd., on 19 September, 2013

Bench: Dilip B.Bhosale, B.Manohar

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IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 19TH DAY OF SEPTEMBER 2013

PRESENT

THE HON'BLE MR.JUSTICE DILIP B.BHOSALE

AND

THE HON'BLE MR.JUSTICE B.MANOHAR

ITA NO.910/2006

BETWEEN:

1. The Commissioner of Income Tax,
Central Circle,
C.R.Building, Queens Road,
Bangalore.

2. The Assistant Commissioner of Income Tax,
Circle - 12(5),
C.R.Building, Queens Road,
Bangalore. .... Appellants

(By Sri.M.Thirumalesh, Advocate)

AND:

M/s.Wintac Ltd.,
16/2, OVH Road,
Basavanagudi,
Bangalore - 560 004. .... Respondent

(By Sri.H.S.Ramabhadran, Advocate)

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ITA filed U/s. 260A of I.T. Act, 1961 arising out of Order dated 02-01-2006 passed in ITA.No.81/Bang/2005 for the year 2001-02, praying that this Hon'ble Court may be pleased to formulate the

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substantial questions of law stated therein and allow
the appeal and set aside the orders passed by the ITAT,
Bangalore in ITA.No.81/Bang/2005 dated 02-01-2006
confirm the order of the Appellate Commissioner
confirming the order passed by the Assistant
Commissioner of Income Tax, Circle-12(5), Bangalore, in
the interest of justice and equity.

      This appeal coming on for Hearing this day, the
court delivered the following:

J U D G M E N T (B.MANOHAR J.)
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The Revenue has preferred this appeal under Section 260A of the Income Tax Act, challenging the order dated 2-1-2006 made in ITA No.81/Bang/2005 passed by the Income Tax Appellate Tribunal, Bangalore (hereinafter referred to as 'the Appellate Tribunal') setting aside the assessment order passed by the Assessing Authority as well as the First Appellate Authority for the assessment year 2001-02.

2. The respondent/assessee M/s.Wintac Limited, earlier known as M/s. Recon Limited, is a company incorporated under the provisions of Companies Act, 1956, carrying on the business of formulations and manufacture of bulk drug, having its three units at No.82/A, Jigani Unit-Manufacturing bulk drugs, Bannerghatta Road Unit-R&D Unit, Nelamangala Unit-formulation.

3. The assessee filed return of income on 31-10-2001 declaring a total loss of Rs.3,68,30,330/-. But determined the tax payable under Section 115JB at Rs.38,26,607/-.

4. The case was selected for scrutiny and notice under Section 143(2) was issued on 25-10-2002. The authorized representative of the assessee appeared on behalf of the assessee. On examination of income tax returns and other details furnished by the assessee- Company, it was noticed that the assessee-company entered into an agreement of sale of two Units i.e. Unit at Jigani and Bannerghatta Unit to M/s. Tumkur Chemicals Limited (hereinafter referred to as 'TCL') for a consideration of Rs.5.75 Crores. Subsequently that agreement was cancelled. In view of that, the assessee/company forfeited a sum of Rs.1.10 crores from the amount paid by the TCL. The said amount was treated as capital receipt and the same is not liable to be taxed. However, the Assessing Authority treated the said amount as revenue receipt and assessed for tax.

5. In the return of income, the assessee/company has shown the closing stock for both the Units as NIL. The closing stock value of Rs.12.5 crores as on 31-3-2000 has been shown. The said closing stock shall be the opening stock as on 1-4-2000, however, the assessee has shown NIL as on 31-6-2000. The Assessing Officer assessed the closing stock at Rs.11,56,74,925/- deducting a sum of Rs.1,21,000/- towards the sale of stock. Further, in the return of income, Rs.4.00 crores received from M/s. Recon Health Care Limited towards the non-competition fee was shown as capital receipt. The Assessing Officer treated the said amount as revenue receipt brought forward to tax, 1/3rd amount for each year. Further, the loss of long term and short term capital loss of

Rs.3,10,22,946/- and Rs.99,00,000/- shown by the assessee was disallowed by the Assessing Officer on the ground that the shares of the company has been sold for lesser value.

6. Further, Rs.25.00 crores received by the assessee from M/s. Recon Health Care Limited towards the transfer of technical knowhow is claimed as capital receipt. However, the Assessing Officer treated the said amount as revenue receipt and brought to tax, by its assessment order dated 30-03-2001 and also imposed penalty under Section 271(1)(c) and issued demand notice. The assessee being aggrieved by the order of assessment dated 30-03-2001 preferred an appeal before the Commissioner of Income Tax (Appeals) Bangalore (hereinafter referred to as 'the First Appellate Authority') challenging the same on various grounds. The First Appellate Authority after considering the matter in detail held that receipt of 1.10 crores of forfeited amount is a revenue receipt and is liable to be taxed. Further, insofar as the closing stock of the bulk drug in the plant is concerned, the Assessing Officer held that some of the stocks have been sold and the life of some of the bulk drugs available with the assessee had expired and reduced the said amount to Rs.1,49,82,784/- instead of Rs.11,56,74,925/- assessed by the Assessing Officer. Insofar as receipt of Rs.4.00 crores from Recon Health Care Limited towards non- competition fee is concerned, it was held to be the revenue receipts and liable to be taxed. Insofar as disallowance of the long term and short term capital loss, the Appellate Authority partly allowed the claim made by the assessee and disallowed the short term capital loss claimed by the assessee. Insofar as receipt of Rs.25.00 crores by the assessee from Recon Health Care Limited towards transfer of the technical knowhow is concerned, the First Appellate Authority held that the consideration received towards sale of technical knowhow and mere condition that knowhow shall not be disclosed to others does not change the character of receipt and it is the consideration towards the sale of capital assets liable to tax under the head of capital gain and not revenue receipt. Accordingly, allowed the appeal in part by its order dated 13-12-2004. The assessee being aggrieved by the order passed by the First Appellate Authority preferred an appeal before the Income Tax Appellate Tribunal, Bangalore Bench in ITA No.81/Bang/2005. Further, the Revenue also preferred an appeal in ITA No.292/Bang/2005 before the Income Tax Appellate Tribunal, Bangalore on some other findings.

7. The Appellate Tribunal on considering the matter in detail allowed the appeal filed by the assessee in part and dismissed the appeal filed by the revenue. The appellate Tribunal held that the forfeited amount of a sum of Rs.1.10 crores received by the assessee towards cancellation of agreement of sale is a capital receipt and the same cannot be taxed. Insofar as the closing stock of bulk drug is concerned, the contention of the assessee was upheld and set aside the order passed by the Appellate Authority confining the addition of a sum of Rs.1,49,82,784/-. Insofar as the receipt of Rs.4.00 crores towards non-competition fee is concerned, the Tribunal held that it is only a capital receipt and not liable to be taxed. With regard to the disallowance of claim of long term and short term capital loss is concerned, full benefit has been given to the assessee by setting aside the order passed by the First Appellate Authority. With regard to the receipt of Rs.25.00 crores, towards transfer of technical knowhow is concerned, it is a capital receipt and not revenue receipt and not liable to be taxed and ordered for deletion. The Revenue being aggrieved by the order passed by the Appellate Tribunal dated 2-1-2006 preferred this appeal.

8. The present appeal was admitted to consider the following substantial questions of law:

1. Whether the Tribunal was correct in holding that the sum of Rs.1,10,000/-

forfeited out of payment received from Rallis India Ltd is to be treated as capital receipt subject to the adjustment under section 51 of the Act and should be excluded as revenue receipt while computing the total income.

2. Whether the Tribunal was correct in holding that the stock pertaining to bulk drug unit and R & D should be taken as NIL as on 30.6.2000 when its realizable value as on 30.03.2000 was Rs.12.78 crores and the Assessing Officer had held that the assessee had adopted a colourable device in order to avoid tax.

3. Whether the Tribunal was correct in holding that the amount of Rs.4 crores received by the assessee as per the agreement dated 30.6.2000 entered by the assessee with M/s.Recon Health Care limited to discontinue its business with a non- competition clause for three year is a capital receipt.

4. Whether the Tribunal was correct in holding that for the computation of capital gains arising on sale of equity shares of M/s.Recon Agro Tech Pvt Ltd., the loss under capital gains is to be computed by adopting cost of acquisition of Rs.0.10 per share when interse parties were interested persons and family members and the entire transaction was a colourable device.

The 5th substantial question of law has been reframed by this court, which reads thus:

5. Whether the Tribunal was correct in holding that the transfer of technical knowhow by the assessee for a consideration of Rs.25 crores should be treated as a capital receipt, not liable to capital gains tax and not consideration received towards sale of capital asset, liable to capital gains tax."

10. We have carefully considered the arguments addressed by the learned counsel appearing for the parties and perused the records.

11. Substantial Question of Law No.1:

> With regard to the first substantial question of law is concerned, Sri.M.Thirumalesh, learned counsel appearing for the appellants contended that the order passed by the Tribunal is contrary to law and the Tribunal has committed an error in arriving at a conclusion that Rs.1.10 crores amount forfeited from the Rally's India Limited (hereinafter referred to as 'the RIL') is a capital receipt to compensate the loss sustained due to the cancellation of agreement of sale. As per the two agreements of sale at clauses 14 and 15, there is a clear agreement between the parties that failure on the part of the purchaser to perform his part of contract, the vendor shall be entitled to terminate the agreements, and to claim Rs.25,00,000/- and Rs.5,00,000/- as liquidated damages from the advance consideration, whereas, the assessee had forfeited Rs.1.10 crores. Hence, the amount over and above Rs.30,00,000/- cannot be treated as capital receipts. The order passed by the

Tribunal is contrary to law.

On the other hand, Sri.H.S.Ramabhadran, learned counsel appearing for the respondent/assessee contended that as per the lease agreement dated 20-10-1999, the assessee leased Bulk Drug Plant to the TCL on receiving Rs.25,00,000/- as security deposit. Within a fortnight, i.e. 5-11-1999, the assessee entered into an agreement of sale of very same Bulk Drug Plant and the security lease amount of Rs.25,00,000/- was treated as advance amount. Similarly, the assessee entered into lease agreement dated 29-11-1999 for lease of R & D Unit to TCL and received the security deposit of Rs.25,00,000/-. Subsequently, the assessee entered into an agreement of sale of the said R & D Unit treating the security deposit as a part of sale consideration and also received Rs.4.49 crores as advance. Pursuant to the agreement, the TCL was put in possession. The TCL sub-leased the said two Units to the RIL. However, the said agreements were cancelled. Since the Unit has been used for more than one year, the RIL had agreed to forego Rs.1.10 crores in favour of the assessee. Further, the said two Units were sold for Rs.8.00 crores to HILKAL Limited as against Rs.9.70 crores as agreed between the assessee and TCL. The loss of 1.70 crores was reduced Rs.1.10 crores. The said amount cannot be treated as Revenue receipt. In support of his contention, he relied upon the Judgments reported in 2000 (243) ITR 243 in the case of TRAVENCORE RUBBER AND LEAD CO. LTD., v/s COMMISSIONER OF INCOME TAX. The order passed by the Tribunal is in accordance with law. The Tribunal after considering the matter, set aside the order passed by the Assessing Authority as well as the First Appellate Authority and the same does not call for interference and sought for dismissal of the appeal.

The records clearly disclose that the assessee had received an advance amount of Rs.4.49 crores in terms of agreements of sale dtd.15-11-1999 and 17-01-2000. However, the said agreements were terminated with the consent of both the parties on 13-1-2001 and 15-1-2001 and handed over both the Units to the assessee. As per the agreement, if the purchaser fails to perform their part of the contract, the Vendor is entitled to terminate the agreement and claim liquidated damages of Rs.25,00,000/- and Rs.5,00,000/- respectively. However, in the present case, by mutual consent of the parties, the RIL had agreed to forego Rs.1.10 crores in favour of the assessee for loss of earnings due to the cancellation of agreement and the loss sustained in the sale transaction. The amount over and above Rs.30,00,000/- has to be treated as revenue receipts. The Assessing Authority as well as the First Appellate Authority had taken the entire amount of Rs.1.10 crores as revenue receipts and assessed to tax. In the facts and circumstances of the case, we are of the opinion that as per the agreement, the assessee is entitled to forfeit only a sum of Rs.30,00,000/- and the remaining amount of Rs.80,00,000/- has to be treated as revenue receipt and the assessee is liable to pay tax. With regard to the severability of compensation paid for the loss of sale transaction and business loss, the Hon'ble Supreme Court in the judgment reported in 1966 Vol. LX ITR 11 in the case of COMMISSIONER OF INCOME-TAX, MADRAS v/s BEST AND CO. (PRIVATE) LTD., has held as under:

> "If the compensation paid was in respect of two distinct matters, one taking the character of a capital receipt and the other of a revenue receipt, we do not see any principle which prevents the apportionment of the income between the two matters. The difficulty in apportionment cannot be a ground for rejecting the claim either of the revenue or of the assessee. Such an apportionment was sanctioned by courts in Wales v. Tilley, Carter v. Wadman and T:Sadasivam v.Commissioner of Income-tax. In the present case apportionment of the compensation has to be made on a reasonable basis between the loss of the agency in the usual course of business and the restrictive covenant. The manner of such apportionment has perforce to be left to the assessing authorities."

The finding of the Appellate Tribunal is contrary to law. Hence, we answer the substantial question of law partly in favour of the Revenue and partly in favour of the assessee.

12. Substantial question of law No.2:

With regard to second question, Sri.M.Thirumalesh, learned counsel appearing for the Revenue contended that the assessee had retained the closing stock in the Bulk Drug Plant and R & D Unit when it entered into an agreement of sale of these two Units with TCL. The closing stock was valued at Rs.12.78 crores as on 31-3-2000. However, it was again valued at NIL on 30-6-2000. He further contended that subsequent to 30-6-2000, the assessee sold the stock of Rs.1.21 crores. The Assessing Officer deleted the said amount and assessed the stock at Rs.11,56,74,925/-. However, the First Appellate Authority assessed the value of the closing stock at Rs.1,49,82,784/- after deducting the waste stock to an extent of Rs.10,06,92,141/-. The finding of the First Appellate Authority is challenged both by the assessee and the Revenue before the Appellate Tribunal. The Tribunal accepted the contention of the assessee and rejected the contention of Revenue. The order passed by the Appellate Tribunal is contrary to law. The Tribunal failed to take note of the fact that the assessee- company entered into an agreement of sale of Bulk Drug Unit and R & D Unit with TCL, the closing stock pertaining to the above was retained with the assessee. The assessee valued the stock pertaining to Bulk Drug Unit and R & D Unit as its realizable value at Rs.12.78 crores on 31-3-2000 and NIL on 30-06-2000. The assessee failed to explain as to what was the reason under which, the value of stock got suddenly eroded its value to Rs.3.00 crores, within three months. No document or register pertaining to above issue is produced. In the absence of the same, the Tribunal ought not to have held that the stock pertaining to Bulk Drug Unit and R & D Unit should be taken as NIL as on 30-06-2000.

On the other hand, Sri.Ramabhadran, learned counsel appearing for the assessee contended that the assessee had discontinued the manufacture of bulk drug during the previous year ended 31-3-2000. The factory was leased to TCL as per the agreement dated 15-11-1999. The said factory was sub-leased to the RIL as sub-lessee of TCL. The stock of Bulk Drug which was valued at Rs.12.78 crores as on 31-3-2000 was valued at NIL in the account as on 31-3-2001. The Assessing Officer also observed that the said Bulk Drug stock was valued at NIL in the account prepared on 30th June 2000 under the Companies Act and placed before the Shareholders. The Assessing Officer sought information from the assessee with regard to scrap of bulk drug of Rs.12.78 crores. The assessee vide its letter dated 3-3-2004 informed that out of Rs.12.78 crores of value of bulk drug, major portion of the stock was WIP, R & D stock, solvent, II crop material, major portions of which carried from many years whose value was reduced year after year on account of non-mobility. The said stock was aggregated about Rs.11.00 crores. The sale of the value of Rs.1.21 crore has taken place from 1.4.2000 to 31.3.2001 and duly accounted for, in the books and offered for the tax. The assessee sold the Unit at Jigani and R & D Unit to HILKAL Limited on 31-3-2001 and declared long term capital gain. There is no dispute regarding the said transaction. The saleable items were sold during financial year 2000-01 and remaining raw materials was shifted to rented warehouse while handing over the factory to HILKAL Ltd. All these raw materials are unsalable items, they are toxic materials of Bulk Drug section, they are waste, have no sale value and not capable of being sold, the market value was taken as NIL. The same was disposed off under the technical advice of Mr.Swaminathan who is a Retired Executive Director of National Environmental Engineering Research Institute. He further contended that whether the stock-in-trade has been properly valued or not is purely a question of fact, and question of law does not arise. He relied upon the judgments reported in (1990) 186 ITR 407 in the case of COMMISSIONER OF INCOME-TAX v/s KUMAUN MANDAL VIKAS NIGAM LTD. and (1992) 193 ITR 597 in the case of COMMISSIONER OF INCOME-TAX v/s BHARAT STEEL TUBES LTD.. The Appellate Tribunal taking into consideration all these aspects of the matter accepted the contention of the assessee and deleted the value of closing stock as NIL. There is no infirmity in the said finding.

The records clearly disclose that the assessee had discontinued the manufacturing of bulk drug during the previous year ended 31-3-2000. The factory at Jigani Industrial area was leased to TCL as per the agreement of lease dated 5-11-1999. The RIL is manufacturing the drug and a portion of the finished goods were sold. The major portion of the stock was WIP, R & D stock, solvents, II crop material, major portion of which carried from many years, whose value was reduced year after year on account of non-mobility. The said stock was aggregated about Rs.11.00 crores. The said goods were not saleable items in the market. Unsalable items were kept in the godown. It was accumulated year to year. Subsequently, all the goods were disposed of in the plot No.28 of KIADB Industrial area, Jigani under the technical supervision of Mr.Swaminathan, in November 2001. The life of the bulk drug was expired and it cannot be sold in the market. The Central Excise Records also disclose that the said goods cannot be sold in the market. The Income Tax Appellate Tribunal, taking into consideration all these aspects of the matter and that the manufacturer has been completely stopped the manufacturing of the bulk drug, has taken the value of closing stock of bulk drug as NIL. The assessee has not adopted any colourable devices in order to avoid the tax. Hence, we find there is no infirmity or irregularity in the said finding. However, the judgment relied upon by Sri.H.S.Ramabhadran is not applicable to the facts of the case on hand. Hence, the finding recorded by the Tribunal is purely a question of fact. Accordingly, the second substantial question of law is held against the Revenue and in favour of the assessee.

13. Substantial question of law No.3:

> The third substantial question of law raised in this appeal is with regard to a sum of Rs.4.00 crores received from M/s.Recon Health Care Limited pursuant to the agreement dated 30-06-2000. As per the agreement, the assessee and the promoters

> of the assessee-company were prevented from carrying on certain business activities. The said sum was treated as a revenue receipt by the Assessing Officer. The Tribunal held that it is a capital receipt not liable to be taxed. The said issue is fully covered by the judgment of the Hon'ble Supreme Court reported in 2011 (332) ITR 602 in the case of GUFFIC CHEMIC (P) LTD. v/s COMMISSIONER OF INCOME TAX wherein the Apex Court has held that the compensation received for restraining the assessee from carrying on competitive business was the capital receipt. The issue before the Supreme Court was whether the amount received by the assessee on a condition not to carry on the competitive business was in the nature of capital receipt. The Supreme Court clearly held that it is capital receipt.

Paragraph 6 of the judgment reads as under:

> Two questions arose for determination, namely, whether the amounts received by the appellant for loss of agency was in normal course of business and therefore whether they constituted revenue receipt ? The second question which arose before this court was whether the amount received by the assessee (compensation) on the condition not to carry on a competitive business was in the nature of capital receipt? It was held that the compensation received by the assessee for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capital receipt.

> In the instant case, Rs.4.00 crores received from M/s.Recon Health Care Limited towards non- competition to discontinue the business of three years has to be held as capital receipt. Accordingly, the third substantial question of law is answered in favour of the assessee.

14. Substantial question of law No.4:

> With regard to the computation of capital gains arising on sale of equity shares of M/s.Recon Agro Tech (P) Ltd., (hereinafter referred to 'RAL') is concerned the Assessing Officer disallowed both long term capital loss of Rs.3,10,22,941/- and short term capital loss of Rs.99,00,000/- claimed by the assessee.

Sri.M.Thirumalesh, learned counsel appearing for the appellants contended that during the accounting year ending 31-3-1997, the assessee transferred its Agro Division (manufacture and marketing of pesticide formulation) i.e. M/s.Agro Tech (P) Limited to RAL which is the subsidiary company of the assessee after obtaining the approval of the shareholders of the assessee-company. Against the net assets transferred, assessee received Rs.3.05 crores and, utilized the same to acquire Rs.25,50,000 equity shares of Rs.10/- each in the financial year 1997-98 and later Rs.1.00 crore in the financial year 2000-01. These shares were sold to Sri.Suresh, Managing Director of RAL at the price of Rs.2.55 lakhs, which was 1% of the value of the share. The assessee indexed the cost of acquisition to Rs.3,12,77,964/- and arrived at long term capital loss of Rs.3,10,22,946/-. The Assessing Officer on verification of the records came to the conclusion that buying and selling of the shares of RAL were between the interested persons and family members as the assessee failed to adduce evidence that the valuation of the share was done at arm length. The Assessing Officer rejected the assessee's claim for long term capital loss.

With regard to the short term capital loss, the Assessing Officer noticed that the assessee invested a sum of Rs.1.00 crore in equity shares of RAL in the financial year 2000-01. However, the said investment was also sold to Sri.Suresh, Managing Director of RAL for Rs.1,00,000/- within a short duration and claimed a short term capital loss of Rs.99,00,000/-. The Assessing Officer on considering the entire matter, disallowed the short term capital loss. On an appeal filed by the assessee, the Appellate Authority directed the Assessing Officer to determine and allow the long term capital loss on sale of 2,55,000 equity shares of RAL as per the balance sheet as on 31-3-2001. The Appellate Authority held that the long term capital loss should be computed based on the value of share as per the balance sheet as on 31-3-2001 at Rs.3.11 per share and similarly the short term capital loss in respect of 3,50,000 shares sold in short term capital loss also was adopted at value of Rs.3.11 per share. The finding with regard to the short term capital loss is confirmed. On an appeal filed by the assessee before the Income Tax Appellate Tribunal, the Appellate Tribunal set aside the findings of both the Assessing Officer as well as the Appellate Authority in respect of long term capital loss as well as the short term capital loss and allowed the claim made by the assessee. It was contended by the assessee that the Tribunal committed an error in holding that the computation of capital gain arises out of sale of equity shares of RAL and agreed to sell the said shares at the rate of Rs.0.10 per share to the Managing Director of RAL and sustained the long term capital loss of Rs.3,10,22,946/-. the share purchased worth Rs.1.00 crore was also sold to the RAL within few days, for Rs.1,00,000/- and suffered the short term capital loss. The purchase and sale of the shares between the close relatives and interested parties and family members, the entire transactions are colourable device. Hence, they are not entitled to claim short term and long term capital losses and sought for setting aside the said finding.

On the other hand, Sri.Ramabhadran, learned counsel appearing for the assessee contended that the assessee was having a separate Agro Division and during the financial year 1997, a separate company was floated by name M/s.Recon Agro Tech (P) Ltd. The assessee has invested Rs.2,55,00,000/- for 25,50,000 equity shares of Rs.10/- each. The said company sustained heavy loss. The assessee with a view to disassociate itself with its subsidiary company, entered into a Memorandum of Understanding with Suresh, Managing Director of RAL and agreed to sell 25,50,000 shares at Rs.0.10 per share. Sri.Suresh, to whom the shares were sold, was neither a relative of any of the promoters of the assessee nor Director of any of the Group Company. The balance sheet of RAL as on 31-3-2001 was prepared after taking into consideration an income of Rs.6.00 crores received from the assessee. The assessee was managing the affairs of the subsidiary companies through its nominee directors. The assessee gave a corporate guarantee to Karnataka Bank for the credit facility. The RAL suffered a loss due to the drought. The Karnataka Bank to whom the assessee has given corporate guarantee issued notice proposing to invoke the Bank Guarantee. The suppliers who have supplied to RAL on the guarantee of the assessee were pressurizing the assessee to pay their dues. In order to avoid the coercive steps and freezing of the assessee's credit facility, the assessee had taken a decision to sell the shares. The Assessing Officer disallowed both short term and long term capital loss. However the Appellate Authority has given partial relief. The Appellate Tribunal after taking into consideration all these aspects of the matter set aside the order passed by the First Appellate Authority and the claim of the assessee both in respect of long term and short term capital loss was allowed. The finding recorded by the Tribunal is purely a question of fact and it is not a fit case for interference by this court.

The Assessing Officer disallowed both the claims of the assessee for short term and long term capital loss. The Appellate Authority directed the Assessing Officer to rework the claim made by the assessee taking the value of each share at Rs.3.11/- per share. The Appellate Tribunal on examining the matter allowed the claim of the assessee. The reasons assigned in paragraph 6.4 reads as under:

"We have carefully considered the relevant facts and the arguments advanced. In this case, it is to be seen that the computation is to be made for sale of shares held as capital asset. Hence what is applicable is section 48 of the Act. As per section 48, the capital gain is to be computed after reducing the cost of acquisition of the assets, cost of any improvement thereto and the expenditure incurred in connection with transfer of capital asset. Such cost is to be reduced from the full value of consideration received or accruing as a result of transfer. There is no provision to substitute the consideration received with the fair market value of asset sold. The transaction is at an arms length. The assessee basically wanted to bet rid of the unit as a whole as well as the share of such unit. Section 52 which earlier provided for adopting the consideration for transfer in case of understatement etc has been omitted by Finance Act, 1987 w.e.f. 1.4.1988. Thus, unless and until it can be proved, that the assessee received something more than the apparent consideration, the Assessing Officer cannot compute the capital gain artificially by substituting fair market value in place of consideration received. There is no finding that transaction is a colorable one or that the agreement is sham. Therefore, there is no reason to substitute the consideration received with any other amount.

Shares sold being unquoted equity shares, one of the recognized methods of valuation if Rule 11 of Schedule III of the Wealth Tax Act, As per Explanation to said Rule, the balance sheet is the balance sheet (including the Notes annexed thereto and forming part of the accounts) as drawn up on the valuation date, and if there is no such balance sheet, the balance sheet drawn up on a date immediately preceding the valuation date, and in the absence of both, the balance sheet drawn up on a date immediately after the valuation date.

There is no dispute that break up value with reference to balance sheet is to be applied. The question is which is the relevant balance sheet. On that, the jurisdictional High Court's case in CED v.J.Krishna Murthy (1974) (96 ITR 87) (although the judgment related to Estate Duty Act) held that the published balance sheet immediately prior to the date of death as relevant of break up method as appropriate. That case is applicable to the facts of the instant case. Admittedly, there is an audited balance sheet as at 30.6.2000 which is prior to November, 2000. Hence, it would not be correct to further look at the subsequent balance sheet i.e., the balance sheet dated 31.3.2001. Further, due consideration must be given to appellant's submission that if balance sheet as at 31.3.2001 is considered , then deduction should be granted for Rs.5 crores foregone by the appellant. The contention of the AO that sale of Recon Agro Tech Ltd Shares was between related parties has been rebutted by the appellant by affidavit (page No.43) of the paper book filed before CIT(A) which has not been disputed by the Assessing Officer in his remand report. Hence, the question of substitution of contracted price should not have arisen. The findings of CIT(A) in respect of long term capital gains have not been challenged by the department. Accordingly the loss under capital gain is to be computed by adopting consideration at Rs.0.10 per share."

We find that there is no infirmity in the finding recorded by the Appellate Tribunal. Under Section 48 of the Income Tax Act, the capital gain is to be computed after reducing the cost of acquisition of the asset, cost of any improvement thereto and the expenditure incurred in connection with the transfer of capital assets. In order to avoid the stringent action being taken by the financial institution, the assessee sold the shares to its subsidiary company in order to stabilize its financial position. No document has been produced by the Revenue to show that the transaction between the assessee and its subsidiary company is a colourable device. The finding recorded by the Appellate Tribunal is purely a question of fact. The Revenue has not made out a case to interfere with the same. Accordingly, we confirm the finding recorded by the Appellate Authority and the substantial question of law is held against the Revenue.

15. Substantial question of law No.5:

> With regard to the receipt of Rs.25.00 crores towards the transfer of technical knowhow, Sri.M.Thirumalesh, learned counsel appearing for the Revenue contended that as per the agreement dated 30th June 2000, the assessee transferred the technical knowhow in respect of certain products to M/s.Recon Health Care Limited. In consideration of the transfer, the transferee agreed to pay a sum of Rs.25.00 crores to the transferor, and the receipt was admitted and acknowledged by the transferor. The consideration received towards transfer of technical knowhow was originally offered to tax as a revenue receipt in the returns filed. However, during the course of assessment, the assessee contending that Rs.25.00 crores received towards transfer of technical knowhow is in the nature of capital receipt and not liable to be taxed, filed a revised statement. The Assessing Officer rejected the contention of the assessee and assessed the said amount to tax under the head business income. The assessee being aggrieved by the assessment order preferred an appeal before the Commissioner of Income Tax (Appeals). The Appellate Authority after examining the matter held that as per the provision of Section 32(1)(ii), the knowhow acquired after 1-4-1998 is a capital asset for the purpose of allowance of depreciation. In the case of assessee, the consideration of Rs.25.00 crores on sale of knowhow being the capital assets would be exigible to the tax under the head capital gain and directed the Assessing Officer to tax the said amount under the head capital gain. The assessee being aggrieved by the order passed by the First Appellate Authority, approached the Income Tax Appellate Tribunal challenging the same. However, the Revenue has not preferred any appeal. The Appellate Tribunal, after examining the records and some of the clauses of the agreement dated 30-06-2000, relying upon the judgment reported in 36 ITR 175 (C.I.T v/s VAZIR SULTAN TOBACOO COMPANY LIMITED) held that in view of the agreement, the assessee is prevented from manufacturing goods with respect to Pharmaceuticals which has been sold to the M/s.Recon Health

Care Limited. The consideration of Rs.25.00 crores received is for not carrying out certain activities pertaining to the business of manufacturing of Pharmaceutical goods. Therefore, the said receipt is a capital receipt and not liable for tax under the capital gain.

The Revenue challenged the order of tribunal in this appeal contending that the findings of the Appellate Tribunal is contrary to the facts. As per the agreement dated 30-06-2000, the assessee has received in all Rs.40.00 crores, i.e. for the sale of technical knowhow, the assessee has received Rs.25.00 crores, Rs.11.00 crores towards sale of brand, and Rs.4.00 crores towards non-competition fee. The finding of the Appellate Tribunal is that consideration of Rs.25.00 crores received is for not carrying out certain activities of business in Pharmaceutical goods is contrary to the facts. Technical knowhow is an intangible asset. Under Section 32(1)(ii) of the Act, it is a capital asset for the purpose of depreciation and exigible to tax under the capital gain. Sri.Thirumalesh relied upon the judgments reported in (2011) 237 CTR 227 (Madras) in the case of INDO TECH ELECTRIC COMPANY v/s DEPUTY COMMISSIONER OF INCOME TAX and (2011) 337 ITR 178 (Delhi) in the case of THE COMMISSIONER OF INCOME TAX v/s MEDIWORLD PUBLICATION PRIVATE LIMITED.

On the other hand, Sri.H.S.Ramabhadran, learned counsel appearing for the assessee contended that the effect of the agreement dated 30-06-2000 was not only for the transfer of knowhow, but also for non-disclosure of technical knowhow to others. As per clause 3(1) of the Agreement, the transferor shall stop using or in any way dealing with the knowhow for the manufacture of the product from the date hereafter, and shall not use or deal with the same hereinafter except under the instruction and license from the transferor on that behalf. Hence it is clear that under the Agreement, the assessee not only has to convey certain knowledge to the transferee but also impose restrain on itself on use of such knowledge. He relied upon the judgment reported in 36 ITR 175 (supra) and contended that Section 55(2A) does not include knowhow as capital assets whose value shown to be taken to be NIL or at the cost of acquisition, though other assets are mentioned therein such as goodwill, trademark, brand name and right to manufacture. Therefore, the receipt is a capital receipt and not liable to be taxed.

The records clearly disclose that during the financial year 2000-01, the assessee-company has received a sum of Rs.40.00 crores from M/s.Recon Health Care Limited as per the agreement dated 30-06-2000. The nature of the transaction was as follows:

(a) The sale of the brand Rs.11.00 crores

(b) Sale of Technical Knowhow Rs.25.00 crores

(c) Non-compete fee Rs. 4.00 crores In the return of income, the assessee-company has offered for tax only the technical knowhow fee, however sale of brands and non-competition fee were claimed as capital receipts and treated as non-taxable.

> During the course of assessment, the assessee claims that a sum of Rs.25.00 crores received on transfer of the technical knowhow was in the nature of capital receipt vide Office letter dated 18-3-2004 and treated the said amount as capital receipt. However, the assessee has not filed revised returns as contemplated under Section 139(5) of the Act.

The three agreements produced by the parties clearly disclose that one is with regard to transfer of the knowhow and another is with regard to non-competition fee and the third agreement is with regard to transfer of its current brand, trade mark. As per the agreement for transfer of technical knowhow, Rs.25.00 crores has been paid to the assessee. In Clause 2 of the agreement it was clearly mentioned that " In consideration of transferee having agreed to pay a sum of Rs.25.00 Crores (Rupees twenty five Crores only) to transferor as consideration, which transferor admits and acknowledges has been paid, the transferor hereby sell outright and transfer its ownership to transferee of all knowhow for the product mentioned in the annexed thereto."

The caption of the said agreement is "The Agreement of Sale of Knowhow". Another agreement was entered into between the assessee and M/s. Recon Health Care Limited. It was captioned as "Non-Competition Agreement". Pursuant to the said agreement, the assessee has received Rs.4.00 Crores (Rupees four crores only). It was agreed between the parties that the assessee directly or indirectly shall not use the name of trademark "RECON" in any manner whatsoever in respect of any product and, or any business. Further, as per the Memorandum of Understanding entered into between the assessee and M/s.Cadila Health Care Limited, the assessee has transferred all tangible and intangible properties and handed over Pharmaceuticals business with brand name and trade mark. Hence, it is clear that an amount of Rs.25.00 crores received was not for restraining the assessee from carrying on the business, on the other hand, it is only a transfer of knowhow in favour of M/s. Recon Health Care Limited. The assessee has already received Rs.4.00 crores towards non-competition agreement.

Under Section 28(v)(a) any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business, or not sharing any knowhow, patent, copyright, trademark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of the goods is intangible goods acquired on or after 1-4-1998 is a capital asset and liable to be taxed under the head 'Capital Gain'. The judgment relied upon by Sri.Ramabhadran reported in CIT v/s VAZIR SULTAN TOBACOO COMPANY LIMITED is not applicable to the facts of the present case. In that case, the compensation has been paid for termination of agency agreement which would be a capital receipt, whereas in the present case, there is a transfer of knowhow. The Madras High Court in Indo Tech Electric Company's case in para 12.3 and 13.2 has held as under:

> "12.3. Technical know-how is defined as an intangible revenue producing asset which can be put to use so as to produce revenue in two ways. The manufacturer can use it himself to make things for sale and make profit in that way, or he can teach it to others, so that they can make their own things, in which case he gets paid for the knowledge and information which he imparts to them. His fees and rewards are then

> revenue in his hands. Under the Income-Tax Act, transfer of Technical know-how is subject to tax only from the Assessment Year 1998- 99 by the amendment through Finance Act, 1997..
>
> 13.2. Therefore, it is clear that inasmuch as the assessee's firm has been taken over as a going concern, it could not have been taken over without the so called technical knowhow. The assessee could not have sold the other tangible assets, keeping it the so called technical knowhow. Hence, we are of the considered view that the receipt for technical knowhow and the compensation for non-competing fees are nothing but a part of composite receipt to diminish the value of the assets of the assessee-firm. The assessee has termed the said amount as technical knowhow in order to escape from the clutches of the provision of Section 55(2) of the Income Tax Act, 1961, under which, the goodwill amount is taxable."

The technical knowhow is an intangible asset, liable to be taxed under the head 'Capital Gain'. The order passed by the Appellate Tribunal holding that the consideration of Rs.25.00 crores received is also for not carrying out certain activities pertaining to the business in manufacture of Pharmaceutical goods. Any consideration received for not carrying out certain activity in connection with business is not taxable earlier to 1-4-2003. Therefore, the receipt is a capital receipt and not liable for the capital gain is contrary to law. Accordingly, the substantial question of law is answered against the assessee and in favour of the revenue.

16. In the light of the aforesaid finding, the appeal is allowed in part.

Sd/-

JUDGE Sd/-

JUDGE mpk/-*