

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 01.06.2016

(Judgment reserved on 27.04.2016)

CORAM:

THE HONOURABLE MR.JUSTICE NOOTY.RAMAMOZHANA RAO

AND

THE HONOURABLE MR.JUSTICE M.V.MURALIDARAN

Tax Case (Appeal) No.1469 of 2007

Commissioner of Income Tax, Chennai.

.. Appellant

Vs.

M/s.TTK Healthcare Ltd.,

(formerly known as M/s.TTK Pharma Ltd),

M/s.TTK Pharma Ltd.,)

5, Old Trunk Road,

Pallavaram, Chennai-600 043.

.. Respondent

Tax Case (Appeal) filed under Section 260-A of the Income Tax Act against the order of the Income Tax Appellate Tribunal, Madras 'C' Bench, dated 15.06.2007 in I.T.A.No.2713/Mds/2004.

For appellant : Mr.M.Swaminathan

For respondent: Mr.Vijay Raghavan for Mr.Venkat Narayanan

JUDGMENT

NOOTY.RAMAMOohana RAO,J

This appeal under Section 260-A of the Income Tax Act, 1961, (for brevity, henceforth referred to as 'Act'), was preferred by the Revenue calling in question the correctness of the order passed by the Income Tax Appellate Tribunal Bench-'C' Chennai in I.T.A No.2713/Mds/2004 dated 20.07.2007.

2. M/s TTK Bio-med Limited was manufacturing Rubber Contraceptives (condoms) and Gloves. It entered into an agreement with London International Group PIC for discontinuing their condom business. London International Group PIC is carrying on business of manufacturing and selling rubber contraceptives all over the world on its own and also through its subsidiaries and joint venture companies. In India, it is in joint venture with M/s TTK & Co (Joint venture Company TTK-LIG). London International Group PIC paid 4,99,000 pounds as non-compete fee to M/s TTK Bio-med Limited for not competing the condoms business. TTK Bio-med has merged with TTK Healthcare Limited, the assessee Company with effect from 01.07.1999. The particular transaction, relating to receipt of non-compete money concerning which this appeal is brought forth by the Revenue is for the assessment year 2000-2001.

3. The assessee company has claimed the amount of Rs.3,44,92,800/- received by it from London International Group PIC as not taxable, treating it as capital receipt. The Assessing Officer, the Assistant Commissioner of Income Tax by his order dated 18.03.2003 assessed the non-compete fee as revenue receipt. The appeal preferred there against to the Commissioner of Income Tax (Appeals) for short, CIT(A) has failed holding that the amount of Rs.3,44,92,800/- received by the assessee company is in consideration of the services rendered/to be rendered and accordingly, the said amount represents revenue receipt. Then the assessee carried the matter in appeal before the Income Tax Appellate Tribunal, which by its order dated 15.06.2007 reversed the findings of the Assessing Officer and the CIT(A) and held that the non-compete amount received by the assessee in question is a capital receipt, but not revenue receipt. Hence, this appeal.

4. Heard Sri.M.Swaminathan, learned Standing Counsel for the Income Tax Department and Sri.Vijay Raghavan for Sri.Venkatnarayanan for the respondent-assessee.

5. Before we proceed further, it would only be appropriate to notice the essential facts. London International Group PIC, (for short LIG henceforth) was carrying on business of manufacturing and sale of rubber contraceptives all over the world apart from other businesses. It carries on its business on its own and also through its subsidiaries or joint venture companies. TTK Bio-med Limited,

inter-alia is engaged in business of manufacturing and marketing rubber contraceptives (condoms) and also gloves. TTK Bio-med Limited was, at that time, in the process of merging with TTK Pharma Limited. It had agreed to discontinue the business of manufacturing and marketing rubber contraceptives (condoms) and not to compete with LIG or their subsidiaries or associates, including the joint venture TTK-LIG. In terms and in accordance with the said agreement, TTK Bio-med Limited agreed to cease to engage itself in the business of manufacturing and marketing rubber contraceptives on and from 01.02.2001 and also agreed to surrender all the know-how received from LIG in the past in relation to the said business. TTK Bio-med has further undertaken that it shall not in any manner whatsoever compete with the business of LIG or its associates, including TTK-LIG insofar as the condom business in India or other countries nor will it associate with any joint venture with any third party in respect of the said business. Bio-med Limited has also undertaken not to engage in the said business directly or indirectly and in case it receives any further enquiries or other information relating to the said business, it shall pass on the same to LIG for further exploitation. In consideration of the above covenants not to compete with LIG or its associates, LIG agreed to pay a sum of 4,99,000 pounds to Bio-med Limited. Accordingly, the payment was made.

6. The question, therefore, that requires to be answered is whether this receipt of money by the assessee is liable to be treated as a capital receipt or revenue receipt. It is not in doubt that, for the relevant assessment year, if the

income is to be treated as capital receipt, it cannot suffer the incidence of taxation, whereas, if it were to be treated as a revenue receipt, the order of assessment as affirmed by the CIT(A) has to be upheld.

7. It will be appropriate to notice as to how this very question has been answered by the Supreme Court in *Oberoi Hotel (P) Ltd vs. Commissioner of Income Tax* (AIR 1999 SC 1110). Paragraphs 3 to 7 of the judgment read as under:

"3. The question whether the receipt is capital or revenue is to be determined by drawing the conclusion of law ultimately from the facts of the particular case and it is not possible to lay down any single test as infallible or any single criterion as decisive. This Court in the case of *Karam Chand Thapar & Bros. P. Ltd. v. Commissioner of Income Tax (Central, Calcutta)*: [1971] 80 ITR 167(SC) discussed and held that in *Commissioner of Income Tax v. Chari and Chari Ltd* : [1965] 57 ITR 400(SC), it was held that ordinarily compensation for loss of an office or agency is regarded as capital receipt, but this rule is subject to an exception that payment received even for termination of agency agreement would be revenue and not capital in the case where the agency was one of many which the assessee held and its termination did not impair the profit making structure of the assessee, but was within the framework of the business, it being a necessary incident of the business that existing agencies may be terminated and fresh agencies may be taken. Thereafter the Court held that it was difficult to lay down a precise principle of universal application but various workable rules have been evolved for guidance.

4. Applying the aforesaid test laid down by this Court in the present case, in our view the Tribunal was right in arriving at a conclusion that it was a capital receipt. Reason is that as provided in Article XVIII of the First Agreement assessee was having an option or right or lien, if owner desired to transfer the hotel or lease or part of the hotel to any other person, the same was required to be offered first to the assessee (operator) or its nominee. This right to exercise its option was given up by a Supplementary Agreement which was executed in September, 1975 between the Receiver and assessee. It was agreed that Receiver would be at liberty to sell or otherwise dispose of the said property at such price and on such terms as he may deem fit and was not under any obligation requiring the purchaser thereof to enter into any agreement with the operator (assessee) for the purpose of operating and managing the hotel or otherwise and in its return, agreed consideration was as stated above in Clause X. On the basis of the said agreement the assessee has received the amount in question. The amount was received because the assessee had given up its right to purchase and or to operate the property. Further it is loss of source of income

to the assessee and that right is determined for consideration. Obviously therefore, it is a capital receipt and not a revenue receipt.

5. Learned Counsel for the Revenue relied upon the decision in the case of Commissioner of Income Tax v. Rai Bahadur Jairam Valji and Ors. : [1959] 35 ITR 148 (SC) and submitted that assessee had the business of running the hotels in various countries and the amount which is received by him is for the termination of first contract which was executed in 1970 and, therefore, it should be considered his revenue receipt. In that case the Court was dealing with a trading contract and held that compensation paid in respect of the rights arising under the trading contract would be a revenue receipt and must be referred to the profits which would be made in carrying out of contract. The Court has also observed :

"Whether a payment of compensation or termination of an agency is a capital or revenue receipt, it would have to be considered whether the agency was in the nature of capital asset in the hands of the assessee, or whether it was only part of his stock-in-trade." '

6. The aforesaid judgment was considered in the case of Kettlewell Sullen & Co. Ltd. v. [Commissioner of Income Tax, Calcutta](#): [1964] 53 ITR 261(SC) , wherein the Court has held as under :

"Whether a particular receipt is capital or income from business, has frequently engaged the attention of the courts. 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 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."

After considering various decisions it was further held as under:

"These cases illustrate the principle that compensation for injury to trading operations, arising from breach of contract or in consequence of exercise of sovereign rights, is revenue. These cases must, however, be distinguished from another class of cases where compensation is paid as a solatium for loss of office. Such compensation may be regarded as capital or revenue; it would be regarded as capital, if it is for loss of an asset of enduring value to the assessee, but not where payment is received in settlement of loss in a trading transaction."

After analysing number of cases, the Court observed that following satisfactory measure of consistency in the principle is disclosed :

"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 leave 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."

7. The aforesaid principle is relied upon in the case of Karam Chand Thapar and Bros's case (supra). Considering the aforesaid principles laid down as per Article XVIII of the Principal Agreement, the amount received by the assessee is for the consideration for giving up his right to purchase and or to operate the property or for getting it on lease before it is transferred or let out to other persons. It is not for settlement of rights under trading contract, but the injury is inflicted on the capital asset of the assessee and giving up the contractual right on the basis of Principal Agreement has resulted in loss of source of assessee's income."

8. Thus, starting from Rai Bahadur Jairam Valji's case, Kettlewell Bullen & Co Ltd case, Karam Chand Thapar & Bros case, the underlying principle spelt-out was to ascertain from the facts and circumstances of the case as to whether the injury is inflicted on the capital asset of the assessee resulting in loss of a source of assessee's income or not. The Supreme Court in Gillanders Arbuthnot & Co. Ltd vs. CIT (1964 (53) ITR 283) has brought out a dichotomy between receipt of compensation by an assessee for loss of agency and receipt of compensation attributable to the negative/restrictive covenant. If the compensation is received for the loss of agency, it is to be treated as a revenue receipt whereas, if the compensation is attributable to a negative/restrictive covenant, then, it would amount to a capital receipt. The Supreme Court in Guffic Chem (P.) Ltd. Vs. Commissioner of Income Tax (2011 (332) ITR 602) examined this very question and in its paragraph 7 held that compensation

received for refraining from carrying on competitive business was a capital receipt and that payment received as non-competitive fee under a negative contract was always treated as a capital receipt till the assessment year 2003-2004, i.e. till the introduction of Section 28 (va) by way of an amendment to the Act with effect from 01.04.2003.

9. There is no serious dispute raised at the Bar with regard to this principle. But the dispute is all about its application to the given fact situation. But however, what Sri.Swaminathan, learned counsel for the Revenue would strenuously contend was that the assessee has not lost the entire source of income by virtue of the agreement entered into with LIG and on the other hand, it had now gained freedom to concentrate all its energy and time in manufacturing and marketing its other products, including gloves. Therefore, it is contended that the impairment suffered by the assessee is not a complete denial of its source of income. It was also urged by Sri.Swaminathan that what has been paid by the LIG is for rendering certain service to it by the assessee, when it has agreed to direct all enquiries and other information relevant to the rubber contraceptive business which the assessee might receive to enable LIG to further exploit the same. It was also further urged that the payment made by LIG cannot be treated as a compensation towards Non-compete Agreement, inasmuch as, a Non-compete Agreement requires stoppage of the activity completely. On the other hand, TTK Bio-med Limited agreed to cease to engage in the business of rubber contraceptives from a future date namely 01.02.2001 and thus, coupled with the

obligation undertaken to forward all further enquiries and information to LIG, the payment made by LIG is liable to be treated only for the service which TTK Bio-med agreed to render to LIG and hence, amounts to a revenue receipt.

10. Sri.Vijay Raghavan, in our considered opinion, has rightly pointed out that, as per Clause (5) of the agreement entered into by and between TTK Bio-med and LIG, LIG has agreed to pay a sum of 4,99,000 pounds so that, TTK Bio-med would not compete with LIG or its associates insofar as rubber contraceptive business is concerned. Covenant No.5 of the agreement is clear, unambiguous and leaves no room to entertain a different opinion thereof. It is plainly a negative covenant agreed to by the TTK Bio-med to refrain itself from manufacturing and marketing rubber contraceptives and also not to associate itself with regard to the said business with any other third parties at any later point of time. It is also true that TTK Bio-med has agreed to cease from engaging itself in the business of manufacture and marketing of rubber contraceptives with effect from 01.02.2001, a subsequent date to that of the agreement. Sri.Vijay Raghavan would contend that this was because the contractual obligations already entered into till then by the TTK Bio-med have got to be met with. It is also true that the TTK Bio-med has agreed to forward all trade information and trade enquiries with regard to rubber contraceptive business to LIG, to enable it to exploit it. Such forwarding the trade enquiries is only an obligation more towards those who approached the TTK Bio-med, as, the failure to forward any such trade enquiries to LIG does not bring about any consequences much less

penal ones with regard to agreement entered into by and between the parties.

11. Hence, we are of the opinion that, applying the legal principles enunciated by the Supreme Court in Rai Bahadur Jairam Valji's case, Kettlewell Bullen & Co Ltd case, Gillanders Arbuthnot & Co Ltd case, Karam Chand Thapar & Bros case, Oberoi Hotel (P) Ltd case and Guffic Chem (P) Ltd case, the amount equivalent to 4,99,000 pounds paid by the LIG is liable to be treated as a measure of compensation towards the negative covenant of non compete entered into by and between Bio-med Limited and LIG. In our opinion, it is not necessary that the assessee need to shelve all his other sources of income as well, for the receipt of compensation to amount to a capital receipt. Like in the Oberoi Hotel's case where assessee has only lost a right to a particular property – only a part of several other business activities which it carries on - compensation received for partial impairment of the business activities normally undertaken by the assessee is liable to be treated as a capital receipt. The litmus test is whether the impairment is one of its sources of income or not and if the answer is that the injury has been caused to one of its sources of income, then it is enough to render the compensation received in that process as a capital receipt. At any rate, with effect from 01.04.2003, by virtue of introduction of Section 28(va) to the Act, all monies received pursuant to a negative covenant become liable for the incidence of taxation, thus obliterating the distinction between the two that was available till then.

12. For the aforementioned reasons, we, answer the question raised by

the revenue in this appeal against it and we uphold the order passed by the Income Tax Appellate Tribunal in I.T.A No.2713/Mds/2004 dated 20.07.2007. Accordingly, the appeal fails and it is accordingly dismissed but however without costs.

(N.R.R.J) (M.V.M.J)

01.06.2016

Index: Yes

Internet: Yes

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1. The Registrar,
Income Tax Appellate Tribunal, Madras 'C' Bench,
Chennai.
2. The Commissioner of Income Tax (Appeals-3),
121, Mahatma Gandhi Road, Chennai-600 034.
3. The Assistant Commissioner of Income Tax,
Company Circle III (2), Chennai-34.
4. The Commissioner of Income Tax, Chennai.

NOOTY.RAMAMOZHANA RAO,J

and

M.V.MURALIDARAN,J

CS

Judgment

in

T.C.(A).No.1469 of 2007

