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IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.1257 OF 2013

Arun Toshniwal,
16, Ishwar Bhavan, 'A' Road, Churchgate
Mumbai - 400 020. ..Appellant.
V/s.

The Dy. Commissioner of Income
Tax 1(3), Aayakar Bhavan, M.K. Road,
Mumbai - 400 020. ..Respondent.

INCOME TAX APPEAL NO.1295 OF 2013

Anurag A. Toshniwal,
16, Ishwar Bhavan, 'A' Road, Churchgate
Mumbai - 400 020. ..Appellant.
V/s.

The Dy. Commissioner of Income
Tax 1(3), Aayakar Bhavan, M.K. Road,
Mumbai - 400 020. ..Respondent.

Mr.Percy Pardiwlla, Senior Advocate with Mr.Ashish Mehta i/b. M/s.
Khaitan & Co. for the Appellant.

Mr.P.C.Chhotaray for the respondent.

CORAM : S.C.DHARMADHIKARI AND A.K.MENON, JJ.

RESERVED ON : 31ST MARCH, 2015

PRONOUNCED ON : 13TH APRIL, 2015

JUDGMENT (PER A.K.MENON, J.)

1. The above two appeals propose the following questions which are termed as substantial questions of law :-

I. Whether on the facts and in the circumstances of the case

and in law, the Tribunal erred in holding that the amount received by the Appellant from Thermo was taxable as business income under the provisions of section 28(va) of the Act, despite the fact that the Appellant was not carrying on any business in the relevant previous year ?

- II. Whether the Appellate Tribunal is correct in holding that carrying on of business is not a pre-condition was chargeability under the head 'profits and gains of business' ?
- III. Whether on the facts and in the circumstances of the case and in law, the ITAT erred in failing to appreciate that the amount received by the Appellant does not fall within S.28(va) and amounts, at best, to a transfer of a right to manufacture or a right to carry a business, taxable under the head capital gains ?

2. The issues involved in both appeals are identical and arise out of non compete and non solicitation agreements entered into between the assessees and one Thermo Electron India LLS Pvt. Ltd.

3. A few facts may be narrated before dealing with the issues in the present appeals-

The assessee in both the appeals were directors of one Chemito Technologies Pvt. Ltd. ('Chemito'). On or about 27th May, 2008, Chemito sold one of its divisions to a company Thermo Electron LLS India Pvt. Ltd. ('Thermo'). Vide an agreement dated 2nd June, 2008, the said Thermo entered into agreements of non

compete and non solicitation under the which the assesseees agreed and undertook not to engage in any business directly or indirectly or otherwise be involved in activity which was similar to that of the division sold to Thermo. For easy reference, we reproduce clause (1) of the said agreement between the Appellant in Appeal No.1257 of 2013 and Thermo :-

"1. Non-compete : In consideration of Thermo paying a sum of Rs.50,000,000/- (Rupees Fifty Million only) on the Completion Date, Mr.Toshniwal hereby undertakes for himself and on behalf of their Affiliates that for an aggregate period of four (4) years from the Completion Date, Mr.Toshniwal shall not, in any part of the world where Thermo sells the products of the Acquired Business or products similar to those sold by the Acquired Business, without the prior written consent of Thermo, directly or indirectly, whether through Affiliates or otherwise :

- i) engage in any business, whether for profit or otherwise, involving the production, development, manufacture, sale or distribution of products that are the same as or similar to the products produced developed, manufactured, marketed, sold or distributed by the Acquired Business as of date hereof and / or during the period of two (2) years prior to the Completion Date; and*
- ii) assist third parties, whether as a consultant, partner, administrator, advisor or otherwise in carrying out the activities of the Acquired Business as of the date hereof: "*

4. The assessee also agreed that for a period of four years from the appointed date, the assessee shall not without prior consent of Thermo, directly or indirectly engage in any business of the division sold to Thermo for a period of 4 years. In consideration of the said undertaking Thermo would pay to the assessee a sum of Rs.5 crores and Rs.2 crores respectively. The Assessing Officer passed an assessment order dated dated 30th September, 2011 under Section 143(3) of the Income Tax Act, 1961 (the Act) stating that the sum received by the appellants were revenue receipts. The assessee appealed before the Commissioner of Income Tax (Appeals) who vide order dated 11th October, 2012 confirmed the order of the Assessing Officer and held that the non compete fee is taxable as income under the provisions of section 28(va) of the Act and not taxable as capital gains. Section 28(va) of the Act reads as under:-

“ (va) any sum, whether received or receivable, in cash or kind, under an agreement for—

- (a) not carrying out any activity in relation to any business; or*
- (b) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services:*

Provided that sub-clause (a) shall not apply to—

- (i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or*

process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

- (ii) *any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India."*

5. Being aggrieved by the order of the Commissioner of Income Tax (Appeals), the assessee filed appeals before the Appellate Tribunal, which while dismissing the appeals vide order dated 16th January, 2013, held that carrying on business is a *sine qua non* and taxable Section 28(i) of the Act. The Tribunal was of the view that it is not necessary to carry on the business in order to attract the provisions of Section 28(va) of the Act.

6. Mr.Pardiwalla, learned Senior Advocate appearing on behalf of the appellant contended that the amount received by the appellant could not be termed as revenue receipts, since the appellant received the amount vide agreement for non compete and non solicitation which provides that he would not engage in any business involving production, development, manufacture, sale or distribution of the product similar to those produced by the division which was sold to Thermo. He submitted that amount in the hands of the assessee was not long term capital gains and that order passed under Section 143(3) of the Act after scrutiny was

incorrect. He submitted that the money had been received by the assessee for agreeing not to carry on the specified business for four years. He, therefore, submitted that the order of the Assessing Officer and apart from other fact finding authorities are incorrect.

7. Mr.Pardiwalla submitted that in Income Tax Appeal Nos.96 of 2012 and 126 of 2013 in the case of Ramesh D. Tainwala V/s. Income Tax Officer, 8(3)-1 & Anr. and V/s. Deputy Commissioner of Income Tax 8(3) respectively, this Court has admitted the above appeals. According to Mr.Pardiwalla, the present case is no different and he is entitled to the benefit of long term capital gains. Mr.Pardiwalla also relied upon the decision of this Court in the case of **John D'souza V/s. CIT** reported in **(2009) 226 ITR 540 (Bom)** wherein this Court has held that the amount was received by the assessee for not carrying on certain activity. He had received compensation of Rs.25 lacs during the financial year 2004-05 in respect of certain properties of which he was the owner and some land related transaction was entered into with M/s. Goa International School (P) Ltd. Accordingly, the amount of Rs.25 lacs was paid to the assessee by Goa International School (P) Ltd. since he would be deprived of his business and relatable income.

8. The Assessing Officer applied Section 28(va)(a) of the

Act since the amount was chargeable to tax and submitted that under section 28(va)(a), the Assessing Officer was justified in holding that the capital receipt was received as compensation and was not capital receipts which is provided under Section 45(1) of the Act. Relying upon the aforesaid decision, Mr.Pardiwalla submitted that amount of Rs.5 crores and Rs.2 crores respectively amounted to capital receipts and claimed the benefit of long term capital gains. He further submitted that it is wrong to have applied the provisions of Section 28(va) and levied tax on the amount of compensation paid for non compete for the reason that the amount is not received for carrying on any business or transaction. According to Mr.Pardiwalla, the Assessing officer, Commissioner of Income Tax (Appeals) and the Tribunal had erred in upholding the application of Section 28(va) of the Act. Accordingly, he submitted that the aforesaid questions are substantial questions of law, which require consideration by this Court.

7. Mr.Chhotaray, learned counsel appearing on behalf of the revenue, on the other hand submitted that the amount received by the assessee were taxable in the hands of the assesseees as receipts from business. According to him, the amount is received as compensation for under the agreement of non compete and non solicitation in relation to business activities, which has been transferred by the assessee to the said company Thermo Electron

LLS India Pvt. Ltd. In support of his contention, Mr.Chhotaray relied upon the decision in the case of **Guffic Chem P. Ltd. V/s. Commissioner of Income Tax and Commissioner of Income - Tax & Anr. V/s. Mandalay Investment P. Ltd.** reported in **[2001] 332 ITR 602 (SC)** wherein it is held that prior to 1st April, 2003, a non compete fee would bear the character of property received. However, after the said date, the same amount is revenue receipt. In that case, the Hon'ble Supreme Court was dealing with the judgment of the Karnataka High Court wherein the High Court held that the compensation received under the non-compete agreement can be treated as a capital receipt. The Hon'ble Supreme Court then went on to determine whether the payment under an agreement not to compete is a capital receipt or a revenue receipt. Two questions arose for determination in that case, firstly, whether the amounts received for loss of agency was in normal course of business and, therefore, it constituted revenue receipts and secondly whether the amount received as compensation on the condition not to carry on a competitive business was in the nature of capital receipt. It was held that the payment of amount received as non competition fee under a negative covenant was treated as a capital receipt till the assessment year 2003-04.

8. It is only vide the Finance Act, 2002 which came into

effect from 1st April, 2003 the said capital receipt was now taxable under section 28(va). Accordingly, the Court held that there is dichotomy between the receipt of compensation by the assessee for loss of business arising out of the negative covenant and that compensation for loss of agency would be a revenue receipt as noted in the decision in the case of *Gillanders Arbuthnot and Co. Ltd. V/s. CIT [1964] 53 ITR 283*. The assessee in that case was dealing with explosives. That agency was terminated and by way of compensation, Imperial Chemical Industries (Export) Ltd. paid two fifths of the commission accrued on past sales and took a formal undertaking from the assessee to refrain from selling or accepting any agency for explosives. This was considered by the Supreme Court and it was held that the said amount received for non-compete agreement was not taxable upto 1st April, 2003 and, therefore, in that case, the amount received is not liable to be taxed. It is clarified by the Supreme Court that section 28(va) of the Act was amendatory and not clarificatory and, therefore, the amount received before the said date was not taxable under Section 28(va) of the Act.

9. Following the aforesaid decision, we are of the view that in the present case, as well the amount received by the assessee was taxable under Section 28(va) of the Act. In the present case, it is evident that had the assessee not entered into an agreement of

non-compete, he would have earned the amount from the business carried on out of the division which was sold to Thermo Electron LLS India Pvt. Ltd. It is the sale of the said division that has deprived him of the income and part of the sale consideration itself, he was required to execute an agreement of non-compete and the compensation received under the said agreement was relatable on a consideration for sale of the business of the division and, therefore, for these reasons also, we are of the view that the amount is taxable under Section 28(va). Furthermore, in the present case, both the assessee have received the amount pursuant to the agreement dated 2nd June, 2008 that is well after 1st April, 2003 and would be covered by the provisions of Section 28(va) of the Act. We are accordingly of the view that no relief can be granted to the appellants. The appeals do not raise any substantial questions of law and the same are dismissed. No order as to costs.

(A.K. MENON, J.)

(S.C.DHARMADHIKARI, J.)