IN THE HIGH COURT OF JUDICATURE AT MADRAS
Dated : 25.07.2012
Coram
The Honourable Mrs.Justice CHITRA VENKATARAMAN
and
The Honourable Mr.Justice K.RAVICHANDRABAABU

TC(A). Nos. 225 and 226 of 2006

Ian Peter Morris
Chennai ... Appellant in both the appeals

-vs-

The Assistant Commissioner of
Income Tax, Salary Circle II
Chennai 34 ... Respondent in both the appeals

Tax Case Appeals against the order of the Income Tax Appellate Tribunal, A Bench, Chennai, dated 20.06.2005 passed in Cross Objection No. 53/ Mds/ 2000 and I.T.A.No.268/ Mds/ 2000 for the assessment year 1994-95.

For Appellant : Mr.V.S.Jayakumar

For Respondent: Mr.T.R.Senthil Kumar

JUDGMENT
(Judgment of the Court was made by CHITRA VENKATARAMAN,J)

The assessee has preferred the above appeals as against the common order of the Income Tax Appellate Tribunal relating to assessment year 1994-95 passed in Revenue's appeal as well as in the cross objection filed by the assessee. The Tax Case (Appeal) No. 225 of 2006 was admitted on the following substantial questions of law:-

"(i) Whether the Tribunal was right in upholding the reassessment made under Section 147 of the Act for the assessment year 1994-95?

(ii) Whether the Tribunal was right in sustaining the levy of the interest under Section 234B and C as consequential in nature, when it should have held that there is no liability to advance tax and therefore no liability for interest keeping in mind Section 208 read with 209 (1)(d)?"

The Tax Case (Appeal) No. 226 of 2006 was admitted on the following substantial questions of law:-

"(i) Whether the Tribunal was right in upholding the reassessment made under Section 147 of the Act for the assessment year 1994-95?

(ii) Whether the Tribunal was right in law in holding that the sum received by the appellant in pursuance of the restrictive covenant is taxable in his hands?"

2. The Revenue's appeal before the Tribunal related to deletion of addition of Rs.21 lakhs, alleged to have been received by the assessee on account of restrictive covenant, which was treated by the Assessing Officer as a revenue receipt, but treated by the Commissioner as a capital receipt. The assessee is stated to be one of the founder director of Log-In Systems Innovations Limited. The company was engaged in the business of software development and consultancy. Under agreement dated 15.10.1993 the business of Log-In Systems Innovations Limited was sold to Synergy Credit Corporation Limited as a going concern for a sum of Rs.6 lakhs. A perusal of the agreement shows that the sale was effective from 1st April 1993. On the very same date of the execution of the agreement, the purchaser company entered into separate agreement with each of the four partners, which includes the assessee herein. Under the terms of the said agreement, the purchaser company offered to pay a sum of Rs.21 lakhs to the assessee on the ground that the assessee shall not carry on business of computer software, development and marketing of any kind. Thus the restrictive covenant was stated to have arisen out of the separate agreement dated 15.10.1993. It is a matter of relevance herein to note that on 8.10.1993, the purchaser company wrote a letter to the assessee herein appointing the assessee as a Executive Engineer with effect from 8th October 1993. Even though the letter reads as offer of appointment, yet, it pointed out that the assessee would be paid gross compensation of Rs.1,77,200/- per annum. The other terms and conditions relating to appointment would be mutually discussed and finalised. The appointment letter also included terms and conditions for appointment. On 19th October 1993, the assessee wrote a letter to the purchaser company wherein he referred to the letter dated 8th October 1993 and stated that he accepted the offer to join the concern from 1.11.1993. Even though the letter dated 19th October 1993 stated that the assessee was to join from 1.11.1993, the fact as regards the employment of the assessee is clear from the letter dated 8th October 1993 written by Synergy Credit Corporation Limited. In the background of the restrictive covenant entered into, question arose as to whether the receipt of Rs.21 lakhs was to be treated as capital receipt. The assessee placed reliance on the decision of the Supreme Court reported in 53 ITR 283 GILLANDERS ARBUTHNOT & CO. LTD v. CIT and 60 ITR 11 CIT v. BEST & CO. P. LTD. The Assessing Officer initiated proceedings under Section 147 read with 143(3) of the Act. In considering the claim made on the receipt of Rs.21 lakhs, the Assessing Officer pointed out that once a person is employed in a company, the employer has full rights to utilise the services of that person. Thus, when Synergy Credit Corporation had employed the assessee, the right of the employer to exploit the expertise of the assessee goes without saying. Consequently, the restrictive covenant was only a make believe agreement mainly intended to give an appearance of capital receipt. The amount of Rs.21 lakhs was held to be an addition to salary and the different nomenclature given would not alter the character of the receipt. Aggrieved by this, the assessee went on appeal before the Commissioner of Income Tax (Appeals).

3. The Commissioner of Income Tax (Appeals) reasoned out as follows:-

The take over of the entire business for a sum of Rs.6 lakhs, that the agreement entered into between the purchaser company and four Directors by paying Rs.21 lakhs each under the restrictive covenant agreement and that the offer of appointment to all four Directors went on almost around the same time frame. Thus, even though there were three agreements, all that had to be considered as a composite event. In the circumstances, the Commissioner of Income Tax (Appeals) rejected the view of the Assessing Officer that the restrictive covenant was only a make believe agreement. He held that the Assessing Officer had not brought out anything on record to indicate that the real salary of the assessee should have been higher than the salary fixed by the agreement dated 8th October 1993. The Commissioner of Income Tax (Appeals) held that payment made under the restrictive covenant was an independent payment and had nothing to do with the salary payment made from month to month. The exploitation of the expertise of the assessee certainly was made by payment of Rs.21 lakhs by the purchaser company. Referring to the decisions of the Supreme Court and High Court, as referred to by the assessee, the Commissioner of Income Tax (Appeals) held that the receipt was only a capital receipt.

As far as the validity of the order passed under Section 147 read with 143 of the Act is concerned, the Commissioner of Income Tax (Appeals) held that the reopening was in order. Thus, while rejecting the assessee's contention on the validity of the order passed under Section 147 read with 143(3) of the Act, on merits of the assessment, the Commissioner accepted the contention of the assessee. In the light of the above, it cancelled the penalty levied under Section 234B of the Act. Aggrieved by the decision of the Commissioner of Income Tax on the aspect of the jurisdiction, the assessee filed Cross Objection before the Income Tax Appellate Tribunal and as regards the merits of the assessment, the Revenue filed appeal before the Tribunal.

4. As far as reassessment under Section 147 of the Act was concerned, the Tribunal held that the intimation under Section 143(1)(a) could not be treated as an order under Section 143(2) and there was no change of opinion in initiating proceedings under Section 147 read with Section 143(2) of the Act. Following the decision of the Allahabad High Court reported in 229 ITR 46 PRADEEP KUMAR HAR SARAN LAL v. ASSESSING OFFICER, the Tribunal held that the order of the Commissioner holding the jurisdiction of the Assessing Officer to make assessing under Section 147 of the Act was correct. Thus, the assessee's cross objection failed on this score.

5. As far as the merits of the assessment is concerned, the Tribunal pointed out to the facts relating to the agreement of sale between the purchaser company and Log-In Systems and Innovations Limited, in which the assessee was the Director. The non compete agreement and the employment agreement formed part of the same transactions. Going by the fact that the assessee was offered employment as early as 8th October 1993, the restrictive covenant entered into on 15.10.1993 would not be called as independent agreement. Thus, the restrictive covenant agreement was only a make believe agreement mainly intended to change the nature of receipt.

6. Referring to the decision reported in 261 ITR 358 K.RAMASAMY v CIT, the Tribunal pointed out that the facts in the decided case and the case on hand are identical. All the four directors of Log-In Systems became Executive Directors of the purchaser company and all four Directors were paid a sum of Rs.21 lakhs each for not carrying on the business of computer software development. In the circumstances, the Tribunal came to the conclusion that the sum of Rs.21 lakhs received by the assessee was in the nature of revenue receipt.

7. Referring to Section 17(3)(iii) relied on by the assessee, the Tribunal held that the said section cannot be held to have retrospective effect and the dispute raised by the assessee was covered by provisions contained in Sections 17(1)(iv) and / or 17(3)(ii) of the Act. Thus, the Tribunal confirmed the assessment. Aggrieved by this, present appeal by the assessee.

8. As far as the first question of law on the reopening of the assessment and validity of the assessment made under Section 147 of the Act is concerned, learned counsel appearing for the assessee fairly stated before this Court that the said issue is covered by decision of this Court reported in 340 ITR 609 CIT v. IDEAL GARDEN COMPLEX (P) LTD. Accordingly, following the same, the first substantial question of law in both the appeals is answered in favour of the Revenue. As such, the Tax Case (Appeals) are dismissed in respect of first question of law.

9. As far as the character of receipt of Rs.21 lakhs is concerned, learned counsel for the assessee produced non compete agreement dated 15.10.1993 as well as agreement of sale of business between Log-In systems and Synergy credit corporation, and submitted that as on the date of the above said agreement, the assessee was not in employment as evident from the letter dated 19th October 1993, but he joined employment only on 1.11.1993. In the circumstances, the Tribunal committed serious error

in looking at these three documents as one single document. Pointing out to the employment of the assessee consequent on the sale and the receipt of Rs.21 lakhs which was to be treated as capital in nature, he pointed out that there are no materials to doubt the genuineness of the restrictive agreement entered into between the parties. In the circumstances, the order of the Tribunal has to be set aside. He pointed out that when the agreement of sale was entered into for acquisition of the business, the payment was not in contemplation, in the sense that the assessee himself had accepted the offer dated 8.10.1993 to join in the purchaser company only on 1.11.1993. In the background of the said facts, the claim of the assessee has to be accepted.

10. Heard learned counsel for the assessee as well as learned standing counsel for the Revenue and perused the materials available on record.

11. As already seen in the preceding paragraph, the agreement for acquisition of the business between Log-In Systems, in which the assessee was a Director and Synergy credit Corporation was entered on 15.10.1993 was effective from 1st April 1993. Thus, on and from 1.4.93, the business of Log-In Systems was transferred to Synergy Credit Corporation. The aggregate price quoted in the agreement was Rs.6 lakhs. It is a matter of record that on the very same date, the assessee is stated to have entered into a non compete agreement. A reading of the said agreement shows a reference to the purchase of the business by Synergy Credit Corporation for a sum of Rs.6 lakhs. That in pursuance of the above said sale agreement, the Synergy Credit Corporation, desirous of availing exclusive rights to the services of the assessee herein imposed a restrictive covenant on the assessee not to carry on business of computer software, development and marketing of any kind. For the said restrictive covenant, on entering into an agreement, the assessee was paid a sum of Rs.21 lakhs in cash as per the time schedule to be mutually agreed upon and in any case not beyond the period of twelve months from the date of the agreement. The restrictive covenant also referred to the period during which restrictive covenant was to operate as five years. Considering the fact that the agreement for acquisition itself was stated to be effective from 1.4.93, one has to see the contents of the letter dated 8.10.1993 written by Synergy Credit Corporation to the assessee. The letter straight away opens with reference to discussion held with the assessee and reads as under,

"This has reference to the discussions held with you.

It gives us pleasure in appointing you as Executive Director in Synergy Credit Corporation Limited with effect from October 08, 1993.

As Executive Director, you will be entitled to the following:-

a) Gross compensation of Rs.1,77,200/- per annum.

b) Other terms and conditions relating to your appointment will be mutually discussed and finalised.

We trust you find the above in order.

We also look forward to a mutually satisfying association in the time to come. "

12. The said letter was replied to on 19.10.1993 by the assessee indicating his acceptance to join from 1.11.1993. As rightly pointed out by the Commissioner of Income Tax (Appeals) in his order and confirmed in the order of the Tribunal, the conduct of the assessee hence has to be seen from the clauses in the agreement. As already seen, the agreement for sale dated back to 1.4.93 and with the discussions on the employment was also there as had been referred in the letter dated 8.10.93, one can only view the letter dated 19.10.93 indicating the acceptance to join the services of the purchaser company by the assessee effective from 1.11.1993 and the restrictive covenant agreement dated 15.10.93 as form part of the same transactions. Thus, with the date of acquisition to date back to 1.4.93, the agreement dated 15.10.93 giving non compete compensation has to be read in terms of letter dated 8.10.93 and 19.10.93. Thus, when the business had already stood transferred as on 1.4.93, the document written on 15.10.93 has to be read as follow up of the employment of the assessee in the

purchaser company as indicated in the letter dated 8.10.93, in which event, Section 17(1)(iv) would automatically apply to the case of the assessee. In addition to the salary shown in the letter dated 8.10.93, any amount received under the so called non compete agreement, would only be treated as salary for the purpose of assessment.

13. Going by the above circumstances, rightly the authorities below rejected the case of the assessee that the receipt of Rs.21 lakhs was only a revenue in character.

14. In the light of the above, we hold that the order of the Tribunal is correct. Consequently, the questions of law in both the appeals answered against the assessee. No costs.

(C.V.,J) (K.R.C.B.,J)
25.07.2012

Index : Yes/No
Internet : Yes/No
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CHITRA VENKATARAMAN,J
and
K.RAVICHANDRABAABU,J

bg/-

To

1. The Assistant Commissioner of Income Tax, Salary circle- II, Chennai

2. The Income Tax Appellate Tribunal, A Bench, Chennai

TC(A). Nos.225 and 226 of 2006

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