

**IN THE HIGH COURT OF HIMACHAL PRADESH
SHIMLA**

ITA No. 24 of 2014

Reserved on: 05.10.2015

Date of Decision: January 4, 2016

Avantor Performance Materials India Limited,
(Formerly known as RFCL Limited).

...Appellant.

Versus

Commissioner of Income Tax, Shimla & another

..Respondents.

Coram:

The Hon'ble Mr. Justice Sanjay Karol, Judge.

The Hon'ble Mr. Justice P.S. Rana, Judge.

*Whether approved for reporting?*¹Yes.

For the Appellant: M/s Chythanaya K.K. and Vijay Kumar
Verma, Advocates.

For the Respondents: Mr. Vinay Kuthiala, Sr. Advocate with
Ms.Vandana Kuthiala, Advocate.

Sanjay Karol, J (oral)

The present appeal stands admitted on the
following substantial questions of law:-

“Whether in the facts and circumstances of the case
and in law, the ITAT was correct in holding that the
compensation of Rs.2,25,99,964 representing
compensation received by the appellant towards
cancellation of the SPA was a revenue receipt
taxable in the hands of the appellant?”

¹ Whether reporters of the local papers may be allowed to see the judgment?

2. In relation to the assessment year 2008-09, M/s RFCL Limited (hereinafter referred to as the assessee), filed return with the Income Tax Department. The case was selected for scrutiny through CASS and notices issued under the provisions of Sections 143(2) and 142(1) of the Income Tax Act, 1961 (hereinafter referred to as the Act).

3. Vide order dated 28.12.2010 (Annexure P-1), the Assessing Officer, reassessed the income by disallowing (i) the depreciation of goodwill and (ii) claim of capital receipt. The order stood affirmed by the Commissioner of Income Tax (Appeals), Shimla, in terms of order dated 12.12.2011 (Annexure P-2). Findings of fact returned by such authorities, on the point in issue, came to be affirmed by the Income Tax Appellate Tribunal, Chandigarh Bench 'B, Chandigarh, vide order dated 02.04.2013 (Annexure P-3).

4. In the instant appeal, we are only concerned with the second issue i.e. as to whether the amount of compensation so received by the assessee is required to be computed as a capital or a revenue receipt.

5. Facts already stand fully considered and appreciated by the authorities below. It is a settled position of law that the burden to establish as to whether the character of the amount received is revenue receipt or not, is always upon the revenue. However once it is so

established, whether it comes under the clause of exemption or not is for the assessee to establish. Facts must be formed by the Tribunal and the High Court must proceed on the basis of such facts as may be determined by the Tribunal, for it is not the requirement of law that the High Court is to look into the facts afresh, overruling them, unless there is a question to that effect, challenging the facts formed by the Tribunal. [*Dr. K. George Thomas Versus Commissioner of Income-Tax, Ernakulam*, AIR 1986 SC 98].

6. Whether the receipt is capital or revenue in nature has to be adjudged on the basis of each case. There cannot be any straightjacket formula as has been so held by the Apex Court in *Commissioner of Income Tax, Gujarat Versus Saurashtra Cement Ltd.*, (2010) 11 SCC 84, wherein Court observed that:-

“14. The question whether a particular receipt is capital or revenue has frequently engaged the attention of the Courts but it has not been possible to lay down any single criterion as decisive in the determination of the question. Time and again, it has been reiterated that answer to the question must ultimately depend on the facts of a particular case, and the authorities bearing on the question are valuable only as indicating the matters that have to be taken into account in reaching a conclusion.

15. In *CIT Versus Rai Bahadur Jairam Valji*, AIR 1959 SC 291, it was observed thus (AIR pp. 292-293, para 2:-

“2. The question whether a receipt is capital or income has frequently come up for determination before the Courts. Various rules have been enunciated as furnishing a key to the solution of the question, but as often observed by the highest authorities, it is not possible to lay down any single test as infallible or any single criterion as decisive in the determination of the question, which must ultimately depend on the facts of the particular case, and the authorities bearing on the question are valuable only as indicating the matters that have to be taken into account in reaching a decision. [Vide *Van Den Berghs Ltd. (Inspector of Taxes) vs. Clark*, (1935) 3 ITR (Eng Cas) 17 (HL)]. That, however, is not to say that the question is one of fact, for, as observed in *Davies (Inspector of Taxes) vs. Shell Company of China Ltd.* (1952) 22 ITR Supp 1 (CA):

‘these questions between capital and income, trading profit or no trading profit, are questions which, though they may depend no doubt to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts.’ “ ”

(Emphasis supplied)

7. Further in *Shri P.H. Divecha (deceased) through LRs & Another Versus The Commissioner of Income-tax, Bombay City I, Bombay*, AIR 1964 SC 758, the Apex Court held that:-

“12. In determining whether this payment amounts to a return for loss of a capital asset or is income, profits or gains liable to income-tax, one must have regard to the nature and quality of the payment. If the payment was not received to compensate for a loss of profits of business, the receipt in the hands of the appellant cannot properly be described as income, profits or gains as commonly understood. To constitute income, profits or gains, there must be a source from which the particular receipt has arisen, and a connection must exist between the quality of the receipt and the source. If the payment is by another person it must be found

out why that payment has been made. It is not the motive of the person who pays that is relevant. More relevance attaches to the nature of the receipt in the hands of the person who receives it though in trying to find out the quality of the receipt one may have to examine the motive out of which the payment was made. It may also be stated as a general rule that the fact that the amount involved was large or that it was periodic in character have no decisive bearing upon the matter. A payment may even be described as “pay”, “remuneration”, etc., but that does not determine its quality, though the name by which it has been called may be relevant in determining its true nature, because this gives an indication of how the person who paid the money and the person who received it viewed it in the first instance. The periodicity of the payment does not make the payment a recurring income because periodicity may be the result of convenience and not necessarily the result of the establishment of a source expected to be productive over a certain period. These general principles have been settled firmly by this Court in a large number of cases. See, for example, *Commr. of Income-tax vs. Vazir Sultan & Sons*, 1959 Supp (2) SCR 375: (AIR 1959 SC 814), *Godrej & Co. vs. Commr. of Income-tax*, (1960) 1 SCR 527: (AIR 1959 SC 1352), *Commr. of Income-tax vs. Jairam Valji*, (1959) 35 ITR 148: (AIR 1959 SC 291), *Senairam Doongarmall vs. Commr. of Income Tax*, (1961) 42 ITR 392: (AIR 1961 SC 1579).”

(Emphasis supplied)

8. The Apex Court in *Kettlewell Bullen and Co. Ltd. Versus Commissioner of Income-tax, Calcutta*, AIR 1965 SC 65, has further held:-

“11. 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 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.”

... ..

“21. But payment of compensation for loss of office is not always regarded as capital receipt. Where compensation is payable under the terms of the contract which is determined, payment is in the nature of revenue and therefore taxable.”

... ..

“36. Where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue : Where by the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee’s income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt.”

(Emphasis supplied)

9. Also in *Travancore Rubber & Tea Co. Ltd. Versus Commissioner of Income Tax, Trivendrum*, (2000) 3 SCC 715, the Apex Court observed that:-

“19. In determining whether compensation received for breach of a contract is a capital or trading receipt, the relevant rule has been formulated by Diplock L. , J. in *London and Thames Haven Oil Wharves Ltd. vs. Attwooll (Inspector of Taxes)*, (1968) 70 ITR 460, 488 (CA) as :

“Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income-tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation.””

10. The apex Court in *M/s Gillanders Arbuthnot and Company Ltd. Vs. Commissioner of Income Tax, Calcutta*, AIR 1965 SC 452, has held as under:

“11. We may now address ourselves to the question, whether compensation paid by the principal company for cancellation of the agency may be regarded as a capital or revenue receipt. We have in a recent case in *Kettlewell Bullen and Co. vs. Commissioner of Income Tax*, C.A. No.226 of 1963 D/- 1-5-1964: (AIR 1965 SC 65) made a survey of the important cases which have arisen before the courts in the United Kingdom and an Indian in India about the principles which govern the determination of the nature of compensation received on the termination of an agency. We observed in that case:

“On an analysis of these cases which fall on two sides of the dividing line, a satisfactory measure of consistency in 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 leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue : Where by the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt”.

11. Applying the aforesaid principles to the given facts, which we clarify we are not reappreciating, we do not find any justification to interfere with the order passed by the authorities below, as by no stretch of imagination can it be said to be perverse, illegal or founded on incorrect or incomplete appreciation of provisions of law, much less facts.

12. Assessee is a Company duly registered under the Companies Act, 1961, having its office at 1201 to 1206, 12th Floor, Pinnacle Business Tower, Shooting Range Road, Surajkund, Faridabad – 121 009, Haryana. Its aim and object being diagnostic, laboratory solutions and chemical research.

13. M/s Sarabhai Zydus Animal Health Limited (hereinafter referred to as Zydus) was incorporated in the year 2000. The equity participation of the said company was in the following manner: (i) 50% with M/s Cadila Healthcare Limited (Cadila Group engaged in the business of Pharmaceuticals and Allied Industries - hereinafter referred to as Cadila) and (ii) 50% with: (a) Ambalal Sarabhai Enterprises Limited, a company incorporated under the Companies Act, 1956, having its registered office at Dr. Vikram Sarabhai Marg, Wadi Wadi, Vadodara 390 023; (b) Mautik Exim Limited, a company incorporated under the Companies Act, 1956, having its registered office at Shantisadan, Mirzapur Road, Ahmedabad; (c) Haryana Containers Limited, a company incorporated under the Companies Act, 1956, having its registered office at Dr. Vikram Sarabhai Marg, Wadi Wadi, Vadodara 390 023; and (d) Mr. Kartikeya V. Sarabhai, S/O Dr. Vikram Sarabhai, currently residing at Chidambaram, Usmanpura, Ahmedabad (hereinafter referred to as the Sellers).

14. It is the case of the assessee that the sellers had pledged their equity with Cadila, against a loan of `21,71,68,263/-. Also they were in debt to the company (Zydus). Vide Special Purchase Agreement dated 10.03.2007 (hereinafter referred to as SPA), the Sellers

agreed to transfer their entire shareholdings (50% of Zydus) in favour of the assessee. This was for a valuable consideration of `72.5 crores. In terms of the SPA, a sum of `24, 81, 68, 263/- was paid as earnest money by the assessee. Undisputedly, as per *inter se* arrangement amongst the shareholders of Zydus, Cadila had a Right of First Refusal (hereinafter referred to as ROFR), which fact is evident from Clause-5 of the SPA.

15. SPA could be terminated in terms of Clause-7.6, which reads as under:-

“7.6 Termination of this Agreement

This Agreement shall not be terminable except in the manner specified herein and this shall continue to be valid and in force till it is terminated.

- (i) The Vendors shall not be entitled to terminate this Agreement on any grounds whatsoever.
- (ii) In the event the Condition Precedent (i.e. the due diligence) to Closing, as specified in Article 6 above, is not completed on or prior to the Closing Date, to the satisfaction of the Purchaser, then the Purchaser shall be entitled to forthwith terminate this Agreement by a written notice to the Vendors.
- (iii) In the event the Other Shareholder exercises its rights to purchase the Shares offered by the Vendors under its Right of First Refusal, on terms and conditions no more beneficial than the terms as set out in this Agreement, then the

Purchaser shall forthwith terminate this Agreement by a written notice to the Vendors.

- (iv) In the event any litigation / proceedings is initiated which impacts the ability of the Parties to achieve Closing under this Agreement, then the Purchaser shall be entitled to forthwith terminate this Agreement by a written notice to the Vendors.”

(Emphasis supplied)

16. Agreement contemplated consequence of termination in the following manner:-

“7.7 Consequences of termination:

- (i) In the event of termination of this Agreement by the Purchaser, the Vendors shall repay the Earnest Deposit Amount and separately, pay a penalty equivalent to 25% annualized return on pro rata basis on the Earnest Deposit Amount or 5% of the Earnest Deposit Amount, whichever is higher, to the Purchaser, as follows:

- (a) where the Agreement is terminated in accordance with the provisions of Article 7.6(ii) above, then within 30 days of the date of such termination;
- (b) where the Agreement is terminated in accordance with the provisions of Article 7.6(iii) above, then within the 60-day period referred to in clause 14.2.2 of the shareholders agreement dated January 29, 2000 executed between the Other Shareholder and Ambalal Sarabhai Enterprises Limited (one of the Vendors herein) or the date on which the Other Shareholder purchases the Shares from the

Vendors, pursuant to its Right of First Refusal, whichever is earlier;

- (c) where the Agreement is terminated in accordance with the provisions of Article 7.6(iv) above, then within 30 days of the date of such termination.
- (ii) Upon the actions specified in Clauses 7.7 (i) above, being completed to the full satisfaction of the Purchaser, the Escrow Agent will release, upon receipt of a written intimation from the Purchaser in this respect, to the Vendors the duly executed blank share transfer forms and the original share certificates relating to the Shares deposited by the Vendors in the manner specified in Article 1.3(v) above."

17. Vide another agreement of the same date, which is termed as a supplementary agreement, Sellers also agreed to convince Cadila to sell their entire shareholding i.e. balance 50% in Zydus, to the assessee. In terms thereof, assessee also deposited `15 crores with the Escrow Agent.

18. Vide communication dated 10.05.2007, the Sellers expressed their inability to sell their shares, conveying Cadila's intention of purchasing the same by virtue and in exercise of their pre-existing contractual Rights of Refusal. Accordingly Sellers, categorically called upon the assessee to terminate the SPA and accept the following sums, in terms of Clause-7 of the SPA:-

- (i) Earnest Deposit Amount: `24,81,68,263.00

(ii)	Interest:	`59,01,645.27
(iii)	Penalty:	`1,24,08,413.15

19. There is nothing on record to establish as to what transpired thereafter, save and except that another supplementary agreement was executed on 22.05.2007 between the assessee and the Sellers, wherein the parties agreed to terminate the SPA by making payments to the assessee in the following manner:-

Sr.No.	Particulars of Payment	Amount
(i)	Repayment of Earnest Deposit Amount under the SPA	Rs.24,81,68,263/-
(ii)	Interest for 63 days (i.e. 9 March 2007 to 10 May 2007 both days inclusive) on the amount specified in para (i) above, calculated @ 14% p.a.	Rs.59,96,833/-
	Less: TDS on interest @ 22.44% (One TDS certificate for interest upto 31.03.07 and another TDS certificate from 01.04.07 to 10.05.07 will be provided within 7 days)	Rs.13,45,689/-
	Net Interest payable now	Rs.46,51,144/-
(iii)	Payment of Penalty as per the SPA	Rs.1,24,08,413/-
(iv)	Compensation for Termination of SPA	Rs.2,25,91,587/-
	Aggregate amount payable	Rs.28,78,19,407/-

20. This amount of `2,25,91,587/-, received as compensation by the assessee for termination of the SPA, was so claimed as a capital receipt, but assessed by the

revenue as revenue receipt and subjected to payment of tax.

21. Now SPA provided for the consequences of the termination of the agreement and in terms thereof, assessee did receive the amounts towards payment of interest and penalty. Compensation for termination was nowhere in contemplation in the SPA. What was the basis for arriving such compensation remains a shrouded secret.

22. It has been rightly held by the authorities that Zydus was engaged in the business, similar to that of the assessee, who was exploring the possibility of expanding its business interests. Compensation is not on account of any injury to any of the capital assets of the assessee. The assessee, as is evident from the order dated 28.12.2010 (Annexure P-1) had also entered into business acquisition agreement with M/s Wipro and Godrej Industries Ltd. The assessee was pursuing strategic inorganic growth through acquisitions. Zydus was in the similar business as that of the assessee. The intent was not to purchase the shares of Zydus but takeover its business for expansion. As observed by Assessing Officer even the view of the statutory auditors was similar to that of the revenue.

23. Noticeably it is the assessee, who had terminated the SPA and not the Sellers and as such there

was no breach thereof, necessitating payment of compensation to the assessee. The SPA was conditional and subject to approval by Cadila.

24. Even otherwise it is well settled legal position that in order to find out whether a receipt is a capital or revenue receipt, one has to see it in the hands of the receiver and in order to find out whether an expenditure is a capital or revenue expenditure, one has to see what it is in the hand of the payer. In the case of *Commissioner of Income Tax, West Bengal-II Versus Shri Kamal Behari Lal Singha, Etc. Etc.*, (1971) 3 SCC 540, the Apex Court has stated the legal position in the following words:

“4. It is now well settled that, in order to find out whether a receipt is a capital or revenue receipt, one has to see what it is in the hands of the receiver and not its nature in the hands of the payer. In other words, the nature of receipt is determined entirely by its character in the hands of the receiver and the source from which the payment is made has no bearing on the question. Where an amount is paid which, so far as the payer is concerned, is paid wholly or partly out of the capital, and the receiver receives it as income on his part, the entire receipt is taxable in the hands of the receiver. Therefore, the fact that the amount sought to be taxed in these appeals was capital gains in the hands of the company is not a relevant circumstance. What we have to see is what it was in the hands of the assessee.”

25. If a receipt is a capital receipt in the hands of a recipient, it does not necessarily follow that expenditure is capital expenditure in the hand of a payer. Whether it is capital expenditure or revenue expenditure would have to be determined having regard to the nature of the transaction and other relevant factors. [*M/s Empire Jute Co. Ltd. Versus Commissioner of Income Tax*, (1980) 4 SCC 25].

26. The assessee knew from the very beginning the conditionality Clause. He was conscious that no injury would be caused to his business in the event of SPA not being materialized and its non execution would in no manner impair its revenue.

27. In the aforesaid factual background, in our considered view, the authorities below have rightly held the amount of compensation to be a revenue receipt. Income earned from such sources was to be taxed as business income.

28. Now in the instant case as already observed, it is not the case of the assessee that his business had come to a halt or impaired the source of income. Hence applying the principle of law laid down in the decisions referred to herein supra (including *Kettlewell Bullen*), we see no reason to interfere with the orders passed by the authorities below.

29. Learned counsel for the parties have cited various decisions, which is only reflective of their industry. We have considered them and having minutely gone through the same, we do not find necessity of dealing with each one of them individually for they are based on given fact situation. In the decisions referred to by the learned counsel for the appellant, which do not find mention herein, it be only observed, that the courts were dealing with cases where there was termination of an agreement, bringing the business of the assessee to a halt or impairing income or source of income.

30. Hence for all the aforesaid reasons, it cannot be said that the authorities below, and more particularly the Tribunal erred in holding the amount of compensation received by the assessee as a revenue receipt taxable in the hands of the assessee. Substantial question of law is answered accordingly.

Present appeal stands disposed of accordingly, so also pending application(s), if any.

(Sanjay Karol),
Judge.

(P.S. Rana),
Judge.

January 4, 2016
(Purohit)