
(2005) 05 CAL CK 0019
In the Calcutta High Court
Case No : IT Appeal No. 333 of 2000

Commissioner of Income Tax

APPELLANT

Vs

A.S. Wardekar

RESPONDENT

Date of Decision : 03-05-2005

Acts Referred:

Income Tax Act, 1961 — Section 10(3), 14, 2(14), 260A, 28

Citation : (2005) 199 CTR 255 : (2006) 283 ITR 432 : (2006) 151 TAXMAN 303

Hon'ble Judges : Soumitra Pal, J;D.K. Seth, J

Bench : Division Bench

Advocate : Md. Nizamuddin, for the Appellant;R.K. Murarka and V. Murarka, for the Respondent

Final Decision : Dismissed

Judgement

Soumitra Pal, J.—The instant IT Appeal preferred by the Revenue u/s 260A of the IT Act, 1961, against the order passed by the learned Tribunal, Calcutta for the asst. yr. 1989-90 was admitted on 19th Dec., 2000 on the following questions :

"(a) Whether, in the facts and circumstances of this case and according to the proper view of the law, the sum of Rs. 1.75 crores received by the assessee for entering into a restrictive covenant of not entering into a competing business with--United Breweries group for a period of five years was receipt by the assessee in the nature of a capital receipt or whether it was a revenue receipt ?

(b) Whether in law the said receipt of Rs. 1.75 crores is not capital gain chargeable to capital gains tax but merely capital receipt not chargeable to any tax whether tax or capital gains tax at all ?

(c) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in deleting the addition of Rs. 1,74,95,000 made by the AO as per provision of Section 10(3) of the IT Act, 1961 ?"

2. The facts found by the learned Tribunal are that the assessee promoted a

partnership firm called M/s Western India Erectors (P) Ltd. Later another company known as Western India Erector (P) Ltd. (WIEL) was promoted in 1970 and most of the contracts were taken over by the company but the firm continued. Subsequently, this company was converted into a limited company. Most of the shares were held by the assessee and his close relatives. The company made public issues. The assessee through good offices of his friends and in terms of agreement dt. 28th Oct., 1988 negotiated the sale of all the shares to United Breweries Ltd. (for short "UBL"). The agreement was between the assessee acting for himself and his associates and the UBL. The agreement also had authorised the assessee to enter into the agreement on behalf of the other shareholders who were his relatives, friends and associates. There was also an agreement or reconstitution of WIEL and how after the sale of shares the affairs of WIEL would be managed. The agreement also provided that the assessee would continue on the board of directors as chairman. The assessee agreed to sign such documents and carry out acts and things as would be reasonably required to give effect of the terms of that agreement. The UBL, however, thought it expedient to bind the assessee by written agreement refraining him from undertaking any business similar to the business of the said company as the assessee was carrying on before and could have carried on in future as in the past once he was free from WIEL. Therefore, the assessee and the UBL entered into another agreement whereby the assessee undertook not to engage himself directly or indirectly for a period of five years from the date of agreement in any activity industrial, commercial or otherwise, which in any manner competes or comes into conflict with the existing business and activity of WIEL. In consideration of such undertaking, the UBL agreed to pay to the assessee a sum of Rs. 175 lakhs. The said sum was duly paid by UBL and its associate companies. It was in this background that the assessee had received the aforesaid amount of Rs. 175 lakhs.

3. The AO held that the receipt was of casual and non-recurring nature subject to exemption prescribed u/s 10(3) of the IT Act, 1961.

Being aggrieved the assessee preferred an appeal. The CIT(A) allowing the appeal held as under :

"In the present case, WIEL was public limited company in which even the public financial institutions held substantial stakes. The amount in question as paid to the appellant not by WIEL but by persons who purchased the WIEL's shares from the appellant, his associates and friends. The amount in question was paid in terms of the aforesaid agreement and almost immediately after the same was executed. The appellant continued to remain managing director of WIEL till he resigned on 1st Aug., 1989. It is far-fetched to say that the amount in question was paid to the appellant by the employer by way of compensation on termination of his employment, when in fact, the same was not in any way connected or related thereto.... The amount was specifically paid for the restrictive covenant and for no other consideration. I have already held that the

said receipt was a capital receipt and was not synonymous with income. The same was also not casual in nature. I, therefore, hold that the said sum of Rs. 175 lakhs or any portion thereof was not taxable as income of the appellant and was also not taxable as income of the appellant and was also not covered by the provisions of Section 10(3) of the Act. The addition of Rs. 74,95,000 made by the Asstt. CIT is, therefore, deleted."

4. The Revenue, being aggrieved by the order passed by the CIT(A), preferred an appeal before the learned Tribunal. The Tribunal held as under :

"...we are of the opinion that the CIT(A) rightly deleted the addition as a sum of Rs. 175 lakhs received by the assessee was not casual in nature and the same was received by virtue of restrictive or non-competitive covenant. So, the receipt was outside the purview of definition of income. Hence, we find no infirmity with the order of the CIT(A). The same is hereby upheld."

5. Mr. R.K. Murarka, learned senior advocate for the assessee, submitted in view of an unreported judgment delivered by the jurisdictional Court in IT Appeal No. 439 of 2000, CIT v. Saroj Kumar Poddar, the question No. 1 is covered in favour of the assessee. The question which arose in CIT v. Saroj Kumar Poddar (supra) whether on facts it can be said that payment under "non-compete agreement" was a colourable device, as the assessee did not sell any assets. The facts appearing at p. 5 of the unreported judgment are as under:

"The facts are not in dispute that assessee had earlier collaboration with Gillette Company and M/s India Saving Products Ltd. was formed and that company has set on the units to produce Gillette blades and other shaving products, that company was formed in 1982, assessee was non-executive chairman of that company. Though the major shareholding was of Gillette Company, but assessee being non-executive chairman of ISP acquired the expertise knowledge in Gillette Company products, such knowledge regarding raw material from where it is available, cheap and better quality manufacturing technique of Gillette products and its market. He had gained this experience for number of years that is from 1982 to 1996. Assessee has also produced the letter dt. 15th Dec., 1994 from Credit Capital Finance Corporation, which manufactures "Shick" brand blades, addressed to assessee wherein Credit Corporation proposed for similar type of collaboration with assessee, as assessee had with Gillette Company. No material has been brought on record by AO to support that "non-compete agreement" is a colourable device. In view of these undisputed facts, we find no reason to disturb the finding of fact of the Tribunal that agreement is not a colourable device."

The High Court dismissing the appeal by the Department held as under :

"That left no doubt that the payment of amount under the agreement dt. 15th Dec., 1996 has been paid to assessee by Gillette Company to refrain assessee from engage himself whether directly or indirectly in any business which undertakes or is engaged in the manufacture or marketing or distribution of razor

blades, shaving systems or shaving preparations. That amount cannot be taxed as revenue receipt, specially when no material has been brought on record by AO to justify that agreement dt. 15th Dec., 1996 is for colourable device."

6. In the case at hand also no material has been brought on record to show that the restrictive covenant refraining the assessee from undertaking any activity economic, industrial or otherwise, which in any way comes into conflict with the activities of WIEL, was a sham agreement. In fact Mr. Nizamuddin, learned advocate for the Revenue, does not dispute the same.

Thus, in view of the judgment in CIT v. Saroj Kumar Poddar (supra), the question No. 1 is answered in favour of the assessee by holding that the sum of Rs. 175 lakhs received by the assessee for entering into a restrictive covenant of not entering into competitive business was a receipt by the assessee of a capital nature and, thus not liable to tax.

7. So far as the question No. 2 is concerned, since the sum of Rs. 175 lakhs was a "capital receipt" having no cost of acquisition or the cost of acquisition could not be assessed, in our view, the sum is not taxable u/s 48 of the IT Act, 1961, and thus it cannot be brought to tax u/s 45 of the Act. This principle of law has been laid down in the judgment in Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty, where the apex Court was considering whether capital gains can arise u/s 45 of the Act on the transfer by the assessee-firm of its goodwill to the newly constituted firm. It was held that none of the provisions pertaining to the head "Capital gains" indicated that they include an asset in the acquisition of which no cost at all can be conceived. It was held that goodwill generated cannot be described as an "asset" within the terms of Section 45 and was not subject to Income Tax under the head "Capital gains". Applying the principle laid down in CIT v. B.C. Srinivasa Setty (supra), this Court in Commissioner of Income Tax Vs. General Industrial Society Ltd., , in which one of us (D.K. Seth, J.) was a party, while considering whether the sum received on a transfer of licence was subject to capital gains or not, held that the cost of acquisition could not be determined in the manner provided u/s 55(2) as it stood then and if the cost of acquisition could not be assessed, it could not be computed and unless it was computable u/s 48, it could not be brought under the purview of Section 48. It was held :

"What was received on transfer of the licence, a capital asset within the meaning of Section 2(14), was not an income from business u/s 28 more particularly under Clause (iv) and though chargeable under the head "Capital gains" u/s 45 but since incomputable by reason of Sections 48 and 49 read with Section 55(2) in asst. yr. 1986-87, the same could not be assessed to capital gains".

8. Similarly in Commissioner of Income Tax Vs. Magnum Export (P) Ltd., in which one of us (D.K. Seth, J.) was a party, this Court while dealing with the issue whether the Tribunal was right in holding that the sale proceeds received by the assessee on the sale of export licence represented capital receipt and was exempt from Income Tax, held that the sum received on transfer of licence was a

capital asset and cannot be charged to tax as income. In our view, the sum of Rs. 175 lakhs received pursuant to the restrictive clause, though a capital receipt since it has no element of cost of acquisition, is incapable of computation and deductions enumerated in Section 48, thus not chargeable to "Capital gains". Thus, the question No. 2 is answered in the affirmative and in favour of the assessee and against the Revenue. 9. So far as question No. 3 is concerned, we find it is covered by the principles of law as laid down in the judgment of the Supreme Court in Commissioner of Income Tax, Mumbai Vs. D.P. Sandu Bros. Chembur (P) Ltd., that tenancy right is a capital asset, the surrender of which would attract Section 45 so that the value would be a capital receipt and assessable, if at all, under item "E" of Section 14 and cannot be treated as a casual and non-recurring receipt u/s 10(3) and subjected to tax u/s 56. Their Lordships repelled an argument by the Revenue that even if the income cannot be chargeable u/s 45 because of inapplicability of the computation provided u/s 48, it could still impose a tax on the residuary head. Their Lordships were of the view that it would be illogical and against the language of Section 56 to hold that everything that is exempted from capital gains by the statute could be taxed as a casual or nonrecurring receipt u/s 10(3) read with Section 56 of the Act. Thus, the question No. 3 is answered in the affirmative and in favour of the assessee and against the Revenue.

Therefore, the appeal is dismissed.

However, in the facts and circumstances, there shall be no order as to costs.

D.K. Seth, J.

9. I agree.