
(2013) 09 KAR CK 0033
In the Karnataka High Court
Case No : I.T.A. No. 910 of 2006

Commissioner of Income Tax

APPELLANT

Vs

Wintac Ltd.

RESPONDENT

Date of Decision : 19-09-2013

Acts Referred:

Citation : (2014) 360 ITR 614

Hon'ble Judges : Dilip B. Bhosale, J; B. Manohar, J

Bench : Division Bench

Judgement

B. Manohar, J.—The Revenue has preferred this appeal u/s 260A of the income tax Act, 1961, challenging the order dated January 2, 2006, made in I.T.A. No. 81/Bang/2005 passed by the income tax Appellate Tribunal, Bangalore (hereinafter referred to as "the Appellate Tribunal") setting aside the assessment order passed by the assessing authority as well as the first appellate authority for the assessment year 2001-02. The respondent-assessee, M/s. Wintac Ltd., earlier known as M/s. Recon Ltd., is a company incorporated under the provisions of the Companies Act, 1956, carrying on the business of formulations and manufacture of bulk drug, having its three units at No. 82/A, Jigani Unit-Manufacturing bulk drugs, Bannerghatta Road Unit-Research and Development Unit, Nelamangala Unit formulation.

2. The assessee filed return of income on October 31, 2001, declaring a total loss of Rs. 3,68,30,330. But determined the tax payable u/s 115JB at Rs. 38,26,607.

3. The case was selected for scrutiny and notice u/s 143(2) was issued on October 25, 2002. The authorized representative of the assessee appeared on behalf of the assessee. On examination of the income tax returns and other details furnished by the assessee-company, it was noticed that the assessee-company entered into an agreement of sale of two units, i.e., unit at Jigani and Bannerghatta unit to M/s. Tumkur Chemicals Ltd. (hereinafter referred to as "TCL") for a consideration of Rs. 5.75 crores. Subsequently, that agreement was cancelled. In view of that, the assessee-company forfeited a sum of Rs. 1.10

crores from the amount paid by TCL. The said amount was treated as capital receipt and the same is not liable to be taxed. However, the assessing authority treated the said amount as revenue receipt and assessed for tax.

4. In the return of income, the assessee-company has shown the closing stock for both the units as nil. The closing stock value of Rs. 12.5 crores as on March 31, 2000, has been shown. The said closing stock shall be the opening stock as on April 1, 2000, however, the assessee has shown nil as on June 31, 2000. The Assessing Officer assessed the closing stock at Rs. 11,56,74,925 deducting a sum of Rs. 1,21,000 towards the sale of stock. Further, in the return of income, Rs. 4 crores received from M/s. Recon Health Care Ltd. towards the non-competition fee was shown as capital receipt. The Assessing Officer treated the said amount as revenue receipt brought forward to tax, one-third amount for each year. Further, the loss of long-term and short-term capital loss of Rs. 3,10,22,946 and Rs. 99,00,000 shown by the assessee was disallowed by the Assessing Officer on the ground that the shares of the company" has been sold for lesser value.

5. Further, Rs. 25 crores received by the assessee from M/s. Recon Health Care Ltd. towards the transfer of technical know-how is claimed as capital receipt. However, the Assessing Officer treated the said amount as revenue receipt and brought to tax, by its assessment order dated March 30, 2001, and also imposed penalty u/s 271(1)(c) and issued demand notice. The assessee being aggrieved by the order of assessment dated March 30, 2001, preferred an appeal before the Commissioner of income tax (Appeals) Bangalore (hereinafter referred to as "the first appellate authority") challenging the same on various grounds. The first appellate authority after considering the matter in detail held that the receipt of 1.10 crores of the forfeited amount is a revenue receipt and is liable to be taxed. Further, in so far as the closing stock of the bulk drug in the plant is concerned, the Assessing Officer held that some of the stocks have been sold and the life of some of the bulk drugs available with the assessee had expired and reduced the said amount to Rs. 1,49,82,784 instead of Rs. 11,56,74,925 assessed by the Assessing Officer. In so far as the receipt of Rs. 4 crores from Recon Health Care Ltd. towards non-competition fee is concerned, it was held to be the revenue receipts and liable to be taxed. In so far as the disallowance of the long-term and short-term capital loss, the appellate authority partly allowed the claim made by the assessee and disallowed the short-term capital loss claimed by the assessee. In so far as the receipt of Rs. 25 crores by the assessee from Recon Health Care Ltd. towards transfer of the technical know-how is concerned, the first appellate authority held that the consideration received towards sale of technical know-how and mere condition that know-how shall not be disclosed to others does not change the character of receipt and it is the consideration towards the sale of capital assets liable to tax under the head of "Capital gains" and not revenue receipt. Accordingly, allowed the appeal in part by its order dated December 13, 2004. The assessee being aggrieved by the order passed by the first appellate authority preferred an appeal before the income tax Appellate Tribunal,

Bangalore Bench in I.T.A. No. 81/Bang/2005. Further, the Revenue also preferred an appeal in I.T.A. No. 292/Bang/2005 before the income tax Appellate Tribunal, Bangalore, on some other findings.

6. The Appellate Tribunal on considering the matter in detail allowed the appeal filed by the assessee in part and dismissed the appeal filed by the Revenue. The Appellate Tribunal held that the forfeited amount of a sum of Rs. 1.10 crores received by the assessee towards cancellation of the agreement of sale is a capital receipt and the same cannot be taxed. In so far as the closing stock of bulk drug is concerned, the contention of the assessee was upheld and set aside the order passed by the appellate authority confining the addition of a sum of Rs. 1,49,82,784. In so far as the receipt of Rs. 4 crores towards non-competition fee is concerned, the Tribunal held that it is only a capital receipt and not liable to be taxed. With regard to the disallowance of claim of long-term and short-term capital loss is concerned, full benefit has been given to the assessee by setting aside the order passed by the first appellate authority. With regard to the receipt of Rs. 25 crores, towards transfer of technical know-how is concerned, it is a capital receipt and not revenue receipt and not liable to be taxed and ordered for deletion. The Revenue being aggrieved by the order passed by the Appellate Tribunal dated January 2, 2006, preferred this appeal.

7. The present appeal was admitted to consider the following substantial questions of law:

"1. Whether the Tribunal was correct in holding that the sum of Rs. 1,10,00,000 forfeited out of payment received from Rallis India Ltd. is to be treated as capital receipt subject to the adjustment u/s 51 of the Act and should be excluded as revenue receipt while computing the total income?

2. Whether the Tribunal was correct in holding that the stock pertaining to the bulk drug unit and the research and development unit should be taken as nil as on June 30, 2000, when its realizable value as on March 30, 2000, was Rs. 12.78 crores and the Assessing Officer had held that the assessee had adopted a colourable device in order to avoid tax?

3. Whether the Tribunal was correct in holding that the amount of Rs. 4 crores received by the assessee as per the agreement dated June 30, 2000, entered by the assessee with M/s. Recon Health Care Ltd. to discontinue its business with a non-competition clause for three year is a capital receipt?

4. Whether the Tribunal was correct in holding that for the computation of capital gains arising on sale of equity shares of M/s. Recon Agro Tech Pvt. Ltd., the toss under capital gains is to be computed by adopting cost of acquisition of Rs. 0.10 per share when inter se parties were interested persons and family members and the entire transaction was a colourable device?

8. The fifth substantial question of law has been reframed by this court, which reads thus:

"5. Whether the Tribunal was correct in holding that the transfer of technical know-how by the assessee for a consideration of Rs. 25 crores should be treated as a capital receipt, not liable to capital gains tax and not consideration received towards sale of capital asset, liable to capital gains tax?"

9. We have carefully considered the arguments addressed by the learned counsel appearing for the parties and perused the records.

Substantial question of law No. 1:

10. With regard to the first substantial question of law is concerned, Sri M. Thirumalesh, learned counsel appearing for the appellants, contended that the order passed by the Tribunal is contrary to law and the Tribunal has committed an error in arriving at a conclusion that Rs. 1.10 crores amount forfeited from Rally's India Ltd. (hereinafter referred to as "RIL") is a capital receipt to compensate the loss sustained due to the cancellation of the agreement of sale. As per the two agreements of sale at clauses 14 and 15, there is a clear agreement between the parties that failure on the part of the purchaser to perform his part of contract, the vendor shall be entitled to terminate the agreements, and to claim Rs. 25,00,000 and Rs. 5,00,000 as liquidated damages from the advance consideration, whereas, the assessee had forfeited Rs. 1.10 crores. Hence, the amount over and above Rs. 30,00,000 cannot be treated as capital receipts. The order passed by the Tribunal is contrary to law.

11. On the other hand, Sri H.S. Ramabhadran, learned counsel appearing for the respondent-assessee, contended that as per the lease agreement dated October 20, 1999, the assessee leased the bulk drug plant to TCL on receiving Rs. 25,00,000 as security deposit. Within a fortnight, i.e., November 5, 1999, the assessee entered into an agreement of sale of the very same bulk drug plant and the security lease amount of Rs. 25,00,000 was treated as advance amount. Similarly, the assessee entered into a lease agreement dated November 29, 1999, for a lease of the research and development unit to TCL and received the security deposit of Rs. 25,00,000. Subsequently, the assessee entered into an agreement of sale of the said research and development unit treating the security deposit as a part of sale consideration and also received Rs. 4.49 crores as advance. Pursuant to the agreement, TCL was put in possession. TCL sub-leased the said two units to RIL. However, the said agreements were cancelled. Since the unit has been used for more than one year, RIL had agreed to forgo Rs. 1.10 crores in favour of the assessee. Further, the said two units were sold for Rs. 8 crores to HILKAL Ltd. as against Rs. 9.70 crores as agreed between the assessee and TCL. The loss of Rs. 1.70 crores was reduced Rs. 1.10 crores. The said amount cannot be treated as revenue receipt. In support of his contention, he relied upon the judgments reported in *The Travencore Rubber and Tea Co. Ltd. Vs. Commissioner of Income Tax, Trivandrum*. The order passed by the Tribunal is in accordance with law. The Tribunal, after considering the matter, set aside the order passed by the assessing authority as well as the first appellate authority and the same does not call for interference and sought for dismissal of

the appeal.

12. The records clearly disclose that the assessee had received an advance amount of Rs. 4.49 crores in terms of the agreements of sale dated November 15, 1999, and January 17, 2000. However, the said agreements were terminated with the consent of both the parties on January 13, 2001, and January 15, 2001, and handed over both the units to the assessee. As per the agreement, if the purchaser fails to perform their part of the contract, the vendor is entitled to terminate the agreement and claim liquidated damages of Rs. 25,00,000 and Rs. 5,00,000, respectively. However, in the present case, by mutual consent of the parties, RIL had agreed to forego Rs. 1.10 crores in favour of the assessee for loss of earnings due to the cancellation of the agreement and the loss sustained in the sale transaction. The amount over and above Rs. 30,00,000 has to be treated as revenue receipts. The assessing authority as well as the first appellate authority had taken the entire amount of Rs. 1.10 crores as revenue receipts and assessed to tax. In the facts and circumstances of the case, we are of the opinion that as per the agreement, the assessee is entitled to forfeit only a sum of Rs. 30,00,000 and the remaining amount of Rs. 80,00,000 has to be treated as revenue receipt and the assessee is liable to pay tax. With regard to the severability of compensation paid for the loss of sale transaction and business loss, the hon"ble Supreme Court in the judgment reported in Commissioner of Income Tax, Madras Vs. Best and Co., :

"If the compensation paid was in respect of two distinct matters, one taking the character of a capital receipt and the other of a revenue receipt, we do not see any principle which prevents the apportionment of the income between the two matters. The difficulty in apportionment cannot be a ground for rejecting the claim either of the revenue or of the assessee. Such an apportionment was sanctioned by courts in *Wales v. Tilley* [1942] 25 TC 136 : [1943] 11 ITR (EC) 69 (HL), *Carter v. Wadman* [1946] 28 TC 41 and *T. Sadasivam Vs. Commissioner of Income Tax, Madras*, . In the present case, apportionment of the compensation has to be made on a reasonable basis between the loss of the agency in the usual course of business and the restrictive covenant. The manner of such apportionment has perforce to be left to the assessing authorities."

The finding of the Appellate Tribunal is contrary to law. Hence, we answer the substantial question of law partly in favour of the Revenue and partly in favour of the assessee.

Substantial question of law No. 2:

13. With regard to the second question, Sri M. Thirumalesh, learned counsel appearing for the Revenue, contended that the assessee had retained the closing stock in the bulk drug plant and the research and development unit when it entered into an agreement of sale of these two units with TCL. The closing stock was valued at Rs. 12.78 crores as on March 31, 2000. However, it was again valued at nil on June 30, 2000. He further contended that subsequent to June

30, 2000, the assessee sold the stock of Rs. 1.21 crores. The Assessing Officer deleted the said amount and assessed the stock at Rs. 11,56,74,925. However, the first appellate authority assessed the value of the closing stock at Rs. 1,49,82,784 after deducting the waste stock to an extent of Rs. 10,06,92,141. The finding of the first appellate authority is challenged both by the assessee and the Revenue before the Appellate Tribunal. The Tribunal accepted the contention of the assessee and rejected the contention of the Revenue. The order passed by the Appellate Tribunal is contrary to law. The Tribunal failed to take note of the fact that the assessee-company entered into an agreement of sale of the bulk drug unit and the research and development unit with TCL, the closing stock pertaining to the above was retained with the assessee. The assessee valued the stock pertaining to the bulk drug unit and the research and development unit as its realizable value at Rs. 12.78 crores on March 31, 2000, and nil on June 30, 2000. The assessee failed to explain as to what was the reason under which, the value of stock got suddenly eroded its value to Rs. 3 crores, within three months. No document or register pertaining to the above issue is produced. In the absence of the same, the Tribunal ought not to have held that the stock pertaining to the bulk drug unit and the research and development unit should be taken as nil as on June 30, 2000.

14. On the other hand, Sri Ramabhadran, learned counsel appearing for the assessee, contended that the assessee had discontinued the manufacture of bulk drug during the previous year ended March 31, 2000. The factory was leased to TCL as per the agreement dated November 15, 1999. The said factory was sub-leased to RIL as sub-lessee of TCL. The stock of bulk drug which was valued at Rs. 12.78 crores as on March 31, 2000, was valued at nil in the account as on March 31, 2001. The Assessing Officer also observed that the said bulk drug stock was valued at nil in the account prepared on June 30, 2000, under the Companies Act and placed before the shareholders. The Assessing Officer sought information from the assessee with regard to scrap of bulk drug of Rs. 12.78 crores. The assessee vide its letter dated March 3, 2004, informed that out of Rs. 12.78 crores of value of bulk drug, major portion of the stock was WIP, research and development stock, solvent, II crop material, major portions of which carried from many years whose value was reduced year after year on account of non-mobility. The said stock was aggregated about Rs. 11 crores. The sale of the value of Rs. 1.21 crores has taken place from April 1, 2000, to March 31, 2001, and duly accounted for, in the books and offered for the tax. The assessee sold the unit at Jigani and the research and development unit to HILKAL Ltd. on March 31, 2001, and declared long-term capital gains. There is no dispute regarding the said transaction. The saleable items were sold during financial year 2000-01 and remaining raw materials was shifted to rented warehouse while handing over the factory to HILKAL Ltd. All these raw materials are un-salable items, they are toxic materials of the bulk drug section, they are waste, have no sale value and not capable of being sold, the market value was taken as nil. The same was disposed of under the technical advice of Mr. Swaminathan who is a

retired executive director of the National Environmental Engineering Research Institute. He further contended that whether the stock-in-trade has been properly valued or not is purely a question of fact and the question of law does not arise. He relied upon the judgments reported in Commissioner of Income Tax Vs. Kumaun Mandal Vikas Nigam Ltd., and Commissioner of Income Tax Vs. Bharat Steel Tubes Ltd., . The Appellate Tribunal taking into consideration all these aspects of the matter accepted the contention of the assessee and deleted the value of closing stock as nil. There is no infirmity in the said finding.

15. The records clearly disclose that the assessee had discontinued the manufacturing of bulk drug during the previous year ended March 31, 2000. The factory at Jigani Industrial area was leased to TCL as per the agreement of lease dated November 5, 1999. RIL is manufacturing the drug and a portion of the finished goods were sold. The major portion of the stock was WIP, research and development unit stock, solvents, II crop material, major portion of which carried from many years, whose value was reduced year after year on account of non-mobility. The said stock was aggregated about Rs. 11 crores. The said goods were not saleable items in the market. Un-saleable items were kept in the godown. It was accumulated year to year. Subsequently, all the goods were disposed of in the plot No. 28 of KIADB Industrial area, Jigani, under the technical supervision of Mr. Swaminathan, in November, 2001. The life of the bulk drug was expired and it cannot be sold in the market. The central excise records also disclose that the said goods cannot be sold in the market. The income tax Appellate Tribunal, taking into consideration all these aspects of the matter and that the manufacturer has been completely stopped the manufacturing of the bulk drug, has taken the value of closing stock of bulk drug as nil. The assessee has not adopted any colourable devices in order to avoid the tax. Hence, we find there is no infirmity or irregularity in the said finding. However, the judgment relied upon by Sri H.S. Ramabhadran is not applicable to the facts of the case on hand. Hence, the finding recorded by the Tribunal is purely a question of fact. Accordingly, the second substantial question of law is held against the Revenue and in favour of the assessee.

Substantial question of law No. 3

16. The third substantial question of law raised in this appeal is with regard to a sum of Rs. 4 crores received from M/s. Recon Health Care Ltd. pursuant to the agreement dated June 30, 2000. As per the agreement, the assessee and the promoters of the assessee-company were prevented from carrying on certain business activities. The said sum was treated as a revenue receipt by the Assessing Officer. The Tribunal held that it is a capital receipt not liable to be taxed. The said issue is fully covered by the judgment of the hon'ble Supreme Court reported in Guffic Chem P. Ltd. Vs. Commissioner of Income Tax, Belgaum and Another, wherein the apex court has held that the compensation received for restraining the assessee from carrying on competitive business was the capital receipt. The issue before the Supreme Court was whether the amount received

by the assessee on a condition not to carry on the competitive business was in the nature of capital receipt. The Supreme Court clearly held that it is capital receipt, Paragraph 6 of the judgment reads as under (page 607):

"Two questions arose for determination, namely, whether the amounts received by the appellant for loss of agency was in normal course of business and, therefore, whether they constituted revenue receipt? The second question which arose before this court was whether the amount received by the assessee (compensation) on the condition not to carry on a competitive business was in the nature of capital receipt? It was held that the compensation received by the assessee for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capital receipt."

17. In the instant case, Rs. 4 crores received from M/s. Recon Health Care Ltd. towards non-competition to discontinue the business of three years has to be held as capital receipt. Accordingly, the third substantial question of law is answered in favour of the assessee.

Substantial question of law No. 4

18. With regard to the computation of capital gains arising on sale of equity shares of M/s. Recon Agro Tech (P.) Ltd. (hereinafter referred to "RAL"), is concerned the Assessing Officer disallowed both long-term capital loss of Rs. 3,10,22,941 and short-term capital loss of Rs. 99,00,000 claimed by the assessee. Sri M. Thirumalesh, learned counsel appearing for the appellants, contended that during the accounting year ending March 31, 1997, the assessee transferred its agro division (manufacture and marketing of pesticide formulation), i.e., M/s. Agro Tech (P.) Ltd. to RAL which is the subsidiary company of the assessee after obtaining the approval of the shareholders of the assessee-company. Against the net assets transferred, the assessee received Rs. 3.05 crores and utilized the same to acquire Rs. 25,50,000 equity shares of Rs. 10 each in the financial year 1997-98 and later Rs. 1 crore in the financial year 2000-01. These shares were sold to Sri Suresh, managing director of RAL at the price of Rs. 2.55 lakhs, which was 1 per cent of the value of the share. The assessee indexed the cost of acquisition to Rs. 3,12,77,964 and arrived at long-term capital loss of Rs. 3,10,22,946. The Assessing Officer on verification of the records came to the conclusion that buying and selling of the shares of RAL were between the interested persons and family members as the assessee failed to adduce evidence that the valuation of the share was done at arm length. The Assessing Officer rejected the assessee's claim for long-term capital loss.

19. With regard to the short-term capital loss, the Assessing Officer noticed that the assessee invested a sum of Rs. 1 crore in equity shares of RAL in the financial year 2000-01. However, the said investment was also sold to Sri Suresh, managing director of RAL for Rs. 1,00,000 within a short duration and claimed a short-term capital loss of Rs. 99,00,000. The Assessing Officer, on

considering the entire matter, disallowed the short-term capital loss. On an appeal filed by the assessee, the appellate authority directed the Assessing Officer to determine and allow the long-term capital loss on sale of 2,55,000 equity shares of RAL as per the balance-sheet as on March 31, 2001. The appellate authority held that the long-term capital loss should be computed based on the value of share as per the balance-sheet as on March 31, 2001, at Rs. 3.11 per share and similarly the short-term capital loss in respect of 3,50,000 shares sold in short-term capital loss also was adopted at value of Rs. 3.11 per share. The finding with regard to the short-term capital loss is confirmed. On an appeal filed by the assessee before the income tax Appellate Tribunal, the Appellate Tribunal set aside the findings of both the Assessing Officer as well as the appellate authority in respect of long-term capital loss as well as the short-term capital loss and allowed the claim made by the assessee. It was contended by the assessee that the Tribunal committed an error in holding that the computation of capital gain arises out of sale of equity shares of RAL and agreed to sell the said shares at the rate of Rs. 0.10 per share to the managing director of RAL and sustained the long-term capital loss of Rs. 3,10,22,946, the share purchased worth Rs. 1 crore was also sold to the RAL within few days, for Rs. 1,00,000 and suffered the short-term capital loss. The purchase and sale of the shares between the close relatives and interested parties and family members, the entire transactions are colourable device. Hence, they are not entitled to claim short-term and long-term capital losses and sought for setting aside the said finding.

20. On the other hand, Sri Ramabhadran, learned counsel appearing for the assessee, contended that the assessee was having a separate agro division and during the financial year 1997, a separate company was floated by name M/s. Recon Agro Tech (P.) Ltd. The assessee has invested Rs. 2,55,00,000 for 25,50,000 equity shares of Rs. 10 each. The said company sustained heavy loss. The assessee with a view to disassociate itself with its subsidiary company, entered into a memorandum of understanding with Suresh, managing director of RAL and agreed to sell 25,50,000 shares at Rs. 0.10 per share. Sri Suresh, to whom the shares were sold, was neither a relative of any of the promoters of the assessee nor the director of any of the group company. The balance-sheet of RAL as on March 31, 2001 was prepared after taking into consideration an income of Rs. 6.00 crores received from the assessee. The assessee was managing the affairs of the subsidiary companies through its nominee directors. The assessee gave a corporate guarantee to Karnataka Bank for the credit facility. RAL suffered a loss due to the drought. The Karnataka Bank to whom the assessee has given corporate guarantee issued notice proposing to invoke the bank guarantee. The suppliers who have supplied to RAL on the guarantee of the assessee were pressurizing the assessee to pay their dues. In order to avoid the coercive steps and freezing of the assessee's credit facility, the assessee had taken a decision to sell the shares. The Assessing Officer disallowed both short-term and long-term capital loss. However, the appellate authority has given partial relief. The

Appellate Tribunal after taking into consideration all these aspects of the matter set aside the order passed by the first appellate authority and the claim of the assessee both in respect of long-term and short-term capital loss was allowed. The finding recorded by the Tribunal is purely a question of fact and it is not a fit case for interference by this court.

21. The Assessing Officer disallowed both the claims of the assessee for short-term and long-term capital loss. The appellate authority directed the Assessing Officer to rework the claim made by the assessee taking the value of each share at Rs. 3.11 per share. The Appellate Tribunal on examining the matter allowed the claim of the assessee. The reasons assigned in paragraph 6.4 reads as under:

"We have carefully considered the relevant facts and the arguments advanced. In this case, it is to be seen that the computation is to be made for sale of shares held as capital asset. Hence what is applicable is section 48 of the Act. As per section 48, the capital gain is to be computed after reducing the cost of acquisition of the assets, cost of any improvement thereto and the expenditure incurred in connection with transfer of capital asset. Such cost is to be reduced from the full value of consideration received or accruing as a result of transfer. There is no provision to substitute the consideration received with the fair market value of asset sold. The transaction is at an arms length. The assessee basically wanted to get rid of the unit as a whole as well as the share of such unit. Section 52 which earlier provided for adopting the consideration for transfer in case of understatement, etc. has been omitted by the Finance Act, 1987, with effect from April 1, 1988. Thus, unless and until it can be proved, that the assessee received something more than the apparent consideration, the Assessing Officer cannot compute the capital gain artificially by substituting fair market value in place of consideration received. There is no finding that transaction is a colourable one or that the agreement is sham. Therefore, there is no reason to substitute the consideration received with any other amount.

Shares sold being unquoted equity shares, one of the recognized methods of valuation is rule 11 of Schedule III to the Wealth-tax Act. As per the Explanation to said rule, the balance-sheet is the balance-sheet (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date, and if there is no such balance-sheet, the balance-sheet drawn up on a date immediately preceding the valuation date, and in the absence of both, the balance-sheet drawn up on a date immediately after the valuation date.

There is no dispute that break up value with reference to balance-sheet is to be applied. The question is which is the relevant balance-sheet. On that, the jurisdictional High Court's case in *Controller of Estate Duty, Mysore Vs. J. Krishna Murthy*, (although the judgment related to the Estate Duty Act) held that the published balance-sheet immediately prior to the date of death as relevant for break up method as appropriate. That case is applicable to the facts of the instant case. Admittedly, there is an audited balance-sheet as at June 30, 2000, which is prior to November, 2000. Hence, it would not be correct to further look

at the subsequent balance-sheet i.e., the balance-sheet dated March 31, 2001. Further, due consideration must be given to the appellant's submission that if balance-sheet as on March 31, 2001, is considered, then deduction should be granted for Rs. 5 crores forgone by the appellant. The contention of the Assessing Officer that sale of Recon Agro Tech Ltd. shares was between related parties has been rebutted by the appellant by affidavit (page No. 43) of the paper book filed before the Commissioner of income tax (Appeals) which has not been disputed by the Assessing Officer in his remand report. Hence, the question of substitution of contracted price should not have arisen. The findings of the Commissioner of income tax (Appeals) in respect of long-term capital gains have not been challenged by the Department. Accordingly, the loss under capital gains is to be computed by adopting consideration at Rs. 0.10 per share."

22. We find that there is no infirmity in the finding recorded by the Appellate Tribunal. u/s 48 of the income tax Act, the capital gain is to be computed after reducing the cost of acquisition of the asset, cost of any improvement thereto and the expenditure incurred in connection with the transfer of capital assets. In order to avoid the stringent action being taken by the financial institution, the assessee sold the shares to its subsidiary company in order to stabilize its financial position. No document has been produced by the Revenue to show that the transaction between the assessee and its subsidiary company is a colourable device. The finding recorded by the Appellate Tribunal is purely a question of fact. The Revenue has not made out a case to interfere with the same. Accordingly, we confirm the finding recorded by the appellate authority and the substantial question of law is held against the Revenue.

Substantial question of law No. 5

23. With regard to the receipt of Rs. 25 crores towards the transfer of technical know-how, Sri M. Thirumalesh, learned counsel appearing for the Revenue, contended that as per the agreement dated June 30, 2000, the assessee transferred the technical know-how in respect of certain products to M/s. Recon Health Care Ltd. In consideration of the transfer, the transferee agreed to pay a sum of Rs. 25 crores to the transferor and the receipt was admitted and acknowledged by the transferor. The consideration received towards transfer of technical know-how was originally offered to tax as a revenue receipt in the returns filed. However, during the course of assessment, the assessee contending that Rs. 25 crores received towards transfer of technical know-how is in the nature of capital receipt and not liable to be taxed, filed a revised statement. The Assessing Officer rejected the contention of the assessee and assessed the said amount to tax under the head "Business income". The assessee being aggrieved by the assessment order preferred an appeal before the Commissioner of income tax (Appeals). The appellate authority after examining the matter held that as per the provisions of section 32(1)(ii), the know-how acquired after April 1, 1998, is a capital asset for the purpose of allowance of depreciation. In the case of the assessee, the consideration of Rs. 25 crores on sale of know-how being

the capital assets would be exigible to the tax under the head "Capital gains" and directed the Assessing Officer to tax the said amount under the head "Capital gains". The assessee being aggrieved by the order passed by the first appellate authority, approached the income tax Appellate Tribunal challenging the same. However, the Revenue has not preferred any appeal. The Appellate Tribunal, after examining the records and some of the clauses of the agreement dated June 30, 2000, relying upon the judgment reported in Commissioner of Income Tax, Hyderabad-deccan Vs. Vazir Sultan and Sons, held that in view of the agreement, the assessee is prevented from manufacturing goods with respect to pharmaceuticals which has been sold to the M/s. Recon Health Care Ltd. The consideration of Rs. 25 crores received is for not carrying out certain activities pertaining to the business of manufacturing of pharmaceutical goods. Therefore, the said receipt is a capital receipt and not liable for tax under the head "Capital gains".

24. The Revenue challenged the order of the Tribunal in this appeal contending that the findings of the Appellate Tribunal are contrary to the facts. As per the agreement dated June 30, 2000, the assessee has received in all Rs. 40 crores, i.e., for the sale of technical know-how, the assessee has received Rs. 25 crores, Rs. 11 crores towards sale of brand, and Rs. 4 crores towards non-competition fee. The finding of the Appellate Tribunal is that consideration of Rs. 25 crores received is for not carrying out certain activities of business in pharmaceutical goods is contrary to the facts. Technical know-how is an intangible asset. u/s 32(1)(ii) of the Act, it is a capital asset for the purpose of depreciation and exigible to tax under the head "Capital gains". Indo Tech Electric Co. Vs. The Deputy Commissioner of Income Tax, and Commissioner of Income Tax Vs. Mediworld Publications Pvt. Ltd., .

25. On the other hand, Sri H.S. Ramabhadran, learned counsel appearing for the assessee, contended that the effect of the agreement dated June 30, 2000, was not only for the transfer of know-how, but also for non-disclosure of technical know-how to others. As per clause 3(1) of the agreement, the transferor shall stop using or in any way dealing with the know-how for the manufacture of the product from the date hereafter, and shall not use or deal with the same hereinafter except under the instruction and licence from the transferor on that behalf. Hence, it is clear that under the agreement, the assessee not only has to convey certain knowledge to the transferee but also impose restrain on itself on use of such knowledge. He relied upon the judgment reported in Commissioner of Income Tax, Hyderabad-deccan Vs. Vazir Sultan and Sons, and contended that section 55(2A) does not include know-how as capital assets whose value shown to be taken to be nil or at the cost of acquisition, though other assets are mentioned therein such as goodwill, trade mark, brand name and right to manufacture. Therefore, the receipt is a capital receipt and not liable to be taxed.

26. The records clearly disclose that during the financial year 2000-01, the assessee-company has received a sum of Rs. 40 crores from M/s. Recon Health

Care Ltd. as per the agreement dated June 30, 2000. The nature of the transaction was as follows:

In the return of income, the assessee-company has offered for tax only the technical know-how fee, however, sale of brands and non-competition fee were claimed as capital receipts and treated as non-taxable. During the course of assessment, the assessee claims that a sum of Rs. 25 crores received on transfer of the technical know-how was in the nature of capital receipt, vide office letter dated March 18, 2004, and treated the said amount as capital receipt. However, the assessee has not filed revised returns as contemplated u/s 139(5) of the Act.

27. The three agreements produced by the parties clearly disclose that one is with regard to transfer of the know-how and another is with regard to non-competition fee and the third agreement is with regard to transfer of its current brand, trade mark. As per the agreement for transfer of technical know-how, Rs. 25 crores has been paid to the assessee. In clause 2 of the agreement it was clearly mentioned that:

"In consideration of the transferee having agreed to pay a sum of Rs. 25 crores (rupees twenty-five crores only) to the transferor as consideration, which the transferor admits and acknowledges has been paid, the transferor hereby sell outright and transfer its ownership to the transferee of all know-how for the product mentioned in the annexed thereto."

The caption of the said agreement is "The agreement of sale of know-how". Another agreement was entered into between the assessee and M/s. Recon Health Care Ltd. It was captioned as "non-competition agreement". Pursuant to the said agreement, the assessee has received Rs. 4 crores (rupees four crores only). It was agreed between the parties that the assessee directly or indirectly shall not use the name of trade mark "RECON" in any manner whatsoever in respect of any product and, or any business. Further, as per the memorandum of understanding entered into between the assessee and M/s. Cadila Health Care Ltd., the assessee has transferred all tangible and intangible properties and handed over pharmaceuticals business with the brand name and trade mark. Hence, it is clear that an amount of Rs. 25 crores received was not for restraining the assessee from carrying on the business, on the other hand, it is only a transfer of know-how in favour of M/s. Recon Health Care Ltd. The assessee has already received Rs. 4 crores towards the non-competition agreement.

28. u/s 28(v)(a), any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business, or 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 the goods is intangible goods acquired on or after April 1, 1998, is a capital asset and liable to be taxed under the head "Capital gains". The judgment relied upon by Sri Ramabhadran reported in CIT v. Vazir Sultan and Sons (supra) is not applicable to the facts of the

present case. In that case, the compensation has been paid for termination of agency agreement which would be a capital receipt, whereas in the present case, there is a transfer of know-how. The Madras High Court in Indo Tech Electric Co.'s case in paragraph 12.3 and 13.2 has held as under:

"12.3. Technical know-how is defined as an intangible revenue producing asset which can be put to use so as to produce revenue in two ways. The manufacturer can use it himself to make things for sale and make profit in that way, or he can teach it to others, so that they can make their own things, in which case he gets paid for the knowledge and information which he imparts to them. His fees and rewards are then revenue in his hands. Under the income tax Act transfer of technical know-how is subject to tax only from the assessment year 1998-99 by the amendment through the Finance Act, 1997...

13.2. Therefore, it is clear that inasmuch as the assessee's firm has been taken over as a going concern, it could not have been taken over without the so called technical know-how. The assessee could not have sold the other tangible assets, keeping with it the so-called technical know-how. Hence, we are of the considered view that the receipt for technical know-how and the compensation for non-competing fees are nothing but a part of composite receipt to diminish the value of the assets of the assessee-firm. The assessee has termed the said amount as technical know-how in order to escape from the clutches of the provision of section 55(2) of the income tax Act 1961, under which, the goodwill amount is taxable."

29. The technical know-how is an intangible asset, liable to be taxed under the head "Capital gains". The order passed by the Appellate Tribunal holding that the consideration of Rs. 25 crores received is also for not carrying out certain activities pertaining to the business in manufacture of pharmaceutical goods. Any consideration received for not carrying out certain activity in connection with business is not taxable earlier to April 1, 2003. Therefore, the receipt is a capital receipt and not liable for the capital gain is contrary to law. Accordingly, the substantial question of law is answered against the assessee and in favour of the Revenue. In the light of the aforesaid finding, the appeal is allowed in part.