IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 19.06.2019

CORAM :

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case Appeal No.1938 of 2008

M/s.Sundaram Finance Ltd.,
21, Pattullos Road,
Chennai – 600 002 ...Appellant

-vs-

The Assistant Commissioner of Income Tax,
Company Circle VI(4),
Chennai – 600 034. ...Respondent

Tax Case Appeal under Section 260-A of the Income Tax Act, 1961, is directed against the Common Order passed by the Income Tax Appellate Tribunal "C" Bench, Chennai in I.T.A No.955/Mds/2008 dated 31.07.2007 for the assessment year 2001-02.

For Appellant : Mr.R.Vijaya Raghavan

For Respondent : Mr.T.Ravikumar

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JUDGEMENT

[Judgement of the Court was delivered by T.S.Sivagnanam, J.]

This Tax Case Appeal by the assessee filed under Section 260-A of the Income Tax Act, 1961, ('the Act' for brevity) is directed against the order passed by the Income Tax Appellate Tribunal “C” Bench, Chennai in I.T.A.No.955/Mds/05 dated 31.07.2007 for the assessment year 2001-02.

2. The above Tax Case Appeal has been admitted on 22.12.2008 on the following substantial questions of law:-

> *"1. Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the amount received towards restrictive convenant is revenue receipt chargeable to tax?*
>
> *2. Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the bad debts recovered by the appellant, which were written off and allowed as deduction in respect of Companies which got amalgamated with the appellant Company, should be taxed in the hands of the appellant'?*

3. We have heard Mr.R.Vijayaraghavan, learned counsel for the appellant/assessee and Mr.T.Ravikumar, learned Senior Standing Counsel for the respondent/Revenue.

4. Mr.R.Vijayaraghavan, learned counsel appearing for the appellant / assessee submitted that question no.2 is not been pressed as the matter has been remanded for fresh consideration. Thus we are required to consider Question no.1, which is, whether the Tribunal was right in law in holding that the amount received towards restrictive covenant is revenue receipt chargeable to tax?

5. The assessment for the year under consideration, namely, 2001-02 was completed by the assessing officer under Section 143(3) of the Act, vide order dated 31.03.2004. Though there were several issues which were dealt with by the assessing officer, we are concerned only with regard to the finding pertaining to the amount received by the assessee towards Restrictive Covenant, whether it is a revenue receipt or capital receipt?.

6. The assessee is the company engaged in the business of hire purchase financing, equipment leasing and allied activities. For the

assessment year under consideration, namely, 2001-02, the assessee filed Return of Income on 31.10.2001 declaring the total income of Rs.8,58,48,600/-. In the scrutiny assessment, which was completed on 31.03.2004, the total income was determined at Rs.120,65,85,728/-. The assessing officer while completing the assessment disallowed the amount received as compensation for restrictive covenant. In the agreement entered into between Royal and Sun Alliance Insurance (RSA), U.K., and General Insurance Company, India, the assessee was paid Rs.16.80 Crores based on the agreement which according to the assessee is the receipt in the capital field, as it was received as consideration for restraining the assessee from entering into insurance business on its own and also restraining itself from negotiating with any other party for entering into insurance business.

7. The assessee filed an appeal before the Commissioner of Income Tax [Appeals]-VI, Chennai ['CIT-(A)' for brevity] . The appeal was allowed by order dated 13.01.2005. The CIT-(A) held that the restrictive clause in the agreement for which amount of Rs.16.80 Crores was paid to the assessee was in view of the commitment given by the assessee restraining itself from negotiating with any other party and restraining itself

from entering into insurance business. Thus, it held that this amount was paid on account of the restrictive covenant and hence it is a capital receipt. Furthermore, it held that the payment was received by the assessee before the commencement of the business activity and therefore, it opined that the amount received by the aseessee was a capital receipt and accordingly, the addition made by the assessing officer was deleted.

8. The assessing officer did not agree with the said contention primarily on the ground that the assessee was not paid any money by the U.K.Company towards the restrictive covenant and only when the assessee subscribed to the share capital on 19.10.2000, this amount was paid and therefore, it cannot be treated as a capital receipt. Accordingly, the assessment is completed.

9. The Revenue filed an appeal before the Tribunal and the Tribunal after taking note of the finding of the assessing officer and finding of the CIT-(A), reversed the order passed by the CIT(A) particularly on the ground that the so called 'Non compete Fee' is being received by the assessee, which is not for the business of insurance and the payment is clearly towards 'exploitation of the service and infrastructure' of the assessee and

hence falls under the revenue field. The assessee is before us on appeal challenging the said finding and we are required to answer the above framed substantial question of law.

10. The agreement entered into between the assessee and the U.K.Company is tiled as "Letter of Intent" agreed and accepted by the parties on 5th April, 2000 in London. The following clause is the subject matter of interpretation:

> *"At the instance of the U.K.Company, assessee restrained itself from interfering with any other party and also refrained from itself entering the insurance business. In consideration of this restraint and the assurance to join hands only with U.K.Company, agreed to pay lumpsum of £2.4 million to the assessee."*

11. While completing the assessment, the assessing officer cannot examine the exigency of business as to what would be the prudent decision from the point of view of the assessee. What is required to be seen is the interpretation which has to be given to the covenant in the Letter of Intent. The assessee has been non-suited on the ground that they were never in the insurance business and the covenant cannot be considered as a restrictive covenant. We do not agree with the said finding

of the assessing officer because there is a background which cannot be ignored by the assessing officer during the relevant point when the "Letter of Intent" was signed. It was the first time, the Government of India took a decision to permit foreign insurance companies to set up general insurance business in India. The entire matter was regulated by the Government of India under the relevant regulations. Thus, several competing companies in India were desirous of starting insurance business with foreign partnerships / Joint ventures. Therefore, commercial prudence demanded the U.K.Company to restrain the assessee, preventing them from entering into insurance business, which they had not done earlier, secondly, preventing the assessee from entering into an agreement with any other foreign insurance company. The condition is clear and lucid and it is to be treated as a 'restrictive covenant' and merely because the assessee was not in the insurance business is not a ground to read down the condition. Thus, we are of the considered view that the interpretation given by the CIT(A) to the said covenant is just and proper and we do not agree with the finding of the assessing officer as well as the Tribunal in this regard.

12. Mr.T.Ravikumar, learned Senior Counsel for the respondent /

revenue vehemently contended that the factual finding that the payment was received by the assessee before the commencement of business is the finding, which stares against the assessee and the same has not been challenged. In our considered view, we are afraid that such a finding cannot work against the assesee. The terms and conditions of the Letter of Intent is clear, in the sense, that it is the condition which precedes other conditions, which relates to 'Investment for allotment of shares'. In fact, this amount which was agreed to be paid as non-compete has been received by the assessee on 23.10.2000 and immediately invested in the shares of the company. To be noted that all the transactions are in the same assessment year, i.e., 2001-2002.

13. In the light of the above, we are of the clear view that the CIT(A) was fully justified in holding that the amount received by the assessee was a capital receipt and was right in deleting the addition made by the assessing officer. Further, we note that the amount has been credited to the capital receipt account in the balance sheet for the year ending 31.03.2001 and the amount does not come anywhere within the inclusive definition of Income as envisaged in Section 2(24).

14. At this juncture, it will be beneficial to refer to the decision of

Hon'ble Supreme Court in Guffic Chem (P) Ltd., V. Commissioner of Income Tax & Another reported in (2011) 332 ITR 0602. The Hon'ble Supreme Court has held that 'payment received as non-competition fee under a negative covenant has to be treated as a capital receipt till the Assessment Year 2003-04'. The said decision supports the case of the assessee.

15. The learned counsel appearing for the assessee referred to the decision of the assessee's own case in **TCA No.159 of 2009 dated 06.03.2019**, which pertains to the capital subsidy received by the assessee from the U.K.Company.

16. It is the submission of Mr.Ravikumar, learned Senior Standing Counsel for the respondent / revenue that the substantial question of law No.1 pertains to capital subsidy and in fact, the decision would enure in favour of the Revenue. We do not agree with the said submission as the Letter of Intent provides "additional investment" at the instance of the assessee and the condition stated 'if at the time of finalisation of shareholders agreement it is found that assessee is required to further infuse equity during the initially agreed pay-back period, U.K.Company will

make a compensatory payment to assessee in an amount to be mutually agreed, before the finalisation of the stareholders agreement'.

17. Thus, we are of the clear view that the order passed by the Tribunal dated 31.07.2007 reversing the order passed by CIT(A) calls for interference. In the light of the above, the appeal filed by the assessee is allowed and the order passed by the tribunal is set aside and the order passed by the CIT(A) dated 13.01.2005 is restored and the substantial question of law framed is answered in favour of the assessee. No costs.

(T.S.S., J.) **(V.B.S., J.)**
19.06.2019

Index: Yes/No

ssd

To

Income Tax Appellate Tribunal "C" Bench, Chennai

T.S.Sivagnanam, J.
and
V.Bhavani Subbaroyan, J.

ssd

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