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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 25.11.2021

CORAM :

THE HON'BLE MR. JUSTICE R. MAHADEVAN

AND

THE HON'BLE MR. JUSTICE MOHAMMED SHAFFIQ

TAX CASE APPEAL NOS. 429 AND 430 OF 2009

M/s. Sundaram Finance Limited,
(Formerly M/s.Lakshmi General finance Ltd.,)
21, Patullos Road,
Chennai - 600 002.

...Appellant in both the appeals

Versus

The Deputy Commissioner of Income tax,
Company Circle - III,
Chennai - 600 034.

... Respondent in both the appeals

Tax Case Appeals filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, "B" Bench Chennai dated 07.05.2008 passed in ITA.Nos.325/Mds/2005 and 2122/Mds/2006.

And against the O/o Commissioner of Income tax (Appeals)-XI, 121, Mahatma Gandhi Salai, Chennai 600 034 and made in ITA.No.114/ITA.No.266/2004-05 and ITA.No.278/2005-2006 order dated 04.01.2005 and 22.06.2006 and against the O/o Assistant Commissioner of Income tax and Company Circle II(4)(I/C) Chennai-34 and made in PAN.No.AAACL0502B date of order 15.03.2004 (ii) the Deputy Commissioner of Income tax Company Circle II(4)(I/C), Chennai 34 and made in PAN/GIR.No.AAACL0502B date of order 30.03.2005 for the assessment year 2001-2002 & 2002-2003 respectively.

For Appellant : Mr.R.Venkatanarayanan
for M/s.Subbaraya Aiyar in both appeals

For Respondent : Mrs. Hemalatha,
Senior standing counsel in both appeals



COMMON JUDGMENT

(Judgment of the Court was delivered by R. MAHADEVAN, J.)

These tax case appeals have been filed by the appellant / assessee, calling in question the correctness of the order dated 07.05.2008 passed by the Income Tax Appellate Tribunal, Chennai "B" Bench, in I.T.A.Nos.325/Mds/2005 & 2122/Mds/2006 respectively, relating to the assessment years 2001-02 & 2002-03.

2. On 07.07.2009, this Court admitted these two tax case appeals on the following common substantial questions of law:-

"(i) Whether on the facts and circumstances of the case the Tribunal was right in law in holding that the amount received towards restrictive covenant is revenue receipt chargeable to tax though receipt of compensation for restraining one's business has been brought only with effect from 01.04.2003 vide amendment to Section 28 by the Finance Act, 2002?

(ii) Whether on the facts and circumstance of the case the Tribunal was right in law in holding that the appellant is not entitled to deduction of the provision made in respect of Non performing Assets which are considered irrecoverable?

3.1 The learned counsel for the appellant / assessee submitted that the first question of law involved in these appeals has already been considered and decided by this Court by judgment dated 19.06.2019 in TCA No.1938 of 2008 in respect of the assessee's own case. For better appreciation, the relevant portion of the said judgment is extracted below:

"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



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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 assessee 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



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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 E 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



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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 assessee. 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.



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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 shareholders 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."

Therefore, the learned counsel sought to allow these appeals in respect of the first question of law raised herein.

3.2 On the other hand, the learned Senior Standing Counsel appearing for the respondent/Revenue has opposed the submissions made on the side of the appellant / assessee, by referring to the decision of the High Court of Delhi in the case of Sharp Business System vs. Commissioner of Income - tax - III, reported in 24/5 CTR 233, wherein similar issue was decided against the assessee and in favour of the Revenue and in paragraph 10, it was held as under:

"10. In the present case, the appellant is a joint - venture between M/s. Sharp & L&T. Apparently, the agreement entered into with the L&T in view of the changed relationship ensures that the latter does not enter into the same business. Although it is contended that the advantage is only by way of facilitation of the appellant's business and ensuring greater efficiency as well as profitability, on the other side, what can be seen is that the arrangement is to endure for a substantial period, i.e. 7 years. Coupled with the fact that the L&T has its own presence in consumer goods sector and would be, if it chooses - able to put up an effective competition for



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business engaged in by the assessee, there is no doubt that the amount is to ensure a certain position in the market by keeping - out L&T. Applying the test indicated in the Empire Jute Co. Ltd (supra), Alembic Chemical Works Co. Ltd. (supra) and Coal Shipments (P) Ltd. (Supra), this Court is the opinion that the deduction cannot be claimed as a revenue expenditure; it clearly falls within the capital field. The first two questions are, therefore, answered against the assessee and in favour of the Revenue."

Stating so, the learned counsel prayed for dismissal of these tax case appeals, by confirming the order passed by the Tribunal, insofar as this issue is concerned.

3.3 It is evident from the records that there was a shareholders agreement, as per which, a non-compete restriction was imposed to the effect that "the assessee received the amount as consideration with an undertaking to restrain themselves from entering into insurance business either on their own or joining with others". Due to the said restriction, it has lost its right to transact with other companies and hence, the same was compensated by the lump sum, which cannot be brought to tax as revenue receipt, but is a capital receipt. Further, it is to be noted that the introduction of sub clause (va) to section 28 to tax this kind of receipt is applicable only from the assessment year 2003-04. That apart, there is no material to show that the said compensation amount received by the assessee during the years in question, was diverted for any other purpose, except for being invested in the share capital of the joint venture company. Therefore, following the earlier orders of this court in TCA No.159/2009 dated 06.03.2019 and TCA No.1938/2008 dated 19.06.2009, we answer this issue in favour of the assessee and against the Revenue.

4.1 Regarding the second question of law, it is submitted by the learned counsel on both sides that the same is covered in favour of the assessee, as per the decision of the Delhi High Court in the case of Commissioner of Income Tax v. Vasisth Chay Vyapar Limited reported in (2011) 330 ITR 044, which was subsequently confirmed by the Honourable Supreme court in the order dated 13.12.2017 passed in Civil Appeal No. 5811 of 2012 etc., batch. The relevant paragraphs of the said decision of the Delhi High Court can profitably be extracted hereunder:-

"17. In this scenario, we have to examine the strength in the submission of learned counsel for the Revenue that whether it can still be held that income in the form of interest though not received had still accrued to the assessee under the provisions of



Income Tax Act and was, therefore, eligible to tax. Our answer is in the negative and we give the following reasons in support:-

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(1) First of all we would discuss the matter in the light of the provisions of Income Tax Act and to examine as to whether in the given circumstances, interest income has accrued to the assessee. It is stated at the cost of repetition that admitted position is that the assessee had not received any interest on the said ICD placed with Shaw Wallace since the assessment year 1996-97 as it had become NPAs in accordance with the Prudential norms which was entered in the books of accounts as well. The assessee has further successfully demonstrated that even in the succeeding assessment years, no interest was received and the position remained the same until the assessment years 2006-07. Reason was adverse financial circumstances and the financial crunch faced by Shaw Wallace. So much so, it was facing winding up petitions which were filed by many creditors. These circumstances, led to an uncertainty in so far as recovery of interest was concerned, as a result of the aforesaid precarious financial position of Shaw Wallace. What to talk of interest, even the principal amount itself had become doubtful to recover. In this scenario it was legitimate move to infer that interest income thereupon has not "accrued". We are in agreement with the submission of Mr. Vohra on this count, supported by various decisions of different High Courts including this court which has already been referred to above.

(2) In the instant case, the assessee company being NBFC is governed by the provisions of RBI Act. In such a case, interest income cannot be said to have accrued to the assessee having regard to the provisions of section 45Q of the RBI and Prudential Norms issued by the RBI in exercise of its statutory powers. As per these norms, the ICD had become NPA and on such NPA where the interest was not received and possibility of recovery was almost nil, it could not be treated to have been accrued in favour of the assessee.

18. As noted above, Mr. Sabharwal, argued that the case of the assessee was to be dealt with for the purpose of taxability as per the provisions of the Act and not the RBI Act which was the accounting



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method that the assessee was supposed to follow. We have already held that even under the Income Tax Act, interest income had not accrued. Moreover, this submission of Mr. Sabharwal is based entirely on the judgment of the Supreme Court in the case of Southern Technology (supra). No doubt, in first blush, reading of the judgment gives an indication that the Court has held that RBI Act does not override the provisions of the Income Tax Act. However, when we examine the issue involved therein minutely and deeply in the context in which that had arisen and certain observations of the Apex Court contained in that very judgment, we find that the proposition advanced by Mr. Sabharwal may not be entirely correct. In the case before the Supreme Court, the assessee a NBFC debited Rs.81,68,516 as provision against NPA in the profit and loss account, which was claimed as deduction in terms of Section 36 (1) (vii) of the Act. The assessing officer did not allow the deduction claimed as aforesaid on the ground that the provision of NPA was not in the nature of expenditure or loss but more in the nature of a reserve, and thus not deductible under Section 36 (i) (vii) of the Act. The assessing officer, however, did not bring to tax Rs.20,34,605 as income (being income accrued under the mercantile system of accounting). The dispute before the Apex court centered around deductibility of provision for NPA. After analyzing the provisions of the RBI Act, their Lordships of the Apex Court observed that in so far as the permissible deductions or exclusions under the Act are concerned, the same are admissible only if such deductions/exclusions satisfy the relevant conditions stipulated therefor under the Act. To that extent, it was observed that the Prudential Norms do not override the provisions of the Act. However, the Apex Court made a distinction with regard to "Income Recognition" and held that income had to be recognized in terms of the Prudential Norms, even though the same deviated from mercantile system of accounting and/or Section 45 of the Income Tax Act. It can be said, therefore, that the Apex Court approved the 'real income' theory which is engrained in the Prudential Norms for recognition of revenue by NBFC. The following passage from the judgment of the Apex Court would bring out the distinction noticed by the Apex Court between permissible deductions/exclusions, on the one hand, and income recognition on the other:-



favour of the assessee. As a result, all these appeals are dismissed."

4.2 In the light of the above decision, the second question of law framed for consideration in these appeals is also answered in favour of the assessee and against the revenue.

5. In the result, both the appeals filed by the assessee stand allowed. No costs.

Sd/-
Assistant Registrar

//True Copy//

Sub Assistant Registrar

av/rsh

To

1. The Deputy Commissioner of Income Tax,
Company Circle - III,
Chennai - 600 034.
2. The Income Tax Appellate Tribunal,
"B" Bench, Chennai.
3. The Commissioner of Income tax (Appeals)-XI,
121, Mahatma Gandhi Salai, Chennai 600 034.
4. The Assistant Commissioner of Income tax,
Circle-II, (A) (I/C), Chennai-34.

+2ccs to Mr.T.Ravikumar, Advocate, S.R.No.60971
+1cc to M/s.Subbaraya Aiyar, Advocate, S.R.No.61316

TCA Nos.429 & 430/2009

RR(CO)
PM/28/01/2022