**IN THE HIGH COURT OF JUDICATURE AT BOMBAY**
**ORDINARY ORIGINAL CIVIL JURISDICTION**

**INCOME TAX APPEAL NO. 950 OF 2009**

Neville Tuli ….Appellant

V/s.

The ITO 3(2)(4), Mumbai …Respondent

**ALONGWITH**
**WRIT PETITION NO. 602 OF 2011**

Neville Tuli ….Petitioner

V/s.

Income Tax Appellant Tribunal,
Mumbai Bench …Respondent

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Mr. Porus Kaka, Senior Advocate a/w Mr. Aditya Vora i/b Mr. Atul K. Jasani for Appellant/Petitioner.
Mr. Sham V. Walve for Respondent-Revenue.

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**CORAM : K.R. SHRIRAM &**
**N. J. JAMADAR, JJ.**
**DATED : 4th FEBRUARY, 2022**

**P.C. :**

**INCOME TAX APPEAL NO. 950 OF 2009**

1. On 29th July, 2009 the following substantial questions of law were framed.

> a) Whether, on the facts and the circumstances of the case, the Tribunal erred not treating that the amount received under the Deed for restrictive covenant as a Capital Receipt not liable to tax ?
>
> b) Whether, on the facts and the circumstances of the case, and in law, the finding of the Tribunal that the Appellant could not be viewed as a threat to the Company's business is perverse, contrary to the material on record and ought to be set aside ?

c) Whether the failure on the Tribunal to follow the decision of a Special Bench by citing cases never cited by either party nor raised nor argued during the course of hearing, and contrary to the principle of natural justice and without the issue being put to the Appellant renders the decision bad in law and liable to be set aside ?

d) Whether the Tribunal sitting as Division Bench ought to have either followed the larger Special Bench decision or in accordance with judicial propriety and practice referred the matter to the President to constitute a larger Bench ?

The facts in brief are as under :

2. Osian's – Connoisseurs of Art Private Limited (hereinafter referred to as the Company) which was incorporated on 22nd June, 2000 appointed appellant as its whole time Director on 10th July, 2000 for a salary of Rs.1,00,000/- per month with effect from 1st July, 2000. In view of his capabilities and knowledge and in order to ensure that appellant did not act/harm the interest of the company upon termination of his employment, the company entered into non-compete agreement dated 7th August, 2000 termed as "Deed for Negative Covenants" (hereinafter referred to as agreement) imposing certain restriction on appellant from carrying out certain professional activities over a period of 10 years after the termination of his employment. Some relevant provisions of the agreement are :

*i) not directly or indirectly engage in or be concerned or connected with any business which is similar to and/or competitive with the business of the company in the metro cities of Bombay, Delhi, Ahmedabad and Bangalore.*

*ii) not directly or indirectly control or operate or cause to controlled or operated or participate in any* *similar business in the metro cities.*

*iii) not associate himself or be an advisor, employee or be a partner in any similar business as aforesaid;*

*iv) to cease and desist from participating in similar business activities as aforesaid and not to use his good will or expertise in respect of similar business as aforesaid;*

In lieu of appellant agreeing not to compete with the company for a period of 10 years after termination, under Article 2 of the agreement the company agreed to pay Rs.2 Crores to appellant. The company satisfied such payment by allotting 20,00,000 Equity Shares of the nominal face value of Rs.10 each to appellant. Articles 3 and 4 of the agreement which contain various further restrictions and obligations are reproduced below :

*"3. In the event that Nevile breaches any covenants herein the company shall be entitled to recover and Nevile shall be liable to reimburse the amount of Rs.2 Crores with interest calculated at the rate 15% p.a. from the date the consideration is paid or shares issued, as the case may be, till the date of reimbursement."*

*"4. For the purpose of enforcement Nevile hereby grants to the company lien in respect of any assets/property of Nevile or amounts due to him that may be lawfully held by the company at the time any breach is committed by Nevile of this agreement till the date of reimbursement."*

3. In the assessment framed by respondent for A.Y. 2001-02, respondent invoked the provision of Section 147 read with Section 148 of the Income Tax Act, 1961 (the Act) for the purpose of taxing the said consideration of Rs.2 Crores which in the opinion of respondent had

escaped assessment. Respondent considered the provision of Section 17(1)(iv) read with Section 17(3)(i) of the Act in adding the amount, i.e., value of the equity shares received by way of the agreement to the salary income. The Assessing Officer contended that the threat from appellant to the company if and when he left the employment, was theoretical and not real, as appellant never had a substantial source of income in the previous assessment years. Hence, respondent took up the contention that appellant would never leave the company or there was any constructive interest on the part of appellant to leave the employment. It was only when appellant had left the employment and at the time of leaving any amount is paid under a negative covenant would there could be a justification or else it has to be treated as salary income.

4. Impugning the Assessment Order, appellant filed an appeal before the Commissioner of Income Tax (Appeals) [CIT (A)] on 25th July, 2005.

Before the CIT (A), appellant contended that the amount received under a negative covenant was not taxable as it was capital receipt. Copious material and evidence was shown to CIT (A) evidencing the capability of appellant and his knowledge in the field. The CIT (A) took the view that amount paid by the company to appellant cannot be termed as a payment towards the negative covenant. The CIT (A) rejected the submissions of appellant and upheld the stand of the Assessing Officer in holding that the threat from appellant to the company was theoretical and not real.

5. Aggrieved by the order of the CIT (A), appellant filed an appeal before the Income Tax Appellate Tribunal (ITAT) on 8th January, 2007. ITAT dismissed the appeal by an order dated 12th December, 2008.

6. Impugning this order of the ITAT, appellant has filed this appeal. It is appellant's case that the tribunal has failed to consider the evidence furnished by appellant in regard to the background, capability and capacity of appellant by merely relying on the lower authorities without, taking into consideration the relevant facts of the case. It is also appellant's case that the ITAT failed to consider several decisions cited before it including that of the Hon'ble Apex Court in ***CIT v. Best and Co. (Private) Ltd.***[1] and the Special Bench in the case of ***Saurabh Srivastava v. DCIT***[2] by stating that the relevant cases only dealt with loss or destruction of existing source of income of the party which are different from the facts of the present case. It is appellant's case that both these judgments categorically and clearly held that in case of payments made to compensate for future income it has to be capital receipt even in the case of salaried employees.

7. Mr. Kaka submitted that payment received as non- competition

1 (1966) 60 ITR 11 (SC)
2 (2008) 111 ITD 287 (Delhi) (SB)

fee under the negative covenant was always treated as capital receipt till the assessment year 2003-2004 and it is only vide the Finance Act, 2002 with effect from 1st April, 2003 that the said capital receipt is now made taxable under Section 28 (va) of the Income Tax Act, 1961. Mr. Kaka submitted that the Finance Act, 2002 itself indicates that during the relevant assessment year compensation received under non-competition agreement was capital receipt not taxable under the Act and it become taxable only with effect from 1st April, 2003 and the Hon'ble Apex Court in ***Guffic Chem P. Ltd. vs. Commissioner of Income Tax*[3]*,*** has held that said Section 28(va) is amendatory and not clarificatory and therefore, as held by the Hon'ble Apex Court, compensation received under non-competition agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide Section 28(va) of the Act and that too with effect from 1st April, 2003.

8. Mr. Walve justified the stand taken by the Assessing Officer, CIT (A) as well as the ITAT. Mr. Walve submitted that by virtue of the definition of the term salary as per Section 17(1)(iv) read with Section 17(3)(i) of the Act receipt of 20,00,000 Equity Shares received by appellant from his employer valued at Rs.2 Crores would be a profit, gain or advantage in addition to salary though not termed as salary but part and parcel of income by way of salary, which would be taxable.

3 (2011) 332 ITR 602 (SC)

9. We have considered the orders annexed to the Appeal Memo and also heard counsel and also considered the compilation of judgments tendered by Mr.Kaka. Relying on these judgments/orders, Mr.Kaka submitted that compensation paid by way of 20,00,000 Equity Shares of the company was in lieu of appellant accepting: (a) restrictive covenant and (b) the restrictive covenant was an independent application and the compensation which was attributable to the restrictive covenant, i.e., 20,00,000 Equity Shares of the company, was a capital receipt and hence not taxable.

Mr. Kaka also relied on the following judgments/orders :

1. Beak (Inspector of Taxes) v. Robson, (1943) 11 ITR 23 (House Lords)
2. Gilladers Arbuthnot & Co. Ltd. v. CIT, (1964) 53 ITR 283 (SC)
3. CIT v. Saroj Kumar Poddar, (2005) 279 ITR 573 (Cal)
4. CIT v. Late G.D. Naidu, (1987) 165 ITR 63 (Mad)
5. CIT v. A.S. Wardekar, (2006) 283 ITR 432 (Cal)
6. B.K. Kotru v. CIT, (2006) 282 ITR 1 (Bom)
7. Rohitasava Chand v. CIT, (2008) 306 ITR 242 (Delhi)
8. CIT v. Shyam Sundar Chhaparia, (2008) 305 ITR 181 (MP)
9. CIT v. Varas International P. Ltd., (2006) 283 ITR 484 (SC)
10. CIT v. Sunil Kinik, (2013) 354 ITR 623 (Karn)
11. Hari Shankar Bhartia v. CIT, (2011) 15 taxmann.com 113 (Calcutta)
12. CIT v. K. Chandrakanth Kini, (2012) 347 ITR 388 (Karn)
13. CIT v. Sapthagiri Distilleries Ltd., (2014) 366 ITR 270 (Karn)
14. CIT v. Wintac Ltd., (2014) 360 ITR 614 (Karn)
15. CIT v. Real Image Pvt. Ltd., (2013) 359 ITR 606 (Mad)
16. CIT v. Spencers & Co. Ltd., (2013) 359 ITR 612 (Mad)
17. CIT v. Shri. Saurabh Srivastava, ITA 116/2009 and CM 1343/2009 Order dated 17-03-2009 (Delhi)
18. CIT v. Rohtisava Chand, Civil Appeal No. (S). 7467 of 2009 Order dated 04-09-2014 (SC)

10. Though Mr. Walve first submitted that Section 28(va) of the Act was clarificatory and not amendatory, but after considering ***Guffic Chem P.***

***Ltd.*** (supra) fairly agreed that the Hon'ble Apex Court has held that the said Section 28(va) of the Act is amendatory and not clarificatory.

11. It is settled law that after the Finance Act, 2002 coming into effect from 1st April, 2003 capital receipt is now made taxable under Section 28(va) of the Act. Whether the amount is received by way of compensation under a restrictive covenant or under a non-competition agreement it would amount to capital receipt in the hands of the recipient. Of course, it would depend on the agreement entered into between the parties. We have considered the agreement and we find that the agreement incorporated restrictive covenant on the right of appellant.

12. The agreement expressly provides that appellant shall not directly or indirectly engage in or be concerned or connected with any business which is similar to and/or in competition with the business of the company in the metro cities of Bombay, Delhi, Ahmedabad and Bangalore and appellant shall not directly or indirectly control or operate or cause to control or operate or participate in any similar business in the metro cities. In fact, the agreement goes to the extent of even stating that appellant shall not associate himself or be an advisor, employee or be a partner in any similar business as that of the company and he shall cease and desist from participating in similar business activities as that of the company and not to use his goodwill or expertise in respect of similar business as that of the

company. To that extent, in our view it was loss of source of income for him in the future. The agreement, i.e., the deed for negative covenants was an independent obligation undertaken by appellant with the company in same field for a period of ten years. Therefore, the compensation attributable to restrictive covenant, i.e., 20,00,000 Equity Shares of Rs.10/- each in the hands of appellant was a capital receipt in as much as it was appellants' profit making capabilities for a period of ten years from the date of appellant leaving the employment of the company either on his own or in association with professional competitors.

13. The ITAT, CIT and the Assessing Officer have proceeded on an erroneous footing that the company came into existence only on 22nd June, 2000 and the assessee was inducted into its employment on 30th June, 2000 and therefore it was not feasible and it is inconceivable that appellant can be a privy to the business secrets of the company within a period of eight days of his employment. The deed of negative covenant does not provide or even indicate that appellant was privy to the business secrets of the company within a period of eight days. The objective for entering into agreement was because the company was engaged in the business of maintenance and collection of art and sale of art by conducting auctions, exhibitions etc., and appellant has been actively and closely associated with the Indian Art Industry for over seven years and was a pioneer in his field with extensive knowledge of the history and aesthetics of Indian Classical

Modern Contemporary Art and has considerable skills, expertise, goodwill and experience in the aforesaid business. Appellant had agreed to be an employee director of the company and by virtue of his employment and on account of his knowledge and skill and since he will be privy to the business secrets of the company, appellant could have been a potential threat in the event of his leaving the employment of the company either on his own or in association with others. To prevent the potential threat being effected, the company believed that appellant should be bound by a negative covenant for a period of ten years from the date when appellant may leave the employment of the company. In consideration of appellant agreeing for the negative covenant, company decided to pay compensation by way of 20,00,000 Equity Shares of Rs.10/- each. We are informed across the bar that the company is in liquidation process before NCLT and the value of this shares today is practically worthless.

14. Respondents have also proceeded on an erroneous basis that statement of income filed by appellant for A.Y. 2000-01 does not show that appellant had income from business of maintenance and collection of art and sale of art and the assessee was showing only interest income and therefore he cannot be stated to be in a position to compete in any manner with the employer company because he did not have any existing business running. According to respondent for any sum stated to be non-compete fess, the same should be paid to any person from whom the real threat of

competition exists and because his return of income for A.Y. 2000-01 does not show any income or business of maintenance and business of collection of art and sale of art, the value of shares received by appellant should be treated as revenue receipt and not capital receipt. In our view, these things really does not matter. All this cannot be the basis for determining whether the amount received by appellant should be revenue receipt or capital receipt. The department has to only consider the agreement entered into and if the agreement indicates that the amount paid by way of compensation was against restrictive covenant or for non-compete that would amount to capital receipt. Of course, unless respondent proves that restrictive covenant or negative covenant agreement was a sham agreement. No material has been brought on record to show that the negative covenant agreement is a sham agreement.

All judgments/orders relied upon by Mr. Kaka certainly hold that whether compensation is received for negative restrictive covenant or non-compete with business of the company, compensation relatable to such activity would be a capital receipt.

15. The Hon'ble Apex Court in ***Guffic Chem P. Ltd.*** (supra) after determining the question of law whether a payment under an agreement not to compete (negative covenant agreement) is a capital receipt or a revenue receipt held as under :

> *6. The above dichotomy is clearly spelt out in the judgment of this Court in Gillanders' case (supra) in which the facts*

*were as follows. The assessee in that case carried on business in diverse fields besides acting as managing agents, shipping agents, purchasing agents and secretaries. The assessee also acted as importers and distributors on behalf of foreign principals and bought and sold on its own account. Under an agreement which was terminable at will the assessee acted as a sole agent of explosives manufactured by Imperial Chemical Industries (Export) Ltd. That agency was terminated and by way of compensation the Imperial Chemical Industries (Export) Ltd. paid for first three years after the termination of the agency two-fifths of the commission accrued on its sales in the territory of the agency of the appellant and in addition in the third year full commission was paid for the sales in that year. The Imperial Chemical Industries (Export) Ltd. took a formal undertaking from the assessee to refrain from selling or accepting any agency for explosives.*

*7. 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. This dichotomy has not been appreciated by the High Court in its impugned judgment. The High Court has misinterpreted the judgment of this Court in Gillanders' case (supra). In the present case, the Department has not impugned the genuineness of the transaction. In the present case, we are of the view that the High Court has erred in interfering with the concurrent findings of fact recorded by the Commissioner of Income-tax (Appeals) and the Tribunal. One more aspect needs to be highlighted. Payment received as non-competition fee under a negative covenant was always treated as a capital receipt till the assessment year 2003-04. It is only vide the Finance Act, 2002 with effect from April 1, 2003 that the said capital receipt is now made taxable [See: Section 28(va)]. The Finance Act, 2002 itself indicates that during the relevant assessment year compensation received by the assessee under non- competition agreement was a capital receipt, not taxable under the 1961 Act. It became taxable only with effect from April 1, 2003. It is well settled that a liability cannot be created retrospectively. In the present case, compensation received under non-competition agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide Section 28(va)*

> *and that too with effect from April 1, 2003. Hence, the said Section 28(va) is amendatory and not clarificatory. Lastly, in CIT v. Rai Bahadur Jairam Valji reported in [1959] 35 ITR 148 it was held by this Court that if a contract is entered into in the ordinary course of business, any compensation received for its termination (loss of agency) would be a revenue receipt. In the present case, both the Commissioner of Income-tax (Appeals) as well as the Tribunal, came to the conclusion that the agreement entered into by the assessee with Ranbaxy led to loss of source of business; that payment was received under the negative covenant and therefore the receipt of Rs. 50 lakhs by the assessee from Ranbaxy was in the nature of capital receipt. In fact, in order to put an end to the litigation, Parliament stepped in to specifically tax such receipts under non-competition agreement with effect from April 1, 2003.*

16. For the above reasons, we answer the questions as under :

| **SR. NO.** | **QUESTION** | **ANSWER** |
|---|---|---|
| (a) | Whether, on the facts and the circumstances of the case, the Tribunal erred not treating that the amount received under the Deed for restrictive covenant as a Capital Receipt not liable to tax ? | Affirmative |
| (b) | Whether, on the facts and the circumstances of the case, and in law, the finding of the Tribunal that the Appellant could not be viewed as a threat to the Company's business is perverse, contrary to the material on record and ought to be set aside ? | Affirmative |

In view of our answer to Question (a) and Question (b) answering Question (c) and (d) would not arise.

17. Appeal disposed with no order as to costs.

**WRIT PETITION NO. 602 OF 2011**

18. In view of deciding the Appeal No.950 of 2009 in favour of appellant, this petition will not survive.

19. Petition dismissed.

**(N. J. JAMADAR, J.)** **(K.R. SHRIRAM, J.)**