IN THE INCOME TAX APPELLATE TRIBUNAL, MUMBAI BENCH "D", MUMBAI

BEFORE SHRI N.V.VASUDEVAN(J.M) & SHRI T.R.SOOD (A.M)

ITA NO.3853/MUM/2010(A.Y. 2007-08)

Ramesh D. Tainwala, 401B, Elegent Business Park, Off Andheri-Kurla Road, Andheri (E), Mumbai – 400 059. PAN:AAAPT9296K (Appellant)	Vs.	Income Tax Officer 8(3)-1, Mumbai. (Respondent)

Appellant by : Shri Farrokh V. Irani
Respondent by : Shri G.P.Trivedi

Date of hearing : 20/09/2011
Date of pronouncement : 07/10/2011

ORDER

PER N.V.VASUDEVAN, J.M,

This is an appeal by the assessee against the order dated 17/3/2010 of CIT(A)-18, Mumbai relating to assessment year 2007-08. The grounds of appeal of the revenue read as follows:

> "1. The Commissioner of Income Tax (Appeals) 18, Mumbai [hereinafter referred to as "CIT(A)] erred in not appreciating the fact that the receipt of Rs. 2 Crore by the appellant does not fall within the purview of Section 28 (va) of the Act.
>
> 2. Without prejudice to the above the CIT(A) erred in classifying the receipt of Rs. 2 Crore as Income from Business u/s. 28(va) of the Act and not considering the same as part of "Full Value of Consideration Received" u/s. 48 of the Act."

2. The Asssessee is an individual. He is director of M/s.Samsonite South Asia Pvt. Ltd. He filed a return of income for A.Y.07-08 declaring total

income of Rs.7,29,18,046/-. Subsequently, the assessee has filed letter dated 31.07.2007 submitted on 01.08.2007, which Is reproduced as under :-

> 'During the year under consideration, the assessee has received a sum of Rs.2,00,00,000/- being compensation for agreeing not to engage in the business in which the assessee has sole expertise and knowledge. The amount, therefore, represents compensation for giving up a source of income which is a capital receipt and does not constitute income in the hands of the assessee. The assessee has relied on various judicial pronouncements on this principle. Reference may be made to V. Venugopala Varma Rajah Vs. CIT 76 ITR 460 and Gillanders Arbuthnot & Co. Ltd. V. CIT 53 ITR 283.
>
> The return of income form does not provide for any documents or explanation to be attached to the form. Under the circumstances the assessee is constrained to submit the above explanation by way of a separate submission. You are requested to kindly consider this submission to b9.zán integral part of the return of income for A. Y. 2OO7-2OO8."

3. The facts with regard to the receipt of Rs.2 Crores as Non-Compete Fee by the Assessee are as follows:

M/S. Tainwala Polycontainers Ltd., (hereinafter referred to as "the Company") is in the business of manufacturing and marketing of blow moulded high molecular, high density polyethylene containers (HMHDPE) (200-235 litres capacity). Another company by name Time Packaging Limited (hereinafter referred to as "Acquirer") is also in the business of manufacture of plastic product business, industrial packaging products businesses including the line of products manufactured by the company. The Assessee was one of the promoter of the company. He together with the following persons (hereinafter referred to as "Sellers") held shares in the company as follows:

List of Promoter Group & Promoters Shareholding of Tainwala Polycontainers Limited

Block A comprising of 4,290,066 Equity Shares aggregating to 55.00% of the total paid up capital of Company and referred to In the Agreement as Sale Shares.

S.No.	L.F.No.	Name	No. of shares	% of share Holding
1.	Demat	Ramesh Tainwala	984,520	12.62%
2.	R0073	Rakesh Tainwala	871,485	11.17%
3.	Demat	Tainwala Holdings Pvt. Ltd.	100,000	1.28%
4.	Demat	Katyan Construction & Developers Pvt. Ltd.	316,330	4.05%
5.	Demat	Shobha Tainwala	852,400	10.93%
6.	A0327	Amishi Tainwala	1,013,461	13.00%
7.	10661	Dungarmal Ramesh Kumar HUF	109,700	1.41%
8.	Demat	Tainwala Chemicals & Plastics (I) Ltd.	42,170	0.54%
		TOTAL (A)	4,290,066	55.00%

Block B comprising of 13,07,328 Equity Shares aggregating to 16.76% of the total paid up capital of the Company and referred to in the Agreement as Optional Sale Shares

S.No.	LF No.	Name	No. of share	% of share Holding
1.	P000259	Periwinkle Fashion Pvt. Ltd.	400,000	5.13%
2.	110	Katyayan Construction & Developers Pvt. Ltd.	699,030	8.96%
3.	S00530	Shobha/Ramesh Tainwala	200000	2.57%
4.	Demat	Tainwala Chemicals & Plastics (I) Ltd.	8,298	0.10%
		TOTAL (B)	13,07,328	16.76%
Grand Total (A) + (B) Shares/ % of shares			**55,97,394**	**71.76%**

The Sellers and Acquirer agreed that both the Company as well as Acquirer have synergies in their business and the consolidation of business will help bring improved logistics, cost savings, higher productivity and shall rationalize marketing and distribution to serve their customers more competitively, cost effectively & efficiently. With this objective to consolidate the operations and enhance the value of stakeholders of Acquirer as well as Company the Acquirer had approached the Sellers/Promoter for purchase of majority shareholding and consequently acquiring the controlling stake in the Company. Accordingly the Acquirer and Sellers reached an understanding to transfer their shareholding as well as operations of Company in good and running conditions to enable the Acquirer to smoothly run the operations thereafter. The entire transaction of transfer of shareholding and control of Company was based on the said premise and was essence of transaction. Since the Company was a listed Company therefore the entire transaction was subject to compliance of Securities Exchange Board of India. (Substantial Acquisition of Shares and Takeovers) Regulation, 1997 or any other applicable Regulations/ Guidelines of SEBI by the Acquirer as well as Sellers.

4. By an agreement dt.13.3.2006, the acquirer agreed to purchase from the sellers, their shareholding in the company. The dispute in this appeal centres around a sum of Rs.2 crores received by the Assessee pursuant to Clause-6 of the agreement dt.13.3.2006 by which the sellers sold their shareholding to the acquirer and further the sellers undertook not to engage directly or indirectly in any business which competes with that of the Assessee for a period of 11 years. Clause-6 of the Agreement dt.13.3.2006 is as follows:

"6. NON-COMPETE .

6.1. The Sellers hereby irrevocably undertake and covenant that, during the period commencing from the Effective Date and ending on the expiry of 11 (Eleven) years after Termination of this Agreement (Non-compete PerIod, they will not directly or indirectly:

6.1.1. carry on, or be engaged, concerned or interested in any business which is similar to or competes either directly or Indirectly of manufacturing industrial packaging products made of plastic or steel and Including drums/barrels, containers, IBC's {intermediate Bulk Containers) (Narrow Mouth, Wide Moth or Open Mouth) with or without L-Ring/XL-Ring in volume capacities of 135-2000 Ltrs.
6.1.2. interfere with, tender for, canvass, solicit or endeavor to entice away from the Company any employees, except the employees as mentioned under Annexure E annexed herewith, or the business of any person who was a customer, client or agent of the Company, for the Company Business;
:6.1.3. supply any product, carry out or undertake or provide any activity or service which is the same as or similar to those with which the Company deals or provide;

6.2. In consideration of the undertakings and covenants of. the Sellers under Clause 6.1, the Acquirers agree to pay to the Sellers Rs.4,QQ1001000 (Rupees Four. Crores only) Non-Cómpete Amount"). The Non-Compete Amount shall be discharged .to the Sellers In the manner set out In Clause 4.

As desired by. Sellers the said Non-compete. consideration of Rs.400. Lacs shall be; paid by Acquirer only :to Mr. Ramesh Tainwala .and Mr. Rakesh Tainwala. in equal proportion of i1s200 lacs• each. and the said payment shall constitute as. A valid discharge of payment of non-compete consideration to all the parties comprised in the definition of Sellers.
6.3 The Sellers further hereby affirm and declare

6.3.1. that they have fully understood the relevance and consequence of Non-Compete Period covenant and have taken due legal advice and consultancy before agreeing to such covenant.

6.3.2. that the Non-compete Period restriction is absolutely reasonable and necessary for Company and the consideration of Rs.4,00,00,000I-paid by Acquirer for the same is adequate

6.3.3. that the continuity of Non-Compete Period shall not be effected by : either a change in the management or ownership of Company or by any restructuring, consolidation and /or amalgamation exercise of Company with Acquirer or any other company

6.3.4 that Acquirer has agreed to pay the Non-compete Amount based on the Non-compete Period representation made by Sellers and the Sellers have no intentions whatsoever to breach the Non-compete Period covenant

6.3.5. that the Acquirer will suffer irreparable harm by a breach of Non- compete covenant1 for which monetary damages would not be an adequate remedy Therefore the Sellers agree that, in the event of a1 threatened or continuing breach of Non-compete covenant, the Acquirer and Company (post acquisition) shall be entitled, without prejudice to any other available remedy, to Immediate injunctive or other equitable relief .

6.3.6. Notwithstanding anything contained herein the Acquirer may notify any. future or third party, about the existence of Non-conipete covenant made by the Sellers.

6.4 Notwithstanding anything contained hereinabove, the Sellers are expressly permitted to manufacture or deal in any other manner in Roto Moulded containers only for storage purposes application (not packaging and transportation) of any capacity and also the production of industrial packagings for transportation of liquids, powders and solids in any form only upto 135 Ltrs capacity and not exceeding 135 Ltrs capacity in any manner whatsoever."

5. The sum of Rs.2 Crores received by the Asssessee pursuant to clause-6 of the Agreement dt.13.3.2006 was not offered to tax by the Assessee in the return of income filed for AY 07-08. As already stated, the Assesee filed a letter dt.31.7.2008 in which the Assessee claimed that the sum of Rs.2 crores being compensation for agreeing not to engage in the business in

which the Assessee had sole expertise and knowledge is a compensation received for giving up a source of income which is a capital receipt and not income chargeable to tax. The Assessee in this regard relied on the decision of the Hon'ble Supreme Court in the case of Gillanders Arbuthnot & Co. Ltd. Vs. CIT 53 ITR 283 (SC).

6. The AO in the course of assessment proceedings brought to the notice of the Assessee that various courts have held that non-compete fees was a capital receipt not chargeable to tax. The AO further pointed out that to put at rest the controversy with effect from 01.04.2003 vide finance Act 2002 a new subsection (va) was inserted in section 28 to bring in the non-compete fess within the preview of section 28 to make it taxable in the hands of the recipient of such income. The Assessee however reiterated his stand that the receipt in question was a capital receipt not chargeable to tax. Alternatively the Assessee submitted that the receipt, if at all it is held to be taxable, has to be taxed as capital gain u/s.45 by treating it as part of the sale of shares and not income from business u/s.28(va) of the Act. It has to be mentioned here that if the alternate claim is accepted then the receipt in question will suffer a lesser rate of tax. It is in this context that the alternate claim of the Assessee, assumes importance. In fact, the only plea of the Assessee before us is on the alternate claim made before the AO. The AO held that the receipt in question is a fee received for not carrying out any activity in relation to any business and therefore chargeable to tax u/s.28(va) of the Act. The AO did not deal with the alternate contention put forth by the Assessee.

7. On appeal by the Assessee the CIT(A) confirmed the view of the AO. On the alternative claim made by the Assessee before the AO, the CIT(A) held as follows:

"5. The fourth ground of appeal is,

Notwithstanding and without prejudice to ground number 3 above, the AO erred in not appreciating the fact that even f the sum of Rs. 2 crore is treated as income, it would form part of the sale consideration of shares in Tainwala Poly Containers Limited sold by the appellant during the year, subject of Capital Gains.

5.1 In this ground of appeal the appellant raised alternative plea that even if the amount is taxable it has to be taxed u/s.48 under the head capital gains and not u/s.28(va). The appellant plea is that he covered by the proviso to u/s.28(va) which reads as under:

> (i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacturer, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains'.

5.2 As mentioned in the earlier paras Clause-3 of share purchase agreement clearly deals with the sale price of the share at Rs.40/- per equity share. Clause-4 and Clause-6 deals with non-compete compensation received by the directors. In view of the clear clauses mentioned in agreement it is not possible to consider non-compete compensation of Rs.2 crores as part of sale consideration to suit the convenience of the appellant. In any case, the appellant is not covered by the provisions of Sec. 28(va) which deals with amount received on transactions pertaining to capital assets and which are chargeable under the head capital gains. Hence this ground of appeal is dismissed."

8. Aggrieved by the order of the CIT(A), the Assessee has preferred the present appeal before the Tribunal.

9. We have heard the submission of the learned counsel for the Assessee who primarily focused on the alternative plea put forth before the revenue authorities. He summarized the law as it prevailed prior to enactment of

Sec.28(va) of the Act and submitted that a receipt on account of undertaking not to engage in competing business commonly referred to as "Non-Compete Fee" was capital receipt not chargeable to tax and therefore sum received by the Assessee has to be taxed only as capital gain. In this regard it was submitted by him that the right to carry on business utilizing his knowledge and skill was a capital asset which was given up by the Assessee and therefore the gain in question will be capital gain and not business income as it is not a payment for losing a source of income. The learned D.R. reiterated the stand of the revenue as reflected in the orders of the revenue authorities.

10. We have considered the rival submissions. We shall first recapitulate the facts of the case. The Assessee is an individual. He was promoter of the company and he together with other promoters of the company held substantial shares. The shares were sold by the promoters to the Acquirer. The Acquirer with a view to ensure that the promoters after sale of the shares do not indulge in competing business and knowing fully well that the promoters had expertise, entered into a non-compete agreement whereby the Assessee was paid Rs.2 Crores for agreeing not to carry on or be engaged, concerned or interest in any business which is similar to or competing either directly or indirectly of manufacturing industrial packaging products made of plastic or steel and including drums/barrels, containers, IBCS etc. for a period of 11 years. Para 6.4 of the agreement provides for some exceptions. The Hon'ble Supreme Court in the case of CIT Vs. Best & CO. 60 ITR 11 (SC) held on the taxability of non-compete fee as follows:

> "The House of Lords in Beak v. Robson (1942) 25 Tax Cas. 33. had to consider whether compensation paid for a restrictive covenant was a capital receipt or a revenue receipt. Under a service agreement the respondent therein covenanted in consideration of the payment to him

of 7,000 pounds on the execution of the agreement, that if the agreement were determined by notice given by him or by his breach of its provisions, he would not compete directly or indirectly with the company within a radius of fifty miles of its place of business until the five years had expired. The House of Lords held that the said amount was a payment for giving up a right wholly unconnected with his office and operative only after he ceased to hold that office, and, therefore, it was not taxable under Schedule E of the Income Tax Acts.

This court in Gillanders Arbuthnot and Co. Ltd. v. Commissioner of Income-tax 53 I. T. R. 283 (S. C.) accepted the said principle and held that the compensation paid for agreeing to refrain from carrying on competitive business in the commodities in respect of the agency terminated or for loss of goodwill was prima facie of the nature of a capital receipt.

In the present case, the covenant was an independent obligation undertaken by the assessee not to compete with the new agents in the same field for a specified period. It came into operation only after the agency was terminated. It was wholly unconnected with the assessee's agency termination. We, therefore, hold that part of the compensation attributable to the restrictive covenant was a capital receipt and hence not assessable to tax."

11. With effect from 01.04.2003 vide finance Act 2002 a new subsection (va) was inserted in section 28 to bring in the non-compete fess within the preview of section 28 to make it taxable in the hands of the recipient of such income.

"28. The following income shall be chargeable to income tax under the head "Profits and gains of business or profession":

(va) any sum, whether received or receivable in cash or kind, under an agreement for-

(a) not carrying out any activity in relation to any business;

Provided that sub-clause (a) shall not apply to-

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any

business, which is chargeable under the head "Capital gains";

Thus payments received as Non-Compete Fee are chargeable to tax u/s.28(va)(a) of the Act. The proviso (i) to Section 28(va)(a) provides for exception to cases where such receipts are taxable as capital gain viz., where any sum is received for transfer of a right to carry on any business which is chargeable to tax as capital gain. Receipts on account of giving up right to carry on business can again be considered as capital receipt or revenue receipt, depending on whether it is compensation paid with the source of income being intact or a compensation for sterilization of the source of income. With the change in law the receipts are taxable, either as business income or capital gain. To ascertain in which category they fall the law as laid down by various judicial pronouncements prior to the above statutory amendments would be relevant. If a receipt is considered as payment of compensation with the source remaining intact it would be revenue receipt falling u/s.28(va)(a) of the Act. If the receipt is a payment for sterilization of the source of income then it would be capital receipt nevertheless falling within the ambit of Sec.45 of the Act, subject however to the condition that there results a transfer of capital asset and the machinery for computation of capital gain u/s.48 capable being applied.

12. As can be seen from the proviso to Clause(i) to clause(a) to Sec.28(va) of the Act, if there is a transfer of right to carry on business then the same would be capital gain. Right to carry on business may not have cost of acquisition and therefore the charge to tax may fail and therefore consequential amendment was made to Sec.55(2) of the Act which provides as follows:

"For the purposes of sections 48 and 49, "cost of acquisition",--

> (a) in relation to a capital asset, being goodwill of a business, or a trade mark or brand name associated with a business or a right to manufacture, produce or process any article or thing or right to carry on any business, tenancy rights, stage carriage permits or loom hours, --
> (i) in the case of acquisition of such asset by the assessee by purchase from a previous owner, means the amount of the purchase price ; and
> (ii) in any other case not being a case falling under sub-clauses (i) to (iv) of sub-section (1) of section 49, shall be taken to be nil ;"

The question for consideration is as to whether the case of the Assessee falls within the proviso (i) to Sec.28(va)(a) of the Act. According to the learned Counsel for the Assessee, the sum of Rs.2 Crores received by the Assessee under clause 6 of the share purchase Agreement dt.13.3.2006 is sum, received, in cash, on account of transfer of the right to carry on any business, which is chargeable under the head "Capital gains".

13. We are of the view that the claim made by the Assessee cannot be accepted. For proviso(i) to Sec.28(va)(a) to apply there must be transfer of the right to carry on any business. The Assessee in the present case was not carrying on any business on his own but was the promoter and director of the company whose shares were purchased by the Acquirer. Clause-6 of the share purchase agreement dt.13.3.2006 does not transfer any right to carry on any business but merely provides that the Asssessee shall not carry out any activity in relation to business of the Assessee. We may also add that the provisions of Sec.45 of the Act would get attracted only when there is a capital gain arising as a result of transfer of a capital asset. The definition of transfer is given in sec.2(47) of the Act. In the present case, the agreement by which the Assessee agrees to refrain from indulging in a business competing with another is independent by itself though it is included in the agreement for transfer of shares. In such agreements there can be no

transfer in any of the modes set out in Sec.2(47) of the Act. Agreement to refrain from carrying on competing business does not fall within any of the modes of transfer as given in the definition of transfer u/s.2(47) of the Act. If the agreement to refrain from indulging in competition is part and parcel of the agreement for transfer of a business and the transferor agrees not to indulge in competition, then it can be said that right to carry on same or similar business was transferred alongwith the business. In the present case what was transferred was shareholding by the promoters. In such a situation there is no question of transfer of a right to carry on business. Therefore payments on account of non-compete fees cannot be brought to tax u/s.45 of the Act. We therefore hold that in the present case the proviso(i) to Sec.28(va)(a) of the Act will not apply. The provisions of Sec.28(va)(a) would apply and consequently the receipt in question would be chargeable to tax as business income and not under the head capital gain. We do not find any grounds to interfere with the order of the CIT(A). Consequently the appeal by the Assessee is dismissed.

14. In the result, the appeal by the Assessee is dismissed.

Order pronounced in the open court on the 7th day of Oct. 2011.

Sd/-	Sd/-
(T.R.SOOD)	(N.V.VASUDEVAN)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Mumbai, Dated. 7th Oct.2011

Copy to: 1. The Appellant 2. The Respondent 3. The CIT City –concerned
4. The CIT(A)- concerned 5. The D.R"D" Bench.

(True copy) By Order

Asst. Registrar, ITAT, Mumbai Benches
MUMBAI.

Vm.

	Details	Date	Initials	Designation
1	Draft dictated on	3/10/11		Sr.PS/PS
2	Draft Placed before author	4/10/11		Sr.PS/PS
3	Draft proposed & placed before the Second Member			JM/AM
4	Draft discussed/approved by Second Member			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			Sr.PS/PS
6.	Kept for pronouncement on			Sr.PS/PS
7.	File sent to the Bench Clerk			Sr.PS/PS
8	Date on which the file goes to the Head clerk			
9	Date of Dispatch of order			