* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

**Reserved on: 18.10.2012**
**Pronounced on : 30.11.2012**

\+ **ITA 602/2010**
**ITA 607/2010**
**ITA 921/2010**

THE COMMISSIONER OF INCOME TAX-XIII ……Appellant

Through: Ms. Rashmi Chopra, Sr. Standing Counsel.

Versus

SH. KANWALJIT SINGH …..Respondent

Through: Dr. Rakesh Gupta, Sh. Ashwani Taneja, Ms. Rani Kiyala, Sh. Piyush Singh and Ms. Ayushi Pareek, Advocates.

**CORAM:**
**MR. JUSTICE S. RAVINDRA BHAT**
**MR. JUSTICE R.V. EASWAR**

**MR. JUSTICE S.RAVINDRA BHAT**
**%**

1. The revenue claims to be aggrieved, in these three appeals, by a common judgment of the Income Tax Appellate Tribunal, and prefers these appeals under Section 260-A of the Income Tax Act. The substantial question of law urged, and which arises for consideration is whether the income from amount earned in terms of a non-Compete Agreement with

Uzind Corporation falls under the head of income from salary or income from business.

2. The brief facts are that the assessee was a General Sales Agent (GSA) of Uzbekistan Airways (UA)- Uzind Corporation (UC) and received a salary of ₹.1,32,000 per annum in that capacity. By a non-compete agreement (NCA) dated 15-03-2002, the assessee received an amount of 7% of the cargo freight and cost of tickets payable by UC to UA in addition to his regular salary. Under Clause 4 of the agreement, the commission payable to the assessee is separate from the remuneration given to him for other services provided by him to UC. It further stipulated that the relationship was on principal-to-principal basis, not intended to be construed as either a partnership or agency.

3. For assessment year 2003-2004, UC showed the non-compete fees as business expenditure and assessee was showing only a part of it (the amount actually received by him during each assessment year) as business income. The AO concluded that commission credited to the firm, UC was ₹. 8.47 crores, while the assessee had shown ₹.74 lakhs as business income, which was to be taxed as salary. The assessee carried the matter in appeal. The CIT (A) was of the opinion that by stating that there was no relationship of control or supervision over him, the assessee had admitted to being the *de-facto* owner of the firm. Thus entering into a non-compete agreement with a firm of which he was the *de-facto* owner was unnecessary and could be seen as measure to reduce the income of the firm. The assessee, by following a

separate method of accounting, only showed the amounts received by him from UC, while UC was claiming that the non-compete fee was business expenditure and was crediting the amount to him. Therefore, the CIT (A) concluded that characterization of the amount as non-compete fees was an attempt to reduce the tax liability and bring it under the head of business income of the assessee. The CIT (A) relied on a decision of the Madras High Court in *CIT v Abdul Wahid Madras High Court* 243 ITR 467 which held that the mere presence of two agreements did not imply that the payment under one was not salary, especially when all the work under it was performed for the benefit of the employer.

4. The Tribunal, by its impugned order, reversed the findings of the CIT (A). The Tribunal felt that none of the lower authorities disputed that commission received was for carrying out any activity that was related to the business. Thus the amount could only be assessed under the head of income from business. Further, an arrangement where the source follows the mercantile system of accounting and the recipient follows the cash system is well recognized and followed, and was thus not a colourable device to evade taxes. Since it is specifically assessable under Section 28 (va), it will be classifiable as income from business and not salary. Further, if UC continued to only show that the amount was credited without the assessee receiving the amount, the revenue has a right to enforce other remedial provisions in the hand of the firm to bring the amount not paid to tax. The Tribunal also based

its finding on the contractual clauses of the Non-compete agreement which stated that the relationship was not employer- employee relationship.

5. The revenue argues that the non-compete fee was part of 'salary' under Sections 16 & 17 of the Income Tax Act which includes, within its definition any fees, wages, commission, bonus, perquisite or profit in lieu of or in addition to salary. Thus the whole amount of fees received should have been taxed as income from salary. It was contended that the assessee had been paid salary by UC since its inception and the employer- employee relationship thus continued even after the non-compete agreement was entered into.

6. It was submitted that UC was nothing but a partnership firm of assessee's wife and daughter and the agreement was only entered into to camouflage this fact. The assessee had admitted to controlling the firm (All the employees receive directions from him and he is the authorized signatory to operate all the bank accounts.) It was emphasized that Section 28(va) only taxes that amount of the income earned by the assessee for the condition for not carrying out any business of which already had an enterprise. It could not thus apply when the assessee does not have any other business.

7. The assessee argued, on the other hand, that he was the controller of the business and not the two partners, who were his daughter and wife. Since the partners of the firm exercised no control and supervision over him, no employer- employee relationship existed. Since control was by him, it was his business and therefore the amount was business income. It was argued

that after the agreement was entered into, he began receiving amounts from UC in a dual capacity- salary in his capacity as an employee of UC and non-compete fees for not taking away business of the firm. Thus the assessee was entitled to receive the amount under the commission even after termination of employment with UC. Therefore, commission was paid out of a separate agreement which did not flow from the employer- employee relationship. It was thus taxable as a business income under Section 28(va).

8. It was also argued that the question as to under which head the income is to be charged has to be assessed in accordance to the addition of Section 28(va)(a) inserted by the Finance Act 2002, w.e.f. AY 2003-2004 which states that any amount received under an agreement for not carrying out any activity in relation to any business will be assessable as business income. Thus, as the amount received under the non-compete agreement fell squarely under this clause, it could not be taxed under any other charging section under the Act.

9. It can be discerned from the above that the controversy is whether the non-compete commission amount received by the assessee from UC amounted to business income, and not, as the revenue contends, salary income. Section 28 taxes "profits and gains of business or profession". The main ingredients for clause (i) to apply are that

(1) there should be a business or profession,

(2) carried on by the assessee,

(3) for some time during the previous year.

(4) The charge is in respect of the profits and gains of the previous year of the business and extends to any business or profession carried on.

10. In this case, the assessee has argued that he is the *controller* of the firm, which translates to him carrying on the business of the firm. Therefore, according to his showing, the control needed to establish an employer-employee relationship is absent. However, if that is correct then he cannot claim the ₹.1,32,000 received by him to be the salary paid by the firm to him in his capacity as an employee. Consequently, all the amounts received by him should be income from business. However, that is not what he contends. Apart from this anomaly, another unexplained factor is why the assessee had to enter into a non-compete agreement with a firm that he controls. In any case, it would have been taxed under the head "income from business" under Section 28 (va).

11. UC was deducting the amount being paid under the non-compete agreement as business expenditure. However, under Section 36 (1)(iii), any amount paid as a bonus, or commission to be deductible, must only be made to employees. According to the SC decision in *Shahzada Nand and Sons v CIT* (1977)108 ITR 358 (SC) [approving *Laxmandas Sejram v CIT* (1964) 54 ITR 763(Guj)], the expressions 'bonus' and 'commissions' under this clause also include payments made under a contract. Thus, in this case it could be applied to the payments being made to the assessee under the NCA. What then follows, is that if the deduction is to be allowed, the assessee must be an employee of UC. If this is so, then the amount received by him is

taxable in his hands under the head of income from salary. This Court in *CIT v Eicher Limited* in 2008 has also held payments made under a NCA to an employee to be a business expenditure. On the other hand, if the assessee is not an employee, and is in fact the controller of the firm, the deduction of the amount paid, as NCA, is impermissible, in the hands of the firm, though it can be taxed as his income from business.

In *Abdul Wahid*, the assessee had been paid commission through separate agreements for their efforts in securing export orders. It was held that mere presence of separate agreements did not mean that the commissions paid were not salary, especially when all the work under it was performed for the benefit of the employer:

> *"the two individuals therein, viz., K. Ameenur Rehman and B. Akbar Pasha were employees during the previous years relevant to these assessment years and had been paid salaries. In addition to salary, they were also paid commission. According to the assessee, the payment of commission was under a separate agreement, which was meant to remunerate them for the efforts put in by them in securing export orders for the company. The salary paid to them, according to the assessee was for the services rendered by them as employees. The assessee claimed that the commission paid had not been received by these two persons in their capacity as employees and therefore those payments were to be regarded as their business income and not as salary income..*
>
> ……. ……
>
> ...
>
> *9. The facts as set out in the order of the Tribunal and in the statement of the case before us, clearly show that these two individuals were the employees of the firm during the relevant period and they were paid*

*salary. A contract of employment necessarily involves the rendering of services by the employee to the employer and the use of his skill, energy and time for the benefit of the business in which he is employed. If the employer chooses to remunerate those services by adopting different measures for different aspects of the services received from the employee, the payments nevertheless retain the character of compensation to the employee for the skill, labour and the time put in by the employee for the benefit of the employer. The definition of salary in Section 17 of the Act is couched in wide terms to take into account the remuneration paid to the employee, whether it is labelled as salary or otherwise by the employer. It is not the label given to the payment that is determinative of the question as to whether it is salary. The definition of salary in Section 17(1) of the Act is an inclusive definition. Sub-clause (iv) of Section 17(1) of the Act makes a specific reference to commission paid in lieu of or in addition to any salary or wages. As observed by Lord Denning the words of the statute are ultimately to be regarded as decisive. When the language of the statute is plain and unambiguous, the width of its meaning cannot be cut down by importing the principles laid down in the cases decided under other statutes in the background of facts which are wholly dissimilar.*

*10. The commission paid to these two employees is to be regarded as part of the salary and the Tribunal was in error in holding otherwise. The mere fact that two agreements existed does not necessarily imply that the payment made under one agreement is not to be regarded as part of salary, when undisputably all the work done under the agreement was performed by the employee for the benefit of the employer. The fact that the employer utilised the same employee to perform different types of work under two separate agreements does not give to such payments a character other than that of "salary", having regard to the wide definition of the term in Section 17(1) of the Act. The Income-tax Officer was right in taking the view that the commission paid was part of the salary.*

12. The respondent failed to point out in what capacity the assessee was given the money from the NCA. The assessee admittedly, did not have a business of his own, and was being treated as an employee for the purposes of the deductions. The relationship must then continue for the purposes of deciding whether the amount received under the NCA is his salary or not.

13. In *CIT v P. Ramajayam* (2004) 186 CTR (Mad) 477 the assessee was engaged as a manager of a retail show store and was paid on a salary-cum- commission basis. The commission was given on the amount of sales made by him, but also had to incur the expenses involved in carrying out the obligations under the separate agreement. The court held in favour of the assessee because under the commission agreement, he had a great amount of freedom to exercise his duties, and would thus not qualify as being 'employed' under the agreement. Thus the income earned from the second capacity under the contract for service, would not be taxed under the head 'income from salary'.

14. The *ratio* of the above case would be inapplicable in this case as the second capacity in which the assessee earned the commission from the NCA cannot be established. The assessee continued to earn the non-compete commission in his capacity as an employee, to refrain from carrying on any business similar to that of UC. The assessee, in this case, also continued his employment with the firm, and was given commission for doing what he was normally expected to do, i.e. work for the said firm in his area of expertise. He was given salary for that; in addition, he was also given

commission for *not competing* with his employer, during his employment, in regard to the same line of business, in which he worked as an employee of the firm. Therefore, the commission amount clearly was part of salary answering the description under the inclusive definition under Section 17 of the Act.

15. In view of the above discussion, the question of law is answered in favour of the revenue, and against the assessee. The appeals consequently succeed, and are allowed.

**S. RAVINDRA BHAT, J**

**R.V.EASWAR, J**

**NOVEMBER 30, 2012**