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आयकर अपीलीय अधिकरण, 'सी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH, CHENNAI

श्री धुव्वुरु आर.एल रेड्डी ,न्यायिक सदस्य एवं श्री जीमंजुनाथ ., लेखा सदस्य के समक्ष
BEFORE SHRI DUVVURU RL REDDY, JUDICIAL MEMBER AND SHRI G. MANJUNATHA, ACCOUNTANT MEMBER

आयकर अपील सं./**ITA No.: 3454/CHNY/2019**
निर्धारण वर्ष / Assessment Year: 2007-08

M/s. Sai Mirra Innopharm Private Limited, 51, 3rd Floor, Tower C, Tek Meadows OMR, Shozhinganallur, Chennai – 600 119. **PAN: AAECS3152L**	v.	The Income Tax Officer, Corporate Ward – 2(3), Chennai.
(अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by : Shri Y. Sridhar, CA
प्रत्यर्थी की ओर से/Respondent by : Ms. R. Anitha, JCIT

सुनवाई की तारीख/Date of Hearing : 12.01.2021
घोषणा की तारीख/Date of Pronouncement : 08.02.2021

आदेश /O R D E R

Per G. MANJUNATHA, AM:

This appeal filed by the assessee is directed against the order of the Commissioner of Income Tax (Appeals)-15, Chennai, dated 30.10.2019 and pertains to assessment year 2007-08.

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2. The assessee has raised the following grounds of appeal:-

"The assessment was completed u/s 143(3) r.w.s 147 of the Income Tax Act on 28.12.2013 by allegedly treating the capital receipt as revenue receipt to the extent of Rs.6,00,00,000/-, The CIT(A) upheld the order passed by the Deputy Commissioner of Income Tax vide his order dt .30.10.2019.

The present appeal is towards the addition made u/s 148

1 The Ld. CIT(A) has erred in the facts and circumstances of the case.
2. Further, the CIT(A), erred in confirming the addition made by the AO to the extent of Rs.6,00,00,000/- u/s 28(va).
3. The order of CIT(A) is arbitrary, unjust and untenable in law.
4. The addition of Rs. 6,00,00,000/- u/s 28(va) is arbitrary, unjust and bad in law. In this regard, the appellant wishes to submit as under:

On Jurisdiction:
1. In this connection it is respectfully submitted Ld.CIT(A) has failed to consider the arguments put forward at the time of hearing and in the written submissions, fairly, judicially on jurisdiction of the issue, the copy of the same is reproduced as below:

a. There is no valid reason for again re-opening the same assessment for the second time, as it was evident that all material, they relied upon were already made available to them during the first assessment itself.
b. The appellant has submitted more than 30 items of details/documents in the first hearing during the assessment proceedings. We enclose herewith the copy of the notice received from AO and submissions made for the same.
c. The submission includes "Notes to Accounts" and "Tax Audit Report". The appellant has reported about the accounting treatment of money received for cancellation of manufacturing contracts in Note No: 10. Further in the Tax Audit Report also the same is reported under "Amount not credited Profit & Loss A/c" and treated as Capital Receipt.
d. In the absence of "any tangible material" to come to the conclusion that there was escapement of income from assessment, the Ld. assessing officer has exceeded his authority to re-open the assessment merely on the basis of "change in opinion".

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e. The appellant wishes to rely on the following case laws:

(i) As the reassessment proceedings without new material but solely on change of opinions, would not be valid [Asian Paints Ltd. V DCIT (2009) 308 ITR 195 (Born).]
(ii)Assessing Officer is not empowered to review on the same set of facts, the assessment order which had already been framed by application of mind, of his own decision or the decision of predecessor CIT Vs. Kelvinator of India Ltd. (2010) 320 ITR 561.
(iii) Difference between Power to review and power to reassess. Change of opinion not a basis of reopening even within 4 years. Rite Investments (P) Ltd., Vs. DCIT 345 ITR 214 (Del).

f. There is a well-known difference between a wrong claim made by an assessee after disclosing all the true and material facts and wrong claim made by the assessee by withholding the material facts. However, in the case of an appellant there is neither wrong claim nor act of non-disclosure of true and material facts before the AO which is dealt in detail on merits of the case.

2. Further it is submitted that the CIT(A) has observed in para No. 6.2 of his order stated that "under normal circumstances the receipt of Rs. 6,00,00,000/- has to be considered as an exceptional item and should be properly disclosed in the financial by way of notes to Accounts. The assessee did not route the receipt of compensation through profit and loss Account and credited the same straight away to Capital reserve and disclosed it in Balance sheet as Capital reserve, whereas the same was shown in schedule B of Balance sheet for the assessment 200 7-08. It is evident from the reasons recorded for reopening is as follows: as seen from the schedule B, the same was capital reserve accumulated during the year amounting to Rs. 8.75 crores. Further, it was observed from the schedule to notes on accounts- item No. 10 and 8 of separate P&L Accounts of SaiMirra Innopharm Private Limited and SaiMirra pharmaceuticals Private Limited respectively that Capital reserve represents compensation received from one of its major customer towards pre-closure of ten years manufacturing agreement."

3. The above schedule was available with the Assessing Officer when the original assessment was completed. Thus the appellant disclosed fully and truly all the materials relevant to the assessment for the Assessment year

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2009-10. After taking into considerations of the above schedule of the Balance Sheet which represents the Capital Accumulation of Rs. 8.75 crores, the AO completed the original assessment u/s 143(3).

a. CIT(A) erred in recognizing a capital receipt as "Extra-ordinary item" or "exceptional item" and deciding it as a revenue receipt. "Extra-ordinary item" or "exceptional items" are those that revenue in nature but not directly resulted due to current year normal operations. Hence, the same should be reported as below line item and will not fonn part of current period profit/loss it will be treated as part of Net Profit. Please refer Guidance Note of ICAI on the Schedule III to the Companies Act, 2013 para 9.6 and para 9.7,which explains the criteria for treating an item as "Extra-ordinary" or "exceptional".

b. Further the method of accounting treatment followed by the appellant for Capital Receipt justified based on the following decisions:
(i) Karnal Co-Operative Sugar Mills Limited vs CIT (SC)
(it) CIT vs. Bokaro Steel (SC)
(iii) CIT vs. Karnal Co-operative Sugar Mills Limited (SC)
(iv) CIT vs. Karnataka Power Corporation (SC)

4. In view of the above one cannot conclude that the assessee has failed to disclose fully and truly all the material facts necessary for the completion of assessment. Hence, this constitutes only the change of opinion and the reassessment proceeding intiated u/s 147 without new material is invalid

In view of the above submissions and case laws cited, the order passed u/s 143(3) r.w.s. 147 is invalid.

<u>On Merits:</u>

1. The' Ld. CIT(A) has erred in facts and circumstances of the case:

2. The Ld. CIT(A) erred in confirming the addition of Rs.6 Crores made by the AO allegedly treating capital receipt as a revenue receipt.

3. The Ld. CIT(A) failed to note that the amount of Rs.6 Crores represents amount received by the appellant company from M/s.Dr.Reddy's Laboratories Limited, for pre-closure of its 10 years manufacturing agreement.

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4. It is neither capital gain u/s 55 nor a non-competing Fees as envisaged u/s 28(va)(a). In this connection, it is respectfully submitted that Ld. CIT(A) has failed to consider the arguments put forward at the time of hearing and written submissions, fairly and judiciary. A copy of the same is produced as below, may kindly be treated as part of these ground.

5. The compensation was received for breach of contract is being treated as capital in nature for the reason that the receipt is for compensating the loss of source of income and therefore is outside the purview of income tax.

6. The Manufacturing agreement by us Viz., M/s.Saimirra Innopharm Pvt. Ltd was entered on 14.04.2000 with M/s.Dr.Reddy's Laboratories Ltd for a period of 10 years. Subsequently, Dr.Reddy's Laboratories Ltd terminated the contracts before the completion of contracted period for their business reasons and demanded us to surrender all the information and manufacturing licenses of the products produced for them. As a result our company incurs huge cash losses due to loss of major source of income.

7. It is held in the case of CIT vs Pane Soft Drinks (2018)400 ITR 108(Bom) that "Compensation for breach of contract resulting in loss of source of income f emanating from termination of a business contract is not a capital gain/business income but a non- taxable capital receipt ". It is to be noted that the decision of the Bombay High Court was upheld by the Hon'ble Supreme Court -(2018) 97 taxmann.com 136(SC).

8. In this case, there is a breach of contract giving rise to claim for damages and the compensation was paid on account of failure to honor the commitment which is capital in nature.(10 Years Manufacturing Agreement).

9. This compensation is for extinction of right to sue which is a capital receipt not chargeable to tax.

10. The Ld.CIT(A) has noted that as the appellant has entered into another agreement with Dr.Reddy's Lab, on similar conditions on 20/11/2006 for a period of TWO months after termination of the manufacturing agreement in September 20006.Based on this the CIT(A)A has concluded the receipt as Revenue Receipt. However, CTT(A) also has

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noted certain conditions mentioned in the termination agreement about, surrender of Licenses, non manufacture of similar products by SMI or its promoters etc., In this context it is permanent to understand the business model that is prevailing the pharmaceutical industry based on which it can be clearly seen that the termination of manufacturing contract by Dr. Reddy lab has resulted in permanent impartment of revenue / profit generating apparatus of the appellant.

11. Domestic Pharmaceutical Industry is mainly divided as contract manufactures and Generic Brand owners. Indian pharmaceutical products are known as generic branded formulations, which is sold under a brand (Brand Name), the ownership of which is with the company which is marketing the brand. During the period under discussion, the Drug Controller accord licenses for the brand for manufacturing. To get a Drug License for the product at a manufacturing facility, the manufacturer has to manufacture sample batches and submit the data to the regulator along with its analytical reports etc., Regulator does an audit of the manufacturing practices of the manufacturer and accord approval for manufacturing of a product under a particular brand. This is the reason for which most of the manufacturing contracts are entered for long term period as shifting of product from one manufacturing site to another takes a long time. During which time the brand owner's sales will be affected, if it stopped over night.

12. The Ld.CIT(A) further noted that the agreement does not cover the aspect of relinquishing appellant's rights under the agreement. However, it can be seen from para 28 which clearly states that the appellant "shall not make any further claims, demands, and disputes" against Dr. Reddy's Lab, which expressly confirms that the payment under the termination agreement is for relinquishing the right of the appellant under the manufacturing contract.

13. The Ld. CIT(A) has also noted that the receipt under the termination agreement is towards Non-Compete Fee, where there are many other terms, conditions and obligations on that are to be met by the appellant under the agreement, which also constitutes the obligations for the appellant. The restrictions is applied only to a limited extent of non production of similar products by the appellant for the period up to 2010, which means for the remaining period of original manufacturing contract.

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There is no restriction on appellant continuing with the business of manufacturing pharmaceutical products and other related activities.

14. In order to bring in to tax net all compensations (including right to sue), a new section28(ii)(e) introduced w.e.f. AY 20 19-20. The compensation received in this case is chargeable to tax u/s 28(ii)(e) only. However, the same was introduced with effect from AY 2019-20 only and does not apply to the year under consideration.

15. In view of the above submissions, compensation received by the appellant is not taxable u/s 28(va).

16. Further the compensation is only to avoid litigation connected with the agreement, further it is in lieu of cancellation of manufacturing contract which is a revenue generating stream of activity.

17. The assessee received the compensation under agreement for relinquish his right to sue in contract agreement. The property asset was not transferred to the assessee. Hence this transaction is outside the scope u/s 2(47) of IT Act. The following case laws are relied in this regard:

> *a. M/s Chheda Ho-using development corporation vs Addln CIT ITAT Mumbai in ITAT No 86/Mum/2017 dated 29/05/2019*
> *b. Bhojison Infrastructure P Ltd Vs. ITO (ITATAhmedabad) dated 1 7/09/2018 inITA 2449/Ahd/2016.*

18. The Appellant has not received the amount under agreement for not to share in knowhow, copyright, Patent, trademark, license as specified u/s 28(va) of act enacted for its taxability under the head of business income.

19. Hence, considering all the above facts, it can be seen that the compensation received by the appellant for termination manufacturing agreement by Dr. Reddy's Lab is towards loss revenue/profit generating apparatus from the appellant and is capital in nature.

20. Further the note on distinction between s 28(va) and 28(ii)(e) filed during the course of appellate proceedings as under has not been considered by CIT(A). The same is reproduced below:

Note on distinction between Section 28(va) and 28(ii)(e)

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Section 28(va) of the Income Tax is reproduced below:
"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; or (b) not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services: 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"; (ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India ".

In this case the appellant received Rs. 6,00,00,000/- from M/s. Dr. Reddy 's Laboratories Limited for pre closing 10 years manufacturing agreement. The compensation was received under agreement for breach of contract for giving rise to claim for damages, for the loss of source of income and for relinquish his right to sue in contract agreement. Hence, this compensation does not fall under the category of Section 28 (va) (a) i.e., not carrying out any activity in relation to any business or Section 28 (va)(b) i.e., not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

In the given case, the appellant is only a contract manufacturer of Dr. Reddy 's Laboratories Limited with the inputs given by them viz., their know-how, patent, trademarks, and speculation of pharma products. Thus, the appellant is not owning any know-how, patent and trademarks, Further, the appellant is not restricted to carry out his business being a manufacturer of pharma products. (emphasis supplied). Whereas, Section 28(va) speaks about "not carrying out any activity in relation to any business; or (b) not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business

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or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services. "Since, the appellant is not compel to quit business (as per the Termination Agreement) as envisaged in Section 28(va) nor appellant posses any know-how, patent and trademarks, the said provision is not applicable to the appellant. Rather, the appellant is only prohibited to use know-how, patent and trademarks of Dr. Reddy Laboratories Limited.

However, the above compensation falls under the category of a new Section 28(ii) (e) introduced w.e.f AY2019-20.

Section 28(ii)(e)
"any compensation due or received by any person, by whatever name called, at or in connection with the termination or the modification of the terms and conditions, as the case may be, of any contract relating to his business shall be chargeable to tax under the head "Profits and gains of business or profession. "(emphasis supplied).
A new sub clause (e) has been added to section 28(ii) to bring into tax net gains / receipts in the nature of compensation arising out of termination / modification of a contract related to business of the assessee.
Earlier the compensation received for breach of contract was being treated as capital in nature and hence was outside the taxable net for the reason that the receipt was for compensating the loss of source of income. Now the compensation received or receivable in connection with termination of contract would become taxable irrespective of whether it is capital or revenue in nature.
In the case of Baroda Cement and Chemicals Ltd (1986) 158 ITR 636 (SC) it is held that the compensation received for not suing the vendor was a capital receipt. Since, right to sue was given up which is not a transferrable right and hence not chargeable to Capital Gain Tax.
Now as per the amendment, the compensation in connection with termination of contract is taxable u/s 28(ii)(e) of the Act.
Now if such compensation receivable as the right to sue in relation to business contact then such sum could become taxable.
The amended provision goes a step further and provides for taxability of all compensation therefore even giving up source of income would now become taxable.

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From the above submissions it is clearly evident that the compensation received from Dr. Reddy laboratories limited falls under the category of Section 28(ii)(e). However, the same was introduced with effect from AY 2019-20 and it is applicable prospectively only, hence it does not apply to the year under consideration.

21. For the above reasons and other reasons that may be adduced at the time of hearing, the addition made by the Assessing Officer may kindly be deleted and justice be rendered.

22. The Appellant craves leave to amend, alter or delete any of the above grounds of appeal."

3. The brief facts of the case are that the assessee is a private limited company engaged in the business of manufacturing and marketing of pharmaceutical products, filed its return of income for assessment year 2007-08 on 31.10.2007 declaring loss of Rs.6,01,45,065/-. The assessment for the impugned assessment year was completed u/s.143(3) of the Income Tax Act, 1961 (hereinafter the 'Act') on 15.12.2009 and determined total loss at Rs.3,00,43,396/- by inter-alia making addition of Rs.3.01 crores towards disallowance of expenditure u/s.40(a)(ia) of the Act and disallowing long term capital loss claimed by the assessee of Rs.4,20,058/-. The case has been subsequently reopened u/s.147 of the Act for the reasons recorded as per which, income chargeable to tax had been escaped assessment within the meaning of Section 147 of the

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Act and accordingly notice u/s.148 dated 23.03.2012 was issued and served on the assessee. The case was taken up for scrutiny and during the course of assessment proceedings, the AO, called upon the assessee, to explain as to why amount received from Dr.Reddy's Laboratories Ltd., for termination of contract manufacturing agreement cannot be assessed as profits liable to be taxed u/s.28(va)(a) of the Act. In response, the assessee submitted that the company had entered into a contract manufacturing agreement with Dr. Reddy's Laboratories Ltd., for manufacturing of drugs for a period of 10 years. Further, Dr. Reddy's Laboratories Ltd terminated the contract before completion of contract period for their business reasons for which they have paid a sum of Rs.6 crores for loss of investments made in manufacturing facilities as well as loss of profit from the business. The assessee further submitted that, since amount received from Dr. Reddy's Laboratories Ltd., is in the nature of capital receipts, the sum has been credited directly to 'reserves and surplus' account. Therefore, it cannot be considered as profits liable to be taxed under the provisions of Section 28(va)(a) of the Act. The AO, however, was not convinced with the explanation furnished by the assessee and according to him, amount received for termination of manufacturing agreement is

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in the nature of a non-compete fee which falls under the purview of provisions of Section 28(va)(a) of the Act. He, further noted that as per the provisions of Section of 28(va)(a) of the Act, any sum received or receivable in cash or kind under an agreement for not carrying out any activity in relation to any business shall be chargeable to Income Tax under the head 'profits & gains of business operation'. Therefore, he opined that compensation received from Dr. Reddy's Laboratories Ltd., towards pre-closure of manufacturing agreement directly relates to the business of the assessee and should be treated as revenue receipts and accordingly rejected various case laws cited by the assessee and made addition of Rs.6 crores u/s.28(va)(a) of the Act.

4. Being aggrieved by the assessment order, the assessee preferred an appeal before the CIT(A). Before the CIT(A), the assessee has challenged re-opening of assessment on the ground that reopening of assessment is not on valid ground, because the AO has formed reasonable belief of escapement of income on the basis of return of income filed by the assessee without reference to any 'tangible material' which comes to his possession subsequent to the date of original assessment proceedings, which is evident from the fact that the reasons

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recorded by the AO clearly states that the AO has formed reasonable belief of escapement of income on the basis of return of income filed for the relevant assessment year. The assessee has also challenged addition made by the AO on merits in light of certain judicial precedents including the decision of Hon'ble Supreme Court in the case of CIT vs. Parle Soft Drinks (Bangalore) P. Ltd., (2018) 400 ITR 108 (Bom) and argued that compensation for breach of contract resulting in loss of source of income is not capital gain / business income, but a non-taxable capital receipt. The assessee further submitted that, in order to bring into tax compensation received for termination of contract, it should be in the nature of non-compete fee for compensating for surrender or non-using of technical know-how which can be brought to tax, but compensation paid for loss of business cannot be brought to tax before amendment to Section 28(ii)(e) of the Act w.e.f., assessment year 2019-20.

5. The ld.CIT(A) after considering relevant submissions of the assessee and also by relying upon certain judicial precedents, rejected legal ground taken for challenging reopening of assessment on the ground that there is no merit in arguments of the assessee that the assessment has been reopened on mere

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change of opinion, because the assessee has failed to file any evidences to prove that it has disclosed fully and truly all material facts necessary for completion of assessment. He further observed that on verification of assessment order dated 15.12.2009, it was noticed that there is no discussion or reference about the issue of compensation received from Dr. Reddy's Laboratories Ltd., and hence, it cannot be said that the AO has formed an opinion and allowed the claim while framing the assessment order u/s.143(3) of the Act. In the absence of evidence to prove that necessary materials have been placed before the AO at the time of assessment proceedings, it cannot be said that the assessment has been reopened on mere change of opinion. Accordingly, rejected legal ground taken by the assessee.

6. As regards, addition towards compensation of Rs.6 crores as revenue receipt, the ld.CIT(A) after taking note of various clauses of manufacturing agreement with Dr. Reddy's Laboratories Ltd., and subsequent termination agreement, came to the conclusion that amount received for termination of agreement constitute income chargeable to tax u/s.28(va)(a) of the Act, because the same is in the nature of non-compete fee

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for not using the technical know-how provided by Dr. Reddy's Laboratories Ltd., for manufacturing of drugs as per the terms of contract. Therefore, he opined that compensation received for termination of contract is in the nature of revenue receipt and AO has rightly taxed the same u/s.28(va)(a) of the Act. The relevant findings of the ld.CIT(A) are as under:-

"6.1. Reopening of assessment bad in law:
In this case, the appellant has agitated the issue relating to reopening of assessment after a period of four years where regular assessment u/s 143(3) was completed by the Assessing Officer. It is the appellant's contention that there is no fresh material brought on record to justify the reopening of assessment and therefore this constitutes change of opinion on the part of the Assessing Officer.

62. The order u/s 143(3) dated 15.12.2009 has been verified in detail. There is no discussion or reference anywhere in the assessment order about the receipt of Rs.6 crores towards compensation. The appellant did not submit any proof during the course of assessment proceedings to show that the appellant had submitted complete details on the receipt of compensation to the Assessing Officer. On the other hand, there was enough material to suggest that the appellant had failed to disclose fully and truly all material facts relevant for computing the assessable income. This is evident from the fact that the assessee did not route the receipt of compensation through the profit and loss account and credited the same straightaway to the capital reserve and disclosed it in the balance sheet as capital reserve which was nil as at the beginning of the year. This receipt of Rs.6 crores is a one-time event and constitutes one sixth of the total revenues disclosed in the financial. The accounting policies also do not throw any light as to the creation of this capital reserve. Under normal circumstances, such a receipt has to be considered as an exceptional item and should be properly disclosed in the financial by way of Notes to Accounts. For these reasons, there cannot be any hesitation in holding that the assessee had failed to disclose truly and fully all the material facts necessary for the completion of assessment. In order to constitute change in opinion', the assessment earlier made must, either expressly or by

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necessary implication, convey an opinion on the issue which becomes the basis for the reason to believe in the subsequent reopening of assessment. Therefore, the AO's re-opening of assessment is upheld and this ground is dismissed.

6.3. Addition of compensation of Rs.6 crores as revenue receipt:

On the above issue, the sequence of events evidenced by documents is delineated hereunder:

(a) Appellant is a contract manufacturer of pharmaceutical items for Dr. Reddy's Laboratories Ltd. The Manufacturing Agreement dated 14.04.2000 was entered into to give effect to this arrangement. The appellant agreed to manufacture for Dr.Reddy's Laboratories, the products agreed as per Schedule A to the agreement. This agreement underwent periodical changes by entering into various agreements in subsequent periods, viz, agreement dated 25th May, 2005 and Agreement dated 17th May 2006 labeled as Supplementary Agreements. This arrangement came to an end through a Termination Agreement dated 25.09.2006.

(b) Para 24, Page 9 of the Agreement refers to a sum of Rs.600 lakhs payable by Dr. Reddy's Laboratories to the appellant. Termination Agreement includes Shri V S Raaman as one of the parties to the agreement who is referred to as VSR, who is the Chairman and Managing Director of Sal Mirra Group of Companies. The agreement also ropes in another entity viz,, M/s Sal Mirra Pharmaceuticals P Ltd. (SMPPL).

(c) In Para 6 of page 3 of the Agreement it was mentioned that

> "Dr. Reddys has terminated all other business arrangements with MIs Sal Mirra for business reason and demanded return of all information and manufacturing licenses."

(d) In Para 7, it is mentioned that Sal Mirra had disputed the termination and claimed vide letter dated 17.02.2006 and in their personal meeting on 13.03.2006 it was contended that the termination of the agreement was premature and will result in huge losses to the tune of Rs. 12 crores during the balance period for the Principal Agreement from April 2006 to April 2010 as it has invested huge amounts in infrastructure, man power

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and other operational commitment based on the principal agreement assurances and promises made by Dr. Reddys.

(e) In Page 4 of the Agreement, it is mentioned as under:

"Termination of Principal Agreement:
All principal agreements executed between M/s Sai Mirra and Dr. Reddys hereby stand terminated effective from April 1 2006.
In Para 4 Sai Mirra and VSR agreed to issue a No Objection Certificate in the agreed format (Annexure III) appointing any other contracting manufacturer other than Sai Mirra or its affiliate or manufacture the same on its own, for manufacture of the products covered under the principal agreement

(f) In Page 6 in Para 12 of the Agreement under the head Non-compete, it is mentioned as under:

> "Sal Mirra and VSR shall not directly or indirectly manufacture finished dosage formulations similar to products using the information till 31.03.2010 or use receptively similar brand names or trademarks to those of Dr. Reddys. Sai Mirra and VSR shall not do any act which is prejudicial to the interest of Dr Reddys."

M/s Sai Mirra and 1/SR agrees that the restrictions hereunder are fair and reasonable.

(g) In Page 9, In Para 24 under the head full and final settlement, it is mentioned as under:

> "In consideration of the obligations of Sai Mirra hereunder and the full and final settlement of all claims of Sal Mirra, Dr Reddy's has agreed to pay a sum of Rs.600 lakhs.

6.4. After going through the above terms and conditions, it is clear that after the claim of termination of the agreements in September 2006, the appellant once again entered into the manufacturing and supply agreement on 20.11.2006 with the same Dr Reddy's Laboratories Ltd. This agreement in pari materia provides for the continuance of the same arrangement that was in place prior to the termination of the earlier agreements entered into. It therefore does not stand to reason as to why the existing arrangement was brought to an end through a claim of Termination Agreement and the same was revived through another

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agreement entered within a period of two months after paying a lumpsum of Rs.6 crores treated by the appellant as a non- revenue receipt liable to be credited to the capital reserve.

6.5. In the light of the factual matrix brought on record, the point that requires adjudication is whether the sum of Rs.6 crores received by the appellant would constitute income chargeable to tax and if so whether the same would fall within the provision of Sec. 28(va)(a) of the Income tax Act. The host of case laws relied upon by the appellant have been rightly distinguished by the Assessing Officer as these decisions have no application for the reason that they have been rendered prior to the insertion of Sec 28(va)(a) viz,, w.e.f.01.04.2003. The Assessing Officer is right in rejecting the contentions of the appellant on this ground.

6.6. it is the appellant's contention that the Termination Agreement and the monetary consideration arising therefrom are in the nature of liquidated damages for breach of contract on the part of Dr Reddy's Laboratories and for the appellant's loss of source of revenue and for relinquishing the appellant's right to sue in pursuance to an agreement. These facts are not borne out by any of the recitals in the various principal agreements referred to earlier. On the contrary, in Page 6 of the Agreement, there is a separate clause which clearly stipulates the terms and conditions for payment of non- compete fee. Therefore, it has to be held that the compensation is in the nature of non compete fee taxable rightly u/s 28(va)(a) as revenue receipt and therefore the addition of the Assessing Officer in accordance with law is confirmed. Therefore, this ground is dismissed."

7. The first issue that came up for our consideration from assessee's appeal is reopening of assessment u/s.147 of the Act.

7.1 The ld.AR for the assessee submitted that reopening of assessment is bad in law and liable to be quashed, because there is no valid reason for reopening of assessment, which is evident

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from the fact that the AO has formed reasonable belief of escapement of income on the basis of 'Notes to Accounts' and 'Tax audit report' filed by the assessee along with return of income which were very much available at the time of assessment proceedings. The ld.AR further submitted that the formation of belief by the AO is not based on any tangible material which came to his possession subsequent to completion of assessment. Therefore, in absence of any fresh tangible material if assessment is reopened, then it is a case of mere change of opinion, which is not permissible under the law. In this regard, the ld.AR relied upon the decision of Hon'ble Supreme Court in the case of CIT vs. Kelvinator India Ltd., (2010) 320 ITR 561. The ld.AR has also relied upon the decision of Bombay High Court in the case of Asian Paints Ltd. vs. DCIT, (2009) 308 ITR 195 (Bom).

7.2 The ld.DR, on the other hand strongly supporting order of the CIT(A) submitted that the AO has formed reasonable belief of escapement of income on sound footing, which is based on 'tangible material' which may come from outside or which may be available within the assessment records, but there should be some material which suggest escapement of income. In this

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case, the AO has formed reasonable belief on the basis of tangible material which suggest escapement of income and hence there is no merit in the arguments of the assessee that reopening of assessment is bad in law.

7.3 We have heard both the parties, perused the materials available on record and gone through the orders of the authorities below. The assessment for the impugned assessment year has been reopened within 4 years from the end of the relevant assessment year. Therefore, when the assessment has been reopened within 4 years from the end of the relevant assessment year, then the proviso to Section 147 has no application. That means, even if the assessee has disclosed materials necessary for assessment that does not make any change in position of law regarding reopening because, when the assessment has been reopened within 4 years, the point that needs to be considered is whether the assessment has been reopened with any tangible material which come to the possession of the AO subsequent to original assessment which suggest escapement of income or not. In this case, the AO has formed reasonable belief of escapement of income on the basis of tangible materials which suggest escapement of income within

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the meaning of Section 147 of the Act. No doubt, the material may be within the file of the AO. But, in order to see whether assessment has been reopened on mere change of opinion or not, the point that needs to be considered is whether the AO has considered the issue or not, at the time of original assessment proceedings. In this case, on perusal of assessment order passed u/s.143(3) of the Act on 15.12.2009, we find that there is no discussion of whatsoever in the assessment order regarding the issue of compensation received for termination of contract. Further, the assessee has also failed to file any evidence to prove that it has furnished necessary details about receipt of compensation to the AO. In absence of any evidence to prove that all materials necessary for completion of assessment were placed before the AO, it cannot be said that the AO has considered the issue and formed an opinion on the issue. Unless, the AO has formed an opinion on the issue on the basis of materials furnished by the assessee, then it cannot be said that the assessment has been reopened on mere change of opinion. We, therefore, are of the opinion that there is no merit in the arguments taken by the assessee challenging reopening of assessment. In so far as, various case laws cited by the assessee including the decision of Hon'ble Supreme Court in the

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case of CIT vs. Kelvinator India Ltd., *supra,* we find that those case laws are not applicable to facts of present case and hence, are not considered. Hence, we reject the ground taken by the assessee challenging reopening of assessment.

8. Coming to the issue on hand, the AO has made addition towards compensation received for termination of manufacturing agreement u/s.28(va)(a) of the Act, on the ground that any sum whether received or receivable in cash or kind under agreement for not carrying out any activity in relation to any business shall be chargeable to Income Tax under the head 'profits and gains of business or profession' for not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

8.1 We have gone through the reasons given by the AO in light of various evidences filed by the assessee, including the agreement between the parties and subsequent termination agreement dated 25.09.2006. On perusal of details filed by the assessee, we find that the assessee has entered into a contract

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manufacturing agreement with Dr.Reddy's Laboratories Ltd., for a period of 10 years for manufacturing of drugs as per the specification provided by the principals, but the know-how required for manufacturing of drugs is not possessed by the assessee. Subsequently, Dr.Reddy's Laboratories Ltd., has terminated the contract before the completion of contract period for the reasons best known to them and demanded the assessee to surrender all the information and manufacturing license for the products produced for them. As a result of this, the assessee company has incurred huge loss in the form of investments made for manufacturing facilities as well as loss of profit from the business for which Dr.Reddy's Laboratories Ltd., has compensated the assessee for such loss and paid a sum of Rs.6 crores in the impugned assessment year. The case of the assessee was compensation received from Dr.Reddy's Laboratories Ltd., is for loss of investments made in manufacturing facility and loss of profit from the business, but not a non-compete fee as referred to u/s.28(va)(a) of the Act, for surrendering technical know-how used for manufacturing of drugs. Therefore, in order to understand whether amount received for termination of manufacturing agreement is in the nature of non-compete fee as referred u/s.28(va)(a) of the Act,

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or a loss of profit from business which can be brought to tax u/s.28(ii)(e) of the Act has to be understand. As per Section 28(ii) of the Act, any compensation or other payment due to or received by an assessee can be brought to tax and such nature of receipts has been defined in sub-clause (a) to (d). Further, sub-clause (e) has been inserted by Finance Act, 2018 w.e.f., 01.04.2019 as per which *"compensation by whatever name called in connection with the termination or the modification of the terms and conditions, of any contract relating to his business can be brought to tax as "Profits and gains of business or profession""*. From this, it is very clear that up to assessment year 2019-20, compensation received for termination of any agreement cannot be taxed u/s.28(ii)(e) of the Act. In this case, the compensation received pertains to previous year before the amendment to Section 28(ii)(e) of the Act. Therefore, the said amount cannot be brought to tax as compensation or any other payment due to or received by any person by whatever name called in connection with termination of terms and conditions of any contract u/s.28(ii)(e) of the Act.

8.2 Having said so, let us examine whether the same falls within the ambit of Section 28(va)(a) of the Act. The provisions

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of Section 28(va)(a) of the Act, deals with any sum whether received or receivable in cash or in kind under agreement for not carrying out any activity in relation to any business for not sharing any know-how, patent, copyright, trade-mark, license, etc. In the present case, from the facts available on record, it is abundantly clear that the assessee acts as a contract manufacturer for drugs and the specification of such drugs has been provided by Dr.Reddy's Laboratories Ltd. Further, the agreement dated 14.04.2000 clearly states that the assessee was in the business of manufacturing and selling of pharmaceutical products and has also necessary facilities and infrastructure required for the manufacture of said products, but has not possessed the know-how required for manufacturing of goods. From the above, it is very clear that the technical know-how required for manufacturing of drugs is supplied by Dr.Reddy's Laboratories Ltd. Further, when the assessee is already in the business of manufacturing and distribution of pharmaceutical products and is not having necessary know-how for manufacturing of drugs to be supplied to Dr.Reddy's Laboratories Ltd., as per the agreement between the parties, the amount paid for termination of contract cannot be brought to tax u/s.28(va)(a) as non compete fee for not using any know-how,

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patent, copyright and trade-mark etc. Therefore, we are of the considered view that compensation received by the assessee under agreement for breach of contract for giving rise to claim for damages is for the loss of source of income and for relinquish his right to sue in contract agreement. Hence, said compensation does not fall under the purview of Section 28(va)(a) of the Act. We further noted that in the given case, the assessee is only a contract manufacturer with inputs given by the principals. Thus, in our considered view the assessee is not owning any know-how, patent and trade-mark required for manufacturing of goods. Consequently, compensation paid for pre-closure of manufacture agreement cannot be brought to tax u/s.28(va)(a) of the Act, because the same is not in the nature of compensation or any sum paid for not carrying out any activity in relation to any business or not sharing any know-how, patent, copyright, trade-mark, license or any other business or commercial right, which is evident from the fact that even after the termination of agreement with Dr.Reddy's Laboratories Ltd., the assessee continue to manufacture and distribute pharmaceutical products.

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8.3 Coming to case laws relied upon by the assessee, the assessee has relied upon the decision of Hon'ble Bombay High Court in the case of CIT vs. Parle Soft Drinks (Bangalore) P.Ltd., where the Hon'ble Court under identical set of facts held that compensation received for breach of contract would be a capital receipt. The matter has been reached to the Hon'ble Supreme Court by way of SLP filed by the Revenue and the Hon'ble Supreme Court in CIT vs. Parle Soft Drinks (Bangalore) P. Ltd., (2018) 97 taxmann.com 136 (SC) upheld the order of the Hon'ble Bombay High Court and dismissed the SLP filed by the Revenue. Therefore, from the above it is very clear that any compensation received for termination of manufacturing agreement is in the nature of capital receipt for loss of investment in business or loss of profit from business but, it cannot be treated as revenue receipts liable to be taxed u/s.28(va)(a) of the Act. For better understanding, the findings of the Hon'ble Bombay High Court are reproduced as under:-

> *" Under the master agreement, the right of first refusal was vested with LFFL to carry out the bottling activities in the territory of Bangalore. There was a clear indication that there would be formation of Bangalore subsidiary and there would be an investment agreement also between the parties for this purpose. The necessary guidelines as to how the subsidiary would be formed, various assignments of the bottling rights only to such a newly formed company and to be held and formed by Parle Group and later on the Coca Cola Company will join in after subscribing 30 per cent of the shares, are the provisions or guidelines in the master agreement*

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itself. It was to this subsidiary company that the bottling rights were to be given in the territory of Bangalore. This subsidiary company was formed as Pane Soft Drinks Pvt. Ltd. Thus, the assessee company was formed only for carrying out bottling activities in the territory of Bangalore. There was, thus, no dispute that the assessee was entitled to receive the compensation amount on the breach of this agreement from Coca Cola Company. Thus, even though the right of first refusal was with LFFL, but it was always agreed U0fl by the parties that the same should be for the newly formed subsidiary at Bangalore. That Bangalore subsidiary is the assessee company only. These bottling activities were to be carried out for the Coca Cola Company in the Bangalore territory for which the assessee was formed. It was not necessary that the assessee should have installed entire plant and machinery for carrying on such right of first refusal itself stated a substantial right and foundation on which the assessee could have built its bottling business. If such right would have been assigned to the assessee, it would have been the source of assessee's income and profit making apparatus. The assessee has also submitted its business plans and various modes for carrying out the bottling business to the Coca Cola Company. There is no dispute that the Coca Cola Company had breached the agreement and particularly the right of first refusal by not assigning the rights. It was on account of breach of this agreement that the compensation amount was settled between the parties. The fundamental right for starting the bottling business was taken away as a result of breach of the right of first refusal by the Coca Cola Company. That is the reason why the Coca Cola Company paid this amount to the assessee and not to LFFL. [Para 15]

All the tests that were evolved by the Supreme Court in the decisions noted above, have been applied and to arrive at the correct conclusion. The view of the Tribunal is not in any way erroneous or illegal. Thus, it is not vitiated by any error of law apparent on the face of the record of perversity. [Para 16]

Pearle Bottlings

- *The matter has to be approached from a factual view point. [Para 18]*
- *Even in the case of Pane Bottling Private Limited, where the Assessing Officer has treated the receipt to be taxed as long term capital gains on protective basis and the Commissioner (Appeals) has treated the same receipt to be taxed as casual and non-recurring taxable income under section 10(3), the argument was that the assessee received this sum of Rs.*

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16.06 crore as compensation from the Coca Cola Company for breach of the right of first refusal agreement with regard to bottling rights of Pune territory. The Assessing Officer, according to the assessee, solely relied upon the observations and findings in the assessment order dated 30th March, 2001 in the case of Aqua Bisslery Limited, wherein, the receipt was taxed under the head 'long term capital gains'. Once the factual basis was laid before the Commissioner (Appeals) and it was found that the same was identical to the case of Panic Soft Drinks Private Limited except for the fact that in the present case, the assessee was in the bottling business for Parle Group of Companies, there was a right of first refusal and the assessee was to carry on the business of bottling for the Coca Cola Company. A detailed business plan was submitted. However, the Coca Cola Company, without any specific reason, rejected the business plan. Thus, there was a breach of the right of first refusal and after negotiation (sic) received compensation in the above sum, which was shown as non-taxable capital receipt. The argument was identical that the Coca Cola had deprived the assessee of all potential right and that was to set up a bottling plant for Pune territory. There was a breach of contract giving rise to a claim for damages and same was paid on account of failure to honour the commitment. That is capital in nature. That source of income, by way of setting up of a bottling plant at Pune territory was lost forever. Hence, relying upon the judgment in the case of Oberoi Hotel (P.) Ltd. v. CIT [1999] 103 Taxman 236/236 ITR 903 (SC), the argument that such a receipt cannot be taxed as revenue receipt or casual income, was accepted. The Tribunal, noted the arguments of the revenue and particularly the summary of the same. Thereafter, the Tribunal dealt with the main dispute and as above. [Para 19]

8.4 In this view of the matter and by respectfully following the case laws discussed herein above, we are of the considered view that compensation received for pre-closure of contract manufacturing agreement with Dr.Reddy's Laboratories Ltd., is in the nature of capital receipt paid for loss of profit from business / loss of investment, but not in the nature of any compensation or

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other sum paid for not using any know-how, patent, copyright, trade-mark, license, etc., which can be brought to tax u/s.28(va)(a) of the Act. The AO as well as the CIT(A) without appreciating the facts, had simply made addition towards compensation received from Dr.Reddy's Laboratories Ltd., u/s.28(va)(a) of the Act. Hence, we direct the AO to delete addition made towards compensation received for termination of contract manufacturing agreement.

9. In the result, appeal filed by the assessee is allowed.

Order pronounced on 8th February, 2021 at Chennai.

Sd/-	Sd/-
(धुव्वुरु आर.एल रेड्डी)	(जी. मंजुनाथ)
(Duvvuru RL Reddy)	(G. Manjunatha)
न्यायिक सदस्य/Judicial Member	लेखा सदस्य /Accountant Member

चेन्नई/Chennai,
दिनांक/Dated, the 8th February, 2021.

RSR

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त /CIT
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF.