IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'A'(SPECIAL BENCH), HYDERABAD

BEFORE SHRI P.M.JAGTAP, ACCOUNTANT MEMBER,
SHRI N.V.VASUDEVAN, JUDICIAL MEMBER
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

ITA No.1034/Hyd/2004
(Assessment Year 2000-01)

Asstt Commissioner of Income-tax Circle 2(3), Hyderabad	V/s	Late Dr.B.V.Raju, Hyderabad (Rep. by L/Rs Smt.I.Rama-vathy,Smt. K.Usha Rani and Smt. N.Shobha Rani), Hyderabad
		(PAN/GIR No. R-705)
(Appellant)		(Respondent)

Appellant by **:** *Shri V.Srinivas, CIT D.R.*
Respondent by : *Shri K.Vasant Kumar, Advocate*

Date of Hearing	6 1.2012
Date of Pronouncement	13.2.2012

ORDER

PER N.V.VASUDEVAN, J.M.:

This Special Bench has been constituted by the Hon'ble President, ITAT, under S.255(3) of the Income Tax Act, 1961 (the Act) to consider and decide the following question, which covers the solitary issue arising out of the appeal filed by the Department for assessment year 2000-01 being ITA No.1034/Hyd/2004

> **"Whether on the facts and in the circumstances of the case the consideration receivable by the assessee in terms of the agreement dated 27.07.1999 is assessable to tax as capital gains in accordance with the amended provisions of law prevailing at the relevant point of time relating to the levy of tax on capital gains."**

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2. The assessee is an individual. He was a chemical engineer with degrees in Management from Harvard University, USA and Doctorate in Science from JNTU, Hyderabad. He was a doyen of cement industry, who started his carreer as a technocrat and rose to the level of Chairman & Managing Director of Cement Corporation of India, a public sector Corporation. While in this job, he had set up many cement factories in various sites in Madhya Pradesh, Andhra Pradesh, Himachal Pradesh, Assam and Karnatka. The Government of India recognized his services with an award of "Padmasree" and "Padmabhushan". He promoted and was Chairman of two cement companies, M/s. Raasi Cements Ltd.(RCL) and M/s. Sri Vishnu Cements Ltd.(SVCL). He did not have controlling interest in RCL and SVCL and therefore M/S.India Cements Ltd., took over RCL and SVCL. Both these companies were subject matter of a hostile corporate takeover by rival company viz. M/s. India Cements Securities Ltd. (ICL) and its associated companies. After the takeover, the assessee lost his business and died in pain on 8th June, 2002.

3. Meanwhile, there was a search conducted in the case of one Shri Ravindra Varma, a close relative of the assessee, who had also worked as Vice Chairman of M/s. Sri Vishnu Cements Ltd. During the course of search, a document was found from the residence of Shri Ravindra Varma in the form of a non-compete agreement. The said agreement was entered into by and between the assessee and M/s. ICL on 27th October, 1999, whereby a sum of Rs.11 crores was agreed to be paid by ICL to the assessee for agreeing not to participate either directly or indirectly in the business of cement/industry. Late Dr.B.V.Raju filed his return of income for the year under consideration on 30th June, 2000, declaring total income of Rs.2,04,549, besides agricultural income of Rs.41,620. Since this amount of Rs.11 crores received under the agreement dated 27th October, 1999 was not disclosed by the assessee in his return of income filed for the year under consideration, a notice under S.148 of the Act was issued by the assessing

officer to the assessee on 7th May, 2002, which was duly served on the Mr.B.V.Raju. Mr.B.V.Raju however died on 8th June, 2002 without complying with the said notice. The assessing officer therefore issued fresh notices under S.148 of the Act to the legal heirs of the assesse and initiated the assessment proceedings for assessment of income that has escaped assessment of the deceased for the AY 00-01.

4. The preamble to the non-compete agreement dt.27.10.99 narrates the reason why the agreement was being entered into. Mr.B.V.Raju during the course of his employment with the above referred Companies acquired a corpus of knowledge, skill, expertise, and experience related to the production, distribution, marketing, running and managing of cement plants and has also acquired or otherwise come in possession of various secret information, know-how and trade secrets relating to the Cement line of business. India Cements Ltd. and its associate companies had acquired RCL from the original promoters during April, 1998. Mr.B.V.Raju together with his family members thereafter continued their business in Cement line with SVCL till October, 1999, when SVCL was proposed to be taken-over by India Cements Ltd., and its associate companies. Mr.B.V.Raju along with other persons entered into an agreement with ICL by which they sold the shares held by them in SVCL. With the acquisition of SVCL, the core family promoters of RCL & SVCL were out of Cement business. ICL with a view to ward off competition, desired that Mr.B.V.Raju should be restrained from starting a fresh cement unit, lest it should have a bearing on their business. With that object in view, ICL entered into a Non-Compete Agreement with Mr.B.V.Raju.

5. During the course of assessment proceedings, the assessing officer confronted the legal heirs of Mr.B.V.Raju with regard to the receipt of Rs.11 crores by the assessee as per the non-compete agreement. They however expressed complete ignorance about the said transaction. The assessing

officer, therefore, made a direct enquiry with ICL which revealed that the sum of Rs.11 crores payable to the assessee as per the non-compete agreement was not paid to him in cash and the same was adjusted against the sums which were due to M/s. Raasi Cement Ltd. by some of the erstwhile customers known to the assessee. RCL got merged with India Cements Ltd., with effect from 1-4-1998. ICL also informed the AO that Mr.B.V.Raju had given an authorization for such adjustment. A copy of such authorization was also furnished to the AO by ICL. The authorization reads thus:

> "ICL Securities Limited, Chennai — October, 27, 1999
> Raasi Cements Limited, Hyderabad
> Dear sir,
> This has reference to the Non Compete Agreement executed by me today with yourselves. The consideration payable by yourselves aggregating to Rs.11 Crores may please be adjusted as mentioned in annexure.
>
> Dr.B.v.Raju
> Encl: Annexure"

The annexure referred to above to the aforesaid letter reads thus:

"Annexure forming part of the Non Compete Agreement dated October 27,1999

Total amount payable towards Non-competition		Rs.11,00,00,000
Less amount to be paid to Raasi Cement Limited towards		
1. Dues by Viswam Cement Limited	Rs. 67,34,000	
2. Dues by Maatha Cement Limited	Rs.1,41,36,000	
3. Dues by Various Transport Contractors	Rs.5,35,30,000	
4. Dues by Coal suppliers	Rs.3,56,00,000	
		Rs.11,00,00,00
Balance payable towards Non-compete fee to Dr.B.V.Raju		Nil

6. ICL also confirmed having squared off the relevant accounts after adjustment by debiting the amounts of the assessee by Rs.11 crores and

crediting the accounts of the said parties thereby reducing their dues to NIL. Based on this information collected by him, the assessing officer concluded that there was a transfer by the assessee by way of **relinquishment of his right to manufacture** or involve in activities connected with the cement line of business to ICL for a period of five years and taking the cost of acquisition of the said right at NIL as per the provisions of S.55(2)(a) of the Act as amended by the Finance Act, 1997 with effect from 1.4.1998, he worked out the capital gains chargeable to tax in the hands of the assessee at Rs.11 crores. Accordingly, addition of Rs.11 crores was made by the assessing officer to the total income of the assessee on account of capital gain arising from the transfer by way of relinquishment of his right by the assessee to manufacture cement and the assessment was completed under S.143(3) of the Act read with S.147 of the Act, vide order dated 26.3.2004.

7. Against the order passed by the assessing officer under S.143(3) of the Act read with S.147 of the Act, an appeal was preferred by the assessee before the learned CIT(A), challenging the addition of Rs.11 crores made by the assessing officer on account of capital gains. Before CIT(A) it was submitted as follows:

(i) It was submitted that it is not known as to for what reasons the entire agreement was made. It was submitted that the letter dated 27th October, 1999 purportedly written by late Dr.BV Raju authorizing M/s. ICL, to adjust the sum of Rs.11 crores payable to Dr.B.V.Raju under the Non-compete Agreement refers to an annexure to the said letter. But the annexure has a title stating that it forms a part of the non-compete agreement dated 27.10.1999. It was submitted that the annexure refers to various parties but there is no reference to these parties in the non-compete agreement. It was argued that the annexure cannot be considered to be a part of the non-compete agreement. It was argued that there is no privity of contract between Dr.B.V.Raju and the parties referred to in the annexure. The Assessee also relied upon the fact that in the letter dated 27.10.1999 produced by M/s. ICL there was reference

only to two debtors, though subsequently, M/s. ICL claimed to have squared off accounts of 8 parties. These eight parties were never informed by M/s. ICL of any such write-off of their dues. Therefore, the agreement cannot be considered to be complete in respect of right and duties of contracting parties.

(ii) It was argued that the AO has relied totally upon a letter dated 27.10.1999 given by M/s.ICL, wherefrom they have stated that monies due to them were adjusted in lieu of the non-compete fee. The AO's basis to justify the claim of M/s. ICL is the audited books of accounts of M/s. ICL. The assessee argued that they have also produced confirmations from the parties, which were alleged to have dues payable to M/s. RCL and as per those confirmations; there were no dues to be paid to M/s. RCL. The books of these parties were also audited. The AO has not examined the books of accounts of these parties denying the liabilities, nor have given them any opportunity to prove their case. The AO has merely accepted the version of M/s. ICL.

(iii) It was submitted that the AO has relied on submission of M/s. ICL regarding accounting entries relating to above transactions. Attention of the CIT(A) was drawn to the version of M/s. ICL as contained in para 3 of their letter dated 9th March, 2004 which is also part of the assessment order which reads thus:

> *"The amount paid to late Dr.B.V.Raju as Non-Compete fee (set off against advances from certain parties) was debited to the investment account. The recoveries of advances have been credited to P&L Account as the advances were at NIL as mentioned in Para (1) above. In effect, having considered these balance at NIL value at the time of integration, the India Cements Limited did not carry these balance in the books and when a recovery was made through the amounts payable to late Dr.B.V.Raju, the entire sum so recovered was considered as income. In other words, the India Cements Limited never claimed these amounts as expenditure (write off) at any point in time on the other hand when the amounts were recovered through late Dr.B.V.Raju, the entire amount of Rs.11 crores was offered as income and subjected to tax."*

The Assessee argued that M/s.ICL had first of all accepted the so-called dues in the name of above parties at NIL value. If those were correct facts as per the admission of M/s. ICL itself, then there was no case for M/s. ICL to say that they had paid Rs.11 crores to late Dr.BV Raju and the same was adjusted against the NIL dues.

(iv) The Assessee also submitted that if M/s. ICL had not claimed the expenditure of Rs.11 crores at any point of time shows that no such monies were ever paid. The Assessee submitted that by showing the entire sum of Rs.11 crores as if recovered through late Dr.BV Raju, M/s.ICL was making an effort to create a false reserve in their own books of accounts.

(v) The Assessee also submitted that in case M/s. ICL had initially given a NIL value to all these outstanding as on 1.4.1998, the date of amalgamation, then the same amount should have also been reduced by them from their liability side of the balance sheet or some other asset should have been created. The AO has not examined this aspect and, therefore, the claim made by M/s. ICL appears to be suspect.

(vi) The Assessee also argued that even if this agreement was genuine, no monies were received either in cash or indirectly through the medium of these so-called debtors of M/s. RCL by late Dr. BV Raju. The AO has not brought any evidence by which it can be said that late DR.BV Raju received the money either directly or indirectly.

(vii) It was argued by the assesse that the alleged payment of non compete fee was made after hostile takeover of M/s.SVCL which was in October, 1999. The transactions of adjustments relates to dues of Ms/. RCL. Apparently, there was no occasion for such consideration of such dues of M/s. RCL, since that takeover was complete long time back in 1997-98."

8. After having considered the submissions made on behalf of the assessee as well as the material available on record before him, the learned CIT(A) found that non-compete agreement was validly entered into between the assessee and the ICL, according to which a sum of Rs.11 crore was to be paid by ICL to the assessee. He held that the said amount due to him was foregone by the assessee for the reasons best known to him. According to the learned CIT(A), the assessee voluntarily did not want the true nature of the transactions to be examined and although there were some adjustments made settling the pending transactions, the exact details thereof or the facts relevant thereto were not known. He noted that ICL itself assigned NIL value to the dues of the concerned parties to ICL on the date of merger, i.e. 1.4.1998. Therefore, the letter given by the assessee on 27.10.1999 authorising the ICL to adjust the sum of Rs.11 crores against the said dues was inconsequential. He held that in these facts and circumstances, the assessee could not with conviction be said to have received the sum of Rs.11 crores and the assessing officer was not justified in bringing to tax the said amount in the hands of the assessee.

9. The learned CIT(A) then proceeded to examine the exact nature of the sum of Rs.11 crores which was receivable by the assessee as per the non-compete agreement dated 27.10.1999. In this regard, he analysed the relevant terms and conditions of the said agreement as well as all the relevant facts and circumstances of the case in which the said agreement was entered into by and between the assessee and the ICL. He held on the basis of such analysis that even after the hostile takeover of his company, ICL was apprehensive that the assessee was always capable and competent to start his business afresh and give tough competition to it. He held that the non-compete fee of Rs.1 crore thus was agreed to be paid by ICL to the assessee to ensure that no further competition was faced. He held that the assessee had personal skills and abilities which were placed under restraint in the non-competition agreement, and the said personal abilities and skills

not being in the nature of capital asset, as defined under S.2(14) of the Income-tax Act, there was no question of any capital gain arising as a result of non-compete agreement, which could be brought to tax in the hands of the assessee. He also held that there was only a restraint on the use of personal skills and abilities of the assessee for a period of five years and there being no cessation or relinquishment or extinguishment of any right, there was no transfer within the meaning of S.2(47) of the Act, so as to give rise to any capital gain. The learned CIT(A) held that the sum of Rs.11 crores itself was agreed to be paid by ICL to the assessee as per the non-compete agreement against a restrictive covenant on the right to exercise the business, and the same was in the nature of a capital receipt not chargeable to tax, before the insertion of provisions of S.28(va) of the Income-tax Act, with effect from 1.4.2003. Accordingly, the addition of Rs.11 crores made by the assessing officer to the total income of the assessee on account of capital gains was deleted by the learned CIT(A). Aggrieved by the order of the learned CIT(A), Revenue has filed this appeal before the Tribunal.

10. The ld. Counsel for the assessee at the outset submitted that the scope of the question before the Special Bench is as to whether the amendment made to Sec.55(2)(a) of the Act by the Finance Act 1997 w.e.f. 1/4/1998 will apply or whether the amendment made to the aforesaid provisions by the Finance Act of 2002 w.e.f. 1/4/2003 whereby "right to carry on business" when transferred would have nil cost of acquisition and improvement for computing capital gains, would apply. His submission was that the CIT(A) has given a finding that there was no evidence about receipt of Rs.11 crores by the assessee and that issue is not before the Special Bench.

11. On this submission, we are of the view that the question referred to the Special Bench is comprehensive enough to cover the question as to whether the CIT(A) was justified in holding that there was no evidence to show that a sum of Rs. 11 crores was received by the assessee under the agreement

dated 27/10/1999. Even the grounds of appeal of the Revenue before the Tribunal challenges the entire findings of the CIT(A). Admittedly as per NCA dated 27/10/1999 a sum of Rs. 11 crores was receivable by the assessee. The plea of the assessee was that it was not actually received. The question referred to the Special Bench, contemplates two issues to be decided, one is as to whether the amount mentioned in the NCA was income that actually accrued to the Assessee and if so whether they could be brought to tax. This in our view is the scope of the question which the Special Bench has been called upon to decide. The preliminary objection of the learned counsel for the Assessee is therefore rejected.

12. We shall first take up for consideration the question as to whether there was accrual of income of Rs. 11 crores to late Shri B.V.Raju from ICL as a result of non-compete agreement. On this issue, the ld. D.R. drew our attention to the findings of the AO given in para 2.5 to 2.12 of the assessment order. It was further submitted by him that when there was a merger of ICL & RCL as on 1/4/1998. RCL had given nil value to the aforesaid dues. According to him though the Non- Compete Agreement (NCA) is dated 27/10/1999, the adjustment of payment of Rs. 11 crores payable under the said agreement relates back to the date on which the debts due to RCL by the various debtors were considered as nil. In this regard ld. D.R drew our attention to the letter dated 27/10/1999 by Shri B.V.Raju, whereby he had agreed to treat the adjustment of dues by various debtors of RCL as payment to himself of the consideration payable under the NCA. His further submission was that the CIT(A) himself accepts that Shri B.V.Raju did not want the true nature of this transaction to be examined. It was his further submission that the CIT(A) has accepted the fact that there was an accrual of income but has come to the conclusion that it cannot be said with conviction that Shri B.V.Raju had received a sum of Rs. 11 crores, without any basis. According to the ld. D.R if there is a doubt or want of corroboration the CIT(A) cannot leave the matter as it is and was

duty bound to make further investigation. If there were doubts as to whether a sum of Rs. 11 crores was received by the assessee as consideration under the NCA dated 27/10/1999, deletion of the addition made by the AO was not the natural consequence and the CIT(A) ought to have exercised his plenary powers and made further investigation. In this regard reliance was placed by Ld. D.R on the decision of the Hon'ble Delhi ITAT in the case of Swaroop Vegetable Products, 96 ITR 468 (Del) and Commissioner of Income-tax v. Late Begum Noor Banu Alladin 204 ITR 166 (AP) (FB). It was his further submission that the CIT(A) had not given positive finding that the assessee did not receive a sum of Rs. 11 crores as non-compete fee. His further submission was that once there is evidence to show that sum of Rs. 11 crores has accrued as income in the hands of the assessee under the non-compete agreement dated 27/10/1999, the burden was on the assessee to show that there was no accrual of income. It was not for the revenue to show that there was no accrual of income. The ld. Counsel for the assessee on the other hand, reiterated the submissions as were made before the lower authorities.

13. We have considered the rival submissions. We have already seen that the legal heirs of Dr.B.V.Raju pleaded complete ignorance of the transaction. The AO therefore called for complete details of the transaction and the accounting treatment given by M/s India Cements Ltd in its books alongwith the relevant extracts of the books of account from M/s India Cements Ltd. In its reply dated 9-3-2004, M/s India Cements Ltd submitted as under:

> "(i) The debts that were adjusted against the amount payable to Late Dr. B. V.Raju were outstandings appearing in the erstwhile cement division of Raasi Cement Limited, which was integrated with The India. Cements with effect from 1.4.1998. As explained, these amounts were considered doubtful of recovery and hence The India Cements Limited assigned nil value at the time of integration. In effect there is no write off in the books of Raasi Cement Limited prior to integration.

(ii) the details of the parties whose outstandings were adjusted against the amount payable to Late B. V. Raju was already furnished to you vide our communication dated 17.11.2003."

(iii) The amount paid to Late Dr. B.V.Raju as Non-Compete Fees (set off against advances from certain parties) was debited to the Investment Account. The recoveries of advances have been credited to P&L Account as the advances were at NIL value as mentioned in para (1) above. In effect, having considered these balance at nil value at the time of integration, The India Cements Limited did not carry these balance in the books and when a recovery was made through the amounts payable to Late Dr.B.V. Raju, the entire sum so recovered was considered as income. In other words, The India Cements Limited never claimed these amounts as expenditure (write off) at any point of time. On the other hand when the amounts were recovered through Late Dr.B. V.Raju, the entire amount of Rs. 11 crores was offered as income and subject to tax."

14. Thus ICL claimed that it paid a sum of Rs.11 crore to Dr.B.V.Raju by way of adjustment of debts due to RCL. The Annual Report of M/s Raasi Cement Ltd for the F.Y. 1997-98 also corroborates the version of ICL. The said debts claimed to have been adjusted against the Non-Compete fee are reflected in the audited accounts of the company. The relevant extracts of the Annual Report which have a bearing in the case are reproduced below:

"6. CURRENT ASSETS, LOANS AND ADVANCES

A) SUNDRY DEBTORS

a) ……………………….

b)……………………….

B) Sales include sale of 13,025.83 tons of clinker to Viswam Cements Limited at prices substantially below the average variable cost of production. The management is reviewing the transaction. Further a sum of Rs. 67.34 lacs is due to from the party and is grouped under the head Sundry debtors.

C) Transactions with Maatha Cements Limited (MCL)

a) Sales include sale of 9517 tons of clinker to Maatha Cements Limited at prices below the average variable cost of production. The management is reviewing the transaction.

b) The Company, pursuant to a contract for manufacture of Slag Cement, advanced a sum of Rs. 75.00 lacs as on interest free advance to MCL. Notwithstanding that the company has terminated the contract with manufacturing unit the above mentioned advance has not been recovered.

c) To facilitate manufacture of slog cement, the company has been transferring material to MCL's plant from time to time. As on March 31, 1998, the value of materials lying with MCL as per the shortages and deterioration in the quality of materials have been reported. In view of the aforesaid the value to the extent of shortage i.e., Rs. 49.05 tons has been classified as Advance Recoverable and the balance Rs. 35.38 lacs has been grouped under inventory.

d) Sundry Debtors include a sum of Rs. 17.31 lacs due front MCL towards sale of Clinker.

The aggregate amount outstanding from MCL is Rs. 141.36 lacs (excluding value of inventory Rs. 35.38 lacs). The entire amount is outstanding as on date and the management is initiating action for recovery of the outstanding.

D) LOANS ANDADVAAYCLS

a)……………………………

b)…………………………

c) Loans and advances include

iv) Rs.549.39 lacs towards incentives paid to some transport contractors of the company during the year 1997-98. The said incentive pertain to the financial year 1996-97 and 1997-98. The management on noticing certain infirmities, is in the process of ascertaining further facts about the entire transaction. Pending reconsideration and final decision by the Board these amounts have not been charged off and is treated as recoverable.

v) A sum of Rs. 356 lacs has been paid to coal suppliers for open market purchase of coal during 1997-98, which includes Rs. 82.56 lakhs to Sri Vishnu Cement Ltd in which the Former Executive Chairman is the Chairman. The management on noticing certain infirmities is in the process of ascertaining further facts about the entire transaction. Pending final outcome of the review the said amount has not been charged off and is treated as recoverable."

15. We are of the view that the monies have flown out of M/s Raasi Cements Ltd and the same are reflected as debtors in their audited

accounts. When RCL was taken over by M/s India Cements Ltd. , the said debts were assigned Nil value. There exists an authorisation of Sri B.V.Raju, that the debts were to be adjusted by M/s India Cements Ltd against the Non-Compete fee payable to B.V.Raju. Therefore, the conclusion of the AO that Late Sri B.V.Raju was paid Rs 11 Crores by M/s India Cements Ltd as Non-Compete fee, in our view is proper. In this regard, we are of the view that the letters given by M/s Maata Cements Ltd and M/s Viswam Cements Ltd stating that no amount is payable to M/s Raasi Cements Ltd as per their books of account cannot be the basis to hold that there was no constructive payment of Rs.11 crores by ICL to Dr.B.V.Raju.

16. We are of the view that in the light of the evidence available on record one has to come to the conclusion that amount of Rs.11 crores accrued to the assessee under the NCA dated 27/10/1999 and that was enough to attract the provisions of Sec.45 of the Act to tax capital gain on transfer of a capital asset. The facts on record further show there were certain debts due to RCL to the extent of Rs. 11 crores. These debts were considered at nil value when ICL took over RCL. Thus these amounts were treated as paid to RCL. ICL when it took over RCL had duly taken into consideration the discharge of these debts by the debtors to RCL. Thus there was an adjustment of the monies payable by ICL to Shri B.V.Raju under the NCA dated 27/10/1999 by treating the debts payable by debtors of RCL to RCL, as discharged. We therefore, restore the findings of the AO in this regard. In our view the discrepancies pointed out by the CIT(A) will not stop accrual of income in the hands of the assessee.

17. Having held that a sum of Rs.11 Crores accrued in the hands of late B.V.Raju during the previous year relevant to AY 2000-01, we shall now examine the chargeability of the same to tax as income under the head "Capital Gains". This will depend on the purpose for which the payment of Rs.11 crores was made by ICL Securities Ltd., to Late B.V.Raju and what was the right that was transferred by Late B.V.Raju for which the amount in

question was paid and the law as it existed at the relevant point of time viz., 27.10.1999.

18. Before we set out the rival contentions on this issue, it has to be highlighted that ICL took over RCL as well as Shri Vishnu Cement Ltd.(SVCL) and the takeover was hostile takeover since both RCL and SVCL were public limited companies whose shares were widely spread out in the market and nobody had controlling block of shares. Ultimately the promoters of RCL and SVCL namely Shri B.V.Raju, Shri K.B.V.Raju and Shri Ravindra Verma sold their share in a negotiated deal to ICL. The aforesaid three persons were promoters of the two companies. Similar payments were made to Shri K.B.V.Raju as well Shri Ravindra Verma. The Tribunal had an occasion to consider taxability of such receipts. In the case of Shri. Ravindra Verma and Shri K.B.V Raju ITA No.640/HYD/2004 and 328/HYD/2004 for A.Y2000-01 order dated 26/6/2009. The Tribunal held that the receipts were not taxable on two counts. (1) The payment in question was a payment as consideration for not indulging in competition (which was chargeable to capital gains tax only w.e.f 1-4-2003 by virtue of amendment to Sec.55(2)(a) of the Act by the Finance Act, 2002) and was not a payment made for a right to manufacture, produce or process any article or thing (which was chargeable to capital gains tax w.e.f 1-4-1998 by virtue of amendment to Sec.55(2)(a) of the Act by the Finance Act, 1997). The assessment year with which we are concerned in this appeal is AY 2000-01. (2) The Tribunal held that it was only SVCL and RCL that were manufacturing cement and, therefore, the amount received by the Assessees who were individuals and promoters of those companies were not engaged in any manufacturing of cement and therefore it cannot be said that the consideration paid for not indulging in competition was a consideration for giving up right to manufacture, produce or process any article or thing. When the present appeal of the Assessee Mr.B.V.Raju came up before the

Division Bench, the Division Bench had some reservations on the aforesaid view and hence a reference was made to the Special Bench.

19. The ld. D.R in this regard submitted that the NCA in clause-1 defines business to mean the business of manufacture, production, development, sale etc. of cement. According to him, therefore, the amount in question was paid for giving up a right to manufacture, produce, or process any article or thing. In this regard ld. D.R submitted that the assessee had vast experience in the cement industry and ICL wanted to restrain him from manufacturing cement and hence a sum of Rs.11 crores was paid.

20. The ld. D.R submitted that it is not correct to say that it is only when the person is already manufacturing a product that he can give up the right to manufacture. In this regard he submitted that right to manufacture and manufacturing rights are akin to right of occupancy and right to occupy. In this regard the following passage from Ramnath Iyer Law Lexicon 5th edition page 4144 was referred to:

> "RIGIT OF OCCUPANCY" AND "RIGHT TO OCCUPY". A right of occupancy must not be confounded with a right to occupy. Those two rights may co-exist in the same person, as when an occupancy tenant himself or by his servants, cultivates his occupancy holding. Or, those two rights may be vested in two different persons, the right of occupancy being vested in the occupancy tenant, and the right to occupy being vested in his tenant during the currency of the latter's tenancy. In the latter case, the position is similar in some respects to the position of a proprietor who lets his land to a tenant, the proprietary right remaining vested in the landlord and the right to occupy the land vesting in the tenant. [15 A. 219 13 AWN 125 (FB)]

It was his submission that a right to manufacture will also take within its fold a right of manufacturing in the sense capacity to indulge in manufacturing. According to him, the right to manufacture is more than what is conferred in the sense of a licence or manufacturing permit. It also

takes into its compass a right that has been generated in any other way, or is self-acquired. According to him ICL has recognised this fact and paid Late B.V.Raju. He also highlighted the amendment to Sec.55(2)(a) of the Act by the Finance Act, 1997 whereby cost of acquisition of "Right to Manufacture, produce or process any article or thing" was specifically fixed by the legislature. It was his contention that the Assessee (late B.V.Raju) had the expertise to manufacture cement and had the right of manufacturing, though he was not manufacturing cement himself. RCL and SVCL were companies promoted by him and right of manufacturing could be said to be with Mr.B.V.Raju also. Therefore he could validly assign a right to manufacture also and had assigned such rights for which he received a sum of Rs.11 crores.

21. It was further submitted by him that the definition of capital asset under section 2(14) of the Act is very wide and includes even right of management which can be called a capital asset. In this regard reference was made to the decision of the Hon'ble Bombay High Court in the case of CIT vs. New India Assurance Company Ltd., 122 ITR 633 and the decision of the Hon'ble Calcutta High Court in the case of CIT vs. National Insurance Company Ltd., 113 ITR 437 (Cal). The ld. D.R also submitted that the decision of the Division Bench of the ITAT Hyderabad Bench in the case of Shri. M. Ravindra Verma (supra) should not be followed. It was submitted by him that the Tribunal in the aforesaid decision has proceeded on the basis that since the assessee was not engaged in manufacturing he could not have transferred a right to manufacture. In this regard ld. D.R submitted that when the agreement dated 27/10/1999 says that right to manufacture was being transferred it was not possible for anybody to say that such an undertaking could not have been given by Shri B.V.Raju.

22. The learned counsel for the Assessee reiterated submission as was made before the CIT(A). In short the contention on behalf of the assessee was that the amount if considered as received by the assesse, is only for

undertaking not to compete in similar business as carried on by ICL and that there was no right to manufacture that was given up by the assessee. Another submission that was made was that right to manufacture cement can be exercised by any person. The question is that whether the assessee was the owner of such right. It was his submission that SVCL and RCL had a right to manufacture but not the assessee. Therefore, the assessee could not have transferred a right which he did not possess. Further reliance was also placed by the ld. Counsel for the assessee on the decision of the Hon'ble Supreme Court in the case of Guffic Chemical Industries Pvt. Ltd. , 320 ITR 602(SC), wherein it was held by the Hon'ble Supreme Court that prior to 1/4/2003 non-compete fee was a capital receipt not chargeable to tax.

23. In his rejoinder ld. D.R relied on the decision of the Division Bench of ITAT, Hyderabad Bench in the case of ACIT vs. J.V.Choudhary, ITA No.486/Hyderabad/02 for A.Y 1998-99, wherein this Tribunal while deleting the addition made on account of non-compete fee was please to observe in Para 8 last few sentence that non-compete fee was equivalent to right to manufacture, produce or process any article or thing and that after assessment year 1998-99 the same would be taxable.

24. We have considered the rival submissions. Before we analyse the rival contentions and the terms of the agreement dt. 27.10.1999, it would be useful to narrate the relevant provisions of the Act as it existed during the relevant A.Y., the law as it existed prior to the insertion of the statutory provisions and the amendments to the relevant provisions of law after the relevant AY.

CAPITAL GAIN VS. NON-COMPETE FEE:

25. CAPITAL GAIN:

Under the Income Tax Act, 1922 capital gain was not included as a head of income and therefore capital gain did not form part of the total income. Certain important amendments were effected in the Income-tax Act by Act

XXII of 1947. A new definition of "capital asset" was inserted as Section 2(4A) and "capital asset" was defined as "property of any kind held by an assessee, whether or not connected with his business, profession or vocation", and the definition then excluded certain properties mentioned in that clause. The definition of "income" was also expanded, and "income" was defined so as to include "any capital gain chargeable according to the provisions of Section 12B". Section 6 of the Income-tax Act was also amended by including therein an additional head of income, and that additional head was "capital gains," Section 12B, provided that the tax shall be payable by an assessee under the head "capital gains" in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset effected after 31st March, 1946, and that such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or transfer took place. The Indian Finance Act, 1949, virtually abolished the levy and restricted the operation of section 12B to "capital gains" arising before the 1st April, 1948. But section 12B, in its restricted form, and the VIth head, "capital gains" in section 6, and sub-sections (2A) and (2B) of section 24 were not deleted and continued to form part of the Act. The Finance (No. 3) Act, 1956, reintroduced the "capital gains" tax with effect from the 31st March, 1956. As a result of the Finance (No. 3) Act of 1956, "capital gains" again became taxable in the assessment year 1957-58. In the Income Tax Act, 1961, the provisions of Sec.45 which are in pari-materia the same as Sec.12B of the Income Tax Act, 1922, have been retained. The same is as follows:

> "45. (1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 53 and 54, be chargeable to income-tax under the head 'Capital gains', and shall be deemed to be the income of the previous year in which the transfer took place."

The Hon'ble Supreme Court in the case of in CIT v. B. C. Srinivasa Shetty [1981] 128 ITR 294(SC) dealt with the question whether capital gain accrue or arise when "Goodwill" of a business is transferred. The Hon'ble Supreme Court held that section 45 of the Act operates if there is a transfer of a

capital asset giving rise to a profit or gain. The Hon'ble Court held that the expression "capital asset" is defined in section 2(14) to mean "property of any kind held by an assessee" and therefore was of the widest amplitude, and apparently covers all kinds of property and goodwill is not expressly excluded by the definition. The Hon'ble Court however held that the definitions in section 2 of the Act are subject to an overall restrictive clause viz., "unless the context otherwise requires". The Hon'ble Court therefore went into the question whether contextually section 45, in which the expression "capital asset" is used, excludes goodwill. The Hon'ble Court after referring to Sec.48 which provides the mode of computation of capital gain viz., deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset "the cost of acquisition of the capital asset ", held that the asset contemplated in sec.45 of the Act is an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. The Hon'ble Court held that goodwill is something built up by the carrying on of a business or profession and cannot be acquired by just paying money. Therefore there can be no cost of acquisition for goodwill which is a self - generated. The Court held that Sec.45 which is the charging section and Sec.48 which is the computation provision together constitutes an integrated code. When there is a case to which the computation provisions cannot apply at all, such a case was not intended to fall within the charging section. In such a case, when the asset is sold and the consideration is brought to tax, what is charged is the capital value of the asset and not any profit or gain.

26. It can thus be seen that for attracting charge to tax under the head capital gain there are certain conditions necessary to be fulfilled, viz.,

(a) There must be a capital asset;

(b) There should be a transfer of the capital asset;

(c) The capital asset should be something which can be acquired by paying a cost i.e., it should be capable of determining the cost of acquisition of the capital asset.

(d) There must be accrual of consideration for transfer of capital asset.

27. THE STATUTORY AMENDMENTS TO OVERCOME THE DIFFICULTIES IN BRINGING TO TAX RECEIPTS ON TRANSFER OF SELF GENERATED ASSETS IN THE HANDS OF THE TRANSFEROR

To overcome the decision in the case of B.C.Srinivasa Shetty (supra) and with a view to ensure that computation provisions do not fail when there is a transfer of goodwill, the provisions of Sec.55(2)(a) were introduced by the Finance Act, 1988 w.e.f 1-4-1989. These provisions read as follows:

> 55. Meaning of "adjusted", "cost of improvement" and "cost of acquisition".—
>
> (1) …………
>
> (2) For the purposes of sections 48 and 49, "cost of acquisition",--
>
> > (a) in relation to a capital asset, being goodwill of a business,--
> >
> > (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, shall be taken to be nil ;

By the Finance Act, 1997 w.e.f 1-4-1998, provisions of Sec.55(2)(a) were again amended as follows:

> (2) 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 right to manufacture, produce or process any article or thing**, 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 ;
>
> (underlining by us for emphasis)

28. Circular No. 763, dated 18th February, 1998 explaining the above provisions of Finance Act, 1997 is as follows:

> "Cost of acquisition and cost of improvement of certain capital assets
>
> 30.1 Up to the assessment year 1988-89, the gains arising on the transfer of goodwill were not liable to tax. This was on account of the judicial view approved by the Supreme Court in CIT v. B. C. Srinivasa Shetty [1981] 128 ITR 294. The rationale of the decision was that goodwill being a self-generated asset and not costing anything in terms of money, the gains could not be computed in accordance with the provisions of the Act. By the Finance Act, 1987, the method of computing the cost of acquisition as well as the cost of improvement of goodwill was provided for. Where goodwill is purchased by the transferor, the cost of acquisition is taken to be the purchase price and in all other cases it is taken to be nil. The cost of improvement in either case is taken to be nil.
>
> 30.2 Instances have come to light where rights to manufacture, produce or process any article or thing have been extinguished for a consideration and claimed to be not taxable.
>
> 30.3 The Act has, therefore, amended sections 55(1) and 55(2) of the Income-tax Act in order to bring extinguishment of such a right to manufacture, etc., within the ambit of capital gains tax. Capital gains tax would be leviable only where such an extinguishment of right to manufacture, etc., is for any consideration. Such receipts will be subjected to capital gains tax on the same basis as already adopted for taxing transfer of goodwill and tenancy rights. The cost of acquisition and cost of improvement will be determined in the same manner as for goodwill."

29. By the Finance Act, 2002, w.e.f. 1-4-2003, the provisions of Sec.55(2)(a) was amended as follows:

> (2) 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 ;

(underlining by us for emphasis)

30. In Circular No.8 of 2002 dt. 27.8.2002 the CBDT has explained the above provisions of Finance Act, 2002, as below:

"39. Amendment of section 55 of the Income-tax Act, 1961

39.1 Under section 45, any capital receipts arising out of transfer of any business or commercial rights are taxable under the head "Capital gains". The amount of "capital gains" is computed according to section 48 of the Income-tax Act, 1961. For this purpose, "cost of acquisition" and "cost of improvement" are defined under section 55. At present, in case of receipts for transfer of right to manufacture, produce or process any article or thing the "cost of acquisition" and "cost of improvement" are taken as "nil" under section 55."

Thus with the aforesaid amendments the difficulty in bringing to tax capital gain on transfer of self generated assets were remedied by the legislature by assigning nil value or actual purchase value as cost of acquisition and nil value as cost of improvement.

31. NON-COMPETE FEE:

An agreement or a clause in an Agreement by which one person agrees not to pursue a similar line of business or profession or trade in competition against another party and the consideration paid for refraining from doing so is called non-compete fee. It is generally found in agreements between employer and employee. The use of such clauses is premised on the possibility that upon their termination or resignation, an employee might begin working for a competitor or starting a business, and gain competitive advantage by abusing confidential information about their former employer's operations or trade secrets, or sensitive information such as customer/client lists, business practices, upcoming products, and marketing plans. Similar covenants are found when businesses are acquired whereby the transferor of the business agrees not to engage in competition against the transferee. Where transferor is a corporate entity, key personnel of the transferor company are also restrained from engaging in competing lines of business

either directly or indirectly or by participating in management or otherwise of a competitor.

32. Whether the receipts in the hands of the recipient of consideration under a non compete agreement or clause in any other agreement whereby a person is restrained from carrying on business in competition, would constitute income or not has engaged the attention of Courts. The first principle to be kept in mind in this regard is the one laid down by the Hon'ble Privy Council in CIT Vs. Shaw Wallace & Co. Ltd. 6 ITR 178 (PC). It was explained by the Hon'ble Privy Council in the said decision that Income is likened to fruits of a tree, while the tree being a source is capital. Income is a periodic return in money or moneys worth coming with some sort of regularity or expected regularity from definite source. When amounts are received with the source being intact, it will be income, while amounts received as compensation for the loss or sterilisation of the source will be capital. 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."

33. The principle as laid down above has been followed in number of judicial pronouncement of various Hon'ble High Courts as also the Hon'ble Supreme Court. It can thus be seen from the above that when there are receipts by a person as Non-compete fee under an agreement not to carry on particular business, then it was regarded as a capital receipt not chargeable to tax.

34. THE STATUTORY AMENDMENTS TO OVERCOME THE DIFFICULTIES IN BRINGING TO TAX RECEIPTS ON ACCOUNT OF NON-COMPETE AGREEMENTS EVEN IN CASE WHERE THERE SUCH RECEIPTS ARE FOR LOSS OF A SOURCE OF INCOME:

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";

35. In Circular No.8 of 2002 dt. 27.8.2002 the CBDT has explained the above provisions of Finance Act, 2002, as below:

> "26. New provisions for taxing the receipts in the nature of non-compete fees and exclusivity rights
>
> 26.1 For the purpose of giving certainty to taxation of receipts in the nature of non-compete fees and fees for exclusivity rights, the Finance Act, 2002, has included within the scope of "profit and gains of business or profession", any sum received or receivable in cash or in kind under an agreement for not carrying out activity in relation to any business ; or not to share any know-how, patent, copyright, trade-mark, licence, 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. However, the provisions clarify that receipts for transfer of right to manufacture, produce or process any article or thing or right to carry on any business, which are chargeable to tax under the head "Capital gains", would not be taxable as profits and gains of business or profession.

36. Thus with the amendment to the law, non-compete fee even if it is capital receipt is now chargeable to tax as Income from business. In Guffic Chem. P. Ltd. v. Commissioner of Income-tax, 320 ITR 602 (SC) the Hon'ble Supreme Court held that 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 receipt by way of non-compete fee was made taxable u/s. 28(va)). The Hon'ble Court also held that it was well settled that a liability cannot be created retrospectively. The Hon'ble Court held that the amendment by insertion of clause (a) to section 28(va) was amendatory and not clarificatory.

37. CAPITAL GAIN OR NON-COMPETE FEE:

The conclusion that emerges from the aforesaid discussion is that when a business is sold and the purchaser enters into agreements to ensure that there is no competition, he may enter into agreements not only with the transferor of the business but also with persons connected with the transferor. He may also pay consideration to the transferor for transfer of business, for not engaging in competition. He may also pay consideration to

persons associated with the transferor not to indulge in competition. The receipts by the transferor or other persons connected with the transferor can be divided into the following categories;

a) The consideration paid by the transferee for transfer of the business to the transferor;

b) Consideration paid to the transferor not to carry on same business directly or indirectly not to indulge in manufacturing same or similar products, not to use the trade names etc. ;

c) Consideration paid to persons associated with the transferor to ensure that they also do not indulge in competing business;

It has to be clarified that the case laws in which the transferee claims the consideration paid as above as revenue expenditure have no bearing whatsoever when we deal with the case of the tax treatment in the hands of the transferee. There are different considerations for determining whether the cost paid by the transferor is to be regarded as capital expenditure or revenue expenditure.

38. As far as category (a) is concerned the receipt would fall for consideration under the head capital gains as there is a transfer of capital asset in respect of which the machinery provisions of computation of capital gain can be applied. As far as category (b) is concerned the consideration received would fall for consideration under the head capital gain but depending upon the law that prevailed at the time of transfer. Self generated assets like, goodwill of a business or a trade mark or brand name associated with a business, 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 by their very nature could not have cost of acquisition and therefore machinery provisions were amended to provide cost of acquisition being treated as nil. These amendments are set out in the later part of this order. As far as category (c) is concerned, the same would fall for consideration to see if it is capital receipt chargeable to tax as on the date of transfer because after 1-4-2003 such consideration even if

regarded as capital receipt would be chargeable to tax u/s.28(va)(a) of the Act. Therefore the law as it prevails on the date on which a person agrees to desist from doing certain acts in relation to any business would be relevant.

39. If a payment is in the nature of non-compete fee received by the transferor when he sells his business and agrees not to carry on the business which he transfers then that would fall for consideration under (category (b) referred to earlier) section 55(2)(a) "right to carry on business". If the non-compete fee is paid to persons associated with the transferor then the same would fall for consideration only under Sec.28(va)(a) of the Act introduced by the Finance Act, 2002, w.e.f 1-4-2003. It is significant to note that the words used in Sec.28(va)(a) of the Act are "not carrying out any activity in relation to any business". 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. When the transferor is already carrying on business and agrees not to carry on business transferred, then the same would fall for consideration only under Sec.55(2)(a) of the Act.

40. With the change in the law receipts on account of giving up right to carry on business even if it is capital receipt would now be chargeable to tax as income from business. The difference would be that if it is paid to the transferor for giving up right to carry on business, it would be regarded as capital gain, the cost of acquisition of right to carry on business being determined in accordance with the provisions of Sec.55(2)(a) of the Act. If it is compensation paid for "not carrying out any activity in relation to any business", which the transferor is not carrying on, the same would be chargeable u/s.28(va)(a) of the Act. If a receipt is considered as payment for not carrying on business which the transferor is already carrying on then

it would be regarded as capital gain, being transfer of a capital asset viz., right to carry on business. Thus for the provisions of Sec.55(2)(a) of the Act to apply the transferor must be carrying on a business which he agrees not to carry on. If the transferor is not already carrying on business then he receives consideration only for “not carrying out any activity in relation to any business”. In that case the provisions of Sec.28(va)(a) of the Act would apply and not the proviso thereto.

41. Now in the case before the special bench we are concerned with consideration paid to persons associated with the transferor. Late B.V.Raju was not carrying on business of manufacture of cement. He was associated with two cement manufacturing companies RCL and SVCL in various capacities. With this background, we will examine the meaning of the expression ‘a Right to Manufacture, produce or process any article or thing” and “ Right to carry on any business” used in Sec.55(2)(a) of the Act.

42. RIGHT TO MANUFACTURE, PRODUCE OR PROCESS ANY ARTICLE OR THING:

What was intended to be covered by the aforesaid expression “Right to Manufacture, produce or process any article or thing” in Sec.55(2)(a) of the Act, can be ascertained by looking into the legislative intention behind introduction of the aforesaid expression. As we have already seen self-generated assets like goodwill were not considered as “Capital Assets” because of the impossibility of computing their cost of acquisition and consequently capital gain on their transfer. By the Finance Act, 1987, the method of computing the cost of acquisition as well as the cost of improvement of goodwill was provided for in Sec.55(2)(a) of the Act. Where goodwill is purchased by the transferor, the cost of acquisition is taken to be the purchase price and in all other cases it is taken to be nil. On the same principle on which capital gain on transfer of goodwill of a business was held to be not

Taxable, other self-generated assets like tenancy rights, stage carriage permits or loom hours, were also held to be not taxable. To bring to tax capital gain on such transfer, Finance Act, 1994 amended Sec.55(2)(a) of the Act w.e.f. 1-4-1995 whereby covered u/s.55(2)(a)of the Act whereby tenancy rights, stage carriage permits or loom hours were also covered and the cost of acquisition and cost of improvement of these capital assets were also to be computed in the same manner as goodwill. By the Finance Act, 1997 w.e.f.1-4-1998, the same principle was also extended to "Right to Manufacture, produce or process any article or thing" by inserting the said expression in Sec.55(2)(a) of the Act and providing method of computing their cost of acquisition and cost of improvement. It is significant to note that in the Board Circular No.763 dt. 18.2.1998 explaining the aforesaid amendment, it has been mentioned that the amendment is being brought to bring to tax extinguishment of such a right to manufacture etc., within the ambit of capital gains tax. By the Finance Act, 2001 w.e.f. 1-4-2002, the principle of ascertaining cost of acquisition and cost of improvement of capital asset being " a trademark or brand name associated with a business" was introduced in the form of amendment to Sec.55(2)(a) of the Acct. In Board Circular No.14/2001 dated 12.12.2001, the scope of the amendment has been explained (in Para 42.1) as follows:

> "42. Providing for cost of acquisition of certain intangible capital assets under Section55-
>
> 42.1 Under the existing provisions of Sub-section (2) of Section 55 of the Income Tax Act, **the cost of acquisition of an intangible capital asset, being goodwill of a business or a right to manufacture, produce or process any article or thing**, tenancy rights, stage carriage permits or loom hours, is the purchase price in case the asset is purchased by the Assessee from a previous owner, and nil any other case. It was pointed out that certain similar self-generated intangible assets like brand name or a trade mark may not be considered to form part of the goodwill of a business, and consequently it may not be possible to compute capital gains arising from the transfer of such asset.
>
> 42.2 The Act has therefore amended cluse (a) of sub-section (2)….."
>
> (underlining by us for emphasis)

43. It is clear from the legislative intention that it is an intangible capital asset that was sought to be covered by the expression “a right to manufacture, produce or process any article or thing”. One such intangible asset that one can think of is a patent. A Patent is a monopoly right granted by the government to a person who has invented new useful articles or an improvement of an article or a new process of making an article. It consists of an exclusive right to manufacture the new article invented or manufacture an article according to the invented process for a limited period. After the expiry of the duration of patent, anybody can make use of the invention. Any Person being the inventor of an invention or his assignee can apply alone or jointly with any other person. As per the Indian Patents Act, 1970 invention means any new or useful (i) art, process, method or manner of manufacture, (ii) machine, apparatus or other article., (iii) Substance produced by manufacture and includes any new and useful improvement of any of them and alleged invention. As can be seen from the legislative intention, there should be a transfer of right to manufacture, produce or process any article or thing by way of extinguishment or curtailment of such right. Thus the provisions contemplate existence of a right to manufacture, produce or process an article or thing. Otherwise the question of extinguishment or curtailment of such a right would not have been contemplated by the legislature. It would therefore be reasonable to presume that what is sought to be covered by the expression “a right to manufacture, produce or process any article or thing” found in Sec.55(2)(a) of the Act, is intangible asset in the form of a patent or similar right.

44. RIGHT TO CARRY ON ANY BUSINESS:

The above expression was introduced in Sec.55(2)(a) of the Act, by the Finance Act, 2002 w.e.f. 1-4-2003. Finance Act, 2002, w.e.f. 1-4-2003, the provisions of Sec.55(2)(a) were amended as follows:

(2) 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 ;

45. In Circular No.8 of 2002 dt. 27.8.2002 the CBDT has explained the above provisions of Finance Act, 2002, as below:

"39. Amendment of section 55 of the Income-tax Act, 1961

39.1 Under section 45, any capital receipts arising out of transfer of any business or commercial rights are taxable under the head "Capital gains". The amount of "capital gains" is computed according to section 48 of the Income-tax Act, 1961. For this purpose, "cost of acquisition" and "cost of improvement" are defined under section 55. At present, in case of receipts for transfer of right to manufacture, produce or process any article or thing the "cost of acquisition" and "cost of improvement" are taken as "nil" under section 55.

39.2 The Finance Act, 2002, has amended section 55 so as to provide that the "cost of a cquisition" and "cost of improvement" for working out "capital gains" on capital receipts arising out of transfer of right to carry on any business would also be taken as "Nil".

46. If the expression "a right to manufacture, produce or process any article or thing" covers "a right to carry on business" then there was no necessity for the Amendment as aforesaid. Thus the two expression have definite and different connotations.

47. We will now advert to the facts of the case before the Special Bench. The relevant clauses of the Non-compete Agreement dt. 27.10.1999 have to be seen to ascertain what was the right that was transferred by Mr.B.V.Raju to ICL. The Agreement in clause-1 defines Business as follows:

"Business" shall mean the business of manufacture, production, development, sale, marketing and distribution of and research into cement and other business related to or connected with the manufacture, production, sale marketing and distribution of and research into cement."

Clause-2 which contains the undertaking of B.V.Raju for which he received a sum of Rs.11 crores, which is the main clause which will decide the nature of right transferred, reads as follows:

"2. COVENANT'S OF THE PARTIES OF THE ONE PART

i. The SECOND PART requires that Dr.BVR shall not, for a period of 5 years after the execution of this First Agreement, either on his own account or on behalf of any other person, directly or indirectly, own, manage, operate, acquire shares, Control or participate in the management, operation or control of any corporate entity, partnership, proprietorship, association or other business entity which directly or indirectly engage in the Business to which Dr. BVR hereby agrees and confirm.

ii. In addition to the above, Dr. BVR agrees that he shall not, in the future.

a) do or commit any act or permit any deed or act to be done, either by himself or through anyone else acting on his behalf to induce, solicit or endeavour to entice away from the Company, any person, firm or company who was a customer of or had dealings with the company in any manner with a view to divert their customer or patronage any other entity engaging in the Business.

b) induce, solicit or endeavour to entice away from the Company or any of its subsidiaries or any other company in the same group as the Company for the time being, on its own account or on the account of any other entity, any director, manager, senior employee or employee of the Company with a view to employ such person with themselves or with such other or any other entity for the purpose of the Business.

c) for a period of' five years after the execution of this agreement, tender any consultancy services relating to the Business or provide any other services to the Business.

d) do or allow to be done by any other person, firm, company or entity acting on his behalf, any act or deed that may affect the Business of the Company.

iii) The restrictions contained in the above clause are accepted as reasonable by Dr. BVR but in the event that any such restriction are found void but would valid if some part of it were deleted or modified

> or the period or area of application altered, such restriction shall apply with such modifications as may be necessary to make them valid and effective."

In clause-3 of the Agreement, ICL refers to the payment of Rs.11 crores as consideration payable for the undertaking given in clause-2 as above. The same is as follows:

> "3. COVENANTS OF THE COMPANY:
>
> i. The company hereby agrees that it shall, in consideration of Dr. BVR agreeing to the restrictions as set out in clause 2 herein above, pay to Dr. B.V.R a sum of Rs. 11,00,00,000/- (Rupees Eleven crores only) simultaneously on the execution of this Agreement, the receipt of which Dr. BVR hereby admit and acknowledge."

48. Keeping in mind the discussion in para 37 to 41 of this order, let us see what was transferred by Mr.B.V.Raju under the agreement dt. 27.10.1999 for which he was paid a sum of Rs.11 crores by ICL. One should also read the above covenants in the non-compete agreement in the light of the preamble to the agreement which gives the background as to why the agreement was being entered into. The preamble to the non-compete agreement refers to the fact that Mr.B.V.Raju during the course of his employment with Cement Corporation of India, RCL and SVCL acquired a corpus of knowledge, skill, expertise, and experience related to the production, distribution, marketing, running and managing of cement plants and has also acquired or otherwise come in possession of various secret information, know-how and trade secrets relating to the Cement line of business. The preamble refers to India Cements Ltd. and its associate companies having acquired RCL from the original promoters during April, 1998. There is also a reference to the fact that Mr.B.V.Raju together with his family members thereafter continued their business in Cement line with SVCL till October, 1999, when SVCL was proposed to be taken-over by India Cements Ltd., and its associate companies. The preamble further refers to the fact that Mr.B.V.Raju along with other persons entered into an agreement with ICL by which they sold the shares held by them in SVCL.

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The preamble further declares that with the acquisition of SVCL, the core family promoters of RCL & SVCL were out of Cement business. It is thereafter that ICL with a view to ward off competition desired that Mr.B.V.Raju should be restrained from starting a fresh cement unit, lest it should have a bearing on their business. With that object in view, ICL entered into a Non-Compete Agreement with Mr.B.V.Raju.

49. The consideration of Rs.11 crores received by BVRaju was not for sale of any business nor was it for not carrying on any business which he was carrying on, which he had transferred. It was also not a payment for a "right to manufacture, produce or process any article or thing". As explained earlier, the sum in question was not paid for transfer of any intangible right in respect of manufacture, production or process of cement. The provisions relating to capital gains are therefore not attracted. The amount was paid for "not carrying out any activity in relation to any business" and would fall within the ambit of Sec.28(va)(a) of the Act. The payment in question clearly falls under the category of a payment for "not carrying out any activity in relation to any business" which at the relevant point of time of accrual in the hands of B.V.Raju, viz., 27.10.1999, was a capital receipt not chargeable to tax. Such receipts became taxable on and from 1-4-2003. As held by the Hon'ble Suprme Court in the case of Guffic Chemical Industries (supra), the provisions of Sec.28(va)(a) are not clarificatory and were applicable only prospectively from 1-4-2003. For AY 00-01, they were not applicable. Therefore the receipts in question were capital receipts and not chargeable to tax in AY 00-01. For the reasons given above, the order of CIT(A) is upheld and the appeal by the Revenue is dismissed.

50. We thus answer the question referred to the special Bench in the negative that is in favour of the Assessee by holding that a sum of Rs.11

crores being consideration receivable by the assessee in terms of the agreement dated 27.07.1999 is not assessable to tax as capital gains in accordance with the amended provisions of law relating to the levy of tax on capital gains prevailing at the relevant point of time viz., 27.10.1999 when a sum of Rs.11 crores accrued as non-compete fee to Mr.B.V.Raju.

Order pronounced in the court on 13th February, 2012

Sd/- (Chandra Poojari) AccountantMember	**Sd/- (P.M.Jagtap) Accountant Member.**	**Sd/- (N.V.Vasudevan) Judicial Member**

Dt/- 13th February, 2012

Copy forwarded to:
1. The Appellant
2. The Respondent
3. The CIT City –concerned
4. The CIT(A)- concerned
5. The D.R., ITAT, Hyderabad.

BVS/VM

(True copy) By Order

Asst. Registrar, ITAT, Hyderbad Benches
HYDERABAD.