



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

% Judgment delivered on: 05.09.2008

+ ITA No. 1228 of 2007

THE COMMISSIONER OF
INCOME TAX-XVI

..... Appellant

-versus-

SHRI S. DHANBAL

..... Respondent

Advocates who appeared in this case:

For the Appellant : Ms Rashmi Chopra

For the Respondent : Mr Ajay Vohra, Ms Kavita Jha and
Mr Sriram Krishna

CORAM :-

**HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE RAJIV SHAKDHER**

1. Whether the Reporters of local papers may be allowed to see the judgment ?
2. To be referred to Reporters or not ?
3. Whether the judgment should be reported in the Digest ?

Yes

BADAR DURREZ AHMED, J (ORAL)

* This appeal is directed against the order dated 12.01.2007 passed by the Income Tax Appeal Tribunal in respect of the assessment year 1998-99. The assessee is an individual Software Engineer. He was a share-holder as well as a working director in IIS



Infotech Limited. That company was taken over by FI Group (U.K.) on 04.12.1997 through a share purchase agreement entered into between the U.K. company and the share-holders of IIS Infotech Limited, which included the assessee. On the very same day, that is on 04.12.1997, the assessee entered into a non-compete agreement with the U.K. company. Essentially, the agreement required the assessee not to take up employment as a software engineer with any other company or enter into any competing business. The result was that if the assessee wanted to function as a software engineer, his avenue was only limited to continue in employment with IIS Infotech Limited provided they agreed to retain his services. The consideration for this non-compete agreement was to be paid by the U.K. company in two instalments. The first instalment was of Rs1,07,36,570/- and the same has received by the assessee on 26.02.1998, that is, in the previous year relevant to the assessment year 1998-99. It may be relevant to note that in the meanwhile on 24.02.1998, the assessee entered into a fresh service agreement with IIS Infotech Limited on substantially enhanced terms.

2. The sole question involved in this appeal revolves around the nature of this receipt of Rs 1,07,36,570/- by the assessee from the



U.K. company. According to the revenue, the said amount constitutes salary and, therefore, would be taxable as income in the hands of the assessee. On the other hand, the assessee has throughout contended that the same represents a capital receipt and is not liable to tax. According to the assessee, the said sum of Rs 1,07,36,570/- was received by way of consideration for his giving up his right to engage in competing employment or business.

3. The Tribunal recorded that there was no dispute that non-compete fees were in the nature of capital receipts and would not be liable to tax prior to the introduction of Clause (va) of Section 28 w.e.f. 01.04.2003. It was, however, the case of the Department that the amount claimed to be received by the assessee from the U.K. company as non-compete fees was actually the salary amount received by him in the guise of non-compete fees to avoid the payment of tax. The Tribunal did not accept this plea of the Department and returned a finding that what was received by the assessee was, in point of fact, non-compete fees and did not constitute salary. The Tribunal also took note of the fact that after the take over by the U.K. company and the signing of the non-compete agreement on 04.12.1997, the assessee had entered into a fresh service agreement



with IIS Infotech Limited on 24.02.1998 on entirely revised terms and conditions. The Tribunal also returned a finding that was no employer-employee relationship between the U.K. company and the assessee so as to treat the aforesaid payment as salary. The Tribunal, therefore, repelled the Department's contention that the amount in question was actually in the nature of salary received by the assessee in the guise of non-compete fees to avoid the payment of tax.

4. The Tribunal also noted the fact that the amount of non-compete fees paid by the U.K. company was treated by it as a capital expenditure not deductible in computation of its income and such treatment by the said company was accepted by the Department. The Tribunal, therefore, concluded that once the amount had been treated in the hands of the payer as non-compete fees, it could not be treated as salary in the hands of the recipient (the assessee herein).

5. This Court had occasion to consider the very same circumstances which arise in the present case in the case of Rohitasava Chand v. Commissioner of Income Tax (ITA No. 611/2007) decided on 20.03.2008. Mr. Rohitasava Chand was also a working director in IIS Infotech Ltd. like the assessee. A similar



non-compete agreement was entered into between him and the company. The only difference in the case of Mr. Rohitasava Chand and the present assessee is that the former did not take up employment subsequently with IIS Infotech Ltd. whereas the assessee entered into a fresh service agreement with IIS Infotech Ltd. According to the learned counsel for the appellant, this is a material distinction between the two cases. For the present, it would be pertinent to note that this Court by virtue of the said decision in ITA No. 611/2007 came to the following conclusion:-

“There is no doubt that the non-compete agreement incorporates a restrictive covenant on the right of the Assessee to carry on his activity of development of software. It may not alter the structure of his activity, in the sense that he could carry on the same activity in a organization in which he had a small stake, but it certainly impairs the carrying on of his activity. To that extent it is a loss of a source of income for him and it is of an enduring nature, as contrasted with a transitory or ephemeral loss. During the currency of the non-compete agreement, the Assessee was restrained from soliciting, interfering, engaging in or endeavouring to carry on any activity, including supply of services or goods concerning software development. The non-compete agreement was independent of the first agreement whereby the Assessee agreed to transfer his shares to the foreign company. Under the circumstances, looking to the case law on the subject and the terms of the non-compete agreement, particularly the restrictive covenant, it is difficult to agree with the view taken by the Tribunal. The receipt in the hands of the



Assessee was certainly a capital receipt in as much as it dented his profit making capabilities.”

6. The only distinguishing feature sought to be set up by the learned counsel for the appellant between the said decision of this Court and the present case is that the assessee in the present case continued in employment with IIS Infotech whereas the assessee in that case did not. To our minds, this is not a distinction which is material for the purposes of consideration as to whether the payment received by the assessee from the U.K. company was a capital receipt or was salary. In fact, because in Rohitasava Chand's case the payment was received by him on the basis of the non-compete agreement without him continuing in service itself is indicative of the fact that the payment was not for services or employment but was by way of consideration for entering into the non-compete agreement. Whether the assessee continued or did not continue in service was immaterial for him for receiving the payment that he did. The payment was in consideration of his giving up his right to enter upon a competing business or take up employment as a software engineer with a competing company. In the case of Mr. Rohitasava Chand, since he did not take up services with IIS



Infotech, he was for the duration of the operation of the non-co...
clause, prevented from taking up employment as a software engineer
with a competing company and from setting up a competing
business. In the present case, the assessee continued with the
employment of IIS Infotech but this did not mean that he did not
give up some of his rights. He did give up his rights to choose to
take up employment with another company which may have been on
better terms. He also gave up his right to start a business of a
competing nature. Therefore, there is no distinction, in so far as the
question in the present case is concerned, between the cases of Mr.
Rohitasava Chand and the present assessee. That being the position
the decision in ITA No. 611/2007 would be clearly applicable to the
present case as well.

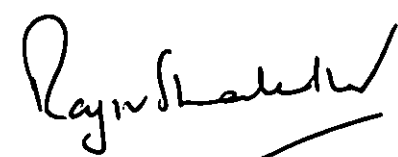
7. It is also be noted that the payment was received by the
assessee from the U.K company and, admittedly, there was no
employer-employee relationship between the U.K. company and the
assessee. Therefore, by any stretch of imagination, the said amount
cannot be regarded as salary in the hands of the assessee.



8. At the time the Tribunal passed the impugned order, ...
decision of this Court in Rohitasava Chand (supra) was not available
to it. However, the Tribunal, de hors the said decision has arrived at
the correct conclusion both on law as well as on facts. No
interference with the impugned order is called for and no substantial
question of law arises for our consideration.

9. The appeal is dismissed.


BADAR DURREZ AHMED, J


RAJIV SHAKDHER, J

September 05, 2008
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