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

\+ **ITA 154/2005**

COMMISSIONER OF INCOME TAX, DEL ..... Appellant
Through: Mr. Zoheb Hossain, learned Senior Standing Counsel.

versus

MRS. TARA SINHA ..... Respondent
Through: Mr. Rajat Navet, Advocate.

CORAM: JUSTICE S. MURALIDHAR
JUSTICE PRATHIBA M. SINGH

O R D E R

% 11.08.2017

Prathiba M. Singh, J.

1. The Respondent Assessee - Mrs. Tara Sinha *(hereafter 'Assessee')*, was working as the President of M/s Tara Sinha McCann Erickson Pvt. Ltd. ('TSME'), an advertising agency. She also held 51% shares of the said company, and McCann Erickson Worldwide Inc. ('MEW') held 40% of the shares of TSME. The remaining 9% shares were held by Associated Corporate Consultants Pvt. Ltd.

2. The Assessee filed her return of income for the Assessment Year ('AY') 1995-96 declaring an income of Rs.12,74,721/. During the AY i.e. on 9th March, 1995, the Assessee resigned from TSME. Upon her retirement, she received payments as under:

(i) Terminal benefit in the form of gratuity amounting to Rs.2,88,462/-.

(ii) Rs.35,13,150/- for the sale of her 51% shareholding in TSME to M/s. Gyan Marketing Associates Pvt. Ltd. vide agreement

dated 10th March, 1995.

(iii) Rs.3,15,31,750/- towards entering into a Non-Compete Agreement with MEW on 10th March, 1995.

3. The Assessing Officer ('AO') issued a show cause notice to the Assessee as to why the amounts received by her from MEW should not be treated as a revenue receipt and as to why her claim, that the said money is a capital receipt, should be rejected. As part of the proceedings, the AO recorded the Assessee on 9th December, 1997 and the AO vide assessment order dated 26th March, 1998 made an addition of Rs.3,15,31,750/- to the returned income of the Assessee.

4. The Assessee, preferred an appeal before the Commissioner of Income Tax (Appeals) ['CIT (A)'], who by order dated 24th December, 1998 deleted the addition made by the AO and held that the payment of compensation in lieu of the non-compete agreement by the Respondent was a capital receipt and not chargeable to income tax.

5. The Revenue approached the Income Tax Appellate Tribunal ('ITAT') vide ITA No.1258/Del/99. The ITAT on 12th December, 2003, dismissed the appeal and held that the amount received was a capital receipt not liable to tax. The Revenue has, thus, approached this Court by way of the present Appeal.

6. This Court on 15th January, 2007 framed the following question of law:

> *"Whether on the facts and circumstances of the case the Income Tax Appellate Tribunal was right in law in holding that the sum of Rs.3,15,31,7501- is not taxable*

in the hands of the assessee being a capital receipt?"

No other question was either pressed or framed.

7. Thus, the only question that is to be decided in this case is as to whether the sum of Rs.3,15,31,750/-, which was paid as a non-compete fee to the Assessee is to be treated as being taxable or not.

Petitioner's Submissions

8. Mr. Zoheb Hossain, learned Senior Standing Counsel appearing for the Petitioner/Revenue, submits that the amount of Rs.3,15,31,750/- is nothing but a terminal benefit, which was couched as a non-compete fee in order to escape the payment of tax.

9. Mr. Hossain relies on the findings of the AO that the said payment of the non-compete fee and the share transactions were "*actually a part of a well-orchestrated plan of breaking up the entire package of terminal benefits received by her.*" Mr. Hossain further relies upon the finding of the AO that all these payments were contiguous in nature i.e., the payment of gratuity, the sale of shares and the non-compete fee. He further relies upon the interpretation of the AO, that the Non-Competition Agreement dated 10th March, 1995 was severely tilted in favour of the Assessee and was in effect not a "serious" Non-Competition Agreement. In support of this finding, the AO had relied upon the clauses in the agreement, which did not impose any restrictions on the Assessee from competing with MEW outside India and that the laws of England were made applicable to the contract and also that the arbitration would be as per International Chamber of Commerce ('ICC')

Paris. The latter two factors, according to the AO, exhibited the non-serious nature of the Agreement i.e., that MEW never intended to enforce the same. Mr. Hossain, thus, submitted that the AO had followed the judgment of the Supreme Court in ***McDowell Company Pvt. Ltd. v. CIT, 1985 (154) ITR 148***, to hold that any transaction ought not to be looked at with blinkers in an isolated manner and has to be viewed from the context in which it belongs. He, thus submits, that the AO had rightly held that the entire consideration of Rs.3,15,31,750/- was taxable under Section 28 (ii) of the Act. Mr. Hossain thereafter submits that a perusal of the list of clients of the Assessee, which included some of the most well known companies, both Indian and multinational, clearly shows that the amounts paid to the Assessee were actually part of the terminal benefits but were merely described as a non-compete fee.

10. Mr. Hossain contended that the CIT (A) had erred in holding that the decision to pay the non-compete fee was merely a "*business prudence*" decision. The growth of TSME after the retirement of the Assessee shows that there has not been any lag or reduction in its revenues and thus the so-called competition from the Assessee could not have dented TSME in any manner.

11. Mr. Hossain urges that the ITAT wrongly upheld the decision of the CIT (A) by relying on the decision of the ITAT in ***Shiv Raj Gupta*** in **ITA No.489/Del/98**, which now stands reversed by this Court.

12. The foundation of Mr. Hossain's arguments rests on the decision of this

Court in ***CIT v. Shiv Raj Gupta 372 ITR 337 (2015)*** *(hereafter 'Shiv Raj Gupta')* dated 22nd December, 2014**.** He specifically relies upon the judgment to argue that this Court considered the Vodafone judgment of the Supreme Court and any camouflage of terminal benefits as a non-compete fee, should be held to be an `abusive tax avoidance'.

13. Mr. Hossain, urges that the entire amount of Rs.3,15,31,751/- ought to be treated as a taxable income and the orders of the ITAT and CIT (A) deserve to be set aside.

Respondent's Submissions

14. Mr. Rajat Navet, learned counsel appearing for the Respondent, submits that the Respondent was a well acknowledged personality in the field of advertising. She was responsible for setting up the advertising agency of McCann Erickson Pvt. Ltd. in India. She has enjoyed a very high stature in the field to the extent that McCann Erickson started to call their agency in India by prefixing the Assessee's name viz., Tara Sinha McCann Erickson *(`TSME')*. Her goodwill and reputation in the advertising field was unparalleled and thus, the amount she received as non-compete fee was truly to avoid her taking away the clients of the agency, post her retirement. The amount paid to her was well deserved and the same was not taxable.

15. Mr. Navet further submits that it is settled law as decided in several cases that non-compete fee is not taxable. He relies upon the following decisions:

1. ***CIT v. HCL lnfosystems Ltd. 385 ITR 35 (Delhi)*** (hereafter, 'HCL

Infosystems'),

2. ***CIT v. Bisleri Sales Ltd. 377 ITR 144 (Bom)*** (hereafter, 'Bisleri Sales'),

3. ***Khanna and Annadhanam v. CIT 351 ITR 110*** (hereafter, 'Khanna and Annandhanam'),

4. ***Guffic Chemical Pvt. Ltd. v. CIT 32 ITR 602 (SC)*** (hereafter, 'Guffic Chemical'),

5. ***Rohitasava Chand v. CIT 306 ITR 242 (Del)*** (hereafter, 'Rohitasava Chand'),

6. ***CIT v. A.S. Wardekar 283 ITR 432 (Cal)*** (hereafter, 'A.S. Wardekar),

7. ***CIT v. Saroj Kumar Poddar 279 ITR 573 (Cal)*** (hereafter, 'Saroj Kumar Poddar'),

8. ***CIT v. Saraswati Publicity (1981) 132 ITR 207 (Mad)*** (hereafter, 'Saraswati Publicity'),

9. ***Lachhman Das v. CIT 124 ITR 706 (Del)*** (hereafter, 'Lachhman Das') and,

10. ***Beak v. Robson (1943) 11 ITR Suppl. 23***

16. Mr. Navet further submitted that the share transactions could not in any manner be held to be tainted at the instance of the Assessee, inasmuch as, the decision as to who should be the purchaser of the shares was of McCann Erickson and the Assessee had no role to play in the same. In any event, according to Mr. Navet, the Non-Competition Agreement was entered into with MEW itself and was a valid and enforceable agreement in law. He sought to distinguish the ***Shiv Raj Gupta* (*supra)*** case based on the fact that

in the said case, the Assessee did not possess a license to manufacture or sell IMFL. The Assessee therein did not have a net worth, which would enable him to set up a new venture or pose a threat to M/s/ Shaw Wallace Company Group *(`SWC')* and that the SWC Group was a much larger group to whom the Assessee would not be pose any threat. Mr. Navet states that, unlike in ***Shiv Raj Gupta (supra)***, which was concerned with the manufacturing business, for which a proper manufacturing license would be required, Mrs. Tara Sinha – the Assessee was fully equipped to start a competing business from the date she retired from TSME. She, having been single-handedly responsible for setting up TSME in India, commanded a position from which she had the potential to take away not just the clients but even key employees of TSME. Thus, MEW had rightly paid a non-compete fee to the Assessee. The nature of the services being rendered by the Assessee were so personal to her that in the service industry such individuals being paid a non-compete fee is not surprising. According to Mr. Navet, in ***Shiv Raj Gupta (supra)***, the sum of Rs. 6.6 Crores was paid as a consideration for sale of shares and not as a non-compete fee. He, thus, submits that the present case is covered squarely by the ratio of ***Khanna and Annadhanam* (*supra*)**, ***Rohitasava Chand* (*supra*)** and ***HCL lnfosystems Ltd* (*supra*)**.

Analysis and Findings

17. It is not seriously disputed by the Revenue that Mrs. Tara Sinha – the Assessee was an acknowledged personality in the advertising field in India. The Revenue's argument is that the money paid as a non-compete fee is, in fact, a terminal benefit and hence taxable. In order to determine as to whether the amount paid as a non-compete fee is taxable or not, it is

necessary to take a look at the relevant Clauses of the Non-Competition Agreement, which read as under:

> *"1. Mrs. Sinha covenants and undertakes that she will not at any time during a period of two years from the date of this Agreement, directly or indirectly,*
>
> *a. be involved in any business in India of marketing communications (advertising, sales promotion, public relations, etc.) as an employee, consultant, partner or otherwise in any other concern/company which is competitive with the present line of business of MEW;*
>
> *b. solicit or perform services in connection with any business in India of marketing communications (advertising, sales promotion, public relations, etc.) of any existing clients of MEW;*
>
> *c. hire any employee of MEW.*
>
> *2. In consideration for the covenants of Mrs. Sinha set out in Clause 1 hereinabove, MEW shall pay to Mrs. Sinha in India the Rupee equivalent of US $ 996,500.*
>
> *5. This Agreement shall be governed by, and interpreted in accordance with the Laws of England.*
>
> *6. If any dispute or difference of any kind whatsoever not otherwise dealt with herein, shall arise between the parties hereto shall promptly and in good faith negotiate with a view to its amicable resolution and settlement. In the event no amicable resolution or settlement is reached within a reasonable time, such dispute or difference shall be referred to and settled by arbitration in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce (ICC), Paris. The venue of arbitration shall be New Delhi."*

18. The AO relied upon the Clauses 3 & 4 of the agreement, which read as under:

> *"3. The restrictions set out in Clause 1 are considered reasonable by the parties, having regard to the mutual promises set out in this agreement, and the consideration payable to Mrs. Sinha under this Agreement, but in the event that any such restriction shall be found to be void but would be valid if some part were deleted, or the period or area of application reduced, such restriction shall apply with such modification as may be necessary to make it valid and effective.*
>
> *4. The restrictions set out in each paragraph of Clause 1 constitute separate and independent restrictions. In the event that any restriction set out in any paragraph shall held to be unenforceable the restrictions set out in the other paragraphs shall be unaffected."*

19. By relying on clauses 3 & 4, the AO came to the conclusion that the true intention of MEW is not to enforce any of the restrictions contained in Clause 1. The AO, in the opinion of the Court, did not construe the agreement as a whole. The AO, incorrectly, interprets Clauses 2, 3 & 4 in holding that they actually contradict each other. The AO was clearly wrong in holding that the agreement was structured in a manner so as to give the Assessee "*adequate loopholes*" to bypass the restrictions with the "*consent of MEW*". He termed the agreement as being non-serious. The AO also appears to have wrongly construed the fact that the payment was received prior to the signing of the agreement and hence it is nothing but a terminal benefit.

20. In the statement of the Assessee, which was recorded by the AO on 9th December, 1997, she had explained to the AO that it was due to her personal efforts that the business of the company had grown and expanded from one office in Delhi to offices in several cities including Mumbai, Bangalore, Calcutta, Chennai and Kathmandu. She has explained the reason to leave TSME, as MEW wanted to drop her name from TSME in order to have a competitive advantage in India. She further explained that the money being paid to her as a non-compete fee was not directly related to the remuneration she was receiving from TSME. The AO acknowledges as under:

> *"5.2 It is clear from the deposition of the assessee that the concern, TSME was actually a brain-child of Mrs. Tara Sinha. In fact, the concern "took shape around her dining table". It is because of her efforts that the agency had grown in stature to what it was at the time of transfer of shares."*

21. In light of the above findings of the AO, the subsequent conclusion of the AO that the money paid to her was not a non-compete fee but a terminal benefit is wholly unsustainable.

22. From the record it is clear that TSME was a brain child of the Assessee. From a reading of Clause 1, it is clear that MEW was apprehensive about her retirement and the effect it could have on their business and hence insisted on the obligations contained. This clause is a clear acknowledgement that she did have the potential and stature to take away a substantial number, if not all, of the clients and the employees of TSME. The non-compete fee paid to her cannot, therefore, be termed as a camouflage or a well- orchestrated plan to avoid payment of tax.

23. It is to be noticed that during the period when TSME had entered India, in 1990, Mrs. Tara Sinha was also operating as Tara Sinha Associates (TSA) for a billing of 1279.17 Lakhs for FY 1989-90. It is, therefore, no surprise that her name was added and pre-fixed to the name of McCann Erickson when TSME was established. The clients of the Assessee, at the time when she retired from TSME, did include some of the most well known Indian and Multinational companies. The Non-Competition Agreement dated 10th March, 1995 is, therefore, clearly a genuine agreement and the Clauses in the agreement that the same would be governed by the laws of England and any disputes would be referred to ICC Paris, cannot be termed as a devious method not to seek enforcement, inasmuch as, such clauses appear regularly in several contracts involving international companies. The AO reads too much into these two clauses.

24. Insofar as, Clauses 3 & 4 are concerned, these are standard severability clauses which appear in most contracts that have multiple obligations cast on the parties. Even if one obligation is held to be illegal or void, other clauses and obligations would be enforceable. These clauses cannot by any stretch of imagination, be held to be a ruse to not enforce the agreement.

25. The CIT (A) and ITAT have rightly held that the non-compete fee is not a taxable income.

26. A similar issue had arisen as far back as in 1942 before the House of Lords in ***Beak v. Robson (supra)***. The relevant portion reads as under:

> *"The sum of £ 7,000 is not paid for anything done in performing the services in respect of which Robson is-chargeable under Schedule E. The consideration which he has to give under-the covenant is to be given not during the period of his employment, but after its termination. He is giving to the company for a sum of £7,000 the benefit of a covenant which will only come into effect when the service is concluded. I agree with the Court of Appeal in the view that to treat this £7,000 as a profit arising from the respondent's office is to ignore the real nature of the transaction. It is quite true that, if he had not entered into the agreement to serve as a director and manager, he would not have received £ 7,000. But that is not the same thing as saying that the £ 7,000 is profit from his office of director so as to attract tax under Schedule E.*
>
> *The Attorney-General points out that it is not uncommon in managerial agreements to include a covenant not to compete after the service is terminated without any separate consideration being allocated to the covenant, and it was suggested that a decision in favour of the respondent in this case might involve the apportionment of the remuneration which a manager receives under his agreement between the profit of his office and the price, paid to secure the covenant. I propose to say nothing about that, and to decide the pre sent case purely upon the terms of the agreement of October 4, 1937. That agreement is admitted to be a bona fide -contract and, so regarded, the £ 7,000 cannot properly be treated as a profit arising from the respondent's office or employment."*

Thus, the amount of 7000 pounds paid to Mr. Robson for agreeing not to engage in a competing business within 50 miles of Newcastle-upon-Tyne without the company's consent, was held to be not taxable. The House of Lords thus held that the test is to establish the *`real nature of transaction'*.

27. In the present case, the *`real nature of the transaction'* is that it is a Non-Competition Agreement wherein the Assessee agreed –

- not to be involved in any business in India of advertisement, sale, promotion, public relations etc., which is competitive with MEW or
- solicit any client of MEW or
- hire any employee of MEW.

28. In lieu of these covenants and undertakings, she was paid an amount of US dollars 996,500 i.e. Rs.3,15,31,750/- at the prevalent exchange rates. The Assessee, as clearly ascertainable from the record, was a lady who enjoyed a stature in the advertising industry and the Non-Competition Agreement, by which she agreed not to compete in India with MEW, was clearly not a sham. She is now 82 years of age and considering that the Revenue's appeal challenges concurrent findings of the CIT (A) and ITAT, we do not find any cause to interfere.

29. In ***Khanna and Annadhanam* (*supra*),** this Court followed the judgment of the Supreme Court in ***Kettlewell Bullen and Company Ltd. v. CIT, [1964] 53 ITR 261 SC***, and held that any payment made which represents compensation for the loss of the source of income would be capital in nature and that it would not be taxable. This Court, while commenting upon the amounts paid to a Chartered Accountant's firm, for terminating an arrangement with Delloitte Haskins and Sells (DHS) held as under:

> *"…It is somewhat difficult to conceive of a professional firm of chartered accountants entering*

into such arrangements with international firms of chartered accountants, as the assessee, in the present case, had done, with the same frequency and regularity with which companies carrying on business take agencies, simultaneously running the risk of such agencies being terminated with the strong possibility of fresh agencies being taken. In a firm of chartered accountants there, could be separate sources of professional income such as tax work, audit work, certification work, opinion work as also referred work. Under the arrangement with DHS there was a regular inflow of referred work from DHS through the Calcutta firm in respect of clients based in Delhi and nearby areas; There is no evidence that the assessee-firm had entered into similar arrangements with other international firms of chartered accountants. The arrangement with DHS was in vogue for a fairly long period of time (13 years) and had acquired a-kind of permanency as a source of income. When that source was unexpectedly terminated, it amounted to the impairment of the profit-making structure or apparatus of the assessee-firm. It is for that loss of the source-of income that the compensation was calculated and paid to the assessee. The compensation was thus a substitute for the source. In our opinion, the Tribunal was wrong in treating the receipt as being revenue in nature…."

30. In ***Guffic Chemical Pvt. Ltd.* (*supra*),** the Supreme Court held that the non-compete fee of Rs.50 Lakhs received by Ranbaxy was a capital receipt. The Supreme Court categorically held as under:

"…Decision

5 The position in law is clear and well settled. There is a dichotomy between receipt of compensation by an assessee for the loss of agency and receipt of compensation attributable to the negative/restrictive covenant. The compensation received for the loss of

agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capital receipt.

6 The above-dichotomy is clearly spelt out in-the judgment of this court in Gillanders' case (supra) in which the facts were as follows. The assessee in that case carded on business in diverse fields besides acting as managing agents, shipping agents, purchasing agents and secretaries. The assesse also acted as importers and distributors on behalf of foreign principals and bought and sold on its own account 'Under an agreement which was terminable at will the assessee acted as a sole agent of explosives manufactured by imperial Chemical Industries (Export) Ltd manufactured by Imperial Chemical Industries (Export) Ltd. That agency was terminated and by way of compensation the Imperial Chemical Industries (Export) Ltd. paid for first three years after the termination of the agency two-fifths of the commission accrued on its sales in the territory of the agency of the Appellant and in addition in the third year full commission was paid for the sales in that year. The Imperial Chemical Industries (Export) Ltd. took a formal undertaking from the Assessee to refrain from selling or accepting any agency for explosives.

7. Two questions arose for determination, namely, whether the amounts received by the Appellant for loss of agency was in normal course of business and therefore whether they constituted revenue receipt? The second question which arose before this Court was whether the amount received by the Assessee (compensation) on the condition not to carry on a competitive business was in the nature of capital receipt? It was held that the compensation received by the Assessee for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capital receipt.

> *This dichotomy has not been appreciated by the High Court in its impugned judgment. The High Court has misinterpreted the judgment of this Court in Gillanders' case (supra)…."*

31. Similar was the view of the Delhi High Court in ***Rohitasava Chand* (*supra*)**, which dealt with the payment of non-compete fee to the Assessee which included a transaction for sale of shares. This Court after reviewing the entire case law on the subject, held as under:

> *"…24. There is no doubt that the non-compete agreement incorporates a restrictive covenant on the right of the assessed 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 an 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 assessed was restrained from soliciting, interfering, engaging in or endeavoring to carry on any activity, including supply or services or goods concerning software development. The non-compete agreement was independent of the first agreement whereby the assessed 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 assessed was certainly a capital receipt in as much as it dented his profit making capabilities…."*

32. The view of the Calcutta High Court in ***Saroj Kumar Poddar* (*supra*)**

and the Madras High Court in ***Saraswati Publicity* (*supra*)** are to the same effect.

33. The present case is clearly distinguishable from the ***Shiv Raj Gupta* (*supra*)** case in which the decision of this Court was made in the context of the facts of the said case involving a specialised regulated business like manufacture and sale of liquor which requires a specific liquor license in each State, manufacturing capability and capital investment, all of which the Assessee therein did not possess.

34. In the facts of the present case, this Court is persuaded to follow the decisions in ***Guffic Chemical Pvt. Ltd* (*supra*), *Khanna and Annadhanam* (*supra*)** and ***Rohitasava Chand* (*supra*)** to hold that the Non-Competition Agreement is genuine and the payment made thereunder is indeed a non-compete fee.

35. The question of law framed is answered in the affirmative i.e. in favour of the Assessee and against the Revenue.

36. The appeal is dismissed but with no order as to costs.

PRATHIBA M. SINGH, J

S.MURALIDHAR, J

AUGUST 11, 2017
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