IN THE HIGH COURT OF PUNJAB & HARYANA AT CHANDIGARH

Date of Decision: 15th May, 2015

1. **<u>ITA No. 557 of 2006</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Smt. Usha Saboo</u> ..Respondent

2. **<u>ITA No. 262 of 2010</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Smt. Pallabi Saboo</u> ..Respondent

3. **<u>ITA No. 263 of 2010</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Shri R.K.Saboo</u> ..Respondent

4. **<u>ITA No. 264 of 2010</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Smt. Anuradha Saboo</u> ..Respondent

5. **<u>ITA No. 351 of 2010</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Shri Jai Vardhan Saboo</u> ..Respondent

6. **<u>ITA No. 352 of 2010</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Shri Yashvardhan Saboo</u> ..Respondent

7. **<u>ITA No. 353 of 2010</u>**

<u>Commissioner of Income Tax-I, Chandigarh</u> ….Appellant

versus

<u>Shri R.K.Saboo</u> ..Respondent

CORAM: HON'B LE MR. JUSTICE S.J.VAZIFDAR, ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE G.S.SANDHAWALIA, JUDGE.

Present : Ms. Urvashi Dhugga, Advocate, for the appellant.

Ms. Radhika Suri, Senior Advocate with
Ms. Rinku Dahiya, Advocate, for the assessee.

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S.J.VAZIFDAR, ACTING CHIEF JUSTICE:-

These appeals are against the order of the Income Tax Appellate Tribunal allowing the respondent's appeals against the order of the Commissioner of Income Tax (Appeals) in proceedings arising out of an assessment order passed under section 143(3) of the Income Tax Act, 1961 in respect of the assessment year 1994-95.

2. The main questions of law are the same in all the appeals. The questions of fact arise on account of the same transaction. The relevant facts are almost identical and are in any event interconnected. We, therefore, dispose of these appeals by this common order and judgment. We will for convenience, however, refer to the facts in ITA No. 557 of 2006.

3. The case in a nut-shell is this. The respondents in the above appeals are members of the Saboo group. Groz Beckert Saboo Ltd. was a joint venture between the respondents and M/s Theodor Groz & Sohne & Ernst Beckert Nadelfabrik Commandit Gesellschaft, a partnership firm in Germany (Groz Beckert group). The Saboo group and Groz Beckert group held 40% and 60% shares of the equity capital of Groz Beckert Saboo Ltd. respectively. Disputes arose between two groups leading to the Saboo group filing a petition for oppression and mismanagement under sections 397 and 398 of the Companies Act, 1956. The petition was dismissed. The Saboo group filed an appeal under section 10F of the Companies Act, 1956 before Delhi High Court. The matter was ultimately settled in terms of a Share Purchase Agreement dated 21.01.1993. ₹ 400/- was stated to be the consideration for the sale of all

the shares held by the Saboo group to the Groz Beckert group. The agreement also contained restrictive/negative covenants given by the Saboo group. The respondents contended that they were entitled to apportion a sum of ₹ 100/- out of ₹ 400/- as consideration for the negative covenants. This claim was rejected by the Assessing Officer and the C.I.T. (A) but was allowed by the order of the Tribunal impugned in this appeal.

4. We have held that although the agreement did not bifurcate the consideration towards the various covenants in the agreement, the assessee was entitled to bifurcate the same and apportion a part thereof towards the negative covenants. The matter in our view is covered in the respondents' favour by the judgment of the Supreme Court. This is also the view taken by several other High Courts. On facts we have held that the amount of ₹ 100/- out of ₹ 400/- apportioned towards the negative/restrictive covenants was infact on the conservative side. In arriving at these conclusions we have also dealt with certain other issues.

5. The respondent filed a return of income of ₹ 5,55,280/-. The Assessing Officer assessed the respondent's income at ₹41,22,020/-. The respondent challenged the order before the Commissioner of Income Tax (Appeals) on various grounds including those that are the subject matter of the present appeal. The C.I.T. (A) dismissed the appeal. The Tribunal allowed the respondent's appeal against this order.

6. The appeal was admitted on the following substantial question of law:-

> "Whether on the facts and circumstances of the case, the Hon'ble ITAT is justified in law in treating a sum of Rs.100/- per share as capital receipt not chargeable to tax

because as per provisions of Section 48, the entire receipts on sale of shares are chargeable to tax?"

7. In 1959, one R.K.Saboo had obtained from the Government of India an industrial licence for the manufacture of hosiery needles. A financial and collaboration agreement was entered into between R.K.Saboo and M/s Theodor Groz & Sohne & Ernst Beckert Nadelfabrik Commandit Gesellschaft, a partnership firm in Germany. By a letter dated 21.11.1959, the Government of India approved the collaboration agreement. The said R.K.Saboo and the Groz Beckert group entered into an agreement to form and promote a private company limited, by shares in India. Accordingly, on 15.10.1960, Groz Beckert Saboo Ltd. was incorporated which later became a deemed public limited company under section 43-A of the Companies Act, 1956. The Groz Beckert group held 60% shares and the said Saboo group i.e. the respondents held 40% shares of the equity capital.

8. In or about the year 1988 disputes and differences arose between the Groz Beckert group and the Saboo group. On 22.01.1992, the Saboo group filed a petition under sections 397 and 398 of the Companies Act, 1956 against the Groz Beckert group for mismanagement and oppression of minority share-holders before the Company Law Board at New Delhi. The Company Law Board by an order dated 22.10.1992 rejected the petition and directed the Saboo group to sell its 40% shares in Groz Beckert Saboo Ltd. to the Groz Beckert group at a value to be determined by M/s S.B.Bilimoria & Company, Chartered Accountants.

The Saboo group filed an appeal under section 10(F) of the Companies Act, 1956 before Delhi High Court in which an interim order staying the operation of the order of the Company Law Board was passed.

9. The members of the Saboo group and the Groz Beckert group settled the matter in terms of a Share Purchase Agreement dated 21.01.1993. The Groz Beckert group is referred to therein as the 'purchaser' and the members of the Saboo group are referred to therein as the 'sellers'. Each of the members of Saboo group agreed to sell, transfer, assign and deliver to the purchaser i.e. the Groz Beckert group their shares having a nominal value of ₹ 10/- per share at the price of ₹ 400/- per share aggregating to ₹ 17.60 crores. The sale price of the shares was inclusive of all dividend rights.

Clause 1.6 of the agreement provided that it was a fundamental condition and essence of the contract that the sale would be of the entire 440,000/- equity shares owned by the Saboo group. The relevant provisions of the Share Purchase Agreement are as under:-

> xx xx xx xx
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> "In consideration of the premises and respective representations, warranties, covenants, agreements and indemnities herein contained, the parties hereto agree as follows:-
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> xx xx xx xx
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> 5.5 **Non-Competition:** For a period of five years after the Closing date, neither sellers nor any firms, companies or other entities owned or controlled by the Sellers will directly or indirectly engage anywhere in India in any business similar to or in competition with the business of the Company as now conducted, or have any interest, directly or indirectly, in any such business.
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> 5.6 **Employees:** For a period of five years after the closing date, neither Sellers nor any of its affiliates or subsidiaries will:
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> a) hire any employee of the company or induce or attempt to induce any employee of the company to leave its employ, or in any way interfere with the

relationship between Company and any of its employees.

b) induce or attempt to induce any supplier, licensee, distributor, customer, or other business relation of the company to cease doing business with it or in any way interfere with the relationship between any customer or business relation and the company, or

c) do any other act detrimental to the company or its affiliates or the business of any of them.

5.7 For a period of five years after the closing date, neither the purchaser nor any of its affiliates or subsidiaries will:

a) hire any employee of the sellers or of any firms, companies or entities owned or controlled by the Sellers or attempt to induce any employee to leave his employ, or in any way interfere with the relationship with such employees.

b) induce or attempt to induce any supplier, licensee, distributor, customer, or other business relation of the Sellers or any firm, companies or any entities owned or controlled by the sellers to cease doing business with it or in any way interfere with the relationship with them; or

c) do any other act detrimental to the Sellers or any firms or Companies or entities owned and controlled by the Sellers, its affiliates or the business of any of them.

5.8 **Intellectual Property Rights:** From an after the closing, sellers will not use or disclose to any third party any confidential information relating to the company or its business (including customer lists). Sellers shall not use and shall do nothing to challenge or otherwise impair the trade name, logos and trade marks and other intellectual property of the Company or the Purchaser."

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xx xx xx xx

6.4 This agreement will be filed by the parties in the appeal pending in the High Court of Delhi at New Delhi being Appeal No. 23 of 1992 with a request to the Hon'ble High Court to take the same on record and to adjourn the

> appeal to a date after 31st August, 1993, on which date the appeal shall be withdrawn and disposed of upon fulfillment of the terms of this agreement and the Escrow Agreement."

10. The respondents contended that out of the sum of ₹ 400/- per share, a sum of ₹ 100/- ought to be apportioned as consideration on account of the negative covenants stipulated in the Share Purchase Agreement. They contended that the said sum of ₹100/- per share would be on account of capital receipts for agreeing to the negative covenants under the Share Purchase Agreement and the same being capital in nature was not chargeable to tax. To justify the basis and the quantum of this claim for apportionment, the respondent filed a valuation report of the Chartered Accountants M/s Vaish & Associates which valued the shares at ₹ 93.12 as per break-up value as on 31.03.1993.

11. The appellants accordingly claimed deduction of ₹ 100/- out of the total sum of ₹ 400/- per share. The Assessing Officer, however, disallowed the same. He held that the respondent/assessee was not entitled to split-up the value of the shares as stipulated in the Share Purchase Agreement. The Assessing Officer held that there was no split-up of the price of ₹ 400/- in the Share Purchase Agreement and that there was no documentary proof that ₹ 100/- out of ₹ 400/- per share was towards the negative covenants.

The Assessing Officer noted the judgments of the Supreme Court and the Madras High Court and observed that in those cases the sale of business and transfer of management or termination of agency and compensation for its transfer and refraining from competition was treated as capital receipt. Curiously, however, he held that the special provisions of the Income Tax Act, namely sections 17 and 28(ii) supersede the principles. He, therefore, refused to follow the judgments. We will deal with section 28(ii) of the Act later.

Referring to the above provision of the Share Purchase Agreement, he held that the Groz Beckert group after paying ₹ 400/- per share would have been foolish not to take the assurances contained in the above provisions. It was contended even before us that these provisions were insisted upon by the Groz Beckert group only out of abundant caution. The Assessing Officer also held on facts that the bifurcation on account of the negative covenants had not been established. This contention was reiterated before us and we will also deal with the same later. He further held that the price of ₹ 400/- was the sale price of each share and that the negative covenants merely followed upon the Groz Beckert group taking over the management. He observed that if there were to be apportionment of the sale consideration, the Directors who relinquished office would get a higher amount than the other members of the Saboo group. It was contended before us that infact there was no apportionment.

12. The C.I.T. (A) held that the respondent in ITA No. 557 of 2006 was neither a Director nor an employee of the company; that she was not a technical expert; that the sale of the shares could not have an element of managerial control. It was held that as the respondent was not a Director or an employee of the company, she could not have any element of managerial control and that she did not have any expertise to run a venture similar to the one run by the purchaser of the shares i.e. Groz Beckert group. He further concluded that the restrictive covenant was not applicable to the respondent in ITA No. 557 of 2006. It was, therefore, held that the entire amount of ₹ 400/- per share was received against the sale of the share and the Assessing Officer

had rightly treated the entire amount as a part of the capital receipt liable for capital gains.

13. It is not necessary at this stage to refer to the order of the Tribunal which we have upheld. We will refer to the same later.

14. Ms. Dhugga, learned counsel appearing on behalf of the appellant submitted as follows:-

I) There being no bifurcation in the agreement between the value of the share and the value of the negative covenants, the respondent/assessee was not entitled to apportionment thereof for the purposes of assessment under the Income Tax Act.

II) There was infact no consideration payable in respect of the negative covenants.

III) The order is perverse.

IV) In any event, the consideration for the negative covenants under Clause 5.5 is assessable to tax under section 28 of the Act.

Re:-I:-

> ***There being no bifurcation in the agreement as regards the value of the share and the value of the negative covenants, the respondent/assessee was not entitled to apportionment thereof for the purposes of assessment under the Income Tax Act.***

15. Ms. Dhugga's, absolute proposition that the assessee is not entitled to seek bifurcation of the consideration stipulated in the Share Purchase Agreement merely because the agreement does not provide for the same is not well founded. In our view, an assessee is entitled to seek bifurcation of the consideration mentioned in the agreement. Whether a part of the consideration was paid in respect of a particular promise or not is a question of fact which must necessarily depend on the facts of each case.

16. Ms. Suri's reliance upon the judgment of a Division Bench of the Bombay High Court in *Baijnath Charurbhuj and another v. Commissioner of Income Tax, Bombay City-II, 1957 Income Tax Reports (Bombay) 643*, is well founded. In that case, the Managing Agency of Gujarat Cotton Mills Ltd. was held by the firm of Shantilal Bhagwandas & Co. and by an agreement dated 18th January, 1938 the said firm assigned the managing agency and 4,736 shares of the company to Sheth Peeramal Chaturbhuj for ₹ 7,51,000/-. By an agreement dated 07.09.1946, Peeramal Girdharlal & Co. agreed to relinquish their managing agency rights and to get M/s Chaturam & Sons appointed the Managing Agents and to sell 65,012 shares of the company at the price of ₹ 65/-per share. The assessee was a partner in Peeramal Girdharlal & Co. and the Taxing Department sought to assess him to tax in respect of capital gains for the assessment year 1948-49 contending that the sale price of each share should be taken at ₹ 65/- i.e. the price mentioned in the agreement. The assessee contended that the market price of the shares on the date of the agreement was ₹ 46/- per share and it is that price which ought to be taken into consideration for determining the capital gain. The Tribunal accepted the department's contention which led to the reference before the Division Bench. Chief Justice Chagla speaking for the Court held:-

> "Now, the Tribunal has found as a fact, and there can be no dispute about it, that the main object or rather the only object of the agreement of the 7th September, 1946, was to get the purchasers of these shares appointed the managing agents of the company. The Tribunal also points out in its order that this was not an ordinary agreement of purchase and sale of shares of the company entered into in the ordinary course of business, and the only reason why it has rejected the assessee's contention was that the parties did not

apportion the price of Rs. 65 to the shares and to the managing agency. Under section 12B(2) for the purpose of computing capital gain the full value of the consideration for which the sale, exchange or transfer of the capital asset is made has to be taken into account, and the short question that we have to consider is : What is the full value of the shares which were sold by the assessee and in respect of which he made a capital gain? It is erroneous to suggest that the full value is necessarily the value which the parties place upon a capital asset. The full value must be the true value, not any artificial value, which parties for any purpose may assign to a particular capital asset. Here we have evidence that these shares were marketable and they had a market price which was Rs. 46 per share. The agreement also makes it clear that it was a composite agreement by which not merely the shares were being sold but the shares and the managing agency rights. Therefore, the consideration paid by the purchasers, viz., Rs. 65 per share, was not the consideration paid for the shares alone but it was a consideration that was paid for the shares and also for the relinquishment of the managing agency by the vendors. It is therefore not possible to accept the contention that the full value of shares within the meaning of section 12B(2) of the Act was Rs. 65 per share. The full value was the market value of Rs. 46 per share and an additional amount was paid by the purchasers because they obtained not only the shares but also the important right to manage the Gujarat Mills Co. Ltd. It is difficult to understand how the mere fact that the parties have not apportioned the consideration between the two assets which were being dealt with by this agreement can make any difference to the rights of the parties. The position might have been different if the market value of the shares could not be ascertained. Then it might be said that it is difficult to put a proper value upon the shares and to put a proper value for the consideration of the assignment or relinquishment of the managing agency. But when the market value is available and when it is known for what price these shares could be purchased or sold, there is no difficulty whatsoever in the apportionment.

Mr. Joshi's contention is that the capital asset which was being sold and in respect of which capital gain was made was not merely the shares but also the managing agency agreement, and therefore if Rs. 65 were obtained by the purchasers they obtained it in respect of the capital asset and the whole of the capital gain must be brought to tax. Now, it is not the case of the Taxing Department and it has never been their case that the capital asset in respect of which capital gain was made by the assessee and which is sought to be taxed was the shares and the managing agency. The whole of the reference is based upon the fact that the only capital asset we are concerned with is the shares and not the managing agency. Therefore, we must separate the managing agency from the shares in considering what is the value to be put upon the shares. Let us test the attitude taken up by the Department from this point of view. Assuming that the parties had put Rs. 5 or Rs. 10 as the value of the shares and they had valued the managing agency for the balance of the consideration, would the Department have accepted the artificial value put by the parties upon the shares if that value was far below the market value? The position is the same here. The parties have put upon the shares a value which is much higher than the market value. Admittedly, it is an artificial value and it is artificial because the value put upon the shares is not the value of the shares alone but it is the composite consideration paid by the purchasers for obtaining the shares and also acquiring the managing agency. Under the circumstances, in our opinion, for the purposes of section 12B(2) the sale price of the shares should be taken at Rs. 46 per share and not Rs. 65 per share." (emphasis supplied).

We are in respectful agreement with the judgment. In particular we agree that the parties not having apportioned the consideration between two or more assets can make no difference to the right of the assessee to seek an apportionment of the consideration in respect of each of them.

17. We see no reason in principle to prevent the assessee from doing so. The value to be ascribed to each transaction must obviously depend upon the evidence and the facts in each case. The tax of whatever nature, must be levied on the basis of the true value of the asset of the transaction and not merely on the basis of the value ascribed to it by the assessee. Indeed, the view to the contrary could cause severe prejudice to the revenue itself. To accept the contention would enable assessees to ascribe artificial values to assets enabling them to avoid tax.

18. As noted by the Division Bench in Baijnath Chaturbhuj's case, the agreement indicated two distinct assets namely the shares and the managing agency. In the case before us the negative covenant and the shares are independent and distinct assets. It was possible to have a separate and independent agreement in respect of each of them. The agreement in terms of the negative covenant contained in Clause 5.5 did not flow out of the agreement to sell the shares. Each of these agreements could have been arrived at independent of the others. Each of the agreements could have been arrived at without and even in the absence of the other. The negative covenant could have been agreed to by the members of the Saboo group without having sold their shares and the members of the Saboo group could have sold their shares without agreeing to the negative covenants. It was therefore not only permissible but necessary to apportion the consideration towards each of the assets provided ofcourse it is possible to ascertain a value of each of the assets.

19. A Bench of three learned Judges of the Supreme Court in *Commissioner of Income Tax, Madras v. Best and Co. (Private) Ltd. 1966*

Income Tax Reports (60) 11, dealt with this very issue. Having found that apart from giving up the agency, the parties had also entered into restrictive covenants, the Supreme Court held :-

> " ....We, therefore, hold that the compensation agreed to be paid was not only in lieu of the giving up of the agency but also for the assessee accepting a restrictive covenant for a specific period.
>
> 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 un-connected with the assessee's agency terminated. We, therefore, hold that that part of the compensation attributable to the restrictive covenant was a capital receipt and hence not assessable to tax.
>
> <u>The next question is whether the compensation paid is severable. If the compensation paid was in respect of two distinct matters, one taking the character of a capital receipt and the other of a revenue receipt, we do not see any principle which prevents the apportionment of the income between the two matters. The difficulty in apportionment cannot be a ground for rejecting the claim either of the revenue or of the assessee.</u> Such an apportionment was sanctioned by courts in *Wales (H.M. Inspector of, Taxes v. Tilley , Carter v. Wadman (H.M. Inspector of Taxes and T. Sadasivam v. Commissioner of Income-tax, Madras.* In the present case apportionment of the compensation has to be made on a reasonable basis between the loss of the agency in the usual course of business and the restrictive covenant. The manner of such apportionment has perforce to be left to the assessing authorities."
>
> (emphasis supplied).

The judgment is a complete answer to Ms. Dhuggas's submission.

20. Ms. Suri, then relied upon a judgment of the Division Bench of Madras High Court in *Parry and Co. Ltd. v. Deputy Commissioner of Income Tax and another 2004 Income Tax Reports 177.* In that case, the assessee was engaged in trading and service activities as cleaning and forwarding agents etc.

Pursuant to certain agreements, a company named HMM Ltd. engaged the assessee as its selling agent in case of diverse products. The agreements were renewed. The parties, however, entered into an agreement for pre-mature termination of the selling agency/distribution arrangement. The HMM Ltd. agreed to pay certain amounts in installments in consideration of the assessee's accepting the pre-mature termination of the agreement. In consideration thereof, the assessee *inter-alia* agreed not to accept or engage itself in any selling/distribution arrangements of any products of any other manufacturer as would compete with the said food products and/or the said toiletries. The assessee had also agreed to other clauses such as a confidentiality clause. The assessee received the amounts due under the agreement. The Assessing officer treated the same as revenue receipts which were taxable. The Commissioner of Income Tax confirmed the order. The Tribunal held 20% of the total compensation as attributable to the restrictive covenant and obligations and directed that the amount be taken as a capital receipt and not liable to tax as income under section 28(ii)(c) of the Act and deleted the addition to that extent. The question in the assessee's appeal to the High Court was whether the compensation would restrict the capital receipt or the revenue receipt. The High Court held that the compensation was in consideration of the pre-mature termination of the selling agency/distributorship agreement and also in respect of the restrictive covenants. Relying upon the judgment of the Supreme Court in the case of *CIT v. Best and Co. P. Ltd. [1966] 60 ITR 11 (SC),* the Division Bench upheld the apportionment.

21. Ms. Suri also relied upon the judgment of the Division Bench of Patna High Court in *Raghubar Narain Singh v. Commissioner of Income Tax,*

1984 Income Tax Reports 447. We will refer to this judgment shortly while referring to a judgment cited by Ms. Dhugga.

22. The submission that the assessee is not entitled to apportionment towards the price of the shares and price of the restrictive covenants merely because the Share Purchase Agreement itself did not bifurcate the same, is rejected. Where the agreement between the parties indicates that the lump-sum consideration was in respect of two or more promises, it is liable to be bifurcated and apportioned between each of the assets. At times bifurcation operates in favour of the assessee and at times in favour of the revenue. In whose favour it operates is irrelevant. In such cases, the consideration must be apportioned towards each of the assets if it is possible to do so.

23. Ms. Dhugga on the other hand relied upon the judgment of a Division Bench of Madras High Court in *Venkatesh (Minor) and others v. Commissioner of Income Tax 2000 (243) ITR 367 Madras*. The question before the High Court under reference was whether any part of the sale consideration received by the assesses for the sale of their shares was to be excluded from the computation of the long-term capital gains on the ground that part of the consideration does not represent the value of the shares sold but constitutes the consideration for the sale of right to control the company with the aid of the shares sold in two companies-Anglo French Textiles Ltd. and Best & Co. (Pondicherry) Pvt. Ltd. The shares were held by all the assessees who belonged to the same family. The shares were sold in two companies at the rate of ₹ 601/- per share and ₹935/- per share, although the prevailing market value of those shares was ₹ 219 and ₹ 185 per share. The Income Tax Officer computed the difference between the value of the shares received by the assessees under the agreement and the cost of acquisition of these shares and

treated the same as long-term capital gains and accordingly assessed that sum to tax. The Income Tax Officer rejected the assessee's contention that the sale price did not wholly pertain to the value of the shares held by them and that part of the amount received by them was the consideration for the transfer of the controlling interest of those companies to the vendees which was evidenced by the fact that the assessees who were Directors would resign from the boards of two companies and induced the vendees companies. Ms. Dhugga relied upon the following observations of the Division Bench:-

> "The argument for the assessees that the controlling interest in the company is capable of being transferred separately, apart from the transfer of shares is wholly untenable. The fact that the vendor has controlling interest and is in a position to place the vendee in control of the company by transferring all his shares or such part as would enable the vendee to exercise control over the company with the aid of the shares so transferred would only enhance the value of the shares transferred. <u>The price paid by the vendee for acquisition of such shares remains the price of those shares though the price so paid is higher than the market price. Controlling interest is but an incidence of the shareholding and has no independent existence.</u> Similar view was taken by the Madhya Pradesh High Court in the case of *Smt. Maharani Ushadevi v. CIT [1981] 131 ITR 445,* wherein also it was pointed out that the controlling interest in a company is an incident arising from holding of a particular number of shares in the company and that such controlling interest cannot be transferred without transferring shares."

The judgment does not support Ms. Dhugga's contention that if due to the negative covenants the price of the share is higher, it still is a part of and constitutes the price of the shares and is not independent of the value of the shares. The controlling interest may well be a part of the value of the shares for it emanates and is dependent upon the shares themselves. As held by the Division Bench, the controlling interest is an incidence of the shareholding and has no independent existence. We have already held that the negative covenant was a distinct right independent of the right of ownership of the shares. The case is, therefore, clearly distinguishable from the one before us.

24. The Division Bench then referred the judgment of the Patna High Court in *Raghubar Narain Singh v. Commissioner of Income Tax 1984 Income Tax Reports 447* wherein it was held that the price received by the vendor who happened to be the Managing Director and who had agreed under the agreement to delegate his power to the vendee was not the consideration for the sale of the shares alone and that part of the consideration was the price for the delegation of the power and therefore, was not to be taken into account while computing the capital gains of the shares. The Division Bench differed with the view of the Patna High Court to the effect that the powers of the Managing Director could be sold in such a manner and held that such illegal sales would not entitle the assessees to claim exemption of tax on capital gains arising from the sale of shares. We are not concerned with such a case at all and therefore, do not express any opinion regarding the same. Suffice it to note, however, that the Division Bench of the Madras High Court did not hold that the consideration cannot be apportioned even if the Court comes to the conclusion that two distinct assets are sold. The Division Bench of the Patna High Court endorsed the principle of bifurcation and apportionment.

25. Ms. Dhugga then relied upon the following observations of the Madhya Pradesh High Court in *Smt. Maharani Ushadevi v. Commissioner of Income Tax, M.P. 1981 Income Tax Report, Vol. 131, 445*:-

"Now, the Tribunal has found that the assessee had in fact paid the price of Rs. 100 per share when the assessee acquired the block of 42,000 shares of the company. It is true that the Tribunal has also found that the market price of the shares of the company at the material time was Rs. 76. But, if for acquiring a block of 42,000 shares the assessee was in fact required to pay Rs, 100 per share, then so far as the assessee was concerned, the cost of acquisition of each share was Rs. 100. The Tribunal, however, held that the sum of Rs. 100 did not represent the cost of acquisition of shares to the assessee because, the assessee acquired, in addition to the shares, a controlling interest in the company and, therefore, the excess amount paid by the assessee over the market price of the share represented the price of controlling interest. This view of the Tribunal proceeds on the assumption that controlling interest is a distinct capital asset which can be acquired or transferred independently of the shares. We see no justification for the view. Controlling interest is an incidence arising from holding a particular number of shares in a company. It cannot be separately acquired or transferred. It flows from the fact that a number of shares are held by a person. If for acquiring that number of shares, a person is required to pay more than the market price of a share and if the transaction is genuine, as has been found in the present case, then, really speaking, the cost of acquisition of the block of shares purchased by the assessee is that which she has in fact paid for holding that block."

"The other decision relied upon by the Tribunal is Baijnath Chaturbhuj v. CIT [1957] 31 ITR 643 (Bom). In that case, it was found that the consideration received by the assessee was really a composite consideration for the transfer of shares and the assignment of managing agency. No doubt, there can be a case of composite consideration but in that case there should be two distinct assets, each capable of being acquired or

> transferred separately. In our opinion, " controlling interest " by itself cannot be acquired or transferred. It is an incidence arising out of holding a particular number of shares and if for holding that number the assessee was required to purchase a block of 42,000 shares at the price of Rs. 100 for each share then Rs. 100 would, in our opinion, be the cost of acquisition of the share so far as the assessee is concerned. For these reasons, our answer to the question refrained by us in M.C.C. No. 411 of 1976 is in the negative and against the department."

26. These observations do not support Ms. Dhugga's submission. The Division Bench only held that the controlling interest is an incidence arising from holding a particular number of shares in the company and cannot be separately acquired or transferred. It is an incidence or a consequence of the holding of the said shares.

In fact, the judgment is against Ms. Dhugga's submission as the Division Bench accepted the view taken by the Division Bench of Bombay High Court in *Baijnath Chaturbhuj's case* (supra). The Division Bench held as under:-

> "The other decision relied upon by the Tribunal is Baijnath Chaturbhuj v. CIT [1957] 31 ITR 643 (Bom). In that case, it was found that the consideration received by the assessee was really a composite consideration for the transfer of shares and the assignment of managing agency. No doubt, there can be a case of composite consideration but in that case there should be two distinct assets, each capable of being acquired or transferred separately. In our opinion, "controlling interest" by itself cannot be acquired or transferred. It is an incidence arising out of holding a particular number of shares and if for holding that number the assessee was required to purchase a block of 42,000 shares at the price of Rs. 100 for each share then Rs. 100 would, in our opinion, be the cost of acquisition

> of the share so far as the assessee is concerned. For these reasons, our answer to the question refrained by us in M.C.C. No. 411 of 1976 is in the negative and against the department."

The Division Bench, therefore, infact accepted the view that even in the case of composite consideration there can be apportionment provided two distinct assets each capable of being acquired or transferred separately are sold or purchased.

27. Lastly, Ms. Dhugga relied upon the following observations of the Supreme Court in *Vodafone International Holdings BV vs. Union of India (2012) 6 SCC 613* :-

> "**167.** As stated, CGP was treated in the Hutchison structure as an investment vehicle. As a general rule, in a case where a transaction involves transfer of shares lock, stock and barrel, such a transaction cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licences and so on as shares constitute a bundle of rights. (See *Charanjit Lal Chowdhury* v. *Union of India* [AIR 1951 SC 41 : (1950) 1 SCR 869] , *Venkatesh* v. *CIT* [(2000) 243 ITR 367 (Mad)] and *Maharani Ushadevi* v. *CIT* [(1981) 131 ITR 445 (MP)] .) Further, the High Court has failed to examine the nature of the following items, namely, non-compete agreement, control premium, call and put options, consultancy support, customer base, brand licences, etc.
>
> **168.** On facts, we are of the view that the High Court, in the present case, ought to have examined the entire transaction holistically. VIH has rightly contended that the transaction in question should be looked at as an entire package.

The items mentioned hereinabove, like, control premium, non-compete agreement, consultancy support, customer base, brand licences, operating licences, etc. were all an integral part of the holding subsidiary structure which existed for almost 13 years, generating huge revenues, as indicated above. Merely because at the time of exit capital gains tax becomes not payable or exigible to tax would not make the entire "*share sale*" *(investment)* a sham or a tax avoidant.

169. The High Court has failed to appreciate that the payment of US $11.08 billion was for purchase of the entire investment made by HTIL in India. The payment was for the entire package. The parties to the transaction have not agreed upon a separate price for the CGP share and for what the High Court calls as "other rights and entitlements" (including options, right to non-compete, control premium, customer base, etc.). Thus, it was not open to the Revenue to split the payment and consider a part of such payments for each of the above items. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or on the basis that the payment is related to a contingency ("options", in this case), particularly when the transaction does not contemplate such a split up.

170. Where the parties have agreed for a lump sum consideration without placing separate values for each of the above items which go to make up the entire *investment in participation*, merely because certain values are indicated in the correspondence with FIPB which had raised the query, would not mean that the parties had agreed for the price payable for each of the above items. The transaction remained a contract of outright sale of the entire investment for a lump sum consideration [see Commentary on *Model Tax*

> *Convention on Income and on Capital* (OECD, 28-1-2003) as also the judgment of this Court in *CIT* v. *Mugneeram Bangur and Co.* [AIR 1966 SC 50 : (1965) 57 ITR 299]]. Thus, we need to "*look at*" the entire ownership structure set up by Hutchison as a *single consolidated bargain* and interpret the transactional documents, while examining the offshore transaction of the nature involved in this case, in that light."

28. These observations in the *Vodafone International Holdings BV vs. Union of India, case* (supra) cannot be read in isolation. Moreover, even these observations do not support Ms. Dhugga's submission that merely because the written agreement entered into between the parties does not bifurcate the consideration and apportion the same, the authorities and/or the assessees are precluded from doing so. Indeed, the issue, as it arises before us, was not considered by the Supreme Court. The Supreme Court considered the aspect in an entirely different context. To understand these observations, it would be necessary to read the judgment in *Vodafone International Holdings BV vs. Union of India (supra)* as a whole. The dispute related to the acquisition by Vodafone International Holdings (VIH) of the entire share capital of CGP Investments (Holdings) Limited (CGP) by an agreement dated 11.02.2007. The revenue contended that the purpose of the agreement was to acquire a 67% controlling interest in another company, Hutchison Essar Ltd. (HEL). CGP in turn indirectly held through other downstream companies shares in HEL as well as other rights, such as, option to acquire further shares in HEL. The matter concerned Section 9(1)(i), namely, transfer of a capital asset situate in India. It is important to note that the lead judgment delivered by the Chief Justice repeatedly noted and held that in that case the Court was concerned with the sale of shares and not with the sale of assets item-wise. The Court dealt with each of the items that the revenue contended had been acquired by

VIH. It was held that the rights did not flow from the share-purchase agreement; that some of the rights, such as, rights of influence/persuasion cannot be construed as a right in the legal sense. For instance, although the holding company would, by virtue of its share holding, have a persuasive effect in respect of the management of its downstream subsidiaries, it did not have an enforceable right to do so in view of the principles of corporate governance in paragraph-111. It was held that a group holding company had no legal right to direct its downstream companies in the matter of voting, nomination of directors and management rights. It was held that various other rights had been acquired by VIH through the acquisition of the CGP share and not through the execution of the share-purchase agreement. After having analyzed each of the ingredients, which were alleged to have been separately transferred, the Supreme Court held:

> "**127.** For the above reasons, we hold that under the HTIL structure, as it existed in 1994, HTIL occupied only a persuasive position/influence over the downstream companies qua manner of voting, nomination of Directors and management rights. That, the minority shareholders/ investors had *participative and protective rights* (including RoFR/TARs, call and put options which provided for exit) which flowed from the CGP share. That, the entire investment was sold to VIH through the investment vehicle (CGP).Consequently, there was no extinguishment of rights as alleged by the Revenue."

Another item that the revenue contended had been transferred separately was the option qua the shares of various companies. It was held that pending exercise of the options, the mere options did not constitute management rights.

29. In the judgment under appeal, the Bombay High Court had come to the conclusion that the transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH and that intrinsic to the transaction was a transfer of other "*rights and entitlements*" which rights and entitlements constituted in themselves "capital assets" within the meaning of Section 2(14) of the Act. The High Court held that VIH acquired the CGP share with other rights and entitlements. The VIH on the other hand contended that it had acquired all the rights through the CGP share alone. It was on the consideration of the facts of that case that Supreme Court come to the conclusion that the matter concerns "*a share sale" and not an asset sale*. It was, therefore, found as a matter of fact that there was no transfer of 'capital asset' other than by way of transfer of the CGP share. The Supreme Court did not hold that even if it had come to the conclusion that the case concerns sale of share and other assets, there could be no bifurcation and apportionment of the consideration stipulated merely because the Share Purchase Agreement did not itself bifurcate the consideration qua the independent components.

30. Our view is, therefore, not inconsistent with the judgment in *Vodafone's case (supra).* As we noted earlier, this is the view of a Bench of three learned Judges of the Supreme Court in *CIT v. Best and Co. P. Ltd. (supra),* which dealt with the very point in issue before us. We are, therefore, in any event bound by the judgment in *CIV v. Best and Co. P. Ltd. (supra)*.

31. The first contention therefore stands rejected. The Tribunal was right in coming to the conclusion that the consideration ought to be bifurcated and a part thereof apportioned towards the restrictive covenants.

Re: (II) ***There was infact no consideration payable in respect of the negative covenants.***

32. Ms. Dhugga contended that in any event in the present case there was infact no consideration payable for any of the covenants stipulated in clause-5 including for the negative covenants contained in clause 5.5. Clause 5.5 prohibited the sellers i.e. members of the Saboo group and the firms, companies and other entities owned and controlled by them from directly or indirectly engaging anywhere in India in any business similar to or in competition with the business of the company i.e. Groz Beckert Saboo Ltd. or from having any interest, directly or indirectly, in any such business.

33. In support of this contention, Ms. Dhugga contended that the members of Saboo group did not have the technical expertise to carry on such business in competition with the business of Groz Beckert Saboo Ltd. In this regard, she relied upon the order of the Company Law Board dated 22.10.1992 recording the submissions on behalf of the Saboo group inter-alia to the effect that due to non-cooperation of the Groz Beckert group to take effective steps for 'indigenization of raw material supply and transfer of technology to the company, the proposal of the Saboo group that more manufacturers of raw material should be contacted was defeated. This according to her indicates an admission on behalf of the Saboo group that it was the Groz Beckert group that was in possession of the technology and that the Saboo group did not have the technology necessary to conduct such business. Further, this submission according to her, established that the Saboo group had not acquired the technical expertise for it is their own case that the Groz Beckert group had not transferred the same to Groz Beckert Saboo Ltd. She also relied upon the observations in the order of the Company Law Board to the effect that under

section 29 of the Foreign Exchange Regulations Act, 1973, a company in which the non-residents holding is more than 40% (as in the case of Groz Beckert Saboo Ltd. wherein the Groz Beckert group had 60% shares holding) would require the permission of the Reserve Bank of India to carry on business in India. In 1973-74, the Government required the Groz Beckert group to reduce its equity ownership in the company but considering the nature of the technology, the Reserve Bank of India permitted the Groz Beckert group to retain 60% of the equity and the Saboo group supported the same. This according to Ms. Dhugga indicated that the technology was of a high level and valuable and that it is the Groz Beckert group that was in possession of the same. She also relied upon the observations in the order of Company Law Board that in the petition the Saboo group alleged that the imported raw material and consumables and most of the imported machinery were purchased by the company i.e. the Groz Beckert Saboo Ltd. from the Groz Beckert group. The Groz Beckert group had ensured that no effective steps were taken for indigenization of raw material supply and that the Groz Beckert group had taken steps to ensure that the Saboo group remained totally dependent on imported supplies.

34. We will assume that the members of the Saboo group did not possess the technical expertise to run a similar business themselves. That does not render clause 5.5 meaningless. It is of vital importance to note that clause 5.5 prevented the members of the Saboo group from directly or indirectly engaging in a similar business or in competition with the business of Groz Beckert Saboo Ltd. The possession of technical expertise required to manufacture a product is not necessary to engage in any business similar to or in competition with the business of another. The term ‘engage’ is of wide

import. The members of Saboo group or any one of them could engage in such business merely as investors. They could in turn acquire the technical expertise from another party. They could enter into a joint venture with another party that has the technical expertise to produce similar goods and to engage in similar competitive business. The mere fact that none of the members of the Saboo group had the technical expertise themselves to manufacture the goods is entirely irrelevant. Their ability to engage in such a business is not dependent on their possessing the technical expertise required for running such a business.

35. Clause 5.5 did not prevent the members of the Saboo group merely from using their technical expertise for the purpose of engaging anywhere in India in any business similar to or in competition with the business of Groz Beckert Saboo Ltd. It prevented them from engaging anywhere in India in any business similar to or in competition with the business of Groz Beckert Saboo Ltd. or to have any interest directly or indirectly in any such business. Interest as an investor would fall within the ambit of the clause. If the members of the Saboo group or any of them invested in such a business, they could have been prevented from doing so in view of clause 5.5.

36. Faced with this, Ms. Dhugga submitted that clause 5.5 did not provide for any penalty for breach thereof.

37. This is entirely irrelevant. It does not indicate that clause 5.5 is meaningless or without any value. If there was a breach of clause 5.5, the Groz Beckert group or the company i.e. Groz Beckert Saboo Ltd. could have filed an action to prevent them from doing so by enforcing the negative covenants. They could also have sought damages for the breach of the covenants. The contention that clause 5.5 is meaningless and of no value is, therefore, rejected.

38. Ms. Dhugga further submitted that in fact there was a breach of the negative covenants as the members of Saboo group had taken over/poached some of the employees of Groz Beckert Saboo Ltd.

39. This is also irrelevant. Assuming that there was a breach, that by itself would not indicate that the clause was sham or bogus or was never intended to be acted upon. Merely because Groz Beckert Saboo Ltd. may not have filed any action to enforce the negative covenants it does not necessarily follow that the covenant was sham and was not intended to be acted upon. They may have refrained from doing so for a variety of valid reasons.

40. The contention that the covenants/negative covenants were sham, bogus and were never meant to be acted upon, is belied by at least one fact. As noted in the order of the Company Law Board, several disputes had arisen between the parties including as regards the expansion programme, transfer of technology, failure of the Groz Beckert group to give a commitment to buy back the needles at the stipulated price, frequent use of casting vote by the Chairman, illegal import of spare parts at inflated cost through the Groz Beckert group and the failure of the Groz Beckert group to take steps for indigenization of raw material supply and transfer of technology to Groz Beckert Saboo Ltd. One important dispute relates to the use of the trade mark. Groz Beckert Saboo Ltd. had an exclusive perpetual licence for unconditional use of the trade mark "GROZ-BECKERT" and other G.B. trademarks/tradenames for exports and domestic sales. The Saboo group allegedly with the knowledge and consent of the Groz-Beckert group, registered its own trademark "GROZ-Beckert SABOO LIMITED (Label)" in respect of needles falling in class 26 and that trademark was mainly used in domestic sales. According to the Groz Beckert group, the application for

registration of that trade mark was made without prior consultation and it objected to the registration thereof. Groz Beckert Saboo Ltd. ultimately withdrew its application on the condition that Groz Beckert group would register its trademark in its own name and Groz Beckert Saboo Ltd. would be permitted to continue to use the trade mark in India. Accordingly, lawyers of Groz Beckert Saboo Ltd. withdrew the application for registration and the said R.K.Saboo confirmed the same.

41. There were prolonged negotiations in this regard. There is nothing to indicate that there was no such dispute. Infact, there obviously were several disputes. This is clear from the fact that the dispute is reflected in the petition filed before the Company Law Board whereas the Share Purchase Agreement was entered into much later namely after the appeal under Section 10-F before the Delhi High Court. It is obviously in view of these various disputes that various clauses were introduced by the parties in the Share Purchase Agreement. Anyone familiar with such matter would know that the agreement is consistent with an exercise for the resolution of such disputes in corporate matters. The negative covenants therein are not at all unusual in such cases. There is nothing to indicate that they were introduced to avoid tax.

42. The submission that there was no consideration for the negative covenants is therefore rejected.

Re:-III ***The order is perverse.***

43. Ms. Dhugga further submitted that the order is perverse inasmuch as the Tribunal failed to take into consideration that even assuming that a sum of ₹ 100/- could be considered to be the consideration for the negative covenants contained in the Share Purchase Agreement, there was no further bifurcation and apportionment of the consideration towards each of the

covenants/negative covenants contained in the various clauses of the Share Purchase Agreement. She submitted that a value must then be attributed to all the covenants/negative covenants such as in Clauses 5.6, 5.7 and 5.8 set out earlier.

44. This submission must be rejected for at least two reasons, the second more important than the first.

45. Firstly, as rightly pointed out by Ms. Suri, this contention was not raised by the Assessing officer. Nor was it raised before the C.I.T. (A) or before the Tribunal. Ms. Dhugga contended that this is a pure question of law and the Department, therefore, ought to be allowed to raise the point before us although it was not raised before the CIT(A) and the Tribunal. Ms. Suri's objection is well founded. There is no justification for allowing the appellant to raise this point for the first time in the appeal before us. Had the contention been raised before the C.I.T. (A) or before the Tribunal, the respondent could conceivably have had several answers to it. If we allow the appellant to raise this contention before us we would be depriving the respondents the opportunity of adducing evidence to deal with the same. This would be unfair to the respondents.

46. Secondly, and more important, in the facts of this case, it would make no difference even if we were to accept Ms. Dhugga's submission. Ms. Dhugga may be right to the extent that there is nothing to indicate that the other covenants/negative covenants would be monetarily worthless and that some monetary value ought to be attributed to them. However, this would not be a pure abstract question of law or a mere inference to which there could be no answer. The Tribunal accepted the value of the shares at ₹ 60.24 per share. The Tribunal, therefore, rightly held that the value of ₹100/- apportioned towards

the negative covenants was not such as to warrant interference. We agree. The Chartered Accountant valued the shares in three different ways. The valuation at ₹ 106.90 per share was arrived at on the basis of Rule 14 of Schedule-III of the Wealth Tax Act, 1957; of the business as a whole, at ₹ 118.90 per share on the yield basis and at Rs. 93.12 on the basis of Rule 11 of Schedule III of the Wealth Tax Act i.e. breakup value. There is nothing to indicate that the valuation report was dishonest or malafide for any reason. Nor is there anything to indicate that it is unsustainable for any reason. It is important to note that there is no ground of appeal before us against the Tribunal's acceptance of the valuation report. The appellants themselves have not valued the shares.

47. In that event even assuming that some valuation is to be attributed to the covenants/negative covenants contained in the Share Purchase Agreement other than Clause 5.5, it would make no difference. The apportionment of sum of ₹ 100/- out of ₹ 400/- towards clause 5.5 would in any event be reasonable. We agree with the findings of the Tribunal that in view of the above facts the apportionment of 25% of the value of shares towards the negative covenants was on conservative basis.

48. In the circumstances, we do not consider it appropriate to interfere with the decision of the Tribunal on this ground. Nor do we think it necessary to remit the matter to the Tribunal for further apportionment.

Re:-IV: ***In any event, the consideration for the negative covenants under Clause 5.5 is assessable to tax under section 28 of the Act.***

49. Section 28(ii)(a) & (b) of the Act relied upon by Ms. Dhugga reads as under:-

> ***28.*** *The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession"-*
>
> *i)* *the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.*
>
> *ii)* *any compensation or other payment due to or received by,*
>
> *(a)* *any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;*
>
> *(b)* *any person, by whatever name called, managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto*;

50. Section 28 (ii) (a) & (b) are inapplicable to the facts of this case. The members of the Saboo group held only 40% of the equity shares in Groz Beckert Saboo Ltd. Their share holding even together did not give them the right to manage the whole or substantially the whole of the affairs of Groz Beckert Saboo Ltd. The terms of the collaboration agreement are important. Under the collaboration agreement, the general administration and management of Groz Beckert Saboo Ltd. was to be in the hands of the two Managing/Executive Directors with equal powers, one to be nominated by the Groz Beckert group and the other to be appointed by the Saboo group. Both the groups were entitled to nominate three Directors each. It is important to note that the Chairman of the Board of Directors was always to be one out of the three nominees of the Groz Beckert group and the Chairman was to have a casting vote. Further in respect of ten specified matters, no decision could be

taken by the Board of Directors or by the company except by the unanimous consent of all the Directors. It cannot be said, therefore, that the Saboo group managed the whole of the affairs of Groz Beckert Saboo Ltd.

51. In this view of the matter, it is not necessary to consider whether section 28(ii)(a)(b) of the Act applies in view of other certain aspects raised by Ms. Suri.

52. Ms. Dhugga rightly agreed that section 28(va) came into force with effect from 01.04.2003 and therefore, does not apply to the present case which pertains to the assessment year 1994-95.

53. The contention, therefore, that the consideration for the negative covenants in 5.5 of the Share Purchase Agreement is assessable to tax under section 28 of the Act is, therefore, rejected.

54. The question of law, is therefore answered against the Revenue/appellants and in favour of the respondents/assessees. The appeals are accordingly dismissed but with no order as to costs.

(S.J.VAZIFDAR)
ACTING CHIEF JUSTICE

(G.S.SANDHAWALIA)
JUDGE

15th May, 2015
'ravinder'

Whether to be referred to the reporter or not.	**√ Yes**	**No.**

RAVINDER SHARMA
2015.05.15 17:55
I attest to the accuracy and authenticity of this document