THE HON'BLE THE CHIEF JUSTICE ALOK ARADHE

AND

THE HON'BLE SRI JUSTICE J.SREENIVAS RAO

INCOME TAX TRIBUNAL APPEAL No.138 of 2007

JUDGMENT: *(Per the Hon'ble the Chief Justice Alok Aradhe)*

Mr. J.V.Prasad, learned Senior Standing Counsel for Income Tax Department for the appellant.

Mr. Rohan Aloor, learned counsel representing Mr. Ch.Pushyam Kiran, learned counsel for the respondent.

2. This appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') has been preferred by the Revenue. The subject matter of the appeal pertains to assessment year 2000-01. The appeal was admitted on following substantial question of law:

> "Whether the finding of the Income Tax Appellate Tribunal that the amount of Rs.6 crores received by the Assessee under an Agreement with PFIZER Company is a capital receipt not liable to tax as the same

is not a revenue receipt exigible to tax, is not erroneous in law for non-considering the relevant facts decided by the Assessing Officer and confirmed by the Appellate Authorities?"

3. The factual background in which the aforesaid substantial question of law arises for our consideration need mention.

4. The assessee is engaged in the business of manufacture and sale of Hepatitis-B Vaccine under the trade name "Shanvac-B". The assessee is equipped with in-house Research and Development team and claims to be the first company in India to develop the Hepatitis-B Vaccine. The assessee on 14.02.2000 entered into a Co-marketing agreement with PFIZER Ltd. Under the said co-marketing agreement, the assessee has agreed to manufacture the Vaccine in bulk quantities for PFIZER Limited and supply the same to it. The said Vaccine was to be promoted, marketed and sold by the PFIZER Limited. The assessee under the co-marketing agreement received a sum of Rs.6 crores.

5. The assessee filed the return of income for the assessment year 2000-01. The assessee was served with a notice on 28.03.2002 under Section 148 of the Act. The Assessing Officer passed an order on 31.03.2004 revising the computation of income. A sum of Rs.6 crores received by the assessee under the co-marketing agreement was treated as revenue receipt. Being aggrieved, the assessee filed an appeal. The Commissioner of Income Tax (Appeals) by an order dated 21.10.2004 affirmed the order of assessment and dismissed the appeal.

6. Thereupon the assessee filed an appeal before the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal'). The Tribunal by an order dated 31.03.2006 *inter alia* held that a sum of Rs.6 crores received by the assessee was not only for transfer of capital assets but also for waiver of certain rights in enduring nature and for accepting certain restrictive covenants. The Tribunal further held that the aforesaid amount of Rs.6 crores was not received from transfer of stock in trade and therefore the same cannot be treated as revenue

receipt. It was therefore held that the assessee has received the aforesaid amount by way of a capital receipt. Hence, this appeal.

7. Learned Senior Standing Counsel for the Revenue has taken various clauses of the co-marketing agreement and has submitted that none of the clauses of the co-marketing agreement affect the trading rights of the assessee. It is further submitted that under the aforesaid agreement, no capital asset has been transferred in favour of PFIZER Limited and there is no sale of the brand under the co-marketing agreement but only a sale of vaccines. It is contended that the said agreement neither affects the trading structure of the assessee in any manner nor the assessee is deprived of its source of income. It is pointed out that under the co-marketing agreement, the assessee is required to supply the vaccine in bulk quantity to PFIZER Limited and agreement has been entered into in usual course of business. It is also urged that the assessee is at liberty to carry on the trade. It is contended that the Tribunal erred in law in reversing the well-reasoned orders

passed by the Assessing Officer as well as the Commissioner of Income Tax (Appeals). In support of his submission, reliance has been placed on the decisions in **Gillanders Arbuthnot and Company Limited vs. The Commissioner of Income-Tax, Calcutta**[1], **Commissioner of Income-Tax, Punjab, Haryana, Jammu & Kashmir and Himachal Pradesh vs. Prabhu Dayal**[2], **Patiala Biscuit Manufacturers Private Limited vs. Commissioner of Income-Tax, Punjab**[3], **Ansal Properties and Industries Ltd. vs. Commissioner of Income-Tax**[4], **Commissioner of Income-Tax vs. Dr. R. L. Bhargava**[5], **Gujco Carriers vs. Commissioner of Income-Tax**[6], and **Commissioner of Income-Tax vs. Manoranjan Pictures Corporation (Priavate) Limited**[7].

8. On the other hand, learned counsel for the assessee has submitted that the assessee has received a sum of Rs.6 crores for transfer of technical know-how and

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[1] AIR 1965 SC 452
[2] AIR 1972 SC 386
[3] (1971) 82 ITR 812 (SC)
[4] (2012) 347 ITR 647 (Delhi)
[5] (2002) 174 CTR (DEL) 50
[6] (2002) 256 ITR 50 (GUJ)
[7] ILR 1998 DELHI 197

for giving up the rights in any new vaccine which may be developed by it in relation to Hepatitis-B. It is also pointed out that under the co-marketing agreement, the assessee has surrendered its knowledge and technical know-how, which is a capital asset. It is therefore contended that any compensation received in lieu of such surrender is a capital receipt. It is contended that since the assessee has entered into a non-compete agreement, the same results in loss of source of income to the assessee, which has an adverse impact on the brand and market share on account of co-marketing agreement. It is pointed out that the consideration is separately defined in the agreement for purchase of vaccine i.e., stock in trade and transfer of certain rights in receipt of covenants. Therefore, the amount received under Clause 7 of the co-marketing agreement cannot be treated as revenue receipt. In support of aforesaid submission, reliance has been placed on the decisions in **Oberoi Hotel Private Limited vs. The Commissioner of Income Tax[8], Commissioner of Income Tax, Punjab, Haryana, Jammu & Kashmir and**

[8] AIR (1999) SC 1110

Himachal Pradesh vs. Prabhu Dayal (supra), **Additional Commissioner of Income Tax vs. K.P. Karanth[9], V.C. Nannapaneni vs. Commissioner of Income Tax, Hyderabad-2[10]** and **Shiv Raj Gupta vs. Commissioner of Income Tax, Delhi-IV[11]**.

9. We have considered the rival submissions made on both sides.

10. The solitary issue which arises for consideration in this appeal is whether the payment of the amount made to the assessee under the agreement is a capital receipt or a revenue receipt. It is well settled that contract or an agreement between the parties must be construed having regard to the intention of the parties and such an intention has to be gathered from the language employed in the agreement. It is equally well settled proposition that an agreement has to be read as a whole. The Supreme Court in **Kettlewell Bullen and Company Limited vs.**

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[9] (1983) 139 ITR 479 (AP)
[10] (2018) 407 ITR 505 (AP)
[11] (2021) 11 SCC 58

Commissioner of Income Tax[12] has laid down the test to distinguish the capital receipt from the revenue receipt. It has been held that where payment is made under a covenant to compensate a person which does not affect his trading structure or his business or deprive him of his source of income, such a covenant being a normal incident of business, which leaves him free to carry on his trade shall be treated as revenue receipt. However, if the covenant impairs the trading structure of the assessee or results in loss of income to the source of income of the assessee, the payment made under such a covenant shall be treated as capital receipt.

11. The issue whether an amount received by the assessee on the condition not to carry on a competitive business was in the nature of capital receipt was considered by the Supreme Court in **Gillanders Arbuthnot and Company Limited** (supra). It was held that the compensation received by the assessee for loss of agency was revenue receipt, whereas compensation received for

[12] [1964] 53 ITR 261

restraining from carrying on the competitive business was capital receipt.

12. The principles laid down in **Kettlewell Bullen and Company Limited** (supra) were referred to with approval in **Prabhu Dayal** (supra).

13. In **Guffic Chem Private Limited** (supra), the Supreme Court reiterated the principles laid down in **Gillanders Arbuthnot and Company Limited** (supra) and held that in case an amount is received under a negative covenant by the assessee, it is in the nature of a capital receipt.

14. A three-Judge Bench of the Supreme Court in **Shiv Raj Gupta vs. Commissioner of Income Tax, Delhi-IV**[13] followed the decision in **Guffic Chem Private Limited** (supra).

15. The nature and character of a receipt whether the same is a capital receipt or a revenue receipt has to be ascertained in the facts and circumstances of the case.

[13] (2011) 11 SCC 58

Therefore, it is necessary for us to advert to the relevant clauses of the co-marketing agreement, which are extracted below for the facility of reference:

> "**2.1 Appointment:** SHANTHA hereby appoints Pfizer as the Exclusive Co-marketer for the product in the Territory.
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> **7. Payment for Appointment, Options and other Rights:**
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> **7.1 Instalments:** In consideration of SHANTHA's granting the right to compete by appointment of PFIZER as the Exclusive Co-marketer under Section 2.1 and the options granted in Section 17.1 and the exclusive negotiation rights and rights of first refusal granted in Section 17.2, PFIZER each of the following payments to SHANTHA, agrees to make unless this Agreement is terminated and the effective date of termination precedes the due date of payment.
>
> (a) 20 million rupees due and payable on the execution and delivery of this agreement;
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> (b) 20 million rupees, due and payable on the later of (i) the date which is two months after the execution of this Agreement and (ii) the date on which SHANTHA obtains written confirmation of a manufacturing license authorizing it to manufacture the PFIZER Brand for sale under Pfizer's Trademark; and
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> (c) 20 million rupees, due and payable on the date which is two months after the later of the dates referred to in Section 7.1 (b).

7.2 Payment procedure: Each such payment shall be made in accordance with Section 9.3.

8. Prices for the Product:

8.1 Prices of Commercial Product: Subject to the other provisions of this Section 8 and the provisions of Section 13, the prices to be paid by PFIZER for the PFIZER Brand purchased for commercial sale shall be those listed in Schedule B. Such prices do not include the costs of shipment, transit insurance or sales tax, which shall be borne by PFIZER.

8.2. Supply of Bonus Goods: If during any period SHANTHA supplies units of the SHANTHA Brand as bonus goods free of charge to its customers or as physicians samples, SHANTHA shall supply PFIZER free of charge with quantity of the same units of the PFIZER Brand as will permit PFIZER to distribute bonus goods free of charge to its customers or as physicians samples (as the case may be) in the same proportion as SHANTHA for the same period of time.

17. Rights to new products within the territory:

17.1.Option for new Hepatitis-B products in the territory: If at any time during the term of this Agreement, SHANTHA develops, manufactures and/or acquires the right to market any new Hepatitis-B vaccine or any vaccine that contains a combination with another Hepatitis-B PRIZER shall have the

exclusive option to become the Exclusive Co-marketeer in the Territory for the vaccine. (a) keep PFIZER reasonably informed of SHANTHA's progress in developing any such vaccine, (b) give PFIZER access to all registrations and technical information relating to the vaccine, and (c) file an application for a separate manufacturing license for a brand of the vaccine that could be co-marketed by PFIZER, in addition to and simultaneously with the application for a manufacturing license filed by SHANTHA for its own brand. PFIZER may exercise the option for any such vaccine at any time within six months after SHANTHA obtains the manufacturing license for the vaccine. If PFIZER exercises its option for any such vaccine, unless the parties agree otherwise, the terms of this Agreement (as supplemented by an agreement on the prices at which SHANTHA supplies the vaccine to PFIZER) shall apply to the new vaccine except that no payments shall be required under Section 7 other than those already provided for and paid for by PFIZER.

17.2 Rights to other new products in the territory: If at any time during the term of this Agreement, SHANTHA develops, manufactures and/or acquires the right to market any new product other than those to whom Section 17.1 applies, the following provision shall apply:

(a) SHANTHA will keep PFIZER reasonably SHANTHA's progress in developing any such product, informed of

(b) SHANTHA will give PFIZER access to all registrations and technical information relating to the product.

(c) Until the end of the six-month period beginning on the date SHANTHA obtains the manufacturing license for the product, SHANTHA will negotiate exclusively with PFIZER concerning commercialization of the product, and will not negotiate with any third parties concerning the product or offer any rights to the product to third parties.

(d) If the parties have not entered into an agreement appointing PFIZER the Exclusive Co-marketer (or some other mutually acceptable agreement) for the product by the end of the six month period referred to in Clause (c), PFIZER shall have a right of first refusal to become the Exclusive Co-marketer (or acquire such other rights as SHANTHA offers a third party) for the new product. As a consequence, SHANTHA shall not grant to a third party the right to promote, market, distribute or sell the new product in the Territory without first offering to grant such rights to PRIZER on terms and conditions no less favourable than those offered to the third party. Within one month following receipt of SHANTHA's offer, PFIZER may accept the offer. If PFIZER accepts the offer, the two parties will finalise, execute and exchange the necessary documents as soon as possible and in any event within two months after the date of PFIZER's acceptance."

16. From perusal of the agreement, the following facts can be gathered:

(i) The assessee has granted the right to market and sale of patent product of the assessee under the brand name of PFIZER.

(ii) In case assessee invents, develops, manufactures or acquire the right to market any new Hepatitis vaccine or any combination of vaccines, the PFIZER shall have the option of becoming the exclusive co-marketer of the future product.

(iii) The assessee's right to grant any right to promote, market, distribute or sell new product to a third party is taken away.

(iv) Under the agreement, if the assessee develops or manufacturers any new product, the PFIZER by virtue of payment made under the agreement, acquires certain rights in such products which includes exclusive co-marketer right as well as right of first refusal.

(v) At the end of the agreement, i.e., after fifteen years, PFIZER shall have the right to manufacture the

product or a competitive product or source the product or competitive product from a third party.

(vi) Clauses 1.14, 2.2, 3.2, 13.2, 17.1 and 17.2 contain restrictive covenants.

(vii) The amount under the agreement has not been paid by PFIZER to assessee for purchase of stock in lieu of certain commercial rights.

(viii) The patents and trademark which have not been obtained by the assessee for the vaccine have been given up for a consideration.

(ix) Thus, rights in capital asset of the assessee have been relinquished by entering into the agreement which is a restrictive covenant.

(x) The assessee has given up the right to appointment exclusively to co-marketer for all future products including combination of vaccine or any other vaccine or any other product.

(xi) The assessee is also required to share all technical information, registration, progress of development etc., of new products with the PFIZER.

17. Thus, the payment of the amount under the agreement has been made to the assessee as it has surrendered its rights in a capital asset, namely patent and trademark. The agreement in question is a negative/ restrictive covenant and the amount has been paid to the assessee in lieu of the rights which it has surrendered under the agreement. The surrender of the rights results in impairment of profit making apparatus of the company and therefore, is a capital receipt.

18. The finding recorded by the Tribunal that the amount received under the agreement is a capital receipt, which has been recorded on the basis of meticulous appreciation of evidence on record. The aforesaid finding cannot be termed as perverse. It is well settled in law that this Court in exercise of powers under Section 260A of the Act cannot interfere with the finding of fact until and unless the same is demonstrated to be perverse. (see **Syeda Rahimunnisa vs. Malan Bi by LRs**[14] **and Principal**

[14] (2016) 10 SCC 315

Commissioner of Income Tax, Bangalore vs. Softbrands India Private Limited[15]).

19. Therefore, the substantial question of law framed by this Court is answered in the negative and in favour of the assessee.

20. In the result, the appeal fails and is accordingly dismissed.

Miscellaneous petitions, if any, shall stand dismissed.

ALOK ARADHE, CJ

J.SREENIVAS RAO, J

18.11.2024
Pln /KL

[15] (2018) 406 ITR 513