



# GUFFIC CHEM P. LTD. VS. C.I.T., BELGAUM AND ANR. (2011 (3) SCALE 595)

## SUPREME COURT OF INDIA

Decided On: 16.03.2011

## RATIO DECIDENDI

“Compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capital receipt.”

## ISSUE

Whether a payment under an agreement not to compete (negative covenant agreement) is a capital receipt or a revenue receipt?

## FACTUAL MATRIX

1. Guffic Chem P. Ltd. (Assessee) was carrying on business of manufacturing, selling and distribution of pharmaceutical and medicinal preparations etc. During the assessment year 1997-98 the Assessee received Rs. 50, 00,000/- (Rupees Fifty Lakhs only) from Ranbaxy as non-competition fee. The said amount was paid by Ranbaxy under an agreement dated 31.3.1997. Under the terms of the agreement, Assessee agreed not to manufacture, itself or through its associate, certain products for 20 years within India and the rest of the world.
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3. In short, the agreement contained prohibitive or restrictive covenant in consideration of which a non-competition fee of Rs. 50 lakhs was received by the Assessee from Ranbaxy. The agreement further showed that the payment made to the Assessee was in consideration of the restrictive covenant undertaken by the Assessee for a loss of source of income.
4. The Assessing Officer treated the non-compete fees as taxable revenue receipt.

### JUDGMENT

1. There is a dichotomy between receipt of compensation by an Assessee for the loss of agency and receipt of compensation attributable to the negative or restrictive covenant. The compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative or restrictive covenant is a capital receipt.
2. The Hon'ble Supreme Court relied on its earlier decision in the case of **Gillanders' Arbuthnot and Co. Ltd v. CIT, Calcutta**, where it was held that the compensation received by the taxpayer for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capital receipt.
3. Payment received as non-competition fee under a negative covenant was always treated as a capital receipt till the assessment year 2003-04. It is only vide Finance Act, 2002 with effect from 1.4.2003 that the said capital receipt is now made taxable. The Finance Act, 2002 itself indicates that during the relevant assessment year compensation received by the Assessee under non-competition agreement was a capital receipt, not taxable under the 1961 Act. It became taxable only with effect from 1.4.2003. It is well settled that a liability cannot be created retrospectively.
4. In the present case, both CIT (A) as well as the Tribunal, came to the conclusion that the agreement entered into by the Assessee with Ranbaxy led to loss of source of business; that payment was received under the negative covenant and therefore the receipt of Rs.50 lakhs by the Assessee from Ranbaxy was in the nature of capital receipt. Further, the Supreme Court relied on its earlier decision in the case of **Commissioner of Income-Tax, Nagpur v. Rai Bahadur Jairam Valji** wherein it was held that if a contract is entered into in the ordinary course of business, any compensation received for its termination (loss of agency) would be a revenue receipt. Accordingly, the non-compete payment was in the nature of capital receipt.

## CONCLUSION

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This ruling has settled the controversy concerning taxability of non-compete fee prior to April 1, 2003.

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