

**IN THE INCOME TAX APPELLATE TRIBUNAL  
COCHIN BENCH, COCHIN**

**Before Shri Chandra Poojari, AM & Shri George George K, JM**

ITA No.102/Coch/2019 : Asst.Year 2003-2004

M/s.IBS Software Pvt. Ltd. 521-524 Nila, Technopark Campus Trivandrum – 695 581. <b>PAN : AAACI5004K.</b>	Vs.	The Asst.Commissioner of Income-tax, Circle 1(1) Trivandrum.
(Appellant)		(Respondent)

Appellant by : S/Sri.M.Gopi Krishnan Nambiar / Rajakannan  
Respondent by : Smt.A.S.Bindhu, Sr.DR

<b>Date of Hearing : 10.04.2018</b>	<b>Date of Pronouncement : 01.05.2019</b>
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**ORDER**

**Per George George K, JM**

This appeal at the instance of the assessee is directed against the Commissioner of Income-tax (Appeals)'s order dated 30.11.2018. The relevant assessment year is 2003-2004.

2. Though several grounds were raised, the solitary issue that was argued was whether amount of Rs.2,61,90,135 could be brought to tax on receipt basis u/s 28(va) of the I.T.Act?

3. The brief facts of the case are as follows:

The assessee is a company engaged in the business of software. For the assessment year 2003-2004, the return of income was filed on 27.11.2003 disclosing a loss of

Rs.12,28,230. The assessee (IBS Group) had entered into an agreement with IBS Software Services (Business Co-operative Agreement dated 31.12.1999 effective from 01.01.2000 – hereinafter referred to as “BCA”). As per the BCA, the current business, the staff and software development facility of the assessee was to be handed over to IBS Software Services. Further, as per clause 2.2 of BCA, the assessee had undertaken not to carry on same or similar business during the subsistence of the BCA. In view of the undertaking not to carry on same or similar business, the assessee was compensated as per Attachment 2 to BCA. During the previous year, relevant to the current assessment year, the assessee had received a sum of Rs.2,61,90,135 as compensation for discontinuance of business.

4. The Assessing Officer issued notice u/s 148 of the I.T.Act to bring to tax the amount of Rs.2,61,90,135. The assessee objected to the proposed addition of Rs.2,61,90,135, stating that entire amount payable as per the BCA had accrued to the assessee at the time of entering into the agreement in the year 1999. It was submitted that it is due to this fact that the assessee had credited the full amount to the capital reserve account. It was further submitted that the compensation paid was capitalized in the books of account of the payee, namely, IBS Software Services as an intangible asset and depreciation was claimed on the same. It was contended that merely because the liability was to be paid in installment does not mean that the income accrued from year to year. The

Assessing Officer, however, rejected the contentions / objections of the assessee and brought to tax the sum of Rs.2,61,90,135. The relevant finding of the Assessing Officer reads as follows:-

*"7. The assessee's contentions have been considered. Though the compensation payable as per agreement was to be fully paid by 31/12/2002, the amount has not been paid and an amount of Rs.46,461/-, Rs.422.56 is still outstanding to be paid by IBS software Services. Section 28(va) has come into effect from 1/4/2003 as per which any amount whether received or receivable in cash or kind in pursuance of an agreement for not carrying on competing business is taxable as business income. The two conditions that (1) the amount is receivable as per the terms of agreement (2) the payment is for not carrying on any activity in relation to business as satisfied in this case. In the circumstances the assessee's contentions are not accepted and the compensation receivable as per agreement for the period from 1/4/2002 to 31/12/2002 amounting to Rs.2,61,90,135/- is brought to tax as business income."*

5. Aggrieved by the addition of Rs.2,61,90,135, the assessee preferred an appeal to the first appellate authority. Several contentions were raised before the CIT(A). The CIT(A) rejected all the contentions raised by the assessee. The findings of the CIT(A) as regards the rejection of assessee's contention that the amount did not accrue in the current assessment year, but in the assessment year 2000-2001 and hence not taxable in the assessment year reads as follows:

*“4.2.3 It is evident from the compensation terms that the non-compete fees is receivable by the Appellant only in monthly installments and accordingly, accrues to the Appellant in the respective months. Hence, there is no merit in the submission of the Appellant that the entire amount of non-compete fees has accrued on the date of agreement itself. Hence, the ground raised on this issue is dismissed.”*

6. Aggrieved by the order of the CIT(A), the assessee preferred the appeal before the Tribunal. The learned Counsel for the assessee confined his submission that the amount accrued in the assessment year 2000-2001 and cannot be brought to tax u/s 28(va) of the I.T.Act on receipt basis in the current assessment year. The assessee has filed a paper book comprising of 166 pages enclosing the audited financial statement of the assessee as well as the payer, IBS Software Services, the BCA dated 31.12.1999, the objections raised with regard to reopening of assessment, etc. The learned Departmental Representative, on the other hand, strongly supported the orders of the Income-tax Authorities.

7. We have heard the rival submissions and perused the material on record. When an Assessing Officer proceeds to include a particular income in the assessment, two questions arise namely: (i) what is the system of accountancy adopted by the assessee? And (ii) if it is the mercantile system of accountancy, subject to the deeming provisions, when has the right to receive that amount accrued? If the A.O. comes to the conclusion that such a right accrued or arose to the assessee

in a particular accounting year, he shall include the said income in the assessment of the succeeding assessment year. If, on the other hand, the assessee follows the cash system of accounting, the income would be includible in the assessment year next following the accounting year in which it was actually received, no matter when it did accrue. From the principles governing the mercantile system set out above, it will be clear that income which has already accrued cannot be sought to be taxed in a subsequent year for the reason that it escaped assessment in its year of accrual even if such escapement be due to a fault or device of the assessee. The proper remedy for the department in such a case would be to reopen the assessment of the earlier year, if possible.

7.1 In the instant case, undisputedly the assessee is following mercantile system of accounting. This fact is evident from the first page of the impugned assessment order. To find out whether the income had accrued in assessment year 2000-2001 or during the current assessment year, necessarily we have to examine the terms / clauses of the BCA. If the income had accrued in the assessment year 2000-2001 when BCA was entered into, necessarily the same cannot be brought to tax in the current assessment year. As per clauses / terms of the BCA, the business, staff, software development facility of the assessee was to be handed over to IBS Software Services. As per clause 2.2 of the BCA, the assessee had undertaken not to carry on same or similar business during the subsistence of BCA. In lieu of the undertaking not to carry

on same or similar business, the assessee was compensated as per Attachment-2 to the BCA. During the relevant assessment year, the assessee received a sum of Rs.2,61,90,135 as compensation for discontinuance of business. The compensation was paid as per Attachment-2 to BCA. The Attachment-2 to the BCA which deals with the compensation terms and break-up of compensation reads as follows:-

**Attachment 2 to the Business Co-operation Agreement No.001/1999**

Compensation Terms

1. IBS Software Services shall compensate IBS Group, as described herein, towards the loss that IBS Group will incur on account of not carrying on same or similar business.
2. IBS Software Services shall pay IBS Group a total of United States Dollars 2.4 Millions (US\$ 2,400,000) and this amount shall be paid in thirty six (36) equal monthly installments, starting from 01 January 2000. The monthly payment, accordingly, shall be US Dollars Sixty Six Thousand Six Hundred and Sixty Seven (US\$ 66,667).
3. IBS Software Services shall pay IBS Group the monthly payment as per clauses 2 above within the first seven days (7) of every month.

Break-up of Compensation Terms:

1. The compensation of US Dollars Two Million Four Hundred Thousand (USD 2,400,000) would comprise of the following amounts:

\* US Dollars Two Million Three Hundred and Twenty Eight Thousand (USD 2,328,000) towards discontinuance of the business; and

\* US Dollars Seventy Two Thousand (USD 72,000) towards the rental of the premises hitherto used by IBS Group for software development activities.

The monthly payment, accordingly, shall be US Dollars Sixty Six Thousand Six Hundred and Sixty Seven (USD 66,667) which would comprise as follows:

\* US Dollars Sixty Four Thousand Six Hundred and Sixty Seven (USD 64,667) only towards discontinuance of business; and

\* US Dollars Two Thousand (USD 2,000) towards rental of the premises hitherto used by IBS Group for software development activities.

2. IBS Software Services shall pay IBS Group the monthly payment as per clauses 2 above within the first seven days (7) of every month.

7.2 The BCA was entered on 31.12.1999 and was effective from 01.01.2000. The total compensation receivable in terms of BCA was amounting to Rs.10.92 crore (2.4 Million US\$). From the terms and clauses of BCA, it is clear that the amount has accrued on the basis of agreement entered. It is due to these facts the assessee had credited the full amount to the capital reserve account. It is also to be mentioned that the compensation paid by the payer, i.e., IBS Software Services was capitalized in their books of account as an intangible asset and depreciation was claimed on the same. It

is clear from the terms / clauses of the BCA that the liability though paid in installments, had accrued when the agreement was entered and was effective from 01.01.2000.

7.3 The Hon'ble Apex Court in the case of *The Morvi Industries Pvt. Ltd. v. CIT (82 ITR 835) (SC)* held that income can be said to accrue when it become due. The date of payment does not affect the accrual of income and the moment the income accrues the assessee gets vested with the right to claim the amount even though it may not be immediately. It was further held in the case that income accrues, when there arises a corresponding liability of the other party, from whom the income become due to pay that amount. These principles were reiterated by the Apex Court in *CIT v. Excel Industries Ltd. (358 ITR 295) (SC)*. In this case the entire amount receivable against the BCA had accrued immediately on execution of the agreement, the taxing of the proportionate amount of nine months upto 31.12.2002 during this year on receipt basis is thus unjustified. The Karnataka High Court in *CIT v. Amco Power Systems Ltd (379 ITR 375) (Kar.)* has upheld the principle that, in mercantile system of accounts, in a case of payment of lump sum consideration, the liability to pay the entire consideration had arisen on the date of the agreement though the payment was deferred over a period of time.

7.4 Further question is whether there is a provision to bring to tax the above amount received by the assessee in the



current assessment year on receipt basis. The A.O. relies on the provisions of section 28(va) of the I.T.Act. Section 28(va) of the I.T.Act was inserted by the Finance Act, 2002 with effect from 01.04.2003. Therefore, the said provision is applicable for and from assessment year 2003-2004. But for section 28(va) of the I.T.Act, the amount received by the assessee would have been a capital receipt and the same would not have been taxable. The further question is whether there is a deeming fiction in section 28(va) of the I.T.Act to bring to tax the amount on receipt basis. Section 28(va) of the I.T.Act inserted with effect from 01.04.2003 reads as follows:-

#### **28. PROFITS AND GAINS OF BUSINESS OR PROFESSION**

The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession",--

.....

(va) any sum, whether received or receivable in cash or kind, under an agreement for--

(a) not carrying out any activity in relation to or profession ; or

(b) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

Provided that sub-clause (a) shall not apply to—

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on or profession, which is chargeable under the head 'Capital gains' ;

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone Layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

7.5 The above provision does not speak of any deeming fiction whereby the amount received can be brought to tax on receipt basis. On the contrary, the amount received or receivable can be brought to tax, depending the system of accounting adopted by the assessee. In the instant case since the assessee has adopted mercantile system of accounting and the amount had accrued in assessment year 2000-2001, the same cannot be brought to tax in the current assessment year. It is ordered accordingly.

8. In the result, the appeal filed by the assessee is allowed.

Order pronounced on this 01<sup>st</sup> day of May, 2019.

Sd/-  
**(Chandra Poojari)**  
**ACCOUNTANT MEMBER**

Sd/-  
**(George George K)**  
**JUDICIAL MEMBER**

Cochin ; Dated : 01<sup>st</sup> May, 2019.  
Devdas\*

**Copy of the Order forwarded to :**

1. The Appellant
2. The Respondent.
3. The Pr.CIT, Thiruvananthapuram.
4. The CIT(Appeals) Thiruvananthapuram.
5. DR, ITAT, Cochin
6. Guard file.

BY ORDER,

(Asstt. Registrar)  
**ITAT, Cochin**