

## Compensation received in connection with termination of share purchase agreement to be taxed as revenue receipt

**Summary – The High Court of Himachal Pradesh in a recent case of Avantor Performance Materials India Ltd., (the Assessee) held that Compensation received in connection with termination of share purchase agreement to be taxed as revenue receipt**

### Facts

- The assessee/a company, paid certain amount as earnest money to purchase shares under SPA (Special Purchase Agreement) from shareholders of Zydus. Later, the sellers expressed their inability to sell their shares.
- The assessee received compensation for termination of SPA and claimed that same as capital receipt.
- The Assessing Officer rejected assessee's claim and reassessed income by claiming the same as revenue receipt.
- On appeal, the Commissioner (Appeals), confirmed the order of the Assessing Officer.
- On appeal, the Tribunal affirmed the order of above authorities.
- On appeal before the High Court:

### Held

- It is the case of the assessee that the sellers had pledged their equity with Cadila, against a loan of Rs. 21,71,68,263/-. Also they were in debt to the company Zydus. *Vide* Special Purchase Agreement dated 10-3-2007 (hereinafter referred to as SPA), the Sellers agreed to transfer their entire shareholdings (50 per cent of Zydus) in favour of the assessee. This was for a valuable consideration of Rs. 72.5 crores. In terms of the SPA, a sum of Rs. 24, 81, 68, 263/- was paid as earnest money by the assessee. Undisputedly, as per *inter se* arrangement amongst the shareholders of Zydus, Cadila had a Right of First Refusal (ROFR), which fact is evident from Clause-5 of the SPA.
- *Vide* another agreement of the same date which is termed as a supplementary agreement, Sellers also agreed to convince Cadila to sell their entire shareholding, i.e., balance 50 per cent in Zydus, to the assessee. In terms thereof, assessee also deposited Rs. 15 crores with the Escrow Agent.
- *Vide* communication dated 10-5-2007, the Sellers expressed their inability to sell their shares, conveying Cadila's intention of purchasing the same by virtue and in exercise of their pre-existing contractual Rights of Refusal. Accordingly Sellers, categorically called upon the assessee to terminate the SPA and accept Earnest Deposit Amount, interest and penalty in terms of SPA another supplementary agreement was executed on 22-5-2007 between the assessee and the sellers,

wherein the parties agreed to terminate the SPA by making payments to the assessee being Earnest Deposit Amount under the SPA, interest, penalty and also compensation for termination of SPA.

- Rs. 2,25,91,587/-, received as compensation by the assessee for termination of the SPA, was so claimed as a capital receipt, but assessed by the revenue as revenue receipt and subjected to payment of tax.
- The SPA provided for the consequences of the termination of the agreement and in terms thereof, assessee did receive the amounts towards payment of interest and penalty. Compensation for termination was nowhere in contemplation in the SPA. What was the basis for arriving such compensation remains a shrouded secret.
- It has been rightly held by the authorities that Zydus was engaged in the business, similar to that of the assessee, who was exploring the possibility of expanding its business interests. Compensation is not on account of any injury to any of the capital assets of the assessee. The assessee, had also entered into business acquisition agreement with Wipro and Godrej Industries Ltd. The assessee was pursuing strategic inorganic growth through acquisitions. Zydus was in the similar business as that of the assessee. The intent was not to purchase the shares of Zydus but takeover its business for expansion. As observed by Assessing Officer even the view of the statutory auditors was similar to that of the revenue.
- Noticeably it is the assessee, who had terminated the SPA and not the sellers and as such there was no breach thereof, necessitating payment of compensation to the assessee. The SPA was conditional and subject to approval by Cadila.
- Even otherwise it is well settled legal position that in order to find out whether a receipt is a capital or revenue receipt, one has to see it in the hands of the receiver and in order to find out whether an expenditure is a capital or revenue expenditure, one has to see what it is in the hand of the payer.
- If a receipt is a capital receipt in the hands of a recipient, it does not necessarily follow that expenditure is capital expenditure in the hand of a payer. Whether it is capital expenditure or revenue expenditure would have to be determined having regard to the nature of the transaction and other relevant factors.
- The assessee knew from the very beginning the conditionality clause. He was conscious that no injury would be caused to his business in the event of SPA not being materialized and its non-execution would in no manner impair its revenue.
- In the aforesaid factual background, the authorities below have rightly held the amount of compensation to be a revenue receipt. Income earned from such sources was to be taxed as business income.
- Now in the instant case as already observed, it is not the case of the assessee that his business had come to a halt or impaired the source of income. Hence applying the principle of law laid down in the decisions referred to *Kettlewell Bullen & Co. Ltd. v. CIT* AIR 1965 SC 65, there is no reason to interfere with the orders passed by the authorities below.

- It is not a case where there was termination of an agreement bringing the business of the assessee to a halt or impairing income or source of income.
- Hence, for all the aforesaid reasons, it cannot be said that the authorities below, and more particularly the Tribunal erred in holding the amount of compensation received by the assessee as a revenue receipt taxable in the hands of the assessee.