

In the High Court of Judicature at Madras

Dated: 04.03.2015

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The Honourable **Mr.JUSTICE R.SUDHAKAR**
and

The Honourable **Mrs.JUSTICE S.VIMALA**

Tax Case (Appeal) No.316 of 2008

Commissioner of Income Tax
Chennai.

.... Appellant

Vs.

Hackbridge Hewittic & Easun Ltd.,
476, Anna Salai, Nandanam,
Chennai – 600 035.

.... Respondent

Appeal under Section 260A of the Income Tax Act against the order dated 5.10.2007 made in I.T.A.No.1183/Mds/2002 on the file of the Income Tax Appellate Tribunal Madras 'A' Bench for the assessment year 1996-97.

For Appellant : Mr.T.R.Senthil Kumar
Standing Counsel

For Respondent : Mr.J.Balachander

J U D G M E N T

(Delivered by R.SUDHAKAR,J.)

This Tax Case (Appeal) filed by the Revenue as against the order dated 5.10.2007 made in I.T.A.No.1183/Mds/2002 on the file of the Income Tax Appellate Tribunal Madras 'A' Bench for the assessment year 1996-97 was admitted on the following substantial question of law:

"i) Whether on the facts and circumstances of the case, the Tribunal was right in holding that no part of the consideration should be apportioned towards goodwill, and that the entire amount should be treated as non compete fee contrary to the ruling of this Court in the case of G.D.Naidu (165 ITR 63)?"

2. The brief facts of the case in a nutshell are as follows:

The assessee company entered into an agreement with Maschinenfabrik Reinhausen GmbH Germany (MR) to sell plant and machinery in respect of Tap Changer Division of the company. The business of the assessee company consisted of two division, viz., Transformer Division manufacturing power transformers and Tap Changer Division. As per the agreement, the assessee undertook not to engage either directly or indirectly in the manufacture of existing range of products. On the basis of the the agreement for cessation of the manufacturing activity, especially "D" and "V" type tap changers

including MA2 and MA9 drive mechanism, a sum of Rs.6.89 crores (approx.) was received by the assessee as a consideration for complying with the terms of agreement and claimed the same as exempt as capital receipt. However, the Assessing Officer held that there was absolute transfer of business's independent unit with all tangible and intangible asset. The Assessing Officer further held there was a separate consideration received for the sale of plant and machinery and related equipments, and hence, the receipt should be attributed to transfer of goodwill and restrictive covenants. Accordingly, the Assessing Officer brought to the tax the amount from capital gains in respect of the transfer of goodwill to the extent of 403.89 lakhs by adopting the cost of acquisition at nil.

3. Aggrieved by the said order of the Assessing Officer, the assessee pursued the matter before the Commissioner of Income Tax (Appeals), who accepted the contention of the assessee, thereby allowed the appeal holding that there was no element of goodwill in the agreement entered into by the assessee with MR in regard to the transfer of business and non-compete clause in the agreement and hence, the entire receipt should be attributed to restrictive covenants/non-compete fee. Accordingly, the Commissioner of

Income Tax (Appeals) deleted the addition.

4. Not satisfied with the order of the Commissioner of Income Tax (Appeals), the Revenue pursued the matter before the Income Tax Appellate Tribunal.

5. The Tribunal, by following the decision in the case of *DCIT V. Indian Syntans Investments (P) Ltd. (2007) (106 TTJ 388)*, dismissed the appeal holding as follows:

" 3. In this case there is no dispute that the assessee company has transferred the technical know-how or any other advantage to the joint venture comprising the assessee company and MR. Under similar circumstances this Tribunal, to which one of us the Accountant Member was a party, has held in the case of *DCIT vs. Indian Syntans Investments (P) Ltd. (2007) (106 TTJ 388)* held that the assessee company surrendered all its trade names, customers list, suppliers list, licenses, permits, approval under an agreement with another company, and the latter having continued the business using its own logo and trade names, there was no intention to acquire the goodwill of the assessee and therefore, the non-compete fee received by the assessee cannot be treated as goodwill and it is not taxable as income. The recourse to sec.55(2) can be made only from the Asst. year 1998-99 in respect

of consideration received for the transfer thereof, which includes extinguishment or curtailment of such right. In this connection the Id. Counsel for the assessee has relied on the CBDT Instruction No.1964 dated 17-03-1999. The appeal before us for the Asst. year 1996-97 and on this count also we are of the opinion that the AO was not justified in charging goodwill as taxable income. On the above reasoning and in the facts and circumstances of the case, we are in full agreement with the findings of the Id. CIT(A) that this compensation was not at all taxable."

6. Aggrieved by the said order of the Tribunal, the Revenue has filed the present Tax Case (Appeal).

7. Learned counsel appearing for the assessee submitted that the issue involved in this appeal has been considered by the Supreme Court in in the case of **Guffic Chem. P. Ltd. V. Commissioner of Income-Tax** reported in **(2011) 332 ITR 602**, wherein, the issue was held in favour of the assessee on the ground that the compensation attributable to a negative/restrictive covenants is a capital receipt.

8. Heard learned standing counsel appearing for the Revenue and the learned counsel appearing for the assessee and perused the materials placed before this Court.

9. The assessment in this case relates to the assessment year 1996-97. It is seen that the Commissioner of Income Tax (Appeals) as well as the Tribunal came to hold that the agreement does not contain any clause which could be referred to transfer of goodwill, since the payment is in relation to cessation of certain manufacturing activity of the assessee company giving exclusive right to M/s.MR. The Appellate Authority as well as the Tribunal accepted the assessee's plea that it is not a payment in respect of goodwill.

10. The admitted fact in this case is the assessee company has transferred the technical know how and other advantages to the joint venture company consisting of the assessee company and MR and the assessee continued its business using its own logo, trade name, licenses, permits and approval under an agreement with another company. The Tribunal came to hold that there was no intention to acquire goodwill of the assessee and therefore, non-compete fee received by the assessee could not be treated as goodwill and it is not

taxable as income.

11. We find, on facts, that there is no reason to differ with the said finding. The reliance placed by the Assessing Officer on Section 55(2)(a) of the Income Tax Act was repelled by the Tribunal rightly on a plea that the said provision came into effect in the year 1998-99, whereas the assessment year in the present case is 1996-97. Therefore, there was no basis to fall back on the said provision. As has been recorded by the Commissioner of Income Tax (Appeals) and the Tribunal, we find, in the facts of the present case, that the non-compete fee received by the assessee is capital in nature.

12. As rightly relied on by the learned counsel appearing for the assessee, similar issue was considered by the Supreme Court in the case of ***Guffic Chem. P. Ltd. V. Commissioner of Income-Tax*** reported in ***(2011) 332 ITR 602***. The facts therein are the assessee carrying on business of manufacturing, selling and distribution of pharmaceutical and medical preparations received a sum of Rs.50 lakhs during the assessment year 1997-98, from Ranbaxy as non-competition fee. The Tribunal held that the said amount was capital receipt. On appeal, the High Court reversed the said decision.

However, On further appeal, the Supreme Court held as follows:

"7. Two questions arose for determination, namely, whether the amounts received by the appellant for loss of agency was in normal course of business and therefore whether they constituted revenue receipt? The second question which arose before this Court was whether the amount received by the assessee (compensation) on the condition not to carry on a competitive business was in the nature of capital receipt? It was held that the compensation received by the assessee for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capital receipt. This dichotomy has not been appreciated by the High Court in its impugned judgment.

*The High Court has misinterpreted the judgment of this Court in Gillanders' case (supra). In the present case, the Department has not impugned the genuineness of the transaction. In the present case, we are of the view that the High Court has erred in interfering with the concurrent findings of fact recorded by the CIT(A) and the Tribunal. **One more aspect needs to be highlighted. 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 [See: Section 28(va)]. 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.

In the present case, compensation received under Non-Competition Agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide Section 28(va) and that too with effect from 1.4.2003. Hence, the said Section 28(va) is amendatory and not clarificatory. Lastly, in Commissioner of Income-Tax, Nagpur v. Rai Bahadur Jairam Valji reported in 35 ITR 148 it was held by this Court 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. 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 `50 lakhs by the assessee from Ranbaxy was in the nature of capital receipt. In fact, in order to put an end to the litigation, Parliament stepped in to specifically tax such receipts under non-competition agreement with effect from

1.4.2003.

(emphasis supplied).

13. In the above-said decision, the Supreme Court emphasised the fact that Finance Act, 2002, which came into effect from 01.04.2003, makes the capital receipt as taxable under Section 28(va) and held that liability cannot be created retrospectively.

14. Similar is the issue in respect of Section 55(2)(a) of the Income Tax Act. The said principle will apply to the provision under Section 55(2)(a), which came into effect only from the assessment year 1998-99. The assessment year in this case is 1996-97. Accordingly, following the above-said decision of the Supreme Court, the issue is answered in favour of the assessee and against the Revenue.

15. In the result, this Tax Case (Appeal) stands dismissed. No costs.

Index : Yes/No
Internet:Yes/No
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(R.S.,J) (S.V.,J)
04.03.2015

To

1. The Income Tax Appellate Tribunal Madras 'A' Bench
2. The Commissioner of Income Tax (Appeals)-XI, Chennai.
3. The Joint Commissioner of Income-tax, Special Range VI, Chennai.

R.SUDHAKAR,J.

AND

S.VIMALA,J.

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