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IN THE HIGH COURT OF DELHI AT NEW DELHI

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ITA 167/2003

Reserved on : November 26, 2015

Date of decision: December 21, 2015

THE COMMISSIONER OF INCOME TAX Appellant
Through: Mr. Raghvendra K. Singh,
Junior Standing counsel.

versus

HCL INFOSYSTEMS LTD Respondent
Through: Mr. Ajay Vohra, Senior
Advocate with Ms. Kavita Jha and Ms.
Mehak Gupta, Advocates.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

J U D G M E N T

21.12.2015

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Dr. S. Muralidhar, J.:

1. This is an appeal by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act') against the impugned order dated 3rd October 2002 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No. 1280/Del/2002 for the Assessment Year ('AY') 1998-99.

Question of law

2. While admitting this appeal on 1st February 2006 the Court framed the following question of law for determination:

“Whether the ITAT was correct in holding that receipt of Rs. 6080.95 lakhs by the Assessee as compensation on termination of joint-venture agreement was not taxable as income under the Head ‘Capital Gains’?”

Background Facts

3. The facts leading to the filing of the present appeal are that the Assessee, HCL Infosystems Limited ('HIL'), which was initially incorporated as HCL Limited under the Companies Act, 1956 on 17th April 1986, was engaged in the manufacture, distribution and sale of computers and services in India. At that stage most of the computer products being manufactured by it were designed in-house.

4. Hewlett Packard Inc (HP), a company incorporated in the United States of America (USA), is engaged in the design, engineering, manufacture, assembly and sale of certain types of computers, along with their components and peripherals. It has substantial experience, expertise and reputation in its area of operations. Hewlett-Packard India Pvt. Ltd. ('HPI') is the subsidiary of HP in India and is engaged in the manufacture of computers in India under licences from HP.

The JVA

5. On 2nd April 1991 HCL Limited, HP, HPI and a majority of its shareholders which included, Mr. Shiv Nadar, Ms. Kiran Nadar, Roshini Nadar, S.S. Nadar, Shiv Nadar Investments Pvt Ltd. and certain other individuals, viz., Ajai Chowdhry, D.S. Puri, Arjun Malhotra, Y.C. Vaidya and Subhash Arora and the companies and individuals named in Exhibit 'A' attached to the Agreement (hereinafter referred to collectively as 'the Control Group') entered into a 'Joint Venture Agreement ('JVA). The agreement was described as 'An Agreement Regarding HCL HEWLETT-PACKARD LTD'. This JVA was further amended on 27th May 1991. In terms of the JVA, the parties agreed to combine their respective computer manufacturing, marketing, servicing and sales activities in India of both

HCL Limited (subsequently renamed as HIL, the Assessee) and HPI. 26% equity in the JVA was held by HP, through its wholly-owned subsidiary, Hewlett-Packard Delaware Capital Inc. ('HPDC'). HIL was permitted to use the name 'Hewlett Packard' under the JVA. The joint venture company was accordingly renamed as HCL Hewlett-Packard Ltd ('HCL HP Ltd.')

6. The basic idea behind the JVA was indicated in the preamble to the JVA. It was that "HCL had been and continues to be recipient of workstation computer technology from HP pursuant to an agreement entered into with Apollo Computers Domain GMBH, a subsidiary of Apollo Computer Inc. (Apollo) which was subsequently assumed by HP when it acquired Apollo." Further, HCL was, pursuant to a certain Representation Agreement dated 24th October 1990, the exclusive representative of HP's computer products in India. The idea was that instead of both HCL and HPI separately representing HP's interests, it was decided to combine their respective activities into one operation to be conducted by a company in India owned jointly by HP and the shareholders of HCL.

7. Para 14.3 of the JVA dated 2nd April 1991 contained a 'non-compete clause'. The parties to the JVA agreed "not to enter, either directly or indirectly, into any business in India which would be in competition with" HCL HP Ltd. For purposes of para 14.3, the manufacture, marketing, sale or support of laptop computers by HCL or its successor in India "shall not be considered a breach of this provision so long as such activities occur prior to any similar activities undertaken by the company." In terms of the JVA, the following rights were available to HCL HP Ltd:

- (a) the right to use the name HP;
- (b) the license to manufacture HP products with exclusive use of HP technology;
- (c) using of HP patents, trademarks, logos, technical know-how, technical skills, drawing specifications, blue prints, test procedures, etc., and
- (d) access to HP's worldwide strategies in marketing, product introduction support and business planning.

8. Under Clause 7 of the JVA, there was to be a transfer of know-how by HP for the manufacture, assembly and sale of selected HP transfer products in India. Clause 7.4 stated that HP would grant certain limited and restricted rights in HP copyrights, HP trademarks and HP patent rights to the HCL HP Ltd on terms and conditions to be negotiated between the two companies. It was made clear that no such grant shall confer upon HCL, the Control Group or HCL HP Ltd. any rights of ownership whatsoever in HP copyrights, HP trademarks or HP patent rights. In terms of Clause 7.5 of the JVA to the extent certain intellectual property rights used by the computer division of HCL Ltd. were not transferred to HCL HP pursuant to the 'Spinoff', HCL agreed to provide to HCL P on a royalty-free basis a non-exclusive licence to use and sub-licence such property rights in perpetuity.

9. Under Clause 1.24 'Spinoff' was defined to mean 'the scheme of arrangement' under which HCL's computer division including the rights under the Technology Licence and Technical Assistance Agreement (TLTAA) together with the remainder assets of HCL would be transferred to HCL HP. The TLTAA was separately executed between HP and HCL HP on 30th October/24th November 1992.

10. Clause 2.2 of the JVA stated that in addition to the provisions of Article 12.4, should HP, “in its sole discretion, determine” that the HCL HP Ltd had breached any trademark or other agreement which has been or may be entered into between HP and HIL or has engaged in any business practices which violate Indian or US Laws or HP’s standards of business conduct, or has failed to meet HP’s standards of excellence in such areas as engineering, product quality, support or customer satisfaction or has engaged in any acts “which are likely to damage the reputation or business interests of HP” or if HP’s ownership of HCL HP Ltd. fall below 25% plus one share, then HP may withdraw such consent or permission and the parties were to take all steps necessary to ensure that the name of HCL HP Ltd. was immediately changed so that in the opinion of HP the name no longer contains any reference to HP. 26% of the shares of HCL HP Ltd were to be deposited into an Escrow and were to be released to HP upon HP’s depositing into the Escrow an amount equal to Rs. 46.8 crores, which amount would be distributed to the share shareholders in accordance with their entitlement.

11. The term ‘Annual Business Plan’ was defined under Clause 1.3 of the JVA as the annual plan of HCL and HPI for the current financial year consisting of

- a. R & D manufacturing and sales plan;
- b. The projected profit and loss statement and balance sheet;
- c. Cash-flow projections; and
- d. Capital expenditure plan.

12. Under Clause 6 of the JVA, the business of HCL HP Ltd. was to be conducted in accordance with an Annual Business Plan. It was subject to the prior approval of the Board and could be amended only by resolution of the Board or agreement of the parties, to be ratified by the Board.

The NCA

13. A separate Non-Competition Agreement ('NCA') was entered into by HP and HCL HP Ltd on 31st October 1991. This was to continue for five years after commencement of commercial production by HCL HP Ltd or six years from the effective date which was earlier. The effective date was the date on which the agreement would be finally approved by the Reserve Bank of India ('RBI'). This NCA provided for licencing of HP transfer products, HP patent rights, HP know-how, HP copyrights and HP trademarks. The licence fee was stipulated in the said agreement.

14. The idea behind the NCA was that the parties desired to "avoid competition with each other by limiting HP India from entering into any new business activities in respect of products directly competitive with the computers/workstations and related software product range manufactured or distributed by HCL HP". For the first time in November 1991, at the request of HCL HP Ltd., HP India released its employees solely engaged in handling business of the said products to HCL HP. In consideration of HP India not agreeing to compete with HCL HP, HCL HP was to pay HP India a sum of Rs. 4.30 crores at a mutually agreed time. The NCA was to be in force for a period of five years from the effective date.

The termination agreement

15. The JVA was terminated by an agreement dated 1st April 1997. The termination agreement was entered into between HP, HCL HP, HPI and the Control Group. It was acknowledged that since the formation of HCL HP, the competitive landscape had changed significantly "due to increased investment and interest in India by HP's global competitors." It

was accordingly decided that the implementation of HP's worldwide model for the distribution of personal computers would be in their mutual best interest and the best approach to ensure long term market growth, pursuant to a letter dated 5th September 1995 (referred to as the 'Letter Agreement'), was to allow HPI the temporary right to establish and manage multiple channels for the distribution and sale of HP personal computer products in India, while retaining HCL HP as a premier channel partner.

16. It was further stated that HP was to "develop a more flexible relationship with HCL HP, fully compensate HCL HP for its agreement to allow HP to develop competing channels of distribution as provided in this and related agreements and provide HCL HP key business and financial support to assist it in the transition period from a licensed manufacturer of HP products to a premier solutions partner as well as strong competitor in a field of multiple HP distributors. HP has, therefore, offered for sale its entire shareholding in HCL HP to the members of the Control Group and in turn obtained the "freedom to implement in India through HPL (for other wholly or owned HP entity) its worldwide sales, distribution and business models and discontinue manufacturing of HP computers and software in HCL HP under the licensing agreements." Correspondingly, the Control Group (referred to as SAAAP) agreed to acquire HP's share in HCL HP "in order to assert more complete ownership and management control over HCL HP's principal business activities."

17. Clause 1 of the Termination Agreement dated 1st April 1997 sets out the offered price by HP to sell all of the shares in HCL HP held by it to all the members of the Control Group and to stipulate the time limit

within which the offer is to be satisfied. Clause 2 which is relevant for the present case reads as under:

“2. HP shall pay to HCL HP as full compensation to HCL HP, its shareholders, creditors and any other interested persons for the past and future loss of exclusive with respect of HP computer products and elimination of non-competition obligations referred to in Article 14.3 of the Joint Venture Agreement the sum of Seventeen Million Dollars (\$17,000,00) as follows:

a. On or before April 5, 1997, eight million dollars (\$8,000,000) (hereinafter referred to as the ‘First Instalment’) to HCL HP’s designated bank outside of India.

b. Upon the completion of the sale by HPDC of the shares in HCL HP offered to SAAAP pursuant to Article I, Nine million dollars (\$9,000,000) (hereinafter referred to as the ‘Final Instalment’).

HP’s obligations to pay instalments under this Article are expressly conditioned on SAAAP’s being in full compliance with the terms of this Agreement.”

18. The payment of the aforementioned sum by HP to HCL HP was Rs. 60.82 crores, which forms the subject matter of the case. The question is about treating the aforesaid sum as income under the Head ‘Capital Gains’.

The Assessment order

19. In the assessment order dated 31st January 2001 under Section 143 (3) of the Act, the Assessing Officer (‘AO’) noted that the compensation was indeed a capital income but held that it was nevertheless taxable under Section 55 (2) of the Act. The AO held that the extinguishment of these bundle of rights by termination of the JVA resulted in transfer of an asset in terms of Section 2(47)(ii) of the Act. The AO rejected the contention of the Assessee that the said capital receipt was not taxable. He held:

"The amendment to Finance Act, 1997 also very clearly states that if the extinguishment of the capital right to manufacture is for consideration it will fall under Section 55. The Assessee is, therefore, covered by the provision of Section 45 read with Section 55 of the Income Tax Act, 1961. The intent of the legislative on this issue is very clear. Section 55(2)(1i) has been amended w.e.f. 1.4. 98 in order to ensure payments such as these are brought to tax. Section 55 (2) (ii) states that in such cases, the cost of acquisition, where the capital asset is a right to manufacture or produce any article or thing will be Nil."

20. The AO held that "the cause and effect of a phenomena have to be considered in totality because they are inter related and inter dependent. The phenomena here is compensation and its cause is termination of JV while its effect is loss of right to manufacture. The cause and effect cannot be artificially separated to arrive at conclusions which are at variance with each other." Accordingly, the entire sum received by HCL HP was brought to tax under Section 45 read with Section 55 of the Act as 'income from capital gain'.

The order of the CIT (A)

21. The Assessee took the matter in the appeal before the Commissioner of Income Tax (Appeals) ['CIT (A)']. By an order dated 31st March 2002 the CIT (A) dismissed the appeal as far as the above issue is concerned. The CIT (A) concurred with the AO and held that under the JVA, the Assessee had acquired a bundle of rights and privileges, which clearly and patently constitute a capital asset. Their extinguishment has resulted in transfer of a capital asset and the capital receipt for such transfer can be taxable as long term capital.

Impugned order of the ITAT

22. The further appeal by the Assessee was allowed by the impugned order of the ITAT. The ITAT noted that even prior to entering into JVA,

the Assessee was engaged in the business of manufacture of computer products as per in-house technology under the trade and brand name of HCL computers. Even after termination of the JVA, the Assessee continued to manufacture computers under its own brand name. The sale of the computers for the year ended 31st March 1997 was shown at Rs. 54164.10 lakhs and at Rs. 55993.54 lakhs as on 31st March 1998. Therefore, it could not be said that the Assessee surrendered the right to manufacture computers and had received compensation for it.

23. The amendment to Section 55 (2) of the Act to treat “a trade mark or brand name associated with the business” as a capital asset for the purposes of computing capital gains was inserted with effect from 1st April 2002. Therefore, the ITAT held that at the relevant time there was no provision for subjecting the compensation received pursuant to the termination of the JA to capital gains tax. The ITAT held that no capital gains tax could be levied under Section 45 of the Act in respect of those capital assets for “which no cost of acquisition is incurred by the Assessee.” Reference was made to the decision of the Supreme Court in ***Commissioner of Income Tax v. B.C. Srinivasa Setty* 128 ITR 294**. Accordingly, the ITAT agreed with the Assessee that the amount received upon termination of the JVA was not taxable as income under the head ‘capital gains’.

Submissions of counsel

24. It is submitted by Mr. Raghvendra K. Singh, learned counsel for the Revenue, that the Assessee had by its own admission enjoyed a bundle of rights under the JVA including a right to manufacture, and not merely the brand name associated with the business. Further, the Assessee had stopped manufacturing its own computers. Instead, it began

manufacturing in-house developed high-end computer products which were technologically more superior. According to him, the cost of acquisition could be determined on the basis of surrender of the right to manufacture computer products and correspondingly capital gain could be computed. He submitted that in terms of the amendment to Section 55 (2) (a) with effect from 1st April 1998, the cost of acquisition of the capital asset was rightly taken to be nil by the AO and the capital gains was rightly calculated on that basis.

25. In reply, Mr. Ajay Vohra, learned Senior counsel for the Assessee, submitted that it was not disputed that upon termination of the JVA, the Assessee's business identity underwent a change affecting its income earning apparatus. Its source of income was sterilised. The termination affected the corporate structure itself severely and not merely the profitability of the company. Therefore, the amount received by the Assessee upon termination of the JVA was in the nature of a capital receipt. However, it was another thing to say that the said sum could be brought to tax under the head 'capital gains' by treating the cost of acquisition to be 'nil'. The error lay in treating the entire bundle of rights as only a right to manufacture. The bundle of rights also included the exclusive right to market the products using the trade mark/HP, which also was extinguished. In fact, simultaneously the parties entered into a distribution agreement whereunder HIL continued to distribute HP products although as an exclusive distributor. Mr. Vohra has placed reliance on a large number of decisions which would be discussed thereafter.

The sum received upon termination is a capital receipt

26. Section 45 of the IT Act deals with 'capital gains'. Section 45 (1)

states that any profit or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income tax under the head 'capital gains' and shall be deemed to be the income of the previous year in which the transfer took place. In the present case the first question that arises is whether the amount received by the Assessee pursuant to termination of the JVA was compensation for the transfer of a capital asset.

27. In ***Kettlewell Bullen & Co. Ltd. v. CIT, Calcutta (1964) 53 ITR 261 (SC)*** the Appellant, Kettlewell Bullen & Co. Ltd. ('KBCL') was a managing agent of six companies including Fort Williams Jute Co. (FWJC). KBCL entered into an agreement with Mugneeram Bangur & Co. (MBC), whereunder MBC agreed to purchase the entire shareholding of KBCL in FWJC; procure repayment of all the loans advanced by KBCL to FWJC and to procure that FWJC will compensate KBCL for the loss of office in the sum of Rs. 3,50,000 after KBCL resigned as its managing agent. KBCL tendered its resignation as managing agent and received Rs. 3,50,000 from FWJC. The question was whether the amount received by KBCL to relinquish the managing agency was a revenue receipt liable to tax. It was held that by relinquishing the managing agency, KBCL parted with an asset of an enduring nature. It mattered little that the KBCL did continue to conduct the remaining managing agency of other companies even after the termination of its agency with FWJC. It was held that it cannot be said as general rule that what is determinative of the nature of a receipt on the cancellation of a contract of agency or office is the extinction or compulsory cessation of the agency or office. Where payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business or deprive him of what in substance is his source of income,

termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated), the receipt is revenue; where by the cancellation of an agency the trading structure of the Assessee is impaired, or such cancellation results in loss or what may be regarded as the source of the Assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt. This test was followed in ***Oberoil Hotel Pvt. Ltd. v. Commissioner of Income Tax [1999] 236 ITR 903 (SC)***.

28. In ***Commissioner of Income Tax v. Bombay Burmah Trading Corporation Ltd (1986) 161 ITR 386 (SC)*** the Respondent took a forest lease from the Government of Burma. At the relevant time the company held about 15 forest leases for a period of 15 years each. With the commencement of the Second World War, the Government extended the lease for indefinite periods to enable its renewal. On 4th January 1948 the Government of Burma came into existence and the new government nationalized forest exploitation. The government took over 1/3rd of the area of the lease on 1st June 1948 and the rest of the 2/3rd on 10th June 1949. Under an agreement entered into between the parties, the Respondent was to make over to the Government its residuary rights under the lease together with the assets and the Government was to hand over to the Respondent company 50,000 tons of teak logs of a specific qualities. In terms of this agreement, the Respondent made over the assets to the government, who in turn handed over 43,860 tons of logs to the Respondent. These aforesaid tons of logs were sold from time to time and a sum of Rs. 1,35,55,611 was realised which was allocated to four years on an agreed basis. The cost incurred for getting these logs was Rs. 225 per ton. The question was whether the sale proceeds were revenue

receipts. It was held that agreement under which the transaction took place did not involve any transaction of sale between the Respondent and the Government. There was merely a barter, viz., an exchange with a transfer of interest in one moveable property with a corresponding transfer of interest in another moveable property. In that process it was observed as under:

“If there was any capital asset, and if there was any payment made for the acquisition of that capital asset, such payment would amount to a capital payment in the hands of the payee. Secondly, if any payment was made for sterilization of the very source of profit making apparatus of the Assessee, or of a capital asset, then that would also amount to a capital receipt in the hands of the recipient. On the other hand, if forest leases were merely stock-in-trade and payments were made for taking over the stock-in-trade, then no question of capital receipt arises. The sum would represent payments of revenue nature or trading receipts. Whether, in a particular case, payments were capital receipts or not would depend upon the facts and circumstances of the case.”

29. In *Khanna and Annadhanam v. Commissioner of Income Tax (2013) 351 ITR 110 (Del)* the Assessee was a firm of Chartered Accountants (CA) from the year 1983. Under an informal agreement, it was referred work by a CA firm in Calcutta which in turn had work referred to it by a firm of CAs based outside India. The understanding between the Assessee and the Calcutta firm was limited to the work in Delhi and surrounding areas only and was formalized by an agreement dated 14th August 1992 between the Assessee and the foreign firm. In 1996, the foreign firm wanted a CA in Bombay to represent its work in India. A release agreement was entered on 14th November 1996 under which the Assessee was no longer to represent the foreign firm in India and after which the foreign firm would not refer any work to the Assessee. In consideration of the termination of the services the Assessee

received a sum of Rs. 1,15,70,000. The AO took the view that the receipt was taxable as part of the professional income of the Assessee. That decision was reversed by the CIT (A). Thereafter, the ITAT further reversed the decision of the CIT (A) and agreed with the AO. While allowing the Assessee's appeal, the Court held that in the above circumstances, the compensation was "a substitute for the source" and therefore, the ITAT was wrong in treating the receipt as revenue in nature. This judgment has been upheld by the Supreme Court by its dismissal of the special leave petition (civil) filed by the Revenue on 31st March 2014 reported in **(2014) 365 ITR (Stat) 210**.

30. It is plain from a reading of the various clauses of the JVA and the other concomitant agreements, as well as the termination agreement, that as a result of the termination of the JVA, the Assessee's income earning apparatus was impaired and its source of income got sterilised. The Court, therefore, concurs with the ITAT that the amount received by the Assessee upon termination of the JVA was in the nature of a capital receipt.

Is the amount received taxable as capital gains?

31. In order to determine the capital gains, if any, arising from the transfer of a capital asset, Section 48 provides that from the full value of the consideration received or accruing as a result of the transfer of the capital asset, the following amounts have to be deducted:

- (a) expenditure incurred wholly and exclusively in connection with such transfer;
- (b) the cost of acquisition of the asset and the cost of any improvement thereto.

32. Ascertaining the 'cost of acquisition' of a tangible asset might not pose as much difficulty as determining the 'cost of acquisition' of an intangible asset. Section 49 deals with the determination of cost with reference to certain modes of acquisition. This is a deeming provision. Under Section 49 (1) (i) to (iv), where the capital asset became the property of an Assessee in any of the circumstances outline thereunder, "the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it." For determining the cost of acquisition of an intangible asset changes were made to Section 55 (2) of the Act.

33. Section 55 (2) (a) as it presently stands reads as under:

Section 55 (2) For the purposes of Sections 48 and 48, cost of acquisition

(a) in relation to a capital asset, being goodwill of a business or a trade mark or brand name associated with a business, or a right to manufacture, produce or process any article or thing or right to carry on any business tenancy rights, stage, carriage permits or loom hours, -

(i) in the case of acquisition of such asset by the Assessee by purchase from a previous owner, means the amount of the purchase price; and

(ii) in any other case (not being a case falling under sub-clauses (i) to (iv) of Sub-section (1) of Section 49, shall be taken to be nil."

34. While the words "or a right to manufacture" was inserted in clause (a) of sub-section (2) with effect from 1st April 1998, the words 'or a trade mark or brand name associated with a business' was inserted by the Finance Act, 2002 with effect from 1st April 2002. The said amendment was explained as under:

"Clause 32 seeks to amend Section 55 of the Income tax relating to meaning of the expressions 'adjusted', 'cost of improvement' and

‘cost of acquisition.’

Under the existing provision contained in clause (a) of sub-section (2), the cost of acquisition in relation to a capital asset, being goodwill of a business or a right to manufacture, produce, or process any article or thing, tenancy rights, stage carriage permits or loom hours, shall be taken to be the purchase price in case the asset is purchased by the Assessee from a previous owner and in any other case such cost shall be taken to be nil.

It is proposed to amend clause (a) of sub-Section (2) to provide that the cost of acquisition in relation to a trade mark or brand name associated with a business shall also be taken to be the purchase price in case the asset is purchased from a previous owner and nil in any other case.

This amend will take effect from 1st April 2002, and will, accordingly, apply in relation to the assessment year 2002-03 and subsequent years.”

35. Prior to the above insertion of “or a trade mark or brand name” the cost of acquisition in relation to a capital asset, being goodwill of a business, or a right to manufacture, produce or process any article or thing, or right to carry on any business, the tenancy rights, stage carriage permits or loom hours would be taken to be nil under Section 55 (2) (a) (ii) if it did not have a purchase price. The expression ‘or right to carry on any business’ was inserted with effect from 1st April 2003.

36. That the above amendments were intended to be prospective, since there is nothing to the contrary stated therein, is fairly well settled. The decisions in *Guffic Chem. P. Ltd. v. Commissioner of Income Tax (2011) 332 ITR 602 (SC)* and *Commissioner of Income Tax v. Vatika Township P. Ltd. (2014) 367 ITR 466 (SC)* are illustrative of this legal position.

37. This has also to be viewed in the context of the corresponding amendments to Section 28 of the Act as far as the consideration received by the Assessee pursuant to a non-compete agreement is concerned. In Section 28, which talks of income chargeable to income tax under the head 'profits and gains of business or profession', Clause (vii) was introduced with effect from 1st April 2003 and read as under:

“13. In Section 28 of the Income Tax Act, after clause (vi), the following shall be inserted with effect from 1st day of April 2003, namely

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

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

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

Explanation – For the purposes of this clause –

(i) 'agreement' includes any arrangement or understanding or action in concert, -

(A) Whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(ii) “service” means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport,

storage, processing, supply of electrical or other energy, boarding and lodging.”

38. The explanatory notes to the above amendment read as under:

“It is proposed to insert a new clause (vii) in Section 28 of the Income Tax Act vide Clause 13 of the Bill so as to provide that any sum whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not to share 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, shall be chargeable to income tax under the head ‘Profits and gains of business or profession’.

It is proposed to insert a new sub-clause (xii) in clause (24) of Section 2 so as to provide that the said sum received or receivable shall be included within the definition of income as defined in that clause.

This amend will take place from 1st April 2003 and will, accordingly, apply in relation to the assessment year 2003-04 and subsequent years.”

39. What emerges from the above amendments is that till 1st April 2003 there was no provision under which the capital gains arising from the transfer of a trade mark or brand name associated with a business could be brought to tax. Likewise till 1st April 2003, the capital gains arising from the transfer of a right to carry on business or any negative 'non-compete' right also could not be brought to tax. In terms of the decisions in *CIT v. B.C. Srinivasa Setty* (*supra*) and *PNB Finance Limited v. CIT, New Delhi* (2008) 307 ITR 75 the settled legal position is that in the absence of a machinery provision, an item of income cannot be assessed to tax.

40. In the present case what stood extinguished as a result of the

termination of the JVA was a bundle of rights of the Assessee. This included the right to manufacture computers using HP knowhow and HP labels, trademarks and patents. At the same time it was not as if the Assessee's right to manufacture its own computers was also taken away by the termination. That stood revived. In any event, there has been no attempt at unbundling the compensation amount, as it were, to determine how much of it pertained to the above constituent rights in the bundle of rights of the Assessee that were extinguished. The AO proceeded on the basis that the entire sum received by the Assessee was for it giving up the right to manufacture HP computers. This overlooked the factual position concerning the extinguishment, as a result of the termination of the JVA, of the entire bundle of rights not limited to the right to manufacture HP computers. The right of HCL HP to revive manufacturing its computers cannot be construed as a 'transfer' of a right. At the same time HP HCL lost its status as an exclusive distributor of HP products. The transfer, if any, of the intangible assets of the kind described under the JVA could not, at the relevant time, be held to fall within the ambit of the kinds of capital assets that were contemplated in Section 55 (2) (a) as it then stood. Therefore, their cost of acquisition could not have been deemed to be 'nil' in terms of Section 55 (2) (a) (ii) of the Act as it stood at the relevant time.

Conclusion

41. The Court, therefore, holds that the receipt of Rs. 6080.95 lakhs by the Assessee as a result of the termination of the JVA during AY 1998-99 was a capital receipt but in light of Section 55 (2) (a) of the Act as it stood at the relevant time, the said amount cannot be brought to capital gains tax. At the relevant time, there was no provision in regard to determining the cost of acquisition of the above intangible assets for the

purposes of computing capital gains tax.

42. Accordingly, the question framed is answered in the affirmative, i.e., in favour of the Assessee and against the Revenue. The appeal is accordingly dismissed but, in the facts and circumstances of the case, with no order as to costs.

DECEMBER 21, 2015
Rk

S.MURALIDHAR, J

VIBHU BAKHRU, J

