

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON 07.11.2016

PRONOUNCED ON: 08.08.2017

CORAM:

**THE HON'BLE MR.JUSTICE NOOTY RAMAMOHANA RAO
&
THE HONOURABLE DR JUSTICE ANITA SUMANTH****T.C.A.Nos.1365 of 2007 and 1175 of 2008**Commissioner of Income Tax,
Chennai

... Appellant in both appeals

R.Radikaa,
10, Paul Appaswamy Street,
T.Nagar,
Chennai -17

VS

Respondent in
T.C.A.No.1365 of 2007M/s.Radaan Media Works India Ltd.,
10, Paul Appaswamy Street,
T.Nagar,
Chennai 600 017... Respondent in
T.C.A.No. 1175 of 2008

Prayer in TCA.No.1365 of 2007: Tax case Appeal filed under section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Madras “B” Bench, dated 25.1.2007 in I.T.A.No.548/Mds/2005.

Prayer in TCA.No.1175 of 2008: Tax case Appeal filed under section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Madras “B” Bench, dated 14.12.2007 in I.T.A.No.2241/mds/2006.

For Appellant in : Mr. S.Swaminathan ,
 both case Assisted
 by Mr.K.Sureshkumar
 For Respondent in : Mr. S.Sridhar
 both cases

COMMON JUDGMENT

(Judgment of the Court was delivered by Anita Sumanth, J.)

These Tax Case (Appeals) have been filed by the Commissioner of Income Tax challenging orders of the Income Tax Appellate Tribunal in respect of assessment year 2001-02. Since the facts relating to both appeals are common, we deal with the same by way of a single order.

2. The Substantial questions of law that arise for consideration are as

follows:

T.C.A.No.1365 of 2007: (appeal by individual)

‘1. Whether in the facts and circumstances of the case, the Tribunal was right in holding that a restrictive covenant of non competition, between the assessee and the company which is almost wholly owned by her is a capital receipt?

2. Whether the Tribunal was right in holding that the entire amount of payment is a capital receipt, when the restrictive covenant is only a small portion of the same?

3. Whether the Tribunal was treating the payment as one made for non competition, when the agreement clearly allows the assessee to work for others, provided she pays 5% of her earnings to the company?’

T.C(A)No.1175 of 2008) (Appeal by Company)

‘1. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the non compete fee brand equity is entitled for depreciation under Section 32 of the IT Act?

2. Whether on the facts and circumstances of the case,

the Tribunal was right in holding that the brand equity is entitled for depreciation under section 32 of the IT Act.'

3. Ms.Radikaa, the assessee in TC(A)1365/2007 is an artist and film director with a significant presence in the big as well as small screens. M/s. Radaan Pictures Private Limited, ('Radaan' in short), the assessee in TC(A) 1175/2007 had entered into an agreement with Ms.Radikaa dated 3.4.2000. The agreement, in recognition of her expertise and skill in the area of film making desired to utilise her services and intellectual capacity for the purpose of its business. Vide Clause 2 of the agreement, the Artist agreed to spend a minimum of four hours a day in providing her expertise in film making, tele serials and discussions to the company, Vide clause 3, she agreed that she would not compete with the business of the Company in India or elsewhere and vide clause 5, she agreed to take the consent of the Company prior to accepting an engagement as an actor by any other film director. She further agreed, vide clause 6, to remit 5% of her individual earnings to the Company.

The agreement, in force for a period of 5 years provided for consideration, at clause 4 thereof, of an amount of Rs. 75 lakhs by way of allotment of 75,000 equity shares of a nominal value of Rs.100/- each.

4. That apart, the parties had entered into a Succession Agreement dated 31.3.2000 that provided for the succession of the company to the business of the individual as a going concern, taking over all the assets and liabilities in its books for a consideration of Rs.4,37,38,900/- by way of allotment of Rs.4,37,389/- equity shares of a face value of Rs.100/- each. The entire business of 'Radaan T.V.' thus stood transferred by the individual to the company as on 30.3.2000. The annexure to the succession agreement detailed the assets transferred including brand equity, valued at a figure of Rs.75 lakhs.

5. Assessments were framed vide order of assessments dated 29.3.2004 in the case of both the individual as well as the company. The assessing officer in the case of the individual was of the view that the amount of 75 lakhs was in the nature of a remuneration paid to the individual for loss

of business occasioned to her by virtue of the terms of non-compete. The officer analysed her business receipts from assessment years 1997-98 onwards, noticing that there was a steady increase in receipts from 1997-98 to 2000-01 - Rs.9.6 lakhs (1997-1998), 14.49 lakhs (1998-1999), 12.12 lakhs (1999-2000) and 15.51 lakhs (2000-2001) respectively. In the financial year relevant to the present assessment year, she had received remuneration of Rs.5 lakhs of which, 5 % was handed over to the company in terms of agreement dated 3.4.2000. Thereafter the individual received income from the company in place of the income earned by her from third parties prior to 03.04.2000. Accordingly he arrived at the conclusion that there had been a drop in business revenue from the sole proprietary that stood compensated by the arrangement for non-compete with the company. The payment of the non-compete fee was thus, according to him, on revenue account.

6. In any event, and more importantly, he noticed that the individual retained control over the business even after execution of the succession agreement dated 31.3.2000 in so far as she continued in the position of a

Director in the company holding more than 99.99 percent voting rights as on 2.4.2000. He was thus of the view that the arrangement of payment of non-compete fee was itself a farce and a colourable exercise.

7. Reliance in this regard, was placed on the decision of the Madras High Court in the case of K.Ramasamy vs. Commissioner of Income Tax (182 ITR 640) to the effect that one should take into account the totality of attendant circumstances in order to decide the true character of a payment made between two entities and pierce the veil if the circumstances so warrant.

8. The assessment in the hands of the assessee was completed making an addition of the non-compete fee of an amount of Rs.75 lakhs. The assessment in the hands of the company was completed disallowing depreciation claimed on the non-compete fee paid as well as the brand equity since the officer was of the view that the assets did not come within the ambit of 'any business or commercial rights of a similar nature' as did other intangible assets.

9. In first appeal, the Commissioner of Income Tax (Appeals) allowed the claim of the assessee relating to non-compete fee following the decision of the Income tax Appellate Tribunal, Chennai, in the case of M/s.R.K.Swamy BBDO, a copy of which was circulated in the course of the hearing before us.

10. The conclusion of the CIT (A) is as follows:-

‘It would be seen from the above that the amount of Rs.75 lakhs was paid to the appellant for agreeing to make available her intellectual capability and capacity and her experience as an artiste in the fields of film acting story treatment and film making to the benefits of the company and also the appellant agreeing not to compete with Radan TV. Therefore it was a clearly a Non compete fee. The issue is directly covered by the decision of the ITAT Chennai in the case of RK Swamy vs ACIT (88 ITD 185). Therefore in view of the said decision the addition of Rs.75 lakhs is deleted. The appeal of the appellant is ALLOWED and the appellant gets a relief of Rs.75 lakhs on this ground of appeal.’

The claim of depreciation on brand equity and non-compete fee was allowed as well.

11. In second appeal by the Revenue, the Tribunal deals with the issue of non-compete fee by order dated 25.01.2007 as below:

‘We have heard both the parties and carefully perused the material on record. On a consideration of the facts and circumstances of the present assessee's case we are of the view that the decision of the Id.CIT(A) is perfectly justified. The Hon'ble Madras High Court in the case of G.D.Naidu held that the compensation relatable to the restrictive covenant was a capital receipt not liable to tax. Respectfully following the said decision of the jurisdictional High Court we see no justification to interfere with the finding of the Id. CIT(A) in this regard. The Id. Counsel also rightly distinguished the decision of the jurisdictional High Court in the case of K.Ramasamy v.CIT (182 ITR 640) relied upon by the Id. DR by stating that in that case the affairs of the company are controlled by the directors who were previously partners of

the firm. We therefore, reject the first ground raised by the Revenue.'

The claim of depreciation on non-compete fee as well as brand equity was upheld by the Tribunal by order dated 14.12.2007.

12. As against the above orders of the Tribunal, the revenue is in appeal before us. We are called upon to decide (i) the taxability of the sum of Rs.75 lakhs received by the individual as non compete fee in T.C.(A).No.1365 of 2007 and (ii) the eligibility to depreciation on brand equity in the hands of the company in T.C.(A).No.1175 of 2008.

13. Mr.Swaminathan, appearing for the Revenue, would assail the orders of the CIT(A) and ITAT vehemently invoking in support the findings of the assessing officer. He would point out that the payment of non-compete fee was itself sham. The assessee was in control of the business from inception and continued to be so until and even after the assessment year in question. The conclusion of the appellate authorities that the amount was

capital in nature was erroneous since it was clearly to enable the receipt of continued profits from business activity.

14. Mr.Sridhar appearing for the assessee would raise the following submissions:

(i) That the approach of the Revenue tantamounts to permitting the income tax department to sit in the armchair of the assessee and decide the commercial aspects of the business which is impermissible;

(ii) The theory of compensation for loss of business canvassed by the assessing officer in support of his conclusion to disallow the payment would rather support the assessee, in so far as such compensation receipt would fall in the capital and not revenue field;

(iii) Compensation received for sterilization or destruction of a capital asset should only be reckoned in the capital field and not otherwise;

(iv) Reliance was placed on the action of the assessing officer who, while framing the assessment in the hands of the company accepts the non

compete fee as allowable expenditure in the hands of the company.

15. Heard learned counsel in detail and perused the case papers in depth.

16. The primary contention of the revenue to the effect that the payment of non-compete fee was a colorable one. Radaan Television was incorporated as a sole proprietary in financial year 1998-1999. The sole proprietorship was converted to a private limited company in financial year 1999-2000 and the name changed from Radaan Pictures Private Limited to Radaan Media Works India Private Limited. In 2003, the closely held company went public with the public offer commencing on 5.2.2003.

17. According to the learned counsel for the assessee, it was the payment of the non compete fee that commenced the process of conversion of the closely held company to one that was widely held and this, according to him, would establish the genuineness of the transaction. He would state that the company, wanting to capitalize on the popularity enjoyed by

Ms.Radhikaa, particularly to further the prospects of the public offer, retained for itself the exclusive benefit and use of her talents and expertise. This was the reason and rationale behind the payment of non-compete fee rendering it genuine and bonafide, he explained.

18. Let us examine the above statement against the facts as they present themselves to us. The sole proprietary was succeeded to by the company on 31.3.2000. The proprietrix was duly compensated for the assets transferred. Parallely an agreement was entered into between the parties on 3.4.2000 to provide for a more systematic utilization and exploitation of the creative talents and skills of the Artist. The Artist, who was managing the business as a proprietary concern continued to be part of the corporate structure, employing the same skill sets as always employed by her. It was only the business setting that was enlarged over the relevant period. Though exclusivity of engagement with the company is sought to be portrayed post execution of the non-compete, her services are still available to third parties, subject to consent by, and receipt of 5% of the income therefrom by the

company. Though learned counsel would point out that the latter has been occasioned only once, in the case of Oscar Films, the very presence of such a clause in the agreement would support the conclusion that the arrangement between parties is only a smokescreen.

19. Ms.Radhikaa was, and continues to be, the face of the business and as proprietrix and thereafter, a director with substantial shareholding, she retained a firm hold on the reins of decision making. The transaction of non compete is thus an illusion in the aforesaid facts and circumstances. The finding of the assessing officer is that the individual artiste continued to be in control of the affairs of the business both prior to and after the date of agreement entered into in March 2000. There is no dispute with regard to the position that while Ms.Radhikaa held more than 99.99% of the shares as on 2.4.2000, the percentage of shareholding before and after the public issue in February 2003 was 68.37 % and 51.33 % respectively. |

20. The argument of the learned counsel for the assessee is to the effect that the agreements executed in march and april 2003 should be viewed as

part of a sequence of events and not in isolation. He would urge that the payment of non-compete fee was, but one factor in a composite business arrangement designed to elevate the business from a small proprietorship to a company and this resulted in sterilization of a source of income. Despite our best efforts, we are at a loss to visualize this scheme in the sequence of events presented. The company went public three years after the date of agreement between the parties and this factor would hardly come to the aid of the assessee.

21. The period between 2000, when the agreements were executed and 2003 when the company went public, have not seen any momentous developments along the lines of what the learned counsel for the assessee has indicated. We thus conclude that the agreements entered into in March and April 2000 are stand alone incidents and not part of a design or scheme of business organization as projected, persuading us to take a conclusion different than what we have indicated above. As such, the agreement would have to be interpreted solely on its own strength.

22. The assessing officer has rightly invoked the decision of the Madras High Court in the case of K. Ramasamy vs. Commissioner of Income Tax. The Division Bench, in that case, was concerned with a business that was carried on by a firm with four partners. Constituents of the partnership firm formed a company and the business of the partnership was leased to the new company for yearly rent. On the day the agreement was entered into between the parties, consideration was paid to the individual partners for their assurance not to carry on competing business of running hotels either individually or in association with others. The Division Bench noted that the identity of the company comprising the four brothers as its share holders and directors on the one hand, and the recipients of the consideration, being the four brothers in their individual capacity on the other, was the same. Piercing the veil, High Court observed that the position of the brothers did not change in substance after the company was formed and given a right to run the business. This observation would equally apply in the present case as well.

23. Learned counsel for the assessee relied upon the judgement of the Supreme Court in the matter of Vodafone International Holdings B V Vs. Union of India (341 ITR 1) and the decision of the Madras High Court in Commissioner of Income Tax Vs. High Energy Batteries (India) Limited for the proposition that in order to ascertain the legal nature of a transaction, one has to look at the entire transaction as a whole and cannot adopt a dissecting approach. In this context, the Supreme Court cautioned that the transaction should be 'looked at' and not 'looked through'. We believe that this is precisely what we have done in this case.

24. Mr.Sridhar would also aver that the concurrent findings of the first and second appellate authorities were not liable to be disturbed, placing reliance on the decision of the Madras High Court in the case of Commissioner of Income Tax Vs. Real Image Private Limited. We are however not impressed with the casual manner in which both the first or second appellate authorities have decided the issue. The burden on the

assessee to establish that the transaction is bonafide and genuine has not been discharged, particularly in the light of the admitted facts set out by the assessing officer relating to the continued control exercised by the assessee in the business.

25. Though submissions have been made on the merits of the matter, in the light of our decision above, that is an answer to substantial questions 1 and 3, we do not proceed to consider the same

26. The Substantial questions in T.C.No.1365 of 2007 are thus answered in favour of the Revenue and against the assessee.

27. Coming to Tax case (Appeal) No.1175 of 2008, the question before us is whether brand equity would be an intangible asset eligible for depreciation in terms of Section 32(1)(ii) of the Act that defines intangible assets in the following terms;

“(ii) know-how, patents, copyrights, trade marks, licences,

franchises or any other business or commercial rights of

similar nature, being intangible assets acquired on or after the 1st day of April, 1998,

Owned, wholly or partly, by the assessee and used for the purposes of the business or profession, the following deductions shall be allowed.”

28. The learned Standing counsel for the Department fairly admitted that the brand equity of a sum of Rs.75 lakhs valued at a sum of Rs.75 lakhs would be an intangible right coming within the purview of 'business or commercial rights' of a similar nature. He also brought to our notice the decision of this High Court in the case of Penta Media Graphics and Delhi High Court in the case of Sharp Business Systems Vs. Commissioner of Income Tax, that support the stand of the assessee.

29. The substantial questions of law in T.C.No.1175 of 2008 are thus decided in favour of the assessee and against the Revenue holding that brand equity constitutes an intangible asset in terms of Section 32(1)(ii) of the Act upon which depreciation is liable to be granted.

30. TC(A) 1365/2007 is allowed and TC(A) 1175 of 2008 is dismissed.

In both the appeals, there shall be no order as to costs.

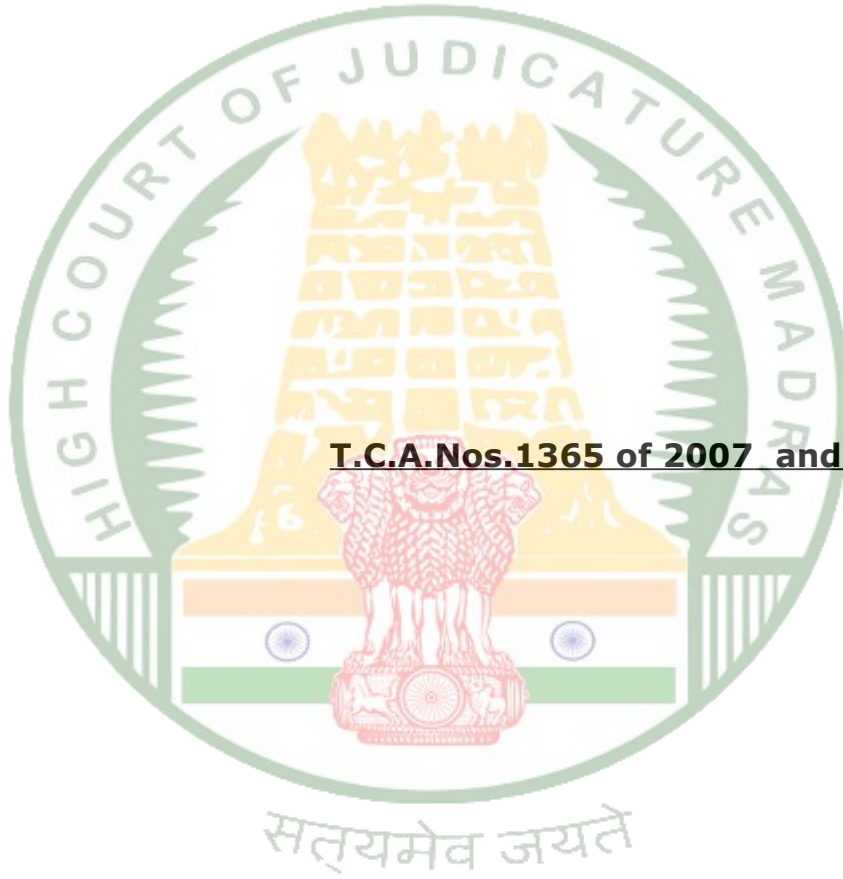
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**NOOTY RAMAMOHANA RAO, J.
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Dr. ANITA SUMANTH, J.**



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