

GURBAX SINGH
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**IN THE HIGH COURT OF PUNJAB AND HARYANA AT
CHANDIGARH**

**ITA No. 193 of 2013 (O&M)
Date of decision: 06.08.2018**

Commissioner of Income Tax, Jalandhar-1, Jalandhar.

.....Appellant

Vs.

**M/s Max India Limited, Bhai Mohan Singh Nagar, Rail Majra, Distt.
Nawanshahar.**

.....Respondent

**CORAM: HON'BLE MR. JUSTICE AJAY KUMAR MITTAL
HON'BLE MR. JUSTICE AVNEESH JHINGAN**

Present: Mr. Vivek Sethi, Senior Standing Counsel for the appellant.

Mr. Ajay Vohra, Senior Advocate with Mr. Gaurav Jain, Advocate
and Mr. Aniket Agrawal, Advocate for respondent.

Ajay Kumar Mittal,J.

1. This order shall dispose of ITA Nos. 193 and 195 of 2013 as according to the learned counsel for the appellant-revenue, the issues involved in both the appeals are identical. However, the facts are being extracted from ITA No. 193 of 2013.

2. ITA No. 193 of 2013 has been preferred by the appellant-revenue under Section 260A of the Income Tax Act, 1961 (in short, “the Act”) against the order dated 08.03.2013, Annexure A.3, passed by the Income Tax Appellate Tribunal, Amritsar Bench, Amritsar (in short, “the

Tribunal”) in ITA No. 154 (ASR) 2011, for the assessment year 2005-06, claiming following substantial question of law.

“Whether on the facts of the case, the Hon’ble ITAT was justified in law in holding that payment of non compete fee is a revenue expenditure and an allowable deduction?”

3. A few facts relevant for the decision of the controversy involved as narrated in ITA No. 193 of 2013 may be noticed. The assessee company is engaged in the business of manufacturing and sale of bulk drugs, films based on polymers of propylene, leather finishing foils as also treasury operations, services to joint ventures/associates company. It is also marketing a range of BOPP Films, a versatile flexible packaging materials etc having multi business and located setup. Return declaring NIL income was filed on 28.10.2005 by the assessee company which was processed accordingly. Later the case was taken up for scrutiny. Notices under Sections 143(2)/142(1) of the Act alongwith detailed questionnaire were issued and served upon the assessee. Assessment was completed under Section 143(3) of the Act on 28.12.2007 at Nil income after setting off brought forward losses. The Assessing Officer while making assessment made disallowance of expenses on account of non compete fee payment. The Assessing Officer disallowed the claim of expenses of ₹ 84,35,140/- which was made by the assessee on account of non compete fee. These expenses were stated to be paid to an ex-employee restraining him for doing particular business/work/job etc for a particular period being inadmissible in law. Aggrieved by the order, the assessee company filed an appeal before the Commissioner of Income Tax (Appeals), [CIT(A)]. Vide order dated 12.01.2011, Annexure A.2, the CIT(A) allowed the appeal filed by the assessee and deleted the addition/disallowance made by Assessing Officer.

Not satisfied with the order, the revenue filed appeal before the Tribunal. Vide order dated 08.03.2013, the Tribunal dismissed the appeal filed by the revenue. Hence the instant appeals by the appellant-revenue.

4. We have heard learned counsel for the parties.

5. The issue that arises for consideration in these appeals is whether non compete fee paid by the assessee-company was revenue in nature or could be disallowed being capital expenditure.

6. Adverting to the judgments relied upon by learned counsel for the respondent-assessee, it may be noticed that in ***Commissioner of Income Tax, West Bengal II vs. Coal Shipments P.Limited***, (1971) 82 ITR 902, the assessee was one of the companies which exported coal to Burma before the Second World War. It was held that the payments made by the assessee were not of a capital nature and were allowable under Section 10(2)(xv) of the 1922 Act because the arrangement between the assessee and H.V.Low and Co. was not for any fixed term but could be terminated at any time at the volition of any of the parties and the payments made to the said company were related to the actual shipment of coal in the course of the trading activities of the assessee and were not related to or tied up in any way to any fixed sum agreed to between the parties. The relevant observations read thus:-

“There are some other tests like those of fixed capital and circulating capital for determining the nature of the expenditure. An item of disbursement can be regarded as capital expenditure when it is referable to fixed capital. It is revenue when it can be attributed to circulating capital. It is not the case of any party that this test of fixed and circulating capital can be invoked in this case nor has reference been made to some of the other tests. The case which has been set up on behalf of the revenue is that

as the object of making the payments in question was to eliminate competition of a rival exporter, the benefit which ensued to the respondent was of an enduring nature and as such, the payment should be treated as capital expenditure. We find ourselves unable to accede to this contention because we find that the arrangement between the respondent and M/s. H. V. Low & Co. Ltd. was not for any fixed term but could be terminated at any time at the volition of any of the parties. Although an enduring benefit need not be of an ever-lasting character, it should not, at the same time,, be so transitory and ephemeral that it. can be terminated at any time at the volition of any of the parties. Any other view would have the effect of rendering the word 'enduring' to be meaningless. No cogent ground or valid reason has been given to us in support of the contention that even though the benefit from the arrangement to the respondent may not be of a permanent. or enduring nature, the payments made in pursuance of that arrangement would still be capital expenditure.....”

Identical question arose before the Madras High Court in *M/s Hatsun Agro Products Limited vs. The Joint Commissioner of Income Tax, Special Range XI, Chennai*, T.C.(Appeal) No.1173 of 2005, decided on 10.4.2017, wherein it was held that courts have over time evolved various tests to determine categorization of expenditure of non compete fee as either capital or revenue but there is no straightjacket method and the application of the tests would vary upon the facts of the case in hand. It was recorded as under:-

“9. The question before us is the categorization of expenditure of non-compete fee as either capital or revenue. The distinction is fine. Courts have, over time, evolved various tests to determine such categorization, but there is no straightjacket method and the application of the tests would vary upon the facts of the case in hand. In the present case, while neither the

assessing officer nor the Tribunal dispute the long association and valuable services rendered by the individuals as well as the importance of retaining these advantages, particularly at the time when it was going public, both officers deny the claim solely based on the fact that the payments results in an enduring benefit.

10. We could do no better than to quote the Supreme Court, in the case of [Empire Jute Ltd vs CIT](#) (124 ITR 1) stating as follows:

If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure. See *Bombay Steam Navigation Co. (1953) P.Ltds* case (supra). The same test was formulated by Lord Clyde in *Robert Addie and Sons' Collieries Ltd.s* case (supra) (C Sess) in these words: "Is it a part of the company's working expenses?-- is it expenditure laid out as part of the process of profit earning?-- or, on the other hand, is it a capital outlay?-- is it expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which is a condition of carrying on its trade at all?" It is clear from the above discussion that the payment made by the assessee for purchase of loom hours was expenditure laid out as part of the process of profit earning. It was, to use Lord Sumner's words, an outlay of a business "in order to carry it on and to earn a profit out of this expense as an expense of carrying it on". [*John Smith and Son v. Moore* [1921] 12 TC 266 (HL)]. It was part of the cost of operating the profit-earning apparatus and was clearly in the nature of revenue expenditure. There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue

account and the test of enduring benefit may break down. ... What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future.

11. Thus, the test of enduring benefit cannot be applied blindly without regard to the facts and circumstances that arise in the given case. We find that the conclusion of the Tribunal that the payment has an enduring benefit and is capital in nature does not take into account the commercial benefit received by the company. In fact, the Tribunal appears to have been guided solely by an earlier decision rendered by it in the case of Asianet Communications. The assessee would incidentally point out that a copy of this decision was not circulated and hence reliance by the Tribunal on this decision is in itself incorrect. He would urge us to consider, as an alternate submission, the remand of the matter to the tribunal in order that he meet and distinguish this decision in full.”

Similar was the position in ***Commissioner of Income Tax vs. Eicher Limited***, (2008) 302 ITR 249 (Delhi). Therein, the question was whether an expenditure on payment to eliminate competition was a capital expenditure or not. It was observed as under:-

“It is quite clear from the above that to decide whether an expenditure of this nature is a capital expenditure or not would depend on the facts of the case. However, it is necessary to know whether the advantage derived by the payer is of an enduring nature, and for this one of the considerations is the

length of time for which the non-compete agreement would operate although that is not decisive. While the length of time for which competition is eliminated may not strictly be decisive in all cases, yet, at the same time, it should not be so brief as to virtually be transitory.”

In other judgments also relied upon by the learned counsel for the respondent-assessee, it was held that the distinction between revenue or capital expenditure would depend upon the facts of each case.

7. Examining the factual matrix involved in the present appeal, admittedly, the assessee claimed deduction of ₹ 83,35,140/- on account of expenditure representing non-compete fee incurred to have been paid to an employee restraining him for doing the particular business/work/job etc. for a particular period. The Assessing Officer disallowed the expenditure holding the same to be capital in nature. On appeal, the CIT(A) deleted the addition/disallowance made by the Assessing Officer. The revenue went in appeal before the Tribunal. The Tribunal relied upon its earlier decision in the case of the assessee for the assessment year 2000-01 wherein it was recorded that non-compete fee was payable by the assessee to safeguard its business interest. It was further recorded that whether expenditure had been incurred for business purposes or not was to be viewed from the point of view of the businessman. Reliance was placed on judgment of the Apex Court in *SA Builders vs. CIT and another*, (2007) 288 ITR 1 holding that the expression ‘commercial expediency’ was an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. It was further observed that the expenditure may not have been incurred under any legal obligation but yet it is allowable as business expenditure if it was incurred on the ground of commercial

expediency. It was concluded that since on the issue whether the expenditure was of revenue or capital in nature, two opinions were possible, therefore, the view taken by the CIT(A) was upheld. Thus, the Tribunal in the present case of the assessee for the assessment year in question rightly upheld the order passed by the CIT(A) holding the payment of non-compete fee to be allowable as revenue expenditure. The relevant findings recorded by the Tribunal in this regard read thus:-

“34. We have heard the rival contention and perused the facts of the case. We find that identical issue came up for consideration before this Bench of the Tribunal in assessee’s own case for the assessment year 2000-01. We also find that the arguments advanced by the learned DR in the present case are almost similar as the arguments advanced by the revenue in that year. The Tribunal for the assessment year 2000-01 held that the payment of non compete fee to Mr. Ashwani Windlass is under the same agreement as is applicable in the present year was allowable as business deduction in the hands of the assessee under section 37(1) of the Act. It was further observed as under:-

‘It is clear on perusal of the non-compete agreements that the non-compete fee was payable by the assessee to safeguard its business interest, as a strategic investor in the various joint ventures of its obligations to the joint ventures companies that neither the assessee nor any of its employees will get into competing business with the joint venture companies. The fact that the assessee’s subsidiary entered into non compete agreement and made the payment is of little consequence, considering that the liability ultimately devolved on the assessee, in law, in view of merger of the subsidiary in the assessee. The circumstances in which the payment was made by the subsidiary were also explained in the non compete agreement. Whether expenditure has been incurred for

business purposes or not is to be viewed from the point of view of the businessman. The Hon'ble Supreme Court in the case of *S.A.Builders vs. CIT* 288 ITR 1 held that the expression 'commercial expediency' is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. It was further observed that the expenditure may not have been incurred under any legal obligation, but yet it allowable as business expenditure if it was incurred on the grounds of commercial expediency.

42. In the present case, the assessee's business interest would have suffered if the ex employee who was in a senior position and was well conversant with and infact instrumental in setting up the above business initially, would have come in competition with the joint venture companies, in which the assessee had substantial interest. The assessee may also have been liable to joint venture companies. Thus, the non-compete fee was paid on account of 'commercial expediency' and was rightly allowed revenue deduction by the A.O.

43. Both the learned authorized representatives and the learned DR have referred to several case laws as to whether payment of non-compete fee is capital or revenue expenditure. In our opinion, it is not necessary to deal with the case law cited on the above assessee and it is suffice to say that the issue whether the above expenditure is of revenue or capital in nature is at most an issue on which two opinions are possible, moreso, considering that the learned CIT(A) in assessee's own case for the assessment year 2001-02 allowed similar claim.'

34.1. We have also perused four decisions referred to by the learned DR. Except for the decision of Hon'ble Delhi High Court in the case of Pitney Bowes India (P) Limited (supra), all other decisions deal with the issue whether the amount received as non compete fee is a capital or revenue receipt. The said decisions are of no relevance in

the present case. As regards, the decision of Pitney Bowes (supra), we agree with the learned AR that the decisions too are not applicable in the present case since the same pertained to payment of non compete fee in relation to transfer of business. the case of the assessee infact is supported by the decision of the ITAT Mumbai Bench in the case of ***Intervet India (P) Limited vs. ACIT***(supra), wherein the payment of non compete fee de hors the purchase of business was held to be revenue expenditure. The decision of the Hon'ble Madras High Court in the case of ***M/s Carborandum Universal Limited vs. JCIT***(supra) also supports the case of the assessee.

34.2 In view of the aforesaid decision of the Tribunal in assessee's own case for the assessment year 2000-01 and on merit as well, we are of the view that no interference is called for in the order of the learned CIT(A) and accordingly the ground raised by the revenue is dismissed."

Learned counsel for the appellant-revenue has not been able to point out any error or illegality in the view taken by the Tribunal, warranting interference by this Court.

8. In all fairness to learned counsel for the appellant-revenue, we proceed to analyse the case law relied upon by him. In ***Commissioner of Income Tax vs. Mandalay Investment P.Limited***, (2011) 332 ITR 602 (SC), the question for consideration was whether the amount of ₹ 50 lacs received by the assessee pursuant to non competition agreement entered into by the assessee with the Ranbaxy Lab. Limited was to be treated as capital receipt and not revenue receipt. The Tribunal held that the amount was a capital receipt but the High Court reversed the decision. On appeal before the Apex Court, it was held that prior to April 1, 2003, when Parliament stepped in to specifically tax such receipts, the payment was in the nature of a capital receipt. In ***CIT vs. Wintac Limited***, (2014) 221 TAXMAN 87 (Kar), it was held by the Karnataka High Court that the amount of ₹ 4 crores received by the assessee from M/s 'R' Limited towards non competition fee to

discontinue the business for three years would be treated as capital receipt. In *Sumeet Taneja vs. Commissioner of Income Tax and another*, (2013) 261 CTR (P&H) 494, the assessee filed his return of income disclosing an income from short term capital gain and income from long term capital gain, besides income from other sources. The Assessing officer held that income from long term capital gain should be treated as business income of the assessee under Section 28(va) of the Act as there was a transfer or purchase of business activities of the assessee. It was held that the agreement between the assessee and the purchaser was not an innocent transfer of shareholdings that would place it within section 2(14) of the Act read with the explanation but a transfer of the business with all pervasive control being entrusted to the purchaser to the complete and absolute exclusion of the seller. All these decisions are based on individual fact situation involved therein and thus, the same are of no help to the learned counsel for the appellant-revenue.

9. In view of the above, the substantial question of law as claimed by the revenue is answered against the revenue and in favour of the assessee. Consequently, both the appeals are hereby dismissed.

(Ajay Kumar Mittal)
Judge

August 06, 2018
‘gs’

(Avneesh Jhingan)
Judge

Whether speaking/reasoned

Yes

Whether reportable

Yes