(2015) 03 MAD CK 0298

In the Madras High Court

Case No : Tax Case (Appeal) No. 316 of 2008

Commissioner of Income Tax — APPELLANT

Vs

Hackbridge Hewittic and Easun Ltd. — RESPONDENT

Date of Decision : 04-03-2015

Acts Referred:
Income Tax Act, 1961 — Section 28(va), 55(2), 55(2)(a)

Citation : (2015) 373 ITR 109

Hon'ble Judges : R. Sudhakar, J;S. Vimala, J

Bench : Division Bench

Advocate : T.R. Senthil Kumar, Standing Counsel, for the Appellant; J. Balachander, Advocates for the Respondent

Judgement

R. Sudhakar, J.—This tax case (appeal) filed by the Revenue as against the order dated October 5, 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 in the 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 Commissioner of Income Tax Vs. Late G.D. Naidu and Others (By Lrs. G.D. Gopal and Another), (1986) 51 CTR 256 : (1987) 165 ITR 63 ?

The brief facts of the case in a nut-shell are as follows:

The assessee-company entered into an agreement with Machinen-fabrik 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 divisions, 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 the existing range of products. On the basis of 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 (approximately) 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 assets. The Assessing Officer further held there was a separate consideration received for the sale of plant and machinery and related equipment, and, hence, the receipt should be attributed to transfer of goodwill and restrictive covenants. Accordingly, the Assessing Officer brought to tax the amount from capital gains in respect of the transfer of goodwill to the extent of Rs. 403.89 lakhs by adopting the cost of acquisition at nil.

2. 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.

3. Not satisfied with the order of the Commissioner of Income-tax (Appeals), the Revenue pursued the matter before the Income-tax Appellate Tribunal.

4. The Tribunal, by following the decision in the case of Deputy CIT v. Indian Syntans Investments (P.) Ltd. [2007] 293 ITR (AT) 177 (Chennai) : [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 Deputy CIT v. Indian Syntans Investments (P.) Ltd. [2007] 293 ITR (AT) 177 (Chennai) : [2007] 106 TTJ 388 (Chennai) held that the assessee-company surrendered all its trade names, customers list, suppliers list, licences, 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 section 55(2) can be made only from the assessment year 1998-99 in respect of consideration received for the transfer thereof, which includes extinguishment or curtailment of such right. In this connection, the learned counsel for the assessee has relied on the Central Board of Direct Taxes Instruction No. 1964, dated March 17, 1999. The appeal before us for the assessment year 1996-97 and on this count also we are of the opinion that the Assessing Officer 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 learned Commissioner of Income-tax (Appeals) that this compensation was not at all taxable."

5. Aggrieved by the said order of the Tribunal, the Revenue has filed the present tax case (appeal).

6. Learned counsel appearing for the assessee submitted that the issue involved in this appeal has been considered by the Supreme Court in the case of Guffic Chem P. Ltd. Vs. Commissioner of Income Tax, Belgaum and Another, (2011) 239 CTR 225 : (2011) 332 ITR 602 : (2011) 3 JT 614 : (2011) 3 SCALE 595 : (2011) 4 SCC 254 : (2011) 3 SCR 899 : (2011) 198 TAXMAN 78 : (2011) 2 UJ 968 , 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.

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

8. 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.

9. 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, licences, 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.

10. 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.

11. 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. Vs. Commissioner of Income Tax, Belgaum and Another, (2011) 239 CTR 225 :

(2011) 332 ITR 602 : (2011) 3 JT 614 : (2011) 3 SCALE 595 : (2011) 4 SCC 254 : (2011) 3 SCR 899 : (2011) 198 TAXMAN 78 : (2011) 2 UJ 968 . The facts therein are the assessee carrying on the 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 (page 607):

"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 Arbuthnot and Co.,Ltd. Vs. The Commissioner of Income Tax, Calcutta, AIR 1965 SC 452 : (1964) 53 ITR 283 : (1964) 8 SCR 121 . 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 Commissioner of Income-tax (Appeals) 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 the Finance Act, 2002, with effect from April 1, 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 April 1, 2003. It is well settled that a liability cannot be created retrospectively. In the present case, compensation received under the 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 April 1, 2003. Hence, the said section 28(va) is amendatory and not clarificatory. Lastly, in Commissioner of Income Tax, Nagpur Vs. Rai Bahadur Jairam Valji and Others, AIR 1959 SC 291 : (1959) 35 ITR 148 : (1959) 1 SCC 110 Supp : (1959) 1 SCR 110 Supp 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 the Commissioner of Income-tax (Appeals) 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 Rs. 50 lakhs by the assessee from Ranbaxy was in the nature of a 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 April 1, 2003."

(emphasis supplied)

12. In the abovesaid decision, the Supreme Court emphasised the fact that the Finance Act, 2002, which came into effect from April 1, 2003, makes the capital receipt as taxable under section 28(va) and held that liability cannot be created retrospectively.

13. 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 abovesaid decision of the Supreme Court, the issue is answered in favour of the assessee and against the Revenue. In the result, this tax case (appeal) stands dismissed. No costs.