(2008) 03 DEL CK 0272

Delhi High Court

Case No: ITA No. of 1094 of 2006

Commissioner of Income Tax		APPELLANT
	Vs	
Eicher Limited, (Previously Royal Enfield Motors Ltd.)		RESPONDENT

Date of Decision: March 20, 2008

Citation: (2008) 218 CTR 612 : (2008) 2 ILR Delhi 979 : (2008) 302 ITR 249 : (2008) 173 TAXMAN 251

Hon'ble Judges: Vidya Bhushan Gupta, J; Madan B. Lokur, J

Bench: Division Bench

Advocate: P.L. Bansal, for the Appellant; Ajay Vohra and Kavita Jha, for the Respondent

Judgement

Madan B. Lokur, J.

The Revenue is aggrieved by an order dated 9th December, 2005 passed by the Income Tax Appellate Tribunal, Delhi Bench ''F'', New Delhi (the Tribunal) in ITA No. 2881/Del/2001 relevant for the Assessment Year 1995-96.

2. A full time employee of the assessed called Vishwanathan had acquired, during the course of his employment, specialized knowledge of technology in the two-wheeler industry as well as of managing the dealership of the market place and other specialized knowledge relating to the two-wheeler business. Vishwanathan entered into an agreement with a company called VCPL to the effect that he would promote VCPL and collaborate with it to set up manufacturing facilities for two-wheelers upon his retirement from the assessed.

3. On coming to know of this, the assessed negotiated a ''non-compete agreement'' with VCPL and Vishwanathan whereby the assessed paid a sum of Rs. 4 crores to VCPL so that VCPL and Vishwanathan would not carry out any business activity with regard to two wheelers. The assessed claimed this amount as a business expenditure but it was disallowed by the Assessing Officer.

4. Feeling aggrieved, the assessed preferred an appeal, which was heard by the Commissioner of Income Tax (Appeals) [`CIT (A)''], who set aside the assessment order and held that the expenditure incurred was a business expenditure. The Revenue then preferred a second appeal, which was dismissed by the Tribunal and that is how the Revenue is before us u/s 260A of the Income Tax Act, 1961.

5. At the outset, it is important to appreciate that we are dealing with a case where payment is made by the assessed towards non-compete fees or pursuant to a restrictive covenant. The question is: Is this a business expenditure or is it a capital expenditure?

6. According to the Revenue, the payment of an amount of Rs. 4 crores as non-compete fee is not allowable as a business expenditure. There is nothing to show how the assessed''s business would be adversely affected if VCPL and Vishwanathan had a tie up. It is also submitted that there is nothing to show how long VCPL and Vishwanathan would not concern themselves with the two wheeler business to the advantage of the assessed. As such, it is submitted that the payment made to Vishwanathan cannot be treated as a business expenditure.

7. These contentions were dealt with both by the CIT (A) as well as by the Tribunal. The undisputed fact is that the payment of Rs. 4 crores is to restrain or prevent VCPL and Vishwanathan from becoming potential business rivals of the assessed. The payment is to protect the assessed''s business interests, its market position and profitability. No new asset is created thereby nor is the assessed's profit making apparatus expanded or increased. The assessed does not suffer any loss or diminution or erosion in its capital assets. On these conclusions, the CIT (A) and the Tribunal decided that the payment was allowable as a business expenditure and that it was not a capital expenditure.

8. The submissions made by learned Counsel for the Revenue before us are to the same effect and we are of the opinion that there is no substantial reason for us to depart from the concurrent view already taken by the CIT (A) and the Tribunal.

9. Learned Counsel for the Revenue relied upon Neel Kamal Talkies Vs. Commissioner of Income Tax, . In that case, an agreement was entered into between the assessed and M/s Prakash Talkies Distributors. In terms of the agreement, M/s Prakash Talkies Distributors was prohibited from exhibiting any films at Virendra Talkies for a period of five years. Relying upon several decisions including Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal, , the Allahabad High Court held that the amount paid by the assessed to M/s Prakash Talkies Distributors was in the nature of capital expenditure since it completely eliminated competition.

10. Learned Counsel for the assessed pointed out, and we think rightly, that the length of time for which the competition was eliminated was important in the facts of that case, but that is not always so. What is more necessary to appreciate is the

purpose of the payment and its intended object and effect. In Commissioner of Income Tax, West Bengal II, Calcutta Vs. Coal Shipment (P) Ltd., , the Supreme Court noted the contention of the Revenue to the effect that payments made to eliminate competition were capital expenditure. Rejecting this contention, it was held on page 909 of the Report as follows:

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 inured 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. Lowe & 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.

11. Dealing with the contention that eliminating competition over some length of time is important, the Supreme Court held as follows:

Although we agree that payment made to ward off competition in business to a rival dealer would constitute capital expenditure if the object of making that payment is to derive an advantage by eliminating the competition over some length of time, the same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any time. How long the period of contemplated advantage should be in order to constitute enduring benefit would depend upon the circumstances and the facts of each individual case.

12. 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.

13. In Commissioner of Income Tax Vs. Late G.D. Naidu and Others (By Lrs. G.D. Gopal and Another), , compensation paid to the assessed was referable to a restrictive covenant in an agreement between the assessed and another party. The question that arose was whether the amount was a capital expenditure or not. The

Supreme Court held that in so far as the assessed is concerned, he did not acquire any separate business nor was any competition eliminated by such an acquisition. Since there was no acquisition of any business by payment of the amount referable to the restrictive covenant and no benefit of an enduring nature was acquired, the Tribunal was correct in holding that the payment could only be treated as revenue outlay and not capital in nature.

14. In Alembic Chemical Works Co. Ltd. v. Commissioner of Income Tax : [1989]177ITR377(SC) , the Supreme Court observed as follows:

There is also no single definitive criterion which, by itself, is determinative as to whether a particular outlay is capital or revenue. What is relevant is the purpose of the outlay and its intended object and effect, considered in a common sense way having regard to the business realities. In a given case, the test of ''enduring benefit'' might break down.

15. In Commissioner of Income Tax, Tamil Nadu II, Madras Vs. Madras Auto Service (P) Ltd., , the Supreme Court referred to Assam Bengal Cement Co. Ltd. and summarized the tests for determining whether an outlay is revenue or capital by giving the following three principles:

1. Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment.

2. Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. '' If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether.

3. Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital.'' (Italics in original)

16. In Madras Auto Service, the assessed had spent some amount to construct a new building after demolishing the old building in which the assessed was a lessee. The assessed had the benefit of the existing lease in respect of the new building at an agreed rent for a period of 39 years. The rent as stipulated in the lease was extremely low but it was found that the concessional rent was on account of the fact that the new building was constructed by the lessee at its own cost. The Supreme Court held that the advantage that the assessed derived by spending the money was that it got the lease of a new building at a low rent. From a business point of

view, therefore, the assessed got the benefit of reduced rent and the expenditure must, consequently, be treated as a revenue expenditure.

17. Applying all these principles to the present case, a few facts stand out quite clearly. The assessed did not acquire any capital asset by making the payment of non-compete fee. It merely eliminated competition in the two wheeler business, for a while. From the record, it is not clear how long the restrictive covenant was to last, but it was neither permanent nor ephemeral. In that sense, the advantage was not of an enduring nature. There is also nothing to show that the amount of Rs. 4 crores was drawn out of the capital of the assessed. On a cumulative appreciation of these facts, it must be held that the CIT (A) and the Tribunal did not err in concluding that the payment of non-compete fee by the assessed was a business expenditure and not a capital expenditure.

18. No substantial question of law arises for consideration. The appeal is dismissed.