ITAT, Bangalore

Associated Electronic and Electrical Industries (Bangalore) (P) Ltd. vs DCIT

IT(SS)A No. 9/Bang/2000, Block Assessment Year : 1988-89 to 1998-99; ITA No. 242/Bang/2001, Assessment Year : 1996-97 (By the Department)

R.V. Easwar, Vice President and N.L. Kalra, Accountant Member

6 February 2009

V. Ramachandran for the Appellant
Swati S. Patil for the Respondent

ORDER

R.V. Easwar:-

1. These two appeals one by the assessee and one by the department arise on the following facts. The assessee is a company engaged in the manufacture and marketing of electrical appliances under the name "Sharp". The assessee was earlier a partnership firm but was later converted into a private limited company. The trade mark "Sharp" was registered on 7.12.1961 and about 21 items were being manufactured by the assessee under the said name. It would appear that M/s. Sharp Corporation of Japan, which was internationally acclaimed as a leading manufacturer of electric and electronic items under the brand name "Sharp" became aware of the fact that the assessee was also selling goods under the said brand name in India and thought that this would affect its business. Accordingly disputes arose between the assessee and Sharp Corporation as to the use of the brand name. Ultimately, a settlement agreement was entered into on 20.6.1995. It was a tripartite agreement with the assessee, Sharp Corporation and one Heeranand who was the director of the assessee company being parties thereto. The gist of the settlement agreement is as follows: The parties agreed to settle their disputes with the assessee acknowledging the ownership of the trade mark "Sharp" with Sharp Corporation. Consequent to this, the assessee assigned all its rights in the trade mark in favour of Sharp Corporation. Under clause 2(iii) the assessee assigned the "Common law rights and goodwill relating to and in trademark SHARP and other trademarks similar to the trademark sharp in favour of SC as set out in the said draft deed of assignment". According to clause 2(iv), the assessee declared in writing acknowledging and accepting that it would discontinue the use of the trademark. Clause 3 related to the payment under the settlement agreement. According to this clause, Sharp Corporation agreed to remit Rs.35 million in an account to the assessee "for the assignment of registered trade marks, pending trade mark copyright applications, common law rights and goodwill and copyrights as contemplated in Article 2(i), (ii) and (iii) and for the covenant and undertaking from AEEI to cease the use of Sharp trade mark in respect of goods under registered trade marks and all other goods...". According to clause 4(1)(a) Sharp Corporation agreed to grant a non-assignable, non-ransferrable, royalty free and sole license to the assessee to use the trade mark "sharp" in respect of six items which are mentioned in annexure - 'C'. It would appear that in all, about 21 items were the subject matter of dispute and Sharp Corporation would use the trade mark exclusively in respect of the other 14 items. Clause 5.1 obliges the assessee to prominently declare the trade mark "Sharp" only in respect of the six items mentioned in Annexure-C. Clause 6.2 obliges the assessee not to use the word "Sharp" as part of its name or trading style. There is a deed of assignment entered into between the same parties and under clause 3 (i), it was stipulated that the assessee will not hereinafter use the trademarks as part of its business or corporate name and will not commit any infringement of the trademark except under a valid license from Sharp Corporation. These are the important clauses of the two agreements which constitute the settlement between the parties.

2. The assessee received the monies of Rs.35 million equivalent to Rs.3.5 crores in two instalments as stipulated in the arrangement.

3. There was a survey of the assessee's premises u/s.133A of the Income-tax Act on 16.10.97 and simultaneously, there was a search u/s.132 of the Act on the premises of Heeranand, the Managing Director of the assessee. The Assessing Officer took the view that but for the search u/s.132 conducted in the premises of Heeranand, the documents relating to the receipt of money from Sharp Corporation by the assessee company would not have been found. Proceedings u/s.158BD were initiated against the assessee company and notice was issued in response to which the assessee filed a return on 28.9.98 disclosing nil undisclosed income. The assessee also disputed the applicability of section 158BD. After narrating these facts and the circumstances leading up to the settlement between the parties the Assessing Officer took the view that the amount was received from Sharp Corporation for transfer of the goodwill and was therefore assessable to tax as capital gains. He also took the view that the amount represented undisclosed income of the assessee since the receipt was unearthed during the search. He. accordingly, treated the amount of Rs.3,99,75,400/- which was the actual receipt by the assessee as the undisclosed income for the asst. year 1996-97. He also added Rs.20 lakhs as estimated value of the license which the assessee got from Sharp Corporation for being used in the six items which the assessee was eligible to manufacture with the Sharp trademark as per the settlement. This amount was also added as undisclosed income for the asst. year 199697.

4. The capital gains of Rs.3,99,75,400/- was also assessed on a protective basis in the assessee's hands u/s. 143(3) of the Act by order dt.30.3.1999.

5. Against both the orders the assessee filed appeals before the Commissioner of Income-tax (Appeals) who held in favour of the assessee. So far as the assessment of the capital gains is concerned, he confirmed the addition of Rs.3,99,75,400/- made in the block assessment as capital gains on transfer of the goodwill, refusing to accept the assessee's contention that what was transferred was only the trade mark and not the goodwill and since the trade mark did not have any cost of acquisition, applying the judgement of the Supreme court in the case of CIT vs. B.C. Srinivasa Shetty (128 ITR 294) there can be no assessment to capital gains. As regards the estimated addition of Rs.20 lakhs being the value of the license allegedly obtained by the assessee from Sharp Corporation, he scaled it down to Rs.10 lakhs, agreeing with the Assessing Officer in principle. In the appeal against the regular assessment order made u/s.143(3) the Commissioner of Income-tax (Appeals) noted that the same addition cannot be made once in the block assessment order and again on protective basis in the regular assessment order. He, accordingly, deleted the addition of Rs.3,99,75,400/- made in the regular assessment order.

6. The assessee has come in appeal against the order of the CIT(A) arising out of the block assessment proceedings. The assessee has contended firstly that the assessment to capital gains is contrary to law and the facts, and that at any rate the receipt did not represent undisclosed income within the meaning of section 158B(b). The addition of Rs.10 lakhs being the estimated value of the license allegedly given to the assessee by Sharp Corporation is also challenged. In the appeal arising out of the regular assessment order, the contention of the department is that the Commissioner of Income-tax (Appeals) was wrong in deleting the protective addition of the capital gains. These are the main contentions of the parties. They have also taken some subsidiary contentions.

7. Taking up the assessee's appeal first, in our considered opinion, there is no transfer of goodwill by the assessee in favour of Sharp Corporation as erroneously decided by the departmental authorities. The importance of maintaining the distinction between the goodwill and the trademark arises because transfer of goodwill became assessable to capital gains tax with effect from 1.4.1988 by virtue of the amendments made to section 55(2). As a result of the amendment the decision of the Supreme Court cited supra became no longer applicable and in the case of transfer of goodwill the cost of acquisition was to be taken at Rs. Nil. So far as trade mark is concerned, the capital gains on the transfer of the same became assessable by virtue of the amendment made to section 55(2)(a) by the Finance Act, 2001 w.e.f. 1.4.2002. We are concerned with the block period commencing from the assessment year 1988-89 and ending with the date of search, namely, 16.10.1997. The capital gains have been assessed as undisclosed income for the assessment year 1996-97. Therefore, the assessment to capital gains can be sustained only if the capital asset transferred was the goodwill of the assessee company; if what is transferred is the trade mark, there will be no capital gains to be assessed since the amendment making the cost of acquisition of trade mark to be taken at Rs. Nil came into effect only from 1.4.2002 as noticed above. There is a well marked distinction between goodwill of a business and the trademark and this has been brought out by the Supreme Court in its judgement in the case of S.C. Khambatta and Co. vs. CIT (41 ITR 500), as follows:

"The goodwill of the business depends upon a variety of circumstances or a combination of them. The location, the service, the standing of the business, the honesty of those who run it and the lack of competition and many of the factors go individually or together to make up the goodwill, though locality always plays a considerable part. Shift the locality and the goodwill may be lost. At the same time, locality is not everything. The power to attract to custom depends on one or more factors as well. In the case of a theatre or restaurant, what is catered, how the service is run and what the competition is, contribute also to the goodwill.

"Trademark" on the other hand is defined to mean a mark used or proposed to be used, in relation to goods for the purpose of indicating a connection in the course of trade between the goods and some person having right to use the trademark. In other words, it represents property rights which can be registered 'In rem'."

Keeping the above observations in mind, if we look into the facts of the present case, what we find is that the goodwill of the business was not transferred by the assessee and it was only the trademark which was transferred as has been clearly mentioned in clause 2(iii) of the settlement agreement. The assessee has transferred the common law rights and goodwill relating to and in the trade mark "Sharp" in favour of Sharp Corporation. The departmental authorities have probably been led to hold that the assessee transferred its goodwill because of the use of the word "goodwill" in the above clause. However, a combined reading of all the clauses in the agreement shows that what was transferred was not the goodwill of the business and the word "goodwill" in the above clause was qualified by the following words namely, "relating to and in trade mark sharp". There is one more good reason to think that the assessee did not sell the goodwill and that is that the goodwill of a business cannot be sold without the business itself. The learned counsel for the assessee, in this connection, has drawn our attention to several treatises, dictionaries, etc., where the word "goodwill" has been explained. In Corpus Juris Secondum, it has been noticed that "goodwill" has no existence except in connection with the continuing business. Goodwill can be sold only along with the business to which it is attached and not independent of it because it is that element of value which inheres in the fixed and favourable consideration of customers, arising from an established and well-known and well connected business. In the case of R.C. Cooper vs. Union of India (AIR 1970 SC 564) it was held by the Supreme Court that goodwill of a business is an intangible business representing the whole advantage of reputation and connection formed with the customers together with the circumstances making the connection durable. It is common ground before us that the assessee did not sell its entire business undertaking to Sharp Corporation. It is, therefore, inconceivable how the assessee could have merely sold the goodwill of the business without selling the business itself. Section 37 of the Trade and Merchandise Marks Act, 1958 provides for assignability and transmissibility of registered trade marks. It says that "Notwithstanding anything in any other law to the contrary, a registered trade mark shall subject to the provisions of this chapter, be assignable and transmissible, whether with or without the goodwill of the business concerned and in respect either of all the goods in respect of which the trade mark is registered or of only some of those goods¨. This section shows that the trade mark can be transferred separately, either with or without the goodwill of the business. The trade mark and goodwill are thus two separate concepts and cannot be mixed up as the Income tax authorities would appear to have done. The assessee continues to carry on business by using the trade mark "Sharp" in respect of six items. It is in respect of the other 14 items that the above trade mark was transferred to Sharp Corporation for consideration. We are, therefore, unable to share the view of the Income tax authorities that what was transferred was the goodwill of the business. In our view, what was transferred was only the trade mark.

8. If the capital asset is the trade mark, it follows that for the year under appeal, no capital gains on the sale of the trade mark can be computed, as already noted, since the provision enabling the cost of acquisition to be taken at Rs. Nil came into effect only from 1.4.2002. Reference may also be made to the circular No.14 of 2001 issued by the CBDT explaining the provisions relating to Direct Taxes introduced by the Finance Act, 2001 (252 ITR (St) p.65) and the notes on clauses to the Finance Bill, 2001 reported in 248 ITR (St) 106 at page 126. These circulars clearly stipulate that it is only from the assessment year 2002-03 that capital gains on sale of trade mark can be computed by taking the cost of acquisition at Rs. Nil.

9. So far as the computation of the capital gains is concerned, the learned counsel for the assessee submitted that the cost of acquisition in the year 1961 when the trade mark was registered or the fair market value thereof as on 1.4.1981 may be taken at the option of the assessee and the benefit of indexation as contemplated in the first proviso to section 48 r.w. Explanation (iii) below the same should be given. The working of the capital gains on this basis has been furnished at page 123 of the assessee's paper book which shows the indexed fair market value at Rs.6,32,25,000/- and after adjusting the same against the consideration of Rs.3,99,75,400/- received from Sharp Corporation, shows a loss of Rs.2,32,49,600/-. Justification has also been given in the assessee's letter to the Assessing Officer dt.20.4.1998. However, this argument was only advanced as an alternative plea to the main contention that in the absence of any provision for the year under appeal enabling the cost of acquisition of the trade mark to be taken at Rs. Nil, no capital gains can be computed in light of the judgement of the Supreme Court in the case of B.C. Srinivasa Shetty (supra). Since we are accepting the main argument that for the year under appeal, in the absence of any statutory provision providing for the cost of acquisition of the trade mark to be taken at Rs. Nil, no capital gains can be computed as held by the aforesaid judgement, it is not necessary for us to consider the alternative argument as to what would be the cost of acquisition and whether the benefit of cost indexation can be given. In this connection, we may also refer to the instruction No. 1964, dt.17.3.1999 issued by the CBDT to all the Chief Commissioners of Income tax and Director Generals of Income-tax. A copy of the instruction has been placed at pages 130 to 132 of the paper book. It must be remembered that at the time when the instruction was issued, there was no statutory provision providing for the cost of acquisition of the trade mark to be taken at Rs. Nil. Even so the above instruction was issued apparently for the reason that there could be an argument that the payment of registration fees for trade marks may be taken as the cost of acquisition and capital gains can be computed accordingly. Para.4(iii) of the instruction is reproduced below:

> "(iii) Where the capital assets are intangible assets (like trade mark etc., listed in para 2 above) not being in the nature of goodwill of a business, the issue to be decided depends upon one vital factor whether such asset sought to be transferred was initially acquired at a cost or whether it was self generated. In the event, such asset was acquired at a consideration, capital gains will have to be calculated in accordance with law in this behalf. However, where such asset in question is a self generating asset, no capital gains will become leviable. It may be clarified that mere payment of some amount for registration of such intangible asset like trade mark etc., may not constitute the cost of

acquisition for the purpose of computation of capital gains."

It may be noticed that the above instruction provides that the registration fees paid in respect of trade mark cannot be considered as cost of acquisition. In the light of this instruction, no capital gains can be computed in respect of the transfer of the trade mark for the year under appeal on the footing that the registration fees paid by the assessee shall represent the cost of acquisition.

10. The other argument of the assessee was with regard to the rate of tax applicable to capital gains. It is the assessee's contention that the rate of tax should be 20% according to section 112(1)(b) of the Act. However, section 113 specifically provides for the rate of tax in the case of block assessment. The rate is 60% and it is applicable to the total undisclosed income for the block period. Since a specific provision is enacted in section 113 to cover block assessment cases, the general provisions of section 112(1)(b) are excluded. In any case, this question is also only of academic interest.

11. We are also not considering the question whether any part of the consideration received by the assessee is referable to any restrictive covenant. It may be remembered that under clause 6.2 of the settlement agreement, the assessee declared and warranted not to use the word "Sharp" as a part of its corporate name, firm name or trading style or as trade mark jointly or individually. The question whether any part of the sale consideration is referable to this restrictive covenant cannot arise because the parties have not apportioned any consideration towards the same and we cannot rewrite the agreement. Clause 3(a) which provides for the consideration of Rs.35 million is for the assignment of the registered and pending trade marks, copy right applications and other applications relating to common law rights and goodwill relating to the trade marks and for the covenant and undertaking from the assessee to cease to use the word "Sharp". However, no consideration has been specifically apportioned to such covenant. Reference was made to the order of the Hyderabad Bench of the Tribunal reported in DCIT and Another vs. K S N Enterprises P. Ltd., and Others (2008) 303 ITR (AT) 229, in which an apportionment was made on estimate to the restrictive covenant. Since our decision is that the sale consideration of Rs.35 million cannot be subjected to capital gains tax, there is no reason to examine the question as to whether a part of the consideration can be apportioned on estimate to the restrictive covenant. Even if an apportionment can be made, it is well settled that a receipt on account of a restrictive covenant not to use the trade mark forever would represent the capital receipt. In any case, the question need not be decided.

12. The other main question which survives for decision is whether the sale consideration can be assessed to capital gains as undisclosed income within the meaning of section 158B(b) of the Act. The definition is broadly worded and includes any entry in the books of account or other document or transaction representing wholly or partly income or property "which has not been or would not have been disclosed for the purposes of this Act". The return of income for the year under appeal was filed on 2.12.1996. In the balance sheet attached to the return of income, the following were disclosed:

In the revised return filed on 13.11.97 i.e., after the date of search/survey the above figures were revised. The following is the position:

Liabilities	Amount	Assets	Amount
Current liabilities	Rs. 2,56,42,472	Reserves and surplus	Rs. 17,08,810
Loans and advances	Rs. 62,97,923	Cash and Bank balances	Rs. 1,05,89,160

The Assessing Officer observed that a part of the amount shown originally as current liabilities was now taken to reserves and surplus and a sum of Rs.1.75 crores was now included as loans and advances in the assets side and also in the reserves and surplus. Thus according to the Assessing Officer the assessee disclosed

Liabilities	Amount	Assets	Amount
Current liabilities	Rs. 3,51,33,190	Reserves and surplus	Rs. 1,05,68,544
Loans and advances	Rs. 81,69,223	Cash and Bank balances	Rs. 2,38,26,433

the receipt of the first instalment of the sale consideration of Rs.1.75 crores only after the date of search.

13. It is not possible to hold that the assessee disclosed the receipt of the first instalment only in the revised balance sheet filed with the revised return which was filed after the date of the search. In the original balance sheet the amount of Rs.1,74,73,2491- was shown as current liabilities because the brothers of Heeranand were also claiming a share in the sale consideration and therefore, the assessee had shown the amount as a liability to them in the balance sheet. However, in the revised balance sheet this amount was taken out of the current liabilities and was shown under the head "loans and advances" as an asset. Thus even in the original balance sheet, the amount had been disclosed. The head under which the amount was disclosed was changed in the revised balance sheet. Further, the facts narrated in paragraph 15 of the assessment order

would clearly show that the first instalment was received through banking channels on 24.10.1995; even the second instalment was received on 17.6.1997 again through banking channels. The total amount received was Rs.3,99,75,399/-, the excess above Rs.3.5 crores representing the difference due to exchange fluctuations. Even in paragraph 16, the Assessing Officer has stated that "while bringing the amount into books the assessee has used an indirect method by showing it under cash and bank balances which would have remained undetected but for the search". When the amount has been received through banking channels and has been shown as part of the cash and bank balances it is not possible to say that the transaction has not been or would not have been disclosed for the purposes of the Act within the meaning of section 158B(b).

14. Recently, the Hon'ble Karnataka High Court has delivered a judgement on 17.10.08 in ITA No.480 of 2004 in the case of CIT vs M/s. Peutronics Pvt. Ltd., In that case, the assessee had shown certain floppies as consumable and claimed it as revenue expenditure but had not disclosed in the closing stock. Pursuant to a search where certain materials were found, the Income-tax Department proceeded to assess the amount as undisclosed income u/s.158B(b) of the Act. On these facts, the Hon'ble High Court held as under:

> "7. It is not in dispute that the materials found in search have been shown in the accounts furnished along with returns for the assessment years in question. But the assessee had shown it as consumables and revenue expenditure, but had not disclosed in closing stock. The assessee had followed the said pattern of accounting consistently earlier while submitting the returns.
>
> 8.......
>
> 9.......
>
> 10. On through consideration of the facts and the provisions of Section 158B(b) of the Income tax Act, we are unable to be persuaded by the contention of Counsel for revenue that the materials found in search amounts to undisclosed income because it is evident from the records and the assessment order of the relevant years in question that these materials were disclosed as consumables and as revenue expenditure. The method of accounting adopted by the assessee may be wrong. The materials might warrant the consideration for tax, but it cannot be said that the materials were not disclosed to the department in the earlier returns. There is no suppression of materials on the part of the assessee while filing the returns for the previous years. In that view of the matter, the question of law are answered in favour of the assessee. The appeal is dismissed."

On the basis of this judgement which we respectfully follow, it is not possible to hold that the compensation received by the assessee for transfer of the trade mark represented undisclosed income.

15. It is further seen that the assessee was facing a litigation in OS No.8277 of 1995 in the court of the City Civil Judge at Bangalore as can be seen from the plaint copy of which is placed at pages 30 to 61 of the paper book. In this litigation the plaintiffs, who were also connected with the assessee company and Heeranand, had prayed for an injunction against the assessee company from using the trade mark "sharp" and to render a true and proper account of the profits made by the assessee company by using the said trade mark. Perhaps the assessee apprehended that the amount received from Sharp Corporation may have to be shared with the plaintiffs which is the reason why it was shown as a liability. The particulars of the litigation were furnished before the Assessing Officer also in the course of the assessment proceedings. Further Smt.Seema Budhrani wife of Heeranand has filed an affidavit before the Commissioner of Income-tax (Appeals) (page.326 of the paper book) in which she has stated that she handed over the documents relating to the foreign inward remittance from Sharp Corporation to the Survey authorities who included them in the search inventory. This affidavit actually repeats and reiterates the assessee's contention raised in its letter dt.11.12.1997 before the Asst. Director of Investigation. A copy of this letter is at pages 62 to 68 of the paper book. The entire letter is in response to the ADI's letter dt.4.12.1997. In para 17 (a) of this letter, the assessee stated that there was no search in its case and that the proceedings were only u/s.133A and any material obtained in the course of the survey cannot be treated as if it was obtained in the course of a search. The Commissioner of Income-tax (Appeals) in para 4.1 of his order has stated that there are documents seized during the search which refer to the transaction with Sharp Corporation but has not specifically stated which document in the panchanama dt.27.12.97 refers to this transaction. The panchanama, copies of which have been filed by the learned DR, do not specifically show that any paper relating to the foreign inward remittance was seized during the search. Even in the statement recorded from Seema Budharani on 16.10.97 u/s. 132 (4), she was asked by question no.32 to explain the foreign inward remittance certificate dt. 17.6.97. This search according to the panchanama took place in the premises of 113F, Brigade Road whereas the assessee's premises is at 133A, Brigade Road. The panchanama is in the name of M. B. Heeranand and Lekharaj Jessumal and Co. P. Ltd., and not in the name of the assessee. Seema Budharani stated in reply that the remittance is for AEEI (assessee company) and it has been accounted in its books. She also stated that it represents compensation amount due for the trade marks held. She also said that a similar amount was earlier received 2 years back and was accounted for. These facts go towards establishing the assessee's case that the amount of Rs.3.5 crores cannot be considered as undisclosed income of the assessee company.

16. For the above reasons, we hold that the amount received from Sharp Corporation cannot be held to be undisclosed income of the assessee.

17. The other addition which is contested in the assessee's appeal is the estimated value of Rs.10 lakhs attributed to the license allegedly granted to the assessee by Sharp Corporation. The addition seems to proceed on wrong premises. Under the settlement agreement the assessee has merely retained the manufacture of six products in the trade mark "sharp" out of the 20. The balance of 14 products were to be manufactured by Sharp Corporation. The assessee has not received any separate consideration for retaining the right to manufacture the 6 products under the trade mark "Sharp". Both the departmental authorities have merely assumed that the assessee was given the right to do so whereas right from the inception in 1961 it was the assessee which was manufacturing all the 20 items under the trade mark "sharp" and what happened under the settlement agreement was it merely retained the right to do so in respect of six products. The right remained with the assessee right from the inception and the settlement agreement merely recognized and reiterated it. It was not a benefit received by the assessee in the course of its business. The addition having been based on erroneous premises is deleted.

18. In the department's appeal, objection is taken to the decision of the Commissioner of Income-tax (Appeals) deleting the addition of Rs.3,99,75,400/- made in the assessment order u/s.143(3) on protective basis. The Commissioner of Income-tax (Appeals) has held that since subsequent to the regular assessment a block assessment order has been passed u/s.158BD on 15.11.99 and the same addition has been made therein, it cannot be taxed even on protective basis in the regular assessment. In our opinion, the Commissioner of Income-tax (Appeals) is right. The addition emanates from certain materials alleged to have been seized in a search conducted u/s.132 of the Act in the premises of Heeranand. The provisions of section 158BD provide for an assessment of the assessee to whom the seized material relates. Accordingly, the income can be included only in the block assessment u/s.158BD and cannot even be included on protective basis in an assessment made u/s. 143(3) of the Act. The Commissioner of Income-tax (Appeals) has, therefore, rightly deleted the same. In any event, since we have held that the addition in the block assessment is without merit, there is no question of assessing the amount in another assessment on protective basis. The decision of the Commissioner of Income-tax (Appeals) is upheld and the appeal of the department is dismissed.

19. In the result, the appeal of the assessee is allowed and the appeal of the department is dismissed with no order as to costs.

Order pronounced in the open court on this 6.2.2009.