* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.784 of 2011**

Reserved on: 13th September, 2011
% Pronounced on: 30th November, 2011

PITNEY BOWES INDIA PVT. LTD. . . . APPELLANT

Through: Mr. C.S. Aggarwal, Sr. Advocate with Mr. Prakash Kumar, Advocate for the appellant.

VERSUS

COMMISSIONER OF INCOME TAX . . .RESPONDENT

Through: Mr. M.P. Sharma, Sr. Standing Counsel.

CORAM :-
HON'BLE THE ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI,ACTING CHIEF JUSTICE:

1. The facts leading to the filing of this appeal may first be recapitulated and these are as follows:

The appellant/assessee company was incorporated on 23.4.2004 under the Companies Act, 1956 and is a wholly owned subsidiary of Pitney Bowes Inc., USA. The assessee is engaged in the business of wholesale trading, selling and

marketing of hi-tech documents and providing maintenance and after sales service of its products. During the year under consideration, the assessee company had acquired mailing business from M/s. Kilburn Office Automation Limited (hereinafter referred to as 'KOAL') as a going concern on a slump sale basis pursuant to Business Transfer Agreement dated 15.10.2004 entered into by the appellant with the later. The consideration for such transfer was stated as ₹18.92 Crores which included a sum of ₹5.94 Crores by way of non-compete fee which was limited for a period of 5 years. Seller Company (KOAL) before the transfer of said business has been acting as a distributor of Pitney Bowes' products in India and Nepal. In the year under consideration, the Pitney Bowes Inc., USA (holding company of the assessee) had decided to enter in the Indian market directly and consequently has caused the incorporation of the assessee company as its wholly owned subsidiary.

2. For the instant assessment year 2005-06, the assessee company filed its return of income, declaring a total loss of ₹2,59,84,980/- as was computed in the computation of income.

3. In the said return, the assessee claimed deduction of non-compete fee of ₹5.94 Crores as business/revenue expenditure in the computation of income filed with the return of income. The Assessing Officer (AO), however, disallowed the same on the ground that the payment of non-compete fee was a capital outlay, non-allowable under Section 37 of the Act. The assessee filed appeal against this order before the CIT (A). The CIT (A) held that the expenditure incurred on non-compete fee by the assessee needs to be allowed on deferred revenue basis, i.e., in five years as the period of non-compete fee agreement is for five years. As such, the CIT (A) allowed ₹1,18,89,458/- being $1/5^{th}$ of the total amount of ₹5,94,47,290/- paid to KOAL by the assessee as non-compete fee.

4. The Revenue preferred an appeal before the Tribunal. The assessee filed a cross-objection.

5. The Income Tax Appellate Tribunal ('the Tribunal' for brevity) held that non-compete fee paid by the assessee is capital in nature, as such disallowed the claim. Further, while dealing with the cross-objection filed by the appellant, the Tribunal restored the alternate plea in respect of

allowance of depreciation under Section 32(1)(ii) of the Act, to the file of the Assessing Officer for deciding it.

6. It is in this backdrop that the present appeal is filed. Submitting that the non-compete fee, in the circumstances of this case, was to be treated as revenue expenditure and non-compete expenditure. It is also submitted that in any case, the Tribunal should have accepted the alternate plea to allow depreciation @ 25% under Section 32(2) (ii) of the Income Tax Act (hereinafter referred to as 'the Act') instead of remitting the case back to the AO for decision on this issue. The appeal was accordingly admitted on the following substantial questions of law:

> "1. Whether the Income Tax Appellate Tribunal was correct in law in holding that the claim of deduction of expenditure incurred as non-compete fee aggregating to Rs.5,94,47,290/- could not be allowed to it either in the instant year or even in five years on deferred basis?
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> 2. Whether the Income Tax Appellate Tribunal was justified in law in remanding the issue in respect of alternate plea of the assessee, instead of directing the Assessing Officer to allow depreciation @25% under Section 32(1)(ii) of the Income Tax Act, 1961?"

Re: Non-compete fee, whether capital or revenue:

7. It was submitted in this behalf that under the agreement entered with KOAL, the assessee did not acquire the

business of photocopiers and drawing office equipment business of the seller. In consideration for the sale of the business by the seller including the transfer of assets, the assessee agreed to pay ₹17,91,15,000/-. Under this Business Transfer Agreement, KOAL had agreed that it shall not compete with the assessee for a limited period of five years, who has acquired the running mail business as a going concern. Clause 33.2 of the Agreement provided for certain adjustments and deductions to be made at closing, from the aforesaid consideration. Under the aforesaid agreement, Clause 7 provided that the seller shall comply with the non-compete obligations set forth in Annexure 1.1(B). From the perusal of the Annexure 1.1(B), it would be seen that it was specifically provided that there is a non-compete obligation of the transferor when it undertook that it shall not either on its own account or in conjunction with any of its affiliates or others and whether directly or indirectly for a period of five years from the closing date establish, develop, carry on or assist in carrying on or be engaged, concerned, interested, or employed in or provide technical, commercial or professional advice to any other

business enterprise or venture which supplies goods and/or services which are competitive with or are of the type supplied by the business at the closing date within the whole of India. It is, thus, evident that the assessee company incurred an expenditure to eliminate the competition for a limited period of five years and was part of lump sum consideration of ₹17,91,15,000/-. It is, thus, crystal clear that there existed an obligation of the transferor, who could not enter into a competition to carry on the business of trading for a limited period of five years to establish, develop, carry on or assist in carrying on or be engaged, concerned, interested or employed in or provide technical commercial or professional advice to any other business enterprise or venture which supplies goods and/or services which are competitive with or are of the same type as supplied by the business.

8. It was, thus, the non-compete fee which had been incurred as a consideration to eliminate competitionwith the transferor for a limited period of five years and such an expenditure could not be treated as capital in nature. The

learned counsel referred to the following judgments in support of his submission:

(i) ***CIT (A) Vs. COAL Shipment (P) Ltd.***, 82 ITR 902;

(ii) ***CIT Vs. Eicher Ltd.***, 302 ITR 249.

9. Learned counsel argued that in ***COAL Shipment (P) Ltd. (supra)***, the Apex Court has held that although payment made toward off competition in business to a rival dealer would constitute capital expenditure if the object of making that payment was to derive an advantage by eliminating the competition over some length of time, the same result would not follow if there was no certainty of the duration of the advantage and the same could be put to an end at any time. It specifically held that 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. This Court in ***Eicher Ltd. (supra)*** reported in 302 ITR 249, has held, after applying the principles laid down by the Apex Court in the case of ***CIT Vs. Madras Auto Services Pvt. Ltd.*** reported in 233 ITR 468 that since the assessee did not acquire any capital asset by making the

payment of non-compete fee, it merely eliminates competition in the two wheeler business, for a while. In the said case, t was not clear how long the restrictive covenant was to last but it was held that the same was neither permanent nor ephemeral. It was argued that in the instant case, the situation is identical and in fact, far-better namely that the benefit was to be derived only for a period of five years and was not ephemeral. It is also undisputed that by incurring the expenditure to eliminate competition it was able to deter M/s KOAL who was trading in the same automation equipment. It was able to increase its revenues thereby earning profits, which is the revenue profit and, thus, the expenditure incurred was in the commercial field.

10. The learned counsel for the Revenue, on the other hand, relied upon the reasons given by the Tribunal in holding the expenditure to be capital in nature. He drew our attention to Para 3 of the impugned order of the Tribunal where the Tribunal had recorded that both the parties agreed that the issue about the non-compete fee by the assessee was covered by the decision rendered by the Tribunal, Principal Bench, Delhi vide judgment dated 30.7.2010 in the case of

M/s Tecumesh India Pvt. Ltd. Vs. Addl. CIT, 132 TTJ 129.

11. We have considered the submissions of both the parties. We find that in the return filed by the assessee, it had given its Notes to the computation and Note file pertained to non-compete fee, which was stated in the following terms:

> "5. Non-Compete fee paid to KOAL
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> During the year, the Company had acquired the mailing business from KOAL as a going concern in pursuance of the BTA on a slump sale basis for a total purchase consideration of Rs. 1892 lacs. A part of the purchase consideration so paid was also towards non-compete fee which restricts the KOAL and its directors to engage itself in the competing business for a period of 5 years. The value of the non-compete fee has been **considered as per the valuation report and has been treated as a capital expenditure in the books of account. It is paid to KOAL for the loss of business that they would suffer for not competing with the Company and therefore, it is in the nature of revenue expenditure.** Accordingly, the same has been treated as revenue expenditure in the tax return. Reliance in this regard is placed on the judgment of Smartchem Technologies Ltd. v. ITO [2005] 97 TTJ 818 (Ahmedabad Tribunal)."
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> (emphasis supplied)

12. Thus, the assessee itself treated the expenditure as capital in the books of accounts. However, at the same time, it was maintained that since it was paid for loss of business that KOAL would suffer for non-compete fee, the same was treated as revenue in nature. Likewise, in Schedule 2 to the balance sheet disclosing 'fixed assets', payment of non-

compete fee is treated as 'intangible assets'. This also shows that the assessee treats this as asset acquired, which is intangible in nature. The issue regarding forwarding of payment was discussed by the Special Bench of the Tribunal in ***M/s Tecumesh India Pvt. Ltd. (supra)*** in greater details and after applying the ratio of various judgments of different High Courts including jurisdictional Court as well as the Supreme Court, the Tribunal summarized in the following terms:

> "129. According to above observations it can be seen that warding off competition in business even to a rival dealer will constitute capital expenditure and to hold them capital expenditure it is not necessary that non-compete fee is paid to create monopoly rights.
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> 130. The assessee also cannot get any help from the decision of Hon'ble Delhi High Court in the case of CIT vs. Eicher Company Ltd. (supra) as in that case their Lordships have clearly found from the record that it was not clear that how long the restrictive covenant was to last and what the assessee had done was that it eliminated the competition in the two-wheeler business for a while. Their Lordships have also found that the benefit received by the assessee in that case was neither permanent nor ephemeral. Therefore, the said decision is not applicable to the facts of the present case as in the case of assessee the non compete agreement is applicable for 5 years, which period has been considered to be sufficient to give enduring benefit in the case of Assam Bengal (supra).
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> 131. With these observations we hold that the expenditure of Rs.2.65 crore claimed by the assessee in pursuance of non-compete agreement dated 10th July, 1997 are capital expenditure, the deduction of

> which cannot be granted to the assessee as revenue expenditure. The main issue is decided against the assessee and in favour of the revenue."

13. The position in the instant case is almost identical. That was a reason that even the learned counsel for the appellant had conceded before the Tribunal that the matter was covered by the aforesaid Special Bench decision.

14. Agreeing with the aforesaid view, we are of the opinion that the Tribunal rightly held that the expenditure was capital in nature. Question No.(1) is answered accordingly.

Re: Applicability of Section 32(1)(ii):

15. Alternate submission of the learned counsel for the appellant was that no doubt, once the expenditure is held capital in nature, the assessee would be entitled to depreciation. The AO had allowed $1/5^{th}$ of the fee treating the same as deferred revenue expenditure, as this fee was for five years. The argument of the learned counsel for the appellant was that when the expenditure was treated as capital in nature, there was no question of treating the same as deferred revenue expenditure. In such circumstance, the depreciation was allowable under Section 32 of the Act. The reason, which is given by the Tribunal for remitting the issue back is that this alternate plea has not been decided by any of the Authorities below, i.e., either the AO or the CIT (A). For this reason, the Tribunal felt it appropriate that the

matter needed to be heard by the AO afresh along with verification of the records by the Revenue Authorities.

16. No doubt, the Tribunal had itself determined the nature of payment, viz., treated the non-compete fee as capital in nature. The order of the Tribunal would further reflect that the alternate submission of the assessee was countered on the ground that no asset was created by making the said payment and there was no question of allowing the depreciation. It was also argued that non-compete fee was for five years and the assessee itself had been pleading that it was revenue expenditure. Such a contention of the Revenue cannot be allowed, which is self-contradictory. When nature of payment is discussed and at that stage, Department pleads that the expenditure is not revenue in nature, but is of capital nature, there is no reason to remit the case back to the AO to determine the nature of expenditure. At the same time, it is still a moot question as to whether depreciation can be allowed thereupon under Section 31(1)(ii) of the Act or not. We may note here that the learned counsel for the Department had referred to the judgment of the Kerala High Court in the case of ***B. Raveendran Pillai Vs. CIT***, 332 ITR 531 (Ker.), on the

basis of which, argument was raised that goodwill is not specifically mentioned in Section 32(1)(ii) of the Act and depreciation is allowable, apart from tangible assets, on such intangible assets, which are specifically enumerated in the said Clause. Though the AO would not have to consider the nature of expenditure, as that has been determined by the Tribunal, at the same time, whether depreciation thereupon is to be allowed or not under Section 32(1)(ii) of the Act has to be decided.

17. We, thus, find no fault in the order of the Tribunal remitting the case back on this aspect to the AO. As a result, question No.(2) is decided in the affirmative, consequence would be to dismiss this appeal. We order accordingly.

ACTING CHIEF JUSTICE

(SIDDHARTH MRIDUL)
JUDGE

NOVEMBER 30, 2011
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