आयकर अपीलीय अधिकरण, 'बी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH, CHENNAI

श्री वी दुर्गा राव,न्यायिक सदस्य एवं श्री जी. मंजुनाथ, लेखा सदस्य के समक्ष

BEFORE SHRI V. DURGA RAO, JUDICIAL MEMBER AND SHRI G. MANJUNATHA, ACCOUNTANT MEMBER

आयकर अपील सं./**ITA Nos.: 1597 & 1598/Chny/2018**
निर्धारण वर्ष / Assessment Years: 2005-06 & 2006-07

M/s.Cavinkare Private Limited, No. 12, Cenotaph Road, Teynampet, Chennai – 600 018.	v.	**The Deputy Commissioner of Income Tax,** Central Circle 2(1), Chennai.
PAN: AAACB 3754B		
(अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by : Shri T. Banusekar, CA
प्रत्यर्थी की ओर से/Respondent by : Smt. R. Anita, Addl. CIT

सुनवाई की तारीख/Date of Hearing : 28.09.2021
घोषणा की तारीख/Date of Pronouncement : 08.10.2021

आदेश /O R D E R

PER G. MANJUNATHA, ACCOUNTANT MEMBER:

These appeals filed by the assessee are directed against common order passed by the Commissioner of Income Tax (Appeals)-18, Chennai, dated 28.12.2017 and pertains to assessment years 2005-06 & 2006-07. Since facts are identical and issues are common, for the sake of convenience, these

appeals were heard together and are being disposed off, by this consolidated order.

2. The assessee has more or less raised common grounds of appeal for both assessment years. Therefore, for the sake of brevity, grounds of appeal filed for assessment year 2005-06 are reproduced as under:

1. *For that the order of Commissioner of Income Tax (Appeals) is contrary to law, facts and circumstances of the case to the extent prejudicial to the interest of the appellant and to any rate is opposed to the principles of equity, natural justice and fair play.*
2. *For that the Commissioner of Income Tax (Appeals) failed to appreciate that the order of the Assessing Officer is without jurisdiction.*
3. *For that the Commissioner of Income Tax (Appeals) erred in concluding that the non-compete fee in the facts and circumstances of the case, is not elig ble for depreciation.*
4. *For that the Commissioner of Income Tax (Appeals) erred in concluding that non-compete fees would be eligible for depreciation only if it is paid in conjunction with transfer of a division.*
5. *For that the Commissioner of Income Tax (Appeals) erred in disallowing the claim of weighted deduction u/s. 35 without appreciating the fact that the vehicles were exclusively used by the staff of Research and Development unit.*
6. *For that the Commissioner of Income Tax (Appeals) erred in treating the loan taken from the sister concern as deemed dividend without appreciating the fact that the said company was amalgamated with the appellant company.*

7. *For that the Commissioner of Income Tax (Appeals) erred in disallowing 5% of exempt income u/s. 14A of the Income Tax Act towards expenditure incurred in earning the exempt income.*

3. The brief facts of the case are that the assessee is engaged in the business of manufacturing and trading of cosmetics and food products, filed its return of income for assessment years 2005-06 and 2006-07 on 31.10.2005 and 30.11.2006 declaring loss of Rs. 8,65,58,890/- for assessment year 2005-06 and total income of Rs. 2,99,54,993/- for assessment year 2006-07. The assessment for the impugned assessment years was completed u/s. 143(3) of the IT Act, 1961 (hereinafter the 'Act') on 20.12.2007 for assessment year 2005-06 and on 31.12.2008 for assessment year 2006 07 where the AO has made additions towards disallowance of depreciation on non-compete fees, additions towards disallowance of depreciation on vehicles u/s. 35 of the Act, disallowance of expenses relatable to exempt income u/s. 14A of the Act and additions towards deemed dividend u/s. 2(22)(e) of the Act. The assessee carried the matter in appeal before the CIT(A). The CIT(A) for the reasons stated in appellate order dated 28.12.2017 partly allowed appeals filed by the assessee, where he has sustained additions towards disallowance

of depreciation on non-compete fees, disallowance of weighted deduction claimed u/s. 35 towards vehicles used for R&D facility, disallowance of expenses relatable to exempt income u/s. 14A of the Act and additions towards deemed dividend u/s. 2(22)(e) of the Act. Aggrieved by the CIT(A) order, the assessee is on appeal before us.

ITA No.1597/Chny/2018

4. The first issue that came up for our consideration from ground nos. 3 & 4 of assessee appeal is disallowance of depreciation on non-compete fees. The fact with regard to the impugned dispute are that the assessee has entered into a Memorandum of Understanding on 26.11.2003 for acquiring the trademark 'Ruchi' from M/s. Ruchi Food Products, a partnership firm and as per said MoU, the assessee has acquired trademark 'Ruchi' along with associate copyrights, goodwill, formulations and know-how relating to process, ingredient, technical or otherwise for manufacture/production of the products agreed under said trademark for consideration of Rs. 15,20,00,000/-. The assessee had also entered into supplemental Memorandum of Understanding dated 15.04.2004 and bifurcated agreed consideration paid in terms of MoU dated 26.11.2003, into

consideration paid for acquiring patents, copyrights, know-how/ formulation and non-compete fees and as per said agreement a sum of Rs. 3 crores has been assigned for non-compete trade agreement. In pursuance to above two MoUs' the assessee entered into a non-compete agreement dated 26.05.2004 and as per said agreement, the seller of Ruchi trademark was prevented from doing any business for a period of 10 years for which a consideration of Rs. 3 crores has been paid. The assessee has treated consideration paid in terms of non compete agreement as an intangible asset falls under 'any other business or commercial rights of similar nature' as envisaged u/s. 32(1)(ii) of Act and claimed depreciation @ 25% The AO has disallowed depreciation claimed on non-compete fee u/s. 32(1)(ii) of the Act on the ground that non-compete fees paid does not confer upon the assessee any right which would be used for the business, but it only restrains other person from carrying on his business in competition with the assessee business. Therefore, he observed that non-compete agreement between the parties restraining the other party in engaging in a competing business, does not in anyway result in any right which could be treated as an asset. The intangible asset defined in the depreciation table

contemplates only rights acquired and capable of being exercised by the owner. Therefore, consideration paid for non-compete agreement is neither asset whether it is tangible or intangible which could be used for the business of the assessee and hence disallowed depreciation claimed on non-compete fees and added back to the total income of the assessee.

5. The Ld. AR for the assessee submitted that the Ld. CIT(A) has erred in sustaining addition made by the AO towards disallowance of depreciation on non-compete fees without appreciating the fact that non-compete fee paid by the assessee in terms of MoU for acquiring trademark Ruchi is part of main agreement of acquiring trademark and other technical know-how, in the nature of any other business or commercial rights of similar nature eligible for depreciation u/s. 32(1)(ii) of the IT Act, 1961. The Ld. AR for the assessee further referring to the agreement between the parties submitted that after going through the clauses of MoU and non-compete agreement, the seller acknowledges that the food business intensely competitive and as such, the technical and business information including, but not limited to recipes, secret ingredients, preserving techniques was

handed over to the assessee and further craved not to participate in, own, manage, operate or conduct any business or have any interest, either directly or indirectly in manufacturing or marketing or distributing or selling in any packaged food business either in India or anywhere in the world for the period of 10 years from the date of acquiring of assignment of the brand Ruchi which resulted in a kind of right in business similar to intangible asset defined u/s. 32(1)(ii) of the Act. He further referring to the decision of Hon'ble High Court of Madras in the case of Pentasoft Technologies Ltd vs DCIT, [2013] 96 DTR 223 submitted that Hon'ble Jurisdictional High Court has clearly held that non-compete fees paid is in the nature of any other business or commercial rights which is eligible for depreciation u/s. 32(1)(ii) of the Act.

6. The Ld. DR on the other hand strongly supporting the order of the CIT(A) submitted that non-compete fees is in the nature of negative right and it cannot be a commercial right of similar nature and the expression similar nature shall be relatable to patents, copy rights and trademark license or franchise or any other business asset. Therefore, she submitted that this negative

right cannot be construed either as the license or as a commercial right to be eligible for deduction u/s. 32(1)(ii) of the Act, 1961. She further referring to decision of the Hon'ble Delhi High Court in the case of Sharp Business System vs CIT in ITA No. 492/12 dated 05.11.2012 submitted that intangibles spelt out in section 32(1)(ii) i.e., know-how, patents, copyright, trademark license/franchise as any other right of a similar kind it confers business or commercial or any other business or commercial right of a similar nature has to be intangible asset. The nature of this rights mentioned clearly spell out an element of exclusivity which ensures to the assessee as a sequel to the ownership. However, in the case of non-compete agreement, the advantage is a restricted one, in point of time and it does not necessarily confer any exclusive right to carry on the primary business activity. Therefore, said negative right cannot be construed as any other business or commercial right of similar nature which qualifies for depreciation u/s. 32(1)(ii) of the Act.

7. We have heard both the parties, perused the materials available on record and gone through orders of the authorities below. We have also carefully considered case laws cited by both

parties. Admittedly, the assessee has paid non-compete fees in terms of an agreement which is carved out from main MoU between the parties for transfer of trademark called 'Ruchi'. The assessee has entered into an agreement for acquiring trademark 'Ruchi' along with other bundle of rights and as per said MoU, the parties have entered into a non-compete agreement and restricted the seller of trademark not to have any kind of right in the business activity for a period of 10 years for which the assessee has paid consideration of Rs. 3 crores. The assessee has treated said consideration as intangible asset, being any other business or commercial right of similar nature and claimed depreciation u/s. 32(1)(ii) of the Act. The AO has disallowed depreciation claimed on non-compete fee on the ground that non-compete fee paid by the assessee neither gives rise to any kind of asset whether tangible or intangible which could be owned and transferable to third party. Therefore, he opined that non-compete fee paid by the assessee for restricting other party to restrain from doing similar kind of business activity for a particular period is nothing but a negative right which cannot be treated as intangible asset, know-how, patent, copy rights, trademark, license, franchise or any other business of the

commercial right of similar nature. The AO has given his own reasons for denying depreciation claimed on non-compete fees and, according to him non-compete fee paid does not confer upon the assessee any right which would be used for the business. However, it only restrain the other person from carrying on his business in competition with the assessee's business. Therefore, he opined that definition of intangible u/s. 32(1)(ii), i.e., any other business or commercial rights of similar nature speaks about a kind of right which could be owned and transferable to the third party, but not to a negative rights called non-compete fee paid for restraining the other party from doing business.

7.1 We have given our thoughtful consideration to the reasons given by the AO in ight of arguments of the assessee and we ourselves do not subscribe to reasons given by the AO, for the simple reason that non-compete fee is generally paid to a person who is in an advantageous position, because the payee is in a position where he can, if he so desires, create a hostile environment for the payer's business either starting a competing business in the same field or by helping the growth of the payer's competitor to ensure that such person does not indulge in such

competing behavior, and to ensuring that the payer can carry on business without bothering about the competition. Further, non-compete agreement are generally for specific periods and after an expiry of the period, the advantage in the non-compete agreement disappears since the payee is no longer bound by it. Hence, we are of the considered view that non-compete fee paid in pursuant to any agreement for transfer of patents, know-how, copy rights or trademark is in the nature of any other business or commercial rights of similar nature, being intangible asset, which is eligible for depreciation u/s. 32(1)(ii) of the Act. The fact that non-compete fee has not been specifically mentioned in section 32(1)(ii) would not result in a negative right inference that depreciation is not allowable on non-compete fee, because of the presence of the phrase "or any other business of commercial rights of similar nature which shows that the legislature intended clause (ii) of section 32(1) to be an inclusive clause and not an exhaustive once restricted to the assets specifically mentioned therein. Therefore, we are of the considered view that there is a merit in the argument of the assessee that non-compete fee paid for restraining the other party from doing competitive business for a specific period in pursuant to a trademark agreement is

intangible in the nature of any other business or commercial rights of similar nature which qualifies with depreciation u/s. 32(1)(ii) of the Act. This legal position if fortified by the decision of the Hon'ble Madras High Court in the case of Pentasoft Technologies Ltd vs DCIT, supra, where the Hon'ble Madras High Court considered relevant fact by following the decision of Supreme Court in the case of Techno Shares and Stocks Ltd vs CIT 327 ITR 323 held that non-compete fee paid by an assessee is in the nature of any other business or commercial right which is eligible for depreciation u/s. 32(1)(ii) of the Act. The Hon'ble High Court while deciding the issue, has laid down the ratio and held that under non-compete agreement the transferor had transferred all its rights in respect of the trademark and such right strengthen those rights under the said non-composite agreement which includes a non-compete clause by virtue of which, the transferor restrains from using the same trademark, copyrights etc. Therefore, the Hon'ble High Court held that non-compete clause under the agreement should be a supporting clause to the transferor of the copy rights and patents rather to strengthen the commercial right, which was transferred in favour of the assessee. A similar view has been taken by a Hon'ble

Bombay High Court in the PCIT vs Ferromatic Milacron India Pvt Ltd, 2018, 99 Taxmann.com 154, where it has considered identical issue and held that non-compete fee is in the nature of any other business or commercial right of similar nature used in explanation to section 32(1)(ii) of the Act and thus, eligible for depreciation. As regard the case laws cited by the Ld. DR in the case of Sharp Business System s CIT 492/2012, although, the Hon'ble Delhi High Court taken a different view and held that non-compete fees is a kind of negative right which does not give rise to any kind of right which could be owned or transfer to third person similar to rights of any other kind of similar nature as mentioned in section 32(1)(ii) Although divergent views are expressed by two different High Courts, but because the Hob'ble Jurisdictional High Court of Madras has taken a view in favour of the assessee in the case of Pentasoft Technologies Ltd vs DCIT, we prefer to follow the Jurisdictional High Court decision which is binding in nature.

7.2 In this view of the matter and considering the ratio of various case laws, we are of the considered view that non-compete fee paid by the assessee in terms of Memorandum of

Understanding for acquiring trademark is nothing but an intangible asset in the nature of any other business or commercial rights of similar nature which qualifies for depreciation u/s. 32(1)(ii) of the Act. Hence, we direct the AO to delete the additions made towards disallowance of depreciation claimed on non-compete fee.

8. The next issue that came up for our consideration from Ground No.5 of assessee appeal is disallowance of deduction claimed u/s.35 of the Act, towards expenditure incurred for Research & Development (R&D) purpose. The assessee has claimed 100% deduction towards two motor cars purchased and given to two staffs, who are working for R&D unit. The AO has denied deduction cla med u/s.35 of the Act, on the ground that the assessee has failed to prove exclusive use of vehicles for R&D purpose.

8.1 The ld.AR for the assessee submitted that the ld.CIT(A) has erred in sustaining additions towards disallowance of deduction claimed u/s.35 of the Act, in respect of two motor vehicles given to staff of the assessee who are working for &D unit without

appreciating the fact that once cars are given to staff, the purpose of use of such vehicle is immaterial.

8.2 The ld.DR on the other hand supporting order of the ld.CIT(A) submitted that in order to claim deduction for any expenditure u/s.35 of the Act, it is a precondition that such expenditure should be exclusively incurred for R&D purpose. Since, the assessee has failed to file necessary evidences to prove use of car for R&D purpose, the AO has rightly denied deduction u/s.35 of the Act.

8.3 We have heard both th parties, perused materials available on record and gone through orders of the authorities below. The admitted fact was that the assessee had given cars to two staff who are working for R&D unit. In fact, the AO has not disputed claim of the assessee that cars were given to staff who are working at R&D unit. The only reason for denial of deduction is that the assessee has not furnished log book maintained by the R&D division to prove that vehicle has been exclusively utilized for R&D purpose. We have gone through reasons given by the AO, but could not subscribe to reasons given by the AO for the

simple reason that, once having accepted the fact that cars were given to staff who are working for R&D unit, then the AO is erred in denial of deduction only for the reason that log book was not filed to prove use of vehicle exclusively for R&D purpose, because it is irrelevant whether vehicles are exclusively used for R&D purpose or other than R&D purpose, but as long as the staff are working for R&D unit, then it is as good as expenditure was incurred for R&D purpose. Therefore, we are of the considered view that the AO as well as the ld.CIT(A) were erred in denying deduction claimed u/s.35 of the Act, towards motor cars provided to staff and hence, we direct the AO to delete addition made towards disallowance of depreciation.

9. The next issue that came up for our consideration from Ground No.6 of assessee appeal is addition made towards deemed dividend u/s.2(22)(e) of the Act. The fact with regard to the impugned dispute are that the assessee has received sum of Rs.50 lakhs loan from its sister concern M/s. Cavin Plastics and Chemicals P. Ltd. The AO has treated loan received from sister concern as deemed dividend u/s.2(22)(e) of the Act, in the hands of the assessee.

9.1 The ld.AR for the assessee submitted that the ld.CIT(A) has erred in sustaining addition made towards deemed dividend u/s.2(22)(e) of the Act, without appreciating fact that loan received from sister concern was in pursuant to commercial expediency because subsequent to the date of loan, the assessee and sister concern were merged by an order of High Court and thus, loan received from sister concern becomes money of the assessee, which was not intended to repay Therefore, once amount received from sister concern looses the character of loan, then same cannot be considered as deemed dividend u/s.2(22)(e) of the Act.

9.2 The ld.DR on the other hand supporting order of the ld.CIT(A) submitted that there is no dispute with regard to the fact that loan received from sister concern and conditions prescribed for invoking provisions of section 2(22)(e) of the Act. Therefore, there is no error in the reasons given by the CIT(A) to sustain addition made by the AO and hence, his finding should be upheld.

9.3 We have heard both the parties, perused materials available on record and gone through orders of the authorities below. There is no dispute with regard to the fact that the assessee has received loan from sister concern and further, M/s. Cavin Plastics & Chemicals P. Ltd., was having reserves & surplus in excess of loans given to the assessee. The conditions precedent for invoking provisions of section 2(22)(e) of the Act, are that if any payment is made by a company by way of advance or loan to a shareholder or to any concern in which shareholder is a member and the second condition is, the company should have accumulated profits over and above the amount of loan. In this case, admittedly two conditions prescribed for invoking provisions of section 2(22)(e) of the Act are satisfied. The only explanation of the assessee is that the purported loan availed from sister concern was not intended to repay because, two companies were subsequently amalgamated by an order of Hon'ble High Court and thus, amount received from sister concern looses the character of loan. We do not agree with arguments taken by the ld.AR for the assessee, for the simple reason that subsistence of loan or advance is immaterial but what is relevant is whether loan is outstanding at the last date of previous year relevant to the

assessment year. In other words, even if loan or advance ceased to be outstanding in the end of the financial year, it can still be deemed as 'dividend' if the other conditions factually exist to the extent of accumulated profits possessed by the company. This legal position is supported by the decision of Hon'ble Supreme Court in the case of Miss. P. Sarada vs. CIT, [1998] 96 Taxman 11. In this case, loan was subsistence at the end of the financial year and further, the sister company's accumulated profits was over and above the amount of loan given to the assessee. Therefore, we are of the considered view that amount received by the assessee from sister concern clearly falls within the provision of section 2(22)(e) of the Act and thus, we are inclined to uphold the findings of ld.CIT(A) and reject ground taken by the assessee.

10. The next issue that came up for our consideration from Ground No.7 of assessee appeal is disallowance of expenditure relatable to exempt income. The assessee has earned exempt income by way of dividend from mutual funds to the tune of Rs.11,31,040/-, but did not made any disallowance of expenditure relatable to exempt income. Therefore, the AO has determined disallowance of expenditure relatable to exempt

income by disallowing 5% of exempt income as expenditure relatable to exempt income.

10.1 The ld.AR for the assessee submitted that the ld.CIT(A) has erred in sustaining addition made by the AO towards disallowance of expenditure relatable to exempt income u/s.14A of the Act, @ 5% of exempt income without appreciating the fact that disallowance made by the AO is excessive. In this regard, he relied upon the decision of ITAT, Chennai in the case of TIL Healthcare Pvt. Ltd., vs. DCIT, ITA No.1808/Mds/2014.

10.2 The ld.DR on the other hand supporting order of the ld.CIT(A) submitted that when assessee is not maintaining separate books of accounts for investment activity, the AO has to determine expenditure relatable to exempt income on estimation basis and thus, there is no error in disallowance computed by the AO.

10.3 We have heard both the parties, perused materials available on record and gone through orders of the authorities below. Admittedly, prior to assessment year 2008-09, the provisions of

Rule 8D was not applicable for determining disallowance of expenditure u/s.14A of the Act. It is also an admitted fact that prior to assessment year 2008-09, various Courts and Tribunals have directed the AO to estimate 2 - 3% of exempt income towards expenditure relatable to exempt income u/s.14A of the Act, depending upon facts of each case. The ITAT, Chennai in the case of TIL Healthcare Pvt. Ltd., *supra,* has considered an identical issue and restricted disallowance to the extent of 2% of exempt income instead of 5% as computed by the AO. Therefore, considering facts and circumstances of this case and also consistent with view taken by the Co-ordinate Bench in the case of TIL Healthcare Pvt Ltd., we direct the AO to restrict disallowance of expenditure relatable to exempt income u/s.14A of the Act, to the extent of 2% of exempt income earned for the year.

11. In the result, the appeal filed by the assessee is partly allowed.

ITA No.1598/Chny/2018

12. The first issue that came up for our consideration from Ground Nos.3 & 4 of assessee appeal is disallowance of

depreciation on non-compete fees. We find that an identical issue had been considered by us in ITA No.1597/Chny/2018 for assessment year 2005-06, where under identical set of facts we held that assessee is entitled for depreciation on non-compete fees. The reasons given by us in preceding para Nos.7 to 7.2, in ITA No.1597/Chny/2018, for assessment year 2005-06 shall *mutatis and mutandis* apply to this appeal as well. Therefore, for similar reasons we direct the AO to delete addition made towards disallowance of depreciation on non-compete fees.

13. The next issue that came up for our consideration from Ground No.5 of assessee appeal is disallowance of weighted deducted claimed u/s.35 of the Act, in respect of vehicles used by staff of R&D unit. A similar issue had been considered by us in ITA No.1597/Chny/2018 for assessment year 2005-06. The reasons given by us in preceding para No.8.3, in ITA No.1597/Chny/2018, for assessment year 2005-06 shall *mutatis and mutandis* apply to this appeal as well. Therefore, for similar reasons we direct the AO to delete addition made towards disallowance of depreciation.

14. The next issue that came up for our consideration from Ground Nos.6 to 10 of assessee appeal is disallowance of expenditure relatable to exempt income u/s.14A of the Act. We find that an identical issue had been considered by us in ITA No.1597/Chny/2018 for assessment year 2005-06. The reasons given by us in preceding para No.10.3, in ITA No.1597/Chny/2018, for assessment year 2005-06 shall clearly apply to this appeal as well. Therefore, for similar reasons we direct the AO to restrict disallowance of expenditure relatable to exempt income @ 2% of exempt income earned for the year.

15. In the result, the appeal filed by the assessee is partly allowed.

16. As a result, both the appeals filed by the assessee are partly allowed.

Order pronounced in the court on 8th October, 2021 at Chennai.

Sd/-	Sd/-
(वी दुर्गा राव)	(जीमंजुनाथ .)
(V. Durga Rao)	**(G. Manjunatha)**
न्यायिक सदस्य/Judicial Member	लेखा सदस्य /Accountant Member

चेन्नई/Chennai,
दिनांक/Dated, the 8th October, 2021
RSR

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त /CIT
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF.