

आयकर अपीलीय अधिकरण, डी' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL, 'D' BENCH : CHENNAI

श्री महावीर सिंह, उपाध्यक्ष एवं श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष
**BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND
SHRI MANOJ KUMAR AGGARWAL, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A No.175/CHNY/2019
निर्धारण वर्ष /Assessment year :2012-2013

Eaton Power Quality Private
Limited,
No.2, E.V.R. Street,
Sedarapet,
Puducherry- 605 111.

Vs. The Deputy Commissioner of
Income Tax,
Pondicherry Circle,
Pondicherry.

[PAN AAACC 6943R]
(अपीलार्थी/**Appellant**)

(प्रत्यर्थी/**Respondent**)

अपीलार्थी की ओर से/ Appellant by : Shri Vishal Kalra, Advocate
प्रत्यर्थी की ओर से /Respondent by : Shri V. Suresh Guduri, IRS, JCIT.

सुनवाई की तारीख/Date of Hearing : 27.09.2023.
घोषणा की तारीख /Date of Pronouncement : 20.10.2023

आदेश / ORDER

PER MAHAVIR SINGH, VICE PRESIDENT:

This appeal filed by the assessee is arising out of the order of the Commissioner of Income Tax (Appeals)-Puducherry in ITA No.177/CIT(A)-PDY/2016-2017, dated 19.11.2018. The assessment was framed by the Deputy Commissioner of Income Tax, Pondicherry Circle, Pondicherry for the assessment year 2012-13 u/s.143(3) of the Income Tax Act, 1961 (hereinafter 'the Act'), vide order dated 07.03.2016.

2. The first two issues, which are common, are as regards to the order of CIT(A) confirming the action of AO in disallowing the payment made by the assessee towards non-compete fee and payment made in respect of customer and other contracts, backlog orders, customer and suppliers lists and claiming the same as revenue expenditure. For this, assessee has raised the following ground Nos. 2 & 3:-

'2. Disallowance of payment of non-compete fees:

2.1. That on the facts and circumstances of the case and in law, the CIT(A) has erred in confirming the disallowance of expenditure amounting to INR 2,42,80,088, being payment for non-compete fees, alleging it to be capital in nature, without appreciating that the expenditure was not incurred for bringing into existence any asset and / or an advantage of enduring nature.

2.2. That on the facts and circumstances of the case and in law, the CIT(A) has erred in confirming the disallowance of non-compete fees holding it to be capital in nature and not appreciating that the agreements for non-compete and asset purchase were independent and mutually exclusive.

2.3. Notwithstanding and without prejudice, that on the facts and circumstances of the case and in law, the CIT(A) has erred in not directing the AO to allow depreciation considering that non-compete fees was treated as capital in nature.

3. Disallowance of expenditure incurred in respect of customer and other contracts, backlog orders, customer and suppliers lists.

3.1. That on the facts and circumstances of the case and in law, the CIT(A) has erred in confirming the disallowance of expenditure amounting to INR 79,11,750, being payment for customer contracts, backlog orders, customer/ suppliers lists, alleging it to be capital in nature, without appreciating that the expenditure was not incurred for bringing into existence any asset and /or an advantage of enduring nature.

3.2. That on the facts and circumstances of the case and in law, the CIT(A) has erred in summarily upholding the action of the AO in disallowing amount paid towards customer contracts, backlog and customer and supplier list without providing any cogent reasons for such disallowance.

3.3. Notwithstanding and without prejudice, that on the facts and circumstances of the case and in law, the CIT(A) has erred in not directing the AO to allow depreciation considering that the above mentioned expenditure was treated as capital in nature”.

3. Brief facts of the case are that the assessee was engaged in the business of manufacturing and selling of fuse and fuse fittings to both export and domestic markets and engaged in trading activities as well. The Assessing Officer during the course of assessment proceedings noted that the assessee company during the previous year 2011-2012 acquired fuse and fuse accessories business from GE India Pvt Ltd for a total consideration of ₹6,12,34,796/-. The Assessing Officer noted that assessee in pursuant to this acquisition claimed the expenditure amounting to ₹3,21,91,838/- u/s.37 of the Act as deduction towards payment for non- compete fees and customer and other contracts, backlog orders, customer and suppliers lists. The Assessing Officer requested the assessee to explain as to how the payments made is allowable. The assessee explained the transactions by filing details of payments, copies of business purchase agreement and non-compete fee agreement. The

Assessing Officer considered the breakup under various heads as under:-

<i>Non Compete Fees</i>	<i>Rs</i>	<i>24,280,088</i>
<i>Customer and other contract</i>	<i>Rs</i>	<i>2,637,250</i>
<i>Backing orders</i>	<i>Rs</i>	<i>2,637,250</i>
<i>Customer and supplier list</i>	<i>Rs</i>	<i>2,637,250</i>
<i>Total</i>	<i>Rs</i>	<u><i>32,191,838</i></u>

The Assessing Officer considered the relevant clause of non-compete agreement, which reads as under:-

"Whereas, the purchaser, consider this agreement as integral to the transactions completed by the Asset Purchase Agreement to protect adequately the interests of the purchasers, and as ancillary to the Asset Purchase Agreement and the sale of the assets to the purchasers, and the purchasers would not consummate such transaction without the sellers execution to the agreement"

and noted that non-compete agreement cannot be considered in the standalone basis. Non-compete fee paid forms part of initial outlay on the acquisition of business and hence the assessee had acquired the right to carry on business unfettered by any completion which results in the protection for business as a whole and will help appreciate the whole of the capital assets. Hence, he treated non-compete fee, customer and

other contracts, backlog orders, customer and suppliers lists as capital expenditure and hence disallowed the amount of ₹3,21,91,838/-. Aggrieved, assessee preferred an appeal before the Id. CIT(A).

4. The Id. CIT(A) after considering the submission of the assessee confirmed the action of the Id. Assessing Officer by observing as under:-

"5.5 I have examined the submissions of the AR of the appellant. The APA and NCA are integrated and execution of one is dependent on the other. As noted already, Non Compete fee paid by the assessee forms part of initial outlay on the acquisition of business by the assessee and combined reading of APA and NCA suggests that NCA was very much a part of the entire part of the purchase of business of GE India by the assessee. As relied on by the AO, the decision of the Delhi Special Bench of the Tribunal in the case of Tecumsch India Pvt. Ltd. Vs. Addl.CIT [127 ITD 1] and decision of the Delhi Tribunal in the case of Sharp Business System India Ltd. Vs DCIT [133 ITD 275] are squarely applicable to the instant case. Reliance is also placed on the decision of the Hon'ble Supreme Court in the case of Assam Bengal Cement Company Ltd. wherein protection fees by the assessee to prevent Competition for the period of IS was held to be providing enduring advantage to the assessee, and therefore, held to be a capital expenditure. The case laws relied on by the assessee do not come to its rescue as facts and circumstances are distinguishable. In CIT Vs Coal shipman Pvt. Ltd. [82 ITR 902] and CIT Vs Eicher Ltd. [302 ITR 249], the facts of the cases were that there was no certainty of duration of advantage and the same could be put to an end at any time. Similarly, in Carborandum Universal Ltd. Vs JCIT (26 Taxmann.com 268], the facts of the case were that the expenditure claimed did not result in any enduring benefit to the assessee.

5.6 In the above facts, circumstances and judicial positions, the payment of Rs.3,21,91,838/- towards payment for non-compete, customer contracts, backlog and customer supplier list has been rightly held to be capital expenditure, and hence,

disallowed u/s 37 of the I.T. Act, 1961. The disallowance is confirmed.

5.7 The alternate plea of the AR to allow for depreciation if the claim of Noncompete fee (NCF) and other related expenditures are treated as capital expenditure has been examined. In this regard, as already noted in the assessment order, the Hon'ble ITAT, Chennai Bench 'A, in the case of Arkema Peroxides India Ltd. Vs CIT (31 Taxmann.com 4) has held that depreciation is not allowable on Non compete fee paid as consideration to the other party for giving up the right to carry on the business for a period of 5 years. The said order of the Honble ITAT was passed of considering various case laws including the decision of Hon'ble Supreme Court in the case of CIT Vs Coal Shipments Pvt. Ld. (82 1TR 902) Ocd the decision of High Court of Madras in the case of CIT Vs GD Naidu (165 ITR 63). Hence, depreciation on Non-compete fee and other related expenditure rightly held as not allowable in the assessee's case".

Aggrieved, now the assessee is in appeal before us.

5. Ld. Counsel for the assessee stated the facts that during the financial year 2011-2012 for commercial consideration, assessee acquired certain assets pertaining to fuse and fuse accessories business of GE India Pvt Ltd pursuant to the asset purchase agreement dated 22.12.2011 for a total consideration of ₹6,12,34,796/-. It was claimed by the assessee that it did not lead to any significant expansion of the existing capacity of the assessee. He drew our attention to the asset purchase agreement which was enclosed in paper book attached at Annexure-4A. He narrated the content of agreement and argued that assessee also entered into non-compete agreement with GE on 22.12.2011 for a period of three years, for which assessee had paid non-compete fee of ₹2,42,80,088/- to GE

India Pvt Ltd. Assessee claimed that the said agreements for asset purchase and non-compete fee are mutually exclusive and independent agreements and he stated the following contents.

- *“The parties to the agreements (.e. the Appellant and GE) clearly understood the rights, duties an obligations under each of the agreements which they have entered into.*
- *The asset purchase agreement was entered into for purchase of specific assets whereas the main objective behind entering into the non-compete agreement was to protect the revenues and profitability of its business”.*

In view of the above, Id. Counsel for the assessee stated that the Assessing Officer had totally erred in holding that the non-compete fee paid by the assessee forms part of the initial outlay on acquisition of the business and a part of the consideration for acquisition of the business. It was further stated by the Id. Counsel for the assessee that deductibility of payment made towards non-compete should be evaluated on a stand alone basis. For this, he placed reliance on the non-compete agreement which reads as under:-

“(1) Acknowledgment: The Sellers and GE acknowledge that the Purchasers will conduct the Business Activities throughout the Territory and that to protect adequately the interest of the Purchasers in the Assets, it is essential that any noncompetition covenant with respect thereto cover all Business Activities and the entire Territory for the duration of the Term.

(2) Trade Name: Except as expressly permitted by the Asset Purchase Agreement, the Sellers and GE hereby agree that, during the Tern, the Participating Units will not, directly or by assisting others, own, manage, operate, join, control. or

participate in the ownership, management, operation, or control of any business conducted under any corporate, product, or trade name or trademark included in the Assets, or name or mark similar thereto, without the prior written consent of the Purchasers.

(3) Non competition Covenant: The Sellers and GE hereby agree that during the Term Participating Units will not, directly or indirectly, conduct Business Activities in the Territory have an equity or profit interest in any Person conducting Business Activities in the Territory.

(4) Non-solicitation:

(A) The Sellers and GE hereby agree that, during the first year of the Term, the Participating Units will not, directly or by assisting others, solicit or attempt to solicit, any business with respect to the Products, equivalent fuses, or substantially similar fuse products or accessories from any Person that purchased a Product, equivalent fuse, or substantially similar fuse product or accessory from the Sellers that would be a violation of Section 1(d) (3) if the purchase occurred during the Term or that was an actively sought prospective customer of the Business during the one year period prior to the Closing Date; and

(B) The Sellers and GE hereby agree that, during the first year of the Term, the Participating Units will not (on behalf of the Participating Units or any other Person). directly or by assisting others solicit or attempt to solicit, any senior management employee of the Purchasers working primarily for the business acquired by Purchasers pursuant to the Asset Purchase Agreement, it being understood that contacts with individuals as part of generalized searches for employees shall not constitute conduct in violation of this provision."

Further, ld. Counsel for the assessee drew our attention to para 1d(1) to 1d(4) and argued that he clarified that the non-compete agreement laid down the restrictive covenants that GE shall not do as under:-

- *'Participate in any business conducted under any corporate, product, or trade name or trademark included in the assets transferred to the Appellant during the term of the Agreement (i.e. 3 years).*

- *Conduct business activities including in India during the term of the Agreement (i.e 3 years)*
- *Solicit business from existing customers in respect of business transferred to the Appellant during the first year of the term*
- *Solicit employees transferred to the Appellant during the first year of the term”.*

It was further submitted by the Id. Counsel for the assessee that this issue was covered by the decisions of Hon'ble Supreme Court in the case of *Empire Jute Company Ltd vs. CIT, 124 ITR 1* and that of *CIT vs. Coal Shipments (P) Ltd, (1971) 82 ITR 902*.

6. Alternatively Id. Counsel for the assessee requested that in case this Bench is not in agreement with the assessee that non-compete payment is revenue in nature and deductible in the subject year in which it was incurred, it was prayed that since the payment was incurred wholly and exclusively for the purpose of business, the expenditure is to be held as capital in nature, the Assessing Officer may be directed to allow depreciation on such expenditure considering the same as an intangible asset under section 32(1)(ii) of the Act.

7. Similar argument were also made in respect of issue of disallowance of deduction in respect of payment towards customer and other contracts, backlogs orders and customer & supplier lists. It was claimed that the cost incurred by the assessee towards customer and

other contracts, backlog orders etc were to enable the assessee to continue the business in a smooth and effective manner and carry out its regular business activities in an uninterrupted manner. Alternative to this, Id. Counsel for the assessee stated that if expenditure is to be held as capital in nature, the Id. Assessing Officer may be directed to allow depreciation on such expenditure considering the expenditure as an intangible asset u/s.32(1) (ii) of the Act.

8. On the other hand, the Id. Senior Departmental Representative placed reliance on the order of the Id. Assessing Officer and that of the Id. CIT(A).

9. We have heard rival contentions and gone through the facts and circumstances of the case. The particular clause of non-compete agreement clearly demonstrate that non-compete fees cannot be considered on standalone basis. The relevant clause is reproduced hereunder:-

"Whereas, the purchaser, consider this agreement as integral to the transactions completed by the Asset Purchase Agreement to protect adequately the interests of the purchasers, and as ancillary to the Asset Purchase Agreement and the sale of the assets to the purchasers, and the purchasers would not consummate such transaction without the sellers execution to the agreement"

We note that non-compete fee paid by the assessee forms part of initial outlay on the acquisition of business by the assessee and in the combined

reading of the asset purchase agreement and non-compete agreement suggest that non compete agreement was very much part of the entire part of the purchase of business of GE India Pvt Ltd by the assessee. Hence, by virtue of non compete agreement assessee has acquired the right to carry on business unfettered by any competition which results in the protection for business as a whole and will help appreciate the whole of the capital assets. Hence, we find no force in the argument of the Ld. Counsel of the assessee. We agree with the alternative argument of the Id. Counsel that since it was held as capital expenditure, the assessee is entitled for depreciation u/s.32 (1)(ii) of the Act. We direct the Id. Assessing Officer to allow depreciation on payments made on non-compete fees and customer and other contracts, backlog orders, customer and suppliers lists u/s.32(1)(ii) of the Act. This issue of the assessee is party allowed as indicated above.

10. The next issue in this appeal of the assessee is as regards to the order of CIT(A) confirming the action of AO in disallowing the provision made towards litigation and sales tax matters. For this, the assessee has raised the following grounds.

'4. Disallowance of provision towards litigation and sales tax matters:

4.1. That on the facts and circumstances of the case and in law, the CIT(A) has erred in disallowing provision towards litigation

and sales tax matters amounting to INR 57,90,464 alleging that the said provision is not based on scientific method”.

11. The brief facts of the case are that the assessee had created a provision of ₹70,76,049/- towards litigation and sales tax matters. The Id. Assessing Officer had disallowed the claim, since assessee neither furnished any satisfactory reply nor submitted any scientific working to the estimate of provision for this expenditure. He disallowed the claim of the assessee. Aggrieved, assessee preferred an appeal before the Id. CIT(A).

12. The Id. CIT(A) after considering the submission of the assessee confirmed the action of the Id. Assessing Officer since assessee has neither furnished any satisfactory reply nor produced any scientific mode for the estimate before him. For this, he placed reliance on the judgment of Hon'ble Supreme Court in the case of *Rotork Control India Pvt Ltd vs. CIT, 314 ITR 62*. Aggrieved, now the assessee is in appeal before us.

13. We have heard rival contentions and gone through the facts and circumstances of the case. We noted that now before us, the assessee filed complete details of provision made to litigation and sales tax matters. The provision was made to the tune of ₹70,76,049/- which includes duty drawback of ₹18,31,290/-, non collection of form C ₹82,383/- and differential duty for SVB loading ₹51,62,367/-. The relevant breakup of such provision & disallowance are as under:-

	<i>Provision created during the subject AY</i>	<i>Amount (₹)</i>
1	<i>Duty drawback</i>	<i>18,31,299</i>
2	<i>Non collection of form C</i>	<i>82,383</i>
3	<i>Differential duty for SVB Loading</i>	<i>51,62,367</i>
4	<i>Total</i>	<i>70,76,049</i>
5	<i>Less: Disallowed under Section 43B in the computation of income (the appellant has considered the provision in respect of form C in this disallowance)</i>	<i>12,85,585 *</i>
6	<i>Balance disallowed by the Id. Assessing Officer</i>	<i>57,90,464</i>

** The said disallowance is also in accordance with the tax audit report.*

The Id. Counsel for the assessee submitted before us that assessee himself disallowed provision made u/s.43B of the Act to the tune of ₹12,85,585/- and restricted the claim to ₹57,90,464/- which is to be considered. The assessee had filed the complete details and explanation which was not available before with the Assessing Officer nor the CIT(A). Hence for better adjudication, we remit the issue back to the file of the Assessing Officer who will allow the claim of ₹57,90,464/- in case assessee files satisfactory reply or produce scientific mode for the estimates. The assessee will file complete details of provisions list before

the Assessing Officer based on scientific basis as held by the Hon'ble Supreme Court in the case of *Rotork Control India Pvt Ltd (supra)*. Hence, this issue of assessee is remitted back to the file of the Id. Assessing Officer for fresh consideration and the orders of the Id. Assessing Officer and Id. CIT(A) on this issue is set aside.

14. In the result, the appeal of the assessee in ITA No.175/CHNY/2019 for the assessment year 2012-2013 is partly allowed for statistical purpose.

Order pronounced on 20th day of October, at Chennai.

Sd/-

(मनोज कुमार अग्रवाल)
(MANOJ KUMAR AGGARWAL)
लेखा सदस्य /ACCOUNTANT MEMBER

Sd/-

(महावीर सिंह)
(MAHAVIR SINGH)
उपाध्यक्ष /VICE PRESIDENT

चेन्नई/Chennai

दिनांक/Dated: 20.10.2023.

KV

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

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