

M/s. Asianet Communications Ltd. vs CIT

[2018](96 taxmann.com 399)

Non-compete fees paid to a director to ward off competition, without any enduring benefit arising therefrom, is a revenue expenditure

1. Factual aspects:

- a. M/s. Asianet Communications Ltd. (ACL) was engaged in the business of television broadcasting. During the assessment year 2000-01, the 2 directors of ACL decided to part ways.
- b. Accordingly, Mr. SK sold his entire shareholding to Mr. RM under a Share Purchase Agreement. Another non-compete agreement was entered into between ACL and Mr. SK whereby Mr. SK was paid non-compete fees for not competing in the business of ACL for the next 5 years.

2. Issue under consideration before the Hon'ble High Court

Whether the consideration paid by ACL to SK for non-compete covenant of 5 years is a revenue expenditure allowable as deduction?

3. Revenue's contentions

The Assessing Officer, CIT(A) as well as the ITAT were of the opinion that non-compete fees paid for 5 years was in the nature of capital expenditure and accordingly, not allowable as revenue expenditure. The Revenue laid out the following reasons:

- a. Non-compete fees was paid as a part of sale buying out the stake of SK in the company The ITAT argued that 2 separate agreements were entered into on the same day, one for sale of shares between RM and SK and another being the non-compete agreement between ACL and SK. Accordingly, looking at the whole picture, payment for non-compete was in addition to consideration for sale of shares and hence capital expenditure.
- b. Accounting treatment - As per books of accounts, ACL amortised the payment towards non-compete and spread it over 5 years. Thus, having treated the same in the

books of accounts as a capital expenditure, ACL is bound to take the same stand for income tax purposes.

- c. Case laws - The Revenue rejected the cases of the Apex Court in CIT vs. G.D.Naidu and Others [1987 168 ITR 63 (CS)] and Empire Jute Co. Ltd. vs. CIT [1980 124 ITR 1 (SC)] relied upon by the assessee on factual grounds.

The Revenue relied on the following case laws on contend that payments made to ward-off competition should be regarded as capital expenditure

- Neel Kamal Talkies vs. CIT [1973] 87 ITR 691 (Allahabad);
- Blaze & Central (P.) Ltd. vs. CIT [1979] 1 Taxman 546 (Madras)
- CIT vs. Hindustan Pilkington Glass Works [1981] 7 Taxman 133 (Calcutta)
- Pitney Bowes India (P.) Ltd. vs. CIT [2012] 17 taxmann.com 116 (Delhi)
- Sharp Business System vs. CIT-III [2012] 27 taxmann.com 50 (Delhi)
- M/s.Tamil Nadu Magnesite Ltd. vs. ACIT in T.C.(Appeal) Nos.907 and 908 of 2007 dated 05.06.2018.

4. Assessee's contentions

- a. Non-compete fees was paid as a part of sale buying out the stake of SK in the company The assessee argued that the 2 different agreements were with different parties and with different objectives. Accordingly, the same cannot be looked at as one. Further, this argument of the Revenue was not raised before the lower authorities.
- b. Accounting treatment - ACL has not capitalised the said expenditure in their accounts, but they have treated as deferred revenue expenditure for a period of five years.
- c. Case laws - The assessee relied on the decision the SC in G.D. Naidu (supra) and Empire Jute Co. (supra) to support its argument that non-compete fees paid for removing a restriction with a view to increasing its profit was revenue in nature and upon payment of the non-compete fee, no new asset was created. It was part of the

cost of operating the profit earning apparatus and was clearly in the nature of revenue expenditure.

The assessee also relied on the following decisions, where similar view has been held:

- Chelpark Co. Ltd. vs. CIT [1991 191 ITR 249 (Mad)]
- CIT vs. Eicher Ltd. [2008 302 ITR 249 (Delhi)]
- Alembic Chemical Works Co. Ltd. vs. CIT [1989 177 ITR 377 (SC)]
- Carborandum Universal Ltd. vs. Joint CIT reported in (2012) 26 taxmann.com 268
- CIT vs. Messrs. Piggot Chapman & Co. (Cal) (1949) 17 ITR 317
- Champion Engineering Works Ltd. vs. CIT (Bombay) 81 ITR 273
- CIT vs. Bowrisankara Steam Ferry Co. (A.P.) (1973) 87 ITR 650
- CIT vs. Andhra Fuels (P.) Ltd. (A.P.) (2016) 70 taxmann.com 271
- M/s.Hatsun Agro Products Ltd., vs. JCIT in T.C.(Appeals) No.1173 of 2005 dated 10.04.2017

5. Held

Non-compete fees paid by ACL to SK is a revenue expenditure allowable as deduction.

The Hon'ble HC observed that:

“the facts clearly disclose that on account of the payment of non-compete fee, the assessee has not acquired any new business, profit making apparatus has remained the same, the assets used to run the business remained the same and there is no new business or no new source of income, which accrue to the assessee on account of the payment of non-compete fee.”

6. Reasons cited by the Hon'ble HC:

- a. Non-compete fees was paid as a part of sale buying out the stake of SK in the company The HC rejected the revenue's argument that payment of non-compete fees in addition to consideration for sale of shares was capital in nature. The HC further observed this question of fact was not disputed before the Tribunal, cannot be raised before the HC in an appeal under Section 260A of the Income Tax Act.

- b. Accounting treatment - The High Court noted that treating an expenditure as deferred revenue expenditure is not same as capitalisation of expense. Further, reference was made to the decision of the Apex Court in Taparia Tools Ltd. [2015] 55taxmann.com 361 (SC) to hold that entries in the books of accounts are not determinative or conclusive and the matter is to be examined on the touchstone of the provisions contained in the Act.
- c. Case laws - Relying on Empire Jute Co. Ltd. (supra), the HC observed that the test to be applied is to see as to whether an expenditure added to the capital of the assessee, whether a new asset was created, whether there was an addition or expansion of the profit making apparatus of the assessee and whether the assessee acquired source of profit or income when such investment was made.
- d. The decisions relied upon by the Revenue were distinguished by the HC on following grounds:
- i. Neel Kamal Talkies (supra) was rendered prior to Empire Jute Co. Ltd. and hence the Revenue would be precluded by referring to the decision of Neel Kamal Talkies;
 - ii. Blaze & Central (P.) Ltd. (supra) was distinguished in G.D. Naidu (supra) stating that the “*case also related to an acquisition of an existing competitive business, whereas in our case it is only a restrictive covenant.*”;
 - iii. Pitney Bowes India (P.) Ltd. (supra) was rendered on a concession made by the learned counsels on either side. This is evident from paragraphs 10 & 13 of the judgment, wherein both the assessee as well as the Revenue treated the expenditure as capital expenditure;
 - iv. The HC distinguished the decision of Sharp Business System (supra) on factual grounds. In Sharp’s case, the Joint-venture company was incorporated in the assessment year 2001-02 and in the first year of business, with a view to warding off competition, it entered into agreement by paying a non-compete fee of Rs.73 Crores to L & T Ltd. However, in the present case, the assessee's business continues to remain the same. Further, it held that the ratio laid down in Sharp’s case that arrangement for a period of 7 years is an enduring benefit does not fulfil the tests laid down by the case of Empire Jute Co. Ltd.

- v. The HC also observed that the decision of Carborandum Universal Limited (supra) applied with full force to the present case wherein 3 agreements were entered into by the assessee, all pertaining to non-compete and that there were different sets of parties. On that facts, the expenditure so incurred was held to be revenue in that case.
- e. The HC delved into the Indian Contract Act, 1872 and observed that a non-compete contract ought to be backed by consideration. The HC further elaborated the contract of non-compete as under:

“The non-compete compensation, from the stand point of the payee of such compensation, is so paid in anticipation that absence of a competition from the other party to the contract may secure a benefit to the party paying the compensation. There is no certainty that such benefit would accrue. In other words, inspite of the fact that a competitor is kept out of the competition, one may still suffer loss. If it were to be a capital expenditure whether or not, an assessee makes a business profit, the character and value of the capital assets will, subject to depreciation, remain unaltered.”

7. Conclusion

Businesses incur various expenses; these expenses also change in accordance with the times we live in. The tests applied by the Hon’ble Madras HC in this case to determine whether or not an expense is a revenue expense, can be useful for other kinds of expenditure too and not just for non-compete fees.