

# The Commissioner Of Income Tax vs M/S Ingersoll Rand International ... on 30 June, 2014

**Bench: N.Kumar, B.Manohar**

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IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 30TH DAY OF JUNE 2014

PRESENT

THE HON'BLE MR.JUSTICE N. KUMAR

AND

THE HON'BLE MR. JUSTICE B. MANOHAR

I.T.A. NO. 452 OF 2013

BETWEEN:

1. THE COMMISSIONER OF INCOME-TAX  
C.R.BUILDING, QUEENS ROAD  
BANGALORE
2. THE ASST. COMMISSIONER OF INCOME-TAX  
CIRCLE - 11(4), RASHTROTHANA BHAVAN  
NRUPATHUNGA ROAD  
BANGALORE

... APPELLANTS

(BY SRI. K.V.ARAVIND, ADV.)

AND:

M/S. INGERSOLL RAND INTERNATIONAL IND. LTD.  
PLOT No. 35, KIADB INDUSTRIAL AREA  
BIDADI, RAMNAGARA TALUK  
BANGALORE - 560109

... RESPONDENT

(BY SRI. K.P.KUMAR, SR. ADV. FOR  
SRI. T. SURYANARAYANA FOR  
M/S. KING & PARTRIDGE, ADVS.)

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THIS ITA IS FILED UNDER SECTION 260-A OF INCOME TAX ACT, 1961, ARISING OUT OF ORDER DT. 30/4/2013 PASSED IN ITA No. 1030/Bang/2011, FOR THE ASSESSMENT YEAR 2006-07, PRAYING TO FORUMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN; ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, Bangalore, IN ITA No. 1030/Bang/2011 DT. 30/4/2013 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE ASST. COMMISSIONER OF INCOME TAX, CIRCLE-11(4), BANGALORE.

THIS ITA COMING ON FOR ADMISSION THIS DAY, N. KUMAR J. DELIVERED THE FOLLOWING:

#### ORDER

The Revenue has preferred this appeal against the order passed by the Tribunal holding, non-compete fee to be capital in nature and that the assessee is entitled to depreciation on the same.

2. The assessee-company is engaged in the business of security and access control system integration. During the previous year relevant to the assessment year 2006-07, the assessee company entered into a Business Purchase Agreement (BPA) with M/s. Dolphin Electromagnetic Technologies Pvt. Ltd. (DETPL), a Mumbai based company. As per the BPA, the assessee company purchased the business of DETPL for a consideration of Rs.11.71 crores. Some of the employees of DETPL were terminated, while others were retained. The purchase consideration included a sum of Rs.54.43 lakhs as non-compete fees paid to Mr.S.K.Sawhney and a sum of Rs.43.55 lakhs paid to him for the purchase of patents. The consideration paid to DETPL also included a sum of Rs.1.8 crores as "Separation costs" paid to those employees of DETPL whose services had been terminated. Further Mr. S.K.Sawhney was also appointed as Vice President and Company Head through a Contract of Employment. Out of the total consideration of Rs.11.71 crores, non- compete fees and patents have been shown as assets in the books and the remaining of Rs.10 crores has been shown as goodwill. The payment of non-compete fees was treated as revenue expenditure in the computation of total income as per the Income-Tax Act, while in the books of accounts it was treated as an asset by the assessee. The assessee had also claimed depreciation on the patents under the Income Tax Act, but no depreciation has been claimed on goodwill under Sec.

32. The Assessing Officer completed the assessment and passed an order. The Assessing Authority, held that non-compete fees is capital in nature and therefore he disallowed it as a revenue expenditure. Aggrieved by the said order, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals). Before the Appellate Authority, the Assessee contended that, if the non-compete fee is paid for warding off the competition for a short period, the expenditure would be of a revenue in nature deductible under Sec. 37 of the Act and if the non-compete fees is treated as capital in nature, then it would be expenditure incurred for the purpose of other intangible assets and hence depreciation at the rate of 25% should be allowed for the relevant assessment years.

However, the Appellate Authority, after reviewing the entire case law, held that the non-compete fee is in the nature of capital expenditure, but it held no depreciation is allowable. However it held, Sec.194J is not applicable to the case on hand.

3. Aggrieved by the said order, the assessee preferred an appeal to the Tribunal. The Tribunal, by the impugned order, held non-compete fee is in the nature of capital expenditure. It is in the nature of a business or commercial right and depreciation is allowable on such an asset and thus allowed the appeal. Aggrieved by the said order, the Revenue is in appeal.

4. Learned counsel for the Revenue, assailing the impugned order, contends non-compete fee does not constitute a commercial or a business right for allowing depreciation under Sec. 32(1)(ii) of the Act. In order to claim depreciation, the assessee should own and use the asset in the business. The user-test is not satisfied in the instant case. Therefore non-compete fee cannot be classified as an asset and consequently no depreciation can be allowed.

Per contra, the learned counsel appearing for the assessee submitted, by virtue of payment to the non-compete fee, the assessee could carry on business without any competition for the limited period which intturn results in advantage to his business and as that advantage confers on him a commercial and a business right and once it is held it is of the nature of capital expenditure, the assessee is entitled to depreciation provided under Sec.32(1)(ii) of the Act.

5. In the light of the aforesaid contentions and the facts of the case, the substantial question of law that arise for our consideration is, Whether the Tribunal was correct in holding that non-compete fee being in the nature of capital expenditure, depreciation is to be allowed on the non-compete fee as it constitutes a commercial or a business right under Sec. 32(1)(ii) of the Act?

6. This provision has been the subject matter of interpretation by various courts. The Delhi High Court in the case of Commissioner of Income Tax Vs. Hindustan Coco Cola Beverages Pvt. Ltd. reported in (2011) 331 ITR 192 (Delhi) dealing with the question of claim of depreciation under Section 32 of the Income Tax Act, 1961, after referring to various judgment has held in para No.21 as under:-

"It is worth noting, the scope of section 32 has been widened by the Finance (No.2) Act, 1998 whereby depreciation is now allowed on intangible assets acquired on or after 1st April, 1998. As per section 32(1)(ii), depreciation is allowable in respect of know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature being intangible assets. Scanning the anatomy of the section, it can safely be stated that the provision allows depreciation on both tangible and intangible assets and clause (ii), as has been indicated hereinbefore, enumerates the intangible assets on which depreciation is allowable. The assets which are included in the definition of "intangible assets" includes, along with other things, any other business or commercial rights of similar nature."

The Apex Court in the case of Nat Steel Equipment Pvt. Ltd. Vs. CCE reported in AIR 1988 SC 631 has explained the meaning of the term "similar" as under:

"The expression "similar" is a significant expression. It does not mean

identical but it means corresponding to or resembling to in many respects; some; what like; or having a general likeness. The statute does not contemplate that goods classed under the words of 'similar description' shall be in all respects the same. If it did these words would be unnecessary. These were intended to embrace goods but not identical with those goods. If the items were similar appliances which are normally used in the household, these will be taxable under Tariff Item No.33C."

The Delhi High Court in the case of Areva T and D India Ltd Vs. Deputy Commissioner of Income Tax (Delhi) reported in (2012) 345 ITR 421 (Delhi) explaining the principles of Ejusdem Generis with reference to Section 32(1)(ii) of the Income Tax Act, 1961 has held in para No.13, which reads as under:-

"In the present case, applying the principle of ejusdem generis, which provides that where there are general words following particular and specific words, the meaning of the latter words shall be confined to things of the same kind, as specified for interpreting the expression "business or commercial rights of similar nature" specified in Section 32(1)(ii) of the Act, it is seen that such rights need not answer the description of "know-how, patents, trademarks, licences or franchises"

but must be of similar nature as the specified assets. On a perusal of the meaning of the categories of specific intangible assets referred to in section 32(1)(ii) of the Act preceding the term "business or commercial rights of similar nature", it is seen that the aforesaid intangible assets are not of the same kind and are clearly distinct from one another. The fact that after the specified intangible assets the words "business or commercial rights of similar nature" have been additionally used, clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate. In the circumstances, the nature of "business or commercial rights" cannot be restricted to only the aforesaid six categories of assets, viz., know-how, patents, trade marks, copyrights, licences or franchises. The

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nature of "business or commercial rights" can be of the same genus in which all the aforesaid six assets fall. All the above fall in the genus of intangible assets that form part of the tool of trade of an assessee facilitating smooth carrying on of the business. In the circumstances, it is observed that in the case of the assessee, intangible assets, viz., business claims; business information; business records; contracts; employees; and know-how, are all assets, which are invaluable and result in carrying on the transmission and distribution business by the assessee, which was hitherto being carried out by the transferor, without any interruption. The aforesaid intangible assets are,

therefore, comparable to a licence to carry out the existing transmission and distribution business of the transferor. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee got an up and running business. This view is fortified by the ratio of the decision of the Supreme Court in Techno Shares and Stocks Ltd.(2010) 327 ITR 323 (SC) wherein it was held that intangible assets owned by the assessee and used for the business purpose which enables the assessee to access the market and has an economic and money value is a "licence" or "akin to a licence" which is one of the items falling in Section 32(1)(ii) of the Act."

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The Madras High Court in the case of M/s.Pentasoftware Technologies Ltd. Vs. The Deputy Commissioner of Income Tax reported in (2014) 264 CTR (Mad) 187 in answering the question whether non- compete agreement / arrangement fall within the ambit of clause (ii) of Section 32(1) of the Act, has held in para Nos.18, 19, 21 and 27, which reads as under:-

"18. The only issue is whether non compete agreement/arrangement would fall within the ambit of clause (ii) of Section 32(1) of the Act.

19. It is the case of the Revenue that this non-compete fee is in the nature of a negative right and it cannot be of a commercial right of similar nature and the expression "similar nature" shall be relatable to patents, copy rights and trade mark licence or franchise or any other business. Therefore, it is submitted that this negative right cannot be construed either as a licence or as a commercial right to be eligible for deduction.

21. Learned counsel for the assessee contended that the non-compete is in effect an indirect licence. However, we are not inclined to agree with the said submission since non compete, at best could be a commercial right because that right is relatable to the transfer of trade mark, copy rights and patents.

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Therefore, the view taken by the Commissioner of Income Tax (Appeals) in this regard is acceptable.

27. In the case of hand, we have analysed the agreement and also in the previous portion of this order elaborated upon the various terms and conditions, which bind the parties had observed that the earlier transfer of the trade mark, patents and other rights in favour of the assessee was undoubtedly the transfer of intangible assets, which in terms of section 32(1)(ii) of the Act would be a capital asset entitled to depreciation."

The Income Tax (Appeals) Tribunal in the case of Assistant Commissioner of Income Tax Vs. Real Image Tech. (P) Ltd. reported in (2009) 120 TTJ 0983 has held in para No.4.4.3 as under:-

"4.4.3 The rival submissions have carefully been examined by me. After carefully analyzing the facts and circumstances of the appellant's case, I find that the intangible assets enumerated in s.32 of the IT Act effectively confer a right upon an assessee for carrying on a business more efficiently by utilizing an available knowledge or by carrying on a business more efficiently by utilizing an available knowledge or by carrying on a business to the exclusion of another assessee. I concur with the views of the learned Authorized Representative that a

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copyright holder or a trademark holder is able to restrain any other person from using the said copyright or trademark and is thereby able to carry on his business more effectively. I find that the object of the acquiring a know-how, patent, copyright, trademark, licence or franchise is to pursue business against the rivals in the same business in a more efficient manner. The object of entering into a non-compete agreement is found to be almost identical, i.e., carrying on business in a more efficient manner by getting rid of competition at least for a limited period of time. Therefore, through payment of non-compete fee the appellant company undoubtedly acquired a commercial or business right which is held to be similar in nature to know-how, patent, copyright, trademark, licence, franchise etc. The commercial right thus acquired by the appellant unambiguously falls in the category of an 'intangible asset' which in accordance with the provisions of s.32(1)(ii) of the IT Act, will qualify for depreciation @ 25 per cent. I accordingly direct the AO to allow depreciation for the asst.yr.2001-02 and subsequent assessment years @ 25 per cent on the non-compete fee of Rs.1,87,94,660 which has already been held to be a capital expenditure by the AO and upheld by the undersigned. The ground of the appeal in this regard succeeds."

The Delhi High Court in the case of Sharp Business System Vs. Commissioner of Income Tax- III reported in (2012) 254 CTR (Del) 233 dealing with

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business expenditure, non-competing fees paid, whether eligible for depreciation under Section 32(1)(ii) has held in para Nos.11 and 12 as under:-

"11. This question arose as a direct sequel to the appellant's alternative submission that if the expenditure is treated as a conferring capital advantage, necessarily they are depreciable. The appellant claims for depreciation of "know-how", "patents", "copyrights", "trademarks", "licenses", "franchises" or other business or commercial rights of similar nature being intangible assets acquired on or after 1st day of April

1998. Arguing by analogy, learned counsel for the appellant relied upon the judgment of the Supreme Court in *Techno Shares & Stocks Ltd.* (supra) where the issue was whether the contention of the assessee that it could claim depreciation on the Bombay Stock Exchange Membership Card held by it on the plea that it was a license or "business or commercial right of similar nature" was upheld. The appellant also relied upon the decision of this Court in *Hindustan Coco Cola Beverages P. Ltd.* (supra) and the judgement of the Kerala High Court in *B. Ravindran Pillai v. CIT* 332 ITR 531 (Ker). As would be evident from Section 32(1)(ii), depreciation can be allowed in respect of intangible assets. Parliament has spelt-out the nature of such assets by express reference to "know-how", "patents", "copyrights", "trademarks", "licenses" and "franchises". So far as patents, copyrights, trademarks, licenses and franchises are

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concerned, though they are intangible assets, the law recognizes through various enactments that specific intellectual property rights flow from them. Licenses are derivative and often are the means of conferring such intellectual property rights. The enjoyment of such intellectual property right implies exclusion of others, who do not own or have license to such rights from using them in any manner whatsoever. Similarly, in the matter of franchises and know-how, the primary brand or intellectual process owner owns the exclusive right to produce, retail and distribute the products and the advantages flowing from such brand or intellectual process owner, but for the grant of such know-how rights or franchises. In other words, out of these species of intellectual property like rights or advantages lead to the definitive assertion of a right in rem. The decisions of this Court in *Hindustan Coco Cola Beverages P. Ltd.* (supra) and that of the Kerala High Court in *B. Ravindran Pillai* (supra) underlined that goodwill is also a species of depreciable right which can claim the benefit of Section 32. Those decisions were based on the ruling of the Supreme Court in *CIT v. B.C. Srinivasa Setty* 1981 (128) ITR 294 (SC) and subsequent cases which have ruled that goodwill is a depreciable capital asset. So far as the decisions in *Techno Shares & Stocks Ltd.* (supra) is concerned, the Supreme Court clearly limited its holding that the right to membership of Stock Exchange is in the nature of "any other business or commercial

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right" which was an intangible asset as is evident from the following observations:

"Before concluding we wish to clarify that our present judgment is strictly confined to the right to membership conferred upon the membership under the BSE Membership Card during the relevant assessment years. We hold that the said right to membership is "business or commercial activity" which gives a non-defaulting continuing membership and right to access Exchange and to participate therein and in that sense it is a license or akin to a license, in terms of Section 32(1)(ii)....."

12. It is, therefore, apparent that the ruling in *Techno Shares & Stocks Ltd.* (supra) was concerned with an extremely limited controversy, i.e. depreciability of stock exchange membership. This Court observes that such nature was held to be akin to a license because it enable the member, for the duration of the membership, to access the Stock Exchange. Undoubtedly, it conferred a business advantage and was an asset which and was clearly an intangible asset. The question here, however, is whether a non- compete right of the kind acquired by the assessee against L&T for seven years amounts to a depreciable intangible asset. As discussed earlier, each of the species of rights spelt-out in Section 32(1)(ii), i.e. know-how, patent, copyright, trademark, license or franchise as or any other right of a similar kind which confers a business or commercial or any other business or commercial right of

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similar nature has to be "intangible asset". The nature of these rights mentioned clearly spell-out an element of exclusivity which enures to the assessee as a sequel to the ownership. In other words, but for the ownership of the intellectual property or know-how or license or franchise, it would be unable to either access the advantage or assert the right and the nature of the right mentioned or spelt-out in the provision as against the world at large or in legal parlance "in rem". However, in the case of a non- competition agreement or covenant, the advantage is a restricted one, in point of time. It does not necessarily - and not in the facts of this case, confer any exclusive right to carry-on the primary business activity. The right can be asserted in the present instance only against L&T and in a sense, the right "in personam". Indeed, the 7 years period spelt- out by the non-competing covenant brings the advantage within the public policy embedded in Section 27 of the Contract Act, which enjoins a contract in restraint of trade would otherwise be void. Another way of looking at the issue is whether such rights can be treated or transferred - a proposition fully supported by the controlling object clause, i.e. intangible asset. Every species of right spelt- out expressly by the Statute - i.e. of the intellectual property right and other advantages such as know-how, franchise, license etc. and even those considered by the Courts, such as goodwill can be said to be alienable. Such is not the case with an agreement not to compete which is purely personal. As a consequence, it is held that the

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contentions of the assessee are without merit; this question too is answered against the appellant and in favour of the Revenue." Section 32 (1) of the Income Tax Act, 1961 deals with Depreciation, which reads as under:

"32(1) In respect of depreciation of--

(i) buildings, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998, owned, wholly or partly, by the assessee and used



for the purposes of the business or profession, the following deductions shall be allowed--

(i) in the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost thereof to the assessee as may be prescribed;

(ii) in the case of any block of assets, such percentage on the written down value thereof as may be prescribed "

7. Section 32 has been widened by the Finance Act No.2 (Act of 1998) whereby depreciation is allowed on intangible assets acquired on or after 1st April 1998. As per Sec.32(1)(ii), depreciation is allowable in respect

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of know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature. The assets which are included in the definition of intangible assets includes along with other things expressly enumerated, any other business or commercial rights of similar nature. Therefore the expression 'business or commercial rights of similar nature' need not answer the description of know-how, patents, copyrights, trade marks, licences, franchises, but must be of similar nature as the specified assets. The fact that after 'the specified intangible assets', the words 'business or commercial rights of similar nature' have been additionally used, clearly demonstrates that the legislature did not intend to provide for depreciation only in respect of specified intangible assets, but also to other categories of intangible assets which were neither feasible nor possible to exhaustively enumerate. The words 'similar nature' is a significant expression. The Apex Court in the case of Nat Steel Equipment Pvt.

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Ltd. vs. CCE reported in AIR 1988 SC 631, explaining the meaning of the word 'similar', held that it does not mean identical but it means corresponding to or resembling to in many respects somewhat like or having a general likeness. The statute does not contemplate that goods classified under the words of similar description, shall in all respects be the same. If it did, these words would be unnecessary.

8. Therefore what is to be seen is, what are the nature of intangible assets which would constitute business or commercial rights to be eligible for depreciation. In this regard, it is necessary to notice that the intangible assets enumerated in Sec.32 of the Act effectively confer a right upon an assessee for carrying on a business more efficiently by utilizing an available knowledge or by carrying on a business to the exclusion of another assessee. A non-compete right encompasses a right under which one person is

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prohibited from competing in business with another for a stipulated period. It would be the right of the person to carry on a business in competition but for such agreement of non-compete. Therefore the right acquired under a non-compete agreement is a right for which a valuable consideration is paid. This right is acquired so as to ensure that the recipient of the non-compete fee does not compete in any manner with the business in which he was earlier associated. The object of acquiring a know-how, patents, copyrights, trade marks, licences, franchises is to carry on business against rivals in the same business in a more efficient manner or to put it differently in a best possible manner. The object of entering into a non-compete agreement is also the same ie., to carry on business in a more efficient manner by avoiding competition, atleast for a limited period of time. On payment of non-compete, the payer acquires a bundle of rights such as restricting receiver directly or indirectly participating in a business which is similar to

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the business being acquired, from directly or indirectly soliciting or influencing clients or customers of the existing business or any other person either not to do business with the person who has acquired the business and paid the non-compete fee or to do business with the person receiving the non-compete fee to do business with a person who is directly or indirectly in competition with the business which is being acquired. The right is acquired for carrying on the business and therefore it is a business right. The word 'commercial' is defined in Black's Law Dictionary as 'related to or connected with trade and commerce in general', 'commerce' is defined as 'the exchange of goods, productions or property of any kind; the buying, selling and exchanging of articles'. A right by way of non-compete is acquired essentially for trade and commerce and therefore it will also qualify as a commercial right. A right acquired by way of non-compete can be transferred to any other person in the

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sense that the acquirer gets the right to enforce the performance of the terms of agreement under which a person is restrained from competing. When a businessman pays money to another businessman for restraining the other businessman from competing with the assessee, he gets a vested right which can be enforced under law and without that, the other businessman can compete with the first businessman. When by payment of non-compete fee, the businessman gets his right what he is practically getting is kind of monopoly to run his business without bothering about the competition. Generally, non-compete fee is paid for a definite period. The idea is that by that time, the business would stand firmly on its own footing and can sustain later on. This clearly shows that the commercial right comes into existence whenever the assessee makes payment for non-compete fee. Therefore that right which the assessee acquires on payment of non-compete fee confers in him a commercial or a

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business right which is held to be similar in nature to know-how, patents, copyrights, trade marks, licences, franchises. Therefore the commercial right thus acquired by the assessee unambiguously

falls in the category of an 'intangible asset'. Their right to carry on business without competition has an economic interest and money value. The term 'or any other business or commercial rights of similar nature' has to be interpreted in such a way that it would have some similarities as other assets mentioned in Cl.(b) of Expln.3. Here the doctrine of ejusdem generis would come into operation and therefore the non-compete fee vests a right in the assessee to carry on business without competition which in turn confers a commercial right to carry on business smoothly. When once the expenditure incurred for acquiring the said right is held to be capital in nature, consequently the depreciation provided under Sec.32(1)(ii) is attracted and the assessee would be entitled to the deduction as provided

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in the said provision ie., precisely what the Tribunal has held.

9. Therefore we do not see any infirmity in the impugned order which calls for interference. Accordingly the substantial question of law is answered in favour of the assessee and against the Revenue.

Ordered accordingly.

SD/-

JUDGE SD/-

JUDGE Rd/-