आयकर अपीलीय अधिकरण "C" न्यायपीठ मुंबई में।

IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH, MUMBAI

BEFORE SHRI SANJAY ARORA, ACCOUNTANT MEMBER &
SHRI AMIT SHUKLA, JUDICIAL MEMBER

आयकर अपील सं./I.T.A. No.7428/Mum/2011

(**निर्धारण वर्ष** / Assessment Year : 2007-2008

ACIT – 1(1), Room No. 579, Aayakar Bhavan, Mumbai – 20.	**बनाम**/ Vs.	M/s Clariant Chemicals (I) Ltd., Ravindra Annexe, 194, Churchgate Reclamation, D V Road, Mumbai – 400 020.
		स्थायी लेखा सं./PAN : AAACC5602P
(अपीलार्थी /**Appellant**)	..	(प्रत्यर्थी / **Respondent**)

आयकर अपील सं./I.T.A. No.8079/Mum/2011

(**निर्धारण वर्ष** / Assessment Year : 2007-2008

M/s Clariant Chemicals (I) Ltd., (Formerly known as Colour-Chem Limited) Ravindra Annexe, 194, Churchgate Reclamation, D V Road, Mumbai – 400 020.	**बनाम**/ Vs.	Addl. Commissioner of Income Tax - 1(1), Aayakar Bhavan, M.K. Road, Mumbai – 20.
स्थायी लेखा सं./PAN : AAACC5602P		
(अपीलार्थी /**Appellant**)	..	(प्रत्यर्थी / **Respondent**)

Assessee by	Shri Farookh Irani
Revenue by	Shri A.C. Tejpal & Shri Premanand

सुनवाई की तारीख /Date of Hearing : 11-11-2014

घोषणा की तारीख /Date of Pronouncement : 19-11-2014

आदेश / **O R D E R**

PER AMIT SHUKLA, J.M.

These are cross appeals filed by the assessee as well as the Department against the order of ld. CIT(A) -1, Mumbai dated 24-08-2011, for the quantum of assessment passed u/s 143(3) of the Income Tax Act, 1961 for the A.Y. 2007-08.

2. The sole issue raised by the assessee in its appeal relates to the disallowance u/s 14 A of the Income Tax Act, 1961 after applying Rule 8-D (2)(ii) of the Income Tax Rules, 1962, by taking 0.5% of the average investments. In Revenue's appeal also, ground no.1 relates to the disallowance u/s 14A of the Act made on account of interest expenditure which has been deleted by the ld. CIT(A) on the ground that assessee has surplus funds of its own, for making the investment.

3. The brief facts qua the issue of disallowance u/s 14A of the Act is that, the assessee has received dividend income of Rs. 97,26,000/- which was claimed as exempt. However, the assessee

did not offer any disallowance u/s 14A in the computation of income. The A.O. noted that the assessee has debited interest expenditure of Rs. 260.75 lakhs in the P&L account and has not attributed any indirect expenditure for earning of the exempt income. After relying on the decision of Special Bench of ITAT in the case of I.T.O. Vs. Daga Capital Management (P) Ltd. (2009) 117 ITD 169 (Mum)[SB] and the decision of Hon'ble Bombay High Court in the case of Godrej and Boyce Mfg. Co. Ltd. vs. DCIT (2010) 328 ITR 81 (Bom.), the AO held that though Rule 8-D is applicable from A.Y. 2008-09, however, as per the formula given in Rule 8-D, a reasonable basis is to be adopted for working out the disallowance. Accordingly he worked out the disallowance aggregating to Rs. 47,97,915/- not only under the head interest expenditure but also for certain indirect expenses. The working of the A.O. has been given in para 4.3 of the assessment order.

4. Before the ld. CIT(A), the assessee had given detail submission with regard to the availability of the surplus funds for making the investments and also about the indirect expenses which can be said to be attributable to earning of exempt income. The ld. CIT(A) deleted the disallowance of interest expenditure on the ground that the assessee has made investments out of its own surplus funds, therefore, there is no direct expenditure in respect of interest expenditure which can be said to have been incurred by the assessee for the purpose of the investments. However, with regard to the indirect expenditure, he held that Rule 8-D should be applied

to work out the reasonable basis, that is, by applying 0.5% of the average investment.

5. Before us, the ld. Counsel for the assessee, Shri Farooq Irani, submitted that the disallowance is being made for the A.Y. 2007-08, in which year admittedly Rule 8-D cannot be held to be applicable. In assessment years 2001-02, 2004-05 and 2006-07 the issue of disallowance of section 14A had come up for consideration before the Tribunal, wherein this issue has been set aside to the file of the A.O. to work out some reasonable basis for disallowance, therefore, in this year also the matter should be restored back to the file of the A.O. to work out the same on reasonable basis, without resorting to Rule 8-D.

6. On the other hand, the ld. D.R. submitted that the A.O. has given a reasonable basis while calculating the disallowance, therefore, no interference should be made. Thus he strongly relied upon the order of the A.O.

7. After carefully considering the rival submissions and also on perusal of the impugned orders and orders of the Tribunal for the earlier years, we find that the issue of disallowance u/s 14-A has come up for consideration before the Tribunal, wherein this matter has been restored back to the file of the A.O. for fresh adjudication to work out the some reasonable basis for disallowance. Admittedly in this year, Rule 8-D is not applicable and therefore some reasonable basis has to be adopted, in view of the decision of

Hon'ble jurisdictional high court in the case of Godrej & Boyce manufacturing (supra). In A.Y. 2006-07, the Tribunal while disposing of the matter to the file of the A.O., observed and held as under:-

> "After considering the rival submissions, we find that the Tribunal has set aside this issue to the file of the Assessing Officer for fresh adjudication. In this year, the learned Commissioner (Appeals) has already given direction to the Assessing Officer to work out the disallowance on some reasonable basis. Thus, we do not wish to interfere in such a finding of the learned Commissioner (Appeals) and the plea of disallowance being restricted to 2% of the dividend income can be taken before the Assessing Officer following the earlier years precedence. Accordingly, ground No. 2, as raised by the Department stands dismissed as the learned Commissioner (Appeals) has already given direction to the Assessing Officer to work out the disallowance on some reasonable basis."

8. Thus, consistence with precedence of the earlier years, the entire issue of disallowance u/s 14-A is set aside to the file of the AO, to examine and work out some reasonable basis for disallowance having regard to the facts of the case, *dehors* rule 8D and after giving proper opportunity to the assessee. Accordingly, the ground raised by the assessee as well as by the Department is treated as allowed for statistical purpose.

9. Now coming to the other grounds raised in Department's appeal. In ground No. 2, the department has challenged the deletion of addition made on account of software acquisition charges which was treated by the A.O. as capital expenditure.

10. Before us, it has been admitted by both the parties that similar issue had come up for consideration before the Tribunal in the earlier years, wherein exact nature of software expenses were incurred and the Tribunal has deleted the said addition by treating it as revenue expenditure.

11. After considering the material placed on record, it is seen that the assessee has debited a sum of Rs. 4,98,85,521/-, being payment made to Clariant International Ltd. for software development and consulting charges. The A.O. had disallowed the said claim on the ground that these expenses have been incurred for acquiring capital asset and hence it is a capital expenditure. The A.O. noted that though, this addition has been deleted by the ld. CIT(A) in A.Y. 2003-04, however, the Department has preferred an appeal before the Tribunal. The ld. CIT(A) following the earlier year order of the CIT(A) has deleted the said addition. After going through the earlier orders of the Tribunal, we find that the this issue has been decided by the Tribunal after discussing the facts in A.Y. 2001-02, 2004-05 and 2006-07. In A.Y. 2006-07, this issue has been decided after observing and holding as under:-

> 15. After considering the findings of the Assessing Officer and the learned Commissioner (Appeals) and also the earlier year orders of the Tribunal, we find that the Tribunal has relied upon various decisions of the High Court, including that of the decision of the Hon'ble Jurisdictional High Court in CIT v/s Raychen RPG Ltd., [2012] 346 ITR 183 (Born.) for coming to the conclusion that the expenditure incurred by the assessee on the software was in the nature

of the revenue expenditure. The relevant observation and the findings of the Tribunal are as under:

> *"13. Apropos Ground N65; this issue is discussed by A.O in para3 at pages 9 & 10 of assessment order. A sum of Rs.23,30,9261was claimed by the assessee as software expenses. This amount represent payment made to Clariant International Ltd. Towards acquisition of right to use the software "Lotus Notes" developed by Clariant International Ltd which according to assessee is powerful, multifaceted software that help to wo effectively. It extends the power of messaging and data exchange to bring all information whether from notes or from Internet and offers very useful tools like e-mail, Calendar, To-do lists etc. All Clariant Group companies are inter connected with "Lotus Note" and connectivity is effected, administered. The AO rejected the claim of the assessee of the expenditure being in the nature of Revenue and held that as it had provided enduring benefit and the expenditure being on account of capital, the assessee was entitled to claim depreciation only. He provided depreciation @ 25% and the balance amount of Rs.17,48,1951- was added to the income of the assessee. The Ld. CIT(A) has sustained the - action of A.0. The assessee is aggrieved, hence, has filed aforementioned grounds.*
>
> *13.1 It was submitted by Ld. AR that similar expenses in respect of A. Y 2002-03 and 2003-04 were held to be allowable as revenue expenditure by Ld. CIT(A). He further submitted that the expenditure is in the nature of user of software which by no stretch of imagination can be said to be of expenditure in the nature of capital. It did not provide any enduring benefit to the assessee and was a powerful tool to carry out the work of the assessee effectively. Reliance was placed on the following*
> *decisions to contend that the expenditure was in the nature of Revenue.*
>
> *(I) CIT vs. Raychem RPG Ltd., 346 ITR 183 (Born)*
>
> *(ii) CIT vs. Asahi India Safety Glass Ltd. 346 ITR 329(Del) (ill) cur vs.Amway India Enterprises, 346 ITR 341 (Del)*
>
> *(iv) San ghvi Salvi Stock Broker Ltd, ITAT Mumbai (unreported)*
>
> *13.2 On the other hand, Ld. DR relied upon the order passed by A. 0 and Ld. CIT(A).*

13.3 We have heard both the parties and their contentions have carefully been considered. According to decision of Hon 'ble Bombay High Court in the case of Raychem RPG Ltd. (supra), if the expenditure incurred on software are to facilitate the assessee's business or enabling the management to conduct the business more efficiently or more profitably then it cannot be said to be in the nature of profit making and has to be treated as 'revenue expenditure. Similarly, Hon 'ble Delhi High Court in the case of Asahi India Safety Glass Ltd (supra) held that software expenditure were revenue in nature. In the case of CIT vs. Amway India Enterprises (supra) also it was held that purchase of software is revenue expenditure. The contentions raised by the assessee before AO were that this expenditure was incurred by the assessee to effectively carry on its business has not been controverted by any material brought on record. In this view of the situation, we hold that Ld. CIT(A) was not right in upholding the action of AO. The expenditure incurred by the assessee on software was in the nature of revenue, hence, allowable as an expenditure. This ground of the assessee is allowed."

16. Thus, consistent with the view taken in the earlier years by the Tribunal, we also hold that the expenditure incurred by the assessee on the software is to be treated as revenue expenditure and, accordingly, the order of the learned Commissioner (Appeals) is affirmed. Ground no.3, raised by the Revenue is dismissed."

12. Since similar facts are permeating through for this year also, therefore, consistent view taken in the earlier years, which is based on the decision of Hon'ble jurisdictional High Court in the case of CIT vs. Raychem RPG Ltd. 346 ITR 183 (Bom), we also treat these expenditure as revenue expenditure. Accordingly ground 2 raised by the Department is dismissed.

13. In ground No. 3 the Department has challenged the deletion of disallowance of non-compete fee paid to Ex-Managing Director amounting to Rs. 154.20 lakhs.

14. Brief facts as noted by the AO are that, in Schedule 19 of the Profit & Loss Account, the assessee has debited non-compete fee of Rs. 154.20 lakhs paid to Ex-Managing director. In response to the show cause notice, the assessee submitted that the said payment has been made to late, Mr. K.J. Bharucha as a non-compete fee on his retirement from the services w.e.f. March 31, 2006. This fee represented compensation for not joining any company or share any expertise with companies having same business for a period of three years. Since such a payment was made to Ex-Managing Director to restrict him to share his experience and expertise for a period of 3 years, so that there is no immediate threat to the interest of assessee's business, therefore, the same is business expenditure. However, the A.O. held that such payment of non-compete fee will result into enduring benefits to the assessee. Accordingly the same was treated as capital expenditure.

15. The ld. CIT(A) relying upon the decision of Hon'ble Delhi High Court in the case of CIT vs. Eicher Ltd. (2008) 302 ITR 249 (Delhi), held that such a payment was paid for a restriction of three years and therefore, there is no question of any enduring benefit coming to the assessee. Moreover, the said Ex-Managing Director expired before the said period of three years, thus, such a payment is nothing but revenue expenditure.

16. Before us, the ld. D.R. strongly relied upon the order of the A.O. and submitted that the payment of non-compete fee is only

for enduring benefit to the assessee and therefore should be held as capital expenditure. In support of his contention, he relied upon the decision of Hon'ble Gujarat High Court in the case of Shree Digvijay Woolen Mills Ltd. vs. CIT (1993) 204 ITR 398 (Guj.) and Hon'ble High court of Punjab in the case of Uttar Bharat Exchange Ltd. vs. CIT, (1965) 55 ITR 550 (Punj).

17. On the other hand, the ld. Counsel for the assessee submitted that this issue is squarely covered by the decision of Hon'ble Delhi High Court in the case of CIT vs. Eicher Ltd. (supra) and also series of Tribunal decisions, a compilation of such decisions were also filed before us. He submitted that the decisions relied upon by the ld. D.R. pertained to payment for certain capital assets which admittedly were in the nature of capital expenditure. None of the case laws were on con-compete fee, that to be paid for a period of three years.

18. After considering the rival submissions and on perusal of facts as recorded by the A.O. and ld. CIT(A), we find that the assessee had paid non-compete fee to its Ex-Managing Director for restricting him to share his expertise or to join any other company in a similar line of business of chemicals for a period of three years on a consideration of Rs. 154.20 lakhs. Since the agreement for restrictive covenant was only for the period of three years to ward-off a potential threat or completion, we are of the opinion that, there can no question of enduring benefit for a long period. Though

the Hon'ble Supreme Court in CIT vs. Coal Shipments Pvt. Ltd. (1971) 82 ITR 902(SC), held that the period for which the restrictive covenant should be in operation to make it revenue expenditure is a matter of judgment and such a judgment should be exercised having regard to the facts and circumstances of the case. If the restrictive covenant is for a indefinite period or for a very large period, then technically it can be said that the advantage is for enduring character and hence, can be termed as " Capital Expenditure". Relying on the same judgment, the Hon'ble Madras High Court in CIT vs. Late G.Naidu & others, 165 ITR 63 (Mad), held that if the restrictive covenant given in the non-compete agreement is for a period of 5 years, then it is on revenue account. This proposition has been retreated by the same High Court in Carborandum Universal Ltd. Vs. JCIT, Tax appeal no. 244 0f 2006, order dated 10.09.2012 in detail after analyzing the aforesaid Supreme Court judgment and other several judgments. The relevant observation and findings are as under:-

> *"As far as the question as to whether an expenditure could be a capital expenditure or revenue expenditure is concerned, the concept that the expenditure yielding an advantage of an enduring nature would be only a capital expenditure, has been fine-tuned, that even when expenditure was incurred for obtaining advantage of enduring benefit, nonetheless, the same can be taken as one of revenue account. J n the decision reported in [1980] 124 ITR 1 (Empire Jute Co. Ltd. Vs. Commissioner of Income Tax (S.C.)), the Apex Court painted out that the test of enduring benefit is not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and*

circumstances of a given case. In a transaction of transfer of allotment of loom hours, on the question as to whether it is a revenue expenditure or a capital expenditure, the Apex Court pointed out that a payment may be a revenue payment from the point of view of the payer and a capital payment from the point of view of the receiver and vice versa. Thus whether an expenditure is capital or revenue has to be determined with regard to the nature of the transaction and other relevant factors. Referring to the decision reported in [1965] 58 ITR 241 (PC) (Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.), the Apex Court pointed out that "there may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may break down. ... What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessees trading operations or enauling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. "

15. Referring to the decision reported in [1965] 56 ITR 52 (SC) (Bombay Steam Navigation CO. [1953J P. Ltd. v. CIT) as well as [1924} 8 TC 671 at 676, (Robert Addie and Sons' Collieries Ltd. v. IRC), the Apex Court referred to the words of Lord Sumner, which may usefully be extracted herein too:

"If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure. See Bombay Steam Navigation Co. (1953) P. Ltd. v. CIT [1965J 56 ITR 52 (SC). The same test was formulated by Lord Clyde in Robert Addie and Sons' Collieries Ltd. v. IRC

[1924} 8 TC 671, 676 (C Sess) in these words: "Is it a part of the company's working expenses is it expenditure laid out as part of the process of profit earning?-- or, on the other hand, is it a capital outlay?-- is it expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which is a condition of carrying on its trade at ell?" It is clear from the above discussion that the payment made by the assessee for purchase of loom hours was expenditure laid out as part of the process of profit earning. It was, to use Lord Sumner's words, an outlay of a business "in order to carry it on and to earn a profit out of this expense as an expense of carrying it on". [John Smith and Son v, Moore {1921]12 TC 266, 296 (HL)]. It was part' of the cost to, operating the profit-earning apparatus and was clearly in the nature of revenue expenditure. "

16. Thus the question as to whether an expenditure is revenue or not has to be seen from the context of an expenditure forming "part of the cost of the income earning machine or structure" as opposed to part of the cost of performing the income-earning operations" [1971] 82 ITR 902 (CIT Vs. Coal Shipments P. Ltd. (S.C.)

17. Thus, the consistent guiding principles in matters of understanding an expenditure as a capital or revenue, as held by the Apex Court, is to find out the aim and object of the expenditure and the commercial necessities of making such an expenditure. The question has to be considered in the background of the facts of each case, that "the idea of "once for all" payment and "enduring benefit" are not to be treated as something akin to statutory conditions; nor are the notions of "capital".or "revenue" a judicial fetish. "_- [1989) 177 ITR 377 (Alembic Chemical Works Co. Ltd.).

18. Going by the above-said principle, if one looks at the decision reported in [1991] 191 ITR 249' (Chelpark Company Ltd. Vs. Commissioner of Income Tax), one may find that the decision that the expenditure was a capita! expenditure and hence not deductible, rested in the context of the peculiar facts Of the case; the partnership with which the assessee had the non-compete agreement got dissolved immediately after the

payment of the non- compete fee and the potential competitor had vanished, On these facts, this Court observed that, whatever the assessee had paid for was of permanent or enduring quality, in the sense that completion had been totally eliminated and protection had been acquired for the business of the assessee as a whole. We do not find that the one based on the facts of the said decision. The question herein as to whether non-compete fee paid to the ex-Managing Director was a revenue or a capita/expenditure, has to be seen in the' context of the facts of this case and the circumstances in which the payments were made.

19. It is not denied by the Revenue that U. Monnnrao was the Chairman and Managing Director of some of the companies which go t merged with the assessee company. The said U. Mohanrao had access to all information starting from manufacturing process, knowhow to the clientele and the products, including the pricing of the products. By a process of amalgamation, the assessee had acquired the business of the amalgamating companies. However, for the fruitful exercise of its business as a business proposition, the assessee thought it fit to enter into a non-compete agreement with a person who had the knowledge of the entire operations, so as to get the full yield of the amalgamated company's business. In that context, rightly, the assessee took a commercial decision to pay non- compete fee to U. Mohanrao and going by the decision of the Apex Court, particularly the decision reported in [1971} 82 ITR 902 (CIT Vs. Coal Shipment, P. Ltd (S.C.)), that the payment was in respect of the performing of the business of the assessee, we have no hesitation in holding that the expenditure is only on revenue account and not on capital account. In the circumstances, we accept the case of the assessee, set aside the order of the Tribunal and allow the Tax Case.

20. It may be pointed out that in the assessee's own case relating to the assessment years 1998-99, 1999-2000 in r.C.Nos.97 and 98 of 2008, by order dated 06.04.2011, Question Nos.2 and 4 herein were raised before this Court. The first question relating to scrap sales was considered and

answered against the assessee, referring to the decision of the Tribunal reported in 97 ITO 306 (JCIT Vs. Virudhunagar Textiles Limited). The second question also was answered against the assessee, following the decision of this Court reported in [2006J 282 ITR 389 (Mad.) (CIT Vs. Chinnapandi) and the third question was also decided against the assessee following the decision reported in [1993} 199 ITR 43 (Escorts Ltd Vs. Union f India).

21. As far as the first question is concerned, we have referred to the decision of the Apex Court to grant relief to the assessee. As far as the second question is concerned, again, we have referred to the decision reported in [2012] 343 ITR 89 (SC) (ACG Associated Capsules Pvt. Ltd. Vs. Commissioner of Income- Tax (Se)) to grant relief to the assessee. In the circumstances, we have considered the said questions in favour of the assessee and had not followed the decision of this Court rendered in the assessee's own case. As far as the third question on the question of depreciation under section 35AB is concerned, on facts, we have held that against the assessee and the same is different from assessee's own decided case, although on a different ground."

19. However, such a payment is also to be seen from the context of commercial and business expediency. If the outgoing expenditure is so inextricably linked or related to carrying on or conduct of the business, that is, it can be regarded as integral part of the profit earning process and not for any acquisition of asset or a right of permanent character and incurring of the expenditure is a condition for carrying on the business, then such an expenditure may be regarded as revenue expenditure. Here the agreement for payment of non-compete fee was only to protect the existing business for a temporary period to ward off completion so that assessee company can get stabilizing period without its long

serving MD. Here no new assets of any enduring benefit has arisen to the assessee on such payment. If the advantage is not for longer period and not enduring in nature, then such a payment of non-compete fee is nothing but business expenditure which is on revenue account. On similar facts and circumstances, the Hon'ble Delhi High Court also in the case of Eicher Ltd. (supra), after discussing various case laws came to the conclusion that payment of non-compete fee for eliminating competition in the two wheeler business cannot be held that assessee has acquired capital asset of enduring nature. The judgments relied by the ld. DR are not only distinguishable on facts but also on ratio decendi, hence not applicable in the present case. Thus on these facts, we hold that such a payment of non-compete fee is allowable as a revenue expenditure and the order of ld. CIT(A) on this score is confirmed. Revenue's ground is thus dismissed.

20. In the result, appeal of the assessee in ITA No. 8079/Mum/2011 is allowed for statistical purpose, whereas appeal of the Revenue in ITA No. 7428/Mum/2011 is partly allowed for statistical purpose.

Order pronounced in the open court on 19th November, 2014

आदेश की घोषणा खुले न्यायालय में दिनांकः 19th November को की गई ।

Sd/- **Sd/-**

(SANJAY ARORA) (AMIT SHUKLA)
ACCOUNTANT MEMBER JUDICIAL MEMBER

मुंबई Mumbai; दिनांक Dated **19.11.2014**

व.नि.स./ RK , Sr. PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A) –1, Mumbai
4. आयकर आयुक्त / CIT – 1, Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai C Bench
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,
सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai