Non-compete fee wasn't taxable prior to AY 2002-03

Summary – The High Court of Madras in a recent case of Hackbridge Hewittic & Easun Ltd., (the Assessee) held that where for assessment year 1996-97 under an agreement, assessee transferred one of its business to other company but continued its business using its own logo, trade name, licenses and permits, no part of non-compete fee received by assessee under aforesaid agreement could be treated as considerations for goodwill and it was not taxable as income

Facts

- Assessee-company entered into an agreement with a German company MR to sell plant and machinery in respect of its Tap Changer Division. As per the agreement, the assessee undertook not to engage either directly or indirectly in the manufacture of existing range of products. A sum of Rs. 6.89 crores (approx.) was received by the assessee as a consideration for complying with the terms of agreement and the same was claimed as exempt as capital receipt.
- The Assessing Officer held that there was absolute transfer of independent unit of business with all tangible and intangible asset. The Assessing Officer held that there was a separate consideration received for the sale of plant and machinery and related equipments, and, hence, the receipt should be attributed to transfer of goodwill and restrictive covenants. Hence, the Assessing Officer brought to tax certain amount from capital gains in respect of the transfer of goodwill by adopting the cost of acquisition at *nil*.
- On appeal, the Commissioner (Appeals) accepted the contention of assessee and held that there was no element of goodwill in the agreement entered into by the assessee with MR in regard to the transfer of business and the entire receipt should be attributed to restrictive covenants/non-compete fees.
- The Tribunal dismissed the appeal of the revenue.
- On appeal to the High Court:

Held

- The admitted fact in this case is that the assessee-company has transferred the technical know-how and other advantages to the joint venture company consisting of the assessee-company and MR and the assessee continued its business using its own logo, trade name, licenses, permits and approval under an agreement with another company. The Tribunal came to hold that there was no intention to acquire goodwill of the assessee and, therefore, non-compete fee received by the assessee could not be treated as goodwill and it was not taxable as income.
- On facts there is no reason to differ with the said finding. The reliance placed by the Assessing Officer on section 55(2)(a) was repelled by the Tribunal rightly on a plea that the said provision came into effect in the year 1998-99, whereas the assessment year in the instant case is 1996-97. Therefore, there was no basis to fall back on the said provision. In the facts of the instant case the non-compete fee received by the assessee is capital in nature.

- The Supreme Court in the case of *Guffic Chem. (P.) Ltd.* v. *CIT* [2011] 332 ITR 602/198 Taxman 78/10 taxmann.com 105 held that payment received as non-compete fee under a negative covenant was always treated as a capital receipt till the assessment year 2003-04. It is only *vide* Finance Act, 2002 with effect from 1-4-2003 that the said capital receipt is now made taxable [See: Section 28(va)]. The Finance Act, 2002 itself indicates that during the relevant assessment year compensation received by the assessee under non-competition agreement was a capital receipt, not taxable under the Act. It became taxable only with effect from 1-4-2003. It is well-settled that a liability cannot be created retrospectively. In the above-said decision, the Supreme Court emphasised the fact that the Finance Act, 2002, which came into effect from 1-4-2003, makes the capital receipt as taxable under section 28(va) and held that liability cannot be created retrospectively.