

Payment made for taking legal advice for purchase of business division is a capital exp.

Summary – The Delhi ITAT in a recent case of Nitrex Chemicals India Ltd., (the Assessee) held that where assessee purchased business division of another concern which also included payment to non-compete fee restraining seller from carrying on similar business for three years, said payment was to be regarded as capital expenditure

Facts

- The assessee purchased one division of 'N' Chemicals which was transferred to the assessee by way of slump sales. The assessee treated the same as capital expenditure in the books of account and claimed depreciation on said amount. For the purpose of computing total income under the Act, the assessee treated Rs. 6.80 crores as non-compete fee on the basis of the value of the intangibles determined by the valuers.
- The Assessing Officer treated the said amount as capital expenditure by holding that the amount claimed as fee for non-compete was nothing but goodwill of the business.
- The Commissioner (Appeals), however, took a view that by entering into a restrictive covenant the assessee had warded off a potential competition from the transferor. He thus held that amount paid as non-compete fee was to be regarded as revenue expenditure.
- On revenue's appeal:

Held

- In the instant case the non-compete fee although identified separately by the valuer but it was inbuilt in the lump sum consideration. The assessee split the lump sum consideration in various tangible and intangible assets on the basis of report of the valuers which was not doubted either by the Assessing Officer or by the Commissioner (Appeals).
- In the present case, the only dispute was relating to the non-compete fee of Rs. 6.80 crores, the said amount was difference in the value of tangible/intangible assets of the going concern which was purchased by the assessee and the lump sum amount paid for taking over the business, so it was in the nature of the goodwill and since the assessee was having the enduring benefit particularly when there was a covenant on the seller for not to run the similar type of business for three years. Therefore, the said amount cannot be considered as revenue in nature as has been held by the Commissioner (Appeals). Since the amount under consideration was in excess of the value of tangible and intangible asset and was a part of the lump sum consideration for acquiring the business, so it was a goodwill.

- Therefore, by considering the totality of the facts, the finding of the Commissioner (Appeals) is set aside on this issue and the view taken by the Assessing Officer that the non-compete fee of Rs. 6.80 crores was nothing but goodwill of the business and a capital expenditure is upheld.
- Now question arises as to whether the assessee is eligible for depreciation on the goodwill. In this regard, it is relevant to point out that the Supreme Court in the case of *CIT v. SMIF Securities Ltd.* [SLP (Civil) No. 35600 of 2009] held that the goodwill is eligible for depreciation under section 32.
- In view of the above, it is held that the non-compete fee amounting to Rs. 6.80 crore paid by the assessee was capital in nature and was eligible for depreciation under section 32.