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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Decided on: 23.08.2016

\+ ITA 247/2016

PR. COMMISSIONER OF INCOME TAX-06 ..... Appellant

Through: Mr. Rahul Chaudhary, Advocate.

versus

NITREX CHEMICALS INDIA LTD. ..... Respondent

Through: Mr. Ved Jain, Advocate along with Mr. Pranjal Srivastava, Advocate.

And

\+ ITA 248/2016

PR. COMMISSIONER OF INCOME TAX-06 ..... Appellant

Through: Mr. Rahul Chaudhary, Advocate.

versus

NITREX CHEMICALS INDIA LTD. ..... Respondent

Through: Mr. Ved Jain, Advocate along with Mr. Pranjal Srivastava, Advocate.

And

\+ ITA 249/2016

PR. COMMISSIONER OF INCOME TAX-06 ..... Appellant

Through: Mr. Rahul Chaudhary, Advocate.

versus

NITREX CHEMICALS INDIA LTD. ..... Respondent

Through: Mr. Ved Jain, Advocate along with Mr. Pranjal Srivastava, Advocate.

And

\+ ITA 318/2016

PR. COMMISSIONER OF INCOME TAX-06 ..... Appellant

Through: Mr. Rahul Chaudhary, Advocate.

versus

NITREX CHEMICALS INDIA LTD. ..... Respondent

Through: Mr. Ved Jain, Advocate along with
Mr. Pranjal Srivastava, Advocate.
And

\+ ITA 319/2016

PR. COMMISSIONER OF INCOME TAX-06 ..... Appellant

Through: Mr. Rahul Chaudhary, Advocate.

versus

NITREX CHEMICALS INDIA LTD. ..... Respondent

Through: Mr. Ved Jain, Advocate along with
Mr. Pranjal Srivastava, Advocate.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MS. JUSTICE DEEPA SHARMA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)

1. The revenue is aggrieved by a common order of the Income Tax Appellate Tribunal (ITAT) pertaining to five assessment years i.e. 2005-2006, 2006-2007, 2007-2008, 2008-2009 and 2009-2010.

2. It is urged that several questions of law arose, chiefly on the following issues:-

1. *Whether payments made by the assessee to its holding company Nitrex Chemicals India Ltd for the use of its trademark and for the purpose of obtaining expertise in commerce, finance, manufacturing etc. amounted to revenue expenditure instead of capital expenditure?*
2. *Whether the finding with respect to additions being disallowances of excessive commission on exports in the circumstances of the case is tenable?*
3. *Whether the computation of capital gains in respect of slump sale of trading businesses on*

account of purchase of shares by ESOP Trust, could be deducted from capital gain under Section 48 of Income Tax Act?

4. *Is the finding on disallowance under Section 14A sound in law? And*
5. *Whether in the circumstances of the case, foreign exchange fluctuation in respect of amounts held by the assessee, could be treated as capital losses rather than as revenue expenditure?*

3. Re: Question No. 1: Whether the payment towards trade mark and use of expertise in the field of commerce, finance etc amounted to capital or revenue expenditure?

4. The assessee acquired an undertaking/ unit of ICI Ltd. The assessee in 2006-2007 had debited amounts under the head "Techno Commercial Agreement" and a further sum was paid towards Brand Licensing Agreement, executed on 14.03.2005. The Assessing Officer "AO" was of the opinion that these expenditures were of an enduring kind and held that they were capital in nature. The assessee, on the other hand, contended that these were revenue expenditure. The CIT (A) accepted the assessee's contention; the ITAT affirmed the order.

5. The revenue's counsel argues that the findings of the CIT (A) and ITAT are erroneous having regard to the nature of the agreement. It was highlighted that even though the agreement was entered into on 14.03.2005, it was sought to be made effective from 01.04.2004. The agreement itself was cancelled

on 30.04.2005. It was therefore submitted that the real nature of the transaction was transfer of ownership rights vested in the "Nitrex" brand as well as technology and commercial information, to the assessee. As to whether the expenditure under the circumstances of the case could have led to creation of an asset of enduring nature or not would have assumed some importance if it had considerable impact. In the present case, there is no dispute that the undertaking itself was sold subsequently in 2005. So far as the use of the trade mark is concerned, the ITAT's reasoning is as follows:-

> *"After considering the submission of both the parties and perusing the material on record, it is noticed that the AO did not doubt the genuineness of the expenses. He only doubted the nature of expenses which were claimed by the assessee as revnue in nature but the AO was of the view that it was capital in nature. In the present case, by incurring the impugned expenses, the assesse had not acquires any tangible/intangible asset which had any lasting and enduring benefit to the assesee's business. The payments were made for using the trade mark of Mis Nitrex Mauritius and to obtain expertise in the field of commerce, finance and manufacturing etc. which were needed for smooth running of the business as the assessee was new in this business and the expenses were paid only for one year. Therefore, we are of the view that the ld. CIT (A) was fully justified in directing the AO to treat those expenses as revnue in nature, we do not see*

any infirmity in order of the ld. CIT(A) on this issue."

6. This court is of the opinion that the finding with respect to tangible or non-tangible asset vesting in the assesee and whether it had or not any lasting or enduring advantage to it is more in the nature of a finding of fact. The findings are also that to use the Nitrex brand, payments were made and it was essential for the assessee to make such payments on account of nature of its business and on account of procuring knowledge for setting up the systems as well as other procedures. In the circumstances, we are of the opinion that no question of law arises on this aspect.

7. Re Question No.2: The issue of excessive commission, was consistently ruled against the assessee, for all the five years. However, in both the CIT (A) and the ITAT, the revenue's contentions were not accepted. Here, the assessee's argument was that the commission could not be characterised as excessive because they were more customary in nature having regard to the historic relationship with M/S Asha export, its export agent. This court is of the opinion that such decisions as to the nature and quantum of commission may differ having regard to the uniqueness of each business and the relationship that it may possess with those associated with it. Unless, the revenue is able to pinpoint extraordinary features, it cannot scrutinize the commercial terms that a business takes into

account in making a decision and contend that certain percentage or quantum of commission is *"excessive"*. Therefore, we are of the opinion that no question of law arises.

8. Re Question No. 3: The revenue's contention here is that sum of ₹ 1,39,76,352/- spent by the assessee at the time of transfer of its business undertaking to fund the ESOP Trust, cannot be characterized as permissible expenditure but rather has to be added back for the purposes of income calculations. The assessee's contention, on the other hand, is that this expenditure was essential and integral part of the sale transaction itself.

9. The necessary facts for appreciation of the question are that the assessee sold a part of its unit as a going concern. In the process the transferee took over the undertaking with the management and employees. The assessee had created and subsequently modified at two different stages, an ESOP (Employees Stock Option Plan) Trust Fund. Apparently, the transferee expressed its inclination to continue the fund and insisted that as a pre-condition for the transfer, the assessee ought to fund it to the extent of the value of the shares that were to be allotted to the employees. According to the revenue, this expenditure was not integrally connected with the transfer and therefore not adjustable from the capital loss as reported in that regard.

The findings of the ITAT on this aspect are as follows:-

> *"72. The Id. CIT(A) after considering the submissions of the assessee deleted the addition by observing as under:*
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> *"1 have gone through the observations of the Assessing Officer as contained in the Assessment Order, submissions of the appellant filed during the course of appellate proceedings and various judicial pronouncements relied upon by the appellant on the issue. I have also examined the contents of Business Transfer Agreement (BTA) entered between Nitrex Chemicals India Ltd. and EAC, Industrial Ingredients Pte Ltd., the Employees Transfer Agreement(ETA) and the Employees Stock Option Plan, 2004 (ESOP,2004). It is seen that the appellant company entered into an agreement to sell the Trading Division of the company which was engaged in the business of whole sales trading in chemicals and whole sale trading business with M/s EAC Industrial Ingredients Pte. Ltd. on 14.10.2005 for a consideration of Rs. 22,15,00,0001- subject to the adjustment regarding net liquid assets and movable assets which are given in Schedule 'J' of BTA. On the same date, the appellant signed an ETA Agreement with M/s EAC also for employees transfer. As per clause 2 of this agreement, it was decided that-*
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> *"2. Pre-completion matter-*

Prior to completion, the employees shall be jointly approached by EAC and or Newco and Nitrex for the purpose of obtaining their acceptance to becoming employees than their current terms and conditions but which shall not include any stock holding and share holding option in Nitrex India Ltd.

3. Condition precedent –

It shall be a condition precedent to completion of the transaction contemplated by the BTA that the management staff shall have confirmed that subject to the completion they will accept to be employee by Newco instead of Nitrex India Ltd.

4.4 EAC and/or Newco shall employ the employees from the completion date on terms and conditions of service which are no less favorable than those which the employees enjoyed immediately prior to the completion date with Nitrex India without any interruption and break in service (but excluding employees stock share holding option).

l. As per the terms and conditions listed above, it was the condition precedent to the completion transaction contemplated in the BTA that the management staff shall have confirmed to accept the employment in the new company instead of the appellant company. It was also a condition that on acceptance of employment, the new company shall employ the employees on terms and conditions of service which are no less

favourable than those which the employees were enjoying immediately prior to completion date of business transfer without any interruption or break up of service. However, in the agreement it is clearly mentioned that in the new company they will not be given any employee stock or share holding options. It is seen that the management employee of the Nitrex were having ESOP which was allowed to them by the appellant company in 2004 as per ESOP 2004 Scheme. As per this, 5.5% of the shares of the company were subscribed by the management team. The company has also entered into ESOP Scheme under which further shares to be allotted to the employees and an ESOP Trust was created on 20th June, 2005 as a custodian of the employees shares. As per the BTA and ETA, certain employees of management team were working with the trading division of the appellant company and in the event of their joining new company, the employees had to divest with their share holding in the company which was in the custody of Trust. As per the ESOP-2004 in the vest of separation of employees for reason other than retirement, the employee had to exercise the option vested on them within three months of the date of resignation. On the joining of the new company, the employee would have lost the benefit of ESOP which would have effected them financially. However, as per the terms and conditions of

BTA, the management team has to agree to join the new company which was a precondition for business transfer agreement. In such a situation, it became necessary for the appellant company to ensure that the management staff accepts to part with their employment with the appellant company and accept the employment of new company. Accordingly, management of team submitted acceptance letter on 09.12.2005 with the agreement of Nitrex Chemicals Stock Option Trust, thereby, the employees agreed to offer the shares held by them to the trust of NITSOP, 2004 and the consideration for such shares was to be determined by applying a price earnings multiple of five to the company's profit after tax for the Financial year 2004-05. However, the management team requested the appellant company to calculate the price of share by suing the profit after tax of the company for F. Y 2005-06 adjusted for EAC warranty claim. As a result of acceptance letter from the management team, the appellant company was able to transfer its trading business to M/s EAC without any hindrance. For buy backing, the management shares by the Trust, the appellant company provided the money to Trust. It is claimed by the appellant that said money is not recoverable from the Trust. However, the company has paid said money in pursuance to the BTA and ETA which was a contractual liability of the company. Without

buy back of the shares from the employees, the business transfer of the trading division would not have been possible. It is claimed by the appellant that the amount spent on buy back of shares by the Trust has been incurred wholly and exclusively in connection with the transfer of the capital assets as contemplated in Section 48 of the IT Act. Hence, the same has to be allowed as deduction while computing the capital gain in respect of the slump sale of trading business.

10. Section 48 of the Act to the extent it is relevant reads as follows:-

The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

(i) expenditure incurred wholly and exclusively in connection with such transfer

(ii) the cost of acquisition of the asset and the cost of any improvement thereto:

11. As is evident, the expression "expenditure incurred wholly and exclusively in connection with such transfers" is in plain terms sufficient to encompass the kind of expenditure with which this Court has to deal with in respect of determining the issue in question. ESOP was an essential term of employment for the assessee's workforce; an ESOP Trust Fund had been created for this specific purpose. Upon the transfer of

the assessee's undertaking, the transferee disclaimed any responsibility to honor the ESOP conditions. As consequence, the funding of the ESOP became an integral part of the transfer itself.

12. In these circumstances, the court is of the opinion that the mode of computation of capital gains had to necessarily take into consideration the ESOP funding through the trust fund by the Assessee at the stage of transfer.

13. Therefore, the court holds that there is no infirmity in the findings of the ITAT. No question of law arises.

14. Re: Question of disallowance under Section 14A: On this aspect the revenue's grievance is confined to three years i.e. 2007-2008, 2008-2009 and 2009-2010. We notice that the decision in the case of ***Maxopp Investment Ltd.Vs CIT, New Delhi*** *(2012) 347 ITR 172 (Del)* would apply in the circumstances. Equally for the last year i.e. year 2009-2010, the AO's omission to record his satisfaction as to the permissibility of the deduction, which is the pre-condition for exercise of the power, persuaded us to hold that no question of law arise.

Re Question No. 5, regarding the treatment of foreign exchange fluctuation- (arising only for AY 2009-2010).

15. The AO had held that loss on account of foreign exchange fluctuation to the tune of ₹ 2,77,72,900/- could not

be claimed as revenue loss and rather had to be disallowed. This was on the basis of his understanding of the authority in ***CIT Vs Woodward Governor India (P) Ltd. 312 ITR 254 SC.*** The CIT(A) was of the opinion that the assessing officer's reasoning was flawed. He held that Section 43A was applicable in the circumstances of the case and AS-11 (Accounting Standard) was relied upon to indicate that exchange fluctuation gains or losses would have to be shown in the profit and loss account.

16. The revenue urges that both the CIT (A) and ITAT fell into error, it is pointed out, in support of its contention, that foreign exchange fluctuation, particularly, the loss reported during the relevant year, was on account of the ECB loan which the assessee had obtained. We notice that this aspect was considered by the ITAT which observed that the ECB loan/advance was an old one and the treatment of the foreign exchange fluctuation especially in case of increase for all the previous years was taken to be on the revenue side. It is necessarily implied that the revenue accepted that the foreign exchange amounts amounted to income and proceeded to deal with it as such.

17. This court is of the opinion that in view of the past revenue treatment, the revenue's submissions by the appellant are unmerited. No question of law arises.

In view of the above findings, the questions of law are answered against the revenue and in favour of the assessee.

The appeal is consequently dismissed as unmerited.

S. RAVINDRA BHAT, J

DEEPA SHARMA, J

AUGUST 23, 2016
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