Payment received for restraining the use of trade-mark which ceases to exist is a capital receipt not chargeable to tax

Background
Recently, the Hyderabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Orient Blackswan Private Limited1 (the taxpayer) held that the payment received by the taxpayer for restraining the use of the trade-mark which is cancelled and no longer available for use as it ceases to exist is a capital receipt not chargeable to tax under the Income-tax Act, 1961 (the Act).

Facts of the case
- The taxpayer, a company engaged in the business of publishing and trading of educational and academic books on its own as well as on behalf of other publishers for which the taxpayer earns commission.
- During the year under consideration, the taxpayer received an amount of INR53,827,108 as compensation in terms of settlement agreement dated 22 November 2007 from M/s. Longman Communications Limited, London (LCL), which is presently known as Pearson Group. LCL was stated to be taken over by the Pearson Group, U.K. The taxpayer was previously named and styled as Orient Longman Pvt. Ltd. The taxpayer was required to change the name of the entity excluding the word ‘Longman’ as per a Tomlin Order. Accordingly, the name of the taxpayer was changed to Orient Blackswan Pvt. Ltd. The genesis of the present dispute lies in a trade-mark held by the taxpayer in the name of ‘Orient Longman’.
- The taxpayer had registered the trade-mark with the trade-mark authority in India since 1980. As submitted, there were pending disputes regarding the use of the trademarks and use of the name ‘Longman’ by the taxpayer in the courts of United Kingdom and India. Subsequently, these disputes were stated to be settled by means of a settlement agreement dated 22 November 2007 between Pearson group and the taxpayer, followed by a compromise order known as ‘Tomlin Order’ passed by the High Court of Justice, Chancery Division U.K. giving effect to the settlement agreement dated 22 November 2007.
- As per this agreement, the taxpayer has undertaken not to use any trade-mark or trademarks which include the word ‘Longman’ or any word or phrase confusingly similar to the word ‘Longman’ in India or anywhere in the world. Thus, the taxpayer was estopped from using the trade-mark which includes the word ‘Longman’ and similarly, the Longman Group or Pearson Group were estopped from using the word ‘Orient’ in combination with ‘Longman’.
- The Assessing Officer (AO) observed that the provisions of Section 28(va) of the Act have been inserted in the Act with effect from 1 April 2003 relevant to Assessment Year (AY) 2003-04 onwards. The aforesaid provision has superseded rulings of various judicial fora which held that a sum received for a restrictive covenant is capital receipt. The AO therefore took a view that after the insertion of clause (va) to Section 28 of the Act, the law has changed its course and such receipts are liable to be taxed as revenue receipts.

---
1 Orient Blackswan Private Limited v. ACIT ITA no.252/Hyd/2012- AY 2008-09, 731 Taxsutra.com

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
The Commissioner of Income-tax (Appeals) [CIT(A)] held that the impugned receipts arose as compensation in the course of business and are in the nature of a revenue receipt. The CIT(A) noted that when a person registers or purchases a trade-mark, the expenditure incurred for this purpose would fall within the class of revenue expenditure as it does not create an asset. The CIT(A) also observed that the settlement agreement vetted by the Tomlin Order of the U.K. Court does not come in the way of carrying on of the business of the taxpayer at all. It was observed that there is absolutely no covenant or restriction on the taxpayer to print books or to engage in the business in which it is already engaged. The CIT(A) observed that in the light of the aforesaid factual background, there is no restrictive covenant on the taxpayer to carry on the trade or business of the taxpayer per se. The CIT(A) thus, confirmed the action of the AO.

**Tribunal's ruling**

- Sub-clause (a) to Section 28(va)² of the Act applies to receipts in the nature of non-compete fee which is not the issue in the present case. The applicability or otherwise of sub clause (b) is in question.
- Based on the relevant obligation clauses of each party to the agreement, the Tribunal observed that the agreement was towards settling various disputes on the use of name ‘Longman’ and does not relate to any transfer of trade-mark etc.
- The settlement agreement has not been entered into in the ordinary course of business, therefore compensation received under a negative covenant for impairment of right to use the word ‘Longman’ is in the nature of capital receipt.
- The Tribunal placed reliance on the decision of Ahmedabad Tribunal in the case of Govindbhai C. Patel³ where it was held that compensation received towards relinquishment of the taxpayer’s right to sue it in the Court of law cannot be treated as revenue receipt taxable as business income under Section 28(va) of the Act.

- The decision in the case of Best & Co and Guffic Chem. ⁴, relied upon by the taxpayer, lays down that a capital receipt is not taxable in the hands of taxpayer. Hence, such receipt towards relinquishment of right to use word ‘Longman’ cannot be taxed unless it is shown that it falls within the purview of Section 28(va)(b) of the Act.
- The taxpayer has been restrained from using the word ‘Longman’ by the Court from doing so. As a sequel to the Court order, the taxpayer is required to cancel the trade-mark. The trade-mark is no longer available for use by the taxpayer. Notwithstanding the fact that certain capital receipts have brought to tax as chargeable income under Section 28(va) of the Act, the extended meaning of taxable income is controlled by the words ‘not sharing’. Section 28(va)(b) of the Act only deals with payment received for not sharing trade-mark etc. this would presuppose that the assessee should own the trade-mark and for a given consideration, has agreed not to share it with any other person. The word ‘sharing’ postulates there must be someone to use the trade-mark. But in the present case, the sharing or otherwise is not possible when trade-mark itself ceases to exist.
- The Tribunal thus held that the payment received cannot be brought to tax as business income under Section 28(va) of the Act.

**Our comments**

Taxability of amount received towards restrictive covenant for the use of intangibles⁵ has been a subject matter of debate before the courts. The Supreme Court in the case of Guffic Chem (P). Ltd. observed that the payment received as non-compete fee under a negative covenant is a capital receipt before the amendment made to Section 28(va) of the Act. Subsequently, to bring such payments within the ambit of taxation, Section 28(va) has been introduced in the Act from AY 2003-04, which brings to tax any sum received or receivable, in cash or in kind, in consideration of a restrictive covenant not to carry out any activity in relation to any business or profession; and for not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods

---

³ Govindbhai C. Patel v. DCIT [2010] 36 SOT 270 (Ahd)
⁴ CIT v. BEST & Co. [1966] 60 ITR 1 SC; Guffic Chem (P.) Ltd. v. CIT [2011] 198 Taxman 78 SC.
⁵ Know-how, patent, copyright, trademark, licence, franchisee, etc.
or provision of services. The Memorandum explaining the provisions of the Finance Bill, 2002 states that the amendment has been introduced for charging to tax such amounts under the head ‘Profits and gains of business or profession’.

The Tribunal, in the instant case dealt with the payment made for a restrictive covenant for an asset which is no longer available for use and it ceases to exist. The Tribunal held that it is a capital receipt and not chargeable to tax under the head ‘Profits and gains of business or profession’.
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.