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

Decided on: 13.04.2015

+ **ITA 178/2001**

COMMISSIONER OF INCOME TAX DELHI-II

.....Appellant

Through: Sh. Arjun Harkauli with Sh. Satyawan
Shekhawat, Advocates.

Versus

M/S. MOTHERSON AUTO P. LTD.Respondent

Through: None.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)

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1. The revenue is aggrieved by the order of the Income Tax Appellate Tribunal (ITAT) dated 12-04-2001 in ITA No. 8036/Del/92. The question of law which arises for determination in this case is:

“Whether the Tribunal was justified in law in holding that the sum of ₹ 51,30,338/- was received by the company from its collaborators on account of goodwill and, therefore, not exigible to tax ?”

2. The facts are that the assessee was taken over by a new company (M/s Motherson Sumi Systems Pvt. Ltd) in terms of a collaboration agreement dated 03-12-1986. The new company was promoted by the assessee and two Japanese companies. Clause 7 (1) of the Collaboration Agreement provided that the consideration of the unit as a going concern

could be adjusted against the goodwill of the assessee. The valuation of the goodwill was to be based on “assumptions and projections” approved by the investing/purchasing Japanese Companies, and evaluated by a chartered accountant nominated with the concurrence of the Japanese companies. This agreement was approved by the Central Government. The total consideration (including the goodwill) agreed upon by the parties was ₹ 60.90 lakhs.

3. During assessment proceedings for AY 1987-88, the assessee claimed the value of goodwill transferred to be ₹ 51,30,338/-. This was not accepted, and was disallowed by the AO, who was of the opinion that valuation of the goodwill was not based on any established or known principle and that the assessee had not acquired expertise of such order as to claim to possess such goodwill. It was also concluded that the assessee had incurred loss during the previous year and further the goodwill claimed was founded on the expertise drawn from the collaborating company/investors, after which M/s Maruti Udyog Ltd. had recognized the assessee. These findings were approved by the Commissioner (Appeals) who rejected the assessee’s claims and confirmed the AO’s corresponding addition.

4. The ITAT, in its impugned order noticed that the report of the chartered accountant, i.e M/s R.K. Khanna & Co. supported the assessee’s stand. It was also held that though the assessee was incorporated in 1984, it had taken over the business of an existing firm, Sehgal Cables. Furthermore, it was noticed that though the assessee incurred losses during the first year of its operation, those losses were wiped out during the next year; moreover, the assessee had orders worth ₹ 4.87 crores in its hand when the takeover transaction had taken place and that it had a manufacturing monopoly over

the product, i.e wireless harness. Consequently, the ITAT allowed the assessee's appeal.

5. Mr. Harkauli, learned counsel for the revenue argued that the ITAT fell into error in setting aside the findings of the AO and the CIT (A). Both those authorities had furnished good and valid reasons for rejecting the valuation of goodwill put forth by the assessee. The revenue contended that to say that the goodwill could be valued at such high rate as was done in the present case, the assessee had to furnish a scientific basis. Counsel emphasized that the mere existence of a huge or substantial order could not have meant that such orders would have necessarily resulted in a profit and the basis for ITAT's order was unsustainable.

6. In *S. C. Cambatta and Co. Private Limited v. Commissioner of Excess Profits Tax, Bombay* (41 I.T.R. 500), the Supreme Court relied on *Federal Commissioner of Taxation v. Williamson* (1943)67 C.L.R. 56(7), where it was held that:

"Hence to determine the nature of the goodwill in any case, it is necessary to consider the type of business and the type of customer which such a business is inherently likely to attract as well as the surrounding circumstances..... The goodwill of a business is a composite being referable in part to its locality, in part to the way in which it is conducted and the personality of those who conduct it, and in part to the likelihood of competition, many customers, being no doubt actuated by mixed motives in conferring their custom"

The Supreme Court in *S.C. Cambatta* also relied upon Jowitt's *"Dictionary of English Law"*; "goodwill" was defined there as follows:

"The goodwill of a business is the benefit which arises from its having been carried on for some time in a particular house, or by a particular person or firm, or from the use of a particular trade mark or trade name."

The Supreme Court then held that:

"It will thus be seen that the goodwill of a business depends upon a variety of circumstances or a combination of them. The location, the service, the standing of the business, the honesty of those who run it, and the lack of competition and many other factors go individually or together to make up the goodwill, though locality always plays a considerable part. Shift the locality, and the goodwill may be lost. At the same time, locality is not everything. The power to attract custom depends on one or more of the other factors as well. In the case of a theatre or restaurant, what is catered, how the service is run and what the competition is, contribute also to the goodwill. From the above, it is manifest that the matter of goodwill needs to be considered in a much broader way than what the Tribunal had done. A question of law did arise in the case, and in our opinion, the High Court should have directed the Tribunal to state a case upon it."

7. A reading of the ITAT's order would reveal that the basis for valuation of goodwill in this case was three fold: (a) the assessee, though established in 1984 in a sense was continually engaged in business since 1975, when Sehgal Cables started functioning (that concern's business was assimilated by the assessee); (b) the assessee had unexecuted orders worth ₹ 4.87 crores in hand, when the collaboration agreement was signed; its profit for one year offset the loss for the previous year; (c) the assessee held a manufacturing monopoly over one product, i.e wireless harness. As is

evident from the Supreme Court's ruling in *S. C. Cambatta*, there is no stipulated matrix of factors which are to be taken into consideration. Whilst the length of time for which a business might operate, its profitability, etc. are relevant, equally whether, and to what extent it has competition in respect of the business activities it undertakes, the market acceptability and demand for the product or services in question, capital employed, unique expertise developed, etc. too are all relevant. The ITAT's view therefore has some basis in law. It is worthwhile to recollect that the Supreme Court, in *Commissioner of Income Tax v. Srinivasa Setty* [1981] [128 ITR 294](#), held that since goodwill is a self-generating asset, its transfer would not give rise to a capital gain. The court observed that:

"Goodwill denotes the benefit arising from connection and reputation. The original definition by Lord Eldon in Cruttwell v. Lye [1810] 17 Ves 335, that goodwill was nothing more than 'the probability that the old customers would resort to the old places' was expanded by Wood V.C. in Churton v. Douglas [1859] John 174 to encompass every positive advantage 'that has been acquired by the old firm in carrying on its business, whether connected with the premises in which the business was previously carried on or with the name of the old firm, or with any other matter carrying with it the benefit of the business'. In Trego v. Hunt [1896] AC 7 (HL) Lord Herschell described goodwill as a connection which tended to become permanent because of habit or otherwise. The benefit to the business varies with the nature of the business and also from one business to another. No business commenced for the first time possesses goodwill from the start. It is generated as the business is carried on and may be augmented with the passage of time. "

Likewise, in *Commissioner of Income Tax v. Official Liquidator* 151 ITR 781, the Madras High Court held that "[t]he other circumstances, such as,

the personality and business rectitude of the owners, the nature and character of the business, its name and reputation, its location, its impact on the contemporary market, etc., are all matters to be considered” while evaluating goodwill.

8. The weight attached by the ITAT to the monopoly enjoyed by the assessee in respect of the product manufactured, the continuous functioning - since the business of Sehgal Cables had been taken over by the assessee (thus ‘*the probability that the old customers would resort to the old places*’ adverted to in *Srinivasa Setty* [supra]); the large volume of orders at hand when the collaboration transaction took place, were sufficient basis for valuation. This Court also notices that the AO and CIT (A) did not advert to the report of M/s R. K. Khanna nor cared to call that firm. In the circumstances, it cannot be held that the valuation of goodwill made by the assessee was unreasonable or untenable in law.

9. For the foregoing reasons, the question of law framed in this case is answered against the revenue and in favour of the assessee. The appeal accordingly fails and is dismissed.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

APRIL 13, 2015