IN THE HIGH COURT OF DELHI AT NEW DELHI

I.T.R. NO. 86 OF 1981

Date of Hearing : 5th December, 2001

Date of Decision : 21st December, 2001

THE COMMISSIONER OF INCOME TAX,
DELHI – VI, NEW DELHI ... ... APPLICANT
THROUGH : MR. SANJEEV KHANNA,
MS. PREM LATA BANSAL
ADVOCATES

- VERSUS -

DR. R.L. BHARGAVA, ... RESPONDENT
NEW DELHI THROUGH : NEMO.

CORAM :

THE HON'BLE MR. JUSTICE S.B. SINHA, CHIEF JUSTICE
THE HON'BLE MR. JUSTICE A.K. SIKRI

1. Whether reporters of local papers may be allowed to see the judgment? ✓

2. To be referred to the reporter or not? ✓

S.B. SINHA, C.J.

The following questions have been referred to this court for its opinion by the Income Tax Appellate Tribunal in terms of Section 256(1) of the Income Tax Act, 1961:

> "1. Whether on the facts and in the circumstances of the case, the Tribunal is correct in law in holding that the sum of Rs.2.50 lakhs is not taxable in the assessee's hands being a capital receipt?
>
> 2. Whether on the facts and circumstances of the case, a part of the sum of Rs.2.50 lakhs is in any case taxable as revenue receipt?"

FACTS

The assessee is a well-known paper technologist. During this year, he entered into an agreement with Regal Papers Ltd., for transfer of complete technology which included technical know-how process and secret formulae for manufacture of high gloss cast-coated papers and boards. For this, he received a sum of Rs. 2,50,000/- from M/s. Regal Papers Ltd. The assessee contended that the amount was not taxable as being Capital Expenditure. The Income-tax Officer, however, treated it as Revenue Expenditure and charged it to tax. The Appellate Assistant Commissioner in appeal upheld that as the assessment condition, the assessee had agreed to transfer complete technology including technical know-how processes and secret formulae for the manufacture of high gloss cast-coated papers and boards to M/s. Regal Papers Ltd. and to assist them to establish the plant for efficient production of the products for a period of five years wherefor the company agreed to pay the assessee an amount of Rs. 2,50,000/-, and thus, the amount received, namely, Rs. 2,50,000/- was in the nature of capital receipt. The department went in appeal before the Tribunal. The Tribunal upheld the view taken by the Appellate Asst. Commissioner. It is appropriate to quote from the Tribunal's order: -

> "3. The Learned Departmental Representative submitted before us that the decision in the case of ***Hindustan Forests Co. Ltd., (60 ITR 470)*** was directly applicable but the learned counsel for the assessee, however, stated that it had no application. We are inclined to agree with the learned counsel for the assessee. The matter before us was in substance parting by the assessee with part of his property for a purchase price. The method adopted by the assessee was not a method of trading by which the assessee acquired particular sum of money as part of the profits and gains of the trade. The assessee was a well-known paper technologist and he had agreed to transfer the complete technology to the company with which he had entered into an agreement. The cases cited by the assessee and referred to by the Appellate Assistant Commissioner fully support the assessee's case. For the reasons recorded by the Appellate Assistant Commissioner, and with which we are inclined to agree, we hold that the amount of Rs. 2,50,000/- has to be treated as capital receipt and we accordingly uphold the Appellate Assistant Commissioner's action and reject the Department's appeal."

For the purpose of disposal of the matter, the terms and conditions, embodied

company and the assessee are required to be noticed. The assessee was possess complete technology for making high gloss cast-coated papers and boards including technical know-how, processes and secret formula for the manufacture thereof. The company had obtained a licence to establish a plant for manufacture of high gloss cast-coated papers with a capacity of 1500 tonnes per annum. As it was desirous of setting up a plant thereof, it had approached the assessee for transfer of complete technology including the technical know-how, process of secret formula in relation thereto. In the said Agreement, it was stipulated:

> 5. "The Company shall be entitled to utilize technology including the technical know-how, processes and secret formulas to be imported, supplied and rendered by the Consultant for establishing a plant for the manufacture of the said products in India, provided however that nothing herein contained shall prevent or restrict the company from exporting or selling in foreign countries the said products manufactured by it in India.
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> 6. The Consultant shall not, during the continuance of this agreement himself manufacture or supply the technology to any other person, firm, company or corporate body in India including technical know-how processes and secret formulas for the manufacture of the said products.
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> 7. The Company shall not communicate, code grant, disclose, dispose after give away the technology including technical know-how, processes, secret formula or specifications, formulations, critical conditions and other knowledge, information or date which may have been transferred by way of technology supplied or furnished by the Consultant to the Company under or by virtue of these presents to any person or persons whosoever, without the prior consent in writing of the Consultant. This obligation shall survive the expiration or other sooner determination of this agreement.
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> 8. In consideration of the Consultant agreeing for the transfer of complete technology including the technical know-how, processes and secret formulas to be Company to enable it to establish a plant for the manufacture of the said products and of the Consultant agreeing during the continuance of this agreement not to himself manufacture nor impart, supply or render to any one also the technology, including supply of technical know-how, processes or secret formula for undertaking manufacture in India of the said products, the Company shall pay to the Consultant a sum of Rs.2,50,000/- (Rupees two lacs fifty thousand only) in the following manners:-

25% on the signing of the agreement
25% by 30th April, 1973 and balance
50% by 31st July, 1973

9. This agreement shall become operative from the date of execution hereof and shall remain operational for a period of 5 years therefrom. The parties hereto shall be at liberty to extend the operation of this agreement on such terms and conditions as they may mutually agree upon."

Mr. Sanjiv Khanna, learned counsel appearing on behalf of the Revenue would contend that the amounts received by the assessee in terms of the said agreement, cannot be treated as capital receipt, but must be treated as a revenue receipt.

Learned counsel for the Revenue would further contend that transfer of professional knowledge for a period of five years by way of know-how, cannot be said to be an absolute transfer, particularly in view of the fact that the said agreement was entered into by and between the parties only for a period of five years. Mr. Khanna would urge that by reason of the said agreement, the assessee has not given up his right but thereby only his services were hired by the assessee for a period of five years. He would urge that there had been no parting off or gifting away of the right to use the said technology for all times to come in favour of the company by the assessee and as such, the receipt must be held to be a revenue receipt and not a capital one. Even it is not a case where a right in relation to right for transfer of a goodwill has taken place. In support of the said contention, strong reliance has been placed on Commissioner of Income-Tax, Bombay City-I v. Ralliwolf Ltd., (1983) 143 ITR 720, Commissioner of Income-Tax, Bombay City-I v. Ciba of India Ltd., (1968) 69 ITR 692 and Commissioner of Income-Tax, UP v. British India Corporation Ltd., (1987) 165 ITR 51.

Learned counsel would contend that the matter would have been different had, in consideration of the afore-mentioned transfer of technical know-how, the assessee would have acquired equity shares in a new company. In Commissioner of Income-Tax, Bombay City-I v. Ciba of India Ltd. (supra), what is know-how, has been considered by the apex court in the following terms:

Viscount Simonds and Lords Tucker and Denning in *Evans Medical Supplies Ltd. v. Moriarty*, (1957) 37 Tax Cas. 540. Counsel said that it was ruled in that case by the majority of the House that money received by a tax payer for making available to another person a right to technical "know-how" is liable to be treated as a capital receipt. It must in the first instance be noted that the House of Lords was dealing with the true character of a receipt by a taxpayer who had made technical "know-how" available to another in consideration of a certain payment. The nature of a receipt as capital or revenue is not always determinative of the nature of the outgoing in the hands of the person who pays it. Again the view expressed by the majority of the House does not lay down any principle which may be of value in deciding this case."

The apex court, upon consideration of *Jeffrey v. Rolls Royce Ltd.*, (1962) 40 Tax Cas. 443, *Musker v. English Electric Co. Ltd.*, (1964) 41 Tax Cas.556 and *Evans Medical Supplies ltd.* (supra), held as under:

"In the case in hand it cannot be said that the Swiss Company had wholly parted with its Indian business. There was also no attempt to part with the technical knowledge absolutely in favour of the assessee.

The following facts which emerge from the agreement clearly show that the secret processes were not sold by the Swiss company to the assessee: (a) the licence was for a period of five years, liable to be terminated in certain eventualities even before the expiry of the period; (b) the object of the agreement was to obtain the benefit of the technical assistance for running the business; (c) the licence was granted to the assessee subject to rights actually granted or which maybe granted after the date of the agreement to other persons; (d) the assessee was expressly prohibited from divulging confidential information to third parties without the consent of the Swiss company; (e) there was o transfer of the fruits of research once for all: the Swiss company which was continuously carrying on research had agreed to make it available to the assessee; and (f) the stipulated payment was recurrent dependent upon the sales, and only for the period of the agreement. We agree with the High Court that the first question was rightly answered in favour of the assessee.

The said decision was considered in some details by a Division Bench of the Bombay High Court in Commissioner of Income-Tax, Bombay City-I v. Ralliwolf Ltd. (supra). Therein also, shares had been given in return for the drawings etc and confidential technical information for the establishment of the factory and production of selected tools for manufacturing in India. Upon consideration of various decisions, the court noticed the test

laid down by *British Dyestuffs Corporation (Blackley) Ltd. v. IRC*, (1924) 12 TC 586 wherein it was stated as under:

> "In ascertaining whether the value of the shares in Ralliwolf acquired by the assessee-company should be treated as receipt on revenue account or on capital account, we must apply the well-known and oft-repeated test laid down by Bankes L.J., in *British Dyestuffs Corporation (Blackley) Ltd. v. IRC*, (1924) 12 TC 586 (CA) where, at p.596, it was observed thus:
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> "The real question is, looking at this matter, is the transaction in substance a parting by the company with part of its property for a purchase price, or is it a method of trading by which it acquires this particular sum of money as part of the profits and gains of that trade? For that purpose one has to look at the nature and substance of the transaction and the agreement as a whole."

A question was posed by the Division Bench as to whether know-how can be properly described as a capital asset and upon consideration as to what know-how means, it was held:

> "The other point is that 'know-how', though very naturally looked upon as part of the capital equipment of a trade, is a fixed asset only by analogy and, as it were, by metaphor. The nature of receipts from it depends essentially, I think, upon the transaction out of which they arise and the context in which they are received."

It was further held:

> The legal position on these authorities, therefore, is that know-how is not strictly a fixed asset and the nature of receipts from the know-how would essentially depend upon the transactions out of which the receipts arise and the context in which the receipts are received. If the imparting of know-how is really in the nature of services rendered without anything more, the receipt must be treated as a revenue receipt. But when consideration received for imparting know-how in association with the disposal of a capital asset, then the receipt will have to be treated as a capital receipt. The position, in our view, is admirably summed up by Walton J. in ***John & E. Sturge Ltd. V. Hessel [1975] 51 TC 183*** at ***206 (CA)***, in the following words:
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> "Accordingly, there is no ground for treating it (know-how) in any way differently from the rendering of any other service by the trader who imparts it: if imparted for consideration, the receipt is a trading receipt. However, the disposal is capable of

which nevertheless does represent the disposal of some capital asset of the trader concerned. Thus, if 'know-how' is imparted as part and parcel of the disposal of a branch of the trader's business, as in ***Evans Medical Supplies Ltd. v. Moriarty [1957] 37 TC 540; [1959] 35 ITR 707 (HL)*** or ***Wolf Electric Tools Ltd v. Wilson [1968] 45 TC 326 (Ch D)***, to which I have already referred, then, as Lord Radcliffe said, the moneys paid for the 'know-how' may properly rank as a capital receipt. *Per contra*, if the disposal is not accompanied by the disposal of a branch of the trader's business or some capital asset to which it can properly be regarded as incident, then it appears to me, as it did to my brother Goulding J. in ***Coalite and Chemical Products Ltd. v. Treeby [1971] 48 TC 171 (Ch D)***, that the consideration paid must be a receipt of the trader's trade. That is not to say that there may not be other sets of circumstances in which the disposal of 'know-how' forms but one part which may yet amount when viewed in the round to the disposal of a capital asset, but so far there is none to be found in the books and nobody has suggested any convincing illustrations of any such other transactions."

The Division Bench came to the conclusion that the value of 3625 shares in the Indian Company, Ralliwolf Ltd., of Rs.100/- each issued to the non-resident assessee-company in consideration of supplying the drawings and information, is of capital nature and not of revenue nature.

Yet again, in Commissioner of Income-Tax, UP v. British India Corporation Ltd. (supra), the apex court relied upon its earlier decision in Commissioner of Income-Tax, Bombay City-I v. Ciba of India Ltd. (supra) and other decisions and held:

> "Having regard to the nature of the agreement and having regard to the facts that the organizational set up under the distributorship agreement was to endure for seven years and upon the expiry of the period, the assessee had no relationship with the organization and that the period of agreement between the assessee and distributors was contemporaneous with the agreement between the assessee and Charles Walker under which the assessee became entitled to use the registered trade marks, it must be considered to be a revenue expenditure."

The question again came up for consideration as to whether a business expenditure would be a capital or revenue expenditure in Jonas Woodhead & Sons (India) Ltd. v. Commissioner of Income-Tax, (1997)224 ITR 342 wherein, upon consideration of Empire Jute Co. Ltd. v. CIT, (1980) 124 ITR 1 (SC) and Commissioner of Income-Tax,

> "It would thus appear that the courts have applied different tests like starting of a new business on the basis of technical know-how received from the foreign firm, the exclusive right of the company to use the patent or trademark which it receives from the foreign firm, the payment made by the company to the foreign firm whether a definite one or dependent upon certain contingencies, the right to use the technical know-how of production or the actively even after the completion of the agreement, obtaining enduring benefit for a considerable part on account of the technical informations received from a foreign firm, payment whether made "once for all" or in different instalments co-relatable to the percentage of gross turnover of the product to ultimately find out whether the expenditure or payment thus made makes an accretion to the capital asset and after the court comes to the conclusion that it does so, then it has to be held to be a capital expenditure. As has been held by this court and already indicated in *Alembic Chemical Works' case* (1989) 177 ITR 377 no single definitive criterion by itself could be determinative and, therefore, bearing in mind the changing economic realities of business and the varieties of situational diversities the various clauses of the agreement are to be examined. But in the case in hand the High Court having considered the different clauses of the agreement and having come to the conclusion that under the agreement with the foreign firm what was set up by the assessee was a new business and the foreign firm had not only furnished information and the technical know-how but rendered valuable services in setting up of the factory itself and even after the expiry of the agreement there is no embargo on the assessee to continue to manufacture the product in question, it is difficult to hold that the entire payment made is revenue expenditure merely because the payment is required to be made at a certain percentage of the rates of the gross turnover of the products of the assessee as royalty. In our considered opinion, in the facts and circumstances of the case the High Court was fully justified in answering the reference in favour of the Revenue and against the assessee."

In the afore-mentioned backdrop, the question raised before this court has to be answered.

Frankfurter, J said "there is no surer way to misread a document than to read it literally" in *Massachusetts B. & Insurance Co. v. U.S.*, (1956) 352 US 128, at p.138.

A contract or an agreement, as it is well known, must be construed having regard to the intention of the parties thereto. Such intention must be gathered from the language used therein. From the said agreement dated 14th December 1972, it appears that possession of complete technology for making high gloss cast quoted papers and boards under the consultant was accepted. The assessee was approached by the company for transfer of

(1) of the said agreement categorically states that the Consultant would transfe... technology. The said transfer of technology is not an absolute one as the Consultant could himself use or transfer the same after a period of five years. In addition to such transfer, the assessee was to render services, which had been enumerated in para 2 thereof. The company of course had the absolute right to utilize technology including the technical know-how, process and secret formula to be supplied and rendered by the assessee, but such entitlement to utilize the technology is confined to five years only. Clause 6 provides for a negative covenant in terms whereof the assessee was precluded from himself manufacturing or supplying the technology to any other person during continuance of the said agreement only for a period of five years. It is important to note that the company was also not to transfer the said technology to any other person without the prior consent in writing of the assessee. The entire amount of consideration was to be paid within a period of seven months. It is, therefore, not difficult to infer that by reason of the said agreement, the services of the Consultant had also been hired for a period of five years.

The agreement has to be read as a whole. So read, it is clear that there had been no absolute parting by the assessee's technical know-how to the company. The assessee was also required to render various services to the company. Such services rendered shall also form part of the consideration. In this case, consideration had been received for imparting know-how not in association with the disposal of a capital asset and thus, the receipt in our opinion should be treated as a revenue receipt.

For the reasons afore-mentioned, we are of the opinion that the question sent to this court for its opinion by the Income Tax Appellate Tribunal must be answered in the negative in favour of the Revenue and against the assessee.

CHIEF JUSTICE

A.K. SIKRI, JUDGE