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

Judgment reserved on : 28.08.2008
% Judgment delivered on : 17.12.2008

+ **ITR 139/1988 AND ITR NO. 202/1989**

COMMISSIONER OF INCOME TAX ..... APPELLANT

versus

J K SYNTHETICS LIMITED …….RESPONDENT

Advocates who appeared in this case:
For the Appellant : Ms Prem Lata Bansal, Advocate
For the Respondent : Mr P N Monga and Mr Manu Monga, Advocates

CORAM :-
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. These references have been made at the instance of the Revenue under Section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act'). A Division Bench of this court, by an order dated 7.1.2008 passed in ITR No. 139/1988 and an order dated 19.5.2008 passed in ITR No. 202/1989, framed the following questions of law, respectively:-

ITR No. 139/1988

"Whether the ITAT was correct in law and on facts in

> interest paid thereon for belated payment was allowable as revenue expenditure?"
>
> ITR No. 202/1989
>
> "Whether on the facts and in the circumstances of the case and having regard to the agreements that the Assessee company entered into with the Italian and West German companies, the payments made of Rs 30,57,499 to M/s Technimont and Rs 3,48,033 to M/s IWKA, West Germany was allowable as revenue expenditure and not as capital expenditure?"

2. The issues involved in the two references are inter-related as they pertain to the same Licence and Technical Assistance Agreement (in short 'the agreement') which would be evident shortly, from the facts detailed out hereinafter. The questions of law on which our opinion is sought, are ubiquitous and perennial in nature, in as much as, whether an expenditure undertaken by an assessee would be in the nature of capital or revenue expenditure, having regard to the provisions of Section 37 of the Act. There is, undoubtedly a plethora of judgments, both of the Supreme Court and of various High Courts on this aspect of the matter. The difficulty which is encountered often, is to slot the facts of a particular case to the law and the principles enunciated by Courts in the country. Fortunately, in this particular case, there has been no submission made by the learned counsel for the parties as to any perversity in the findings recorded by the authorities below. The counsel who appeared before us i.e, Ms Prem Lata Bansal for the Revenue and Mr P N Monga for the assessee, laid stress on what, according to them, ought to have followed logically upon

appreciation of the facts on record, as also from, reading of various clauses of the agreement to which, reference is made.

3. In this context it would, therefore, be necessary to first record the facts as found by the authorities below:-

4. On 29.04.1974, the assessee entered into an agreement with one, M/s Technimont, Italy for manufacture of Acrylic Fibre. The assessee also entered into another agreement with one, M/s IWKA, a West German entity. The date of agreement with M/s IWKA is not set out either in the statement of case or in the orders of the authorities below. It is important to note that the agreement with M/s Technimont referred to another company by the name of Montefibre which, in turn, was a successor of one, M/s Chatillon. M/s Montefibre as per the agreement, was the owner of knowhow and patent rights for the design, erection, operation and production of Acrylic fibre. Importantly, M/s Technimont which had a licence for use of know-how of patent rights owned by Montefibre had the right to sub-license the same to other parties. It is in this contextual background that an agreement was entered into between M/s Technimont and the assessee.

5. Under the agreement, the assessee was required to pay a total sum of 623 million Italian Liras which, at the relevant time, amounted to Rs 54,54,794/- in consideration for the use of know-how, basic design engineering and technical assistance. The point to be noted is that the total amount of 623 million Italian Liras or the equivalent i.e.

Rs 54,54,794/- was paid by the assessee for three different aspects of the same transaction. This basic fact emerges, as noted by the authorities below, from a reading of Article 9 of the agreement.

> "9.1 The fees to be paid by JK to TEC for the use of the KNOW HOW in India, basic design engineering and technical assistance provided for herein is 623 (six hundred and twenty three) million Italian Liras consisting of:
>
> *a)* 186,500,000 : one hundred eighty six million five hundred thousand) Italian Lira for the *grant of the process and know-how licence under Article 2;*
>
> b) 250,000,000 (two hundred and fifty million) Italian lira for the *supply of the know-how and basic design engineering as referred to in Article 3;*
>
> c) 186,500,000 (one hundred eighty six million five hundred thousand Italian lira for the *supply of technical assistance and continuous know-how in Italy, including training of JK's personnel in Italy, as referred to in Article 5.*
>
> The amounts indicated under (a)/(b) and (c) are firm and not subject to escalation."

6. Out of a total consideration of 623 million liras, the assessee on its own treated a sum of 250 million liras expended towards supply of basic design engineering of the plant as capital expenditure, while the remaining 373 million liras which, at the relevant point of time was equivalent to Rs 30,57,499, spent on grant of process and know-how licence, and for supply of technical assistance and, continuous know-how including training of company's personnel, in Italy, as revenue expenditure. In short, two identical sums of money amounting to 186.5 million liras each, amounting in all to 373 million liras, towards grant of process and know-how licence, as well as, technical assistance and continuous know-how, in

the assessee, as revenue expenditure, in its return for, assessment year 1976-77.

7. The Assessing Officer disallowed the claim made by the assessee and treated the sum of Rs 30,57,499/- to be paid to M/s Technimont and Rs 3,48,003 to IWKA, as capital expenditure, broadly, on the following grounds:-

(i) even though the erection of the Acrylic plant, in respect of which an agreement had been entered into with M/s Technimont had commenced in 1975, it had not been completed, therefore, the business of Acrylic division had not come into existence;

(ii) in view of the above, no distinction could have been drawn by the assessee in respect of liability incurred under the agreement with M/s Technimont, towards basic engineering design, which was capitalized, and that which was incurred towards acquisition of grant of process and know-how licence, and for supply of technical assistance and continuous know-how, as well as, towards training of assessee's personnel, in Italy;

(iii) the entire expenditure had been incurred for setting up of the plant which had not commenced production and hence, had to be treated as capital expenditure;

(iv) the expenditure in issue also fulfilled the test of enduring benefit, in as much as, the expenditure incurred for acquisition of 'process know-how' and 'technical expertise' of personnel who would look after the Acrylic fibre division once it commenced manufacture will result in enduring benefit to the assessee and hence, result in an acquisition of an asset;

(v) the process/know-how involved certain secret formula which came into the possession of the assessee; thus the expenditure in issue being an integral part of setting up of the Acrylic fibre division will result in an acquisition of a benefit of a permanent nature to the assessee; and

(vi) technical assistance and training at this stage of setting up of the Acrylic fibre division was distinct from an exchange, training or refresher course which is normally attended by the employees for updating their knowledge. It is a case of permanently acquiring a technique, which will, result in setting up the plant and using it in future.

8. On the same basis, the Assessing Officer also disallowed the treatment by the assessee as revenue expenditure, the sum of Rs 3,48,033/- incurred for manufacture of machines under the agreement entered into with M/s IWKA.

9. Pertinently, the Assessing Officer also disallowed depreciation and rebate on the sum of Rs 30,57,499/- incurred in connection with the grant of process, know-how and technical assistance with respect to the Agreement entered into with M/s Technimont. However, depreciation

was allowed on Rs 3,48,033/- incurred in connection with the Agreement entered into with M/s IWKA.

10. The assessee being aggrieved, filed an appeal with the Commissioner of Income Tax (Appeals) [hereinafter referred to as the 'CIT(A)']. The CIT(A) based on the material placed on record, and upon perusal of the judgments cited before him, examined the nature of the expenditure in the background of the following question posed by him, which according to him arose for determination. According to the CIT(A), in our opinion rightly, the basic issue which arose for determination was whether the payments made by the assessee were for acquisition of an asset or, for a use of technical knowledge and information for running the business during the period of the Agreement and for a mere user of patents and trademark. If, what had been acquired under the Agreement by the assessee, was merely a licence for use of technical knowledge of the foreign collaborator, the payment would not bring into existence an asset of an enduring nature and, therefore, ought to be regarded as an expenditure incurred by the assessee for the purposes of running the business during the period of the Agreement.

10.1 In the background of the aforesaid poser, the CIT(A) found the following facts:-

(i) the ownership of the technical know-how vested with M/s Montefibre. M/s Technimont with whom the assessee had entered into an agreement, had only a right to licence the said know-how and patent rights;

(ii) the assessee had not acquired any exclusive rights. It had on the contrary acquired a ‘non exclusive’ and a ‘non-transferable’ licence to use the process.

(iii) under Article 8 of the Agreement, the assessee could not use the process or know-how supplied by M/s Technimont for construction of any new plant either in India or in any other country. The assessee was, as a matter of fact prohibited from using the process for setting up or expansion of a new plant without the say of M/s Technimont. As a matter of fact, under Article 15, the assessee could not use the process and know-how for any other purpose except to the extent permitted by M/s Technimont under Article 8 of the Agreement;

(iv) the assessee was required to keep the ‘process and know-how’ secret and confidential. The assessee was prohibited from revealing the process to a third party without the prior consent of M/s Technimont;

(v) the assessee was bound under Article 15.4 in respect of obligations undertaken, for a period of 12 years;

(vi) M/s Technimont was required to provide technical assistance for a period of 7 years; and

(vi) ***technical assistance which was provided by M/s Technimont for the purposes of construction and setting up of the plant was not only paid separately as per Articles 5.1, 5.2, 5.3, 5.5, 5.5.1(a) and 5.5.2(2) but was also capitalized alongwith the payments for basic design engineering. The only item which the assessee claimed as revenue, related to technical assistance for training of its personnel and, in connection with the day to day running of the plant for the period provided under the agreement i.e 7 years***.

10.2 Based on the aforesaid findings, the CIT (A) reversed the view taken by the Assessing Officer and allowed the liability incurred as a deductible expenditure, both, with respect to, M/s Technimont and M/s IWKA by treating them as revenue expenditure.

11. Aggrieved by the order of the CIT(A), the matter was carried in appeal to the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal). The Tribunal sustained the view taken by the CIT(A) with regard to payments made to M/s Technimont, as well as, M/s IWKA. In arriving at the said conclusion, the Tribunal based its decision on the findings and reasons recorded hereinbelow:-

(i) M/s Technimont was not the owner of the technical know-how. The technical know-how belonged to another company, namely, M/s Montefibre. M/s Montefibre owned both the know-how, as well as, patent rights. M/s Technimont had only a right to licence the said know-how. In other words, M/s Technimont was only the licensee of the know-how of patent rights owned by Montefibre;

(ii) the grant of licence by Montefibre to M/s Technimont was 'non-exclusive', and irrevocable, as well as, permanent which, in other words, gave M/s Technimont the right to sub-lease or sub-licence the right under its licence to any third party and, in order to, enable it to do so, M/s Montefibre had to grant to M/s Technimont a licence which was permanent and irrevocable. ***The assessee had acquired the technical know-how for a limited period of 7 years. The department's submission that the assessee had acquired know-how for unlimited period was factually incorrect;***

(iii) the assessee under the Agreement had acquired only an ***access*** to information. The assessee had, in fact, acquired know-how which was related to process of manufacture and no trade name or trademark had been acquired by the assessee; and

(iv) the payments under the Agreement were made by the assessee for the purposes of acquiring technical knowledge to erect a factory and thereafter to operate and train the personnel of the assessee; and hence, are payments, which cannot be categorized as those resulting in an enduring advantage.

11.1 Importantly, on the aspect whether payments related to a new business or an existing business; it noted that the CIT(A) had pointed out that the payments are to be regarded as payment for extension of existing business, and that the departmental representative had fairly conceded this point, resultantly, no arguments were addressed on the said issue. Pertinently, it returned a finding of fact that the records demonstrated, that the products, were already being manufactured by the assessee, and hence, the payments made by the assessee to increase its profitability by applying a new method of manufacture or process of manufacture could not be said to be on capital account.

12. Aggrieved by the aforesaid judgment of the Tribunal, the Commissioner of Income Tax filed an application before the Tribunal under Section 256(2) of the Act for referring questions of law to this Court. This application was allowed and the above-mentioned questions were referred to us.

13. In support of the case of the Revenue, Ms Prem Lata Bansal, Advocate has submitted that a holistic reading of the Agreement would show that the entire transaction which, even though divided into three segments, is a composite whole and is inseparable. It is submitted by the learned counsel for the Revenue, that it is inexplicable in the facts of this case that if, expenditure incurred by the assessee towards basic design engineering for setting up of the plant is treated by the assessee as capital in nature then, how is that, the remaining part of the expenditure towards acquisition of process know-how and training of personnel is treated as revenue. The learned counsel for the Revenue has buttressed her

submissions by laying stress on the fact that what has been acquired by the assessee is know-how which is unlimited in span of time and, is 'permanent' and irrevocable in nature. She submits, in that sense, the impugned expenditure both, in respect of, M/s Technimont and M/s IWKA has resulted in a benefit of an enduring nature and hence, was required to be treated as capital expenditure and not as revenue expenditure as claimed by the assessee.

13.1 She also submitted that what the assessee was manufacturing was an entirely new product. In support of her submissions Ms Prem Lata Bansal, the learned counsel for the Revenue cited the following authorities:-

(i) Assam Bengal Cement Co Ltd vs CIT: (1955) 27 ITR 34 (SC)

(ii). Scientific Engineering House (P) Ltd vs CIT: (1986) 157 ITR 86 (SC)

(iii). CIT vs Warner Hindustan Limited: (1986) 160 ITR 217 (AP)

(iv). Jonas Woodhead & Sons (India) Ltd vs CIT: (1997) 224 ITR 342 (SC)

(v). CIT vs Southern Structurals Ltd: (1977) 110 ITR 890 (Mad)

(vi). Ram Kumar Pharmaceutical Works vs CIT: (1979) 119 ITR 33 (All)

(vii). CIT vs. Toshniwal Electrodes Manufacturing Co Ltd: (1991) 192 ITR 209 (Bom)

(viii). CIT vs Polyformalin (P) Ltd (1986) 161 ITR 36 (Ker)

14. As against this, the learned counsel for the assessee has basically relied upon the findings returned by the CIT(A) and the Tribunal. It is the

acquired, in the instant case, was only a licence for use of process and know-how. The payments made by the assessee did not result in an acquisition of either an asset or a benefit of an enduring nature. It was contended by the learned counsel for the assessee that the liability towards the said expenditure was incurred for the expansion of the assessee's business. He contended that the assessee was already in the same line of business as it had been manufacturing synthetic fiber since 1962. According to the learned counsel for the assessee, no new business had been set up by him as found by the authorities below. The liability towards the impugned expenditure was incurred by the assessee to run its business in a more efficient manner, so as to, enhance its profitability. Mr P N Monga, also contended, that this was also true of the expenditure incurred towards training of employees by M/s Technimont. In support of his submission, Mr P N Monga, Advocate relied upon the following judgments:-

(i). CIT vs Ciba of India Ltd.: (1968) 69 ITR 692 (SC)

(ii). Mysore Kirloskar Ltd vs CIT : (1978) 114 ITR 443 (Kar)

(iii). CIT vs Tata Engineering & Locomotive Co Pvt Ltd : (1980) 123 ITR 538 (AP)

(iv). Praga Tools Ltd vs. CIT: (1980) 123 ITR 773 (AP)

(v). Hylam Ltd vs CIT: (1973) 87 ITR 310 (AP)

(vi). CIT vs SLM Maneklal: (1977) 101 ITR 133

(vii). CIT vs IAEC Pumps Ltd: (1998) 232 ITR 316 (SC)

(viii). CIT vs Eicher Motors Ltd: (2007) 293 ITR 464 (MP) (ix). Sriram Refrigeration Industries Ltd vs. CIT: (1981) 127 ____ 746 (Del)

(x). CIT vs Mihir Textiles: (2006) 287 ITR 232 (Guj.)

(xi). Sriram Pistons & Rings Ltd vs CIT: (2008) 177 Texmann 81

(xii). Bajaj Tempo Ltd vs CIT: (1994) 207 ITR 1017 (Bom)

(xiii). CIT vs MRF: (1983) 144 ITR 678 (Mad)

(xiv). CIT vs Aquapump Industries: (1996) 218 ITR 427 (Mad)

15. Having heard the learned counsel for both, the Revenue, as well as, the assessee and perused the records, we are of the view that the references deserve to be answered in favour of the assessee, for the reasons given hereinafter:-

DISCUSSION OF SUPREME COURT CASES CITED BEFORE US

16. ***Assam Bengal Cement Co Ltd v. Commissioner of Income Tax, West Bengal,*** ***(1955) 27 ITR 34***: In this case, the assessee acquired from the Government of Assam, for the purpose of carrying on the manufacture of cement, a lease of lime stone quarries for a period of 20 years in consideration of payment of yearly rents and royalties. The assessee, in addition to rents and royalties, agreed to pay two further sums under the covenants contained in clauses 4 & 5 of the lease in issue as 'protection fee'. The 'protection fee' was paid in lieu of lessor giving an undertaking not to grant lease, permit or a prospecting licence with regard to lime stone to any other party without a condition that no

limestone could be used for the manufacture of cement. In this context, the Supreme Court, after considering a bevy of authorities, affirmed the principles enunciated by the full Bench of the Lahore High Court in <u>***Benarsidas Jagannath in Re:***</u> ***(1947) 15 ITR 185.*** The Supreme Court encapsulated the essence of the judgement of the Full Bench of the Lahore High Court in its observations made at page 45 to 47. These being apposite are extracted hereinbelow:-

> ***"…..This synthesis attempted by the Full Bench of the Lahore High Court truly enunciates the principles which emerge from the authorities. In cases where the expenditure is made for the initial outlay or for extension of a business or a substantial replacement of the equipment, there is no doubt that it is capital expenditure. A capital asset of the business is either acquired or extended or substantially replaced and that outlay whatever be its source whether it is drawn from the capital or the income of the concern is certainly in the nature of capital expenditure. The question however arises for consideration where expenditure is incurred while the business is going on and is not incurred either for extension of the business of for the substantial replacement of its equipment. Such expenditure can be looked at either from the point of view of what is acquired or from the point of view of what is the source from which the expenditure is incurred. If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset of advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source***

concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or revenue expenditure. The source or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. It is was part of the fixed capital of the business it would be of the nature of capital expenditure and if it was part of its circulating capital it would be of the nature of revenue expenditure. These tests are thus mutually exclusive and have to be applied to the facts of each particular case in the manner above indicated. It has been rightly observed that in the great diversity of human affairs and the complicated nature of business operations it is difficult to lay down a test which would apply to all situations. One has therefore got to apply these criteria, one after the other from the business point of view and come to the conclusion whether on a fair appreciation of the whole situation the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure in which latter event only it would be a deductable allowance under section 10(2)(xv) of the Income-tax Act. The question has all along been considered to be a question of fact to be determined by the Income-tax authorities on an application of the broad principles laid down above and the courts of law would not ordinarily interfere with such findings of fact if they have been arrived at on a proper application of those principles……

The expression "once and for all" used by Lord Dunedin has created some difficulty and it has been contended that where the payment is not in a lump sum but in instalments it cannot satisfy the test. Whether a payment be in a lump sum or by instalments, what has got to be looked to is the character of the payment. A lump sum payment can as well be made for liquidating certain recurring claims which are clearly of a revenue nature, and on

which is prima facie an expenditure of a capital nature may as well be spread over a number of years and yet retain its character as a capital expenditure. (Per Mukherjea, J., in Commissioner of Income-tax v. Piggot Chapman & Co. ([1949] 17 I.T.R. 317, 329)). The character of the payment can be determined by looking at what is the true nature of the asset which has been acquired and not by the fact whether it is a payment in a lump sum or by instalments. As was otherwise put by Lord Greene, M.R., in Henriksen (Inspector of Taxes) v. Grafton Hotel Ltd. ([1942] 2 K.B. 184) :

"The thing that is paid for is for a permanent quality although its permanence, being conditioned by the length of the term, is shortlived. A payment of this character appears to me to fall into the same class as the payment of a premium on the grant of a lease, which is admittedly not deductible".

The case of Tata Hydro-Electric Agencies Ltd., Bombay v. Commissioner of Income-tax, Bombay Presidency and Aden ((1937) L.R. 64 I.A. 215) affords another illustration of this principle. It was observed there :-

"If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business."

The expression "once and for all" is used to denote an expenditure which is made once and for all for procuring an enduring benefit to the business as distinguished from a recurring expenditure in the nature of operational expenses.

The expression "enduring benefit" also has been judicially interpreted. Romer, L.J., in Anglo-Persian Oil Company, Limited v. Dale ([1932] 1 K.B. 124, 146) agreed with Rowlatt, J. that by enduring benefit is meant enduring in the way that fixed capital endures :

"An expenditure on acquiring floating capital is not made with a view to acquiring an enduring asset. It is made with a view to acquiring an asset that may be turned over in the course of trade at a comparatively early date."

Latham, C.J., observed in Sun Newspapers Ltd. & Associated Newspapers Ltd. v. Federal Commissioner of Taxation ((1938) 61 C.L.R. 337, 355) :

"When the words 'permanent' or 'enduring' are used in this connection it is not meant that the advantage which will be obtained will last for ever. The distinction which is drawn is that between more or less recurrent expenses involved in running a business and an expenditure for the benefit of the business as a whole"...... e.g. ...... - "enlargement of the goodwill of a company." - "permanent improvement in the material or immaterial assets of the concern."

To the same effect are the observations of Lord Greene, M. R. in Henriksen (H. M. Inspector of Taxes) v. Grafton Hotel Ltd. ((1942) 24 T. C. 453) above referred to.

These are the principles which have to be applied in order to determine whether in the present case the expenditure incurred by the company was capital expenditure or revenue expenditure. ***Under clause 4 of the deed the lessors undertook not to grant any lease, permit or prospecting licence regarding limestone to any other party in respect of the group of quarries called the Durgasil area without a condition therein that no limestone shall be used for the manufacture of cement. The consideration of Rs. 5,000 per annum was to be paid by the company to the lessor during the whole period of the lease and this advantage or benefit was to endure for the whole period of the lease. It was an enduring benefit for the benefit of the whole of the business of the company and came well within the test laid down by Viscount Cave.*** *It was not a lump sum payment but was spread over the whole period of the lease and it could be urged that it was recurring payment. The fact however that it was a recurring payment was immaterial, because one had got to look to the nature of the payment which is its*

> *turn was determined by the nature of the asset which the company had acquire.* ***The asset which the company had acquired in consideration of this recurring payment was in the nature of a capital asset, the right to carry on its business unfettered by any competition from outsiders within the area. It was a protection acquired by the company for its business as a whole. It was not a part of the working of the business but went to appreciate the whole of the capital asset and make it more profit yielding.*** *The expenditure made by the company in acquiring this advantage which was certainly an enduring advantage was thus of the nature of capital expenditure and was not an allowable deduction under section 10(2)(xv) of the Income-tax Act."*

16.1 While applying the aforesaid principle to the facts of the case being considered by us, one will have to keep in mind the nature of the asset acquired and the resultant benefit acquired by virtue of the payment. A close scrutiny would show it is distinguishable from the facts of the present case. In ***Assam Bengal Cement Co Ltd*** *(supra),* payments were made as 'protection fee' in terms of clauses 4 and 5 of the lease agreement, whereby the lessor had undertaken not to grant any lease, permit or prospecting licence regarding lime stone to any other party in respect of certain quarries without the condition, that the limestone would not be used for manufacture of the cement within the assessee's area. The 'protection fee' even though paid annually enured to the benefit of the assessee for whole period of the lease. It is in this context the Court came to the conclusion that it was an enduring benefit, for the benefit of the whole business of the company, and came, well within the test laid down by Viscount Cave. The fact that 'protection fee' was not a lump sum payment but a recurring payment was immaterial because one had to look at the nature of the payment which, in turn, was determined by the nature of the asset which the assessee had acquired. The assets which the assessee had acquired in consideration of this recurring payment was in the nature of a capital asset i.e. a right to carry on its business unfettered by any competition from outsiders within the area. *It was a protection acquired by the company for its business as a whole. It was not a part of the working of the business but went on to appreciate the whole of the capital asset and make it more profit yielding.* The Court thus concluded that the expenditure incurred by the assessee in acquiring this advantage was certainly an enduring advantage and hence, in the nature of capital expenditure.

17. ***Commissioner of Income-Tax, Bombay City I v. CIBA of India Ltd* (1968) 69 ITR 692**. In this case, the assessee was an Indian subsidiary of a Swiss Company. The assessee was engaged in the development, manufacture and sale of medical and pharmaceuticals preparations. The parent Swiss company entered into an agreement with the assessee which, inter alia provided, that in consideration of payment in the form of technical and research contribution for the use of its Indian patent and trade marks, it would obtain, scientific and technical assistance. Under the agreement, the assessee was prohibited

any confidential information received under the agreement, in particular, data connected with the manufacturing process. The Swiss company, under the agreement, granted to the assessee full and sole right and a licence in the territory of India, in respect of, the patents listed in the Schedule accompanying the agreement, so as to enable the assessee to make use of, exercise rights, and vend the inventions referred to therein, as also, the use of trade mark set out in the second schedule accompanying the agreement, in the territory of India. By virtue of clause 3, the sole right of the assessee under the Swiss company's Indian patent was limited to existing licences granted by the Swiss company to third parties. Furthermore, a right was also reserved in favour of the Swiss company to conclude other licence agreements with third parties. In consideration of this, the assessee was to pay half yearly, a certain percentage of the contributions of the total of the net sale price of all the pharmaceutical products manufactured and/or sold by the assessee. In the background of these broad facts, Mr Justice J.C. Shah (as he then was) speaking for the court made the following crucial observations on page 701:-

> *"....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:***

> ***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 may be 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 no transfer of the fruits of research once for all: the Swiss Company which was continuously carrying on research and 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."***

18. In ***Empire Jute Co Ltd v. Commissioner of Income Tax;*** ***(1980) 124 ITR 1***, the facts briefly were that the assessee was engaged in the business of manufacture of jute. The assessee was the member of the Jute Mills Association which was formed with the object of, inter alia, protecting the trade of its members, by regulating the production of the mills, run by its members. In pursuance thereto, the members had entered into a working time agreement, whereby the number of working hours per week for which the mills were entitled to work their 'looms' was restricted. In this background, the assessee had purchased 'looms hours' from four other mills. The issue which arose for consideration of the court was whether the money expended by the assessee for purchase of "loom hours" was revenue or capital expenditure. The observations of the Supreme Court being apposite are extracted hereinafter:-

> *".....The Revenue, however, contended that by purchase of loom hours the assessee acquired a right to produce more than what it otherwise would have been entitled to do and this right to produce additional quantity of goods constituted addition to or augmentation of its profit making structure. The assessee acquired the right to produce a larger quantity of goods and to earn more income and this, according to the Revenue, amounted to acquisition of a source of profit or income which though intangible was never-the-less a source or "spinner" of income and the amount spent on purchase of this source of profit or income, therefore, represented expenditure of capital nature.* ***Now it is true that if disbursement is made for acquisition of a source of profit or income, it would ordinarily, in the absence of any other countervailing circumstances, be in the nature of capital expenditure.*** *But we fail to see how it can at all be said in the present case that the assessee acquired a source of profit or income when it purchased loom hours. The source of profit or income was the profit making apparatus and this remained untouched and unaltered. There was no enlargement of the permanent structure of which the income would be the produce or fruit.* ***What the assessee acquired was merely an advantage in the nature of relaxation of restriction on working hours imposed by the working time agreement, so that the assessee could operate its profit-earning structure for a longer number of hours. Undoubtedly, the profit earning structure of the assessee was enabled to produce more goods, but that was not because of any addition or augmentation in the profit making structure, but because the profit making structure could be operated for longer working hours. The expenditure incurred for this purpose was primarily and essentially related to the operation or working of the looms which constituted the profit earning apparatus of the assessee.*** *It was an expenditure for operating or working the looms for longer working hours with a view to producing a larger quantity of goods and earning more income and was, therefore, in the nature of revenue expenditure."*

18.1 The other important observation which the Supreme Court made in this, was, that there may be cases where the test of enduring benefit may breakdown even though expenditure incurred may result in revenue account. The Supreme Court observed that the natu... advantage had to be viewed in a commercial sense and it was only when the advantage was in the capital field that the expenditure would be disallowable on application of the said test. *It further went on to say that if the advantage consists merely in facilitating assessee's trading operation or enabling the management to carry on business more efficiently and profitably while leaving the fixed asset untouched the expenditure would be on revenue account even though the advantage may endure for an indefinite period.* The Supreme Court observed that the test of enduring benefit is, therefore, not a conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case. At page 13 of the said report, the Supreme Court enunciated an important principle by approving the dictum laid down by Dixon J., ***Hallstorm's Property Ltd v. Federal Commissioner of Taxation*** ***(72 CLR 634)***, which reads as follows:-

> ***"When dealing with cases of this kind where the question is whether expenditure incurred by an assessee is capital or revenue expenditure, it is necessary to bear in mind what Dixon, J. said in Hallstorm's Property Limited v. Federal Commissioner of Taxation 72 C.L.R. 634 : "What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process." The question***

> ***necessity or expediency. If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure…."***

19. ***Scientific Engineering House Pvt Ltd v. CIT, Andhra Pradesh; (1985) 157 ITR 86.*** In this case, the assessee, who was, in the business of manufacture of scientific instruments and apparatus entered into two separate collaboration agreements with a Hungarian Company, one for the manufacture of theodolites and other for the manufacture of microscopes. The terms of both agreements were identical. Under the terms of the said agreement, the foreign collaborator agreed that in consideration of Rs 80,000/-, in each case, it would supply to the assessee technical know-how required for the manufacture of the said instruments. In order to enable the assessee to manufacture the instruments in India, the foreign collaborator in terms of clause 3 of the said agreement, agreed to render "documentation service" by supplying to the assessee an updated, correct and complete set of each of the documents which included manufacturing drawings and full processing documents, as also, complete set of specifications of raw-material, lay-out of manufacturing process and know-how, sample drawings and casting drawings. The assessee had claimed before the Income Tax Authorities that the payment made under the said agreement to the

foreign collaborator resulted in acquisition of depreciable assets. The question which came up for consideration was whether monies spent by the assessee for acquiring, from the foreign collaborator, 'documentation service', whereby the assessee acquired technical know-how requisite for the purpose of manufacturing the instruments, in question, were payments on capital account and hence, brought into existence a depreciable asset. The Supreme Court observed that the answer to the question was dependent on a proper interpretation of the terms and conditions of the two agreements. After examining the terms of the agreement it disagreed with the view expressed by the Tribunal and the High Court by observing as follows:-

> *".....Having regard to the rival contentions that were urged before us, it is clear that two questions really arise for determination in the case. The first is whether the 'documentation service' (supply of 5 complete sets of documents) agreed to be and actually rendered by the foreign collaborator to the assessee under the two agreements was incidental to the other services contemplated therein or whether it was the principal service for which mainly the payment of Rs 1,60,000 was made by the assessee as a result whereof the assessee acquired all the technical know-how requisite for the purpose of manufacturing the instruments in question? And secondly whether the said expenditure, which was entirely of a capital nature, brought into existence a depreciable asset? The answer to the former question depends upon the proper interpretation of the terms and conditions of the two agreements while the answer to the latter depends upon whether a capital asset like the technical know-how acquired in the shape of drawings, designs, charts, plans, processing data and other literature which formed the basis for the*

would fall within the wide and inclusive definition of 'plant' given in Section 43(3) of the Income Tax Act, 1961.

Turning to the first question, having regard to the relevant terms of the two agreements we find it very difficult to accept the view concurrently expressed by the Tribunal and the High Court that the 'documentation service' undertaken to be rendered by the foreign collaborator to the assessee was incidental or that the payment of Rs. 1,60,000 could not be regarded as being mainly for and by way of purchase price of the drawings, designs, charts, plans and all the documents comprised in 'documentation service' specified in Clause 3 of the agreements. Such a view as will be shown presently runs counter to the express language contained in Clauses 3 and 6 of the agreements……

The tenor of the agreements clearly shows that the various documents such as drawings, designs, charts, plans, processing data and other literature included in documentation service, the supply whereof was undertaken by the foreign collaborator, more or less formed the tools by using which the business of manufacturing the instruments was to be done by the assessee and for acquiring such technical know-how through these documents lump sum payment was made. In other words, the payment of Rs. 80,000 under each of the agreements was principally for rendition of 'documentation service'."

19.1 It is obvious that the result of the case pivoted on the finding that the payments made by the assessee to the foreign collaborator was not for services which were incidental to the principal service, which was, for the purchase of drawings, designs, charts and plans required for the purpose of manufacture of instruments, in question i.e. theodolites and microscopes. The Supreme Court rejected the contrary view of both the Tribunal and the High Court, whereby they held that the payments were

Court was called upon to decide was whether the documentation provided to the assessee by the foreign collaborator would come within the definition of a 'plant' within the meaning of Section 43(3) of the Act. As is obvious, the fact situation of this case is different to the issue under consideration in the present appeal and hence, would not be applicable.

20. ***<u>Commissioner of Income Tax v. I.A.E.C. (Pumps) Ltd;</u> (1998) 232 ITR 316.*** The question which the court was called upon to consider was "whether amount paid by the respondent-assessee to the foreign collaborator for the technical know-how is capital or revenue". The Supreme Court sustaining the view of the Madras High Court and cited with approval the following observations contained in the judgment of the Madras High Court.

> *"……Having regard to the said Clauses, we are clearly of the opinion that the Tribunal was right in its conclusion that the whole of the amount paid by the assessee constitutes revenue expenditure and has to be allowed as a deduction. From the terms of the agreement referred to above, the following facts are clear;*
>
> ***(1) The agreement itself provides that what was granted by Aturia to the assessee is merely a license to use its patents and designs exclusively in India;***
>
> ***(2) The agreement is for a duration of 10 years with the parties having the option to extend the agreement or renew the same, subject to the approval of the Government of India;***
>
> ***(3) During the currency of the agreement, Aturia had***

> ***consent of the assessee and to make available to the assessee any improvements, modifications and additions to designs;***
>
> ***(4) Aturia has also undertaken to enable the assessee to defend any counterfeit by others and also had undertaken to share the expenses with reference thereto;***
>
> ***(5) The assessee shall not disclose to third parties any of the documents made available by Aturia to the assessee without having received a written authorisation from Aturia.***
>
> ***We are of the opinion that the above features clearly establish that what was obtained by the assessee is only a license and what was paid by the assessee to Aturia is only a license fee and not the price for acquisition of any capital asset….."***

20.1 The Supreme Court, crucially observed that, the High Court's conclusions were correct, in as much as, it had appreciated that the amounts which were paid by the assessee to the collaborator were only on account of licence fee and not a price for acquisition of capital assets and hence, the entire payment be treated as revenue expenditure.

21. ***<u>Alembic Chemical Works Co Ltd v. Commissioner of Income Tax, Gujarat;</u> (1989) 177 ITR 377***. In this case, the assessee since 1961 had been engaged in the business of manufacture of antibiotics and pharmaceuticals. The assessee was granted a licence for manufacture, at its plant, a well-known antibiotic "penicillin". In 1963, in order to increase the yield of penicillin the assessee negotiated with a Japanese Company for supply of requisite technical know-how, so as to, achieve substantially higher level of performance and/or production. In

consideration thereof, the assessee made a "once for all paym..., against which, the assessee was supplied by the Japanese company the sub-cultures of the most suitable penicillin producing strain, as also, technical information, know-how and written description of the process for fermentation of penicillin, along with, a flow-sheet of the process for a pilot plant, design and specification of main equipment, for such a pilot plant. Furthermore, the Japanese company was also obliged to arrange for the training of the representatives of the assessee at the Japanese company's plant, in Japan at the assessee's expense as also advice, which the assessee would receive, in order to engage in large scale manufacture of penicillin for the period of two years from the effective date of agreement. Importantly, the assessee was required to keep technical know-how supplied to it confidential and secret, with a further prohibition, on the assessee in parting with the technical know-how in favour of others or to seek patent for the process. In these circumstances, the lump sum payment made by the assessee to the Japanese company was claimed by the assessee as a revenue expenditure. In the context of these facts, Mr Justice M.N. Venkatachaliah (as he then was) made the following observations:-

> *"……In computing the income chargeable under the head "Profits and gains of business or profession", section 37 of the Act, enables the deduction of any expenditure laid out or expended wholly and exclusively for the purpose of the business or profession, as the case may be. The fact that an item*

the purposes of the business, by itself, is not sufficient to entitle its allowance in computing the income chargeable to tax. In addition, the expenditure should not be in the nature of a capital expenditure. In the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is well nigh impossible to formulate any general rule, even in the generality cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants; but as masters they tend to be over-exacting….

On a consideration of the matter, we are persuaded to hold that there was no material for the Tribunal to record the finding that the assessee had obtained under the agreement a "completely new plant" with a completely new process and a completely new technical know-how from Meiji. Indeed, the High Court recognized the fallacy in this assumption of the Tribunal that a completely new plant was obtained by the assessee, though, however, the High Court attributed the inaccuracy to what it considered to be some inadvertence or misapprehension on the part of the Tribunal in that regard. But the High Court was inclined to the view that a completely new process and technical know-how was obtained from Meiji under the agreement. Certain assumptions fundamental to, and underlying, the approach of the High Court are that the agreement dated October 9, 1963, envisaged a new process and a new technology so alien to the extant infrastructure, equipment, plant and machinery in the assessee's enterprises as to amount to an entirely new venture unconnected with the different from the line of the assessee's extant business. It is in that sense that the expense was held not to have been incurred for the purposes of the day-do-day business of the assessee but for acquiring a new capital asset…..

We are inclined to agree with Sri Ramachandran that there was no material for the Tribunal to hold that the

> *business or that the entire gamut of the existing manufacturing operations for the commercial production of penicillin in the assessee's existing plant had become obsolete or inappropriate in relation to the exploitation of the new sub-culture of the high yielding strains of penicillin supplied by Meiji and that the mere introduction of the new bio-synthetic source required the erection and commissioning of a totally new and different type of plant and machinery. Shri Ramachandran is again right in the submission that the mere improvement in or updating of the fermentation process would not necessarily be inconsistent with the relevance and continuing utility of the existing infrastructure, machinery and plant of the assessee……*
>
> *The improvisation in the process and technology in some areas of the enterprise was supplemental to the existing business and there was no material to hold that it amounted to a new or fresh venture. The further circumstance that the agreement pertained to a product already in the line of the assessee's established business and not to a new product indicates that what was stipulated was an improvement in the operation of the existing business and its efficiency and profitability not removed from the area of the day-to-day business of the assessee's established enterprise.*
>
> *It appears to us that the answer to the questions referred should be on the basis that the financial outlay under the agreement was for the better conduct and improvement of the existing business and should, therefore, be held to be revenue expenditure……"*

22. ***<u>Jonas Woodhead and Sons (India) Ltd v. Commissioner of Income Tax;</u> (1997) 224 ITR 342:-*** In this case, the question which came for consideration before the Supreme Court was as follows:-

> "Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that 25% of the amount paid by the assessee as royalty to Jonas Woodhead and Sons, was capital expenditure and,

> the provisions of the Income Tax Ac t, 1961, for the assessment years 1967-68 and 1968-69."

22.1 This question arose in the background of the following facts. The assessee was engaged in the business of manufacture of automobiles springs. The assessee entered into an agreement with Jonas Woodhead and Sons (India) Ltd, a company of United Kingdom, for manufacture of all types of springs and suspension for road and rail vehicles. Under the agreement, the assessee was to receive technical information and know-how relating to the setting up of a plant suitable for manufacture of products, as well as, technical know-how relating to setting up of the plant itself i.e., the drawings, estimates, specifications, manufacturing methods, blue prints of production and testing equipment and other data and information necessary to manufacture the product and to set up proper and efficient plants. In consideration thereof, the assessee was to pay royalty on fixed rate based on the turnover of the licensed product. On commencement of the production, assessee made certain payments as royalty. In the assessment proceeding the Income Tax Officer disallowed 25% of the aforesaid payments on the ground that such payment represented a consideration for service provided by the foreign company of an 'enduring nature' and was therefore, in the nature capital expenditure. While sustaining the view of the High Court that 25% of the payment made by the assessee was in the nature of capital expenditure and hence, not allowable as a deduction, the Supreme Court

"…..The question whether a particular payment made by an assessee under the terms of the agreement forms a part of capital expenditure or revenue expenditure would depend upon several factors, namely, whether the assessee obtained a completely new plan with a completely new process and completely new technology for manufacture of the product or the payments was made for the technical know-how which was for the betterment of the product in question which was already being produced; whether the improvisation made, is part and parcel of the existing business or a new business was set up with the so-called technical know-how for which payments were made; whether on expiry of the period of agreement the assessee is required to give back the plans and designs which were obtained, but the assessee could manufacture the product in the factory that has been set up with the collaboration of the foreign firm; the cumulative effect on a construction of the various terms and conditions of the agreement; whether the assessee derived benefits coming to its capital for which the payment was made. This Court in the case of Alembic Chemical Works Co. Ltd. v. Commissioner of Income Tax [1989] 177 ITR 377 has indicated that "in the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is not possible to form any general rule even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation". This Court further held that there is no single definitive criterion which, by itself, is demarcative, whether a particular outlay is capital or revenue. And therefore, "once for all" test as well as the test of "enduring benefit" may not be conclusive. Consequently, the various terms and conditions of the, agreement, the advantages derived by an assessee under the agreement, the payment made by the assessee under the agreement, are all to be taken into account and then it has to be decided whether the whole or a part of the payment thus made is a capital expenditure or a revenue expenditure…….."

In the case of Commissioner of Income-Tax, Bombay City I v. CIBA of India Ltd. (1968) 69 ITR 692 (SC) *between the parties that the assessee did not become entitled exclusively even for the period of the agreement, to the patents and trademark of the Swiss company; it had merely access to technical knowledge and experience in the pharmaceutical field which the Swiss company commanded. The assessee on that account have a mere licensee for a limited period of a technical knowledge of the Swiss company with the right to use the patent and trademark of that company. The assessee acquired under the agreement merely the right to draw for the purpose of carrying on its business as a manufacturer or dealer upon the technical knowledge of Swiss company for limited period. By making a technical knowledge available the Swiss company did not part with any asset of its business, nor did the assessee acquire any asset or advantage of an enduring nature for the benefits of its business and, therefore, the said contribution was merely a revenue expenditure or a business expenditure."*

The reason why the Supreme Court sustained the view of the Tribunal in this case that part of the royalty paid in the said case had to be held as paid towards capital account is evident from the following observations in the said case. ***But in the case in hand the Tribunal 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 <u>a new business</u> and the foreign firm had not-only furnished information and the technical know-how but rendered valuable services <u>in setting up of the factory itself</u>*** *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 a revenue expenditure merely because the payment is required to be made on a certain percentage of the rates of the gross turnover of the products of the income 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......."*

22.2 It is clear in this case, the Supreme Court in concluding that a part of the payment was made on capital account, took note of the fact that the Tribunal had returned a finding, that the foreign firm under the agreement was obliged to assist the assessee in setting up a new business. The finding in the present case is to the contrary. In any event impugned expenditure relates to licence fee the purpose of which is different as explained in the latter part of our judgement.

<u>DISCUSSION OF HIGH COURT CASES:</u>

23. ***<u>Mysore Kirloskar Ltd. v. Commissioner of Income Tax, Banglore</u> (1978) 114 ITR 443.*** In this case a full bench of the Karnataka High Court was called upon to consider whether monies paid to the foreign company for acquisition of technical knowledge for a limited period could be construed as revenue expenditure. The main thrust of the judgment is contained paragraphs 17-18 of the judgment of the Court. The observations of the Division Bench being apposite are extracted hereinbelow:-

> *"………Read as a whole, it is seen that under the agreement the assessee acquired merely the right* ***to draw*** *for the purpose of carrying on its business as a manufacturer of certain articles upon the technical knowledge of the foreign company for a limited period. The foreign company did not part with any of its assets absolutely for ever or for any limited period of time. It continued to have a right of user of its knowledge, even after the agreement had run its course: its right in this behalf was not lost. The assessee did not acquire any right to the user of the name 'HERBERT' in regard to*

Actually it could not use that name and had to discontinue such user or associating that name with the products to be manufactured thereafter. In the words of the Supreme Court in Ciba's case:-

"…….by making that technical knowledge available the foreign company did not part with any asset of its business, nor did the assessee acquire any asset or advantage of an enduring nature for the benefit of its business….."

From the terms of the agreement it is clear that (1) No secret process or technical knowledge was sold by the foreign company to the assessee, (2) the period of user was for 15 years; (3) the object of the agreement was to obtain the benefit of the technical assistance for running the business; (4) the permission was granted to the assessee subject to rights actually granted or which may be granted after the date of the agreement to other persons though outside India; (5) the assessee was expressly prohibited from divulging the confidential information to third parties; (6) there was no transfer of fruits of research once for all; and (7) the foreign company which was continuously carry-ing on research had agreed to make it available to the assessee. These are the very factors which were taken into consideration by the Supreme Court in coming to the conclusion that the expenditure was of revenue nature and allowable under Section 10 (1) (xv) of the Indian Income-tax Act 1922, which is pari materia with Sec. 37 of the Income-tax Act 1961. Therefore, it is clear that the facts and circumstances in the instant case are indistinguishable from those in Ciba's case, The Supreme Court in the course of its judgment referred to the decision of the House of Lords in Jeffrey v. Rolls Royce Ltd. ((1965) 56 ITR 580) (HL) and Mus-ker v. English Electric Co. ((1964) 41 Tax Cas 556) and distinguished the decision in Evans Medical Supplies Ltd. v. Mori-arty ((1959) 35 ITR 707) (HL). The principles enunciated by the Supreme Court in Ciba's case were applied by the High Court of Calcutta in Commr. of Income-tax (Central) Calcutta v. Hindustan General Electrical Corporation Ltd. The learned Judges referred to the speech of Viscount Rad-cliffe in Musker v. English Electric Co. Ltd. and

> *"In my opinion, there are two considerations which govern cases of this kind and which go a long way towards destroying the force of the analogies by which the appellant's argument seeks to prove that the transactions under review were sales of fixed assets, and that receipts arising from them ought to be treated as receipts on capital account, One is that in reality no sale takes place. The appellant had after the transaction what it had before it. There is no property right in "know-how" that can be transferred, even in the limited sense that there is a legally protected property interest in a secret process. Special knowledge or skill can indeed ripen into a form of property in the fields of commerce and industry, as in copyright, trademarks and designs and patents, and where such property is parted with for money what is received can be, but will not necessarily be. a receipt on capital account, But imparting "know-how" for reward is not like this, any more than a teacher sells his knowledge or skill to his pupil,"*

23.1 It is also important to note that in this case the Full Bench of the Karnataka High Court over-ruled the judgement of its own court in ***Mysore Kirloskar Ltd. v. Commissioner of Income Tax*** *(supra).*

24. ***Ramkumar Pharmaceutical Works v. CIT; (1979) 119 ITR 33 (All.).*** This was a case where the assessee, which was, in the business of manufacture and sale of saccharine entered into an agreement with a West German Company. Under the agreement, the assessee was to receive from the foreign collaborator know-how and data for the construction and operation of the plant for manufacture of saccharine. In consideration, the assessee was to pay a lump sum down payment followed by royalty @ 2.5% of the sale value of the manufactured product, subject to, a maximum of DM 35,000/-, for the next five years.

how and data was parted with, by the foreign collaborator, for setting up and operating of a plant for production of saccharine, and that, know-how and data was transferred to the assessee for being used by it in future without any time limit. The Court observed that the only restriction which was placed on the assessee was that it could not transfer the know-how to anyone else and that, it had to be kept a secret. The Court observed that this was a case of acquisition and not merely a user for all limited time. The assessee according to the Court obtained an advantage of enduring nature and thus the payment for acquisition of such know-how was clearly capital in nature.

24.1 This case as is evident turned on its own facts.

25. ***Commissioner of Income Tax v. Tata Engineering & Locomotive Co Pvt Ltd*** ***(1980) 123 ITR 538***. This was a case where the Bombay High Court was considering payments made by the assessee to the German collaborator with respect to provision of drawings, designs and technical information required for manufacturing of automotive products. Under the agreement the assessee could also use the name and the trade mark of the German collaborator. The point to be noted in this case was that after the agreement came to an end, the assessee was entitled to continue its manufacture, but without the use of the trade name Tata-Mercedez-Benz. The Division Bench, while holding that the payments in the agreement were in the nature of revenue expenditure,

technical information is really in the nature of having access to techniques of production, it cannot be said that the payments made in lieu thereof were on capital account. The rationale provided by the Division Bench was that, instead of employing persons having knowledge of the techniques and utilizing their knowledge, what was being done, is that the technical know-how was being acquired under a collaboration agreement. The Division Bench went on to hold, that the fact that, the same information was being continuously used whether in the same form or in an improved form will, therefore, not be relevant in deciding whether technical know-how obtained under such an agreement is a capital asset. The Court observed that technical know-how made available to a party under such an agreement does not stand on the same footing as protected rights in a registered patent. According to the Division Bench, there was no property right in a know-how which can be transferred just as, it is, in a limited sense, in a patent. The Division Bench of the Bombay High Court rejected the contention that the expenditure was capital in nature since, once the know-how was made available, the assessee could continue to use it for its production even after the expiry of the agreement; on the ground that this aspect was wholly immaterial for the purposes of ascertaining whether such an expenditure could be treated on capital account. The Division Bench categorically disagreed with the view of the Madras High Court taken in ***Addl. Commissioner of Income Tax v Southern Structural Ltd*** *(supra)* which, in turn, was based on the view held in ***Fenner Woodroffe & Co Ltd v. Commissioner of Income-Tax*** ***(1976) 102 ITR 665.***

26. ***Praga Tools Ltd v. Commissioner of Income-Tax, Hyderabad; (1980) 123 ITR 773(AP)***. In this case, the Full bench of the Andhra Pradesh High Court was called upon to examine the nature of payments made by the assessee under a licence agreement with a foreign company for manufacture of certain tools and cutter grinding machine, for which, the foreign company was to supply the accessories, designs, technical know-how with the latest modification and assistance. The agreement was for a period of 10 years and thereafter, renewable for a further period of five years with mutual consent. The assessee was required to pay royalty at the rate of 5% on the Indian selling price, on the production of the machine, subject to Indian taxes. The Full Bench like in the case of ***Tata Engineering & Locomotive Co Pvt Ltd*** *(supra)* came to the conclusion that merely because the agreement provided that the assessee was entitled to retain technical know-how, designs and drawings even after the expiry of agreement did not alter the nature of the transaction. There was, according to the court, no property right transferrable in technical know-how. The fact that the assessee was not entitled to use the trade mark of the foreign company for the products manufactured by it after the expiry of the agreement clinched the issue. The Court also observed that in determining the nature of the

evidenced by the documents and the surrounding circumstances had to be taken into consideration in arriving at the decision. The Court observed that the circumstances had to be viewed in the larger context of business, each factor or circumstance by itself may not be decisive. Importantly, in this case the Full bench over-ruled the judgment of its own court in ***Hylam Ltd v. CIT (A.P.)*** ***(1973) 87 ITR 310***. In these circumstances we do not consider it necessary to discuss the said case i.e., ***Hylam Ltd.*** *(supra)*

27. ***Commissioner of Income Tax v. Polyformalin (P.) Ltd;*** ***(1986) 161 ITR 36 (Ker)***. This is a case, in which, the Division Bench of the Kerala High Court was called upon to consider the correctness of the view taken by the Tribunal in respect of, the nature of royalty payment made under a collaboration agreement. The Tribunal had taken the view that, the payments made contained an element of capital; this would be clear from the questions referred by the Tribunal to the High Court for its opinion under Section 256(1) of the Act. Upon a reading of the facts in this case, it seems that at various points of time, the assessee entered into three collaboration agreements with the same collaborator. Broadly, the assessee, which was in the business of manufacture and sale of organic and synthetic chemicals under various agreements, sought technical know-how and right to use trade mark of the collaborator for production of urea formaldehyde resin. Under the

with regard to any further improvements in the technical know-how which it may obtain. The assessee was required to keep the technical know-how which it received confidential. In the background of these broad facts, the matter travelled up to the Tribunal. The Tribunal in the proceedings before it, returned a finding of fact that a part of the payment of royalty under the agreement was attributable to 'initial manufacture' and hence, would have to be treated as capital in nature, while the remaining payment would be on revenue account. It seems that the Division Bench of the High Court, while sustaining the view of the Tribunal that there was an element of capital in the royalty payments was persuaded by this finding of fact returned by the Tribunal.

28. ***Commissioner of Income Tax v. Warner Hindusthan Ltd*** ***(1986) 160 ITR 217 .*** This was a case where the assessee has entered into a collaboration agreement with an American company. The agreement was entered into at the inception and before setting up of the plant. The foreign collaborator i.e., the American company held a 40% shares in the assessee company. The foreign collaborator i.e., the American company had a right to terminate the agreement if the American company's shareholding in the assessee company fell below 40%. The American company was required to provide expertise in the construction of the factory, lay-out, as also, the know-how which, the American company was required to keep updated. The American

connection with setting up of the plant and manufacture of the products and facilities at the assessee's plant and also, at the plant of the assessee's associates and, for the training of associates' personnel. Under the agreement, the assessee had no right to use any trade name, however, it could continue to use the know-how even after termination of the agreement. In this case, in consideration thereof, the assessee paid certain sums of money to the American Company during the assessment years, under consideration. The assessee had claimed these payments as technical fee and hence, as revenue expenditure. The Tribunal held the payment, in issue, to be in the nature of revenue expenditure. The High Court, considering the facts of said case, reversed the view of the Tribunal on the grounds that: First of all, the collaboration agreement was not on record; Secondly, the agreement related to assistance at the very inception i.e., formation of a company; Thirdly, the agreement provided for not only transfer of know-how, but also for consultancy assistance and help, in several other areas; And lastly, the American Company had a 40% shareholding in the assessee company and, under the provisions of the agreement the American Company could terminate the agreement if its equity holdings fell below 40%. The High Court concluded that, therefore, it could not be said that the payments made were only for the acquisition of know-how. The High Court most crucially observed that there was neither a running or an existing business nor, was the know-how acquired in connection with the manufacture of a new item, in relation, to a running business. The sum and substance of the court discussion was that there was no way of apportioning that part of the payment which was made towards acquisition of the know-how under the agreement. This is a critical distinction which will have to be borne in mind while considering the impact of this case.

29. ***CIT v. Toshniwal Electrodes Manufacturing Co Ltd* (1991) 192 ITR 209 (Bom)**. In this case we find that there is no discernable ratio and hence, it does not call for any discussion. The court decided the case based on a decision in an earlier reference, relating to the same assessee, which had travelled to the Court.

30. ***Addl. Commissioner of Income Tax v. Southern Structural* (1997) 110 ITR 890 (Mad)**. In this case, the assessee was engaged in the manufacture of goods wagon for supply to Indian Railways. The assessee entered into an agreement with a British Company. Under the agreement, the British Company was required to acquire a 40% shareholding in the assessee company on certain basis. The British company, under the agreement, was also required to give to the assessee Company technical assistance in the form of inventions, designs relating to railway wagons, whether obtained or not, which were owned by the British Company. The British Company under the agreement had also undertaken to supply to the assessee at their request full technical advice

have acquired in relation to design and manufacture of existing type of railway wagons and which could be of assistance to the assessee in tendering for any other order for such a wagon or, in manufacturing the same at Madras. In consideration thereof, the assessee was to pay a certain percentage of the works price, in respect of, certain kinds of wagons. Importantly, the agreement was required to subsist for a minimum of 10 years, which was terminable by either party on giving 12 months prior notice. Upon the expiration of the agreement both parties were to be relieved of their obligations, in particular, the assessee was free to use without a charge, all such information made available by the British Company, during the tenure of the agreement. In coming to the conclusion that the monies paid by the assessee to the British Company were in the nature of capital expenditure, the Division Bench of the High Court, was impressed by the fact that the assessee could use the information acquired for an indefinite period, and that too, free of charge. In other words, whatever information was acquired by the assessee during the period of the agreement would enure to the benefit of the assessee without any limitation of time. In coming to this conclusion the Division Bench applied the principle laid down by its own court in the case of ***Fenner Woodroffe & Co Ltd v. Commissioner of Income-Tax*** *(supra).*

30.1 As discussed above the Full Bench of the Andhra Pradesh High the Madras High Court in the aforesaid case. We respectfully agree with the view taken in ***Praga Tools Ltd*** *(supra).*

31. ***Commissioner of Income Tax, Gujarat – I v. S.L.M. Maneklal Industries Ltd*** ***(1977) 101 ITR 133***. This was also a case where the assessee had entered into three agreements with certain foreign collaborators. The first agreement was for manufacture of rotary air-compressors. The second agreement was for the manufacture of rotary blowers and water-ring pumps, and the third agreement, was for the manufacture of vertical diesel engines. The agreements were entered into between the Swiss collaborator and one T. Maneklal. Pursuant to discussions between the two contracting parties, a new company S.L.M. Maneklal Industries Ltd (which was the assessee in the case) was floated and by subsequent agreement, it was agreed between one S.L.M. on the one hand and one, Maneklal on the other, that in the three agreements, referred to above, wherever the name "T. Maneklal" appeared the name of new company S.L.M. Maneklal Industries should be substituted. Under the agreements the assessee company made payments for the price of supply of workshop drawing, manufacturing instruments etc.; which were spread over a period of five years and accordingly, the assessee claimed deduction of 1/5th of the expenditure for drawings and designs in respect of each of the three agreements. The Income Tax Officer treated the said payments as capital in nature

shape of designs and drawings. The matter travelled right up to the Tribunal. The Tribunal held that it was a clear case of licence and not of sale so far as, designs and drawings and patterns were concerned and that, by parting with them, the right of the foreign collaborator had not diminished, in any, manner. The Tribunal also held that payments made for the use of drawings, designs and patterns did not bring into existence an asset of an enduring nature. The Division Bench of the High Court sustained the view of the Tribunal. The Division Bench held that the workshop drawings, manufacturing instruments etc. were obtained by the assessee company from the foreign company for the purpose of enabling it to exploit the licence agreement and to manufacture rotary air-compressor under the licensing agreement. It further held that the supply of workshop drawings was for the purpose of main licence itself, and in the course of, working the terms and conditions of the license to manufacture rotary air-compressor. It also observed that other expenditure incurred in connection with capital asset is not expenditure of a capital nature. The nature of the expenditure depends essentially upon the totality of the attendant circumstances obtaining in respect of a transaction and the context in which it is made. Where a payment is made for the ownership of a capital asset, which is the tool of the assessee’s trade, it may not be difficult to come to the conclusion that the expenditure is in the nature of capital expenditure. Where, however the benefit of a capital asset is secured as one element of a comprehensive arrangement, by virtue of which a trader seeks to obtain advantage, with the end in view to expand his business and earn greater profits, the whole transaction will have to be critically analyzed in order to find out whether the expenditure incurred is a part of that transaction for acquiring the benefit for the use of the capital asset and hence, is in the nature of capital expenditure. The court came to the conclusion that no property for the workshop drawings passed to the assessee. There was no independent sale of the workshop drawings, and furthermore, the workshop drawings, by themselves, were of no use to the assessee unless they were meant for the purpose of manufacturing of different types of machinery. The Division Bench was impressed by the fact that the assessee was required to keep the information obtained as confidential and to use the same, only for the purpose of working the license agreement, and that too only during the continuance of the licensing agreement.

32. ***Commissioner of Income Tax v. Eicher Motors Ltd;*** ***(2007) 293 ITR 464 (MP)***. It was again a case dealing with expenditure incurred on acquisition of technical know-how. The Division Bench of the Madhya Pradesh High Court, Indore Bench observed that the matter should be decided by taking into account all circumstances and the weight, which may have to be given to a particular circumstance, must depend on common sense and business point of view rather than juristic

classification of the juristic rights, if any, secured employee ... exhausted in the process.

33. ***Sriram Refrigeration Industries Ltd v. Commissioner of Income Tax, Delhi – I;*** ***(1981) 127 ITR 746 (Del)***. This is a judgment of a Division Bench of this court. In this case, the assessee, who was in the business of manufacture of sealed compressors for air-conditioners and refrigerators, entered into a technical assistance agreement with Westhinghouse Electric, an international company. The said foreign collaborator provided information in the form of basic designs, data, drawings, process specifications, material specifications etc. The Division Bench after examining the facts, as well as, the case law on the subject held that the whole object of the agreement was to obtain benefit of technical assistance for running the business, on a restricted licence and to accord limited use of patent rights of the foreign company, the use of which, was restricted to the assessee alone and that too for the duration of the agreement. It concluded that on examining the basic features of the agreement the foreign company had not parted with the "technical knowledge" absolutely in favour of the assessee as the foreign company had not sold their secret process to the assessee. It was of the view that it could not be said that assessee had absolutely acquired any knowledge or asset. The payments, according to the Division Bench were made to have an 'access' to the knowledge and

day-to-day, and that, it was not of much significance as to whether the agreement was entered into at the time of commencement of business or in the course of business which is already being carried out.

34. ***Sriram Pistons & Rings Ltd. v. Commissioner of Income Tax, New Delhi;*** ***(2008) 177 Taxmann 81***. This is again a judgment of Division Bench of this Court, wherein this court, after examining a plethora of case law including the judgment of this court in the case of ***Sriram Refrigeration Industries Ltd*** *(supra)* has followed the view held in another judgment of a Division Bench of this Court in ***Triveni Engg. Works ltd. v. CIT*** ***(1982) 136 ITR 340***. The observations made in para 17, 28 & 29 being apposite are set out below:-

> *" ....The Supreme Court interpreted this to mean that the right pertained more to the use of the know-how than to its exclusive acquisition by the assessee. The Supreme Court also noted that there is no single definitive criterion which by itself is determinative of the question whether a particular outlay was revenue in nature. What is relevant is to see the intended object and effect of the agreement between the parties, considered in a common sense manner having regard to business realities. The Supreme Court noted that in a given case, the test of 'enduring benefit' might break down as laid down by the Supreme Court in* **CIT v. Associated Cement Companies Ltd** *(1988) 172 ITR 257.*
>
> *Applying the various principles that have been laid down, we find that there was in fact no absolute transfer of any right in the documentation given by Riken to the assessee. The assessee was entitled to use the technical know-how for a period of five years or for a lesser period, in case the agreement was terminated before that. The assessee did not have a free hand to sub-license the technical know-how and that was possible only with the prior written permission*

to treat as confidential in inventions, drawings, documents, specification etc. furnished by Riken to the assessee. Even though the assessee was entitled to use the name of Riken in the marketing of its products but that right would cease upon the expiry or terminated of the agreement.

As already noted, the Agreement was valid only for a period of five years but could be terminated earlier. There is no magic in the word "sold" used in clause 5.0 of the agreement because on a reading of the agreement as a whole, it appears to us that what was transferred to the assessee was only a right to use the technical know-how of Riken and there was no sale of the technical know-how which the assessee could exploit. The assessee's right were hedged in with all sorts of conditions, clearly making it a case of right to use the technology and not sale of the technical know-how......"

34.1 From the above, it is clear that despite the use of the word 'sold' in one of the clauses of the agreement, in relation to, technical know-how and the process which the assessee acquired, this Court held that, if on a holistic reading of the agreement it appears that what was transferred to the assessee was only a right to use technical know-how and not sale of technical know-how then the expenditure would have to be treated as one on revenue account.

35. ***Bajaj Tempo Ltd v. Commissioner of Income Tax;* (1994) 207 ITR 1017 (Bom)**. Mr. Justice B.N. Srikrishna (as he then was) speaking for the Division Bench cited with approval the observations of the judgement of its own court in ***Tata Engineering & Locomotive Co (P) Ltd*** *(supra)* that there was no property right in know-how which can be transferred just as, it is, in a limited sense in a patent. The court approved the observation of its own Division Bench in the case of ***Tata***

Engineering & Locomotive Co (P) Ltd *(supra)* that technical know how made available by a party to an agreement does not stand on same footing as protected rights under a registered patent. The Division Bench distinguished the judgment of the Supreme Court in the case of ***Scientific Engineering House P. Ltd*** *(supra)* by observing that the Supreme Court in that case was considering whether the 'documentation service' was the main service rendered by the foreign collaborator and also, that the documentation service supplied to the assessee in the said case constituted 'book' or 'plant' so as to entitle the assessee to claim depreciation thereon. The Division Bench ***observed that "the argument before the Supreme Court did not appear to have turned on the issue whether the payments made for procuring such documents really amounted to capital expenditure or revenue expenditure."***

36. ***Commissioner of Income Tax, Tamil Nadu- III v. Madras Rubber Factory (1983) 144 ITR 678***. This was a case where the assessee entered into an agreement with an American Company which dealt with two distinct matters, namely (i) planning and setting up of a tyre factory (ii) continuous supply of information and technical consultancy services for a period of years for running the factory after its installation. The Court noted that there was no dispute that the payment which related to the first item i.e., for setting up of the factory were capital in nature in the hands of the assessee, and consequently, the

However, under the agreement, the assessee was also required to p... the foreign company for the consultancy services supplied by the foreign company from time to time for running the factory and for maintaining production. The Income Tax Officer took the view that though payments made for consultancy service for running the factory were on revenue account there would be an element of capital and hence, disallowed 25% of the fee payable by the assessee attributable to capital element, while allowing the balance 75% as revenue expenditure. The view of the assessee was over-turned by the first Appellate Authority and the Tribunal. The Department carried the matter to the High Court. The High Court held that the agreement by itself kept two aspects of the collaboration agreement distinct and separate, one was connected with the initial setting up of the factory and the other was connected with running of the factory. The fee paid by the parties for obtaining technical consultancy services required for keeping the factory running was in the nature of revenue expenditure. The Court rejected the argument of the Revenue that, since the assessee was not bound to return the know-how acquired during the contract period the expenses incurred for obtaining the same had to be treated as capital expenditure as it had acquired the use of knowledge beyond the contractual period and hence, was in the nature of an enduring advantage. In this connection the following observations of the court are of significance:-

".....We must reject the argument of Mr. Jayaraman as unsound. It is based on the supposition that any expenditure or outlay by a taxpayer which results in enduring benefit to his trade must, without more, be regarded as capital in character. The truth, however, is that enduring benefit is not the acid test of capital expenditure in all cases. Even its celebrated author, Viscount Cave, while laying down this testin Atherion v. British Insulated and Helsby Cables Ltd. (1925) 10 TC 155 (HL), did not mean to propound a doctrine in unqualified terms. In the recent Empire Jute Co.'s case (1980) 124 ITR 1, our Supreme Court has had occasion to clarify this position. They explained Viscount Cave's dictum this way: enduring benefit or advantage might enure to an assessee's business either in a capital field of its activity or in a non-capital field; in every case, therefore, the inquiry must be directed as much to the character of the expenditure as to the nature of the advantage derived therefrom.

The Supreme Court's enunciation of the test of enduring benefit is particularly apposite in the present case. It may be conceded that what Mansfield or its resident engineer in India were imparting to the assessee on operational matters might tend to outlast, and endure beyond, the contract period. There is, however is a saying in Tamil that knowledge once acquired is everlasting, and it cannot be destroyed either by flood or by fire, nor can it be obliterated or even diminished by being imparted to others. Technical or commercial knowledge acquired by a trader or industrialist is of this kind, enduring, if not everlasting. Expenditure to acquire it cannot be disallowed merely because knowledge dies hard. It is only where the expenditure bears on the fixed capital or other capital structure of the assessee that it can be regarded as capital in nature. ***Where the expenditure, although enduring in character has its impact on the running of the business, there can be no doubt that it is out and out revenue expenditure. If the position were otherwise, practically any item of revenue outgoing in the day-to-day running of a business can be broken up and dissected in an effort to discover in it some fractional element or other of a***

> ***benefit or advantage tends to pay in the business. This, however, is not the law.*"**

37. ***Commissioner of Income Tax v. Aquapump Industries;* (1996) 218 ITR 427.** The Division Bench of the High Court was called upon to determine as to whether expenses incurred by the assessed to acquire technical know-how were in the nature of revenue expenditure. In this case, there was an agreement between the assessee and a collaborator, under which the collaborator allowed the assessee to use its brand name for the production, manufacture and sale of specified products. In consideration, the assessee paid royalties to the collaborator who agreed to allow manufacture of articles for five years. The collaborator under the agreement was required to furnish technical information pertaining to manufacture of the said articles. The issue which came before the Madras High Court was whether royalty payments made by the assessee could be treated as revenue expenditure. The court observed that expenditure to acquire knowledge cannot be disallowed merely because knowledge dies hard. It is only where the expenditure bears on the fixed capital or other capital structure of the assessee that it can be regarded as capital in nature. Where the expenditure, although enduring in character has its impact on the running of the business, there can be no doubt that it is revenue expenditure.

BROAD PRINCIPLES WHICH EMERGE ON READING OF VARIOUS AUTHORITIES

38. An overall view of the judgments of the Supreme Court, as well as, of the High Courts would show that the following broad principles have been forged over the years, which require, to be applied to the facts of each case:-

(i) the expenditure incurred towards initial outlay of business would be in the nature of capital expenditure, however, if the expenditure is incurred while the business is on going, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring benefit for the business, if that be so, it will be in the nature of capital expenditure. If the expenditure, on the other hand, is for running the business or working it, with a view to produce profits, it would be in the nature of revenue expenditure;

(ii) it is the aim and object of expenditure, which would, determine its character and not the source and manner of its payment;

(iii) the test of "once and for all" payment i.e., a lump sum payment made, in respect of, a transaction is an inconclusive test. The character of payment can be determined by looking at what is the true nature of the asset which is acquired and not by the fact whether it is a payment in 'lump sum' or in an instalment. In applying the test of an advantage of an enduring nature, it would not be proper, to look at the advantage obtained, as lasting forever. The distinction which is required to be drawn is, whether the expense has been incurred to do away with, what is a recurring expense for running a business, as against, an expense undertaken for the benefit of the business as a whole;

(iv) an expense incurred for acquisition of a source of profit or income would in the absence of any contrary circumstance, be in the nature of capital expenditure. As against this, an expenditure which enables the profit making structure to work more efficiently leaving the source or the profit making structure untouched, would be in the nature of revenue expenditure. In other words, expenditure incurred to fine tune trading operations to enable the management to run the business effectively, efficiently and profitably leaving the fixed assets untouched would be an expenditure of a revenue nature even though the advantage obtained may last for an indefinite period. To that extent, the test of enduring benefit or advantage could be considered as having broken down;

(v) expenditure incurred for grant of License which accords 'access' to technical knowledge, as against, 'absolute' transfer of technical knowledge and information would ordinarily be treated as revenue expenditure. In order to sift, in a manner of speaking, the grain from the chaff, one would have to closely look at the attendant circumstances, such as:-

(a) the tenure of the Licence.

(b) the right, if any, in the licensee to create further rights in favour of third parties;

(c) the prohibition, if any, in parting with a confidential information received under the License to third parties without the consent of the licensor,

(d) whether the Licence transfers the 'fruits of research' of the licensor, 'once for all',

(e) whether on expiry of the Licence the licensee is required to return back the plans and designs obtained under the Licence to the licensor even though the licensee may continue to manufacture the product, in respect of, which 'access' to knowledge was obtained during the subsistence of the Licence.

(f) whether any secret or process of manufacture was sold by the licensor to the licensee. Expenditure on obtaining access to such secret process would ordinarily be construed as capital in nature;

(vi) the fact that assessee could use the technical knowledge obtained during the tenure of the License for the purposes of its business after the Agreement has expired, and in that sense, resulting in an enduring advantage, has been categorically rejected by the courts. The Courts have held that this, by itself, cannot be decisive because knowledge by itself may last for a long period even though due to rapid change of technology and huge strides made in the field of science, the knowledge may with passage of time become obsolete;

(vii) while determining the nature of expenditure, given the diversity of human affairs and complicated nature of business; the test enunciated by courts have to be applied from a business point of view and on a fair appreciation of the whole fact situation before concluding whether the expenditure is in the nature of capital or revenue.

39. In the context of the present case what has emerged is as follo...

a. The agreement was in three parts. One part related to purchase of basic design, engineering and for provision of technical assistance by the collaborator to the assessee. For this purpose a sum of 250 Million Liras were paid by the assessee to the collaborator. This expenditure was capitalized by the assessee, on his own.

b. The balance amount expended by the assessee being; 3.73 million Liras, for grant of process and know-how Licence and for supply of technical assistance and continuous know-how, which included, training to its employees, in Italy; was treated as revenue expenditure by the assessee.

39.1 The important finding returned by the authorities below, on consideration of the facts obtaining in the case and on interpretation of the terms of the agreement, was that; First of all, what the assessee acquired was 'access' to the technical information; Secondly, there was no transfer of ownership with respect to the process and the know-how under the agreement, in favour of the assessee; Lastly, the 'access' to technical know-how did not relate to any secret process or patent rights or use of trade mark or trade name. As recorded by the authorities below the technical know-how was owned by one M/s Montefibre, the successor to another concern known as, M/s Chatillon. M/s Monte permanent License in favour of M/s Tecnimont. This was, as found by the authorities below, done to enable M/s Technimont to exercise its rights under the License by granting a sub-License to third parties, in this case the assessee. The submission of the learned counsel for the Revenue, based on Article 2.12 of the Agreement, to the effect that, what the assessee had obtained was a permanent right by virtue of the Agreement is incorrect; in view of the fact that, M/s Tecnimont could not have granted that, which it did not itself possess. In any event, grant of Licence by itself does not result in transfer of property, in a limited sense as, in the case of, patent rights. It is not the case of the Revenue that any patent rights were transferred in favour of the assessee.

39.2 In our opinion, in view of the aforementioned findings, in particular, that under the Agreement the assessee had only acquired 'access' to technical information, that is, know-how which related to the process of manufacture, which was not; related to any secret process or patent rights or even the right to use a trademark or trade name under the Agreement, the payments in issue, made for such a purpose, can only be categorized as one made on revenue account.

39.3 The Revenue, in order to buttress their submission with respect to the permanent character and so called enduring nature of the advantage obtained under the Licence, had submitted that the Agreement had no time limit prescribed for working the Licence. This submission of the noted, hereinabove, under Article 15.4 the obligation for ce... purposes was limited to 12 years, and likewise, under Article 5.5.1 and 5.5.2 M/s Tecnimont was obliged to give advice for a period of 7 years.

39.4 In respect of payments made by the assessee towards training of personnel and supply of technical assistance and continuous know-how as referred to in Article 5 of the Agreement, it is clear on an application of the tests enunciated by Courts, that it would not result in an advantage of enduring nature, especially as noted above, that by virtue of Article 5.5.1 and 5.5.2 M/s Tecnimont was obliged to give advice limited to a period of 7 years.

39.5 It is important, at this juncture, to refer to the finding returned by CIT(A), which has been, sustained by the Tribunal, to the effect that, all payments which related to setting up of the plant as per Article 9.1(b) of the agreement, as well as, expenses towards technical assistance provided by M/s Tecnimont for the purpose of construction and setting up of the plant were not only to be paid separately, as per Article 5.1, 5.2, 5.3, 5.5.1(a) and 5.5.2(2) but, had also been capitalized and not claimed by the assessee as a revenue expenditure. The only item which the assessee had claimed as revenue expenditure related to technical assistance granted for a period of 7 years for training of its personnel and in connection with running of the plant day-to-day. In view of these findings, which when, analysed in the light of the test evolved by the

Courts, it cannot, but be held, that the expenditure in issue would have to be treated as one, on revenue account.

39.6 The submission of the learned counsel for the Revenue that the expenditure was incurred by the assessee for manufacturing a new product, is not only factually incorrect, but completely contrary to the stand taken by the Revenue both before the CIT(A), as well as, the Tribunal. The Tribunal has, as indicated above, hereinabove categorically noted that the Revenue had fairly conceded that the expense incurred was for extension of an existing business. The Tribunal, in no uncertain words, recorded a finding that, the record demonstrated, that the products, in issue, were already being manufactured by the assessee and hence, payments made by the assessee towards this end, would only go to increase the profitability; as what it had obtained, by virtue of the Agreement was a new method of manufacture or process of manufacture.

39.7 Similarly, in respect of payments made to M/s IWKA, the CIT(A) found that, the know-how for which the assessee had made payments was for manufacture of machines. The CIT(A), examined the Agreement of the assessee with M/s IWKA, and found that, the assessee had been granted an exclusive manufacturing licence for India. He, however noted, that the assessee was not permitted to use any knowledge or experience gained for any other purpose. The CIT(A) also returned the finding that under the Agreement, M/s IWKA w... provide the following services to the assessee.

a) assistance in Germany in planning, construction and installation of JK's Engineering Workshops;
b) delivery of Germany of drawings and technical data;
c) transfer in Germany of the use of IWKA manufacturing know-how;
d) transfer of IWKA sales know-how;
e) training of specialists for JK in Germany and India;
f) delegation of IWKA staff member for technical assistance to India;
g) exchange of experiences including continued technical assistance and development.

39.8 In the background of these facts, the CIT(A) came to the conclusion that the expenditure incurred by the assessee on know-how during the year, under consideration, was in respect of, a business which was already in existence and hence, the payments were made for user of licence and were akin to the payments made to M/s Tecnimont. The CIT(A) agreed with the assessee that money paid to M/s IKWA was required to be treated as expenditure on revenue account. This finding of the CIT(A) has been sustained by the Tribunal.

40. Given the findings returned by both the CIT(A), as well as, the Tribunal and given the discussion held above by us, we have no hesitation in coming to the conclusion that Rs 30,57,499/- paid to M/s Technimont and Rs 3,48,033/- paid to M/s IKWA had to be treated as revenue expenditure.

41. In view of the fact that we have already held that the third instalment of know-how fee which related to grant of technical assistance and continuous know-how, in Italy, including training of personnel, in Italy is revenue in nature, any interest paid in relation to delayed payments will also, have to be treated, as one, which is, on revenue account.

42. In view of the above discussion, both questions referred to us are answered in favour of the assessee and against the Revenue. These references are accordingly disposed of. However, in the circumstances the parties shall bear their own costs.

RAJIV SHAKDHER, J.

December 17, 2008 **BADAR DURREZ AHMED, J.**
mb/kk