* **HIGH COURT OF DELHI AT NEW DELHI**

Judgment Reserved on : 16th July, 2010
% Judgment Pronounced on: 6th September, 2010

\+ **ITA 56/2009**

THE COMMISSIONER OF INCOME TAX-II ..... Appellant
Through: Mr. Sanjeev Sabharwal, Adv.

versus

MUNJAL SHOWA LTD. ..... Respondent
Through: Ms. Kavita Jha, Adv.

AND

ITA 85/2009

THE COMMISSIONER OF INCOME TAX-II ..... Appellant
Through: Mr. Sanjeev Sabharwal, Adv.

versus

MUNJAL SHOWA LTD. ..... Respondent
Through: Ms. Kavita Jha, Adv.

AND

ITA 86/2009

THE COMMISSIONER OF INCOME TAX-II ..... Appellant
Through: Mr. Sanjeev Sabharwal, Adv.

versus

MUNJAL SHOWA LTD. ..... Respondent
Through: Ms. Kavita Jha, Adv.

CORAM:
HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE MANMOHAN

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

DIPAK MISRA, CJ

In this batch of appeals, the controversy raised being similar, they were heard analogously and are disposed of by a common order. For the sake of clarity and convenience, we shall refer to the facts in ITA No.56/2010 where the revenue has called in question the defensibility of the order dated 9.1.2009 passed by the Income Tax Appellate Tribunal, Delhi Bench 'D' (for short 'the tribunal') pertaining to the assessment year 1994-95. The revenue has raised the following two questions as questions of law:

> "2.1 Whether learned ITAT correct in law in holding that the expenditure incurred by the Assessee on account of design and drawing fees as Revenue expenditure instead of capital expenditure?
>
> 2.2 Whether learned ITAT erred in holding that the fees paid to the foreign technician for imparting training to Indian technician as Revenue expenditure instead of capital expenditure?"

2. The basic facts which are requisite to be stated are that the assessee – respondent is engaged in the business of manufacture of shock absorbers used in automobile vehicles. It incurred expenses on travel and stay of foreign technical personnel of M/s Showa Corporation, Japan and also on design and drawing charges payable to M/s Showa Corporation, Japan. The assessee treated the same as deferred revenue expenditure in the accounts but while filing the return claimed the entire expenses as revenue expenditure. Originally, the assessing officer allowed the claim on the basis

of entries in the books of accounts. The said order of assessment framed under Section 143(3) of the Income Tax Act, 1961.

3. The said original assessment came to be dealt with by the CIT(A) who treated the same as capital expenditure. The assessee carried the matter before the tribunal. The tribunal by its earlier order remitted the matter to the file of the assessing officer to examine whether the expenses were actually capital or revenue. After the remit, the assessing officer treated the expenses as capital expenditure which was confirmed by the CIT(A).

4. Being dissatisfied with the aforesaid order of the first appellate authority, the assessee preferred an appeal before the tribunal. The tribunal took note of the factum that the assessee had entered into a technical collaboration contract on 22.5.1995 with M/s Showa Corporation, Japan. The tribunal referred to various clauses of the agreement. Clause 1 of the agreement dealt with LICENSOR, Clause 2 of the agreement dealt with LICENSEE and Clause 3 of the agreement dealt with LICENSEE that desires to receive technical assistance from the Licensor for the manufacture of shock absorbers, and the Licensor was willing to give such technical assistance in accordance with this contract. The terms "Know-how" and "Technical Service" have been described as follows:

> "4. The terms "Know-how" means those designs, drawings, standards, specifications and all other technical data, information and knowledge relating to Products design and / or the manufacturing technology of the Products or the Parts (except for the Industrial Property

Rights hereinafter defined) which are necessary for the manufacture, assembly, inspection, maintenance, repair or service of the Products or the parts and which LICENSOR owns as of the date of the execution of this contract or will develop or obtain during the term of the Contract and is entitled to license to LICENSEE, and all documents, whether original or copies, containing any such drawings, standards, specifications and technical data, information or knowledge relating to the manufacturing technology. However, excluded are such information and knowledge which may be made public without act or negligence on the part of the LICENSEE.

5. The term "Technical service" means the following:

-1. Training of technicians

-2. Purchase of facilities and machinery with LICENSEE fund

-3. Installation of facilities

-4. Design and construction of factory

-5. Technical advice and service for start-up of facilities and factory."

5. Article 7 dealt with 'Technical Assistance', Article 14 with 'Maintenance of Secrecy', Article 17 with 'Industrial Property Rights' and Article 19 with 'Consideration'. The same, being relevant, are reproduced below:

"Article 7. Technical Assistance

LICENSOR shall, subject to the payment by LICENSEE of the consideration pursuant to Article 19 below,

provide LICENSEE with the following license, technical information, assistance and services necessary for the manufacture of the Products and the Parts to be procured in the Territory of the extent that LICENSOR shall does necessary advisable after consultation with the LICENSEE.

1. License to use the Industrial Property Rights.

2. Following technical documents in English in LICENSOR's standard form (by reproducible copy plus two printed copies).

a. Parts drawing

b. Parts list

c. Materials list

d. Process control sheet

e. Quality inspection standard and procedures including those for bought-out parts.

f. Operation standard.

g. Tools, jigs and gauges specification, and catalogues.

h. Product performance data.

i. Personnel requirement planning sheets.

j. Product final inspection, standard and procedures including functional tests, endurance tests etc.

3. Following information on the procurement of the manufacturing facilities:

a) Manufacturing facilities lists and catalogues.

b) Plant layout for use in manufacturing facilities installation.

c) Advice related to manufacturing facilities and on the construction of factory building including items like electricity, water, gas fuel and compressed air.

d) Drawing and operational manuals of facilities to be supplied by LICENSOR.

Article 14. Maintenance of Secrecy

1. LICENSEE hereby agrees that it shall use, or cause to be used the know how and technical information furnished to it by LICENSOR under this Contract only for the purposes of this Contract and that it shall not either during the term of this Contract or thereafter, make known, divulge or communicate any such know-how or technical information in any way or manner whatsoever to any person to whom disclosure is not authorized by this Contract.

2. LICENSEE shall take all necessary precautions to keep the know-how secret and confidential.

Article 17. Industrial Property Rights

1. It is hereby agreed and understood by the parties hereto that the use of the Industrial Property Rights and know-how shall be granted by LICENSOR solely for the purpose of the manufacture, assembly and sale of the Products and the Parts in accordance with and the during the term of this Contract.

It is also hereby agreed that the payment of royalty made by LICENSEE under Article 21 hereto shall constitute full compensation for use by LICENSEE by patent rights register in the Territory and forming part of the Industrial Property Rights until the expiring of such patent rights.

Article 19. Consideration

1. In consideration for the technical assistance provided by LICENSOR to LICENSEE pursuant to Article 7 hereof, LICENSEE shall pay to LICENSOR the royalty in the amounts and percentage specified below:

A) Royalty

1. LICENSEE shall pay royalty to LICENSOR for the products manufactured and assembled within the territory. But the payment of royalty shall become due when the products are sold.

II. Royalty to be paid by LICENSEE to LICENSOR shall be three (3) per cent of the ex-factory sales price of the Products invoiced by the LICENSEE."

6. The tribunal, after referring to the said terms of the agreement, came to hold that the assessee was merely granted licence to manufacture the products as per the drawings and designs provided by the licensor. The drawings and designs merely enabled the assessee to manufacture the shock absorbers. Due to change in the model of the vehicles, the assessee was required to change the design of such shock absorbers from time to time for which new drawings and designs were required and the same also required training of the assessee's personnel. This training was provided by the

licensor's personnel. The amount that was paid by the assessee only en the assessee to facilitate the manufacturing process but he did not acquire the proprietary right in such drawings and designs. Thereafter, the tribunal referred to its order passed in ***DCIT v. Bharat Seats Ltd.*** in ITA No.2394/Del of 2004 wherein the tribunal relied on the decision in ***ACIT v. TEI Technologies P. Ltd.*** in ITA No.5079/Del/04. The decision rendered in ***TEI Technologies P. Ltd.*** (supra) travelled to this Court and the same was given the stamp of approval in ***CIT v. T.E.I. Technologies P. Ltd.***, (2008) 304 ITR 262 (Delhi). The tribunal eventually came to hold that the expenses were incurred for training the personnel of the assessee and for availing drawings and designs to manufacture the shock absorbers but not for acquiring technology itself and, therefore, it could not be held to be capital expenditure.

7. We have heard Mr. Sanjeev Sabharwal, learned counsel for the revenue, and Ms. Kavita Jha, learned counsel for the respondent – assessee. The hub of the matter is whether the tribunal is justified in treating the expenditure as capital expenditure or revenue expenditure.

8. In ***Alembic Chemical Works Co. Ltd. v. Commissioner of Income-Tax, Gujarat*** (1989) 177 ITR 377, the Apex Court referred to the decisions in ***City of London Contract Corporation v. Styles***, [1887] 2 Tax Cas 239, ***Vallambrosa Rubber Co. v. Farmer***, [1910] 5 Tax Cas 529, ***British Insulated Helsby Cables Ltd. v. Atherton***, [1926] AC 205, ***Assam Bengal Cement Companies Ltd. v. CIT***, [1955] 27 ITR 34, ***Sitalpur Sugar Works***

Ltd. v. CIT, [1963] 49 ITR (SC) 160, ***Lakshmiji Sugar Mills Co. L CIT***, [1971] 82 ITR 376 (SC), ***Travancore Cochin Chemicals v. CIT***, [1977] 106 ITR 900 (SC) and ***Sun Newspapers Ltd. and Associated Newspapers Ltd. v. Federal Commissioner of Taxation***, [1938] 61 CLR 337 and came to hold as follows:

> "It would, in our opinion, be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in this fast-changing area of medical science. The state of the art in some of these areas of high priority research is constantly updated so that the know-how cannot be said to be the element of the requisite degree of durability and nonephemerality to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeon-holing an outlay such as this as capital. The circumstance that the agreement in so far as it placed limitations on the right of the assessee in dealing with the know-how and the conditions as to non-partibility, confidentiality and secrecy of the know-how incline towards the inference that the right pertained more to the use of the know how than to its exclusive acquisition."

9. In the case of ***Jonas Woodhead And Sons (India) Limited v. Commissioner of Income Tax***, [1997] 224 ITR 342 (SC), the Apex Court, after referring to the decisions in ***Empire Jute Co. Ltd. v. CIT***, [1980] 124

ITR 1, ***CIT v. Tata Engineering and Locomotive Co. P. Ltd.***, [1980] ITR 538, ***Alembic Chemical Works Co. Ltd.*** (supra), ***CIT v. CIBA of India Ltd.***, [1968] 69 ITR 692 (SC), ***CIT v. Lucas T.V.S. Limited (No.1)***, [1977] 110 ITR 338 (Mad), ***CIT v. Sarada Binding Works***, [1976] 102 ITR 187 (Mad), and ***Agarwal Hardware Works (P.) Ltd. v. CIT***, [1980] 121 ITR 510 (Cal), held thus:

> "It would thus appear that the courts have applied different tests like starting of a new business on the basis of technical know-how received from the foreign firm, the exclusive right of the company to use the patent or trademark which it receives from the foreign firm, the payment made by the company to the foreign firm whether a definite one or dependant upon certain contingencies, the right to use the technical know how of production or the activity even after the completion of the agreement, obtaining enduring benefit for a considerable part on account of the technical informations received from a foreign firm, payment whether made "once for all" or in different instalments co-relatable to the percentage of gross turnover of the product to ultimately find out whether the expenditure or payment thus made makes an accretion to the capital asset and after the court comes to the conclusion that it does so, then it has to be held to be a capital expenditure. As has been held by this court and already indicated in Alembic Chemical Works' case [1989] 177 ITR 377 no single definitive criterion by itself could be determinative and, therefore, bearing in mind the changing economic realities of business and the varieties of situational diversities the various clauses of

> the agreement are to be examined. But in the case in hand the High Court having considered the different clauses of the agreement and having come to the conclusion that under the agreement with the foreign firm what was set up by the assessee was a new business and the foreign firm had not only furnished information and the technical know-how but rendered valuable services in setting up of the factory itself and even after the expiry of the agreement there is no embargo on the assessee to continue to manufacture the product in question, it is difficult to hold that the entire payment made is revenue expenditure merely because the payment is required to be made at a certain percentage of the rates of the gross turnover of the products of the assessee as royalty. In our considered opinion, in the facts and circumstances of the case the High Court was fully justified in answering the reference in favour of the Revenue and against the assessee."

10. In ***T.E.I. Technologies P. Ltd.***, (supra), the Division Bench of this Court was dealing with a scenario where the assessee had entered into a joint venture agreement with the foreign company to carry out manufacturing operation of CRT sockets, electronic components like TV remote control, etc., for the domestic market as well as for exports. The assessee had paid the technical support fee to the foreign companies, namely, Tyco Asia Investment Ltd. as well as Elentec Co. Ltd. The assessing officer held that the benefit received by the assessee was of an enduring nature and, therefore, the amount was treated as a capital expenditure and not as a revenue expenditure. The CIT(A) reversed the finding of the assessing

officer on the foundation that there was no transfer of technical know-h the setting up of the plant and machinery but the payment was only to enable the assessee to manufacture the products. In other words, the technical support was in the form of technical advice rather than sharing of any technical know-how, designs, drawings, etc. The tribunal concurred with the view expressed by the CIT. On a further appeal being preferred, the Division Bench referred to the decision in ***Gannon Norton Metal Diamond Dies Ltd. v. CIT*** [1987] 163 ITR 606 wherein the Bombay High Court held that if the know-how acquired relates to the process of manufacture, then any payment made for the said purpose would have to be considered as a revenue expenditure since the acquirer does not obtain any asset of an enduring nature because it is more in the nature of a payment for consultancy. The Bench referred to the decision in ***Empire Jute Co. Ltd. v. CIT*** (supra) and came to hold that it is not every advantage of an enduring nature that can be classified as a capital expenditure. One has to take a pragmatic and commercial view of the matter and if that is done, there can be no doubt that the assessee acquired technical know-how to enable it to manufacture the products and this was more in the nature of information guidance or payment for consultancy. Being of this view, the Bench concurred with the conclusion arrived at by the tribunal.

11. In ***Shriram Pistons And Rings Ltd. v. Commissioner of Income-Tax***, [2008] 307 ITR 363 (Delhi), the Division Bench was dealing with the fact where the assessee had entered into a technical collaboration agreement with a foreign company of Japan for the manufacture of piston rings. The

agreement was in two parts : one, to provide comprehensive technical k how and the second, dealing with technical assistance by the foreign company to the assessee for manufacturing and selling the product known as piston rings. The Bench was concerned with the transfer of the know-how. After perusing the clauses of the agreement and relying upon the decisions in ***CIBA of India Ltd.***, (supra), ***Alembic Chemical Works Co. Ltd.*** (supra), ***CIT v. Associated Cement Companies Ltd.***, [1988] 172 ITR 257 and ***Triveni Engineering Works Ltd. v. CIT***, [1982] 136 ITR 340, the Bench came to hold as follows:

> "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-licence the technical know-how and that was possible only with the prior written permission from Riken. For all other matters, the assessee was liable to treat as confidential all inventions, drawings, documents, specifications 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 termination 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 Assesee's rights 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.
>
> That being our conclusion, we are in agreement with the view expressed by the Tribunal that there was no sale of technical know-how by Riken to the assessee and therefore, the payment made by the assessee to Riken was a revenue expenditure."

12. In the case at hand, the know-how was granted by the foreign company solely for the purpose of manufacture, assembly and sale of products during the term of the contract and the licensee was to pay royalty to the licensor. The drawings and designs which were supplied by the licensor only enabled the assessee to manufacture the goods, namely, the shock absorbers. The assessee was required to change the design of such shock absorbers from time to time for which new drawings and designs were required. For the aforesaid purpose, the training of the personnel of the assessee was imperative. If the agreement is read in entirety in a purposeful manner, there can be no trace of doubt that the know-how acquired relates to the process of manufacturing and for a tenure and the documents, designs and specifications which have been supplied by the licensor are only for facilitating the said purpose of manufacturing. This is basically in the realm of technical support and thus, the decisions in ***T.E.I. Technologies P. Ltd.***,

(supra) and ***Shriram Pistons And Rings Ltd.*** (supra) get squarely attr to the case at hand.

13. In view of the aforesaid analysis, we do not perceive any merit in these appeals and, accordingly, they are dismissed without any order as to costs.

CHIEF JUSTICE

MANMOHAN, J

SEPTEMBER 6, 2010
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