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

\+ **ITA No.1943/2010, 763/2011 & 765/2011**

% ITA No. 1943/2010 Reserved On: APRIL 21, 2011
ITA Nos. 763/2011 & 765/2011 Reserved On: MAY 25, 2011

Judgment Delivered On**:** 11.07.2011

THE COMMISSIONER OF INCOME TAX-IV NEW DELHI .... **APPELLANTS**

Through: Mr. Sanjeev Sabharwal, Advocate for the appellant.

Versus

G4S SECURITIES SYSTEM (INDIA) PVT. LTD. .... **RESPONDENTS**

Through: Ms. Kavita Jha, Advocate for the respondents.

CORAM:
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1.	Whether reporters of 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

M.L. MEHTA, J.

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1. The question of law which arises for consideration in these appeals is common. These appeals concern with the same Assessee, though these pertain to different Assessment Years.

2. ITA 1943/2010 and ITA 765/2011 are directed against the impugned common order dated 10.07.2009 of the ITAT (for short 'the Tribunal'). These pertain to assessment years 2003-04 and 2002-03 respectively. ITA 763/2011 is against the impugned order dated 03.07.2009 of the Tribunal and it pertains to assessment year 2005-06.

3. It so happened that ITA 1943/2010 pertaining to assessment year 2003-04 came to be heard by us prior in time than the other two appeals. This appeal was admitted only on one substantial question of law which is as under:

> *"Whether learned ITAT/CIT(A) erred in deleting the addition of Rs.40,30,509/- on account of Royalty, ignoring that payment made as royalty has element of Capital Expenditure?"*

4. In the other two appeals viz ITA 763/2011 and 765/2011 also identical question came up for consideration for admission. The counsel of both the parties in these cases also being the same, they adopted the arguments as made in ITA 1943/2010. The substantial question of law in all the three appeals being identical and there being only difference of amounts involved, we would like to make a brief narration of facts stating the background under which this question has arisen for our consideration. For the sake of convenience, we record the facts

from ITA 1943/2010, which would cover other two cases as well. Brief facts entailing the present appeals are as under:

5. The Assessee is a private limited company and engaged in a business of providing guard services, development of computer software, staff training etc. The assessee filed its return of assessment year 2003-04 on 28.11.2003 declaring income of ₹10,73,40,025/-. However, the Assessment Order was also framed under Section 143(3) of the Income Tax Act ('the Act' for short) wherein it was observed by the Assessing Officer that assessee had paid royalty in lieu of technical knowhow assistance from M/s Group 4 Falck A/S, Denmark for exclusive use for five years, which was extendable by every five years in terms of agreement dated 20.06.2002. The assessee had debited certain amount to Profit & Loss Account by way of royalty for technical knowhow and use of trade mark to a foreign company namely M/s. Group 4 Falck A/S, Denmark for the right to use logo, trade mark and technical knowhow in pursuance of agreement dated 20.06.2002 through Group 4 Holding Pvt. Ltd. on the basis of 1% of net sales. The payment of the royalty was approved by the Government of India.The Assessing Officer held the payment of royalty in lieu of technical knowhow in the nature of enduring advantage for exclusive use and therefore, on *ad-hoc* basis he held that 25% of the royalty to be construed as

payments of the capital nature. It is noted that identical order was passed by the Assessing Officer in the assessment year 2002-03 and also in the assessment year 2005-06. The assessee preferred appeal against the order of the Assessing Officer before CIT(A). The order of the Assessing Officer passed in the assessment year 2002-03 and 2003-04 was challenged before CIT(A) who decided the appeals in favour of the assessee vide order dated 28.01.2008. The appeal for the assessment year 2005-06 was allowed by the CIT(A) vide its order dated 17.02.2008 following the order of CIT(A) dated 28.01.2008. Revenue preferred appeals before the Tribunal. The Tribunal dismissed the appeals of the Revenue for the assessment year 2005-06 vide impugned order dated 03.07.2009 which is in challenge before us in ITA 763/2011. Following the order of 03.07.2009, the Tribunal also dismissed the appeals of the Revenue for the assessment year 2002-03 and 2003-04 which is challenged before us vide ITA 765/2011 and 1943/2010 respectively.

6. We have heard the learned counsel for the parties and perused the record.

7. At the outset it may be noted that it was following agreement dated 20.06.2002 between Group 4 Falck A/S, Denmark and Group 4 Holding Pvt. Ltd., that a further sub license agreement

was entered into by Group 4 Holding Pvt. Ltd. and the Assessee. This sub license agreement is also dated 20.06.2002.

8. Similar definition of trade mark, G4F knowhow, as existing in the agreement between G4F and Group4 Holding Private Limited are also incorporated in the sub license agreement. Clause 4.1 of the sub license agreement provides for the operational period of the agreement for a term of 5 year from the effective date, and continuance' thereafter for further successive 5 years period unless either party give 6 months written notice to other party prior to the end of any such 5 year period that the agreement should not be renewed. Clause 17 of the sub license agreement acknowledges that G4F has the right to enforce, or to enjoy the benefit of any term of this agreement which is expressly or impliedly in favour of G4F. In clause 4.6 of the sub license agreement, it has been provided that on termination or expiration of the sub license agreement, the assessee shall return all G4F knowhow obtained in pursuant to the Agreement. At Clause 4.7 it has been provided that on termination or expiration of the agreement, the appellant/assessee shall not thereafter make any use of the trade mark, trade name or G4F knowhow and shall forthwith change its corporate and/or trade names.

9. From the terms of the agreement it is noticed that this arrangement was for a period of 5 years, which may be extended by another period of 5 years unless either party gives 6 months notice to the other party prior to the end of such 5 years period. The payment of commission @ 1% was based on the net sales and not lumpsum. On the termination of expiration of the sub license agreement, the assessee was to return all G4F knowhow obtained pursuant to the said agreement. Not only that, the assessee was not even entitled to make use of the trade mark name or G4F knowhow and was forthwith to change its' corporate and/or trade names. All rights and knowhow, therefore, continued to vest in G4F and it was only the right to use the knowhow that was made available to the assessee and that too based on its net sales. That means all the royalty paid in the shape of 1 % of net sales for the use of trade mark and right to use knowhow could not be considered to be of enduring nature and thus capital expenditure. The expenditure was to be of revenue nature. In the case of ***Jonas Wood Head and Sons Vs. CIT, 117 ITR 55***, it was held that the question regarding capital or revenue expenditure depends on the terms of agreement in each case. In the case of ***CIT Vs. Gujarat Carbon Ltd., 254 ITR 294***, it was held that the payment of revenue under the agreement was directly relatable to services which

were in the revenue field and were allowable as revenue expenditure. In the case of ***Goodyear (I) Ltd. Vs. ITO 73 ITD 189(Delhi)***, the assessee had not acquired ownership right of technical knowhow but transfer of use of licenses. There was no advantage of enduring nature and hence it was held to be a case of revenue expenditure. In the case of ***Travancore Sugar and Chemicals Ltd. 62 ITR 566 (SC)*** it was held that whenever a payment is based on a percentage of turnover or profits, it necessarily has no relation to the capital value of the asset, because it cannot be known at the time of the agreement what the turnover or profits will be over a period of years. In another case reported as ***DCIT Vs. Swaraj Engines Ltd. (2002) 124 Taxman 188***, the Tribunal held, revenue payment is allowable as revenue expenditure, since it is related to sales and that it is paid for better conduct, efficiency and improvement of the existing business or product manufactured by the assessee. In the case of ***CIT Vs. Lumax Industries Ltd. (2008) 173 Taxman 290 (Delhi)***, this Court has also held that the payment of license fee on year to year basis for acquisition of technical knowledge would not amount to capital expenditure, but the revenue expenditure.

10. From the ratio of the above said cases, we are of the considered view that under the terms of the agreement as noted above, the

ownership rights of the trade mark and knowhow throughout vested with G4F and on the expiration or termination of the agreement the assessee was to return all G4F knowhow obtained by it under the agreement. The payment of royalty was also to be on year to year basis on the net sales of the assessee and at no point of time the assessee was entitled to become the exclusive owner of the technical knowhow and the trade mark. Hence, the expenditure incurred by the assessee as royalty is revenue expenditure and is therefore, relatable under Section 37(1) of the Act. We thus, answer the question in favour of the Assessee and against the Revenue and consequently dismiss all the three appeals.

M.L.MEHTA
(JUDGE)

A.K. SIKRI
(JUDGE)

JULY 11, 2011
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