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* IN THE HIGH COURT OF DELHI AT NEW DELHI

DECIDED ON: 18.09.2012

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ITA-576/2012

DIRECTOR OF INCOME TAX

..... Appellant

Through: Mr. Deepak Chopra, Sr. Standing
Counsel.

versus

ITALIAN THAI DEVELOPMENT CO LTD

..... Respondent

Through: Nemo.

CORAM:

MR. JUSTICE S. RAVINDRA BHAT

MR. JUSTICE R.V. EASWAR

MR. JUSTICE S.RAVINDRA BHAT (OPEN COURT)

% The Revenue seeks to appeal against the order of the ITAT dated 25.11.2011 in ITA No.2560/Del/2011. It is urged that the impugned order so far as it allowed the assessee deduction of Rs.23,96,362/- paid as upfront fee and a further sum of Rs.20,000/- on account of bank charges is in error of law.

2. The assessee, a foreign company registered in Bangkok has its office in India; it was engaged in certain works in Hydro Electric Power Project in Himachal Pradesh. It obtained a loan of Rs.87 Crores (equivalent to US \$ 2 Crore) from Standard Chartered Bank, N.Y. The terms of the agreement



stated that “net commission” was payable in US \$ 200,000/- to the Standard Chartered Bank, New York. The Assessing Officer was of the opinion that the amount of tax on the upfront fees borne and paid by the assessee had to be disallowed under Section 40 (a) (ii) and, therefore, disallowed the sum of Rs.23,96,362/-. Applying the same logic, he also disallowed the sum of Rs.20,000/- paid as bank charges.

3. The CIT (A) upheld the disallowance and also held that the expenditure was in the course of acquiring a capital asset. The ITAT agreed with the assessee, holding that the tax borne by the assessee was a part of the entire consideration agreed to be paid. In doing so, the ITAT relied upon and followed the judgment in *Tata Yadogawa Ltd v. CIT*, (2011) 335 ITR 53 and *CIT v. Standard Polygraph Machines P. Ltd.* (1998) 243 ITR 788 (Mad.). The ITAT allowed the appeal of the assessee, following the said two judgments. The view expressed in *Tata Yadogawa* which was followed is extracted below: -

“Under the collaboration agreement the know-how was to be provided to the assessee by ESW, in consideration whereof the assessee was to pay a sum of two million Deutsche Marks (hereinafter referred as “DM”) overseas, i.e., Austria in three equal installments in the manner laid down in paragraph 13.1 of the agreement. In addition to the above, the agreement provided that taxes, if any, on the aforesaid payment were to be borne by the assessee vide paragraph 13.5 of the said agreement. After approval of the said technical collaboration agreement by the appropriate authorities, the assessee applied under section 195(2) of the Income-tax Act, 1961 (hereinafter referred to as “the Act” for short) to the Assessing Officer (hereinafter referred to as “the AO”), for grant of permission to remit the said consideration without deduction of tax at



source. 9 The Assessing Officer passed orders directing the assessee to deduct TDS under section 195(2) of the Act directing the assessee to deduct TDS while remitting the payments to ESW. As a result the assessee paid certain amounts by way of income-tax on the remittances and also paid some further amounts by way of “research and development cess” before making the remittances. The assessee filed appeals under section 248 of the Act against the orders passed by the Assessing Officer under section 195(2) of the Act. In the appeals the assessee asserted that no income-tax was payable on the remittances to ESW because of the provisions of the Act read with the international agreement for avoidance of double taxation. The appeals of the assessee were allowed by the Commissioner of Income-tax (Appeals) upholding the aforesaid contention of the assessee and holding that no income-tax was payable on the remittances. However, the Income-tax Department went in appeal before the Income-tax Appellate Tribunal against the orders of the Commissioner of Income-tax (appeals). Because those appeals filed by the Department were pending before the Income-tax Appellate Tribunal, therefore, the Assessing Officer refunded the income-tax deposited by the assessee along with the interest accrued on the said tax in terms of section 244A, after obtaining indemnity bonds guaranteeing redeposit of the refunded tax and interest, in case the order of the Commissioner of Income-tax (Appeals) were reversed by the Income-tax Appellate Tribunal. The Income-tax Appellate Tribunal dismissed the appeals and thereafter also rejected the applications of the Department seeking reference under section 256(1) of the Act (as the said section stood in the relevant years). The orders rejecting the reference applications of the Department under section 256(1) by the Income-tax Appellate Tribunal were served upon the assessee on May 17, 1999, that is to say in the financial year relevant to the Assessment Year 2000-01. Thereupon the assessee credited the refunded amounts in its audited accounts drawn up for the said financial year ending March 31, 2000 corresponding to the Assessment Year 2000-01 in accordance with section 41 of the Act.”



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So far as the first question is concerned, we find from section 35AB that deduction is permissible in respect of any lump sum consideration for acquiring any know-how for use for the purposes of the assessee's business. "consideration" in section 35AB is to be understood in the sense in which it has been used in the Indian Contract Act. Therefore the word "consideration" would include the entire obligation of the assessee, without which the assessee would not be able to acquire the know-how. On the facts of this case the obligation of the assessee under the agreement with ESW extended not merely to remitting the amount of two million DM to ESW, but also extended to payment of taxes which would include the income-tax as well as the research and development cess. It seems quite obvious that if the assessee had not paid the tax or the research and development cess, and had merely made payment of the two million DM to ESW, the latter would not be obliged to part with the know-how in view of the terms of the collaboration agreement. Therefore, payment of these taxes is as integral a part of the "consideration" as the payment of two million DM. In fact, the Income-tax Department is itself treating not merely the amount of two million DM paid to ESW but also the research and development cess, as part of "consideration". In these circumstances we find no logical reason for not treating the income-tax paid by the assessee in terms of the collaboration agreement as part of the "consideration" for acquisition of the know-how. We hold accordingly and answer the first question as above. A reference in this connection may be made to the decision of the Supreme Court in the case of McDowell and Co. Ltd. v. CTO reported in [1985] 154 ITR 148 (SC) wherein it was held that excise duty was part of the "consideration". Another direct decision covering the question is by the Madras High Court in the case of Standard Polygraph Machines P. Ltd. [2000] 243 ITR 788 (Mad.)."

4. Having regard to the above reasoning which we have no reason to



disagree with, and the language of Section-40 (a) (ii) - which in our opinion is expansive enough to cover payments of the kind as the Court has now to deal with – we feel that no substantial question of law arises for consideration.

The appeal is, therefore, dismissed.

**S. RAVINDRA BHAT
(JUDGE)**

**R.V. EASWAR
(JUDGE)**

SEPTEMBER 18, 2012
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