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

\+ **ITA No. 417/2013**

Reserved on: 25th September, 2013
Date of Decision: 19th December, 2013

COMMISSIONER OF INCOME TAX – VI **....Appellant**
Through Mr. Amol Sinha, Sr. Standing Counsel

Versus

HUTCHINSON ESSAR TELECOM PVT. LTD. **....Respondent**
Through Mr. N.K. Kaul, Sr. Advocate with
Mr. Salil Kapoor, Mr. Vikas Jain and
Mr. Sanat Kapoor, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJIV KHANNA, J.

For detailed order see ITA No. 1336/2010 titled ***Commissioner of Income Tax versus Bharti Hexacom Limited*** pronounced today.

(SANJIV KHANNA)
JUDGE

(SANJEEV SACHDEVA)
JUDGE

DECEMBER 19th, 2013
kkb/NA

* IN THE HIGH COURT OF DELHI AT NEW DELHI

\+ ITA No. 1336/2010

Reserved on: 13th August, 2013
% Date of Decision: 17th December, 2013

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr.Kamal Sawhney, Sr. Standing Counsel

versus

BHARTI HEXACOM LTD ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and Mr.Kaanan Kapur, Advocates

ITA 1679/2010

COMMISSIONER OF INCOME TAX .....Appellant
Through: Mr.Kamal Sawhney, Sr. Standing Counsel

Versus

BHARTI CELLULAR LTD ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and Mr.Kaanan Kapur, Advocates

ITA 1680/2010

COMMISSIONER OF INCOME TAX .....Appellant
Through: Mr.Kamal Sawhney, Sr. Standing Counsel

Versus

BHARTI CELLULAR LTD ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and Mr.Kaanan Kapur, Advocates

ITA 114/2012

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr.Abhishek Maratha, Senior Standing Counsel
With Ms.Anshul Sharma, Adv.

Versus

BHARTIHEXACOM LTD ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and
Mr.Kaanan Kapur, Advocates

ITA 996/2011

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr.Abhishek Maratha,
Senior Standing Counsel
With Ms.Anshul Sharma, Adv.

Versus

BHARTI HEXACOM LIMITED ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and
Mr.Kaanan Kapur, Advocates

ITA 1328/2010

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr.Kamal Sawhney, Sr. Standing
Counsel

Versus

BHARTI HEXACOM LTD ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and
Mr.Kaanan Kapur, Advocates

ITA 177/2012

COMMISSIONER OF INCOME TAX ..... Appellant
Through:Mr.Abhishek Maratha, Senior
Standing Counsel with
Ms.Anshul Sharma,Adv.

Versus

BHARTI AIRTEL LTD ..... Respondent
Through: Mr.Ajay Vohra, Ms.Kavita Jha and
Mr.Kaanan Kapur, Advocates

ITA No. 893/2010

Reserved on: 29th November, 2013
Date of Decision: 19th December, 2013

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr.Kamal Sawhney, Sr. Standing
Counsel

versus

BHARTI CELLULAR LTD. ..... Respondent
Through: Ms.Kavita Jha, Advocate

ITA 1333/2010

COMMISSIONER OF INCOME TAX .....Appellant
Through: Mr.Kamal Sawhney, Sr. Standing Counsel

Versus

BHARTI TELENET LTD. ..... Respondent
Through: Ms.Kavita Jha, Advocate

ITA No. 417/2013

Reserved on: 25th September, 2013
Date of Decision: 19th December, 2013

COMMISSIONER OF INCOME TAX – VI ....Appellant
Through Mr. Amol Sinha, Sr. Standing Counsel

Versus

HUTCHINSON ESSAR TELECOM PVT. LTD. ....Respondent
Through Mr. N.K. Kaul, Sr. Advocate with Mr. Salil Kapoor, Mr. Vikas Jain and Mr. Sanat Kapoor, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJIV KHANNA, J.

This common judgment/order will dispose of appeals filed by Commissioner of Income Tax, Delhi – I/Delhi VI, as identical question of law arise for consideration in the following cases:

S No.	ITA No.	Name of the Assessee	Assessment Year
1.	1328/2010	Bharti Hexacom	2003-04
2.	1336/2010		2004-05
3.	114/2012		2006-07

4.	996/2011		2007-08
5.	893/2010	Bharti Cellular	2000-01
6.	1680/2010		2001-02
7.	1679/2010		2002-03
8.	177/2010	Bharti Airtel Ltd.	2005-06
9.	1333/2010	Bharti Telenet Ltd.	2000-01
10.	417/2013	Hutchinson Essar Pvt. Ltd	1999-2000

2. The principal and core issue raised in the present appeals is similar i.e. whether licence fee payable is capital or revenue expenditure. However, there is one basic difference between appeals listed at Sl. Nos. 1 to 9 in paragraph 1 above, and the appeal in the case of Hutchison Essar Pvt. Ltd. i.e. ITA 417/2013 which should be noticed and referred to at the very outset. The said appeal relates to assessment year 1999-2000 and pertains to licence fee paid under and in terms of an agreement executed in 1994 with the Department of Telecommunications/Government of India, whereas other appeals listed at Sl. Nos. 1 to 9 above, relate to variable licence fee on revenue sharing basis paid under the new Telecom Policy, 1999. However, as the facts and issues are identical, we have deemed it appropriate to decide the appeal filed against Hutchison Essar Pvt. Ltd. along with appeals at Sl.Nos. 1 to 9. Wherever necessary, we have dealt with the issue and contentions raised in the said appeal separately.

3. Common substantial question of law required to be decided in these appeals reads:-

> "1. Did the Tribunal fall into error in holding that the variable licence fee paid by the assessees was properly deductible as revenue expenditure?

4. As is apparent from the substantial question of law quoted above, the issue raised is whether the variable licence fee paid by the

respondents under Indian Telegraph Act, 1885, and Indian Wireless Fee Act 1933, payable under the New Telecom Policy 1999 or 1994 agreement, is revenue expenditure or capital expenditure which is required to be amortized under Section 35ABB of the Income Tax Act, 1961 (Act, for short).

5. At the very outset, we would like to reproduce Section 35ABB, which reads:

> "35ABB.(1) In respect of any expenditure, being in the nature of capital expenditure, incurred for acquiring any right to operate telecommunication services[either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year] and for which payment has actually been made to obtain a licence, there shall, subject to and in accordance with the provisions of this section, be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.
>
> *Explanation.*—For the purposes of this section,—
>
> [(*i*) "relevant previous years" means,—
>
> (*A*) in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;
>
> (*B*) in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent previous year or years during which the licence, for which the fee is paid, shall be in force;]
>
> (*ii*) "appropriate fraction" means the fraction the numerator of which is one and the denominator of which is the total number of the relevant previous years;
>
> (*iii*) "payment has actually been made" means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

(2) Where the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of the transfer, shall be allowed in respect of the previous year in which the licence is transferred.

(3) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred to obtain the licence and the amount of such expenditure remaining unallowed shall be chargeable to income-tax as profits and gains of the business in the previous year in which the licence has been transferred.

Explanation.—Where the licence is transferred in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(4) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are not less than the amount of expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed under sub-section (1) in respect of the previous year in which the licence is transferred or in respect of any subsequent previous year or years.

(5) Where a part of the licence is transferred in a previous year and sub-section (3) does not apply, the deduction to be allowed under sub-section (1) for expenditure incurred remaining unallowed shall be arrived at by—

(*a*) subtracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed; and

(*b*) dividing the remainder by the number of relevant previous years which have not expired at the beginning of the previous year during which the licence is transferred.

(6) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the licence to the amalgamated company (being an Indian company),—

(*i*) the provisions of sub-sections (2), (3) and (4) shall not apply in the case of the amalgamating company; and

(*ii*) the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.]

[(7) Where, in a scheme of demerger, the demerged company sells or otherwise transfers the licence to the resulting company (being an Indian company),—

(*i*) the provisions of sub-sections (2), (3) and (4) shall not apply in the case of the demerged company; and

(*ii*) the provisions of this section shall, as far as may be, apply to the resulting company as they would have applied to the demerged company if the latter had not transferred the licence.]

(8) Where a deduction for any previous year under sub-section (1) is claimed and allowed in respect of any expenditure referred to in that sub-section, no deduction shall be allowed under sub-section (1) of section 32 for the same previous year or any subsequent previous year."

6. As is apparent from the Section itself, it applies when expenditure of capital nature was/is incurred by an assessee for acquiring a right for operating telecommunication services. It is immaterial whether the expenditure is/was incurred before or after commencing the business to operate telecommunication services. But, the payment should be actually made. We agree with the counsel for the respondents that the said provision does not stipulate or mandate that any expenditure for a right to operate telecommunication services or payment made for the said licence as per the section is deemed to be a capital expenditure. Section 35ABB is not a deeming provision but comes into operation and is effective when the expenditure itself is of a capital nature and is incurred for acquiring a right to operate telecommunication services or is made to obtain a licence for the said services. It can be incurred

before commencement of business or thereafter, but should be incurred during the previous year. Thus Section 35ABB by itself does not help us in determining and deciding the question whether licence fee paid under the New Telecom Policy 1999 or under the 1994 agreement, was/is capital or revenue in nature.

7. Undisputed facts which are relevant may be now noticed. The respondent companies are engaged in business of telecommunication services and value added related services. They have procured licence in different circles. Originally the said licences were awarded under licence agreement executed in 1994. The period of licence as stipulated was for ten years initially, expandable for one year or more at the discretion of the authorities. The licence could not be assigned, transferred in any manner, whatsoever to any third party or by entering into agreement by sub-licence, partnership etc. The authorities had the right to revoke the agreement on breach of any term or on default of payment by giving sixty days notice. The licence was issued on non-exclusive basis and the authorities reserved their right to operate the same services within the geographical area and had right to modify the conditions of the licence as stipulated in the Schedules A to D, when considered necessary or expedient in the interest of general public or for proper conduct of telegraph services or for security considerations. Even otherwise, the authorities had the right to terminate the licence at any time in public interest by giving sixty days notice. Schedule A, prescribed the area of service; Schedule B prescribed the tariff ceiling and stipulated that all tariff increases shall be subject to prior approval of the authorities but the lower tariff could be charged from the users without prior approval.

There was stipulation that no free time could be given in the air time.

Licence fee payable under this agreement was as under:-

"PAYMENT OF LICENCE FEES

19.1 The Licence fee payable by licencee for each service area shall be regulated as follows:-

Service Area	Licence Fee For 1st Year	2nd Year	3rd Year
	(Rupees in Crores)		
Bombay	3	6	12
Delhi	2	4	8
Calcutta	1.5	3	6
Madras	1	2	4

4th Year and onwards

@ Rs. 5 lakhs (five lakhs) per 100 (one hundred) subscribers or part thereof; subject to the minimum shown below:-

Service Area	Minimum Licence Fee for Fourth to Sixth Year (for each year)	Seventh year onwards (for each year)
	(Rs.in crores)	
Bombay	18	24
Delhi	12	16
Calcutta	9	12
Madras	6	8

a) For purpose of charging the lump-sum Licence fee for the first three years, the year shall be reckoned as twelve months, beginning with the date of commissioning of services or completion of 12 months from date of signing of Licence Agreement, whichever is earlier.

b) The fourth year for purpose of charging the Licence fee shall be the period from the completion of the third year as defined above to the 31st day of March

succeeding. The annual Licence Fee for the fourth year will therefore, be computed prorate with reference to the actual number of days. Thereafter, the year for purpose of levy of Licence fee shall be the financial year i.e. 1st April to 31st March and part of the year as balance period, if any.

c) For the purpose of calculation of Licence fee from the fourth year onwards as indicated in para 19.1 above, the number of subscribers at the end of each month shall be added for all the months of the year and divided by the number of completed months.

.....

(f) The rate of Rs. five lakhs per hundred subscribers or part thereof is based on the unit call rate of Rs.1.10. Fourth year onwards, as defined in the clause 19.1(d), the rate of Rs. five lakhs will be revised based on the prevalent unit call rate. The revision will be limited to 75% of the overall increase in the unit rate during the period preceding such revision.

Agreement further stipulated:

19.2 On completion of three years from the date of commissioning/provision of services; the Authority reserves the right to fix the share of the gross revenue from rental, air time charges for all other services provided from the cellular network of the Licensee, as additional licence fee.

19.3 The annual Licence fee as prescribed above does not include Licence fees payable to WPC wing of Ministry of Communications (WPC) for use of Radio Frequencies which shall be paid separately by the Licensee on the rates prescribed by the WPC and as per procedure specified by it (condition 20)."

8. National Telecom Policy 1999 stands recorded in communication dated 22nd July, 1999. The said policy stipulates that licencee would be required to pay one time entry fee and licence fee on percentage share of gross revenue. Entry fee chargeable would be the fee payable by the existing operator upto 31st July,1999 calculated upto the said date and adjusted upon notional extension of the

effective date. Licence fee as a percentage of gross revenue under the licence shall be payable w.e.f. 1st August, 1999. The quantum of revenue share to be charged as licence fee would be finally decided after obtaining recommendation of Telecom Regulatory Authority of India (TRAI) but meanwhile the Government had fixed 15% of the gross revenue of the licencee as provisional licence fee. On receipt of TRAI's recommendation by the Government, final adjustment of the dues would be made.

9. Clause (vi) of the said letter indicates that there were only two cellular operators in the area/service area and it was postulated that if either of the cellular operator did not accept the package, both the existing operators would continue the earlier licence till the validity of the said licence. In clause (vii), stipulated that upon migration to National Telecom Policy 1999, the licensees would forego right of operating in the regime of limited number of operators as per existing licencing agreement and would operate in multiple licence regime i.e. additional licences without any limit might be issued in a given service area. It was further stipulated that there shall be a lock-in of the present shareholding for a period of 5 years from the date of licence agreement and the transfer of shareholding directly or indirectly through subsidiary or holding companies shall not be permitted during this period. However, issue of additional share capital by licencee companies/their holding companies, by issue of private placements/ public issues would be permitted. This lock-in time would not be applicable in case of transfer of shares by enforcement of pledge by the lending financial institutions/banks due to defaults. The period of licence was stated to be 20 years from the effective date of the existing licence agreement i.e., the 1994

agreement. Migration to National Telecom Policy 1999, was on the condition and premise that the conditions should be accepted as a package in entirety and simultaneously and all legal proceedings shall be withdrawn and no dispute for the period upto 31st July, 1999, shall be raised at any future date. After the terms were accepted, amendments in the existing licence agreement would be signed.

10. The respondents have migrated and accepted the National Telecom Policy, 1999. Respondents herein in ITA Nos. 1328/2010, 1336/2010, 114/2012, 996/2011, 893/2010, 1680/2010, 1679/2010, 177/2010, 1333/2010 have paid the licence fee upto 31st July, 1999, i.e. one time licence fee as stipulated in the letter/ communications dated 22nd July, 1999 and have treated the said payment as capital expenditure.

11. Hutchinson Essar Telecom Pvt. Ltd., respondent in ITA No. 417/2013 has not treated the fourth year payment under the 1994 agreement as capital expenditure but as revenue expenditure, and their contentions are being examined separately below.

12. In view of the legal issue involved, we are not referring to the factual details in respect of each assessment year i.e. details with regard to date of filing of return, income declared under normal provisions, book profits etc. We shall concentrate upon the legal issue raised and the facts relevant for determining the said legal issue. For the purpose of clarity, we have recorded and set out details of the writ petitions, name of the respondent-assessee, the assessment years and the amount involved:

S No.	ITA No.	Name of the Assessee	Assessment Year	Amount Involved
1.	1328/2010	Bharti Hexacom Ltd.	2003-04	Rs.8,69,16,000/-
2.	1336/2010		2004-05	Rs.10,89,74,250/-
3.	114/2012		2006-07	Rs.27,60,36,300/-
4.	996/2011		2007-08	Rs.48,83,07,556/-
5.	893/2010	Bharti Cellular Ltd.	2000-01	Rs.27,82,30,588/-
6.	1680/2010		2001-02	Rs.54,93,43,930/-
7.	1679/2010		2002-03	Rs.61,07,90,625/-
8.	177/2010	Bharti Airtel Ltd.	2005-06	Rs.2,76,48,900/- Net amount disallowed after disallowance and amortization.
9.	1333/2010	Bharti Telenet Ltd.	2000-01	Rs.4,80,67,869/-
10.	417/2013	Hutchinson Essar Pvt. Ltd	1999-2000	Rs.18,64,57,000/-

13. The contention and the facts highlighted by the Revenue are that respondents were granted a licence under an agreement executed under the Indian Telegraph Act. This agreement dated 29th November, 1994, in the case of Bharti Cellular Ltd. (date of agreement with each respondents may be different but the terms are identical) states that pursuant to the request of the licencee i.e. the respondent assessee, the authority had agreed to grant licence to the assessee on the terms and conditions appearing hereinafter to establish, maintain and operate cellular mobile services. The said agreement further stipulates that in consideration of mutual covenants and licence fee payable in advance, the licensor, i.e. the Government grants licence to the licencee, i.e. the assessee, to establish, maintain and operate cellular mobile service. The emphasis has been laid on the words 'establish, maintain and operate' in the original licence and it was highlighted that it was only pursuant to licence agreement that the respondent assessees could establish the business. The National Telecom Policy 1999 did modify terms of the original licence but the new policy did not change the true nature and character of the licence fee. Only the method of computation was altered and changed.

Therefore, the respondent assessees who accept and admit that licence fee payable under the 1994 agreement was capital in nature, cannot dispute and deny the capital nature of the same payment under National Telecom Policy 1999. Even under the 1994 agreement for the 4th year, the respondent assessee had to pay the fixed sum per 100 subscribers. The nature and character of the payment was same but amount was modified to 15% of the gross revenue under the National Telecom Policy 1999. Further, mere payment of an amount in installments does not convert or change the capital payment to revenue in nature. The criteria of once and for all payment or installment payment co-relatable to percentage of gross-turnover was not determinative of the true character of the payment. True nature of the payment has to be determined on the basis of the advantage or benefit procured which in the present case relates to initial set-up of business. Right to the licence had resulted in acquisition of right to operate. Thus it was a capital payment. The term of the licence was/is 10 or 20 years from the date of commencement and therefore, the expenditure was capital in nature.

14. The contention of the assessee, on the other hand, was that the licence fee payable under the National Telecom Policy 1999 was revenue in nature. The earnings were/are shared. The licence fee depends upon the gross revenue and was/is payable yearly. Licence by itself was not an asset or a right which could be sold. Under the National Telecom Policy, 1999 there was no limit on the number of operators and the licence granted was non-exclusive. New operators were issued licences and were required to pay one time licence fee for entry and start of operations in addition to yearly turnover based licence fee. Onetime payment of licence fee was capital in nature and

yearly payable licence fee was not capital in nature as it was essential and an annual necessity/obligation to continue to do business. It was a running expense. Nature of expenditure incurred was not on addition to fixed capital but for maintaining and operating the business of telecommunication. The nature of expenditure should be judged in commercial sense. Annual variable expenditure did not create or add to a profit making apparatus. It was not part of machinery or a plant. The appellant was wrongly assuming that the licence fee paid on yearly basis was a source of profit. The licence fee paid on yearly basis was a fee payable for continuing business activity and on non-payment, licence could/can be revoked. Thus, there was/is no enduring benefit. A licence being an indivisible right and cannot be bifurcated into right to establish, operate and maintain.

15. Before we examine the legal position, we would like to first deal with and examine the contention as to whether or not licence under the National Telecom Policy 1999 was transferable and the effect thereof. The licence stands issued to the company as the operator, but behind the company are the real owners i.e. the shareholders. However, a shareholder is distinct and not synonymous with company to whom the licence under the Telegraph Act, has been issued. Clause (viii) of the National Telecom Policy, 1999 permits transfer of shareholding by the shareholders directly or indirectly after lock-in period of 5 years. Therefore, it bars the licencee i.e. respondents herein from registering or recording change of shareholding pattern directly or indirectly with subsidiary company within such period. However, additional equity share capital by the licencee company or their holding companies by private placement or public issues was/is permitted. We are concerned in the present case

with the licence granted to the respondent companies and the nature and character of the licence in their hands and not the value of the shares held by the shareholders, in spite of the fact that there was a lock in period or prohibition regarding transfer of shares for the period of 5 years and thereafter the shares were transferable. There cannot be any doubt or debate that while computing the value of the share in the hands of the shareholder, the factum and position that the respondent company has been allotted the licence was/is a relevant and important factor. However, we do not think that this can be the sound and sole basis or ground to hold that the licence in the hands of the respondent company was/is a capital asset. Value of a share in the hands of a shareholder may not determinatively and conclusively reflect and answer the question whether the asset held by the company was a capital asset. Market value of a share is dependent upon several factors including future prospects, nature of trade etc. These may not be an asset for the company. We cannot on this basis alone, determine and decide whether the variable licence fee paid on annual basis is capital or revenue in nature. At the same time the license was/is an important and relevant aspect that determined/determines the true market value of the respondent companies.

16. At this stage, it would be appropriate to refer to relevant case law on the subject though we did not find or come across any decision of the Supreme Court or the High Court directly applicable to the factual matrix of the present cases. Starting point of discussion on the said question invariably begins with the decision of the Supreme Court in the case of *Empire Jute Co. Ltd. vs. Commissioner of Income Tax* (1980) 124 ITR 1 (SC). Revenue in the said case

relied upon an earlier decision of the Supreme court in *CIT vs. Maheshwari Devi Jute Mills Ltd.* [1965] 57 ITR 36 (SC), whereir sale of loom hours were held to be in nature of capital receipt and hence not taxable. The said decision was distinguished on several grounds but noticeably it was recorded that the said case had proceeded on a common accepted basis that loom hours was an asset. In *Empire Jute Co. Ltd. (supra)*, on deeper elucidation of relevant facts, it was noticed that there was contractual agreement restricting the right of every mill to work their looms to their full capacity as there was over capacity but low demand. This restriction had the effect of limiting the production and consequently the profits which the assessee could earn. Under the same agreement, one mill could transfer loom hours to another for consideration subject to conditions. Thus, purchase of loom hours had the effect of relaxing the restriction on operation of loom hours and enabled the purchaser to work their looms for longer duration and earn profits. The Supreme Court observed that capital expenditure was one made with a view to bring into existence an asset for enduring benefit to the trade. But this rule of enduring benefit was subject to and could break down for good reasons. The nature of advantage has to be considered in commercial sense and only when the advantage was in capital field, the expenditure could be disallowed by applying the enduring benefit test. If the advantage consisted merely facilitating trading operations or enabling the management or conduct of business more efficiently or profitably, while leaving the fixed capital untouched, the said expenditure would be on revenue account, though the advantage may endure for an indefinite period. Enduring benefit test, therefore, was

not conclusive and cannot be mechanically applied withou considering the commercial aspect.

17. The second test which can be applied was fixed and circulating capital test. Fixed capital being what the owner turns to profit by keeping it in his possession; circulating capital is what the assessee makes profit by parting or letting the product/asset change masters/hands. This test could be applied when the acquisition of asset clearly falls within one of the two categories but the test would breakdown where the expenditure does not fall easily within the specified category. The demarcation line between assets out of which profits were earned and the profit made upon assets or with assets, was thin and difficult to draw in several cases. It was observed that purchase of loom hours was not like circulating capital (labour, raw material, power etc.), but "loom hours" were also not a part of fixed capital. Revenue's contention that purchase of loom hours was for acquisition of source of profit or income and, therefore, capital expenditure, was rejected on the ground that source of profit or income was the profit making apparatus which had remained untouched. There was no enlargement of permanent structure or capital assets. Primarily and essentially the expenditure was relating to operation or working of looms, which constituted profit earning apparatus. The Supreme Court, however, added a word of caution that in the field of taxation, analogies could be deceptive and misleading but nevertheless they referred to an example of an assessee acquiring raw material regulated under a quota system to increase his production. Money spent to acquire the quota right, it was observed would entitle the assessee to acquire more raw material to increase profitability of the profit making apparatus and would undoubtedly be

revenue expenditure as it was a part of the operating cost. However, the said example relates to already existing or ongoing industry. Outgoing whether it was revenue or capital, it was highlighted, should depend upon practical and business point of view, rather than juristic classification of legal rights. The question should be judged in the context of business necessity or expediency; was the expenditure a part of assessee's working expenditure or a part of process of profit earning; whether the expenditure was necessary to acquire a right of permanent character, the possession of which was a condition for carrying on trade ?, etc.

18. It may be now appropriate and proper to refer to judgments of the Supreme Court relating to lease agreements as they may have some bearing and elucidate legal principles which are of relevance. In *Assam Bengal Cement Co. Ltd. vs. CIT, West Bengal* (1955) 27 ITR 34 (SC), payment made by the assessee for acquiring lease of mine stone quarries for manufacture of cement for 20 years on payment of yearly rent as well as protection fee to ward off competition, was held to be capital expenditure. In the said case, the consideration payable was per annum but was for the entire or whole duration of the lease and it protected and gave right to the assessee to carry on business unfettered from outsiders. It was held that the expenditure was not a part of the working or operational expenses but for acquiring a capital asset. Similarly, in *Member of the Board of Agricultural Income Tax, Assam vs. Sindhurani Chaudurani and Ors.* (1957) 32 ITR 169 (SC), salami or lump sum payment for non-recurring nature made by the prospective tenant to the landlord as consideration for settlement of agricultural land and parting with certain rights paid anterior to landlord and tenant relationship, it was

held was not in the nature of rent, and thus, capital payment. It was emphasized that the payment was not for use of land but for the land to be put to use by the assessee. Salami was not rent paid in advance.

19. In *Enterprising Enterprises vs. Deputy Commissioner of Income Tax* (2007) 293 ITR 437, the Supreme Court affirmed the decision of Madras High Court reported in [2004] 268 ITR 95, after referring to *Pingle Industries Ltd. vs. CIT* [1960] 40 ITR 67 (SC); *Gotan Lime Syndicate v. CIT* [1966] 59 ITR 718 (SC) and *Aditya Minerals Pvt. Ltd. vs. CIT* [1999] 239 ITR 817 (SC), stating that distinction lies between the case of where royalty or rent was paid and where the entire amount of lease premium was paid either at one time or in installments. Royalty or rent would be revenue expenditure, while the latter would be capital expenditure.

20. This brings us to an earlier decision of the Supreme Court in the case of *Pingle Industries Ltd. vs. Commissioner of Income Tax, Hyderabad* (supra). The majority judgment held that the quolnama which entitled the assessee to extract stones from quarries for a period of 12 years on annual payment (some amount was paid in advance to secure annual payment) was capital expenditure as the assessee was extracting stones which after dressing were sold as flag stones. It was observed that the lease was for long term with right to extract stones in six villages, without limit by measurement or quantity, and entitled the assessee to exclusive rights. The majority held that the expenditure was capital in nature and cannot be equated with cases wherein assessee had acquired right to pick up tendu leaves for manufacture of bidi, which was equivalent to purchasing of raw material for manufacturing business. It was observed that stones in

situ were stock in trade of business, but lease payments were capital in nature as the stones only upon extraction became stock in trade. The payment though periodical was neither rent nor royalty, but payment was for acquiring an asset for enduring benefit i.e. right to extract stones and not stones itself.

21. In *Jabbar (M.A.) vs. CIT, Andra Pradesh* [1968] 68 ITR 493 (SC), the assessee had taken a short term lease of 11 months for quarrying purposes to carry away, sell and dispose of sand which was lying on the surface of river bed without excavation or skillful extraction. The said expenditure was held to be of revenue character, in spite of fact that the interest on land was also conveyed, observing that this was not decisive. The decisive factor was the object for which the lease was taken and the nature of payment, when and while obtaining the lease. This decision was distinguished by the Supreme Court in *R.B. Seth Moolchand Suganchand vs. CIT, New Delhi* (1972) 86 ITR 647 as minerals in this case were part of the land and had to be won, extracted and brought to the surface unlike the case of *Jabbar (M.A.) (supra)* where the minerals i.e. the sand was on surface and thus was a case relating to expenditure for acquisition of stock in trade and, revenue in nature. Similar treatment was given to the licence fee paid for one year for prospecting emeralds which was in addition to royalty on emerald excavated and sold. The first part i.e. the licence fee for prospecting, it was held was capital. The contention that the licence fee was not a lease rent and did not create interest in land was rejected, observing that prospecting licence was issued before operations had started and was paid irrespective of the mineral obtained. This demonstrated that the object for the payment was to initiate business; though the period of licence was one year it

did not make the payment, revenue payment. Prospecting license fee cannot be equated with payment for stock in trade.

22. In *CIT vs. Bombay Burmah Trading Corporation* (1986) 161 ITR 386, the Supreme Court observed that lump sum consideration paid on surrender of export rights in a forest lease, where the assessee had right to extract and cut timber and remove them on payment of royalty, was capital payment. The payment was for sterilization of the profit making apparatus i.e. the capital asset. The forest lease was also not a stock in trade. The determining factor, it was observed was nature of trade in which the asset was employed. If the payment made, represented profit in a new form, it would be income, but if the money paid related to structure of assessee's profit making apparatus and affected the conduct of business, the sum received for cancellation or variation of agreement, would be a capital receipt.

23. In *Commissioner of Income Tax vs. Madras Auto Services (P) Ltd.* (1998) 233 ITR 468 (SC), the assessee had incurred expenditure on demolishing the existing building and constructing a new building at their own expense. The new building belonged to the lessor and the assessee remained a lessee but at a low rent. Term for lease was 39 years but the Supreme Court held that the expenditure was revenue in nature as the newly constructed property from the beginning was owned by the lessor. It was emphasized that the asset created, though of enduring nature, did not belong to the assessee (there have been statutory amendments but we are not required to examine the said amendments in the present decision. The ratio is relevant). Reference was made to *Lakshmiji Sugar Mills Co. P. Ltd. vs. CIT* (1971) 82 ITR 376 (SC), wherein expenditure incurred on

construction and development of roads between different sugarcane producing centers and sugar factories was held to be revenue in nature as it was incurred for the purposes of facilitating running of assessee's motor vehicles etc. Similarly in *L.H. Sugar Factory and Oil Mills (P) Ltd. vs. CIT* (1980) 125 ITR 293 (SC), amount paid as contribution for construction of roads in an area around the factory under a scheme was held to be revenue in nature. *CIT vs. Associated Cement Companies Ltd.* (1988) 172 ITR 257 (SC) was quoted and observed that the expenditure incurred to concrete the main road was revenue as the installation and accessories were assets of the municipality. This was despite the fact that the assessee had secured immunity from liability to pay municipal rates and taxes for 15 years. In these cases, the expenditure had been incurred to bring about some kind of enduring benefit but did not bring into existence any asset for the benefit of the assessees. The expenses were made for the purposes of conducting business more profitably and fruitfully and the asset created did not belong to the assessee. It was noticed that the creation of asset, resulted in saving of considerable revenue expenditure in form of lower rent.

24. In *Alembic Chemical Works Co. Ltd. Vs. Commissioner of Income Tax, Gujarat* (1989) 177 ITR 377 (SC) the assessee had acquired know-now to produce higher yield and sub-culture of high yielding range of penicillin. The said expenditure was in the line of existing manufacture. It was lump-sum payment but the expenditure was held to be revenue in nature primarily on two grounds that it was incurred for the purpose of day to day business, which was manufacture of penicillin and, therefore, not for entirely a new venture unconnected and different from existing business. Secondly,

it would be unrealistic to ignore rapid advances in research in antibiotic and attribute a degree of durability and permanence to technical know-how in this fast changing area. Rapid strides in science and technology in the field of medicines cannot be readily pigeon-holed as capital outlay. Moreover, it was not a case of exclusive acquisition.

25. Having reproduced several judgments on the question of the decisive tests, it would be appropriate to notice one decision wherein expenditure incurred has been held to be in part capital and revenue because the tests show that expenditure incurred was for several considerations i.e. there was overlapping of capital and revenue expenditure. This aspect has been examined in detail separately below. In *Jonas Woodhead and Sons (India) Ltd. vs. Commissioner of Income Tax* (1997) 224 ITR 342 (SC), question arose whether 25% of the amount paid as royalty to the foreign company for technical information/ know how relating to setting up of a plant for manufacture of products was capital expenditure. Referring to the issue in question, it was observed that the answer would depend upon several factors including whether the assessee had set up a completely new plant with a new process, new technology, or the technical knowhow was for betterment of the product which was already being produced; was it a part and parcel of existing business or a new business?, Whether on expiry of period of agreement, the assessee was required to give the plans, drawings etc., or could continue to manufacture the products?, etc. It was accordingly observed as under:-

> "In the case of Alembic Chemical Works Co. Ltd. v. Commissioner of Income-Tax Gujarat :

[1989]177ITR377(SC) , the question for consideration was whether the lump-sum payment made by the assessee for obtaining the know-how to produce higher yield and sub-culture of high yielding strain of Penicillin would be a capital expenditure or a revenue expenditure. The Tribunal had rejected the claim of the assessee holding the expenditure to be a capital expenditure. On appeal to this Court it was held:

(i) It would 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 could not be said to bear the element of the requisite degree of durability and no ephemerality 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-holding an outlay, such as this, as capital,

(ii) 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 of 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 to 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 overexacting.

(iii) The question in each case would necessarily be whether the tests relevant and significant in one set of circumstances are relevant and significant in the case on hand also. Judicial metaphors are narrowly to be watched, for, starting as devices to liberate thought, they end often by enslaving it.

The idea of "once for all" payment and "enduring benefit" are not to be treated as something akin to statutory conditions; nor are the notions of "capital" or "revenue" a judicial fetish. What is capital expenditure and what is revenue are not eternal verities but must

> needs be flexible so as to respond to the changing economic realities of business. The expression "asset or advantage of an enduring nature" was evolved to emphasise the element of a sufficient degree of durability appropriate to the context."

26. At this stage, it would be relevant to clarify and elucidate the once and for all payment test. It is not necessary that once and for all payment would result in an enduring benefit nor is it a firm rule that periodical payments do not show enduring benefit. The said test has its apparent limitation, if we apply the said test without equal importance to the questions; what was acquired and why payment was made? The real and core test is whether payment (whether once and for all or in installment) was for acquisition of capital asset or rights of enduring benefit. Quantum of payment is not relevant for determining the said question as it is the nature and quality of payment and not quantum or manner of payment which is decisive. Lump-sum payment can represent revenue expenditure, if it is incurred for acquiring circulating capital though payment is made in one go and similarly payment made in installments can in fact be for acquiring a capital asset, price of which is paid for over a period of time.

27. It would be relevant here to produce the tests or principles laid down in a recent decision of this court in *CIT vs. J.K. Synthetics Ltd.* [2009] 309 ITR 371 (Delhi) which are as under:-

> " 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, effi-ciently 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 licence 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 licence to third parties without the consent of the licen-sor,

(d) whether the licence transfers the "fruits of research" of the licen-sor, "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 the assessee could use the technical knowledge obtained during the tenure of the licence 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."

In *CIT vs. Saw Pipes Limited* (2008) 300 ITR 35, the Delhi High Court observed, that as the service lines did not belong to the assessee and the expenses were incurred to enable the assessee to conduct its business more efficiently, the expenditure was revenue in nature.

28. Recently, this Bench had dealt with a similar question in the case of Oracle India Pvt. Ltd./Oracle Software India Limited , ITA Nos. 25/2012 and 797/2006 and other connected cases decided on 25th November, 2013 and it was elucidated that underlined purpose of differentiating capital and revenue expenditure was matching of costs with income or receipts i.e. direct association between cost incurred and earning of specific item of income to compute true and correct taxable income. In *Oracle India Private Ltd.* (supra) it has been highlighted that while determining the question whether payment was capital or revenue in nature, the primary aim of the court or the authority was to determine income earned by the assessee during two points of time without impairing his capital or incurring personal debts. The concept of capital maintenance was critical in distinguishing whether the expenditure was for capital or revenue purposes. Reference can also be made to the decision of Delhi High Court in *CIT vs. Sharda Motors Industry Ltd.* (2009) 319 ITR 109 (Del.).

29. When we turn to the facts of the present case, the following position emerges:

i. The licence was issued under a statutory mandate and was required and acquired, before the commencement of operations or business, to establish and also to maintain and operate cellular telephone services.

ii. The licence was for initial setting up but, thereafter for maintaining and operating cellular telephone services during the term of the licence.

iii. Contrary to what was stated, under the licence agreement executed in 1994 the considerations paid and payable were with the understanding that there would be only two players who would have unfettered right to operate and provide cellular telephone service in the circle. The payment, therefore, had element of warding off competition or protecting the business from third party competition.

iv. Under the 1994 agreement, the licence was initially for 10 years extendable by one year or more at the discretion of the Government/authority.

v. 1994 Licence was not assignable or transferable to a third party or by way of a sub-licence or in partnership. There was no stipulation regarding transfer or issue of shares to third parties in the company.

vi. Under the 1994 agreement, the licencee was liable to pay fixed licence fee for first 3 years. For 4th year and onwards, the licencee was liable to pay variable licence fee @ Rs.5,00,000/-

per 100 subscribers or part thereof, with a specific stipulation on minimum licence fee payable for 4th to 6th year and with modified but similar stipulations from 7th year onwards.

vii. The licence could be revoked at any time on breach of the terms and conditions or in default of payment of consideration by giving 60 days' notice.

viii. The authority also reserved the right to revoke the licence in the interest of public by giving 60 days' notice.

ix. Under 1999 policy, the licencee had to forego the right of operating in the regime of limited number of operators and agreed to multiparty regime competition where additional licences could be issued without limit.

x. There was lock in period on the present shareholding for a period of 5 years from the date of licence agreement i.e. the effective date and even transfer of shareholding directly or indirectly through subsidiary or holding company, was not permitted during this period. This had the effect of 'modifying' or clarifying the 1994 agreement, which was silent.

xi. Licence fee calculated as a percentage of gross revenue was payable w.e.f. 1st August, 1999. This was provisionally fixed at 15% of the gross revenue of the licencee but was subject to final decision of the Government about the quantum of revenue share to be charged as licence fee after obtaining recommendation of the Telecom Regulatory Authority of India (TRAI).

xii. At least 35% of the outstanding dues including interest payable as on 31st July, 1999 and liquidated damages in full, had to be paid on or before 15th August, 1999. Dates for payments of arrears were specified.

xiii. Past dues upto 31st July, 1999 along with liquidated damages had to be paid as stipulated in the 1999 policy, on or before 31st January, 2000 or earlier date as stated.

xiv. The period of licences under 1999 policy was extended to 20 years starting from the effective date.

xv. Failure to pay the licence fee on yearly basis would result in cancellation of licences. Therefore, to this extent licence fee was/is payable for operating and continuing operations as cellular telephone operator.

30. Having noted the aforesaid factual position, we feel that payment of licence fee was capital in part and revenue in part and it would not correct to hold that the whole fee was capital or revenue in entirety. The licencees i.e. the assessees in question required a licence in order to start or commence business as celluar telephone operator. The requirement to procure a licence or pay licence fee was a precondition before the assssee could commence or set up the business in question. The fee was certainly paid to the Government for permitting and allowing an assessee to set up/start cellular telephone service which otherwise was not permitted or prohibited under the Telegraph Act. In a way, it was a privilege granted to the assessee subject to payment and compliance with the terms and conditions.

31. Licence fee under the 1994 agreement ensured that there would be only two private operators in a circle and thus their limited monopoly would be protected and competition by way of third party private players was warded off. Restricted monopoly of the licencees was ensured. The licence fee fixed included an element towards the said right of the licencees. 1994 agreement, for first three years postulated a lump-sum payment irrespective of number of subscribers. Minimum fee was also prescribed for later years. It appears that licencees were unable to make payments as per the 1994 agreement and under the 1999 policy, were required to pay lump-sum payment for past arrears before specified dates.

32. There was restriction under the 1994 agreement, on transfer of the licence or even grant sub-licence but there was no specific restriction on change of shareholding. 1999 policy ensured that even shareholding did not change for a period of 5 years from the effective date. The effect of acquiring the licence has been examined in paragraph 15 above. The licence was not assignable or transferrable as such, but induction of share capital, transfer of shares etc. was permitted subject to conditions in the 1999 policy. In commercial sense the licence constituted and continues to be the most valuable right which the company has and possesses. Thus, the payment made is for acquiring the licence which is essential and mandatory, prerequisite for establishing the business and for operations or continuance and running of business. Yet, as observed below, it cannot be equated with one time entry fee which a person has to pay to establish the business. It therefore, represents composite payment, both capital and revenue.

33. The licence fee was imposed and payable under the Indian Telegraph Act and other statutory provisions and was/is mandatory. Failure to pay the same would/will result in discontinuance or stoppage of business operations. Under 1999 policy, the amount payable speaks of sharing of gross revenue earned by the service provider from the customers. 1994 agreement as noticed did have a provision for sharing but with minimum payment stipulation. In case of non-payment of licence fee, the licence could be revoked and licencee was not permitted to carry on and continue cellular telephone service. Thus, the licence fee payable was/is equally with the objective and purpose to maintain and operate cellular telephone services. It was also an operating expense and non payment can lead to cancellation as one of the consequences. Endurement requires current expenses and is subject to payment on revenue share. It will not be correct to hold or propound that entire payment during the term of licence, is deferred capital payment. This was/is not the intent under the 1994 agreement or 1999 policy. The intent is to also share the gross earning to maintain and operate the licence.

34. The licence fee as such is similar to both prospecting fee, acquisition of right to lease as well as leases which enabled removal of sand/tendu leaves, etc. as nothing has to be won over, or extracted. Part payment was towards an initial investment which an assessee had to make to establish the business. It was a precondition to setting up of business. It has element and includes payment made to acquire the 'asset' i.e. the right to establish cellular telephone service. But the licence permits and allows the assessee to maintain, operate and continue business activities. Payment of licence fee has certain

ingredients and is like lease rent which is payable from time to time to be able to use the licence.

35. The licence acquired was initially for 10 years and the term was extended under the 1999 policy to 20 years but this itself does not justify treating the licence fee paid on revenue sharing basis under the 1999 policy as a capital expense made to acquire an asset. As observed in ***Empire Jute Co. Ltd. (supra)***, the enduring benefit test has limitation and cannot be mechanically applied without considering the commercial or business aspects. Practical and pragmatic view and considerations rather than juristic classification is the determinative factor. The payment of yearly licence fee on revenue sharing basis is for carrying on business as cellular telephone operator. It is a normal business expense.

36. Read in this manner, the licence granted by the Government/ authority to the assessee would be a capital asset, yet at the same time, the assessee has to make payment on yearly basis on the gross revenue to continue, to be able to operate and run the business, it would also be revenue in nature. Failure to make stipulated revenue sharing payment on yearly basis would result in forfeiting the right to operate and in turn deny the assessee, right to do business with the aid of the capital asset. Non-payment will prevent and bar an assessee from providing services.

37. Counsel for the Revenue has relied upon decision of the Himachal Pradesh High Court in ***Mohan Meakin Breweries Ltd. Vs. Commissioner of Income Tax***, (1997) 220 ITR 878. In the said case the High Court has held that payment made to the State towards license fee or permit under the provisions of Punjab Excise Act and

Punjab Distilleries Rules applicable to the State of Himachal Pradesh, was capital expenditure. The imposition was for construction, for working of distillery and referred to manufacture of different kinds of liquor. We respectfully doubt the ratio of the said decision to the extent it observes that license fee for working of the distillery and relating to quality/kind of liquor would be capital expenditure. The expenditure incurred for operating or running of distillery would not be capital expenditure as it relates to and is a part of the operational expenses. These cannot be equated with capital expenditure incurred in the form of fee paid to the Registrar of Companies at the time of fresh incorporation, the analogy drawn in the said decision. The Division Bench of Himachal Pradesh High Court in the said decision has quoted the following passage from "Kanga and Palkhivala's the Law and Practice of Income-tax, Eighth Edition, Volume I" :-

> "License, permit and monopoly. — There are some early English cases on this topic which have to be used with caution. Payment by the lessee of licensed hotel premises to the local authorities as the 'monopoly value' on the grant of a three year license was held to be capital expenditure on the ground that the monopoly right of trading for three years as a licensed victualler attained the dignity of a capital asset. Likewise, money expended by a brewery firm in an attempt (successful or unsuccessful) to acquire new licensed premises or by a public carrier to obtain a license for a larger fleet of vehicles or the price of a license granted to a carting contractor for a period of eight years to deposit earth, slag, etc., on the land of the licensor, was held to be capital expenditure.
>
> The law has evolved considerably as a result of acceptance of the crucial principle that the distinction between capital and revenue expenditure should be determined from the practical and business view point and in accordance with sound accountancy principles, eschewing the legalistic approach. A license fee is revenue expenditure, and payments made to the State for a license or permit are none the less deductible although the license or permit may carry with it an exclusive right, where the 'monopoly' or the exclusive character of the

> right is incidental to the license or permit. Annual payments made to the State, in lieu of tax on motor vehicles per trip, for the exclusive right to ply buses on a certain route, are revenue disbursements, and so also are royalties paid to the State for a monopoly right to excavate raw materials or stock-in-trade or for an exclusive license to manufacture sugar."

38. In *Mohan Meakin Breweries Ltd.* (supra) the Division Bench rightly observed that that the aforesaid passage supports the case of the assessee. Thus, we observe that the expenditure incurred for establishing or for setting up/construction of any factory/business would be capital, but the amount paid on yearly basis for running or operation of the factory/business would be normally revenue in nature.

39. The next question or issue which arises is whether the Court can bifurcate and divide the licence fee into capital and revenue and what percentage or ratio should be attributed to revenue and capital account. It is the contention of the Revenue that the respondent assessee i.e. Bharti Cellular Ltd., Bharti Hexacom Ltd. and Bharti Airtel Ltd. had themselves treated and regarded the licence fee payable under the 1994 agreement as capital expenditure. Even in case of Hutchinson Essar Pvt. Ltd., licence fee paid under 1994 policy for first three years was treated by the assessee as capital expenditure. In the fourth year Hutchinson Essar Pvt. Ltd. has treated the variable licence fee payable subject to minimum of @ Rs.5,00,000/- per 100 subscribers as revenue expenditure and the other assessees have treated the revenue sharing licence fee under the 1999 policy as revenue expenditure. The 1999 policy has to be read alongwith original agreement but it did make a substantial dent and substantially modified the original agreement. Under the 1999 policy, the new

entrants were liable to pay entry fee which was the total licence fee payable upto 31st July, 1999, and thereafter they were liable to pay the variable licence fee. Thus, the new entrants have clearly paid the "capital" entry or establishment fee and then are obliged to pay operating or maintenance fee in form of variable licence fee.

40. In *Jonas Woodhead and Sons (India) Ltd. (supra)*, the Assessing Officer had himself treated 25% of the amount paid as royalty as capital and the balance amount was treated as revenue expenditure. Similarly in *Southern Switch Gear Ltd. vs. CIT* (1998) 232 ITR 359, the Supreme Court has affirmed decision of the Madras High Court in *CIT vs. Southern Switch Gear Ltd.* (1984) 148 ITR 272, wherein royalty payable was apportioned and 25% thereof was treated as capital payment or expenditure on the ground that the right to manufacture certain goods exclusively in India should be taken as an independent right secured by the assessee from the foreign company and this right was of enduring nature. The more authoritative and lucid discussion for the purpose of the present controversy is in *CIT, Madras vs. Best and Co. (Pvt.) Ltd.* (1966) 60 ITR 11(SC). In the said case, the respondent assessee was carrying on business and had innumerable agencies. Compensation was received on account of cancellation of one agency and the question was whether the said compensation was capital or revenue in nature. Majority judgment answered the said question observing that compensation and loss of agencies could be both capital and revenue depending upon facts of each case and whether the cancellation had affected the earning apparatus or structure from physical, financial, commercial and administrative point of view. The answer required examination; how many agencies the assessee had; their nature, how

many agencies were lost and what was the effect on the income as well as the structure of the entire business; whether the loss of agency was ordinary incident in the course of business etc. In the said case, compensation received was held to be revenue expenditure as the respondent assessee had innumerable agencies in different lines and had given up only one, to continue business in other lines. Loss of agency, it was observed, was in normal course of business and being a part of normal business, the amount received as compensation was revenue in nature. At the same time, it was accepted that the compensation paid/received was also on account of restrictive covenant for a specified period under which the assessee had undertaken not to take up competitive agency. It was observed that compensation attributable to the restrictive covenant was a capital receipt and, therefore, not taxable. It was observed:-

> "In the present case, the covenant was an independent obligation undertaken by the assessee not to compete with the new agents in the same field for a specified period. It came into operation only after the agency was terminated. It was wholly unconnected with the assessee's agency termination. We, therefore, hold that that part of the compensation attributable to the restrictive covenant was a capital receipt and hence not assessable to tax.
>
> The next questions whether the compensation paid is severable. If the compensation paid was in respect of two distinct matters, one taking the character of a capital receipt and the other of revenue receipt, we do not see any principle which prevents the apportionment of the income between the two matters. The difficulty in apportionment cannot be a ground for rejecting the claim either of the Revenue or of the assessee. Such an apportionment was sanctioned by courts in Wales v. Tilley, Carter v. Wadman (H.M. and T. Sadasivam v. Commissioner of Income-tax, Madras. In the present case apportionment of the compensation has to be made on a reasonable basis between the loss of the agency in

> the usual course of business and the restrictive covenant. The manner of such apportionment has perforce to be left to the assessing authorities
>
> 22. The answer to the question referred to the High Court is that only such part of the sums of Rs. 66,790 and Rs. 3,35,371 as is attributable to the loss of the agency is assessable under section 10 of the Act for the assessment years 1951-52 and 1952-53. We accordingly modify the answer given by the High Court in that regard."

In *Tilly v. Wales (Inspector of Taxes)* [1943] A.C. 386, the House of Lords observed that the amount paid was partly in consideration of surrender of assessee's right to pension and partly for surrender of increased salary under an agreement. Pension amount was held to be capital and not taxable but, the sum paid for reduction in salary was taxable. The amount had to be apportioned reasonable for the two considerations.

41. Thus, it would be appropriate and proper to apportion the licence fee as partly revenue and partly capital.

42. The next obvious question is, on what basis apportionment should be done and what could be the proportion of apportionment between capital and revenue expenditure. We have given due consideration to the said issue and felt that it would appropriate and proper to divide the licence fee into two periods i.e. before and after 31st July, 1999. The licence fee paid or payable for the period upto 31st July, 1999 i.e. the date set out in the 1999 policy should be treated as capital and the balance amount payable on or after the said date should be treated as revenue. There are several reasons why we have taken the said date as a cut-off point, rather than partly apportioning expenses through the entire term of the licence. These reasons are elucidated in the paragraph below.

43. Licence fee was payable for establishment, maintenance and operation of cellular telephone service. Establishment and set up took place in the initial years and thereafter the payments made were/are for operation or maintaining the cellular telephone service. Initial outlay and payment, therefore, is capital in nature, whereas the outlays and payments made subsequently are to operate and maintain the service. 1999 policy in the form of letter dated 22nd July, 1999 also refers to one time entry fee which is chargeable and had to be calculated as licence fee dues payable upto 31st July, 1999 and licence fee was thereafter payable on percentage share of gross revenue. The new licences issued to others also stipulated one time entry fee and then licence fee payment on sharing basis. In view of the new 1999 policy, the earlier policy which restricted competition, underwent a change and licencees forgo their right to operate in the regime of limited number of operators. Another reason why we feel that lisence fee payable for the period on or before 31st July, 1999 should be treated as capital and the amount payable thereafter as revenue, is justified and appropriate in view of Section 35ABB. We have already quoted the said section above. The provision provides that licence fee of capital nature shall be amortized by dividing the amount by number of remainder years of licences. Thus, the capitalized amount of licence fee is to be apportioned as a deduction in the unexpired period of the licence. The provision will have ballooning effect with amortized amount substantially increasing in the later years and in the last year the entire licence fee alongwith the brought forward amortized amount would be allowed as deduction. After a particular point of time, deduction allowable under Section 35ABB would be more than the actual payment by the assessee as licence fee for the

said year. This would normally happen after the mid-term of the licence period. Section 35ABB, therefore, ensures that the capital payment is duly allowed as a deduction over the term and once the expenditure is allowed, it would be revenue or tax neutral provided the tax rates remain the same during this period.

44. ITA Nos. at serial Nos. 1 to 9 above primarily relate to variable license fee, which is to be shared under the 1999 Policy whereas, ITA No. 417/2013 filed against Hutchison Essar Ltd. relates to the period of variable license fee payable for the fourth year under the 1994 Agreement.

45. The effect thereof is that we are treating about 20% of the expenditure in terms of the tenure as per the 1999 Policy as capital in nature, whereas if we apply the 1994 Agreement, we would be treating about 40% of the expenditure as per the tenure as payable towards establishing or setting up of cellular business. By the time 1999 Policy was implemented in the case of the respondents-assessees, the cellular telephone business had already commenced and was in operation. The 1999 Policy had the effect of extending period of licence from 10 years to 20 years, but from the effective date. The view, we have taken, effectively means that the entire license fee paid in the initial first four years is treated as capital in nature i.e. the expenditure incurred to establish cellular telephone business, whereas the balance expenditure payable on year to year basis from 5th year onwards is treated as revenue expenditure to run and operate cellular telephone business.

46. However, we would like to discuss two judgments relied upon by Huthison Essar Pvt. Ltd. in support of their contention that the

variable fee even prior to 31st July, 1999 should be treated as revenue expenditure. As noted above, this was the 4th year and the contention of the assessee is that in this year even as per the 1994 agreement, payment had to be made on revenue sharing basis subject to the minimum guarantee. Learned counsel for the assessee had relied upon *CIT vs. Sharda Motors Industry Ltd.*(supra). In the said case reference was made to *J.K. Synthetics Ltd. (supra)* to hold that no substantial question of law arises. The Revenue had relied upon *Southern Switch Gear Ltd. vs. CIT* (1998) 232 ITR 359 (SC), but the said judgment was distinguished on the ground that lump-sum royalty was paid and 25% thereof was disallowed by the tribunal on the ground that it was capital payment. In *Sharda Motor Industries Ltd. (supra)*, royalty was to be paid on quantity of goods produced calculated per piece. However, this does not appear to be sole basis why the payment made was treated as revenue expenditure. The court had relied upon other facts which are noticed in paragraph 3 of the same judgment i.e. the payment was made for running business. The question of apportionment and payment was not made to establish business. In *CIT vs. Modi Revlon (P.) Ltd.* (2012) 26 Taxmann.com 133 (Delhi), a Division Bench of this High Court observed that the tests evolved over the period have disapproved the applicability of the 'once and for all' payment and more structured approach which would take into account several factors like the licence tenure; whether licence created further rights; whether there was restriction for use of confidential information; whether benefits were transferred once and for all; whether after expiry of the licence, plans and drawings were to be returned, etc. As held and observed above, it is nature and object for which the payment is made which

determines the character of payment. In the said case, it was observed that there was nothing to show or to suggest vesting of know-how in the assessee and therefore, the assessee did not derive any enduring benefit. Thus, the royalty payment was held to be revenue in nature.

47. In view of the aforesaid findings, the substantial question mentioned above in item Nos.1 to 9 is answered in the following manner:

(i) The expenditure incurred towards licence fee is partly revenue and partly capital. Licence fee payable upto 31st July, 1999 should be treated as capital expenditure and licence fee on revenue sharing basis after 1st August, 1999 should be treated as revenue expenditure.

(ii) Capital expenditure will qualify for deduction as per Section 35ABB of the Act.

48. The appeal ITA No. 417/2013 by the Revenue in the case of Hutchison Essar Pvt. Ltd., pertains to the assessment year 1999-2000 i.e. year ending 31st March, 1999. It is for the period prior to the period 31st July, 1999. As per the discussion above, the licence fee payable on or before 31st July, 1999 should be treated as capital expenditure and the licence fee payable thereafter should be treated as revenue expenditure. In view of the aforesaid position, the question of law admitted for hearing in this appeal as recorded in the order dated 21st August, 2013, has to be answered in favour of the revenue and against the respondent assessee.

49. In ITA Nos.893/2010 and 1333/2010, an additional issue arises for consideration. This additional issue relates to interest on delayed payment of license fee and whether the same was capital or revenue

expenditure. By order dated 18th September, 2012, the following substantial question of law was admitted for hearing and disposal:-

> "Whether the Tribunal fall into error in holding that the interest on the delayed payment of license fee also partook of the same nature as license fee and was deductible as revenue expenditure?"

50. We are inclined to pass an order of remand on this question as we find that the facts on the said aspect are not lucid and clear. In the assessment-year 2000-01, the assessment year subject matters of ITA 893/2010 and 1333/2010 in the case of Bharti Cellular Ltd. and Bharti Telenet Ltd. now known as Bharti Infotel Ltd., the assessee had paid interest of Rs.1.75 crores and Rs.2.24 crores to the Department of Telecommunication for delayed payment of license fee. The Assessing Officer disallowed the said payments observing that these were on capital account. The assessment order records that no details had been furnished and the expenses pertained to prior period. The payment was considered to be capital in nature because the license fee was also capital expenditure.

51. Commissioner (Appeals) in the case of Bharti Cellular Ltd. (ITA 893/2010) held that interest paid was capital expenditure because license fee itself was capital in nature. The said opinion was followed by Commissioner (Appeals) in the case of Bharti Telenet Ltd., now known as Bharti Infotel Ltd. The answer to the question would depend upon the finding whether payment related to license fee payable period prior to 31st July, 1999 or was for the subsequent period. If interest paid was in respect of license fee payable for the period prior to 31st July, 1999, it will have to be capitalised. Similarly, if the interest was payable on license fee for the period post

31st July, 1999, it should be treated as revenue in nature/character. The contention that it was a prior period expense does not appeal to us and has to be rejected, as the interest was paid during the year in question.

52. Learned counsel for the assessees has submitted that there cannot be any factual dispute that this interest was paid to the Department of Telecommunication on delayed payment of license fee under the 1999 policy and not on account of license fee payable for period prior to 31st July, 1999. We cannot from the facts on record, decipher the exact details as this aspect has not been examined by the tribunal. The tribunal has held that interest paid was revenue in nature because the license fee payable itself was revenue in nature, irrespective of fee payable prior to 31st July, 1999. We have held to the contrary. The said question of law, therefore, is answered in favour of the Revenue and against the respondent-assessee but with an order of remand to decide the controversy afresh keeping in view the observations made above.

53. The appeals are accordingly disposed of. In the facts and circumstances, there will be no orders as to costs.

(SANJIV KHANNA)
JUDGE

(SANJEEV SACHDEVA)
JUDGE

DECEMBER 19th, 2013
kkb/NA/VKR