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

Judgment reserved on July 24, 2014
Judgment delivered on December 02, 2014

\+ ITA 50/2000
COMMISSIONER OF INCOME TAX ..... Appellant

Versus

SHRI KRISHAN KUMAR ..... Respondent

\+ ITA 69/2004
COMMISSIONER OF INCOME TAX ..... Appellant

Versus

M/S SUPER CASSETTES INDUSTRIES LTD... Respondent

\+ ITA 457/2004
THE COMMISSIONER OF INCOME TAX ..... Appellant

Versus

M/S SUPER CASSETTES INDUSTRIES LTD... Respondent

\+ ITA 460/2004
COMMISSIONER OF INCOME TAX ..... Appellant

versus

M/S SUPER CASSETTES INDUSTRIES LTD... Respondent

\+ ITA 524/2004
COMMISSIONER OF INCOME TAX ..... Appellant

versus

M/S SUPER CASSETTES INDUSTRIES LTD... Respondent

\+ ITA 576/2008

COMMISSIONER OF INCOME TAX DELHI..... Appellant

versus

SUPER CASSETTES INDUSTRIES LTD. ..... Respondent

Through: Mr. Rohit Madan, Sr. Standing Counsel for appellant/revenue.

Mr. Ajay Vohra,Sr.Adv. with Ms Kavita Jha and Mr. Vaibhav Kulkarni, Advocates for respondent/assessee.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V.KAMESWAR RAO

V.KAMESWAR RAO, J.

1. This batch of appeals involves an identical substantial question of law, whether the royalty paid is a revenue expenditure and thereby should be allowed as a deduction. Insofar as the appeal being ITA No. 69/2004 is concerned, two additional questions have been framed and the same would be referred and dealt with separately after answering the question with regard to the nature of expenditure.

2. The appeals pertain to various Assessment Years, the details and the deletion of additions as upheld by the Tribunal are given below:

Appeal Number	Amount	Assessment Year
ITA 50/2000	Rs.1,50,500/-	1989-90
ITA 69/2004	Rs.85,91,760/-	1989-90
ITA 457/2004	Rs.95,66,219/-	1993-94
ITA 460/2004	Rs.1,17,93,547/-	1991-92
ITA 524/2004	Rs.54,31,061/-	1992-93
ITA 576/2008	Rs. 1.2 Crores	1993-94

ITA No. 50/2000

3. In this appeal, the following substantial question of law was framed by this Court:

> *"Whether ITAT and CIT(A) are correct in law in treating the expenditure on account of royalty as a revenue expenditure?"*

4. The assessee had income from two proprietorship concerns; one, M/s. Krishna International and the other M/s. Shree Krishna Pictures. The business of M/s. Krishna International was manufacturing of Audio Cassettes (blank and recorded) and its components and manufacturing of blank video cassettes and the business of M/s. Shree Krishna Pictures was distribution of feature films. During the Assessment Year, M/s. Krishna International had shown a gross profit of Rs. 34,27,224/- on the total sales of Rs. 1,17,15,875/-/-. Insofar as the expenses shown against the royalty, Rs. 1,50,500/- was debited as revenue expenditure.

5. The Assessing officer was of the view that the royalty expenditure was for acquiring an asset of enduring nature. The objective of the expenditure was to procure rights which were in the nature of permanent assets in the hands of the assessee. The producer had assigned full rights to the assessee in consideration of payment of royalty. The Assessing Officer referred to the agreement to hold that on payment of royalty, the assessee acquired rights in respect of recording and for producing,

selling and public performance etc. The rights included the market rights, whether and/or when to discontinue and recommence the sale of records of the said work, and to fix and alter the price of such records etc. The Assessing Officer added Rs. 1,50,500/- to the income, treating the amount paid as payment on capital account.

6. In appeal, the Commissioner of Income Tax (Appeals) [CIT(A), in short], relying upon his earlier order in the case of Super Cassettes Industries Private Limited (Appeal No. 120/89-90) for the Assessment Year 1986-87 held that the royalty payment was a revenue expenditure because the recorded music was sold as a manufactured product. It was observed that by and large, the songs for which the royalty was paid did not have long life and majority of songs had short life and accordingly, the addition made by the Assessing Officer of Rs. 1,50,500/- was deleted.

7. In appeal filed by the appellant-Revenue, the Income Tax Appellate Tribunal ('Tribunal' in short) referred to its earlier judgment in the case of **Super Cassettes Industries Pvt. Ltd., [1992] 41 ITD 530** to upheld the order of the CIT(A).

<u>ITA No. 457/2004</u>

8. For the Assessment Year 1993-94, the following substantial question of law was framed by this Court:

> *"Whether the ITAT was correct in law in deleting the addition of Rs. 95,66,219/- made by the Assessing Officer on account of royalty expenses paid by the assessee?"*

Suffice to state that the said expenses on account of royalty were disallowed by the Assessing Officer, being a capital account.

9. On appeal filed by the assessee, the CIT(A), relying upon its own order for the Assessment Year 1990-91, 1991-92 and 1992-93 deleted the addition so made by the Assessing Officer.

10. The appeal of the revenue before the Tribunal was dismissed.

ITA No. 460/2004

11. In this appeal, which pertains to the Assessment Year 1991-92, the following substantial question of law was framed by this Court on 22.02.2005:

> *"Whether the ITAT was correct in law in deleting the addition of Rs. 1,17,93,547/- made by the Assessing Officer on account of royalty expenses paid by the assessee?"*

12. The assessee company had debited the profit and loss account by an amount of Rs. 1,29,76,564/- claiming royalty expenses as revenue expenditure. The Assessing Officer disallowed the amount of Rs. 1,17,93,547/-, observing that it was in the nature of capital expenditure.

13. The CIT(A), relying upon the appeal for the Assessment Year 1990-91, directed the Assessing Officer to follow the observations made

therein. In other words, the addition was deleted.

14. The appeal filed by the revenue was dismissed and the order of the CIT(A) was upheld by the ITAT.

ITA No. 524/2004

15. In this appeal, which pertains to the Assessment Year 1992-93, the following substantial question of law was framed by this Court on 28.02.2005:

> *"Whether the ITAT was correct in law in deleting the addition of Rs. 54,31,061/- made by the Assessing Officer on account of royalty expenses paid by the assessee?"*

16. The Assessing Officer had noticed that an amount of Rs. 54,31,061/- has been debited to the profit and loss account. On explanation sought by the Assessing Officer, the respondent-assessee asserted that the royalty paid should be deducted from income being a revenue expenditure. The Assessing Officer, noticed that in the earlier years, the issue had been decided in favour of the assessee, but the department had not accepted the appellate decision. He added amount of Rs. 54,31,061/- to the income, treating it as capital expenditure.

17. The CIT(A) on the issue of royalty followed the decision for the Assessment Years 1990-91 and 1991-92 and deleted the addition as made by the Assessing Officer.

18. On appeal, the Tribunal upheld the order of the CIT(A).

ITA No. 576/2008

19. In this appeal, which pertains to the Assessment Year 1994-95, the following substantial question of law was framed by this Court on 30.07.2008:

> *"Whether the ITAT was correct in law in deleting the addition of Rs. 1.2 Crores made by the Assessing Officer on account of royalty expenses paid by the assessee by treating it as capital expenditure?"*

20. The expenses on royalty claimed by the assessee in the Assessment Year in question was Rs. 1,01,87,761/-. The assessee had based its claim on the decision of the Tribunal for the Assessment Year 1985-86. It was the case of the respondent-assessee that the company was engaged in reproduction of audio sound and music from the master plate provided by the film producers and distributors. This master plate contained the original sound track of the film with whose help, the assessee prepared audio cassettes for sale. It was claimed that after the marketing of the cassettes, the master plate became useless and as such, its life was very short. On this ground, the master plate was linked to a licence granted for a specific period for manufacture. The respondent-assessee relied upon the ruling of the Supreme Court in ***Gotan Lime Syndicate Vs. CIT, [1966] 59 ITR 718.*** It was also stressed that the payment of royalty was related to annual profits and therefore was

revenue in nature. The Assessing Officer for the following reasoning concluded that the payment of royalty was a capital expense:

> *"a) The assessee acquires a source of its stock in trade by acquiring rights of films and audio cassettes for use in its home produced blank audio & video cassettes.*
>
> *b) The master plates or U-matics do not become useless since following that analogy all over the world classical films and records of the last century should have vanished. The master tape is utilized to create further master tapes which are utilized in production. The high speed duplicators and sound recording equipment does away with the need of a pristine master record.*
>
> *c) The life of a master record or U-matics is not transient. The T-Series group itself is known for its remix cassettes of old Hindi Songs which have survived so far.*
>
> *d) The master plates and U-matics are not stock in trade but are a source of stock in trade. The assessee does not sell them as such, hence the expenses are capital expenses.*
>
> *e) The assessee is not required to pay any recurring amount for the case of the master plates, records or film prints. Therefore no revenue element is involved as in the case of Gotan Lime Syndicate Vs. CIT (1996) referred above.*
>
> *f) The asset acquired by the assessee is of durable nature and generates incomes.*
>
> *g) The assessee and the T-Series group enjoy a near monopoly over regional songs and Hindustani song cassettes and the royalty to the artistes is not paid per piece. All payments are lump sum and the assessee gets to produce mix or remix versions or versions cassettes at its own leisure."*

The Assessing Officer accordingly added the amount paid to the income of the respondent-assessee, as capital expenditure.

21. On appeal, the CIT(A) deleted the addition made by the Assessing Officer by holding as under:

> *"1.3 I have carefully considered the matter. I have also gone through the reasons given by the Ld. Assessing Officer in his assessment order to treat this expenditure as capital expenditure. I find that the Ld. Officer has gone to a lot of pains to analyse the various ingredients of the transaction involving transfer of film or audio rights. At the same time, I find that CIT(A)-IX, New Delhi had also made detailed analysis of the various facts of this transaction and after an exhaustive discussion of all the aspects he held that the royalty was allowable as revenue expenditure. This view was also approved by the ITAT Delhi Bench 'A' in the appellant's own case for assessment year 1985-86. In the present case before me, it is seen Assessing Officer has not brought any fresh facts which had not been considered either by the CIT(A) or by the ITAT in coming to the above decision. In the circumstances, I find no reason for diverging from the above decision. In the result, the appellant succeeds on this ground of appeal".*

22. The Tribunal, relying upon its own judgment in the assessee's own case reported in **[1992] 41 ITD 530,** which has already been referred to above, has upheld the order of the CIT(A) in deleting the disallowance.

ITA No. 69/2004

23. The following substantial questions of law were framed by this Court in this appeal:

> *"i) Whether ITAT order was correct in law in deleting the addition of Rs. 85,91,760/- made by the Assessing Officer on account of royalty expenses paid by the assessee?*
> *ii) Whether the ITAT was correct in law by deleting an addition of Rs. 2,32,900/- on account of purchase of carpets by treating it as revenue expenditure?*
> *iii) Whether ITAT was correct in law in deleting an addition of Rs. 2,13,801/- claimed to have been spent by Bombay Video Division despite the fact that the business activities of this unit had not started till the end of the assessment year in question?"*

24. The return of income for the Assessment Year 1989-90, was filed on 27.03.1991 declaring 'Nil' income. The assessment order was passed on 27.03.1992. During the course of assessment proceedings, the Assessing Officer noticed that assessee had claimed Rs. 85,91,760/- as revenue expenditure on account of payment made for acquiring rights in respect of music etc. from other parties. The Assessing Officer held that this expenditure was capital in nature and accordingly made addition of this amount by disallowing the expenditure. Similarly, the Assessing Officer rejected an addition of Rs. 2,32,900.13/- made by the assessee for purchasing the carpets by treating it as capital in nature. The assessee had also claimed an expenditure of Rs. 2,13,801/- in its video division in Bombay office. This expense was claimed for making feature films. It was noticed by the Assessing Officer that commercial activities had not started at the Video Division in Bombay as such this expenditure was not allowable.

25. Against the order of the Assessing Officer, the assessee filed an appeal before the CIT(A) on the issue of royalty payment as well as on the issue of expenses incurred on carpets. The CIT(A) followed orders for the earlier years, treating royalty payment as revenue in nature. Expenses incurred by Bombay Video Division were also allowed but the disallowance of payment for purchase of carpets was affirmed by the CIT(A).

26. Against the order of the CIT(A), both revenue and assessee had filed cross appeals before the Tribunal. The Tribunal, vide impugned order dated 18.02.2003 allowed relief to the assessee in respect of carpet payment, and on other issue, dismissed the appeal of the revenue.

27. Mr. Rohit Madan, learned counsel for the revenue would submit that the Tribunal has erred in treating the expenditure on account of royalty as revenue expenditure, for that, royalty expenditure was for getting advantage of enduring nature. The objective of the expenditure was to acquire rights which were in the nature of permanent assets in the hands of the assessees. According to him, the assessees-respondents got the rights in respect of recording, producing, selling and public performance etc. including the right to decide whether and/or when to discontinue and recommence the sale of records of the said works and to fix and alter the price of such records etc. He would state that the life of

the music is enduring as the old songs and music are still very popular and popularity of good music cannot be bound by time. He would state that even though, for an earlier assessment year, the ITAT had decided in favour of the assessees, the judgment has not been accepted and has been challenged in this Court. He would rely upon the judgment of the ITAT reported as ***[2002] 82 ITD 641 (Mum), TIPS Cassettes and Record Company Vs. Assistant Commissioner of Income Tax,*** more specifically para 27.

28. On the other hand, Mr.Ajay Vohra, learned counsel appearing for the respondents-assessees would state that the assessees were engaged in reproduction of audio sound and music from the master plate provided by the film producers and distributors. This master plate was said to contain the original sound track of the film with whose help the assessee prepares audio cassettes for sale. It was claimed that after the marketing of the cassettes, the master plate became useless and as such, its life was very short. According to him, the master plate was like a licence granted from a specific period for manufacture. It was stressed that the payment of royalty was related to annual profit and therefore, revenue in nature. He would also state that for every new music recording, a totally different plate was required. He states that the plate was embedded with the music and as a raw material, was a revenue expense. According to

him, the manner of payment for the plate would not make any difference and expenditure incurred for procuring the plate embedded with the music was surely for revenue generation and cannot be termed as a capital expenditure. Cost of the plate cannot be a capital expense. Even music rights would be revenue expense, as music software is not enduring in nature. He would rely upon the following judgments in support of his case:-

(i) Income Tax Officer Vs. Five Star Audio, [2013] 34 Taxmann.com (Chennai-Trib.)

(ii) Star Music Vs. DCIT [2013] 34 taxmann.com 235 (Chennai-Trib.)

(iii) CIT Vs. Subramanian [2005] 144 Taxman 728 (Mad)

(iv) Tips Cassettes & Record Co. Vs. ACIT [2002] 82 ITD 641 (ITAT Mum.)

(v) Gramophone Co. of India Ltd. Vs. DCIT [1994] 48 ITD 145 (ITAT Cal.)

(vi) CIT Vs. Modern Theatres Ltd. [1963] 50 ITR 548 (Mad.)

(vii) Empire Jute Co. Ltd. Vs. CIT [1980] 124 ITR 1 (SC)

(viii) Alembic Chemical Works Co. Ltd. Vs. CIT [1989] 177 ITR 377 (SC)

(ix) Gotan Lime Syndicate Vs. CIT [1966] 59 ITR 718 (SC)

29. Having considered the submissions made by the learned counsel for the parties, at the outset, we note that during the submissions, a reference was made to a reference case No. ITR 301/1994 decided by

this Court wherein, one of the assessee was M/s. Super Cassettes Industries Ltd. and the said reference was made by the Tribunal to this Court on identical issue. We had accordingly called for the record of ITR 301/1994. We have perused different orders passed by this Court. We note that the said reference was not answered keeping in view that the tax effect in that case was less than Rs.10 lakhs. We further note that a Review Petition No. 574/2011 was filed by the revenue which was listed on 30.09.2011 when the same was withdrawn with liberty to file a fresh application in terms of the orders passed by the Supreme Court in CC No. 13964/2011 titled as CIT (Central) III Vs. Surya Herbal Ltd. dated 29.08.2011. It appears that no action was taken by the revenue for filing fresh application. Suffice to note that the said reference pertains to the AY 1985-86. It also appears that based on the order of the Tribunal in the reference case, which pertains to the AY 1985-86, the royalty payment in the subsequent assessment years has been treated as revenue expenditure.

30. It is necessary to note here that none of the parties to these appeals have filed copy of agreement executed between the respondent-assessees and the producers/owners of the original copy right. Revenue being the appellant, if they wanted to rely upon the document should have filed the same. We accordingly proceed to answer the questions, as per the facts

recorded by the Tribunal. Having already referred to the issue(s) which falls for our consideration in these appeals, we proceed to note the position of law.

31. In ***Empire Jute Co. case (supra),*** the Supreme Court while dealing with the facts wherein the assessee was engaged in the business of manufacture of jute, and was a member of the Jute Mills Association, which was formed on the object of inter alia protecting trade of its members by regulating production in the mills. In pursuance thereto, the members had entered into a working time agreement whereby the number of working hours per week for which the mills were entitled to work their looms to their full capacity was capped, as there was overcapacity but lower 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 its looms for longer durations 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 of merely facilitating trading operations or enabling the management for conduct of business more efficiently and profitably while leaving the fixed capital untouched, the said expenditure would be on revenue account, though the advantage may endure for an indefinite period. The enduring benefit test was therefore not conclusive and cannot be mechanically applied without considering the commercial aspect. Similarly in ***Alembic Chemicals Work Co. Ltd.'s case (supra),*** the assessee had acquired knowhow to produce higher yields and sub-cultures of high yielding range of penicillin. The said expenditure was in the line of existing manufacture. It was a lumpsum payment but the expenditure was held to be revenue in nature, primarily on the ground that it was incurred for the purpose of day to day business, which was manufacture of penicillin, and therefore was not for a new venture, unconnected and different from the existing business. Secondly, rapid strides in science and technology in the field of medicine cannot be readily pigeon holed as capital outlay.

From the reading of both the judgments, the following principles emerge:-

(i) There may be cases where expenditure, even if incurred

for obtaining advantage of enduring benefit, may, nonetheless be on revenue account and the test of enduring benefit may break down.

(ii) It is not every advantage of enduring nature acquired by an assessee that brings the case within the principles laid down in the enduring benefit test.

(iii) If the advantage consists of merely in facilitating the assessees' trading operations or enabling the management or conduct of assessees' business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though, the advantage may endure for an indefinite period.

(iv) The test of enduring benefit is not conclusive and cannot be applied blindly and mechanically without regard to particular facts and circumstances of a given case.

(v) 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 the capital or revenue, a judicial fetish. What is capital expenditure and what is revenue expenditure are not eternal varieties but must

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

32. In ***Travancore Sugars and Chemicals Ltd. Vs. CIT, [1966] 62 ITR 566 (SC)***, the assessee company acquired certain government concerns and was made liable to pay to the government a part of profit share every year. It was held that since the annual payment was for an indefinite period of time unrelated to the capital value of the assets or a fixed purchase consideration, the expenses were revenue in nature. In ***Assam Bengal Cement Co. Ltd. Vs. CIT, [1955] 27 ITR 34 (SC),*** it was held that if the expenditure is not for the purpose of bringing in existence of any asset or advantage but for running of business or working for it to produce profit, it would be a revenue expenditure. Similarly, in ***Commissioner of Income Tax Vs. J.K.Synthetics Ltd. [2009] 309 ITR 371 (Delhi),*** this Court was of the view that the amounts paid for process and technical know-how, supply of technicians and training of personnel is a revenue expenditure. The expression 'enduring benefit', has been judicially interpreted by Romer L.J. in ***Anglo-Persian Oil Company Ltd. Vs. Dale, (1932) 1 KB 124*** by agreeing with Rowlatt J. that enduring

benefit, means enduring in the way that a fixed capital endures; "an expenditure on acquiring floating capital is not made with a view to acquiring an enduring asset. It is made with a view to acquiring an asset that may be turned over in the course of a trade at a comparatively early date". In ***M.A.Jabbar Vs. CIT, [1968] 68 ITR 493 (SC),*** wherein the assessee had taken a short term lease of eleven months for quarrying purposes to carry away, sell and dispose of sand which was lying on the surface of river bed without excavation or skilful extraction. The said expenditure was held to be revenue in character, even though, the interest of land was also conveyed. The decisive factor was the object for which the lease was taken and the nature of payment, when and while obtaining the lease. In ***Gotan Lime Syndicate's case (supra),*** the Supreme Court dealt with a case where the assessee firm which carried on the business of manufacturing lime from limestone, was granted under a lease the right to excavate lime-stones in certain areas. On expiry of lease, the same was extended for short periods. On a change of policy, 15 square miles of lime deposits were sanctioned to the assessee on October 4, 1954. Between the period July, 1952 to the date the new lease was to be given effect, a fixed royalty of Rs. 96,000/- per annum had to be paid on the basis of dead rent. The assessee could not carry away any other mineral which might be found in the area and he was

further allowed to go on the land and win them. Payments were finalized by Mining Engineer who fixed the royalty at Rs. 96,000/- per year as the royalty fixed by the rules was far less than that figure. For each assessment years between 1954 to 1957, the assessee paid an amount of Rs. 96,000/- to the government and claimed it to be revenue deduction. In the absence of material to show that any part of royalty had to be treated as premium and referable to the acquisition of mining lease, the royalty payment included the dead rent had relation only to the lime deposits to be got and were therefore treated as revenue expenditure. Although, the assessee did derive an advantage; assuming that advantage was to last at least for a period of five years, there was no payment once for all. The royalty was not a direct payment for securing an enduring advantage; it had relation to the raw material to be obtained. The reason why royalty was allowed as revenue expenditure was the relation it had to the amount of raw material to be excavated or extracted. You take more, the more royalty you pay.

33. A Division Bench of this Court in the judgment reported as ***Commissioner of Income Tax Vs. J.K. Synthetics Limited, [2009] 309 ITR 371 (Delhi)*** after referring to various judgments of the Supreme Court and various High Courts, has summarized the broad principles, as under:

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

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

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

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

indefinite period. To that extent, the test of enduring benefit or advantage could be considered as having broken down;

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

> *(a) the tenure of the Licence.*
>
> *(b) the right, if any, in the licensee to create further rights in favour of third parties,*
>
> *(c) the prohibition, if any, in parting with a confidential information received under the License to third parties without the consent of the licensor,*
>
> *(d) whether the Licence transfers the 'fruits of research' of the licensor, 'once for all',*
>
> *(e) whether on expiry of the Licence the licensee is required to return back the plans and designs obtained under the Licence to the licensor even though the licensee may continue to manufacture the product, in respect of, which 'access' to knowledge was obtained during the subsistence of the Licence.*
>
> *(f) whether any secret or process of manufacture was sold by the licensor to the licensee. Expenditure on obtaining access to such secret process would ordinarily be construed as capital in nature;*

(vi) the fact that assessee could use the technical knowledge obtained during the tenure of the License for the purposes of its business after the Agreement has expired, and in that sense, resulting in an enduring advantage, has been categorically rejected by the courts. The Courts have held that this, by itself, cannot

> *be decisive because knowledge by itself may last for a long period even though due to rapid change of technology and huge strides made in the field of science, the knowledge may with passage of time become obsolete;*
>
> *(vii) while determining the nature of expenditure, given the diversity of human affairs and complicated nature of business; the test enunciated by courts have to be applied from a business point of view and on a fair appreciation of the whole fact situation before concluding whether the expenditure is in the nature of capital or revenue".*

This Court in ***Oracle India (Pvt.) Ltd. Vs. Commissioner of Income Tax, [2014] 264 CTR 144 (Delhi)*** while dealing with a case wherein the assessee was incorporated on 18.01.1993 and was a subsidiary of Oracle Corporation, USA. The subsidiary company entered into an agreement with parent company under which it was granted non-exclusive, non-assignable right and authority to duplicate on appropriate carrier media software products and other products retaining the ownership of the copyrights in the software and all associated and Intellectual property rights in the products. The agreements stipulated that the appellant shall duplicate and reproduce the software in India and sub-licence the same as per the terms of the sub-licence deed stipulated and with the holding company retaining the entire data/intellectual property rights in the software. The assessee was to pay royalty to the holding company @ 30% of the list price of the licenced products as prescribed in the Indian

published price fixed in consultation with the licensor. Apart from the royalty, some other amounts were to be paid by the assessee. The question arose, whether the business expenditure was capital or revenue in character. This Court, after referring to the various judgments including some referred above, has held as under:

> *"As noticed above, in the present case the appellant is duplicating software and sells the same to generate income. It requires master copies, which have to be updated and upgraded to be able to sell the said software. In case the appellant had imported the said software and sold the same, it would be stock in trade and deductible. However, when the master copies were used for duplication and the software replicated and transferred on the media as a result of the said activities was then sold, the master copy itself might not be stock in trade as such in strict sense, but it did not have a long life and its value and life span was small since it perished and diminished when the upgraded version or a better software in form of the next master copy was imported, for the purpose of duplication. When we accept the said position, the requirement of enduring benefit fails and it cannot be said that any capital asset was acquired or purchased. In these circumstances, we need not apply and go into the other test or caveats. The flaw and the error committed by the tribunal is that they applied other tests or caveats without first ascertaining and determining whether enduring benefit test is satisfied or not. The enduring test*

may not be the sole, exclusive or universal test but is considered to be the primary test".

34. We note that with regard to one of the assessees in this batch of appeals namely Super Cassettes Industries Ltd. for the Assessment Year 1987-88, an identical issue was decided by the Delhi Bench of ITAT, a reference of which has already been given above, and which is reported as ***Super Cassettes Industries Pvt. Ltd. Vs. CIT, [1992] 41 ITD 513,*** in the following manner:-

> *"11. In the instant case, the component with the help of which, the assessee is able to carry out one of its activity of manufacturing and trading in pre-recorded tapes and gramophone records is the plate, which plate is not one but as many as the agreements for making of the copies are entered into. There is every likelihood that, the contract for making of copies may be, entered into on the last of the days of the accounting year and that, the plate may have been paid for on the last of the few days of the year, and the reproduction of it may be still in process. All these factors are common in any business of manufacture. As submitted by the assessee, the product manufactured is based on reproduction of the sound, music etc. from the master plate into tapes and records by the use of electrical and magnetic impulses. These are embedded into the master plate,*

and the assessee only makes an identical copy of the same. The copy so made is therefore, possible only with the help of the original. Therefore, the master plate could be termed as the raw material, formula etc. For every master plate provided to the assessee, except for the similarity of the blank plate, all other factors, such as music, sound, dialogue are very different. The activity of the assessee is basically that of a jobber, who carries on the functions of job-work, on the material provided or on the material prescribed to it by the owner. In the instant case, the assessee is allowed to use its own tapes, gramophone records manufactured by it, for filling them up with the sound contained in the master plate. The content of the plate is a design, the formula, raw material all embedded into one. The plate in these circumstances could not be termed to be of capital nature. The initial payment of lump sum also does not change its basic character as elucidated above. The recurring payment dependent upon the sales also indicates that, the royalty would become due only when the product so made are sold and therefore, what is dependent upon an uncertain happening could not be on capital account at all. The recurring payment is similar in nature to the royalty or dead rent paid for the extraction of limestone from the quarries, as has been held by the Supreme Court in Gotan Lime Syndicate's case. We are therefore of the opinion that, the royalty

> *paid including the cost of the plate is on revenue account and hence fully allowable as deduction in computing the income from business".*

35. Insofar as the case in hand is concerned, we note, the issue pertains to two types of payment. The first one is a fixed amount or a lump sum payment for the master plate and copyright in the music and the second, being royalty which is recurring in nature, depending upon the quantum of sale i.e. volume of sales generated by a particular record/cassettes of an album/song. First, dealing with the fixed amount expenditure, the question would arise whether the same has an enduring benefit. If the enduring benefit test is fulfilled, the conclusion possible could be that the payment was for acquiring a capital asset and expenditure related to it is capital expenditure. But the enduring test could break down for good valid reasons. For good reasons, this test need not be applied as a test to determine the nature of expenditure. The admitted position is that the assessees are in the business related to manufacture and sale of music cassettes. Looking from a commercial angle, it is seen and a common knowledge that music/film songs do not have a long life. Each year, expenditure was incurred to acquire and procure similar rights in new music. It was a recurring expenditure quite similar and like acquiring and purchasing raw material, used in earning profits. Increase in raw

material would increase production, turnover and corresponding profits. In case, such rights were not acquired and purchased from time to time, the assessee would go out of the business. Further and importantly, sale of new music initially, we all know is brisk but fades and ceases to be catchy after sometime. When popularity fades, the sales falter and returns/incomes does not flow and stops. There are a few songs which are evergreen and are heard by the public at large and remain popular even after few/many years of their release. Some songs of the 1960s and 1970s/80s are considered immortal and timeless. The percentage of such music and songs is abysmally small and probably in the range of 5% to 10% of the music/songs launched every year. The said percentage would necessarily depend upon several factors, which again would be fact specific like the music director, type of music, the singer etc. These facts and factors have not been adverted to and elucidated in the assessment orders, as the Assessing Officer with foreordained commitment disallowed the entire expenditure, unmindful that possibly, it would difficult to sustain the entire addition. Order of remit, after a long time gap would have difficulties. Proceeding on the premise that 5% of the expenditure on the plate etc. had enduring benefit, to that extent, the expenditure could be considered as a capital expenditure, we are not inclined to interfere and partially reverse the final outcome. The capital

amount or asset so created would be of a minuscule value and there would be a minimal tax effect. Question of depreciation would arise. The position stood settled over these years. Any order at variance would unsettle the settled position. In the facts of the case, this Court is of the view that accounts should not be re-written because of the smallness and minimum tax effect.

36. Coming to the royalty paid to the producers on the sales effected, it must be held that the same is a revenue expenditure, moreso, when it is clear that the main business of the assessees was manufacture of blank cassettes and pre-recorded cassettes. The purchase of music rights and reproducing is the purpose of its business. The royalty payment for the cassettes sold is an expenditure in relation to the business activity of the assessee and on this ground and reason, should be regarded as revenue expenditure. It was an expenditure incurred in the normal course of business and was related to the revenue generated and payable accordingly. It did not secure and add to value or create any new capital asset.

37. The substantial question of law at serial no. 1 is thus decided in favour of the respondent-assessees and against the appellant-revenue.

38. Since two more substantial questions of law arise for consideration in ITA No. 69/2004, we proceed to decide the said questions, which

read:-

> *"ii) Whether the ITAT was correct in law by deleting an addition of Rs. 2,32,900/- on account of purchase of carpets by treating it as revenue expenditure?*
>
> *iii) Whether ITAT was correct in law in deleting an addition of Rs. 2,13,801/- claimed to have been spent by Bombay Video Division despite the fact that the business activities of this unit had not started till the end of the assessment year in question?*

39. Insofar as the question (ii), is concerned, the same relates to deletion of an addition of Rs. 2,32,900/- on account of purchase of carpets by treating it as revenue expenditure. We note that the Assessing Officer had treated it as a capital expenditure. He further directed that the depreciation be allowed on the same. The CIT(Appeals) was of the view that since he had already held in the earlier year that the cost of carpet was a capital expenditure, the action of the AO was to be confirmed. The reasoning of the CIT(Appeals) was that since the carpets were used in the recording room, it was a part of plant and machinery. We note that the ITAT, for the earlier year 1987-88, was of the following view:

> *"21. As regards the expenditure of Rs. 1,79,577/- laying down the carpets in the recording studio, we find that an atmosphere has to be created for recording of the cassettes. The recording rooms have to be sound*

proof and dust proof. By laying down the carpets in these rooms, it is augmentation of efficiently carrying on the business. The factory was running in three shifts and due to rush of staff, life of carpets was short. Such carpets have to be replaced at frequent intervals. As has been held in the case of Shri Hari Mills Pvt. Ltd. reported in 237 ITR 188. The expenditure on replacement could not be treated as capital expenditure. The replacement, renewals and repair were to keep the business going on and the amount expended was for the purpose of continuing the business without breakdown and such expenditure has to be held to be revenue in nature. We, therefore, reverse the finding of the CIT(A) and direct the AO to allow the deduction of expenditure incurred on carpets. Depn., if any allowed, has to be withdrawn".

40. On the basis of above, for the assessment year in question i.e. 1989-90, it was held that the expenditure incurred for the purchase of carpet was revenue expenditure. It was a replacement costs and in the nature of current repairs. From the above, we note that the Tribunal has relied upon judgment reported as ***[1999] 237 ITR 188 (Mad)*** in ***Shri Hari Mills Pvt. Ltd.,*** wherein, it was held that the expenditure on replacement could not be treated as capital expenditure and having recorded a finding of fact that the life of the carpets is very short and have to be replaced at frequent intervals, we are of the view that the

conclusion of the Tribunal is not perverse and the same is justified. The question of law is, therefore, decided in favour of the respondent assessee and against the appellant revenue.

41. Insofar as the issue whether the Tribunal was right in deleting an addition of Rs. 2,13,801/- claimed to have been spent by the Bombay video division despite the fact that the business activities of this unit had not commenced/set up till the end of the assessment year in question, is concerned, the factual findings of the Assessing Officer were not accepted in the appellate orders. The Assessing Officer, while making disallowance of the said amount had observed that the expenditure was not admissible as deduction since it pertained to the video division in Bombay as the assessee has not started activities in this division in Bombay and the expenses are in the nature of pre-operative expenses. The CIT(Appeals) reversed the factual finding of the Assessing Officer on the ground that the assessee was engaged in the manufacture of audio and video cassettes both blank and recorded, therefore, the video film division was closely linked up with the said business activity. The purpose of making video film was to increase the market of the video cassettes. The direct expenses linked to video movies was treated as a part of the stock in trade. The nature of expenses consist of salaries and wages, selling, distribution and administrative expenses etc. and the

same could be claimed as a business expenditure because the video division at Bombay was closely linked with the day to day business activity of the assessee, being undertaken. The expenditure as such was not to procure or purchase an equipment or machinery. The expenses were in the nature of salary, wages to employees, selling, distribution and administrative expenses. The Tribunal upheld the said conclusion of the CIT(Appeals) on the ground that the expenses incurred are purely revenue in nature. We agree with the conclusion of the Tribunal. That apart, the tax effect is very low. The question of law is accordingly decided in favour of the respondent assessees and against the appellant-revenue.

42. In view of our aforesaid discussion, the appeals stand dismissed with no order as to costs.

(V.KAMESWAR RAO)
JUDGE

(SANJIV KHANNA)
JUDGE

DECEMBER 02, 2014/akb