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

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\+ **ITA 386/2015**

PR. COMMISSIONER OF INCOME TAX - 10(2) ..... Appellant

Through: Mr Raghvendra Singh, Junior Standing Counsel.

versus

GROZ ENGINEERING TOOLS PVT. LTD. ..... Respondent

Through: Mr Pranjal Srivastava, Advocate.

WITH

7.

\+ **ITA 474/2015**

PR. COMMISSIONER OF INCOME TAX -4, ... Appellant

Through: Mr Raghvendra Singh, Junior Standing Counsel.

versus

GROZ ENGINEERING TOOLS PRIVATE LIMITED ..... Respondent

Through: Mr Pranjal Srivastava, Advocate.

WITH

8.

\+ **ITA 475/2015**

PR. COMMISSIONER OF INCOME TAX -4, ... Appellant

Through: Mr Raghvendra Singh, Junior Standing Counsel.

versus

GROZ ENGINEERING TOOLS PRIVATE LIMITED ..... Respondent

Through: Mr Pranjal Srivastava, Advocate.

AND

9.

\+ **ITA 476/2015**

PR. COMMISSIONER OF INCOME TAX-4 ..... Appellant

Through: Mr Raghvendra Singh, Junior Standing Counsel.

versus

GROZ ENGINEERING TOOLS PRIVATE LIMITED ..... Respondent

Through: Mr Pranjal Srivastava, Advocate.

CORAM:
HON'BLE DR. JUSTICE S.MURALIDHAR
HON'BLE MR. JUSTICE VIBHU BAKHRU

ORDER

% 04.09.2015

1. These four appeals are directed against the following orders of the Income Tax Appellate Tribunal ('ITAT'):

(i) the common order dated 14th October, 2014 passed in ITA Nos.637 & 638/Del/2013 for Assessment Years ('AYs') 2005-06, 2006-07 and 2007-08 and

(ii) the order dated 14th November, 2014 in ITA No.4776/Del/2013 for AY

2008-09.

2. The Assessee is a 100% export oriented unit located at Gurgaon engaged in the manufacturing of machine tools. For the AY 2005-06, the Assessee's case was selected for scrutiny. A notice under Section 143(2) of the Act along with the questionnaire was sent to the Assessee on 18th June, 2007. In its return of income, the Assessee had claimed royalty expenses amounting to Rs.50,20,122/- paid to M/s Macnaught Pvt. Ltd., Australia (MPL). The Assessee by reply dated 20th September, 2007 stated that MPL had agreed to allow the Assessee to manufacture and sell a limited number of 'Macnaught' products. When the Assessee was asked to explain why the royalty expenses should not be capitalised since the Assessee was getting an advantage of an enduring nature, the Assessee in its reply dated 5th October, 2007 submitted that it had approached MPL to provide the specifications including drawings of various dyes and details of quality control procedure and equipment. MPL had also allowed the Assessee to use the trademark 'Macnaught' on these products in consideration of the royalty. The Assessee pointed out that royalty was linked to the volume of sales and, therefore, should be allowed as business expenditure.

3. In its order dated 16th November, 2007 for AY 2005-06, the Assessing Officer (AO) did not accept the above explanation of the Assessee and concluded that the use of these drawings, procedure and trademark of MPL was going to bring an advantage of an enduring nature to the Assessee. He, therefore, capitalized the royalty paid by the Assessee to MPL. However, he allowed 25% depreciation thereon to the Assessee. The balance amount of Rs.37,65,091/- was added to the income of the Assessee.

4. An appeal was filed by the Assessee against the said order before the Commissioner of Income Tax (Appeals) [CIT (A)]. In the order dated 10th December, 2012, the CIT (A) examined the copy of the agreements dated 19th November, 2002 and 1st June, 2005 entered into by the Assessee with MPL and observed that these were 'very casual in nature and also not on any stamp paper so it does not carry proper legal sanction'. It was held that the sanctity of the royalty agreements was '*prima facie* doubtful' and that the justification for the royalty payments was 'also not properly known'. The CIT (A) enhanced the disallowance to Rs.57,27,094/-.

5. A similar view was taken by the AO and CIT (A) for the other AYs i.e. 2006-07, 2007-08 and 2008-09. The CIT (A) has in the order dated 29th July,

2013 for AY 2008-09, while affirming the order of the AO, extracted the entire royalty agreement entered into between the Assessee and MPL as at 1st June, 2005. The agreement is brief and sets out that MPL had agreed that 'in certain circumstances' the Assessee could manufacture and sell 'a limited number of the Macnaught products'. The agreement also sets out, in a tabular form, the rate of royalty per unit for a whole set of products manufactured by the Assessee.

6. In the impugned orders, the ITAT has observed, on perusal of the very same agreement, that the royalty is essentially being paid for use of the trademark 'Macnaught' on the products of the Assessee and for using the drawings etc. The expenditure was incurred wholly and exclusively for the purposes of the business of the Assessee. From the payments made to MPL, the Assessee had deducted tax at source and deposited it with the Government. The genuineness of the payment was also not in doubt. In the circumstances, the ITAT was of the view that the CIT(A) was not justified in enhancing the addition made by the AO by capitalising the royalty. The appeals of the Assessee were, accordingly, allowed.

7. It is urged before us by Mr. Raghvendra Singh, the learned Junior

Standing counsel for the Revenue, that the royalty agreement between the Assessee and MPL was vague. There was nothing to indicate that the use of the trademark was permitted only for a limited period after which it would revert to MPL. It was also not clear whether there was anything to indicate that the benefit thereunder could not continue indefinitely. He urged that document was drawn up in a very casual manner without completely spelling out the rights and obligations of the parties. According to him, the royalty agreement was a sham document without any legal sanctity.

8. There was sufficient opportunity for the AO, if he doubted the genuineness of the payment of royalty by the Assessee to MPL, to have conducted a detailed inquiry. The Assessee on its part furnished the agreement between itself and MPL under which it was *inter alia* permitted to use the trademark 'Macnaught' on its products. The royalty was payable per unit of the product and, therefore, was clearly linked to sales. There was also no doubt that such payment was in fact made by the Assessee to MPL. It is also not in doubt that MPL was not related to the Assessee in any manner. In the circumstances, there should have been some reasonable basis for the CIT(A) to simply conclude that this was a sham transaction and proceed to enhance the disallowance. The interpretation of the agreement by

the ITAT appears to be plausible. The Court is not persuaded to hold that the impugned order of the ITAT is perverse.

9. No substantial question of law arises. The appeals are dismissed.

S.MURALIDHAR, J

VIBHU BAKHRU, J

SEPTEMBER 04, 2015
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