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

+ ITA 1069/2011

CIT Appellant
Through Mr. Kamal Sawhney, Sr.
Standing Counsel & Mr. Amit
Shrivastava, Advocate.

versus

EKL APPLIANCES LTD. Respondent
Through Mr. V.P. Gupta, Mr. Bassant
Kumar & Mr. Anuj Bansal, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V.EASWAR

% **ORDER**
22.02.2012

This appeal by the Revenue under Section 260A of the Income Tax Act, 1961 (Act, for short) relates to assessment year 2002-03 and arises out of the order of the Income Tax Appellate Tribunal (tribunal, for short) dated 11th February, 2011 in ITA No. 3895/Del/2010.

2. Pursuant to the order passed by the Commissioner of Income Tax (Appeals) under Section 263 of the Act, the Assessing Officer passed an order dated 30th July, 2007 holding that the royalty payment of Rs.108.64 lacs was capital



expenditure, inter alia, for acquisition of a capital asset.

3. The CIT(Appeals) deleted the said addition. The said order has been affirmed by the tribunal.

4. We reproduce the reasoning given by the Assessing Officer to make the said addition:

“3. The assessee vide his letter dated 23.07.2007 has submitted that royalty of Rs.108.64 cannot be considered as capital as it is not for acquisition of any capital asset (trade mark). It is only for ‘user’ thereof and is payable every year, based on the sales in the year.

The arguments of the assessee cannot be accepted as the expenditure is in the nature of capital and give enduring benefit to the assessee. In view of the Supreme court decision in the case of Southern Switch Gear Ltd. 232 ITR 359, it cannot be allowed and is therefore disallowed and added to the income of the assessee.”

5. The order passed by the Assessing Officer is cryptic and non-reasoned. It does not explain and state why and on what ground the payment of royalty in the present case was to be treated as a capital expenditure and was not a revenue expense. The payment of royalty as per the assessment order was for use of trade mark and was payable for user and quantum dependent upon the sales in the year.



6. The CIT(Appeals) examined the agreement in question and found that it was for use of technology and technical information. The CIT(Appeals) referred to the terms of the agreement and has recorded that the assessee had not secured any exclusive privilege to either manufacture or sell the products. The right to use technology and technical information was for prescribed period and not perpetual. No benefit or right accrued in perpetuity.

7. The tribunal in the impugned order has accepted the reasoning given by the CIT(Appeals).

8. The aforesaid conclusion of the tribunal is in accord with the decision of the Supreme Court in ***CIT versus Ciba of India Limited***, (1968) 69 ITR 692 (SC) and their subsequent decision in the ***Commissioner of Income Tax versus I.A.E.C. (Pumps) Limited***, (1998) 232 ITR 316 (SC). Referring to these decisions, a Division Bench of this Court in ***Commissioner of Income Tax versus G4S. Securities System (India) (P) Limited***, (2011) 338 ITR 46, has held as under:-

“9. From the terms of the agreement it is noticed that this arrangement was for a period of 5 years, which may be extended by another period of 5 years unless either party gives 6 months notice to the other party prior to the end of such 5 years period. The



payment of commission @ 1% was based on the net sales and not lumpsum. On the termination of expiration of the sub license agreement, the assessee was to return all G4F knowhow obtained pursuant to the said agreement. Not only that, the assessee was not even entitled to make use of the trade mark name or G4F knowhow and was forthwith to change its' corporate and/or trade names. All rights and knowhow, therefore, continued to vest in G4F and it was only the right to use the knowhow that was made available to the assessee and that too based on its net sales. That means all the royalty paid in the shape of 1 % of net sales for the use of trade mark and right to use knowhow could not be considered to be of enduring nature and thus capital expenditure. The expenditure was to be of revenue nature. In the case of ***Jonas Wood Head and Sons Vs. CIT, 117 ITR 55***, it was held that the question regarding capital or revenue expenditure depends on the terms of agreement in each case. In the case of ***CIT Vs. Gujarat Carbon Ltd., 254 ITR 294***, it was held that the payment of revenue under the agreement was directly relatable to services which were in the revenue field and were allowable as revenue expenditure. In the case of ***Goodyear (I) Ltd. Vs. ITO 73 ITD 189(Delhi)***, the assessee had not acquired ownership right of technical knowhow but transfer of use of licenses. There was no advantage of enduring nature and hence it was held to be a case of revenue expenditure. In the case of ***Travancore Sugar and Chemicals Ltd. 62 ITR 566 (SC)*** it was held that whenever a payment is based on a percentage of turnover or profits, it necessarily has no relation to the capital value of the asset, because it cannot be known at the time of



the agreement what the turnover or profits will be over a period of years. In another case reported as ***DCIT Vs. Swaraj Engines Ltd. (2002) 124 Taxman 188***, the Tribunal held, revenue payment is allowable as revenue expenditure, since it is related to sales and that it is paid for better conduct, efficiency and improvement of the existing business or product manufactured by the assessee. In the case of ***CIT Vs. Lumax Industries Ltd. (2008) 173 Taxman 290 (Delhi)***, this Court has also held that the payment of license fee on year to year basis for acquisition of technical knowledge would not amount to capital expenditure, but the revenue expenditure.

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

9. In light of the aforesaid legal position, we do not find any substantial question of law arises on this aspect.



10. The second issue raised by the Revenue is in respect of addition of Rs.66,86,974/- made by the Assessing Officer disallowing the entry made by the assessee in books towards doubtful debts/advances. The Assessing Officer disallowed the said claim holding as under:-

“ The claim of the assessee cannot be allowed as no details regarding these expenses have been filed, whether these were actually trade debts incurred in the course of business, what steps were taken to recover the amount and why these have been written off. Hence the amount of Rs.66,86,974/- is disallowed and added to the income of the assessee.”

11. The aforesaid findings given by the Assessing Officer are cryptic and devoid of any reasoning. The CIT(Appeals) had asked for a remand report in view of the facts stated by the assessee that they had given advance of Rs.66,68,000/- to Doshi Plastic Industries for supply of packaging material and there were other small amounts/petty balances payable by other third parties. Application filed under Rule 46A by the assessee was allowed. The CIT (Appeals) after examining the facts and material brought on record deleted the addition of Rs.66,68,000/-. He, however, confirmed the balance addition of Rs.18,974/- for lack of evidence.



12. The tribunal has dismissed the appeal of the Revenue against the said deletion. We may notice that the tribunal has referred to Section 36(1)(vii) of the Act, which is not applicable in the factual background. However, we are not inclined to admit any substantial of law on the said aspect, in view of the findings of fact, which have been recorded by the CIT(Appeals) and affirmed by the tribunal regarding the said claim. The said claim was admissible under Section 37 read with Section 28 of the Act.

In view of the aforesaid reasoning, no substantial question of law arises in the present appeal and the same is dismissed.

SANJIV KHANNA, J.

R.V. EASWAR, J.

FEBRUARY 22, 2012
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