

(1977) 04 MAD CK 0033

In the Madras High Court

Case No : Tax Case No"s. 193 of 1973 and 138 to 142 of 1975 (Reference No"s. 19 of 1973 and 121 to 125 of 1975)

Additional Commissioner of Income Tax and Another

APPELLANT

Vs

Southern Structurals Ltd.

RESPONDENT

Date of Decision : 05-04-1977

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1977) 110 ITR 890

Hon'ble Judges : Sethuraman, J;Balasubrahmanyam, J

Bench : Division Bench

Advocate : J. Jayaraman and Nalini Chidambaram, for the Appellant; T.V. Balakrishnan, C.V. Mahalingam and A.J. Rebello, for the assessee in T.C. No. 193 of 1973, for the Respondent

Judgement

Sethuraman, J.—At the instance of the Additional Commissioner of Income Tax, Madras-II, Madras, the following question has been referred to this court for its opinion :

T.C. No. 193 of 1973.

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that 25% of the "technical aid fees" paid by the assessee-company to the foreign company, Messrs. Metropolitan Cammel Carriage and Wagon Company Ltd., England, amounting to Rs. 27,204 and disallowed as a capital by the Income Tax Officer should be allowed as a deductible revenue expenditure ?"

This reference relates to the assessment year 1964-65. For the assessment years 1965-66 to 1969-70, at the instance of the Commissioner of Income Tax, Tamil Nadu-III, Madras, the following question has been referred to this court:

T.C. Nos. 138 to 142 of 1975.

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that 25% of the "Technical aid fees" paid by the assessee-company to the foreign company, M/s. Metropolitan Cammel Carriage and Wagon Company Ltd., England, amounting to Rs. 19,345, Rs. 33,400, Rs. 19,367, Rs. 18,318 and Rs. 11,018 respectively for each of the assessment years 1965-66 to 1969-70 disallowed as capital by the Income Tax Officer should be allowed as a deductible revenue expenditure ? "

2. It may be seen that both the questions relate to the identical subject-matter though the years with reference to which they arise are different. The assessee is a company engaged in the manufacture of goods wagons for supply to the Indian Railways under a contract entered into with the Government of India, Ministry of Railways, and also in executing contracts for steel structures. The assessee entered into an agreement with a company called M/s. Metropolitan Caramel Carriage and Wagon Company Ltd., hereinafter referred to as " Metro " or " British company ", on 19th May, 1961, Under this agreement, as a condition of Metro entering into the agreement, Metro had to acquire a shareholding in the assessee-company on certain basis. It is unnecessary to go into the details of the shareholding. It is enough to mention that the British company was to acquire 40% of the estimated equity shares of the assessee. Clause 2 of the agreement is material and we, therefore, set it out here:

" (a) Metro hereby grant to Southern (assessee) the right to use for the duration of this agreement all inventions and designs relating to railway wagons, whether patented or not, owned by Metro. The rights covered by this agreement are not transferable without the prior consent of Metro.

(b) Metro undertakes to supply Southern at their request from time to time with full technical information, advice, manufacturing data and details which Metro may have acquired in relation to the design and manufacture of any existing type of railway wagon and which may be of assistance to Southern in tendering for any order for such wagons or in manufacturing the same in Madras. Such information and advice shall include the benefit of all the knowledge gained by Metro as a result of their long experience in the design and manufacturing of railway wagons with particular reference to welded wagons.

(c) For the term, of this agreement, each of the parties thereto will bring to the notice of the other all important improvements which they may make in the design or manufacture of any particular type of railway wagon in which the other may be involved, such information to be accompanied by full particulars of the improvements.

(d) As remuneration for the services, advice and assistance given and rendered by Metro, as mentioned in Articles 2(a) and 2(b) and 2(c) hereof, Southern will pay to Metro a technical aid fee based on the ex-works value of all wagons produced by Southern within the first ten years after this agreement comes into force on the following basis :

(1) No technical fee will be payable to Metro for any assistance which Southern may receive from them in the production of a riveted C.R. type wagon or other riveted four-wheelers for which the R.D.S.O. has given designs, specifications and working drawings.

(2) 11/4% (One and one quarter per cent.) of the works price of all box wagons or similar welded types or welded components thereof produced under designs, specifications, drawings supplied by R.D.S.O.

(3) 2% of the ex-works price of all wagons other than C.R. or box types for which orders are placed with Southern by the Railway Board and for which designs, specifications and drawings are supplied by Metro. Such technical aid fees shall be payable not later than 31st March in each year in respect of the wagons completed under the terms of the agreement by Southern during the previous calendar year."

3. Clause 3 provides for training the employees of the assessee. Clause 4 which is also material may be extracted here :

" This agreement shall remain in force for a minimum of ten years from the date of the signing thereof whereupon or on any date thereafter it may be terminated by either party to the agreement giving 12 months" notice in writing to the other. Upon the expiration of this agreement both parties will be free from further obligations and Southern will have the continued use, free of charge, of all information made available by Metro during the period of validity of this agreement."

4. It is unnecessary to refer to the rest of the terms of the agreement.

5. With reference to the payments made under this agreement, the question that arose for the consideration of the Income Tax Officer was whether the whole of it or a part thereof alone was liable to be allowed as deduction. The Income Tax Officer considered that 25% of the payments made could be taken as capital in nature so as to be disallowed. Accordingly, following the decision of the Mysore High Court in Mysore Kirloskar Ltd. Vs. Commissioner of Income Tax, Mysore, , the Income Tax Officer disallowed 25% of the payments made in each of these years. It is the sums arrived at on this basis which are referred to in the questions set out already. The assessee appealed to the Appellate Assistant Commissioner contesting the disallowance of the said 25% of the total payments made in the respective years. The Appellate Assistant Commissioner allowed the assessee's claim and thereafter the matter was taken on appeal to the Tribunal by the Income Tax Officer. The Tribunal after considering the terms of the agreement came to the conclusion that the amount representing 25% of the total payments made by the assessee to the British company was also liable to be allowed as a deduction, and had been rightly allowed by the Appellate Assistant Commissioner. It is these orders of the Income Tax Appellate Tribunal that are challenged in the form of the question set out already.

6. On a perusal of the agreement, it is clear that the assessee entered into an agreement with Metro not only for the purpose of getting a participation in the equity capital of the assessee-company, but also for getting technical assistance from the said company. The technical assistance took the shape of the British company giving the assessee-company all inventions and designs relating to railway wagons, whether patented or not, owned by the British company. It also required the British company to give full technical information in relation to the design and manufacture of any existing type of railway wagon which may be of assistance to the assessee. There were also obligations, mutual in nature, to communicate important matters in the design or manufacture of any particular type of wagon and also for the purpose of training the employees of the Indian company in the British company's works. Clause 4 which we have already extracted and which appears to be crucial in the matter of consideration of the assessee's claim for allowance clearly provides that after the expiration of the agreement, the assessee will be free from any further obligation to pay any amount to the British company, while the assessee would have the continued use, free of charge, of all information made available by the British company during the period of validity of the agreement. In other words, whatever information was acquired by the assessee during the period of the agreement can enure to its benefit without any limitation of any period of time. In the context of the above facts, the question for consideration is whether the amount paid in full was liable to be allowed as a deduction. In a case decided by this court in *Fenner Woodroffe and Co. Ltd. Vs. Commissioner of Income Tax*, a similar agreement of technical collaboration came up for consideration. In that case though there were no specific provisions like clause 4 extracted already, the assessee was not required to return any designs or plans that had been communicated to it. With the result, the assessee could use the technical data and knowledge acquired even after the period of agreement and deal with it as if it were its own assets. No doubt in clause 2, there is certain amount of limitation on the assessee not being in a position to assign the benefits it obtained by reason of the communication of the inventions and designs relating to the manufacture of railway wagons. However, that does not in any manner take the present case out of the principle laid down in the decision of this court in *Fenner Woodroffe and Co. Ltd. Vs. Commissioner of Income Tax*, . The assessee has acquired an enduring benefit by this agreement. To that extent, the amount paid is clearly capital.

7. Learned counsel for the assessee sought to contend that the present case is governed by an earlier decision of this court in *Commissioner of Income Tax Vs. Sarada Binding Works*, . The assessee in that case entered into an agreement with one Nagi Reddy under which it obtained the right to run a business for a consideration of Rs. 5,000 per annum plus a sum equal to 10% of the net profit of each year of business. By a settlement in 1962, Nagi Reddy settled his right under the agreement on his two grandsons who sold their rights to the assessee in 1963 for a consideration of Rs. 1,50,000. During the relevant accounting

years, the assessee had paid Nagi Reddy certain amounts in accordance with the terms of the agreement and the assessee claimed that the said amount was liable to be allowed as a deduction as a business expenditure. This claim was negated by the Income Tax Officer and by the Appellate Assistant Commissioner on the ground that the payment was a consideration for the purchase of the business. The Tribunal, however, held that there was an outright purchase of the business of the assessee and the payments are allowable as a revenue expenditure in view of certain decisions relied on by it. The High Court on reference held that even if the agreement in question amounted to an outright purchase of the business, the payment was not related to any specified sum which was agreed upon by the parties as purchase price of the business and, therefore, the amount paid can be treated as a revenue expenditure.

8. We are of the opinion that the said decision has no scope for application here. We are not concerned with the acquisition of a business. We are concerned with the terms of the agreement by which the assessee has the benefit of technical know-how, which benefit it could use for eternity, as it were. Under these circumstances, we consider that the amounts disallowed by the Income Tax Officer were rightly disallowed as capital in nature and that the Appellate Tribunal was wrong in confirming the allowance as made by the Appellate Assistant Commissioner. We answer the question in the negative and against the assessee. The Commissioner will be entitled to his costs. Counsel's fee Rs. 500, one set.