

**(1991) 06 GUJ CK 0016**  
**In the Gujarat High Court**  
**Case No : Income-tax Reference No. 3 of 1980**

Anup Engineering Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

---

**Date of Decision :** 25-06-1991

**Acts Referred:**

Income Tax Act, 1961 — Section 32, 37

**Citation :** (1991) 192 ITR 633

**Hon'ble Judges :** R.K. Abichandani, J; R.C. Mankad, J

**Bench :** Division Bench

**Advocate :** J.P. Shah, for the Appellant; B.J. Shelat, for the Respondent

---

## Judgement

R.C. Mankad, J.—Messrs. Chinubhai Manibhai and Shrenik Kasturbhai entered into an agreement dated December 28, 1961, with Messrs. Machinefabriek Reineveld, a company incorporated in Holland with limited liability ("foreign company" for short), under which the foreign company agreed to place at the disposal of the limited liability company, which Messrs. Chinubhai Manibhai and Shrenik Kasturbhai intended to incorporate in India all the present and future know-how, the use of patents and all technical details with complete workshop drawings for manufacture of their engineering products, on the terms and conditions set out in the agreement. Such technical collaboration was for a period of ten years from the date of incorporation of the said limited liability company or from the date effective steps were taken in execution of the agreement, whichever was later. It was provided in the agreement that, notwithstanding the expiry of the agreement, after the stipulated period of ten years, the said limited liability company was to continue to use the patents licensed under the agreement for the unexpired period of the patents for which it is valid under the Indian Patents and Designs Act, 1911, or any Indian Act relating to registration of patents. The agreement provided that the foreign company shall, as a consideration for manufacturing and selling rights, use patents, know-how, workshop drawings and other technical collaboration provided by them, as

detailed in clause (1) :

(a) be allotted equity shares of any denomination for a total value of Rs. 2,50,000 equivalent to 10 per cent. of the initial issued capital of Rs. 25,00,000 for consideration other than cash in the limited liability company to be registered by Messrs. Chinubhai Manibhai and Shrenik Kasturbhai for this project;

(b) be paid Rs. 1,00,000 for workshop drawings in two instalments; Rs. 50,000 against workshop drawings and the balance of Rs. 50,000 when the factory goes into production; and

(c) be paid three per cent. Commission for detailing the specifications, placing orders, purchasing and inspection prior to despatch of workshop machinery to be imported.

2. In pursuance of the said agreement. The limited liability company-Anup Engineering Limited, the assessee herein - was incorporated on November 14, 1962. The board of directors, of the assessee-company, at its meeting held on August 31, 1963, adopted and approved the said agreement dated December 28, 1961, entered into with the foreign company. March 26, 1963, is the date on which the assessee-company commenced business as per the certificate issued by the Registrar of Companies. The first instalment of Rs. 50,000 for workshop drawings was paid on November 27, 1963, and the second installment of Rs. 50,000 on November 15, 1968. The assessee-company commenced production under the said collaboration agreement in December, 1963, and the first sale was effected in 1969. It may be mentioned here that allotment of equity shares of the value of Rs. 2,50,000 was made on May 8, 1965.

3. The board of directors of the assessee-company passed the following resolutions on April 24, 1972 :

"RESOLVED that cost of drawings of Rs. 1,00,000 which was not written off in the year 1969 because of insufficiency of profits, be written off in the accounts of the year 1971 and that necessary steps be taken for claiming the deduction of the same in Income Tax assessment for the relevant assessment year to the accounting year 1969.

FURTHER RESOLVED that an amount of Rs. 2,50,000 paid to Messrs. Machinefabriek Raineveld N. C. Holland as consideration for manufacturing and selling rights, patents and know-how and other technical know-how, etc., account be written off in equal instalments every year from the year of sale of production under the collaboration agreement, i.e., 1963, till the expiry of collaboration agreement which is November, 1973.

FURTHER RESOLVED that since no account was written off in the years 1969 and 1970 in view of insufficiency of profits in those years, an amount of Rs. 50,000 for the year 1969, Rs. 50,000..... for the year 1971 be written off in the books of account of the company in the year 1971".

4. The assessee-company allocated the payment of Rs. 2,50,000 on account of technical know-how as under :

|                                                     |          |                    |          |     |
|-----------------------------------------------------|----------|--------------------|----------|-----|
| Rs. (a) Manufacturing and selling rights            | 50,000   | (b) Use of patents | 1,50,000 | (c) |
| Technical know-how for a limited period of 10 years | 1,00,000 | -----              | Total    |     |
|                                                     | 2,50,000 | -----              |          |     |

5. The assessee-company also allocated payment of Rs. 1 lakh for the workshop drawings, as under :

|                                   |        |                               |        |
|-----------------------------------|--------|-------------------------------|--------|
| RS. (a) Against workshop drawings | 50,000 | (b) Against drawing of patent | 50,000 |
| -----                             | Total  | 1,00,000                      | -----  |

6. In the course of the assessment for the assessment year 1970-71, the assessee-company claimed before the Income Tax Officer, as revenue expenditure, (i) Rs. 50,000 being one-fifth of Rs. 2,50,000 being the value of equity shares (equivalent to 10 per cent. of the initial issued capital of the assessee-company) allotted for consideration other than cash to the said foreign company in terms of clause 9 (a) of the said collaboration agreement dated December 28, 1961, on account of technical know-how, etc., (ii) Rs. 1,00,000 in terms of clause 9 (b) of the said collaboration agreement paid in cash of two instalments of Rs. 50,000 against workshop drawings and Rs. 50,000 after the factory and gone into production. The Income Tax Officer disallowed the claim of the assessee-company for the amount paid towards technical know-how as revenue expenditure. He also rejected the assessee-company's claim to treat the workshop drawings as plant and machinery and to allow depreciation thereon u/s 32 of the Income Tax Act, 1961, ("the Act" for short).

7. In the course of the assessment for the assessment year 1971-72, the assessee-company claimed before the Income Tax Officer depreciation on the basis of the written down value of the workshop drawings, treating them as plant and machinery within the meaning of section 32 of the Act. The Income Tax Officer, however, in view of his decision for the assessment year 1970-71, rejected the claim of the assessee-company.

8. The Appellate Assistant Commissioner confirmed the view of the Income Tax Officer in the appeals preferred by the assessee-company.

9. Being aggrieved by the orders passed by the Appellate Assistant Commissioner in the appeals against the assessment made for the assessment years 1970-71 and 1971-72, the assessee-company carried the matter in appeal before the Income Tax Appellate Tribunal ("the Tribunal" for short). The Tribunal did not accept the submission made on behalf of the assessee-company that the payment of Rs. 2,50,000 on account of technical know-how, etc., should be treated as revenue expenditure. The assessee-company, however, in the alternative, pleaded that the Appellate Assistant Commissioner had erred in not allowing depreciation and development rebate in respect of technical know-how of Rs. 2,50,000 and on the amount of Rs. 1,00,000 paid for workshop drawings.

The Tribunal took the view that it could not be said that the assessee-company was not the owner of the workshop drawings placed at its disposal. The assessee-company was not liable to return the workshop drawings that were placed at its disposal. The Tribunal also referred to the finding which the Income Tax Officer recorded in the assessment order for the assessment year 1970-71, that the workshop drawings could be the assessee-company's own property for being exploited for all times to come. According to the Tribunal, workshop drawings were plant and, therefore, the assessee-company was entitled to depreciation on the sum of Rs. 1,00,000 paid by it for the said workshop drawings u/s 32 of the Act in the assessment year 1970-71, and, on the written down value thereof, in the assessment year 1971-72. However, so far as Rs. 50,000 allocated by the assessee-company to manufacturing and selling rights were concerned, the Tribunal took the view that no part thereof could be added to the amount of Rs. 1,00,000 paid for technical know-how. Similarly, the assessee-company was also not entitled to claim depreciation on the sum of Rs. 1,00,000 allocated for the use of patents. In other words, the Tribunal rejected the assessee-company's claim for depreciation on the amount of Rs. 60,000 allocated for manufacturing and selling rights and Rs. 1,00,000 allocated for use of patents.

10. It is in the background of the above facts that the following questions have been referred to us, for our opinion, u/s 256(1) of the Act, at the instance of the assessee-company :

"(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee was not entitled to claim depreciation on the sum of Rs. 1 lakh allocated for use of patents ?

(2) If the answer to question No. 1 is in the negative, whether the Tribunal was right in holding that no part of Rs. 50,000 allocated by the assessee-company to manufacturing and selling right was to be added to the amount of Rs. 1 lakh paid for technical know-how ?

(3) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the assessee is entitled to depreciation in respect of technical know-how of Rs. 1,00,000 for the assessment year 1970-71 ?

(4) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee was entitled to depreciation in respect of technical know-how on the cost of Rs. 1 lakh referred to in question No. 3 ?"

11. So far as question No. 1 is concerned, in the course of arguments, learned counsel for the assessee-company submitted that the assessee-company was entitled to claim depreciation on the sum of Rs. 1 lakh allocated for the use of patents under Circular No. 16(XI-A), dated May 31, 1961, issued by the Central Board of Direct Taxes. It is submitted that the question of allowing expenses incurred on the purchase of patents, for the purposes of Income Tax assessments, either as an admissible deduction from business profits or by way

of depreciation, was under the consideration of the Government and it was after considering this question that the Government issued the circular dated May 31, 1961. As stated in the circular, the Government decided that the expenditure incurred on purchase of patent rights could be treated as consolidated revenue expenditure by spreading it over a period of 14 years. The said circular stated that, accordingly, such expenditure may be allowed to be written off over the abovementioned period. Learned counsel for the assessee-company submitted that the assessee-company had purchased patent rights under the aforesaid collaboration agreement dated December 28, 1961, and, therefore, its case was directly covered by the said circular dated May 31, 1961. On the other hand, it was contended by learned counsel for the Revenue that the assessee-company could not be said to have purchased the patent rights under the said collaboration agreement and, that, therefore, it was not entitled to the benefit under the said circular. However, it appears that the claim of the assessee-company has not been examined in the light of the said circular No. 16 (XI-A), dated May 31, 1962. Under the collaboration agreement dated December 28, 1961, the assessee-company had acquired an exclusive right for the use of the patents for manufacture of engineering products of the foreign company. Under clause (12) of the collaboration agreement, the foreign company bound themselves not to engage in manufacture either unilaterally or in collaboration with any party in India, Pakistan, Burma, Ceylon, Nepal, Malaya, Indo-China and Thailand of the same or similar machinery and plant to be manufactured by the assessee-company. It would appear from the terms of the collaboration agreement that neither the foreign company nor any other company could have used the patents of the foreign company for manufacture of the engineering products of the foreign company. It would, therefore, appear that the assessee-company had acquired an exclusive right for the use of the patents in respect of the engineering products of the foreign company. Therefore, prima facie, they could be said to have purchased the patents or rights in respect of the patents so far as our country is concerned. Therefore, prima facie, Circular No. 16 (XI-A), dated May 31, 1961, appears to be applicable to the patent rights under the collaboration agreement. However, since the claim of the assessee-company has not been examined in the light of Circular No. 16 (XI-A), dated May 31, 1961, we are not inclined to express our final opinion in regard to the claim made by the assessee-company. Having regard to the facts and circumstances of the case, in our opinion, following the decision of the Supreme Court in COMMISSIONER OF Income Tax, WEST BENGAL I Vs. INDIAN MOLASSES CO. P. LTD., , the proper course to be adopted is to refer the matter back to the Tribunal for considering the claim of the assessee-company in the light of Circular No. 16 (XI-A), dated May 31, 1961.

12. So far as question No. 2 is concerned, learned counsel for the assessee-company does not press this question. We, therefore, confirm the view taken by the Tribunal and answer question No. 2 in the affirmative and against the assessee.

13. So far as questions Nos. 3 and 4 are concerned, they are directly covered by the decision of the Supreme Court in Scientific Engineering House (P) Ltd. Vs. Commissioner of Income Tax, Andhra Pradesh, . Respectfully following the said decision of the Supreme Court, we answer questions Nos. 3 and 4 in the affirmative and against the Revenue. Reference answered accordingly with no order as to costs.