
(1992) 10 BOM CK 0026

In the Bombay High Court

Case No : Income-tax Reference No. 129 of 1977

Bajaj Tempo Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 15-10-1992

Acts Referred:

Citation : (1993) 112 CTR 131 : (1994) 207 ITR 1017

Hon'ble Judges : Sujata V. Manohar, J; B.N. Srikrishna, J

Bench : Division Bench

Advocate : G. Krishnan, for the Appellant; G.S. Jetley, for the Respondent

Judgement

B.N. Srikrishna, J.—This reference u/s 256(1) of the Income Tax Act, 1961, refers for the opinion of this court the following questions :

"1. Whether, on the facts and in the circumstances of the case and on a true interpretation of the agreement dated January 12, 1964, the payment of Rs. 48,312 was in the nature of capital expenditure ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the capital expenditure of the assessee of Rs. 48,312 representing payment to the foreign collaborator was entitled to development rebate and depreciation and in dismissing Miscellaneous Application No. 32/PN/75-76 ?"

2. Of these two questions, the first question has been referred at the instance of the assessee, while the second question has been referred at the instance of the Revenue. The year of assessment is 1966-67.

3. The assessee is a company which carries on business in the manufacture and sale of three-wheeler tempos. For the relevant assessment year 1966-67, the previous year ended on September 30, 1965. In the concerned assessment year, the assessee claimed, by way of revenue expenditure, an amount of Rs. 48,312 paid to Messrs. Zahnradfabrik Friedrichshafen Aktiengesellschaft of Germany

(hereinafter referred to as the "German company"). The Income Tax Officer disallowed this claim on the ground that this payment had been made to the German company for obtaining a complete set of master-drawings and other technical documentation necessary for the purpose of starting manufacture of automatic gear boxes and, therefore, this was an item of capital expenditure. The view of the Income Tax Officer was confirmed by the Appellate Assistant Commissioner in appeal. In further appeal, the Income Tax Appellate Tribunal referred to the various clauses of the agreement between the assessee and the German company and took the view that the payment in question was capital, as it was laid out for a new line of manufacture, a new type of gear box, by utilising the information which was made available by the German company; that the technical information derived under the agreement became a permanent manufacturing activity of the assessee since it was not required to return any of the technical documents at the end of the term of the agreement. Thus, the Tribunal took the view that the information being of a permanent nature, enduring for an indefinite period of time, expenditure for acquiring the said information was capital expenditure by applying the classic test of bringing into existence of an asset of enduring nature.

4. It is necessary to mention certain other facts at the outset. The assessee was manufacturing three-wheeler tempos which were known as Viking Tempos. The gear boxes fitted on these vehicles were not being manufactured by the assessee earlier, but were supplied by the German company and were merely fitted into the Viking Tempos by the assessee. Presumably, to avoid a drain on foreign exchange, the assessee decided to manufacture the gear boxes in its own factory with the help of its existing plant and machinery, but needed technical know-how for the said manufacture. Consequently, the assessee entered into an agreement with the German company for acquiring the requisite technical know-how.

5. The agreement dated January 12, 1964, between the assessee-company and the German company has several articles. Each article deals with one component of the services which was to be rendered by the German company under the agreement. The overall object of the agreement appears to be transfer of the technical know-how by the German company to the assessee to enable it to carry on the manufacture of gear boxes of the Viking Tempos in its own factory. Article 2 of the agreement deals with the technical documentation which was to be extended by the German company to the assessee. Details are specified with regard to the documentation which the German company was required to make available and it is provided that, in consideration, the assessee would pay a one time lump sum amount of DM 40,000 (forty thousand) for this information. Article 3 of the agreement deals with technical assistance and service to be rendered by the German company to the assessee. This article provides that the German company would furnish to the assessee all technical data and information concerning design modifications or change in the manufacturing process of the concerned gear boxes or its components; furnish to the assessee all drawings, information of production, operations and processing instructions

required for the said purpose; place at the disposal of the assessee their technical personnel for studying all specific problems concerning the manufacturing of the product and, finally, that the German company would provide technical training to a specified number of technical people for a certain period. For these services, the assessee was required to pay a tax-free service charge of 2 per cent. based upon the difference in value of the gear box manufactured and/or distributed by the assessee and of such parts or components which would be supplied completely finished or semi-finished by the German company to the assessee from time to time for assembling and manufacturing the gear boxes in India. Article 4 of the agreement provides for payment of royalties. The German company granted a non-exclusive, non-transferable licence for manufacturing the concerned gear boxes in the assessee's own works or for manufacture of the said gear boxes by other suppliers according to the design specifications and information supplied by the German company. The licence granted was extended in order to grant the fitting of the concerned gear box to the Viking Tempos manufactured by the assessee for sale. As consideration for the licence granted under this article, certain royalty amounts prescribed at different rates were made payable. Article 5 provides the manner of working out the payments to be made under the agreement; article 6 deals with rendering of statements of accounts; article 7 deals with quality control and responsibility of the parties; article 8 deals with the obligation of either party to inform the other party by notice in case it did not intend to apply for patents covering improvements made in the gear box in question; article 9 is the secrecy clause; article 10 provides that the agreement would be for a period of eight years, renewable for another two years automatically, subject to prior approval of the Government of India, unless one of the parties renounces the agreement in writing by a notice of one year to the other party prior to the expiration of the period. Clause 3 of article 10 expressly provides that after termination of the contract, the assessee would refrain from using the name, trademark or other notions, denominations, giving the impression that the gear box manufactured by it was a design of the German company. Article 11 of the agreement deals with stipulations regarding the objects of the contract. Article 12 deals with disputes and reference to arbitration, while article 13 deals with the liability to pay the stamp duty.

6. Interestingly, out of the several payments made under this agreement, the Income Tax Officer disallowed only the amount of Rs. 48,312 which fell within the purview of article 1. The other payments under the agreement appear to have been allowed as revenue expenditure, without dispute.

7. The question as to whether any expenditure laid out for the purpose of a business is in the nature of capital or revenue has troubled the courts for long. Despite exercise of considerable judicial ingenuity for resolution of this vexed question, no decisive or conclusive test to differentiate the two appears to have evolved. Faced with varying factual situations, courts have adopted a pragmatic view of the matter and decided the issue upon a consideration of the totality of

the circumstances. Judicial authorities on this subject appear to play merely the role of signposts, indicating the general direction to be followed.

8. Though a number of authorities were cited at the Bar on general principles as to when an expenditure laid out for the business can be treated as capital or revenue, it is sufficient to focus our attention only on those cases which deal with expenditure for purchase of technical know how, as that is the issue in the present case.

9. The earliest judgment cited on this point is the judgment of the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, . In this case, the assessee-company had entered into an agreement with a foreign principal company for transfer of the latest technology in the field of pharmaceuticals. In consideration of the right to receive scientific and technical assistance, it had agreed to make contributions at certain stipulated rates of its net sale price of the products sold by it. The consideration was towards technical consultancy and technical service rendered and research work done, cost of raw material used for experimental work and royalties on trade marks used by the assessee. The agreement was a restrictive agreement under which the assessee could not divulge to others, any secret process under the agreement without written consent of the principal company, nor was it allowed to assign the benefit of the agreement or grant sub-licenses of the patents and trademarks. Upon termination of the agreement, for any reason, the assessee had to cease to use the patents and trademarks and return to the foreign company all technical documents and materials received under the agreement and refrain from communicating any such information to anyone else. The agreement was for a stipulated period of five years subject to cancellation by either party. The question that arose before the Supreme Court was whether the contribution payable under the agreement, other than those paid for royalties, was admissible as an allowance under clause (xii) or clause (xv) of section 10(2) of the Indian Income Tax Act, 1922. The Supreme Court took the view that the contribution was allowable as revenue expenditure u/s 10(2) (xv) on the ground that the assessee did not, under the agreement, become entitled exclusively to any assets, even for the period of the agreement. It had merely access to the technical knowledge and experience in the pharmaceutical field which the foreign company commanded. Since it had merely a licence for a limited period of the technical knowledge of the foreign company, with the right to use the patents and trade marks of that company, the Supreme Court was of the view that the assessee acquired, under the agreement, merely a right to draw, for the purpose of carrying on its business as a manufacturer and dealer of pharmaceutical products, upon the technical knowledge of the foreign company for a limited period. By making that technical knowledge available, the foreign company did not part with any asset of its business, nor did the assessee acquire any asset or advantage of an enduring nature for the benefit of its business. The Supreme Court approvingly cited two decisions of the House of Lords in *Jeffrey v. Rolls-Royce Ltd.* [1962] 40 TC 443 and *Musker v. English Electric Co. Ltd.* [1964] 41

TC 556. In *Rolls-Royce Ltd.'s case* [1962] 40 TC 443 payment received for licensing a foreign Government to manufacture aero-engines with the accumulated technical knowledge of the taxpayer and for supplying the necessary information and drawings, and for advising the foreign Government as to improvements and modifications in manufacture and design, instructing the licensee's personnel in their works and for releasing members of their own staff to assist in the manufacture of engines by the licensee was held to be received on revenue account of the taxpayer's trade. In *English Electric Company's case* [1964] 41 TC 556, the assessee had contracted with the Admiralty to design and develop a turbine and to license its manufacture by a limited number of companies in the United Kingdom, Australia and Canada and also contracted with the Government of Australia and an American aircraft manufacturing corporation to license the manufacture of a bomber which the taxpayer had designed and developed, and received fixed lump sum payments as a consideration for imparting "manufacturing technique" to the licensee. The receipts under this agreement were also held by the House of Lords to be income.

10. The line of reasoning adopted by the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, has been followed by a number of judgments in this court. In *Commissioner of Income Tax, Bombay City-I Vs. Tata Engineering and Locomotive Co. Pvt. Ltd.*, , this court had to consider a somewhat similar case. Under two agreements between the assessee and the foreign company, technical know-how and technical advice were bought by the assessee for which payments were made under the agreements. Under the first agreement, the assessee was to be provided with drawings and designs and full technical information required for the manufacture of automotive products. The said company was also to provide training facilities for Indian personnel in their German plant. The assessee was entitled to use the name and trade mark of Daimler Benz. The agreement was for a period of 15 years with a right of termination thereof by six months' notice on either side. After the expiry of the agreement, the assessee was entitled to continue its manufacture but they were not allowed to use the trade name of Tata Mercedes Benz. Under the second agreement, the foreign company agreed to give technical advice, information and assistance to Telco steel foundry and provide facilities for training Indian personnel in their Belgian plant. The agreements provided for payments of royalty and a percentage of profits for provision of know-how. The assessee had claimed the amounts paid under the collaboration agreements and expenses incurred in training its personnel for the assessment year as deductible revenue expenditure. After an elaborate consideration of the terms of the two agreements and referring to the judgment of the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, , and this court's earlier judgment in *Antifriction Bearings Corporation Ltd. v. CIT* [1978] 114 ITR 335, the court held that in the payment for taking advantage of know-how from a foreign firm, there was no transfer or acquisition of an asset and, therefore, it must follow that any expenditure incurred in connection with an exploratory mission or a visit

intended to finalise the collaboration agreement, in the form of travelling expenses, would also have to be treated as revenue expenditure. It also held that an agreement of foreign collaboration, where foreign know-how is availed of in lieu of payment, is in substance a transaction of acquiring the necessary technical information with regard to the technique of production. The fact that the said information is continued to be used, after the expiry of the agreement, whether in the same form or in an improved form will, therefore, not be relevant in deciding whether technical know-how obtained under such an agreement is a capital asset. The court pointed out that technical know-how made available by a party to such an agreement does not stand on the same footing as protected rights under a registered patent. There is no property right in know-how which can be transferred just as it is, in a limited sense, in a patent. In any case, a party making the know-how available can hardly make any attempt to retrieve all the information supplied after the other party to the agreement has fully equipped itself and made itself familiar with the technical information and know-how supplied. The fact that the production can still be continued after the expiry of the agreement was, therefore, held to be wholly immaterial for deciding whether such know-how can be treated as a capital asset.

11. In *Acc-Vickers Babcock Ltd. Vs. Commissioner of Income Tax, Bombay City II*, , the same view had been expressed in this court.

12. *Kirloskar Pneumatic Co. Ltd. Vs. Commissioner of Income Tax, Poona*, which is heavily relied upon by the assessee is a much later judgment which reiterates the same view. In fact, this case bears a very close resemblance to the facts of the assessee's case. The assessee therein which was formed to manufacture various types of machinery, including air-compressors, entered into an agreement with a foreign company, the object of which was mainly to acquire technical know-how for manufacture and sale of certain industrial refrigerating compressors. The foreign collaborator agreed under the agreement to provide drawings and information and to keep the assessee informed about research and development carried on in its works. It was also required to train personnel of the assessee regarding manufacture, use and maintenance of the products. The agreement was for a period of six years with a provision for extension for another six years with a right to either party to terminate the agreement by a stipulated notice. The assessee was required to pay a lump sum amount as consideration for the drawings which the assessee was not obliged to return even on termination of the agreement, and also as compensation for the right to export to certain territories, to pay a fee of 3 per cent. on the net proceeds of the products for future development work and technical assistance and a royalty of 2 per cent. on net products for the right to use patents and the name of the foreign collaborator on its products. On the question whether the payments made under the agreement were taxable as revenue expenditure, this court took the view that the agreement had to be considered generally and broadly and, reading it as a whole, it was clear that the intention of the parties was not to enter into a separate contract for the purchase of the drawings, but the intention

of the assessee was to acquire technical knowledge or know-how from the foreign company for a limited period and that the drawings were acquired as part of this technical knowledge. This court took the view that the know-how derived was bound to become obsolete with technological developments and changes in techniques, Hence, the assessee did not acquire any asset or benefit of an enduring nature and the payments made by it were allowable as revenue expenditure.

13. In a recent judgment of the Supreme Court in *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) , the Supreme Court was concerned with the same issue. After a review of several English judgments and its own judgments, the Supreme Court held that the amounts expended by the assessee did not result in a completely new product or completely new process, since the agreement with the Japanese company was intended for acquiring technical know-how with regard to a new strain of penicillin which had been developed by the Japanese company. Though the facts before the Supreme Court were slightly different, some of the observations made by the Supreme Court in its judgment are significant and of help. With regard to the transient nature of the technical know-how, the Supreme Court observed (at page 390) :

"It would, in our opinion, be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of insurability and permanence to the technical know-how at any particular stage in this fast-changing area of medical science. The state-of-the-art in some of these areas of high priority research is constantly updated so that the know-how cannot be said to be the element of the requisite degree of durability and non-ephemerally to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeon-holing an outlay such as this as capital."

14. The Supreme Court further observed (at page 384) :

"In the infinite variety of situational diversities, in which the concept of what is capital expenditure and what is revenue arises, it is well nigh impossible to formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants; but as masters they tend to be over-exacting."

15. It was held that the question in each case would necessarily be, whether the tests held as relevant and significant in one set of circumstances are relevant and significant in the case on hand also. As cautioned by the Supreme Court (at page 386), "Judicial metaphors are narrowly to be watched, for, starting as devices to liberate thought, they end often by enslaving it". The Supreme Court opined that 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 "capital" or "revenue" a judicial fetish.

16. The body of judicial opinion seems to suggest that the court is required to take a pragmatic view, using decided cases merely as analogous. It is this approach which we propose to adopt in the present case.

17. Mr. Jetley, learned counsel for the Revenue, attempted to persuade us that the case of the assessee was distinguishable from Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., , on account of various factual dissimilarities. He pointed out that the agreement was for a different duration, that the assessee had a right to retain the technical documentation at the expiry of the agreement and further that the assessee was free to continue to utilise the technical knowledge derived in the manufacturing of the gear boxes for the Tempo Viking vehicles, even after expiry of the agreement. We find nothing noteworthy in these arguments, which had all been considered and rejected by this court in Commissioner of Income Tax, Bombay City-I Vs. Tata Engineering and Locomotive Co. Pvt. Ltd., .

18. Mr. Jetley invited our attention to the judgment of the Supreme Court in Scientific Engineering House (P) Ltd. Vs. Commissioner of Income Tax, Andhra Pradesh, , and contended that this judgment makes a radical departure from the stream of thinking in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., through the several judgments of this court noticed earlier. He points out that in this case the Supreme Court has in indubitable terms held that payments made for acquiring technical documents, data sheets and such others are payments of capital nature. Relying upon this judgment, he submits that whatever may have been the nature of the payments under the other articles of the assessee's agreement, payments made under article 1, for acquisition of technical documentation, must fall within the ratio of the Supreme Court judgment in Scientific Engineering House (P) Ltd. Vs. Commissioner of Income Tax, Andhra Pradesh, and we must hold that such payment is on account of capital. The argument, though prima facie attractive, does not convince us. In Scientific Engineering House (P) Ltd. Vs. Commissioner of Income Tax, Andhra Pradesh, , the appellant-assessee was a manufacturer of several scientific instruments and apparatuses. It had entered into two collaboration agreements, one for manufacture of theodolites, and the other for the manufacture of microscopes. Under the agreements, in consideration of payment of certain amounts, the foreign collaborator agreed to supply to the assessee all up-to-date technical documents, drawing material, layouts, etc. In respect of such documentation service, the assessee was required to make a lump sum payment of Rs. 80,000 under each of the agreements. The agreement also provided for the collaborator to render training and imparting of knowledge of the know-how of manufacturing these instruments. The agreement was to remain in force for five years. A question arose as to whether the payments made by the assessee of Rs. 1,60,000 and Rs. 80,000 under each agreement towards the

documentation service, which was debited in the accounts of the assessee under the head "Library", was entitled to depreciation in the concerned assessment year. Although the Tribunal held that the supply of designs, etc., was only incidental to and in furtherance of other services which the foreign collaborator was expected to render, the Tribunal did not go into the question whether the documents fell within the meaning of the expression "book", but allowed deduction of a certain amount as revenue. The High Court in reference held that the documentation service was incidental to the other services and that the entire amount of Rs. 1,60,000 was capital expenditure, but that what was brought into existence was a non-depreciable asset and, therefore, the appellant was not entitled to any relief. In appeal, the Supreme Court accepted the claim of the assessee and came to the conclusion that a reading of the several clauses of the agreement made it clear that rendition of documentation service was really the main service to be rendered by the foreign collaborator. The Supreme Court also took the view that these documents which were made available in the form of designs, layouts and drawings were "book" and as such fell within the expression "plant" in section 43(3) of the Income Tax Act, 1961, in respect of which depreciation was allowable as of any other plant. In our view, this judgment is capable of being distinguished on several grounds. In the first place, the Supreme Court found, as a matter of fact, that the documentation service rendered to the assessee was really the main service to be rendered by the foreign collaborators and other services were merely incidental. Secondly, the question that was debated before the Supreme Court was whether the documentation supplied to the assessee amounted to "book" or "plant" and as such the assessee was entitled to claim depreciation thereupon. The arguments before the Supreme Court do not appear to have turned on the issue as to whether the payments made for procuring such documents really amounted to capital expenditure or revenue expenditure. As we read it, the proposition that emerges from this judgment is that, if under an agreement an assessee is given mainly documentation service, then the expenditure towards that would amount to capital expenditure. We are unable to accept that this proposition applies the assessee's case. This is so, because we are unable to read the assessee's agreement with the German company as an agreement the predominant purpose of which was to render mere documentation service. As pointed in *Kirloskar Pneumatic Co. Ltd. Vs. Commissioner of Income Tax, Poona*, it is not possible to scan a contract in bits and pieces to determine its nature, nor by referring to a particular clause. As we read the agreement of the assessee with the German company, the predominant object of the agreement was to render technical know-how to the assessee. In relation to the main purpose, one of the incidental objects was to transfer the designs, data sheets and such other technical documents. We are unable to accept the argument of Mr. Jetley that the agreement in question, when read in its entirety, should be held to be an agreement mainly for the purpose of supply of documents. When the true purpose of the agreement is discovered, there is no difficulty in applying the ratio of the judgments of this court in *Commissioner of Income Tax, Bombay City-I Vs.*

Tata Engineering and Locomotive Co. Pvt. Ltd., and Kirloskar Pneumatic Co. Ltd. Vs. Commissioner of Income Tax, Poona, to the assessee's case. We are of the view that the agreement was predominantly an agreement for purchase of technical knowledge or information. By expending money thereon, the assessee can neither be said to have brought into existence any asset, or at any rate an asset of an enduring nature. We cannot lose sight of the observations of the Supreme Court made in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., and Alembic's case : [1989]177ITR377(SC) that in these days of fast changing world of technology, the frontiers of scientific and technical knowledge shift rapidly, and what is current today may become obsolete in no time. The thread of reasoning which runs from Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., to Alembic's case : [1989]177ITR377(SC) and through the several judgments of our High Court noticed by us, supports the view that the state-of-the-art technology of modern times can neither be deemed to be permanent, nor of an enduring nature, so as to satisfy the "enduring asset" test.

19. Mr. Jetley invited our attention to various judgments of the Supreme Court and of our High Court in support of the general principles adopted by the courts in distinguishing capital and revenue expenditure. As observed earlier, we need not undertake this exercise afresh, and we have focussed our attention on the issue in the background of transfer of technical knowledge and technical know-how. We derive fortification for our view from the judgments of the Supreme Court in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., and Alembic's case : [1989]177ITR377(SC) and the judgments of this court noticed earlier. We have, therefore, not made any reference to the judgments on general principles cited at the Bar. Mr. Jetley also desired to cite judgments of other High Courts which took a contrary view according to him. Since there are judgments of the Supreme Court and of our own High Court, by which we are bound, we have not allowed him to cite the judgments of other High Courts.

20. In the premises, the two questions referred for our opinion are answered as under :

Question No. 1 : In the negative and in favour of the assessee.

Question No. 2 : Needs no answer in view of our answer to question No. 1.

21. In the circumstances of the case, there will be no order as to costs.