
(2011) 11 KAR CK 0192
In the Karnataka High Court
Case No : ITA No. 1297 of 2006

CIT

APPELLANT

Vs

Luwa India Ltd.

RESPONDENT

Date of Decision : 30-11-2011

Acts Referred:

Income Tax Act, 1961 — Section 143 (1) (a), 143 (2), 143 (3), 32

Citation : (2012) 205 TAXMAN 342

Hon'ble Judges : V.G. Sabhahit, J;S.N. Satyanarayana, J

Bench : Division Bench

Advocate : K.V. Arvind and M.V. Seshachala, for the Appellant; S. Parthasarathi, for the Respondent

Final Decision : Allowed

Judgement

V.G. Sabhahit, J.—This appeal is filed by the revenue being aggrieved by the order passed by the Income Tax Appellate Tribunal Bangalore Bench A (hereinafter called the ITAT) in ITA No. 1301 (Bang/2002 dated 22-5-2006 for the assessment year 1997-98 wherein the appeal filed by the Revenue was dismissed and cross objection filed by the assessee has been allowed. The material facts necessary for consideration of the substantial questions of law that arises for consideration in this appeal are as follows:

The assessee filed a return of income on 28-11-1997 showing the total income of Rs. 32,48,934/- which was processed u/s 143(1)(a) of the Income Tax Act, 1961 (hereinafter called the Act). When the case was taken up for scrutiny u/s 143(3) of the Act. it was found that amount of Rs. 28,07,950/- towards royalty which is a capital expenditure has been treated as revenue expenditure and further, the expenditure incurred by the President and his wife has been shown as expenses towards business of the company and depreciation claimed is excessive as two machinery have been discarded and therefore, notice u/s 143(2) of the Act was issued to the assessee. The assessee appeared before the assessing officer and contended that the amount of Rs. 28,07,950/- has been paid as licence fee as

per the agreement which has been entered into with M/s. Luwa AG Switzerland at 5% on sales net of cost of standard, as per the approval given by the Reserve Bank of India and since the said amount has been paid based on the sales made and is recurring in nature, the entire expenditure is revenue expenditure. The assessee relied upon certain decisions including the decision in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., However, the assessing officer held that in view of the agreement entered into with M/s. Luwa, Switzerland, the payment of royalty would amount to capital expenditure as the company use the know-how and technology granted under the licence in the manufacture of the product and therefore it was a capital expenditure in nature. The assessing officer further held that the assessee had failed to prove that accompanying of the wife of the President on a foreign tour was for business purpose and therefore, is not entitled to deduction. The assessing officer has further held that once the assets have been discarded treating them as obsolete, the same should have been considered for reduction of the block for computing the depreciation on the same and therefore, the total depreciation in respect of different assets so reduced comes to Rs. 22,442/- which is added back in the total income of the assessee. Accordingly, the assessing officer passed the order of assessment. Being aggrieved by the said assessment order, the assessee filed an appeal before the Commissioner of Income Tax (Appeals)-I, Bangalore in ITA No. 228/R-11/CIT (A)1/99-2000. The appellate authority, by order dated 5-7-2002 reversed the finding of the assessing officer that an expenditure of Rs. 28,07,950/- paid as licence fee to M/s. Luwa Switzerland is a capital expenditure and cannot be called as a revenue expenditure and held that the expenditure of Rs. 28,07,950/- paid as licence fee is a revenue expenditure. Further, in respect of disallowance of the travelling expenses of the President accompanied by his wife, the appellate authority confirmed the disallowance of 50% of the expenses claimed as for non-business purposes. In respect of the disallowance of depreciation, the appellate authority confirmed the finding of the assessing officer and accordingly, allowed the appeal in part. Being aggrieved by the said order, the Revenue has filed an appeal before the ITAT in ITA No. 1301(Bang)/2002 and the assessee filed cross objections No. 4 (Bang)/2003. The ITAT, after considering the contentions of learned counsel appearing for the parties, by order dated 22-5-2006 allowed the cross objections and dismissed the appeal holding that licence fee amounting to Rs. 28,07,950/- is a revenue expenditure having regard to the terms of the agreement and by following the decision of the Hon"ble Supreme Court in Ciba India Ltd. (supra). The ITAT, in regard to the travelling expenses of the President and his wife, by following the decision of the Kerala High Court in Commissioner of Income Tax Vs. Appollo Tyres Ltd., held that tour of the President was for the purpose of discharge of social-cum-business obligation and therefore, held that, the assessee is entitled to claim deduction. Further, in respect of disallowance of depreciation claimed by the assessee on the assets discarded due to obsolescence, the ITAT allowed the claim of the assessee. Being aggrieved by the same, the Revenue has preferred this appeal.

2. The appeal has been admitted on 30-8-2007 to consider the following substantial questions of law which arise for determination in this appeal.

(1) Whether the Tribunal was right in reversing the finding of the Assessing Officer that the royalty payment of Rs. 28,07,950/- paid to M/s. Luwa Switzerland in respect of obtaining new technology and know-how and rights and services should be treated as the capital expenditure as held by the Assessing Officer?

(2) Whether the Tribunal was correct in holding that the payment of Rs. 1,43,699/- towards foreign tour expenses of wife of the president of the assessee is an allowable deduction for business purpose?

(3) Whether the Tribunal was correct in allowing depreciation on the assets as claimed by the assessee and not worked out by the Assessing Officer based on the block assets held during the assessment year as per the computation prescribed u/s 32 of the Act.

3. We have heard the learned counsel appearing for the appellant and the learned counsel appearing for the respondent in the light of the decisions relied upon by learned counsel appearing for the parties.

4. The learned counsel appearing for the appellant submitted that royalty payment of Rs. 28,09,950/- to M/s. Luwa Switzerland as per the agreement is capital expenditure as rightly held by the assessing officer and the appellate authority and the ITAT were not justified in treating the same as revenue expenditure as the company use the technology and know-how which is necessary in the manufacture of the product and therefore, the order of the ITAT is erroneous. In support of his contention, he has relied upon the decision of the Hon'ble Supreme Court in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, wherein the Hon'ble Supreme Court has considered the points to be kept in mind while considering as to whether the expenditure is a revenue or capital, at para 6, has observed as follows:

The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all embracing formula which can provide a ready solution to the problem, no touchstone has been devised. Every case has to be decided on its own facts, keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the courts may be referred to as they might help to arrive at a correct decision of the controversy between the parties. One celebrated test is that laid down by Lord Cave L.C. in *Atherton v. British Insulated and Helsby Cables Ltd.* (1925) 10 TC 155, 192 (HL), where the learned Law Lord stated:

... when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special

circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

This test, as the parenthetical clause shows must yield where there are special circumstances leading to a contrary conclusion and, as pointed out by Lord Radcliffe in *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* (1965) 58 ITR 241 (PC), it would be misleading to suppose that in all cases, securing a benefit for the business would be, *prima facie*, capital expenditure so long as the benefit is not so transitory as to have no endurance at all. There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case. But even if this test were applied in the present case, it does not yield a conclusion in favour of the revenue. Here, by purchase of loom hours no new asset has been created. There is no addition to or expansion of the profit-making apparatus of the assessee. The income-earning machine remains what it was prior to the purchase of loom hours. The assessee is merely enabled to operate the profit making structure for a longer number of hours. And this advantage is clearly not of an enduring nature. It is limited in its duration to six months and, moreover, the additional working hours per week transferred to the assessee have to be utilised during the week and cannot be carried forward to the next week. It is therefore, not possible to say that any advantage of enduring benefit in the capital field was acquired by the assessee in purchasing loom hours and the test of enduring benefit cannot help the revenue.

He has also relied upon the decision of Hon^{ble} Supreme Court in *The Eimco K.C.P., Madras Vs. Commissioner of Income Tax, Madras*, wherein the Hon^{ble} Supreme Court, having regard to the facts of the said case, held that allotment of shares in consideration of technical know-how cannot be termed as expenditure much less revenue expenditure. He has also relied upon a decision of the Hon^{ble} Supreme Court in *Alembic Chemical Works Co. Ltd. Vs. Commissioner of Income Tax, Gujarat*, wherein the assessee in the business of manufacture of pencillin, subsequently, to increase the yield of pencillin with the better technology, entered into an agreement with a foreign company and payment of technical know-how fees in one lump sum amount would amount to

revenue expenditure and is allowable as deduction.

5. learned counsel appearing for the respondent-assessee submitted that it is clear from the terms of the agreement that what is granted is the licence and not any proprietary right and the patent or know-how and the licence fee is related to net sales made and value of the export and further, having regard to the terms of the agreement, the expenditure incurred towards payment of licence fee can never be said to be capital expenditure. In support of his contention, he has relied upon the decision of the Hon'ble Supreme Court in Commissioner of Income Tax, Madras-II Vs. I.A.E.C. (Pumps) Ltd., Madras, wherein, having regard to the agreement granting assessee exclusive licence to use patents and designs for 10 years with an option to extend or renew the agreement, payments made by the assessee would amount to revenue expenditure and not capital expenditure. He further submitted that it is well settled that points to be kept in mind while considering the question as to whether expenditure incurred is revenue expenditure or capital expenditure has been laid down by the Hon'ble Supreme Court in Empire Jute Co. Ltd. case (supra) referred to by the learned counsel appearing for the appellant. The ITAT being the final authority on the question of law, has decided that the expenditure was revenue in nature and therefore, the order of the ITAT is justified.

6. We have given careful consideration to the contentions of learned counsel appearing for the parties and scrutinized the material on record in the light of the decisions relied upon by the learned counsel appearing for the parties.

Re: Substantial question of law No. (1)

7. It is clear that though certain decisions have been relied on to determine the question as to whether the expenditure incurred is capital or revenue, there is no universal formula that is laid down and finding would depend upon the facts of the given case and depend upon the terms of the agreement, method of payment and the valuation upon which payment is made and also on other material facts of the case. In the present case, the ITAT having regard to the contents of the agreement entered into by the assessee with M/s. LUWA Switzerland has held that the licence that was granted does not confer any proprietary right in obtaining technical know-how, the licence is granted as per the agreement subject to payment of royalty to make use of know-how and technology. The royalty payable is depending upon the sales made and export. The said finding is on the question of fact and cannot at all be said to be perverse or arbitrary. As the facts in this case are identical to the facts of the case in Ciba of India Ltd. case cited above and also the decision in I.A.E.C. (Pumps) Ltd. (supra) cited above. There is no merit in the contention of learned counsel appearing for the appellant that since know-how and technology granted by the licence and the patents is of enduring nature, the same would constitute capital expenditure as the payment made is on the basis of sales and export made by the assessee. The mere fact that the said know-how and patent has been acquired even before commencement of production in this case would not in any

way material itself having regard to the agreement and payment of royalty as referred to above and therefore, finding of the ITAT that the expenditure made towards royalty in a sum of Rs. 28,07,950/- is revenue expenditure is justified and we answer the first substantial question of law against the revenue and in favour of the assessee.

Re: substantial question of law No. (2)

8. This question relates to the finding as to whether the ITAT was justified in holding that disallowance of deduction of Rs. 1,08,300/- incurred towards foreign tour expenditure by the President accompanied by his wife is allowable. The assessing officer held that no material was produced to show that the wife was entitled to accompany the President of the assessee on social obligation and therefore, in the absence of any material, the assessee is not entitled to deduction of full expenditure and the expenditure incurred in respect of the wife would not be granted and therefore, deduction to the extent of 50% of the expenditure was allowed and the same has been confirmed by the appellate authority. The ITAT held that the material on record would show that the President had gone abroad with his wife to attend budget conference and the same cannot be a social obligation and purpose of the social obligation being wife of the President and it is not the case of the Revenue that wife of the President did not accompany the President and that they had travelled abroad for budget conference i.e., for the purpose of business of the assessee and further, the finding of the ITAT is supported by the decision of the Kerala High Court in Apollo Tyres Ltd. case (supra) cited above. The learned counsel appearing for the appellant submitted that appellate authority had confirmed the order of the assessing officer as it was shown that the wife had not accompanied the President of the company to discharge social obligation. In support of his contention, he has relied upon the decision of this Court in Mac Explotec (P) Ltd. Vs. Commissioner of Income Tax, The decision in the said case is not applicable to the Revenue in the present case as in the said case, assessee's claim was the expenditure on education of son of the Director in a foreign country and therefore, the said expenditure was disallowed. Having regard to the above said facts of the case and the finding of the ITAT that the wife of the President of the respondent-company accompanied the President to the Budget Conference to discharge social obligation and visit was towards part of the business of the respondent-assessee, we hold that finding of the ITAT is justified and answer the said substantial question of law also against the revenue and in favour of the assessee.

Re: Substantial question of law No. (3)

9. This question relates to depreciation claimed by the assessee. The assessee has been claiming depreciation on block assets and since it was found that some of the assets had been discarded and depreciation had been claimed, explanation was sought for from the assessee and it was submitted by the assessee that once block assessment has been accepted, mere deletion of some of the

machineries could not affect the depreciation to be claimed towards block assessment. The assessing officer rejected the explanation of the assessee and held that depreciation claimed is liable to be reduced proportionate to the depreciation claimed in respect of two machineries which have been discarded, and which have not been used in the manufacture of the product by the assessee, no depreciation can be claimed and accordingly, proportionally disallowed the amount of Rs. 22,442/- which has been confirmed by the appellate authority and reversed by the ITAT. The learned counsel appearing for the revenue submitted that two of the assets have been discarded and the same have not been used in the manufacture, no depreciation can be claimed in respect of the machineries which had not been used and to that extent, though payment is made depreciation is claimed on block of assets, the assessing officer was justified in proportionately reducing the depreciation by Rs. 22,442/-. The learned counsel appearing for the assessee submitted that depreciation is claimed on the basis of block assessments, the mere fact that two of the machineries were discarded and were not in any way affect the depreciation claimed in respect of block assets.

10. It is well settled that depreciation can be claimed only in respect of machinery that are used in the manufacture of the product and when certain machinery out of the block assets have been discarded, the question of claiming depreciation for the machinery would not arise merely on the basis that depreciation was claimed on the block assets, the very set of expenditure is due to wear and tear of the machinery in the manufacture of the product of the assessee and when the machinery had been discarded, the question of depreciation in respect of those machinery also merely because depreciation is claimed on the block assets may not arise and therefore, the appellate authority has rightly confirmed the order of the assessing officer that depreciation claimed has to be proportionately reduced in respect of the machineries discarded in a sum of Rs. 22,442/- and the ITAT was not justified in setting aside the said finding and accordingly, we answer the said substantial question of law in favour of the revenue and against the assessee. In view of the above, we pass the following:

ORDER

The appeal is allowed in part. The finding of the ITAT treating the payment of licence fee of Rs. 28,07,950/- as revenue expenditure and disallowance of expenditure incurred towards travelling and stay of President of the company and his wife is confirmed. However, finding of the ITAT that disallowing proportionate depreciation claimed as ordered by the assessing officer confirmed in appeal is set aside and to that extent, the order passed by the appellate authority confirming the order of the ITAT that the said expenditure would be Rs. 22,442/- is restored.

Partly in favour of assessee.