

(2011) 07 DEL CK 0123

In the Delhi High Court

Case No : ITA No's. 1943 of 2010 and 763 and 765 of 2011

Commissioner of Income Tax

APPELLANT

Vs

G4S Securities System (India) P. Ltd.

RESPONDENT

Date of Decision : 11-07-2011

Acts Referred:

Income Tax Act, 1961 — Section 143(3), 37(1)

Citation : (2011) 181 DLT 535 : (2011) 338 ITR 46 : (2011) 8 RCR(Civil) 264 : (2012) 20 TAXMAN 487

Hon'ble Judges : M.L. Mehta, J;A.K. Sikri, J

Bench : Division Bench

Advocate : Sanjeev Sabharwal, for the Appellant; Kavita Jha, for the Respondent

Judgement

M.L. Mehta, J.—The question of law which arises for consideration in these appeals is common. These appeals concern with the same assessee, though these pertain to different assessment years. I. T. A. No. 1943 of 2010 and I. T. A. No. 765 of 2011 are directed against the impugned common order dated July 10, 2009, of the income tax Appellate Tribunal (for short "the Tribunal"). These pertain to the assessment years 2003-04 and 2002-03 respectively. I. T. A. No. 763 of 2011 is against the impugned order dated July 3, 2009, of the Tribunal and it pertains to the assessment year 2005-06.

2. It so happened that I. T. A. No. 1943 of 2010 pertaining to the assessment year 2003-04 came to be heard by us prior in time than the other two appeals. This appeal was admitted only on one substantial question of law which is as under:

Whether the learned income tax Appellate Tribunal/Commissioner of income tax (Appeals) erred in deleting the addition of Rs. 40,30,509 on account of royalty, ignoring that payment made as royalty has element of capital expenditure?

3. In the other two appeals, viz., I. T. A. Nos. 763 of 2011 and 765 of 2011 also identical question came up for consideration for admission. The counsel of both

the parties in these cases also being the same, they adopted the arguments as made in I. T. A. No. 1943 of 2010. The substantial question of law in all the three appeals being identical and there being only difference of amounts involved, we would like to make a brief narration of facts stating the background under which this question has arisen for our consideration. For the sake of convenience, we record the facts from I. T. A. No. 1943 of 2010, which would cover other two cases as well. The brief facts entailing the present appeals are as under:

4. The assessee is a private limited company and engaged in a business of providing guard services, development of computer software, staff training, etc. The assessee filed its return of the assessment year 2003-04 on November 28, 2003, declaring income of Rs. 10,73,40,025. However, the assessment order was also framed u/s 143(3) of the income tax Act ("the Act" for short) wherein it was observed by the Assessing Officer that the assessee had paid royalty in lieu of technical know-how assistance from M/s. Group 4 Falck A/S, Denmark, for exclusive use for five years, which was extendable by every five years in terms of the agreement dated June 20, 2002. The assessee had debited certain amount to the profit and loss account by way of royalty for technical know-how and use of trade mark to a foreign company, namely, M/s. Group 4 Falck A/S, Denmark, for the right to use logo, trade mark and technical know-how in pursuance of the agreement dated June 20, 2002, through Group 4 Holding Pvt. Ltd. on the basis of 1 per cent. of net sales. The payment of the royalty was approved by the Government of India. The Assessing Officer held the payment of royalty in lieu of technical know-how in the nature of enduring advantage for exclusive use and, therefore, on ad hoc basis he held that 25 per cent. of the royalty to be construed as payments of the capital nature. It is noted that an identical order was passed by the Assessing Officer in the assessment year 2002-03 and also in the assessment year 2005-06. The assessee preferred an appeal against the order of the Assessing Officer before the Commissioner of income tax (Appeals). The order of the Assessing Officer passed in the assessment years 2002-03 and 2003-04 was challenged before the Commissioner of income tax (Appeals) who decided the appeals in favour of the assessee, vide order dated January 28, 2008. The appeal for the assessment year 2005-06 was allowed by the Commissioner of income tax (Appeals), vide its order dated February 17, 2008, following the order of the Commissioner of income tax (Appeals) dated January 28, 2008. The Revenue preferred appeals before the Tribunal. The Tribunal dismissed the appeals of the Revenue for the assessment year 2005-06, vide the impugned order dated July 3, 2009, which is in challenge before us in I. T. A. No. 763 of 2011. Following the order of July 3, 2009, the Tribunal also dismissed the appeals of the Revenue for the assessment years 2002-03 and 2003-04 which is challenged before us, vide I. T. A. Nos. 765 of 2011 and 1943 of 2010 respectively.

5. We have heard the learned counsel for the parties and perused the record.

6. At the outset it may be noted that it was following the agreement dated June

20, 2002, between Group 4 Falck A/S, Denmark, and Group 4 Holding Pvt. Ltd., that a further sub-licence agreement was entered into by Group 4 Holding Pvt. Ltd. and the assessee. This sub-licence agreement is also dated June 20, 2002.

7. Similar definition of trade mark, G4F know-how, as existing in the agreement between G4F and Group 4 Holding Pvt. Ltd. are also incorporated in the sub-licence agreement. Clause 4.1 of the sub-licence agreement provides for the operational period of the agreement for a term of 5 years from the effective date, and continuance thereafter for further successive 5 year period unless either party gives 6 months" written notice to other party prior to the end of any such 5 year period that the agreement should not be renewed. Clause 17 of the sub-licence agreement acknowledges that G4F has the right to enforce, or to enjoy the benefit of any term of this agreement which is expressly or impliedly in favour of G4F. In clause 4.6 of the sub-licence agreement, it has been provided that on termination or expiration of the sub-licence agreement, the assessee shall return all G4F know-how obtained in pursuant to the agreement. At clause 4.7 it has been provided that on termination or expiration of the agreement, the appellant/assessee shall not thereafter make any use of the trade mark, trade name or G4F know-how and shall forthwith change its corporate and/or trade names.

8. 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 year period. The payment of commission at 1 per cent. was based on the net sales and not lump sum. On the termination or expiration of the sub-licence 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 know-how, therefore, continued to vest in G4F and it was only the right to use the know-how 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 per cent. of net sales for the use of trade mark and right to use the know-how 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 Woodhead and Sons (India) Ltd., Madras Vs. Commissioner of Income Tax, Madras, it was held that the question regarding capital or revenue expenditure depends on the terms of agreement in each case. In the case of Commissioner of Income Tax Vs. Gujarat Carbon Ltd., 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 India Ltd. v. ITO [2000] 73 ITD 189 (Delhi), the assessee had not acquired the ownership right of technical know-how 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 Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala, 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 Deputy CIT v. Swaraj Engines Ltd. [2002] 124 Taxman 118 (Chand), 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 v. Lumax Industries Ltd. [2008] 173 Taxman 390 (Delhi), this court has also held that the payment of licence fee on year to year basis for acquisition of technical knowledge would not amount to capital expenditure, but the revenue expenditure. 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 know-how throughout vested with G4F and on the expiration or termination of the agreement the assessee was to return all G4F know-how 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 know-how and the trade mark. Hence, the expenditure incurred by the assessee as royalty is revenue expenditure and is, therefore, deductible u/s 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.