
(2014) 08 MAD CK 0142

In the Madras High Court

Case No : Tax Case (Appeal) Nos. 2574 to 2579 of 2006

Commissioner of Income Tax

APPELLANT

Vs

Hitech Arai Ltd.

RESPONDENT

Date of Decision : 05-08-2014

Acts Referred:

Income Tax Act, 1961 — Section 143, 35AB, 37, 80HHC, 80HHC(3)

Citation : (2014) 368 ITR 577

Hon'ble Judges : R. Sudhakar, J;G.M. Akbar Ali, J

Bench : Division Bench

Judgement

R. Sudhakar, J.—These appeals are filed by the Revenue assailing the order dated October 21, 2005, passed by the Income-tax Appellate Tribunal "C" Bench, Chennai, in I.T.A. Nos. 289 (Mds.)/2001, 1565(Mds.)/2003, 1869(Mds.)/2003, 2069(Mds.)/2003, 3312(Mds.)/2004 and 3313(Mds.)/2004 for the assessment years 1995-96 and 1997-98 to 2001-02, by raising the following substantial questions of law:

"(i) Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that the amount paid by the assessee to the foreign company pursuant to the collaboration agreement dated December 8, 1993, is in the nature of royalty and not fee for technical know how?

(ii) Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that 5 per cent of the sale proceeds of the product paid by the assessee to the foreign company pursuant to the collaboration agreement dated December 8, 1993, is in the nature of royalty and not fee for technical know-how?

(iii) Whether, in the facts and in the circumstances of the case, the provisions of section 35AB read with Explanation 2 to section 9(1)(vii) can be invoked?

(iv) Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that the amounts paid by the assessee to the foreign company pursuant to the collaboration agreement dated December 8, 1993, is allowable

as revenue expenditure and not to be treated as capital expenditure?

(v) Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that excise duty and sales tax collection should be excluded from the total turnover for the purpose of calculation of deduction under section 80HHC? and

(vi) Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that the income from wind mill should be excluded from the turnover for computation of deduction under section 80HHC?"

1.1. At the outset, we notice that substantial question of law (v), namely, "Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that excise duty and sales tax collection should be excluded from the total turnover for the purpose of calculation of deduction under section 80HHC?", is squarely covered by a decision of the Supreme Court in Commissioner of Income Tax, Coimbatore Vs. Lakshmi Machine Works, and has been answered in favour of the assessee.

1.2. In Lakshmi Machine Works case, referred supra, the Supreme Court held that (headnote): "section 80HHC of the Income-tax Act, 1961, is a beneficial section. It was intended to provide incentive to promote exports. The intention was to exempt profits relatable to exports. Just as commission received by the assessee is relatable to exports and yet it cannot form part of "turnover" for the purposes of section 80HHC, excise duty and sales tax also cannot form part of "turnover". Just as interest, commission, etc., do not emanate from the "turnover" so also excise duty and sales tax do not emanate from such turnover. Since excise duty and sales tax did not involve any such turnover such taxes had to be excluded. Commission, interest, rent, etc., do yield profits but they do not partake of the character of turnover and therefore they are not includible in the "total turnover". If so, excise duty and sales tax also cannot form part of the "total turnover" under section 80HHC(3)".

1.3. In view of the decision of the Supreme Court in Lakshmi Machine Works case, referred supra, second question of law (v) formulated in these appeals is answered against the Revenue.

2. We also notice that substantial question of law (vi), namely, "Whether, in the facts and in the circumstances of the case, the Tribunal was right in holding that the income from wind mill should be excluded from the turnover for computation of deduction under section 80HHC?", has also been decided in favour of the assessee in (2002) 257 ITR 60. In view of the above, the substantial question of law (vi) is answered against the Revenue and in favour of the assessee.

3. In these appeals, the substantial questions of law (i) to (iv), referred supra, are entwined and they are dealt with together. From a reading of the said substantial questions of law, the core question that arises for consideration is "When the two technical collaboration agreements dated May 24, 1989, and

December 8, 1993, do not provide for any lump sum payment, whether the payment of royalty by the assessee should be treated as cost of technical know-how, which would fall under section 35AB of the Income-tax Act?"

4.1. To decide the above issue, let us briefly traverse the relevant facts of the present case. The respondent-assessee is engaged in the manufacture of automobile parts and components. They entered into technical collaboration agreement dated October 7/24, 1986, with a Japanese company, namely, Arai Seisakusho Co. Ltd. As per the said agreement, the assessee was granted exclusive licence to manufacture and sell the entire range of reed valves. The said agreement was valid for a period of ten years. Article 7(1) of the said agreement stipulates the manner in which payment should be made by the assessee to the Japanese company and for better clarity, the article 7(1) is extracted hereunder:

"Article 7. Technical licence fee

1. In consideration of the right and licence granted under this agreement,

a. HI-TECH shall pay to ARAI the lump sum of U.S. two hundred ten thousand dollars (US \$ 210,000) in three standard instalments, the first instalment U.S. seventy thousand dollars (US \$ 70,000) to be paid after the agreement is filed with RBI and capital goods clearance if any obtained, the second instalment U.S. seventy thousand dollars (US \$ 70,000) on delivery of technical documentation in total and the third and last instalment U.S. seventy thousand dollars (US \$ 70,000) to be obtained on the commencement of commercial production or four (4) years after the agreement is filed with RBI and capital goods clearance if any obtained, whichever is earlier. The Indian tax arising out of this lump-sum payment will be borne by HI-TECH on behalf of "ARAI".

(b) HI-TECH shall further pay to ARAI the running royalty of five per cent (5 per cent) for a period of five (5) years from the commencement of production calculated on the ex factory price of product, net of excise duties minus the cost of standard bought-out components and landed cost of imported components, manufactured by HI-TECH. This royalty payment will be subject to Indian taxes."

As per article 7(1)(a) of the agreement, payment has to be made by the assessee in lump sum, in three instalments. Article 7(1)(b) stipulates that royalty has to be paid for a period of 5 years at 5 per cent per year on the ex factory price of the product.

4.2. It is pertinent to point out that for the assessment years 1986-87, the Department accepted the assessee's plea for bringing technical know-how fee as per article 7(1)(a) of the agreement under section 35AB of the Income-tax Act (for brevity, "the Act") and the royalty as per article 7(1)(b) of the agreement under section 37 of the Act. The assessment continued to be done in the above said manner up to 1994-95, namely, for nine assessment years.

4.3. In the meanwhile, on May 24, 1989, the assessee entered into another

technical collaboration agreement with the very same Japanese company for grant of licence to manufacture and sell the entire range of seals, for which payment was prescribed under article 7(1) of the said agreement in the following manner:

"Article 7. Technical licence fee

1. In consideration of the right and license granted under this agreement,

HI-TECH shall further pay to ARAI the running royalty of five per cent (5 per cent) for a period of five (5) years from the commencement of production calculated on the ex factory price of product, net of excise duties minus the cost of standard bought out components and landed cost of imported components manufactured by HI-TECH. This royalty payment will be subject to Indian taxes."

The payment made in terms of the above article was claimed by the assessee as revenue expenditure in terms of section 37 of the Act and accepted by the Department.

4.4. Thereafter, on December 8, 1993, another technical collaboration agreement was entered into between the very same parties for grant of licence to manufacture and sell the entire range of " rings, oil seals, molded rubber parts, reed valve assemblies and for this, payment terms are set out under article 7(1) of the said agreement, which reads as under:

"Article 7. Technical licence fee

1. In consideration of the right and licence granted under this agreement,

HI-TECH shall further pay to ARAI the running royalty of five per cent (5 per cent) for a period of five (5) years from the commencement of production effective date of this agreement calculated on the ex-factory price of products, net of excise duties minus the cost of standard bought out components and landed cost of imported components manufactured by HI-TECH. This royalty payment will be subject to Indian taxes."

The payment made in terms of the above article was also accepted by the Department as revenue expenditure in terms of section 37 of the Act.

4.5. Thereafter, the assessee entered into another technical collaboration agreement dated February 11, 1999, with the Japanese company to continue the usage of technical know-how granted under agreements dated October 7/24, 1986, and May 24, 1989, for a further period of five years in respect of license to manufacture and sell the entire range of " rings, oil seals, molded rubber parts, reed valve assemblies. In other words, this agreement renews the licence granted under the agreements dated October 7/24, 1986, and May 24, 1989, for a further period of five years. Article 7(1) of the said agreement provides for payment terms and the same reads as under:

"Article 7. Technical licence fee

1. In consideration of the right and licence granted under this agreement,

HI-TECH shall further pay to ARAI the running royalty of five per cent (5 per cent) for a period of five (5) years from the date of this agreement calculated on the ex factory price of products, net of excise duties minus the cost of standard bought out components and landed cost of imported components manufactured by HI-TECH. This royalty payment will be subject to Indian taxes."

4.6. Subsequent to the above, the parties have entered into another technical collaboration agreement on April 1, 2002, of which we are not concerned in these appeals.

4.7. The dispute in this case arose during the assessment year 1995-96. In the assessment made under section 143 of the Act, the Assessing Officer treated a part of royalty payment as fees for technical know-how and proportionately made disallowance of Rs. 10,41,667 stating that it is capital expenditure falling under section 35AB of the Act. But the Assessing Officer accepted the other part of royalty as revenue expenditure and did not raise a dispute thereon. As against the said order of disallowance, the assessee appealed to the Commissioner of Income-tax (Appeals), who confirmed the order of the Assessing Officer. The assessee preferred further an appeal to the Tribunal challenging the said order.

4.8. However, for the assessment years 1997-98 to 2001-02, the Assessing Officer took a uniform stand that royalty payment is only a payment for technical know-how granted by the Japanese company and, therefore, it is capital expenditure falling under section 35AB of the Act and the same was disallowed. Aggrieved by these assessment orders, the assessee went on appeal and the Commissioner of Income-tax (Appeals) allowed the appeals in favour of the assessee. Challenging the said order, the Revenue went on appeal to the Tribunal.

4.9. The Tribunal accepted the plea that payment towards royalty is revenue expenditure and not capital expenditure in terms of section 35AB of the Act.

4.10. Aggrieved by the said order, the Revenue is before us raising the substantial questions of law, referred supra.

5. We have heard Mr. M. Swaminathan, learned senior standing counsel appearing for the Revenue and Mrs. Pushya Sitaraman, learned senior counsel appearing for the respondent and perused the decision of the Tribunal and the authorities below.

6. In this case, the Tribunal interpreted the agreements dated May 24, 1989, and December 8, 1993, as agreements for grant of licence to an existing company for manufacture and sale of automobile parts and components and it is not technical know-how for setting up a new plant and for manufacturing a completely new product with the aid and assistance of the foreign company. The Tribunal, based on records, was of the firm view that the assessee in this case is an existing company manufacturing automobile parts and components and the same is not disputed by the Revenue.

7. The agreement dated October 7/24, 1986, provides for lump sum payment for technical know-how, apart from royalty. The subsequent agreements dated May 24, 1989, and December 8, 1993, provide for grant of licence on payment of royalty. The Tribunal took note of the fact that the said two agreements do not provide for payment of lump sum, as in the case of the first agreement dated October 7/24, 1986. To come to the conclusion that the subsequent renewal agreement dated February 11, 1999, is only in the nature of licence for the technical know-how granted earlier on October 7/24, 1986, and that there was no scope for setting up any new factory, for which it should be termed as capital expenditure, the Tribunal relied upon the decision of this court in *S.R.P. Tools Ltd. Vs. Commissioner of Income Tax*, wherein the decision of the Supreme Court in *Jonas Woodhead and Sons (India) Ltd. Vs. Commissioner of Income Tax*, was distinguished and it was held as under (page 692):

"The decision of the Supreme Court in *Jonas Woodhead and Sons (India) Ltd. Vs. Commissioner of Income Tax*, relates to a case where the payment was made for the setting up of a factory. Learned counsel for the Revenue strongly placed reliance on the following observations of the Supreme Court in the above said decision (headnote):

The question whether a particular payment made by an assessee under the terms of an agreement forms a part of capital expenditure or revenue expenditure, would depend upon several factors, namely, whether the assessee obtained a completely new plan with a complete new process and completely new technology for manufacture of the product or the payment was made for the technical know-how which was for the betterment of the product in question which was already being produced; whether the improvisation made is part and parcel of the existing business or a new business was set up with the so-called technical know-how for which payments were made; whether on expiry of the period of agreement the assessee is required to give back the plans and designs which were obtained, but the assessee could manufacture the product in the factory that has been set up with the collaboration of the foreign firm; the cumulative effect on a construction of the various terms and conditions of the agreement; whether the assessee derived benefits coming to its capital for which the payment was made."

It is not clear from the facts found by the Appellate Tribunal that the assessee obtained technical knowledge for the setting up of a new plant and for manufacture of a completely new product with the aid and assistance of technology of the foreign company. Furthermore, as we have already seen, the assessee had an existing business and from the mere fact that certain new products are sought to be manufactured it cannot be stated that it had set up a new plant with a new technology and the cumulative effect of the various terms of the agreement clearly show that the expenditure cannot be regarded for acquiring a capital asset by the assessee. Though the assessee had a right to use the technical know-how even after the completion of the agreement, that fact

itself would not be conclusive to hold that the payment was of capital nature. The question whether the payment can be regarded as revenue or capital in nature depends upon the object of the expenditure and the effect of the expenditure and the impact of the expenditure in the business carried on by the assessee and for that purpose, it is necessary to bear in mind the business exigencies on the basis of which the agreement had been entered into. We have carefully perused the terms of the agreement and the various articles of the agreement clearly show that the assessee was given only a licence and had access to the information for the running of the business of the assessee. No doubt, as found by the Commissioner (Appeals), the agreement was for a new product, but on that factor, it cannot be stated that the assessee acquired an enduring advantage in the capital field. Therefore, we are of the opinion that the Tribunal was not justified in holding that the amount paid under the agreement should be regarded as capital expenditure. Hence, we are of the view that the second question in so far as it relates to the payment of technical know-how, should be answered in favour of the assessee."

8. The learned senior standing counsel appearing for the Revenue pleads that the amount paid by the assessee to the Japanese company is for setting up of a factory for manufacture of new product and, therefore, the said expenditure is capital in nature. In this regard, strong emphasis was placed on the decision of the Supreme Court in *Jonas Woodhead and Sons (India) Ltd. Vs. Commissioner of Income Tax*, , more particularly paragraph 13, which reads as follows (page 352):

"It would thus appear that the courts have applied different tests like starting of a new business on the basis of technical know-how received from the foreign firm, the exclusive right of the company to use the patent or trademark which it receives from the foreign firm, the payment made by the company to the foreign firm whether a definite one or dependant upon certain contingencies, the right to use the technical know-how of production or the activity even after the completion of the agreement, obtaining enduring benefit for a considerable part on account of the technical information received from a foreign firm, payment whether made "once for all" or in different instalments co-relatable to the percentage of gross turnover of the product to ultimately find out whether the expenditure or payment thus made makes an accretion to the capital asset and after the court comes to the conclusion that it does so, then it has to be held to be a capital expenditure. As has been held by this court and already indicated in *Alembic Chemical Works Co. Ltd. Vs. Commissioner of Income Tax, Gujarat*, no single definitive criterion by itself could be determinative and, therefore, bearing in mind the changing economic realities of business and the varieties of situational diversities the various clauses of the agreement are to be examined. But in the case in hand the High Court having considered the different clauses of the agreement and having come to the conclusion that under the agreement with the foreign firm what was set up by the assessee was a new business and the foreign firm had not only furnished information and the technical know-how but

rendered valuable services in setting up of the factory itself and even after the expiry of the agreement there is no embargo on the assessee to continue to manufacture the product in question, it is difficult to hold that the entire payment made is revenue expenditure merely because the payment is required to be made at a certain percentage of the rates of the gross turnover of the products of the assessee as royalty. In our considered opinion, in the facts and circumstances of the case the High Court was fully justified in answering the reference in favour of the Revenue and against the assessee. These appeals are accordingly dismissed but in the circumstances without any order as to costs."

9. In our considered opinion, on facts, the decision in Jonas Woodhead and Sons (India) Ltd.'s case, referred to supra, was rightly distinguished by the Tribunal following the decision of this court in S.R.P. Tools Ltd.'s case, referred to supra, as there was no setting up of a new factory based on the original technical collaboration agreements or by the subsequent renewal agreements. What was sought to be renewed is only the licence for manufacturing and selling the automobile parts and components, for which royalty was to be paid for the subsequent periods, after the expiry of the original period of licence. We, therefore, concur with the findings of the Tribunal that the payment made in terms of the two agreements dated May 24, 1989, and December 8, 1993, is purely revenue in nature, as they provide for payment of licence fee for manufacture and sale of the products which are manufactured pursuant to the first agreement dated October 7/24, 1986, and the said fact is also not in dispute. The Tribunal has at length discussed the scope of these agreements and come to the conclusion that the payments made under the technical collaboration agreements are purely in the nature of revenue expenditure and not capital expenditure.

10. We find no justifiable reason to differ with the said finding rendered by the Tribunal, more so taking note of the fact that the Department had for the assessment years 1986-87 to 1994-95, namely, for a period of nine years, accepted the fact that the payment made towards royalty is revenue expenditure and had not raised dispute thereon. That apart, even for the assessment year 1995-96, the Assessing Officer has partially treated the payment of royalty as revenue expenditure. The sudden volte face by the Department on this issue appears to be on account of a new interpretation by the subsequent Assessing Officer. At this juncture, we would like to observe that the view of the Department, while interpreting the very same agreement, cannot be inconsistent. Unless there is a change in law or on the basis of new and acceptable material which went unnoticed, the opinion should not differ from time to time based on the perception of individual officers. Citizens expect consistency not only in judicial orders, but also in the orders passed by quasi-judicial authorities. For the foregoing reasons, we hold that the payment of royalty based on the two agreements dated May 24, 1989, and December 8, 1993, is revenue expenditure. Accordingly, the substantial questions of law (i) to (iv) are answered against the Revenue and in favour of the assessee.

In fine, these appeals are dismissed. No costs.