
(1993) 03 KL CK 0023

In the High Court Of Kerala

Case No : Income-tax Reference No. 54 of 1988

Commissioner of Income Tax

APPELLANT

Vs

Kar Valves Ltd.

RESPONDENT

Date of Decision : 10-03-1993

Acts Referred:

Income Tax Act, 1961 — Section 32, 43, 43(3)

Citation : (1993) 204 ITR 490

Hon'ble Judges : K.S. Paripoornan, J; K.P. Balanarayana Marar, J

Bench : Division Bench

Advocate : P.K.R. Menon and N.R.K. Nair, for the Appellant; C.M. Devan, C.N. Ramachandran Nair and A.M. Shaffique, for the Respondent

Judgement

K.P. Balanarayana Marar, J.—At the instance of the Revenue, the Income Tax Appellate Tribunal has referred the following questions of law for the decision of this court :

"1. Whether, on the facts and in the circumstances of the case, the assessee is entitled to capitalise Rs. 25,125 and is not the order of the Tribunal vitiated for not considering the claim independently on merits ?

2. Whether, on the facts and in the circumstances of the case and on an interpretation of the agreement,--

(i) the assessee is entitled to capitalise the entire technical fees paid to Messrs. Engine Valves ?

(ii) the Tribunal is justified in interfering with the order of the Officer confirming the capitalisation to 50 per cent. of the technical fees?"

2. The respondent-assessee is a limited company formerly known as Cochin State Power and Light Corporation Ltd. They were engaged in the business of distribution of electricity in Ernakulam town. After takeover of the undertaking on December 2, 1970, the assessee-company started a plant for the manufacture of

automobile engine valves. The income assessable for the assessment year 1974-75 was only interest and dividend and the income returned was after deducting the overheads, depreciation, etc. The assessee charged 20 per cent. of the total overhead expenses to the profit and loss account and the balance 80 per cent. capitalised to the new project. For the assessment year 1974-75, the Income Tax Officer rejected the claim of the assessee in respect of 20 per cent. expenditure. On second appeal, the Income Tax Appellate Tribunal held that an amount of Rs. 20,000 could be treated as referable to the business as well as the interest and dividend income. The Income Tax Officer was directed to allow a deduction of 20 per cent. the assessee claimed the balance amount of Rs. 25,215 as capital expenditure which was referable to the value of assets then on hand. The Income Tax Officer did not accept the claim. On appeal, the Commissioner of Income Tax (Appeals) allowed the claim and it was held that the balance amount of Rs. 25,215 pertaining to the new valve project at Bangalore was capital expenditure and could be capitalised. The claim of the assessee was, therefore, allowed. On further appeal, the Tribunal confirmed the order of the Commissioner (Appeals). These facts cover questions Nos. 1 and 2 proposed before the Tribunal by the Commissioner of Income Tax. The said aspect is covered by question No. 1 referred to this court.

3. For the assessment year 1975-76, the assessee claimed the entire expenditure on payment of technical know-how fees amounting to Rs. 5,50,000. The Income Tax Officer allowed only 50 per cent. of the amount. On appeal, the Commissioner of Income Tax (Appeals) allowed the claim in full. The Tribunal confirmed the view of the Commissioner in the second appeal. Interpreting the relevant clauses in the agreement entered into between the assessee-company and Messrs. Engine Valves Ltd., the Tribunal held that when fees were paid for supplying and imparting of know-how, the assessee has rightly capitalised the entire technical fees paid to Messrs. Engine Valves. Question No. 3 proposed by the Commissioner of Income Tax before the Tribunal arises from this finding of the Tribunal and which has been referred to this court as question No. 2.

4. The Tribunal declined to refer question No. 1 proposed by the Revenue for the reason that it is covered by question No. 2. It was thereafter that the two questions aforementioned were referred to this court u/s 256(1) of the Income Tax Act.

5. Heard standing counsel for the Revenue, Sri P.K.R. Menon, and Sri C.M. Devan for Menon and Pai for the respondent.

6. The assessee included in the capital cost of the assets an amount of Rs. 5,50,000 paid towards fees for technical know-how to Messrs. Engine Valves Ltd., a foreign company in collaboration with whom the assessee had set up the engine valves project at Bangalore. The Income Tax Officer held that only 50 per cent. of the amount could be capitalised. According to him, the payment related not merely to the acquisition and erection of the machinery and plant, but also for imparting of technical and secret processes for production and also for

training of the personnel of the assessee in the plant of the collaborator for running the plant. It was for these reasons that the Income Tax Officer declined to accept the assessee's claim for capitalisation of the entire fees paid for technical know-how. Still he permitted capitalisation of 50 per cent. viz., Rs. 2,75,000. The Commissioner of Income Tax, on a consideration of the relevant clauses contained in the agreement and the decisions on the matter, allowed the assessee's claim in full. On second appeal, the Tribunal also concurred with that decision. On hearing counsel and on a perusal of the relevant clauses in the agreement, annexure-E, we find no error in the order of the Tribunal in allowing the entire amount claimed towards fees paid for technical know-how as capital expenditure.

7. Clause 3-A of annexure "E" agreement provides that the licensor, Messrs. Engine Valves Ltd., shall give to the licensee (assessee) the technical data, designs, specifications and such other documents as may be necessary which will enable the licensee to commence the manufacture and continue the production of valves. The information or services to be rendered or provided by the licensor in consideration of the technical fees to be paid by the licensee are enumerated in that paragraph. Clause 7 stipulates for payment of a sum of Rs. 5,50,000 as technical fees. This amount was to be paid in five instalments at the rate of Rs. 1,10,000 each. The periods during which the amounts are to be paid also find a place in that paragraph. The licensor has to give the data and other specifications to commence the manufacture and continue the production of valves. Interpreting these clauses in annexure-E agreement, the Tribunal is of the view that the lump sum fee of Rs. 5,50,000 is paid by the assessee for supplying and imparting of know-how, setting up of the factory and establishing, manufacturing and rendering all such assistance as may be necessary for the manufacture of valves. It is for that reason that the Tribunal concurred with the view of the Commissioner (Appeals). We are of the view that the order of the Tribunal does not disclose any error in the interpretation of the clauses of annexure-E agreement.

8. Clause 3-A directs the licensor to give the technical data and specifications for the purpose of commencing the manufacture as well as to continue the production of valves. The assessee has undertaken to pay a total sum of Rs. 5,50,000 towards fees. The assessee has further agreed that the valves manufactured by it under the terms of the agreement shall be manufactured in all respects in accordance with the specifications and designs and conform to the qualities prescribed from time to time by the licensor. The licensor was also given the liberty to visit the factory and premises of the licensee to inspect the valves manufactured or in the course of manufacture to see that the licensee complied with all the requirements of the licensor as to the quality of valves. The licensee has further undertaken to provide samples of the valves, raw materials used and detailed technical/test reports to the licensor as and when required. The fees were therefore paid for commencing the business and to continue the same. The payment therefore formed the basis of the business of manufacturing valves.

9. A question arises as to whether the amount so paid goes into the capital cost and if so, whether the full amount paid by the assessee should be capitalised. In this connection, learned counsel for the respondent draws our attention to the decision of the Supreme Court in *Scientific Engineering House (P) Ltd. Vs. Commissioner of Income Tax, Andhra Pradesh*, . The question for determination in that case was as to whether the payment of Rs. 1,60,000 by the assessee to the collaborator was attributable partly or wholly towards the acquisition of a depreciable asset. The amount was agreed to be paid for rendering "documentation service" by supplying complete sets of all the documents including designs, drawings, charts, plans and other literature as per the agreement entered into between the assessee and the collaborator. The Supreme Court held that the drawings, designs, charts, plans, processing data and other literature comprised in the "documentation service" as specified in Clause 3 of the agreement constituted "book" and fell within the definition of "plant" in Section 43(3) of the Income Tax Act, 1961. It was observed that "plant" was not necessarily confined to apparatus which was used for mechanical operations or processes. The test to be applied, according to the Supreme Court, was as to whether the article fulfils the function of a plant in the assessee's trading activity. Was it a tool of his trade with which he carried on his business ? The Supreme Court held that, if the answer was in the affirmative, it would be a plant.

10. It is further observed that the purpose of rendering such documentation service by supplying these documents was to enable it to undertake its trading activity of manufacturing theodolites and microscopes and these documents had a vital function to perform in the manufacture of these instruments. It was with these documents that the assessee was able to commence its manufacturing activity. The Supreme Court held that these documents really formed the basis of the business of manufacturing the instruments in question. The expenditure incurred by the assessee by way of purchase price of the drawings, designs, etc., comprised in the "documentation service" specified in Clause 5 of the agreement was held to be of capital nature as a result whereof a capital asset of technical know-how in the shape of drawings, designs, etc., was acquired by the assessee. The Supreme Court further held that the capital/asset acquired by the assessee, viz., the technical know-how in the shape of drawings, designs, etc., is a depreciable asset.

11. In the light of the principles enunciated by the Supreme Court in the aforementioned decision and on an interpretation of the relevant clause contained in annexure-E agreement, the conclusion reached by the Tribunal that the sum paid towards technical fees was rightly capitalised by the assessee is justified. No error has been committed by the Tribunal in holding so. Question No. 2 has, therefore, to be answered against the Revenue.

12. The other question relates to allowance of an amount of Rs. 25,215 as capital expenditure. A total sum of Rs. 45,215 was claimed as expenses pertaining to the old Ernakulam electrical undertaking for the year 1974-75. For that

assessment year, the assessee had allocated 80 per cent. of the expenses incurred during the year to capital and 20 per cent. to revenue by debiting the profit and loss account. This amount of Rs. 45,215 represented 20 per cent. of the total expenses allocated to revenue expenditure. That was claimed as a deduction by the assessee in the return filed by it for the assessment year 1974-75. By annexure "F" order of the Income Tax Appellate Tribunal, a portion of the expenses was found to be attributable to the electricity business. The Tribunal was of the opinion that Rs. 20,000 could be treated as referable to the business as well as the interest and dividend income. The Income Tax Officer was directed to allow a deduction of Rs. 20,000. For the subsequent assessment year 1975-76, the balance amount of Rs. 25,215 was claimed as includible in the actual cost of the assets. The Commissioner of Income Tax (Appeals) allowed this deduction. On further appeal, the Tribunal declined to interfere holding that the assessee had actually capitalised the amount and included it in the cost of the assets. According to learned counsel for the Revenue, this finding of the Tribunal was rendered on a wrong interpretation of the finding given by the Tribunal in annexure-F order. As rightly pointed out by him, there is nothing in the order, annexure-F, to show that the balance amount of Rs. 25,215 had to be treated as capital expenditure. The Tribunal, in annexure "D" order, would observe that the finding of the Tribunal in annexure-F order meant that the amount to be capitalised was not 80 per cent. of the expenses of the year as estimated by the assessee but also a further sum of Rs. 25,215. There is nothing in annexure-F order indicative of this inference. The only observation in annexure-F order is to the effect that an amount of Rs. 20,000 out of the total sum of Rs. 45,215 could be treated as referable to the business as well as interest and dividend income. It is also pointed out that the assessee had already capitalised 80 per cent. of the expenses which they considered as on capital account and that the entire amount of Rs. 45,215 was on revenue account. This claim of the assessee is not seen to have been denied. The Tribunal was, therefore, not correct in treating Rs. 25,215 as capital expenditure on the ground that the Tribunal had rendered such a finding in annexure "F" order. It is not so. Question No. 1 has, therefore, to be answered in favour of the Revenue.

13. For the aforesaid reasons, question No. 1 is answered in favour of the Revenue and against the assessee and question No. 2 in favour of the assessee and against the Revenue.

14. A copy of this judgment under the seal of the court and signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.