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In the Karnataka High Court

Case No : IT Appeal No. 1536 of 2005

Commissioner of Income Tax — APPELLANT

Vs

Molex (India) Ltd. — RESPONDENT

Date of Decision : 13-07-2010

Acts Referred:
Income Tax Act, 1961 — Section 143 (1) (a), 37 (1), 43 B

Citation : (2011) 238 CTR 65 : (2012) 344 ITR 156 : (2010) 194 TAXMAN 52

Hon'ble Judges : N. Kumar, J;B.V. Nagarathna, J

Bench : Division Bench

Advocate : M.V. Seshachala, for the Appellant; G. Sarangan and Vani H., for the Respondent

Judgement

N. Kumar, J.—This appeal is by the revenue, challenging the order passed by the Tribunal which has held that the expenses incurred for imparting technical know-how to the assessee is to be treated as a revenue expenditure u/s 37(1) of the Income Tax Act, 1961 (The Act'') and the entire expenditure is allowable instead of 1/6th allowed by the Assessing Officer. The appeal also pertains to two other aspects which are now concluded by the Judgments of the Apex Court.

2. The brief facts leading to this proceeding is as under:

For the assessment year 1995-96 the assessee company furnished return of income declaring total income of Rs. 1,96,03,050. It was processed u/s 143(1)(a) by making prima facie disallowance u/s 43B in respect of unpaid sales tax for Rs. 2,450. Later the case has been taken up for scrutiny and accordingly notice u/s 143(2) was issued to assessee company. The assessee incurred an amount of Rs. 21,50,000 towards technical fee which was paid to the foreign technicians. The assessee was called upon to show cause why the said amount should not be covered u/s 35AB of the Act. The assessee contended in terms of the foreign collaboration agreement, technical fee is to be paid in connection with the visits by employees of Molex Inc. for familiarization, inspection, testing and quality control. No technology transfer takes place nor any technology is acquired under

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the said agreement and, therefore, the expenditure incurred in this regard is to be allowed u/s 37(1) of the Act. However, the Assessing Officer held it is not correct to distinguish this payment to technicians from technical know how. Hence, the deduction claimed was disallowed and deduction was allowed as per the provisions of Section 35AB. Aggrieved by the said order, the assessee preferred an appeal. The Appellate Authority affirmed the said order of the Assessing Officer and dismissed the appeal. Aggrieved by the same, the assessee preferred an appeal to the Tribunal. The Tribunal on proper interpretation of the two agreements entered into between the assessee with the foreign company held the agreement dated 10-3-1994 is for imparting necessary know-how and expertise to the personnel in the use and exploiting of the technical data whereas the agreement dated 30-9-1993 is for assisting the assessee in its manufacturing and other operations. By this assistance, the assessee did not acquire any know-how but only to carry out the manufacturing operation carefully. The persons visiting India had not parted with any technical know how. Thus, the payment is for use of technical expertise rather than for acquiring any technical know how. Acquiring some knowledge by the personnel of assessee when they are trained by foreign technician is different than acquisition of technical know-how. Thus, the expenses did not fall within the meaning of Section 35B, but can be considered as revenue expenditure u/s 37(1) of the Act. Thus, it held the entire expenses was allowable as deduction instead of 1/6th. Aggrieved by the said order, the revenue is in appeal.

3. At the time of admitting this appeal, though three substantial questions of law were raised in the appeal memo, it was held question No. 2 is already answered against the revenue in the connected matter by this Court in ITA 134/2005 on 3-3-2010 and question No. 3 is answered against the revenue by the Judgment of this Court in CIT v. Bharat Earth Movers Ltd. [2004] 137 Tax 421 (Kar.) and, therefore, the appeal was admitted to consider question No. 1. The said question No. 1 reads as under:

Whether the Tribunal was correct in holding that a sum of Rs. 20,48,000 paid by the assessee to Molex USA for providing technicians to train assessee''s personnel in manufacturing, testing, inspection and quality control of its products and to impart know-how and technical data and suggest improvements thereto, as per the mutual agreement sub-clause 7.4 did not fall u/s 35AB of the Act, but was entitled to total relief u/s 37(1) of the Act?

4. Learned Counsel for the revenue contended though the parties have entered into two agreements, the second agreement is for imparting the technical know-how to the employees of the assessee. It is for imparting the technical know how, consideration is paid though not in lump sum and not in a specified manner and therefore, it cannot be said the aforesaid payment does not fall u/s 35AB and it is to be treated as a revenue expenditure entitled to deduction u/s 37(1) of the Act.

5. Per contra, learned Counsel for the assessee submitted what is payable for

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acquiring the know-how is the "Royalty" and what is payable for imparting that know-how is "Fee". Section 35AB applies to a case of lump sum payment of consideration for acquiring a know-how to be used for a manufacturing process. Therefore, payment made to a Company for providing the assistance of its technicians to impart that know-how would not fall u/s 35AB as it is a revenue expenditure. The tribunal, on a proper consideration of the terms of the two agreements, keeping in mind the statutory provisions and the Judgments on the point has rightly held that the assessee is entitled to deduction u/s 37(1) of the Act and therefore, the case do not call for any interference.

6. In order to appreciate the rival contentions, certain undisputed facts have to be noticed. Admittedly, there are two agreements dated 10-3-1994 and 30-9-1993. Under the agreement dated 10-3-1994 a lump sum payment of Rs. 71,73,815 is paid as royalty. Under the agreement dated 30-9-1993 a sum of Rs. 20,48,000 is paid towards technicians fees. It is in this context it is relevant to refer to clause 7.4 under the agreement dated 10-3-1994:

Molex shall use its best efforts to arrange for the visits by its technicians, as may be necessary, to Licensee''s Plant in India for the purpose of assisting Licensee in connection with the manufacture, testing, inspection and quality control of the product and to impart necessary know-how and expertise to Licensee''s personnel in the use and exploitation of the Technical Data and improvements thereto. Licensee shall directly bear the air fare and other travelling and living expenses of each such technician. Licensee shall pay Molex Fees as may be mutually agreed and as may be permissible, per man for each day. Said payment shall be in addition to the air fare and other travelling and living expenses of the technicians to be borne directly by Licensee. All fees, costs and expenses on account of such technicians shall be paid to Molex within ninety (90) days after receipt of statement or invoice therefore from Molex.

7. Therefore, it is clear from the aforesaid clause, apart from paying consideration for acquiring the know-how which was by way of lump sum payment, and by a separate agreement it was agreed that the Molex shall arrange for the visits of its technicians to the assessee plant in India for the purpose of assisting the assessee in connection, with the manufacture, testing, inspection and quality control of the product and to impart necessary know-how and expertise the assessee''s personnel for the use and exploitation of the technical data and improvements thereto.

8. It is significant to note that the assessee had to directly bear the air fare and other travelling and living expenses of each such technician. Further, the assessee had to pay Molex, fees as was mutually agreed and as was permissible, per man for each day. The said payment was in addition to the air fare and other travelling living expenses of the technicians to be borne directly by the licensee. Therefore, it is clear the amount paid for imparting the necessary know-how and expertise to the assessees personnel cannot be construed as a payment for acquiring the know-how as firstly, such a payment was not made in lump sum as

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required u/s 35AB and secondly, that payment is not for acquisition of know-how but to impart the knowledge of that know-how to the assessee''s personnel for the use and exploitation of the technical data and improvements thereto. Therefore, for attracting Section 35AB, three conditions must exist. They are:

(1) A lump sum consideration;

(2) It is for acquiring the know-how and

(3) The said acquisition is to be used for his business.

9. In the case of imparting this technical know-how, firstly, there is no lump sum payment. Imparting know-how to the assessees personnel would arise only after acquiring the know-how and therefore, this imparting is distinct from acquisition of know-how though both of them are for the use of the assessees'' business. As rightly held by the tribunal, it is in the nature of a revenue expenditure incurred by the assessees in his business after acquiring the know-how for a lump sum consideration. Therefore, the entire amount has to be deducted u/s 37(1) of the Act and it does not fall u/s 35AB. Accordingly, we answer the said substantial question of law in favour of the assessee and against the revenue.

Ordered accordingly.

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