

(1998) 04 MAD CK 0138

In the Madras High Court

Case No : TC No. 1583 of 1986 30 April 1998 A.Y. 1980-81

COMMISSIONER OF INCOME TAX

APPELLANT

Vs

SIMPSON and CO. LTD.

RESPONDENT

Date of Decision : 30-04-1998

Acts Referred:

Citation : (1998) 150 CTR 492

Hon'ble Judges : N.V. Balasubramanian, J; Jayasimha Babu, J

Bench : Full Bench

Advocate : C. V. Rajan, for the Revenue P. P. S. Janarthanaraja, for the Assessee, for the Appellant;

Judgement

N.V. Balasubramanian, J.

The short and familiar question that arises in the above tax case is whether the payment to the foreign collaborator is a revenue expenditure or a capital expenditure. The assessment year which we are concerned is 1980-81. The assessee claimed deduction in the computation of income for the assessment year 1980-81 in a sum of Rs. 20,56,956 representing a lumpsum paid to foreign collaborator, one M/s Perkins Engines Ltd., England, towards import of technical know-how documentation relating to a new three cylinder diesel engine. The Income Tax Officer held that the amount paid was a capital expenditure as the assessee company had the benefit of technical know-how indefinitely with a condition that in the first 10 years the technical know-how supplied by the foreign concern will not be parted with by the assessee to any other Indian or foreign concern. Since there are no restrictions for the use of the technical know-how beyond the period of first 10 years, the Income Tax Officer was of the view that the assessee had acquired the technical know-how and he held the payment had to be regarded as a capital expenditure.

2. The assessee has challenged the order of the Income Tax Officer before the Commissioner (Appeals). The Commissioner (Appeals) found that the assessee

was manufacturing "P-3TA" model of diesel engines with the technical know-how supplied by the same English company which could be fitted in a tractor manufactured by a sister-concern of the assessee, viz., M/s. Tractors and Farms Equipments Ltd. The said Tractors and Farms Equipments Ltd. had changed over to a new model of a tractor which necessitated the assessee to change its engine model and accordingly introduced "AD-3152" version of diesel engine as designed by Perkins Engines Limited. The Commissioner (Appeals) noticed that in the case of TAFE, the Tribunal held the payment was a revenue expenditure and following the order of the Tribunal, he held the payment should be regarded as revenue in nature.

The Tribunal, on an appeal preferred by the revenue upheld the view of the Commissioner (Appeals) and held that the payment should be treated as revenue expenditure. At the instance of the revenue, the Tribunal has stated a case and has referred the following question of law for our consideration :

"Whether, on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the amount of Rs. 10,56,956 paid for acquiring technical know-how should be allowed as a revenue expenditure?"

3. We have perused the agreement for sale of technical information and know-how produced before us by the learned counsel for the assessee. In the preamble portion of the agreement, it is stated that the assessee was desirous of acquiring update knowledge and technical information for the purpose of assembling and manufacturing in India the diesel engines, and the seller was also in the position to sell and transmit to the assessee the know-how and technical information for the purpose mentioned earlier. The definition of know-how found in the agreement means engineering data, components, specification of materials, information relating to the process and the manufacture of components and spare parts, assembly and finishing instructions, engineering reliability standards, test specifications and inspection and running in regulations, after sales maintenance and recommendation. Under the agreement the foreign company agreed to sell the complete set of know-how documentation. But the purpose of the agreement read together with the various clauses is for the purpose of assembling and manufacturing in India the diesel engines specified in the agreement. In other words, the assessee had entered into agreement and paid the payment to obtain technical know-how for the purpose of utilising the same in assembling and manufacturing in India the diesel engines. The purpose of the payment is for the use of the knowledge in the manufacture of the specified engine. We have also seen that the necessity arose for the assessee to enter into the technical know-how agreement because the TAFE had suddenly changed the model of the tractor manufactured by it and, therefore, the assessee had to change its engine model to suit the new model manufactured by Tractors and Farm Equipments Ltd. The Income Tax Officer disallowed the claim as a revenue expenditure only on the ground that there was no prohibition against the firm's using the technical know-how beyond the period of 10 years.

But he failed to notice that the English company is not prohibited from transferring such technical information to any other Indian or foreign concern even during the period of 10 years. The next objection raised by the Income Tax Officer was that the assessee can utilise the technical know-how for even beyond the period of 10 years. This view of the Income Tax Officer is quite untenable. With the rapid change in the technology, it was found that technical knowledge obtained by the assessee would become obsolete during the course of few years from the date of agreement. Though under the agreement there was a transfer of technical documentation, the intention of the parties is important to determine the object behind the payment and the intention of the parties was that the payment has been made for business purposes and not for acquiring technical know-how. The fact that there is no prohibition against the user beyond the period of 10 years is also not of any significance as it cannot be said that the assessee had derived any enduring benefit and it was found that in view of the present state of technological development, the technical know-how obtained becomes obsolete and useless at the end of 10 years. Even that apart, we have seen that the assessee had to change its model of engine to suit the needs of the purchaser and it cannot be said that the assessee had acquired any enduring advantage in the payment of the same in question.

4. Let us consider the various cases cited by the learned counsel. In *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) , the Supreme Court laid down the following tests to determine whether a particular question is a revenue expenditure or not :

"It would, in our opinion, be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in this fast-changing area of medical science. The state of the art in some of these areas of high priority research is constantly updated so that the know-how cannot be said to be the element of the requisite degree of durability and non ephemerality to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeon-holing an outlay such as this as capital. The circumstance that the agreement in so far as it placed limitations on the right of the assessee in dealing with the know-how and the conditions as to non-partibility, confidentiality and secrecy of the know-how incline towards the inference that the right pertained more to the use of the know-how than to its exclusive acquisition".

Applying the tests laid down by the Supreme Court, it is not possible to attribute a degree of endurability or permanence to the technical knowledge in the fast changing area of automobile field. The assessee in the instant case had to change its design of the engine to be fitted in the tractors to suit the needs of its buyer. The vast change in the economic scenario and the rapid development in the industrial field would make us a little slow to characterise the payment as a

capital expenditure. The fact that there is a restriction placed on the right of user of the technical knowledge during the course of the agreement, the condition regarding the transferability of the know-how during the agreement, the confidential nature of the know-how are all circumstances which one should take into account in considering the question whether the expenditure can be regarded as a capital expenditure or not. Though the agreement provides for the purpose of the technical know-how, the nomenclature is not conclusive of the matter. The right obtained under the agreement, in our opinion has impact on the running of the assessee's business, and therefore, the expenditure in our opinion would be revenue in nature. We are, therefore, of the opinion that the tests laid down by the Supreme Court in the decision cited supra are satisfied.

5. This court in the case of Commissioner of Income Tax, Tamil Nadu-III Vs. Madras Rubber Factory Ltd., , rejected a similar contention urged on behalf of the revenue and held because the knowledge obtained might endure beyond the contract period, it would not make the expenditure as a capital expenditure. The following tests laid down by the court are apposite to the facts of the case.

"Technical or commercial knowledge acquired by a trader or industrialist is of this kind, enduring, if not everlasting, Expenditure to acquire it cannot be disallowed merely because knowledge dies hard. It is only where the expenditure bears on the fixed capital or other capital structure of the assessee that it can be regarded as capital in nature. Where the expenditure, although enduring in character has its impact on the running of the business, there can be no doubt that it is out and out revenue expenditure."

The same view also taken by the Calcutta High Court in Commissioner of Income Tax Vs. Avery India Ltd.,), wherein the court held a benefit that might endure long in the assessee's business may none-the-less be in the revenue field, if the benefit is in respect of an asset which is part of the circulating capital and the fact that an exclusive right had been obtained by the assessee from the foreign collaborator or the assessee had the right to use the technical knowledge even after the period of agreement would make no difference and is of no consequence. We are, therefore, of the opinion that there is no capital element involved in the payment made under the technical collaboration agreement from the foreign collaborator. The Tribunal found that the agreement had been entered into only for the purpose of running the business more profitably and effectively and with a view to yield profit to the assessee. We have seen that the assessee had necessarily to change its pattern of the manufacture of the diesel engine to suit to the needs of its buyer, viz., TAFE. As held by this court, by acquiring technical knowledge the advantage acquired cannot be regarded as of enduring value due to fast changing technology in the automobile field.

6. Strong reliance has been placed by learned counsel for the revenue on the decision of the Supreme Court in the case of Scientific Engineering House (P) Ltd. Vs. Commissioner of Income Tax, Andhra Pradesh, . The apex court held that the drawings, designs, plans, processing data and other literature

comprising "documentation service" fall within the definition of "plan" within the meaning of section 43(3) of the Act. It is no doubt true in the case before the Supreme Court the assessee therein made a lumpsum payment for the purchase of the drawings, designs, charges, etc. The Supreme Court, therefore, held that the said items can be regarded as a plan. Though on a first flush the decision of the Supreme Court in the case cited supra would appear to support the case of the revenue, on a careful consideration of the decision of the Supreme Court, we are of the opinion the decision has no application to the facts of the case as the know-how in the instant case had been acquired by the assessee for running its business. The case before the Supreme Court was that, only with the aid of the documents supplied, the assessee was able to commence its manufacturing activity and those documents formed the basis of the business of manufacturing the instruments in question. On the other hand, the assessee in the instant case was already a manufacturer of diesel engine and to change the type of diesel engine manufactured by it, the assessee had to go in for an agreement to obtain technical knowledge. In other words, the assessee was in the manufacturing line earlier and the object of the assessee in obtaining technical knowledge was to run business of manufacturing the diesel engines more profitably. Therefore, the decision of the Supreme Court cited supra is distinguishable on the facts of the case.

7. In *Jonas Woodhead and Sons (India) Ltd. Vs. Commissioner of Income Tax*, the Supreme Court has laid down the following tests to determine the question when an expenditure can be regarded as a capital or revenue expenditure :

"The question whether a particular payment made by an assessee under the terms of the 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 for 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, This court in the Case of *Alembic Chemical Works Co. Ltd. v. :* [1989]177ITR377(SC) had indicated that "in the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is not possible to form any general rule even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation". This court further held that there is no single definitive criterion which, by itself, is demarcative, whether a particular outlay is

capital or revenue. And, therefore, the "once for all" test as well as the test of "enduring benefit" may not be conclusive. Consequently, the various terms and conditions of the agreement, the advantage derived by an assessee under the agreement, the payment made by the assessee under the agreement, are all to be taken into account and then it has to be decided whether the whole or a part of the payment thus made is capital expenditure or revenue expenditure".

The Supreme Court in its earlier decision in *Alembic Chemical Works Co. Ltd. v. CIT* (supra), held that no single definitive criterion, by itself, is determinative whether a particular outlay is capital or revenue. Applying the tests laid down by the Supreme Court, it cannot be said that the assessee obtained a new plant for a complete new technology for the manufacture of the product. The payment of the instant case was made for the betterment of the production of the diesel engine already manufactured and it was existing business of the assessee. Though after the expiry of period of agreement, the assessee was not required to give back the plans, designs, due to the vast changing in the automobile field, the advantage obtained was ephemeral. Therefore, the tests laid down by the Supreme Court are satisfied in the facts of the case and we, therefore, hold that the Tribunal was correct in its conclusion that the payment should be regarded as revenue in nature. Accordingly, we answer the question of law referred to us in the affirmative and against the revenue. However, in the circumstances, there will be no order as to costs.