
(1998) 04 MAD CK 0047

In the Madras High Court

Case No : Tax Case No. 1583 of 1986 (Reference No. 1055 of 1986)

Commissioner of Income Tax

APPELLANT

Vs

Simpson and Co. Ltd.

RESPONDENT

Date of Decision : 30-04-1998

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1999) 239 ITR 83

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

Bench : Division Bench

Advocate : C.V. Rajan, for the Appellant; P.P.S. Janarthana Raja, for the Respondent

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 with 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 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 ten 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 the

first ten 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 of Income Tax (Appeals). The Commissioner of

Income Tax (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., Tractors and Farm Equipment Ltd.

The said Tractors and Farm Equipment 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 of Income Tax

(Appeals) noticed that in the case of TAFE, the Income Tax Appellate Tribunal held the payment was a revenue expenditure and following the

order of the Appellate Tribunal, he held the payment should be regarded as a revenue in nature.

3. The Income Tax Appellate Tribunal, on an appeal preferred by the Revenue upheld the view of the Commissioner of Appeals and held that the

payment should be treated as a revenue expenditure. At the instance of the Revenue, the Appellate 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 Appellate 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 ?

4. We have perused the agreement for sale of technical information and know-how produced before us by learned counsel for the assessee. In the

preamble portion of the agreement it is stated that the assessee was desirous of acquiring updated knowledge and technical information for the

purpose of assembling and manufacturing in India the diesel engines, and the seller was also in a 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 recommendations. 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 made 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 for the tractor manufactured by it and, therefore, the assessee had to change its engine model to suit the new model manufactured by the Tractors and Farm Equipment Limited. The Income Tax Officer disallowed the claim as a revenue expenditure only on the ground that there was no prohibition against the firms using the technical know-how beyond the period of ten 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 ten 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 ten 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 a 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 ten 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 ten 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 sum in question.

5. Let us consider the various cases cited by 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 (page 390) :

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 nonephemerality 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 pigeonholing 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.

6. 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 purchase of the technical know-how, the nomenclature is not

conclusive of the matter. The right obtained under the agreement, in our opinion has an 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.

7. 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 that 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 (page 684) :

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.

8. The same view also taken by the Calcutta High Court in Commissioner of Income Tax Vs. Avery India Ltd., wherein the court held that 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

efficiently and with a view to yield profit to the assessee. We have seen that the assessee had necessarily to change its pattern of manufacture of the

diesel engine to suit 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.

9. Heavy 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, where the apex court held that the drawings, designs, plans, processing data

and other literature comprising "documentation service" fall within the definition of "plant" 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, charts,

etc. The Supreme Court, therefore, held that the said items can be regarded as a plant. Though at first blush 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 engines and to change the type of diesel engines 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 the 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.

10. 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 (page 347) :

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 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. This court in the case of *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) has 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.

11. The Supreme Court in its earlier decision in *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) 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 in the instant case was made for the betterment of the production of the diesel engines 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 changes 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.