
(2017) 01 AHC CK 0045
In the Allahabad High Court
Case No : Income Tax Appeal No. 143 of 2005

Commissioner of Income Tax

APPELLANT

Vs

UPCOM Cables Ltd.

RESPONDENT

Date of Decision : 09-01-2017

Acts Referred:

Income Tax Act, 1961 — Section 37(1)

Citation : (2017) 292 CurTR 280

Hon'ble Judges : Sudhir Agarwal and Ravindra Nath Mishra-II, JJ.

Bench : Division Bench

Advocate : D.D. Chopra and Manish Mishra, Advocates, for the Appellant

Final Decision : Dismissed

Judgement

1. Heard Sri Manish Mishra, Advocate, for appellant and perused the record.
2. This appeal under Section 260-A of Income Tax Act, 1961 (hereinafter referred to as "Act, 1961") arising from judgment and order dated 28.02.2005 passed by Income Tax Appellate Tribunal, Lucknow Bench, Lucknow (hereinafter referred to as "Tribunal") in Income Tax Appeal No. 596/Alld/95 and Income Tax Appeal No. 450/Alld/95 Tribunal was admitted on following two substantial questions of law:

"I. Whether on the facts and in the circumstances of the case, Tribunal was justified in holding an amount of Rs. 18,20,277.00 being royalty paid to its collaborators, M/s CEAT, CAVI and SAPI, Italy for technical collaboration as revenue expenditure.

II. Whether on the facts and in the circumstances of the case Tribunal has failed to appreciate that Assessing Officer had rightly distinguished the decision of the Bombay High Court in CIT v. Tata Engineering and Locomotives Co. Pvt. Ltd. (1980) 123 ITR 538 relied upon by the assessee and has rightly treated the amount of royalty as capital expenditure relying upon the order passed by the Apex Court in M/s Scientific Engineering House reported in 157 ITR 86."

3. In the present case, from the facts, as emerged from record, it is clear that "technical know-how" remained property of Foreign Company and Assessee has only right to use the same on payment of royalty to the said Company.
4. The dispute relates to Assessment Year 1988-89. The facts in brief, necessary for determination of aforesaid questions may be narrated as under.
5. The respondent-Assessee entered into an agreement with M/S CEAT, CAVI Italy (hereinafter referred to as "Foreign Company") for providing technical know-how in the manufacture of its products. It is called Technical Collaboration Agreement where under Assessee agreed to pay one time Technical know-how fee of Rs. 18,20,227/- and "Royalty" at 2 per cent of net ex-factory selling price of the product.
6. The aforesaid "Royalty" was payable to Foreign Company for a period of five years from the date of commencement of production. Assessee commenced its production on 23.03.1987 and account for the first time were closed on 31.12.1987. The disputed assessment therefore is for the period from 23.03.1987 to 31.12.1987 (Assessment Year 1988-89).
7. Assessee filed return before Assessing Authority i.e. Income Tax Officer, Company Circle, Lucknow (hereinafter referred to as A.A.") on 30.06.1998 declaring loss of Rs. 4,58,24,694/-. The return was filed as per Section 115J of Act, 1961 declaring book profit of Rs. 1,48,880/-. Original return was not found traceable in the Office of A.A., hence it required Assessee to file a revised return which was filed on 28.02.1989. After notices issued under Section 143(2) and 142(1), A.A. made assessment order under Section 143(3) on 08.03.1991.
8. Assessee had claimed payment of "Royalty" of Rs. 18,20,227/- as "revenue expenditure" but A.A. did not accept it and treated as "Capital Expenditure" and added to the total income.
9. Assessee preferred appeal before Commissioner of Income Tax (Appeals)-II, Lucknow (hereinafter referred to as "CIT(A)") who reversed the view taken by A.A. in respect to aforesaid amount of "Royalty" and. accepted claim set up by Assessee that it is "capital expenditure". Against this part of order of CIT(A), and some other aspects, Revenue as well as Assessee both preferred Income Tax Appeal No. 596/Alld/1995 and Income Tax Appeal No. 450/Alld/1995, respectively, before Tribunal. Tribunal confirmed the view taken by CIT(A) and rejected appeal preferred by Revenue on this aspect. Present appeal, therefore, has been preferred by Revenue against aforesaid decisions of CIT(A) and Tribunal and confined to the question "whether amount of "Royalty" paid by Assessee to Foreign Company should be treated as "capital expenditure" or "revenue expenditure".
10. Tribunal while upholding the view of CIT(A) and rejecting claim of Revenue has said in para 15 of impugned judgment that Assessee was granted license subject to terms and conditions to utilize the patent and know-how in

manufacture of licensed product within India and to sell, use or otherwise dispose off licensed product within the territory. Foreign Company had granted to Assessee non-exclusive right to manufacture, use and sell products in India under the rights of patent, owned or controlled by Licensor i.e. Foreign Company.

11. Licensor, however, agreed to grant license to use know-how, as itemized in Exhibit-B, attached to the Agreement. Assessee was to get salary of its employee from Licensor and necessary expenses were to be borne on this aspect. Article 5.1 provides lump-sum payment in US Dollars, two lacs, in three instalments, before commencement of commercial production. Article 5.2 of Agreement provides that at the end of each accounting period, "Royalty" shall be paid, equal to 2 per cent of net ex -factory selling price of all the licensed products, manufactured and sold by Assessee-Comapny, commencing with commercial production's starting date and would continue for a period of five years. Article 6 provides for imparting further information to Assessee in respect of new inventions, methods, processes, materials etc. in the said technology. Article 7 provides secrecy clause and Article 9 provides that on termination of agreement, Assessee shall return to Licensor all written technical information, design, drawing, plans, specifications and pamphlets relating to licensed product and knowhow originally supplied by Licensor to Licensee under the Agreement.

12. Tribunal relied on Delhi High Court's judgment in Addl. Commissioner of Income Tax v. Shama Engine Valves Ltd. (1982) 138 ITR 216 wherein a dispute arose, whether payment of "Royalty" should be treated to be "Revenue expenditure" or "Capital expenditure". After referring to various Clauses of Agreement, in that case, Delhi High Court observed that Assessee had obtained a license to manufacture valves, right to sell the same and assistance in carrying it out. The recurring payment of "Royalty" was for the use of know-how/assistance and not for its acquisition. It was recurring charge on the net selling value and no advantage of enduring benefit was obtained. Payment of "Royalty" has a direct nexus with the carrying on or conduct of business of Assessee, and, commercially considered, it had to be treated as an integral part of profit-making process. The expenditure was "Revenue" in nature. Tribunal said, since it is an agreement for five years, where after Assessee had to return all relevant material relating to know-how, acquired through Agreement, there was no advantage of enduring benefit obtained by Assessee and, hence, in view of Delhi High Court, the view taken by CIT(A) was correct.

13. Basic facts with regard to relevant Clauses of agreement as discussed in the judgment of Tribunal are not disputed before us. Learned counsel appearing for Revenue submitted that in view of Supreme Court's judgment in Jonas Woodhead and Sons (India) Ltd. v. Commissioner of Income Tax 1997 (224) ITR 342 and Southern Switch Gear Ltd. v. Commissioner of Income Tax and another 1998 (232) ITR 359 and, Kerala High Court's judgment in Commissioner of Income Tax v. Polyformalin (P.) Ltd. 1986 (161) ITR 36 (Kerala) payment of "Royalty" and acquisition of technical know-how must be treated to be a

permanent and enduring benefit acquired by Licensee and therefore Tribunal in taking an otherwise view has erred in law.

14. A Division Bench of this Court has recently discussed all the authorities in detail necessary to examine as to how a particular payment can be treated to a "revenue expenditure" or "capital expenditure" when paid in the form of royalty or technical knowhow fee in a recent judgment dated 21.12.2016 in Income Tax Appeal No. 503 of 2008 (Commissioner of Income Tax, Ghaziabad v. M/S Honda Siel Cars India Ltd.) and other connected matters.

15. The term "Revenue Expenditure" as such is not defined in the Act, 1961. Thus term "Revenue Expenditure" was explained in Assam Bengal Cement Co. Ltd. v. Commissioner of Income Tax, AIR 1955 SC 89 (at page 96) as under: "If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure."

(Emphasis added)

16. In Commissioner of Income Tax v. Ciba of India Limited (1968) 69 ITR 692 (SC) a question arose, whether payment made by Assessee to Ciba Limited, Basle, pursuant to agreement dated 17.12.1947 is an admissible deduction under Section 10(2)(xii) of Income Tax Act 1922. Ciba of India Limited was originally floated in the name of "Ciba Pharma Limited" and subsequently became "Ciba of India Limited", an Indian subsidiary of "Ciba Limited, Basle", (the Swiss Company), and is engaged in the development, manufacture and sale of medical and pharmaceutical preparation. Swiss company originally carried on business in India of selling its products through a subsidiary called "Ciba (India) Ltd". After incorporation of Assessee on December 13, 1947, activities of Swiss company in India were bifurcated; Pharmaceutical section was taken over by Assessee i.e Ciba of India Ltd., while other business relating to dyes and chemicals remained with "Ciba (India) Ltd." which subsequently changed to "Ciba Dyes Ltd", a subsidiary of Swiss company. An agreement dated 17.12.1947, was executed between Swiss company and Assessee in consideration of payment of "technical and research contribution for the use of Indian patents and or trade marks" to communicate the results of its research work, in so far as they relate to the products which were already manufactured or processed or sold by Assessee. Court held that "Royalty" payment made by Assessee were revenue expenditure and, for this purpose, it held that secret processes were not sold by Swiss company to Assessee. Further, the reasons that prevailed with the Court to hold "Royalty" payment as "Revenue Expenditure", are: (a) licence was for a period of five years, liable to be terminated in certain eventualities even before expiry of the period; (b) object of the agreement was to obtain the benefit of technical assistance for running the business; (c) licence was granted to

Assessee subject to rights actually granted or which may be granted after the date of agreement to other persons; (d) Assessee was expressly prohibited from divulging confidential information to third parties without consent of Swiss company; (e) there was no transfer of fruits of research once and for all; the Swiss company which was continuously carrying on research had agreed to make it available to Assessee and (f) stipulated payment was recurrent dependent upon the sales, and only for the period of agreement. Court stressed upon the fact that Assessee acquired under the agreement merely right to access to technical knowledge and experience for the purpose of carrying its business and was merely a licensee for a limited period of technical knowledge of Swiss company with right to use patents and trade works of that company by making that technical knowledge available. Swiss company did not part with any asset of its business nor did the Assessee acquire any assets or part in the nature of benefits or advantage.

17. In *L.B. Sugar Factory and Oil Mills (P) Ltd, Pilibhit v. Commissioner of Income Tax, U.P Lucknow* (1980) 125 ITR 293(SC) the question was considered in a different but interesting context. Assessee was a sugar factory engaged in manufacture and sale of crystal sugar at Pilibhit, State of U.P. In 1952-53, a dam was to be constructed by State of U.P at a place called Deoni. A road, Deoni Dam-Majhala was constructed connecting Deoni Dam with Majhala. Collector requested Assessee to make some contribution towards construction of Deoni Dam and Deoni Dam-Majhala Road pursuant whereunto Assessee contributed certain amount. Assessee also contributed some amount towards meeting the cost of construction of roads in the area around its factory under a Sugar Cane Development Scheme promoted by State of U.P. as part of Second Five Year Plan. Assessee claimed deduction on both the amounts it had contributed as deductible expenditure under Section 10(2)(xv) of Indian Income-tax Act, 1922. It was disallowed by Assessing Officer on the ground that expenditure incurred was of capital in nature. Appeal before CIT also failed. In Tribunal, two Members of the Bench differed in their view, one held "Revenue Expenditure" another "Capital Expenditure". The matter was referred to a third Member who instead of going into the question whether expenditure could be treated as "Capital Expenditure" or "Revenue Expenditure" took a third view that contribution was made by Assessee as a good citizen and cannot be said to be in relation to business of Assessee and for that reason it disallowed payments as deductible expenditure under section 10(2)(xv). Assessee, therefore, failed in appeal before Tribunal. Then matter came to High Court who also upheld view taken by Tribunal with the reasoning that expenditure was not related to business activity of Assessee. With respect to one amount which Assessee contributed on the request of Collector for construction of dam and connecting road, Supreme Court upheld the view of Courts below that it was as a good citizen and not connected with the business of Assessee, hence disallowable under section 10(2)(xv). With respect to another item, which Assessee paid under Sugarcane Development Scheme, Court followed the test laid down in *British Insulated and Helsby Cables*

Ltd. v. Atherton 10 TC 155 where learned Law Lord Cave L.C. stated "When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital" and said that this test is a well known test for distinguishing capital and revenue expenditure but not of universal application. It must yield where there are special circumstances leading to a contrary conclusion. For this opinion, Court referred to Lord Radcliffe in Commissioner of Taxes v. Nohanga Consolidated Copper Mines Ltd. (1965) 58 I.T.R 241 where it was highlighted that it would be misleading to suppose that in all cases securing a benefit for the business, would be prima facie capital expenditure so long as the benefit is not so transitory as to have no endurance at all. Court relied on its earlier decision in Empire Jute Company Ltd. v. Commissioner of Income Tax (1980) 124 ITR 1 (SC) that there may be cases where expenditure even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may break down. Court further said as under:

"It is not every advantage of enduring nature acquired by an Assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only whether the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the Assessee's business operations or enabling management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though advantage may endure for an indefinite future."

18. It was therefore, held that the expenditure incurred in the scheme was on revenue account and not capital. Hence, it was allowable as deduction under section 10(2)(xv).

19. Praga Tools Ltd. v. Commissioner of Income Tax (1980) 123 ITR 773 a decision of Full Bench of Andhra Pradesh High Court is relied by Assessee. Here again we find that Assessee, a Government Company was carrying on business in the manufacture of precision and machine tools, machinery and forgings since 1942. On 2nd January, 1961, Assessee entered into a licence agreement with a foreign collaborator, M/s A.A Jones and Shipman Ltd. Leicester, U.K for manufacture of Jones-Shipman Tool and Cutter Grinding Machine with all items of standard equipment. The foreign collaborator was to supply necessary designs, drawings, Technical know-how and assistance. It also agreed to assist Assessee in the production of main castings of machine and also to sell all relative jigs, fixtures, tools, gauges, raw materials and special parts as ordered at their normal commercial retail value. The agreement also required foreign collaborator to furnish all technical information with the latest modifications and standards,

for this Assessee was to pay certain amount to foreign collaborator on signing of agreement and Royalty subsequently. Court said that in order to decide whether a particular expenditure is "Capital" or "Revenue", there is no rule of thumb or test of principle or universal application. In fact dividing line between two is very thin. The scrutiny is to be made in respect of the nature and character of the business, the object for which expenditure has been incurred and it is not an individual test but totality or cumulative effect of all the relevant facts and circumstances which would help in arriving at a particular inference. It referred to an extract from a Full Bench judgment of Lahore High Court in Benarsidas Jagannath, In re (1947) 15 ITR 185 which was approved in Assam Bengal Cement Co.Ltd. v. CIT (supra) which reads as under:

"If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence."

20. It also referred to the decision of Supreme Court in Gotan Lime Syndicate v. Commissioner of Income Tax (1966) 59 ITR 718 wherein it was held that expenditure incurred to secure an enduring advantage must not invariably be treated as capital expenditure and royalty payment including dead-rent, which has no direct nexus for securing an enduring benefit but has relation to the raw material viz. lime deposits, was held to be a "Revenue Expenditure". Court found that under the agreement, amount paid by Assessee at the time of signing was not claimed to be "Revenue Expenditure". However, the amount paid towards "royalty" was for the benefit of business and, therefore, should be treated to be a "Revenue Expenditure". It held:

"Where the expenditure has a direct nexus, connection or relation to the carrying on of or conducting the business of the assessee, it must be regarded as an integral part of the profit-making process. In such a case, it must be held to be a revenue expenditure. Where the purpose and object of the expenditure is to acquire an asset or right of an enduring nature or permanent character, it is a capital expenditure."

21. In Scientific Engineering House (Pvt.) Ltd. v. Commissioner of Income-Tax, Andhra Pradesh (1986) 157 ITR 86 (SC) relied on behalf of Revenue, there was no question involved, whether a particular payment of amount was "Capital" or "Revenue" Expenditure". On the contrary, issue was, whether payment made by

Indian Company to Foreign Collaborator could be construed as acquisition of depreciable asset in terms of collaboration agreement. Indian company, M/s Scientific Engineering House (Pvt.) Ltd., was engaged in manufacture of Scientific Instruments and Apparatus like dumpy levellers, levelling staves, prismatic compass, etc. It entered into two separate collaboration agreements dated 15.3.1961 and 31.3.1961 with M/s Metrimpex Hungarian Trading Company, Budapest for manufacture of microscopes and theodolites. Foreign Company agreed to supply Indian company all "Technical know-how" required for manufacture of two instruments namely microscopes and theodolites. The object was to enable Assessee to manufacture said instruments of certain specifications. Assessee acquired right to manufacture in India, under its own trade mark, and name but under the licence-MOM Hungary-of the Foreign supplier, the said instruments, and right to sell the same in India. Assessing Officer held that payment made for acquiring "Technical know-how" amount to "Capital Expenditure" since no tangible or depreciable asset was brought into existence, hence no depreciation can be claimed. Appellate Authority, in appeal, preferred by Assessee took the view that what Assessee had done was to make an outright purchase of certain specimen drawings, charts, plans, etc, on special papers and these documents collected together, constituted a book on which depreciation would be allowable. In further appeal, Tribunal observed that some of the services of Foreign Collaborator do qualify for "Revenue" account and therefore, to the extent, services qualified for "Revenue" account, may be allowed to be deducted and rest may be added. In appeal Supreme Court considered the question, whether "Technical know-how" in the shape of drawings, designs, charts, plans, processing data and other literature falls within the definition of "Plant". It replied aforesaid question by referring to judgments and reasonings in *Yarmouth v. France* (1987) 19 QBD 647 a case in which it was decided that a cart horse was plant within the meaning of section 1(1) of the Employers' Liability Act, 1880. It was held:

"There is no definition of plant in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a business man for carrying on his business not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business."

22. Court also referred and approved decision in *Commissioner of Income tax v. Elecon Engineering Company Ltd.*, (1974) 96 ITR 672 (Guj) wherein it was held that drawings and patterns which constitute know-how and are fundamental to Assessee's manufacturing business are "plant". Court held that payment made by Assessee to Foreign Collaborator was attributable wholly towards acquisition of a depreciable asset.

23. In *Alembic Chemical Works Co.Ltd. v. Commissioner of Income Tax, Gujarat* (1989) 177 ITR 377 (SC) a company engaged in the manufacture of antibiotics and pharmaceuticals, was granted licence for manufacture in its plant, well-

known antibiotic, penicillin. It negotiated with M/s. Meiji Seika Kaishna Limited ("Meiji" for short), a reputed enterprise engaged in the manufacture of antibiotics in Japan, which agreed to supply to Assessee, requisite "Technical-know-how" so as to achieve substantially higher levels of performance or production of more than 10,000 units of penicillin, per millilitre, of "cultured-broth"- with the aid of better technology and process of fermentation and with better yielding penicillin-strains developed by foreign company i.e Meiji. The negotiations culminated into an agreement dated 09.10.1953, where under Meiji, in consideration of the "once for all" payment of 50,000 U.S. Dollars agreed to supply to Assessee, the "sub-cultures of the Meiji's most suitable penicill in producing strains", the technical information, know-how and written description of Meiji's process for fermentation of penicillin along with a flow-sheet of the process on a pilot plant, the design and specifications of the main equipment in such pilot plant, arrange for the visits to and training at Assessee's expense, of technical representatives of the Assessee, Meiji's plant at Japan and to advise Assessee in the large scale manufacture of penicillin for a period, limited to 2 years from the effective date of the agreement. It was also stipulated that technical know-how supplied by Meiji was to be kept confidential and secret by Assessee. It was prohibited from parting with technical know-how in favour of others or to seek any patent for the process. Assessing Authority held that expenditure was in the nature of acquisition of an asset or advantage of an enduring benefit, therefore, it was a capital outlay and hence, declined deduction. This view was affirmed in appeal by Commissioner as well as Tribunal. At the instance of Assessee, reference was made to High Court who answered the question against Assessee. Hence matter went in appeal to Supreme Court. Referring to some earlier judgments, Court culled out certain principles laid down therein to determine, whether expenditure of Assessee was "Capital Expenditure" or "Revenue Expenditure" and said :

"(i) When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital (referred to British Insulated Helsby Cables Ltd. v. Atherton, (1926) AC 205).

(ii) If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure.

(iii) The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure."

24. Court in Alembic Chemical Works Co. Ltd. (Supra) held that three aspects should be considered, (a) the character of the advantage sought, and in this, its

lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part and (c) the means adopted to obtain it.

25. It was further observed that there is no single test or principle or rule of thumb which is paramount. It is ultimately a question of law, but a question which must be answered in the light of all the circumstances which are reasonable to take into account, and the weight which must be given to a particular circumstance in a particular case, must depend on common sense rather than on strict application of any single legal principle.

26. Referring to *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia*, (1966) AC 224 (PC) Court in *Alembic Chemical Works Co.Ltd.* (supra) observed that solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances, some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a common sense appreciation of all guiding features which must provide the ultimate answer. Court said that the idea of "once for all" payment and "enduring benefit" are not to be treated as something akin to statutory conditions; nor are the notions of "Capital" or "Revenue" a judicial fetish. What is "Capital Expenditure" and what is "Revenue" are not eternal varieties but must need be flexible so as to respond to the changing economic realities of business. The expression "asset or advantage of an enduring nature" was evolved to emphasize the element of a sufficient degree of durability, appropriate to the context. It was clarified that the phrase "enduring benefit" in *British Insulated and Helsby Cables Ltd. v. Atherton*, 1926 A.C. 205,213 (HL) was not thinking of advantages that are permanent. There is a difference between the lasting and everlasting. The time over which the thing "endures" is a matter of degree and one element only to be considered. Thereafter Court looked into the process of making antibiotics and penicillin and observed that Indian company was already engaged in the preparation of antibiotics since long. In the background facts, Court held, it cannot be said that the area of improvisation by obtaining know how from foreign collaboration was not a part of improvisation of existing business or that the entire gamut of existing manufacturing operations for the commercial production of penicillin in the Assessee's existing plant had become obsolete or inappropriate in relation to exploitation of the new sub-cultures of the high yielding strains of penicillin. It cannot be said that mere introduction of new bio-synthetic source required erection and commissioning of a totally new and different type of plant and machinery. Adding the fact that agreement placed limitations on the right of assessee in dealing with the know-how and the conditions as to non-partibility, confidentiality and secrecy of the know-how inclined towards the inference that the right pertained more to the use of the know-how than to its exclusive acquisition. Hence, payment was to be treated as "Revenue Expenditure".

27. In *M/s Jonas Woodhead & Sons Ltd. v. The Commissioner Of Income-Tax* (supra), Assessee Company was incorporated in March 1963 to carry on the business of manufacture of automobiles springs, entered into an agreement with M/s. Jonas Woodhead and Sons Ltd. of United Kingdom for manufacture of all types of springs and suspension for road and rail vehicles. The foreign company was to provide Assessee, technical information and know-how, relating to and suitable for manufacture of the products as well as the technical know-how relating to setting up of the plant itself, the drawings, estimates, specifications, manufacturing methods, blue prints of production and testing equipment and other data and information necessary to manufacture the products and to set up proper and efficient plants. In lieu of the aforesaid information etc., Assessee was to pay "Royalty" to the foreign company. Production of Assessee commenced on 01.01.1966 and "Royalty" was to be paid to foreign company in terms of the agreement. Assessing Officer held payment to foreign company of an enduring nature and treated it to be a "capital receipt". Assessee lost before Commissioner as well as Tribunal in appeal and also in High Court and therefore, in last, matter came to Supreme Court. The questions considered by Court, were (i) 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 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; (ii) whether the improvisation made, is the part and parcel of existing business or a new business was set up with the so-called technical know-how for which payments were made; (iii) whether on expiry of the period of agreement, 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; (iv) what is the cumulative effect on a construction of the various terms and conditions of the agreement and (v) whether Assessee derived benefits coming to its capital for which the payment was made.

28. Relying on tests laid down in the earlier authorities including *Alembic Chemical Works Co. Ltd, v. Commissioner Of Income Tax* (supra), Court decided the issue against Assessee observing that under the agreement with foreign firm Assessee had to set up a new business and foreign firm had not only furnished information and technical know-how but also rendered valuable services in setting-up of the factory itself and even after expiry of agreement, there is no embargo on Assessee to continue to manufacture the product in question. Court held that merely because payment is required to be made at a certain percentage of the rates of gross turnover of the products of Assessee as "Royalty", it cannot be said that the entire payment is a "Revenue Expenditure".

29. In *Commissioner of Income Tax, Hyderabad v. Warner Hindustan Ltd.* 1998 (9) SCC 533 Court did not examine this aspect in detail since the amount

involved in dispute was small. Hence, it is not an authority on the question whether technical fee paid to a foreign company would be a ""Capital Expenditure" or ""Revenue Expenditure".

30. In Commissioner of Income Tax v. I.A.E.C (Pumps) Ltd. (1998) 232 ITR 316 again this question arose whether amount paid by Assessee to a foreign collaboration for Technical know-how is a "Capital Expenditure" or "Revenue Expenditure". Court upheld the view taken by High Court that it was "Revenue Expenditure". Referring to the finding recorded by High Court that the Assessee acquired under the terms and agreement only a licence to use other party's patent and knowledge and not a benefit of enduring nature which will constitute acquisition of an asset.

31. This Court in Commissioner of Income Tax v. Prem Heavy Engineering Works Pvt. Ltd. (2006) 282 ITR 11 (All) also had an occasion to consider a similar question. Assessee entered into an agreement on 11.04.1984 with the West German Company who was specialised in manufacture of machinery and equipment for Cane Sugar Industry. Assessee itself was a company engaged in the business of manufacture and sale of Sugar Machinery parts. Assessee was interested in acquiring "Technical know-how" from foreign company on Cane Sugar Mills size, able to accommodate rollers upto a specific dimension and in furtherance thereof, agreement was executed wherein foreign company agreed to supply "Technical know-how" in the form of workshop drawings, documentation for basic engineering on structural components and individual parts, not manufactured by foreign company itself, data on necessary special tools and special manufacturing techniques, assembly instructions, arrangement drawing of the mill, foundation and loading plan, operation and maintenance instructions, information on the storage of spare parts etc. The agreement allowed to make use of the "Technical know-how" to manufacture the mill at its workshops in India, to sell the mill within India without any limitation and also to export the mill to Countries other than certain Counties mentioned in the agreement. Assessee was entitled to use know-how for the purpose of performing under agreement only and keep such documentation confidential even after termination of agreement. This Court referred to various authorities as we have discussed above and held that under the agreement there was no absolute parting by the assessee with his technical know-how. The consideration received was for imparting know-how not in association with the disposal of a capital asset. It was for a limited period, not permanently, and not for establishment of any plant or machinery but for manufacture of equipment and machinery for Cane Sugar Plant. Hence, it was not of enduring nature and a ""Revenue Expenditure" and not ""Capital Expenditure". This decision evidently makes it clear that therein agreement and parting of Technical know-how was not for establishment of plant and machinery but for manufacture of equipment and machinery of Cane Sugar Plant which was a distinguishing feature.

32. The judgment relied by the Revenue in Southern Switch Gear Ltd. v.

Commissioner of Income Tax and another (supra) is a short order passed by Supreme Court dismissing appeal preferred by Assessee and confirming the order of High Court. It reads as under:

"We have perused the order of the High Court. We have also seen the agreement. We are not persuaded to hold that the view taken by the High Court is erroneous, the appeals are dismissed. There will be no order as to costs."

33. From the aforesaid judgment, it is difficult to cull out any exposition of law laid down therein as such. However, in the Law Report, brief facts from judgment of Madras High Court judgment have been given which show that High Court held that various clauses of agreement show that the technical knowledge which Assessee obtained through agreement with Foreign Company secured to Assessee an enduring advantage and benefit in that the same was available to Assessee for its manufacturing and Industrial process even after termination of agreement. Right to manufacture certain goods exclusively in India should be taken to be an independent right secured by Assessee from the Foreign Company which was of an enduring nature and hence the technical fee cannot be allowed as revenue expenditure and High Court confirmed the view of Tribunal that at least 25 per cent of technical aid fee should be treated as capital. Thus, the aforesaid judgment shows that one fourth of total amount paid towards technical know-how fee was held capital and rest as revenue expenditure.

34. Kerala High Court in Commissioner of Income Tax v. Polyformalin (P.) Ltd. (supra) has looked into this aspect from a different angle. Relying on Supreme Court's judgment in Scientific Engineering House P. Ltd. v. CIT (supra), it has observed that expenditure incurred for acquisition of technical know-how by way of designs, drawings, charts, plans and other literature was capital in nature which would add to the cost of the plant and machinery and Assessee would be entitled to depreciation and development rebate. The Court held that documents will fall within the definition of plant and depreciable assets. It also followed a Gujarat High Court's Judgment in CIT v. Elecon Engineering Co. Ltd. 1974 (96) ITR 672 wherein also it was held that drawings and patterns which constitute know-how and are fundamental to the Assessee's manufacturing business are plant. That being so, it held that expenditure is of capital nature.

35. The question as to whether a particular payment made towards technical know-how fee or royalty to a Foreign Company in lieu of an Agreement will be a "capital expenditure" or "revenue expenditure" would depend upon facts of individual case, and, in particular, various terms of Agreement involved therein.

36. In the present case, a concurrent finding has been recorded by CIT(A) and Tribunal both that on termination of Agreement, which was for a period of five years, Assessee would return all relevant material relating to know-how acquired through Agreement. This is one of the relevant consideration observed in Alembic Chemical works Ltd. v. CIT(A) (supra) to hold that in such a case, payment towards "Royalty" would be "Revenue expenditure" and not "Capital". The

agreement also shows that it was not an exclusive right available to the Assessee, inasmuch in para 13 of Annexure, of foreign collaboration, approval accorded by Government of India provides that in case item of manufacture is one which is patented in India, payment of "Royalty"/lump sum made by Indian Company to Foreign collaborator, during period of agreement shall constitute full compensation for use of patent right till expiry of life of patent and Indian Company shall be free to manufacture that item even after expiry of the collaboration agreement without making any additional payments. Assessee claimed that royalty payment is part of percentage of selling price of product and not for acquiring technical know-how of manufactured licensed product having enduring benefit. These facts available on record have not been disputed and we have not been shown any authority so as to justify to take a different view than what has been taken by Tribunal.

37. In view thereof, we answer both the aforesaid questions against Revenue and in favour of Assessee and confirm the view taken by Tribunal on all these aspects.

38. In the result, the appeal fails and is dismissed with cost.