
(1978) 07 KAR CK 0010
In the Karnataka High Court
Case No : IT Ref. No. 31 of 1975

Nippon Electronics (P.) Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 13-07-1978

Acts Referred:

Citation : (1979) 1 TAXMAN 122

Hon'ble Judges : Venkataramaiah, J

Bench : Single Bench

Advocate : K.P. Kumar and Patridge, for the Appellant; S.R. Rajasekharamurthy, for the Respondent

Final Decision : Allowed

Judgement

Venkataramaiah, J.—At the instance of the assessee the income tax Appellate Tribunal, Bangalore Bench, has referred the following two questions for the opinion of this court u/s 256(1) of the income tax Act, 1961 (hereinafter referred to as "the Act") : (i) Whether, on the facts and in the circumstances of the case and on a proper interpretation of the two agreements dated 27th December, 1966, and 12th October, 1967, the Tribunal was right in holding that the payments of Rs. 1,95,300 were not for designs and blue-prints as such but for diverse considerations?

(ii) If the answer to the first question is in the negative, whether on the facts and in the circumstances of the case, the designs and blue-prints constituted plant for purpose of allowance of depreciation under the income tax Act, 1961?

The assessee is a company in which the public are not substantially interested. It was incorporated on June 12, 1967. One Mr. M.S. Nagappa is its managing director. Prior to the incorporation of the company, Mr. Nagappa entered into an agreement with M/s. Nippon Communication Industrial Company Ltd., Japan, on December 27, 1966. The agreement was for collaboration in the erection of a manufacturing plant for production of capacitors. Under article 3(b) (i) of that

agreement the said Japanese company agreed to provide designs, plans, drawings, specifications and engineering know-how to enable the licensee to construct a manufacturing plant and to commence production of the capacitors. The Japanese company also agreed to assist the assessee in other ways such as furnishing information with regard to specifications and procurement sources of the machinery and equipment required for the production of capacitors and rendering assistance in the testing of material procured by the assessee in accordance with the recommendations and specifications furnished as stated above. Under article 6 of the agreement in consideration of the services and assistance to be rendered in accordance with the agreement and disclosure to the assessee of the Japanese company's proprietary information and technical know-how in accordance with the provisions of article 3(b) referred to above, the assessee agreed to pay 20,000 U.S. dollars. After its incorporation, the assessee entered into an agreement dated October 12, 1967, with another Japanese company, known as M/s. Sansei Denki Kabushiki Kaisha, known in English as M/s. Sansei Electric Company Ltd., Japan, in connection with the manufacture of switches. Under that agreement the said Japanese company undertook to provide the assessee with its designs, plans, drawings, specifications and engineering know-how to enable the assessee to construct a manufacturing plant and to commence production of switches and in consideration thereof the assessee agreed to pay 2,500 sterling pounds. The construction of the buildings was started in August, 1967. Installation of machinery was taken up during June/ July, 1968, and was completed by September, 1968. Two Japanese experts arrived and assisted the assessee in the erection of machinery and trial runs. Commercial production of capacitors was started in January, 1969, and of switches in May, 1969. In the books of account of the assessee, there was a capitalisation of a total sum of Rs. 4,62,000 as on June 30, 1968. This sum included the sum of Rs. 1,95,380 paid to the Japanese "companies towards technical assistance and some other expenses. During the assessment year 1970-71 (relating to the accounting period ending June 30, 1969) the assessee claimed that the sum of Rs. 1,95,300 which had been paid by it to the Japanese companies under the agreements referred to above had been paid for the purpose of acquiring the necessary drawings, designs and technical data for the purpose of construction of the plant for manufacturing capacitors and switches and that the said drawings, designs and technical data constituted "plant" referred to in section 32(1) of the Act and that it was entitled to claim depreciation allowance in respect of it. The ITO disallowed the claim of the assessee observing: The assessee has capitalised expenditure incurred up to 30th June, 1968. This figure includes technical assistance fee paid to the foreign collaborator amounting to Rs. 1,95,300. The technical assistance fee paid is for technical information passed on by the foreign collaborator and the assessee can use the information passed on even after the expiry of the period of the agreement. Thus, admittedly it is a capital asset. But the assessee has allocated this expenditure on buildings and plant and machinery. This procedure is irregular for the reason that the value of the land, building, has not been

increased by the assessee possessing certain technical information. Thus, the procedure of capitalising this payment to plant and building is not correct. It is an item of capital expenditure on which no depreciation can be claimed. Hence, the claim for depreciation on this is not allowed. In the revised working this amount has been excluded for the purposes of depreciation and depreciation has been allowed only on the net figures.

2. In the appeal filed by the assessee, the AAC did not deal with this issue at all though he allowed some relief in other respects. On further appeal, the Tribunal held : "We find it difficult to hold that designs and blue-prints constitute plant for the purpose of depreciation. In any case, on the basis of the agreement the payments are not for designs and blue-prints as such but for diverse considerations, the major one of which appears to be know-how", and dismissed the appeal. At the instance of the assessee, the Tribunal has referred the two questions extracted above. The first question relates to the latter part of the finding recorded by the Tribunal, and the second question relates to the earlier part.

3. It is clear from the terms of the two agreements which are referred to above that the assessee paid the amounts payable under the agreements in consideration of the Japanese companies furnishing necessary designs, drawings, technical data and other information necessary for the erection of the factory for manufacturing capacitors and switches, and also in consideration of other assistance rendered to it by them. We are of the view that part of the amounts so paid must be treated as having been paid in consideration of the Japanese companies providing designs, drawings, plans and technical data. The Tribunal was, therefore, in error in holding that the payments were not in regard to these items. It should have held that the payments had been made partly for these items and partly for other assistance rendered by the Japanese companies. The answer to the first question has, therefore, to be in the negative.

4. The answer to the next question depends upon the construction to be placed on section 32 of the Act. Section 32(1) of the Act provides for allowing depreciation in respect of buildings, machinery, plant or furniture owned by the assessee and used for the purpose of business or profession in accordance with the prescribed rates, in the course of the computation of the profits arising out of the business carried on by the assessee for purposes of determination of the tax payable under the Act.

5. Whereas the contention of the assessee before the authorities under the Act was that the designs, drawings, plans and technical data which were necessary for the erection of the factory for manufacturing goods fell within the meaning of the expression "plant" found in section 32 of the Act, the contention of the department was that they did not.

6. It is well known in the world of commerce that the income of a businessman is always the surplus by which the gross receipts from his business exceed the

expenditure incurred on land, labour, capital and managerial skill and all other tangible and intangible assets used for the purpose of the business. The capital contributed by a businessman in the course of his business may be in the form of fixed assets or circulating capital. Ordinarily, any expenditure which is not of capital nature incurred in the course of business or trade is treated as revenue expenditure, but so far as the fixed assets which are utilised for the purpose of business are concerned, a certain percentage of their value is deducted periodically in the course of computation of the profits made by him. The amount so deducted is popularly known as "depreciation". Without taking into account such depreciation, it would not be possible to arrive at the true profits. It is only on account of this the statute has provided for depreciation allowance being allowed in certain respects u/s 32 of the Act subject to certain conditions. That section specifically refers to four items on which depreciation can be allowed, namely, buildings, machinery, plant and furniture owned by the assessee and used for the purpose of the business. There is no dispute that the items with which we are concerned, namely, designs, drawings, plans and technical data do not come within category of buildings, machinery and furniture. u/s 43(3) of the Act an inclusive definition of the "plant" is given. It states that "plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purpose of business or profession. The definition is not an exhaustive one. There is no dispute in this case that the assessee has used the designs, drawings, plans and technical data which it acquired for valuable consideration from the Japanese companies in the course of its business. The expenditure incurred by the assessee in that connection is not treated by the department as revenue expenditure. As mentioned earlier, if no depreciation is allowed in the case of these items, it would not be possible in this case also to ascertain the true profits. The principal argument urged on behalf of the department before the appellate authorities to deny the depreciation allowance was that these items did not come within either the traditional meaning of the expression "plant" or within the extended meaning of that expression in section 43(3) of the Act.

7. At this stage it is appropriate to quote a passage from Jerome Frank's *Law and the Modern Mind*:

Gmelin quotes a minister of justice who used to exhort young judges in this manner: "When a case is to be decided, you had better at first leave your Code alone. After you have understood the facts thoroughly, consider what would be right according to your common sense and the law of nature and equity; then when you have thoroughly made up your mind on the case, look at your Code and behold! You will find that the statute fits your own conclusion exactly in almost all cases and that its intention is nothing but what you intend also" Gmelin adds: "It is entirely true that by following that method an unbiased judge will find at first glance what is true and right in thousands of cases". (Gmelin was the Justice of the Court of Appeals in Stuttgart).

8. If this case is considered with the above background, there should be no

difficulty in holding that all items of expenditure which are involved in the course of a business as far as possible have either to be classified as revenue expenditure or expenditure of capital nature and wherever the expenditure is of capital nature, the depreciation has to be allowed in order to ascertain the true profits. In the instant case we are concerned with the expenditure incurred on the acquisition of items such as designs, drawings, plans and technical data without which it was not possible to erect the factory for manufacturing capacitors and switches. Section 32(1) provides that depreciation is allowable in respect of plant. The Supreme Court has held in *Commissioner of Income Tax, Andhra Pradesh Vs. Taj Mahal Hotel, Secunderabad*, that the expression "plant" should be given a wide meaning. In that connection it observed (p. 47):

Now it is well settled that where the definition of a word has not been given, it must be construed in its popular sense if it is a word of every day use. Popular sense means "that sense which people conversant with the subject-matter with which the statute is dealing, would attribute to it". In the present case, section 10(5) enlarges the definition of the word "plant" by including in it the words which have already been mentioned before. The very fact that even books have been included shows that the meaning intended to be given to "plant" is wide. The word "includes" is often used in interpretation clauses in order to enlarge the meaning of the words or phrases occurring in the body of the statute. When it is so used, these words and phrases must be construed as comprehending not only such things as they signify according to their nature and import, but also those things which the interpretation clause declares that they shall include. The word "include" is also susceptible of other constructions which, it is unnecessary to go into.

9. It is significant that the inclusive definition found in section 43(3) of the Act includes "books" also within the meaning of the expression "plant" even though some years ago such an extended meaning would have been given even by economists.

A word, as said by Holmes, is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in colour and content according to the circumstances and the time in which it is used." [vide *Manickam & Co. v. State of Tamil Nadu* [1977] 39 STC 12, 17 (SC)].

10. Viewed from the above angle "plant" might be regarded as that without which production cannot go on. Drawings, designs, plans, technical data can be compendiously included in the expression "technical know-how" necessary for the purpose of carrying on business.

11. In *Rolls-Royce Ltd. v. Jeffrey (Inspector of Taxes)* [1962] 1 WLR 425; [1965] 56 ITR 580, 585 (HL), Lord Radcliffe in the course of his speech, observed:

My Lords, I think that the issue of this appeal depends upon a right appreciation of just two matters. One is the nature of this asset of the appellants which is conveniently comprehended in the word "know-how", the other is the nature of

the considerations given by them in exchange for the payment of the sums of money which are the subject of this dispute.

First, as to "know-how". I see no objection to describing this as an asset. It is intangible: but then so is goodwill. It would be difficult to identify with any precision the sources of the expenditure which has gradually created it and, patents apart, I would not have thought of it as a natural balance-sheet item. But it is a reality when associated with production and development such as that of Rolls-Royce, and a large part, though not the whole of it, finds its material record in all those lists, drawings and manufacturing and engineering data that are specified in the various licence agreements.... "Know-how" is an ambience that pervades a highly specialised production organisation and, although I think it correct to describe it as fixed capital so long as the manufacturer retains it for his own productive purposes and expresses its value in his products, one; must realise that in so describing it one is proceeding by an analogy, which can easily break down owing to the inherent differences that separate "know-how" from the more straightforward elements of fixed capital. For instance, it would be wrong to confuse the physical records with the "know-how" itself, which is the valuable asset: for, if you put them on a duplicator and produce one hundred copies, you have certainly not multiplied your asset in proportion. Again, as the facts of the present appeal show, "know-how" has the peculiar quality that it can be communicated to or shared with others outside the manufacturer's own business, without in any sense destroying its value to him. It becomes, if you like, diluted, and its value to him may be affected, though, in my view, it begs the question to say that that value is necessarily reduced because the asset is used for outside instruction.

These considerations lead me to say that, although "know-how" is properly described as fixed capital by way of analogy, it is the kind of intangible entity that can very easily change its category according to the use to which its owner himself decides to put it.

12. The meaning of the expression "plant" was considered in *Jarrold v. John Good & Sons Ltd.* [1962] 1 WLR 1101 (Ch D). Pennycuik J., in his judgment, observed as follows, at page 1105:

The expression "plant" was considered by the Court of Appeal in *Yarmouth v. France* [1887] 19 QBD 647, 658, a case under the Employers' Liability Act, 1880, and was defined or described by Lindley L.J. in the following terms: "There is no definition of plant in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a businessman 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." This description was adopted by two of the majority in the House of Lords in *Hinton v. Maden & Ireland Ltd.* [1959] 1 WLR 875; [1960] 39 ITR 357. Lord Reid said: "It is not disputed that plant is also used in the Act as an ordinary English word. It is not altogether an easy word to construe: it may have

a more or less extensive meaning according to its context. As a general statement of its meaning, I would adopt the words of Lindley L.J. in *Yarmouth v. France* [1887] 19 QBD 647, 658 (CA):" and he then sets out the words I have just read. Lord Jenkins said: "On this point I am, for the present purpose, content to accept as a sufficient statement of the ordinary meaning of the expression "plant" the words of Lindley L.J. in *Yarmouth v. France* [1887] 19 QED 647, 658 (CA) and he too sets out the words.

13. In *Commissioner of Income Tax, Gujarat-II Vs. Elecon Engineering Co. Ltd.*, the High Court of Gujarat after considering several cases including *Rolls-Royce's* case [1965] 56 ITR 580 (HL), where some doubts had been expressed about the true nature of technical know-how, came to the conclusion that items such as drawings, patterns and technical information necessary for the carrying on of business came within the meaning of the expression "plant" under section 32 of the Act and the assessee was entitled to claim depreciation allowance in respect of them in accordance with the rules governing it. After reviewing several authorities the Gujarat High Court observed (at p. 698):

On reviewing these authorities, a broad consensus emerges from which the essential characteristics of plant can be clearly gleaned. The word "plant", in its ordinary meaning, is a word of wide import and in the context of section 32 it must be broadly construed. It includes any article or object, fixed or movable, live or dead, used by a businessman for carrying on his business. It is not necessarily confined to an apparatus which is used for mechanical operations or processes or is employed in mechanical or industrial business. It would not, however, cover the stock-in-trade, that is, goods bought or made for sale by a businessman. It would also not include an article which is merely a part of the premises in which the business is carried on as distinguished from a part of the plant with which the business is carried on. An article to qualify as plant must furthermore have some degree of durability and that which is quickly consumed or worn out in the course of a few operations or within a short time cannot properly be called "plant". But an article would not be any the less plant because it is small in value or a large quantity thereof is consumed while being employed in carrying on business. In the ultimate analysis the inquiry which must be made is as to what operation the apparatus performs in the assessee's business. The relevant test to be applied is : Does it fulfil the function of plant in the assessee's trading activity? Is it the tool of the taxpayer's trade? If it is, then it is plant no matter that it is not very long-lasting or does not contain working parts such as a machine does and plays a merely passive role in the accomplishment of the trading purpose.

14. We respectfully agree with the view taken by the High Court of Gujarat. The time has now come when we may have to revise our views in some respects regarding the distinction which is being observed so far between tangible assets and intangible assets while considering the question of depreciation allowance. We cannot forget that as time passes, it is not only that tangible assets that

depreciate but also intangible assets like technical knowledge become obsolete as progress is made in science research. Moreover, when technical know-how is acquired by incurring expenditure, there is no justification in denying appropriate deduction, in respect of its cost while computing taxable profits if it can be brought under the heading, "plant". In view of the foregoing we would not be committing an error in taking the view that the word "plant" when it is construed liberally as required by the Supreme Court in Commissioner of Income Tax, Andhra Pradesh Vs. Taj Mahal Hotel, Secunderabad, includes within its meaning designs and blueprints also. We, therefore, hold that the designs and blue-prints referred to in question No. 2 do constitute "plant" for purposes of allowing depreciation u/s 32 of the Act.

15. In the result, the first question is answered in the negative and the second question in the affirmative. The parties shall bear their own costs.