
(1979) 11 AP CK 0007

In the Andhra Pradesh High Court

Case No : Case Referred No. 115 of 1976

Praga Tools Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 19-11-1979

Acts Referred:

Companies Act, 1956 — Section 617
Income Tax Act, 1922 — Section 10(2)
Income Tax Act, 1961 — Section 256(1), 37

Citation : (1980) 123 ITR 773

Hon'ble Judges : C. Kondaiah, C.J.;Punnayya, J;Amareswari, J

Bench : Full Bench

Advocate : P.R. Ramachandra Rao, for the Appellant; P. Rama Rao, for the Respondent

Judgement

C. Kondatah, C.J.—The Income Tax Appellate Tribunal, Hyderabad Bench, has, at the instance of the assessee, referred the following question of law u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as " the Act ") for the opinion of this court:

" Whether, on the facts and in the circumstances of the case, the sums of Rs. 1,01,282 and Rs. 97,357 paid by the assessee by way of royalty to its foreign collaborators during the accounting years relevant for the assessment years 1965-66 and 1966-67 respectively are deductible as revenue expenditure u/s 37 of the Income Tax Act, 1961 ? "

2. In order to appreciate the scope and ambit of the question, we shall briefly refer to the facts admitted or found by the Tribunal which gave rise to the question : The applicant-assessee is a Government company u/s 617 of the Companies Act, 1956, which has been carrying on business in the manufacture of precision and machine tools, machinery and forgings since 1942. On January 2, 1961, the assessee-company had entered into a licence agreement with a foreign collaborator, M/s. A. A. Jones and Shipman Ltd., Leicester, U. K., for the

manufacture of what is described as " Jones-Shipman " Tool and Cutter Grinding Machine Model 310--16"X8" capacity, complete with all items of standard equipment, M. 20 motor-drive unit and X-17 Indexing attachment for which the collaborator was to supply the necessary designs, drawings, technical know-how and assistance. Jones & Shipman agreed to assist the assessee in the production of the main castings of the machine and also to sell all relative jigs, fixtures, tools, gauges, raw materials and special parts as ordered at their normal commercial retail value. Jones & Shipman also agreed to furnish all the technical information with the latest modifications and standards. In consideration of the grant of the manufacturing rights and for providing assistance under the agreement, the assessee-company agreed to pay to Jones & Shipman ₹1,000--₹500 on the signing of the agreement and ₹500 on the supply of the documents mentioned in Clause 4 of the agreement--and royalty of 5% of the Indian selling price on the production of the machine described in Clause 1 during the currency of the agreement. Clause 13 of the agreement provides that royalty would become due when any machine or part thereof is completed and ready for despatch from the works of the assessee-company. The net amount of royalty to be paid by the assessee for the ten years from the signing of the agreement shall not be less than ₹20,000 sterling and it shall be payable half-yearly in sterling within sixty days of the half-years ending with 31st March and 30th September, respectively, and shall be subject to Indian taxes. The agreement is for a period of 10 years and it may be renewed thereafter for a period of five years by mutual consent, Under Clause 15, the termination of the agreement shall not affect the rights of the assessee-company to use for the purpose of their business all the information, techniques, patents, copyrights, drawings, plans and documents relating to the machine which have been transferred from the foreign collaborators to the assessee or which may have come into their possession during the agreement. The assessee would be entitled to use this information free of any royalty or other payments and without any objection on the part of the foreign collaborator provided that all payments under the agreement have been duly paid by the assessee. However, the assessee-company shall no longer have the right to use the Jones & Shipman name or trademark. The rights and liabilities of either party to the agreement shall not be assigned to a third party without the written consent of the other party according to Clause 17.

3. Similarly, the assessee had entered into another agreement on October 26, 1960, with M/s. Kearney & Trecker-C.V.A. Ltd., Hove, Sussex, U.K., for the manufacture of what is described as " Drill chucks contained in the manufacturing range of C.V.A." Clause 1 of the agreement, which is very material, reads thus :

" The object of this agreement is to enable Praga to manufacture under licence Drill chucks contained in the manufacturing range of C.V.A. and for this purpose the two parties agree to collaborate to the utmost,"

4. The collaborator agreed to supply to the assessee the complete manufacturing

drawings and lists of parts, prints of all jigs, fixtures, special tools, gauges and special machines used by C. V. A. for the manufacture, assembly, inspection, complete specifications of raw materials, complete sets of up to date layouts, and technical service by deputing their senior executives and expert technicians. Clause 10 of the agreement states that in consideration of the grant of the manufacturing rights and for providing supplies, services and their assistance under the agreement, the assessee-company shall make a payment of ₹ 2,000--₹ 500 on the signing of the agreement, ₹500 on the supply of documents and ₹ 1,000 within twelve months of the signing of the agreement--free of Indian taxes to C.V.A. The agreement shall be for a period of ten years which may be extended for a further period on terms to be agreed upon by the parties. Clause 12 requires the assessee-company to pay the collaborator during the currency of the agreement, royalty of 5% on sales effected by the assessee subject to Indian taxes calculated in Praga's list prices reduced by the commission payable to Praga's selling agents. The said royalty is payable half-yearly in sterling before the expiry of sixty days from the end of the half-year periods. The termination of the agreement after the period of ten years shall not affect the right of the assessee-company to use for the purpose of their business all the information, techniques, patents and copy right and other rights, drawings, plans and documents which have been transferred to it or which may have come to their knowledge or possession pursuant to the agreement without any royalty and other payments. The collaborator agreed to the grant of expert right to the assessee, for the Drill chucks covered by the agreement, in respect of Burma, Ceylon and Pakistan. Clause 15 prohibits assignment of the rights and liabilities for either party under the arrangement to a third party or firm without the written consent of the other party.

5. By virtue of the aforesaid agreements, the assessee had paid by way of royalty to the aforesaid two foreign collaborators the following amounts during the accounting years relevant for the assessment years under consideration.

Asst. Year A. A. Jones & Shipman Ltd. Kearney & Tracker-C. V. A. Ltd. Total

Rs. Rs. Rs.

1965-66 84,036 17,246 1,01,282

1966-67 74,697 22,660 97,357

6. The assessee's claim for deduction of the aforesaid two amounts by treating the same as revenue expenditure was disallowed by the ITO in his orders of assessment holding that they were capital payments. The AAC allowed the appeals preferred by the assessee-company holding that the payments related strictly to production and they must be regarded as an integral part of the profit earning process. Aggrieved by the decision of the AAC, the department instituted appeals before the Tribunal contending that the royalty payments in question were made for the acquisition of an asset of an enduring nature, viz., drawings, designs and technical know-how for the manufacture of a different type of

machinery which was not in the production range of the assessee but was a patented product of the collaborators and as such they constituted capital expenditure. The Tribunal, relying upon the decisions of this court in *Hylam Ltd. Vs. Commissioner of Income Tax, Karnataka High Court in Mysore Kirloskar Ltd. Vs. Commissioner of Income Tax, Mysore*, and of the Bombay High Court in *Commissioner of Income Tax, Bombay City I Vs. Devidas Vithaldas and Co.*, and on a consideration of all the relevant clauses in the agreements, held thus :

" What the assessee was acquiring from the collaborators was a licence to manufacture certain patented machinery which was in the production range of the collaborators and patented by them as also the designs and drawings and technical know-how for the manufacture together with complete specification of raw materials required for the component parts of each item. The drawings and designs and the know-how became the property of the assessee and the assessee was free to use the same in its manufacture after the termination of the agreement with the collaborators..... Though the payment of royalties is linked to the selling price of the machinery, it cannot be treated as an integral part of the "profit earning process". The payment was essentially for acquisition of a capital asset. But it has been agreed to be computed with reference to production. If the payment directly related to the manufacture of items which are already in the production range of the assessee and what the assessee acquired was only information regarding improved techniques of manufacture, the payment could be said to relate to the " profit earning process" and as such revenue in nature. But that was not the case here. As already stated, the two types of machinery to be manufactured by the assessee under the agreements were entirely new items which were patented by the collaborators and which were in their production range only."

7. Again in para. 10 it proceeded to find :

" Unlike in *Ciba of Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, , the assessee in the case before us became the owner of the designs and the know-how for the manufacture of the machinery patented by the collaborators and that the collaborators permanently parted with the technical know-how in favour of the assessee which enures to the benefit of the assessee even after the expiry of the agreement. Again, it is not the case of the assessee that the payments in question were made for the purpose of acquiring a new technical know-how for the manufacture of the items of machinery which was already in its production range."

8. The Appellate Tribunal, therefore, held that the royalty payments in question made by the assessee to the foreign collaborators were rightly treated as capital expenditure by the ITO. Hence this reference.

9. The sum and substance of the contention of Sri P.R. Ramachandra Rao, learned counsel for the assessee, is that the assessee has not acquired, under the agreements from the foreign collaborators, any advantage of an enduring

benefit of permanent nature except securing technical know-how, knowledge and assistance to enable it to manufacture Jones & Shipman tool and cutter grinding machine and drill chucks as described in the agreements and that, therefore, the payment of half-yearly royalty on the basis of the production and sale of the products so manufactured is in the nature of revenue but not capital expenditure. According to him, this case is governed by the decision of the Supreme Court i Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., and the decision of this court in Hylam Ltd. Vs. Commissioner of Income Tax, requires reconsideration as the decisions of the Mysore and Bombay High Courts in Mysore Kirloskar Ltd. Vs. Commissioner of Income Tax, Mysore, and Commissioner of Income Tax, Bombay City I Vs. Devidas Vithaldas and Co., respectively on which reliance has been placed in Hylam Ltd. Vs. Commissioner of Income Tax, have been overruled.

10. This claim of the assessee is resisted by the learned standing counsel for the revenue, Sri P. Rama Rao, contending, inter alia, that what the assessee acquired, according to the terms of the agreement, has been rightly held by the Tribunal to be of an enduring benefit of a permanent nature and, therefore, the payment of royalties, though linked to the production and selling price of the machinery, is essentially for the acquisition of a capital asset. But the same cannot be treated as an integral part of profit-earning process. Further, it is emphasised that the two types of machinery to be manufactured by the assessee under the agreements were found to be entirely new items which were patented by the collaborators and which were in their production range only. The assessee, without payment of any royalty or any amount, would be entitled to make use of the know-how, knowledge and patent acquired by it after the expiry of the periods specified in the agreements. The decision in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., cannot be taken aid of by the assessee herein as in that case the assessee upon the termination of the agreement agreed to return to the Swiss company all copies of information, scientific data or material sent to it and to refrain from communicating the same to any person and not to use the patents and trade marks.

11. In this reference, we are not called upon to decide the nature of the lump-sum payments of ₹ 1,000 and ₹ 2,000 made by the assessee to the foreign collaborators on the signing of the agreements and on the supply of documents and within twelve months after the signing of the agreements as mentioned in Clauses 12 and 10, respectively. What we are concerned with is about the nature and character of the half-yearly payments of royalties in respect of the Jones & Shipman tools and cutter grinding machine and drill chucks on the basis of the production and sales respectively subject to Indian taxes during the accounting years corresponding to the assessment years 1965-66 and 1966-67.

12. Now, therefore, we have to consider the question as to what is meant by the acquisition of an asset or advantage of an enduring benefit which would make the payment capital in nature and whether the acquisition of technical know-how

and scientific assistance and manufacturing process would amount to acquiring an asset or advantage of an enduring benefit.

13. Before advertng to the facts and circumstances of the case on hand, we may usefully refer to the law relating to the nature and character of an expenditure. The question whether a particular expenditure is capital or revenue in nature is a vexed one. The dividing line between the two is very thin. There is no rule of thumb or test or principle which has got a universal application to determine this question. However, courts have laid down certain broad tests to be decided as to whether an expenditure is capital or revenue. The court has to examine the nature and character of the business and the objects for which the expenditure has been incurred. Viewed in the larger context of business necessity or expedience, each factor or circumstance by itself is not decisive. It is the totality or the cumulative effect of all the material facts and circumstances evidenced by documents and the surrounding circumstances that are to be taken into consideration to arrive at a decision as to what was the nature and character of the transaction from the commercial point of view. Different tests have been enunciated and applied in this regard by the courts in various decisions, of which we may mention here some important decisions pertaining to the test of acquiring an asset or advantage of an enduring benefit which is material for the determination of the question before us.

14. The Supreme Court in *Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal*, approved the principles laid down by the Full Bench of the Lahore High Court in (1947) 15 ITR 185 Lahore for the purpose of deciding the question as to whether an expenditure is revenue or capital. Therein it was laid down at page 45 :

" 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."

15. The aforesaid decision of the Supreme Court is an authority for the proposition that it would be properly attributable to capital if the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business whereas if the expenditure is made for the purpose of running the business or working it with a view to produce the profits, it would be a revenue expenditure. It would be immaterial whether the source of

the payment was capital or whether the payment was made once and for all.

16. We may usefully refer to the decision of the Supreme Court in *Gotan Lime Syndicate Vs. Commissioner of Income Tax, Rajasthan and Delhi*, wherein it was held that the expenditure incurred to secure an enduring advantage must not invariably be treated as capital expenditure and the royalty payment including the 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. It was categorically held:

" It is not in every case that an expenditure in respect of an advantage of an enduring nature is capital expenditure."

17. The following passage in the aforesaid case at page 727, which succinctly lays down the law on this aspect, may be noticed:

" It is not the law that, in every case, if an enduring advantage is obtained, the expenditure for securing it must be treated as capital expenditure, for, as pointed out by Channell J., in *Alianza Company v. Bell* [1904] 2 KB 666 " In the ordinary case, the cost of the material worked Up in a manufactory is not a capital expenditure; it is a current expenditure, and does not become a capital expenditure merely because the material is provided by something like a forward contract, under which a person for the payment of a lump sum down secures a supply of the raw material for a period extending over several years", This illustration shows that it is not in every case that an expenditure in respect of an advantage of an enduring nature is capital expenditure. The reason underlying the illustration is that the payments made to enter into a forward contract have relation to the raw material eventually to be obtained. Viscount Cave acknowledged that in certain cases an expenditure for obtaining an enduring advantage need not be capital expenditure for he inserted the words " in the absence of special circumstances leading to an opposite conclusion " within brackets.

We are of the opinion, that in the present case, the royalty payment is not a direct payment for securing an enduring advantage : it has relation to the raw material to be obtained.....the royalty payment, including the deadrent, have relation only to the lime deposits to be got. "

18. Applying the aforesaid principles enunciated by the Supreme Court, we have to examine whether in fact an enduring advantage or permanent benefit has been secured by the assessee in the present case by the payment of the royalties in question during the years of account to the two foreign collaborators and if it is so, whether the royalty payment is or is not a direct payment for securing an enduring advantage or the payments have relation only for running the business or working it with a view to produce profits

19. As pointed out earlier, the Tribunal, in arriving at its conclusion that the payment of royalties by the assessee to the foreign collaborators was made to

secure an enduring advantage for permanent benefit, relied upon the decision of this court in *Hylam Ltd. Vs. Commissioner of Income Tax*, and distinguished the decision of the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, .

20. We may usefully refer at this stage to *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, , which is the leading case on this aspect. The respondent-assessee therein was an Indian subsidiary of Ciba Ltd. of Basle, a Swiss company whose pharmaceutical section in India was taken over by the assessee from January 1, 1948. The Swiss company under an agreement dated December 17, 1949, granted to the assessee full and sole right of licence under the patent listed in the agreement to make use, exercise and vend the inventions specified therein in India and also a licence to use some specified trade marks and deliver to the assessee all processes, formulae, scientific data, working rules and prescription pertaining to the manufacture or processing of products discovered and developed in the Swiss company's laboratories and supply all scientific and technical know-how and assistance. The assessee in consideration of the aforesaid right to receive scientific and technical know-how and assistance from the foreign collaborator, agreed to make contributions of 5%, 3% and 2% of the net sale price of the products sold by the assessee for a period of five years from January 1, 1948, (i) technical consultancy, and technical service rendered and research work done ; (ii) cost of raw material used for experimental work; and (iii) royalties on trade marks used by the assessee. By a supplemental agreement dated July 15, 1949, the contribution under Article III payable by the assessee was reduced from 10 per cent. to 6 per cent. of the net selling price of the pharmaceuticals. The payments made by the assessee to the Swiss company during the accounting years corresponding to the assessment years 1949-50 to 1953-54 were claimed as deductions u/s 10(2)(xii) of the Indian I.T. Act, 1922. The ITO himself allowed the amount of 2% paid towards royalty of trade marks but disallowed the contributions made towards technical consultancy and technical service and the cost of raw material used for experimental work. The AAC agreed with the assessing authorities. But the Income Tax Appellate Tribunal allowed the deductions u/s 10(2)(xii) or, in any event, u/s 10(2)(xv). The High Court of Bombay affirmed the view of the Tribunal that the expenditure was admissible u/s 10(2)(xv). On appeal by the department, the Supreme Court noted the following facts that emerged from the agreement entered into in that case, viz., (1) the licence was for a period of five years, liable to be terminated in certain eventualities even before the expiry of the period ; (2) the object of the agreement was to obtain the benefit of the technical assistance for running the business ; (3) the licence was granted to the assessee subject to the rights actually granted or which may be granted after the date of the agreement to other persons ; (4) the assessee was expressly prohibited from divulging confidential information to third parties without the consent of the Swiss company ; (5) there was no transfer of the fruits of research once for all; and (6) the stipulated payment was recurrent, dependent upon the sales, and only for

the period of the agreement. The Supreme Court, on a consideration of the facts, agreed with the view of the High Court that the payments were admissible u/s 10(2)(xv) and held that the assessee did not acquire any asset or advantage of an enduring nature for the benefit of its business except acquiring the right to draw for the purpose of carrying on its business as a manufacturer and dealer of pharmaceutical products, upon the technical knowledge and know-how of the Swiss company for a limited period, nor did the Swiss company part with any asset of its business.

21. In *Acc-Vickers Babcock Ltd. Vs. Commissioner of Income Tax, Bombay City II*, it was held that payment of Rs. 47,602 by the assessee therein to a foreign firm, viz., Fuller, on account of the first instalment in the financial year 1961-62 for the grant of the exclusive right and licence to manufacture and sell and use in India certain types of machinery and equipment, viz., supply of know-how, drawings, designs, technical and engineering knowledge, was a revenue expenditure but not capital. It differed from the view taken by the Tribunal in that case. The Tribunal found that there was transfer of the fruits of the research, inasmuch as the necessary know-how designs, drawings, specifications and technical information which were in the possession of Fuller were passed on to the assessee-company and the right acquired was different from the object of technical assistance in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, . The aforesaid finding of the Tribunal was disapproved by the High Court in a reference. The High Court, while considering the purpose of the expenditure laid much stress on the opening words of Clause 10 of the agreement therein that "all the payments referred to in Sub-clauses (a) to (d) thereof have been agreed to be made in consideration for the technical and manufacturing information given by Fuller to AVB (the assessee) and the right and licence for manufacture and sell the Fuller-equipment listed therein ". The learned judge, Tulzapurkar J., speaking for the court, observed at page 330 (103 ITR):

" Having regard to various clauses of the agreement in question and the salient features thereof as indicated above, it seems to us quite clear that the expenditure of 1,00,000 U.S. dollars payable in yearly instalments of 10,000 U.S. dollars for ten years was clearly for the purpose of securing from Fuller a licence and all the necessary technical know-how including designs, drawings, specifications and other technical information to enable the assessee to manufacture and sell that equipments listed in the agreement. In other words, the payment was for the benefit of the entire technical know-how agreed to be made available to the assessee to enable it to manufacture and sell the listed equipments so that the assessee could earn profits. The expenditure was thus so related to the carrying on of the business that it will have to be regarded as an integral part of the profit-making process and there does not appear to be any indication that the payments undertaken to be made by the assessee under the agreement, particularly under Sub-clause (a) of Clause 10, was for the purpose of acquisition of an asset or a right of a permanent character, the possession whereof was a condition precedent to the continuance of its business. "

22. The contention of the learned counsel for the revenue is that the agreement entered into in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., , was for a period of five years only which was liable to be terminated even earlier in certain events where as the agreement in the aforesaid case was for ten years and was liable to be extended by periods of five years unless written notice of six months for termination was given by either party and, therefore, it is not decisive of the matter. The duration of the agreement is not very material as it is only for some period. This decision is an authority for the proposition that where an expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment, the aim and object of the expenditure would determine its character and nature. The source or the manner of the payment would then be of no consequence. Where the expenditure is so related to the carrying on or conducting of the business that it might be regarded as an integral part of the profit-making process, it should be held to be revenue expenditure. However, if the purpose and aim of the expenditure is to acquire an asset or a right of a permanent character, the possession whereof is a condition precedent to the commencement or continuance of the business, the expenditure would be of a capital nature.

23. A Full Bench of the Karnataka High Court in Mysore Kirloskar Ltd. Vs. The Commissioner of Income Tax, Bangalore, held that the acquisition of the right to draw up the technical knowledge of the foreign companies for a limited period of 15 years for the purpose of carrying on its business does not amount to acquiring any asset or advantage of an enduring nature for the benefit of its business and the payments made by the assessee therein under the agreements to a foreign collaborator were revenue in nature. The object of the agreements therein, which were for a period of 15 years, was to obtain the benefit of the technical assistance for running the business and therein the permission was granted to the assessee subject to rights actually granted or which may be granted after the date of the agreements to other persons though outside India and the foreign companies had agreed to make their research and advantage available to the assessee. The earlier decision of the Division Bench of the Mysore High Court in Mysore Kirloskar Ltd. Vs. Commissioner of Income Tax, Mysore, on which much reliance has been placed by this court in Hylam Ltd. Vs. Commissioner of Income Tax, was overruled.

24. The Calcutta High Court has consistently taken the view that payments made by an assessee to a foreign collaborator in the circumstances as found in the present case are invariably revenue expenditure. See Commissioner of Income Tax (Central) Vs. Hindusthan General Electrical Corporation Ltd., ; Commissioner of Income Tax Vs. Aluminium Corporation of India Ltd., ; Commissioner of Income Tax Vs. Associated Electrical Industries (India) Private Ltd., ; Commissioner of Income Tax Vs. Indian Oxygen Ltd., and Agarwal Hardware Works (P.) Ltd. Vs. Commissioner of Income Tax, . In the case cited last, viz., Agarwal Hardware Works (P.) Ltd. Vs. Commissioner of Income Tax, , the Calcutta High Court specifically dissented from the view taken by this court in

Hylam Ltd. Vs. Commissioner of Income Tax, .

25. We shall now refer to the Hylam Ltd. Vs. Commissioner of Income Tax, decided by a Division Bench of this court. Therein the assessee paid royalties for acquiring a licence for the use of the special knowledge of the processes covered by certain patents owned by the collaborator English company in respect of the manufacture of anew product copper-clad laminates. Though the new laminated project was of an allied nature, it was held that it did not amount to extension of the assessee's business and that the acquisitions of the special knowledge in respect of a new product would amount to the acquisition of an advantage or an asset of the assessee's business. The collaborator company parted with their patents, which were the assets, in favour of the assessee for the whole of the unexpired period of those patents, whose normal life was 16 years. The royalties payable were only ? 5,000 and the assessee was no more liable to pay any royalty if the amount paid had reached ? 5,000 which represented 1/3rd of the cost and the expenses incurred by the English company in developing such laminated products. The payment of the so-called royalty had no direct relation to the user of these patents. The reasons assigned by the learned judges to distinguish that case from Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., were :

(1) The technical know-how in Ciba's case was with regard to the same products which the assessee-company was already manufacturing whereas the special knowledge related to a new product in Hylam Ltd. Vs. Commissioner of Income Tax, .

(2) In Ciba's case after the expiry of the agreed period, the special knowledge, scientific data and the material relating to it had to be returned to the Swiss company whereas it was not so in Hylam's case.

(3) In Ciba's case, the period of agreement was only five years and it was also liable to be cancelled earlier whereas the advantage or the benefit of the user of the patented processes in Hylam's case was not only for the entire life of those patents but also for the extensions and re-grants thereof.

(4) The price for the entire user in Hylam Ltd. Vs. Commissioner of Income Tax, , had been fixed at ? 5,000 whereas no price as such had been fixed for the user of the special knowledge for the entire period of licence or use in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., .

26. The first reason of the learned judges that in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., , the product related to one which the assessee-company was already manufacturing is not correct. In Ciba's case, art, 1 of the deed of agreement provided thus (p. 696):

" (1) Ciba Basle will communicate currently and/or at request of Ciba Pharma all the results of its research work, in so far as they relate to the said products which, are already manufactured or processed or sold by Ciba Pharma or which

shall hereafter with the prior approval of Ciba Basle be manufactured or processed or sold by Ciba Pharma.....In this case Ciba Basle undertakes to deliver to Ciba Pharma all processes, formulae, scientific data, working rules and prescriptions pertaining to the manufacture or processing of said products, which have been discovered and developed in Ciba Balse's laboratories and will forward to Ciba Pharma as far as possible all scientific and bibliographic information, pamphlets or drafts, which might be useful to introduce licensed preparations and to promote their sale in India. "

27. To the same effect is the observation of the learned judge, Tulza-purkar (as he then was) of the Bombay High Court who delivered the judgment for the court in *Acc-Vickers Babcock Ltd. Vs. Commissioner of Income Tax, Bombay City II*,

" With respect, we may point out that in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, , the technical " know-how " was not merely with regard to the same products which Ciba India was already manufacturing but the technical " know-how " was also to extend to new products which Ciba India were to manufacture after the agreement had come into operation. As such, in our view, the aspect that the technical " know-how " is supplied for manufacturing a new product, though relevant, would not be decisive of the matter. "

28. The period of five years specified in the agreement in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, is not decisive. However, *Hylam Ltd. Vs. Commissioner of Income Tax*, is distinguishable on two material facts found therein. Firstly, the payment of fixed sum of ₹ 5,000 in the shape of royalty was equivalent to 1/3rd of the cost and the expenses incurred by the collaborator-English company in developing new laminated products at the request of the assessee. Secondly, the use of the patents was not for any limited period but for the whole of the unexpired period of the patents.

29. The decision of this court in *Hylam Ltd. Vs. Commissioner of Income Tax*, is, therefore, incorrect and *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, was distinguished on incorrect and unsubstantial grounds particularly because the agreement in that case was of a short duration and that at the end of it copies of information supplied had to be returned. The right to use a patent is not converted into a capital asset by its being extended over the whole life of the patent. The return of copies of technological information is immaterial since the knowledge acquired therefrom is such that, it would never be returned and the same remains always with the Indian company. The annual payment based on a percentage of the turnover and unrelated to any fixed sum was held to be revenue expenditure in *Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala*, , We are unable to understand as to how the collaboration agreements would make any difference of the nature and character of the expenditure incurred for such annual payments.

30. As per Lord Denning in *Evans Medical Supplies Ltd. v. Moriarty* [1959] 35 ITR 707 there could be no distinction between the money paid for disclosing information of secret processes and money paid for other information and that the amount paid for " know-how " in the course of the assessee's trade was income and not capital. In *Jeffrey v. Rolls-Royce Ltd.* [1965] 56 ITR 580 it was held that the payment received for licensing a foreign Government to manufacture aero-engines with the accumulated technical knowledge of the taxpayer and for supplying the necessary information, drawings, designs, advice and assistance in the manufacture of engines by the licensee was held to be revenue receipt. The amounts received by the taxpayer for his imparting manufacturing technique to the licensee to design and develop a turbine and to license its manufacture were held to be income in *English Electric Company's* case [1964] 41 TC 556. The know-how cannot be treated to be property if it is imparted for the purpose of enabling the assessee to manufacture specialised products in the course of its business.

31. That apart, the decision of the Bombay High Court in *Commissioner of Income Tax, Bombay City I Vs. Devidas Vithaldas and Co.*, relied upon by the learned judges in *Hylam Ltd. Vs. Commissioner of Income Tax*, has been reversed by the Supreme Court. The decision of the Division Bench of the Mysore High Court in *Mysore Kirloskar Ltd. Vs. Commissioner of Income Tax, Mysore*, which has been relied upon by the learned judges in *Hylam's* case, has also been overruled by the recent Full Bench decision of the Karnataka High Court in *Mysore Kirloskar Ltd. Vs. The Commissioner of Income Tax, Bangalore*, . With great respect to the learned judges, we are unable to persuade ourselves to agree with the view expressed in *Hylam Ltd. Vs. Commissioner of Income Tax*, as it does not represent the correct position of law. It is, therefore, overruled.

32. On the other hand, the facts of the present case do squarely fall within the decision in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, . We do not find any rationale or basis to distinguish *Ciba's* case from the present one as pointed out earlier.

33. On a close reading of the facts and circumstances we are of the view that the expenditure, with which we are concerned in the present case, is having direct nexus, connection or relation to the very carrying on or conducting of the business of the assessee which must be regarded as an integral part of the profit-making process. The very aim and object of the payment of royalty, which is based on the production and sale of the products manufactured by the assessee-company, is with the sole purpose of securing from the foreign collaborators manufacturing licence and all the necessary technical know-how including designs, drawings, specifications and other technical information to enable the assessee-company to make and sell the products indicated in the agreements. This is amply proved by Clause (1) of the earlier agreement dated 26th October, 1960, between the assessee-company and *Kearney & Trecker-C.V.A. Ltd.*, which reads thus : "

" The object of this agreement is to enable Praga to manufacture under licence Drill chucks contained in the manufacturing range of C.V.A. and for this purpose the two parties agree to collaborate to the utmost."

34. The mere fact that the foreign collaborators have agreed to grant to the assessee-company the right to manufacture under exclusive licence in India, under the trade mark " C. V. A. Praga " Drill Chucks of all sizes and descriptions as listed in C.V.A. price lists in the first agreement and the right to manufacture under exclusive licence in India under the Jones & Shipman trademark " Jones-Shipman " tool and cutter-grinding machine with all the technical know-how and assistance, would not in any way alter the very nature and character of the payments in question. By Clause 2 of Article II, the Swiss company in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., granted to the assessee " full and sole right and licence " in the territory of India under the patent listed in Sch. I, to make use, exercise and vend the inventions referred to therein and to use the trade marks set out in Sch. II in the territory of India. Hence, this would not in any way alter the position in the present case.

35. The Tribunal appears to have applied the decision of Hylam Ltd. Vs. Commissioner of Income Tax, on the assumption that the facts are similar. In the present case also, as in the case of Ciba's case, the assessee was prohibited to use the trade mark of Jones-Shipman after the expiry of the agreement. But the Tribunal took the view that such a restriction does not exist in the agreement. In the case of the other agreement, the rights and liabilities of either party to the agreement shall not be assigned to a third party or firm without the consent of the other party. Such restriction was considered in Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd., to be a pointer to indicate that the expenditure is of revenue character.

36. The Tribunal is more obsessed by the fact that the two types of machinery to be manufactured by the assessee under the agreements were entirely new items which were patented by the collaborators, that the assessee became the owner of the designs and the know-how for the manufacture of the machinery patented by the collaborators and that the collaborators permanently parted with the technical know-how in favour of the assessee which enures to the benefit of the assessee even after the expiry of the agreement. The assessee's counsel complains that the Tribunal had erroneously assumed that it is not the case of the assessee that the payments in question were made for the purpose of acquiring a new technical know-how for the manufacture of an item of machinery which was already in its production range since it is their main plea. When once the assessee had the advantage of utilising the special knowledge and technical know-how along with the specific drawings, designs and other information during the period under agreements, it does not alter the true state of affairs by agreeing that the assessee would be free to make use of the aforesaid technical know-how and knowledge even after the expiry of the period of agreements. There is no property right in the know-how which is transferable. The imparting

of special knowledge and technical know-how by the foreign collaborators to the assessee-company would be just like a teacher selling his skill or knowledge to his pupil.

37. In the present case, the original payments of ₹ 1,000 and ₹ 2,000 under the two agreements are not claimed to be a revenue expenditure. The assessee had to pay to Jones-Shipman not less than ₹ 20,000 sterling, and it may also exceed, depending upon the circumstances. That apart, these payments are made subject to Indian taxes. The amounts payable towards royalty are liable to Indian taxes which include Income Tax also. If it is a capital receipt, for the sale or transfer of a capital asset no Income Tax need be paid. Applying the principles of business expediency, it is also just and proper to allow these payments as revenue expenditure as they relate to the manufacturing process and the profit-making process. As stated earlier, each factor by itself is not decisive. It is the totality or the cumulative effect of all the facts and circumstances that would be the prime guiding factor to decide the aim and object of the expenditure, be it capital or revenue. 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.

38. On a consideration of the entire facts and circumstances, we hold that the expenditure in the present case is revenue in character and not capital.

39. For all the reasons stated, our answer to the question is in the affirmative and in favour of the assessee holding that the payments in question are allowable deductions being revenue in character. There shall be no order as to costs.