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**(1987) 08 AP CK 0013**

**In the Andhra Pradesh High Court**

**Case No : Case Referred No. 274 of 1982**

Veljan Hydrair (P.) Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

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**Date of Decision : 13-08-1987**

**Acts Referred:**

Income Tax Act, 1961 — Section 37

**Citation : (1989) 177 ITR 552**

**Hon'ble Judges : Y.V. Anjaneyulu, J;B.P. Jeevan Reddy, J**

**Bench : Division Bench**

**Advocate : S. Parvatha Rao, for the Appellant; M. Suryanarayana Murthy, for the Respondent**

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## **Judgement**

B.P. Jeevan Reddy, J.—Two questions are referred for the opinion of this court, one at the instance of the assessee and the other at the instance of the Revenue. The question referred at the instance of the Revenue is:

"Whether, on the facts and in the circumstances of the case, the sum of Rs. 1,50,000 paid to Flick-Reedy Corporation, USA, was correctly classified as revenue expenditure ?"

The question referred at the instance of the assessee is as follows:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that only one-fifth of the disclosure fee of Rs. 1,50,000 payable to the foreign collaborator was an allowable deduction in the assessment year 1974-75 ?"

2. The assessee-company carries on business in manufacture of air and hydraulic cylinders, valves filters, lubricators, regulators, etc. The assessee was, inter alia, manufacturing spool type valves since 1967-68. The assessee wanted to improve its product by manufacturing seal-less type of valves which were supposed to be of better design. For that purpose, it entered into a collaboration agreement dated October 1, 1970, with Flick-Reedy Corporation of USA. The agreement was

for a period of five years. Under it, the Flick-Reedy Corporation granted to the assessee, an exclusive non-transferable licence to manufacture, sell and use the licensed products in India during the period of the said agreement using the technical data supplied by it. Para 4 of the agreement says that the agreement is a continuing agreement. In other words, during the period of five years for which the agreement shall be in force, the foreign collaborator was to continue to supply the new design, improvements and other technical data to the assessee, and the assessee was to make use of the same and improve its products. The consideration is provided in para 12 of the agreement. It is 20,000 dollars subject to Indian taxes to the extent leviable, the said amount is payable in five equal annual installments.

3. The assessee claimed deduction of the entire amount of Rs. 1,50,000 (representing the equivalent of 20,000 dollars) for the assessment year 1974-75, on the ground that it is maintaining its accounts on the mercantile basis, and inasmuch as the liability has accrued during the relevant accounting year, it is entitled to deduct the entire amount notwithstanding that actually only one-fifth of the said amount was paid during the relevant assessment year. The Income Tax Officer, however, disallowed the claim holding that the expenditure was capital in nature following the decision of this court in *Hylam Ltd. Vs. Commissioner of Income Tax*, . On appeal, the Appellate Assistant Commissioner disagreed with the Income Tax Officer and held that the expenditure is revenue in nature but he held that only the sum of Rs. 30,000 paid during the accounting year relevant to the assessment year concerned herein alone should be given deduction and not the entire amount of Rs. 1,50,000. Both the Revenue and the assessee filed appeals which were dismissed by the Tribunal, affirming the decision of the first appellate authority whereupon each party sought the reference as stated above.

4. We shall first take up the question referred at the instances of the Revenue. It is clear from the facts stated above that the assessee's was a continuing business. The assessee was engaged in the manufacture of valves seven prior to its entering into an agreement with the foreign collaborator. It was manufacturing "spool-type valves" and the technical collaboration agreement in question was entered into only with a view to improve the product. We may also mention that the decision of this court in *Hylam Ltd. Vs. Commissioner of Income Tax*, followed by the Income Tax Officer has been overruled later by this court in *Praga Tools Ltd. Vs. Commissioner of Income Tax*, . It has been clearly held in the said Full Bench decision that where the technical know-how is obtained merely for improving the product by an industry which is already established, the payment would only be in the nature of revenue and not a capital payment.

5. This is also the decision of the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Ciba of India Ltd.*, .

6. For the above reasons, we answer the question referred at the instance of the Revenue in the affirmative, i.e., in favour of the assessee and against the

Revenue.

7. Now, coming to the question referred at the instance of the assessee as we have already noticed, it is a continuing agreement. This is not a case where certain technical know-how was sold or delivered at one stage. The consideration was also being paid in installments. Here is a case where the agreement is valid for five years, and the foreign collaborator is bound to supply the new improvement and other technical improvements to the assessee, from time to time, during the said period of five years. The corresponding stipulation is that the assessee shall pay one-fifth of the 20,000 dollars every year. In such a case, it is not possible to say that merely because the assessee is maintaining its accounts on the mercantile basis. The liability to pay the entire amount has accrued at once, i.e., in the accounting year in question. The liability to pay arises from year to year. The liability to pay depends upon the continuance of the agreement and the performance of the respective obligations by both the parties.

8. For the above reasons, we agree with the Tribunal that the assessee was not entitled to deduct the entire amount Rs. 1,50,000 in the assessment year now in question, but only an amount of Rs. 30,000 which he has actually paid.

9. Shri. S. Parvatha Rao, learned counsel for the assessee, relied upon the decision of the Bombay High Courts in *Additional Commissioner of Income Tax, Bombay City-I Vs. Buckau Wolf New India Engineering Works Ltd.*, . He contended that the agreement considered by the Bombay High Court was a similar agreement, where an amount of Rs. 1 lakh was payable in five installments. From the report, however, it does not appear whether the agreement considered by the Bombay High Court in that case was a continuing agreement like the one before us. It is, therefore, not possible for us to say that the principle applied by the Bombay High Court in that case should necessarily be applied herein. We have to keep the nature and stipulations of the agreement in view and decide the question of accrual of the liability.

10. For the above reasons, we answer the question referred at the instance of the assessee in the affirmative, i.e., in favour of the Revenue and against the assessee.

11. In view of our answer to the question referred at the instance of the assessee, Mr. Parvatha Rao made a request that the payments made by the assessee in the subsequent assessment year shall be given deduction in the respective assessment years. He submitted that inasmuch as he was contending in this case that the entire amount should be given deduction in this assessment year alone, the assessee might not have claimed deduction of the amount paid in the subsequent assessment years. We think that the request is a legitimate one. Accordingly, we direct the authorities to verify the payment made in each of the subsequent assessment years and allow the same. No costs. Order accordingly.