

***THE HONB'E SRI JUSTICE G. CHANDRAIAH**

AND

THE HON'BLE SRI JUSTICE CHALLA KODANDA RAM

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+I.T.T.A.No.153 OF 2004

%09.10.2015

The Commissioner of Income-tax, Hyderabad-I

..... APPELLANT

AND

M/s. Advanta India Ltd., Secunderabad

.....RESPONDENT

! Counsel for the appellant: Sri J.V. Prasad

^ Counsel for respondent : Sri Percy Pardivala

< Gist:

> Head Note:

? Cases referred:

148 ITR 272

2.232 ITR 359

³.(1997) 224 ITR 342

4.(1989) 177 ITR 377 (SC)

⁵.(1998) 232 ITR 316 (SC)

⁶. (1989) 177 ITR 377 (SC)

7. (1994) 207 ITR 813 (Cal)

8. (1998) 231 ITR 849 (Mum)

9. 251 ITR 155 (Cal)

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I.T.T.A.No.153 OF 2004

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JUDGMENT: (per GC,J)

This appeal is filed by the Revenue under Section 260-A of the Income Tax Act, 1961 (for short, the "the Act"), questioning the order dated 21.02.2003, passed by the Income Tax Appellate Tribunal, Hyderabad Bench 'B', Hyderabad, in I.T.A.No.37/Hyd/99, for the assessment year 1995-96, raising the following substantial questions of law for consideration of this Court:

- i. "Whether on the facts and in circumstances of the case the Tribunal was correct in law in holding that the payment of technical know-how fee was revenue expenditure and not capital in nature.
- ii. Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure on account of payment of royalty was revenue in nature."

The brief facts of the case are that the respondent/assessee was originally incorporated under the name and style of M/s. I.T.C Zeneca Limited and its name was changed to M/s. Advanta India Limited on 30.09.1998. In the course of its business during the assessment year 1995-96, the assessee paid an amount of Rs.2,75,85,300/- to M/s. Zeneca Limited, U.K towards technical know-how fee and the assessee had also paid an amount of Rs.47,34,306/- towards royalty and claimed the said payments as revenue expenditure. It is further stated that the Assessing Officer observed that the expenditure incurred by the assessee towards technical know-how fee falls within the ambit of Section 35AB of the Act and allowed 1/6th of the amount so claimed as deduction. The Assessing Officer had also treated 1/4th of royalty paid as capital expenditure. On appeal filed by the assessee, the Commissioner of Income Tax (Appeals) (for short “the C.I.T Appeals”) treated 75% of the technical know-how fees as revenue expenditure and 25% as being capital in nature, and thus allowing 75% of the fees paid towards Technical know-how as deduction under Section 37 of the Act. The C.I.T (Appeals) had also held that the disallowance of 1/4th royalty payment as capital in nature. Aggrieved thereby, the assessee filed an appeal before the Income Tax Appellate Tribunal in I.T.A.No.37/Hyd/1999 and the Department being aggrieved by the order of the C.I.T (Appeals) in treating only 25% of technical know-how fees as capital in nature, filed an appeal in I.T.A.No.109/Hyd/1999 before the Tribunal. The Tribunal clubbed both the appeals filed by the assessee and the department and disposed of the same by a common order dated 21.02.2003, partly allowing I.T.A.No.37/Hyd/1999 and dismissed the I.T.A.No.109/Hyd/1999. Aggrieved the order dated 21.02.2003, passed by the Tribunal in I.T.A.No.37/Hyd/1999, the present appeal is filed by the department.

Heard Sri J.V. Prasad, learned standing counsel for the appellant/ department and Sri Percy Pardivala, learned senior counsel for the respondent/assessee.

The facts are not in dispute. The principal question which falls for consideration in the present case and the facts as found by the Tribunal as to “whether the expenditure incurred by the respondent-assessee is to be fully allowed as a revenue expenditure or a part of it is to be capitalized as a capital expenditure”. It is well

recognized by various judicial pronouncements that a particular expenditure is revenue or capital in nature is a vexed question and the same would have to be determined in each case on appreciation of the facts of the particular case. The question as to whether the amount paid for acquiring Germplasm and Technical know-how needs to be determined with particular reference to the terms of the contract and agreement between the assessee and the foreign company Zeneca Limited, U.K. Though, the assessing authority sought to invoke Section 35AB of the Act to the expenditure, the C.I.T Appeals after analyzing the nature of transactions involved in the agreement had categorically negated the same. It may be noted that the revenue did not question about the decision of the C.I.T Appeals, so far as Section 35AB of the Act, has no application. The First Appellate Authority after analyzing the agreement in detail and by placing reliance on the judgment of the Madras High Court in the case of **Commissioner of Income Tax, Tamil Nadu vs. Southern Switchgear Limited** as confirmed by the Supreme Court in **Southern Switchgear Limited vs. Commissioner of Income Tax, Tamil Nadu**, had disallowed 1/4th of the expenditure paid as consideration for the agreement dated 01.10.1994. Both the revenue and the assessee filed appeals separately against the C.I.T Appeal's common order. The Tribunal had analyzed the agreement in detail and by applying the principles laid down in various judgments held that the expenditure incurred by the assessee in obtaining Germplasm and the technical know-how under the agreement dated 01.10.1994, would qualify to be allowed fully as revenue expenditure. In the process of discussion, the Tribunal found that the assessee came into existence by acquisition of the existing business of Hyson India Limited and the business commenced from 1.9.1994. The Germplasm and Technical know-how were acquired by the assessee after commencement of the business by the assessee. By applying the six tests laid down in the case of **Jonas Woodhead & Sons (India) Limited vs. CIT**, the Tribunal came to conclusion that there was no new business which was started on the basis of Technical know-how received from the foreign firm. With regard to Test No.2, though the Article 18 of the agreement gives exclusive rights to the assessee company, the assessee is not entitled to sub license in whole or in part of the licensee without consent from the licensor and further the licensor has right to assign or otherwise transfer the agreement or any rights there-under. With regard to 3rd test, the consideration for the agreement was certain and definite except with respect to royalty which is to be computed based on the production. Tribunal found the consideration which was

agreed to be paid under the agreement is both for providing Germplasm as well as the technical know-how. With regard to 4th test, it was found that the assessee has to return the Germplasm, but continue to use the technical know-how. However, the technical information can be continued to be used by them. Further, it was found that there is a mutual obligations to exchange the developments and improvements that may result on account of constant research on the part of the licensee and licensor and it is provided distinctly as to how the improved property could be shared based on certain definitive parameters. With regard to 5th test considering the nature of the technology and the rapid advancements taking place in the field of biotechnology, it was found that there is enduring benefit that is derived by the assessee. So far as the 6th test is concerned, the same was not dealt with as in the present case the payment was one lump sum payment for acquiring Germplasm along with technical know-how and the duration of the agreement was five years.

Before us, on behalf of the revenue, it was emphatically canvassed that the assessee had acquired Germplasm which itself is an asset and further the technical know-how for use to exploit the same for the purpose of the assessee's business. The technical know-how and the Germplasm is an asset of capable of giving an enduring benefit to the assessee and further considering the facts on record had rightly apportioned the expenditure in the ratio 1/4th as capital in nature and 2/3rd in the nature of revenue by applying the legal tests laid down in a judgment of the Madras High Court in **CIT vs. Southern Switchgear Limited** (1 supra) which is approved by the Supreme Court in **Southern Switchgear Limited vs. CIT** (2 supra).

The learned counsel for the appellant/revenue also relied upon the following judgments

- i. Southern Switch Gear Ltd. Vs. CIT and another (1998) 232 ITR 359 (SC)
- ii. Jones Woodhead and Sons (India) Ltd., vs. CIT (1997) 224 ITR 342 (SC)
- iii. CIT, Tamil Nadu-II vs. Southern Switch Gear Ltd (1984) 148 ITR 272 (Mad).
- iv. CIT vs. Shriram Bearings Ltd (2001) 251 ITR 155 (Cal)

- v. Jyothi Electric Motors Ltd. Vs. CIT (1999) 237 ITR 280 (Guj)
- vi. Fenner Woodroffe & Co. Ltd. Vs. CIT, Madras (1976) 102 ITR 665 (Mad.)
- vii. Ram Kumar Pharmaceutical Works vs. CIT (1979) 119 ITR 33 (All.)

apart from making submissions with regard to inapplicability of the judgments cited on behalf of the respondent/assessee. Likewise, learned senior counsel Sri Parsi Pardivala, on behalf of the assessee, had also placed reliance on the following judgments:

- i. CIT vs. CIBA of India Ltd (1968) 69 ITR 692 (SC)
- ii. Praga Tools Ltd vs. CIT (1980) 123 ITR 773 (AP)
- iii. Coromandal Fertilizers Ltd vs. CIT (1984) 148 ITR 546 (AP)
- iv. Alembic Chemicals Works Company Ltd vs. CIT (1989) 177 ITR 377 (SC)
- v. Veljan Hydrair Pvt Ltd vs. CIT (1989) 177 ITR 552 (AP)
- vi. CIT vs. Avery India Ltd (1994) 207 ITR 813 (Cal)
- vii. CIT vs. Kirloskar Tractors Ltd (1998) 231 ITR 849 (Mum)
- viii. CIT vs. I.A.E.C (Pumps) Ltd (1998) 232 ITR 316 (SC)
- ix. CIT vs. J.K Synthetics Ltd (2009) 309 ITR 371 (Delhi)
- x. CIT vs. Hero Honda Motors Ltd (2015) 372 ITR 481 (Del)

We have heard the elaborate arguments on both sides and perused the record apart from going through the various judgments relied upon by both the counsel. Having given our anxious thought to the matter in issue we do not find it necessary to extract or deal with a large number of case law which has been cited before us by various Courts except making a reference to the judgments of the Supreme Court wherein the cases of this nature were considered. In this context, it is useful to refer to the guidance provided by the Supreme Court in the cases of **Alembic Chemicals Works Company vs. CIT** and **Jonas Woodhead and sons India** (3 supra), and the Supreme Court had summarized the tests by reference to various cases earlier.

In the context of the guidance provided in those judgments, we may consider the arguments advanced before us. At this stage, we may note that the CIT Appeals itself did not agree with the views of the assessing officer in entirety and however found that only a small portion of the expenditure could be treated as capital in nature by applying the principles laid down in the case of **Southern Switchgear Limited** (2 supra) whereas the assessee had relied on the judgment reported in a case of **CIT vs. I.A.E.C (Pumps) Ltd** as more appropriate. All the cases ultimately emphasis as a rule, the analysis and proper understanding of the agreement between the parties as providing a correct picture with respect to the aspect as to how a particular expenditure is to be treated. In the case on hand, we had set out the findings as recorded by the Tribunal in the earlier paragraphs. In the present case, there is no challenge to the findings recorded by the Tribunal by raising a question of perversity of a fact. In view of the settled principles of law, the questions raised before us are required to be considered and answered on the facts as found and recorded by the Tribunal.

On the analyses of the agreement, we find that 1) it is termed as a licensing agreement and the parties contemplated the same to be as a licensing agreement. 2) Under the agreement, the assessee (licensee) to get a right and license to use the technical information and the Licensor Germplasm to research and develop, produce and sell products within the India. 3) The assessee gets immunity from legal proceedings with respect to patent rights, if any in India. The assessee acquires documents relating to technical information and with genetic material for maize, sunflower, canola, mustard, sorghum, millet and cotton. Assessee also would get assistance in acquiring appropriate personal, facilities, plant, machinery and equipment for the research, development, production and processing of products by the licensee. Assessee gets the right to use, produce and sell the Germplasm in a specified products by way of sub-license to its affiliates.)

One of the conclusions arrived at by the Tribunal is with regard to whether there is any enduring benefit likely to accrue in favour of the assessee on account of the agreement. This question was answered in the negative by the Tribunal by

reference to the fast changing development in the field of biotechnology. Reliance was also placed on the judgment of the Supreme Court in the case of **Alembic Chemicals Works Company vs. CIT** apart from the judgments in the cases of **CIT vs. Avery India Ltd**, **CIT vs. Kirloskar Tractors Ltd** and **CIT vs. Shriram Bearings Ltd**.

One significant aspect of the agreement is that the assessee is not required to return the licensee's Germplasm, except in the case of termination of the agreement in terms of Article 16 of the Agreement. (Wrongly assumed by the Tribunal as returnable). Article 16 provides for termination of the agreement only in case of the breach of the agreement as set out therein. In other words, the Germplasm which has been supplied to the assessee and the relevant material on multiplication of the same is available for the assessee's use even after the currency of the agreement.

A close reading of the agreement in the present case would disclose that the consideration is paid for acquiring a living organism Germplasm and also for technical know-how. C.I.T (Appeals) had apportioned the same, 1/4th as on capital account and 2/3rd on revenue account. Under the licensing agreement, the products produced or developed with the Germplasm and the technical know-how provided under the agreement are the revenue earning products for the assessee. In other words, they are material or tools in the hands of the assessee for generating the revenue. The agreement is valid for a period of five years from the date of commercial production and eight years from the date of execution. In the sense, the Germplasm is the revenue earning apparatus. The technical knowledge which has been acquired in the process of implementation particularly in the bio-technology field would certainly benefit the assessee even after the expiry of the agreement period and there is no embargo on the assessee for using the expertise and knowledge acquired. Further, by clearly defining 'Licensee Germplasm' and 'Licensor Germplasm' and setting out a right to access the 'Licensor's' improvements during the currency of the agreement the agreement has ensured the benefits of research, development and improvements to the Licensee, the assessee. Further, in terms of Article 8 of the agreement, Licensor to have access to the Licensee's improvements but subject to payment of consideration in terms of Article 5.1(d) of the Agreement. These clauses viewed in the context of the intention of the parties would certainly point out that both the parties intended to benefit for a

considerable period of time out of the relationship emanating from the agreement. Even though in the Bio-technology field changes are likely to happen in fast phase, the assessee still has the benefit of the same in view of the dynamic nature of the agreement entered into between the assessee and the technology provider. This in our considered view is a distinct and distinguishing factor, which would benefit the assessee giving an enduring benefit to the assessee. In that view of the matter, the judgment of the Supreme Court in **Alembic Chemicals Case** (5 supra) is distinguishable. In that view of the matter, apportioning a part of the expenditure in the nature of a capital expenditure by the CIT Appeals cannot be termed as erroneous. This single distinguishing factor is sufficient to answer the Question No.1 in favour of the revenue and against the assessee.

Accordingly, the Question No.1 is answered in favour of the revenue and against the assessee.

So far as the Question No.2 that is amount of royalty is concerned, it is agreed to be paid by the assessee and the same needs to be treated as revenue expenditure particularly considering the fact that the same is linked to the percentage of consideration received on sale of the products produced by the assessee by use of the Germplasm and with the help of the technical know-how.

Accordingly, the Question No.2, is answered in favour of the assessee and against the revenue.

With the above observations, the appeal is disposed of. No order as to costs.

Miscellaneous petitions, if any pending in this appeal, shall stand closed.

G. CHANDRAIAH,J

Date:09.10.2015.

Note:

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THE HONB'E SRI JUSTICE G. CHANDRAIAH

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Date:09.10.2015.