®

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 07TH DAY OF OCTOBER 2015

PRESENT

THE HON'BLE MR.JUSTICE VINEET SARAN

AND

THE HON'BLE MR.JUSTICE B MANOHAR

ITA No.766 OF 2009 c/w ITA Nos.769/2009, 1046/2008, 765/2009 & 767/2009

IN ITA No. 766/2009 C/w ITA Nos.769/2009, 765/2009 & 767/2009 AS COMMON APPEALS:

BETWEEN:

1. The Commissioner of Income-tax,
   C.R.Building, Queens Road,
   Bangalore

2. The Income-Tax Officer,
   Ward-11(1), C.R.Building,
   Queens Road, Bangalore

...Appellants

(By Sri.K.V.Aravind, adv A/w Sri. G.Kamaladhar, adv.,)

AND:

M/s. AMCO Power Systems Ltd.,
(now known as M/s. AMCO Soft India Ltd.,)
Hebbal-Bellary-Jakkur Road,
Byatarayanapura, Bangalore – 560 092.

...Respondent

(By Sri. A.Shankar & M.Lava, advs.,)

These ITAs are filed U/S 260-A of IT Act, 1961 arising out of order dated: 10.07.2009 passed in ITA No.172/BNG/2009, for the Assessment Year 2001-02 in ITA No.766/2009; ITA No.170/BNG/2009, for the Assessment Year 1999-2000 in ITA No.769/2009; ITA No.173/BANG/2009, for the Assessment Year 2002-03 in ITA No.765/2009; & ITA No.171/BNG/2009, for the Assessment Year 2000-01 in ITA No.767/2009 praying that this Hon'ble Court may be pleased to:

i. Formulate the substantial questions of law stated therein,

ii. Allow the appeal and set aside the order passed by the ITAT Bangalore in ITA No.172/BNG/2009, dated: 10.07.2009 in ITA No.766/2009; ITA No.170/BNG/2009 in ITA No.769/2009; ITA No.173/BANG/2009 in ITA No.765/2009; & ITA No.171/BNG/2009 in ITA No.767/2009 confirming the order of the Appellate Commissioner and confirm the order passed by the Income Tax Officer, Ward-11(1), Bangalore in the interest of justice and equity.

IN ITA No.1046/2008:

BETWEEN:

1. The Commissioner of Income-tax,
   C.R.Building, Queens Road,
   Bangalore

2. The Income-Tax Officer,
   Ward-11(1), C.R.Building,
   Queens Road, Bangalore

...Appellants

(By Sri. Jeevan.J.Neeralgi, Adv.,)

AND:

M/s.AMCO Power Systems Ltd.,
(now M/s. AMCO Soft India Ltd.,)

Hebbal-Bellary-Jakkur Road,
Bangalore – 560 092.

...Respondent

(By Sri. A.Shankar & M.Lava, advs.,)

This ITA is filed U/S 260-A of I.T Act, 1961 arising out of Order dated: 13.06.2008 passed in ITA No.889 & 896/BNG/2007, for the Assessment Year 2003-04, praying that this Hon'ble Court may be pleased to:

i. Formulate the substantial questions of law stated therein,

ii. Allow the appeal and set aside the order passed by the ITAT Bangalore in ITA No.889 & 896/BNG/2007, dated 13.06.2008 confirm the orders of the Appellate Commissioner and confirm the order passed by the Income tax officer, Ward-11(1), Bangalore in the interest of justice and equity.

These ITAs coming on for hearing this Day, ***VINEET SARAN J.*** delivered the following:

JUDGMENT

The present appeals are filed by the Revenue against the order of the Tribunal for the assessment years 1999-2000, 2000-01, 2001-02, 2002-03 & 2003-04. One question is common in all the appeals and other question is related to the assessment year

2003-04 alone, for which, ITA No.1046/2008 has been filed. As such, we shall treat ITA No.1046/2008 as the leading case, in which both the questions have been raised.

2. The respondent-assessee M/s.AMCO Power Systems Limited is a Company engaged in the manufacture and sale of storage batteries. By an agreement dated 01.03.1998 between M/s.AMCO Batteries Limited (for short **'ABL'**) and the respondent-assessee-M/s. AMCO Power Systems Limited (for short **'APSL')**, the former had agreed to transfer the technical know-how and grant of non-exclusive license with effect from 01.03.1998 to the respondent-assessee to manufacture and sell Pocket Plate Nicad Batteries on payment of lumpsum consideration of Rs.5.00 crores for the licence and right to use the technology. According to the said agreement, the payment was to be made as per the following schedule:

1.	Before 31/5/1998	Rs. 10 lakhs
2.	Before 31/5/1999	Rs. 25 lakhs
3.	Before 31/5/2000	Rs. 25 lakhs
4.	Before 31/5/2001	Rs. 25 lakhs
5.	Before 31/5/2002	Rs. 25 lakhs
6.	Before 31/5/2003	Rs. 100 lakhs
7.	Before 31/5/2004	Rs. 100 lakhs
8.	Before 31/5/2005	Rs. 100 lakhs
9.	Before 31/5/2006	Rs. 90 lakhs

3. However, admittedly the payment for the entire consideration was not made by the assessee-APSL to ABL strictly as per the schedule but according to the details given herein below:

i.	31/05/1998	Rs.	10,00,000
ii.	01/09/1999	Rs.	50,00,000
iii.	16/03/2002	Rs.	5,00,000
iv.	31/03/2002	Rs.	40,00,000
v.	25/04/2002	Rs.	5,00,000
vi.	17/01/2003	Rs.	5,00,000
vii.	03/04/2004	Rs.	30,000
viii.	13/04/2004	Rs.	1,60,000
ix.	13/07/2004	Rs.	1,00,000
x.	27/07/2004	Rs.	2,00,000
xi.	06/09/2004	Rs.	3,00,000
xii.	10/12/2004	Rs.	5,00,000
xiii.	09/03/2005	Rs.	10,000
xiv.	31/01/2006	Rs.	3,72,00,000
	Total	Rs.	5,00,00,000

4. For the assessment year 2003-04, the facts of which are alone being considered in this appeal, the respondent-assessee filed its return of income on 28.11.2003 wherein NIL income was shown after setting off losses brought forward from earlier years. The said return of income was processed under Section 143(1) of the Income Tax Act, 1961 (hereinafter referred to as '***the Act***' for short) and accepted on 06.02.2004. Subsequently, the case of the assessee relevant to assessment year 2003-04, was taken up for scrutiny and assessment under Section 143(3) of the Act, which was completed on 28.02.2006 and the income of the assessee for the said year was determined at Rs.1,34,03,589/-. This was done so, primarily because the deduction under Section 35AB of the Act, as claimed by the assessee, was disallowed and the lease rentals paid were also disallowed. The said assessment order also did not allow the setting off of losses of the previous years by invoking Section 79 of the Act.

5. Similarly, for the earlier four assessment years 1999-2000, 2000-01, 2001-02 and 2002-03, the case of the assessee was reopened under Section 147/148 of the Act and the benefit granted in such years under Section 35AB of the Act was disallowed. However, because of limitation, the assessment for the assessment year 1998-99, in which also the benefit of Section 35AB of the Act had been claimed and granted, could not be reopened.

6. Aggrieved by the order of assessment passed under Section 143(3) of the Act, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals) for the assessment year 2003-04, primarily on two grounds:– (1) disallowance of Rs.83,33,333/- (being 1/6th of Rs.5.00 crores claimed as deduction under Section 35AB of the Act) in respect of the expenditure incurred for acquiring technical know-how; (2) denial of set-off of brought forward business loss on the ground

that the provisions of Section 79(a) of the Act are not complied. By an order dated 09.03.2007 passed by the Commissioner of Income Tax (Appeals), the appeal of the respondent-assessee was partly allowed and benefit of deduction claimed under Section 35AB was granted; but respondent-assessee was not found to be entitled to set-off of the brought forward losses, considering the change in beneficial holding of 51% or more, as provided under Section 79 of the Act.

7. Being aggrieved by the order of the Commissioner of Income Tax (Appeals), the assessee as well as Revenue, both filed appeals before the Income Tax Appellate Tribunal, Bangalore, Bench-B. (hereinafter referred to as ***'the Tribunal'*** for short). The assessee challenged disallowance of the benefit claimed regarding set-off of brought forward losses, whereas the Revenue filed an appeal challenging the grant of deduction under Section 35AB of the Act to the

assessee. The assessee had also challenged the disallowance of lease rentals paid by it to the extent of Rs.2,08,080/-. The Tribunal, however dismissed the appeal of the Revenue, and partly allowed the appeal of the respondent-assessee by allowing the benefit of set-off of brought forward losses, but did not give the benefit of lease rentals paid by the assessee. Challenging the said order of the Tribunal, the Revenue has filed this appeal raising two substantial questions of law, which, by consent of learned counsel for the parties are re-framed as under:

> *1. "Whether the Tribunal was correct in holding that the assessee would be entitled to carry forward and setoff of business loss despite the assessee not owning 51% voting powers in the company as per Section 79 of the Act by taking the beneficial share holding of M/s. Amco Properties & Investments Ltd.,?*
>
> *2. Whether the Appellate Authorities were correct in holding that the assessee would be*

entitled to claim deduction in accordance with Section 35AB of the Act in respect of the sum of Rs.5 crores for transfer of technical know-how, which amount was payable in installments between 31.5.1998 to 31.5.2006?"

8. In ITA No.1046/2008 relating to the assessment year 2003-04, both the questions are raised, whereas in the remaining appeals relating to other assessment years, it is only the second question that has been raised.

9. We have heard Sri.Jeevan J Neeralgi and Sri.K.V.Aravind, learned counsel for the Revenue in all the appeals; and Sri.A.Shankar, learned counsel appearing for the respondent-assessee in all the appeals, and have perused the records.

10. **Question No.1**:

This question relates to whether the respondent-assessee would be entitled to carry forward and set-off

of business losses even though, as per the Revenue, the voting power of the respondent had been reduced below 51% of the shareholding, and consequently voting power of the respondent Company had reduced to less than 51%.

11. Admittedly, upto the assessment year 2000-01, all the shares of the respondent-Company were held by the ABL. In the assessment year 2001-02, the holding of ABL was reduced to 55% and the remaining 45% shares were transferred to a subsidiary of ABL, namely AMCO Properties and Investments Limited (for short 'the **APIL**'). In the assessment year 2002-03, ABL further transferred 49% of its remaining 55% shares to Tractors and Farm Equipments Limited (for short 'the **'TAFE'**) and consequently ABL retained only 6% shares and its subsidiary APIL held 45% shares and the remaining 49% shares were with TAFE. Similar shareholding continued for the assessment year

2003-04. For easy understanding, shareholdings of the respondent-Company for the relevant assessment years is given in the chart below:

Financial Year	31/3/1999	31/3/2000	31/3/2001	31/3/2002	31/3/2003
Assessment Year	1999-2000	2000-01	2001-02	2002-03	2003-04
Share holding Pattern					
a) ABL	100%	100%	55%	6%	6%
b) TAFE	Nil	Nil	Nil	49%	49%
c) APIL	Nil	Nil	45%	45%	45%

12. The relevant Section 79 of the Act reads as under:

S.79: "Carry forward and set off of losses in the case of certain companies"

Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless-

(a) on the last day of the previous year the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less

than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred.

Provided.....

Provided further .....

(b) [omitted w.e.f. 01.04.1989]

(emphasis supplied)

13. The said Section provides that where there is a change in shareholding of a Company, no loss incurred in any year prior to the previous year shall be carried forward and set-off against the income of the previous year, unless on the last day of the previous year the shares of the Company carrying not less than 51% of the voting power were beneficially held by persons who beneficially held shares of the Company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred.

14. The contention of the learned counsel for the Revenue is that, upto the assessment year 2001-02

there was no dispute that the ABL continued to have 51% or more shares as its shareholding. In the said assessment year, the ABL was holding 55% shares and that its subsidiary APIL was holding 45% shares. For the assessment year 2002-03, when the ABL transferred 49% shares (out of its 55%) to TAFE, then ABL was left with only 6% shares, meaning thereby, it was left with less than 51% shares. It is contended that, consequently its voting power was also reduced from 55% to 6%, and the remaining 94% was divided between TAFE and APIL at 49% and 45% respectively. It is, thus, contended that the Company would hence not be entitled to claim carry forward and set-off of business losses in the assessment years 2002-03 and 2003-04. Learned counsel has submitted that even though the APIL may be wholly owned subsidiary of ABL, but both the companies would be separate entities and cannot be clubbed together. By transfer of its 49% shares to TAFE, the shareholding of ABL was reduced to 6% only,

and the submission thus is that the provisions of Section 79 of the Act would be attracted for denying the benefit of carry forward losses to the respondent-assessee.

15. Per contra, Sri.A.Shankar, learned counsel appearing for the respondent-assessee, has submitted that it is not the shareholding which has to be taken into consideration, but the voting power which was held by a person or persons who beneficially held shares of the Company, and has thus contended that because the ABL was holding 100% shares of APIL, which was a wholly owned subsidiary of ABL and fully controlled by ABL, even though the shareholding of ABL had been reduced to 6%, yet the voting power of ABL remained 51% and as such, the provisions of Section 79 of the Act would not be attracted in the present case.

16. The Tribunal, after accepting the submission of the assessee, held that 51% of the voting power was beneficially held with the ABL during the assessment years 2002-03 and 2003-04 also, and would thus be entitled to carry forward and set-off of business losses for the previous years.

17. The fact that ABL is the holding Company of APIL, which is the wholly owned subsidiary of ABL and that Board of Directors of APIL are controlled by ABL, is not disputed. The submission of the learned counsel for the respondent-assessee that the shareholding pattern is distinct from voting power of a Company, has force. Section 79 of the Act specifies that *"not less than 51% of the voting power were beneficially held by persons who beneficially held shares of the Company carrying not less than 51% of the voting power."* Since the ABL was having complete control over the APIL, which is the wholly owned subsidiary of ABL, in our view, even

though the shareholding of ABL may have reduced to 6% in the year in question, yet by virtue of being the holding Company, owning 100% shares of APIL, the voting power of ABL cannot be said to have been reduced to less than 51%, because together, both the companies had the voting power of 51% which was controlled by ABL.

17. The purpose of Section 79 of the Act would be that benefit of carry forward and set-off of business losses for previous years of a company should not be misused by any new owner, who may purchase the shares of the Company, only to get the benefit of set-off of business losses of the previous years, which may bear profits in the subsequent years after the new owner takes over the Company. For such purpose, it is provided under the said Section that 51% of the voting power which was beneficially held by a person or persons should continue to be held, then only such

benefit could be given to the Company. As we have observed above, though ABL may not have continued to hold 51% shares, but Section 79 speaks of 51% voting power, which ABL continued to have even after transfer of 49% shares to TAFE, as it controlled the voting power of APIL, and together, ABL had 51% voting power. Meaning thereby, the control of the company remained with ABL as the change in shareholding did not result in reduction of its voting power to less than 51%.

18. While dealing with a case under Section 79(a) and (b) of the unamended Section [Clause (b) was deleted w.e.f. 01.04.1988] and while relating to Clause (a) of Section 79 of the Act, the Apex Court in ***Commissioner of Income Tax V/S Italindia Cotton Private Limited*** *(1988) 174 ITR 160 (SC),* held that the Section would be applicable only when there is change in shareholding in the previous year which may result in change of control of the Company and that every

such change of shareholding need not fall within the prohibition against the carry forward and set-off of business losses. In the present case, though there may have been change in the shareholding in the assessment year 2002-03, yet, there was no change of control of the Company, as the control remained with the ABL as the voting power of ABL, along with its subsidiary Company APIL, remained at 51%. The Supreme Court further observed that the object of enacting Section 79 appears to be to discourage persons claiming a reduction of their tax liability on the profits earned in the Companies which had sustained losses in earlier years. In the present case, the control over the Company, with 51% voting power, remained with ABL and, as such, in our view, the provisions of Section 79 of the Act would not be attracted.

19. Accordingly, we answer the first question in favour of the assessee and against the Revenue, and confirm the finding of the Tribunal in this regard.

20. <u>Question No.2:</u>

This question relates to the entitlement of the assessee for grant of deduction under Section 35AB of the Act, in respect of payment of Rs.5 Crores for transfer of technical know-how, which was transferred on 01.03.1998, and as per the agreement, the amount was payable between 31.5.1998 and 31.05.2006; and had actually been paid within time though not strictly as per the instalments provided in the agreement, the details of which have already been given earlier in this order.

21. The submission of learned counsel for the appellant-Revenue is that the benefit can be claimed only when the actual payment is made, and since no payment was made on the date of transfer of the

technical know-how (which was 01.03.1998), as the first payment was made only on 31.05.1998, which was in the financial year 1998-99, the benefit of Section 35AB of the Act could not be availed by the assessee-respondent. It is contended that "paid" for the purpose of Section 35AB of the Act would be as per the definition of "paid" provided in sub-section (2) of Section 43 of the Act, according to which, it would be actual payment made or liability incurred. According to the appellant-Revenue, the liability of the assessee arose on the date when it was responsible/liable to pay as per the agreement, and not on the date of transfer of the technical know-how.

22. Per contra, learned counsel for the respondent-assessee has submitted that the liability to pay would arise on the date of the agreement, when the know-how had been transferred, even though the assessee may be required to pay the amount on a later

date, as per schedule in the agreement. It is contended that the 'liability to pay' is different from the 'liability to discharge such liability' in terms of the contract. It is submitted that the moment the know-how was transferred on 01.03.1998, in terms of the agreement of the same date, the 'liability to pay' arose, and as such, the assessee would be entitled to the benefit of Section 35AB of the Act, as there is no dispute about the fact that the assesseee was following the mercantile system of accounting and not the cash system.

23. For the purpose of deciding the question, the relevant Sections of the Income Tax are: S.**32(1)(ii)** (relating to depreciation); S.**35AB** (relating to expenditure on know-how); S.**43(2)** (relating to definition of paid); and S.**43(B)** (relating to certain deductions to be made on actual payment). The said Sections are reproduced below:

"Depreciation.

S.32(1)(ii) *In respect of depreciation of—*

(i) xxxx

(ii) *know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998, owned, wholly or partly, by the assessee and used for the purposes of the business or profession, the following deductions shall be allowed—*

(i) in the case of assets of an undertaking engaged in generation of generation and distribution of power, such percentage on the actual cost thereof to the assessee as may be prescribed;

(ii) in the case of any block of assets, such percentage on the written down value thereof as may be prescribed.
Provided……"

S.35AB. Expenditure on know- how

(1) *Subject to the provisions of sub- section (2), where the assessee has paid in any previous year [relevant to the assessment year commencing on or before the 1st day of April, 1998] any lump sum consideration for acquiring any know-how for use for the purposes of his business, one- sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years.*

(2) xxxx
(3) xxxx

Definitions of certain terms relevant to income from profits and gains of business or profession

S.43(2): *In sections 28 to 41 and in this section, unless the context otherwise requires-*

(1) *xxxx*

(2) "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head "profits and gains of business or profession"

(3) xxxxx
(4) xxxxx
(5) xxxxx
(6) xxxxx

Certain deductions to be only on actual payment

S.43B *Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of -*

(a) any sum payable …….
(b) any sum payable …….
(c) any sum referred ……
(d) any sum payable…….
(e) any sum payable……
(f) any sum payable…….

shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method

of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum ***is actually paid by him.***

24. The brief history of the law relating to grant of depreciation with regard to know-how may be first explained. Prior to 01.04.1998, know-how was not a depreciable asset. But after 01.04.1998, because of amendment in Section 32 of the Act, know-how is now a depreciable asset. Know-how acquired after 01.04.1998 would be a depreciable asset. For the purpose of this case, it may be noted that know-how was acquired on 01.03.1998, which was prior to 01.04.1998, and hence the assessee would not be entitled to benefit of depreciation. The corresponding amendment was brought in Section 35AB of the Act, wherein it was provided that the benefit of the said Section, which was with regard to expenditure on know-how, would be only when the assessee has paid (as lump sum consideration) for the know-how, prior to 01.04.1998.

Before 01.04.1998, transfer of know-how was treated as a capital expenditure, covered by the provisions of Section 35AB of the Act. After 01.04.1998, by virtue of amendment brought in Section 32 of the Act, treating know-how as a capital asset, depreciation was allowed on the amount spent on transfer of know-how. Intangible assets, such as know-how, patent rights etc., were included for depreciation only after 01.04.1998, which was by the amendment in Section 32 of the Act.

25. In the present case, there is no dispute about the fact that know-how was acquired on 01.03.1998, which was prior to 01.04.1998. It is also not disputed that payment for acquiring such know-how was made only in instalments after 01.04.1998. The question now would be as to whether the benefit of Section 35AB of the Act would be available to the assessee, which provides that if the assessee has, prior to 01.04.1998, paid any lumpsum consideration for

acquiring the know-how, then 1/6th of the amount so paid shall be deducted in computing the profits and gains of the business for that year and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding years.

26. For this, we have to analyze what would the word "paid" mean in the context of the present case. Sub-section(2) of Section 43 of the Act defines "paid" to mean as 'actually paid' or 'incurred'. 'Actually paid' would be as per the cash system of accounting, and 'incurred' would be for the mercantile system of accounting. Admittedly, the assessee was following the mercantile system of accounting. The crucial word thus would be "incurred". According to the appellant-Revenue, the assessee would incur such liability to pay only as per the schedule given in the agreement, which was between 31.05.1998 and 31.05.2006. It is contended that the dates given in the schedule would be

the relevant dates, as it was only when payment was not made (as per the schedule) that the assessee could be said to have become liable for making payment. According to the Revenue, the liability to pay would occur or arise on such date due for payment, as per the schedule, and not earlier.

27. Learned counsel for the respondent-assessee has however submitted that the liability to pay would arise on the date when the technical know-how was transferred, which was 01.03.1998; and merely because the payment had been deferred, it cannot be said that the liability had not incurred on such date, as the assessee was following the mercantile system of accounting and not the cash system. Learned counsel has also submitted that 'actual payment' is different from 'incurring of liability to pay'. For this, reliance has been placed on Section 43 B of the Act which provides for certain deductions to be given only on actual

payment even in case of accounts being maintained as per mercantile system, meaning thereby that the Statute also recognizes there is a difference between the 'actual payment' and 'incurring of liability to pay'.

28. Liability to pay would also be different from due for payment or due for disbursement. Once the know-how has been transferred, meaning thereby, it has been acquired by the assessee and the assessee has started using the know-how, it would become liable to pay on such date of transfer of know-how, even though the payment for the same may be due on a deferred date.

29. The payment, in the present case, had been deferred to such dates as provided in the agreement, which have been reproduced herein above. The Act itself contemplates certain deductions to be given only on 'actual payment' (as in case of Section 43B), even in

case where mercantile system of accounting is followed. Such is not the case for Section 35AB, where "paid" has to be considered in terms of the definition provided under sub-section(2) of Section 43 of the Act, which, provides for actually paid or incurred the liability to pay. The moment there is liability to pay, which in our opinion, would be on the date of transfer of the technical know-how, the provisions of Section 35AB would be attracted.

30. In the present case, for the assessment year 1998-99, such benefit was given and has not been withdrawn. However, for the subsequent four years i.e., for assessment years 1999-2000, 2000-01, 2001-02, 2002-03, the cases have been re-opened, and the benefit which was granted by accepting the return under Section 143(1) of the Act has been withdrawn; and for the assessment year 2003-04 the same was denied by the Assessing Officer itself.

31. In support of their submissions, learned counsel for both parties have relied on the following three decisions of the Apex Court:

i) ***Keshav Mills Ltd. –vs- Commissioner of Income Tax*** *(1953) 23 ITR 230*

ii) ***Morvi Industries Ltd., -vs- Commissioner of Income Tax*** *(1971) 82 ITR 835*

iii) ***Commissioner of Income Tax –vs- Gajapathy Naidu*** *(1964) 53 ITR 114*

32. In the case of ***Keshav Mills (supra),*** in paragraph-13, the Apex Court has held as under:

> *"The mercantile system of accounting or what is otherwise known as the double entry system is opposed to the cash system of book keeping under which a record is kept of actual cash receipts and actual cash payments, entries being made only when money is actually collected or disbursed. That system brings into credit what is due, immediately it becomes legally due and before it is actually received and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed. The profits or gains of the business which are thus credited are not realised but having been earned are treated as received though in fact there is nothing more than an*

> *accrual or arising of the profits at that stage. They are book profits. Receipt being not the sole test of chargeability and profits and gains that have accrued or arisen or are deemed to have accrued or arisen being also liable to be charged for income-tax the assessability of these profits which are thus credited in the books of account arises not because they are received but because they have accrued or arisen"*
>
> *(emphasis supplied)*

It has further been held in paragraph-16 of the judgment that *"it follows from the above that the mercantile system of accounting treats profits or gains as arising or accruing at the date of the transaction notwithstanding the fact that they are not received or deemed to be received and under that system, book profits are assessed as liable to tax".*

33. In our view, the ratio of the decision would go in favour of the assessee and not the Revenue, as the moment a legal liability to pay arises, and before the actual disbursement is made, the assessee has incurred the liability to pay the amount, which, in the present

case, would be on the date of transfer of know-how, which was on 01.03.1998.

34. The observations made by the Apex Court in the case of ***Morvi Industries (supra)*** would also go in favour of the assessee and not the Revenue. In paragraph-12 of the said judgment, it has been observed as follows:

> *"The appellant-company admittedly was maintaining its account according to the mercantile system. It is well known that the mercantile system of accounting differs substantially from the cash system of book keeping. Under the cash system, it is only actual cash receipts and actual cash payments that are recorded as credits and debits; whereas under the mercantile system credit entries are made in respect of amounts due immediately they become legally due and before they are actually received; similarly, the expenditure items for which legal liability has been incurred are immediately debited even before the amounts in question are actually disbursed. Where accounts are kept on mercantile basis, the profits or gains are credited though they are not actually realised, and the entries thus made really show nothing more than an accrual or arising of the said profits at the material time. The same is the position with regard to debits made."*

35. As such, accrual of income would be different from receipt of income and the moment the income accrues, the party gets the vested right to claim such amount and conversely the moment the liability to pay arises, such liability is incurred by the assessee.

36. The ratio in the case of ***Gajapathy Naidu (supra)*** would also go in favour of the assessee as it has been held that *"an income accrues or arises when the assessee acquires right to receive the same"* and it is further held that the mercantile system of accounting *"brings into credit what is due immediately it becomes legally due and before it is actually received; and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed".*

37. In the present case, the assessee, following the mercantile system of accounting, had in its books of

account shown the amount of Rs.5 crores as liable to be paid, or as liability to pay on the date on which it acquired the technical know-how, which was 01.03.1998, as the legal liability had been incurred even before it was actually disbursed.

38. Much emphasis has been laid by learned counsel for the Revenue on the phrase *'lumpsum consideration'* in Section 35AB of the Act. It is contended that the payment, or the incurred liability to pay, should be in lumpsum and if the payment is not made in lumpsum, but in instalments, as in the present case, the benefit of Section 35AB would not be given to the assessee. The said issue was considered by the Jharkand High Court in the case of ***Tata Yodogawa Ltd., -vs- Commissioner of Income-Tax*** *(2011) 335 ITR 53 (Jharkhand)* and in paragraph-16 of the said judgment it was held that "*the word "lumpsum" as used before the word "consideration" in Section 35AB, only*

exclude periodical or turnover based payments like royalty etc., and in one time payment for the know-how would fall within the expression "lumpsum" and if it is fixed and specified in the agreement, although it may be payable in instalments".

39. We are also of the opinion that the expression "lumpsum consideration" used in Section 35AB of the Act, in the facts of the present case, would only mean that the liability to pay the entire amount or "lumpsum consideration" had occurred on the date of the agreement and transfer of know-how, even though the payment may not have been made in lumpsum, but deferred over a period of time.

40. While dealing with the said Section, the Bombay High Court, in the case of ***Commissioner of Income-Tax –vs- Raymond Ltd.,*** *(2012) 71 DTR (Bom) 258,* which was also based on facts similar to the

present case, where *"the second agreement was entered into by the assesseee on 1st October 1993 for acquisition of technical know-how for upgrading agreement was to be valid for three years and a total consideration of US $9,00,000 was payable @ US $ 3,00,000 per year",* it was held that "*the expression "paid" must be understood in the context of the provisions of Section 43(2) which defines it to mean actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head 'Profits and gains of business or profession'. In a judgment of a Division Bench of this Court in Additional Commissioner of Income-tax Vs. Buckau Wolf New Indian Engineering Works Ltd. (1985) 46 CTR (Bom) 200: (1986) 157 ITR 751 (Bom), the issue arose in the context of an agreement under which an assessee was to pay an amount of Rs.1,00,000/- to its German collaborators in annual instalments of Rs.20,000/- and the question which was referred was whether the entire amount of Rs. 1,00,000/-*

represented revenue expenditure deductible while computing the total income of the assessee for the Assessment Year 1967-68. The Division Bench noted that the question which was required to be considered was whether there was accrual of liability in the assessment year, though with a facility of a deferred payment. The Court held that it was an admitted position that the assessee kept its accounts on the basis of the mercantile accounting system, and if the terms of the agreement were construed it would have to be held that the assessee had incurred the entire liability for the payment of Rs.1,00,000/- in the assessment year under consideration though the actual payment was spread over five years. The judgment of the Division Bench also followed a decision of the Supreme Court in Kedarnath Jute Mfg. Co. Ltd. Vs. CIT (1971) 82 ITR 363 (SC) in holding that the issue as to whether the assessee is entitled to a deduction will depend on the provisions under which it is claimed and not on the existence or

absence of entries in the books of account which would not be conclusive or decisive. In the present case, there is a finding that though the payment of the consideration under the agreement dated 1st October 1993 was to take place by installments it would still constitute a lump sum consideration since the amount was fixed and was not variable on the basis of other unforeseen eventualities. The assessee had evidently incurred the liability to pay the entire amount under the agreement dated 1st October 1993. In that view of the matter the finding of the CIT(A) that the assessee would be entitled to a deduction of one-sixth of the entire amount in respect of which the assessee had incurred a liability in the previous year relevant to the Assessment Year in question is correct. The finding is also justified having regard to the meaning of the expression "paid" in Section 43(2)".

41. In ***Bharat Earth Movers –vs- Commissioner of Income Tax*** *(2000) 245 ITR 428 (SC)*,

the Supreme Court has categorically held that "*if a business liability has arisen in the accounting year, the deduction should be allowed even if such liability may have to be quantified or discharged at a future date*".

42. In a recent judgment of ***Taparia Tools Ltd. –vs- Joint Commissioner of Income Tax*** *(2015) 372 ITR 605 (SC)*, the Supreme Court was dealing with a case where the assessee-Company had given two options to the debenture holders, to either receive interest periodically, or to opt for one time upfront payment of Rs.55 per debenture. In such facts, the Apex Court held that *"the moment the second option was exercised by the debenture holder to receive the payment upfront, the liability of the assessee to make the payment in that very year, on exercising of this option, has arisen and this liability was to pay interest at Rs.55 per debenture."* While considering the definition "paid" in sub-section(2) of Section 43 of the Act, it was held that

"even if the amount is not actually paid but 'incurred', according to the method of accounting, the same would be treated as 'paid' ".

43. In the facts of the present case and in light of the law laid down in the aforesaid case, we are of the opinion, that the assessee would be entitled to claim deduction in accordance with Section 35AB of the Act in respect of sum of Rs.5 Crores for transfer of technical know-how, even though the amount was payable and paid in instalments on subsequent dates. This we say so, also because the law is well settled that while interpreting the provisions of taxing statutes, where two views are possible, the one which is in favour of the assessee should be adopted.

44. As such, for the forgoing reasons, we answer question No.2 also in favour of the assessee.

45. Consequently, both the questions of law are answered in favour of the assessee and against the Revenue and the appeals are, accordingly, ***dismissed.*** No order as to costs.

Sd/-
JUDGE

Sd/-
JUDGE

Mpk/TL