IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 03.08.2020

CORAM

THE HONOURABLE **DR. JUSTICE ANITA SUMANTH**

W.P. No.27359 of 2019
and
WMP. Nos.26800/2019 & 7107/2020

International Flavours Fragrances
India Pvt Ltd Rep by its Director P.Ramprasad
1-5 Seven Wells Street St.Thomas Street,
Chennai-600 016. .. Petitioner

Vs.

1 The Joint Commissioner
LTU Chennai Wanarpathy Block 121 Mahatma
Gandhi Road Chennai

2 The Assistant Commissioner
of Income Tax LTU Chennai Wanarpathy Block
121 Mahatma Gandhi Road Chennai

3 The Deputy Commissioner
of Income Tax LTU-2 Chennai 1775 Jawaharlal
Nehru Inner Ring Road Anna Nagar West
Extension Chennai - 600 101. .. Respondents

Prayer: Writ Petition filed under Article 226 of the Constitution of India praying to Writ of **Certiorari** to call for the records in Notice No.ITBA/ AST/ S/ 148/ 2018-19/ 1015475668(1) dated 28.03.2019 on the file of 1st Respondent and consequential Order No.ITBA/ AST/ F/ 17/ 2019-20/ 1017568340(1) dated 26.8.2019 on the file of the 2nd Respondent herein and to quash the same.

For Petitioner : Mr.Srinath Sridevan

For Respondent : Mrs.Hema Muralikrishnan
Senior Standing Counsel

O R D E R

The petitioner challenges an order dated 26.08.2019 rejecting the objections to assumption of jurisdiction to re-assess the income of the petitioner under the provisions of the Income Tax Act, 1961 (in short 'Act') for the assessment year (A.Y.) 2013-14.

2. Heard Mr.Srinath Sridevan, learned counsel for the petitioner and Mrs.Hema Muralikrishnan, learned Senior Standing Counsel for the respondent.

3. The sequence of relevant dates and events is as follows:

i) For A.Y.2013-14, the petitioner filed a return of income on 28.11.2013. The return was accompanied by necessary annexures, such as the Tax Audit Report in Form 3CB and 3CD, Form No.10CCB and Transfer Pricing Report in Form 3CEB.

ii) The Transfer Pricing Report specifically detailed the royalty paid by the petitioner to International Flavours and Fragrances, USA, an associated enterprise. The complete details in regard to the entity to which the payment had been effected, the class of transaction (manufacture), the amount paid as

per books of accounts and the fact that the same was at arms length and the methodology used for arriving at the Arms Length Price (ALP) being the comparable uncontrolled price method (CUP), were set out.

iii) The return was picked up for scrutiny and notice under Section 143(2) dated 03.09.2014 was issued by the third respondent.

iv) On 19.09.2014, the petitioner responded enclosing all annexures to the return of income.

v) Since the assessment involved transactions inter se the petitioner and its related parties and associated enterprises, the matter was referred to the Transfer Pricing Officer (TPO) for determination of ALP.

vi) The TPO issued notice under Section 92CA(3) dated 30.03.2016 followed by a questionnaire under Section 142(1) dated 15.04.2016.

vii) One of the queries raised inter alia related to the details of international transactions entered into by the petitioner with foreign entities, the nature of income received and expenses along with copies of the relevant agreements and details of tax deducted at source (TDS).

viii) Vide reply dated 29.04.2016, complete details as sought for were provided. The reply of the petitioner at point 4.7 provides a copy of the Intellectual Property Licence Agreement between itself and US entity providing for the payment of royalty and under reply dated 20.05.2016 further details regarding the payments made to Associated Enterprises were supplied.

ix) On 24.06.2016, the details of royalty paid and the impact of the transaction on the profit and loss account was set out.

x) Thereafter, the TPO, vide notice dated 05.10.2016 posted the assessment for completion and sought for various particulars needed for the same.

xi) At point 7 of the aforesaid questionnaire, the details of royalty and management serve charges debited to the profit and loss account and the details of tax deducted on the same were sought.

xii) The TPO also specifically sought an explanation as to why the royalty payment not be treated as capital expenditure and disallowed and in this connection also sought a copy of the agreement copy.

xiii) The petitioner replied on 14.10.2018 wherein at point 12, it states as follows:

> *12. Royalty and Management Fee: Refer Annexure 4. The copy of the agreement for royalty payment is enclosed in Annexure 8. It is submitted that the royalty is payable annually based on a percentage of sale of products vide Emulsions, Cap-lock granules, Spray-dry, Flavour products for the use of technology provided by IFF Inc for the manufacture of the said products. It is a running royalty and not capital in nature and hence is an allowable under section 37 of the Act.*

xiv) The order of TPO came to be passed on 31.10.2016 wherein the royalty paid was also taken into account in computation of ALP and a downward adjustment was recommenced in the finalization of assessment.

xv) Upon receipt of the order of TPO, an order of draft assessment dated 30.12.2016 was served on the petitioner. Upon consideration of the submissions made by the petitioner vide letter dated 24.01.2017, an order of final assessment came to be passed on 13.12.2017.

4. It is clear on a perusal of the narration above, that the issue relating to payment of royalty, specifically whether such payment should be considered as capital expenditure or revenue expenditure had been considered by the Officer and duly taken into account in framing the Transfer Pricing Order as well as the order of assessment.

5. The order of assessment dated 13.02.2017 specifically notes the adjustment recommended by the TPO wherein reference had been made to payment of royalty as well. The proceedings for re-assessment challenged in this Writ Petition should be seen in the context of the narration above.

6. After completion of assessment on 13.02.2017, the petitioner received a notice under Section 148 on 28.03.2019, five years from the end of the assessment year in question. The assumption of jurisdiction by the Assessing Officer came to be questioned by the petitioner in line with the procedure set out by the Supreme Court in *GKN Driveshafts (India) Ltd. V. Income Tax Officer* (259 ITR 19) after it filed a return of income and sought reasons on the basis of which the re-assessment had been initiated.

7. The reasons dated 30.07.2019 supplied by the Officer are as follows:

Subject:- Reasons for Re-opening of Assessment – furnishing of – Reg.

It is seen from the M.R. for the AY 2013-14 that the assessee company (Licencee) has paid an amount of Rs.1,35,14,620/- to M/s.International Flavours & Fragrances INC, New York (IFFFUSA) towards royalty and claimed it as revenue expenditure. It is seen from the Intellectual Property Licence Agreement entered into between the assessee company and IFF USA that the licensor (i.e.IFF USA) is the owner of certain intellectual property relating to the development, manufacture, marketing promotion and distribution and/or sale of the products and both the parties have agreed that the licensor desires to grant licencee (i.e. the assessee company) to utilize such intellectual property in connection with the development, manufacture, marketing promotion and distribution and/or sale of the products and licensee desires to pay royalty in exchange. As per the agreement, the intellectual Property shall mean and include all technical information, date, know-how processes, procedures, consumer insights, methods, flow charts, drawings, formulae, specifications, designs, process technology, patents, patent applications and patent disclosures etc.

In this connection, it is observed that as per the agreement entered into with IFF USA, the assessee is having a right to manufacture and sell the products in India using the licensed technology provided. Thus, a right has been conferred on the assessee for manufacturing and selling the products and the royalty payment was towards technical information provided by the licensor in respect of manufacturing methods of the products and the right was granted to the assessee company to manufacture and sell the products. Thus, an asset in the form of commercial right has been acquired by the Assessee which gives the assessee an enduring benefit and also exclusive advantage to assessee's business. Thus, royalty payments should be treated as capital expenditure and after allowing eligible depreciation (@ 25% on Rs.1,35,14,620) Rs.33,78,655 balance amount claimed as revenue expenditure to the tune of Rs.1,01,35,965 needs to be disallowed.

Excess deduction claimed: Rs.1,01,35,965

8. Proceedings for re-assessment initiated beyond four years from the end of the relevant assessment year have to satisfy the added condition set out in the proviso to Section 147 of the Act. Normally, the time limit for initiation of re-assessment is four years from the end of the subject assessment year with an extended period of two years provided to the Department conditional upon the Department establishing that the alleged escapement of income was attributable

to the failure of the assessee to file a return or to make a full and true disclosure of its income for the relevant period.

9. In the present case, the petitioner has filed a return of income in time and thus the only condition to be satisfied would be whether the alleged escapement of income is on account of the failure of the petitioner to make a full and true disclosure of its income at the first instance.

10. The reasons for re-assessment are premised upon the classification of the royalty paid by the assessee being 'capital' in nature, as against the claim of it being 'revenue' in nature, by the assesssee/petitioner. All details relating to the payment of royalty have been supplied by the assessee commencing from the disclosures in the annexures to its return of income Queries and responses specific to the aforesaid issue were exchanged between the petitioner on the one hand and the TPO and Assessing Officer on the other. Supporting evidences for the petitioners' claim that the royalty was running royalty and thus revenue in nature was also filed. This issue has engaged the attention of the respondents since the TPO has specifically raised a query with regard to the classification of royalty as capital vis-a-vis revenue and sought an explanation in this regard.

11. The relevant details being on record and having engaged the attention of the officers of the Department, this is not a case where the alleged

escapement can be attributed to any failure on the part of the assessee/petitioner.

12. A perusal of the reasons extracted elsewhere in this order only referred to the issue of classification of royalty on merits and nowhere it is stated that there has been any failure by the petitioner in making a disclosure in this regard. To be fair to the Assessing Officer, he does not even make such allegation in the reasons for re-assessment and rightly so, since the material available would show a full disclosure by the petitioner at all stages of assessment.

13. Thus I am of the view that the impugned order dated 26.08.2019 rejecting the objections to assumption of jurisdiction is liable to be quashed and I do so.

14. For the sake of completion, I may refer to the judgment of the Hon'ble Supreme Court in the case of *The Parashuram Pottery Works Co. Ltd. V. The Income Tax Officer, Circle – I, Ward 'A', Rajkot, Gujarat* (106 ITR 1), wherein the Supreme Court, taking a cue from the decision of the Privy Council in *Compania General de Tabacos v. Collector of Internal Revenue,* (275 U.S. 87 (1927)) has categorically stated that the hallmark of a civilized society is one that allows stale issues to rest without feeling the need to rake the same up repeatedly. The relevant portion of the judgment reads as follows:

‘ At the same time, we have to bear in mind that the policy of law is that there must be a point of finality in all legal proceedings, that state issues should not be reactivated beyond a particular stage and that lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity. So far as income-tax assessment orders are concerned, they cannot be reopened on the scope of income escaping assessment under section 147 *of the Act of 1961 after the expiry of four years from the end of the assess- ment year unless there be omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment. As already mentioned, 'this cannot be said in the present case. The appeal is conse- quently allowed; the judgment of the High Court is set aside and the impugned notices are quashed ‘*

15. This writ petition is allowed. No costs. Connected Miscellaneous Petitions are closed.

03.08.2020

Index:Yes
Speaking order
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Dr.ANITA SUMANTH, J.

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