IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 20TH DAY OF NOVEMBER 2020

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE H.T.NARENDRA PRASAD

I.T.A. NO.101 OF 2016

BETWEEN:

M/S. TELCO CONSTRUCTION CO. LTD.,
(NOW KNOWN AS TATA HITACHI
CONSTRUCTION MACHINERY CO. PVT. LTD)
45, JUBILEE BUILDING, MUSEUM ROAD
BANGALORE-560025
REP. BY ITS MANAGING DIRECTOR
SRI. SANDEEP SINGH
AGED ABOUT 55 YEARS
S/O SRI. JOGINDER
SINGH JOGI.

... APPELLANT

(BY SMT. JINITHA CHATTERJEE, ADV., FOR
SRI. S. PARTHASARATHI, ADV.,)

AND:

THE ASST. COMMISSIONER
OF INCOME-TAX, CIRCLE-12(4)
NO.14/3, 4TH FLOOR
RASTROTHANA BHAVAN
(OPP. RBI), NRUPATHUNGA ROAD
BANGALORE-560001.

... RESPONDENT

(BY SRI. K.V. ARAVIND, ADV.)

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THIS ITA IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 23.09.2015 PASSED IN ITA NO.667/BANG/2014 FOR THE ASSESSMENT YEAR 2008-09, PRAYING TO:

(I) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED ABOVE.

(II) ALLOW THE APPEAL AND SET ASIDE THE ORDER OF THE ITAT DATED 23.09.2015 BEARING ITA NO.667/BANG/2014 FOR THE ASSESSMENT YEAR 2008-09 WITH REGARD TO UPHOLDING OF DISALLOWANCE OF ROYALTY PAYMENT BY THE ASSESSING OFFICER. PASS SUCH OTHER SUITABLE ORDERS AS THIS HON'BLE COURT DEEMS FIT TO GRANT ON THE FACTS AND CIRCUMSTANCES OF THE CASE IN THE INTEREST OF JUSTICE AND EQUITY.

THIS ITA COMING ON FOR HEARING, THIS DAY, **ALOK ARADHE J.**, DELIVERED THE FOLLOWING:

JUDGMENT

This appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the Act for short) has been preferred by the assessee. The subject matter of the appeal pertains to the Assessment year 2008-09. The appeal was admitted by a bench of this Court vide order dated 10.08.2016 on the following substantial question of law:

> *(i) Whether the royalty payment for user of technical know-how and intellectual property rights along with the right to manufacture for a temporary period was required to be considered as revenue*

expenditure and to be allowed under Section 37(1) of the Act.

(ii) Whether the Tribunal was right in upholding the view of the assessing officer that the expenditure towards royalty was a capital expenditure as the user of rights by way of know-how, intellectual property had resulted in enduring benefit to the Appellant when there was no acquisition of any capital asset.

2. Facts leading to filing of this appeal briefly stated are that the assessee is a company engaged in the business of manufacture, purchase and sale of hydraulic excavators, loaders, mechanical shovels, cranes and spare parts thereof. The assessee filed its return of income on 29.09.2008 for the Assessment Year 2008-09 declaring total income of Rs.483,41,12,190/-. The assessee claimed deduction on account of payment of royalty made by it to M/s Hitachi Construction Machinery Company Private Limited, Japan at the rate of 1% of the net factory

selling price to the extent of Rs.91,06,005/- under Section 37(1) of the Act. The aforesaid amount was paid for use of technical know-how and grant of rights for manufacture of Hitachi licence products, which included intellectual property. It is the case of the assessee that the aforesaid amount has been used for the purposes of business of the assessee and therefore, the claim for deduction under Section 37(1) of the Act is permissible.

3. The Assessing Officer made an instruction by visiting the manufacturing and research and development units of the assessee at Telcon premises at Jamshedpur in the State of Jharkhand and was of the opinion that know how including intellectual property of Hitachi Construction Machinery Company Private Limited was used in 6 models to develop and indigenize the products to suit the Indian market. It was held that as per the agreement between the parties, there was no payment in lumpsum and royalty was payable at the rate of 1% of the net factory selling price and the

royalty was required to be paid in respect of each of new Hitachi licence products sold by the assessee for a period of 7 years from the date of commencement of commercial production or ten years from the execution of the agreement, whichever is earlier. The Assessing Officer by an order dated 30.12.2011 inter alia concluded that the payment was made for acquiring a right, which provided enduring benefit and held that the same was a capital expenditure, which creates acquisition of right in the use of technical know-how and grant of rights for manufacture of licence, which include intellectual property. Accordingly, the claim of deduction under Section 37(1) of the Act was disallowed.

4. The assessee thereupon filed an appeal before the Commissioner of Income Tax (Appeals) who by an order dated 14.02.2014 inter alia held that the very fact that royalty payment is a percentage of sales clarifies that the nature of expenses is revenue as the link to the actual sales, which determines the quantum

of payment. It was also held that the assessee under no circumstances would be in a position to transfer the rights. Thus, the Commissioner of Income Tax (Appeals) held that the assessee is entitled to allowance of deduction of Rs.91,06,005/- as the same is revenue expenditure under Section 37(1) of the Act.

5. The revenue thereupon filed an appeal before the Income Tax Appellate Tribunal (hereinafter referred to as 'the tribunal' for short). The tribunal by an order dated 23.09.2015 inter alia held that the rights obtained for manufacture of licence products and also user of technical know-how and intellectual property which was provided to the assessee would give an enduring benefit to the assessee and therefore, the expenditure should be held as capital expenditure. Accordingly, the order passed by the Commissioner of Income Tax (Appeals) was reversed and the order passed by the Assessing Officer was restored. In the aforesaid factual background, the assessee has filed this appeal.

6. Learned counsel for the assessee submitted that assessee is an existing manufacturing unit and no new unit was set up for manufacturing a new product after obtaining the licence to use the technical know-how from the Hitachi. It is further pointed out that the aforesaid fact was verified by the Assessing Officer as well as Commissioner of Income Tax (Appeals) and it was not disputed by the tribunal. It is also pointed out that in terms of the technology licence agreement executed by the assessee for a limited period of using technical know-how for a period of seven years and taking into account the fact that the payment was based on percentage of net sale, the same ought to have been treated as revenue expenditure and not capital expenditure as there was no transfer of rights on the product / technical know-how and therefore, the licence to use the technical know-how could not have been treated as capital asset. It is also urged that the payment of royalty made by the assessee do not fall

within the purview of capital asset as defined under Section 2(14) of the Act. It is also contended that rights are to be considered as capital asset only in case of an Indian company, whereas, in the instant case, the company with whom the assessee had entered into an agreement was not an Indian Company but was a company governed by the laws of Japan. It is also submitted that tribunal failed to appreciate that every licence obtained on which royalty was being paid, there was an enduring benefit, but the same did not result in any acquisition of any capital asset to consider the expenditure as capital expenditure. In support of aforesaid submissions, reliance has been placed on the decisions in ***'CIT VS. CIBA OF INDIA LTD.', 69 ITR 692, CIT VS. I.A.E.C. (PUMPS) LTD', 232 ITR 316, 'PCIT VS. WESTERN AGRI SEEDS LTD', 'CIT VS. J.K.SYNTHETICS LTD.', 309 ITR 371, 'CLIMATE SYSTEMS INDIA LTD. VS. CIT', 319 ITR 113, 'CIT VS. ASHOKA MILLS LTD', 218 ITR 526, CIT VS.***

HERBALIFE INTERNATIONAL INDIA PVT. LTD.', ITA NO.3/2009 and ***'CIT VS. LUWA INDIA LTD', 75 DTR 367.***

7. On the other hand, learned counsel for the revenue submitted that the assessee came into existence by virtue of technical licence agreement and therefore, payment under the agreement is capital expenditure. In this connection, our attention has been invited to Clause (b) as well as Clauses 2.1 and 2.2 of the agreement. It is also pointed out that the know how remains with the assessee even after the expiry of the royalty period and there is no obligation under the agreement to return the same. It is argued that the amount of royalty paid by the assessee is capital expenditure and know how provided under the agreement is acquisition of intangible asset having enduring benefit and the finding of the tribunal is based on appreciation of material available on record and the assessee has neither pleaded nor has proved any

perversity in the finding recorded by the tribunal, which is a finding of fact. In support of aforesaid submissions, reliance has been placed on decision of the Supreme Court in ***'HONDA SIEL CARS INDIA LTD. VS. COMMISSIONEROF INCOME-TAX, GHAZIABAD', (2017) 82 TAXMANN.COM 212 (SC).***

8. We have considered the submissions made by learned counsel for the parties and have perused the record. Section 2(14) of the Act defines the expression capital asset to mean property of any kind held by an assessee whether or not connected with his business or profession. Section 2(14) defines the expression 'capital asset' exhaustively. An explanation is appended to Section 2(14), which provides that for removal of doubts it is hereby clarified that property includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever. The aforesaid explanation is inclusive and explains the

meaning of the property and in no way restricts the meaning of the expression 'property'. Section 37(1) of the Act provides for deduction of any expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purposes of business or profession shall be allowed in computing the income chargeable under the head 'profits and gains of business or profession'.

9. It is well settled in law that distinction between capital and revenue expenditure with reference to acquisition of technical information and know-how has been spelled out in various cases and the primary test to ascertain whether a expenditure is a capital expenditure or revenue expenditure is the same viz., enduring nature test, which means where the expenditure is incurred which gives enduring benefit, it will be treated as capital expenditure. The aforesaid view has been taken by Ciba India Ltd. supra and

aforesaid principle was reiterated in Honda Siel Cars India Ltd. supra.

10. In the instant case, before proceeding further it is apposite to take note of the relevant clauses of the Technical Licence Agreement viz., Clause (b), Clause 1.13, 2.2, 2.4, 11.1, 15.2, and 24.1, which is reproduced below for the facility of reference:

> *(b) Telcon is a Joint Venture of Hitachi and Tata Motors Limited (formerly known as Tata Engineering and Locomotive Company Limited and hereinafter referred to as "Tata Motors") and has been set up with the object of engaging in the manufacture, marketing and servicing of the Hitachi licence products and Telcon's products.*
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> *1.13* ***"Technical Know-How"*** *shall mean product information, drawings, manufacturing procedure and methods, technical documentation and other technical information owned by or available with or to Hitachi, relating but not limited to*

manufacture, quality standards, functional tests, inspection and servicing of Hitachi Licence Products and shall include all intellectual property in relation thereto.

2.2 Subject o the terms and conditions of this agreement, Hitachi hereby grants to Teclcon, an exclusive but non-transferable licence, to manufacture and / or assemble the Hitachi Licence Products within the territory using technical know-how furnished by the Hitachi pursuant hereto and to sell or otherwise dispose of the Hitachi Licence Products, in the manner specified below.

2.4 Hitachi License Products manufactured by Telcon shall be sold only under the trade name / brand name of "Tata-Hitachi" in India. Telcon shall not use "Hitachi" as part of the trade name /brand name outside India, except with the prior written consent of Hitachi. Telcon shall, if required, enter into separate trade mark license agreements for the use by Telcon of the "Hitachi" and "Tata" trade / brand name and trade marks, upon terms and conditions

(including payments, if any) acceptable to the respective owners thereof.

11.1 Telcon shall start commercial product of specific Hitachi licence products within an agreed time frame and in any event, subject to receipt by Telcon of the technical know-how within the time periods specified in Article 3.1 above, no later than three years from the Effective date.

15.2 Royalty, as above, shall be applied to each new Hitachi licence products sold by Telcon, for either a period of seven (7) years from the date of commencement of commercial production of such product, or ten (10) years from the execution of this agreement, whichever is earlier (hereinafter referred to as 'the Royalty Period.")

24.1 Unless terminated in the manner hereinafter provided, the term of this agreement for a Hitachi Licence Product, shall be the period commencing from the Effective date and ending on expiry of eleven years from the date of commencement of

commercial production thereof. Accordingly, notwithstanding the expiry of the Royalty Period, Telcon shall be entitled to continue the manufacture and sale of the Hitachi License Products for the aforesaid term of this agreement.

11. Thus, from perusal of the relevant clauses of the agreement, it is clear that the assessee is a joint venture company and under the agreement has been granted non transferable licence to manufacture / assemble the Hitachi licence products within the territory using technical know-how furnished by Hitachi and to sell otherwise dispose of the Hitachi licence products. The products shall be sold only under the trade / brand name of Tata Hitachi. It is also pertinent to note that even expiry of the 11 years from the date of commercial production, the assessee is entitled to continue the manufacture and sale of Hitachi licence products for the aforesaid term of the agreement. Under the agreement, the assessee has incurred an

expenditure which gives him enduring benefit, therefore, the same has to be treated as capital expenditure. The Assessing Officer as well as the tribunal rightly held that payment of royalty made by the assessee is a capital expenditure and is not a permissible deduction under Section 37(1) of the Act. The findings recorded by the tribunal in this regard are based on meticulous appreciation of evidence on record and by no stretch of imagination can said to be perverse.

In view of preceding analysis, the substantial questions of law framed by a bench of this court are answered against the assessee and in favour of the revenue. In the result, the appeal fails and is hereby dismissed.

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