Reportable

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

{ ITA 16 of 2008,ITAs 1011/2007, 107/2009, 293/2010, 840/2010 & 839/2010}

% Judgment Reserved on:14th September, 2010
Judgment Pronounced on : 08th October, 2010

(1) ITA 16 OF 2008

THE COMMISSIONER OF INCOME TAX . . . APPELLANT

THROUGH: Ms.Prem Lata Bansal, Advocate

VERSUS

DENSO INDIA PVT. LTD . . .RESPONDENT

THROUGH: Mr. M.S. Syali, Sr. Advocate with Mr. Satyen Sethi, Ms. Mahua Kalra, Mr. Sumit K. Singh and Ms. Tunsal Syali, Advocates.

(2) ITA 1011 OF 2007

THE COMMISSIONER OF INCOME TAX . . . APPELLANT

THROUGH: Ms.Prem Lata Bansal, Advocate.

VERSUS

M/S BHARAT SEATS LTD. . . .RESPONDENT

THROUGH: Mr. M.S. Syali, Sr. Advocate with Mr. Satyen Sethi, Ms. Mahua Kalra, Mr. Sumit K. Singh and Ms. Tunsal Syali, Advocates.

(3) ITA 107 OF 2009

THE COMMISSIONER OF INCOME TAX . . . APPELLANT

THROUGH: Ms.Prem Lata Bansal, Advocate.

VERSUS

M/S BHARAT SEATS LTD. . . .RESPONDENT

THROUGH: Mr. M.S. Syali, Sr. Advocate with Mr. Satyen Sethi, Ms. Mahua Kalra, Mr. Sumit K. Singh and Ms. Tunsal Syali, Advocates.

(4) ITA 293 OF 2010

THE COMMISSIONER OF INCOME TAX . . . APPELLANT

THROUGH: Ms.Prem Lata Bansal, Advocate.

VERSUS

M/S BHARAT SEATS LTD. . . .RESPONDENT

THROUGH: Mr. M.S. Syali, Sr. Advocate with Mr. Satyen Sethi, Ms. Mahua Kalra, Mr. Sumit K. Singh and Ms. Tunsal Syali, Advocates.

(5) ITA 840 OF 2010

THE COMMISSIONER OF INCOME TAX . . . APPELLANT

THROUGH: Ms.Prem Lata Bansal, Advocate.

VERSUS

M/S BHARAT SEATS LTD. . . .RESPONDENT

THROUGH: Mr. M.S. Syali, Sr. Advocate with Mr. Satyen Sethi, Ms. Mahua Kalra, Mr. Sumit K. Singh and Ms. Tunsal Syali, Advocates.

(6) ITA 839 OF 2010

THE COMMISSIONER OF INCOME TAX . . . APPELLANT

THROUGH: Ms.Prem Lata Bansal, Advocate.

VERSUS

M/S BHARAT SEATS LTD. . . .RESPONDENT

THROUGH: Mr. M.S. Syali, Sr. Advocate with Mr. Satyen Sethi, Ms. Mahua Kalra, Mr. Sumit K. Singh and Ms. Tunsal Syali, Advocates.

CORAM:-

THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. The issues involved in all these appeals are of identical nature. The Counsel for the parties are agreed that the issues involved in ITA

16/2008 should be considered and the legal position in that case would govern the other appeals as well.

2. The respondent assessee is engaged in manufacturing and sale of auto electrical products such as Starters, Alternators, Wiper Motors, CDI, Magnetos etc., for four wheelers and two wheelers. The assessee company is promoted primarily by two Japanese Companies which are M/s Denso Corporation, Japan and M/s Sumitomo Corporation, Japan. These two companies had share holding 47.93% and 10.27% respectively. Even M/s Sumitomo Corporation, Japan is an associate company of M/s Denso Corporation, Japan. Thus, these two companies have an overall share holding of 58.20% which is sufficient to exercise overall management and control over the assessee company. However, that is not a relevant consideration for the issue involved in the instant appeal.

3. Here, we are concerned with the assessment year 2001-02. For this year, the respondent assessee had filed return declaring income at ₹ 14,77,51,457/-. During the assessment proceedings, the Assessing Officer noticed that the assessee had deposited ₹ 371.60 lacs on technical know-how fees. In addition, the assessee had also made payment of ₹ 77,03,487/- for the knowhow taken as part of the plant and machinery. The break-up of the entire know how fee paid is as under:-

“S.No.	Nature of payment	Amount	Remarks
1.	Acquisition of know how	3,08,14,000	Being 80% of total know how fees payable for acquisition of know how.
2.	Supply of technology	63,46,000	for supply of technology for improvement of the existing products.
TOTAL KNOW HOW FEE DEBITED TO P & L		3,71,60,000	

3.	Know how taken as part of	77,03,487 Being 20% of the total know how payment taken as part of the plant and machinery but no depreciation charged”

The assessee had treated payment of ₹ 3,08,14,000 made to M/s Denso Corporation, Japan in acquisition of know-how as capital expenditure. On this amount, depreciation under Section 32 was claimed. Likewise, the payment of ₹ 77,03,487/- was treated by the assessee as capital expenditure . However, due to oversight, no claim for depreciation under Section 32 of the Income-Tax Act was made in this behalf.

4. Be that as it may, the dispute relates to the payment of ₹ 63,46,000/- which was paid by the assessee to M/s Denso Corporation, Japan, for supply of technology and improvement of the existing products. The assessee has claimed that this expense was revenue in nature and was allowable as business expenditure in its entirety during the assessment year in question. The Assessing Officer, however, treated this expenditure as capital in nature. He, therefore, disallowed the same as revenue expenditure and was of the view that only depreciation thereupon under Section 32 of the Act shall be allowed. The assessee challenged this disallowance by the Assessing Officer by filing an appeal before the Commissioner of Income Tax (Appeal) but was unsuccessful in so far as this issue is concerned. Vide orders dated 30th August, 2004, the CIT (A) observed that drawing and designing of technology was part of intangible assets. The assessee himself had admitted that the technical information in the form of drawing and designing was obtained to improve the quality of manufactured products. Therefore, the said expenditure was to be treated as capital expenditure eligible for depreciation in view of the amended provisions of Section 32 with effect from 1st April, 1998. In further appeal to the

ITAT, the assessee has emerged victorious. Its contention has been accepted by the Tribunal, who has held vide impugned decision dated 19th January, 2007 that the aforesaid amount of ₹ 63,46,000/- paid by the assessee for supply of technology for improvement of products is to be allowed as revenue expenditure. ITAT has observed that the design acquired by the assessee was not in relation to setting-up of the plant or machinery but related to the process of manufacturing and as such the assessee did not obtain any asset of enduring nature. Know how acquired by the assessee explained only the production process and it did not result in the acquisition of any capital asset. Provisions of Section 32 amended with effect from 1st April, 1998 cannot be extended to treat the revenue expenditure as capital expenditure eligible for depreciation. The instant appeal filed by the revenue was admitted on 6.9.2010 on the following substantial question of law:-

> "A. Whether the ITAT was justified in law in holding that the amount of ₹ 63,46,000 paid by the assessee for acquiring technical know-how was allowable as revenue expenditure?
>
> B. Whether expenditure incurred by the assessee for acquisition of technical know-how was a revenue expenditure or a capital expenditure eligible for depreciation under Section 32 of the Act?"

5. As the counsel for the parties were ready to argue the matter finally at a short date, the case was listed for arguments on 14th September, 2010 on which date the arguments were heard and judgment reserved. With this background, we proceed to decide the questions of law so formulated. From the brief narration of facts disclosed above, it clearly transpires that for acquiring know-how by the assessee from M/s Denso Corporation, Japan a substantial amount by way of payment was given i.e. ₹ 3,08,14,000/- and ₹ 77,03,487/-. This amount was treated by the assessee itself as expenditure which was capital in nature. In addition, payment of ₹ 63,46,000/- was also made.

In order to ascertain the correct nature of this payment we may have to dig into the circumstances under which this payment came to be made by the assessee to M/s Denso Corporation, Japan. As noticed above, the assessee is in the business of manufacture and sale of auto electrical products such as Starters, Alternators, Wiper Motors, CDI, Magnetos etc., for four wheelers and two wheelers. It is manufacturing the products for its Indian clients like Maruti India and Hero Honda etc. For the production and manufacturing of the aforesaid items for these vehicles, it has obtained technical know-how from M/s Denso Corporation, Japan and payment made for acquiring this technology has been capitalized by the assessee.

6. It so happened that whenever there is a change in the model or design manufactured by the Indian clients of the assessee, the assessee is also required to suitably modify its design to enable it to manufacture those items in accordance with the modified design of the automobile. To facilitate and incorporate these changes in the technical know-how and design already provided by M/s Denso Corporation, Japan,certain modifications are required. For this purpose, i.e. to enable the assessee to incorporate the modification in the earlier designs to suit the requirement of its clients, the assessee entered into an agreement i.e. dated 25th April, 2000 with M/s Denso Corporation, Japan. Since the payment of ₹ 63,46,000 was made under that agreement, the import effect and implication of this agreement will have direct bearing on the nature of the expenditure made under the agreement with which we are concerned. We, thus, reproduce hereunder the relevant portion of the said agreement:-

> "Whereas DNJP has been engaged in the development, manufacture and sale of various kinds of automotive electrical and electronic equipment and has acquired substantial amount of technical information and experience for such products;

Whereas, Denso India Ltd. (DNIN) has been engaged in the manufacture and sale of some of automotive electrical and electronic equipment, and has to meet all requirements of its local customers in supplying them any products ordered by them.

Whereas, DNIN is not in a position to develop or design new products to suit the specific requirements of its customers therefore, DNIN has requested DNJP and DNJP has agreed to make new design (s) or carry out new application work regarding such products on behalf of DNIN.

Now, therefore, the parties hereto agree to the following terms and conditions:

Article 1: Definitions

For the purpose of this Agreement, the following terms shall have the following meanings:
(1) "products" shall mean products which are manufactured or to be manufactured in future by DNIN specified in Annexure 1.
(2) "Application works" shall mean the modification or application or design works regarding the products, or works for planning manufacturing process and/ or lines or other work, which are required to make the basic underlying technology compatible with the Indian conditions and customer specific requirements, and which, upon request by DNIN, will be performed by DNJP for and on behalf of DNIN with respect to the manufacture of the products at DNIN.

Article 2: Consignment of Application works

2.1 During the terms of this agreement, DNIN hereby consigns the Application Works under this Agreement, including the following information:

- Technical requirements of the customer;
- conditions for performance calculation;
- conditions for evaluations of bench-test

2.4 Any result including intellectual property rights and technical information arising out of such application works shall be solely owned by DNJUP and shall be used by DNIN only for manufacturing, using and selling products.

Article 3: Payment

3.1 DNIN shall pay to DNJP a fee for the Application Works to be calculated by the hourly rate set forth in paragraph 3.2 and the expenses actually incurred at DNJP through performing such Application Work (hereinafter fee and expenses collectively referred to as "Application costs"). However, total amount of such payments during the term of this Agreement

shall not exceed two hundred million Japanese Yen (Y 200,000,000)

3.2 The hourly rate provided in Paragraph 3.2 above shall be six thousand two hundred fifty Japanese Yen (Y 6250) at the effective date of this Agreement, and shall be changed to the rate to be negotiated by both parties from time to time during the term of this Agreement, according to the change of the wage rate in DNJP."

7. On scrutiny of the aforesaid agreement, the Tribunal was of the view that since, the new design was only modification of the earlier design, it could not be said that the assessee had acquired any new capital asset and on the contrary, it had merely improved its original design. The payment had been made for improving the quality of products being manufactured and not to introduce any new line of products. The assessee had not even acquired any proprietary interest in the said design and was merely a licensed user of the modified know-how provided by M/s Denso Corporation, Japan. Under these circumstances, opined the Tribunal, the payment made was revenue in nature and thus allowable as expenditure For this view, the Tribunal relied upon the judgment of Bombay High Court in ***Gannon Norton Metal Diamond Dies Ltd.*** *Vs.* ***CIT,*** *163 ITR 606* and extracted the following discussion threfrom:-

"It is undoubtedly true that in the instant case a new company was being formed to manufacture the product which was hitherto being manufactured by the foreign collaborators and imported by the Indian partners, that is, Gannon Dunkerley & Company Ltd. It is, however, to be remembered that in Telco's case [1980]123ITR538(Bom) the agreement with Messrs Daimler Benz was for manufacturing trucks which were not at all being manufactured by Telco at the time of the collaboration agreement. Telco was up to the time of this collaboration only making locomotives and for its new proposed activity, namely, for the manufacture of trucks, it set up a new factory after obtaining know-how from its German collaborators, which collaboration was being considered by the High Court. In principle, it would seem to make no difference between a case where an existing company undertakes a totally new line of activity for which it has to establish a new factory, and a case where for manufacturing a new product a

new company is constituted or formed. What we have to consider is whether the payment has been made for acquiring an asset of an enduring nature. **If know-how has been acquired unrelated to secret or patented processes or the right to use the trade name or trade mark then the acquirer of that know-how - since that phrase was repeatedly used or emphasised would seem to acquire no asset of an enduring nature.** If the know-how acquired relates to the setting up of the plant or machinery, then perhaps it may have to be held to be capital in nature, although we are not called upon to decide that question in the present reference. If the know-how acquired relates to the process of manufacturing, then the payment made for the same would have to be considered as revenue expenditure, since the acquirer does not obtain by the expenditure any asset of an enduring nature. It is only the acquisition of information, guidance or, to put it in more familiar terminology, "payment for consultancy". That the consultant gives certain diagrams, specifications, list of machinery and estimate of expenses, and explanations as to how the production process is to be carried on and what safeguards are necessary to be ensured for securing a quality product which would be accepted by the market would seem to make no difference."

8. The Tribunal also referred to its judgment in the case of ***T.E.I Technologies Pvt. Ltd***. wherein similar payment was treated as expenditure having hue of the revenue. The Tribunal also referred to the judgment of Supreme Court in ***Impire Jute Co. Ltd. 124 ITR 1,*** for the proposition that in a case where expenditure even if incurred for obtaining an advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test, namely, whether the assessee has obtained any asset of an enduring nature. What is material to consider is the nature of the advantage in a commercial sense, and it is only where the advantage is in the capital field that the expenditure would be held as capital expenditure. If the advantage consists merely in facilitating the

assessee's trading operation or enabling the management and conduct of the assessee's business to be carried on more efficiently, the expenditure would be on revenue account, even though, the advantage may for an indefinite future.

9. At this stage itself, before we come to the nature of the challenge posed by Ms. Bansal to the aforesaid judgment of the Tribunal, we deem it appropriate to point out that the judgment of the Tribunal in ***TEI Technologies*** (supra) has been upheld by this Court in the case of ***Commissioner of Income Tax*** *Vs.* ***TIE Technologies,*** 304 ITR 262. While holding that no question of law arises and dismissing the appeal on that ground, this Court observed:-

> "There is a finding of fact given by the Tribunal that all that the assessed received was technical assistance in the manufacture of the products. There was no transfer of technology or knowhow etc. which would enable the assessed to set up its plant and machinery.. In Gannon Norton Metal Diamond Dies Ltd. v. CIT [1987]163ITR606, the Bombay High Court held that if the knowhow acquired relates to the process of manufacture, then any payment made for this purpose would have to be considered as a revenue expenditure since the acquirer does not obtain any asset of an enduring nature it is more in the nature of a payment for consultancy.
>
> In so far as the present case is concerned, we find that the only service that was rendered to the assessed was in relation to the process of manufacture. Even assuming that this would give the assessed an advantage of an enduring nature, but as held by the Supreme Court in Empire Jute Co. Ltd. v.CIT [1980] 124 ITR 1, it is not every advantage of an enduring nature that can be classified as a capital expenditure. One has to take a pragmatic and commercial view of the matter and if that is done, there can be no doubt that the assessed acquired technical knowhow to enable it to manufacture the products and this was more in the nature of information guidance or payment for consultancy.

> In any event, in view of the concurrent finding of fact by the CIT (A) and the Tribunal, both authorities having gone through the relevant documents, we are not inclined to disturb the conclusion arrived at"

In the aforesaid backdrop, the revenue had hardly any arguable case against the findings that the payments made were revenue in nature.

10. Ms. Bansal, however, took an altogether different rout in her appeal to demonstrate that the payment could still be treated as falling under Section 32 of the Act, thus liable to depreciation only and, therefore, could not be allowed as business expenditure. This submission of hers was based on Section 32 of the Act, as amended by Finance Act, 1998 w.e.f. 1.4.1999, and particularly the insertion of Clause-(ii) to sub Section-(1) thereof. Before we refer to the contention, we deem it appropriate to reproduce the relevant portion of Sub-section (1)of Section 32 of the Act:-

> "**Depreciation.**
>
> 32.(1) (In respect of depreciation of-
>
> (i) buildings, machinery, plant or furniture, being tangible assets;
>
> (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-)"

11. The argument of Ms. Bansal was predicated on Clause-(ii). She submitted that now even the intellectual property rights in the form of know-how, patents, copy rights, etc. including **licence** are eligible

for depreciation as per the aforesaid Clauses. She thus submitted that when the know-how is given even in the form of a licence, it falls under Section 32 and what can be allowed thereon is the depreciation under that provision. She also referred to the following judgments in support of her contention that the drawings furnished by M/s Denso Corporation, Japan, could be treated as "plant" under Section 32 (1) (i) of the Act and, therefore, the expenditure was to be termed as capital in nature warranting depreciation thereupon.

12. In the case of the ***CIT*** *Vs.* ***Elecon Engineering Co. Ltd.*** *96 ITR 672* the Court held as under:-

> "Know-how is a peculiar kind of asset. It is the accumulated fund of knowledge acquired by years of observation, research, experimentation and experience. The whole of it is not in an intangible form even while it is in the process of being acquired and very often it takes a physical form, as it grows, in the shape of formulae, drawings, patterns, blue-prints, specifications and so on. The material form it takes not only facilities preservation, collation and ready reference, but also makes it perceptible and visible and easily capable of being transmitted to others. The books, which one consults to inform one's mind and thereby uses them in the course of one's business or provision, are expressly included within the meaning of the word "plant", there is no reason to exclude from the wide range of its meaning objects of similar nature as drawings, patterns, designs, specifications, etc., which also like books are the embodiment of know-how and serve the purpose of teaching at long range. We are of the opinion, therefore, that having regard to the clear legislative intent to give a wide meaning to the word "plant", material record of know-how (even assuming that know-how itself is intangible) is clearly included within the meaning of the word "plant" in section 32."

13. In the case of ***Scientific Engineering House P. Ltd. Vs. C.I.T*** *(1986)* 157 ITR 86 (SC), it was, *inter alia,* held as follows:-

> “In other words the test would be: Does the article fulfil the function of a plant in the assessee's trading activity? Is it a tool of his trade with which he carries on his business? If the answer is in the affirmative, it will be a plant.
>
> If the aforesaid test is applied to the drawings, designs, charts, plans, processing data and other literature comprised in the 'documentation, service' as specified in Clause 3 of the agreement it will be difficult to resist the conclusion that these documents as constituting a book would fall within the definition of 'plant'. It cannot be disputed that these documents regarded collectively will have to be treated as a 'book', for, the dictionary meaning of that word is nothing but a "a number of sheets of paper, parchment, etc. with writing or printing on them, fastened 'together along one edge, usually between protective covers; literary or scientific work, anthology, etc., distinguished by length and from & magazine, tract etc." (vide Webster's New World Dictionary). But part from its physical for the question is whether these documents satisfy the functional test indicated above. Obviously the purpose of rendering such documentation service by supplying these documents to the assessee was to enable it to undertake Its trading activity of manufacturing the theodolites and microscopes and there can be no doubt that these documents had a vital function to perform in the manufacture of these instruments; in fact it is with the aid of these complete and upto date sees of documents that the assessee was able to commence its manufacturing activity and these documents really formed the basis of the business of manufacturing the instruments in question. True, by themselves these documents did not perform any mechanical operations or processes but that cannot militate against their being a plant since they were in a sense the basic tools of the assessee's trade having a fairly enduring utility, though owing to technological advances they might or would in coarse of time become obsolete. We are, therefore, clearly of the view that the capital asset acquired by the assessee, namely, the technical know-how in the shape of drawings, designs charts, plans, processing data and other literature falls within the definition of 'plant' and therefore a depreciable asset.”

14. The meaning of the expression "plant" was also examined by the Apex court in the case of ***Scientific Engineering*** *(supra)* and it was, *inter alia, held as under:*

> “that "documentation service" comprised of drawings, designs, charts, plans, processing data and other literature, etc., and can be treated as "plant" and depreciation can be allowed thereon. That being the position, an obvious answer to the question is in the affirmative, in favor of the assessee and against the Revenue.”

15. There is a clear fallacy in the aforesaid line of argument advanced by the learned counsel for the revenue. The attempt is to cover the payment under Section 32 of the Act and then to assert that it qualifies for depreciation. There from, the learned counsel wants to draw the inference that the payment is capital in nature and not revenue. This kind of “reverse engineering” in our view is not permissible.

16. As per the Scheme of the Act, we have to first determine the nature of expenditure, namely, whether it is of revenue in nature or whether the expenditure is capital in nature or it has the flavor of revenue expenditure To determine this, tests are provided by various judgments of the Apex Court as well as High Courts. That is the precise exercise undertaken by the Tribunal; by referring to the judgments of the Supreme Court, the Bombay High Court and that of Delhi Bench of the Tribunal. Once it is found that the expenditure incurred is the revenue expenditure, and it is incurred during the course and for the purposes of business, same becomes allowable expenditure in its entirety under Section 37 of the Act. The question of depreciation would arise only if it is first determined and established that the expenditure is capital in nature. Once it is capitalized, the question of quantum of depreciation would come in and only then the provisions of Section 32 would come into play, in order to determine, first, whether the expenditure is of the nature which falls within the ambit of Section 32 to be entitled to

depreciation and second, the rate at which such deprecation is to be allowed.

17. The judgments cited by the learned counsel for the revenue are the cases where the assessees had claimed depreciation even on capital expenditure relating to drawings, designs etc. The dispute was not as to whether the expenditure is revenue or capital in nature. The assessee had accepted that the expenditure was capital in nature and wanted depreciation. It was denied by the Assessing Officer on the ground that Section 32 of the Act did not provide depreciation on such an expenditure. Clause-(ii) which is inserted by the Finance Act,1998 was missing at the relevant period when the aforesaid cases were decided. It was in this backdrop that the assessee wanted the such expenditure to be covered by Clause-(i) of sub Section (1) of Section 32 of the Act, which includes depreciation on “plant”. Under these circumstances, the question had arisen as to whether the acquisition of such drawings, designs, etc would amount to “plant” within the meaning of that provision. The Court in order to give benefit to the assessee had interpreted the expression “plant” very widely, as is clear from the reading of the extracted portion of the judgments referred to hereinabove.

18. By inserting Clause-(ii), in sub Section (1) of Section 32 of the Act, the Legislature has granted the benefit to the assessee, by providing depreciation in respect of capital expenditure incurred on know-how, patents,. copyright, trade mark etc. This also becomes clear from the memorandum explaining the provision in the Finance (No.2) Bill, 1998, reported in 231 ITR (St.) 28 at page 243 which reads as under:-

“Depreciation to be allowed on intangible assets

Under the existing provisions, depreciation is allowable when building, plant, machinery or furniture is used by the assessee for the purposes of his business or profession.

It is proposed to widen the scope of this section so as to provide that depreciation will also be allowed where intangible assets are owned wholly or partly by the assessee and are used by such assessee for the purposes of his business or profession. Intangible assets, such as know-how, patent rights, copyrights, trade m arks, licences, franchises or any other business or commercial rights of the assessee will form a separate block of assets. As and when any capital expenditure is incurred by an assessee on acquiring such intangible assets the amount of such expenditure will be added to the block of intangible assets and depreciation will be claimed on the written down value at the end of the financial year.

As a consequence of this amendment, it is proposed to provide that any expenditure of a capital nature incurred before the 1st April, 1998, on the acquisition of patent rights or copyrights used for the purposes of business shall not qualify for deduction under the said section 35A. It is also proposed to amend sub-section (1) of section 35AB accordingly as to restrict the provisions of that section to lump sum payments by the assessee in any previous year relevant to assessment year 1998-99.”

19. These are termed as “intangible assets” in contra distinction to building, machinery, plant or furniture which are “tangible assets” as stipulated in Clause-(i). Thus, now the depreciation is permissible in respect of any of these tangible or intangible assets, falling within these two Clauses of Sub-section (1). The question of allowing deprecation would arise only when it is first determined that the expenditure incurred is capital in nature. It is for this reason, we are not in a position to accept the argument of Ms. Bansal.

20. Clause-(ii) uses to significant expressions, namely, “acquired” and “owned”. Thus, know-how , patents, etc which are intangible

assets should be acquired by the assessee on or after 01.4.1998 and owned, wholly or partly by the assessee in order to become capital asset. In the present case, the findings of facts are recorded that no such asset was acquired or owned by the assessee. It is only modification of the asset already acquired for which the amount is expended. We have already reproduced the relevant clauses of the agreement arrived at between the assessee and M/s Denso Corporation, Japan under which payments in question were made. For the purposes of standardizing the modification to suit the requirement of the clients of the assessee, namely, manufactures of automobiles, technical fee was paid for the services rendered, whichpayment is described as “fee for the application works” under the agreement.

21. In ***CIT*** Vs. ***J.K. Synthetics Ltd***. (2009) 309 ITR 371, after elaborately discussing the entire case law on the subject, the court culled out the broad principles to determine as to whether expenditure in a particular case would be capital or revenue expenditure. One of the principles enumerate therein reads as under:-

> (v) Expenditure incurred for grant of License which accords 'access' to technical knowledge, as against, 'absolute' transfer of technical knowledge and information would ordinarily be treated as revenue expenditure. In order to sift, in a manner of speaking, the grain from the chaff, one would have to closely look at the attendant circumstances, such as:
>
> (a) the tenure of the Licence.
>
> (b) the right, if any, in the licensee to create further rights in favour of third parties,
>
> (c) the prohibition, if any, in parting with a confidential information received under the License to third parties without the consent of the licensor,

(d) whether the Licence transfers the 'fruits of research' of the licensor, 'once for all',

(e) whether on expiry of the Licence the licensee is required to return back the plans and designs obtained under the Licence to the licensor even though the licensee may continue to manufacture the product, in respect of, which 'access' to knowledge was obtained during the subsistence of the Licence.

(f) whether any secret or process of manufacture was sold by the licensor to the licensee. Expenditure on obtaining access to such secret process would ordinarily be construed as capital in nature."

22. The question had come up for consideration before this Court in ***CIT*** s. ***Sharda Motors Industrial Ltd.*** 319 ITR 109. After analyzing the agreement and the payments made in that case, the court concluded that the expenditure was revenue in nature in the following words:-

"In the present case, on facts, it was, inter alia, found as follows:

(a) in that case the grant of technical aid was for setting up of the factory combined with the right to sell products while in our case our company is already producing exhaust systems and the technology agreement was not for setting up of the factory.

(b) in the cited case the foreign company who gave the technology agreed not to manufacture similar products in India while there is no such regulation in our agreement.

(c) in the cited case the technical knowledge obtained was held to give an advantage of enduring nature to the assessee-company and as it had the right to continue to manufacture the product even after termination of the agreement. While in our case the design patent applies to the foreign company and we are only licensed to produce the goods for Hyundai Car and we cannot continue to produce the goods if the agreement is terminated. This itself is a major difference between the case cited by your honour and the facts of our case.

> 7. On the facts and after applying the aforesaid principle, it becomes crystal clear that the expenditure is of revenue nature.
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> 8. Learned Counsel for the Revenue submits that the Tribunal has not considered the effect of the judgment of the Supreme Court in Southern Switchgears Ltd. v. CIT [1998] 232 ITR 359, inasmuch as in that case the payment of royalty was treated as capital expenditure. However, what is glossed over is that under the terms of the agreement in that case, the assessee-company therein had agreed to pay the foreign company lump sum of royalty and it was in these circumstances the same was treated as capital expenditure and the Tribunal had disallowed 25 per cent. thereof. In the present case, as pointed out above, royalty is to be paid on the quantity of the goods produced, calculating per piece of the said goods produced. Therefore, the Tribunal rightly held that the aforesaid judgment not applicable to the facts of the present case."

23. The foregoing leads us to conclude that the Tribunal was justified in its opinion that the payment made in question was allowable as revenue expenditure and not as capital expenditure allowable for deprecation under Section 32 of the Act. We, thus, answer both the questions in favour of the assessee and against the revenue resulting in the dismissal of ITA 16/2008 as well as all other appeals.

(A.K. SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

OCTOBER 08, 2010
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