

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "E" DELHI**

**BEFORE SHRI KUL BHARAT, JUDICIAL MEMBER
&
SHRI PRADIP KUMAR KEDIA, ACCOUNTANT MEMBER**

I.T.A. No.1338/DEL/2018
Assessment Year 2014-15

M/s. Nefab India Pvt. Ltd., 277 & 278, Sector-7, IMT Manesar, Gurgaon, Haryana.	v.	DCIT, Circle-3(1), Gurgaon, Haryana
TAN/PAN: AACCN1599G		
(Appellant)		(Respondent)

Appellant by:	Shri S.K. Aggarwal, CA Ms. Akanshi Bhatia, CA		
Respondent by:	Shri Bhopal Singh, Sr.D.R.		
Date of hearing:	15	03	2022
Date of pronouncement:	31	03	2022

ORDER

PER PRADIP KUMAR KEDIA, A.M.:

The captioned appeal has been filed at the instance of the assessee against the order of the Commissioner of Income Tax (Appeals)-I, Gurgaon ['CIT(A)' in short], dated 20.12.2017 arising from the order dated 19.12.2016 passed by the Dy. CIT, Circle-3, Gurgaon under Section 143(3) of the Income Tax Act, 1961 (the Act) concerning AY 2014-15.

2. As per its grounds of appeal, the assessee has challenged the disallowance of expenditure amounting to Rs.20,71,510/- as capital expenditure being 25% of royalty amount paid of Rs.82,86,039/- by the assessee on account of use of technical know-how and technical process of licensor.

3. Briefly stated assessee is a subsidiary of Nefab AB, Sweden and is engaged in the business of manufacture and sale of customized packaging solutions to various customers in India. For the assessment year under consideration, the assessee filed its return of income declaring loss of Rs.4,80,43,901/-. The case of the assessee was selected for scrutiny. In the course of assessment, the Assessing Officer *inter alia* observed that the assessee has incurred expenditure towards royalty for use of technical know-how and technical process of the licensor amounting to Rs.82,86,039/-. The Assessing Officer took note of certain clauses of the license agreement dated 01.01.2008 with its parent company Nefab AB, Sweden and came to conclusion that a part of the royalty expenses for use of technical know-how etc. requires to be treated as capital expenditure. The Assessing Officer accordingly disallowed royalty expenses to the extent of 25% as expenditure of capital nature but however allowed depreciation on such capital expenditure @ 25% under Section 32 of the Act.

4. Aggrieved, the assessee preferred appeal before the CIT(A). The CIT(A) however affirmed the disallowance of 25% of the royalty expenses being capital expenditure.

5. Aggrieved, the assessee preferred appeal before the Tribunal.

6. Ld. Counsel for the assessee, at the outset, adverted to the license agreement entered into with the parent company and submitted that the assessee was using the exclusive license for the use of technical know-how, patent rights and trademark rights owned by the appellant parent company. It was pointed out that as

per clause 2.5 of the agreement, there was no transfer of ownership of technical process know-how or the patent rights or the trademark rights from the licensor (parent company) to the licensee (assessee company) and the licensor continued to remain the sole owner of such technical process know-how. As per the agreement, the royalty payable was calculated at 2% of the total amount of sale of subject products using such technical process know-how etc. and thus the quantum of fee paid is variable and not fixed. It was further pointed out that as per clause 4.2 of the agreement, the assessee herein shall receive such technical information and maintain same in strictest confidence and shall not reveal or disclose the same to any third party. It was submitted that term/period of this agreement was three years subject to automatic renewal for additional period unless terminated by either party to the agreement. As per clause no.7.5 of the license agreement, upon termination, the assessee was required to immediately cease the use of any and all technical process know-how together with patent rights and trademark rights etc. as provided by the licensor. It was thus submitted that the terms of license agreement clearly provides for use of technical know-how process only upto the subsistence of license agreement and the right to use comes to an end on termination of agreement. It was pointed out that the CIT(A) itself has admitted that there is no transfer of any technical process know-how and use of licensor trademark rights *per se* and such rights can be used only upto the period of license and as such, there is no permanent or long term benefits accruing to the assessee.

6.1 In this factual backdrop, ld. counsel for the assessee submitted that the CIT(A) has wrongly applied the ratio of

decision of Hon'ble Supreme Court in the case of **CIT vs. Southern Switchgear Ltd., 148 ITR 273 (Mad)** without any delineation on its applicability to the facts of the case.

6.2 Ld. Counsel essentially contended that;

(i) the assessee has only right to use the technical know-how till the time, the license is in force;

(ii) technical know-how is used to improve the existing business which is already set up and not to set up a new business;

(iii) the use of such technical knowhow is restricted to the assessee alone and the assessee company cannot exploit it in any other manner for. Also, there are continuous changes in existing products and their designs and the technical process know-how is thus continuously provided and upgraded by the licensor to suit the changes in the existing products of the assessee;

(iv) the judicial pronouncements relied upon by the Revenue Authorities are rendered in squarely different factual backdrop and thus cannot be applied.

(v) Judicial precedents and principles laid down in CBDT Circular No.21 dated 09.07.1969 supports the case of assessee.

7. Ld. DR for the Revenue, on the other hand, placed reliance upon the orders of the lower authorities and submitted in furtherance that text and tenor of license agreement would suggest that the assessee has acquired the right to use the technical process know-how for perpetual use and the benefit accruing to the assessee is of long term in nature giving rise to the creation of capital asset of considerable value. Ld. DR accordingly submitted that no interference with the order of the CIT(A) is thus called for

in the light of the decision of the Hon'ble Supreme Court in the case of **CIT vs. Southern Switchgear Ltd** (supra).

8. We have carefully considered the rival submissions and perused the orders of the lower authorities and material referred to and relied upon. The assessee, in the instant case, has incurred certain royalty payment in consideration of use of technical know-how etc. as per license agreement. The solitary issue in question in factual set up is whether payment towards use of technical know-how in terms of license agreement between the assessee and the parent company would give rise to any capital expenditure or the entire amount of royalty for use of technical know-how can be regarded as revenue expenditure as claimed by assessee.

9. As pointed out on behalf of the assessee, the salient features of the license agreement broadly are; the assessee is entitled to use the technical know-how exclusively and cannot exploit for the benefit of other parties; the assessee is prohibited to use the technical knowhow on expiry of license period, i.e. the benefit flowing from license agreement is not available after its termination; technical know-how under the agreement is being used to improve the existing business which is already set up with enabling clauses like upgradation of such technical know-how.

9.1 A reading of the license agreement thus gives an impression that the assessee cannot sub-license the same to any third party and the licensor continues to exercise all pervasive domain over the ownership over the technical knowhow in exclusion to the licensee assessee. The assessee has been merely given a license to use the licensed information/technical know-how during the currency of license agreement. Further, there is a confidentiality

clause which prevents the assessee from disclosing the licensed information to a third party. To reiterate, the assessee is not entitled to the use of licensed technical know-how on termination of agreement and is obliged under the contract, to relinquish the advantage accruing by virtue of license agreement. All the above features of the agreement make it unequivocal that what the assessee, in essence, has acquired under the agreement is a mere right to use the licensed technical know-how in question. A mere access to the technical knowledge by virtue of such license agreement, in our view, could not permit the revenue authorities to artificially assume certain part of the expenditure as advantage of capital nature or something akin to acquisition of any asset or advantage of enduring nature for the benefit of its business. In the case in question, it cannot be said that the Sweden Company had relinquished its command over the impugned technical know-how information in favour of the assessee in any manner. In the absence of any vested advantage to assessee or any indefeasible right, it is farfetched to hypothetically presume any component of capital expenditure implicit in the outgo towards royalty.

9.2. Under these circumstances, we find considerable merit in the plea of the assessee for claiming the entire royalty expenditure for use of technical know-how as revenue expenditure. We also find that the judgment rendered by the Hon'ble Madras High Court in the case of **CIT vs. Southern Switchgear Ltd.**, reported in 148 ITR 273 (Mad) as affirmed by Hon'ble Supreme Court, reported in 232 ITR 259 (SC) weighed in the mind of CIT(A) is in different factual backdrop with real difference. In that case, the assessee was entitled to use the benefit flowing from license even after the termination of license agreement. This feature is the dividing line

for inapplicability of decision in Southern Switchgear. Hence, there is no scope of treating the royalty paid for the 'licensed information' as capital expenditure in the facts of the case.

12. In the result, the appeal of the assessee is allowed.

Order pronounced in the open Court on 31/03/2022.

Sd/-
[KUL BHARAT]
JUDICIAL MEMBER

DATED: **31/03/2022**

Prabhat

Sd/-
[PRADIP KUMAR KEDIA]
ACCOUNTANT MEMBER