

IN THE INCOME TAX APPELLATE TRIBUNAL 'A' BENCH, PUNE

SHRI INTURI RAMA RAO ACCOUNTANT MEMBER
AND
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

ITA No. 1859/PUN/2018
Assessment Year : 2014-15

The Asstt. C.I.T. Circle 9, Pune

Appellant

Vs.

Mercedes-Benz India Pvt. Ltd.
E-3 MIDC Chakan,
Phase III, Chakan Industrial Area
Kuruli & Nighoje
Tal. Khed, Pune-410 501
PAN AABCM 1789 L

Respondent

Appellant by : Shri Hitendra B. Ninawe

Respondent by : Shri Pramod Achuthan

Date of Hearing : 23-08-2022

Date of Pronouncement : 24-08-2022

ORDER

PER PARTHA SARATHI CHAUDHURY, JM

This appeal preferred by the Revenue emanates from the order of the Id. CIT(A)-6, Pune dated 04-09-2018 for assessment year 2014-15 as per the following grounds of appeal

- “1. Whether on the facts and circumstances of the case and in law, the Id. CIT(A) was justified in deleting the addition of Rs. 19,89,99,599/- considering the royalty expenditure of Rs. 19,8,99,599/- as revenue expenditure as against the capital expenditure as against the capital expenditure held by the A.O?
2. Whether on the facts and circumstances of the case, the Id. CIT(A) was justified in deleting the addition of Rs. 4,49,02,579/- considering the Homologation Expenses of Rs. 4,49,02,579/- as revenue expenditure as against the capital expenditure held by the A.O?
3. The appellant craves leave to add, amend or alter any of the above grounds of appeal.”

2. At the outset, the Id. Counsel for the assessee submitted that the issues in respect of revenue's appeal in this case are covered substantially in entirety in assessee's favour in assessee's own case by the order of the Tribunal for A.Y. 2012-13 in ITA No. 495/PUN/2017 dated 15-07-2022. The first issue is with regard to disallowance of royalty expenditure whether the

same is a capital or revenue expenditure. We find that in ITA No. 495/PUN/2017 (supra) in assessee's own case this issue has been discussed by the Tribunal and has been held that the royalty expenditure is revenue in nature. The relevant paragraph of the I.T.A.T. order is as follows:

"27. Ground No. 16 is with regard to the disallowance of royalty expenditure. The assessee submits that it is a Company incorporated under the provisions of the Companies Act, 1956, and is engaged in the manufacture and sale of Mercedes-Benz passenger cars in the Indian market. Pursuant to a 'Technology License Agreement' entered by the Appellant with Daimler AG, it had paid an amount of Rs 12,51,11,877 as royalty to Daimler AG during FY 2012-13. The key terms of the agreement, as amended from time to time provide the following:

- *Grant to MB India a non-exclusive license within India to assemble, manufacture and sell licensed vehicles and engines ('licensed products') including pertinent parts and components;*
- *Non-exclusive right to MB India to export such licensed products;*
- *Supply by Daimler AG to MB India of drawings and designs and full technical product documentation required for the manufacture of licensed products;*
- *Continuous support by Daimler AG to MB India of all technical information relating to improvements and developments in the manufacturing process of the licensed products;*
- *Right to use of the name and trademarks of Daimler AG during the currency of the agreement; and*
- *Providing training to MB India's personnel at Daimler AG premises.*

(a) In consideration of the above, as per Article 13 of the agreement, MB India is required to pay to Daimler AG, an annual royalty at 5% of the value addition on licensed vehicles sold after 1 January 1999. The agreement gets amended from time to time to amend/extend the scope by adding or deleting vehicles models. The terms of the agreement were further amended with effect from 1 October 2007 based on the perusal of various clauses of the agreement as summarized above, it can be seen that:

MB India has not acquired know-how from Daimler AG on an outright basis. MB India has only acquired a license/right to use know-how of Daimler AG in respect of the licensed products.

The agreement clearly provides that Daimler AG will remain the sole and exclusive owner of the technical know-how, technical information, trade mark etc. and that MB India is debarred from claiming any title to the said rights. Such license right cannot be equated with ownership rights.

The right of MB India to manufacture and sell licensed products in India does not restrict the rights of Daimler AG to sell the Licensed Products in India.

No copyright has been transferred to MB India. In fact the agreement states that copyright of the technical product documentation, including any modifications as well as the know-how and any patents contained therein would remain the property of Daimler AG.

There are restrictions placed on MB India from divulging confidential information obtained under the agreement to any third party.

Upon the termination of the agreement, MB India is required to immediately discontinue all assembling/ manufacturing and sales operations of the licensed products

(c) *From the above terms and conditions, it is clear that MB India's rights under the agreement ends on termination of the agreement. It also evident that MB India has neither acquired any assets on an outright basis nor secured any enduring advantage. The benefit secured by MB India is essentially a license right to use the know-how for the period of the agreement and the royalty expenditure in this regard is therefore revenue in nature.*

(e) *In relation to AY 2012-13, as mentioned above, the Ld. AO relying on the orders passed by the erstwhile AO's during the assessment proceedings for AY 2004-05 to AY 2011-12 and further relying on the Hon'ble DRP's directions pertaining to AY 2007-08 to AY 2011-12 disallowed the royalty expenses by considering it to be a capital expenditure in its Draft Assessment order. The said ground was further raised before the Hon'ble DRP, however the DRP by considering it to be an issue similar previous year upheld the disallowance made by the Ld. AO.*

(f) *Further, the assessee submitted that the facts of the ground have already been considered in A.Y. 2002-03 to A.Y. 2013-14 and A.Y. 2014-15. In respect of the said issue in A.Y. 2002-03 the co-ordinate Bench Pune held that the royalty paid MB India is revenue expenditure. The relevant observation of Pune Bench Tribunal is as follows:*

“ We find no infirmity in the above decision of the Ld.CIT(A). From the various terms and conditions of the agreement, we find the Assessee has neither acquired any asset on an outright basis nor secured any enduring advantage. We find force in the argument of Ld. Counsel for the Assessee that the benefit secured by the Assessee is essentially a licensed right to use knowhow for the period of the agreement. Therefore, the royalty expenditure in this regard, in our opinion, is revenue in nature.”

29. The assessee further submits that the status on account of royalty for various years is provided as follows:

| Assessment Year | Status | Date of the order | Status of the Issue |
|---------------------------------------|---|--|--|
| AY 2000-01 and AY 2001-02 | - Allowed as revenue expenditure by the Hon'ble CIT(A) and also confirmed by the Hon'ble ITAT for AY 2000-01 and AY 2001-02 | 23 December 2021 | In Favour of MB India |
| AY 2002-03 | -Allowed as revenue expenditure by the Hon'ble ITAT for AY 2002-03 | 06 June 2016 (Refer page 131 to 192 of the Paper Book) | Department Appeal pending before Hon'ble Bombay High Court for admission of appeal |
| AY 2003-04 and AY 2004-05 | -Allowed as revenue expenditure by the Hon'ble ITAT for AY 2003-04 and AY 2004-05 | 30 Sept 2016 (Refer page 88 to 130 of the Paper Book) | |
| AY 2005-06 | -Allowed as revenue expenditure by the Hon'ble ITAT for AY 2005-06 | 25 October 2018 (Refer page 23 to 65 of the Paper Book) | Department Appeal pending before Hon'ble Bombay High Court for admission of appeal |
| AY 2006-07, AY 2007-08 and AY 2008-09 | -Allowed as revenue expenditure by the Hon'ble ITAT for AY 2006-07, AY 2007-08 & AY 2008-09 | 30 April 2019 (Refer Page 1 to page 22 of the Paper Book) | |
| AY 2009-10, | -Allowed as revenue expenditure | 31 July 2019 | |

| Assessment Year | Status | Date of the order | Status of the Issue |
|---|---|--|--|
| AY 2010-11 and AY 2011-12 | by the Hon'ble ITAT for AY 2009-10, AY 2010-11 and AY 2011-12. | (Refer page 1540 of the Legal Paperbook) | |
| AY 2013-14 | Hon'ble DRP upheld AO's order considering royalty expenditure to be capital in nature | Not Applicable | Pending before Hon'ble ITAT |
| AY 2014-15 | Expenditure allowed by the Hon'ble CIT(A) as revenue deduction | Not Applicable | |
| AY 2015-16 AY 2016-17 and AY 2017-18 | Disallowed by the Hon'ble AO based on the decisions in previous years | - | Pending before Hon'ble CIT(A) |
| AY 2018-19 | Disallowance made by the DRP in the DRP directions. Final order pending to be issued | Final order is yet to be issued | Appellant to file an appeal once final order is issued |

(g) Respectfully following the aforesaid decision of Pune Tribunal in assessee's own case on the same parity of reasoning, facts and circumstances, we hold that the royalty expenditure in this regard is revenue in nature. Accordingly the Ground No. 16 stands allowed."

3. The Id. D.R fairly conceded that the issue has been covered in favour of the assessee.

4. Having heard the parties and considering the decision in ITA No. 495/PUN/2017 (supra) on the same parity of reasoning in the same facts and circumstances, we dismiss this ground of appeal raised by the Revenue.

5. The next ground is the disallowance of Homologation Expenditure whether it is capital expenditure or revenue expenditure. We find that this issue has also been considered by the Tribunal in assessee's own case in ITA No. 495/PUN/2017 (supra) and has been held as follows:

"28. Ground No. 17 is with regard to disallowance of Homologation expenditure. The learned A.O disallowed the expenditure incurred on homologation amounting to Rs. 2,34,85,773/- by considering it to be a capital expenditure. During the assessment proceedings the assessee was asked to explain the nature of expenses in response to which the assessee submitted the details of the expenditure and also provided reasons as to why the said expenditure should be considered as a revenue expense. The assessee further submits that on this issue for A.Y. 2009-10, 2010-11 and 2011-12 in assessee's own case the Pune Tribunal has held this expenses to be a revenue expenditure.

In ITA No. 546/PUN/2016 and others dated 31-7-2019 on this issue Pune Tribunal held as follows;

23. We have heard the rival contentions and perused the record. In the line of business of assessee i.e. manufacture and sale of passenger cars, the automobiles which were manufactured were governed by Central Motor Vehicles Act (CMV Act) and Central Motor Vehicle Rules (CMV Rules). Under the said regulations, it is mandatory to seek approval from the agency of the Government before making any technical changes in the existing model and also before introducing new vehicle / any upgraded version of existing vehicle before its commercial use. The ARAI makes the certification in this regard. Rules 91 to 126A of CMV Rules regulate the construction, equipment and maintenance of motor vehicles. The requirement of Rule 126 is that every manufacturer or importer of motor vehicles shall submit Prototype of vehicles, to be manufactured or imported by him, for testing by the Vehicle Research and Development Establishment of the Ministry of Defence of the Government of India or ARAI, Pune or the Central. In the process of homologation, the assessee is under compulsion to provide to ARAI, for testing purpose, the auto components as well as entire vehicle, in case it wants to upgrade the same and/or import the new vehicle. After testing, ARAI issues a certificate of homologation for the particular vehicle. The assessee claims that material which was provided to ARAI and once it was returned to the assessee and the same was mainly scrapped as from safety perspective, it cannot be used in new cars. The assessee had debited cost of such material consumed during homologation process and also the cost of certification under the head homologation cost. It was put to the assessee that what happens to the engines in fully built cars or new cars, which were sent for certification and it was fairly pointed out that in case they were in usable condition, the same were not destroyed. In case of any technical variation in any existing vehicle or any of the components that the assessee wants to introduce in the existing vehicles, it was incumbent upon the assessee to get homologation certificate before any change was so introduced. Another expenditure which was incurred was that ARAI may in random, choose any car (as produced) for conducting conformity of production. Hence, it were not only the initial stage for which specifications need to be approved from ARAI but even for the existing vehicles, random checks were made that the assessee was manufacturing the same in conformity with the procedure laid down. The expenditure thus, laid out was for the purpose of smooth running of business and the revenue expenditure merits to be allowed in the hands of assessee. The assessee had also filed breakup of homologation expenses incurred during the year under consideration and we have perused the same. Hence, there is no merit in the stand of authorities below in disallowing the same on the ground that the said expenditure may have enduring benefit to the business of assessee.

24. The Hon'ble Supreme Court in Empire Jute Co. Ltd. Vs. CIT (1980) 124 ITR 1 (SC) had laid down that test of enduring benefit cannot be applied blindly and mechanically, without regard to particular facts and circumstances. Merely because the aforesaid expenditure results in an enduring benefit would not make such expenditure as capital in nature, as while allowing any expenditure in the hands of assessee, the intent and purpose of expenditure is to be kept in mind and whether the same is incurred for smooth running of business, then, such expenditure is revenue in nature. Accordingly, we direct the Assessing Officer to allow homologation expenses of ₹ 1.25 crores (approx.). The ground of appeal No.8 raised by assessee is thus, allowed."

29. Respectfully following the aforesaid judgment on the same parity of reasoning Homologation expenses are held as revenue expenditure. Ground No. 17 stands allowed."

6. The Tribunal in the aforesaid decision has held Homologation expenses as revenue expenditure. The Id. D.R could not bring on record any contrary decision favouring the Revenue. Therefore, on the same parity of reasoning in the same facts and circumstances, we dismiss this ground of appeal also raised by the Revenue.

7. In the result, appeal of the **Revenue is dismissed.**

Order pronounced in the open Court on this 24th August 2022.

Sd/-
(INTURI RAMA RAO)
ACCOUNTANT MEMBER

sd/-
(PARTHA SARATHI CHAUDHURY)
JUDICIAL MEMBER

Pune; Dated, this 24th day of August 2022
Ankam

Copy of the Order forwarded to :

1. The Appellant.
2. The Respondent.
3. The Pr. CCIT 5 , Pune.
4. The CIT(A)-6, Pune
5. The D.R. ITAT 'A' Bench Pune.
6. Guard File

/// TRUE COPY ///

BY ORDER,
Sr. Private Secretary
ITAT, Pune.

ITA No. 1859/PUN/2018
Mercedes Benz India
A.Y. 2014-15

| | | Date | |
|----|--|------------|----------|
| 1 | Draft dictated on | 23-08-2022 | Sr.PS |
| 2 | Draft placed before author | 23-08-2022 | Sr.PS |
| 3 | Draft proposed and placed before the second Member | | JM/AM |
| 4 | Draft discussed/approved by second Member | | AM/JM |
| 5 | Approved draft comes to the Sr. PS/PS | | Sr.PS/PS |
| 6 | Kept for pronouncement on | 24-08-2022 | Sr.PS/PS |
| 7 | Date of uploading of order | 24-08-2022 | Sr.PS/PS |
| 8 | File sent to Bench Clerk | 24-08-2022 | Sr.PS/PS |
| 9 | Date on which the file goes to the Head Clerk | | |
| 10 | Date on which file goes to the A.R | | |
| 11 | Date of dispatch of order | | |