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IN THE HIGH COURT OF DELHI AT NEW DELHI

{ITA 1037 OF 2009}

Judgment reserved on: 26.10.2010

Judgment delivered on: 29.11.2010

COMMISSIONER OF INCOME TAX

. . . APPELLANT

Through: Ms. Prem Lata Bansal, Sr. Standing Counsel.

VERSUS

OCL INDIA LIMITED

. . .RESPONDENT

Through: Mr. R.M. Mehta, Advocate

CORAM:-

HON'BLE MR. JUSTICE A.K. SIKRI

HON'BLE MR. JUSTICE SURESH KAIT

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. This appeal was admitted on 26th October, 2010 framing the following substantial question of law:-

“Whether ITAT was correct in law in sustaining addition only to the extent of 20% out of total payment of ₹ 47, 25,000/- made by the assessee to M/s Feedback Strategic Consultancy Services Pvt. Ltd., treating the same as in capital field and allowing balance 80% as revenue expenses?”

Since both the counsel for the parties were ready to argue the matter finally, we heard the counsel for the parties and reserved the judgment on the same day.

2. The payments made by the assessee to M/s Feedback Strategic Consultancy Services Pvt. Ltd. (hereinafter referred to as 'the Consultant') for detailed study on cement market in India etc. is to be treated as revenue expenditure or the capital expenditure, is the question posed for determination. The Assessing Officer held the view that the entire expenditure was in the capital field and, therefore, treated is to be the capital expenditure. He thus disallowed the payment of ₹ 47.25 lacs made to the Consultant. The CIT (A) confirmed this order of the Assessing Officer. However, in further appeal, the Tribunal has deleted the addition to the extent of 80%, inasmuch as, it has held that only 20% of the total expenditure would be capital expenditure and remaining 80% amount spent is revenue in nature. In order to ascertain the nature of expenditure, it would be necessary to find out the nature of services rendered by the Consultant for which consultancy fee was paid to them.

3. The assessee company is in the business of manufacture of cement, refractories and manufacture of Ammonium Chloride and Soda Ash at Rajgangapur, Orissa. It wanted a detailed study of cement market in India with a view to improve the cement market by the cement company. For carrying out the study, it hired the services of the aforesaid consultants. As per the explanation given by the assessee, the task assigned to the Consultant was to carry out the detailed study of cement market in India and to advise the assessee company whether any change in the product mix is needed, keeping in view the capacities available, expansions plans of the competitors and the potential demand scenario. The Consultants were also to identify the deficit area where assessee's product can be diverted and sold more profitably.

4. Before the Assessing Officer, the submissions of the assessee was that these expenses had been incurred out of commercial expediency to cope with the difficulty posed by the increasing competition in marketing the cement manufactures by the assessee. Therefore, the expenditure incurred was not only in the course and conduct of the business but in fact necessary for protecting the market share in the face of tough competition. On this basis, the assessee pleaded that the expenditure incurred was wholly and exclusively for the purposes of the business of the assessee company and was an allowable deduction as revenue expenditure. It was also contended that such an expenditure cannot be treated as capital expenditure as it had neither resulted in acquisition of an asset nor the assessee had attained benefit of enduring nature. Furthermore, no new product had been manufactured and on the existing production capacity of the assessee had also not been increased.

5. This submission of the assessee, however, did not find favour with the Assessing Officer who rejected the reasoning given by the assessee. The Assessing Officer was of the view that a detailed study of cement market in India was carried out by the Consultant with a view to improve the marketing of cement and the consequence thereof was that based on that report, the assessee had changed its marketing strategy and also increased its production of certain varieties of cement in subsequent years and thereby witnessed growth both in terms of quality and profits. Looking from this angle, the Assessing Officer held that the assessee had got the benefits of enduring nature lasting for future years and, consequently it was to be treated as capital expenditure.

6. The CIT (A) while confirming the aforesaid order of the Assessing Officer further added that the projection of trends for future years, in demand consumption patterns indicate a benefit, that would be enduring in nature as the same pertains to future trends up to a number of years as well as the fact that the assessee would stand to gain permanently from the expert opinion thus obtained.

7. Before the Income Tax Appellate Tribunal, the assessee again reiterated its submission that the agreement between the assessee and the Consultant delineated the scope of study and was confined to the following major areas:-

1. The existing cement capacities and the production there against giving trend of last few years, giving/projecting likely increase in the capacities separately in green field and brown field projects.
2. The demand of cement giving growth trend in last few years, next ten years, projections considering the consumption pattern in housing/commercial construction, infrastructure and other development projects.
3. Consolidation of industry and future trends
4. Possible mergers and acquisitions in the eastern region
5. Report on expansion in the capacities of our existing cement plant.

8. It was emphasized that on the basis of extensive study extended by the said Consultant the advise which was given by the Consultant to the assessee was on the issue as to whether any change in the product mix is needed, whether the assessee was required to identify the deficit area where the assessee's product can be diverted and sold more profitably. On this premise, the submission

of the assessee was that the nature of addition in commercial sense which the assessee was going to get by incurring the said expenditure was not in capital field as it consists merely in facilitating the assessee's trading operations or enabling the management to conduct the assessee's business more efficiently or more profitable while leaving the fixed capital untouched. It was argued that even if the advantage endures for indefinite future, it would not make any difference as neither new business was set up as a result of the said studies nor any asset was created.

9. The Tribunal after considering the rival contentions took a view that neither the Assessing Officer was entirely correct nor the assessee. According to it, the report submitted by the Consultant covered both the areas i.e. the study of market for trading activities as well as possible acquisition in eastern region and expansion of existing cement plant. According to the Tribunal, as far as the expenses incurred for conducting the survey with regard to trading activities and enabling the management to conduct the business more efficiently are concerned, such expenses are deserves to be treated in the revenue field only because they pertain to day to day activities of the assessee. However, as far as expenses incurred for getting report for starting new project or enhancing the capacities of existing plant, then such expenses are to be treated in the capital field.

10. The Tribunal then undertook the exercise of apportioning the expenditure incurred and took the view that 20% of total expenses would qualify as capital expenditure and balance amount is to fall in the category of revenue expenditure. This is based on the following discussion:-

“The next question arises for our consideration is how much expenses are relatable towards the capital field. On due consideration of the facts and circumstances, we find that the assessee has sought study report on five issues from Ms/ Feedback Consultancy Services Pvt. Ltd. Out of those five issues only two are relating to expansion or starting of new projects. Therefore, in our opinion if we allocated 20% of the total expenses towards obtaining these report then ends of justice would meet. We direct the AO to treat 20% of the expenses in the capital field and allow the deduction of the rest of the expenses.”

11. Before us, both the parties adopted the same path which were treaded before the authorities below.

12. We have already mentioned above the scope of the study. Five major areas were assigned to the Consultant on which these Consultants were to undertake the study and give their reports.

13. We may first spell-out the principles which are to be kept in mind to determine as to whether such expenses are to be treated capital or the revenue expenditure. These are neatly culled out in the case of **CIT Vs. J.K. Synthetics Ltd.**, 222 CTR 339 by this Court, as under:-

“BROAD PRINCIPLES WHICH EMERGE ON READING OF VARIOUS AUTHORITIES

38. An overall view of the judgments of the Supreme Court, as well as, of the High Courts would show that the following broad principles have been forged over the years, which require, to be applied to the facts of each case:

(i) the expenditure incurred towards initial outlay of business would be in the nature of capital expenditure, however, if the expenditure is incurred while the business is on going, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring benefit for the business, if that be so, it will be in the nature of capital expenditure. If the expenditure, on the other hand, is for running the business or working

it, with a view to produce profits, it would be in the nature of revenue expenditure;

(ii) it is the aim and object of expenditure, which would, determine its character and not the source and manner of its payment;

(iii) the test of 'once and for all' payment i.e., a lump sum payment made, in respect of, a transaction is an inconclusive test. The character of payment can be determined by looking at what is the true nature of the asset which is acquired and not by the fact whether it is a payment in 'lump sum' or in an instalment. In applying the test of an advantage of an enduring nature, it would not be proper, to look at the advantage obtained, as lasting forever. The distinction which is required to be drawn is, whether the expense has been incurred to do away with, what is a recurring expense for running a business, as against, an expense undertaken for the benefit of the business as a whole;

(iv) an expense incurred for acquisition of a source of profit or income would in the absence of any contrary circumstance, be in the nature of capital expenditure. As against this, an expenditure which enables the profit making structure to work more efficiently leaving the source or the profit making structure untouched, would be in the nature of revenue expenditure. In other words, expenditure incurred to fine tune trading operations to enable the management to run the business effectively, efficiently and profitably leaving the fixed assets untouched would be an expenditure of a revenue nature even though the advantage obtained may last for an indefinite period. To that extent, the test of enduring benefit or advantage could be considered as having broken down;

(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;

(vi) the fact that assessee could use the technical knowledge obtained during the tenure of the License for the purposes of its business after the Agreement has expired, and in that sense, resulting in an enduring advantage, has been categorically rejected by the courts. The Courts have held that this, by itself, cannot be decisive because knowledge by itself may last for a long period even though due to rapid change of technology and huge strides made in the field of science, the knowledge may with passage of time become obsolete;

(vii) while determining the nature of expenditure, given the diversity of human affairs and complicated nature of business; the test enunciated by courts have to be applied from a business point of view and on a fair appreciation of the whole fact situation before concluding whether the expenditure is in the nature of capital or revenue.

14. Governed by the aforesaid principles, we are of the view that the Tribunal has rightly held that the scope of study was the mixture of both the areas namely part of it related to the study from which benefit of enduring nature was sought to be achieved and part thereof related to the treating activities. Therefore, the expenditure incurred was required to be apportioned between the two viz capital and revenue expenditure.

15. When we come to the allocation of this expenditure, the reason for allocating 20% of the expenses towards capital expenditure is not discernible from the order of the Tribunal. According to the Tribunal itself, out of the five aspects on which report to the Consultant was sought, two related to expansion or starting of new projects. On this observation of the Tribunal there is no dispute. This is correct as areas no. 4 & 5 relate to possible acquisition in southern region and expansion of existing cement plant and from these studies benefit of enduring nature was sought to be derived at. Then the obvious fallout would be to allocate 40% of the total expenditure and not 20% to the head "capital expenditure".

16. We, therefore, answer the question by holding that the Tribunal was not correct in sustaining addition only to the extent of 20% treating as incurred in the same capital field and it should have sustained addition to the extent of 40% of the addition on total payment of ₹ 47.25 lacs as capital expenditure. The order of the Tribunal is modified accordingly.

(A.K. SIKRI)
JUDGE

(SURESH KAIT)
JUDGE

NOVEMBER 29, 2010
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