

IN THE HIGH COURT OF JUDICATURE AT MADRAS**DATE : 24.02.2015****CORAM****THE HONOURABLE MR. JUSTICE R.SUDHAKAR
AND
THE HONOURABLE MR. JUSTICE R.KARUPPIAH****T.C. NO. 959 OF 2007**Commissioner of Income Tax
Chennai.

.. Appellant

- Vs -M/s.Saka Marketing Services P Ltd.
52, Jawaharlal Nehru Road
Ekkattuthangal
Chennai – 97.

.. Respondent

Appeal filed under Section 260-A of the Income Tax Act against the order dated 22.12.06 passed by the Income Tax Appellate Tribunal, Madras 'C' Bench, made in ITA No.792/Mds/2001.

For Appellant : Mr. J.Narayanaswamy

For Respondent : Mr. Vijayaraghavan for
M/s.Subbaraya Aiyar Padmanabhan**JUDGMENT****(DELIVERED BY R.SUDHAKAR, J.)**

Aggrieved by the order passed by the Tribunal in allowing the appeal filed by the assessee, the appellant/Revenue is before this Court by filing the present appeal. This Court, vide order dated 04.07.2007, admitted the appeal on the following substantial question of law :-

"Whether on the facts and circumstances of the case, the Tribunal was right in holding that the loss in non-performance of the contract and expenditure on increase in forward cover for foreign exchange, incurred in respect of a new joint venture, which did not materialise, is revenue expenditure?"

2. The point in issue here is *whether loss arising in the course of a new line of business activity is to be allowed as revenue expenditure or as capital expenditure?*

3. The facts, in a nutshell, are as follows :-

The case is relatable to the assessment year 1996-1997. The respondent/assessee is a company, which is engaged in the business of marketing of bulk drugs and formulations. In order to improve their business activity, they undertook market study of drugs and identifying potential customers so that the business activity of marketing bulk drugs and formulations could be enhanced. In this regard, during the relevant financial year, the assessee company identified a bulk drug "Ebuprofen" as one of the promising bulk drugs for the purpose of marketing through their company. The assessee procured a trial order for execution through M/s.Karnataka Malladi Biotics Ltd. (for short 'KMBL'), Bangalore. There was an agreement between the assessee and KMBL, whereby the marketing of Ebuprofen was to be done by the assessee company and it has to be paid a commission out of the profits accruing to KMBL on export of this product in the following

manner :-

"25% of the profits out of this product transaction would be to the share of KMBL and the remaining 75% to the assessee."

4. Further, the agreement also made it clear that any loss in the transaction would be borne by the assessee company. Due to misfortune and unfavourable market conditions, the product could not be manufactured and sold during the period in question and, therefore, the orders came to be extended and in order to cover possible exchange fluctuations, the assessee obtained forward cover through the State Bank of Mysore, however, in the name of KMBL, which is a requirement as per Reserve Bank of India guidelines. It further appears that RBI, thereafter, barred the companies from roll-over of the forward cover and, therefore, it resulted in a loss to the assessee/respondent in view of the foreign exchange fluctuations. This transaction resulted in a loss to the assessee company to the tune of Rs.40,63,503/=, which was paid over to the bank. It is also on record that the bank, viz., State Bank of Mysore, debited to the assessee's account prior to 31.3.1996, consequent to the settlement of foreign exchange cover, which is the subject matter of the loss sustained by the assessee.

5. According to the assessee, the loss had occurred during the previous year relevant to the assessment year 1996-1997 and, therefore, it is a business loss. The Department as well as the CIT (Appeals) took a

different view in the matter stating that it is a new enterprise on the part of the assessee and, therefore, the loss is capital in nature and not a loss that occurred in the course of business. Aggrieved against the orders of the Assessing Officer and the CIT (Appeals), the assessee preferred appeal before the Tribunal.

6. The Tribunal, taking note of the above stated undisputed fact, came to the conclusion that the loss, as incurred by the assessee, is in the course of its business activity and the activity in question is part and parcel of the same activity of marketing bulk drugs. There was no new enterprise, as held by the Assessing Officer and the CIT (Appeals), but the activity is the same one the assessee was already carrying on. For better clarity, the relevant portion of the order of the Tribunal is extracted hereinbelow :-

"4. The Id. Counsel was able to explain before us that the assessee is already in the same line of business and the company has identified Ebuprofen one of the promising bulk drug and accordingly the company had procured an order for trial execution only as an extension of its business through KMBL, Bangalore and not as a new business. It is settled law that when loss incurred in a business activity it is to be allowed. The assessee was able to explain before us that the loss was incurred only during the year and the agreement with KMBL also together with RBI permission supports the contention of the assessee that the loss is a business loss and it is not a new line of business then the one the assessee was already carrying on. However, the Id. DR defended the orders of the authorities below. Since the assessee was able to

establish before us the claim that the expenditure in question was incurred wholly and exclusively for its business, we set aside the orders of the authorities below and direct the AO to allow the claim of the assessee as business loss for the Asst. year 1996-97."

Aggrieved by the said order of the Tribunal, the appellant/Revenue is before this Court by filing the present appeal.

7. Heard the learned standing counsel appearing for the appellant/Revenue and the learned counsel appearing for the respondent/assessee and also perused the materials available on record.

8. The moot question before this Court is whether the activity of the assessee would be a new enterprise for the purpose of treating the loss as capital expenditure.

9. Similar issue arose before the Gujarat High Court in the case of ***Commissioner of Income Tax – Vs – Suhrid Geigy Ltd. (1996 (220) ITR 153 (Guj))***, wherein, the Gujarat High Court considering the decision of the Supreme Court in *Alembic Chemical Works Co. Ltd. v. CIT* [1989] 177 ITR 377 (SC) held as follows :-

"In Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377 (SC) the assessee-company was engaged in the manufacture of antibiotics and pharmaceuticals. It was granted licence for the manufacture of penicillin. Until 1963, it

has already made substantial investment of over Rs. 66 lakhs for setting up plant, etc., for the production of penicillin. Initially, the appellant was able to achieve only moderate yields. With a view to increasing the yield, the appellant negotiated with Meiji, a reputed Japanese enterprise whereunder in consideration of a once for all payment of 50,000 US \$, it agreed to supply the assessee a pilot plant, the technical information, know-how and written description of Meiji's process for fermentation of penicillin with a flow sheet of the process in the pilot plant and to arrange for the training of the appellant's representatives in various plants in Japan at the assessee's expense and advise the assessee in large scale manufacture for a period of two years. The assessee was to get technical know-how confidentially and secretly and not to seek any patent for the process. The assessee's claim for deduction of the sum paid to the Japanese company as revenue expenditure was disallowed by the Department holding that the expenses were capital in nature, for the purpose of setting up a new plant and a new process and for complete replacement of the equipment inasmuch as a new process and new type of plant was to be put up in place of the old process and old plant. The High Court also rejected the assessee's claim. Reversing the decision of the High Court, the Supreme Court observed that there was no material before the Tribunal to come to the finding that the appellant had obtained under the agreement a completely new plant with a completely new process and a completely new technical know-how. The business of the appellant was to manufacture penicillin. Even after the agreement, the product continued to be penicillin. There was no material before the Tribunal that the area of improvisation was not part of the existing business.

There was no material to hold that it amounted to a new or fresh venture. What was stipulated was an improvement in the operations of the existing business and its efficiency and profitability not removed from the area of day-to-day business of the appellant's established enterprise. The financial outlay under the agreement for the better conduct and improvement of the existing business was revenue in nature and was allowable deduction in computing the business profits of the appellant.

In coming to this conclusion, the court also noticed the principles which should govern while deciding such issues by the courts.

The most important aspects relevant for the present purpose which can be culled out from the above discussion is that where expenses are incurred in areas which supplement the existing business and is not a fresh or new venture and agreement of acquiring technical know-how pertain to product already in the line of the established business which was intended to improve the operations of the existing business, its efficiency and profitability from the area of day-to-day business of the appellant's established enterprise's expenses be treated as revenue and not capital. On the other hand, if the technical know-how is acquired for the purpose of establishing altogether a new or fresh venture, launching of a new enterprise, the same expenditure may be treated as capital and not revenue. In such cases the test of enduring benefit might break down. That is to say, the argument that the knowledge having become once part of the knowledge bank of the acquirer, cannot be taken back in a sense and will always remain with the assessee and is enduring. But looking to the business realities, namely, the purpose for which knowledge has been acquired becomes determining the true

character of the expenditure."

10. From the decision as extracted above, it is clear that the main parameters that are necessary for the expense to be treated as revenue expenditure is where expenses are incurred in areas which supplement the existing business and is not a fresh or new venture and agreement relates to revenue and the said activity is for the purposes of improving the operations of the existing business, its efficiency and profitability from the area of day-to-day business of the appellant's established enterprise's, expenses be treated as revenue and not capital.

11. In the case on hand, a careful reading of the order of the Tribunal and the facts as narrated above, it is clear that there is absolutely no justification for the Department to hold that there was a new line of business on which there occurred a loss. The parameters enunciated in the decision in *Suhrid Geigy Ltd. Case (supra)* is squarely attracted to the facts of the present case, justifying the loss of the assessee as a business loss, as admittedly, the assessee is in the business of marketing bulk drugs, formulations, etc., and one of its ventures has ended in a loss and that loss is attributable to business and it cannot be deemed to be a new enterprise and a capital expenditure.

12. For all the reasons stated above and in the light of the parameters

enunciated above for treating a particular expenditure as capital or revenue, this Court is of the considered opinion that the order passed by the Tribunal requires no interference. Accordingly, the ***substantial question of law is answered in favour of the assessee/respondent and against the appellant/Revenue.***

13. In the result, finding no merits warranting interference with the order passed by the Tribunal, the appeal is dismissed. However, in the circumstances of the case, there shall be no order as to costs.

(R.S.J.) (R.K.J.)

24.02.2015

Index : Yes/No

Internet : Yes/No

GLN

To

1. Commissioner of Income Tax
Chennai.
2. The Income Tax Appellate Tribunal
'C' Bench, Chennai.

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AND
R.KARUPPIAH, J.

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