

THE HON'BLE SRI JUSTICE C.V.NAGARJUNA REDDY
&
THE HON'BLE SRI JUSTICE M.S.K.JAISWAL

R.C.No.50 of 2000

DATE:- 02-02-2018

Between:

V.B.C.Industries Limited,
Visakhapatnam

..... APPLICANT/ ASSESSEE

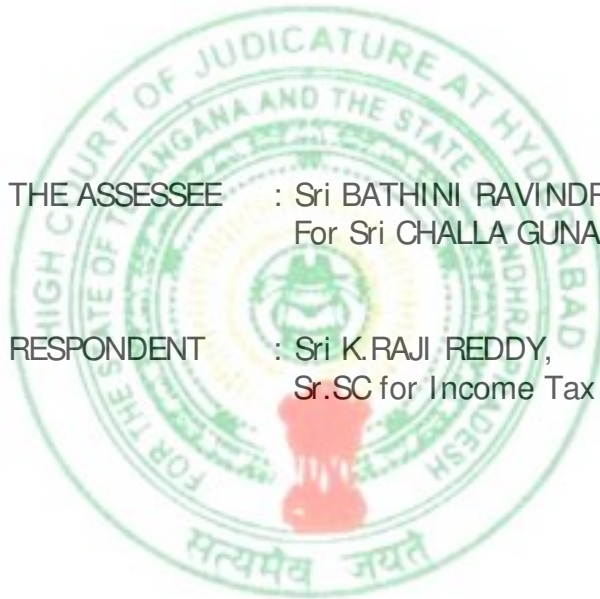
AND

Commissioner of Income Tax,
Visakhapatnam

.....RESPONDENT

COUNSEL FOR THE ASSESSEE : Sri BATHINI RAVINDRA
For Sri CHALLA GUNARANJAN

COUNSEL FOR RESPONDENT : Sri K.RAJI REDDY,
Sr.SC for Income Tax



THE COURT MADE THE FOLLOWING:

THE HON'BLE SRI JUSTICE C.V.NAGARJUNA REDDY
&
THE HON'BLE SRI JUSTICE M.S.K.JAI SWAL

R.C.No.50 of 2000

ORDER: (per Hon'ble Sri Justice M.S.K.Jaiswal)

The Income Tax Appellate Tribunal, Hyderabad, made the reference for the decision of this Court raising the following questions for being answered:-

- 1) Whether on the facts and in the circumstances of the case, the Hon'ble Tribunal is correct in holding that the expenditure of Rs.11,52,506/- incurred by the assessee in connection with the Project Development and Investigation is with a view to bringing into existence an asset or advantage of an enduring nature?
- 2) Whether on facts and in the circumstances of the case, the Hon'ble Tribunal is correct in holding that the said expenditure incurred is not for the same business that was being carried on by the assessee, on the mere ground that it relates to a new line of activity?
- 3) Whether on facts and in the circumstances of the case, the Hon'ble Tribunal having conceded that the decision of the Karnataka High Court in the case of CIT v. Bharat Earth Movers Ltd. (155 ITR 321) is applicable to the assessee, is correct in applying the decision of the Supreme Court in Scientific Engineering House Pvt.Ltd. (157 ITR 86), in spite of the jurisdictional High Court's observation in the case of CIT v. Venkateswara Transmission P.Ltd. (171 ITR 476) that the Supreme Court did not consider the question whether the expenditure is capital or revenue in that case?
- 4) Whether on facts and in the circumstances of the case, the Hon'ble Tribunal is correct in holding that the two decisions of the jurisdictional High Court in the case of Barium Chemicals Ltd. (168

ITR 164) and in the case of Sri Krishna Bottlers Ltd. (175 ITR 154) are applicable to the facts of the case, even though the question whether the expenditure is capital or revenue did not come up for consideration in those two cases?

- 5) Whether on facts and in the circumstances of the case, the Hon'ble Tribunal is correct in holding that the decision of the Hyderabad Bench of the Tribunal in Coromandel Fertilizers Ltd. case (29 ITD 455) is not applicable to the facts of this case for the reason that the decision of the Supreme Court and the jurisdictional High Court in the case of Scientific Engineering House Pvt.Ltd. (157 ITR 86) and Venkateswara Transmission P.Ltd. (171 ITR 476) respectively were not considered in that decision, though the question whether the expenditure is capital or revenue did not come up for consideration in those decisions?
- 6) Whether on facts and in the circumstances of the case, the Hon'ble Tribunal was correct in law in disallowing the assessee's claim for deduction in full of the expenditure of Rs.11,52,506/- representing partly payment made to VBC Chemicals Ltd., towards 'Project Development and Investigation Expenses' and partly further expenses incurred under that project during the relevant previous year?
- 7) Whether on facts and in the circumstances of the case, the Hon'ble Tribunal is correct in law in holding that the expenditure incurred on 'Project Development and Investigation' of Rs.11,52,506/- was capital in nature attributable towards the acquisition of a depreciable asset, applying the decision of the Supreme Court in Scientific Engineering House Private Limited (157 ITR 86) and also the two decisions of the jurisdictional High Court in Barium Chemicals Ltd. (168 ITR 164) and Krishna Bottlers Ltd. (175 ITR 154)?

2. The following facts are enumerated in the statement of the case:

The Assessee, a company, carrying on business in soft drinks, filed its returns on 27.10.1988 for the period ending with 30.09.1987 showing the income of Rs.65,54,435/- and the assessment was completed under Section 143(3) of the Income Tax Act, 1961, determining the total income at Rs.78,37,090/-. The Assessing Officer added a sum of Rs.1,10,080/- being the security deposits received on bottles and wooden crates being trading receipts, as well as the disputed sum of Rs.11,52,506/- treating it as expenses of capital nature having been spent by the assessee for obtaining licence and project report from the transferor VBC Chemicals Limited for the manufacture of ammonium nitrate under a specific agreement. On appeal, the Commissioner of Income Tax (Appeals), vide the order dated 29.08.1990, deleted the former addition but not the latter, i.e., the amount of Rs.11,52,506/-.

3. Being aggrieved by the said order of the appellate authority, the assessee filed I.T.A.No.1655/Hyd/90 before the Income Tax Appellate Tribunal, contending that the assessing officer is not justified in disallowing the sum of Rs.11,52,506/- it being the project development and investigation expenses claimed as a deduction from the business income.

4. The Tribunal, by order, dated 31.10.1991, dismissed the appeal, while observing that the business of the assessee was bottling of soft drinks and aerated water but subsequently desired to diversify its activities by engaging itself in an altogether different business of manufacture of ammonium nitrate project for which it entered into an

agreement with VBC Chemicals Limited and incurred expenditure of Rs.11,52,506/- in obtaining the project report for setting up of new business and that hence the expenditure does not come under revenue expenditure and it would be in the nature of capital expenditure.

5. We have heard Sri Bathini Ravindra for Sri Challa Gunaranjan, learned counsel for the assessee and Sri K.Raji Reddy, learned senior Standing Counsel for Income Tax.

6. The contention of the learned Counsel appearing for the assessee is that the Assessing Officer ought not to have disallowed the expenses claimed by the assessee amounting to Rs.11,52,506/- spent towards the Project Development and Investigation since the said amount was paid as consideration for transfer of knowhow relating to the new project concerning the market survey, identification of collaborators and suitable process etc. It is further contended that merely because the company, which has transferred the knowhow has shown the same as capital expenditure, it cannot be treated as such in the hands of the assessee. That the transferee of the know-how treated it as capital expenditure as it had not started its business unlike the case of the assessee, but acquired the know-how and used it for development of the existing business. It is further submitted that the Assessing Officer erred in not properly interpreting the case law on subject and erroneously disallowed the amount as claimed on the ground that it is a capital expenditure but not revenue expenditure which do not qualify for exemption in the relevant year.

7. On the other hand, the contention of the Revenue is that the Appellate Officer has rightly followed the decisions of the Supreme Court as well the jurisdictional High Court and held that the amount is a capital expenditure but not a revenue expenditure. That in the instant case, the original business of the assessee was bottling of soft drinks and aerated water but subsequently the assessee desired to diversify its activities by engaging itself in an altogether different business of manufacture of ammonium nitrate for which it entered into an agreement with the transferee company viz., VBC Chemicals Limited for purchasing the valuable information gathered by it. It is submitted that the assessee cannot claim the amounts spent by it towards acquiring the know-how from transferee company as liable to be deducted treating it as a revenue expenditure.

8. Having heard the submissions of the learned Counsel for both sides and perusing the material on record, the point that falls for adjudication is as to whether the amounts spent by the assessee and claimed as an exemption treating it as a revenue expenditure is liable to be allowed or whether it is the capital expenditure which is liable to be adjusted in accordance with Section 35-D of the Income Tax Act?

9. In order to determine as to whether the expenditure is a revenue expenditure or a capital expenditure, the aim and object and the true nature and substance of the expenditure should be considered. Expenditure would be capital in nature and not deductible in its entirety in the assessment year if it is made with a view to bringing into existence of an asset or advantage of enduring nature and further that it is not

necessary for the existing business. If the amount is spent for facilitating the existing business, or treating operations or was to enable it to manage its business more efficiently, then the amount spent thereon can be treated as a revenue expenditure.

10. In the instant case, the assessee has been carrying on the business of soft drinks but incurred expenditure in obtaining a project report for setting up business of manufacture of ammonia nitrate. A perusal of the record leaves no room for doubt that admittedly the expenditure was not incurred directly by the assessee, but it has acquired know-how for altogether a different business purpose. For manufacture of soft drinks or aerated water bottling unit, the business of ammonia nitrate is altogether alien. By no stretch of imagination, can it be said that by spending the amount for acquiring the know-how of the business of ammonia nitrate, the assessee can be said to have spent the amount with the object of increasing or expanding its existing business. There is no nexus whatsoever in between the manufacture of soft drink bottles and ammonia nitrate, which has acquired the know-how from VBC Chemicals and therefore the amount spent therefor cannot be said to be a revenue expenditure but to be treated as a capital expenditure.

11. The facts of the case further reveal that VBC Chemicals intended to start a project for manufacturing of ammonium nitrate and nitric acid. In this connection, the said company incurred expenditure towards acquiring the know-how but however VBC Chemicals did not start the business but transferred the same to the assessee viz., VBC Industries, which has acquired the licence for manufacturing ammonium nitrate and nitric acid

which was standing in the name of VBC Chemicals. However, even the assessee has not commenced commercial production till the end of the previous year relevant to the assessment. The amount of Rs.1,06,091/- represents the direct expenses incurred by VBC Chemicals on this project and the same was debited in their account, which has been re-imbursed. The facts further show that the assessee has acquired the licenced manufacturing ammonium nitrate and what has been paid by the assessee to the transferor company is a consideration for licence.

12. It may be useful to look into the provisions of Section 35D of the Income Tax Act which reads as under:-

“35D. Amortisation of certain preliminary expenses:- (1)

Where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs, after the 31st day of March, 1970, any expenditure specified in Sub-Section (2)—

- (i) before the commencement of his business, or
- (ii) after the commencement of his business, in connection with the extension of his undertaking or in connection with his setting up a new unit,

the assessee shall, in accordance with and subject to the provisions of this Section, be allowed a deduction of an amount equal to one-tenth of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or, as the case may be, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation:

(Provided that where an assessee incurs after the 31st day of March, 1998, any expenditure specified in sub-section (2), the provisions of this sub-section shall have effect as if for the words “an amount equal to one-tenth of such expenditure for each of the ten successive previous years”, the words “an amount equal

to one-fifth of such expenditure for each of the five successive previous years” had been substituted.)

(2) The expenditure referred to in Sub-section (1) shall be the expenditure specified in any one or more of the following clauses, namely:”

- a) Expenditure in connection with-
 - (i) preparation of feasibility report;
 - (ii) preparation of project report;
 - (iii) conducting market survey or any other survey necessary for the business of the assessee;
 - (iv) xxxxx
- b) xxxx
- c) where the assessee is a company, also expenditure-
 - i. xxxxx
 - ii. xxxxx
 - iii. by way of fees for registering the company under the provisions of the Companies Act, 1956 (1 of 1956)
 - iv. xxxxx
- d) xxxx

13. Even though reliance is placed upon the decisions of the different High Courts but suffice it to refer to a recent decision of the Supreme Court reported in HONDA SIEL CARS INDIA LTD. v CIT¹ The aspects that were considered by the Supreme Court in the above said decision are as under:-

- “(a) the Appellant was granted indivisible and non-transferable right to manufacture in India the range of products using know how/technology licensed by HMCL;
- (b) the Appellant had during the currency of the agreement only the right to access the manufacturing know-how/technology owned by HMCL;
- (c) there was no transfer of the know-how/technology in favour of the Appellant and the proprietary rights therein always vested in HMCL;

¹ (2017) 395 ITR 713 (SC)

If the aforesaid factors are taken in isolation, probably the claim of the Assessee may be justified. Distinction between capital and revenue expenditure with reference to acquisition of technical information and know-how has been spelled out by this Court as well as High Courts in series of cases. Primary test which is adopted to differentiate between capital and revenue expenditure remains the same, namely, the enduring nature test. It means where the expenditure is incurred which gives enduring benefit, it will be treated as capital expenditure. In contradistinction to the cases where expenditure of concurrent and reoccurring nature is incurred and the later would belong to revenue field. Technical information and know-how are intangible. They have different and distinct character from tangible assets. When the expenditure is incurred to acquire a tangible asset, determination as to whether the said acquisition of tangible asset is of capital nature or the expenditure is of revenue nature, may not pose a problem. However, in case of technical information and know-how, having regard to their unique characteristic, the questions that need to be posed for determining the nature of such an expenditure are also of different nature. In case where there is a transfer of ownership in the intellectual property rights or in the licences, it would clearly be a capital expenditure. However, when no such rights are transferred but the arrangement facilitates grant of licence to use those rights for a limited purpose or limited period, the Courts have held that in such a situation, the royalty paid for use of such technical information or know-how would be in the nature of revenue expenditure as no enduring benefits is acquired thereby. This was so held in a classic case, entitled Commissioner of Income Tax, Bombay City I v. Ciba India Limited MANU/SC/0125/1967 : (1968) 69 ITR 692 (SC). In the said case, the Assessee company had procured know-how in the form of processes, formulae, scientific data, working, prescription and other intellectual property rights developed by a Swiss Company,

to produce licensed preparations and to promote their sale in India. In spite of the fact that the Swiss Company had granted to the Indian Assessee "full and sole right and licence" in the territory of India under the patents listed in Schedule-I, to make use, exercise and vend the inventions referred to therein and to use the trade marks set out in Schedule-II in the territory of India, this Court held that what was conferred was a mere right to use. The Indian Assessee, it was observed, was not entitled to exclusive rights to patents, trademarks etc. As per the agreement, proprietary information was not to be divulged to third parties without consent. The rights granted enabled access to the technical knowledge and experience with right to use patents and trademarks for a limited period. The Swiss Company did not part with any asset of its business, nor did the Indian Assessee acquire any asset or advantage of enduring nature. The right empowered the Indian Assessee to draw for the purpose of carrying on its business as a manufacturer and rely upon the technical knowledge of the Swiss Company. There was no attempt to part with technical knowledge absolutely in favour of the Indian Assessee. It was not a case of transfer of intellectual rights once for all. Thus, the expenditure incurred was revenue in nature."

14. The Supreme Court has referred to the decision in ALEMBIC CHEMICAL WORKS CO.LTD. v. CIT² wherein it was observed as under:-

"The Assessee was engaged in the manufacture of antibiotics and pharmaceuticals on the basis of licence which was granted to it by the Government for manufacture of antibiotic, penicillin etc. It entered into an agreement with Japanese Company for supply of requisite technical know-how so as to achieve substantially high

² (1989) 177 ITR 377 (SC)

level of performance or production with the aid of better technology and process of fermentation and with better yielding penicillin strains that was developed by the foreign company. Under the agreement, royalty was to be paid. This royalty payment was treated as capital expenditure till the stage of the High Court. This Court reversed the judgment of the Courts below by holding the expenditure would be revenue in nature. In its judgment, the Court culled out certain principles laid down therein to determine, whether expenditure of Assessee was 'Capital Expenditure' or 'Revenue Expenditure' and said:

(i) When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital (referred to *British Insulated Helsby Cables Ltd. v. Atherton*, [1926] AC 205).

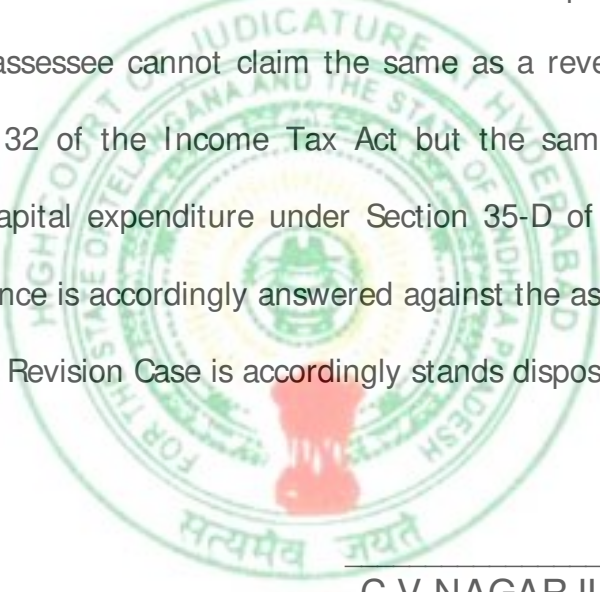
(ii) If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure.

(iii) The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure.

It was also held that three aspects should be considered, (a) the character of the advantage sought, and in this, its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part and (c) the means adopted to obtain it.”

15. Upon perusal of the provisions of Income Tax Act and the decisions of the Apex Court, referred to supra, we have no hesitation in holding that the amounts spent by the assessee in the relevant assessment year was rightly treated as capital expenditure for the reason that the amount was spent for establishment of a new project altogether but not for expanding its existing business. As already observed, the assessee was in the business of manufacturing soft driks and it has acquired the know-how and licence from a transferor which was in the business of ammonium nitrate which is a chemical substance. We see no similarity in between the two activities and since the amount was not for expanding its existing business, the assessee cannot claim the same as a revenue expenditure under Section 32 of the Income Tax Act but the same is liable to be treated as a capital expenditure under Section 35-D of the Income Tax Act. The reference is accordingly answered against the assessee.

16. The Tax Revision Case is accordingly stands disposed of.



C.V.NAGARJUNA REDDY,J

M.S.K.JAI SWAL,J

Date: 02.02.2018
Dsr/Smr