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*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ ITA 325/2005

Reserved on : 14th December, 2017

Date of decision : 20th April, 2018

M/S HILTON ROULUNDS LTD.

. Appellant

**Through: Mr. Ajay Vohra, Senior Advocate
with Mr. Prakash Kumar & Mr.
Aniket D. Aggarwal, Advocates.**

versus

COMMISSIONER OF INCOME TAX

..... Respondent

Through: Mr. Ruchir Bhatia, Advocate.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MS. JUSTICE PRATHIBA M. SINGH

JUDGMENT

Prathiba M. Singh J.,

The short question arising in the present appeal is – Whether the payment of Rs.1 Crore for exclusive use of the trade mark “HILTON” is to be treated as capital expenditure or revenue expenditure?

2. M/s. Hilton Roulands Ltd. (*hereinafter ‘appellant’*) entered into Trade Mark license agreement dated 27th January, 1993 (*hereinafter ‘first license agreement’*) which was later substituted with license agreement dated 9th November, 1995 (*hereinafter ‘second license agreement’*) with M/s. Hilton Rubbers Limited (*hereinafter ‘HRL’*). The questions that arise in this case are to be adjudicated in the context of these agreements.

Brief Background

3. M/s Roulands Fabriker Denmark (*hereinafter ‘RF’*) along with HRL and Industrialisation for Developing Countries, Copenhagen (*hereinafter*

'IFU') formed the appellant as a joint venture in India. HRL owned 50% of the equity shares of the appellant, and RF and IFU held 26% and 24% respectively of the said joint venture. At the time when the joint venture was formed, the first license agreement dated 27th January 1993, was entered into, under which the appellant was granted by HRL license to use the Trade Mark HILTON in respect of Raw-Edge and Wrapped V-Belts. The relevant clauses of the said agreement are as under:

"2(a). Subject to the terms of this Agreement the Proprietor hereby grants to the User for the term of this Agreement an exclusive right to use upon or in connection with Raw Edge, Wrapped V-Belts and other power transmissions belts excluding flat transmission belts (hereinafter referred to as "the Goods") the Trade Mark in India and in such other countries to which the Goods are exported.

3(a). In consideration of the said right, the User shall pay to the Proprietor a running royalty on the domestic sale (i.e. sales within the Republic of India) of Raw-Edge and Wrapped V-Belts at the rate of 1.8% of the net selling price from the date of commercial production thereof.

The expression Net Selling Price shall mean ex-factory selling price of Raw-Edge and Wrapped V-Belts excluding sales tax, excise duty and other governmental taxes and levies, insurance, forwarding and packaging expenses nad freight charges.

(b). Unless otherwise specified by the Proprietor, the royalty hereunder shall be paid to Hilton Rubbers Limited, S-21, Green Park Extension, i_e "" Delhi 110016, in India Rupees at half yearly intervals, within 60 days at the end of each calendar half year.

7(a). The User recognizes the Proprietor's title to the Trade Mark and shall not at any time do or suffer to be

done any act or thing which will in any way impair the rights of the Proprietor in and to the Trade Mark. In particular but without prejudice to the generality of the foregoing, the User undertakes not to use the Trade Mark in any manner which may jeopardize the distinctiveness or validity of the Trade Mark and shall apply and use the Trade Mark only on or in connection with such of the Goods and only in such form and manner as the Proprietor or his representative may from time to time direct or approve and the labels, containers, packagings, pamphlets, advertisements and the like used in connection with the Goods shall show the Trade Mark in such a manner and with such lettering and marking as may be so directed or approved.

11. This Agreement shall come into force on the date hereof and the User shall be entitled to use the Trade mark as an exclusive User thereof for the Goods. Subject to earlier termination in accordance with the provisions of Clauses 12 & 13, this Agreement shall run for an initial period of 10 years and shall continue thereafter without limit of time until terminated by at least 12 calendar months' previous written notice given by either party to the other.

(emphasis supplied)

Thus, as per the First license agreement:

- a) The appellant was granted an exclusive right to use the Trade Mark “HILTON” in India in respect of Raw-Edge and Wrapped V-Belts;
- b) Ownership of the mark vested in HRL;
- c) Running royalty on domestic sale was payable to the HRL;
- d) License was terminable by 12 months' notice or by 30 days' notice in case of breach of the terms of the agreement;

e) License could also be terminated if the appellant did not adhere to the conditions of use under the agreement, or if the rights in the mark were endangered in any manner.

4. Though, the agreement was for a period of 10 years, a second license agreement was entered into on 9th November, 1995. The relevant clauses of the second license agreement 1995 read as under:

“1. The Proprietor is registered as the Proprietor in India of the Trade Mark "Hilton" which the Registration No.325863 (hereinafter called the "Trade Mark") shown in the Schedule hereto and has exclusive rights in the Trade Mark.

2. By a Trade Mark License Agreement dt. January 27, 1993 (Hereinafter "First Agreement") entered into between the proprietor and the user, the user has right to use the Trade Mark "Hilton", either alone or as part of a trade name (including but not limited to "Hilton Optiflex". "Hilton Optiset" and "Hilton Optitex"). In India and in all other countries to which the user may intend to export Raw-Edge and Wrapped v. Belts, subject to the terms and conditions set forth in the said agreement.

3. By a Joint Venture Agreement dated 13, 1992 (hereinafter "JV Agreement") entered into between Proprietor, M/s Roulunds Fabriker, Denmark (hereinafter "RF) and the Industrialization for Developing countries, Copenhagen (hereinafter "IFU), the parties hereto have formed and established the User as a Joint Venture and have subscribed to the share capital of the user on the trade and conditions wet forth in the JV Agreement.

4. Proprietor, having decided to sell its entire shareholding in user to RF or its nominee(s) is desirous of signing a new Trade Mark License

Agreement (hereinafter "Principle Agreement") which overrides the first agreement, in the entirety.

.....

1. The User hereby acknowledges and confirms that the Proprietor has at all material times been the lawful sole and exclusive owner of the Trade Mark throughout the world including the Union of India and of the rights attaching to the said Trade Mark been used in relation to business in the said goods advertisement or promotional material or otherwise in connection therewith.

2. Subject to the terms of this Agreement the Proprietor hereby grants to the User for the term of this agreement an exclusive right to use upon or in connection with Raw Edge, Wrapped V. Belts and other power transmission belts excluding that transmission belts (hereinafter referred to as the Goods) the Trade Mark in India and in such other countries which the goods are exported.

3. This agreement shall come to effect from the day of signing of this agreement (hereinafter referred to as "Effective Date).

4. In consideration of the said right, the User shall pay to the Proprietor a sum of Rs. 10,000,000/- (Rupees ten million only) within 3 weeks of time Effective Date. In the event that the payment is not made as aforesaid, the said amount will carry interest w.e.f 22nd day of the effective date till the date of actual payment as below:

.....

12. This agreement shall come into force from the Effective Date, and the User shall be entitled to use the Trade Mark as an exclusive user thereof for the goods. Subject to earlier termination in accordance with the provisions of clause 13 & 14, this agreement shall run for an initial period of 10 years and shall continue thereafter without limit of the time until terminated by

at least 12 calender months previous written noticed given by either party to the other.”

(emphasis supplied)

Thus, in the second license agreement the terms were:

- a) That HRL had decided to sell its entire shareholding in the appellant to RF.
- b) Instead of a royalty payable periodically, a onetime royalty of Rs.1 Crore was payable towards the Trade Mark license.
- c) Exclusive right to use the mark was given to the appellant.

5. The short question that has arisen is as to whether the payment of Rs.1 Crore made under the second license agreement to HRL by the appellant was entitled to deduction under Section 37(1) of the Income Tax Act, 1961 (*hereinafter ‘the Act’*) as revenue expenditure?

6. The Reserve Bank of India gave no objection for the making of payment on 30th March, 1996. The appellant/assessee filed its return of income for assessment year (*hereinafter ‘AY’*) 1996-97 declaring a loss of Rs.23,39,304/-. Deduction was claimed under Section 37(1) of the Act in respect of payment of Rs.1 Crore made to HRL for use of Trade Mark under the second license agreement. Assessment was completed under Section 143(3) of the Act and the income of the appellant was determined at Rs.84,95,035/-. The assessing Officer (*hereinafter ‘AO’*) came to the conclusion that since the payment of Rs.1 Crore was absent in the earlier license agreement and it was for use of the brand, the expenditure of Rs.1 Crore cannot be related to the business of the appellant. The AO further held that the said expenditure was of capital nature and was of an enduring nature. Relevant findings of the AO are as under:

- a) Since the first license agreement was already in operation there was no purpose in entering into the second license agreement.
- b) The reason given in clause 4 of the second agreement clearly showed that the transaction was one of sale of shareholding.
- c) There were payments made to RF towards royalty and technical know-how. The expenditure gives enduring benefit to the business and was distinguishable from a recurring expenditure.
- d) Even the clauses of termination were vague and based on hypothetical conditions.
- e) In effect, the Trade Mark license was perpetual as there was no clause stipulating that the Trade Mark would revert to the owner after a definite time period.

On these grounds, deduction as revenue expenditure was disallowed by the AO.

7. The Commissioner of Income Tax (Appeals) [*'CIT(A)', for short*], on 24th March, 2000, after examining the matter and relying upon the decision of the Supreme Court in ***Madras Industrial Investment Corporation v. CIT (1997) 225 ITR 802 (SC)*** held that the payment of Rs.1 Crore was revenue expenditure and the appellant was entitled to the deduction. CIT(A) concluded that the expenditure incurred in connection with right to use the trademark was important in the operations of the business of the assessee as also for its efficiency and profitability. Accordingly, the deduction was allowed.

8. The Income Tax Appellate Tribunal (*'ITAT', for short*) on 22nd December, 2004 held that since two agreements were entered into on 9th

November, 1995, one for use of the trademark and another for sale of shareholding, the payment of Rs.1 Crore was not a pure trademark license. ITAT specifically relied upon clause 12 of the second license agreement. On this, the ITAT held as under:

“Since the HRL has sold the entire share holding in assessee and the right to use the Trade Mark on one day and the agreements suggest that it was not only a license to use the Trade Mark but also a sale of Trade Mark, by allowing the assessee to use for a unlimited period, one inference can only be drawn that the assessee has procured the enduring benefit for its business by using this trade made through this agreement against lump sum payment and the expenditure incurred in capital expenditure.”

9. The ITAT held that since the right to use was for an unlimited period, and there was no clause for renewal and/or any further consideration, the trademark, though termed as a license, was in effect, final sale of the mark. Thus, the ITAT held that the payment of Rs. 1 Crore is for an enduring benefit and hence is capital in nature.

10. On 13th September, 2005, the following question of law was framed in the present appeal:

“Whether the Income Tax Appellate Tribunal was right in law in holding that the payment of Rs. 1 crore in terms of the agreement dated 09.11.1995 represented capital expenditure could not be allowed as deduction under the Income Tax Act, 1961?”

Submissions of the appellant/assessee

11. Mr. Ajay Vohra, learned Senior counsel for appellant relied on the above mentioned judgments and also cited the recent judgment of a Division

Bench of this Court in *McDonalds India Pvt. Ltd. & Ors. v. Commissioner of Trade and Taxes (2017) 241 DLT 769 (DB)* (*‘McDonalds’*, for short). In *McDonalds (supra)*, the Court was concerned with the question as to whether the consideration revealed by the McDonalds was taxable under the Delhi Value Added Tax Act, 2004 (*‘DVAT Act’*, for short). This Court held that proceedings were under the sale or purchase of goods while in a trademark license arrangement, the franchise agreement, insofar as they were related to the right to use the mark, were not subjected to DVAT levy. The observations of the Court are under:

“McDonald’s and the petitioners (Sagar Ratna, and Bikanerwala) are solely engaged in providing franchise services to its franchisees and the same would thus not be liable to VAT under the provisions of the DVAT Act, as the franchise service is expressly a taxable service and cannot be treated as goods. From a perusal of the facts of the cases, as well as the provisions of the franchise agreements, it can be concluded that what was intended to be transferred was not the trade mark, but an entire gamut of services, which includes, inter alia, a guide that educates the franchisees on various aspects of business and conduct to market the business. To segregate the terms of the agreement to levy VAT on only specific aspects of it would be inexact. Moreover, the Appellant and the Petitioners are already paying service tax levied on the franchise agreements, and there can be no overlapping of taxes. The subject matters in List I and List II of the Seventh Schedule to the Constitution are distinct and once a particular service is subject to service tax, it cannot be treated as a sale of goods and subject to VAT. Thus, the definition of “intellectual property” and levy of sales tax on transfer of right to use trade marks, patents and copyrights etc. will not apply in the case of a franchise

agreement. This was highlighted in paragraphs 88 and 89 of BSNL (supra). ”

12. This Court held that since franchise agreements were subjected to service tax there cannot be any levy of sales tax. Thus, franchise agreement was held to only grant the representational right and not right to sell or manufacture the goods.

13. It was submitted by Mr. Vohra that under both the license agreements, only the right to use was given. Right to ownership in the mark was not transferred. The mere fact that instead of 1.8% net royalty, a lumpsum royalty was fixed. This fact alone does not change the nature of the transaction. He submits that the court cannot go behind the transaction and an exclusive right to use has to be construed as such.

Submissions of the Respondent

14. Mr. Ruchir Bhatia, on the other hand, submits that the appellant company was set up on 13th August, 1992 and though initially it was a joint venture, the shareholding got completely transferred by means of the Share Purchase agreement in 1995. The second license agreement dated 9th November, 1995 was executed at the time of transfer of the shareholding. According to Mr. Bhatia, clause 12 of the second license agreement would show that the right to use the mark was granted in perpetuity. Thus, when the payment of Rs.1 Crore was made, the benefit that was acquired was of an enduring nature. He places heavy reliance on a recent judgment of the Supreme Court in ***Honda Siel Cars Ltd. v. CIT, (2017) 395 ITR 713 (SC)*** (*hereinafter, 'Honda Siel'*) wherein it has been held as under:

“3. The dispute which has arisen is as to whether the said technical fee of 30.5 million US Dollar payable in

five equal instalments on yearly basis is to be treated as revenue expenditure or capital expenditure.

.....

22. When we apply the aforesaid parameters to the facts of the present case, the conclusion drawn by the High Court that expenditure incurred was of capital nature, appears to be unblemished. Admittedly, there was no existing business and, thus, question of improving the existing technical know-how by borrowing the technical know-how of the HMCL, Japan did not arise. The Assessee was not in existence at all and it was the result of joint venture of HMCL, Japan and M/s. HSCIL, India. The very purpose of Agreement between the two companies was to set up a joint venture company with aim and objective to establish a unit for manufacture of automobiles and part thereof. As a result of this agreement, Assessee company was incorporated which entered into TCA in question for technical collaboration. This technical collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery etc. so as to bring in existence manufacturing unit for the products. Thus, a new business was set up with the technical know-how provided by HMCL, Japan and lumpsum royalty, though in five instalments, was paid therefor.

23. No doubt, this technical know-how is for the limited period i.e. for the tenure of the agreement. However, it is important to note that in case of termination of the Agreement, joint venture itself would come to an end and there may not be any further continuation of manufacture of product with technical know-how of foreign collaborator. The High Court has, thus, rightly observed that virtually life of manufacture of product in the plant and machinery, establishes with assistance of foreign company, is co-extensive with the agreement. The Agreement is framed in a manner so as

to given a colour of license for a limited period having no enduring nature but when a close scrutiny into the said Agreement is undertaken, it shows otherwise. It is significant to note in this behalf that the Agreement provides that in the event of expiration or otherwise termination, whatsoever, licensee, i.e., joint venture company/Assessee shall discontinue manufacture, sale and other disposition of products, after the residuary products. All these things then shall be at the option of licensor. In other words, licensee in such contingency would hand over unsold product and parts to licensor for sale by him. In case licensor does not exercise such an option and the product is allowed to be sold by the licensee, it would continue to pay royalty as per rates agreed under the agreement. Clauses 19 & 21, in our view, make the Agreement in question, i.e. establishment of plant, machinery and manufacture of product with the help of technical know-how, co-extensive in our continuance of Agreement. The Agreement also has a clause of renewal which, in our view, in totality of terms and conditions, will make the unit continue so long as manufacture of product in plant and machinery, established with aid and assistance of foreign country will continue. Since, it is found that the Agreement in question was crucial for setting up of the plant project in question for manufacturing of the goods, the expenditure in the form of royalty paid would be in the nature of capital expenditure and not revenue expenditure. The Tribunal is conclusion that it is only the other three memoranda which were necessary for setting up the manufacturing payment of technical fees/royalty on the ground that this agreement was not in connection with the setting up of plant or manufacturing facilities, is not correct. It would be interesting to note that even the Tribunal had nurtured doubt on the nature of this expenditure as TCA was signed simultaneously with the other memoranda to facilitate setting up of a new factory and

not improvising the earlier set up. This doubt has expressed by the ITAT itself in the following words:

Our doubt was why the payment, at least of the lump sum technical know-how fees, cannot be considered as being connected to the initial starting up of the business and hence not allowable since the know-how was bring obtained for the first time and was crucial to the setting up of the business of the Assessee which undisputedly was to manufacture Honda cars in India. It may be recalled that was also the view taken by the Assessing Officer. Further, the Assessee was not already in the manufacture of cars and was commencing such an activity for the first time. It was not a case of a business already in existence. The payment was an “once for all” payment, though staggered over a period of years.”

15. He also submits that the Trade Mark license was infact was valid upto only 3rd June, 2005. Clause 1 of the second license agreement, according to Mr. Bhatia, showed that the Trade Mark was permitted to be used either alone, or as a trade name, or as a combination mark. Even after the Trade Mark was abandoned by HRL, the fact that the appellant continued to use the word “HILTON” as part of its trade name shows that enormous advantages had been gained under the second license agreement and without any payment whatsoever, the word “HILTON” was used. Thus, he submits that the ITAT and AO were right in holding that the expenditure is a capital expenditure and the deduction is not liable to be allowed.

Analysis and Findings

Capital expenditure and Revenue expenditure - Tests

16. There is exhaustive case law on the various tests distinguishing capital and revenue expenditure. In *CIT, Bombay v. Ciba of India Ltd. AIR 1968*

SC 1131, the Supreme Court, was dealing with a case whereby a Swiss company had licensed its patents to its Indian subsidiary, in order to enable it to make full use of and vend the inventions stated therein, as also its trademark. However, under the agreement, the Swiss Company reserved the right to terminate the license at any given point, and also precluded the Indian Company from acquiring any proprietary right in its intellectual property. The licensee was merely granted a ‘right to use’ to the Indian Company. The Supreme Court, on these facts, held as under:

“13. The assessee did not, under the agreement, become entitled exclusively even for the period of the agreement, to the patents and trade marks of the Swiss Company it had merely access to the technical knowledge and experience in the pharmaceutical field which the Swiss Company commanded. The assessee was on that account a mere licensee for a limited period of the technical knowledge of the Swiss Company with the right to use the patents and trade marks of that Company.....

.....

15. The assessee acquired under the agreement merely the right to draw, for the purpose of carrying on its business as a manufacturer and dealer of pharmaceutical products, upon the technical knowledge of the Swiss Company for a limited period by making that technical knowledge available the Swiss Company did not part with any asset of its business nor did the assessee acquired any asset or advantage of an enduring nature for the benefit of its business.”

17. In ***Empire Jute Company Ltd. v. CIT, (1980)124 ITR 1 (SC)***, which was a case dealing with purchase of loomhours (number of working hours on the loom), the Supreme Court observed as under:

*“The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all embracing formula which can provide a ready solution to the problem; no touchstone has been devised. Every case has to be decided on its own facts, keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the courts may be referred to as they might help to arrive at a correct decision of the controversy between the parties. One celebrated test is that laid down by Lord Cave L.C. in **Atherton v. British Insulated and Helsby Cables Ltd.** [1925] 10 TC 155, 192 (HL), where the learned Law Lord stated:*

“.... 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 a 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.”

*This test, as the parenthetical clause shows, must yield where there are special circumstances leading to a contrary conclusion and, as pointed out by Lord Radcliffe in **Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.** [1965] 58 ITR 241 (PC), it would be misleading to suppose that in all cases, securing a benefit for the business would be, prima facie, capital expenditure “so long as the benefit is not so transitory as to have no endurance at all.” There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee*

that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case."

Thus, in this case the Supreme Court held that test of enduring benefit is not an absolute or a conclusive test and depends on the facts and circumstances of each case.

18. In ***Alembic Chemical Works Co. Ltd. v. CIT***, [1989] 177 ITR 377 (SC), the Supreme Court followed the decision in ***Empire Jute*** (*supra*) and held:

"There is also no single definitive criterion which, by itself, is determinative as to whether a particular outlay is capital or revenue. The 'once for all' payment test is also inconclusive. What is relevant is the purpose, of the outlay and its intended object and effect, considered in a common sense way having regard to the business realities. In a given case, the test of 'enduring benefit' might break down. In CIT v. Associated Cement Companies Ltd. [1988] 172 ITR 257 (SC) at p. 262, this court said:

"As observed by the Supreme Court in the decision in Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1 (SC), that there may be

cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none the less, or be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principles laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test."

In the result, for the foregoing reasons, the appeal succeeds and is allowed and the question of law referred to the High Court for its opinion in ITR No. 78 of 1970 is answered in the affirmative and against the Revenue. The judgment under appeal is set aside."

Even a 'once for all' or lumpsum payment was held to be inconclusive in deciding whether the expenditure was capital or revenue in nature.

19. In ***CIT v. Madras Auto Services (P.) Ltd. [1998] 233 ITR 468 (SC)***, while dealing the question as to whether money spent by the tenant for construction in lieu of benefit of reduced rent for the additional space was capital or revenue expenditure, the Supreme Court observed as under:

"All these cases have looked upon expenditure which did bring about some kind of an enduring benefit to the company as a revenue expenditure when the expenditure did not bring into existence any capital asset for the company. The asset which was created belonged to somebody else and the company derived an enduring business advantage by expending the amount. In all these cases, the expense has been looked upon as having been made for the purpose of conducting the business of the assessee more profitably or more successfully. In the present case also, since

the asset created by spending the said amounts did not belong to the assessee but the assessee got the business advantage of using modern premises at a low rent, thus, saving considerable revenue expenditure for the next 39 years, both the Tribunal as well as the High Court have rightly come to the conclusion that the expenditure should be looked upon as revenue expenditure.”

20. Even this Court has had occasion to deal with cases where it had to determine the nature of expenditure i.e., capital or revenue. In ***CIT v. Saw Pipes Ltd. [2008] 300 ITR 35 (Del)***, the State Electricity Board had set up electricity lines for which service charges were paid by the Assessee. This Court held that the expenditure for the same should be held to be revenue expenditure.

21. In ***CIT v. J.K. Synthetics Ltd. (2009) 309 ITR 371 (Del)*** (hereinafter, ‘*JK Synthetics*’), this Court, dealing with a case where an Indian Company had acquired a license from an Italian Company for use of technical knowledge and user of its patents and trade marks, held as under:

“31. 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 the 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 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 the revenue expenditure;

(ii) it is the aim and object of the 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 b 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."*

22. Relying upon *JK Synthetics (supra)*, this Court in *CIT v. V.R.V. Breweries & Bottling Industries Ltd. (2012) 347 ITR 249 (Del)* held as under:

“22.2 The observation made in paragraph 58 at page 414 of the aforementioned judgment, on which reliance has been placed by the learned counsel for revenue seeks only to emphasise that the assessee in that case, had only acquired access to technology which was not related to any secret process or patent rights and thus in continuum it is mentioned that not even a right to use the trademark or brand name had inhered in the assessee. From this, it cannot be concluded, as is sought to be done by the learned counsel for the revenue that any payment made for use of trademark or trade name ipso facto will give colour to the payment as if it is made on capital account. This is in our view is a complete mis-reading of the judgment. It is well settled that a judgment is an authority for what it decides and not what is construed as logically flowing from it. Judgments cannot be read as statutes. A stray sentence picked out of context, cannot be used to turn its ratio around.

22.3 We have already referred to the provisions of the agreement. A perusal of the provisions of the agreement would show all that the assessee acquired was the use of the brand names and the trade marks of SWCL, which find a mention in Appendix-C annexed to the said agreement. The assessee acquired no right to any secret process or formulae or even any right title and interest in the trade marks and brands under which the IMFL products were sold. As a matter of fact assessee's rights were co-terminus with the subsistence of the said agreement. Therefore, we have no hesitation in rejecting the contention of the revenue in this regard.....It is quite evident that the Revenue took the stand, though erroneously, that royalty paid on use of

brand names and trade marks would classify the expenditure as one made on capital account.”

23. Thus, extrapolating from the judgments referred to above, in the context of trademark licensing, in order to determine whether a particular expenditure is capital or revenue in nature, some of the factors that are relevant are -

- i. the nature of the right being given - exclusive, non-exclusive, permanent or term based;
- ii. the benefit being derived - whether enduring, long term, short term;
- iii. the nature of payment being made - periodic, lump sum, revenue linked payments etc.

24. The above factors are singularly not determinative of the nature of the expenditure. It depends on the facts of each case. In a given case, a lump sum payment may still be revenue expenditure. A long term licence, without ownership vesting in the licensee could also be revenue expenditure. An exclusive right to use, to the exclusion of the owner, though termed as a licence, could be a transfer of title in the mark, and could constitute capital expenditure. Thus, the Court has to see not merely the terms of the agreement but also the facts and circumstances surrounding the agreement in order to determine the nature of the expenditure.

Licensing of Trade Marks

25. Trade Marks which are both registered and unregistered can be transferred. The transfer of a Trade Mark can either be by means of a license or an assignment. A license to a registered Trade Mark in India can be of two kinds:

- a) A simple license agreement which is in the nature of a permissive use;
- b) A Registered User, wherein the license agreement is registered with the Registrar of Trade Marks and certain rights accrue to the licensee as per statute.

26. An assignment is however a complete transfer of the right and title in a mark. Assignments can also be of various kinds. For eg., Assignment could be product specific, territory specific, but they will vest complete and absolute ownership in the assignee. Assignment of a registered trade mark can be with or without the goodwill of the business concerned. Such an assignment can be in respect of all the goods or services or part of the goods or services for which the mark is registered. However, an unregistered trademark is assignable with the goodwill of a business and if the same is assigned without the goodwill of the business, the nature of the transfer would have to be determined on the facts of a particular case.

27. The fundamental test to determine as to whether a particular mark has been licensed or assigned is to see if the licensor/assignor has retained any rights in the mark. If rights are retained with the owner, usually it is a license and if no rights are retained by the owner, then it would usually be an assignment. A license is, therefore, nothing but a permissive use of the mark, which permission, is revocable. A 'right to use' is usually a license and not an assignment, except in certain circumstances. Some of the questions that determine whether an arrangement is a license or an assignment include:

- i) Whether the user acknowledges the licensor's right and title over the mark?
- ii) Whether it is a mere right to use the mark or it was a transfer/assignment of a permanent nature?
- iii) Whether the manner of use is specified and restricted and the effect thereof on the rights of the user?
- iv) Whether the payment made by the User is one-time, fixed running royalty or a percentage of sales, with or without investment made by the Licensor on marketing and advertising?
- v) Whether the licensor has right of supervision and control over the use of the mark?
- vi) Whether sole and exclusive right was conferred on the user and the effect thereof?
- vii) Whether the user can further transfer his rights to third party, with and without consent of the licensor and the effect thereof?
- viii) Whether the licensor had the right to terminate the license and if so, under what circumstances?
- ix) Whether upon termination by the licensor, the user has to stop use of the mark?
- x) Whether or not the right to sue is given and conferred on the user?
- xi) Whether there is a transfer of goodwill of the business and/or goodwill in the mark?
- xii) Whether there are multiple users of the same mark?

28. A license agreement usually has some or all of the above stipulations. Thus, the nature of the agreement can be easily deduced from the existence of all or any of the above conditions/characteristics. In some circumstances however, an exclusive licence which excludes the owner from using the mark and vests perpetual rights without any termination clause, could constitute an assignment. However, the present case is not one such case.

29. The question in the present case is as to whether the right in the mark “HILTON” was transferred in a manner that was to give a long term benefit to the appellant. The first agreement contains an acknowledgment that HRL was the owner of the mark. The agreement grants an exclusive right to use “HILTON” owned by HRL to the appellant. The appellant could not, without HRL’s permission apply for registration of the mark on its own or dispute the ownership of HRL. If any infringement came to the knowledge of the appellant, it had to seek the prior written consent of HRL, which had the right to decide as to what action it would take whether with or without the appellant, in respect of such infringer. An application could have been filed to register the appellant as a registered user and such application could have been made jointly only. The termination clause was clear. Though the initial period was 10 years, the agreement could have been terminated with 12 months’ written notice by either party. The termination was automatic under some circumstances as detailed in the agreement. One of the reasons for termination could be the termination of the joint venture agreement. Upon termination of the license agreement, the appellant would not have any rights to use or seek registration of the mark “HILTON”. This agreement was in the nature of a license agreement and had all the trappings

of a license. The rights of HRL were completely preserved and only a right to use was being given to the appellant. No long term benefit accrued to the appellant. The royalty payable by the appellant was 1.8% of the net selling price from the date of commercial production.

30. The second Agreement dated 9th November, 1995 was almost identically worded to the first license agreement, except for the fact that the royalty was now Rs.1 crore as a lump-sum for a period of 10 years.

31. The question as is relevant to the present case is, therefore, whether any long term benefit was acquired by the appellant under the agreement dated 9th November, 1995, so as to categorize the payment of Rs.1 crore as a capital expenditure.

32. It is relevant to record some important facts at this stage. The mark "HILTON" in respect of Raw Edge, Wrapped V Belts, was a mark which was known in India in the relevant industry. It was being used by HRL which was the original owner for many years prior to the joint venture agreement. The registration of the mark Hilton dates back to 3rd June, 1977 and the user claimed for the said mark was from 1st December, 1972. When the joint venture was entered into, the mark was licensed to the joint venture company i.e. the appellant which, thereafter, became a subsidiary of RF. HRL did not have any stake in the appellant after 9th November 1995. The appellant company which was known as Hilton Roulunds Ltd. is now known as Contitech India Private Limited. Thus even the corporate name of the company has changed, though subsequently. The settled position in law is that use by a licensee would also inure to the benefit of a licensor, for it would continue to remain the owner, unless there was also part transfer of

title. In this case, title and ownership of the mark was not transferred. The appellant only had permission and approval to use the mark. Thus, the benefit of the use of the mark “HILTON” during the period when it stood licensed to the appellant inures to HRL. In *Fedders Lloyd Corporation Ltd. v. Fedders Corporation ILR (2005) I Delhi 478*, it was held use of the trademark by a licensee inures to the benefit of the licensor. This position was again reiterated by this Court in *Formula One World Championship Ltd. v. Commissioner of Income Tax, International Taxation -3 (2017) 390 ITR 199 (Del)*.

33. Thus, when the benefit of the use of the mark has inured to the licensor i.e. HRL, the amount, that has been paid to HRL was a consideration for permission to use the mark, and not for acquiring ownership rights in the mark. The mark “HILTON” did not belong to the appellant. It also did not belong to either of its current promoters i.e. RF or IFU. It belonged to HRL which was one of the joint venture partners when the appellant was initially formed. The use of the mark “HILTON” thus, merely facilitated the appellant’s business in India i.e. it facilitated the appellant’s entry into India under the brand name and the trade name which was familiar to the industry and market. The advantage of having used the mark “HILTON” between 1992 and 2005 could endure and benefit the appellant as a permitted and authorized user, but it cannot be called an acquisition and benefit of capital nature so as to constitute capital expenditure. The appellant did not purchase and acquire title in the trademark. It did not retain any rights in the mark. In fact the appellant no longer uses the word “HILTON” either as a trade mark or trade name or as a

part of its corporate name. Thus, the payment of Rs.1 crore was for the purpose of obtaining an advantage in carrying on its business and is therefore in the revenue field.

34. In order to ascertain whether there was permanent transfer of the trademark “HILTON” in favour of the appellant, we had asked and called upon the counsel for the appellant to state the present position. The appellant has filed additional documents stating that the name of the appellant was changed to ‘Roulands Codan India Limited’ on 29th November, 2006. Subsequently, there was another change as of 11th December, 2006. The appellant is now known as ‘Contitech India Private Limited’. Appellant states that they had applied for transfer and registration of the trademark “Hilton Euroflex” on 13th January, 1994, but on 28th April, 1999 they had deleted the word “Hilton” from the said application. Appellant has also placed on record pamphlet/price list that they had not used the mark “HILTON” and are marketing their goods on the mark “Roflex”, which is their registered trademark since 10th July, 1996. We would accept and not proceed on the basis that the subsequent change in trademark would not be conclusive and determinative of the fact whether the mark “HILTON”, was acquired by the appellant as a capital asset or the payment made was to use the mark “HILTON”, which belonged to and was owned by a third party, namely, HRL. Subsequent facts would only confirm our opinion and ratio that the right conferred on the appellant under the second license agreement entered into 9th November, 1995 had only authorized the appellant to use the mark for ten years. The appellant had not acquired any permanent ownership or title in the said mark. The said payment though in lump sum was made to

use the said mark and could well have been made with reference to the total sales as was the position in the first agreement dated 27th January, 1993. Certain terms and conditions for using the mark “HILTON” were changed and altered vide agreement dated 9th November, 1995, but in substance with reference to the rights acquired there was no difference between this agreement and earlier license agreement dated 27th January, 1993.

35. All the above facts point to the clear conclusion that the payment of Rs.1 crore ought to be treated as revenue expenditure. There is no doubt in the proposition relied upon by the revenue, as held in *Honda Siel (supra)*, the Court has to look at the real nature of the agreement. On an analysis of the agreement on record, there is no doubt that it was merely a trademark license agreement, which conferred no enduring benefit or long term benefit to the appellant.

36. A supplemental corporate license agreement was executed along with the first license and the second license agreement. Under these agreements also the right to use the corporate name “Hilton” was non-exclusive and royalty free. Though, it was to remain in full force and executed without any limit of time, a licensor had the right to terminate the said agreement with 30 days’ notice. Thus, even the corporate name license agreement was terminable and did not create ownership rights in the appellant for the word “HILTON”. The Court takes notice of the fact that the corporate name has in any event been changed by the appellant. Moreover, before the Income Tax Authorities, the appellant had filed to letters dated 16th March, 1997 and 24th September, 1997 signed by the Company Secretary of the Appellant and by HRL, respectively. Both these letters confirm that the right to use the mark

“HILTON” was for a limited period of 10 years. The Revenue submits that under clause 12, there was no limitation of time in the license. This position when considered in isolation would be correct, however, when read with the letters submitted to the Income Tax Authorities, as also the stoppage by the appellant of the use of the mark “HILTON” both as a trade mark and as a trade name, it is clear that the appellant was merely a licensee of the mark.

37. Under these circumstances, the question of law is answered in the negative, in favour of the Assessee and against the Revenue. It is directed that the payment of Rs. 1 crore be treated as revenue expenditure for the AY 1996-97. In the facts of the present case, there shall be no order as to costs.

PRATHIBA M. SINGH, J

SANJIV KHANNA, J

APRIL 20, 2018/dk