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T.C.A.Nos.255 of 2012 & 43 of 2013

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED 04.09.2023

CORAM

THE HON'BLE Mr. JUSTICE R. MAHADEVAN
AND

THE HON'BLE Mr. JUSTICE MOHAMMED SHAFFIQ

T.C.A.Nos.255 of 2012 & 43 of 2013

Commissioner of Income Tax
Chennai

.. Appellant in both TCAs

Vs.

M/s.Shriram Chits Tamil Nadu Ltd.
Greens Dugar 4th Floor
149, Greens Road
Chennai 600 006

.. Respondent in both TCAs

T.C.A.No.255 of 2012 filed under Section 260-A of the Income Tax Act, 1961, against the order dated 30.03.2012 passed by the Income Tax Appellate Tribunal 'D' Bench, Chennai, in I.T.A.No.1182/Mds/2011, relating to the AY 2008-2009.

T.C.A.No.43 of 2013 filed under Section 260-A of the Income Tax Act, 1961, against the order dated 08.05.2012 passed by the Income Tax Appellate Tribunal 'C' Bench, Chennai, in I.T.A.No.1842/Mds/2010, relating to the AY 2007-2008.



For Appellant : Mr.J.Narayanaswamy
in both TCAs Standing Counsel
For Respondent : Mr.R.Sivaraman
in both TCAs

COMMON JUDGMENT

(Judgment of the court was delivered by R. MAHADEVAN, J.)

These tax case appeals are filed by the appellant/Revenue, challenging the orders passed by the Income Tax Appellate Tribunal, 'D' Bench, Chennai, in I.T.A.No.1297/Mds/2011 dated 30.03.2012 relating to the Assessment Year 2008-2009 and by the Income Tax Appellate Tribunal 'C' Bench, Chennai, in I.T.A.No.1842/Mds/2010 dated 08.05.2012 relating to the Assessment Year 2007-2008, respectively.

2.By separate orders dated 25.04.2013, the aforesaid appeals were admitted on the following substantial question(s) of law:

T.C.A.No.255 of 2012 :

“(i) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was correct in holding that the payment of royalty is not towards acquisition of intangible asset and is revenue expenditure, merely following its earlier order in ITA.No.1512/Mds/2010, which has not attained finality ?



T.C.A.No.43 of 2013 :

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“(i) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was correct in holding that the payment of royalty is not towards acquisition of intangible asset and is revenue expenditure, merely following its earlier orders, which have not attained finality ?

(ii) Whether the Income Tax Appellate Tribunal was correct in stating that the method of calculation of the disallowance set forth in Rule 8D would be applicable only for AY 2008-09 and subsequent assessment years ?

(iii) Whether the Income Tax Appellate Tribunal was right in not holding that the method adopted by the assessing officer to compute the expenditure attributable to income not includable in total income is scientific and therefore the disallowance under 14A is to be sustained?”

3.Today, when these matters were taken up for consideration, the learned counsel appearing for the appellant / Revenue fairly submitted that the identical substantial question of law raised in T.C.A.No.255 of 2012 and the substantial question of law No.1 raised in T.C.A.No.43 of 2013, has already been considered and decided in favour of the assessee, by a common judgment dated 30.06.2022 passed by this court in T.C.A.No.755 of 2009 etc. batch. The relevant paragraphs of the said judgment are extracted below for ready reference:

“7.7. It is an admitted fact that the assessee companies had entered into licence agreement with the parent company viz., M/s.Shriram Chits & Investments Pvt. Ltd., for use of its logo, on payment of royalty based on turnover and the same is renewable. As already stated, it is the claim of the assessee companies that the license agreement confers the right to use the logo with restrictions viz., non-transferable and non-exclusive; there is no



acquisition and there is only the right to use and not ownership; and therefore, the royalty payment which is revenue in nature, falls within the general provisions of section 37(1) and not under section 32(1)(ii).

7.8. This court is bound by the legal proposition laid down In the decision in **CIT v. Ciba of India Ltd, (supra)** referred to on the side of the assessee companies. In that case, the Hon'ble supreme court answered the question, whether the payment made by the assessee to the swiss company towards technical and research contribution for the use of its Indian patents and /or trade marks, in pursuance of an agreement, is an admissible deduction, in favour of the assessee. Such a conclusion was arrived at, after a detailed analysis of the terms of the agreement, nature of the expenditure incurred and the other relevant factors. The following passage extracted from the said judgment is important:

In the case in hand, it cannot be said that the swiss company had wholly parted with its Indian business. There was also no, attempt to part with the technical knowledge absolutely in favour of the assessee.

"The following facts which emerge from the agreement clearly show that the secret processes were not sold by the swiss company to the assessee:(a) the licence was for a period of five years, liable to be terminated in certain eventualities even before the expiry of the period; (b)the object of the government was to obtain the benefit of the technical assistance for running the business; (c)the licence was granted to the assessee subject to rights actually granted or which may be granted after the date of the agreement to other persons; (d)the assessee was expressly prohibited from divulging confidential information to third parties without the consent of the swiss company; (e)there was no transfer of the fruits of research once for all: the swiss company which was continuously carrying on research and had agreed to make it available to the assessee; and (f) the stipulated payment was recurrent dependent upon the sales, and only for the period of the agreement. We agree with the High Court that the first question was rightly answered in favour of the assessee."

However, it is imperative for this court to apply the law laid down by the Apex Court to the facts of the present case, to determine the nature of the royalty payment made by the assessee companies i.e., whether it is revenue or capital expenditure.

7.9. At this juncture, it is apposite to refer to the decision of the Hon'ble supreme court in **CIT v. Wavin (I) Ltd. (supra)** which was referred to by the Tribunal, while passing the orders impugned herein and it was held by the Hon'ble Supreme court as follows:

"The expenditures were incurred to obtain benefit of research and development made by the foreign company. The technical information given to the Indian company was "non-exclusive" and "non-transferable". In other words, this is not an out and out sale of technical know-how. The assessee was merely given a non-exclusive and non-transferable right of



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user of the technical information. Expenditures in these facts cannot be said to be for acquisition of any asset at all.”

7.10. Furthermore, in the judgment of the Supreme Court in **Honda Siel Cars India Ltd v. CIT (supra)**, it was held that while deciding, whether royalty payment for technical know-how is capital or revenue expenditure, the enduring benefit test has to be applied; and the conditions to be satisfied for treating the expenditure under technical collaboration, as capital in nature, are (i) there is no existing business and (ii) agreement is crucial for setting up a new manufacturing plant. The relevant passage of the said judgment of the supreme court is usefully extracted below:

“19. 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 a 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 a 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 CIT v. Ciba India Limited (AIR 1968 SC 1131).”

7.11. Thus, it is crystal clear from the aforesaid decisions of the Hon'ble supreme court that royalty payment made by the assessee, for use of logo or trademark for a particular period, for improvement / expansion of business, would qualify as revenue expenditure. The Judgment in **Honda Siel Cars India Ltd (supra)** is of no assistance to the revenue as in that case, the



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technical know-how was shared pursuant to technical collaboration agreement and not only technical information was transferred, but on field complete assistance was given pursuant to the joint venture agreement. Further, in that case, the very same business was set up by the transferee company. However, in the present case, it is not the case. The grant of licence to use the intellectual property of the parent company for limited purpose, cannot be treated as transfer of ownership or title. Though the licence is renewed periodically, it by itself does not guarantee the renewal. Similarly, the parent company is always at liberty to not only cancel the license, but also grants such rights to any other organization. Further, the findings of the Apex Court in the above judgment that when the intellectual property right is not transferred, but permitted to be utilized for a particular period, would have to be treated as revenue expenditure, on application to the facts of this case, tilts the balance in favour of the assesseees. Every expenditure incurred to acquire some right over intangible asset, cannot be ipso facto termed as capital expenditure. The nature of the assets, right, information or technical know-how that is transferred, must be such that without which the transferee could never commence the business. As rightly contented by the learned senior counsel appearing for the assesseees, the benefit granted by the licensor is not enduring in nature in the present cases. The assessing officer without appreciating the terms of the licence agreement and ascertaining the nature of the expenditure incurred by the assessee companies, disallowed the deduction of royalty payment and allowed the depreciation at 25% treating it as capital expenditure. However, the appellate authorities, while deleting the disallowances made by the assessing officer, have rightly treated the royalty payment as revenue expenditure. Once the payment of royalty is treated as revenue expenditure, automatically, it goes without saying that the assesseees would be entitled to 100% deduction. Therefore, we need not interfere with the orders passed by appellate authorities. Accordingly, the substantial questions of law relating to royalty, are answered in favour of the assesseees."

4. In respect of the substantial question of law no.2 raised in T.C.A.No.43 of 2013, the learned Standing Counsel appearing for the appellant/Revenue fairly submitted that the Hon'ble Supreme Court in the decision in *Maxopp Investment Ltd. v. Commissioner of Income Tax, New Delhi [(2018) 91 Taxmann.com 154(SC)]*, decided the same in favour of the assessee, by holding that Rule 8D is prospective in nature and could not have been made applicable



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in respect of assessment years prior to 2007, when this rule was inserted. For better appreciation, the relevant portion of the said decision, is extracted hereunder:

"43. Few appeals are filed by the Revenue against the assessees which pertained to the period prior to the introduction of Rule 8D of the Rules. Here, the case is decided in favour of the assessees also on the ground that Rule 8D of the Rules is prospective in nature and could not have been made applicable in respect of the Assessment Years prior to 2007 when this Rule was inserted. This view has already been upheld by this Court in Civil Appeal No. 2165 of 2012 Essar Teleholdings Ltd. (supra), that the said Rule is prospective in nature. On this ground alone, these appeals of the Revenue fail as it is not necessary to go into the other issues."

In the light of the above, the substantial question of law no.3 in TCA.No.43 of 2013 will have to be answered, according to the learned standing counsel appearing for the appellant.

5.In view of the submissions so made on the side of the appellant / Revenue and also following the decisions of this court as well as the Supreme Court as referred to above, the substantial questions of law raised herein are answered in favour of the assessee and these Tax case Appeals filed by the Revenue are dismissed. No costs.

[R.M.D,J.] [M.S.Q, J.]
04.09.2023

Neutral Citation : Yes/No
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R. MAHADEVAN, J.



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