IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 11.09.2023

CORAM :

THE HONOURABLE MR. JUSTICE R. MAHADEVAN
and
THE HONOURABLE MR. JUSTICE MOHAMMED SHAFFIQ

TCA.Nos.886, 892, 893 & 894 of 2017

Commissioner of Income Tax
Chennai ... Appellant in all Tax Case Appeals

Vs

M/s. Shriram City Union Finance Ltd.,
Mookambika Complex,
No.4 Lady Desika Road,
Mylapore Chennai - 600 004. ... Respondent in all Tax Case Appeals

Appeals preferred under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Chennai "B" Bench, dated 29.01.2016 in I.TA.No.868/Mds/2015, I.TA.No.869/Mds/2015, I.TA.No.870/Mds/2015 and I.TA.No.871/Mds/2015.

For Appellant : Mr.J.Narayanasamy in all cases

For Respondent : Mr.R.Sivaraman in all cases

COMMON JUDGMENT

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

These tax case appeals have been filed by the appellant/Revenue, challenging the order dated 29.01.2016 passed by the Income Tax Appellate Tribunal, Chennai 'B' Bench, in I.TA.No.868/Mds/2015, I.TA.No.869/Mds/2015, I.TA.No.870/Mds/2015 and I.TA.No.871/Mds/2015. respectively, relating to the assessment years 2010-2011 and 2011-2012, by raising the following substantial questions of law:-

In TCA.Nos.886 and 892 of 2017:-

> "*(i) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the royalty paid by the assessee towards the use of logo of Shriram Chits and Investments P Ltd is to be treated as revenue expenditure without appreciating that as per the section 32 w.e.f. 1.4.99 the royalty is to be treated as intangible asset of capital nature and consequently the royalty payment is a capital expenditure and the assessee is entitled for depreciation only.*
>
> *(ii) Whether on the facts and in the circumstances of the case the tribunal was right in holding the expenditure incurred on Employee Stock Option Scheme is allowable as revenue expenditure."*

In TCA.Nos.893 and 894 of 2017:-

"Whether on the facts and in the circumstances of the case the Tribunal was right in holding that provisions of sec 14A rw Rr 8D cannot be invoked to compute the indirect expenditure of Rs.13.77 Cr for earning the exempt income, for the purpose of disallowance u/s 14A on the ground that the assessing officer had not expressively recorded a specific satisfaction that the said expenses were incurred to earn exempt income."

2. However, during the course of hearing, the learned counsel appearing for the appellant / Revenue has produced redrafted grounds / Questions of law in TCA.Nos.893 and 894 of 2017, which have been agreed to by the learned counsel appearing for the respondent / assessee and they are as follows:-

"*(i) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the royalty paid by the assessee towards the use of logo of Shriram Chits and Investments P Ltd is to be treated as revenue expenditure without appreciating that as per the section 32 w.e.f. 1.4.99 the royalty is to be treated as intangible asset of capital nature and consequently the royalty payment is a capital expenditure and the assessee is entitled for depreciation only.*

(ii) Whether on the facts and in the circumstances of the case the tribunal was right in holding the expenditure incurred on Employee Stock Option Scheme is allowable as revenue

expenditure."

3. The learned counsel appearing for the appellant / Revenue further submitted that the substantial questions of law, raised in all these appeals are covered, by a common judgment dated 30.06.2022 passed by this court in T.C.A.No.755 of 2009 etc. batch in respect of the assessee's own case. The relevant paragraphs of the said judgment are extracted below for ready reference:

<u>Substantial question of law No.1 - Royalty :-</u>

> *"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 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 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 assessees. 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 assessees, 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 assessees 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 assessees.

Substantial question of law No.2 - ESOP:-

8.6. Admittedly, the ESOP scheme is a voluntary scheme launched by the employer to issue shares to their employees, with an intent to give a stake to the employees in the organisation as incentives for performing better. Such an expenditure is incurred to facilitate and promote the business and there is no enduring benefit or advantage or creation of asset to the company, rather it is to earn more revenue and the expenses incurred for such purpose is nothing but revenue expenditure. It is a general principle that any expenditure incurred for the purpose of business is a deductible expenditure and the amount spent by an assessee for labour / employees' welfare, would be deductible as revenue expenditure. In ***Dalmia Jain & Co. Ltd v. CIT [81 ITR 754],*** the Hon'ble supreme court held that *"expenditure incurred for maintenance of business is revenue in nature"*.

8.7. According to the assessees, the ESOP benefit is taxable in the hands of employees as 'perquisite' under section 17(2) of the Act and it was brought within the purview of Fringe Benefit Tax, which is an employee related expenditure. It is further pointed out by the assessees that similar claim of ESOP expenses for deduction raised for the assessment years 2006-07, 2007-08 and 2008-09, was allowed by the assessing officer. However, the same was disallowed by the assessing officer relating to the assessment year 2009-10, by placing reliance on the decision of the Hon'ble supreme court in ***Brooke Bond India Ltd v. CIT*** (cited supra), wherein, it was held that "*though the increase in capital results in expansion of the capital base of the company and incidentally that would help in the business of the company and may also help in the profit making, the expenses incurred in that connection still retain the character of a capital expenditure since the expenditure is directly related to the expansion of the capital base of the company*". Whereas the learned senior counsel appearing for the assessees submitted that the decision in ***Brooke Bond India Ltd***, does not relate to ESOP expenditure and it was a plain case of increase in authorised capital and therefore, the said decision cannot be applicable to the facts of the present case, wherein, the grant of ESOP is a benefit given to the employees and not to the public.

8.8. This court agrees with the contentions so raised on the side of the assessees. Importantly, it is to be noted here that the issue involved herein is squarely covered by the decision of this court in ***CIT v. PVP Ventures Ltd.*** (cited supra) which was followed by the Tribunal while passing the orders impugned herein. In the said decision, this court held the order of the Tribunal allowing the deduction of ESOP expenditure, as an ascertained expenditure. The following passage is relevant and is extracted below:

> *"11. As regards the second issue which is now canvassed before this Court viz., on the issue of expenditure of 66.82 lakhs towards the issue of shares to the Employees Stock Option is concerned, the Tribunal pointed out that the shares were issued to the employees only for the interest of the business of the assessee to induce employees to work in the best interest of the assessee. The allotment of shares was done by the assessee in strict compliance of SEBI regulations, which mandate that the difference between the market prices and the price at which the option is exercised by the employees is to be debited to the Profit and Loss Account as an expenditure. The Tribunal pointed out that what had been adopted was not notional or contingent as had been submitted by the Revenue. Pointing out to the Employees Stock Option Plan, the Tribunal in its order stated that it was a benefit conferred on the employee. So far as the company is concerned, once the option was given and exercised by the employee, the liability in this behalf got ascertained. This was recognised by SEBI and the entire Employees Stock Option Plan was governed by guidelines issued by SEBI. On the facts thus found, the Tribunal held that it was not a case of contingent liability depending on the various factors on which the assessee had no control. The expenditure in this behalf was an ascertained liability, thus the expenditure incurred being on lines of the SEBI guidelines, there could be no interference in the relief granted by the Assessing Authority for the expenditure arising on account of Employees Stock Option Plan. This expenditure incurred as per SEBI guidelines and granted by the Officer could not be considered as erroneous one calling for exercise of jurisdiction under Section 263 of the Act."*

8.9. It is also to be noted at this juncture that as against the aforesaid decision of this Court, SLP (C) No. 9091 of 2014 was filed and it was ultimately, dismissed on 28.03.2014, as a result of which the judgment of this Court thus, attained finality.

8.10. Further, in the decision of the Karnataka High Court in ***CIT v. Biocon Ltd. [(2020) 121 taxmann.com 351 (Karnataka)],*** the question as to whether the expenditure towards ESOP is allowable as deduction under section 37(1) of the Act, was considered and was ultimately decided that the same amounted to definite legal liability, which has to be allowed as deduction, after considering the definition of "employees stock option" under section 2(15A) of the Companies Act, 1956. The new provision under section 2(37) of the Companies Act, 2013 also is in similar lines.

8.11. In the light of the aforesaid legal proposition, this court comes to a conclusion that the Tribunal was correct in holding that the ESOP expenditure is revenue in nature and the assessee is entitled for deduction. Accordingly, the orders passed by the Tribunal in deleting the disallowances of ESOP expenses by the assessing officer, do not require any interference in these appeals. Resultantly, this issue stands answered in favour of the assessees."

4. In view of the 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.)**
11.09.2023

Index : yes/no
Internet : yes/no
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To

1. The Income Tax Appellate Tribunal,
   Chennai "B" Bench.

2. Commissioner of Income Tax
   Chennai.

R. MAHADEVAN, J
and
MOHAMMED SHAFFIQ, J

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