

IN THE HIGH COURT OF PUNJAB AND HARYANA AT  
CHANDIGARH

1. ITA-244-2005

M/s Rockman Cycles Industries Ltd. ....Appellant

vs.

Commissioner of Income Tax (Appeals), Central,Ludhiana and anr. ...Respondents

2. ITA-281-2005

M/s Highway Cycles Industries Ltd. ...Appellant

vs.

Commissioner of Income Tax (Appeals), Central,Ludhiana and anr. ...Respondents

3. ITA-282-2005

M/s Highway Cycles Industries Ltd. ...Appellant

vs.

Commissioner of Income Tax (Appeals), Central,Ludhiana and anr. ...Respondents

4. ITA-283-2005

M/s Highway Cycles Industries Ltd. ...Appellant

vs.

Commissioner of Income Tax (Appeals), Central,Ludhiana and anr. ...Respondents

5. ITA-630-2005

M/s Highway Cycles Industries Ltd. ...Appellant

vs.

Commissioner of Income Tax (Appeals), Central,Ludhiana and anr. ...Respondents

*Date of decision:- 09.02.2023*

CORAM: HON'BLE MS. JUSTICE RITU BAHRI  
HON'BLE MRS. JUSTICE MANISHA BATRA

Present: Mr. Akshay Bhan, Sr. Advocate with  
Mr. Shantanu Bansal, Advocate &  
Mr. Nishant Mishra, Advocate  
for the appellant (s).

Ms. Pridhi Jaswinder Sandhu, Standing counsel  
for the respondent-department.

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**Ritu Bahri, J.**

This judgment shall dispose of the above mentioned five appeals together, as common questions of law and facts are involved therein. However, for facility of reference, the facts are being taken from ITA-244-2005.

Appellants have filed the above mentioned appeals under Section 260-A of the Income Tax Act, 1961 (for short 'Act 1961') challenging order dated 03.02.2005 (A/Y 96-97 in **ITA No. 244-2005**), order dated 31.01.2005 (A/Y 98-99 in ITA No. **281-2005**), order dated 28.12.2004 (A/Y 96-97 in ITA No. **283-2005**), order dated 28.12.2004 (A/Y 97-98 in ITA No. **282-2005**) & order dated 08.09.2005 (A/Y 1999-2000 in **ITA No. 630-2005**) whereby the appeals filed by the revenue-department are partly allowed.

Brief facts of the case are that the appellant-Company filed its return declaring income at Rs.1,88,79,150/- for the assessment year 1996-97 on 28.11.1996 and the same was processed under Section 143 (1) (a) of Act 1961, vide order dated 21.03.1997. The appellant-Company engaged in the business of manufacturing of cycles. During the relevant assessment year (96-97), the appellant-company claimed deduction on account of travelling expenditure incurred on the director's wife accompanying their husbands on business tours, to the tune of Rs.1,56,076/-. The appellant-company claimed

deducted under Section 37 of Act 1961 on account of expenditure of Rs.61,38,000/- paid to M/s Mckinsey and Company Ltd for professional serviced rendered by it. However, the Assessing Officer disallowed both the claims of the assessee-Company, vide order dated 26.02.1999 (A-1).

Feeling aggrieved against the above order, the appellant-Company preferred appeal before the Commissioner of Income Tax (Appeals) and the same was partly allowed on 11.08.1999 (A-2) by allowing the claim of the assessee i.e qua the travelling expenditure as well as fees to M/s Mckinsey and Co. Ltd for professional services.

The revenue-department went in appeal impugning the above order dated 11.08.1999 (A-2) and the same was allowed, vide order dated 03.02.2005 and hence the present appeal.

The point for consideration in the present appeals would be whether the appellant-Company is entitled for the deduction on account of travelling expenditure incurred on the director's wife accompanying their husbands on business tours and futher on account of expenditure paid to M/s Mckinsey and Company Ltd for professional serviced rendered by it.

With respect to the first part that whether the appellant-company is entitled for the deduction on account of travelling expenditure incurred on the director's wife accompanying their husbands on business tours, learned senior counsel has referred to ***judgment dated 22.12.1985 of M/s Avon Cycles Pvt. Ltds vs. ACIT in ITA No. 939/Chandi/90 and the decision of Keral High Court in the case of CIT vs. Apoll Tyres Ltd 237 ITR 706***

With respect to the second part that whether the appellant-company is entitled for the deduction on account of expenditure paid to M/s

Mckinsey and Company Ltd for professional serviced rendered by it., learned senior counsel has shown agreement dated 10.11.1995 between M/s Mckinsey and Company and M/s Rockman Cycle Industries which shows that the company was to assist in developing a growth strategy and profit improvement programme for the appellant-Company. M/s Mckinsey and Company has also to render service which includes a market survey etc for the purpose of improvement efficiency. The agreement dated 10.11.1995 is taken on record as Annexure A-1.

Reference has been made to Section 35 AB of Act 1961 and the relevant portion of Section 35AB is extracted below:

“35AB. Expenditure on know-how.- (1) Subject to the provisions of Sub-section (2), where the assessee has paid in any previous year any lump sum consideration for acquiring any know-how for use for the purposes of his business, one-sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years.

(2) xxxxx

(3) xxxxx.”

*Explanation.- For the purposes of this section, "know- how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).*

As per the above section, for all intents and purposes, it should be the technical knowledge, which would assist in manufacturing. Further in the present case, as per agreement dated 10.11.1995 (A-1), M/s Mc Kinsey and Company was to assist in developing a growth strategy and

profit improvement programme for the appellant-Company. This agreement does not show that any industrial information is being given which will assist in manufacturing or processing of any goods. It is a consultancy agreement and this agreement would not fall under Section 35AB of Act 1961.

Now reference can be made to Section 37 of the Act 1961, which reads as under:-

*“37.(1) Any expenditure (not being expenditure of the nature described in [sections 30 to 36](#) and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".*

*Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.*

*Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.*

*(2) [\*\*\*]*

*(2B) Notwithstanding anything contained in sub-section (1), no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.*

The agreement dated 10.11.1995 (A-1) falls under Section 37 of Act 1961. Moreover, as per Section 35AB of Act 1961, the deduction has to be given in one financial year and with respect to remaining deduction, it

has to be claimed equally in next five years. Hence, this expenditure is to be treated as revenue expenditure.

Learned senior counsel for the appellant has now referred to a judgment of Delhi High Court in a case of ***Indo Rama Synthetics India Ltd vs. Commissioner of Income Tax, 2011 (133) ITR 18*** wherein the appellant-company had engaged the services of McKinsey and Co., an international firm of consultants for carrying out a detailed study on the various aspects relating to the operations of the appellant-company and to suggest measures for improving the operational efficiency and profitability of the appellant-company. The contract terminated before expiry of one year and a sum of Rs 74.04.128/- was paid by the appellant to the said McKinsey and Co and this payment was claimed for previous years as deduction but the said benefit of deduction was denied by the Tribunal on the ground that the appellant had failed to establish that the payment made to M/s. McKinsey and Co. was revenue in nature. However, the Tribunal has accepted the fact that even when there was no formal written agreement with M/s. McKinsey and Co, the report was submitted by the said company for the task assigned. The appeals preferred against the order of Assessing Officer were dismissed. However, Hon'ble Delhi High Court allowed the appeal of the assessee and in para No. 21 and 22, observed as under:-

*"21. This approach of the Tribunal is not correct in law. Interestingly, the Tribunal has accepted the fact that even when there was no formal written agreement with M/s. McKinsey and Co, the report was submitted by the said company for the task assigned. This report was produced before the Assessing Officer/Commissioner of Income-tax (Appeals). The Tribunal noted that as per the assessee the perusal of the report clearly indicated that the engagement was for the purpose of improving the operational efficiencies of the assessee and enhance the*

*profitability of the existing business. In these circumstances, not much importance could be attached to the fact that there was no written agreement with the said consultants to ascertain the scope of the study when such scope of study could very well be discerned from the report submitted by the consultants. To remove any doubts, learned counsel for the appellant produced the report given by the said consultants for our perusal as well and reading thereof confirms the contention of the appellant.*

*22. The helplessness shown by the Tribunal, for want of written agreement, was, therefore, clearly inappropriate. Once it is accepted as a fact that the assignment given to the said consultants was for the purpose of improving operational efficiencies and was not to incur any enduring benefit in capital field but to carry on the existing business more efficiently and profitably, the irresistible conclusion which follows is that such expenditure was allowable as business expenditure (See CIT v. Praga Tools Ltd. (1986) 157 ITR 282 (AP) and CIT v. Crompton Engineering Co. Ltd. (2000) 242 ITR 317 (Mad)).*

Learned senior counsel for the petitioner (s) has referred to judgment of Calcutta High Court in a case of ***J.K. Industries vs. Commissioner of Income Tax, (Central-I), passed in I.T.A No. 624-2004, decided on 17.03.2011*** whereby at the time of admission of the appeal, the following substantial question of law was framed:-

“Whether the Tribunal was justified in law in disallowing the foreign travel expenditure of the spouses of the appellant's Managing Directors and Deputy Managing Directors who accompanied their husbands on business visit and its purported findings that the accompaniment of the spouses was not for business expedience/purpose of the business/direct or indirect benefit to the appellant and disallowing the expenditure of Rs.7,92,058/- for the assessment year 2000-01 are arbitrary, unreasonable and perverse?”

Hon'ble Calcutta High Court partly allowed the appeal of the assessee and observed as under:-

“In the Act itself the word business expenditure' has not been defined but Sections 30 to 37 deal with the claim of deduction on business expenditure. According to those provisions, if any expenditure is made in the nature mentioned in Sections 30 to 36 of the Act, those must be in tune with those provisions, but if any other expenditure is made which is not in the nature prescribed in Sections 30 to 36 of the Act those can be allowed as business expenditure provided those are not of the nature of personal expenditure or capital expenditure.

There is no dispute that amounts spent for the foreign tour of the wife of the Managing Director is not in the nature of capital expenditure. Therefore, the only question is whether the same is in the nature of personal expenditure so as to deprive the assessee of the benefit of Section 37 of the Act.

In the case before us, the fact that the Managing Director of the Company visited the foreign country for the purpose of the business of the assessee is not in dispute and the Assessing officer has also accepted such expenditure on the Managing Director for the above purpose as the business expenditure of the assessee. The fact that his wife also accompanied him on such tour is not in dispute. It appears from the resolution of the Board of Directors of the assessee that the wife of the Managing Director accompanied him because of the following decision of the Board:

"If on such tours he is accompanied by his wife, it goes a long way to benefit the Company since warm human relations and social mixing promotes better business understanding. Also wife of the Director is sometimes required to accompany him on his tour abroad as a matter of reciprocity in international business. In the circumstances, it was felt that wife of the Managing Director may accompany him on tours abroad as and when necessary."

Thus, it was a decision of the Company to send her for promoting better business understanding and as a matter of reciprocity in international business for the reasons thought fit by the Company. Therefore, the reason assigned by the Tribunal, that as the wife of the Managing Director is not an employee the expenditure made for her foreign tour cannot be accepted as business expenditure, is not tenable in the eye of law. It is not the law that business expenditure should be limited to the expenditure made for an employee only.

As pointed out by the Supreme Court in the case of *The Commissioner of Income-tax, Bombay vs. M/s. Walchand and Co. (Pvt.) Ltd., Bombay (supra)*, the Income-tax authorities have to decide whether the expenditure claimed as an allowance was incurred voluntarily and on grounds

of commercial expediency. In applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of the business, the Supreme Court proceeded, the reasonableness of the expenditure has to be judged from the point of view of the businessman and not of the Revenue. In the said case, the Income-tax Officer was of the view that there was no adequate Increase in the earnings of the assessee, for the increase in remuneration was not reflected in the increase in profits of the assessee and that it appeared that as compared to the previous years, the business profits disclosed by the assessee had fallen by Rs.2 lac and, therefore, the increase in expenditure could not be justified as laid out wholly and necessarily for the purposes of the business. The Supreme Court, however, disapproved the said reason and held that an employer in fixing the remuneration of his employees is entitled to consider the extent of his business, the nature of the duties to be performed, and the special aptitude of the employee, future prospects of extension of the business and host of other related circumstances. The rule that increased remuneration can only be justified if there be corresponding increase in the profits of the employer was erroneous.

Applying the aforesaid principle to the facts of our case, we hold that when the Board of Directors of the assessee had thought it fit to spend on the foreign tour of the accompanying wife of the Managing Director for commercial expediency, the reasons being reflected in its resolution quoted by us, it was not within the province of the Income-tax Authority to disallow such expenditure by sitting over the decision of the Board, in the absence of any specific bar created by the Statute for such expenditure.

Heard learned counsel for the parties.

The agreement dated 10.11.1995 would fall under Section 37 of the Act, thus, the service rendered relate to the re-arrangement of manufacturing and sale activities. Further Section 35B provides that where the assessee has paid any lump sum consideration for acquiring any know how for use for the purpose of his business, deduction is allowable to the assessee at rate of 1/6 in six consecutive years. This expenditure is to be treated as revenue expenditure. The judgment of Delhi High Court in a case of *Indo Rama Synthetics India Ltd* is directly applicable to the facts of the present case.

Reference at this stage can further be made to a judgment of Hon'ble the Supreme Court of India in a case of ***Honda Siel Cars India Ltd vs. Commissioner of Income Tax, Ghaziabad, 2017 (8) SCC 170*** wherein M/s Honda Motors Company Ltd, Japan had entered into joint venture dated 12.09.1995 with M/s SEIL Ltd. After getting the necessary information from the Government of India, a joint venture company in the name of the assessee was incorporated. An agreement dated 21.05.1996 between HMCL, Japan and the assessee was entered into known as Technical Collaboration Agreement. The dispute before Hon'ble the Supreme Court was that whether the technical fee of 30.5 million US dollar payable in five equal installments on yearly basis is to be treated as revenue expenditure or capital expenditure. The appeal was dismissed and in para No. 22 and 23 observed as under:-

*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 improvising 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 therefore.*

*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 licence 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, parts and 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 licensee, it would continue to pay royalty as per rates agreed under the agreement. Clauses 19 and 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 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 company, 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 facilities and payment thereunder would qualify as capital expenditure, and not the payment of technical fees/royalty on the ground that this agreement was not in connection with the setting up of a 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 this 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.”*

Applying the ratio of the above mentioned judgments to the facts of the present case, the appeals are allowed and impugned orders are set aside. The appellant (s) company shall be entitled to treat the travelling expenses of the Director's wives as well as fees paid to M/s Kinsey and Co Ltd for professional service for the relevant assessment year as revenue expenditure.

**(RITU BAHRI)**  
**JUDGE**

**09.02.2023**  
G Arora

**(MANISHA BATRA)**  
**JUDGE**

*Whether speaking/reasoned* : Yes/No  
*Whether reportable* : Yes/No