

(2010) 01 MAD CK 0173

Madras High Court

Case No: Tax Case (Appeal) No. 629 of 2004

Commissioner of Income Tax

APPELLANT

Vs

Elgi Ultra Industries Ltd.

RESPONDENT

Date of Decision: Jan. 19, 2010

Acts Referred:

- Income Tax Act, 1961 - Section 143(1)(a), 143(2), 143(3), 260A, 35AB

Citation: (2010) 321 ITR 390

Hon'ble Judges: P.P.S. Janarthana Raja, J; D. Murugesan, J

Bench: Division Bench

Advocate: T. Ravikumar, for the Appellant; V.S. Jayakumar, for the Respondent

Final Decision: Allowed

Judgement

P.P.S. Janarthana Raja, J.

The above tax case appeal is filed by the Revenue u/s 260A of the income tax Act, 1961, against the order of the income tax Appellate Tribunal, Chennai "C" Bench, dated January 30, 2004 made in I.T.A. No. 532/Mds/1997. When the above appeal was posted for admission on August 20, 2004, this court admitted the same on the following substantial questions of law:

Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the expenses incurred to get technical know-how is fully allowable u/s 37 of the income tax Act, 1961 ?

2. The assessee is a company engaged in the manufacture of textile machinery accessories like transmission belts, cots and aprons, loom components, etc. The relevant assessment year is 1995-96 and the corresponding accounting year ended on March 31, 1995. The assessee filed its return of income on November 29 1995, declaring income of Rs. 21,39,740. The Assessing Officer sent intimation u/s 143(1)(a) of the income tax Act, 1961, on March 11, 1996. Subsequently, notice u/s 143(2) of the Act was issued and assessment was completed u/s 143(3) of the Act

determining the total income of Rs. 28,41,340. While computing the assessment, the Assessing Officer disallowed the claim of Rs. 7,41,675 towards technical know-how and he has allowed the 1/6th of the amount u/s 35AB of the Act, i.e., Rs. 1,23,613. The balance amount of Rs. 6,18,062 was disallowed by the Assessing Officer. Aggrieved by that order, the assessee has filed an appeal before the Commissioner of income tax (Appeals), Coimbatore. The said Commissioner (Appeals) confirmed the assessment and dismissed the appeal. Aggrieved by that order, the assessee has filed an appeal before the income tax Appellate Tribunal, Chennai. The Tribunal has held that the amount paid towards technical know-how is a revenue expenditure and allowed the entire amount claimed by the assessee and allowed the appeal. As against that order, the Revenue has filed the present appeal.

3. The learned counsel appearing for the Revenue submitted that the Tribunal is wrong in allowing the technical know-how expenditure as revenue expenditure u/s 37 of the income tax Act, 1961. He further submitted that the Tribunal ought to have appreciated section 35AB of the Act, which is squarely applicable to the facts of the present case since know-how fees is paid as per the agreement dated September 25, 1994. So, the Assessing Officer was justified in restricting the 1/6th of the total amount paid by the assessee and disallowed the balance portion and in support of his contention he relied on the decision of this court in the case of [Commissioner of Income Tax Vs. Tamil Nadu Chemical Products Ltd.](#), and [Commissioner of Income Tax Vs. Drilcos \(India\) Pvt. Ltd.](#), Therefore, the order passed by the Tribunal is not in accordance with law and the same has to be set aside.

4. The learned counsel appearing for the assessee submitted that once the expenditure incurred is revenue expenditure, it has to be allowed u/s 37 of the Act and the Tribunal is correct in allowing the said deduction and has also relied on the decision of the apex court in the case of [Commissioner of Income Tax Vs. Swaraj Engines Ltd.](#), in support of his contention and the same has to be confirmed.

5. Heard the learned counsel appearing on either side and perused the materials available on record. It is seen from the order of the Tribunal that it has allowed the appeal by relying on the following judgments:

- (1) [Commissioner of Income Tax Vs. Simpson and Co. Ltd.](#),
- (2) [Jonas Woodhead and Sons \(India\) Ltd. Vs. Commissioner of Income Tax](#),
- (3) [Alembic Chemical Works Co. Ltd. Vs. Commissioner of Income Tax, Gujarat](#), and
- (4) [Commissioner of Income Tax, Madras-II Vs. I.A.E.C. \(Pumps\) Ltd., Madras](#),

6. In the aforesaid decisions only applicability of section 37 of the Act has been considered and nowhere the scope of section 35AB of the Act has been dealt with. The apex court in the case of [Commissioner of Income Tax Vs. Swaraj Engines Ltd.](#), while considering the scope of section 35AB, held as follows (page 444):

On the first question, it has been vehemently urged by Shri Iyer, learned senior counsel on behalf of the respondent-assessee, that the High Court was right in dismissing the Department's appeal in limine following its earlier judgment in the case of [Commissioner of Income Tax Vs. JCT Electronics Ltd.](#). On the first question, there is considerable amount of confusion. It appears that prior to the assessment year 1995-96, the Department has been contending that the royalty expenditure comes within the ambit of section 35AB. However, there is some doubt as to whether the said contention regarding applicability of section 35AB was at all raised. In this regard, the order of the Assessing Officer is not clear principally because it has focused only on one point, viz., whether such expenditure is revenue or capital in nature. At the same time, it is important to note that even for the applicability of section 35AB, the nature of expenditure is required to be decided at the threshold because if the expenditure is found to be revenue in nature, then section 35AB may not apply. However, if it is found to be capital in nature, then the question of amortization and spread over, as contemplated by section 35AB, would certainly come into play. Therefore, in our view, it would not be correct to say that in this case, interpretation of section 35AB was not in issue. Our above reasoning is further fortified by the question framed by the High Court in the impugned judgment which reads as under:

Whether, on the facts and in the circumstances of the case, the Hon'ble income tax Appellate Tribunal is right in upholding the decision of the Commissioner of income tax (Appeals) that the payment of royalty made by the assessee-company to M/s. Kirloskar Oil Engine Ltd. to acquire technology know-how under the agreement dated October 19, 1989, is a revenue expenditure and does not come within the ambit of the provisions of section 35AB of the income tax Act, 1961, whereas the payment is a capital expenditure in view of the following judgments:

- (A) [Fenner Woodroffe and Co. Ltd. Vs. Commissioner of Income Tax](#),
- (B) [Ram Kumar Pharmaceutical Works Vs. Commissioner of Income Tax](#),
- (C) [Commissioner of Income Tax Vs. Warner Hindusthan Ltd.](#), and
- (D) [Commissioner of Income Tax, Tamil Nadu-II Vs. Southern Switchgear Ltd.](#),

On a bare reading of the said question, it is clear that applicability of section 35AB in the context of royalty paid to Kirloskar as a percentage of the net sale price being revenue or capital in nature and depending on the answer to that question, the applicability of section 35AB also arose for determination before the High Court. Be that as it may, the said question needs to be decided authoritatively by the High Court as it is an important question of law, particularly, after insertion of section 35AB. Therefore, we are required to remit the matter to the High Court for fresh consideration in accordance with law.

On the second question, we do not wish to express any opinion. It is for the High Court to decide, after construing the agreement between the parties, whether the expenditure is revenue or capital in nature and, depending on the answer to that question, the High Court will have to decide the applicability of section 35AB of the income tax Act. On this aspect we keep all contentions on both sides expressly open.

7. From a reading of the aforesaid decision, it is clear that the Supreme Court directed the High Court first to decide the matter whether the expenditure incurred is revenue or capital expenditure. After construing the agreement entered into between the parties and depending on the result, the High Court has to decide the applicability of section 35AB of the Act. In the present case, absolutely there is no details regarding the technical know-how payment and also there is no discussion by any of the authorities below that how the technical know-how is the revenue expenditure. There is complete lack of details in respect of agreement entered into between the assessee and the foreign collaborator and the Revenue has not enclosed the copy of the said agreement. In view of the absence of details and discussion in the order, it is difficult for this court to determine whether the expenditure incurred towards technical know-how is the revenue or capital expenditure. The authorities below have not given any details regarding the technical know-how payment. In these circumstances, the order passed by the Tribunal is set aside and the matter is remitted back to the income tax Appellate Tribunal, "C" Bench, Chennai, to decide the matter afresh in accordance with law as expeditiously as possible, after giving opportunity to the assessee. The above tax case appeal is allowed and the matter is remitted to the income tax Appellate Tribunal, "C" Bench, Chennai, to decide the matter afresh in accordance with law and in the light of the above judgments, after taking into consideration the observations made in this decision. No costs.