REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 4918 OF 2017
(@ SPECIAL LEAVE PETITION (CIVIL) NO. 2140 OF 2017)

HONDA SIEL CARS INDIA LTD. .....PETITIONER (S) APPELLANT(S)

VERSUS

COMMISSIONER OF INCOME TAX, GHAZIABAD .....RESPONDENT(S)

W I T H

CIVIL APPEAL NO. 4919 OF 2017
(@ SPECIAL LEAVE PETITION (CIVIL) NO. 4261 OF 2017)

CIVIL APPEAL NO. 4920 OF 2017
(@ SPECIAL LEAVE PETITION (CIVIL) NO. 4319 OF 2017)

CIVIL APPEAL NO. 4921 OF 2017
(@ SPECIAL LEAVE PETITION (CIVIL) NO. 4356 OF 2017)

A N D

CIVIL APPEAL NO. 4922 OF 2017
(@ SPECIAL LEAVE PETITION (CIVIL) NO. 4249 OF 2017)

J U D G M E N T

A.K. SIKRI, J.

Assessee in all these appeals is Honda SIEL Cars Ltd.

(hereinafter referred to as the “Assessee”). Question of law that is raised is also identical. Five appeals are filed only because of the reason that same issue has occurred in different Assessment Years, i.e., for the years 1999-2000, 2001-2002, 2002-2003, 2003-2004 and 2005-2006.

2) M/s. Honda Motors Company Limited, Japan (hereinafter referred to as “HMCL, Japan”) had entered into a joint venture dated September 12, 1995 with M/s. SEIL Ltd., a company incorporated under the Indian Companies Act. After getting necessary approval from the Government of India, a joint venture company in the name of the assessee was incorporated. After incorporation of the assessee as a joint venture, An agreement dated May 21, 1996 between HMCL, Japan and the assessee was entered into, known as ‘Technical Collaboration Agreement’ (for short, ‘TCA’). As per the TCA, HMCL, Japan which is engaged in the business of development, manufacture and sale of automobiles and their parts agreed to give ‘license’ and ‘technical assistance’ to the assessee. The TCA also stipulated different kinds of technical know-how and technical information which were to be provided by HMCL, Japan (as a licensor) to the assessee (as a licensee). For providing the aforesaid facilities, it was

agreed that a consideration/lump sum fee of 30.5 million US Dollar would be paid by the assessee to the HMCL, Japan in five continuous equal installments and payment thereof was to commence from third year after commencement of commercial production. Besides, assessee was also liable to pay royalty of 4%, both on internal and exports, subject to taxes.

3) The dispute which has arisen is as to whether the said 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.

4) The assessee had filed its first return for the Assessment Year 1999-2000 (in which year, first installment was paid) showing the said expenditure as revenue expenditure. Though, in the normal assessment, the expenditure was allowed as such, thereafter a notice was issued under Section 148 of the Income Tax Act (hereinafter referred to as the 'Act') stating that said expenditure was capital in nature and, therefore, instalment towards royalty paid in the sum of Rs. 79602000/-, by the assessee to HMCL, Japan in that year had escaped assessment. Ultimately, orders were passed treating the same as capital expenditure. In the subsequent years, the Assessing Officer again treated the royalty

paid as capital expenditure. The assessee filed appeals before the CIT(A) which were dismissed. However, further appeals before the Income Tax Appellate Tribunal (ITAT) were allowed and the ITAT held that the expenditure is to be treated as the revenue expenditure. Against the order of the ITAT, the Department went in appeal before the High Court of Allahabad which has allowed these appeals thereby reversing the order of the ITAT and agreeing with the view taken by the Assessing Officer the payments of royalty expenditure in-question are to be treated as capital expenditure. In the present appeals challenging the impugned judgment dated December 21, 2016 passed by the High Court is challenged.

5) With the aforesaid preliminary remarks about the nature of controversy, we now proceed to take note of the facts in some detail.

6) As mentioned above, joint venture company, namely, the assessee was incorporated by HMCL, Japan and SEIL, India.

> "8. Total share capital of HSCIL/Assessee was 36 crores shares out of which 35,63,99,995 shares were held by HMCL, Japan while remaining 3600005 shares held by M/s. Seil India. In other words, joint venture was almost owned by HMCL, Japan, having around 99% shares and Seil India (local Indian

company) owned only 1% shares.

9. Thereafter, M/s. HMCL, Japan who held about 99% share of joint venture company/subsidiary company, i.e., Assessee, entered into an agreement on 21.5.1996 with HSCIL/Assessee which is called as "Technical Collaboration Agreement". Agreement stipulated and termed HMCL, Japan as "licensor" and HSCIL/Assessee as licensee."

14. In view of aforesaid licence, a consideration/lump sum fee agreed between parties was 30.5 million U.S Dollar, payable in five continuous equal installments by licensee to licensor and payment thereof was to commence from third year after commencement of commercial production. Besides, licensee was also liable to pay royalty of 4%, both on internal and exports, subject to taxes. Article 14 of agreement which talks of lump sum fee and royalty reads as under:

"14.1 In consideration of the right and licence granted to licensee under Article 2 hereof and of the furnishing of the Technical Information under Article 4.2 hereof, licensee shall pay to LICENSOR the following fees:

1. Lumpsum fee:

The amount of lumpsum fee payable by the licensee to the LICENSOR shall be USS 30.5 million. This fee shall be payable in 5 continuous equal annual installments, the amount of each of which installments shall be six million one hundred thousand US dollars (USS6,100,000), beginning from the 3rd year after the commencement of Commercial Production. The lump sum fees shall be payable by licensee in currency of US dollars by bank transfer remittance to the bank account designated by LICENSOR, based on final government approval.

2. Royalty:

The rate of royalty payable by the licensee to the LICENSOR shall be Four (4) percent; both on internal sales and exports, subject to taxes.

The royalty shall calculated on the basis of the ex-factory sale price of the product exclusive of excise duties, minus the cost of standard bought out components and the landed cost of imported components irrespective of the source of procurement, including ocean-freight, insurance, custom duties, and other similar charges.

The royalty shall be payable for a period of seven (7) years from the date of commencement of Commercial Production.

List of standard bought out items is as per exhibit II.

14.2 The total amount of royalty specified in the counter signed report and invoice under Article 13.1 hereof shall be payable by licensee in the currency of US Dollars by bank transfer remittance to the bank account designated by LICENSOR, so that such remittance shall reach LICENSOR not later than the 10th day of month next following the month in which such countersigned report and invoice reach licensee. In the event the currency in which the amount of running royalty is calculated differs from the currency in which payment of the running royalty is to be made, then conversion shall be made in accordance with the final quotation of the telegraphic transfer selling rate of exchange prevailing at the time of remittance by the Delhi office of any international bank, mutually agreed separately.

14.3 All payments and remittances by licensee will be subject to Tax Deduction at Source (TDS)/levy of CESS (under Research and Development Cess Act, 1986). Receipt by LICENSOR of any payment tendered hereunder shall not constitute LICENSOR'S acceptance of any account, schedule or figure on which such payment is based. All payments made or to be made by licensee to LICENSOR hereunder shall not be refundable to licensee, in any facts or circumstances whatsoever. If licensee fails to make any payment here under on the due date, licensee agrees to pay a late payment fee in the amount equivalent to LIBOR +TWO (X) percent per annum in the payment currency, calculated on the basis of a 365 day year, subject to Government of India/RBI approvals/guidelines prevailing at that time.

14.4 It is understood and confirmed that it should be separately agreed to by the parties hereof in the "Memorandum on Exchange of Technicians" referred to in Article 4 hereof the any and all fees, costs, expenses and other consideration for and in connection with the technical guidance provided by LICENSOR by dispatching to licensee technical experts (s) of LICENSOR and the technical training of licensee's engineers) at a factory or factories of LICENSOR or any of its designers, including but not limited to technical guidance fees, per dien allowances, traveling expenses, staying or living expenses and other incidental expenses, shall be payable by licensee to LICENSOR in accordance with such" Memorandum on Exchange of Technicians", separate from and in addition to the payments under this Article 14, and that no amount of any such fees, costs, expenses or other consideration is included in the payments under this Article 14."

(emphasis added)

15. Article 19 provides term/tenure of agreement and reads as under:

> “ Article 19. TERMS OF AGREEMENT :
>
> This Agreement shall become effective on the Effective Date, and shall continues in full force and effect for period of ten(10) years from the date of agreement or seven (7) years from the date of commencement of commercial production, and shall thereafter be renewed subject to the prevailing laws in India; provided, however, that this Agreement may be terminated by either party at the end of the initial period as mentioned above or at the end of any subsequent renewed period by written notice to that effect given to the other party at least three (3) months prior to the expiration of initial period or any

subsequent renewed period. Notwithstanding the foregoing, in the event of termination of the Joint Venture Agreement, this Agreement shall accordingly terminate forthwith."

(emphasis added)

“16. Agreement can be terminated by either of the parties by giving sixty days' notice, in case of default in performance of obligations under the agreement, as contemplated in Clause 20.1. Consequence of termination of agreement is provided in Article 21 and reads as under:

"21.1 In the event of the expiration or any other termination of this Agreement for any reason whatsoever, (except where the parties have taken steps for the renewal of the agreement) and unless otherwise agreed upon by the parties hereto,

1. licensee shall, within 90 days, discontinue (I) the manufacture, sale and other disposition of the Products and the Parts, and (ii) the use of the Intellectual Property Rights, Technical Information licensed or furnished by LICENSOR under this Agreement.

2. licensee shall promptly return to LICENSOR all particular documents and tangible property supplied by LICENSOR in connection with this Agreement and belonging to LICENSOR and shall keep all Information received by licensee hereunder secret and confidential in accordance with Article 7 hereof;

3. licensee shall not be entitled to demand from LICENSOR, for the reason of the expiration or termination of this Agreement or the failure to renew or extend it, any damages, reimbursements or other payments on account of the current or prospective profits on licensee's sale or anticipated sale of the Products and the Parts, or on account of the establishment, development or maintenance of the goodwill or other business of licensee, or on account of any other cause of thing whatsoever, except as provided in this Agreement;

4. Even after the expiration or termination of this Agreement for any reason whatsoever, the licensee permits LICENSOR or its agents to have access to licensee's factories and other facilities and to make the necessary inspection to confirm whether licensee is observing its obligations under this Article 21.1;

5. LICENSOR may at its option, but without obligation to do so, repurchase or cause to be repurchased at fair price agreed upon by the parties hereto, all or any portion of the Products and the Parts which licensee then has on hand and which remain unsold and unused at the time of the expiration or termination of this Agreement;

6. LICENSOR may at its option sell, directly or indirectly, the Products and the Parts repurchased by it under paragraph (5) above in the Territory or any other country, without any liability on the part of LICENSOR, to account to licensee for any part of the proceeds of such sale or any other sums whatsoever;

7. If LICENSOR does not exercise its option referred to in Paragraph (6) above within a reasonable period of time after the expiration or termination of this Agreement, then licensee may, notwithstanding the provision set forth in Paragraph (1) above, sell on a non-exclusive basis, the Products and the Parts which licensee has on hand at the time of the expiration or termination of this Agreement within such a reasonable period of time as may be agreed upon by the parties hereto; provided, however, that such sale shall be made in accordance with this Agreement and without impairing LICENSOR's reputation, provided further that the said sale shall be so executed without using the Trade mark of the LICENSOR in full or in part, and provided further, that running royalties thereon shall be paid to LICENSOR on the same terms and conditions as provided herein.

(emphasis added)

21.2 This expiration or any other termination of this Agreement here under shall be without prejudice to any right which shall have accrued to either party here under prior to such expiration or termination."

(emphasis added)”

7) As is clear from the reading of Article 14 of the Agreement, the aforesaid royalty in 5 equal installments was to be paid for the right in license that was granted by the HMCL, Japan to the assessee under Article 2 as well as for furnishing of technical information under Article 4.2. Under the aforesaid articles, HMCL, Japan had to provide manufacturing facilities, know-how, technical information and it also gave information regarding intellectual property rights to the assessee which the assessee was entitled to exploit only as a licensee and without getting any rights in the said intellectual property belonging to HMCL, Japan. The terms ‘manufacturing facilities, intellectual property rights, know-how and technical information’ were defined in clauses 3, 5, 6 and 7 of the Agreement which reads as under:

> “3. The term “Manufacturing Facilities” shall mean jigs, tools, dies, machinery and equipment which licensee for the manufacture, assembly, testing of inspection of the products.
> 5. The terms “Intellectual Property Rights” shall mean those patents, utility models design patents and other intellectual property rights directly relating to the Products or the licensed parts themselves relating to the manufacture of the products or the licenced parts (including many pending applications thereof, but excluding trademarks, and excluding patents utility

models design patents and other intellectual property rights relating to the Manufacturing Facilities and the manufacture thereof) which Licensor owns at the time of execution of this Agreement or may own from time to time during the term of this Agreement or under which Licensor is entitled to grant a licence to licensee.

6. The term “know-Hose” shall mean any and all secret technical information (except for the Intellectual Property Right), whether in writing or not, including but not limited to drawings, standards, specifications, material lists, process manuals and direction maps, which directly relates to the products or the licenced parts themselves or is necessary for the manufacture of the products or the licenced parts and which Licensor owns at the time of execution of this Agreement or under which Licensor is entitled to grant a licence to licensee.

7. The term “Technical Information” shall mean () the KnowHow, and (II) any technical information, not included in the KnowHow, such as service materials and Japanese Industrial Standard (JIS), whether in writing or not, which directly relates to the products or the licenced parts or is necessary for the manufacture of the products or the licenced parts and which Licensor owns at the time of execution of this Agreement or may own from time to time during the term of this Agreement or under which Licensor is entitled to grant a licence to licensee, and the Technical Information shall include the “Technical Materials” (emphasis added)

13. Licence was granted by HMCL, Japan to an indivisible, non-transferable and exclusive right and licence to manufacture, use and sell the products and the licensed parts within the territory under the intellectual property rights by using knowhow, and technical information. It also provided that licensee, i.e., HSCIL/Assessee may grant sub-licenses with a prior written consent of licensor. It also provided that to sale or export any products and parts, to any place outside territory of India, prior consent of licensor would be required.”

8) It may also be pointed out, at this stage, that as a part of Agreement, certain memoranda were also executed between the parties, viz.:

(a) Memorandum on exchange of technician

(b) Memorandum on supply of parts

(c) Memorandum on supply of manufacturing facilities

9) It is on the analysis of the aforesaid clauses of the Agreement that issue needs to be decided. As per the Revenue, technical know-how and royalty payments are of enduring nature and, therefore, they would qualify as capital expenditure. On the other hand, the assessee maintains that it had acquired mere right to use technical information provided by HMCL, Japan and, thus, it did not lead to creation of any asset of enduring nature. Therefore, it was to be treated as revenue expenditure.

10) The High Court, after taking note of various judgments on the subject and the principles laid down in those judgments, came to the conclusion that royalty was for enduing benefit of the business. It was not only for running the business but for bringing the business into existence and then for running and sustaining it. In other words, main reason which persuaded the High Court to

come to the aforesaid conclusion was that there was no existing business which needed to be improvised with the aid of technical know-how. This TCA was executed with the aim and objective to establish a new unit for manufacture of automobiles and parts thereof. Therefore, a new unit was brought into existence in the form of assessee on which HMCL, Japan, a foreign company, had absolute control as it held 99% shares in the joint venture. Further, technical know-how agreement for technical collaboration which not only included transfer of technical information, but, complete assistance, actual, factual and on the sport, for establishment of plant and machinery etc. so as to bring into existence manufacturing unit for the products. The Agreement also provided for continuous assistance at every stage. The High Court was of the opinion that in the aforesaid circumstances, the test laid down by the **Full Bench of Madras High Court in *M/s. Jonas Woodhead and Sons* (India) vs. *Commissioner of Income Tax*[1]** becomes applicable which is to the effect that whenever a complete new plant with a complete new process, with new technology for a manufacture of product is brought into existence, payment for such technical know-how is to be treated as capital expenditure. The High Court also remarked that the

[1] 1979 (117) ITR 55

expenditure in the form of technical know-how fee and royalty was not only for running the business but for bringing the business into existence and, therefore, could not be treated as the revenue expenditure.

11) Mr. Tripathi, learned senior counsel appearing for the assessee submitted at the outset that on identical issue pertaining to this very assessee, Delhi High Court has taken a contrary view in the case of ***CIT*** vs. ***Hero Honda Motors*** *[(2015) 327 ITR 481(Delhi)]* holding that payment of technical know-how fee and royalty was in the nature of revenue expenditure. His further submission was that the very premise on which Allahabad High Court had given the impugned judgment, was contrary to record. In this behalf his submission was that the High Court had proceeded on the premise that the technical know-how fee and royalty was paid for setting up the plant for manufacture of automobiles which are contrary to the factual finding recorded by the Tribunal in this case. According to him, the know-how was provided to the assessee for the purpose of manufacturing of products in India. He also argued that the High Court was influenced by irrelevant factors like extent of share holding of HMCL, Japan in the assessee which was of no relevance. The learned counsel laid

much emphasis that in terms of TCA, the appellant had only acquired the right to use the technical know-how provided by HMCL for manufacture of products, during the currency of the TCA, which was for an initial period of ten years from the date of agreement or seven years from the date of commercial production. The ownership rights in the know-how continued to remain with HMCL, Japan and the appellant was not authorized to transfer the know-how license to any other person or assign or convey the same to any third party. Thus, what the appellant acquired was only a limited right to use and exploit the know-how for manufacture of products and parts.

12) The learned counsel for the Revenue refuted the aforesaid submissions of Mr. Tripathi. His contention was that finding of fact was arrived at by the Assessing Officer, which was confirmed by the CIT(A) as well that a new asset in the form of setting up of a new company had come into existence with the aid of technical know-how and, therefore, the expenditure in-question was capital expenditure. He further submitted that the view which was taken by ITAT was un-sustainable and, therefore, rejected by the High Court. Referring to the reasoning given by the High Court in the impugned judgment which is already taken note of above, his

submission was that the same should be accepted.

13) We have considered the respective submissions of counsel for the parties on either side. First thing which is discernible in the impugned judgment of the High Court is that the High Court has proceeded entirely on the basis that technical know-how was used for setting up of a plant for manufacture of automobiles. Judgment of the ITAT, on the other hand, reveals that it had arrived at a contrary conclusion.

14) Record reveals that simultaneously with the signing of TCA, certain other agreements were also entered into between HMCL, Japan and the assessee on May 21, 1996.

15) Nomenclature of these three agreements is already taken note of above. These are 'Memorandum on Exchange of Technicians', 'Memorandum on Supply of Parts' and 'Memorandum on Supply of Manufacturing Facilities'. The Tribunal went into the nature of these agreements. Engineers and technicians were sent by HMCL, Japan to India for providing necessary guidance for setting up of plant. Likewise, Memorandum on Supply of Parts related to the supply by HMCL, Japan of parts required for the manufacture of Honda cars. This Agreement basically provided each sale and purchase of pats shall be effected in accordance

with the terms and conditions of an individual purchased contract for the parts, which means that the supply of parts is governed by separate contracts. Third Agreement known as 'Memorandum on Supply of Manufacturing Facilities' stipulated the specification of the manufacturing facilities to be sold by Japanese company to the assessee, their sale prices and the time of delivery which was to be separately decided by the parties from time to time. It contained detailed provisions in respect of the specifications and changes thereto, terms of payment, inspection before delivery, functional testing of materials, packing, insurance, on-sight inspection, warranty title risk, patents, trademarks etc. Undoubtedly, payments made in respect of facilities given under the aforesaid Memoranda are capitalised by the assessee, showing the same to be the capital expenditure. Contrasting these three Memoranda with the TCA, ITAT returned a finding to the effect that for setting up the manufacturing facilities and for the tax, separate agreements had been entered into by the parties and separate payments were made by the assessee as consideration therefor. This makes it clear that the payment of technical know-how and royalty are not part of payments for setting up the plant which manufactures the Honda cars in India but, were made to enable the assessee to manufacture the Honda cars in India which are its stock and trade. The Tribunal was conscious of the fact that this TCA was also entered into at the time of setting up of the fact and since the know-how was being obtained for the first time and was crucial to the setting up of the business of the assessee. It posed a question as to whether this could make the difference and the expenditure was to be treated as capital expenditure. However, after noticing that no such distinction was drawn by Delhi High Court in ***Shriram Refrigeration Industries Vs. Commissioner of Income Tax***[2] and ***Triveni Engineering Works Ltd. Vs. CIT***[3] and the test applied was as to whether the expenditure, whether incurred at the time of setting up of the business or later, acquisition of technical know-how or was only for the use of the know-how for a particular period. Applying the aforesaid test, the Tribunal found that TCA in-question gave a limited right to the assessee to use the technology with no ownership or proprietary rights therein.

16) The aforesaid conclusion recorded by the ITAT has been upset by the High Court in the impugned judgment. It would be pertinent to point out that even the High Court has not interpreted the clauses

[2] 1981 (127) ITR 746
[3] 1981 (136) ITR 340

of the TAC to conclude that proprietary rights in the technical know-how stood acquired by the assessee. It has proceeded on the basis that it was only right to use the technical know-how which was given. Its conclusion rests entirely on the basis that the technical know-how was given for setting up of the new plant. It is this difference of opinion which is to be settled here.

17) A reading of the TCA would bring out the following pertinent aspects:

> "(a) the appellant was granted indivisible and non-transferable right to manufacture in India the range of products using know how/technology licensed by HMCL;
>
> (b) the appellant had during the currency of the agreement only the right to access the manufacturing know-how/technology owned by HMCL;
>
> (c) there was no transfer of the know-how/technology in favour of the appellant and the proprietary rights therein always vested in HMCL;
>
> (d) the appellant was to keep the know-how/technology confidential and was barred from assigning the same to any third party.
>
> (e) the agreement was for a period of 10 years and was renewable at the option of the parties; and
>
> (f) on the expiry of the agreement, the appellant was prohibited from using the know-how/technology and as duty bound to return all copies of the drawings, designs, etc. made available by HMCL under the agreement"

18) 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 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 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 ***Commissioner of Income Tax, Bombay City I*** v. ***Ciba India Limited***[4]. In the said case, the assessee company had procured know-how in the form of processes, formulae, scientific data, working, prescription and other intellectual property rights developed by a Swiss Company, to produce licensed preparations and to promote their sale in India. Inspite of the fact that the Swiss Company had granted to the Indian assessee “full and sole right and licence” in the territory of India under the patents listed in Schedule-I, to make use, exercise and vend the inventions referred to therein and to use the trade marks set out in Schedule-II in the territory of India, this Court held that what was conferred was a mere right to use. The Indian assessee, it was observed, was not entitled to exclusive rights to patents, trademarks etc. As per the agreement, proprietary information was not to be divulged to third parties

[4] (1968) 69 ITR 692 (SC)

without consent. The rights granted enabled access to the technical knowledge and experience with right to use patents and trademarks for a limited period. The Swiss Company did not part with any asset of its business, nor did the Indian assessee acquire any asset or advantage of enduring nature. The right empowered the Indian assessee to draw for the purpose of carrying on its business as a manufacturer and rely upon the technical knowledge of the Swiss Company. There was no attempt to part with technical knowledge absolutely in favour of the Indian assessee. It was not a case of transfer of intellectual rights once for all. Thus, the expenditure incurred was revenue in nature.

19) Likewise, in ***Alembic Chemical Works Co. Ltd.*** v. ***Commissioner of Income Tax, Gujarat***[5], the assessee was engaged in the manufacture of antibiotics and pharmaceuticals on the basis of licence which was granted to it by the Government for manufacture of antibiotic, penicillin etc. It entered into an agreement with Japanese Company for supply of requisite technical know-how so as to achieve substantially high level of performance or production with the aid of better technology and

[5] (1989) 177 ITR 377

process of fermentation and with better yielding penicillin strains that was developed by the foreign company. Under the agreement, royalty was to be paid. This royalty payment was treated as capital expenditure till the stage of the High Court. This Court reversed the judgment of the Courts below by holding the expenditure would be revenue in nature. In its judgment, the Court culled out certain principles laid down therein to determine, whether expenditure of assessee was 'Capital Expenditure' or 'Revenue Expenditure' and said:

(i) 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 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 (referred to British Insulated Helsby Cables Ltd. v. Atherton, [1926] AC 205).

(ii) If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure.

(iii) The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure.

20) It was also held that three aspects should be considered, (a) the character of the advantage sought, and in this, its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part and (c) the means adopted to obtain it.

21) The decision went in favour of the assessee primarily on the ground that the assessee in that case was already engaged in the preparation of antibiotic since long. Therefore, it could not be said that the area of improvisation by obtaining know-how from foreign collaboration was not a part of improvisation of existing business or that the entire gamut of existing manufacturing operation for

the commercial production of penicillin in the assessee's existing plant had become obsolete or inappropriate in relation to the exploitation of the new sub-cultures of the high yielding strains of penicillin. The Court also emphasised that it cannot be said that mere introduction of new bio-synthetic source required the erection and commissioning of a totally new and different type of plant and machinery. To this, added factors were that the agreement placed limitations on the right of the assessee in dealing with the know-how and the conditions as to non-partibility, confidentiality and secrecy of the know-how inclined towards the inference that the right pertained more to the use of know-how than to its exclusive acquisition. This case is significant for our purposes in two respects:

(i) If the technical know-how obtained under the agreement for which technical fee/royalty is paid is for a limited period and only right to use the technical know-how is there during the agreement with no right of acquisition, coupled with the fact that the said technical know-how is utilised for improvising the existing business, the expenditure would be treated as revenue expenditure. This case, thus, gives an indication that if such a technical know-how is for the purpose of setting up a new business, the position may be different.

(ii) Another aspect which needs to be noted is that while rendering the aforesaid decision, this Court observed that there is no single test or principle or rule of thumb which is paramount. It is ultimately a question of law, but a question which must be answered in the light of all the circumstances which are reasonable to take into account, and the weight which must be given to a particular circumstance in a particular case, must depend on common sense rather than on strict application of any single legal principle. It was also observed that solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances, some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a common sense appreciation of all guiding features which must provide the ultimate answer. This Court also said that the idea of 'once for all' payment and 'enduring benefit' are not to be treated as something akin to statutory conditions; nor are the notions of "Capital" or "Revenue" a judicial fetish. What is 'Capital Expenditure' and what is 'Revenue' are not eternal varieties but must need be flexible so as to respond to the changing economic realities of business. The expression "asset or advantage of an enduring nature" was evolved to emphasize the element of a sufficient degree of durability, appropriate to the context.

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 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 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."

24) However, discussion that follows thereafter suggests that the ITAT was satisfied with the explanation of the assessee that the High Courts have always applied the test as to whether the expenditure, whether incurred at the time of setting up of business or later, was for acquisition of the technical know-how or was only for the use of know-how for a particular period. ITAT felt satisfied with the said explanation and held that the expenditure was

revenue in nature. It is at this stage that the Tribunal erred in not approaching the issue in right perspective.

25) Coming to the judgment of the Delhi High Court in the case of this very assessee, it would be noticed that in that case, technical know-how was obtained for improvising scooter segment, which unit was already in existence. On the contrary, in present case, the TCA was for setting up of new plant for the first time to manufacture cars. The Delhi High Court specifically noted this fact in para 14 of the judgment. While analysing the agreement in that case which was for providing technical know-how in relation to the product i.e. two wheelers and three wheelers and the purpose was to introduce 'new models' of the said product developed by the Japanese Company, the High Court noted that the agreement specifically recorded that the respondent assessee was already engaged in the business of manufacturing, assembling, selling and otherwise dealing with two/three wheelers and their parts as a joint venture. It referred to the earlier collaboration agreement dated January 24, 1984 and the subsequent amendment thereto which conferred and had granted to the respondent assessee a right and licence to manufacture, assemble, sell, distribute, repair and service two/three wheelers.

The aforesaid distinction between the two Agreements has made all the difference in the results. As a consequence, we find no merit in these appeals which are dismissed with cost.

...J.
(A.K. SIKRI)

...J.
(ASHOK BHUSHAN)

NEW DELHI;
JUNE 09, 2017

ITEM NO.6 COURT NO.4 SECTION - XI
(For judgment)

S U P R E M E C O U R T O F I N D I A
RECORD OF PROCEEDINGS

CIVIL APPEAL NO.4918 OF 2017

HONDA SIEL CARS INDIA LTD. Appellant(s)

VERSUS

COMMISSIONER OF INCOME TAX, GHAZIABAD Respondent(s)

With
C.A.No.4922/2017
C.A.No.4921/2017
C.A.No.4920/2017
C.A.No.4919/2017

Date : 09/06/2017 These appeals were called on for judgment today.

For Petitioner(s) Ms.Manasvini Bajpai, Adv.
Mr. R.Chandrachud, Adv.

For Respondent(s) Ms.Sadhna Sandhu, Adv.
Ms.Nivedita Nair, Adv.
Ms.Gargi Khanna, Adv.
Mr.Natkarni Nisha Bagchi, Adv.
Ms.Anil Katiyar, Adv.
Ms.Sangita Rai, Adv.

Hon'ble Mr.Justice A.K.Sikri pronounced the judgment of the Bench comprising His Lordship and Hon'ble Mr.Justice Ashok Bhushan.

The appeals are dismissed with cost in terms of the signed judgment.

(SATISH KUMAR YADAV) (H.S.PARASHER)
AR-CUM-PS COURT MASTER
(Signed reportable judgment is placed on the file)