IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'E' DELHI

ITA No.3738(Del)/2011
Assessment Year: 2008-09

ASSTT COMMISSIONER OF INCOME TAX
CIRCLE 5(1), NEW DELHI

Vs

MODI REVLON PVT LTD
1400, MODI TOWER, 98, NEHRU
PLACE, NEW DELHI
PAN NO:AAACM5901B

Rajpal Yadav, JM and K G Bansal, AM

Dated: October 21, 2011

Appellant Rep by: Shri Raj Tandon, CIT, DR
Respondents Rep by: Shri Salil Kapoor & Shri Ankit Gupta, Advs.

ORDER

Per: K G Bansal:

Ground nos. 2 and 2.1 taken up by the revenue are against deleting of the disallowance of Rs. 4,54,85,325/- made by the AO out of royalty expenses. Reliance has been placed on the decision of Hon'ble Supreme Court in the case of *Southern Switch Gears Ltd., (1984) 232 ITR 359.*

2. At the outset, the ld. counsel for the assessee submitted that the issue stands covered by the decision of "D" Bench of Delhi Tribunal in the case of the assessee for assessment years 2005-06 and 2006-07 in *ITA Nos. 5 and 2063(Del)/2009* a copy of which has been placed before us. The relevant portion of the decision is reproduced below:-

"5. We have considered the rival contentions carefully and gone through the orders of the authorities below. From the record, we found that the know-how agreement between RML and the assessee had been initially for a period contained in foreign collaboration letter issued by the FIPB, Govt.of India. According to their letter bearing No.FC.II.27(94) dated 14.1.1994, the duration of the agreement approved was 10 years from the date of agreement or 7 years from the date of commencement of commercial production. Accordingly, the seven years term expired on 29.8.2002. Pursuant to press note No.2 of 2003 dated 24.6.2003 issued by Govt.of India, the assessee made a request to the Government on 21.7.2003 for seeking extension of technical collaboration agreement. The Department of Economic Affairs, Govt.of India accorded the approval by letter of even No. dated 6.8.2003. Accordingly, the supplement agreement dated 16.9.2003 was executed between RML

and the assessee, which is made effective from 1.10.2003. Clause 1 of the said supplement agreement reads as under:-

"The Agreement will continue from 1 October 2003 until such time as both parties mutually decide to terminate the Agreement."

6. According to clause 3 of the agreement, this supplement agreement is part of the original assessment except as modified and therefore, all the terms and conditions remained unchanged. The original know-how license agreement was entered into on 14.1.1994 at the time of inception of business of the company and the payments of royalty under that agreement were made till August 2002 i.e. for a period of 7 years from the commencement of agreement as per the approval of the GOI. The payment of royalty in the year under assessment was made in terms of supplement agreement dated 16.9.2003. Hence, there is no question of any fresh input of know-how/technology and the payments are only in respect of continued use of brand name and patents owned by the foreign company. Hence no benefit of enduring nature is derived by assessee against these payments of royalty. As per various clauses of know-how license agreement vis-à-vis supplement agreement dated 16.9.2003, the royalty payable as net sales of taxes the know-how has been provided by the contract manufacturer in terms of clause 4.01 of the agreement for limited purpose of manufacturing Revlon products only when passing on any property in the sale to the assessee. Obligations of the contract manufacturer were clearly defined in the agreement between the assessee company and the contract manufacturer, according to which obligation relating to royalty payment has not been passed on to the contract manufacturer. The entire benefit of the know-how was meant for manufacturing of the products to be supplied to the company and there was no obligation of contracting manufacturer to pay royalty to the licensor. Since the assessee company was enjoying the complete benefit of the know-how to run its business, the expenditure incurred every year on payment of royalty was revenue in nature and is very much a business expenditure. These expenditure cannot be classified as capital expenditure. From the record, we found that arrangement entered into by the assessee with KCPL and WMPL was for bona-fide commercial needs which cannot be tested against touchstone of tax avoidance. The royalty payment was made by the assessee in the normal course of its business which is revenue in nature, allowable u/s 37(1) of the Act. The know-how license was granted way back in 1994 in terms of an earlier agreement dated 22.7.1994 and the payment of royalty was in terms of the supplementary agreement dated 16.9.2003. Even as per para 12.01 of the agreement upon expiration or termination of this agreement, the licensee shall have no right to exploit or in any way to use the know-how and shall forthwith discontinue all use of the know-how and shall not thereafter use the know-how and so on. Thus, it is clear that the know-how has not been sold to the company and the licensor has an exclusive ownership of the know-how, therefore there is no reason to disallow the expenditure incurred on royalty payment which is revenue in nature, by treating the same as capital expenditure.

7. The CIT(A) has accepted assessee's method of computing royalty on the basis of sales value of WML and addition made in this regard of Rs.21.39 million deleted. However, CIT(A) has made ad-hoc addition of 5% of royalty relying on Hon'ble Supreme Court judgment in the case of Southern Switchgear. The CIT(A) has made a chart showing comparison of the facts of the case of Southern Switchgear and the assessee's own facts and found out that only one fact i.e. the assessee has an exclusive right to manufacture is common in both. The CIT(A) has held that since

one of the condition mentioned in that order namely "the right to manufacture is exclusive in India" is also applicable in case of assessee, therefore small part of payment (5% of royalty) made by assessee deserves to be capitalized as against capitalization of 25% of royalty paid.

8. In terms of the agreement, there is no dispute to the fact that the assessee had been given only right to use know-how and the patents and at no point of time any property of enduring benefit has been transferred in favour of the assessee. In view of the decision of Hon'ble Supreme Court in the case of CIBA India – 69 ITR 692, it can safely be concluded that where the assessee cannot assign or sublicense any part of the right obtained from the know-how, the payment made thereof cannot be termed as capital in nature. In the instant case, RML has not provided any assets to the assessee for establishing any factory, by giving right to use technical know-how, no asset of enduring nature was acquired and upon termination the assessee was not entitled to use the industrial properties and know-how of RML. Enduring benefit can be said only if right to manufacture is given even after termination of the agreement.

9. In the result, the ground taken by the assessee with regard to revenue nature of royalty payment is allowed, whereas the ground of the Revenue is dismissed in both the years under consideration."

2.1 The ld. CIT, DR fairly submitted that the matter stands covered by the aforesaid decision, however, the decision has not been accepted by the revenue. There are strong reasons to have a re-look at the decision and, therefore, even if the present bench of the Tribunal chooses to follow the earlier decision, his submissions may be incorporated in the order.

2.2 The ld. CIT, DR briefly furnished the findings of the AO that –(i) the computation of royalty is not correct as per agreement, (ii) the expenditure on royalty has not been incurred wholly and exclusively for the purpose of business as the assessee neither manufactures the goods nor sells them on its own, and (iii) a part of the expenditure is capital in nature in view of the decision of apex court mentioned in the ground of the revenue. Briefly, the facts are that the assessee has been paying royalty to Revlon Mauritius Ltd. computed @ 5% of net domestic sales and 8% of export sales. The amount payable as per the agreement comes to Rs. 3,40,52,880/- as per computation furnished on page 5 of the assessment order. As against the aforesaid, the assessee has claimed deduction of Rs. 7,10,24,985/- as per computation given on page 2 of the assessment order. The AO has considered 75% of the royalty payable as revenue expenditure and 25% as capital expenditure. Therefore, the revenue expenditure is computed at Rs. 2,55,39,660/-. Thus, the claim to the extent of Rs. 4,54,85,325/- has not been allowed.

2.3 The ld. DR has drawn our attention to various pages of the paper book, the contents of which are discussed hereinafter briefly. In the agreement dated 27.07.1994, under which the royalty is paid, the term "Know-how" mean formulae, processes, receipts, product specification, technical and manufacturing data, information, equipment specification, specification of raw-material, and other technical information and data necessary to manufacture Revlon products. Various licenses have been granted to the assessee as per Article 2 under the head "Know-How License" and "Patent License". Under the Know-How License, the Licensor granted to the assessee the exclusive right to use the know-how in any plant approved by the Licensor in accordance with the processes, specification and recipes

thereof in connection with manufacture, marketing, sale and distribution of Revlon products in the territory. Under the Patent License, the assessee has been granted exclusive right to use the patents in the manufacture, distribution and sale of Revlon products in the territory. The Licensor is under obligation to provide free of cost all modifications and improvements made by it to the know-how and even the assessee is obliged that any right to register and obtain patents in any respect of such modifications and improvements vest exclusively in the Licensor. In view of the improvement clause, it is submitted that the finding of the Tribunal in paragraph no. 6 to the effect that there is no question of any fresh in-put of know-how or technology and payments are made in respect of continued use of brand name and patent owned by the foreign company is not correct. Consequently, the finding that no benefit of enduring nature is derived by the assessee requires re-consideration. The agreement has been novated on 16.09.2003 under which the novated agreement shall remain in force from the date of agreement till such time as both the parties mutually decide to terminate the same. The agreement is open ended and, therefore, various benefits derived by the assessee from the agreement are of enduring nature.

2.4 Reliance has been placed on the decision of Hon'ble Delhi High Court in the case of *My Fair Lady Ltd. Vs. ITO, (1988) 41 Taxman 22 (Mag.).* In this case, the assessee was granted license by one ML to use its brand name MF in respect of cosmetics manufactured by the assessee on the condition that the assessee will pay royalty @ 2% of the sales on all such items in respect of which the brand name MF was used. Further, the ML was to provide technical know-how to the assessee for manufacture of hair removing creams and waxes on consideration of payment of royalty computed on the basis of 5% of the sale proceeds in the first year and 3% in the second year. Thereafter, the assessee would have exclusive right over the said item. The question was-whether, payment of 5% royalty was for acquisition of capital asset and hence a capital expenditure? After considering various decisions, it has been held that payment of 5% royalty was for acquisition of a capital asset. It was not of importance that the acquired asset did not last beyond a period of four years. The reason is that it was paid to acquire the know-how outright and not by way of exploiting the know-how by using the patent or otherwise. Thus, the question was decided in favour of the revenue and against the assessee.

2.5 Further, reliance has been placed on the decision of Hon'ble Allahabad High Court in the case of *Ram Kumar Pharmaceutical Works Vs. CIT, (1979) 119 ITR 33***.** The assessee paid royalty for five years after which nothing was required to be paid and still it was able to use knowhow for long time. As the agreement provided that know-how and the data stood transferred to the assessee for being used by it in future without time limit, the only restriction was that it could not transfer the same to any one else, it was held that the royalty paid constituted an item of capital expenditure.

2.6 In the case of *CIT Vs. Shri Ram Bearings Ltd., (2001) 119 Taxman 970 (Cal.),* the assessee entered into a technical collaboration with a foreign company for supply of technical know-how for a lump-sum consideration It was claimed as revenue expenditure. The Hon'ble Court mentioned that the agreement subsisted for a period of five years. Thereafter, the assessee could continue to use the know-how and to manufacture the product whether patented or not. It was held that the expenditure is capital in nature.

2.7 In the case of *Controls & Switch Gear Co. Ltd. Vs. DCIT, decided by the Delhi Tribunal in ITA No. 5007(Del)/2007* for assessment year 2003-04, dated 31.12.2010, the agreement was to subsist for a period of 10 years and thereafter the assessee could use technical information, improvements, patent etc. free of charge for a period of 10 years. Thus, residuary benefit was available to the assessee free of charge. Relying on the decision in the case of Southern Switch Gear Ltd. (supra), it was held that 25% of the expenditure is capital in nature.

2.8 We have considered the facts of the case and submissions made before us. We find that under the agreement, the assessee has been granted the right to use know-how, patents and improvements. The original agreement dated 27.7.1994 subsisted for a period of 10 years and thereafter it has been novated on 16.09.2003. The new agreement is open ended and various terms and conditions are the same as in the original agreement. In fact, this agreement mentions that it will become the part of the original agreement except for minor modifications made in it. Various issues regarding the nature of expenditure and its computation have already been considered by the Tribunal. It has also taken into account the fact that the assessee does not manufacture the goods on its own and also does not sell or market the products on its own. The Tribunal has also considered the matter of computation of royalty. We are of the view that although it is an open ended agreement, it is only for the use of know-how and patents including improvements to the know-how. No proprietary right has been passed on to the assessee in the know-how or the patent. Therefore, the view taken by the Tribunal in the decision for assessment years 2005-06 and 2006-07 is followed. The result is that these grounds are dismissed.

3. Ground nos. 3 and 3.1 are against the deletion of the addition of Rs. 87,60,601/- made by the AO by invoking the provision contained in section 40A(2) of the Act. The facts are that the assessee claimed deduction of consultancy charges of Rs. 1,17,60,601/-. The AO had taken the position in earlier years that the agreement is an arrangement to siphon off part of the profits and divert the same to joint venture partners. Therefore, following the earlier order, deduction of Rs. 30.00 lakh only was allowed, which is stated to be the fair market value of the services rendered by Shri U.K. Modi to the assessee-company on behalf of joint venture partner. The ld. CIT(Appeals) had decided the matter against the revenue in earlier years. It was also found by him that the matter had been decided against the revenue by the Tribunal in assessment years 2005-06 to 2007-08. Therefore, he deleted the addition.

3.1 The only point made by the ld. DR is that the ld. CIT(Appeals) did not ask for proof of services availed of by the assessee. The case of the ld. counsel is that the matter is covered under earlier decision of the Tribunal.

3.2 We have considered the facts of the case and submissions made before us. The disallowance has not been made on the ground that no service has been availed of by the assessee in lieu of payment of the aforesaid amount. His case is that the payment is a devise for siphoning off profits. No proof has been brought on record in respect thereof. He has merely relied on his findings of earlier years which have been reversed by the Tribunal. Therefore, following the decision of the Tribunal, these grounds are also dismissed. For the sake of ready reference, the relevant portion of the decision of the Tribunal is reproduced below:-

"11. We have considered the rival contentions and found from the record that the consultancy charges have been paid in lieu of MMPL for providing various advices as

discussed in above para. Mr.U.K.Modi has represented one of the joint venture parties, MMPL, as director, in the business of collaboration with RML. We found him as an instrument in negotiating the collaboration as representative of MMPL for which he himself gave his personal undertaking. We also found that Mr.U.K.Modi did not render any services in his capacity as director of the assessee company and is not being paid any remuneration to work as a director. Sufficient evidence was produced before the AO to indicate that MMPL was actively involved in day to day activities of the assessee company. MMPL has duly incorporated the consultancy charges in his income and paid due taxes thereon, it cannot be said that agreement was entered for siphoning of income of the sister concern. In view of the decision of Dhanrajgiriji Raja Narsinghji – 91 ITR 544, it is upon the assessee to decide what expenses are to be incurred or what is required for business purposes and it is not open to the Revenue to prescribe as to what expenses are to be incurred by the assessee. The categorical finding recorded by the CIT(A) with regard to reasonability of the consultancy charges paid has not been controverted by learned DR, we therefore do not find any reason to interfere in the order of CIT(A) for deleting disallowance made by the AO by invoking provisions of Section 40A(2)."

4. Ground no. 4 is against deletion of the disallowance of Rs. 10,31,886/- made by the AO from advertisement and sale promotion expenses. The disallowance has been made by the AO on the grounds that the expenditure of Rs. 2,36,934/- in respect of advertisement in print media is in respect of brand promotion. Further, the advertisement expenditure pertains not only to the assessee but also confer benefits to other associate concerns and, therefore, the assessee is entitled to the deduction of proportionate expenditure only. The allocation is made on the basis of turnover of the assessee to the total turnover of the group concerns. The ld. CIT(Appeals) has deleted the addition by following the decision of the Tribunal in earlier years. The only point made by the ld. DR is that factual basis for making the claim has not been fully examined by the ld. CIT(Appeals).

4.1 We find that the issue stands covered by the decision of the Tribunal for assessment years 2005-06 and 2006-07. Respectfully following the decision, it is held that no interference is required in the decision of the ld. CIT(Appeals). For ready reference, paragraph no. 14 of the earlier decision of the Tribunal is reproduced below:-

"14. We have considered the rival contentions and found from the record that an agreement was entered into by the assessee according to which WMPL has to bear only the cost of advertising and other expenses relating to consumer sector. As the benefit of promotion of brand "Revlon" accrued only to the assessee, the same is required to be incurred by assessee himself. We also found that in spite of the agreement with WMPL, the assessee was not precluded from incurring advertising expenses since it was purely commercial decision taken by the assessee. Since the assessee was the brand owner, it has vested interests and incurring of expenditure for promotion of brand was in the interest of the business of the assessee company only. We also found that similar expenditure was allowed consistently in the past and no disallowance has been made towards these expenses. Even under the scrutiny assessment for AY 2000-01 & 2001-02, similar expenditure was allowed. There is no change in the facts and circumstances during the year, even on the principle of consistency, such expenditure cannot be disallowed. On the similar reasoning, the disallowance made by the lower authorities during AY 2006-07 also stands deleted.

Accordingly, we do not find any merit in the disallowance made by the lower authorities on account of expenditure incurred for advertising and publicity."

5. Ground no. 5 is to the effect that the ld. CIT(Appeals) erred in restricting the disallowance to Rs. 8,87,557/- against Rs. 73,26,507/- made by the AO. This ground has not been argued by the ld. CIT, DR possibly because no such disallowance has been made by the AO, as seen from the computation of income made by him as under:-

Profit and gains of business Returned total income as per the computation of income filed with the return	Rs.4,92,65,389/-
Add:	
1. Royalty disallowed	Rs.4,54,85,325/-
2. Excess payment of Consultancy Charges disallowed u/s 40A(2)	Rs.87,60,601/-
3. Proportionate advertising expenses disallowed	Rs.10,31,886/-
Total Income:	**Rs.10,45,43,201/-**

5.1 The issue also does not emanate from the order of the ld. CIT (Appeals). Therefore, the ground is dismissed as infructuous.

6. In the result, the appeal is dismissed.