IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'I' MUMBAI

ITA No.4379/Mum/2005
Assessment Year: 1997-98

NICHOLAS PIRAMAL INDIA LTD
(SUCCESSOR IN BUSINESS OF PHON POULENC (I) LTD
4th FLOOR PIRAMAL TOWER ANNEXURE
GANPATRAO KADAM MARG
LOWER PAREL, MUMBAI-13
PAN NO:AAACR3171J

Vs

JOINT COMMISSIONER OF INCOME TAX
RANGE-5, MUMBAI

R K Panda, AM and Asha Vijayaraghavan, JM

Dated: April 29, 2011

ORDER

Per: R K Panda:

This appeal filed by the assessee is directed against the order dated 24.3.2005 of the CIT (A) –XIX, Mumbai relating to Assessment Year 1997-98.

2 This appeal was earlier decided by the Tribunal vide order dated 11.06.2009 giving part relief to the assessee. Subsequently, the Tribunal vide order dated 17.2.2010 against M.A. filed by the assessee recalled ground of appeal No. 2 of the assesse's appeal for fresh adjudication. Therefore, this order is confined only to adjudicate ground No. 2 of the assessee's appeal which reads as under:

"On the facts and circumstances of the case and in law, the CIT(A) erred in upholding the action of the Assessing Officer in disallowing marketing know-how expenditure amounting to Rs. 270 lakhs as revenue expenditure and treating the same as capital expenditure on the alleged ground that the same had been incurred in connection with the acquisition of new line of business.

He failed to appreciate and ought to have held that expenditure incurred on marketing know-how was only out of commercial expediency and did not result into benefit of enduring nature.

The appellant therefore prays that it be held that expenditure incurred on acquiring marketing know-how is revenue expenditure and accordingly the aforesaid disallowance made by the Assessing Officer be deleted."

3. Facts of the case in brief, are that during the year under consideration, the assessee company acquired a part of branded and generic pharmaceuticals business

of Max India Ltd. The A.O. noted that the assessee entered into "Memorandum of Understanding" (MoU) with *Max India Ltd., on 9.11.1996* to acquire branded and generic pharmaceuticals business for Rs. 325 lacs. In consequence of this MoU, the assessee entered into three agreements with Max India Ltd., on 27.1.1997. First agreement was for acquisition of trademarks and goodwill for which consideration was fixed at Rs. 50 lacs. Second agreement was for transfer of generic business, market know-how and non-competition for five years for which consideration was fixed at Rs. 270 lacs. Third agreement was for acquisition of technical know-how for a consideration of Rs. 5 lacs. The assessee company has treated Rs. 50 lacs paid for acquisition of trademarks with goodwill as capital expenditure. But the balance payment of Rs. 2,75,00,000/- has been claimed as revenue expenditure in the return of income. In the books of accounts as mentioned in note 1(f) of notes to Accounts, these expenses were written off over a period of 5 years. During the year, the assessee has only debited Rs. 9,16,667/- into the P&L account and balance amount has been shown as deferred expenditure under the head miscellaneous expenditure in the balance sheet. In the competition of income filed along with the return, the assessee company has added back the amount of Rs. 9,16,667/- debited to the P&L account but made a claim of deduction of total amount of Rs. 2,75,00,000/-.

3.1. The A.O. asked the assessee to explain as to how this amount of Rs. 2,75,00,000/- is a revenue expenditure and also to explain as to why this expenditure should not be treated as capital expenditure and technical know-how fees should not be amortised as per the provisions of sec. 35AB.

3.2 The assessee in its replies submitted that the payment made to Max India Ltd amounting to Rs. 2,70,00,000/-and Rs. 5,00,000/- are allowable as revenue expenses. Regarding application of section 35AB, the assessee submitted that in the case of assessee, know-how is related to marketing knowledge and information and it does not relate to knowledge relating to manufacture or processing of goods as defined in sec. 35AB. Therefore, the amount of Rs. 2,75,00,000/- does not come under the compass of sec. 35AB. It was vehemently contended that the know-how acquired by the assessee's is for strengthening the existing marketing and distribution network of the company. It was submitted that the company has been in pharmaceutical business in last several years. It has been primarily in the business of branded pharmaceutical products and has its own marketing and distribution network. The assessee has now acquired the marketing and distribution know-how for generic range of products from Max India Ltd. Generic products are not branded products. Generic products need push distribution/selling, rather than a pull type of selling. In other words, the generic products required more of a support of strong and wide network of distributors and dealers, good pricing that is what is acquired by the assessee from max India Ltd for which the payment of Rs. 2,75,00,000/- has been made. It was further contended that the nature of these arrangement and the benefit that is acquired out of it is not of a lasting arrangement as it mainly consist of marketing/distribution network and in such an arrangement dealer can switch off or a distributor can leave. The market scenario is volatile in these days and such arrangement is changing on day to day basis because of the competition and changing pattern that is emerging in the market place. It is, therefore, not correct to conclude that the payment for this kind of arrangement can be treated as capital expenditure.

3.3 It was further contended that the assessee company has not acquired the entire business of Max India Ltd. After this arrangement, Max India Ltd has been carrying

on its ongoing business enterprise. In fact, Max India Ltd has come for an issue of bonus shares. Thus, it was contended that this arrangement relates to marketing know-how and technical know-how. It is not for buying the business but only for extending the company's product range and obtaining the allied facilities in marketing and distribution thereof which is of revenue nature.

3.4 As regards non-competition clause, it was submitted that the said clause provides non-competition only during 5 years period and even during such period, Max India Ltd has all the freedom, such as manufacturing, marketing, promoting, acting as a loan licensee, subject only to certain conditions, such as non repetition of design, colour scheme or calligraphy etc. Non-competition clause is one of the routine clauses which is normally put in such agreement and cannot be interpreted to make said payment made by the company to Max India Ltd as capital expenditure. Five years period does not justify treating the expenditure as of capital in nature. Various case laws were also cited as per para 12.4 of the assessment order.

3.5 However, the Assessing Officer was not satisfied with the explanations given by the assessee. He held that the various case laws relied on by the assessee do not have any application to the facts of the assessee's case. He held that in the instant case, the assessee company has exclusively acquired the trade marks with good will, technical know-how and also entered into a noncompetition clause. Acquisition was not confined to a limited period but it was forever. He held that the assessee company acquired the branded and generic business of Max India Ltd. According to the Assessing Officer, by such acquisition, the assessee has enlarged its profit making apparatus from which the assessee could draw an enduring benefit. The amount of Rs. 2,70,00,000/-, therefore, is an investment. Generic formulations acquired by assessee are new profit making apparatus and expenditure is on capital account. He held that even if the assessee acquired a part of business of another person, the expenditure will be of capital nature. It is not necessary that the entire business should be acquired. Such acquisition would accelerate company's sales turnover and profits in coming years. The noncompetition agreement also indicates that the assessee has acquired advantage of enduring nature. For the above proportions, the Assessing Officer relied on the following decisions:

i) Behari Lal Beni Paarshad vs CIT 35 ITR 576 (Punj)

ii) Truck Operators Union vs CIT 86 ITR 322 (Del)

iii) Neel Kamal Talkies vs CIT 87 ITR 691 (All)

iv) Blaze & Central P Ltd vs CIT 120 ITR 33 (Mad)

v) CIT vs Hindustan Pilkington Glass Works 139 ITR 581 (Cal)

vi) Chelpark Co ltd vs CIT 191 ITR 249 (Mad)

vii) Grover Soap P Ltd vs CIT 221 ITR 229 (MP)

3.6 The Assessing Officer further held that the effective date i.e. date from which the transaction will be effective and enforceable falls in the subsequent assessment year

i.e. Assessment Year 1998-99. He rejected the explanation by the assessee that the company had incurred the liability to pay for the marketing know-how in the accounting year ended on 31.3.1997, the agreement is dated 27.1.1997, the sums of Rs. 41 lacs and Rs. 125 lacs were paid by the date of execution of the said agreement, that the company follows mercantile system of accounting, that the unpaid account had been duly provided, that the liability was wholly ascertained, that the effective date i.e. 30.6.1997 as defined in the agreement is only an outer limit for the compliance with the substantive part of the conditions and so long as both the parties are satisfied and that there is no question of pushing the effective date beyond the said date of agreement i.e. 27.1.1997. According to the Assessing Officer, the very fact that part of the payment was required to be made on the effective date proves that the transaction pertains to succeeding year.

3.6.1. The A.O also sought information from Max India Ltd as reproduced in Para 13.4 of the assessment order. According to the Assessing Officer from the reply received from max India ltd, the effective date was 1.7.1997. The assessee was confronted with the reply received from Max India ltd. It was explained by the assessee that on the date of agreement the liability accrued, that the conditions regarding effective date is nothing but fixing the terms of payment for the transaction which took place on 27.1.1997. According to the Assessing Officer, the liability accrued only on the effective date i.e. 1.7.1997. According to him, effective date is important because on that date only certain enforceable liability had accrued or arisen. Thus, the liability pertains to Assessment Year 1998-99 and not to Assessment Year 1997-98. Rejecting the various explanations given by the assessee and relying on a couple of decisions, the A.O. held that the expenditure is of capital in nature and that the expenditure did not pertain to this assessment year.

3.7 Before the CIT(A), the assessee reiterated the same submissions as made before the Assessing Officer and cited various case laws. It was submitted that the various decisions relied on by the Assessing Officer are distinguishable and not applicable to the facts of the present case. However, the CIT(A) also was not convinced with the arguments advanced before him. He distinguished the various decisions cited before him and held that expenditure of Rs. 270 lakhs incurred by the assessee company is capital in nature. While doing so, he noted that the crux of the matter is the nature of transaction. For this purpose, the MOU dated 9.11.96 is the basic document. He analysed the various clauses of the agreement and came to the conclusion that Max India Ltd. wanted to sell and the assessee company has purchased (a) certain part of the branded pharmaceuticals, (b) entire generic formulation business, (c) export registration and (d) technical & marketing knowhow relating to such branded formulation business and generic formulation business.

3.8. According to ld. CIT(A), generic drugs are those drugs which by virtue of expiry of the period of patent ownership, are not governed by the Patent Act. Anybody is free to make such generic product and market the same. They may be branded by each manufacturer by different names. Since the assessee was not in this line of business and was desirous of acquiring such business from Max India Ltd., therefore, the assessee has acquired a new line of business i.e. business of manufacturing and marketing unpatented and generic products as against existing business of manufacturing and marketing of patented products. He further held that the bifurcation made by the assessee towards payment of consideration of Rs. 325 lakhs into three components ie. (i) marketing knowhow, (ii) technical knowhow & (iii) sale/assignment of brands is not based on any scientific, concrete or tangible data

base. Therefore, the entire amount needs to be viewed together as payment for acquiring certain new business of manufacturing and marketing unpatented and generic products along with the related technical and marketing knowhow. According to him, the three agreements dtd. 27.1.97 flow from the MOU dt. 9.11.96 and therefore cannot be read or viewed independent of the MOU which had determined the consideration. Relying on the decision of Hon'ble Supreme Court in the case of *Jonas Woodhead & Sons (India) Ltd. Vs. CIT reported in 224 ITR 342 (SC)*, the decision of Hon'ble Madras High Court in the case of *CIT vs. W.S. Insulators of India Ltd., reported in 243 ITR 348* and host of other decisions mentioned at para 13 to 15 of his order , he held the amount of Rs. 270 lakhs paid as capital expenditure. Further relying on a couple of decisions, he held that the compensation paid in view of the non-competition agreement is of an enduring benefit and, therefore, cannot be allowed as a deduction. He, however, disagreed with the view of the A.O. that the liability pertains to A.Y. 1998-99 and held that the liability accrued during the year in view of the dates of the MOU and the dates of the agreement.

3.9. Aggrieved with such orders of the ld. CIT(A), the assessee is in appeal before the Tribunal.

4. The ld. counsel for the assessee reiterated the same submissions as made before the A.O. and ld. CIT(A) and submitted that the assessee company acquired part of the generic pharmaceutical business of M/s Max India Ltd., for Rs. 3.25 crores as per the terms of MoU with M/s Max India Ltd dt 9.11.1996. As per terms of the MoU, the assessee company entered into three agreements with M/s Max India Ltd dt 27.1.1997. The first agreement with M/s Max India Ltd was for acquisition of trademarks and goodwill for Rs. 50 lakhs, which has been treated as capital in nature and the assessee is not in appeal on this issue. The second agreement was for transfer of generic business, marketing know-how and non competition fee for 5 years for Rs. 2.70 crores. The third agreement was for acquisition of technical know-how for manufacturing for consideration of Rs. 5 lakhs. He submitted that the Assessing Officer has treated the amount of second and third agreement as capital in nature and has made a disallowance of Rs. 2.75 crores. He submitted that the marketing know-how was acquired by the assessee, which relates to the marketing knowledge and information and does not relate to manufacturing or processing of the goods. The know-how acquired by the assessee is for strengthening the existing marketing and distribution network of the company. The assessee company is already in the business of branded pharmaceuticals since the last 70 years and has its own marketing and distribution net work and therefore, it could not be said that the assessee has started or acquired a new line of business. He submitted that the generic products of pharmaceutical are not the branded product thereof. The generic products require more support of strong and wide network of the distributors and dealers as compared to the branded products of pharmaceutical products. He submitted that the assessee has not acquired the entire business of M/s Max India Ltd. and it has only acquired the marketing know-how. With regard to the generic products of pharmaceutical from Max India Ltd. with regard to the non-competitive clauses, he submitted that the said clauses provide for non-competitive only for a period of 5 years and even during this period M/s Max India Ltd. has the freedom such as manufacturing, marketing, promoting and acting as a loan licensee subject to certain conditions such as non-repetition of design, colour scheme or calligraphy. In these facts, he submitted that the amount of Rs. 2.70 crores paid by the assessee for acquiring marketing know-how to M/s Max India Ltd. Is revenue in nature. He submitted that the various case laws cited by the revenue authorities have no relevance to the facts of the case of the assessee as the agreement of the assessee

company with M/s Max India Ltd. mainly provides for supply of marketing know-how of generic business, whereas the decisions cited by the Assessing Officer and CIT(A) relate to the issue of arising enduring benefit to the assessee. He submitted that the Assessing Officer has disallowed the claim of Rs. 2.70 crores on two counts, namely (i) that the expenditure incurred by the assessee was capital in nature and (ii) that the expenditure did not pertain to the relevant year as the liability has accrued in the subsequent Assessment year. He submitted that the second ground of the Assessing Officer in disallowing the claim of the assessee that the expenditure did not pertain to the relevant year has been decided in favour of the assessee by the CIT(A), who has held that the expenditure did pertain to the year under consideration. He submitted that the revenue has not filed any appeal against the order of the CIT(A) on this issue and therefore, the only issue which remains to be decided by the Tribunal is that whether the expenditure incurred by the assessee for acquisition of marketing know-how of generic products is capital or revenue in nature. He referred to the relevant clauses of the MOU and the three agreements entered into by the assessee company with M/s Max India Ltd., and a copy of which is filed in the compilation before the Tribunal. He submitted that the agreement dt. 27.01.97 for supplying the market know-how in term No. 1 has explained the meaning of "Marketing Know-how" as knowledge of potential and existing market and marketing techniques, results and analysis of market service, knowledge of and creation of distribution of net work and all other information and knowledge used by M/s Max India Ltd. in the marketing of the products. He submitted that the market information was necessary for the assessee to establish itself in the generic pharmaceutical products business and but for the acquisition from M/s Max India Ltd., the assessee company would have to appoint its own marketing personnel for surveying the vast market of generic pharmaceutical products in the country.

The ld counsel for the assessee relied on the following decisions:

i) CIT vs Kirloskar Tractors Ltd – 231 ITR 849 (Bom)

ii) Madras Auto Service P Ltd 223 ITR 468 (SC)

iii) CIT vs Hede Consultancy P Ltd & Anr 258 ITR 380 (Bom)

iv) G-4 S Security Services (I)P Ltd vs DCIT 9 DTR(Del) (Trib) 353

v) ACIT vs Ashima Syntex Ltd 117 ITD 1 (Ahd –SB)

vi) Airtime Marketing & Sales Ind P Ltd

vii) CIT vs Ciba of India ltd 69 ITR 692 (SC)

viii) Alemibic Chemical Works CO Ltd vs CIT 177 ITR 377(SC)

ix) Triveni Engg Works Ltd vs CIT 136 ITR 340 (Del)

x) CIT vs Power Build Ltd 244 ITR 19 (Guj)

xi) CIT vs. Anand Bazar Patrika Ltd. 184 ITR 542 (Cal)

xii) Coromandel Fertilisers Ltd. Vs. CIT 148 ITR 546 (A.P)

xiii) CIT vs. Tata Engineering & Locomotive Co. (P) Ltd. 123 ITR 538(Bom.)

4.1. The ld D.R. on the other hand while supporting the order of the CIT(A) submitted that the order of the CIT(A) relying upon various applicable and relevant judicial precedents is in accordance with law and needs to be upheld. He submitted that the landmark judgment of the Hon'ble Supreme Court in the case of *Assam Bengal Cement CO Ltd vs CIT reported in 27 ITR 34 (SC)* is squarely applicable to the facts of the present case. He submitted that the assessee was earlier in the business of patented products and now by acquiring the business of non patented generic and branded formulations, the assessee has vastly improved its profit making apparatus. It is a clear case of extension of business and the expenditure so incurred falls in the category of capital expenditure. The know-how acquired by the assessee from Max India Ltd was not in connection with the existing business of manufacturing and marketing of patented drugs but for the purpose of extension of business. As per the Director's report, this would accelerate the assessee's sales turnover and profits in the coming years. Thus, the benefit derived by the assessee was not temporary or ephemeral but was of enduring nature. The assessee is trying to project the acquisition of marketing know-how as being separate from or independent of the acquisition of business of non-patented generic and branded formulations from Max India Ltd in terms of MoU dated 9.11.1996 which cannot be permitted. Expenses incurred under all the three agreements have to be viewed not in isolation but as a whole and the cumulative effect of all the terms and conditions of the MOU as well as three separate agreements have to be taken into account. Referring to the various decisions relied on by the ld. CIT(A), he submitted that the order of the ld. CIT(A) on this issue be upheld.

5. We have considered the rival submissions made by both the sides, perused the orders of the A.O. and ld. CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions relied on by both the sides. There is no dispute to the fact as per the MOU dtd. 9.11.96 with Max India Ltd., the assessee company acquired part of the branded and generic pharmaceutical business for Rs. 325/- lakhs. There is also no dispute to the fact that as per the terms of the MOU the assessee company entered into three agreements with Max India Ltd. dtd. On 27.1.1997. The first agreement is for acquisition of trade mark & goodwill for Rs. 50 lakhs which has been treated as capital in nature by the assessee. The second agreement is for transfer of generic business, marketing knowhow and non-competition fees for 5 years for Rs. 270 lakhs. The third agreement for acquisition of technical knowhow for manufacturing for a consideration of Rs. 5 lakhs. There is no dispute to the fact that the assessee company has treated the above Rs. 270 lakhs and Rs. 5 lakhs respectively as revenue expenditure. We find that the A.O. disallowed the claim of revenue expenditure of Rs. 270 lakhs on two counts ie. (i) the expenditure incurred by the assessee was capital in nature because of enduring benefit and (ii) the expenditure did not pertain to the year under consideration since the liability accrued in the subsequent year.

5.1. We find the ld. CIT(A) relying on a couple of decisions held that expenditure of Rs. Rs. 270 lakhs incurred by the assessee company is capital in nature. He, however, held that the disallowance by the A.O. on the ground that the liability has not accrued during the year but pertained to the next year is not correct. We find the above finding given by the ld. CIT(A) that the expenditure did pertain to the

impugned assessment year in view of the dates of MOU and dates of the agreement has not been challenged by the Revenue. Therefore, the only issue to be decided is as to whether the amount of Rs. 270 lakhs paid by the assessee for transfer of generic business, marketing knowhow and non-competition fees for 5 years to Max India Ltd. is revenue in nature as claimed by the assessee or capital in nature as held by the A.O. and upheld by the ld. CIT(A).

5.2. We find the definition of "marketing know-low" given in clause (1) of the agreement dtd. 27.1.97 (a copy of which is placed at paper book page 28) reads as under:-

"Marketing know-how shall mean knowledge of potential and existing markets, marketing techniques, results and analysis of market surveys, knowledge of and the creation of distribution network and all other information and knowledge used by Max India in the marketing of the products."

5.3 Clause (4) of the agreement i.e terms for payment of "marketing know-how" reads as under (Page 31 of the paper book):-

"In consideration of Max India providing the marketing know-how to RPIL under this agreement, RPIL shall pay to Max India an aggregate of Rs. 270 lacs . The aforesaid amount of Rs. 270 lacs shall be payable as follows....".

5.4 Similarly, we find from Clause (5) of the agreement i.e. non-competition which provides non-competition only during the 5 years period and even during such period, Max India has all the freedom such as manufacturing, marketing, promoting, acting as loan licensee subject only to certain conditions such as non-repetition of design, colour scheme or calligraphy etc. We find the 3 seperate agreements dtd. 27.1.97 between the assessee company and Max India Ltd. Bifurcating the consideration of Rs. 3.25 crores into 3 parts for acquisition of 3 different rights is as per clause 5 of MOU dtd. 9.11.96 which is as per page 4 of the paper book. After going through the above agreements and MOU, we are of the considered opinion that the assessee company has not acquired the entire business of Max India Ltd. It is not buying the business but only extending the company's product range and obtaining the allied facilities in marketing and distribution thereof which is revenue in nature. It does not relate to manufacturing or processing of the goods so as to treat the same as capital in nature.

5.5. From the various clauses of the agreement, we find force in the submissions of the ld. Counsel for the assessee that the purpose of acquiring such information was to avoid spending on a recurring basis, time, money and efforts in carrying out market surveys, appointing professionals and/or expert staff for working out marketing and sales strategies and forecasts and thereby reducing the learning period and augment the company's profits from the very first year. Thus, the expenditure incurred on acquisition of the information was out of commercial expediency and as a substitute for a series of other revenue expenses that would have to be incurred on appointing experts/professionals and conducting market surveys etc. on pharmaceutical products which is the existing line of business of the assessee. We also find force in the submission of the ld. Counsel for the assessee that the non-competition clause in case of the assessee is one of the routine clauses which is normally put in such agreements and cannot be interpreted to make the said payment made by the assessee to Max India as capital expenditure.

5.6. We find the Hon'ble A.P. High Court in the case of Coromandel Fertilisers Ltd. (supra) following the decisions of Hon'ble Supreme Court in the cases of *CIT vs. Ciba of India Ltd. (69 ITR 692)* and *Empire Jute Co. Ltd. Vs. CIT (124 ITR 1)* has held as under:- (short notes)

" In the case of a collaboration agreement, the cumulative effect of all the terms and stipulations of the agreement and the nature of the benefit accrued and the restrictions imposed on the respective parties, the period during which the agreement is operative and the rights that flow to the assessee therefrom have to be taken into account and on an assessment of all those factors, the question whether the expenditure incurred by payment of the consideration under the agreement constitutes revenue or capital expenditure has to be determined. In this context, it cannot be ignored that with the pace of developing technology and scientific knowledge and easy inter-communication between advanced countries and the developing countries, technical know-how with respect to each product, far from remaining static, would be not only developing at a very fast pace but also spreading to all parts of the world quickly. Therefore, technical know-how is liable to speedy obsolescence and might not be a benefit of an enduring nature.

In the case of elimination of competition also, the test laid down is whether benefit of an enduring nature was acquired and, in determining that, the court should consider whether a competitor in business was eliminated for a considerable period of time.

The main object of the assessee, a company with its registered office in Andhra Pradesh, was manufacture of fertilizers in India. It entered into an agreement with EID Parry whereby EID Parry agreed to impart to the assessee its know-how regarding agronomical research, soil formation and chemical compositions, cropping patterns particularly applicable to South India as also its know-how for promoting sale of fertilizers manufactured by it. EID Parry agreed not to sell its products in Andhra Pradesh and other areas adjacent thereto. The assessee paid Rs. 6,34,500 to EID Parry and claimed it as revenue expenditure. The claim was rejected by the Income-tax Officer and this was confirmed by the Tribunal.

Held, that in the instant case technical know-how was not totally transferred to the assessee. The assessee was given only an exclusive right to use the know-how in Andhra Pradesh and other areas adjacent thereto. The assessee could not assign this know-how to any third party. Acquisition of sales know-how, market conditions and soil compositions were not of a lasting and enduring nature. The amount paid for it would, therefore, constitute revenue expenditure. The technical know-how in this case being of a fleeting nature and liable to become obsolete, the fact that no period was prescribed during which EID Parry might not sell complex fertilizers within Andhra Pradesh and its adjacent areas, was not of much consequence. Thereby it could not be said that any tangible benefit of an enduring nature was acquired by the assessee so as to make the expenditure incurred by it capital expenditure. The amount of Rs. 6,35,400 paid by the assessee was, therefore, deductible under section 10(2)(xv) of the 1922 Act."

5.7. We find the Hon'ble Bombay High court in the case of Tata Engineering & Locomotive Co. (P) Ltd. (supra) has held as under (short notes) :-

"Technical know-how cannot be called a tangible asset. Technical know-how and technical advice for the time being cannot in these days of technological and scientific development and consequent change in production techniques, be treated as a capital asset. The length of the period of agreement is not of much consequence, if the nature of the advice made available is such that it cannot be called a capital asset. Merely because an assessee who has entered into a contract with regard to know-how is entitled to use the know-how even after the agreement has expired it does not mean that he has acquired a benefit of an enduring nature. Agreement of foreign collaboration where foreign know-how is availed of in lieu of payment, is in substance a transaction of acquiring the necessary technical information with regard to the technique of production Instead of employing persons having knowledge of techniques and utilising their knowledge technical know-how is acquired. Technical know-how made available by a party to such, an agreement does not stand on the same footing as protected rights under a registered patent.

The assessee, Telco, entered into two agreements one with Daimler Benz and another with, Henricot. Under the first agreement Daimler Benz were to provide drawings and designs and full technical information required for the manufacture of automotive products. They were to provide training facilities for Indian personnel in their German plants. Telco could use the name and trade mark of Daimler Benz. The period of agreement was fifteen years but one of the parties could terminate the agreement by six months' notice in case of a serious breach of its terms and conditions. After the agreement came to an end Telco was entitled to continue its manufacture but they could not use the trade name of Tata-Mercedez-Benz. Under the second agreement Henricot agreed to give technical advice, information and assistance to Telco steel foundry and provide facilities for training Indian personnel in their Belgian plant. The agreements provided for payments of royalty and a percentage of profits for provision of know-how. Telco had to bear the expenses of training its personnel in the foreign factories. Telco claimed the amounts paid under the collaboration agreements and expenses incurred in training its personnel for the assessment year 1959-60 as deductible expenditure:

Held, (i) on the facts, that in essence the agreements were for acquiring technical knowledge regarding methods of production and in the case of Daimler Benz for use of the trade name. The assessee had not acquired any asset or advantage of an enduring nature for the benefit of its business. The amounts paid for provision of know-how and licence to use the trade name were revenue expenditure.

(ii) that the expenditure on training of personnel was incurred with a view to achieving maximum and efficient production. The expenditure incurred on such training was closely related to the profit earning process and was allowable as revenue expenditure"

5.8. We find the Hon'ble Supreme Court in the case of Alembic Chemical Works Co. Ltd. (supra) has held as under:- (short notes):-

"On June 8, 1961, the appellant, a company engaged in the manufacture of antibiotics and pharmaceuticals, was granted a licence for the manufacture of penicillin. By the year 1963, it had already made an outlay of more than Rs. 66 lakhs for setting up a plant for the production of penicillin. In the initial years, the appellant was able to achieve only moderate yields of penicillin. With a view to increasing the yield, the appellant started negotiations in 1963, with Meiji, a reputed

Japanese enterprise engaged in the manufacture of antibiotics, which culminated in an agreement dated October 9, 1963, whereunder Meiji, in consideration of a "once for all payment" of U.S.$ 50,000 (equivalent then to Rs. 2,39,625), agreed to supply to the appellant the "subcultures of Meiji's most suitable penicillin producing strains," in a pilot plant, the technical information, know-how and written description of Meiji's process for fermentation of penicillin along with a flowsheet of the process in the pilot plant, and the design and specifications of the main equipment in such pilot plant, and to arrange for the training of the appellant's representatives in Meiji's plant in Japan at the appellant's expense and advise the appellant in large scale manufacture of penicillin for a period of two years. The appellant was to keep the technical know-how confidential and secret and was not to seek any patent for the process. For the assessment year 1964-65, the appellant claimed deduction of the sum of Rs. 2,39,625 as a revenue expenditure. Both the Department and the Tribunal rejected the claim holding that the expenditure was capital in nature. In coming to this conclusion, the Tribunal held, on an interpretation of the agreement, (i) that the appellant had to instal a larger plant modelled on the pilot plant; (ii) that the payment was not made in the course of carrying out an existing business but was for the purpose of setting up a new plant and a new process; (iii) that the outlay was incurred for complete replacement of the equipment of the business inasmuch as a new process with a new type of plant was to be put up in the place of the old process and old plant. On a reference, the High Court held that the sum of Rs. 2,39,625 was not a revenue expenditure. On appeal to the Supreme Court:

Held, reversing the decision of the High Court, (i) that there was no material before the Tribunal to come to the finding that the appellant had obtained under the agreement a "completely new plant" with a completely new process and a completely new technical know-how from Meiji. The business of the appellant from the commencement of its plant in 1961 was the manufacture of penicillin. Even after the agreement, the product continued to be penicillin and the agreement with Meiji stipulated the supply of the "most suitable sub-cultures" evolved by Meiji for purposes of augmentation of the yield of penicillin.

(ii) That there was no material for the Tribunal to hold that the area of improvisation was not a part of the existing business or that the entire gamut of the existing manufacturing operations for the commercial production of penicillin in the appellant's existing plant had become obsolete or inappropriate in relation to the exploitation of the new sub-cultures of the high yielding strains supplied by Meiji. The mere improvement in or updating of the fermentation-process would not necessarily be inconsistent with the relevance and continuing utility of the existing infrastructure, machinery and plant of the appellant.

(iii) That the limitations placed in the agreement on the right of the appellant in dealing with the know-how and the conditions as to non-partibility, confidentiality and secrecy of the know-how, pertained more to the use of the know-how than to its exclusive acquisition.

(iv) That the improvisation in the process and technology in some areas of the enterprise was supplemental to the existing business and there was no material to hold that it amounted to a new or fresh venture. The further circumstance that the agreement pertained to a product already in the line of the appellant's established business and not to a new product indicated that what was stipulated was an improvement in the operations of the existing business and its efficiency and

profitability not removed from the area of the day to day business of the appellant's established enterprise. The financial outlay under the agreement was for the better conduct and improvement of the existing business and was revenue in nature and was allowable as a deduction in computing the business profits of the appellant.

By the Court : (i) "It would be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in this fast changing area of medical science. The state-of-the-art in some of these areas of high priority research is constantly updated so that the know-how could not be said to bear the element of the requisite degree of durability and nonephemerality to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeonholing an outlay, such as this, as capital."

(ii) "In the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is well-nigh impossible to formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants; but as masters they tend to be overexacting."

(iii) "The question in each case would necessarily be whether the tests relevant and significant in one set of circumstances are relevant and significant in the case on hand also. Judicial metaphors are narrowly to be watched, for, starting as devices to liberate thought, they end often by enslaving it."

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 verities but must needs 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 emphasise the element of a sufficient degree of durability appropriate to the context.

There is also no single definitive criterion which, by itself, is determinative whether a particular outlay is capital or revenue. The "once for all" payment test is also inconclusive. What is relevant is the purpose of the outlay and its intended object and effect, considered in a commonsense way having regard to the business realities. In a given case, the test of "enduring benefit" might break down.

5.9 Similarly, we find the Hon'ble Supreme Court in the case of *CIT vs. Ciba of India Ltd. reported in 69 ITR 692* has held as under (Short notes):-

"The assessee (originally named Ciba Pharma Ltd.) was an Indian subsidiary of Ciba Ltd. of Basle, a Swiss company engaged in the development, manufacture and sale of medical and pharmaceutical preparations. The pharmaceutical section of the Swiss company in India was taken over by the assessee from January 1, 1948. Under an agreement dated December 17, 1949, the Swiss company undertook to deliver to the assessee all processes, formulate, scientific data, working rules and prescriptions

pertaining to the manufacture or processing of products discovered and developed in the Swiss company's laboratories and to forward to the assessee as far as possible all scientific and bibliographic information, pamphlets or drafts, which might be useful to introduce licensed preparations and to promote their sale in India. It granted to the assessee full and sole right and licence under the patent listed in the agreement to make, use, exercise and vend the inventions specified therein in India and also a licence to use certain specified trade marks in the territory subject to any existing licence which third parties held at the date of agreement, or which the Swiss company might grant to third parties thereafter. In consideration of the right to receive scientific and technical assistance the assessee agreed to make contributions of 5 per cent., 3 per cent., and 2 per cent., respectively, of the net sale price of the products sold by the assessee towards, (i) technical consultancy and technical service rendered and research work done; (ii) cost of raw material used for experimental work; and (iii) royalties on trade marks used by the assessee. The assessee further agreed: (a) not to divulge to third parties without the consent of the Swiss company any confidential information received under the agreement; (b) without the written consent of the Swiss company, not to assign the benefit of the agreement or grant sub-licences of the patents and trade marks; and (c) upon termination of the agreement for any cause to cease to use the patents and trade marks and to return to the Swiss company all copies of information, scientific data or material sent to it and to refrain from communicating any such information, scientific data or material received by it to any person. The agreement was to be in force for a period of 5 years from January 1, 1948, and was liable to cancellation by either party if the other party failed to perform or observe the provisions of the agreement, by giving it 3 months' notice. By a subsequent agreement the contribution payable was reduced from 10 per cent. to 6 per cent. of the net selling price of the pharmaceuticals. The question was whether the contribution other than that part paid as royalties (royalties having been allowed as a deduction) was admissible as an allowance either under clause (xii) or under clause (xv) of section 10(2) of the Indian Income-tax Act, 1922:

Held, (i) that the contribution was not allowable under section 10(2)(xii) as expenditure laid out or expended on scientific research. Payment made to recoup another person for expenditure or scientific research incurred by that other person, even if it might ultimately benefit the assessee, was, unless it was carried on for or on behalf of the assessee, not expenditure laid out or expended on scientific research related to the business of the assessee under section 10(2)(xii).

(ii) That, however, the contribution was allowable as business expenditure under section 10(2)(xv). The assessee did not under the agreement become entitled exclusively even for the period of the agreement, to the patents and trade marks of the Swiss company; it had merely access to the technical knowledge and experience in the pharmaceutical field which the Swiss company commanded. The assessee was on that account a mere licensee for a limited period of the technical knowledge of the Swiss company with the right to use the patents and trade marks of that company. The assessee acquired under the agreement merely the right to draw, for the purpose of carrying on its business as a manufacturer and dealer of pharmaceutical products, upon the technical knowledge of the Swiss company for a limited period; by making that technical knowledge available the Swiss company did not part with any asset of its business, nor did the assessee acquired any asset or advantage of an enduring nature for the benefit of its business.

Ciba Ltd., Basle, the Swiss company, and May and Baker Ltd., had mutually granted to one another a non-exclusive licence in respect of sulphathiazole products in different countries including India. They had agreed to take all necessary steps to defend patents granted to or applied for by them in respect of sulphathiazole products against infringement. Before the assessee-company was incorporated, May and Baker Ltd. instituted a suit in the Calcutta High Court against Boots Drug Co., alleging infringement of its Indian patents. It was found necessary, pending the suit, to amend the specifications of the patents, and the High Court granted permission to amend the plaint conditionally on May and Baker paying to Boots Drug Co. costs of and incidental to the application for amendment. May and Baker complied with the order for payment of costs and the Swiss company paid its share of costs to May and Baker Ltd. The assessee reimbursed that amount to the Swiss company and claimed it as a permissible deduction in computing its profits:

Held, that the assessee was not entitled to deduct the contribution it made to the Swiss company since the assessee was not entitled to the patent rights of sulphathiazole products. Nor could the assessee be said to be seeking to protect its trading interests by making the payment."

5.10. In view of the ratio laid down by the decisions cited above and as per the various other decisions relied on by the ld. Counsel for the assessee mentioned at para 4 of this order, the amount of Rs. 270 lakhs paid for transfer of generic business, market know-how and non-compete fee for 5 years in our opinion has to be treated as revenue in nature being incurred for commercial expediency.

6. The various decisions relied on by the ld. CIT(A) in our opinion are not applicable to the facts of the present case and are distinguishable. In the case of *EID Parry India Ltd. Vs. CIT reported in 257 ITR 253 (Madras)* and relied on by the ld. CIT(A), we find the expenditure were incurred for the purpose of setting up a new project. Expenditure has been incurred in the year prior to the asst. Year in question. The assessee has subsequently abandoned that project. Accordingly, it was held that such expenditure is not a revenue expenditure.

6.1 In the case of *Swadeshi Cotton Mills Co. Ltd. Vs. CIT 63 ITR 65*, relied on by the ld. CIT(A) we find the assessee entered into contract for purchase of textile machinery. Subsequently, the order was cancelled as the machinery was not required in the altered circumstances. Compensation was paid to the contracting party. Accordingly, it was held that it is a capital receipt.

6.2 In the case of *CIT v. Reinz Talbors Pvt. Ltd. – 252 ITR 637* and relied on by the ld. CIT(A) we find an agreement was entered into by the assessee with a foreign concern for providing technical know-how in its manufacturing activity. The facts of this case are entirely different, but comparable with the amount of Rs. 5 lakhs which the assessee in the instant appeal has paid for technical know-how on which it has claimed the deduction 1/6 th to be allowed as per provisions of Sec. 35 B, but the same has no application on the amount of Rs. 2.7 crores paid for marketing know-how.

6.3. We find the the ld. CIT(A) has also relied on the decision of the Hon'ble Supreme Court in the case of *EIMCO K.C.P. Ltd. V. CIT – 242 ITR 659*. In this case, a new company was set up and entered into an agreement for technical know-how to manufacture Eimco sedimentation and filtration equipment and as per the

agreement, collaborator has to supply general technical data including manufacturing drawing. It confirmed the finding of the CIT(A) that this is a capital expenditure u/s 35A and the assessee is entitled to 1/4 th of the same as deduction.

6.4. In so far as the decision of Hon'ble Supreme Court in the case of Jonas Woodhead & Sons (India) Pvt. Ltd. (supra) and relied on by the ld. CIT(A), we find the same is also not applicable to the facts of the present case. In that case, under the terms and conditions of the agreement between the parties, it was stipulated that the foreign company would give the appellant the technical information and know-how relating to the setting up of a plant suitable for manufacture of the products as well as the technical know-how relating to the setting up of the plant itself, the drawings, estimates, specifications, manufacturing methods, blue prints of production and testing equipment and other data and information necessary to manufacture the product and to set up proper and efficient plants. On these facts, it was held that the composite payment was payment for technical know-how and services rendered for setting up the plant and manufacture of products. Accordingly, 1/4 th of the payment was treated as capital expenditure and balance was treated as revenue expenditure. It was held that what was set up by the appellant was a new business and the foreign company had not only furnished information and technical know-how but rendered valuable services in the setting up of the factory itself and even after the expiry of the agreement, there was no embargo on the appellant to continue to manufacture the product in question. Hence, entire payment could not be held to be revenue expenditure, merely because the payment was required to be made at a certain percentage rate of the gross turnover of the products as royalty and accordingly, 25% of the sum paid as royalty by the appellant company was treated as capital expenditure and 75% of the amount was held to be revenue in nature. However, the facts of the case are entirely different. The assessee in the instant case as per the terms of the agreement has paid Rs. 2.70 crores for transfer of generic business, market know-how and non compete fee.

6.5. The ld. CIT(A) also relied on the decision of the Hon'ble Madras High Court in the case of *CIT vs. W.S. Insulators of India Ltd. – 243 ITR 348* according to which if a new technology is acquired for manufacturing of new products, it would be a capital expenditure. However, the above decision, in our opinion, is also not applicable to the facts of the present case and distinguishable in view of the various decisions of the Hon'ble Supreme Court and of other High Courts cited above in favour of the assessee.

7. Considering the totality of the facts of the present case and in the light of the discussions above, we hold that the amount of Rs. 270 lakhs incurred as per agreement for transfer of generic business, marketing know-how and non-competition fee for 5 years is revenue in nature being out of commercial expediency. Accordingly, the order of the ld. CIT(A) on this issue is set aside and the A.O. is directed to allow the expenditure as revenue in nature. The ground raised by the assessee is accordingly allowed.

8. In the result, ground No. 2 of assessee's appeal is allowed.

(Order pronounced on the 29.4.2011.)