S. Kumars Tyre Manufacturing Co. Ltd. vs Deputy Commissioner Of Income Tax on 3 January, 1997

Equivalent citations: [1997]61ITD326(INDORE)

ORDER

Satish Chandra, A. M.

1. The appeal by the assessee arises out of the order dt. 8th Dec., 1995 of the CIT(A)-II, Indore, pertaining to the asst. yr. 1992-93.

2. The assessee has taken x grounds of appeal. Vide petition dt. 9th Sept., 1996 the assessee sought to take the following additional ground No. x. :-

> "That the interest charged under s. 234B of Rs. 97,27,390 is illegal and wrong since there was no default in payment of advance-tax by the appellate company as per the provisions of the IT Act, 1961. The interest so charged being illegal, wrong and bad in law, the same requires to be deleted in full."

2.1 Shri M. C. Mehta, the learned counsel for the assessee, submitted that the said additional ground, being purely question of law, may be admitted. On query by the Bench, he admitted that the issue raised in the additional ground was not raised before the CIT(A). He also admitted that this new ground was not set forth in the memorandum of appeal filed before the Tribunal. In the written submission dt. 23rd Sept., 1996, it has been stated that the grounds of appeal were got drafted by the Directors of the company from a counsel in Bombay. While drafting the said appeal, the learned counsel concentrated only on the additions maintained by the learned CIT(A) in the computation of income. It seems that the learned counsel did not go through the ITNS-0 as enclosed with assessment order, in which the learned A. O. has charged interest under s. 234B of Rs. 97,29,390. It was also stated therein that after filing of appeal it was found that the company was not required to pay any advance-tax and, therefore, the interest charged by the learned A. O. was contrary to law and this ground remained to be taken in appeal. Accordingly, the additional ground regarding charging of interest under s. 234B has now been taken. He argued that the new ground, being of purely legal nature, be admitted. He referred to the following decisions :

Hukum Chand Mills vs. CIT (1967) 63 ITR 232 (SC);

CIT vs. Mahalakshmi Textile Mills Ltd. (1967) 66 ITR 710 (SC);

Taylor Instrument Co. (India) Ltd. vs. CIT (1992) 198 ITR 1 (Del);

CIT vs. Mahalakshmi Sugar Mills Co. Ltd. (1993) 200 ITR 275 (Del);

CIT vs. Smt. Khairunnisa Ebrahim (1993) 201 ITR 903 (Ker);

Sirdar Carbonic Gas Co. Ltd. vs. CIT (1993) 204 ITR 886 (Bom);

CIT vs. Lallubhai Gordhandas Mehta Charitable Trust (1994) 207 ITR 104 (Guj);

Santlal Kalyani & Co. vs. CIT (1995) 213 ITR 273 (Raj);

National Newsprint & Paper Mills Ltd. vs. CIT (MCC No. 203 of 1990 decided by M. P. High Court on 13th March, 1996).

2.2 The admission of the additional ground was objected to by Shri S. K. Singh, the learned Departmental Representative. He submitted that additional ground cannot be admitted by the Tribunal if such a ground has not been taken before the CIT(A). To support his contention that the additional ground must arise out of the order of the CIT(A) and that a new subject matter cannot be raised in an appeal to the Tribunal by raising additional ground, he referred to the following judgments :

CIT vs. Late Begum Noon Banu Alladin (1993) 204 ITR 166 (AP) (FB);

Hukum Chand Mannalal & Co. vs. CIT (1980) 126 ITR 251 (MP);

CIT vs. Karamchand Premchand (P) Ltd. (1969) 74 ITR 254 (Guj);

V. Ramaswamy Iyangar & Anr. vs. CIT (1960) 40 ITR 377 (Mad);

CIT vs. Anand Prasad & Ors. (1981) 128 ITR 388 (Del);

CIT vs. Orient Prospecting Co. (1983) 141 ITR 301 (Guj).

2.3 Shri Singh further submitted that no appeal is provided in s. 246 of the Act against charging of interest under s. 234B and it was in this background that the assessee had not filed any appeal against levy of interest under s. 234B by the AO. He also argued that additional ground cannot be admitted if it involves further investigation into facts. In support, he cited the following case laws :

CIT vs. Dehati Co-op. Marketing-cum-Processing Society (1981) 130 ITR 504 (P&H);

Bihar State Road Transport Corpn. vs. CIT (1984) 149 ITR 208 (Pat) (FB).

2.4 In this counter-argument Shri Mehta stated that no investigation into facts is involved. Neither any evidence is required to be furnished before AO/CIT(A). Referring to the decision of the apex Court in Central Provinces Manganese Ore Co. Ltd. vs. CIT (1986) 160 ITR 961 (SC), he submitted that it has been held by their

Lordships that it is open to an assessee to dispute the levy of interest under s. 139(8) or 215 provided he limits himself to the ground that he is not liable to levy at all.

3. We have considered the rival submissions and perused the decisions relied upon by the parties. It is not in dispute that as against loss of Rs. 1,02,86,772 disclosed in the return, the AO completed the assessment on positive income of Rs. 2,42,17,560, vide order dt. 28th Feb., 1995 under s. 143(3) of the Act. This resulted in demand of Rs. 2,36,61,273 including therein interest of Rs. 97,29,390 charged under s. 234B. It is an admitted position that the assessee did not agitate the issue of levy of interest under the said section before the CIT(A). The assessee had not offered any explanation as to why ground relating to levy of interest under the said section was not taken before the CIT(A). The explanation for omission to set forth any ground relating to levy of interest under the said section in the memorandum of appeal filed before the Tribunal is not convincing at all. Sec. 234B provides for levy of interest where the assessee has either failed to pay advance-tax during a financial year which he is liable to pay under s. 208 or the advance tax paid by him under s. 210 falls short of 90 per cent of the assessed tax. Perusal of ITNS-150 reveals that the assessed tax consequent to computation of total income worked out to Rs. 1,39,25,097. No advance tax was paid by the assessee and after allowing credit of TDS of Rs. 25,969 the balance assessed tax was worked out at Rs. 1,38,99,123. No argument has been advanced by Shri Mehta in support of the contention raised in the additional ground that there was no default in payment of advance-tax by the assessee as per provisions of the Act. Having regard to the provisions of s. 234B coupled with the fact that no appeal is provided against levy of interest under s. 234B in sec. 246 and the facts of the assessee's case as narrated above, we are of the view that the ratio of decision in Central Provinces Mangnese Ore Co. Ltd. (supra) is inapplicable to the assessee's case.

4. In CIT vs. Late Begum Noor Banu Alladin (supra), their Lordships of Andhra Pradesh High Court held that the jurisdiction of the Tribunal is restricted to subject-matter of dispute before the first appellate authority. Their Lordships have observed, thus :

"The subject-matter of appeal before the Tribunal cannot be anything different from the subject-matter of appeal before the AAC and necessarily it should be something which arises out of the determination made by the AAC. However, there is no taboo against raising a new ground or a new plea touching the same subject-matter. If the assessee is precluded from taking a new ground unrelated to the subject-matter before the AAC, he cannot avail of r. 11 and obtain leave of the Tribunal to raise such ground for the first time. This rule must be read subservient to the provision in the Act providing for the right of appeal. So read, it is clear that the additional ground that could be permitted to be raised under r. 11 is the one that should relate to the subject-matter of the appeal which, in turn is linked to the subject-matter of the order passed by the first appellate authority. Even from the stand-point of general

> principles there is a salutary principle underlying a taxing statute that there should be a finality to the proceedings so that an element of certainty could be ushered in as early as possible in the interests of both sides. The assessments need not be thrown to contest throughout the stages of appeal, revision and reference. There is a fallacy in thinking that, in reality, there is no lis between the parties before the Tribunal and that the Tribunal should set upon itself the task of recomputing the tax liability irrespective of whether the ground was raised before the AAC or even before it.
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> A decision of the Supreme Court takes its colour from the question involved in the case and while applying the decision to a later case, the Courts must carefully try to ascertain the true principle laid down by the decision of the Supreme Court. It is not proper to pick out words or sentences from the judgment divorced from the context. In CIT vs. Kanpur Coal Syndicate Ltd. (1964) 53 ITR 225 (SC), the Supreme Court was only highlighting the plenary powers of the AAC but not the Tribunal. In CIT vs. Mahalakshmi Textile Mills Ltd. (1967) 66 ITR 710 (SC), the Supreme Court cannot be said to have laid down a proposition that any question, whether it relates to the same subject-matter or not, can be raised at any time before the Tribunal and the Tribunal can grant relief on an item of income which was never disputed earlier."

5. While arriving at the above conclusion, their Lordships dissented from the Full Bench decision of Bombay High Court in Ahmedabad Electricity Co. Ltd. vs. CIT (1993) 199 ITR 351 (Bom) (FB) relied upon by the assessee and followed the decision of the jurisdictional High Court in Hukumchand & Mannalal Co. vs. CIT (supra) wherein their Lordships of M. P. High Court have held that when in an appeal to the AAC against an order of assessment, the assessee has not questioned the decision of the ITO rejecting claim for deduction made by the assessee, and the AAC in his order has also not considered that point, the assessee is not entitled to question the decision of the ITC on that point in an appeal to the Tribunal against the order of the AAC and the Tribunal is not entitled to allow the assessee to agitate that question.

5.1 Much reliance has been placed by Shri Mehta, the learned counsel for the assessee, on the decision of Rajasthan High Court in Santlal Kalyani & Co. vs. CIT (supra). On perusal of this decision, we find that it does not render any assistance to the assessee at all. On the contrary, it supports the stand of the Revenue as canvassed by the learned Departmental Representative. In the decision (supra), having noticed the decisions in CIT vs. Kanpur Coal Syndicate (supra), Addl. CIT vs. Gujargravures (P) Ltd. (1978) 111 ITR 1 (SC), Jute Corpn. of India vs. CIT (1991) 187 ITR 688 (SC), Hukumchand Mills Ltd. vs. CIT (1967) 63 ITR 232 (SC) (supra), CIT vs. Mahalakshmi Textiles Mills Ltd. (1967) 66 ITR 710 (SC) (supra), Ahmedabad Electricity Co. Ltd. vs. CIT (1993) 199 ITR 351 (Bom) (FB) (supra), CIT vs. Late Begum Noon Banu Alladin (supra), CIT vs. Cellulose Products of India Ltd. (1985) 151 ITR 499 (Guj) (FB) their Lordships of Rajasthan High Court at pages 280-281 of (1995) 213 ITR 273 (Raj) concluded, thus :

> "On the basis of the various judgments mentioned above, it is evident that the power of the first appellate authority, namely, the AAC or the CIT(A) have to be considered in the light of the decisions of the apex Court in the case of CIT vs. Kanpur Coal

Syndicate referred to above, and the first appellate authority shall have the same power as that of the ITO and has discretion to allow an additional ground to the appellant before it.

The position of the Tribunal in second appeal stands on a different footing. After an assessment is made, the order could be challenged before the first appellate authority by an assessee, and after the said decision, the second appeal can be filed before the Tribunal by the assessee as well as by the Department. The other side has also the right for cross-objection and, thus, in respect of any matter which has been adjudicated upon by the first appellate authority the Tribunal has full jurisdiction to decide any of such issues and even to permit the raising of a new ground which was not raised at the time of submission of the second appeal. There may be circumstances where the point was not raised before the ITO or even before the first appellate authority in respect of any addition or deduction. If the point is purely legal, then on the basis of the evidence on record, a new ground could be raised. For example, if the assessee is entitled to deduction under two sections and the deduction was claimed only under one section, before the Tribunal the new ground could be raised in respect of such deduction that it is allowable under the other sections as well, or alternatively and since sufficient evidence exists on record, the power could be exercised by the Tribunal in entertaining the fresh ground. This power cannot be exercised in respect of a new source of income, or, such a point for which either there is no evidence in existence of the evidence is insufficient. Another point which requires consideration is that if the ITO has decided a particular point, and before the first appellate authority that addition or deduction was not challenged and the matter was challenged before the Tribunal, in such a circumstances, it would amount that the appeal is directly entertained by the Tribunal against the order of the ITO on such a point, which has not been considered by the first appellate authority. This is not permissible under law."

6. On consideration of the facts and circumstances of the case in hand before us, we hold that no reasons at all have been shown by the assessee as to why the grounds relating to levy of interest under s. 234B was not raised before the CIT(A). No convincing reasons have been shown as to why the ground was not raised at the time of filing the appeal before the Tribunal. The appeal was filed before the Tribunal on 5th Feb. 1996. The hearing commenced from 12th Aug., 1996 and it was only after part-hearing of the case of 13th Aug., 1996, 14th Aug., 1996, 27th Aug., 1996 28th Aug., 1996, 29th Aug., 1996, 3rd Sept., 1996 that the impugned additional ground was sought to be taken by moving a petition dt. 9th Sept., 1996 filed before the Bench on 10th Sept., 1996 during the course of hearing. There is nothing on record to enable us to hold that there was bona fide omission on the part of the assessee in raising the impugned additional ground. We, therefore, decline to admit the additional ground sought to be taken before us.

7.1 We may now proceed to deal with the issues raised in the appeal ground-wise. Ground No. 1.1 & 1.4 (a) relate to the same issue, namely, that the Revenue has treated receipt of Rs. 2,88,51,613 by the assessee on termination of foreign collaboration agreement as business income as against the assessee's claim thereof as capital receipt, the same having been received on extinguishment of right to receive the technical know-how to manufacture and sale tyres and tubes. Ground No. 1.4(b), (c), (d), (e), (f), (h), (i) have been admitted by Shri Mehta, the learned counsel for the assessee, to be explanatory to the above ground No. 1.1, 1.4(1) & (g). It has also been agreed to by Shri Mehta that ground No. 1.3(i) to (x) need not be considered, these being denial mainly of observations of CIT(A). Ground Nos. 1.2 and 1.4(j)(k) relate to the sum of Rs. 2,29,50,782 taxed by the Revenue as business income of the asst. yr. 1992-93, presently under consideration as against the claim of the assessee that it pertained to the succeeding asst. yr. 1992-93. Ground No. 1.4(1) and (m) were not passed. Likewise, ground No. 1.5 and 1.6 have not been pressed. We, therefore, dismiss those sub-grounds of ground No. 1, which have not been pressed.

7.2 Let us now take up ground No. 1.1 & 1.4(a) as also ground No. 1.2 and 1.4(j) and (k) for consideration, which relate to the aforesaid sums of Rs. 2,88,51,613 and Rs. 2,29,50,762. The facts are these. The assessee is a limited company engaged in manufacture of tyres and tubes as also trading of fabrics. The promoters of the company had moved an application dt. 30th Sept., 1985 to the Govt. of India in the Ministry of Industry (Department of Industrial Development) for foreign collaboration with M/s Michelin, France for manufacture of tyres and tubes for scooters and motor-cycles. The Govt. of India conveyed its approval, vide letter No. FC-134(86)/662(85) dt. 12th June, 1986 subject to the following conditions in addition to those detailed in the Annexure thereto :

> (i) Royalty : 3 per cent subject to taxes for a period of five years.
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> (ii) Lump sum know-how fee : Rs. 20 lakhs subject to taxes; and
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> (iii) The duration of the agreement shall be for a period of eight years from the date the agreement is filed with Reserve Bank of India.

7.3 Pursuant to the above approval of the Govt. of India, the parties entered into foreign collaboration agreement/memorandum of understanding in July, 1985; the technical know-how agreement dt. 22nd June, 1987 as also technical services agreement France/India both dt. 22nd June, 1987.

7.4 The salient features of the technical know-how agreement dt. 22nd June, 1987 are these. Clauses 1.4 and 1.5 define the terms 'technical know how' and 'technical services'.

Clause 2 provides for grant of licence whereby Michelin granted to the assessee company non-exclusive right to use the technical know-how in the establishment of the plant at Pithampur and to manufacture all types of cross ply pneumatic tyres of international standard for scooters and motor-cycles as also tubes used in conjunction with such tyres. Michelin also granted non-exclusive right to use, distribute and sale in all countries the licensed products so manufactured by the assessee except these countries where Michelin has a 'two-wheel' manufacturing facility (i.e.) at the time of executing agreement, France, Spain, Itly and Nyjeria).

Clause 3 provides for payment. The licencee i.e. the assessee was to pay Michelin lump sum of Rs. 20 lakhs in three equal instalments of Rs. 6,66,686 in French Francs. In addition, the assessee also agreed to pay a recurring royalty on an annual basis of a period of five years from the date of commencement of the manufacturing of the licenced products to be calculated @ 3 per cent of the net sale price of the licenced products.

Clause 4 provides for transfer and safeguarding of technical know-how. As per cl. 4.3, the assessee agreed to hold in strict confidence of technical know-how and to cause its personal to abide by the said understanding. Clause 4.3 stipulates that the assessee licencee shall restrict the internal disclosure within its own organisation to the limited number of employees. Clause 4.4 required the licencee to prevent unauthorised disclosure by its employees of the technical know-how either within its organisation or outside. Clause 4.5 laid down the procedure to be followed by the parties to ensure the safe-transmittal of the technical know-how.

Clause 5 forbids the licencee to apply for patents on technical know-how or technical services either in India or elsewhere.

Clause 6 provides for indemnification and insurance.

Clause 7 provides that the duration of the agreement shall be eight years w.e.f. 26th Dec., 1986, which by mutual agreement and subject to approval by Govt. of India may be extended for additional five years until mid-night of 25th Dec., 1999.

Clause 8 provides for termination of agreement. Clause 8.1 states that the agreement shall expire automatically as set forth in cl. 7. Clause 8.2 states that the agreement shall automatically terminate if the foreign collaboration agreement is terminated for any reason. Clause 8.3 lays down the procedure for termination of the term. Clause 8.6 provides that the agreement shall automatically terminate in the event there is a change in the ownership or control of the agency (assessee company).

Clause 9 stipulates the consequences upon termination. As per clause 9.1, in the event of termination of agreement, Michelin shall cease to transfer the technical know-how, For two years after termination of the agreement, the assessee shall continue to abide by the confidentiality procedure set forth in cl. 4 above. Clause 9.2 provides that the termination of the agreement shall not relieve the assessee company from any liability arising from licencee's unauthorised use or disclosure of the technical know-how. Clause 9.3 states that in the event of termination of the agreement for breach of contract by the assessee, it shall not be relieved from payment obligations.

Clause 10 provides for assignment. Clause 10.1 states that the agreement is personal to the licencee. The licencee has agreed not to assign, transfer, sub-licence, change or part with any of its rights or obligations under the agreement without the prior written consent of Michelin.

Clauses 11, 12, 13 & 14 provide for governing law procedure for conciliation and arbitration, force majure and mode of communication/notices, etc.

8. Accordingly, the factory was to be set up by the assessee at Pithampur, District Dhar, having capacity of approx. 5/8 lakhs units of products (tyres & tubes) per annum. The assessee paid lump sum technical know-how fees in three equal instalments of Rs. 6,66,666 on 24th Feb., 1987, 29th Sept., 1987 and 19th Oct., 1989. The first two payments were debited to pre-operative expenses account in books in asst. yr. 1989-90, whereas the third payment was debited to work-in-progress account in the books in asst. yr. 1990-91. The assessee adjusted the royalty payment aggregating Rs. 8,38,152 in books; Rs. 1,72,964 in asst. yr. 1988-89; Rs. 2,94,550 in asst. yr. 1989-90 and Rs. 3,70,638 in asst. yr. 1990-91 by charging them to P&L a/c of the respective assessment year. Subsequently, the entire royalty amount was capitalised in respective assessment year and written back in the asst. yr. 1992-93, as royalty payment was not made at all.

9. It appears that the disputes arose between the parties, namely, Michelin and S. Kumar Tyre Manufacturing Co. (for short 'SKTMC') concerning the implementation of various terms under the agreements. The parties entered into settlement agreement dt. 22nd Nov., 1991. The notable features of the said settlement agreement are : Cl. 1.1 provides that SKTMC shall accept the payments made in accordance with Cl. 1.4 below in full and final settlement of all claims, disputes and/or liabilities against Michelin, arising or related directly or indirectly from the agreement. As per Cl. 1.2, SKTMC agreed not to disclose and/or transfer the technical information received by it from Michelin to any third party for a period of two years starting from 30th Nov., 1991. As per Cl. 1.3, SKTMC further agreed not to refer to the word 'Michelin' or to any trade mark, trade name and logo owned or used by Michelin or its affiliates or to the source of technology received from Michelin in manufacture, sale, marketing and distribution of its products or in any other way with respect of its operation and business.

9.1 In consideration of the waivers and undertakings contained in the aforesaid clauses, Cl. 1.4 provides for :

> (a) Payment to the assessee company by Michelin a total sum of US $ 1,91,08,000 as follows :
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> (i) US $ 1,11,08,000 on or before 5-12-1991.
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> (ii) The balance US $ 8,00,000 by 30-11-1992 at the latest.

It was further stipulated that if the first payment is not made by due date, SKTMC shall have an option of considering the settlement agreement as null & void.

(b) Michelin shall waive of claims against SKTMC arising directly or indirectly from the agreements.

9.2 Clause 1.5 provides that the payments made in accordance with Cl. 1.4 above shall be held in ESCROW by M/s Clifford Chance (Peris) in a bank and shall not be realised until legal opinion confirming the execution of the settlement agreement is obtained.

9.3 As per Cl. 2, SKTMC undertook to return all the confidential information and documents conveyed to it by Michelin by 30th Nov., 1992.

9.4 Clause 3 provides that upon receipt of final payment under cl. 1.4(ii) above, the agreement shall be terminated.

9.5 Clauses 4 to 7 are not relevant for the purposes.

10. In the statement of total income accompanying the return for the asst. yr. 1992-93 filed on 31st Aug., 1992, the assessee company declared the first payment of US $ 1,11,08,000 equivalent to Rs. 2,88,51,613 as capital gains being amount received on extinguishment of rights and claims from Michelin. The assessee claimed deduction of the entire sum under s. 54E on account of investment in IDBI capital bonds within six months.

11. Notes No. 4, 5, & 6 below the aforesaid statement of total income states, thus :

> "4. The company during the year has received US $ 11,18,000 towards extinguishment of its rights & claims from Company General Des Establishment, Michelin, its technical collaborators as per agreement dt. 22nd Nov., 1991. The convertible value of the said amount of US $ 11,18,000 amounting to Rs. 2,88,51,613 as received by the company from the said collaborators has been credited by it in its P&L a/c for this year. The company claims that there being no identification cost of acquisition towards the amount received for extinguishment of its rights and claims against the foreign collaborator and the same being an item of capital gain is not taxable as per the decision of Supreme Court in the case of B. C. Shrinivas Shetty (1981) 128 ITR 294 (SC). However, as a matter of abundant caution, the company has purchased 3 years IDBI Capital Bonds of Rs. 2,90,00,000 on 19th May, 1992 and accordingly claims that even if the said amount is treated as liable to capital gains, exemption on the same is allowable under s. 54E of the IT Act.
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> 5. The rights under an agreement constitute a capital asset; for this reliance is placed on following decision :
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> (i). CIT vs. Tata Services Ltd. (1980) 122 ITR 594 (Bom);
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> (ii). CIT vs. Sterling Investment Corpn. (1980) 123 ITR 441 (Bom).

6. That all the three conditions viz. existence of capital asset, extinguishment of rights and receipt of consideration as a result of such extinguishment are present, the said amount received from the foreign collaborators is a capital receipt."

12. The balance payment of US $ 8,00,000 equivalent to 2,29,50,782 has been disclosed in the return for the asst. yr. 1993-94 filed on 31st Dec., 1993 by way of miscellaneous receipts credited to P&L a/c. In note 5 below statement of total income, this sum was claimed as capital receipt not

liable to tax. Note 5 reads as under :

> "5. The company during the year has received US 8,00,000 from Compagnie Generals Des Establishments, Michelin, its technical collaborators as per agreement dt. 22nd Nov., 1991. Equivalent to Indian Rs. 2,29,50,782. The said amount has been credited to P&L account under the head miscellaneous receipt. The aforesaid amount has been received for agreeing not to disclose or transfer the technical information received from Michelin to any third party and not to refer to word Michelin or to any trade marks, trade names and logo owned or used by Michelin or its affiliates, to the agreements or to the source of the technology received by the assessee company from Michelin in the manufacture, sale, marketing and distribution of its products or in any other way with respect to its operations and business. The company claims that the amount of Rs. 2,29,50,782 towards above agreement is a capital receipt, and, therefore not liable to tax. However, as a matter of abundant caution and to avoid incidence of additional tax, the company has offered the said amount in the above computation. If the assessment for this year is not selected under scrutiny it shall or presumed that the claim of the company treating the amount of Rs. 2,29,50,782 as capital receipt has been accepted and the loss for this year shall be increased for set off in subsequent years by Rs. 2,29,50,782."

13. During the course of assessment proceedings, the AO required the assessee to justify its claim that the aforesaid two receipts represented consideration for transfer of capital assets. It was submitted before him that there was capital asset consisting of right to receive the technical know-how to manufacture and sale tyres and tubes. This right was transferred. Since there was extinguishment of the said right, the consideration received was on account of transfer of capital assets.

14. The contention of the assessee was not acceptable to the AO. He was of the view that the amount received upon termination of the agreement was not on account of surrender of any right nor relinquishment of any capital asset. Instead, it was in the nature of reimbursement of losses. He, therefore, observed that the assessee has been maintaining its accounts on mercantile basis. Therefore, the entire amount of Rs. 5,18,02,396 (Rs. 2,88,51,613+2,29,50,782) was taxable in asst. yr. 1992-93, presently under consideration. The salient points made by the AO in para 11 of his order have been noted by the CIT(A) at pages 9-10 of his appellate order, thus :

> "(i) The appellant has received US $ 11,18,000 equivalent to Rs. 2,88,51,613 in the present assessment year and further amount of Rs. 2,29,50,782 has been received in the next year from foreign collaborator.
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> (ii) As per agreement of July, 1986 under which three separate agreements were drawn, the foreign collaborator was required.
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> (a) to provide non-exclusive licence of technical know-how to manufacturer of the specifications to be defined with the right to sub-licence, but only upon prior written

approval of Michelin;

(b) the rendering of technical services in France for assimilating the technical know-how;

(c) the rendering of technical services in India for assimilating the technical know-how manufacturing the products.

(iii) The factory was set-up in India without any assistance from Michelin and no amount was paid to Michelin in any form in connection with the setting up of the factory.

(iv) The damages received on account of settlement of contract are of the same nature as the purpose for which the contract was entered into. Since the contract was for providing technical know-how, the payment of which was claimed by the appellant on revenue account in asst. yr. 1989-90 and was accepted by the Department, and even otherwise there are a plethora of the decision, to the effect that payment for use of technical know-how was a revenue expenditure, the AO has held that damages received also constitute revenue receipt and not capital receipt, because there was no surrender of any right nor extinguishment of any asset for which the damages were received.

(v) The nature of dispute between the appellant and Michelin which has resulted into settlement dt. 21st Nov., 1991 has not been disclosed to the Department. Only a report prepared by Arthur Anderson estimating the damages arising from the alleged breach of technical know-how agreement has been produced wherein actual losses upto 31st March, 1991 suffered by the appellant in the tyre manufacturing business have been considered and future losses have been projected. In this background, the AO has held that quite clearly the damages received after such valuation are for compensation of the assessee for the business losses accrued to it on account of defective technical know-how.

(vi) Keeping in view the production and sale record of tyres and tubes for the asst. yrs. 1992-93 to 1994-95 the AO has established that due to cancellation of technical know-how agreement in November, 1991, the business of the appellant has not suffered in any manner which shows that there has been no loss of any capital asset due to such cancellation of the agreement and for this reason, the AO has held that the receipt was on revenue account.

(vii) Keeping in view the contents of the settlement agreement and the report of the Arthur Anderson, the AO has held that the appellant company has been compensated by the foreign collaborator for the loss of revenue and also to stop the appellant from creating any disputes, claims and liabilities against the foreign collaborator in connection with the agreement which have been settled.

(viii) The amount has been received in two instalments in the present assessment year and the next year. Since the accounts are being maintained on mercantile basis as indicated in the audit report filed with the return, the entire amount equals to UD $ 19,18,000 becomes receivable in the present assessment year and only part payment has been deferred. Therefore, the aggregate amount of Rs. 5,18,02,396 becomes taxable in the present assessment year itself."

Accordingly, the AO made the impugned addition of Rs. 5,18,02,396 to the income of the assessee. The assessee appealed.

15. Before the CIT(A), the stand of the assessee was repeated. It was also argued that the company mainly relied on the written opinion of Shri Bansi S. Mehta, C. A. and, accordingly, purchased IDBI Bonds to claim exemption under s. 54E of the Act. It was also stated that the second amount of Rs. 2,29,50,782 was received in the asst. yr. 1993-94 and has been offered as business income in that year. It was argued that the addition of both the impugned amounts be deleted. The AO, who, attended the appellate proceedings, submitted that the assessee gave different treatment to the part of the same receipts in two years. The first instalment, which was received during the asst. yr. 1992-93, has been shown as capital receipt, while the other instalment received in the asst. yr. 1993-94 has been shown by the assessee as business income. There is no justification therefor. It was, thus, argued that the amount of compensation cannot be treated as capital receipt in the asst. yr. 1992-93 when the same has already been offered as revenue income by the assessee in the asst. yr. 1993-94.

16. The stand of the AO found favour with the CIT(A). According to him, the undisputed facts are that the assessee entered into an agreement with Michelin for procuring technical know-how and the payment made by if has rightly been claimed as revenue expenditure. Thereafter, the assessee commenced production utilising such technical know-how in asst. yr. 1989-90 and started suffering losses year after year. Whether such losses were on account of alleged sub-standard technology provided by the Michelin or some other reasons is not clear, but it is apparent that the assessee-company threatened Michelin in some way or the other on the strength of such losses and in return not only escaped the cancellation of the agreement entered earlier but also received compensation of the amounts, in question. The CIT(A) perused the memorandum of understanding dt. 8th July, 1986 and subsequent agreement dt. 22nd June, 1987. According to him, he did not find any compensation clauses in them, which lay down that the foreign collaborator shall pay compensation to the licencee in case it suffers losses by using technical know-how provided under the agreement. On the other hand, all the duties and liabilities have been cast only on the licencee i.e. the assessee-company, and several conditions have been imposed under the heading 'Indemnification & Insurance', which he extracted on p. 12 of his order. He further noted that there is provision for termination of the agreement by notice or failure of either party to discharge its obligation under agreement for more than 90 days after signing of notes. In case Michelin for some reason fails to discharge the responsibilities under the agreement, it has been provided in Cl. 10.2 of the agreement dt. 22nd June, 1987 that Michelin upon written notice the licencee shall provide such services by an authority of Michelin and shall remain responsible for fulfilment of the obligations. He noted that nowhere it has been provided that in case Michelin fails to discharge the obligations,

it shall pay any amount as compensation. Under these circumstances, the CIT(A) expressed the view that the only logical reason for Michelin to agree to pay compensation is that they wanted to avoid litigation and save the damage of their reputation by making the assessee to stop from publishing that the technical know-how provided by Michelin was of sub-standard quality. He noted the stipulations in Cls. 1.1, 1.2 and 1.3 of the settlement agreement dt. 22nd Nov., 1991, which reinforced his view that the Michelin were concerned with their reputation and were bothered with likely loss of reputation in the world market, if the assessee company made it publish that their technology was sub-standard.

16.1 On the strength of the alternate submission contained in paras 4.8 & 4.9 of the assessee's letter dt. 18th July, 1995 about set off of working loss of tyre division aggregating to Rs. 5,79,87,928 upto February, 1992 against income of Rs. 5,18,02,396, the CIT(A) concluded that the assessee itself has conceded the impugned receipts as business income.

16.2 The CIT(A) further observed that the assessee had only right to receive the technology from Michelin and Michelin never refused to supply such technology. The compensation is, therefore, not on account of termination of any right but it is in the nature of damages which have been received in the course of carrying on of the business activity and, therefore, the amounts constitute revenue receipt.

16.3 The CIT(A) further noticed that in the settlement agreement dt. 22nd Nov., 1991, there is no mention at all of the basis of making payment in two instalments. In a subsequent letter of Clifford Chanse dt. 10th June, 1992, it has been clarified that the sum of US $ 1,11,08,000 i.e. the first instalment was in consideration of Cls. 1.1 and 1.3 i.e. for non-disclosure of technology to any third party for a period of two years and non-use of the word 'Michelin' or their trade mark or logo in any manner. The CIT(A) took note of the fact that the assessee has itself shown the second instalment as its business income. In his opinion, the first instalment also is in the nature of business income, as it has not been received on account of extinguishment of any right.

16.4 Regarding the opinion dt. 1st April, 1992 of Shri Bansi S. Mehta, C. A., the CIT(A) observed that the same is based on the decisions of CIT vs. Tata Services Ltd. (supra) and CIT vs. Sterling Investment Corporation (supra) and has been given under the impression that the assessee had certain rights and claims under the foreign collaboration agreement. After studying the facts of the decision (supra), the CIT(A) reached the conclusion that the decision in Sterling Investment Corporation Ltd. is not applicable to the issue involved and the decision in Tata Services Ltd. has been rendered in a situation where the amount received was for loss of a right which is not the facts of the assessee's case, as here the assessee had only right to receive technology from Michelin which never refused to supply such technology.

16.5 Noticing the facts of 5th ITO vs. R. M. B. Aradhya (1994) 49 ITD 14 (Bang), the CIT(A) observed that it is not true that damages received for non-fulfilment of rights are always capital receipts. Facts and circumstances under which damages are received are relevant for determination of the nature of receipt. He remarked that in the assessee's case the damages have been paid by Michelin only to prevent the assessee from its nuisance value are not on account of non-fulfilment of any obligation.

16.6 According to the CIT(A), the decision of the apex Court in CIT vs. Raibahadur Jairam Valji & Ors. (1959) 35 ITR 148 (SC) is directed on the point. In that case, their Lordships held that generally the payment made in settlement of rights under a trade contract are trade receipts. Their Lordships have further held that a receipt is a capital receipt or a revenue receipt will depend upon whether it is a compensation for injury inflicted on a capital asset or stock-in-trade. According to him, in the case of the assessee, there is no injury inflicted on any capital asset and payment has been received in consequences of an agreement in the nature of a trade contract. He, therefore, expressed the view that the same has got to be held as a trading receipt. The CIT(A) applied the decision of the apex Court in Seth Banarsidas Gupta vs. CIT (1987) 166 ITR 783 (SC) to the facts of the assessee's case. In the decision (supra), their Lordships held that the amount received under a compromise or by amicable arrangement were in the nature of profit to be received by the assessee for interest held in the business. He noted that in the case of the assessee, the agreement of July, 1986 was entered by the assessee in its business interest and, therefore, the settlement agreement of November, 1991 is also in the interest of business. He, therefore, was of the view that the damages received are clearly on account of a compromise, which has to be held as revenue receipt.

16.7 The CIT(A) also referred to the decision in CIT vs. Best & Co. (P) Ltd. (1966) 60 ITR 11 (SC), wherein it has been held that in case where compensation is received for loss of enduring assets, it would be a capital receipt but where it was received due to an ordinary incident in the course of business, it shall amount to a revenue receipt. The CIT(A) noted that in assessee's case, there is no loss of any enduring asset and the damages have been received on account of an ordinary incident that the assessee behind the shield of loss suffered year after year compelled the foreign collaborator to agree to compensate. In his opinion, such compensation has to be held as revenue receipt.

16.8 The CIT(A) also considered the observations of their Lordships of Madras High Court in R. V. Lakshmiah Naidu & Co. vs. CIT (1963) 48 ITR 661 (Mad) and stated that the evaluation report of Arthur Anderson about the damages and estimate thereof established that the assessee received compensation on account of losses suffered by it and not on account of non-fulfilment of any right under the agreement. The CIT(A), therefore, held that the compensation so received is only on revenue account after testing the same on the theory of equivalence.

16.9 According to the CIT(A), the assessee was not entitled to any compensation as per terms of the agreement. The payment received by the assessee is, therefore, a voluntary payment made by Michelin, France under the fear of litigation and loss of reputation. The assessee received the payments in question on account of help given by it in the form of restraining itself from its nuisance value. Such payment has been received in the course of running of the business and in connection with running of such business and not on account of any remote consideration. He, therefore, held the view that the same constituted business receipt.

16.10 In the final analysis, the CIT(A), held that the amount of Rs. 5,18,02,396 receivable under the settlement agreement of 22nd Nov., 1991 has rightly been taxed as business income in the asst. yr. 1992-93 because the accounts are maintained on mercantile basis. According to him, there is no basis at all on which the assessee has shown one part in asst. yr. 1992-93 and the other in asst. yr. 1993-94. Similarly there is no basis on which the first instalment is shown as capital receipt and the second as business income.

16.11 For the reasons aforesaid, he confirmed the impugned addition. Dissatisfied, the assessee is in appeal before us.

17. Shri M. C. Mehta, C. A., argued on behalf of the assessee company. The Department has been represented by Shri S. K. Singh, learned Departmental Representative. Both have been heard at length.

18. Inviting our attention to the approval dt. 12th June, 1986 granted by the Govt. of India to the promoters of the company to enter into collaboration agreement with Michelin (copy at P. P. 101 - 105 of the paper book), Shri Mehta submitted that the Revenue authorities have not considered items 7, 9 & 13 of the Annexure to the said approval. Item 7 stipulated that export shall be permitted to all countries except where the foreign collaborator has existing licencing arrangement for manufacture. In the later case, the countries concerned shall be specified. As per item 9, the Indian company should be free to sub-licence the technical know-how/product design/engineering design under the agreement to another Indian party should it become necessary. It further stipulated that the terms of such licence will, however, be as mutually agreed to by all the parties concerned including the foreign collaborator and will be subject to the approval of Govt. In item 13, it was stipulated that in case the item of manufacture is one which is patented in India, the payment of royalty/lump sum payment made by the Indian company to the foreign collaborator during the period of agreement shall also constitute full compensation for the use of the patent rights till the expiry of the life of the patent and the Indian company shall be free to manufacture that item. Shri Mehta argued that the Govt. of India had directed the parties to enter into exclusive agreement for India and permitted export to all countries except France, Spain, Itly and Nygeria. Referring to the memorandum of understanding (copy at p. p. 109-121 of paper book), Shri Mehta submitted that the proposed scope of Michelin technical collaboration included a non-exclusive licence of technical know-how to manufacture and sale tyres and tubes with the right to sub-licence but only upon prior written approval of Michelin. In this connection, he also referred to para 6.5 of the memorandum of understanding (p. 117 of the paper book).

18.1 Shri Mehta led us through the appellate order. He pointed out that the CIT(A) is not correct in observing at p. 2 of his order that there are no instances of goods rejected nor return of goods sold in view of the details of such rejected goods available at p. 165 of the paper book. He, however, admitted that such details had not been failed before the AO. As per the said details filed before the CIT(A), the claim of purchaser for rejected goods amounted to Rs. 2,12,099 in the accounting period relevant to the asst. yrs. 1991-92 and 1992-93. In addition sales return amounted to Rs. 27,41,434 during the accounting period relevant to the asst. yrs. 1990-91, 1991-92 and 1992-93. Shri Mehta also refuted the observation of the CIT(A) at para 5 on p. 10 to the effect that the nature of dispute had not been disclosed to the Department, as the AO has himself noted in para 11.6 of his order that the settlement agreement provided for payment of US $ 19,19,000 for certain reasons. He also had reservations on the observations of the CIT(A) in para 10.2 of his order, wherein the CIT(A) stated that Shri Mehta had submitted that the second amount received in next year has been offered as business income in the next year. Shri Mehta submitted that the second amount had not been offered as business income as alleged in the next year. However, it was done by way of note below the statement of total income. Referring to the details of royalty adjusted by the assessee in its books appearing at p. 166 of the paper book, Shri Mehta submitted that the royalty payable has been capitalised in the asst. yrs. 1988-89, 1989-90, 1990-91 and 1991-92. These were never claimed as revenue expenditure as observed by the CIT(A) in para 10.4 of his order. He also refuted the allegation of threat given by the assessee to Michelin as observed by the CIT(A) on p. 12 of his order. Shri Mehta further submitted that it was by way of alternate argument before the CIT(A) that he had submitted before him that having come to the conclusion that the commercial production of tyre division had started w.e.f. 4th May, 1988 loss for the asst. yrs. 1990-91 and 1991-92 required to be accepted and be allowed set off against this year's income computed by the AO. He had never conceded/admitted that the impugned receipts constituted the assessee's business income as stated by the CIT(A). As regards the CIT(A) observation that the assessee itself had shown the second instalment to be part of its business income, he submitted that it was shown as precautionary measure so as to avoid liability of additional tax if intimation under s. 143(1)(a) were issued.

18.2 Shri Mehta argued that pursuant to the permission granted by the Govt. of India to enter into foreign collaboration agreement with M/s Michelin - France, the assessee company obtained exclusive licence for manufacture of 2-wheeler tyres and tubes in India. The know-how and knowledge to manufacture the said tyres and tubes once obtained, understood and applied could not be taken away from the minds of the staff of the assessee-company by the collaborators. He stated that till the agreement was terminated, the assessee had the permission to use the trade name and support of the collaborators. According to him, all these put together were items of enduring nature and, thus, a capital asset. Hence, the compensation of Rs. 2.88 crores received by the assessee-company was in the nature of capital receipt. In the alternative, he submitted that if the amounts paid or payable to the foreign collaborator are treated as the cost of the assets, the said compensation is liable to capital gains tax. Since the conditions laid down in s. 54E of the Act have been fulfilled, the assessee is not liable to capital gains tax either.

18.3 As regards the second instalment of Rs. 2.29 crores, Shri Mehta submitted that the said amount was to remain for the year in escrow account with P is solicitor and, therefore, right to receive the said amount accrued or arose in the asst. yr. 1993-94. In this connection, he referred to Cl. 1.4(a)(ii) and cl. 1.5 of the settlement agreement dt. 22nd Nov., 1991 as also the clarificatory letter dt. 10th June, 1992 of Clifford Chance (these documents appear at ps. 155-161 of the paper book). Shri Mehta further submitted that since the settlement agreement in respect of payment of US $ 8,00,000 (equivalent to Rs. 2.29 crores) was in restraint of trade as per para (b) of letter dt. 10th June, 1992 of Clifford Chance, the said amount was not taxable.

18.4 In support of the above submissions, reliance was placed on the following decisions :

(i) CIT vs. Bombay Burmah Trading Corporation (1986) 161 ITR 386 (SC);

(ii) K. Eapen Jacob vs. CIT (1987) 166 ITR 199 (Mad);

(iii) CIT vs. Merchandisers (P) Ltd. (1990) 182 ITR 107 (Ker);

(iv) CIT vs. H. S. Shivarudrappa (1993) 200 ITR 1 (Kar)

(v) CIT vs. Ace Builders (P) Ltd. (1993) 202 ITR 324 (Bom);

(vi) CIT vs. Saraswathi Publicities (1981) 132 ITR 207 (Mad);

(vii) Addl. CIT vs. Dr. K. P. Karanth (1983) 139 ITR 479 (AP);

(viii) CIT vs. Automobile Products of India Ltd. (1983) 140 ITR 159 (Bom);

(ix) CIT vs. Late G. D. Naidu & Ors. (1987) 165 ITR 63 (Mad); and

(x) CIT vs. Smt. Lila Ghosh (1994) 205 ITR 9 (Cal).

18.5 Shri Mehta further submitted that the decisions relied upon by the CIT(A) and discussed by him at pp 15-16 of his order are distinguishable on facts from the case of the assessee. According to him, in those cases, compensation was paid in relation to the business asset and not in relation to the capital assets. In the case of the assessee, he pointed out that the compensation has been received on account of injury inflicted on the capital assets, namely, trade mark, use of technical know-how, logo, etc.

19. Shri Singh, the learned Departmental Representative supported the orders of the Revenue authorities. At the very outset, he drew our attention to the stipulations in the technical know-how agreement dt. 22nd June, 1987 (copy at pp 125-142 of the assessee's paper book). He pointed out that Cl. 2 stated that the assessee was granted non-exclusive right to use the technical know-how to manufacture the licenced products. The assessee was also granted non-exclusive right to use, distribute, and sale the licenced products. Shri Singh argued that it is obvious from the stipulations in Cl. 2 that Michelin had the right to grant the above rights to others as well in India as well as outside India. According to him, it is a mere co-incidence that at the material time Michelin had not granted licence to any licencee other than the assessee. Referring to Cls. 4.2, 4.3, 4.4 & 4.5, Shri Singh pointed out that these clause(s) bind the assessee company as also its employees from disclosing the technical know-how received from Michelin. Clause 6 binds the assessee on a number of points and the assessee has been made liable to Michelin for all acts and omissions of the employees of the assessee company. Referring to Cl. 8.2, Shri Singh submitted that it is stipulated therein that the agreement shall automatically terminate if the foreign collaboration agreement is terminated for any reason. He argued that it is evident therefrom that the agreement can be terminated even if there is no failure to provide technical know-how or for any other reason whatsoever. Referring to Cl. 8.6, Shri Singh argued that the licence provided to the assessee is very personal to the persons who owned the company at the time of agreement, as it is stipulated therein that agreement shall terminate in the event of change in ownership or control of licencee. Shri Singh further submitted that Cl. 9.1 had two portions, namely, upon termination of the agreement Michelin shall cease to transfer the technical know-how and all other information and the licencee shall continue to abide by the confidentiality procedure set forth in sub-clause(s) of cl. 4 for two years after termination of the agreement. Shri Singh argued that the stipulation in Cl. 9.1 makes it

abundantly clear that the assessee has no right to disclose technical know-how even after the termination of the agreement for a period of two years. Clause 9.2 binds the assessee even after termination of the agreement from making unauthorised use or disclosure of the technical know-how. Shri Singh argued that Cl. 9.3 provides for payment obligations for breach of agreement by the assessee-company. There is no clause for payment of compensation for breach of agreement by Michelin. Shri Singh pointed out that Cl. 10.1 prohibits the assessee-company to assign, transfer, sub-licence, change or part with any of its rights or obligations under the agreement without prior written consent of the Michelin. Thus, the assessee has no right to sub-licence or change or part with or to transfer or assign any rights under the agreement. According to Shri Singh, from the reading of the agreement as a whole it would be clear that the licence granted to the assessee is personal; it cannot be transferred or disclosed. Further the agreement can be terminated for any reason. It does not provide for any damages to be paid by Michelin to the assessee in any event on failure by them. Under these circumstances, it can easily be deduced that the assessee has not acquired any capital assets. What the agreement has provided is a permission of user of technical know-how for consideration.

19.1 As regards the argument of Shri Mehta that the authorities did not consider items 7, 9 & 13 of the Annexure to foreign collaboration approval annexed to the approval of Govt. of India, Shri Singh submitted that these clauses are general in nature. Clause 9 only provides that the assessee can sub-licence with permission from Michelin and approval by Govt. of India. He argued that the technical know-how agreement in Cl. 2 itself provided that the licence is non-exclusive, which means that the agreement has not made the assessee an exclusive user of technical know-how. It has, therefore, not resulted in acquisition of any capital assets by the assessee.

19.2 Shri Singh further argued that there are numerous decisions wherein it has been held that the assessee does not acquire a capital asset when he enters into an agreement for non-exclusive licence for use of technical know-how for a definite period for consideration paid in lump sum amount or royalty or both. He cited the following decisions :

(i) CIT vs. Tata Engineering & Locomotive Co. (P) Ltd. (1980) 123 ITR 538 (Bom);

(ii) CIT vs. Oblum Electrical Industries (P) Ltd. (1981) 127 ITR 409 (AP);

(iii) CIT vs. T. Maneklal Mfg. Co. Ltd. (1978) 115 ITR 725 (Bom);

(iv) CIT vs. Wyman Gordon (India) Ltd. (1983) 144 ITR 911 (Bom) ; and

(v) CIT vs. National Engineering Industries Ltd. (1991) 190 ITR 525 (Cal).

In support of the proposition that Michelin had not transferred any capital asset to the assessee, reliance was placed on the decision in the case of Rolls-Royce Ltd. vs. Jeffery (Inspector of Taxes) (1965) 56 ITR 580 (HL). Shri Singh stated that the facts of this case are identical to those of the assessee in hand.

19.3 Inviting our attention to settlement agreement dt. 22nd Nov., 1991, Shri Singh submitted that Cls. 1.1, 1.2 and 1.3 contain the conditions binding the assessee after the termination of the agreement. He pointed out that Cl. 1.2 is nothing but reproduction of Cl. 9.1 of the technical know-how agreement dt. 22nd June, 1987, whereby the assessee was bound not to disclose any information to any third party. It is, therefore, clear that the payment of compensation by Michelin was not for non-disclosure of any information to any third party. Clause 1.1 makes it clear that the compensation was paid for the reason that the assessee shall not sue Michelin. Referring to Cl. 1.3 of the settlement agreement, Shri Singh pointed out that Cl. 10.1 of the technical know-how agreement binds the assessee not to assign, transfer, sub-licence, etc. Shri Singh, therefore, vehemently argued that the settlement agreement basically provide for payment of compensation since the agreement did not run through its full duration of eight years. According to him, the impugned compensation was received by the assessee, as the agreement had not run for its full course. It is not for transfer of any capital asset or extinguishment of any right of the assessee. In fact, the assessee has no right. It had only permission to use technical know-how provided by Michelin for consideration. Since there was no right, Shri Singh argued, the question of its transfer or extinguishment thereof does not arise at all. At this stage, he referred to the decision in Vania Silk Mills (P) Ltd. vs. CIT (1991) 191 ITR 647 (SC). In this case, their Lordships held that only those cases of extinguishment of any rights in assets fall within the ambit of s. 2(47) which are on account or as a result of transfer of asset by known means i.e. sale, exchange, etc. Shri Singh submitted that in the case of the assessee in hand, no transfer of capital assets has taken place and, therefore, there is no question of extinguishment of any right.

19.4 Shri Singh further stated that the technical know-how agreement does not provide for any damages to be paid by Michelin on account of premature termination. Since the assessee has obtained non-exclusive licence for consideration for eight years and the agreement has been terminated before it completed its full term, the assessee has a right to sue Michelin for damages/compensation. The right to compensation arises from s. 64 of the Indian Easement Act. This right to sue may belong to assessee but the right is not transferable by virtue of s. 6(e) of Transfer of Properties Act, 1882. Shri Singh submitted that, on the other hand, s. 73 of Indian Contract Act provides for payment of compensation in case of breach of contract by any party to the contract to the party aggrieved. According to Shri Singh, the agreement to provide technical know-how has been terminated for non-performance for the reasons not disclosed to the Department. He argued that as a result of premature termination of agreement, the assessee received compensation. Therefore, what the assessee has received is compensation and not any consideration for transfer of any asset. He submitted that the right to sue is not a transferable right and the assessee has no other right under the agreement except the right to sue and, therefore, the assessee could not transfer any thing.

19.5 Shri Singh further argued that the settlement agreement took place in November, 1991 relevant to the asst. yr. 1992-93. There was, thus, no agreement in existence during the period relevant to the asst. yrs. 1993-94 and 1994-95. Nonetheless, there has been production of tyres and tubes in the factory of the assessee; therefore, after the termination of the agreement, production of the assessee did not suffer. On the contrary, production and sale showed increasing trend in subsequent years. It cannot, therefore, be said that any injury was inflicted on income earning apparatus of the assessee, which is apparent from the result of the assessee's business. He further argued that there is distinction between injury to income earning capital assets and loss in the business. The agreement was terminated w.e.f. November, 1991 but the assessee continued to produce and sale tyres and tubes on its own account after termination of the agreement upto September, 1993. Thereafter the same plant has been used for providing job work to Apollo Tyres i.e. production of tyres and tubes as per specifications given by Apollo Tyres. He, therefore, submitted that it is incorrect to say that there is injury to capital assets or apparatus by which income is earned. It is not so.

19.6 In support of the proposition that if agreement does not run for an agreed period and terminates earlier, the compensation received partakes the character of revenue receipts as it is in lieu of profit that would have been earned, Shri Singh referred the following decisions :

(i) CIT vs. Rai Bahadur Jairam Valji & Ors. (1959) 35 ITR 148 (SC);

(ii) National Steel Works Ltd. vs. CIT (1962) 46 ITR 646 (SC);

(iii) Bush, Beach And Gent Ltd. vs. Road (1940) 8 ITR 36 (KB); and

(iv) CIT vs. South India Pictures Ltd. (1956) 29 ITR 910 (SC).

He also referred to the following two recent decisions :

(i) CIT vs. Oberoi Hotels (India) (P) Ltd. (1994) 209 ITR 732 (Cal); and

(ii) Blue Star Ltd. vs. CIT (1990) 217 ITR 514 (Bom).

19.7 As to the nature of compensation, Shri Singh drew our attention to the report of Arthur Anderson, C. A. available at pages 184 - 195 of the assessee's paper books. He pointed out that in the said report M/s Arthur Anderson estimated the loss arising to the assessee on account of inadequate technical know-how provided by Michelin. They have estimated the loss actually incurred by the assessee upto 31st March, 1991 and thereafter they have estimated the potential loss, which may occur to the assessee. On the basis of sums of loss incurred or likely to be incurred by the assessee, the amount of compensation payable under the termination agreement has been fixed. Shri Singh argued that it is apparent from the above that the compensation received by the assessee is on revenue account and hence the same is a revenue receipt.

19.8 As regards the argument of Shri Mehta that the instalment was received by the assessee on account of restraint of trade, Shri Singh argued that it is a far fetched proposition. He stated that Cl. 1.2 of the settlement agreement provides that the assessee shall not disclose technical information for two years. The assessee was bound by Cl. 9.1 of the technical know-how agreement not to make such disclosure for two years after termination. He, therefore, submitted that the assessee has no right to disclose the technical know-how. He further stated that Cl. 1.3 provides that the assessee agrees not to refer to Michelin or to the word Michelin or any trade name, logo, etc. and also agrees not to refer the technology received in the manufacture, sale, marketing, distribution, etc. of its product. Shri Singh argued that this clause broadly provides that the assessee is prohibited from making/using word Michelin or its trade mark, logo or even the technology received by the assessee in the manufacture, sale etc. of its products. He submitted that the assessee was provided the licence only. Since the licence is terminated, the assessee losses the right to make use of any thing or right provided in that licence. The assessee, therefore, does not have any right to use any word Michelin or to make use of technology received for the manufacture by the assessee. Secondly, Cl. 9.2(b) of the technical know-how agreement provides that the assessee shall not be relieved from any liability arising from licencee's unauthorised use or disclosure of technical know-how. Shri Singh argued that the assessee was bound by the technical know-how agreement itself not to make use of technology or to make disclosure. The assessee, therefore, did not possess any right whatsoever to make use of technology or to disclose technical know-how after the termination. Therefore, in the absence of any right, he argued that, question of exercising restraint by the assessee does not arise. According to him, there is no case of restraint trade involved in Cls. 1.2 & 1.3 of settlement agreement. The aforesaid clauses mention only those points, which were prohibited by the technical know-how agreement. He, therefore, submitted that there is no restraint of trade involved. He took pains to point out that the decision relied upon by Shri Mehta in the case of Dr. K. P. Karanth, Saraswati Publicity and Late G. D. Naidu & Ors. (supra) had no relevance at all to the facts of the assessee's case. In those cases, there was restraint in trade in consideration of which compensation was received whereas in the assessee's case there was no restraint of trade as a result of termination of agreement and, therefore, the aforesaid decisions are not relevant at all.

19.9 Drawing our attention to Cl. 1.4 of the settlement agreement, Shri Singh submitted that the said clause only provides that the amount of U. S. $ 8,00,000 shall be payable latest by 30th Nov., 1992. It does not say that it will not be paid before the said date. He argued that Michelin could have as well paid the amount immediately after 22nd Nov., 1991 i.e. the date of settlement agreement. He argued that the settlement agreement only provides last date for payment and not the first date for payment of this amount. He, therefore, submitted that it is incorrect to say that the said amount had not fallen due in asst. yr. 1992-93. According to Shri Singh, the right to receive the entire compensation amount of US $ 1,91,08,000 had accrued to the assessee on the date of termination of agreement i.e. 22nd Nov., 1991. Clause 1.4 of the settlement agreement gives the payment schedule only. He further submitted that Cl. 1.5 thereof provides the procedure for payment. It does not affect in any way the assessee's right to receive the entire compensation (sic). He pointed out that both the instalments were received by the assessee-company during the period relevant to the asst. yr. 1993-94 but the assessee chose to bifurcate them in asst. yrs. 1992-93 and 1993-94 artificially. However, once the right to receive the entire compensation accrued to the assessee, the entire compensation has to be taxed in the year of accrual i.e. asst. yr. 1992-93 and actual receipt being of no relevance. In support of the above proposition, he relied on the following decisions :

(i) Morvi Industries Ltd. vs. CIT (1971) 82 ITR 835 (SC);

(ii) Rungta Sons Ltd. vs. CIT (1964) 54 ITR 447 (Cal);

(iii) CIT vs. T. N. K. Govindarajulu Chetty (1987) 165 ITR 231 (SC); and

(iv) CIT vs. A. Gajapathy Naidu (1964) 53 ITR 114 (SC).

20. We have carefully considered the rival contentions of the parties and the decisions relied upon by them. We have also perused the material made available to us by the parties. The undisputed facts may be recapitulated. Michelin of France and S. Kumar of Indore had signed a memorandum of understanding on 27/29th Sept., 1985 and had thereafter approached the Govt. of India for approval of foreign collaboration agreement. The Govt. of India accorded approval on 12th June, 1986. Pursuant thereto, foreign collaboration agreement was signed between the parties on 8/15th July, 1986. In furtherance thereof, the parties entered into technical know-how agreement and technical services agreement on 22nd June, 1987. The salient features of the technical know-how agreement have already been set out earlier.

20.1 The Govt. of India had approved the foreign collaboration agreement on three specific conditions, namely, the payment by the assessee of (i) royalty at 3 per cent for a period of five years; (ii) lump sum know-how fee of Rs. 20,00,000; and (iii) eight years duration of the agreement. In consideration of non-exclusive right granted by Michelin to the assessee to use the technical know-how and to manufacture tyres and tubes as also to use, distribute and sale in all countries except France, Spain, Italy and Nygeria the manufactured products. The assessee paid the agreement know-how fee in three equal instalments on 24th Feb., 1987, 29th Sept., 1987 and 19th Oct., 1989. The payment schedule was to be in accordance with the terms of foreign collaboration approval. Accordingly, presumably the first instalment was paid after the foreign collaboration agreement was filed with RBI on 26th Dec., 1996; by 29th Sept., 1987 the Michelin had delivered the technical know-how documents to the assessee and in any case by 19th Oct., 1989 the commercial production had commenced. However, as per the assessee, the commercial production commenced on 4th May, 1988 i.e. in the year of account relevant to the asst. yr. 1989-90.

20.2 It is an admitted position that the royalty payable as per foreign collaboration agreement has not been paid to Michelin, though sums aggregating Rs. 8,38,152 were provided for in the books in asst. yrs. 1989-90 to 1991-92, but ultimately written back in asst. yr. 1992-93.

20.3 The collaboration agreement did not subsist for eight years, as disputes arose between the parties. Eventually settlement was arrived at and a settlement agreement was entered into on 22nd Nov., 1991, whereby Michelin agreed to pay to the assessee the total sums of US $ 1,91,08,000 as follows :

(i) U. S. $ 1,11,08,000 equivalent to Rs. 2,88,51,613 on or before 5th Dec., 1991; and

(ii) The balance US $ 8,00,000 equivalent to Rs. 2,29,50,782 by 30th Nov., 1992 at the latest.

20.4 The controversy before us is two fold, namely, the nature of compensation amounts received by the assessee and the taxability or otherwise thereof in the asst. yr. 1992-93.

20.5 Before we proceed to consider the nature of impugned receipts, it would be better to realise the difficulty in doing so. In CIT vs. South India Pictures Ltd. (supra) their Lordships of the Supreme Court observed that it is well recognised that the problem of discriminating between an income receipt and a capital receipt and between an income disbursement and a capital disbursement is not always easy to solve. Even though the distinction is well recognised and easily applied in general, cases do arise from time to time where the item lies on the border-line and the task of assigning it to income or capital becomes one of much refinement. In that case, the assessee which carried on the business of distribution of films had entered into three agreements for advancing monies to certain motion pictures producers towards the production of films and acquiring the rights of distribution thereof. After the assessee had exploited to certain extent its right of distribution of the films, the agreements were cancelled and the producers paid an aggregate sum of Rs. 26,000 to the assessee towards commission. The Tribunal and the High Court held that the sum was a capital receipt. On appeal to the Supreme Court, their Lordships held that the sum paid to the assessee was not compensation for not carrying on its business but was a sum paid in the ordinary course of business to adjust the relation between the assessee and the producer; the termination of the agreements did not radically or at all affect or alter the structure of assessee's business; the amount received by the assessee was only so received towards commission i.e. as compensation for the loss of commission which it could have earned had the agreements not been terminated; the amount was not received by the assessee as the price of any capital assets sold or surrendered or destroyed but the amount was simply received by the assessee in the course of its going distributing agency business from that going business; that, therefore, the sum was an income receipt.

In CIT vs. Raibahadur Jairam Valji & Ors. (supra) their Lordships observed that in the determination of the question whether a receipt is capital or income, it is not possible to lay down any single test as infallible or any single criterion as decisive. The question must ultimately depend on the facts of the particular case. In this case, their Lordships held that once it is found that a contract was entered into in the ordinary course of business, any compensation received for its termination would be a revenue receipt, irrespective of whether its performance was to consist of a single act or a series of acts spread over a period. Their Lordships further held that payment made in settlement of that contract is an adjustment of the rights under the contract and must be referred to the profits which could be made in the carrying out of that contract. Their Lordships concluded, thus :

> "Generally payments made in settlement of rights under a trading contract are trading receipts and are assessable to revenue. But where a person, who is carrying on business, is prevented from doing so by external authority in exercise of a paramount power and is awarded compensation therefor, whether the receipt is a capital receipt or a revenue receipt will depend upon whether it is compensation for injury inflicted on a capital asset or on a stock in trade."

In Seth Banarsidas Gupta vs. CIT (supra) the assessee and five of his brothers were partners in a firm each having 1/6th share. Two of the brothers D&K leased out their respective shares to the assessee on an annual payment but the leases were cancelled, D & K each undertaking to pay the assessee certain amounts for five years. On these facts, their Lordships held that amounts received by the assessee from D & K constituted taxable income as those amounts received under a compromise or by amicable arrangement were in the nature of profits to be received by the assessee for the interest held in the business. In CIT vs. Oberoi Hotels (India) (P) Ltd. (supra), their Lordships held that where a contract is entered into in the ordinary course of business, such a contract is part of the business itself and any receipt on account of termination of such a contract can only be a trading receipt. In Blue Star Ltd. vs. CIT (supra), their Lordships held, thus :

> "The question whether a particular income arising from determination of a contract is a capital receipt or revenue receipt is a difficult question to answer. Where, on a consideration of the circumstances, a payment is made to compensate a person for cancellation of a contract, which does not affect the trading structure of the recipient's business nor deprive the recipient of what in substance is the source of income, termination of the contract being a normal incident of the business and such cancellation leaving the recipient of the amount free to carry on its trade, the receipt is revenue. However, where by a cancellation of agency, the trade structure of the assessee is impaired or such cancellation results in the loss of what may be recorded as the source of the assessee's income, payment made to compensate for such cancellation of agency is normally a capital receipt."

20.6 Let us analyse the case of the assessee before us in the light of the principles of law enunciated in the decisions (supra). It has been contended by Shri Mehta that by obtaining exclusive licence for manufacture of two wheeler tyres and tubes in India and having permission to use the trade name of the collaborator, the assessee company had acquired a capital asset of an enduring nature. We are afraid, we are unable to accept this contention. Perusal of the memorandum of understanding and the technical know-how agreement entered into by the parties would reveal that the foreign collaborator had granted to the assessee non-exclusive right to use the technical know-how to manufacture tyres and tubes. The foreign collaborators had also granted non-exclusive right to use, distribute and sale the manufactured products. There is nothing in the approval letter of the Govt. of India to indicate that the assessee was granted exclusive licence. In consideration of the non-exclusive licence granted by Michelin, the assessee had to pay lump sum of Rs. 20 lakhs in three equal instalments and a recurring royalty on annual basis for five years @ 3 per cent of the net sales. The assessee had also agreed to hold in strict confidence of technical know-how and had undertaken to prevent unauthorised disclosure by its employees of the technical know-how either within its organisation or outside. The assessee was also forbidden to apply for patents on technical know-how or technical services either in India or elsewhere. The agreement was to run for eight years w.e.f. 26th Dec., 1986 but it could be terminated in the event of termination of the foreign collaboration agreement for any reason. The agreement was liable to be terminated in the event of change in the ownership or control of the assessee company. For two years after the termination of the agreement. The assessee had to abide by the confidentiality procedure set forth in Cl. 4 of the agreement. The assessee was also prohibited from assigning, transferring, sub-licencing, changing or parting with any of its rights or obligations under the agreement without the prior written consent of Michelin. All these stipulations in the technical know-how agreement go to indicate that the assessee was a mere licencee for a limited period of eight years of the technical know-how of Michelin with the right to use the patents and trade marks of Michelin. Michelin had not parted with any asset by making the technical know-how available to the assessee. We are, therefore, of the view that the assessee did not acquire any capital asset or advantage of an enduring nature. In the case of Tata Engg. & Locomotive Co. (P) Ltd. (supra), their Lordships of Bombay High Court held, thus :

> "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 decisions relied upon by Shri Singh, the learned Departmental Representative support the above view.

20.7 Shri Mehta, the learned counsel for the assessee, had also contended that the amount of Rs. 2,88,51,613 constituted capital receipt as it had been received on extinguishment of right to receive the technical know-how. According to him, since the compensation was received in full and final settlement of the assessee's rights and claims, there is an extinguishment of rights so that a transfer within the meaning of s. 2(47) of the Act had taken place. Hence, the compensation was an item of capital gains. The contention of Shri Mehta cannot be accepted. Under s. 45 of the Act, capital gains tax is attracted on profits or gains which arise from the transfer of capital asset. As per s. 2(47) of the Act, transfer in relation to a capital asset made, inter alia, be brought about by the extinguishment of the rights therein. As stated earlier, technical know-how does not constitute a capital asset as held in Tata Engg. & Locomotive Co. (P) Ltd. (supra), unless the capital asset exists, if fact, there cannot be a transfer of it. In the case of Vania Silk Mills (P) Ltd. (supra), their Lordships of the Supreme Court have held that whatever the mode by which transfer is brought about, the existence of the capital asset during the process of transfer is a pre-condition. Their Lordships further observed as under :

> "Since associated words and expressions like 'sale', 'exchange', etc., used in the definition of 'transfer' in s. 2(47), imply the existence of the asset and of the transferee according to the rule of noscitur a sociis, the expression 'extinguishment of any rights' would take colour from those associated words and expressions and will have to be restricted to the sense analogous to them. If the legislature had intended to extend the definition to any extinguishment of right, it would not have included the obvious instances of transfer, viz., sale, exchange, etc. Hence, the expression 'extinguishment of any rights therein' will have to be confined to the extinguishment

> of rights on account of transfer and cannot be extended to mean any extinguishment of right independent of or otherwise than on account of transfer."

In the light of the decision (supra), it is held that there was no transfer of capital asset within the meaning of s. 2(47) of the Act on extinguishment of rights therein. We are, therefore, unable to accept the opinion of Shri Bansi S. Mehta, C. A. The CIT(A) has rightly held that the decisions in Tata Engg. & Locomotive Co. (P) Ltd. and Sterling Investment Corpn. (supra) did not render any assistance to the assessee, as in the assessee's case the assessee's right to receive technology was never refused by Michelin. We find force in the argument of Shri Singh that as the agreement had been terminated before it completed its full term, the assessee had right to sue Michelin for compensation, which might arise (sic) to the assessee from s. 64 of the Indian Easement Act. He had argued that though the assessee had right to sue Michelin but the said right is not transferrable by virtue of s. 6(e) of Transfer of Properties Act, 1882. There was no rebuttal on the above arguments from the side of the assessee. As a matter of fact, the assessee had received compensation consequent to premature termination of the agreements, which was also in accordance with the provisions of s. 73 of the Indian Contract Act. The said section stipulates payment of compensation on breach of contract by any party to the party aggrieved. We, therefore, reject the contention raised on behalf of the assessee that the compensation was received for extinguishment of any rights or transfer of any capital assets.

20.8 It is an admitted position that the assessee had utilised its capital asset, namely, plant and machinery etc. for the production of tyres and tubes after the termination of agreement(s). The Revenue has brought on record material to demonstrate that production and sale of tyres and tubes in the asst. yrs. 1993-94 and 1994-95 had not declined. The technical know-how agreement concerned the method of production and the assessee had switched on to its own production after the termination of the agreement. This amply proved that no injury to the income earning apparatus, namely, capital assets had been inflicted by the termination of the agreement. As argued by Shri Mehta, the ld. counsel for the assessee. Shri Singh, the learned Departmental Representative has vehemently argued that the business loss suffered by the assessee is not attributable to any injury to the capital asset of the assessee.

There could be other reasons, like, adverse market conditions for the business loss without affecting the assessee's capital assets, namely, plant & machinery. This argument of Shri Singh, the learned Departmental Representative remained uncontroverted.

20.9 Study of the report of Arthur Anderson, C. A. (copy at pp. 184-195 of the assessee's compilation) would go to reveal that the amount of compensation was fixed to compensate the estimated loss actually accrued upto 31st March, 1991 and thereafter as also potential loss which may arise to the assessee. The compensation received is, therefore, on revenue account. In Raibahadur Jiram Valji (supra), their Lordships of the apex Court have held that the payment made in settlement of rights under a trade contract is trading receipt and is assessable to revenue. As stated earlier, the compensation in the case of the assessee has not been received for injury inflicted on a capital asset. The ratios of decisions in Oberoi Hotels (India) (P(Ltd. and Blue Star Ltd. (supra) also support the Revenue's stand that compensation received on account of termination of agreement is revenue receipt provided there is no injury to the capital asset. Having regard to the facts of the assessee's case in hand, we hold that the impugned receipts are revenue receipts. These are capital receipts and the decisions in Bombay Burmah Trading Corpn. and Barium Chemicals Co. (supra) relied upon by Shri Mehta do not advance the case of the assessee, as those decisions are distinguishable on facts. Shri Mehta has also argued that the second instalment of Rs. 2,29 crores is not taxable, as it was received in restraint of trade, which is obvious from para (b) of letter dt. 10th June, 1992 of Clifford Chance. Support was derived from certain decisions referred to earlier. We have minutely gone through the settlement agreement dt. 22nd Nov., 1991 as also the letter dt. 10th June, 1992 of Clifford Chance. It is observed therefrom that Cls. 1.2 and 1.3 of settlement agreement reiterate the same stipulations which were contained in the original licence agreement. Clause 9.1 of the technical know-how agreement had provided that for two years after termination of the agreement, the assessee shall continue to abide by the confidentiality procedure set forth therein. Same stipulation is contained in Cl. 1.2 of the settlement agreement whereby the assessee agreed not to disclose the technical information to any third party for a period of two years after the termination of the agreement. By no stretch of imagination, it can be said that the impugned amount of Rs. 2,29 crores i.e. the second instalment was for non-disclosure of technical information to any third party for two years after the termination of the technical know-how agreement. Perusal of Cl. 10.1 of the technical know-how agreement would show that the agreement was personal to the licencee who agreed not to assign, transfer, sub-licence, change or part with any of its rights or obligations without the prior written consent of Michelin. This is what is stipulated in Cl. 1.3 of the settlement agreement. We, therefore, reject the contention of Shri Mehta that the Cls. 1.2 & 1.3 of the settlement agreement put restraint of trade upon the assessee consequent to which the amount in question was received. In our opinion, there is nothing in the settlement agreement which prohibits the assessee from manufacture of tyres and tubes nor there is any restriction on sale thereof. As stated earlier, the assessee was only provided the licence to use the technical know-how. The assessee has also not been prohibited to carry on any other activity. Appraisal of the documents in question lead us to the irresistible conclusion that the entire compensation was received by the assessee on account of the fact that the agreement could not run its full duration of eight years and had to be terminated in between. We, therefore, reject the contention of Shri Mehta that there was any restraint of trade by virtue of which the assessee had received the compensation amount in question. We have gone through the decisions relied upon by Shri Mehta. None of the decisions is relevant, as in those cases there was restraint in trade by the first party to the agreement and in consideration thereof the amounts had been received. In the case before us, no restraint in trade was imposed by Michelin and the impugned amount was not received in consideration of restraint in trade. The decision in Smt. Lila Ghosh (supra) relied upon by Shri Mehta is altogether on a different issue.

20.10. From the aforesaid discussion, we conclude that the entire compensation of Rs. 5,18,02,396 constituted revenue receipt and is liable to be assessed as such. We now proceed to consider the year of taxability of the said amount of compensation. There is no dispute as to the year of taxability of the first installment of compensation of Rs. 2,88,51,613. The assessee had itself credited the above amount to its profit and loss account of the previous year relevant to the asst. yr. 1992-93. The dispute in this regard relates to the second instalment of compensation of Rs. 2,29,50,782. We have to again turn to the settlement agreement dt. 22nd Nov., 1991. Clause 1.4 (a)(ii) provided for payment of US $ 8,00,000 by Michelin by 30th Nov., 1992 at the latest. Shri Mehta, the learned counsel for the assessee, has argued that the date 30th Nov., 1992 falls in the account year relevant to the asst. yr. 1993-94 and has, therefore, been credited to the P&L a/c under the head 'miscellaneous receipt' relevant to the asst. yr. 1993-94. A close look to Cl. 1.4 would reveal that consequent to the settlement agreement dt. 22nd Nov., 1991. Michelin had agreed to pay to the assessee total sum of US $ 1,91,08,000. It is, therefore, obvious that the right to receive the entire compensation of US $ 1,91,08,000 accrued to the assessee on 22nd Nov., 1991 i.e. the date of settlement agreement, which date falls in the account year relevant to asst. yr. 1992-93. It is an admitted position that the assessee is following mercantile system of accounting. If that be so, the credit entries have to be made in respect of amounts due immediately they become legally due and before they are actually received. As stated earlier, the entire compensation amount of US $ 1,91,08,000 had become legally due on 22nd Nov., 1991 i.e. the date of settlement agreement and, therefore, the entire compensation is taxable in the asst. yr. 1992-93 irrespective of fact that the second instalment was received in the subsequent assessment year. The decisions relied upon by the Revenue support the above view. We have perused the decision in H. S. Sivarudrappa and A. S. Builders (P) Ltd. (supra) relied upon by Shri Mehta. These decisions do not render any assistance to the assessee in view of the principles of law enunciated by the apex Court in the decisions relied upon by the Revenue. As stated earlier. in the assessee's case the entire compensation had fallen due to the assessee on the date of settlement agreement, which falls in the asst. yr. 1992-93. We, therefore, hold that the Revenue is justified in bringing to tax the amount of US $ 8,00,000 equivalent to Rs. 2,29,50,782 in the asst. yr. 1992-93. Ground No. I of the assessee is, accordingly, decided against it.

21. Ground No. II relates to the power subsidy of Rs. 4,66,116 received by the assessee in the year of account. The Revenue has treated the said power subsidy as revenue receipt and reliance has been placed on the decision in Panyam Cement & Mineral Industries vs. CIT (1979) 117 ITR 770 (AP). Aggrieved, the assessee is before us.

22. The learned representatives of the parties have brought to our notice that the issue is covered in favour of the assessee by the decision of Indore Bench of the Tribunal in Kashyap Sweetners (P) Ltd. vs. Dy. CIT in ITA No. 704/Ind/94 dt 25th Jan., 1995 for the asst. yr. 1991-92. Following, with respect, the decision (supra), we decide this ground in favour of the assessee.

23. Ground No. III relates to disallowance out of entertainment expenses account. The AO found that the assessee had claimed expenses on refreshment to staff at Rs. 1,10,720 and on sales promotion at Rs. 89,117. He was of the view that the expenses debited under the head 'sales promotion' were of entertainment in nature incurred on providing refreshment etc. to the customers and part of the refreshment to staff was attributable to entertainment. He estimated the entertainment expenses at Rs. 50,000 and after allowing Rs. 5,000 added Rs. 45,000 to the income of the assessee. On appeal, the CIT(A) opined that the disallowance was short computed by Rs. 11,608. He, therefore, enhanced the disallowance by Rs. 11,608 Aggrieved, the assessee is before us.

24. Shri Mehta invited our attention to the details of refreshment to staff and of sales promotion appearing at pp 20 & 44 of the paper book respectively. He submitted that sales promotion expenses

were inclusive of presentation articles worth Rs. 69,703 which did not bear the logo of the company. Relying on the decisions in the case of CIT vs. Indian Aluminum Cables Ltd. (1990) 183 ITR 611 (Del) and in the case of CIT vs. Allana Sons (P) Ltd. (1995) 216 ITR 690 (Bom), he submitted that no disallowance out of above expenditure is justified, as those articles did not have any advertisement value. In the alternative, he submitted that the disallowance out of the expenditure on presentation articles on estimate by the CIT(A) is excessive. Shri Singh, the learned Departmental Representative on the other hand, supported the order of the CIT(A).

25. We have considered the rival submissions and perused the orders of the Revenue authorities as also the documents placed before us. We noticed that out of total claim of Rs. 1,10,720 under the head 'refreshment to staff' Rs. 88,229 represented subsidy provided by the assessee for lunch and tea to the staff. Another sum of Rs. 17,881 was claimed to have been spent on providing tea to the staff of the Company's Depots at Madras, Hyderabad, Bangalore and Nagpur. In view of Expln. 2 below s. 37(2A), no amount can be disallowed out of the above expenses as these would be beyond the ambit of entertainment expenditure, as the same were incurred on providing food and tea etc. by the assessee to its employees at the works site. We, however, noticed that do details of Rs. 4,610 have been placed on record by the assessee. Likewise, there is no detail of Depot expenses of Rs. 6,817 debited to the sales promotion expenses account. The expenditure aggregating Rs. 12,597 on meeting hotel bills is undoubtedly of the nature of entertainment expenses. We, therefore, held that the entertainment expenses aggregated Rs. 24,024 (Rs. 4,610 + Rs. 12,597 + Rs. 6,817) out of which Rs. 5,000 may be allowed under s. 37(2A) and the disallowance be restricted to the balance amount.

The expenditure on presentation of gift articles aggregating Rs. 69,703 has been treated by the Revenue as entertainment expenditure. The claim of the assessee is that these presentation articles were presented on occasions of festivals etc. to customers and dealers and were in the nature of sales promotion. We find force in the argument of Shri Mehta that in the absence of there being logo of the company of the presentation articles, this cannot be taken as having any advertisement value either. Having regard to the decisions (supra) relied upon by Shri Mehta, we are of the view that no disallowance is justified out of the claim of Rs. 69,703 (Rs. 13,200 + Rs. 56,503) claimed under the head 'sales promotion'. We, therefore, set aside the order of the CIT(A) on the point and direct the AO to modify the assessment in the light of our observations above. We order accordingly.

26. Ground No. IV relates to disallowance out of legal expenses account. The AO had disallowed sums of Rs. 2,52,160 and Rs. 2,70,353 paid to M/s Little & Co. as also Rs. 15,000 paid to M/s Arthur Andersen & Associates on the ground that no details of services rendered were furnished. The disallowance has been confirmed by CIT(A). Aggrieved, the assessee is before us.

27. Shri Mehta submitted that Little & Co. had negotiated settlement agreement with Michelin at Bombay, Paris & Hongkong and the payments to them had been made for services rendered by them. He invited our attention to a letter dt. 20th Jan., 1991 from Little & Co. (copy at p. 56 of the paper book), whereby Little & Co. agreed to advise and represent the assessee in the matter pertaining to the dispute with Michelin. He also invited out attention to their two bills (copies at pp 57-58 of the paper book). Shri Mehta contended that the expenses were incurred for the purposes of business and, therefore, the disallowance is unjustified. In the alternative, he submitted that the

above two bills were inclusive of Rs. 1,24,750 and Rs. 1,48,750 towards professional services rendered by Little & Co. and, therefore, the disallowance can at best be restricted to the aforesaid sums in the two bills for lack of information. He also agreed that the bill of Rs. 15,000 of Arthur Andersen dt. 31st March, 1992 is not available with the assessee. Shri Singh, on the other hand, submitted that the details of professional services rendered by Little & Co. have not been filed before the AO/CIT(A). The bills do not specify the kind of professional services rendered. He argued that unless the nature of services is known, it is difficult to state whether the expenditure is revenue or capital in nature. He also argued that the expenditure cannot be allowed merely because the payment has been made. The onus lay on the assessee to prove that the expenditure has been made for the purposes of business and is of revenue nature. He also submitted that the details of travelling expenses on foreign trip of the partner of Little & Co. now submitted before the Tribunal needed verification by the Revenue authorities. Moreover, travelling expenses cannot prove the nature of professional services rendered. He, therefore, submitted that the disallowance is justified.

28. We have considered the rival submissions. We observe that the nature of professional services rendered by Little & Co. of Bombay and details thereof have not been brought on record by the assessee. Similarly, there is no evidence regarding the purpose for which the payment of Rs. 15,000 was made to Arthur Andersen, as for want of the bill the same is not ascertainable. We, therefore, restrict the disallowance aggregating Rs. 2,88,500 (Rs. 1,24,750 + Rs. 1,48,750 + Rs. 15,000). The order of the CIT(A) is modified to this extent. Regarding the balance claim on air ticket and hotel expenses of one of the partners of Little & Co., in support of which certain debit vouchers have been filed before us, we are of the view that in the interest of justice it would be fair to remit the case to the AO for the purpose of necessary verification as to the allowability or otherwise of the same. The assessee shall produce necessary evidence before the AO along with justification for allowability of the expenses on air ticket and hotel expenses etc. claimed in respect of one of the partners of Little & Co. which are included in valuation and verification fee account. The AO shall consider and decide the allowability or otherwise of this claim on merits after allowing reasonable opportunity of being heard to the assessee. We order accordingly.

29. Ground No. V relates to disallowance of Rs. 71,808 on account of shrinkage in textile divisions. From the quantitative details filed, the AO noticed that the assessee had claimed shrinkage of 5860.60 mtrs. in cotton textile and of 281.35 mtrs. in shirting. Since there was no co-relation between the purchases and shortages or between sales and shortages, he negatived the assessee's claim, which resulted in the impugned disallowance. The assessee appealed.

30. Before the CIT(A), it was contended that the assessee purchased grey cloth which has to be first dipped into water and thereafter processing is done. It was pointed out that shrinkage occurs at the time of dipping of grey cloth in water. It was also submitted that the assessee had unprocessed opening stock of suitings and shirtings. Hence, there could not be any co-relation between shrinkage and purchases on month to month basis. It was also stated that shrinkage was about 2 per cent only which could not be considered as excessive. The submissions of the assessee did not find favour with the CIT(A), who confirmed the disallowance with the observation that the assessee had no record of processing and no evidence was brought on record in support of the claim that opening stock consisted of unprocessed grey cloth. The assessee is aggrieved.

31. We have heard the learned representative of the parties. It is not in dispute that the assessee purchases grey cloth which after dipping in water is processed. If grey cloth is dipped in water, some shrinkage is inevitable. However, we find that the assessee has not maintained full and complete record as to how much grey cloth was dipped in water monthwise and how much shrinkage had occurred. Keeping in view the over all facts and circumstances of the case, in our opinion, it would be reasonable to allow shortage @ 1 per cent. The AO is directed to work out the disallowable shortage on this basis and modify the assessment accordingly.

32. Ground No. VI relates to publicity expenses. The assessee had incurred publicity expenses at Rs. 21,26,328 in asst. yr. 1989-90. In that year, instead of claiming the entire expenditure on revenue account, the assessee divided the entire expenditure in five years and claimed an expenditure of Rs. 3,84,485 on pro rata basis in asst. yr. 1989-90. The same was allowed. In the year of account, the assessee claimed Rs. 12,40,356 for the first 11 months and capitalised the same. It claimed further amount of Rs. 35,438 for the last month. The AO held the view that proportionate amount on prorata basis can only be allowed. This amount worked out to Rs. 4,25,265. It resulted in disallowance of Rs. 8,50,530. The assessee carried the matter in appeal.

33. It was contended before the CIT(A) that the AO having treated that there was regular business of tyre for the whole year, he ought to have allowed the entire amount, which was capitalised during the year, as the genuineness of such expenses is not doubted. It was further contended that, in fact, the entire expenditure other<+> than the amount allowed in asst. yr. 1989-90 should have been allowed in the asst. yr. 1992-93. It was further submitted that the assessee has been assessed on loss figure upto the asst. yr. 1991-92 and, therefore, relying on the decision in CIT vs. Rajendra Trading Co. (P) Ltd. (1984) 146 ITR 637 (Cal) and CIT vs. C. M. Rajgarahia (1980) 121 ITR 778 (Pat), it was submitted that further deduction of Rs. 12,81,133 ought to have been allowed. The contentions of the assessee were not acceptable to the CIT(A). He observed that the assessee had incurred entire expenditure of Rs. 21,26,323 in the asst. yr. 1989-90 but the assessee instead of claiming the deduction of the entire sum claimed deduction of Rs. 3,84,486 on pro rata basis in asst. yr. 1989-90. Accordingly, the assessee should have preferred the claim in the asst. yrs. 1990-91 and 1991-92 on pro rata basis. This was not done. He opined that strictly speaking even the amount of Rs. 4,25,265 should not have been allowed, as the expenditure had been incurred in an earlier year and there is no scheme of deferred revenue expenditure in the IT Act. According to him, the decisions relied upon by the assessee were not on the point at issue. Aggrieved, the assessee is before us.

34. Shri Mehta submitted that whenever a new product comes into the market, massive expenditure on advertisement is incurred and the same is claimed as deferred revenue expenditure usually in five years. It was for this reason that in the asst. yr. 1989-90, the assessee had claimed only 1/5th of the entire publicity expenditure. Accordingly to him, even if the entire claim was made in asst. yr. 1989-90, it would have resulted in carry forward of higher amount of losses. In support of the proposition that deferred revenue expenditure is allowable on proportionate basis, he relied on the decision in the case of Saurashtra Cement & Chemical Industries Ltd. vs. CIT (1995) 213 ITR 523 (Guj), besides the decisions (supra) referred to before the CIT(A). He, therefore, submitted that the publicity expenses be allowed in full, as the AO was not justified in allowing the claim on pro rata basis. Shri Singh, the learned Departmental Representative on the other hand, submitted that there

is no scheme of deferred revenue expenditure in the Act. The assessee chose to follow such a scheme and, therefore, the AO has rightly allowed the expenditure for 12 months on pro rata basis.

35. We have considered the rival submissions as also perused the decisions relied upon by Shri Mehta. It is not in dispute that no amount on publicity was incurred in the asst. yr. 1992-93 presently under consideration. The stand of the Revenue that there is no scheme of deferred revenue expenditure in the Act could not be controverted by Shri Mehta with cogent reasons and specific provisions in the Act. Nonetheless the Revenue has allowed the expenditure on pro rata basis, as per the scheme followed by the assessee itself in the year of account<+>the AO could not, however, allow the expenditure on pro rata basis and rightly so pertaining to the asst. yr. 1990-91 and 1991-92 in the year of account. We, therefore, reject the contentions of Shri Mehta, as we find that the decision relied upon by him do not render any assistance to the assessee in the matter.

36. Ground No. VII relates to the deduction under s. 80HH & 80-I of the Act. No claim was made in the return which disclosed loss. Since the loss claimed by the assessee was converted into assessment of total income on positive figure, it was claimed before the CIT(A) that the AO ought to have allowed deductions under s. 80HH & 80-I. The claim has been negatived by the CIT(A) on the ground that the deductions under the aforesaid sections as amended is admissible if the profits and gains are derived from an industrial undertaking. But in the case of the assessee, the total income has been computed on positive figure as a result of inclusion of an amount of Rs. 5,18,02,396 received from Michelin. Such income cannot be said to have been derived from an industrial undertaking. In support of his view, the CIT(A) relied upon certain decisions. Being aggrieved, the assessee is before us.

37. Relying on note 1 below statement of total income to the effect that the return is subject to all other claims allowable as per law, Shri Mehta argued that on the basis of the above note the AO should have allowed deductions under ss. 80HH & 80-I once the loss returned was converted into positive total income. He further submitted that the amount of Rs. 5.18 crores is directly related to the assessee's business. Hence, the assessee is entitled to deduction under the aforesaid sections on income that may be finally determined. Shri Singh, the learned Departmental Representative supported the order of the CIT(A).

38. We have considered the rival submissions. In our opinion the stand of the assessee cannot be accepted. In the case of CIT vs. Eastern Seafoods Exports (P) Ltd. (1995) 215 ITR 64 (Mad), their Lordships of Madras High Court have considered the import of the expression "derived from" and have held, thus :

> "Profit or gain can be said to have been derived from an activity carried on by a person only if the said activity is the immediate and effective source of the said profit or gain. There must be a direct nexus between the activity and the earning of the profit or gain."

Their Lordships went on to add "the income, profit or gain cannot be said to have been derived from an activity merely by reason of the fact that the said activity may have held to earn the said income or profit in an indirect or remote manner." In the light of the above decision, we are of the view that the CIT(A) is correct in holding that as per amended provisions only profits and gains which are directly derived from an industrial activity are entitled to deductions under ss. 80HH & 80-I and not those which may just be related thereto. In the case of the assessee, the compensation amount of Rs. 5.18 crores cannot be said to be income derived from an industrial activity. We, therefore, reject this ground of the assessee.

39. Ground No. VIII has not been pressed. It is dismissed as not pressed.

40. Ground No. IX relates to denial of set off of unabsorbed business loss and un-absorbed depreciation of asst. yrs. 1990-91 and 1991-92 against the income of the assessment year under consideration. It was noticed that the assessee had not shown business losses in the returns of the preceding two years. The Revenue, therefore, negatived the assessee's claim on the ground that for claiming set off of business loss, a return of income declaring such losses should be filed timely and thereafter such loss should be determined and that there is no provision for determination of such loss in a subsequent year when there is surplus of income and set off is possible. Support was derived from the case of CIT vs. Dalmia Cement (Bharat) Ltd. (1995) 216 ITR 79 (SC), Jai Drinks (P) Ltd. vs. CIT (1995) 82 Taxman 279 and CIT vs. Shri Someshwar Sahkari Sakhar Karkhana Ltd. (1989) 177 ITR 443 (SC). Aggrieved, the assessee is before us.

41. Shri Mehta argued that the AO should have computed those losses which the assessee may have incurred in the asst. yrs. 1990-91 and 1991-92 and should have allowed set off of such determined losses against the income of the asst. yr. 1992-93. For this proposition, reliance was placed on the decision in CIT vs. Manmohandas (1966) 59 ITR 699 (SC). He carried us through the decisions in Dalmia Cement (Bharat) Ltd. (supra) and submitted that it will help the assessee, as the assessee is still in appeal before the CIT(A) for the earlier asst. yrs. 1990-91 and 1991-92. In oppugnation, Shri Singh, the learned Departmental Representative submitted that their Lordships of the Supreme Court have held in Dalmia Cement (Bharat) Ltd. (supra) that the assessee cannot claim in assessment proceedings for a subsequent year that losses in the earlier years should be determined carried forward and set off against the profits in the subsequent year. Accordingly to him, the decision relied upon by the assessee no longer holds good, as the controversy under the old Act cannot arise under the IT Act, 1961. He invited our attention to the observation of the apex Court at p. 101 of 216 ITR, wherein their Lordships observed that under the present Act, s. 143(3) requires the AO to determine the loss, if there is any and that the assessee has a right to appeal under s. 246(a) of the Act. He argued that under the new Act, the determination of loss has to be in the assessment year itself. The successor AO has now no authority to determine the loss in any earlier year as was held in the case of CIT vs. Manmohandas (supra). He submitted that in the asst. yrs. 1990-91 and 1991-92 there was no claim of loss and losses were not determined in those years. Loss, if any, of the asst. yrs. 1990-91 and 1991-92 cannot be determined in the asst. yr. 1992-93. He submitted that if the assessee had forgiven its claim in the asst. yrs. 1990-91 and 1991-92 deliberately, the same cannot be revived merely because there is positive income in the asst. yr. 1992-93.

42. We have considered the rival submissions. It is not in dispute that in asst. yr. 1989-90, return was filed by the assessee declaring business loss and claiming depreciation an investment allowance. Claims of the assessee were allowed by the AO. It is in this backdrop that the AO has allowed set off of unabsorbed depreciation and unabsorbed investment allowance of the asst. yr. 1989-90 against the income of the asst. yr. 1992-93. We noticed that in the asst. yrs. 1990-91 and 1991-92, the assessee gave a note below the statement of total income that net working of the tyre division has been shown as work in progress to be eventually capitalised and depreciation is not being claimed. It is, therefore, obvious that the assessee had taken a conscious decisions not to claim loss and depreciation in the above two years. In asst. yr. 1992-93, the assessee claimed that the losses of the asst. yr. 1990-91, 1991-92 and loss of asst. yrs. 1992-93 upto 28th Feb., 1992 have been capitalised and depreciation has been claimed. Note No. 3 below statement of total income refers (sic). We observe that the above claim was negatived by the AO and the depreciation on capitalisation was also disallowed. We find that before the CIT(A), the assessee accepted the action of the AO and did not press the appeal before the CIT(A) on the point relating to this issue. Since the AO computed the profit or loss of the entire year in the asst. yr. 1992-93 on the ground that the business had already commenced in the asst. yr. 1989-90, the assessee contended before the CIT(A) that the loss of asst. yrs. 1990-91 and 1991-92 which had not been claimed by the assessee in those years be allowed to be set off against the profits of the asst. yr.. 1992-93. This submission has not been accepted by the CIT(A). We are in agreement with the reasons recorded by him. We, therefore, decline to interfere with his decision on the profit and reject this ground of the assessee as well.

43. Ground No. X relates to the additional ground, which has already been dealt with.

44. In the result, the appeal is partly allowed.