Commissioner Of Income-Tax vs Hindusthan Motors Ltd. on 23 February, 1990

Equivalent citations: [1991]192ITR619(CAL)

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Bench: Suhas Chandra Sen

JUDGMENT

Suhas Chandra Sen, J.

1. The following questions of law have been referred to this court by the Tribunal under Section 256(1) of the Income-tax Act, 1961 :

2. R.A. No. 683 (Cat) of 1984 "1. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that royalty and commission payments to various foreign companies were in the nature of revenue expenses and that they should be allowed as business expenditure ?

2. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that the commission and brokerage paid to agents were not in the nature of sales promotion expenses and, therefore, not disallowable under Section 37(3A) of the Income-tax Act, 1961 ?"

3. R. A. No. 684 (Cal) of 1984 :

> "1. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that royalty and commission payments to various foreign companies were in the nature of revenue expenses and that they should be allowed as business expenditure ?
>
> 2. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in deleting the disallowance made by the Income-tax Officer under Section 40A(5) of the Income-tax Act, 1961 ?"

4. R. A. No. 685 (Cal) of 1984 :

> "1. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that royalty and commission payments to

various foreign companies were in the nature of revenue expenses and that they should be allowed as business expenditure ?

2, Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in deleting the disallowance made by the Income-tax Officer under Section 40A(5) of the Income-tax Act, 1961 ?"

5. R. A. No. 686 (Cal) of 1984 :

"1. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that royalty and commission payments to various foreign companies were in the nature of revenue expenses and that they should be allowed as business expenditure ?

2. Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that commission and brokerage paid to agents were not in the nature of sales promotion expenses and therefore, not disallowances under Section 37(3A) of the Income-tax Act, 1961 ?"

6. The assessment years involved are the assessment years 1976-77 to 1979-80 for which the relevant accounting periods are the financial years 1975-76,1976-77, 1977-78 and 1978-79, respectively.

7. The Tribunal has stated that the first question is common for all the assessment years under consideration.

8. The Tribunal, has recorded the following facts in the statement of case :

9. The point involved related to the disallowance of payment of royalty and technical fees paid to the foreign concerns by the assessee. The Income-tax Officer noted in the assessment order for the assessment year 1976-77 that the assessee claimed deduction of Rs. 45,35,912 as royalty and technical fees paid to the foreign parties. The Income-tax Officer noted the different amounts paid during the earlier years and the amounts debited during the year to those four foreign companies. He examined the agreement made between the assessee and M/s. General Motors Corporation which was in respect of setting up a factory at Madras by providing technical knowledge and services for the manufacture of rear dump, scraper, front-end loader, etc. He pointed out that the foreign company would supply without charge, a reproducible copy of layout, detail and assembly drawings, specification, etc., and other items of technical information and know-how in order to enable the assessee to carry out the Euclid manufacturing programme. He also noted that, for the additional copies of the technical information, the assessee was charged by the foreign company at standard rates for such supply. He also pointed out that there was a provision for sending foreign technicians to the assessee for assisting in the work and that apart, he noted that the assessee was granted the right to use the technical information and know-how for the purpose of the above programme and that the assessee was also granted licence, to manufacture, use and to sell such components and, in

consideration, the assessee was to pay licence fee at 61/2 per cent. of the net sale price to the foreign company.

10. The Income-tax Officer pointed out that the agreement covered a fairly long period of 12 years, after which the assessee would have the property in the information, specification and technique provided by the foreign company and it can exploit the same indefinitely without payment of further consideration.

11. The Income-tax Officer found that the assessee had set up a huge plant near Madras several years ago with a capital outlay exceeding Rs. 2 crores for the manufacture of Euclid products and that the assessee was not required to pay a lump sum for all the rights and advantages in this respect and the payments were to be made on a periodical basis depending on production and sale of the articles. According to the Income-tax Officer, the assessee had obtained a not easily available or readily acquirable information and know-how without any initial payment in an area in which the assessee had no knowledge or skill or ability and obtained the right to use the same even after expiry of the agreement. He, therefore, inferred that, by incurring the above expenditure on licence fee, the assessee had acquired an asset or advantage of enduring benefit and, therefore, such expenditure was in the nature of capital.

12. The Income-tax Officer pointed out that the other collaboration agreement was entered into between the assessee and Messrs. Marion Power Shovel Co, under which the assessee was allowed an exclusive right to manufacture 93-M Crawler-mounted diesel-powered excavator, etc. He found that the agreement was envisaged for a fairly long period. On the reasons noted earlier, the Income-tax Officer considered the payments to this company also as capital in nature.

13. There was another agreement made between the assessee and U. S. Industries (Inc.) Clearing Division in order to furnish the working drawings, specification, etc., to the assessee. The points involved were also similar in the case of this agreement and the method of payment of royalty on periodical basis was considered by the Income-tax Officer to be capital in nature as the assessee had acquired an asset or advantage of enduring benefit.

14. There was another payment made to Machinenfabrik Augsbury of Rs. 3,633 as royalty and technical know-how assistance. The assessee did not produce the collaboration agreement or any other agreement in support of the claim. The payment was disallowed by the Income-tax Officer.

15. A similar claim by the assessee was disallowed by the Income-tax Officer in respect of the assessment years 1977-78 and 1978-79 relating to the payments to General Motors Ltd. and to Marion Power Shovel Ltd. For the assessment year 1979-80, the payments made by the assessee to General Motors were disallowed.

16. The assessee took up the matter before the Commissioner of Income-tax (Appeals) contending that the royalty and technical know-how fees were always treated as revenue expenditure and there was no change in the facts or law and there was no reason for the Income-tax Officer to change the procedure. The Commissioner of Income-tax (Appeals) was of the view that, in matters of taxation,

the principles of res judicata would not apply. He also dealt with the various points made out by the assessee before him. The assessee relied on the decision of the Hon'ble Calcutta High Court in the case of Agarwal Hardware Works (P.) Ltd. . It was stated on behalf of the assessee that the factory at Madras was set up ten years ago and that the goods in respect of which the technical know-how was obtained have been manufactured by the assessee for a long time and that the assessee had already been engaged in the business of manufacture of such goods and no new item was manufactured with reference to the said agreement. It was also contended that the assessee was given a licence for user only for the period of the agreement and all the drawings, etc., would have to be returned on termination of the agreement.

17. The Commissioner of Income-tax (Appeals) found that it was clear that the payments of royalty and technical know-how fees were based on sales and that for the assessment year 1976-77, royalty payment was of Rs. 32,69,762 to General Motors Ltd., Scotland, whereas, the royalty for the assessment year 1979-80 came to Rs. 79,54,452. He allowed the claim of the assessee following the ratio of the decision in the case of Agarwal Hardware .

18. On further appeal, the Tribunal affirmed the order of the Commissioner of Income-tax (Appeals).

19. On behalf of the Revenue, Mr. Mitra has contended that the expenditure was clearly of capital nature. He laid great emphasis on the fact that the technical and other information supplied by the foreign companies would become the properties of the assessee after the period of licence came to an end. Therefore, he has contended that these agreements stood on a footing different from the agreements that were considered in various other judgments.

20. I am unable to uphold this contention of Mr. Mitra. The agreement does not indicate that there was an out and out sale of assets of the foreign companies to the assessee. On the contrary, the interests of the foreign companies were safeguarded by the various clauses of the agreement. For example, in the agreement between MARION and HINDUSTHAN, CLAUSE (xvi) provided that HINDUSTHAN would hold secret and confidential and would not disclose, make, divulge or communicate to any person and would not use except under and pursuant to that agreement, any of the drawings, designs, manufacturing and materials specifications, technical information and other data pertaining to the manufacturing, sale and distribution of the said 93-M which HINDUSTHAN might acquire from MARION under the agreement.

21. Clause (xvii) of the agreement provided that HINDUSTHAN should obtain Marion's approval to enter into a sub-licensing agreement and that HINDUSTHAN should impose upon the sub-licensee the same requirements of secrecy and non-disclosure as were contained in Clause (xvi) of the agreement.

22. Clause (xviii) of the agreement provided that, in case the agreement was terminated, all drawings, designs, manufacturing and materials specifications, technical information and other data furnished to Hindusthan by MARION should be surrendered to MARION within 90 days of the termination of the agreement.

23. Clause (xix) of the agreement provided that MARION would be allowed to appoint an inspector to inspect the quality and standards of fitness of all the products manufactured and assembled by Hindusthan in order to ensure that the products were in conformity with the quality and standard of fitness required under the agreement.

24. Clause (xx) of the agreement provided that, unless written approval was first obtained from MARION, HINDUSTHAN should not, directly or indirectly, manufacture or cause to be manufactured any excavator and/or crane developed from a basic excavator, whether such excavators and/or cranes be mounted on crawlers and/or wheels, rubber or pedestal or barges or any combination thereof other than 93-M.

25. Paragraph 7 of the agreement provides for compensation and payment under two Sub-clauses (i) and (ii), which are as follows :

> "7. Compensation and payment :
>
> "(i) Hindusthan shall pay MARION a technical service fee in accordance with the schedule appended hereto designated as Schedule-A and hereby made part of this agreement. All other payments shall be due at the end of each quarter and shall be made in U. S. dollars, converted from Indian rupees at the official rate of exchange existing at the time the payment falls due. The payment shall be accompanied with a written report signed by the managing agents or other designated officer of Hindusthan showing all the transactions upon which such payment is based.
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> (ii) Remittance shall be made to an account of MARION at a bank outside the territory to be designated by MARION."

26. Paragraph 10 of the agreement related to termination of the agreement under various circumstances.

27. From all these paragraphs and clauses of the agreement, it does not appear that there was any out and out sale of the designs, drawings, technical information or technical know-how by the foreign companies to Hindusthan Motors Ltd.

28. Mr. Bajoria, appearing on behalf of the assessee, has contended that, even after the period of the agreement, Hindusthan was not entitled to deal with the drawings, designs or other tangible materials. Hindusthan could retain the information it had gathered in the course of execution of the agreement after the period of licence was over, solely for the purpose of its own business.

29. Having regard to all these clauses, it does not appear that there exists any special feature in the agreement which would make this a case of transfer of a capital asset. Assuming that, after 12 years of the licence period, the technical information supplied by the foreign company under the agreement, will be the property of Hindusthan Motors Ltd., without any further payment, that by itself will not make the agreement a contract for sale of technical know-how. The secret formula, the

technical know-how and other things may become the property of the assessee-company after 12 years but, by that time, the said secret formula or technical information may become obsolete and of no value in view of advancement of technology.

30. Moreover, the agreement has nowhere provided that the secret information or the drawings and designs will become the property of Hindusthan Motors after the licensing period is over.

31. The Supreme Court, in the case of CIT v. Ciba of India Ltd. , considered the case of a technical collaboration agreement between an Indian company and a Swiss company for transfer of technical information and observed (pp. 701, 702) :

> "The following facts which emerge from the agreement clearly show that the secret processes were not sold by the Swiss company to the asses-see : (a) the licence was for a period of five years, liable to be terminated in certain eventualities even before the expiry of the period ; (b) the object of the agreement was to obtain the benefit of technical assistance for running the business ; (c) the licence was granted to the assessee subject to rights actually granted or which may be granted after the date of the agreement to other persons ; (d) the assessee was expressly prohibited from divulging confidential information to third parties without the consent of the Swiss company ; (e) there was no transfer of the fruits of research once for all ; the Swiss company which was continuously carrying on research had agreed to make it available to the assessee ; and (f) the stipulated payment was recurrent dependent upon the sales, and only for the period of the agreement. We agree with the High Court that the first question was rightly answered in favour of the assessee,"

32. The agreement in the instant case contains all these features pointed out by the Supreme Court in the case of CIT v. Ciba of India Ltd.

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33. It should also be noted in this connection that the agreements were all entered into long before the relevant accounting periods. The royalty has been paid since 1971-72. Payments have been allowed for all these years up to the assessment year 1975-76 as revenue expenditure without any dispute. It is for the first time in the course of the assessment year 1976-77 that the Income-tax Officer took the stand that these expenditures are not allowable. It was contended on behalf of the Department that there was no res judicata in income-tax matters. It is true that there is no res judicata but there must be some substantial ground for one Income-tax Officer to differ from the view taken by another Income-tax Officer in an earlier assessment year.

34. In that view of the matter, question No. 1 must be answered in the affirmative and in favour of the assessee. Therefore, the question raised in R. A. No. 683/(Cal) of 1984 which is also a common question in all the assessment years of this case is answered in the affirmative and in favour of the assessee.

35. Question No. 2 in R. A. No. 684/(Cal) of 1984 is answered in the affirmative and in favour of the assessee in view of the decision of this court in the case of Hindustan Motors Ltd. v. CIT [1985] 156 ITR 223.

36. Question No. 2 raised in R. A. No. 686/(Cal) of 1984 relates to deductibility of expenditure claimed by the Revenue to be in the nature of sales promotion expenditure.

37. The facts relating to the expenditure were noted by the Commissioner of Income-tax (Appeals) in the following manner :

> "The Income-tax Officer has held that commission and brokerage paid are in the nature of sales promotion expenses. According to the authorised representative, commission and brokerage were paid on actual sales and the same cannot be considered to be part of sales promotion expenses. I have considered this point in detail in the case of Tims Products Limited. In that case, I have held that nothing is disallowable under Section 37(3A) out of commission and brokerage paid to agents with reference to actual sales made by them."

38. The Tribunal has upheld the order of the Commissioner of Income-tax (Appeals).

39. It is the case of the assessee that, on the basis of actual sales effected by agents and brokers, the commission and brokerage were paid in the usual course of sale of the products of the assessee. These expenditures do not come within the expression "sales promotion expenses".

40. The relevant provisions of Section 37(3A) are as under :

> "Notwithstanding anything contained in Sub-section (1) but without prejudice to the provisions of Sub-section (3), where the aggregate expenditure incurred by an assessee on advertisement, publicity and sales promotion in India exceeds forty thousand rupees, so much of such aggregate expenditure as is equal to an amount calculated as provided hereunder shall not be allowed as a deduction ..."

41. The case of the assessee is that, on the basis of actual sales effected by agents and brokers, the commission and brokerage were paid in the usual course of sale of the products of the assessee. These expenditures cannot be treated as sales promotion expenses.

42. We are inclined to uphold this contention made on behalf of the assessee. Section 37(3A) speaks of "advertisement, publicity and sales promotion". "Sales promotion" is a phrase of wide amplitude. In fact, "advertisement and publicity" may well come within the ambit of the phrase "sales promotion". By using the phrase "advertisement, publicity and sales promotion" in Section 37(3A), the Legislature clearly indicated that a certain type of expenditure will not be allowed as deduction beyond the limit specified in that Section. "Sales promotion" must be construed ejusdem generis with the earlier two expressions "advertisement and publicity". The meaning of the word "promote" has been given in Webster's New World Dictionary, 2nd edition, as under :

> "1. To raise or advance to a higher position or rank (promoted to a foremanship). 2. To help bring about or further the growth or establishment of (to promote the general welfare). 3. To further the popularity, sales, etc., by publishing and advertising (to promote a product). 4. (slang) to clear (something) by devious or cunning means. 5. To move forward a grade in school."

43. It appears from the dictionary meaning that costs incurred to sell goods simpliciter will not come within the meaning of the word "promotion".

44. In order to sell the goods manufactured, selling costs have to be incurred. The seller may engage middlemen or wholesalers to sell the goods ; commission and brokerage will have to be paid to them for this purpose. These expenditures will have to be incurred for the purpose of selling the goods. But every type of expenditure incurred in connection with sale of goods will not come within the phrase "advertisement, publicity and sales promotion". Selling costs may include many types of expenditure. Only those expenditures which are of the nature of "sales promotion" will come within the mischief of Section 37(3A).

45. The position has been made clear by the circular issued by the Central Board of Direct Taxes in this connection after the introduction of Section 37(3A) in the statute by Circular No. 240 dated May 17, 1978 (see [1979] 117 ITR (St.) 17) which is as under :

> " Circular No. 240, dated May 17, 1978.
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> Subject : The Finance Act, 1978--Explanatory Notes on the provision relating to direct taxes....
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> 12.1. Disallowance of a part of expenditure on advertisement, publicity and sales promotion--Section 37(3A) to (3D).--In order to place a curb on extravagant and socially wasteful expenditure on advertisement, publicity and sales promotion at the cost of the Exchequer, the Finance Act has inserted a new Sub-section (3A) in Section 37 of the Income-tax Act for the disallowance of a part of such expenditure in the computation of taxable profits. The main features of the new Sub-section (3A) read with related Sub-sections (3B), (3C) and (3D) inserted in Section 37 are as follows : --
>
> (a) The provision for the disallowance of a specified portion of such expenditure will apply only in relation to expenditure on advertisement, publicity and sales promotion in India.
>
> (b) Although this provision will apply to all categories of taxpayers carrying on any business or profession, no disallowance will be made in cases where the aggregate amount of such expenditure does not exceed Rs. 40,000.
>
> (c) Where a taxpayer has set up an industrial undertaking for the manufacture or production of any articles, no disallowance will be made under this provision in

> respect of expenditure on advertisement, publicity or sales promotion incurred by the taxpayer for the purposes of the business of such undertaking for three previous years, namely, the previous year in which such undertaking begins to manufacture or produce such articles and the two previous years immediately following that year ...

12. 3. The provisions of new Sub-section (3A) will not apply in relation to any expenditure incurred by the taxpayer on the following, namely : --

> (i) advertisement in any small newspaper ;
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> (ii) advertisement in any newspaper for recruitment of personnel ;
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> (iii) the publication in any newspaper of any notice required to be published by or under any law ;
>
> (iv) the maintenance of any office for the purpose of advertisement, publicity or sales promotion ;
>
> (v) the payment of salary (as defined in Clause (1) of Section 17) to any employee engaged in advertisement, publicity or sales promotion ;
>
> (vi) the holding of, or the participation in, any press conference, sales conference, trade convention, trade fair or exhibition ;
>
> (vii) publication and distribution of journals, catalogues or price lists ;
>
> (viii) such other items as may be prescribed by rules framed by the Central Board of Direct Taxes ....

12. 4. As the terms 'publicity' and 'sales promotion' have a wide amplitude, expenditure incurred by taxpayers on fashion shows ; beauty contests, consumer contests, consumer gift offers and free samples or gifts will fall within the ambit of new Sub-section (3A) of Section 37 of the income-tax Act."

46. The circular is also indicative of the types of expenditure which will be treated as for the purpose of sales promotion. Fashion shows, beauty contests, consumer contests, consumer gift offers and free samples have an element of publicity and are devices for sales promotion. These are not expenditures incurred for selling of goods simpliciter. If a company allows a commission to the retail outlets for the purpose of selling their goods that will not be expenditure for sales promotion.

47. Therefore, in our view, brokerage and commission paid for selling the goods will not come within the mischief of the phrase "advertisement, publicity and sales promotion."

48. In that view of the matter, question No. 2 is also answered in the affirmative and in favour of the assessee.

49. Therefore, all the questions referred in R. A. No. 683/(Cal) of 1984, R. A. No. 684/(Cal) of 1984, R. A. No. 685/(Cal) of 1984 and R. A. No. 686/ (Cal) of 1984 are answered in the affirmative and in favour of the assessee.

50. There will be no order as to costs.

Bhagabati Prasad Banerjee, J.

51. I agree.