

**IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH 'A', NEW DELHI**

**Before Sh. Amit Shukla, Judicial Member**

**Dr. B. R. R. Kumar, Accountant Member**

**(Through Video Conferencing)**

**ITA No. 6520/Del/2014 : Asstt. Year : 2011-12**

DCIT, Circle-1(2), New Delhi	Vs	M/s. Advance Surfactants India Ltd. 511/2/1, Rajokari Delhi- 110038
<b>(APPELLANT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AABCA9042Q</b>		

**Assessee by : None**

**Revenue by : Sh. Sohail Malik, Sr. DR**

<b>Date of Hearing: 03.11.2020</b>	<b>Date of Pronouncement: 16.12.2020</b>
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**ORDER**

**Per Dr. B. R. R. Kumar, Accountant Member:**

The present appeal has been filed by the revenue against the order of the Id. CIT(A)-IV, New Delhi dated 17.09.2014.

2. Following grounds have been raised by the revenue:

*"1. Whether on the facts and in the circumstances of the case, the Ld. CIT(A) has erred in directing the AO to treat the royalty expenses of Rs. 8,71,73,129/- as revenue expenditure."*

3. The grounds are directed against action of the AO in treating royalty expenses of Rs. 8,71,73,129/- as capital expenditure. The appellant claimed these expenses as revenue expenses. The AO was of the view that the same were capital in nature and therefore, disallowed the same and allowed depreciation @ 25% and made addition of Rs. 6,53,79,850/-.

For the sake of ready reference, the relevant part of the assessment order is reproduced below:

*"4] Following the stand taken in the last assessment year also, the assessee (here-in-after referred as ADVANCE) has debited royalty expenses of Rs. 8,71,73,129/- paid to Chemteac freezone enterprises ( hereafter referred to as CHEMTECH) and claimed the same as revenue expenditure.*

*4.2] The AR of the assessee vide order sheet entry dated 03.12.2012 was asked to submit a detailed note on allowability of expenditure debited under the head Royalty. He was also show caused vide order sheet entry dated 07.01.2014 that why this expenditure should not be disallowed as it was done during earlier assessment year. In response to the queries and show cause the assessee produced copy of agreement only.*

*The copy of agreement and reply of the assessee submitted during the earlier assessment year have been considered by me. As recorded in the earlier assessment order, the assessee submitted that,*

*"In terms of clause 7.3, a lump sum payment of 1 lac US Dollars has to be made to M/s Chemtec. Out of this, a sum of USD 80,000/- is mainly for technical audit, technical designs and drawings. These expenses should normally be booked under the head 'Technical or Professional Consultancy', but as they formed part of a common agreement, they have been debited under the head 'Royalty'. From this technical audit and designs the assessee company has not acquired any advantage of enduring income. In fact, in clause 7.4, it is further clarified that out of the agreed lump sum payment, a sum of 60,000 USD would be paid on completion of technical audit of the existing plant. On the basis of the technical suggest technical know-how amounts to professional advance which can under no circumstances be treated as capital expenditure. The invoice raised by Chemtec would clarify the submission of assessee. The second limb of the payment is production based. In terms of clause 7.5 payment shall be based on quantities manufactured using the techno logy provided by M/s Chemtec. In terms of Article 12, it is made clear*

*that the Assessee Company shall not acquire any right to use the name of M/s Chemtec. In terms of Article 14.3 the agreement is for a period of five years with a right to Chemtec to terminate the agreement earlier subject to certain conditions".*

*4.3] In this context, it is imperative to mention agreement with M/s Chemtec which comes into effect from 04.10.2007 as pointed out as per earlier assessment order, which are as under:*

*1. ARTICLE 2- GRANT OF LICENCE*

*2.1) CHEMTEC, in so far it lawfully may, grant to ADVANCE a non-transferable and indivisible license to the PRODUCT RANGE KNOW HOW for the manufacture of PRODUCTS in the PLANT and to sell within and outside India the product so manufactured.*

*2.2) CHEMTEC undertakes that it shall not grant during the life of this Agreement any right to a third party to use the PRODUCT RANGE KNOW HOW for the production within India or outside India of the PRODUCTS.*

*2.3) ADVANCE undertakes that it will not make or have made any PRODUCTS outside India without the prior written consent of CHEMTEC. The right of ADVANCE to exports the PRODUCTS manufactured WILL BE permitted only to countries permitted by CHEMTEC and is subject to may be agreed in writing.*

*2.4) ADVANCE shall not be free to sub-license in such terms and conditions as India without the prior written approval of CHEMTEC and the Government of India, if so required.*

*(2) 5.1) CHEMTEC guarantees, to the extent mentioned below, the effectiveness and the validity of the PRODUCT RANGE KNOWHOW to be supplied.*

*by CHEMTEC does of effectiveness in terms of*

*5.2) In case the PRODUCT RANGE KNOW HOW not enable ADVANCE TO achieve desired level finished products to raw materials (Known as Yield Ratio) within a period of twelve (12) weeks, additional technical assistance will be provided by CHEMTEC to ADVANCE.*

*"Article 7.3- ADVANCE shall remunerate CHEMTEC for the technical information as detailed in Article 3.1 and know how as described under Article 3.2 with USD One lakh (100000) as a lump sum net of Indian taxes. On the above amount, USD Eighty thousand (80,000) shall be paid as fee for technical designs & drawing and technical audit of existing unit and USD Twenty Thousand (20,000) shall be towards provision of other PRODUCT RANGE KNOW HOW.*

*(3) 7.4) The payment of above amount as stipulated as under Article 7.3 shall be made as follows:*

*i. A sum of USD Sixty thousand (60,000) within sixty (60) days from receipt from all approval and registration required by an Agreement and subject to completion of the technical ADVANCE by CHEMTEC and suggesting a know the yield in the existing manufacturing locations of ADVANCE.*

*ii. A sum of USD Twenty Thousand (20,000) within 9 (nine) months from receipt from CHEMTEC know how documents specified in Article 3.1, 3.2 of this technology for increasing the successful implementation of know how suggested the existing manufacturing locations of advance.*

*iii. A sum of USD Twenty Thousand within twelve (12) months from the successful implementation of know how suggested by CHEMTEC to advance in the existing manufacturing locations of advance.*

*Article 7.5 - For the licensing right as in Article 2 and in exchange for continuing technical assistance as in Article 3.8 ADVANCE shall pay in respect of the PRODUCTS manufactured by it during the terms of this Agreement a royalty as per the following details:*

*.....*

*b) For next two years i.e. 1<sup>st</sup> April, 2008 to 31<sup>st</sup> March, 2010 paid @ USD12.00 on quantities manufactured provided by CHEMTEC.*

*ii. A sum of USD Twenty Thousand (20,000) within from CHEMTEC know how documents specified Agreement and successful implementation of the yield at the existing plants of Advance.*

*Article 8.4 - In case CHEMTEC holds any patent in respect of PRODUCTS in India, the payment of royalty/lump sum payment already made by ADVANCE to CHEMTEC during the period of this Agreements shall also constitute full compensation for use of the patent rights till the expiry life of the patent and ADVANCE shall be free to manufacture that item even after expiry of the collaboration agreement.*

*(4) 14.6) Upon expiration of this agreement according to 14.3 above, the following shall apply for the time after expiration:*

*14.6.1] ADVANCE shall have a non exclusive right to continue to use the PRODUCT RANGE KNOW HOW In India communicated to ADVANCE before expiration and shall have the right to keep all document furnished to ADVANCE under the agreement and shall not pay any license fee thereof, provided however, that the PRODUCT RANGE KNOW HOW shall remain the legal and absolute property of CHEMTEC with the limitation set forth here above.*

*4.4]The assessee Company since its incorporation is in the business of manufacturing activity of producing Acid Slurry (LABSA) from LAB & Sulphur and Adjunct Powder from AOS (Paste). The ADVANCE is paying lumpsum payments and royalty payments separately. As may be noted from the clauses of the agreement cited above, the assessee is deriving enduring benefits by virtue of its agreement with Chemtech as explained hereunder:-*

*4.4.1] Article 2 of this agreement, CHEMTECH has allowed ADVANCE right to sell the products both inside and outside India by providing the product range knowhow. It has further undertaken that it shall not grant during the life of this agreement any right to a third party to use the product range know how for production within or outside India. This obviously means that ADVANCE has obtained exclusive rights for specified products by obtaining technical knowhow from CHEMTECH.*

*4.2.2] Article 5.2 says about increase in the yield ratio on the basis of product range know how supplied*

*by CHEMTECH. This is undoubtedly giving enduring benefits to the assessee.*

*4.4.3] Article 7.3 and 7.4 talks about lumpsum payment totaling USD one lakh over a period of time and is linked to the providing know how for increasing the yield and further successful implementation CHEMTECH for increasing the yield. It is clear that this lumpsum payment is for the purposes of increasing the yield ratio of ADVANCE and therefore is providing enduring benefits to the assessee.*

*4.4.4] Article 8.4 categorically confers the right to any such rights held by CHEMTECH in India payments. In other words, ADVANCE has acquired valid even after the expiry of this agreement.*

*4.4.5] Article 14.6.1 provides that even after expiration of agreement, ADVANCE shall continue to use the technical knowhow. Thus, it has acquired post termination rights and consequently enduring benefits.*

*5] The above view is supported with the judicial pronouncements made in the case of Fenner Woodroffe & Co. Ltd. vs. CIT (1976) 102 ITR 665 (Madras) where it was held by the Hon'ble Madras High Court that the assessee was not required to return any designs or plans that had been communicated to it. With the result, the assessee could use the technical data and knowledge acquired even after the period of agreement and deal with it as if it were its own assets. It was held that the assessee had acquired an enduring benefit by this agreement.*

*5.2] Further in the case of Addl. CIT vs. Southern Structurals Ltd. (1977) 110 ITR 890 (Madras) also it was held that where under a collaboration agreement with a foreign co., the assessee had obtained technical assistance by way of inventions and designs, with mutual obligations on exchange of technical information, and though it was prohibited from parting with the information, the assessee was free to use all the information after the expiry of the agreement, the assessee had acquired an enduring*

*benefit by the above agreement. To that extent, the amount paid was held clearly capital.*

*5.3] In the case of Southern Switch Gear Ltd. Vs CIT 232 ITR 359 (SC), the Hon'ble Apex Court has upheld the finding of the Madras High Court that the right to manufacture certain goods exclusively in independent right, secured by the assessee from the foreign co. which was of an enduring nature.*

*6] In view of above factual matrix and legal position, as concluded in the last assessment year, it is held that a sum of Rs 8,71,73,129/- claimed as expenditure is capital in nature and after allowing for the depreciation @ of 25%, a sum of Rs. 6,53,79,846.75/- is added back to the total income of the assessee."*

4. The Id. CIT (A) deleted the addition holding that the royalty payment is linked to production and hence to be treated as revenue expenditure.

5. Aggrieved the revenue filed appeal before us. The Id. DR relied on the agreement mentioned in the assessment order and the Articles pertaining to grant of license. He relied on the following judgments:

- *Fenner Woodroffe & Co. Ltd. Vs CIT (1976) 102 ITR 665 (Madras)*
- *Addl. CIT Vs Southern Structurals Ltd. (1977) 110 ITR 890 (Madras)*
- *Southern Switch Gear Ltd. Vs CIT 232 ITR 359 (SC)*

6. The Id. AR relied on the submissions made before the Id. CIT (A).

7. Heard the arguments of both the parties and perused the material available on record.

8. The relevant part of the Articles of grant of license are as under:

1. It is a non-transferable indivisible license to manufacture the products.
2. No other person is granted such license in India.
3. The products have to be made within India.
4. Exports of products from India are controlled by the licensor
5. The licensor is not free to sub-license in India
6. The licensor should ensure that the products meet the standards laid down
7. The royalty has to be paid on the quantities manufactured
8. For the futures year from instant year, the royalty has also to be paid on the quantities manufactured using the technology provided by the licensor.

9. We have gone through the case laws supported by Id. DR and also examined the issue to determine whether the expenditure incurred by the assessee has given any enduring benefit by the virtue of its agreement. We find that the assessee has to pay royalty based on the production on annual basis and one time lumpsum payment is to be made for technical audit, technical design and drawings. These payments pertained to transfer of technology and for roll out for the manufacturing process which is a precursor to argument existing manufacturing capacities. Para 7.5 of the agreement provides as under:

*"7.5 For the licensing rights as in Article 2 and in exchange for continuing technical assistance as in Article 3.8 ADVANCE shall pay in respect of the*

*PRODUCTS manufactured by it during the terms of this Agreement a royalty as per the following details:*

*a) In the first financial year of operation i.e. from 4th October, 2007 to 31st March, 2008 the royalty shall be paid @ USD 6.00 on quantities manufacturing by Advance using technology provided by CHEMTEC.*

*b) A sum of USD Twenty Thousand (20,000) within 9 (nine) months from receipt from CHEMTEC know how documents specified in Article 3.1 3.2 of this Agreement and successful implementation of the technology for increasing the yield at the existing plants of Advance.*

*c) A sum of USD Twenty Thousand (20.000) within twelve (12) months from the successful implementation of know how suggested by CHEMTEC to advance in the existing manufacturing locations of advance.*

*The above-mentioned payments are subject to the maximum of Five(5) percent of the total Sale value. The aforesaid royalty amount will be calculated on the basis of the net sale price of the product exclusive of export duty minus cost of standards bought out component and the landed cost if the imported components (and not of raw material) irrespective of source of procurements including ocean freight, insurance, custom duty etc. Further all trade discounts, commission return, allowances or rebate for defective merchandises, packing freight, shipping and transporting charges, sales taxes and other and outgoing levies or taxes will also be deducted while computing the net ex-factory sale price of the product.*

*The royalty due to CHEMTEC shall be paid in 6 months from the end of the financial year subject to Audit being carried out both at ADVANCE and CHEMTEC. The above royalty is net of Indian taxes and will be paid for a period of 5 years during the period of agreement. Taxes leviable on payments under this clause will be borne by ADVANCE."*

10. From the above, it can be deciphered that the royalty payment was based on production. There was no enduring benefit gained by the assessee. The Hon'ble Jurisdictional High Court in the case of Climate Systems India Ltd. Vs CIT 319 ITR 113 (Del) held that where the royalties is paid based on the production output it should be treated as revenue expenditure. Since, the amount paid as royalty is based on the production which should be treated as revenue expenditure, we hereby decline to interfere with the order of the Id. CIT (A).

11. In the result, the appeal of the revenue is dismissed.  
Order Pronounced in the Open Court on 16/12/2020.

Sd/-

**(Amit Shukla)**  
**Judicial Member**

Sd/-

**(Dr. B. R. R. Kumar)**  
**Accountant Member**

**Dated: 16/12/2020**

\*Subodh\*

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

**ASSISTANT REGISTRAR**