

आयकर अपीलीय अधिकरण, 'ए' न्याय पीठ, चेन्नई
**IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH, CHENNAI**

श्री महावीर सिंह, उपाध्यक्ष एवं श्री जी. मंजुनाथ, लेखा सदस्य के समक्ष

**BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND
SHRI G. MANJUNATHA, ACCOUNTANT MEMBER**

आयकर अपील सं./ITA Nos.: 718 & 719/Chny/2018

निर्धारण वर्ष / Assessment Years: 2011-12 & 2014-15

Assistant Commissioner of Income
Tax,
Large Taxpayer Unit -2,
Chennai – 600 034.

M/s. India Japan Lighting
v. Limited,
"Aalim Centre", 2nd Floor, 82,
Dr. Radhakrishnan Salai,
Mylapore, Chennai – 600 004.
[PAN: AAACI-2673-L]

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by

: Shri. AR V Sreenivasan, Addl. CIT

प्रत्यर्थी की ओर से/Respondent by

: Shri. N V Balaji, Advocate

सुनवाई की तारीख/Date of Hearing

: 16.11.2022

घोषणा की तारीख/Date of Pronouncement

: 23.11.2022

आदेश / O R D E R

PER G. MANJUNATHA, ACCOUNTANT MEMBER:

These appeals filed by the Revenue are directed against separate, but identical orders of Commissioner of Income-tax (Appeals)-5, dated 11.12.2017 and pertains to assessment years 2011-12 & 2014-15. Since, the facts are identical and issues are common, for the sake of convenience, these appeals

were heard together and are being disposed of by this consolidated order.

2. The brief facts of the case are that the assessee company is engaged in the business of manufacturing and sale of automotive lighting equipment, filed its return of income for assessment year 2011-12 on 29.11.2011 declaring total income of Rs. 2,59,79,628/- and for the assessment year 2014-15 filed its return of income on 29.11.2014, declaring loss of Rs. 32,81,43,050/- and book loss of Rs. 43,22,49,379/. The assessment have been completed u/s. 143(3) r.w.s. 92CA of the Income-tax Act, 1961 (hereinafter referred to as "the Act") for assessment year 2011-12 & 2014-15 and determined total income of Rs. 9,96,49,995 for assessment year 2011-12, and loss of Rs.26,36,09,196/- for assessment year 2014-15, by making various additions towards disallowance of royalty payment, treating it as capital in nature, excess depreciation on UPS and disallowance of expenses in relation to exempt income u/s. 14A r.w.r. 8D of the Income-tax Rules, 1962 (hereinafter referred to as "the Rules, 1962"). The assessee carried the matter in appeal before the first appellate authority and the Ld. CIT(A) for reasons stated in their appellate order

dated 11.12.2017 for both assessment years deleted additions made by the AO towards royalty payment, excess depreciation on UPS and disallowance of expenses u/s. 14A r.w.r. 8D of the Rules, 1962. Aggrieved by the CIT(A) order, Revenue is in appeal before us.

3. The first issue that came up for our consideration from ground no.2 of assessee's appeal for both assessment years is deletion of addition made in respect of royalty payment. The assessee company has made royalty payment to Koito Manufacturing Company Ltd., on the basis of agreement dated 24.11.1995, which permits the assessee exclusive right to manufacture and sale of products in India using a licensed technology. The AO disallowed 25% of royalty payment on the ground that said royalty has been paid towards technical information provided by the foreign company in respect of manufacturing methods of products and license granted to the assessee to manufacture and sell the products is in nature of capital expenditure, which gives enduring benefit to the assessee.

4. We have heard both the parties, perused materials available on record and gone through orders of the authorities below. The Ld. Counsel for the assessee at the time of hearing submitted that this issue is covered in favour of the assessee by decision of the ITAT, Chennai benches in assessee's own case for assessment year 2007-08 in ITA No. 2154/Mds/2011, where under identical set of facts and also on very same royalty agreement between the assessee and Kito Manufacturing Company, Japan, the Tribunal held that royalty payment for using technology provided by foreign company is revenue in nature which cannot be treated as capital in nature, which gives enduring benefit to the assessee. The Ld. DR, although admitted fact that the Tribunal has decided the issue in favour of the assessee, but supported order of the AO and submitted that the AO had brought out how and why royalty payment cannot be said as revenue in nature and therefore, submitted that the findings recorded by the AO should be upheld. We find that the Tribunal had considered an identical issue in light of agreement between the assessee and Kito Manufacturing Company, Japan for payment of royalty for using licensed technology and exclusive license to manufacture and sell products in India and upon considering relevant facts

held that royalty payment by appellant company in terms of agreement between the parties has to be held as revenue in nature. The relevant findings of the Tribunal are as under:

"12. We have perused the orders and heard the rival submissions. The question raised is regarding payment of royalty to Koito Manufacturing Ltd., Japan. Whether such royalty paid could be allowed in full as revenue expenditure or whether it had to be considered as a capital outgo, was an issue before this Tribunal in assessee's appeals for assessment years 2004-05 to 2006-07. It was held by this Tribunal at paras 3 to 6 of its order dated 10th June, 2011, as under:-

"3. We have considered the rival submissions and have perused the entire relevant provisions of law and precedents applicable thereto and relied before us. It was argued on behalf of the assessee that in assessment year 2003-04, the Department has itself accepted this expenditure as revenue expenditure and has allowed the same as deduction u/s 35(2AB). This fact could not be successfully controverted from the side of the Revenue. We have found from the perusal of the agreement that KMC granted the assessee an exclusive right to manufacture and sell the products in India using the licenced technology provided. An exclusive right has been conferred on the assessee for manufacturing and selling the products in India. The payment of royalty towards technical information provided by a foreign company in respect of manufacturing methods of the products and the licence granted to the assessee-company to manufacture and sell the products was treated by the Assessing Officer as acquiring of an advantage of enduring nature and thus, held it to be a capital expenditure. On the other hand, the argument advanced by the Id.AR is that those expenses for acquisition of technical know-how year after year have been held by the Hon'ble Madras High Court as 'revenue expenditure'. In this regard, reliance was also placed on the decision of Hon'ble Supreme Court rendered in the case of Alembic Chemical Works Co. Ltd vs CIT, 177 ITR 377. The Id.DR has relied on various decisions and has filed their zerox copies before us.

4. A piquant situation has arisen because it is a case where royalty was paid initially and also running expenses towards royalty are being paid year after year. As per this agreement for

transfer of know-how as technical aid, initial royalty of 9 lakhs US Dollar has to be paid, and thereafter running royalty at the rate of 3.5% of the net sales is required to be paid by the assessee. We have to examine the stipulations made in the agreement qua the rights reserved by both the parties to determine whether the assessee has acquired a right to use the 'technology and licence' during the assessment years or whether the payments towards know-how/licence falls within the ambit of section 32 or not. The assessee-company has entered into a technical licence agreement with KMC, which had a 50% shareholding in the assessee-company, to manufacture and sell the contract products in India using licenced technology. The assessee-company paid a lump sum amount of 9 lakhs US Dollars to KMC to get this technology. This amount was paid in three instalments of 3 lakhs US Dollars from financial year 1996-97 to 1998-99. Apart from this, the assessee-company has been paying royalty @ 3.5% for products manufactured by using licenced technology supplied by KMC This royalty is paid @ 3.5% of net sales less imported components. As per this agreement, if there is no sales, no royalty is payable by the assessee.

5. We have gone through various Articles of this agreement which are incorporated in the appellate order for assessment year 2005-06 towards which our attention was also invited. The Assessing Officer has relied on the decision of Hon'ble Madras High Court rendered in the case of CIT vs Southern Switchgear, 148 ITR 272, affirmed by the Hon'ble Supreme Court in 232 ITR 359, to hold that the entire royalty paid has to be treated as capital. But we have noticed that the facts of this case are slightly different and the Hon'ble Madras High Court has held in numerous other decisions that mere grant of exclusive right to manufacture may not result in acquiring any capital asset. In this regard, decision of Hon'ble Madras High Court in the case of CIT vs Lucas TVS Ltd, 110 ITR 338 which has been confirmed by the Apex Court by dismissing the SLP of the Revenue, 196 ITR 78 (Statute); CIT vs Sundaram Clayton, 136 ITR 350 (Mds); CIT vs Brakes India Ltd, 136 ITR 322(Mad); CIT vs Lakshmi Cardt Clothing, 149 ITR 712 and CIT vs IAEC Pumps, 110 ITR 353 which has been affirmed by the Hon'ble Supreme Court in the 232 ITR 316, are relevant. The Hon'ble Jurisdictional High Court has been consistently holding that grant of right to use technical know-how coupled with exclusive right to manufacture will not result in any asset of enduring benefit. In the case of Southern Switchgear(SS), the facts are that all drawings/specifications and other data furnished to SS were to be in English with measurement shown in the system currently

used by brush but shall be the property of SS on the condition that SS shall agree to hold such property always subject to the continued fulfillment in clause 6(c), 6(d), 23 & 25 of this agreement and the period of ten years thereafter. But technical assistance contemplated in the agreement covered the establishment of the factory and the operation thereof for the manufacture of transformers of all kinds and types. Thus, the property in that case, i.e, the drawing, was transferred to Indian company and the technical know-how transferred was also for the setting up of the factory which are all in the capital field. In those circumstances, 25% of the payment had been held to be capital because only 25% of the initial lump sum and royalty payment was considered as capital. In the given case, no such property has been transferred to Indian Company nor is the technical data provided to set up the plant. Keeping in view the differential nuance of facts between the facts of assessee's case and other decisions of Hon'ble Madras High Court referred to above, out of which two have been affirmed by the Apex Courts whose facts are more akin to the facts of the given case, it would be just and prudent to apply the ratio decidendi thereof. The capital element involved definitely, in our considered opinion, can be attributed and has been covered in the lump sum payment made in the beginning, which has been allowed u/s 35AB. The Hon'ble Supreme Court, in the case of CIT vs Swaraj Engines Ltd, 309 ITR 443, has clearly held that section 35AB is to be applied in respect of expenditure on technical know-how which is in the capital field and the entire amount is allowable in case it is in the revenue filed. There are numerous cases available on this issue, but there is no need to discuss all of them. The treatment given by the Id. CIT(A) to 25% of the expenses towards royalty payment, as capital and thereafter allowing depreciation thereon, is not correct approach in our opinion. Recently, the Hon'ble Madras High Court in the case of CIT vs Panasonic Carbon India Company Ltd., vide its judgment dated 12.7.2010 in Tax case Appeal Nos.552,553, 554 and 556 of 2010, has taken a decision in favour of the assessee after discussing the judgment of Hon'ble Supreme Court rendered in the case of CIT vs IAEC Pumps Ltd (supra). In that case, the technical know-how for setting up the factory of the assessee-company and commencing its production was provided by MEI [a foreign company] in consideration of a lump sum payment to MEI which was capitalized in the assessee's books of account in respective years of payment. The royalty was paid by the assessee from June 1984 onwards based on the sales effected at the rate of 2.5% on domestic sales and at 5% on exports. The court was deciding whether such royalty payment would fall within the category of revenue expenditure or capital

expenditure. The High Court has taken a view in favour of the assessee. The Chennai Bench, recently in the case of Nippo Batteries Co. Ltd vs ACIT, [2011] 7 ITR (Trib) 303 (Chennai) has decided similar issue by holding that such type of royalty payment cannot be bifurcated without any provision in the agreement and the entire payment has to be treated as revenue expenditure allowable as deduction. The Bench has discussed more than a dozen of decisions of various High Courts including that of the Hon'ble Madras, Delhi and Apex Court to arrive at its above conclusion.

6. The Id.DR has relied on the decision of Hon'ble Supreme Court rendered in the case of Southern Switchgear Ltd vs CIT, 232 ITR 359. About this decision, we have already mentioned that the facts are slightly different in that case. Similarly, the facts in the case of CIT vs W.S.Insulators of India Ltd, 243 ITR 348(Mad), are akin to the case of Hon'ble Supreme Court in Southern Switchgear Ltd(supra), in which products manufactured by the assessee were to be tested by the licensor and the drawings and documents were not to be used by the licensee for the purpose other than the purpose of the agreement which was acquiring know-how and licence for manufacture of products based on drawings provided by the foreign company. In that case, it was held that payment for obtaining know-how, drawings and information is primarily a capital expenditure, but still the Assessing Officer had allowed 20% of such expenditure as revenue which was treated as attributable to technical advice regarding day-to-day operations, layout, etc. In our opinion, this decision is not directly applicable to the facts of the given case. Another decision relied on by the Id.DR is of Hon'ble Supreme Court rendered in the case of Jonas Woodhead & Sons Ltd vs CIT, 224 ITR 342 in which it has been held that when assessee sets up a new business and the foreign firm in addition to supplying technical know-how renders valuable services in setting up the factory itself and assessee is allowed to manufacture the product in question even after the expiry of the agreement it is justified in holding that 25% of the royalty, though paid on percentage of gross turnover, was capital expenditure. Ostensibly, the facts of this case are entirely distinguishable from the case in hand. Therefore, after considering the entire facts, circumstances and legal position, we hold that the expenses debited towards royalty payments in all these assessment years have to be treated as revenue payment in toto. Our above finding results in allowing the appeals of the assessee and dismissing the appeal of the Revenue.”

Respectfully following the above decision, we hold that royalty has to be allowed as revenue outgo for the impugned assessment year."

5. In this view of matter and by following the decision of coordinate bench in assessee's own case for earlier years, we are of the considered view that there is no error in reasons given by the Id. CIT(A) to delete addition made towards disallowance of royalty payment and thus, we are inclined to uphold the findings of the Id. CIT(A) and reject ground taken by the Revenue for both assessment years.

6. The next issue that came up for our consideration from ground no. 3 of Revenue's appeal for assessment year 2011-12 is excess depreciation claimed on UPS @ 60%. The Ld. AO has disallowed excess depreciation claimed on UPS @ 60% on the ground that the UPS and printers are in the nature of office equipment which are eligible for depreciation @ 15% and cannot be treated as computer and computer software to claim higher depreciation of 60%.

7. We have heard both the parties, perused materials available on record and gone through orders of the authorities

below. We find that the issue of depreciation on UPS and printer as part of computer and computer software is decided by the Hon'ble Jurisdictional High Court of Madras in the case of M/s. Brakes India Limited vs DCIT in TCA No. 551/2013, where it has been held that UPS and printer are integral part of computer and computer software and are eligible for higher depreciation of 60%, but not normal depreciation of 15% as applicable to office equipment. The CIT(A) by following the decision of Hon'ble Madras High Court in the above case has rightly deleted additions made towards excess depreciation claimed on UPS and thus, we are inclined to uphold the findings of the Ld. CIT(A) and reject ground taken by the Revenue for the assessment year 2011-12.

8. The next issue that came up for our consideration from Revenue's appeal for both the assessment years is disallowance of expenditure in relation to exempt income u/s. 14A r.w.r. 8D of the Rules, 1962. The AO has disallowed expenses relating to exempt income u/s. 14A by invoking Rule 8D of the Income Tax Rules, 1962 @ 0.5% of average of investment and made additions on the ground that whether or not dividend is earned for the relevant assessment year, but

expenses relatable to said income needs to be disallowed. On appeal, the Ld. CIT(A) has deleted additions made by the AO towards disallowance of expenses u/s. 14A r.w.r. 8D of Rules, 1962 on the ground that when there is no exempt income for relevant assessment year, the question of disallowance of expenses relatable to said exempt income does not arise.

9. We have heard both the parties, perused materials available on record and gone through orders of the authorities below. The issue of disallowance of expenditure u/s. 14A r.w.r. 8D of the Income Tax Rules, 1962 in absence of exempt income for any assessment year is no longer res integra. The Hon'ble Jurisdictional High Court of Madras in the case of M/s. Redington India Ltd. Vs. ACIT (2017) 77 taxmann.com 257 (Mad) has considered an identical issue and held that when there is no exempt income in relevant assessment year, there cannot be a disallowance of expenditure u/s. 14A in relation to any assumed income. In this case, the counsel for the assessee stated that for both the assessment years, the assessee has not earned any exempt income and the same has been accepted by the Id. DR present for the Revenue. Therefore, we are of the considered view that there is no error

in the reasons given by the Ld. CIT(A) to delete additions made towards disallowance of expenditure u/s. 14A r.w.r. 8D of the Income Tax Rules, 1962, because in both assessment years the assessee did not earned any dividend income which was exempt income u/s. 10(34) of the Act and thus, we are inclined to uphold the findings of the CIT(A) and reject the ground taken by the Revenue for both the assessment years.

10. In the result, the appeals filed by the Revenue are dismissed.

Order pronounced in the court on 23rd November, 2022 at Chennai.

Sd/-
(महावीर सिंह)
(MAHAVIR SINGH)
उपाध्यक्ष/Vice President

Sd/-
(जी. मंजुनाथ)
(G. MANJUNATHA)
लेखासदस्य/Accountant Member

चेन्नई/Chennai,

दिनांक/Dated, the 23rd November, 2022

JPV

आदेशकीप्रतिलिपिअग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्था/Respondent
3. आयकरआयुक्त (अपील)/CIT(A)
4. आयकरआयुक्त/CIT
5. विभागीयप्रतिनिधि/DR
6. गार्डफाईल/GF