

IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'A', BANGALORE

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

AND

SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

I.T.A No.667/Bang/2014
(Assessment Year : 2008-09)

Asst. Commissioner of Income-tax,
Circle -12 (4), Bangalore

..Appellant

v.

Telco Construction Co. Ltd,
45, Jubilee Building, Museum Road,
Bangalore 560 025
PAN : AA ACT9077B

..Respondent

Assessee by : Shri. S. Anantha, CA
Revenue by : Shri. G. R. Reddy, CIT – DR-I

Heard on : 03.09.2015
Pronounced on : 23.09.2015

ORDER

PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :

In this appeal filed by Revenue directed against an order dt.14.02.2014,
it has altogether raised six grounds of which, grounds 1, 5 and 6 are general
needing no adjudication.

02. Ground.2 is reproduced hereunder :

“On the facts and in the circumstances of the case the learned CIT (A) erred in law in deleting the addition of Rs.4,97,44,319/- as interest attributable to capital work in progress by considering that the hundi discount charges incurred by the assessee was for material purchases and the reliance placed by the AO on the decision of CIT v. Tin Box CO. (2003) ITR 637 (Del) holds good on this issue.”

03. Facts apropos are that assessee a manufacturer of hydraulic excavators, loaders, mechanical shovels, cranes and spare parts, had filed its return for impugned assessment year declaring income of Rs.4,83,41,12,190/-. During the course of assessment proceedings it was noted by the AO that a sum of Rs.91,02,00,000/- was shown as capital work-in-progress. Assessee had during the relevant previous year claimed interest expenditure of Rs.4,98,17,000/-. As per the AO, if assessee had sufficient surplus for funding its capital work-in-progress, then it would not have incurred such heavy interest expenditure. When put on notice assessee replied that it had not incurred any interest expenditure on the funds used for capital work-in-progress. AO however did not accept this contention. According to him assessee had availability of surplus funds, but it had outflow of Rs.56,08,80,810/- for acquisition of fixed assets alone. Thus as per the AO assessee could not establish that interest-free funds were available with it for utilisation in the capital work-in-progress. Relying on the judgment of Hon'ble

Delhi High Court in the case of CIT v. Tin Box Co [(2003) 260 ITR 637], AO made interest disallowance of Rs.4,98,00,000/-. Actual disallowance as per the AO ought to have been Rs.11,60,50,500/- being 12.75% of the capital work-in-progress of Rs.91,02,00,000/-. The rate of 12.75% was estimated by the AO based on PLR of SBI. However he restricted the disallowance to Rs.4,98,00,000/- lakhs being the amount which assessee had debited as interest expenditure in its P & L account.

04. In its appeal before the CIT (A), argument of the assessee was that it had cash from operating activities of Rs.229.51 crores. As per the assessee, it did not have any borrowings at all. Sum of Rs.4.98 crores considered by the AO as interest payment was only hundi discounting charges. On the reliance placed by the AO on the case of Tin Box Co. (supra), submission of the assessee was that there concerned assessee had given interest free loans to sister concerns and the facts were entirely different. Thus as per the assessee, disallowance was unjustified.

05. CIT (A) was appreciative of these contentions. According to him, the sum of Rs.4,97,44,398/- out of total Rs.4,98,17,000/- shown as interest expenditure was hundi discounting charges. As per the CIT (A), cash-flow statement filed by the assessee clearly supported its case that cash- inflow from operations came to

Rs.229.51 crores. He thus held that assessee had its own money for funding its investments in capital work-in-progress. Taking this view of the matter, he deleted the disallowance.

06. Now before us, Ld. DR strongly assailing the order of the CIT (A) submitted that existence of interest-free funds was never proved by the assessee.

07. Per contra, Ld. AR submitted that audited cash-flow statement for relevant previous year was filed by the assessee before the lower authorities. Placing reliance on paper book page 3, he submitted that the audited statement clearly indicated absence of utilisation of any loan for capital work-in-progress.

08. We have perused the orders and heard the rival contentions. Cash flow statement for the year ending 31.03.2008 as appearing at paper book page 3 of the assessee is reproduced hereunder :

	2007-2008		2006-2007
	Rs ' Crs	Rs ' Crs	Rs ' Crs
A. Cash flow from Operating Activities			
Net Profit before tax		490.94	280.40
Adjustments for:			
Provision for Doubtful Debts	5.26		8.62
Loss on Assets Sold/Scrapped/Written off (Net)	0.31		0.93
Depreciation	21.50		18.31
Unrealised Foreign Exchange Fluctuations (Net)	10.24		(0.70)
Interest (Net)	0.38		2.63
		37.69	
Operating Profit before working capital changes		528.63	310.19
Adjustments for changes in:			
Inventories	(109.33)		(87.14)
Sundry Debtors	(48.49)		(21.34)
Loans & Advances	(10.54)		13.92
Current Liabilities and Provisions	38.32		158.85
		(130.04)	64.29
Cash Generated from Operations		398.59	374.48
Income Tax Paid (net)		(169.08)	(97.57)
Net Cash (used) in / from Operating Activities		229.51	276.91
B. Cash flow from Investing Activities			
(Increase)/ Decrease in Inter Corporate Deposits		71.57	(80.00)
(Increase)/ Decrease in investments		(103.96)	(49.49)
Purchase of Fixed Assets		(122.81)	(37.34)
Interest Income		4.60	1.40
Sale of Fixed Assets		0.31	1.26
Net Cash (used) in / from Investing activities		(150.29)	(164.17)
C. Cash flow from Financing Activities			
Repayment of Long Term Borrowings		-	(26.10)
Increase / (Decrease) in Short Term Borrowings		-	(36.92)
Dividend Paid (including dividend tax)		(46.80)	(28.51)
Interest		(4.98)	(4.03)
Net Cash (used) in / from Financing Activities		(51.78)	(95.56)
Net Increase/(Decrease) in Cash & Cash Equivalents		27.44	17.18
Opening Balances of Cash & Cash Equivalents		51.79	34.61
Closing Balances of Cash & Cash Equivalents		79.23	51.79
SIGNIFICANT ACCOUNTING POLICIES		11	
NOTES TO ACCOUNTS		12	

Cash-flow statement has not been disputed by the Ld. DR. It is clear that assessee had generated Rs.229.51 crores from its operating activities. As against this, investments in fixed assets, and capital work-in-progress was only Rs.122.81 crores. Effectively it means that assessee had more than sufficient

own funds for financing the capital work-in-progress. In addition there were no loans what-so-ever raised by the assessee during the relevant previous year. Hence in our opinion interest disallowance was only presumptive without any basis. Ld. CIT (A) was justified in deleting it. No interference is called for. Ground.2 is dismissed.

09. Ground.3 is reproduced below :

“On the facts and in the circumstances of the case the decision of learned CIT (A) on the issue of provision of warranty is not acceptable. The Ld. CIT (A) has not analysed the issue for holding that the ratio laid down by the Hon’ble Supreme Court in the case of Rotork Controls India P. Ltd reported in 314 ITR 062, Karnataka High Court decision in Motor Industries Co. Ltd in concluding that post sale warranty expenses form part of the sale proceed fixed by the company and held that the additions made by the AO cannot be sustained and the same is deleted.”

10. Facts apropos are that assessee had charged a sum of Rs.38 lakhs towards warranty in its profit and loss account. AO on verification of the records it was found that an opening warranty provision of Rs.27,21,000/- and there was a current debit of Rs.23,26,000/-. However, as per the AO assessee had incurred only Rs.19,38,000/- towards warranty expenditure. AO was of the opinion that the balance of Rs.25,25,000/- in the provision account as also the actual expenditure incurred for warranty could not be substantiated by the assessee. He disallowed both the opening warranty provision of Rs.21,27,000/- as well as warranty expenditure of Rs.23,36,000/- debited in the profit and loss account. Total disallowance came to Rs.44,63,000/-.

11. Aggrieved assessee moved in appeal before the CIT (A). Argument of the assessee was that in view of judgment of Hon'ble Apex Court in the case of Rotork Controls India P. Ltd (supra), claim of warranty was allowable. Assessee also pointed out that similar issue had come up in its own case for A. Y. 2006-07 and the CIT (A) had allowed the claim. CIT (A) after going through the findings of his predecessor for A. Y. 2006-07 held that the claim was allowable.

12. Now before us, Ld. DR strongly assailing the order of CIT (A) submitted that provision for warranty unless and until it was made on a scientific basis could not be allowed. As per the Ld. DR, assessee had not produced any details regarding the actual warranty expenditure nor had it furnished the scientific basis on which the provisioning was done. Ld. DR submitted that CIT (A)'s order for A. Y. 2006-07 could not be cited as a reason for allowing the claim this year also. According to him, assessee might have been able to give full details of warranty provisioning for the A. Y. 2006-07, but for the impugned assessment year it was unable to produce such particulars.

13. Per contra, Ld. AR strongly supporting the order of CIT (A) submitted that provision for warranty account clearly reflected the actual warranty expenditure of Rs.19.38 lakhs. According to him actual provisioning for the year was Rs.23.36 lakhs only. In any case, as per the Ld. AR disallowance of opening balance of warranty provision was uncalled for. Ld. AR submitted that assessee was selling hydraulic excavators, loaders, mechanical shovels etc., all

of which were subject to one year warranty. It had estimated warranty expenditure for various assessment years considering the expenditure incurred for earlier assessment years. Thus according to him the view of the AO that warranty was merely an estimate was incorrect. Reliance was once again placed on the judgment of Hon'ble Apex Court in the case of Rotork Controls India P. Ltd (supra).

14. We have perused the orders and heard the rival contentions. There cannot be any dispute that the type of equipment assessee was selling would have necessarily carried with it a warranty. Therefore the view of the AO that assessee could not have incurred any warranty expenditure and ought not have made any warranty provisioning prima-facie appears to be incorrect. What we find from the assessment order is that assessee was unable to provide any details as to the actual warranty expenditure of Rs.19.38 lakhs incurred during the relevant previous year nor the basis on which provision amount of Rs.23.36 lakhs was arrived at. Judgment of Hon'ble Apex Court in the case of Rotork Controls India P. Ltd (supra) cannot be cited as a precedent for claiming any amount as provisioning at the sweet will of an assessee. Hon'ble Apex Court has set out certain clear criteria for allowance of such claims. After considering various judgments on the issue, Hon'ble Apex Court held that there should be facts which would establish existence of defects in items manufactured and sold and the historical trend should indicate expenditure being incurred for warranty. Or in other words, provisioning should be for the present obligation arising from

past events which is expected to result in out-flow of resources in respect of which reliable estimate is possible for the amount of obligation. Reliability of the estimate made by the assessee has to be demonstrated by means of past data. Here, as noted by the AO assessee could not furnish evidence for the actual warranty expenditure of Rs.19,38,000/- debited in its profit and loss account. It also could not give historical data for showing that the warranty provisioning of Rs.23,36,000/- was done on a scientific basis. We are of the opinion that the CIT (A) allowed the claim of the assessee without verifying these facts. Issue therefore in our opinion requires a fresh look by the AO. Orders of the lower authorities on this issue is set aside and remitted back to the AO for consideration afresh in accordance with law. Ground 3 of the Revenue is allowed for statistical purpose.

15. Ground 4 of the Revenue reads as under :

“On the facts and in the circumstances of the case the opinion of the learned CIT (A), that the very fact that the Royalty payment is 1% of the sales, elucidate the nature as revenue expenditure, is not acceptable as the grant of right for manufacture by the Hitachi, brings in enduring nature of benefit to the assessee.”

16. Facts apropos are that assessee had charged in its profit and loss account a sum of Rs.91,06,005/- as royalty expenditure. Assessee explained before the AO that such royalty payments were made to Hitachi Construction Co. Ltd ('HCCL' in short), Japan, which was an associated enterprise, and the rate was 1% of net ex-factory selling price of products marketed under Hitachi brand. Such payments as per the assessee were for the grant of licence to use technical

knowhow and for the rights for manufacturing Hitachi License products, including the intellectual property. AO made a personal visit to the manufacturing and R & D units of the assessee. He noted that the R & D unit was working with technical know how including the intellectual property obtained from HCCL for six models manufactured by the assessee. As per the AO, assessee had by virtue of the technology agreement with HCCL received licence to use technical know how and rights to manufacture Hitachi Licensed products including intellectual property contained therein for six models. Said agreement stated that no lumpsum technical knowhow fees was to be paid by the assessee to HCCL, but a royalty had to be paid by the assessee calculated at the rate of 1% of the net ex-factory selling price of the units sold. Such royalty was payable for a period of seven years from the date of commencement of commercial production or ten years from the execution of agreement, whichever expired earlier. From these conditions set out in the agreement, AO came to a conclusion that assessee was not liable to make any payment to HCCL after the period of seven years or ten years, as the case may be. As per the AO once this period was over assessee could use the technical know how obtained for itself and continue manufacturing the Hitachi Licensed products on its own without making any payment to HCCL. Reliance was placed by the AO on the annual report of the assessee company wherein it was mentioned that design team of the assessee was developing attachments / aggregates and features for hydraulic excavators, which was one among the many products for which royalty was

paid by the assessee. Thus as per the AO, intellectual property embedded in these items for which royalty was being paid by the assessee became assessee's own property after a period of seven years from the date of commercial production, and effectively assessee was receiving an enduring benefit. Such enduring benefit converted the payment of royalty to a capital expenditure as per the AO. Just because the royalty payment was worked as a percentage of the sale value, as per the AO, the colour and character of the payment did not change. He made a disallowance of Rs.91,06,005/- considering it as capital outgo.

17. Aggrieved assessee moved in appeal before the CIT (A). As per the assessee, there were no lumpsum payment as technical knowhow fees. Argument of the assessee was that there was no enduring benefit received by it. Specific reliance was placed on Hon'ble Delhi High Court in the case of CIT v. EKL Appliances Ltd [(2012) 345 ITR 241], Hon'ble Gujarat High Court judgments in the case of CIT v. Ashoka Mills Ltd [(1996) 218 ITR 526] and CIT v. Raipur Manufacturing Co. [(1998) 231 ITR 598]. CIT(A) was appreciative of these contentions. According to him, assessee's agreement with HCCL was one for technology sales, where no lumpsum knowhow fees was to be paid by the assessee. As per the CIT (A), payment of royalty was a percentage of the sales and this by itself reflected its revenue nature. Agreement, as per the CIT (A) resulted only in a right of use of technical know how and conferred only a limited domain over the rights. Assessee had no right

to transfer such know how. According to him, judgment of Hon'ble Delhi High Court in the case of EKL Appliances Ltd (supra) was squarely applicable. He deleted the addition made by the AO.

18. Now before us, Ld. DR strongly assailing the order of CIT (A) submitted that agreement entered with HCCL clearly showed that the technical know how and the intellectual property over which assessee had a right of use for seven / ten years became all of its own after such seven / ten years. As per the Ld. DR it was not a case where assessee was having only rights for only a temporary period. There is nothing in the agreement which barred the assessee from manufacturing the same equipment even after the period of agreement. This being the case, as per the Ld. DR, assessee obtained an enduring benefit. Therefore as per the Ld. DR, CIT (A) fell in error in considering royalty payments as revenue outgo.

19. Per contra, Ld. AR supporting the order of CIT (A) submitted that the technical licence agreement dt.01.09.2006 placed at paper book pages 78 to 93A clearly indicated that assessee had no right to transfer the technical know how made available by HCCL. Assessee could sell products only under the brand name of Tata Hitachi. Agreement only gave a right for using the trade mark for a specified number of years. As per the Ld. AR assessee did not get any enduring benefit. Period of agreement was only for seven years and therefore the payment effected by the assessee at the rate of 1% of sale value was nothing but revenue out go. Reliance was once again placed on the judgments of

Hon'ble Delhi High Court in the case of EKL Equipment Appliances (supra) and Hon'ble Gujarat High Court judgments in the cases of Ashoka Mills Ltd (supra) and Raipur Manufacturing Co. (Supra). Specific reliance was also placed on Chennai bench decision of the Tribunal in the case of Nippo Batteries Co. Ltd v. ACIT [(2011) 48 ITR (Trib) 184].

20. We have perused the orders and heard the rival contentions. Issue before us is whether the payments effected by the assessee pursuant to an agreement dt.01.09.2006 to M/s. HCCL was a revenue out go or a capital out-go. As per the AO, this agreement resulted in an enduring benefit to the assessee and hence though the consideration paid by the assessee to HCCL was a percentage of the sale value, still it retained all qualities of a capital out go and could not be considered as a revenue out-go. Articles 2 and 3 of the agreement entered by the assessee with HCCL is reproduced hereunder :

Article 2 Provision of Technical Know How and Grant of Rights to Telecon

2.2 *Subject to the terms and conditions of this Agreement, Hitachi hereby grants to Telcon, an exclusive but non-transferable license, to manufacture and/or assemble the Hitachi License Products within the Territory using Technical Know How furnished by Hitachi pursuant hereto and to sell or otherwise dispose of the Hitachi License Products, in the manner specified below:*

2.2.1 *Telcon shall be entitled to undertake, on an exclusive basis, the manufacture, marketing and sale of Hitachi License Products in Category I Territory.*

- 2.2.2 *Telcon shall be entitled, on a non-exclusive basis, to undertake the marketing and sale of Hitachi License Products in Category II Territory, without any permission from Hitachi. Accordingly, Telcon shall be entitled to establish subsidiaries, branch offices, rep offices and/or liaison offices in such Category II Territory to undertake and facilitate and service its marketing and sales business, without prior intimation to or approval from Hitachi. Telcon shall not be entitled to undertake manufacture of the Hitachi License Products in Category II Territory.*
- 2.2.3 *Telcon shall not be entitled, on a non-exclusive basis, to undertake the marketing and sale of Hitachi License Products in Category III Territory, but only with prior written consent from Hitachi, which consent shall not be unreasonably withheld. Telcon shall not be entitled to undertake manufacture of the Hitachi License Products in Category III Territory.*
- 2.2.4 *Telcon shall not be entitled to undertake the manufacture or marketing / sales of Hitachi License Products in Category IV Territory, except as provided in Article 4.12.1 of the Shareholders Agreement.*
- 2.3 *The license granted hereunder by Hitachi shall not include the right to Telcon to grant any sublicense. It is, however, understood that Telcon has the right to have the Hitachi License Products manufactured for it or to subcontract with a third party to manufacture the Hitachi License Products upon prior consent of Hitachi's resident representative at Telcon. In such event, Telcon may disclose to the third party such of the Technical Know How licensed by Hitachi as may be required, subject to appropriate confidentiality undertakings by the sub-contractor concerned; Provided however, Telcon shall continue to be primarily responsible for ensuring compliance of its obligations hereunder.*

2.4 Hitachi License Products manufactured by Telcon shall be sold only under the trade name/ brand name of "Tata-Hitachi" in India. Telcon shall not use "Hitachi" as part of the trade name/ brand name outside India, except with the prior written consent of Hitachi. Telcon shall, if required, enter into separate trade mark license agreements for the use by Telcon of the "Hitachi" and "Tata" trade! brand name and trade marks, upon terms and conditions (including payments, if any) acceptable to the respective owners thereof.

2.5 The rights and licenses granted hereunder shall be valid individually, for each Hitachi License Product.

2.6 Upon phase out by Telcon of the manufacture of any Hitachi License Product, Telcon shall immediately notify Hitachi.

Article 3 Supply of Technical Know How

3.1. Hitachi shall make available the Technical Know How inn writing to Telcon including but not limited to the following, to the extent that Hitachi and Telcon deem necessary and adequate and to the extent necessary for the manufacture and service by Telcon, within the scope agreed upon between the Parties, provided however, that Hitachi shall not be obliged to supply to Telcon Technical Know How for Key Components A, except for dimensional drawings necessary for assembly and after-sales-service of Hitachi License Products:

3.1.1 Product information and Product application

3.1.2 Production drawings for Parts/ Components/ Assemblies

3.1.3 Parts List (bill of material) and Parts Standard List and information about sources of procurement

- 3.1.4 Functional test and inspection standards and procedures for manufactured items and acceptance test and inspection standards for procured items.*
- 3.1.5 Drawings of jigs, fixtures, gauges and tools necessary for manufacture, assembly and inspection.*
- 3.1.6 Table of materials for Hitachi's production schedule including operational sequences.*
- 3.1.7 Hitachi's design and engineering standards of material and processes.*
- 3.1.8 Schematic (outline and installation) drawings and / or procurement and performance tests / specifications in case of Components and Spare Parts not manufactured by Hitachi but purchased from outside sources as would be essential for Telcon to have in order to develop them indigenously.*
- 3.1.9 Copies of operation/ maintenance manuals (handling), parts catalogue and service manual/ service instructions.*
- 3.1.10 List of machines and equipment and their procurement specifications, if available, generally employed for the manufacture of various Components of the Hitachi License Products at Hitachi.*
- 3.1.11 Check lists for the operation test/inspection of the Hitachi License Products along with specifications of equipment required for such operation test! inspection.*
- 3.1.12 Technical information, design and advice concerning changes / modifications including material specification and standardization that Telcon may consider necessary for adaptation of the Hitachi License Products to suit Indian conditions.*
- 3.1.13 The items specified in (3.1.1) to (3.1.5) above shall be made available to Telcon no later than four (4) months from the Effective Date and the remaining items shall be made available to Telcon no later than eight*

(8) months from the Effective Date. However, Hitachi shall make all efforts to make them available to Telcon at the earliest.

21. In our opinion it is clear that HCCL was to provide the assessee, technical know how for manufacture of Hitachi license products. It had also agreed to make available such know how in writing. Assessee was having the right to establish subsidiaries, branch office and market the Hitachi license products on non-exclusive basis as per the different category classification. At this juncture it is necessary to have a look at the consideration part of this agreement which is given in articles 15 & 16. These article are reproduced here under :

15.1 For the Hitachi Licensed Products listed in item 1 to 17 of Schedule II of the Shareholders' Agreement and subject to 4.11 of the Shareholders' Agreement, Telcon shall pay to Hitachi, a royalty on the sale of Hitachi License Product(s), which shall be calculated on the "net ex-factory selling price" of Telcon for the Hitachi License Products, at the rate of 1% (one percent) as specified in Schedule IV hereto. The expression "net ex-factory selling price" shall mean the net ex-factory sale price of the Hitachi License Products, exclusive of excise duties minus the cost of standard bought out components, cost of packing and the landed cost of imported components irrespective of the source of procurement including freight, insurance, customs duties etc.

15.2 Royalty, as above, shall be applied to each new Hitachi License Product sold by Telcon, for either a period of seven (7) years from the date of commencement of commercial production of such Product, or ten (10) years from the execution of this Agreement, whichever is earlier (hereinafter referred to as "the Royalty Period").

15.3 *The royalty shall be computed semi-annually as of the last days of June and December of each year and shall be paid to Hitachi within ninety (90) days, after the respective last days mentioned above.*

15.4 *Telcon shall, at the time of each payment of royalty, submit to Hitachi the written report of the production, quantity and ex-factory sale price of the products manufactured during each six-month period certified by Chartered Accountant within sixty (60) days after the last days of June and December.*

Article 16 Payments

16.1 *The royalty and lump sum fee shall, unless otherwise specified by Hitachi, be made in Japanese Yen to a bank account designated by Hitachi, subject to all regulatory approvals and requirements.*

16.2 *All payments for the Components and Spare Parts supplied by Hitachi shall be made by Telcon in a manner to be mutually agreed by the Parties from time to time.*

16.3 *All remittances shall be accompanied by certificates showing the deduction of taxes at source. Telcon shall furnish evidence of payment of tax so deducted, to the relevant tax authorities.*

16.4 *Telcon shall make and retain true and accurate records, files and books of account, containing all the data reasonably required for the full computation and verification of the amounts to be paid and the information to be given to Hitachi in terms hereof. In the event Hitachi so desires, Telcon shall, during usual business hours permit Hitachi or its duly authorized representatives with prior appointment with Telcon, to inspect such records, files and books for the sole purpose of determining the amounts payable to Hitachi.*

22. There cannot be any doubt that assessee had received and HCCL had made available technical know how for manufacture of Hitachi license products. As argued by the Ld. DR just because the consideration was calculated as a percentage applied on net ex-factory selling price, we cannot say that it was a revenue outgo. Whether by this payment assessee got an enduring benefit can be gathered from article 24, which is reproduced here under :

24. 1 Unless terminated in the manner hereinafter provided, the term of this Agreement, for a Hitachi License Product, shall be the period commencing from the Effective Date and ending on expiry of eleven years from the date of commencement of commercial production thereof. Accordingly, notwithstanding the expiry of the Royalty Period, Telcon shall be entitled to continue the manufacture and sale of the Hitachi License Products for the aforesaid term of this Agreement.

24.2 For the Hitachi Licensed Products listed in item 1 to 17 of Schedule II of the Shareholders' Agreement, so long as the Shareholders Agreement continues to be in force and is effective, upon expiry by efflux of time, of this Agreement, Hitachi shall, upon the written request of Telcon, renew the same as so requested, with no obligation on the part of Telcon to make any additional payments and with no obligation on the part of Hitachi to supply Components and Spare Parts otherwise than in accordance with the specific terms of this Technology License Agreement.

24.3 For the Hitachi Licensed Products not listed in item 1 to 17 of Schedule II of the Shareholders' Agreement, this Agreement may, subject to necessary regulatory approvals, be extended by mutual agreement of the Parties and upon terms and conditions that may be mutually agreed. Negotiations for the purpose may be commenced by the Parties not less than 12 months prior to the expiry of the term of this Agreement.

24. 4 Notwithstanding expiry or any termination of this Agreement, the provisions hereof relating to Warranties and indemnity, Secrecy, supply of Spare Parts and arbitration shall survive and remain valid and binding upon the Parties.

23. It is clear from the above article that assessee could continue manufacture and sale of Hitachi licensed products and based on shareholders' agreement, Hitachi was obliged to renew its commitments with no obligation on the assessee. It would be relevant to have a look at articles 26 & 27 also which read as under :

Article 26 Procedure for termination and consequences thereof

26.1 Termination of this Agreement shall not release either Party from any liability to the other Party, which at the time of such termination has already accrued, nor affect in any way the survival of any right or obligation of a Party, which is expressly stated elsewhere in this Agreement to survive such termination.

26.2 In the events specified under Article 25.1, 25.2(ii) and/or 25.2(iv) above, the following provisions will apply:

26.2.1 With respect to Hitachi License Products not yet in commercial production by Telcon, all further rights and obligations of the Parties (other than those already accrued) shall cease immediately and Hitachi shall refund promptly to Telcon, all payments until then made by Telcon for such Products:

26.2.2 With respect to Hitachi License Products already in commercial production by Telcon:

(a) Either Party shall be entitled to terminate this Agreement by a written notice to the other Party, of three (3) years from the occurrence of such event.

(b) During such notice period, Telcon shall be entitled to continue manufacture and marketing/ sales thereof against payment of royalty for such Products, in accordance with the provisions of this Agreement, with the use of the "Hitachi" brand name/ trade name and Hitachi shall be obliged to continue supplies of Components for such Products to Telcon in terms of this Agreement. Hitachi shall issue to Telcon a no-objection letter to enable it to source such Components from third parties after termination of this Agreement.

(c) Hitachi shall be obliged to continue supplies of Spare Parts for such Products to Telcon in terms of this Agreement for a period of seven (7) years from such termination.

26.3 *In the events of breach by Telcon specified under Article 25.2(i), 25.2(iii) or 25.3 above, the following provisions will apply:*

26.3.1 *With respect to Hitachi License Products not yet in commercial production by Telcon, Hitachi shall have the right to forthwith terminate this Agreement in which event all further rights and obligations of the Parties (other than those already accrued) shall cease immediately and Hitachi shall refund promptly to Telcon, all payments until then made by Telcon for such Products, whether by way of lump sum technical know how fees or otherwise. Alternatively, Hitachi may choose not to terminate this Agreement with respect to such Products.*

26.3.2 *With respect to Hitachi License Products already in commercial production by Telcon:*

(a) *Hitachi shall be entitled to terminate this Agreement by a written notice to Telcon, of the lesser of: (A) three (3) years from the occurrence of such event, or (B) the balance term of this Agreement.*

(b) *During such notice period, Telcon shall be entitled to continue manufacture and marketing / sales thereof against payment of royalty for such Products, in accordance with the provisions of this Agreement, -(but without the use of the "Hitachi" brand name / trade name), and Hitachi shall be obliged to continue supplies of Components for such Products to Telcon in terms of this Agreement.*

(c) *Hitachi shall be obliged to continue supplies of Spare Parts for such Products to Telcon in terms of this Agreement for a period of seven (7) years from such termination.*

(d) *During such notice period, Telcon (but not Hitachi) shall remain bound by the non-compete provisions of Article 18 of this Agreement.*

26.4 *In the events of breach by Hitachi specified under Article 25,2(i) 25.2(iii) or 25.4 above, the following provisions will apply:*

26.4.1 *With respect to Hitachi License Products not yet in commercial production by Telcon, Telcon shall have the right to forthwith terminate this Agreement in which event all further*

rights and obligations of the Parties (other than those already accrued) shall cease immediately and Hitachi shall refund promptly to Telcon, all payments until then made by Telcon for such Products, whether by way of lump sum technical know how fees or otherwise. Alternatively, Telcon may choose not to terminate this Agreement with respect to such Products.

26.4.2 With respect to Hitachi License Products already in commercial production by Telcon:

- (a) Telcon shall be entitled to terminate this Agreement by a written notice to Hitachi of the lesser of; (A) three (3) years from the occurrence of such event, or (B) the balance term of this Agreement.*
- (b) During such notice period, Telcon shall be entitled to continue manufacture and marketing / sales of all Hitachi License Products in accordance with the provisions of this Agreement against payment of royalty for such Products and with the use of the "Hitachi" brand name /trade name.*
- (c) Hitachi shall be obliged to continue supplies of Components for all such Products to Telcon in terms of this Agreement during such notice period and shall issue to Telcon a no-objection letter to enable it to source such Components from third parties thereafter and shall assist Telcon in doing so.*
- (d) Hitachi shall be obliged to continue supplies of Spare Parts for all such Products to Telcon in terms of this Agreement for a period of seven (7) years from the end of the balance term of this Agreement.*
- (e) During the notice period referred to above, Hitachi (but not Telcon) shall remain bound by the non-compete provisions of Article 18 of this Agreement.*

Provided that where the termination is on account of an event specified under Article 25.2(i) above, the aforesaid actions shall not prejudice any other rights and remedies available to Telcon.

Article 27 General Provisions :

27. Subject to the provisions of Article 26 above, in the event of the termination of this Agreement, all rights and privileges of Telcon hereunder shall terminate and revert to Hitachi, and Telcon shall cease all use of the Technical Know how, including the intellectual property, and return to Hitachi all tangible and material representations of the Technical Know how and intellectual property in written, pictorial or other recorded form then held by it or by any employee, and/or agent in terms of this Agreement or otherwise, who shall have received any such Technical Know-How, directly or indirectly, from Telcon.

24. No doubt in the above article it is mentioned that on termination of the agreement the technical know how shall revert back to HCCL and assessee would cease the use of such technical know how on the termination mentioned there in. However as per article 26 whether termination was based on agreement between assessee and HCCL or was through a written notice, the right or obligation of the parties expressly stated in the agreement clearly survived. Thus in our opinion assessee had every right to use the technical know how obtained by it from HCCL, even after the expiry of the seven or ten year period mentioned in the agreement. Assessee could not have used the Hitachi brand name after the said period, but it could still use the technical knowhow. Technical knowhow obtained by the assessee in our opinion did give it an enduring benefit.

25. Coming to the judgment of Hon'ble Delhi High Court in the case of EKL Appliances Ltd (supra), question before their Lordship was whether disallowance of brand fee / royalty payment made to an associated enterprise abroad was justified. The payments effected by the assessee in said case was

brand-fee, at the rate of 0.5% on the net sales for the brand name 'Kelvinator. Here what we find is that the payments effected by the assessee', though it gave it a right to use Hitachi brand name, was not for using the brand name but for the technical know how made available by HCCL to the assessee for manufacturing Hitachi license products.

26. As for the Gujarat High Court judgment in the case of Ashoka Mills Ltd, (supra) the royalty payment were for using the trade mark which their Lordships held as not creating a permanent right for the assessee. Agreement was for eight-year use of trade mark. However, in the case before us, as we have already noted, even after expiry of agreement period, assessee could still continue to manufacture the products using the technical knowhow obtained by it from HCCL. As for the judgment of the very same High Court in the case of Raipur Manufacturing Co (supra), royalty was paid for use of trade mark.

27. Coming to the last decision relied on by the Ld. AR which is of the Chennai Bench of the Tribunal in the case of Nippo Batteries Co. Ltd (supra), concerned assessee had a right to use the technical know how for a limited period and not there after. Here on the other hand assessee was free to use the technical knowhow obtained by it from HCCL even after the period of agreement. Therefore the said decision would not apply on facts here.

28. We are thus of the opinion that CIT (A) fell in error in considering the payment of royalty made by the assessee as revenue out go. We set aside the

order of CIT (A) and reinstate the addition made by the AO. Ground 4 of the Revenue stands allowed.

29. In the result, appeal of the Revenue is partly allowed.

Order pronounced in the open court on 23rd day of September, 2015.

Sd/-

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER

(ABRAHAM P GEORGE)
ACCOUNTANT MEMBER

MCN*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income-tax
4. Commissioner of Income-tax(A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar