IN THE INCOME TAX APPELLATE TRIBUNAL
(DELHI BENCH 'C' : NEW DELHI)

BEFORE SHRI RAJPAL YADAV, JUDICIAL MEMBER
and
SHRI B.C. MEENA, ACCOUNTANT MEMBER

ITA Nos.637 & 638/Del./2013
(Assessment Years : 2005-06 & 2006-07)

M/s. Groz Engineering Tools Pvt. Ltd., C – 717, New Friends Colony, New Delhi – 110 065.	vs.	DCIT, Circle 12 (1), New Delhi.

(PAN : AABCG4017H)

ITA No. 4373/Del./2013
(Assessment Year : 2007-08)

M/s. Groz Engineering Tools Pvt. Ltd., C – 717, New Friends Colony, New Delhi – 110 065.	vs.	Addl.CIT, Circle 12 (1), New Delhi.

(PAN : AABCG4017H)

(Appellant) (Respondent)

Assessee by : Shri Ved Jain & Smt. Rano Jain, CAs
Revenue by : Shri Satpal Singh, Senior DR

ORDER

PER B.C. MEENA, ACCOUNTANT MEMBER :

ITA No.637/Del/2013 emanates from the order of CIT (Appeals)-X, New Delhi dated 07.12.2012 for the Assessment Year 2005-06. Although there are various grounds in the appeal, however, at the time of hearing, ld. AR submitted that he is not contesting any other ground except ground nos.2(i), 2(ii) and 3(i) in which the issue is with regard to the payment of royalty.

2. ITA No.638/Del/2013 emanates from the order of CIT (Appeals)-X, New Delhi dated 10.12.2012 for the Assessment Year 2006-07. In this appeal also, the assessee has taken many grounds, however, the ld. AR submitted that he will pursue only the ground no.2(i), 2(ii) and 3(i) in which the issue of payment of royalty is involved.

3. ITA No.4373/Del/2013 emanates from the order of CIT (Appeals)-VIII, New Delhi dated 31.03.2013 for the Assessment Year 2007-08. In this appeal also, the assessee has taken many grounds, however, the ld. AR submitted that he is only pursuing ground nos.2 to 4 in which the issue of payment of royalty is involved.

4. Since ld. AR is only pursuing the issue involved regarding payment of royalty and no other ground was pleaded before us, therefore, all other grounds raised in the appeal memo are dismissed as not pressed. The only issue regarding payment of royalty is being disposed of by this common order in all the three Assessment Years, for the sake of brevity, as the facts and circumstances are same in all the three years.

5. In the Assessment Year 2005-06, the assessee has paid royalty of Rs.50,20,122/- and the Assessing Officer disallowed a sum of Rs.37,65,091/- treating the expenditure as capital in nature after allowing depreciation @ 25%. Thus, the net addition to the income was of

Rs.37,65,091/-. Similarly, in the Assessment Year 2006-07, the royalty expenditure claimed of Rs.49,01,101/- and the same was disallowed treating as capital expenditure in nature after allowing depreciation @ 25%. The relevant para of Assessing Officer's order for Assessment Year 2005-06 is reproduced as under :-

> **"Capitalization of royalty expenses.**
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> The assessee in its return of income had claimed royalty expenses amounting to Rs.5020122/- paid to M/s Macnaught Pvt. Ltd. Vide questionnaire dated 10/07/07, the assessee was asked to furnish the details of the royalty expenses along with the copy of the relevant agreement. The details furnished by the assessee vide its reply dated 20/09/07 showed that the royalty had been paid on account of M/s Macnaught Pvt. Ltd. having agreed to allow the assessee to manufacture and sell a limited number of the Macnaught products. Thereafter, vide order sheet entry dated 20/09/07, the assessee was asked to explain as to why the royalty expenses should not be capitalized since the assessee was getting an advantage of an enduring nature out of the same.
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> In response the assessee vide its reply dated 05/10/07 submitted that it had approached M/s Macnaught Pvt. Ltd. for production of their products in India with their technology and M/s Macnaught Pvt. Ltd. had provided their specification including drawings of various dyes and details of quality control procedure and equipment and had also allowed the assessee to put the trademark "Macnaught" on these products in consideration of the royalty. The assessee further argued that the royalty was linked to the volume of the sales. Thus, the assessee argued the royalty expenses should be allowed to the assessee.
>
> The reply of the assessee has been duly considered and found to be unacceptable. From the reply of the assessee is very clear that the assessee is basically using the drawings of various dyes, quality control procedure and most importantly the trademark "Macnaught" of M/s Macnaught Pvt. Ltd. for

> which the royalty is being paid. The use of these drawings, procedure and trademark is only going to bring an advantage of an enduring nature to the assessee and so the expenditure on the same is clearly an expenditure for acquiring an intangible asset which would bring long term benefit. In view of the above, the royalty paid by the assessee is hereby capitalized. However, depreciation @25% is allowed to the assessee. Therefore, after allowing depreciation of Rs. 1255031/- on Rs. 5020122/-, the balance amount of Rs. 3765091/- is added to the income of the assessee. Since I am satisfied that the assessee has furnished inaccurate particulars of its income, penalty proceedings under section 271(1)(c) are being initiated separately."

The disallowance in the Assessment Years 2006-07 and 2007-08 is also on the similar grounds and the language of the order is almost same.

6. The CIT (A) has sustained/enhanced the addition and the relevant portion of the order from the Assessment Year 2005-06 is reproduced as under :-

> "2.3. I have gone through the observations and findings of the assessing officer, submissions of the A. R. of the appellant, copies of relevant royalty agreements, this ground of the appellant is being finalized after making the following observations :
>
> (a) On going through the copy of the agreement dated 19.11.2002 and 01.06.2005, it is observed that these agreements are very casual in nature and also not on any stamp paper which has proper legal sanctity. It is also surprising to note that even when such large corporate entities are entering into agreement, even the basic legal documentation is not properly followed up. Accordingly, the sanctity of these royalty agreements are prima facie doubtful. Further, on reading the one page agreement, the basis of these payments have not been elaborately discussed. The only item stated in this agreement states that the appellant company shall make payment of certain amounts on a per unit basis. The justification for these payments are also not properly known.

In fact, on going through the agreement it appears that the assessing officer did not have adequate details to understand the basis of all these payments. The arguments of the A.R. of the appellant are not at all justified regarding the nature of technology transfer or per unit basis payments, since such cryptic agreement cannot form the basis of nature of arguments put forth by the A.R. of the appellant.

(b) The A.R. of the appellant also relied upon several judicial pronouncements in his submissions. However, all these judicial pronouncements would not be relevant in this case since in the present case even the nature of the royalty agreement is very cryptic and does not elaborate the conditions of payments in detail. Regarding the other judicial decisions are clear cut clauses in those agreements whereby details of such payments are always laid down specifically. In this case, the reliance placed by the A.R. on those judicial pronouncements of Coal Shipment P. Ltd 82 ITR, Jacobs P. Ltd. 120 ITR etc. are not relevant.

(c) The A.R. of the appellant has not been able to justify the complete background of royalty payments and cryptic agreement. The claim made for these payments shows the casual approach of the appellant. The only claim regarding the payments being based on the output is also not fully supported by any clauses in the agreement where it is nowhere mentioned that no payment shall be made in case of no production being done by the appellant.

(d) During the course of appellate proceedings, the appellant was provided opportunity to explain the basis of royalty payment during the year and a letter dated 08-11-2012 was issued seeking an explanation as to why the addition on account of royalty payment for A.Y. 2006-07 should not be enhanced to Rs.49,01,101/-. In response to this letter, the A.R. of the appellant has made a submission on 27-11-2012 in which it was stated that actually the royalty payments have been made and M/s Macnaught Pvt. Ltd. had supplied various technical details to the appellant on the basis of which these payments were justified. It was also submitted that copies of some of the drawings and proof of payment was being provided which was sufficient to explain the royalty payments made to Macnaught Pvt. Ltd. It was argued by the A.R. that without paying the royalty, the assessee would not be in a position to produce / sell Macnaught products. Therefore, these expenses were exclusively for business purposes and should be allowed as revenue expense during the year.

(e) These submissions of the A.R. of the appellant are very general in nature and no specific submissions or arguments have been provided by the A.R. of the appellant to justify these payments to Macnaught Pvt. Ltd. on the basis of cryptic and casual agreement which was produced.

2.4. On going through the assessment order also it is observed that the assessing officer had not appreciated the casual nature of the agreement and had not examined the issue whether this payment was justified as a business expense at all. Since there is no legal backing to the agreement and there is nothing mention in the agreement regarding the justification for these payments, the issue of the payments being capital or revenue is secondary and the primary issue remains, whether such payments are at all justified and exclusively for the business purpose of the appellant. It is pertinent to note that even during the appellate proceedings, the A.R. of the appellant has only made casual submissions only emphasizing that certain technical details / drawings were provided by Macnaught Pvt. Ltd. and also that, proof of payment for these amounts in the form of bills was available. However, these two arguments are neither sufficient nor convincing to justify that these payments were wholly and exclusively for business purposes and there was any justification for making these payment in light at very casual agreement which did not have any legal sanctity. After careful consideration of the facts of the case and the documents available as well as the replies of the A.R. of the appellant as to why the disallowance should not be enhanced, I am convinced that the full amount of Rs.50,20,122/- should be disallowed in current year itself and there was no justification of these payments as business expense. Accordingly, the disallowance is enhanced from Rs.37,65,091/- to Rs.50,20,122/-."

7. While pleading on behalf of the assessee, ld. AR submitted that the CIT (A) enhanced/sustained the addition on the ground that assessee has

failed to justify the business purpose of the expenses claimed on account of royalty. He submitted that CIT (A) has given the following reasoning for sustaining the addition :-

> "i) the agreement on the basis of which royalty has been paid are very general agreement and do not have any legal sanctity in view of the fact that they have not been documented on any stamp paper;
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> ii) the basis on which the royalty has been paid has not been justified clearly in these agreements;
>
> iii) the only issue mentioned in the agreement is that royalty would be paid per unit as agreed;
>
> iv) no terms and conditions regarding payment of the royalty have been outlined in these agreements;
>
> w) there are no clauses in the agreement which show that no payment shall be made in case of no production being done by the appellant.
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> vi) The CIT(A) also held that appellant is using trademark 'MACNAUGHT' which is a benefit of enduring nature and these expenses are not revenue in nature."

He pleaded that CIT (A)'s order is untenable. MACNAUGHT Pty. Ltd. (hereinafter referred to as "MACNAUGHT" in short) was established in 1984 by Colin Macnaught. MACNAUGHT is a 100% wholly owned company based in Turrella, Sydney, Australia which designs and manufactures a wide range of high quality equipment for the lubrication and fluid transfer industries including grease pumps and guns, fuel pumps, hose reels and flow meters. These products are sold in the agricultural, industrial, automotive, mining, aviation and marine industries throughout the world. The assessee is manufacturing products and selling the same in the name of MACNAUGHT and have been paying royalty as specified in the arrangement entered into with MACNAUGHT. Therefore, the CIT (A)'s reasoning for disallowing the royalty expenditure is untenable in law. The arrangement between the assessee and the Australian company has been duly signed by both the parties. The rate per piece has also been specified therein. The royalty has been paid in actual. MACNAUGHT is not a related concern of the assessee. There is no allegation that the payments were bogus and it was an arranged affair. This is an actual payment after deduction of TDS and remitted through proper banking channel in foreign exchange. Therefore, the observation of the CIT (A) is not based on any specific finding. The rate, the products on which these are payable are clearly stated in the agreement. There is no legal requirement that there should be a detailed agreement between the parties. However, the only thing required is that there should be an arrangement under which payments have to be made. Section 37(1) of the Income-tax Act, 1961 provides for allowability of the expenditure incurred wholly and exclusively for purposes of the business. The assessee has actually incurred this expenditure for the business purposes, therefore, the CIT (A) was not justified in sustaining the disallowance. Ld. AR also placed reliance on the order of ITAT, Mumbai in the case of M/s. India Fashions Ltd vs. ITO in ITA

No.5262/Mum/2011 dated 08.08.2014 for the proposition that non-existence of written agreement cannot be sole basis for disallowance of commission payment if other evidences prove the fact of incurring for such expenditure wholly and exclusively. Proof/existence of a written agreement between the assessee and the commission agent is not a requirement for allowing the expenditure of the commission payment made by the assessee. He also relied on the decision of ITAT, Mumbai in the case of Harrison Garment Division vs. JCIT 18(2), Mumbai in ITA No.3022/Mum/2012 & ITA No.6480/Mum/2012 order dated 30.04.2014 for the proposition that when there was no formal written agreement between the assessee and the agent, but commission has been paid on regular basis to the agent in earlier as well as subsequent assessment years; mere existence of an agreement cannot decide the allowability of commission payment, it is the presence of surrounding circumstances and the basic facts that decide the issue in conclusive manner; non-existence of written agreement cannot be sole base for disallowance of commission payment, if other evidences prove the fact of incurring of such expenditure wholly and exclusively for the business purposes. He also placed reliance on the decision of Smt. Godavari Devi Sehgal vs. ITO reported in (1992) 40 ITD 71 (Delhi) wherein the matter was referred to the third Member and it was the view of all three Members that mere absence of a written agreement would not justify disallowance of a part of commission paid. Ld. AR also placed reliance on the decision of Hon'ble Karnataka High Court in the case of Ritz Hotels (Mysore) Limited vs. CIT reported in (1992) 196 ITR 614 (Kar) for the proposition that in the absence of a specific agreement to make the payment of commission, any payment made cannot be allowed, the Hon’ble High Court has held that we are not able to agree with the reasoning of the Appellate Tribunal. He also relied on the decision of Hon’ble jurisdictional High Court in the case of CIT vs. Agra Beverages Corporation (P.) Ltd in ITA Nos. 966 of 2009 and 836 of 2010 dated 25.01.2011 wherein the Hon’ble High Court has held that the Tribunal rightly allowed this claim as business expenditure which could not be denied merely on the ground that there was no written agreement between Pepsi and the assessee for payment of the aforesaid amount; the amount is represented as hire charges for the coolers which were installed in the premises of the assessee and it would be clearly business expenditure. Reliance was also placed on the decision of CIT vs. Gautam Creations (P) Ltd. reported in (2007) 213 CTR 543 (Del) wherein the Assessing Officer disallowed deduction of commission holding that the assessee was unable to satisfactorily explain the payments and the work done by the agents to whom the commission was paid and the Hon'ble Delhi High Court held that Tribunal on appreciation of evidence held that there was an agreement, though not a written agreement between the parties and that work was done by the commission agents pursuant thereto justifying the commission payments made to them by the assessee; no substantial question of law arises from the impugned order since it is based on appreciation of evidence and no perversity has been shown in the view taken by the Tribunal. Ld. AR also relied on the decision of Hon'ble Delhi High Court in the case of Indo Rama Synthetics India Ltd vs. CIT reported in (2011) 333 ITR 18 (Del) and also placed reliance on the decision of ITAT in the case of Anupam Synthetics (P) Limited vs. JCIT reported in (2007) 14 SOT 46 (DELHI).

7.1 Further, it was also pleaded that the expenditure was also capital in nature was also not correct as is evident from the agreement as no right has been created or purchased by the assessee from the MACNAUGHT except to use their trademark to undertake production of MACNAUGHT product. Since the assessee has not acquired any right from MACNAUGHT it cannot transfer any right to others. The fundamental difference between using a technology and acquiring is that knowhow remain exclusive property of the licensee and the payment for the same is capital in nature. However, in assessee's case, the consideration is paid only for the use of technology and no right accrued to the assessee i.e. Licensee, therefore, such expenditure was revenue in nature. He also placed reliance on the case of Climate Systems India Ltd. vs. CIT reported in (2009) 319 ITR 113 (Del) for the proposition that royalty paid by assessee to the foreign collaborator at specified percentage of its domestic and export sales for using the technology and availing of technical services provided by the latter under the technical collaboration agreement is allowable as revenue expenditure. He also placed reliance on the decision of Hon'ble Delhi Hon'ble High Court in the case of CIT vs. Sharda Motor Industrial Ltd. reported in (2009) 319 ITR 109 (Del) and Hon'ble M.P. High Court in the case of CIT vs. Eicher Motor Ltd. reported in (2007) 293 ITR 464 (MP). Further, he placed reliance on the decision of Hon'ble Madras High Court in the case of CIT vs. M. Subramaniam reported in (2005) 272 ITR 525 (Mad.) wherein the Hon'ble High Court has held that the royalty payable to the assignor, that was variable and was unknown at the time the agreement was entered into. At that point of time, it was not possible to predict the volume of sale as also the price at which the cassette was to be sold, and as a result, the amount that would become due and payable to the assignor in future was not known. The sum paid subsequently which sums were variable and not ascertained at the time of assignment would lie in the field of revenue and not capital.

7.2 Ld. AR also made alternate submission in which he submitted that even if the royalty payment is capital in nature, the amount of the payment made since 2002 till date and if it is considered that assessee has incurred expenditure for acquiring technology then the obvious implication shall be that the payment made in each of the year shall be in respect of technology acquired by the assessee initially. If that is the case then entire expenditure needs to be considered as capital expenditure in the first year itself and depreciation has to be allowed since beginning. In the alternate plea, ld. AR submitted a working of the depreciation and pleaded that it gives much more than the claim of the assessee. The details submitted are reproduced as under :-

"Assessment Year	Total Expenditure
2005-06	Rs. 50,20,122/-
2006-07	Rs. 49,01,101/-
2007-08	Rs. 33,39,732/-
2008-09	Rs. 57,27,094/-
2009-10	Rs. 71,86,909/-
2010-11	Rs. 24,54,907/-
2011-12	Rs. 54,11,233/-
TOTAL :	Rs.3,40,41,098/-

The depreciation allowable for each year will be as under :-

Assessment Year	Written Down Value	Depreciation @ 25%	Written Down Value
2005-06	Rs.3,40,41,098/-	Rs.85,10,275/-	Rs.2,55,30,823/-
2006-07	Rs.2,55,30,823/-	Rs.63,82,706/-	Rs.1,91,48,118/-
2007-08	Rs.1,91,48,118/-	Rs.47,87,030/-	Rs.1,43,61,089/-
2008-09	Rs.1,43,61,089/-	Rs.35,90,272/-	Rs.1,07,70,816/-
2009-10	Rs.1,07,70,816/-	Rs.26,92,704/-	Rs.80,78,112/-
2010-11	Rs.80,78,112/-	Rs.20,19,528/-	Rs.60,58,584/-
2011-12	Rs.60,58,584/-	Rs.15,14,646/-	Rs.45,43,938/-

He finally pleaded that there is hardly any revenue implication in this ground as the assessee is entitled for exemption u/s 10B of the Act on majority of sales.

8. On the other hand, ld. DR relied on the orders of the authorities below and pleaded to sustain the addition.

9. We have heard both the sides. The assessee company is a manufacturing company and engaged in the engineering tools. It is a 100% export oriented unit located in Gurgaon, Haryana. This unit is eligible for exemption u/s 10B of the Act on the profit earned. The assessee company was paying the royalty expenses to MACNAUGHT on the various products sold by it as agreed with MACNAUGHT on 19.11.2002. MACNAUGHT is an Australian company. It has no connection with the management of the assessee company. This royalty is being paid by the assessee for putting the trademark MACNAUGHT on the products of the assessee and using drawing etc. This royalty was linked to the volume of sales. The assessee is using the knowhow, trademark and licenses without any right to the license. The rights remained with the licensor, therefore, this payment of royalty cannot be treated as capital in nature. It was paid for use of technology and trademark, therefore, the same was revenue expenses. Further, this expenditure has been incurred wholly and exclusively for the purpose of

business of the assessee. The assessee has deducted TDS and deposited the same with the Government. The genuineness of the payment is also not in doubt. In such circumstances, we find that the CIT (A) was not justified in sustaining/enhancing the addition and the Assessing Officer was not justified in treating the amount as capital in nature. Considering the various case laws relied upon by the ld. AR for the assessee, we allow the appeal of the assessee. Since we have allowed the appeal of the assessee we do not find any necessity to consider the alternate pleadings of the ld. AR with regard to the claim of depreciation and taking the cost of acquisition of technology at initial stage at sum total of the royalty paid in various subsequent years.

9. In the result, all the three appeals of the assessee are partly allowed.

Order pronounced in open court on this 14th day of October, 2014.

Sd/-	**sd/-**
(RAJPAL YADAV)	**(B.C. MEENA)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated the 14th day of October, 2014
TS

Copy forwarded to:

1.Appellant
2.Respondent
3.CIT
4.CIT(A)-X, New Delhi.
5.CIT(ITAT), New Delhi.

AR/ITAT