

# SUPREME COURT OF INDIA

EIMCO K.C.P. Ltd.

Versus

Commissioner of Income Tax Madras

(D.P. Wadhwa and S.S. Mohammed Quadri, JJ.)

Civil Appeal No. 4058-59 of 1994.

25.02.2000.

## JUDGMENT

**S.S. Mohammed Quadri, J.** - The judgment and order passed by the Division Bench of the High Court of Madras in T.C. Nos. 1224 and 1225 of 1997 dated January 17, 1983 is subject-matter of challenge in these appeals.

2. The appellant-assessee is a Company registered under the Indian Companies Act. It was incorporated in the year 1965. Two companies M/s. Eimco Corporation Inc. (for short 'Eimco'), an American company, and M/s. K.C.P. Ltd. (for short 'KCP'), an Indian Company, promoted the appellant company. The authorised capital of the appellant was Rs. 10,000,000/- consisting of 1,000,000/- equity shares of Rs. 10/- each. Each of them agreed to subscribe Rs. 4,70,000/- out of which each will have to pay initially a sum of Rs. 4,70,000/- out of which each will have to pay initially a sum of Rs. 2,80,000/- towards its contribution. Towards its share Eimco contributed technical know-how consisting of right and license to manufacture existing Eimco Sedimentation and filtration equipment, along with the supply of and/or the agreement to supply general technical data including manufacturing drawings in the form as used and possessed by Eimco, relating to the sales, application, selection, material requirements, manufacture, installation and operation of such equipment, including but not limited to test procedures, instruction manuals, technical manuals, general arrangement and detail drawings, flow charts, research and development reports, sales manuals and bulletins, operating reports on existing installations and installation and operation manuals. It valued the know-how etc. at a sum of Rs. 2,35,000/- and paid the balance in cash as its contribution. The Board of Directors of the appellant allotted equity shares of Rs. 2,35,000/-, being of the value of the know-how, to Eimco by resolution passed on April 29, 1968. In the assessment year 1969-70, the appellant claimed deduction of Rs. 2,35,000/- as revenue expenditure paid to Eimco towards consideration for supply of technical know-how by it. By order dated March 25, 1970, the Income Tax Officer treated that as a capital expenditure and allowed 1/4th of the said amount as allowable expenditure under Section 35-A of the Income Tax Act (for short 'the Act'). The appellant challenged that order before the Appellate Assistant Commissioner on the ground that the whole expenditure ought to have been allowed as revenue expenditure. While so, the Commissioner of Income Tax in exercise of its power under Section 263(1) of the Act revised the said order of the Income Tax Officer dated March 25, 1970 holding that the amount in question could not be treated as expenditure and that granting 1/4th of the said amount as capital expenditure under Section 35-A was erroneous and prejudicial to the interest of the revenue and thus set aside

the same. Thereafter, the Appellate Assistant Commissioner dismissed the appeal and directed that 1/4th amount be added back as income of the assessee. Against both the orders, the appellant filed appeals before the Income-tax Appellate Tribunal. The Tribunal, on December 12, 1975, allowed appeals of the appellant taking the view that the said amount was revenue expenditure of the appellant. At the instance of the Revenue, the following two questions were referred to the High Court under Section 256(1) of the Act :

"(1) Whether on the facts and in the circumstances of the case, the Commissioner could interfere, acting under Section 263 of the Income-tax Act, 1961 with the order of the Income-tax Officer on a point which was directly in appeal before the Appellate Assistant Commissioner ?

(2) Whether on the facts and in the circumstances of the case, the sum of rs, 2,35,000/- paid by the assessee company to the foreign collaborator constitute revenue expenditure."

Both the questions were answered in favour of the Revenue and against the assessee by the High Court in the impugned order.

3. Mr. M. Uttam Reddy, learned counsel appearing for the appellant, did not seriously canvass the correctness of the impugned order in regard to the first question and in our view rightly. Having regard to Section 263 of the Income Tax Act and the decision of this Court in *Commissioner of Income-tax, Bombay v. Amritlal Bhogilal & Co.*, 32 ITR 130 and judgments of High Court of assam in *Ramlal Onkarmal v. Commissioner of Income-tax, Assam*, 44 ITR 578 and of Kerala in *Kelpunj Enterprises v. Commissioner of Income-tax, Kerala*, 108 ITR 249, which we approve, we confirm the answer to the first question recorded by the High Court.

4. Regarding the second question Mr. Reddy vehemently contended that the amount of Rs. 2,35,000/- was paid by the appellant to the foreign collaborator to acquire the know-how so it was revenue expenditure and ought to have been so held by the High Court. Mr. Shukla argued that know-how etc. are contributed by Eimco towards its share of the capital and that no amount was paid by the appellant to Eimco, allotment of shares of Eimco by the appellant could not be treated as expenditure incurred by it for purchase of know-how.

To appreciate the contention of Mr. Reddy, it may be necessary to quote Section 37(1) of the Income Tax Act here :

"37. *General* - (1) Any expenditure (not being expenditure of the nature described in Sections 30 to 36 \* \* \* and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed to computing the income chargeable under the head "Profits and gains of business or profession."

5. A plain reading of the above provision makes it clear that it is a residuary provision and allows an expenditure, not covered under Sections 30 to 36 in computing the income chargeable under head "profits and gains of business or profession", on fulfilment of the other requirements, namely, (i) the expenditure should not be in the nature of capital expenditure or personal expenses of the assessee; (ii) it should have been laid out or expended wholly and exclusively for the purposes of the business or profession; (iii) it should have been expended in the previous year.

6. The question is whether the amount in question can be treated as expenditure and whether it was

expended wholly and exclusively for the purpose of the business of the appellant.

7. In support of his contention that Rs. 2,35,000/- were spent for purchase of technical know-how, so it is a revenue expenditure. Mr. Reddy relied upon a letter addressed by the Vice-President of the Eimco Corporation to the Director of K.C.P. Ltd. on April 14, 1965.

The relevant excerpts of the said letter read as under :-

"In general, we agree that the organisation will follow that set forth in the Memorandum and Articles of Association of the K.C.P. - Tives Lille - Cail Private Limited (a corporation of India), but with the following specific provisions to which we have agreed.

1. The Company will be organised and headquartered in India as an Indian Corporation with broad corporate powers.

2. The name of the company will be EIMCO-K.C.P. Private Ltd.

3. There will be two subscribers for one share each - each partner will designate one subscriber.

4. Authorised capital is to be Rs. 10,000,000/- consisting of 1,000,00 equity shares of Rs. 10/- each.

5. Each partner will subscribe to Rs. 470,000; of this amount each will initially pay in Rs. 280,000 or equivalent after approval by the Government of India and before commencement of operation; and the balance of the amount subscribed will be contributed by each partner, in equal amounts, as and if required for operation of the business.

6. The amount initially paid in by Eimco will primarily consist of Eimco's know-how, valued at Rs. 235,000 and cash. Know-how consists of the right and licence to manufacture existing Eimco Sedimentation and filtration equipment, along with the supply of and or the agreement to supply general technical data including manufacturing drawings in the form as used and possessed by Eimco, relating to the sales, application, selection, material requirements, manufacture, installation and operation of such equipment, including but not limited to test procedures, instruction manuals, technical manuals, general arrangement and detail drawings, flow charts, research and development reports, sales manuals and bulletins, operating reports on existing installations and installation and operation manuals. The balance of the initial investment will be in cash."

8. A plain reading of the letter indicates that Eimco and K.C.P. agreed to float the appellant company with authorised capital of Rs. 10,000,000/- consisting of 1,000,000 equity shares of Rs. 10/- each. Each of them agreed to subscribe Rs. 4,70,000/- out of which the amount equivalent to Rs. 2,80,000/- was to be paid (after approval by the Government of India and before the commencement of operation). Eimco valued the know-how etc. at a sum of Rs. 2,35,000/- and paid the balance in cash towards its contribution.

9. What in effect was done by the appellant in allotting equity shares of Rs. 2,80,000/- to Eimco, was to reimburse the contribution of Eimco by way of know-how, which can never be treated as expenditure much less an expenditure laid out wholly and exclusively for purpose of the business of the appellant. It is not a case where after the incorporation, the appellant-company in the course of

the carrying on its business, spent the said amount for acquiring any asset. Reliance by Mr. Reddy on the judgment of this Court in *Alembic Chemical Works Co. Ltd. v. Commissioner of Income-Tax, Gujarat, 1989(177) ITR 377* is wholly inappropriate. There know-how was acquired to produce higher yield and sub-culture of high yielding strain of penicillin. The assessee-company was already engaged in manufacturing of antibiotics including penicillin before it acquired the know-how. Therefore, it was a case of a running company acquiring know-how to increase its yield and quality of its product and for the better conduct and improvement of the existing business and therefore the amount spent on acquiring know-how was held to be revenue expenditure.

10. In our view, the High Court has rightly concluded that allotment of equity share by the appellant to Eimco, in the circumstance of the case, cannot be termed as 'expenditure much less revenue expenditure' and rightly answered the question referred to it against the appellant-assessee. We find no merit in these appeals which are accordingly dismissed with costs.