

SUPREME COURT OF INDIA

Commr.of Income Tax-II,Chandigarh

Vs.

Swaraj Engines Ltd.

C.A.No.3347 of 2008

(S.H. Kapadia and B. Sudershan Reddy JJ.)

06.05.2008

ORDER

1. Leave granted.
2. This Civil Appeal is filed by the Revenue against the order passed by the Punjab & Haryana High Court in I.T.A.No.131/2004. The impugned decision is dated 18th May, 2006.
3. M/s. Swaraj Engines Ltd. (respondent herein) entered into an agreement of transfer of technology know-how and trade mark with Kirloskar Oil Engines Ltd. under which royalty was payable it. The claim for deduction in respect of the said payment was made by the respondent. It is important to note that during the relevant Assessment Year 1995-96, royalty was paid by the assessee as a percentage of net selling price of the licensed goods products.
4. Two questions arise for determination in this Civil Appeal. Firstly, whether the question regarding applicability of Section 35AB of *Income Tax Act, 1961* was ever raised by the AO in this case? The second question which arises for determination in this case is whether the expenditure incurred is revenue expenditure or whether it is an expenditure which is capital in nature and depending on the answer to the said question, the applicability of Section 35AB of the Income Tax Act needs to be considered.
5. On the first question, it has been vehemently urged by Shri Iyer, learned senior counsel on behalf of the respondent-assessee, that the High Court was right in dismissing the Department's appeal in limine following its earlier judgment in the case of C.I.T. vs. M/s. J.C.T. Electronics Ltd. in I.T.A. No.383/2004. On the first question, there is considerable amount of confusion. It appears that prior to Assessment Year 1995-96, the Department has been contending that the royalty expenditure comes within the ambit of Section 35AB. However, there is some doubt as to whether the said contention regarding applicability of Section 35AB was at all raised. In this regard, the order of AO is not clear principally because it has focused only on one point, viz., whether such expenditure is revenue or capital in nature. At the same time, it is important to note that even for the applicability of Section 35AB, the nature of expenditure is required to be decided at the threshold because if the

expenditure is found to be revenue in nature, then Section 35AB may not apply. However, if it is found to be capital in nature, then the question of amortization and spread over, as contemplated by Section 35AB, would certainly come into play. Therefore, in our view, it would not be correct to say that in this case, interpretation of Section 35AB was not in issue. Our above reasoning is further fortified by the question framed by the High Court in the impugned judgment which reads as under:

“Whether on the facts and in the circumstances of the case, the Hon'ble ITAT is right in upholding the decision of the Commissioner of Income-Tax (Appeals) that the payment of royalty made by the assessee company to M/s. Kirloskar Oil Engine Ltd. to acquire technology know- how under the agreement dated 19.10.89, is a revenue expenditure and does not come within the ambit of provisions of Section 35AB of the Income Tax Act, 1961, whereas the payment is a capital expenditure in view of the following judgments.

A. *Femmur Woodruf & Co.Ltd. V. CIT*¹ .

B. *Ram Kumar Pharmaceuticals Works V CIT*² .

C. *CIT V. Warmar Hindustan Ltd.*³

D. *CIT V. Southern Switch Gears Ltd.*⁴”

6. On bare reading of the said question, it is clear that applicability of Section 35AB in the context of royalty paid to Kirloskar as a percentage of the net sale price being revenue or capital in nature and depending on the answer to that question, the applicability of Section 35AB also arose for determination before the High Court. Be that as it may, the said question needs to be decided authoritatively by the High Court as it is an important question of law, particularly, after insertion of Section 35AB.

7. Therefore, we are required to remit the matter to the High Court for fresh consideration in accordance with law.

8. On the second question, we do not wish to express any opinion. It is for the High Court to decide, after construing the agreement between the parties, whether the expenditure is revenue or capital in nature and, depending on the answer to that question, the High Court will have to decide the applicability of Section 35AB of the Income Tax Act. On this aspect we keep all contentions on both sides expressly open.

9. Accordingly, the impugned judgment of the High Court is set aside and the matter is remitted for fresh consideration in accordance with law.

10. The Appeal is allowed accordingly with no order as to costs.

¹102 ITR 665 (Mad)

²119 ITR 33 (All)

³160 ITR 217 (AP)

⁴148 ITR 272 (Mad)