SUPREME COURT OF INDIA

Mangalore Ganesh Beedi Works

Vs.

Commissioner of Income Tax, Mysore & Anr.

C.A.No.10547-10548 of 2011

(Madan B.Lokur and S.A.Bobde,JJ.,)

15.10.2015

JUDGMENT

Madan B.Lokur,J.,

1. These appeals are directed against a judgment and order dated 23 rd December, 2010 passed by the Division Bench of the High Court of Karnataka at Bangalore in ITA Nos. 69-70 of 2001.

2. The three substantial questions of law considered by the High Court were as follows:-

> "i) Whether Rs. 12,24,700/- claimed as revenue expenditure by the Association of persons which was constituted by the three partners of the erstwhile firm, MGBW, can be allowed as permissible deduction in the hands of the said Association of persons under Section 37 of the Income-Tax Act, 1961, as being laid out or expended wholly and exclusively for the purpose of business of the said Association of Persons?
>
> ii) Whether the Assessee was entitled to claim any deduction on the alleged expenditure for acquisition of patent [trademarks] rights, copyrights and know-how, in terms of Section 35A and 35AB of the Act?
>
> iii) Whether the Tribunal had erred in directing the Assessing Officer to capitalize the value of trademarks, copyright and technical know-how by treating the same as plant and machinery and grant depreciation therein?"

3. In its conclusion, the High Court answered the first two questions in the negative and the third question in the affirmative in favour of the Revenue and against the Assessee. While doing so, the High Court set aside the findings of the Income-Tax Appellate Tribunal (for short 'the Tribunal") and restored the order of the Assessing Officer. The relevant assessment year is 1995-96.

4. Broadly, the facts of the case indicate that in 1939 late Sri S. Raghuram Prabhu started the business of manufacturing beedis. He was later joined in the business by Sri Madhav Shenoy as a partner and thus M/s. Mangalore Ganesh Beedi Works (for short 'MGBW') came into existence with effect from 28 th February, 1940.

5. The partnership firm was reconstituted from time to time and its last reconstitution and partnership deed contained Clause 16 relating to the manner in which the affairs of the partnership firm were to be wound up after its dissolution. Clause 16 of the partnership deed reads as follows:-

> "16. If the partnership is dissolved, the going concern carried on under the name of the Firm Mangalore Ganesh Beedi Works and all the trade marks used in course of the said business by the said firm and under which the business of the partnership is carried on shall vest in and belong to the partner who offers and pays or two or more partners who jointly offer and pay the highest price therefor as a single group at a sale to be then held as among the partners shall be entitled to bid. The other partners shall execute and complete in favour of the purchasing partner or partners at his/her or their expense all such deed, instruments and applications and otherwise and him/her name or their names of all the said trade marks and do all such deed, acts and transactions as are incidental or necessary to the said transferee or assignee partner or partners."

6. Due to differences between the partners of MGBW, the firm was dissolved on or about 6th December, 1987 when two partners of the firm applied for its winding up by filing Company Petition No. 1 of 1988 in the High Court. While entertaining the Company Petition the High Court appointed an Official Liquidator and eventually, after hearing all the concerned parties, a winding up order was passed on 14th June, 1991.

7. In its order passed on 14th June, 1991 the High Court held that the firm is dissolved with effect from 6 th December, 1987 and directed the sale of its assets as a going concern to the highest bidder amongst the partners. The relevant extract of the order passed by the High Court reads as follows:-

> "(i) The dissolved partnership firm - Mangalore Ganesh Beedi Works as a going concern shall be sold to such of its partner/s, who makes an offer of a highest price, the same not being less than the minimum (reserved) price of Rs. 30 crores (Rupees Thirty Crores) within 11-7-1991 accepting further liability to pay interest at 15% per annum towards the amount of the price payable to partner/s from 6-12-1987 till the date of deposit."

8. The High Court also prescribed certain other activities such as conducting the auction by the Official Liquidator etc.

9. Pursuant to the order passed by the High Court on 14th June, 1991 an auction was conducted in which three of the erstwhile partners forming an association of persons (hereinafter referred to as 'AOP-3') emerged as the highest bidders and their bid of Rs.92

crores for the assets of MGBW was accepted by the Official Liquidator on or about 17 th November, 1994. With effect from 18 th November, 1994 the business of the firm passed on into the hands of AOP-3 but the tangible assets were actually handed over by the Official Liquidator to AOP-3 on or about 7th January, 1995.

10. MGBW (hereinafter referred to as the 'Assessee') filed its return for the period 18th November, 1994 to 31st March, 1995 and subsequently filed a revised return. Broadly, the Assessee claimed a deduction of Rs. 12,24,700/- as a revenue expenditure permissible under Section 37 of the Income-Tax Act, 1961 (hereinafter referred to as 'the 'Act') towards legal expenses incurred. The Assessee also claimed depreciation under Section 35A and 35AB of the Act towards acquisition of Intellectual Property Rights such as rights over the trademark, copyright and technical know-how. In the alternative, the Assessee claimed depreciation on capitalizing the value of the Intellectual Property Rights by treating them as plant.

11.The Assessing Officer passed an order on 30th March, 1998 rejecting the claim of the Assessee under all the three Sections mentioned above. Feeling aggrieved, the Assessee preferred an appeal before the Commissioner of Income-Tax (Appeals) who passed an order on 15th October, 1998. The appeal was allowed in part inasmuch as it was held that the Assessee was entitled to a deduction towards legal expenses. However, the claim of the Assessee regarding deduction or depreciation on the Intellectual Property Rights was rejected by the Commissioner of Income-Tax (Appeals).

12. As a result of the appellate order, the Revenue was aggrieved by the deduction granted to the Assessee in respect of legal expenses and so it preferred an appeal before the Tribunal. The Assessee was aggrieved by the rejection of its claim in respect of the Intellectual Property Rights and also filed an appeal before the Tribunal.

13. By an order dated 19th October, 2000 the Tribunal allowed the appeal of the Assessee while rejecting the appeal of the Revenue.

14. The impugned order was then passed by the High Court as mentioned above. It is under these circumstances that the assessee is now before us in appeal.

Question No. 1

15. In respect of the first question the issue really is whether the expenses incurred by the Assessee were for protecting the business of the firm or were expenses incurred for personal reasons namely consequent to disputes or differences relating to the ownership of the going concern with the erstwhile partners of the Assessee.

16. The Tribunal examined the issue in substantial detail. It was held by the Tribunal that the concern was in fact a going concern and therefore, the legal expenses incurred were for defending the business of the going concern and for protecting its interests. It could not be said that the expenses were personal in nature, nor could it be said that the expenses were unreasonable or not bona fide. It was found that the expenses incurred did not pertain to the

period prior to the AOP-3 taking over the going concern but they were expenses incurred after the business was taken over by AOP-3 and that they related to legal proceedings that were pending in the High Court. The Tribunal noted that even the Assessing Officer did not treat the expenditure as being of a capital nature.

17. On a consideration of the issues placed before the Tribunal, including the decision of this Court in *Dalmia Jain and Company Limited v. Commissioner of Income Tax*[1] it was held that the expenses incurred by the Assessee were honest and reasonable and were incurred for the purposes of protecting the business of the firm as a going concern. In Dalmia Jain, this Court relied upon *Shree Meenakshi Mills v. CIT*[2] and held:

> "[D]eductibility of expenditure incurred in prosecuting a civil proceeding depends upon the nature and purpose of the legal proceeding in relation to the assessee's business and the same cannot be affected by the final outcome of that proceeding. However wrong-headed, ill advised, unduly optimistic or overconfident in his conviction the assessee might appear in the light of the ultimate decision; expenditure in starting and prosecuting a civil proceeding cannot be denied as a permissible deduction in computing the taxable income merely because the proceeding had failed, if otherwise the expenditure was laid out for the purpose of the business wholly and exclusively, that is, reasonably and honestly incurred to promote the interest of the business. Persistence of the assessee in launching the proceeding and carrying it from Court to Court and incurring expenditure is not a ground for disallowing the claim."

18. The High Court did not accept the view of the Tribunal and in support of that it was contended before us by learned counsel for the Revenue that the highest bid of AOP-3 was accepted by the High Court on or about 21st September, 1994 and therefore there was no question of the expenses being incurred for protecting the business of the going concern subsequent to that date. In other words all the legal expenses incurred were prior to 21st September, 1994 and were therefore personal in nature.

19. We are not at all impressed with the submission of learned counsel for the Revenue. There is a clear finding of fact by the Tribunal that the legal expenses incurred by the Assessee were for protecting its business and that the expenses were incurred after 18th November, 1994. There is no reason to reverse this finding of fact particularly since nothing has been shown to us to conclude that the finding of fact was perverse in any manner whatsoever. That apart, if the finding of fact arrived at by the Tribunal were to be set aside, a specific question regarding a perverse finding of fact ought to have been framed by the High Court. The Revenue did not seek the framing of any such question. In this regard, reference may be made *to K. Ravindranathan Nair v. Commissioner of Income Tax*[3] wherein it was observed:

> "The High Court overlooked the cardinal principle that it is the Tribunal which is the final fact-finding authority. A decision on fact of the Tribunal can be gone into by the High Court only if a question has been referred to it which says that the finding of the Tribunal on facts is perverse, in the sense that it is such as could not reasonably have

> been arrived at on the material placed before the Tribunal. In this case, there was no such question before the High Court. Unless and until a finding of act reached by the Tribunal is canvassed before the High Court in the manner set out above, the High Court is obliged to proceed upon the findings of fact reached by the Tribunal and to give an answer in law to the question of law that is before it."

20. Accordingly, we hold that the High Court was not justified in upsetting a finding of fact arrived at by the Tribunal, particularly in the absence of a substantial question of law being framed in this regard. Therefore, we set aside the conclusion arrived at by the High Court on this question and restore the view of the Tribunal and answer the question in favour of the Assessee and against the Revenue.

Question Nos. 2 & 3

21. As a preface to answering these questions, we must accept and acknowledge that intellectual property rights have a value. There is a tacit acceptance of this in *Bharat Beedi Works (P) Ltd. v. CIT*[4] wherein it has been observed that there is a value attached to a brand name.

22. Proceeding from this starting point, it must be noted that the fundamental basis on which these questions were decided against the Assessee and in favour of the Revenue is the finding of the High Court that what was sold by way of auction to the highest bidder was the goodwill of the partnership firm and not the trademarks, copyrights and technical know-how. Reliance was placed on the Report dated 24th January, 1989 of the Chartered Accountants Rao and Swamy, commissioned during the pendency of Company Petition in the High Court. In this Report, the total assets of MGBW were valued at Rs. 28,58,01,410.02. The total liabilities were valued at Rs.26,55,77,389.02 thereby making the net assets worth Rs.2,02,24,021.30. The Chartered Accountants specifically stated in the Report that the net assets excluded goodwill. The Report calculated goodwill on the super profit method by taking three times the profit for 5 years (30.06.1983 to 30.06.1987). This was then calculated at Rs. 26.10 crores. It is on this basis that the reserve price for the auction was fixed at Rs.30 crores, as mentioned in the order of 14th June, 1991 passed by the High Court. According to learned counsel for the Revenue, MGBW was already the owner of the trademarks, copyrights and technical know-how and essentially the rights in the intellectual property might be included in goodwill, but these were not auctioned off but were relinquished in favour of AOP-3 and, therefore, the Assessee.

23. AOP-3 on the other hand had obtained a separate valuation from the Chartered Accountant M.R. Ramachandra Variar. In his Report dated 12th September, 1994 the technical know-how was valued at Rs. 36 crores, copyright was valued at Rs 21.6 crores and trademarks were valued at Rs. 14.4 crores making a total of Rs. 72 crores. These figures were arrived at by taking 5 times the average profits for the last 5 years (ended 31st March, 1994). It is not necessary to go into calculating the bifurcated value of the three intangible assets except to say that the trademarks were given a value since in the beedi industry the trademark and brand name have a value and the Assessee's product under trademark '501' had a

national and international market. As far as the copyright valuation is concerned, beedis are known not only by the trademark but also by the depiction on the labels and wrappers and colour combination on the package. The Assessee had a copyright on the content of the labels, wrappers and the colour combination on them. Similarly, the know-how had a value since the aroma of beedis differs from one manufacturer to another, depending on the secret formula for mixing and blending tobacco. The claim for depreciation/amortization by the Assessee is limited to this amount of Rs. 72 crores.

24. While passing orders on the bid given by the Assessee, the High Court tacitly accepted, in its order of 22nd December, 1994 that the trademarks and copyrights were the intangible assets of MGBW[5]**.** It is on this basis (and the extant accounting practice) that the Assessee made necessary entries in its books including in the balance sheet.

25. However, what is equally important is that the Variar Report mentioned that it did not consider any value for goodwill since the trademarks, copyrights and know-how had tremendous business value as the firm had been enjoying the status of being India's largest beedi manufacturer over the last five decades. After taking into consideration the net assets and liabilities of MGBW, the Chartered Accountant arrived at the net value of the going concern at Rs. 90 crores. On this basis, AOP-3 gave its bid of Rs. 92 crores which was eventually accepted.

26. In the case of *M. Ramnath Shenoy*[6] (an erstwhile partner of MGBW) the Tribunal accepted (after a detailed discussion) the contention of the Assessee that trademarks, copyrights and technical know-how alone were comprised in the assets of the business and not goodwill. It was also held that when the Revenue alleges that it is goodwill and not trademarks etc. that is transferred, the onus will be on the Revenue to prove it, which it was unable to do. The Tribunal then examined the question whether the sale of these intangible assets would attract capital gains. The question was answered in the negative and it was held that the assets are self-generated and would not attract capital gains. The decision of the Tribunal has been accepted by the Revenue and we really see no reason why a different conclusion should be arrived at in so far as the Assessee is concerned.

[5] The High Court held, Company Application No.436/1994 is allowed and the sale of Mangalore Ganesh Beedi Works as a going concern with all its assets, tangible and intangible whatsoever and wherever they are with trade name and all other trade marks copy rights and privileges owned and enjoyed by the said firm together with all liabilities of the out-going partners excluding their tax liabilities is hereby confirmed in favour of the purchasing group namely applicants in Company Application No.436/1994; subject to the final orders that may be passed in Company Application No.433/1994. The out-going group of partners presently in Management of the affairs of M/s Mangalore Ganesh Beedi Works, are hereby directed to deliver forthwith the possession of the entire business of the said dissolved partnership firm together with all trade marks, trade names, copy rights, Book of Accounts, documents relating to assets and liabilities, Bank Accounts etc., under the supervision of the Official Liquidator, who shall submit a report as to the completion of the process of delivery of possession as aforesaid to this Court, within four weeks from today.

[6] ITA No.258 (Bangalore/1997) decided on 10th July, 1997 relevant to Assessment Year 1995-96

27. The High Court denied any benefit to the Assessee under Section 35A and Section 35AB of the Act since it was held that what was auctioned off was only goodwill and no amount was spent by AOP-3 towards acquisition of trademarks, copyrights and know-how. In coming to this conclusion, reliance was placed on the Report of the Chartered Accountants Rao and Swamy who stated that the assets of MGBW were those of a going concern and were valued on the goodwill of the firm and no trademarks, copyrights and know-how were acquired. It was further held, in our opinion rather speculatively by the High Court, that the valuation made by the Chartered Accountant of AOP-3 that is M.R. Ramachandra Variar that the goodwill was split into know-how, copyrights and trademarks only for the purposes of claiming a deduction under Section 35A and Section 35AB of the Act and the value of the goodwill was shown as nil and the deduction claimed did not represent the value of the know-how, copyrights and trademarks.

28. We leave open the question of the applicability of Section 35A and Section 35AB of the Act for an appropriate case. This is because learned counsel submitted that if the Assessee is given the benefit of Section 32 read with Section 43(3) of the Act (depreciation on plant) as has been done by the Tribunal, the Assessee would be quite satisfied. Unfortunately, the alternative aspect of the Assessee's case was not looked into by the High Court.

29. Therefore, now the question to be answered is whether the Assessee is entitled to any benefit under Section 32 of the Act read with Section 43(3) thereof for the expenditure incurred on the acquisition of trademarks, copyrights and know-how.

30. The definition of 'plant' in Section 43(3) of the Act is inclusive[7]. A similar definition occurring in Section 10(5) of the Income Tax Act, 1922[8] was considered in *Commissioner of Income Tax v. Taj Mahal Hotel*[9] wherein it was held that the word 'plant' must be given a wide meaning. It was held:

> "Now it is well settled that where the definition of a word has not been given, it must be construed in its popular sense if it is a word of every day use. Popular sense means "that sense which people conversant with the subject-matter with which the statute is dealing, would attribute to it". In the present case, Section 10(5) enlarges the definition of the word "plant" by including in it the words which have already been mentioned before. The very fact that even books have been included shows that the meaning intended to be given to "plant" is wide. The word "includes" is often used in interpretation clauses in order to enlarge the meaning of the words or phrases occurring in the body of the statute. When it is so used, those words and phrases must be construed as comprehending not only such things as they signify according to their nature and import but also those things which the interpretation clause declares that they shall include. The word "include" is also suspectible of other constructions which it is unnecessary to go into."

[7] "plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock; 8 "plant" includes vehicles, books, scientific apparatus and surgical equipment purchased for the purposes of the business, profession or vocation;

31. The question is, would intellectual property such as trademarks, copyrights and know-how come within the definition of 'plant' in the 'sense which people conversant with the subject-matter with which the statute is dealing, would attribute to it'? In our opinion, this must be answered in the affirmative for the reason that there can be no doubt that for the purposes of a large business, control over intellectual property rights such as brand name, trademark etc. are absolutely necessary. Moreover, the acquisition of such rights and know-how is acquisition of a capital nature, more particularly in the case of the Assessee. Therefore, it cannot be doubted that so far as the Assessee is concerned, the trademarks, copyrights and know-how acquired by it would come within the definition of 'plant' being commercially necessary and essential as understood by those dealing with direct taxes.

32. Section 32 of the Act as it stood at the relevant time did not make any distinction between tangible and intangible assets for the purposes of depreciation. The distinction came in by way of an amendment after the assessment year that we are concerned with. That being the position, the Assessee is entitled to the benefit of depreciation on plant (that is on trademarks, copyrights and know-how) in terms of Section 32 of the Act as it was at the relevant time. We are, therefore, in agreement with the view taken by the Tribunal in this regard that the Assessee would be entitled to the benefit of Section 32 of the Act read with Section 43(3) thereof.

33. In this context, it may also be mentioned that by denying that the trademarks were auctioned to the highest bidder, the Revenue is actually seeking to re-write clause 16 of the agreement between the erstwhile partners of MGBW. This clause specifically states that the going concern and all the trademarks used in the course of the said business by the said firm and under which the business of the partnership is carried on shall vest in and belong to the highest bidder. Under the circumstances, it is difficult to appreciate how it could be concluded by the Revenue that the trademarks were not auctioned off and only the goodwill in the erstwhile firm was auctioned off. *In D. S. Bist & Sons v. CIT* [8] it was held that the Act does not clothe the taxing authorities with any power or jurisdiction to re-write the terms of the agreement arrived at between the parties with each other at arm's length and with no allegation of any collusion between them. 'The commercial expediency of the contract is to be adjudged by the contracting parties as to its terms.'

34. The issue, looked at from any angle, would lead to the conclusion that Question No. 3 is required to be answered in the negative, in favour of the Assessee and against the Revenue. We do so accordingly. Question No. 2 is left open for consideration in an appropriate case.

35. The appeals are disposed of in the above terms. No costs.

[1] *(1971) 81 ITR 754 (SC)*
[2] *(1967) 63 ITR 207 (SC)*
[3]*(2001)247 ITR 178 (SC)*
[4] *(1993) 3 SCC 252, paragraph 13.*
[9]*(1971) 3 SCC 550*