

Royalty paid for Licence to Manufacturing/Sale & Technical Know-How having enduring benefit is Capital Expense

M/S Telco Construction Company vs. The Assistant Commissioner

I.T.A No. 101 of 2016

Date-20.11.2020

Fact of the Case

- In the present case Telco Construction Company is the assessee who is engaged in the business of manufacture, purchase and sale of hydraulic excavators, loaders, mechanical shovels, cranes and spare parts thereof.
- The assessee claimed deduction on account of payment of royalty made by it to M/s Hitachi Construction Machinery Company Private Limited, Japan at the rate of 1% of the net factory selling price to the extent of Rs.91,06,005 under Section 37(1) of the Act.
- The aforesaid amount was paid for use of technical know-how and grant of rights for manufacture of Hitachi licence products, which included intellectual property. The question is whether such expenditure to be considered as revenue expenditure and to be allowed under Section 37(1) of the Act.
- The other issue raised was whether the expenditure towards royalty was a capital expenditure as the user of rights by way of know-how, intellectual property had resulted in enduring benefit to the Appellant when there was no acquisition of any capital asset.

Decision of the Case

- The division bench of Karnataka High Court observed the distinction between capital and revenue expenditure with reference to acquisition of technical information and know-how has been spelled out in various cases and the primary test to ascertain whether a expenditure is a capital expenditure or revenue expenditure is the same viz., enduring nature test, which means where the expenditure is incurred which gives enduring benefit, it will be treated as capital expenditure.
- The court further clarified that the assessee is a joint venture company and under the agreement has been granted non transferable licence to manufacture / assemble the Hitachi licence products within the territory using technical know-how furnished by Hitachi and to sell otherwise dispose of the Hitachi licence products. The products shall be sold only under the trade / brand name of Tata Hitachi.
- The court noted that even expiry of the 11 years from the date of commercial production, the assessee is entitled to continue the manufacture and sale of Hitachi licence products for the aforesaid term of the agreement.
- The assessee has incurred an expenditure which gives him enduring benefit, therefore, the same has to be treated as capital expenditure.
- The Assessing Officer as well as the tribunal rightly held that payment of royalty made by the assessee is a capital expenditure and is not a permissible deduction under Section 37(1) of the Act," the court said.