IT : Where assessee-company entered into an agreement to take over business of a proprietory concern, in view of fact that in terms of agreement only a license to use copyright was granted to assessee, however, it had not acquired copyright itself, license fee paid by assessee was to be allowed as revenue expenditure

[2018] 90 taxmann.com 383 (Punjab & Haryana)

HIGH COURT OF PUNJAB AND HARYANA

Principal Commissioner of Income-tax-2, Chandigarh

v.

Mobisoft Tele Solutions (P.) Ltd.

S.J. VAZIFDAR, CJ. AND AVNEESH JHINGAN, J.
IT APPEAL NO. 434 OF 2015
FEBRUARY 22, 2018

Ms. Urvashi Dhugga, Adv. *for the Appellant.* **Ms. Radhika Suri**, Sr. Advocate and **Manpreet Singh Kanda**, Adv. *for the Respondent.*

ORDER

Avneesh Jhingan, j. - This is an appeal against the order of the Income Tax Appellate Tribunal setting aside the orders of the CIT (Appeals) and the Assessing Officer (for short, `the AO'). The addition made of royalty paid for the use of the brand name `phoneytune.com' to one Tarun Mohan, a director of the assessee, was deleted. The licence fee paid to M/s Phonographic Performance Ltd. was held to be revenue expenditure by the Tribunal.

2. The matter pertains to the assessment year 2009-10.

3. According to the appellant, the following substantial questions of law arise in this appeal :-

(*i*) Whether on the facts and in the circumstances of the case and in law, the `royalty' payment would be allowable as business expenditure, where the same has not been exclusively and wholly incurred for business purposes?

(*ii*) Whether on the facts and in the circumstances of the case and in law, the order of the Tribunal is not perverse in holding that the transaction was not a colorable devise to reduce the tax liability of the company in which the Managing Director was none other than the beneficiary Proprietor of royalty particularly when no evidence of any patented product in possession of the Proprietor could be produced and all the stipulates in the agreement showed that it was for the exclusive benefit of the proprietor, and also when no proof of brand value of phoneytune.com was established?

(*iii*) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT was correct in not appreciating the applicability of the provisions of section 47 (xiv) read with section 47A (3)?

(*iv*) Whether on the facts and in the circumstances of the case and in law, the

Hon'ble ITAT was right in treating the `copyright expense' as a revenue expense when the Income Tax Act, 1961 alongwith the Income Tax Rules, w.e.f. A.Y. 1999-2000, has explicitly mentioned copyrights as an intangible asset?

(*v*) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT was right in treating the `copyright expense' as a revenue expense relying on the decisions of Hon'ble Supreme Court in the case of CIT Vs. IAEC (pumps) Ltd. 232 ITR 316 (SC) which was delivered prior to amendments in section 32 (1) (ii) of the Income Tax Act, 1961 and in Rule 5 (1) of the Income Tax Rules, 1962, w.e.f. A.Y. 1999-2000, whereby intangible assets, inter-alia, copyrights have been included in the appendix I prescribing intangible assets as a separate block of assets on which depreciation is applicable @ 25%?

(*vi*) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT was right in treating the copyright expense with enduring benefits as revenue expenditure?"

Re : Questions No. (i) and (ii)

4. Questions (i) and (ii) are answered in the assessee's favour in view of the judgment of this Court dated 07.08.2015 in the assessee's case Pt. Commissioner of Income Tax -2 Vs. M/s Mobisoft Tele Solutions P. Ltd., ITA Nos. 193-194-197 of 2015. These questions arose in the appeals filed by the revenue in the case of the assessee for the assessment years 2006-07, 2007-08 and 2008-09. This court vide order dated 07.08.2015 passed in ITA Nos. 193, 194 and 197 of 2015 answered these questions against the revenue. It was held that the AO and CIT (Appeals) erred in holding that Tarun Mohan had entered into an agreement with himself. The authorities ignored the fundamental concept that the assessee being a Company incorporated under the Companies Act, 1956 is a separate legal juristic entity. It was held that the assessee Company was entitled to use the trade mark as licensee thereof and that the payment of royalty for the same is nothing unusual.

Re : Question No. (iii)

5. This question is also answered in favour of the assessee by the said judgment. Mrs. Dhugga, the learned counsel for the appellant, however submitted that the judgment did not consider the effect of Sections 47 (xiv) and 47A (3).

6. The AO finalised the assessment under Section 143 (3) of the Income Tax Act, 1961, vide order dated 29.12.2011. Among other things, the AO made an addition of Rs. 17,97,858/- on account of royalty paid to the assessee's director Shri Tarun Mohan. The earlier assessment order passed in the case of the assessee for the assessment year 2008-09 was followed. Further licence fee of Rs. 2,03,78,978/- paid to M/s Phonographic Performance Ltd. was treated as capital expenditure.

7. The CIT (Appeals) partly allowed the assessee's appeal vide order dated 25.09.2012. The addition made by the AO on account of royalty paid to Shri Tarun Mohan was upheld, relying upon the earlier decisions in the case of the assessee for the assessment years 2007-08 and 2008-09. The licence fee paid was held to be capital expenditure as the acquired asset has benefit which is enduring in nature.

8. Aggrieved by the order of the CIT (Appeals), the assessee as well as the revenue filed appeals before the Tribunal. The Tribunal by the impugned order dated 03.07.2015 partly allowed the appeal of the assessee and dismissed the appeal of the revenue.

9. The assessee company filed its return for the relevant assessment year. In the return, among other

things, the amount of royalty paid to Shri Tarun Mohan was claimed as a business expenditure. The licence fee paid to M/s Phonographic Performance Ltd. was claimed to be a revenue expenditure. The case was taken up in scrutiny. The AO sought an explanation from the assessee on various issues, including on the issues of royalty and the licence fee paid. The assessee filed a reply. The AO was not satisfied with the reply filed.

10. One Tarun Mohan carried on business in the firm's name and style of phonytunes.com as the sole proprietor thereof. The assessee company entered into an agreement dated 18.02.2003 to take over the business of the proprietory concern of Tarun Mohan. The agreement was signed by Shri Tarun Mohan as proprietor of the selling concern and as a director of the assessee i.e. the purchaser. He had invented a technology from which ring tones could be created of songs. It appears that he had registered his copyright in respect of the word "phoneytunes.com". In the agreement the assessee-respondent is referred to by its previous name – ITIDA. `PT' in the agreement is a reference to the firm name phoneytunes.com. Articles 2 and 3 of the agreement read as under :-

> ***"Article 2 – Transfer***
>
> *In consideration of the agreement and subject to the terms and conditions hereto, PT hereby agrees to sell, assign, transfer and convey the assets to ITIDA (assessee's previous name) as provided herein and ITIDA would purchase and acquire the assets on and from the closing date subject to the terms and conditions of this agreement. The assets relating to the business which are to be sold, assigned, transferred and conveyed shall include without limitation the following:-*
>
> *1. Fixed assets.*
>
> *2. All inventories to the extent listed in Schedule-1.*
>
> *3. The intellectual property rights in the business except the brand name of phoneytunes.com shall be transferred and for using the brand name ITIDA has to pay 2% of gross revenue receipts as royalty after two years of the closing date.*
>
> *4. All other current assets including cash & bank balances and loans & advances.*
>
> *The assets as mentioned above shall be sold, transferred, conveyed and assigned to ITIDA free and clear from any encumbrances, liens, charges, claims, restrictions of whatsoever nature .*
>
> ***Article 3 – Consideration***
>
> *In consideration of PT agreeing to sell, assign, transfer and convey the assets to ITIDA on the terms and conditions stated in this agreement, ITIDA shall pay to Mr. Tarun Mohan, sole proprietor of PT a purchase price or consideration of a sum of Rs. 5,81,231/- and in consideration of all intellectual property rights (other than brand name) and for the use of brand name of phoneytunes.com a consideration of 2% of the gross revenue receipts under the relevant business after 2 years of closing date." (emphasis supplied)*

From the above Articles, it is evident that Shri Tarun Mohan permitted the assessee to use the intellectual property vested in him, viz. the mark `phoneytunes.com'. He had not assigned the same to the assessee Company. He was entitled to receive royalty of 2% of the gross revenue receipts under the relevant business after two years of the closing date. It would be appropriate to note at this stage that the transfer of assets etc. by the sole proprietor was against consideration of Rs. 5,81,231/-. Shri Tarun Mohan also acquired shareholding in the assessee company.

11. As we noted earlier, question No. (iii) is also covered in the assessee's favour by virtue of the judgment dated 07.08.2015 in ITA Nos. 193, 194 and 197 of 2015. Mrs. Dhugga however contended

that the judgment does not consider Sections 47 (xiv) and 47A (3) which read as under :-

47. Nothing contained in section 45 shall apply to the following transfers :—

(i) to (xiii) x x x

(xiv) where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company :

***Provided** that —*

(a) *all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;*

(b) *the shareholding of the sole proprietor in the company is not less than fifty per cent of the total voting power in the company and his shareholding continues to remain as such for a period of five years from the date of the succession; and*

(c) *the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company;*

47A. (3) Where any of the conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) of section 47 are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45 by virtue of conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) of section 47 shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the requirements of the proviso to clause (xiii) or the proviso to clause (xiv), as the case may be, are not complied with.

12. Section 45 deals with tax on capital gains. Section 47 excludes certain transfers from the purview of Section 45. Such transfers would not be regarded as transfers for the purpose of section 45. Clause (xiv) of section 47 deals with transfers where a proprietary concern is succeeded by a company in the business carried on by it, as a result of which the sole proprietary concern sells or otherwise transfers the capital assets to the company. The proviso to clause (xiv) provides three conditions. Proviso (c) provides that the sole proprietor has not received directly or indirectly any consideration, except by way of allotment of shares in the company. Shri Tarun Mohan has admittedly received consideration in cash of Rs. 5,81,231/-which includes payment of royalty for the use of the brandname. Moreover he has admittedly not received shares as consideration for the same. Thus, Section 47 has no application to the case.

13. The case set up by the appellant is that as Tarun Mohan is being paid royalty, therefore, there is a violation of clause (xiv) of section 47, as the consideration, apart from allotment of shares, has passed to the sole proprietor. On this basis, sub-section (3) of section 47A should be invoked and the said consideration would be deemed profit and gain of the assessee company. Section 47A lays down the conditions, which if violated, would result in withdrawal of exemption as provided under section 47. Sub-section (3) of section 47A deals with violation of clause (xiii) or proviso to clause (xiv) of section 47. The result of violation would be that the amount of profits or gains arising from the transfer will be treated as deemed profits and gains of the successor company chargeable to tax in the previous year in the hands of the company.

14. The issue raised has no foundation to stand. There are no findings of fact recorded that the

provisions of section 47 were invoked for claiming exemption from capital gains while making transfers from the sole proprietary concern to the assessee company. The applicability of section 47A would arise only if it is established that section 47 was pressed into service. In absence thereof, the deeming provision of sub-section (3) of section 47A cannot be invoked.

15. There is another angle. From the reading of Article 3 of the agreement, it is evident that Tarun Mohan received a consideration of Rs. 5,81,231/- and royalty for the use of the brand name. This itself shows that exemption of section 47 was not available, as proviso (c) to clause (xiv) of section 47 had not been complied with. The appellant has not contended or established that the assessee availed the benefit of Section 47.

16. The question is, therefore, answered against the appellant.

Re : Questions No. (iv), (v) and (vi)

17. Questions No.(iv), (v) and (vi) in fact raise a common question, viz. whether the copyright fee paid to M/s Phonographic Performance Ltd. is a revenue expenditure or a capital expenditure.

18. The findings recorded by the Tribunal on this issue are based on appreciation of the facts. They cannot be said to be perverse or irrational. The three questions raised are not substantial questions of law.

19. The relevant clauses of the agreement between the assessee company and M/s Phonographic Performance Ltd., are as below :-

Grant of License

2.1 The Licensor grants to the Licensee and its authorized representative and/or agents during the Term, throughout the Territory, a non exclusive, non transferable license for the use of Licensed Works for the sole purpose of providing the Services as mentioned in this Agreement :

2.1.1 to use, reproduce, modify, edit, compile, and/or adapt the Licensed Works so as, and only to the extent necessary, to create Ring Tones; this right has been temporarily granted until such time that the copyright owners are not making available the Licensed Works for use as ringtones;

2.1.2 to copy the Ring Tones to Licensee's wholly owned or controlled secure servers located at the named premises within the Territory and/or in the US and/or computer servers of the Sub-Licensees/partners ("Computer Servers");

2.1.3 to Download or transmit the Ring Tones to Licensee's or the Sub-Licensee's End-Users who have subscribed to and paid or agreed to pay for such services ("Subscribers");

2.1.4 to prepare and publicly perform excerpts and samples of the Licensed Works of duration not exceeding fifteen (15) seconds for monophonic format and thirty (30) seconds for polyphonic format, solely for promotional purposes on the Licensee's and the Sub-Licence's website/IVR/WAP or such other method of sampling;

2.1.5 to use the track title/title of the Licensed Works, names of the Licensors' members represented on the Licensed Works and any other related material, for the purpose of identifying the Licensed Works on the Service.

PROVIDED that :-

2.1.6.1 each Ring Tone can be created from only one Licensed Work;

2.1.6.2 each Ring Tone cannot exceed thirty (30) seconds in monophonic format and forty five (45)

seconds in polyphonic format;

2.1.6.3 the Ring Tones shall not be copied or stored by any other third party onto whatever media except onto the

a. Licensee's/Sub Licensee Computer Servers

b. End Users Cellular phone, hand held Devices or such wireless devices.

2.1.6.4 the Licensee shall not itself or indirectly through any other person in respect of any copying pursuant to this Agreement segue, mix or re-mix or overlap, edit, change or otherwise manipulate the sounds of any Licensed Works, other than as otherwise authorized herein;

2.1.6.5 the substantial identity of any Licensed Work or relevant part thereof shall not be changed in the corresponding Ring Tone;

2.1.6.6 Licensee shall not incorporate any voice-over of any kind or interview or other commentary during the playing of any Licensed Works;

2.1.6.7 Any use by Licensee of the Ring Tones for a purpose other than in furtherance of the Licensee's Service (s) shall be subject to separate negotiation and agreement between the parties.

2.2 Notwithstanding the rights granted under 2.1.1, 2.1.2 & 2.1.3 the Licensor reserves the right to store the Licensed Works (as Ring Tones) at its wholly owned and fully controlled computer servers and make it available to the Licensee to be distributed to its End-Users."

20. The Tribunal on appreciating the agreement rightly came to the conclusion that only a license to use the copyright was granted to the assessee company. The assessee company had not acquired the copyright. In such circumstances, the license fee paid is a revenue expenditure. In this regard, the Tribunal rightly followed the decision of the Supreme Court in the case of ***CIT* v. *I.A.E.C (Pumps) Ltd.,*** 232 ITR 316. The question raised before the Hon'ble Apex Court was :

"whether the amount paid by the respondent-assessee to the foreign collaborator for technical know-how is a capital expenditure or a revenue expenditure"?

The Supreme Court held as under :

"We heard counsel. We are of the view that the High Court posed the correct question that arose for consideration and also applied the proper principles of law to the instant case. By applying the proper principles of law to the agreement in question, the High Court concluded that the amounts paid to the collaborator is only a "licence fee" and not the price for acquisition of a "capital asset". It was concluded that the entire payment constitutes revenue expenditure and the questions were answered in favour of the assessee."

21. Mrs. Dhugga relied upon section 32. She argued that 'copyright' finds mention in section 32. The result is that depreciation can be claimed on copyright. On the said basis, it is argued that copyright fee is a capital expenditure. The argument has no merit. Relevant portion of section 32 is re-produced below :-

32. (1) In respect of depreciation of —

(i) buildings, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998,

owned, wholly or partly, by the assessee and used for the purposes of the business or profession, the following deductions shall be allowed —

*(*i*) in the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost thereof to the assessee as may be prescribed;*

*(*ii*) in the case of any block of assets, such percentage on the written down value thereof as may be prescribed.*

'Copyrights' find mention in section 32. The depreciation of copyright etc. can be claimed subject to two conditions viz. it must be owned wholly or partly by the assessee and it must be used for the purpose of business or profession. The word "and" between the two conditions establishes that both the conditions must subsist for the applicability of Section 32.

22. It has been held in the present case that the assessee company did not own the copyright. It was only granted a license to use the same. Such a case would not be covered under section 32. The finding recorded by the Tribunal that only usage of the license was transferred is neither perverse nor irrational.

23. The questions are answered against the appellant.

24. The appeal is, therefore, dismissed.

■■