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Additional Commissioner of Vs. Nestle India Ltd.

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Jan-10-2005

Reported in : (2005)94TTJ(Delhi)53

Judge : S Tiwari, N Karhail

Appellant : Additional Commissioner of

Respondent : Nestle India Ltd.

Judgement :

1. Appeal in ITA No. 4545/Del/2000 is the appeal filed by the Revenue on 20th Nov., 2000, against the order of the CIT(A)-XXI, New Delhi, dt.

31st Aug., 2000, in the case of the assessee in relation to order of assessment under Section 143(3) for the asst. yr. 1997-98. In response, the assessee has filed on 12th Sept., 2002, a cross-objection numbered as CO No. 135/Del/2002. Appeal in ITA No. 2239/Del/2002 is the appeal filed by the assessee on 23 May, 2002, against the order of the CIT(A)-XVI, New Delhi, dt. 21st Feb., 2002, in the case of the assessee in relation to assessment order under Section 143(3) for the asst. yr.

1998-99.

2. As the common facts and disputes are involved in these appeals and the cross-objection, the same were argued together by the learned counsel for the assessee and the learned Departmental Representative.

We are disposing them by this consolidated order for convenience.

3. The main dispute in these appeals pertains to the deduction claimed by the assessee-company on account of payments made to two companies, viz., Nestec Ltd. and Societe Des Produits, Nestle SA, hereinafter referred to as Nestec and SPN respectively. These two companies were 100 per cent subsidiary of Nestle SA, Switzerland. As to the shareholding of the assessee-company, i.e., M/s Nestle India Ltd., 51 per cent was held by two companies, namely, M/s Nestle SA and M/s Nestle Holding Ltd. Bahamas and 49 per cent by others including Indian public. The Nestle Holding Ltd. Bahamas was 100 per cent subsidiary of M/s Nestle S.A, Switzerland. The assessee-company has been making such payments to Nestec and SPN for last several assessment years and the deduction of the same as claimed by the assessee has been allowed in those assessment years. During the course of the assessment proceedings, for the asst. yr. 1997-98, the assessee claimed deduction of a sum of Rs. 47 crores under the head "Royalty for technical assistance" and the AO examined the claim of deduction in detail. He addressed a letter dt. 7th June, 1999, to the assessee-company seeking further information specified therein. Thereafter, the learned AO issued detailed questionnaires and made several requisitions as per order-sheet entry dt. 20th Sept., 1999 and 6th Oct., 1999. The assessee made its submissions to the AO by its letters dt. 6th Oct., 1999 and 29th Nov., 1999. The AO also issued a letter dt. 9th Nov., 1999, to Mr.

Carlo M.V. Donati, Managing Director of the company and directed that Mr. Donati should appear in person on 10th Dec., 1999. He issued summons under Section 131 for his compliance and directed that the Managing Director should be prepared and bring along with him the documents, evidence or any other details deemed fit for making submissions regarding the payment of royalty for technical assistance.

He was also asked to bring any evaluation made by any scientific and technical institution regarding royalty to be paid on technical assistance and its quantification. In response, Mr. Donati made a reply by the letter dt. 10th Dec., 1999, that he did not have the necessary expertise in respect of the issues under

consideration by the learned AO. For the specialized and technical area of income-tax, the company had in-house experts who were competent and authorized to deal with the subject. As the learned AO was not satisfied with the responses provided, the company had referred the matter to an eminent senior counsel. Mr. Donati sought to be excused. The learned AO rejected the above submissions by his letter dt. 10th Dec., 1999. He informed the managing director of the assessee-company that his response was not proper. Under the law of India, the managing director was responsible for the affairs and issues involving the company. The issue was of royalty for technical assistance and the facts and the basis of payment could be explained only by the managing director and his team of marketing executives rather than the tax officers of the assessee-company. The learned AO informed the managing director that his personal compliance along with the details, supporting evidence and documents was of prime importance, He informed the managing director that his personal compliance even without details was of prime importance.

4. The assessee replied by its letter dt. 24th Dec., 1999. According to the AO, the compliance was not as per requirement and he, therefore, once again issued detailed questionnaire vide order-sheet entry dt.

29th Dec., 1999. He further directed that the technical persons in charge of each manufacturing unit should be produced in person for examination along with supporting documents/evidence for clarification in regard to payment of royalty for technical assistance. The assessee made its submissions dt. 7th Jan., 2000. Further, on 18th Jan., 2000, Mr. Donati, Managing Director, appeared along with Mr. J.M. Stoker, Executive Vice President (Technical), Shri B. Murli, Head of Legal and Company Secretary, Mr. Duggal, Head of Financial Control and Taxation and Shri S.K. Sharma, Manager (Taxation). Mr. J.M. Stoker made submissions regarding the technicalities of technical assistance and the written submission dt. 18th Jan., 2000, was also made.

Subsequently, the assessee made the submissions vide letter dt. 1st Feb., 2000 and 15th Feb., 2000. While the learned AO has reproduced verbatim in the assessment order all requisitions and order sheet noting made by him, he has

summarized the assessee's reply including letters dt. 6th Oct., 1999; 29th Nov., 1999; 24th Dec., 1999; 7th Jan., 2000; 18th Jan., 2000; 1st Feb., 2000 and 15th Feb., 2000, in para 10 of the assessment order. According to the AO the points submitted by the assessee were that the Government of India had in terms of Indian Industrial policy announced in 1991 and still in force allowed Indian companies to pay royalty up to 5 per cent on domestic sales and 8 per cent on export sales whereas the royalty paid by the assessee was only 3.5 per cent on domestic sales and 5 per cent on export sales.

According to the assessee, the payment of fixed amount for technical assistance fee was not the best thing in the interest of the company in the market for fast moving consumer goods where consumers' liking for a product was changing every day, Contracting for a fixed amount of royalty could be disastrous if the product did not click in the market.

In the sales link agreements, the technical assistance provider's interest in the success of the product is the highest which ensures that the receiver of the technical assistance benefits from the latest technological development and assistance. Accordingly, the assessee-company was receiving technological improvement and technical assistance on a continual basis and some of the major technological improvements were enumerated by the assessee-company as briefly indicated by the AO in sub-para c of para 10. The assessee pointed out that the royalty was being paid to world's number one food company, i.e., Nestle Group of Switzerland who had been carrying out extensive research and made investment in research to the tune of more than Rs. 6,000 crores in last three years. The assessee explained that royalty payments for technical assistance were not connected with the profitability of the company. The profit was a derivative figure depending on various factors outside the direct and reasonable control of the technical assistance provider. The assessee also relied upon the fact that while the profit before the tax of the company during financial years 1995-96 and 1998-99 had gone up by 161 per cent, the royalty payment had gone up by 87 per cent only, i.e., just about half of the growth in profit. The fact that the royalty payment had been made to group/holding companies could not be the ground to determine the reasonableness of payment. The Department in the earlier

assessment years had duly accepted the same terms and conditions of the agreement.

The assessee-company was looking after its own interest as distinguished from the interest of the group. The assessee had entered into royalty agreement for the business of Soya based product but discontinued the same as the product was not found to be commercially viable. The payments were being made only for those products that were commercially successful in India and not all the products of Nestle Group. The assessee-company paid for tested technology. The technology being received by the assessee-company was proprietary and in terms of the agreements, complete confidentiality and secrecy had to be maintained. There was no question, therefore of any evaluation of royalty by an outside financial institution. The RBI was the nodal agency of Government of India for payment of royalty for technical assistance. In these matters discretion of the businessman was supreme unless the AO derived authority under Section 40A(2). The onus was on the Department to prove that because of the close connection between the payer and the payees, the excess payment had been made. Vide letter dt. 18th Jan., 2000, and during the personal hearing, Mr. J.M. Stoker, Executive Vice President (Technical) had made detailed submissions regarding the technical assistance received by the assessee and the payments made by the assessee-company were not hit by the provisions of Section 40A{2) of the IT Act, 1961. The powers under Section 92 could be applied-only if the Department had evidence or material to the effect that payments made to a foreign company were not commensurate with the market value of the services received.

5. The learned AO did not agree that the provisions of Section 40A(2) were not attracted. M/s Nestle S.A. Switzerland was holding 51 per cent shareholding in Nestle India Ltd. through a chain of subsidiaries.

Hence it was necessary to lift the corporate veil to see the real nature of the transaction. The learned AO relied on the judgment of Hon'ble Supreme Court in the case of State of Uttar Pradesh v. Renu Sagar Power Co. (1988) 1 SCC 177 : AIR 1988 SC 1737 : 70 Comp Cas 127 (SC) in this respect. He held that the provisions of Section 40A(2)(b)(iv) were attracted. Besides Article 9 of DTAA

between India and Switzerland contained the provision where in the case of excess payments to an associated enterprise, the profits of the companies could be adjusted. The provisions of Section 92 as also general provisions of the Act contained in Sub-sections (2) and (3) of Section.

143 also empowered the AO to examine the reasonableness of payment so as to arrive at taxable profit of the assessee. According to the learned AO, a clear and deliberate organized camouflage had been perpetuated to take away 50 per cent of the net profit of the assessee-company in the form of royalty. On such royalty payments, only a very small amount of withholding tax was being paid in India as against the corporate tax otherwise leviable on the assessee on whole of its income. The fact that the Department in earlier years had accepted the payments for royalty was of no consequence since the principle of res judicata was not applicable to the income-tax proceedings.

6. The learned AO enumerated the payments of royalty vis-a-vis, product-wise break-up of the turnover and payments of royalties in a tabular form in para 9 of the assessment order. He noted that this year, the assessee's turnover was Rs. 967.32 crores as against Rs. 817.75 crores in the preceding year. The book profit amounted to Rs. 59.97 crores as against Rs. 49.95 crores in the preceding year. In earlier asst. yrs. 1994-95 and 1995-96, the royalty payments were Rs. 9.28 crores and Rs. 17.20 crores respectively against the turnover of Rs. 589,47 crores and Rs. 755.10 crores. For asst, yr. 1997-98, the payment of royalty was almost equal to the book profit. The learned AO further noted that the Agron Industrial Unit had shown a turnover of Rs. 166.81 crores, profit of Rs. 42.78 crores and royalty payment of Rs. 7.74 crores whereas for the Nanjangud Industrial Undertaking, the assessee showed the turnover of Rs. 144.71 crores, profit of Rs. 8,69 crores and payment of royalty Rs. 5.98 crores. Thus, the payment of royalty on the product-wise profit was not proportionate to the profit being generated in various units. In this background, the assessee was asked to file the complete working on the basis of which, the percentage of royalty payment for technical assistance was fixed up at the time of signing of the agreement. As huge amounts were being paid, the assessee-company was also asked to explain whether any annual evaluation of the payment of royalty was made keeping in view those

aspects, the following queries were made ; "(a) The day/year when the product was started manufacturing in India.

(b) The product-wise details of sale, profit, the quantum of royalty paid during the period of agreement. The product-wise costing and the total expenses, giving profit of each of such product.

(c) The details of all technical services and assistance rendered by the group/holding companies for which the royalty payment was made.

(d) The complete profile and balance sheet of the company M/s Societe Des Produits Nestle SA and Nestec SA to justify their receiving such huge amount of royalty for technical assistance.

(e) The complete working particularly in the interest of the assessee-company at the time of signing agreement and the issues, facts, dimensions, etc., examined. The correspondences and other such documents/evidences showing the basis and justification for working out the payment of royalty at such a huge amount.

(f) The quantum or analysis of technical services rendered and its impact on the production and sale of the product for which the royalty is being paid.

(g) List of technical persons of Societe Des Products Nestle SA and Nestec SA and their visit to India and details of services/technical assistance rendered to the various products.

(h) Whether any evaluation and analysis of technical assistance being monitored and maintained by the assessee-company and if so the production of such documents, data, etc., and their consequent effect on the future course of technical assistance and payment of royalty thereon.

(i) The details of expenses on travelling and stay of technical person of Nestec SA or any other group companies and who had borne the expenses thereon." 7. According to the AO, despite repeated and specific queries and even after summons to Mr. Carlo M.V. Donati, the Managing Director of the assessee-company, no working was produced to show that any exercise had ever been

carried out to evaluate the payment of royalty for technical assistance vis-a-vis commercial expediency of the assessee-company.

Though there were seven agreements, no details had been produced regarding separate evaluation of technical assistance received product-wise and no working was submitted showing the impact of such technical assistance on the profit earned on each such product. It, therefore, appeared to the learned AO that the commercial expediency had never been criteria on which the payment of royalty for technical assistance was made to the group/holding company. According to the AO, in the ultimate analysis, the payment of royalty for technical assistance had to be viewed vis-a-vis the profit generated by the company because the main goal of a business venture remains profit at the top.

8. According to the learned AO, the payment of almost equal to book profit was nothing but an arrangement to transfer excessive profit to group/holding company. The course of business was so arranged that the business transacted between them produced the resident assessee-company less than the ordinary profits that might be expected to arise in the business. It was totally wrong to say that the payment of royalty for technical assistance approved by the Government of India could not for that reason be examined by the AO. The argument that the payment of royalty was in the interest of the assessee-company could not be accepted unless the working was provided. No working was done like what was the sale of each of the product and what was going to be the effect of technical assistance on the quality and consequent sale of such product finally on profit. It was pertinent to note that all the products on which the royalty for technical assistance was paid and agreement entered into had long been under production in India by the assessee-company itself. Year-wise introduction was enumerated by the AO in para 28 of the assessment order. The argument that Nestle Group was world-wide number one food company, had the latest technology were again general submissions. The chart showing the profit before tax from financial year 1995-96 and 1998-99 did not serve the purpose because the agreements were entered product-wise and any total concept misled the fact and it showed that no such product-wise exercise had been carried out. The assessee submitted that there was technological improvement and note on technology introduced was furnished.

But the query that such introduction of technology had such huge international pricing was never worked out and justified. Therefore, the assessee-company was asked to get its technological assistance services examined by any competent scientific institute specializing in food products. However, the assessee-company ignored this point in the name of confidentiality and secrecy. According to the learned AO, the argument that the payment of royalty for technical assistance had been approved by the Government of India did not hold ground. Only two agreements with respect to instant hot and cold water soluble tea and soya product were specifically approved by the Department of Industrial Development, Government of India. The royalty payments of these two agreements amounted to Rs. 55.02 lakhs and Rs. 36.55 lakhs only. As to the approval by the RBI, the learned AO pointed out that it had been clearly mentioned therein that the approval related to FERA Act, 1973, only. The RBI was concerned only with the release of foreign exchange.

The Industrial Policy of 1991 also had different purpose, i.e., for inviting foreign direct investment in India and enable foreign companies to do business in India competing with Indian industry in the march towards globalisation. It could not be presumed that once the assessee had followed the enabling provisions to do business in India, then all other laws became subservient to the enabling industrial policy.

9. The learned AO argued that the product of the assessee such as coffee, tea, chocolates, noodles, etc. were day-to-day consumer products. They were not patented or copyright products though the same may be under a brand. The ingredients of such products were commonly known and the process of manufacturing was also routine. In view of the nature of such products and that too being produced by the assessee-company itself in India for many years, as early as 1960, suddenly entering into an agreement for technological assistance was for taking the advantage of guidelines issued in the form of Industrial Policy. The learned AO further argued that in the absence of details filed by the assessee, it was difficult to arrive at the correct amount which should be allowed as royalty for technical assistance. It was noticed that out of total sum of Rs. 47 crores, a sum 6f Rs. 20.72 crores had been paid only on coffee that had been under manufacture

by the assessee-company since 1964. The learned AO did not see force in the contention of the assessee that over the years, the foreign collaborator of the assessee-company had evolved the improved technology of the process of breaking large molecules in coffee beans which resulted in greater solubility of compound and that the improved technology had been evolved for aroma recovery and handling in coffee process resulting into an enhanced taste profile. According to the AO, these technological advancement could not be considered worth payment of Rs. 20.72 crores in one year only. The assessee had not furnished the details regarding international pricing of technology/technical assistance with respect to the coffee in order to justify the huge payment of Rs. 20.72 crores. The assssee's Nanjangud Industrial Undertaking had the profit of Rs. 8.69 crores only on a turnover of Rs. 144.71 crores and royalty amounted to Rs. 5.98 crores. The payment of royalty for Nanjangud Industrial Undertaking was, therefore, excessive with reference to the book profit. This clearly indicated that the profitability from the coffee was extremely low and did not justify huge payment made by the assessee by way of royalty. The learned AO, therefore, disallowed the assessee's payment of Rs. 20.72 crores in respect of coffee to the extent of Rs. 10 crores and royalty for other products to the extent of Rs. 5 crores after invoking the provisions of Section 40A(2)(b), Section 92 and Article 9 of DTAA.10. During the course of hearing before the CIT(A), the assessee reiterated its contentions. The assessee stated that out of seven technical collaboration agreements, two had been specifically approved by the Ministry of Industries and remaining five got automatic approval under the current policy. All the agreements provided for supply of latest know-how to the assessee-company including sending of technical persons. The AO had accepted the very same agreements in the past. The break up of payment of Rs. 47 crores was as follows :3. R&D cess on royalty @ 5 per cent Rs. 2,23,94,000---------- The assessee argued that these royalty payments had been made purely on account of commercial expediency and there were no extraneous factors.

The assessee as a businessman entered into these agreements and that being so, the AO was not justified in inferring and making part disallowance of the royalty payments. The learned CIT(A) held that the AO made the disallowance basically on the following premises : (i) That the impugned royalty payments were high

compared to the profit earned.

(ii) That no review was undertaken to see whether the payments of royalty in question could be pruned.

(iv) That the higher royalty payments were a device to siphon off parts of possible profits in the garb of royalty payments, thereby reducing the profits earned in India and also tax incidence in India.

11. According to the learned CIT(A), the above mentioned premises of the AO were not acceptable. The royalty payments were in terms of sales in the range of 3.5 per cent to 5 per cent against the Government's norms of 5 per cent to 8 per cent. The assessee's arguments that the profit is a derived figure which may be low, high or even negative whereas the sales figures are invariable and, therefore, the royalty is usually linked to sales were acceptable. Looking at the payments from the businessman point of view, it was difficult to see as to how the same could be considered as excessive. The learned AO had not applied any yardstick whereas measured against the Government norms of royalty payments the same appeared very reasonable. The learned CIT(A), therefore, deleted the disallowance of Rs. 15 crores made by the AO.Aggrieved by that order, the Revenue is in appeal before us.

12. During the course of the assessment proceedings for the asst. yr.

1998-99, the AO relied upon the findings of his predecessor for the asst. yr. 1997-98. He noted that the disallowance as made by the AO had been deleted by the learned CIT(A) but that order had not been accepted by the Department and second appeal had been filed before the Tribunal As the basic facts of royalty payments had not changed and the Department was in second appeal on the issue, the learned AO disallowed a sum of Rs. 17 crores being the disallowance of Rs. 10 crores out of royalty on coffee amounting to Rs, 20.92 crores and Rs. 7 crores out of royalty payment on other products amounting to Rs. 37.38 crores.

13. During the course of hearing before the learned CIT(A), the assessee filed the written submissions on 23rd Nov., 2001. The assessee submitted that it was a

leading manufacturer of food items in India. It procured technical know-how and assistance from its foreign collaborator for which purpose it had entered into nine agreements.

These agreements provided for the assessee to use all available know-how relating to manufacture of various products, its future improvements and development, deputing experts for matters requiring on the spot technical assistance, arrangement for training of technical persons and generally advising the assessee on all the technical matters concerning manufacturing operations, productions, methods, quality control, etc. The payment made by the assessee-company was within the framework of Industrial Policy of 1991. In the past, the payments had been accepted. During the course of the assessment proceedings for the asst. yr. 1998-99, the AO had asked the assessee to provide : (c) Justification for fixing the rate of royalty at 3.5 per cent and 5 per cent; and The assessee had furnished these details before the AO. The assessee's arguments have been summarized by the learned CIT(A) in para 6. In short, the assessee relied upon the terms of the agreements and pointed out that it enabled the assessee to make use of the latest technology available in the world throughout the period of agreements to manufacture products of international quality. "As to the liberalization of Industrial Policy in 1991, the assessee submitted that the same was because the Government realized the importance of the Indian business availing the fruits of the technology developed internationally on an on-going basis. Hence, the restrictions over payment of royalty were removed. All the agreements were within the parameters of Industrial Policy. Reliance was placed on the Supreme Court judgment in the case of LIC v. Escorts Ltd. and Ors. (1986) 1 SCC 264 : 59 Comp Cas 548 (SC). The AO also filed the written comments before the learned CIT(A). It was pointed out that the royalty payment was more than 40 per cent of the profits on the products concerned. The learned AO recapitulated various contentions of the AO for asst. yr.

1997-98.

14. The learned CIT(A) confronted the assessee with the aforesaid report of the AO for the asst. yr. 1998-99. The assessee filed its rejoinder by way of letter dt.

4th. Jan., 2002, and that has been reproduced in para 8 of the impugned order of the learned CIT(A) for the asst. yr. 1998-99. The assessee denied that during the course of the assessment proceedings for the asst. yr. 1997-98, the assessee had not furnished the details required by then AO. The assessee argued that for the asst. yr. 1997-98, the learned CIT(A) had mainly acted on commercial expediency. The learned CIT(A) did not ignore the provisions of Section 40A(2) and Section 92 because, he found that the payment made by the assessee to be "very reasonable". As to the payment net of tax, the assessee pointed out that the rate of 5 per cent and 8 per cent mentioned in the Industrial Policy of 1991 were net of taxes rates. The assessee vehemently opposed the contention regarding the assessee's failure to explain with evidence the commercial expediency in paying royalty. The assessee relied in this behalf on its letter dt.

24th Dec., 1999 and 8th Jan., 2000, for the asst. yr. 1997-98 and letters dt. 8th Feb., 2001 and 19th Feb., 2001 for the asst. yr.

1988-99.

15. In addition to his earlier report, the AO submitted further report dt. 21st Jan., 2002, to the learned CIT(A) for asst. yr. 1998-99. He submitted that the payments made by the assessee were covered by the provisions of Section 40A(2). While the assessee was relying on two approvals specifically made by the Department of Industrial Development, there was automatic approval under Industrial Policy in respect of other agreements. There was approval of RBI only for the remaining products, and that approval had been given within the specific provisions of FERA only. The proceedings before the IT authorities were of different nature and required examination of the business expediency of the expenditure. The learned AO pointed out that from the asst. yrs. 1989-90 to 2000-01, the profit before tax had gone up from Rs. 20.19 crores to Rs. 116.73 crores and the royalty payment had gone up from 0.51 crores to 58.30 crores. While the profit before tax had gone up by six times the royalty payment had gone up by approximately 10 times which substantiated the finding of the AO that the assessee was trying to arrange business transaction in such a manner that it resulted in less than ordinary profit which might be expected in the business of the assessee-company.

16. Apart from the report dt. 21st Jan., 2002, another report dt. 22nd Feb., 2002, was submitted by the Addl. DIT (Inv.) formerly the AO who had made the assessment order for the asst. yr. 1997-98. That report has been reproduced by the learned CIT(A) in the second half of para 8.

In brief, the Addl. DIT alleged that during the assessment proceedings for the asst. yr. 1997-98, the assessee had given answers only in general terms to the queries of the AO. The assessee had not furnished the complete profile and balance sheet of two foreign companies to whom the royalty payments had been made. The nine agreements in question had been entered into by the assessee post liberalization in 1991 taking advantage of the fact that in place of specific approval an automatic route had been provided. It was, therefore, deliberate policy on behalf of the assessee-company to siphon away the profit in the liberalized atmosphere and processes in vogue in India after liberalization. For the asst. yr. 1988-89, the royalty payment was 2.5 per cent of the profit before tax. The same was 5.2 per cent in the asst. yr. 1991-92.

But suddenly in the asst. yr. 1997-98 it was 78.37 per cent. Therefore, it was more than 3/4th of the profit. Even for the asst. yr. 1998-99, it was 49.94 per cent of the profit before tax. The assessee was throughout making its case on the low rate of royalty in terms of its turnover rather than connecting the same with its profitability. In the context of Transfer Pricing, the amendment had been made to Sections 92 to 92F. There were several methods laid down such as comparable uncontrolled price method; resale price method; cost plus method; profit split method and transaction net margin method. The assessee had also not furnished the details regarding the filing of the return by the recipient non-resident companies in India. The learned Addl. DIT argued that the Nestle was a trademark that had been in India for a very long time. It, therefore, did not require a brand payment to its holding company of Switzerland. There was no force in the argument that the holding company had not charged for the use of brand in India. The very fact that they had not charged any money for the use of the brand in India clearly showed that it was not commercially expedient or legally permissible to do so. Similarly, the so-called approval of the payments by the shareholders was academic only as the payee had 51 per cent equity in the assessee-company. The learned Addl. DIT

alleged that the technical assistance received by the assessee was of general nature and no specific information had been provided by the assessee. It was also not explained how the recipient company had come to own the technical know-how.

17. The learned CIT(A) forwarded the report of the Addl. DCIT dt. 21st Jan., 2002, and Addl. DIT dt. 22nd Jan., 2002, to the assessee. The assessee filed further written submission dt. 13th Feb., 2002, that have been extracted by the learned CIT(A) in para 9. In brief, the assessee emphasized that it was widely held public limited company whose shares are listed on leading stock exchange in India. The market value of its share was at Rs, 500 per share against the face value of Rs. 10 each. That more than adequately reflected the confidence of society in general and investing public in particular in the fair practices of the assessee-company. If there were any iota of truth in the allegation made by the Department, the same would have certainly impacted the company's share price. The assessee-company was 40 years old law-abiding company. It was one of the highest taxpayers in the country. Direct tax payments by the assessee-company during the last six years on account of income-tax and dividend tax alone aggregated to more than Rs. 360 crores. The Board of Directors included eminent members and the substantial portion of the share capital had been held by the Indian and Foreign Financial Institutions. It was pointed out that the person who got 100 shares in the year 1970 at face value, it resulted into 3712 shares of the market value of Rs. 19 lakhs in addition to dividend of Rs. 2,66,563. The assessee-company was holding status of Star Trading House and its export turnover had increased to Rs. 292 crores in the asst. yr. 2001-02 from a level of Rs, 4.6 crores in the asst. yr. 1989-90.

18. In its reply dt. 13th Feb., 2002, the assessee-company strongly disputed the legal contention of the Department that the provisions of Section 40A(2)(b) are applicable. As to the approval granted by the RBI, the assessee contended that there was no difference between the approval by the RB! and that of Government of India. The AO failed to take any cognizance of CBDT Circular No. 6-P, dt. 6th July, 1968, where in para 75 it was clarified by the Board that when scale of remuneration of a director of a company has been approved by the Company Law Administration, there was no question of disallowance of any part thereof in the

income-tax assessment. On the same basis, once the reduce payment of royalty was approved by RBI, the same should not have been questioned in the income-tax assessment. The assessee argued that the commercial expediency was required to be viewed from the point of view of the businessman and not that of the AO. Reference was made to the judgments reported in Newtone Studio Ltd v. CIT (1955) 28 ITR 378 (Mad), Chairman, ITAT v. Y.E. Aboo (1956) 30 ITR 27 (Rang), F.E.Dinshaw Ltd. v. CIT (1959) 36 ITR 114 (Bom), Section Veeraiah Reddiar v. CIT (1962) 45 ITR 100 (Ker) and Raman & Raman Ltd. v. CIT (1962) 46 ITR 400 (Mad).

19. Under the technical know-how agreements, the assessee-company also received the benefit of experienced foreign technicians. The assessee got its own personnel trained by the foreign company for no extra charges. The assessee argued that there was an error in the approach to link the royalty payments with the profit of a particular year. It was not practicable and, therefore, the Government of India also did not recognize in its approval that had always been based upon turnover. As to the provisions of Section 92, the AO failed to demonstrate that the assessee's profits after the payment of royalty were less than the ordinary profit and that was the condition precedent for invoking the provisions of Section 92. The comparison between the ratio growth of royalty payment and ratio growth of profit during the period from 1990-91 to 2001-02 was irrelevant. Without prejudice, the assessee submitted that the AO should have taken the net profit and not profit before tax as the base year 1989-90 and made the comparison on that basis. The assessee pointed out that for the asst. yr. 1989-90, the net profit ratio of the assessee-company was 7.67 per cent. The weighted average net profit ratio of subsequent period 1990-91 to 2001-02 was 8.67 per cent, which was higher than that in the base year 1989-90. It was also argued that the assessment completed in the earlier year could not be arbitrarily ignored. Reference was made to the judgment reported in HA. Shah & Co. v. CIT & EPT (1956) 30 ITR 618 (Bom).

20. As to the report of the Addl. DIT, the assessee argued that the profile of the foreign companies to whom the royalty was paid had been mentioned in the preface of each of the royalty agreement. The assessee-company could not be

obliged to obtain the balance sheets from them as they were separately managed companies and the assessee-company did not have any say in their business affairs. Sales linked royalty payment was a global practice recognized by the Government of India. It could not be linked with the profits for obvious reason because profit depended on a host of other external factors beyond the control of service provider and scope of service agreements. The assessee reiterated para 9 of Section C of the submission dt. 23rd Nov., 2001.

Royalty rates paid by group companies in comparable countries like China, Sri Lanka, Bangladesh were cited to support the royalty payment by the assessee-company. As to the assessee not furnishing the information, the assessee argued that the same were supplied whenever asked for. Particulars as to how the technologies were developed by the recipient company were irrelevant to the issue of allowability of royalty payment in the assessment of the assessee-company. The assessee took strong exception to the observations of the Addl. DIT that it was deliberate policy on the part of the company to siphon away the profits in liberalized atmosphere and that the assessee was trying to take undue advantage of liberal industrial policy of Government of India.

The assessee also relied on the decision of the Tribunal, Pune in the case of Kinetic Honda Motors Ltd. v. Jt CIT (2001) 72 TTJ (Pune) 72 : (2001) 77 ITD 393 (Pune).

21. The learned CIT(A) observed that he had considered at length the order of his predecessor for the asst. yr. 1997-98 as well as the assessment order passed in the asst. yr. 1997-98 and the written submissions of the parties and their oral arguments. He found that his predecessor allowed the relief mainly relying on the Government norms of allowing royalty payments ranging from 5 per cent to 8 per cent while the assessee had shown the payments at 3.5 per cent and 5 per cent only. The learned CIT(A) begged to differ from his predecessor in this respect. He found that the position relating to royalty payments and turnover of the assessee during the different assessment years was as under :----------Asst. yr.

Turnover Total amount of Royalty as % of royalty and tax turnover----------2000-01 15,517,088 518,978 3.341999-00 15,699,637 540,309 3.441998-99 15,211,346 555,270 3.651997-98 12,530,188 447,647 3.571996-97 10,286,293 288,430 2.801995-96 7,517,597 163,860 2.181994-95 5,717,393 88,410 1.551993-94 5,238,655 75,646 1.44---------- The learned CIT(A) noted that the royalty payments as percentage of turnover had been steadily increasing every year, so much so that from 1.44 per cent for the asst. yr. 1993-94, it went up to 3.65 per cent in respect of the asst. yr. 1998-99. This showed that the maximum royalty had been paid as percentage of turnover in respect of the asst. yr.

1998-99 as compared to the earlier years as also in subsequent years.

There was no reason for such steady increase in the payment of royalty as a percentage on turnover of the assessee inasmuch as no substantive evidence was produced to show that the assessee-company had received any extra services during the asst. yr. 1998-99. The learned CIT(A), therefore, concluded that all was not well with the claim of deduction of the assessee. The CIT(A), thereafter proceeded to compare the ratio between the turnover and net profit and payment of royalty on profit, which according to him were as follows:----------Asst yr.

Turnover Total amount of Profit before tax Net profit Royalty royalty, tax and (But after charge ratio to net R&D cess.

of royalty) profit Rs. (crores) Rs. (crores) Rs. (crores) per cent per cent----------2001-02 1781 62.2 215.9 12.12 28.832000-01 1551 54.4 170 10.98 31.991999-00 1569 56.7 130 8.31 43.461998-99 1521 58 116 7.67 49.951997-98 1253 47 59.9 4.79 78.371996-97 1028 30 49.9 4.86 60.631995-96 751 17 66.4 8,83 25.911994-95 571 9 53.3 9.33 17.391993-94 523 7.9 46.3 8.84 17.151992-93 420 1.95 43.5 10.36 4.481991-92 334 1.51 28.9 8.64 5.241990-91 264 1.2 21 7.99 5.711989-90 263 51 20 7.67 2.53---------- 22. The learned CIT(A) found that the ratio of royalty to net profit worked out at a whopping 49.95 per cent in respect of asst. yr. 1998-99 and 78.37 per cent in respect of asst.

yr. 1997-98 whereas the same was as low as to 2.53 per cent, 5.71 per cent, 5.24 per cent, 4.48 per cent, etc., in respect of asst. yrs. 1989-90 to 1992-93. Even the figures for 1993-94 to 1995-96, were relatively low as 17.15 per cent, 17.39 per cent and 25.91 per cent only, respectively. In respect of asst. yrs. 2000-01 and 2001-02, the percentage worked out at only 31.99 per cent and 28.83 per cent. He, therefore, found that the claim of royalty was quite disproportionate so far as the asst. yrs. 1998-99 and 1997-98 were concerned. The ratio was high for asst, yr. 1996-97 also but in that year the issue was not examined by the AO. There was no res judicata in income-tax proceedings. According to the learned CIT(A), it appeared as if the assessee was doing business not for itself but for the closely connected companies to whom the royalties for technical assistance had been paid.

23. The learned CIT(A) examined also the details of net profit ratio mentioning the position as follows :---------- Asst yr.

Turnover Profit before tax (but Net profit ratio (1) (2) (3) (4=3/2*100)----------2001-02 17,813,662 2,159,694 12.12 %2000-01 15,517,088 1,703,371 10.98 %1999-00 16,699,637 1,305,309 8.31 %1998-99 15,211,346 1,167,300 7.67 %1997-98 12,530,188 5,99,765 4.79 %1996-97 10,286,293 4,99,526 4.86 %1995-96 7,517,597 6,64,009 8.83 %1994-95 5,717,393 5,33,710 9.33 %1993-94 5,238,655 4,63,147 8.84 %1992-93 4,206,520 4,35,656 10.36 %1991-92 3,348,885 2,89,226 8.64 %1990-91 2,640,822 2,10,941 7.99 %Total from asst. yrs. 115,728,086 10,031,654 8.67 %1990-91 to 2001-02---------- 24. The learned CIT(A) found that as against the average ratio of 8.67 per cent for the period from 1990-91 to 2001-02, the ratio for asst.

yr. 1998-99 was only 7.67 per cent, i.e., 1 per cent below the average of 10 years period. The learned CIT(A) argued that the assesses started making payment of royalty after over two decades of commencement of its business. It was admitted that even in the earlier years, the assessee had benefit of services for which no

royalty payment was made. In that view of the-matter, the assessee had paid very high royalty payments for asst. yr. 1998-99 which were quite disproportionate to the legitimate requirements of the situation. It was a colorable device on the part of the assessee and, therefore, the assessee's case was hit by the judgment of the Hon'ble Supreme Court in the case of McDowell & Co Ltd. v. CTO (1985) 154 ITR 148 (SC).

25. During the course of hearing before the learned CIT(A), the assessee had relied upon the judgment of the Pune Bench of Tribunal in the case of Kinetic Honda Motors Ltd. (supra). The CIT(A) held that the facts of the assessee's case were distinguishable because in the case of Kinetic Honda Motors Ltd. (supra) the royalty payment was made for technical assistance for setting up of the plant for manufacture and sale of scooters whereas in the case of the assessee, practice of royalty payment was started after two decades of the commencement of business in India. The learned CIT(A) found support from the Advance Ruling reported in XYZ, In re (1999) 235 ITR 565 (AAR). On p. 573, it had been held that the corporate veil was required to be lifted to see the real nature of the transaction. The learned CIT(A) also referred to the judgment of Hon'ble Supreme Court in the case of State of U.P. v.Renusagar Power Co. (supra) to the effect that the doctrine of lifting corporate veil was expanding in the context of modern jurisprudence.

26. According to the learned CIT(A), enquiries were made with the Asst.

Director, Enforcement Directorate and it was found that certain FERA violation by the assessee during the period 1994-95 was detected in relation to irregularity in the export of coffee by the assessee-company. Investigation revealed that while ostensibly the assessee-company had concluded contracts with several Russian companies for sale of coffee in Indian rupees, but the entire operation was actually controlled by Nestle World Trade Corporation, Switzerland, and that the same consignments were sold to other than LC opening parties.

27. The CIT(A) found that the reliance placed by the assessee on Industrial Policy of 1991 and judgment of the Hon'ble Supreme Court in the case of Life Insurance Corp. v. Escorts Ltd. (supra) was not justified. The Industrial Policy of 1991 did not suggest all other laws of the country would be dwarfed in comparison to the

Industrial Policy resolution of the Government. Those were broad guidelines so as to enable the entrepreneurs to take their investment decision in India. As against those broad guidelines, specific provisions of Section 40A(2)(b) of the IT Act, 1961, empowered the AO to disallow the excess and unreasonable payments. The judgment of Hon'ble Supreme Court in the case of McDowell & Co. Ltd. (supra) also referred to colorable devices for avoiding tax. The provisions of Section 92 also contained specific provision relating to avoiding of tax of the kind done by the assessee.

These provisions were clearly applicable to the case of the assessee inasmuch as the assessee-company had paid unreasonable amount as royalty to the closely connected companies. In the case of Jagatram Ahuja v. CGT (2000) 246 ITR 609 (SC), it was held that the words and expressions defined in one statute as judicially interpreted do not afford a guide to the construction of the same words and expression in another statute unless both statutes are in para materia. Hence the general provisions of Industrial Policy of 1991 could not be applicable in a specific situation hit by the provisions of Section 92 of the Act.

Similarly, RBI looked after the foreign exchange transactions whereas the requirement of direct tax laws was different. The requirement of direct tax laws could not be rendered superfluous for the reason of RBI approval.

28. The CIT(A) did not accept the contention of the assessee that the disallowance of Rs. 17 crores for the asst. yr. 1998-99 out of the royalty of Rs. 58,3 crores was merely an ad hoc disallowance. The disallowance made by the AO was 29,15 percent. The disallowance of Rs. 15 crores out of the royalty payment of Rs. 47 crores for asst. yr.

1997-98 worked out 31.91 per cent. The learned CIT(A) also rejected the contention of the assessee that it should be given the benefit of higher deduction under Section 80HH in respect of the disallowance of royalty payment. According to him, this alternative plea could be considered only if the assessee had surrendered and accepted the -disallowance of 17 crores made by the AO. The learned CIT(A), therefore rejected the alternative contention also and upheld the disallowance of Rs. 17 crores made by the AO for asst. yr. 1998-99.

Aggrieved by that order, the assessee also is in appeal in ITA No.2239/Del/2002.

29. At the outset, in the course of hearing of these appeals by us, the learned CIT (Departmental Representative) argued that there was an error on the part of the authorities below in describing the payments made by the assessee as 'royalty'. The fact of the matter was that the assessee paid technical assistance fee and not any royalty. He, therefore, requested certain time to be allowed to file additional grounds of appeal in this behalf for asst. yr. 1997-98. Subsequently, on 13th Aug., 2004, the following additional grounds of appeal were filed in relation to Revenue's appeal for asst. yr. 1997-98 : "In the facts and circumstances of the case and law, the order of the leaned CIT(A) is perverse inasmuch as that, (a) He has deleted the disallowance made for the remuneration paid as fees for technical assistance, erroneously holding it as royalty payment for technical know-how.

(b) The learned CIT(A) has ignored the material fact in the form of agreements for technical assistance which were on record and under which the payments have been made and has treated the entire payment as royalty for technical know-how." After considering the matter, we admitted the additional grounds of Revenue as above mentioned for asst. yr. 1997-98.

30. At the time of making his arguments, Mr. Lav Saksena filed before us 3 charts. Initiating the arguments, the learned CIT (Departmental Representative) stated that royalty indicated the payment on account of the assessee deriving recurring benefit out of any past and present performance of the payee. Out of seven agreements made by the assessee with the foreign companies, five did not mention any such thing. Only two agreements, which were approved by FIPB pertained to royalty. The assessee did not submit other agreements for approval of FIPB and rightly so as they did not pertain to royalty. Even the agreements in question had mentioned "remuneration" and not "royalty". Thus, the payments were agreed upon for services to be rendered by the payees prospectively. The justification of payment made by the assessee and claim of deduction had to be seen keeping this aspect in view. He then referred to Chart I and pointed out that barring a few items most of the products were being manufactured by the assessee for a long time and in particular Nescafe for which the maximum

payment was made, had been produced by the assessee-company in India since 1964. By the time the agreements in question were entered into by the assessee-company, most of the brands had been well established in the market and the assessee had already commenced production in full swing. In such circumstances, one could not help wondering as to why the assessee made payments to the foreign companies almost equal to the profits derived by the assessee himself. The learned CIT (Departmental Representative) referred to chart n and pointed out that there were 7 agreements for asst. yr. 1997-98 that had been entered into by the assessee during the period starting from 4th Feb., 1992 to 29th Aug., 1997. The agreements were thus, not in relation to any new products and mostly pertained to those products, which the assessee had already been manufacturing and successfully marketing in India.

31. Lastly, the learned CIT (Departmental Representative) referred to Chart III and pointed out that for the asst. yr. 1989-90 the total turnover of the assessee was Rs. 263 crores and profit before tax but after royalty amounted to Rs. 20 crores. The royalty was paid amounting to Rs. 0.51 crore only. The percentage of royalty to profit was only 2.53 per cent. However, for asst. yr. 1997-98, the assessee paid remuneration of Rs. 47 crores against the total turnover of Rs. 1,253 crores and profit before tax but after royalty amounting to Rs. 59.9 crores. The payment was equal to 78.37 per cent of net profit. For asst. yr. 1998-99, the figures were Rs. 1,521 crores, Rs. 58 crores and Rs. 116 crores, respectively and thus the payment was equal to 49.95 per cent of net profit. It was, therefore, essential to examine as to what the assessee had got for having parted with such a huge junk of its profit. This aspect of the issue assumed utmost importance when it was realized that the payees were none other than 100 per cent subsidiaries of Nestle SA, Switzerland, who owned 51 per cent of the share capital of the assessee-company.

32. The learned CIT (Departmental Representative) followed up his oral arguments by a written note. The AO had sought justification for payment of such huge amounts. Inter alia, the AO sought details regarding year-wise figures of product-wise turnover and such royalty payment, manufacturing profit, etc. The AO also inquired whether any review was undertaken from time to time to evaluate the need to pay royalty at percentages fixed earlier including certification of the merit

of the royalty arrangement by a competent third party. The AO also found that provisions contained under Section 40A(2)(b) and under Section 92 of the IT Act were squarely applicable in the case of the assessee.

33. As mentioned above, the AO found that the assessee-company had shown a book profit of Rs. 53.43 crores for which the said royalty was paid amounting to Rs. 47 crores. It was found from the perusal of the assessment record that in respect of profit from Egron Industrial Unit, the assessee-company showed a profit of Rs. 42.78 crores on a turnover of Rs. 168.16 crores and paid a royalty of Rs. 7.74 crores. It was also found that in respect of Nanjangud Industrial undertaking the assessee-company had shown a turnover of Rs. 154.7 crores and profit of Rs. 8.6 crores after payment of royalty of Rs. 5.89 crores. Compared to these royalties, it was found that the amounts paid to the holding/controlling company or subsidiary thereof was too excessive. In fact, it was found to be more than 40 per cent of the profit on the product concerned. In order to look into the justification the assessee was requested to provide complete details of turnover, remuneration paid thereon, the quantum of profit derived on the sales of such products, etc. These details were required to examine the quantum of profit derived on the sale of a particular product and the justification for payment of remuneration for technical assistance on the basis of commercial expediency. The details as required by the AO were not furnished by the assessee even though umpteen opportunities were given. The assessee, however, did provide details of turnover and royalties paid in respect of each product. On a careful scrutiny of the limited details filed, the AO found that out of the total payment for technical assistance amounting to Rs. 47 crores a sum of Rs. 20.72 crores was paid on coffee only on account of different brand of coffee like Nescafe, Sunrise Premium and Sunrise Extra. The AO found that there was no technological advancement in the field of coffee, which had been in production since 1964, had taken place, which could justify a payment of royalty of Rs. 20.72 crores. The profitability from coffee was found to be extremely low and it could not justify payment of a huge amount. Invoking Section 40A(2)(b), Section 92 of the IT Act, 1961, and the provisions contained under Article 9 of DTAA with Swiss Federation and the general law of the land that each expense must be for the benefit and for the purpose of the business, the AO on estimate disallowed a sum of Rs. 10 crores. Out of the

balance amount of payments, the AO made an estimated disallowance of Rs. 5 crores in the absence of various details regarding various products, which were not filed by the assessee. The disallowance, apparently, was extremely reasonable.

34. The learned CIT(A) had deleted the disallowance by holding that the royalty payments amounted to 3.5 per cent on domestic sales and 5 per cent on export sales as against the norms fixed by Government of India which permitted payment of royalty up to 5 per cent on domestic sales and 8 per cent on export sales. The learned CIT(A) had also accepted the assessee's argument that royalty payments for technical know-how which went into the manufacture of products should be usually linked to sales and not to profits. The learned CIT(A) had completely ignored the fact that the AO had strived to go into the commercial expediency behind the impugned payments amounting to Rs. 47 crores. It was towards this objective that the AO sought various details in his elaborately discussed order running into 39 pages. The assessee never provided the substantative details that could prove the commercial expediency to the satisfaction of the AO. The learned CIT(A) had failed to appreciate that the two recipients of the said royalty were fully covered by the provisions of Section 40A(2)(b) and Section 92 of the IT Act, 1961.

Although gross payment of 4.2 per cent on domestic sales and 6 per cent on export sales had actually been paid by the assessee, a comparison of net payment (after TDS) of 3.5 per cent and 5 per cent for domestic sales and export sales, respectively, was made against overall gross limits of 5 per cent and 8 per cent laid down by the Government to justify the said payments. The percentages stated by the assessee were accepted as such by the CIT(A). Whereas the AO had not disputed the linkage of payment percentage to turnover, in the absence of facts and figures requisitioned from the appellant, he had endeavoured to determine the commercial expediency of the payment of huge amount of fees for technical assistance vis-a-vis profit earned by the assessee.

It was pertinent to note that the assessee failed to explain with evidence the commercial expediency in paying such huge amount vis-a-vis actual technical assistance rendered by the two non-resident companies What should have been

appreciated by the learned CIT(A) is that the AO correctly applied Section 92 after proving close connection between the assessee-company and the two non-resident companies to whom impugned royalties had been paid. The AO had been able to prove that the said royalty agreements were in fact made to transfer profits to the non-resident shareholders through 100 per cent subsidiary companies since it was only after relaxation of Government norms in the year 1990 to attract foreign capital that the ceiling for automatic approval of royalty payment had been increased and the assessee-company had made five out of seven agreements immediately thereafter for such products which had been produced and marketed since the 1960's and the 1970's and no evidence for any new technology transferred to the assessee-company by overseas associates was placed on record.

35. In such situation, the AO was fully justified in making a disallowance of Rs. 15 crores on account of excessive fees for technical assistance and the order of the learned CIT(A) deserved to be challenged. A second appeal was, therefore, filed. The learned CIT(A) had thus erred in law and on facts in deleting the disallowance made for remuneration paid as fees for technical assistance, erroneously holding it as royalty payment for technical know-how. The learned CIT(A) had also ignored the material fact in the form of agreements for technical assistance, which were on record and under which the payment had been made and had treated the entire payment a royalty for technical know-how.

36. The learned counsel for the assessee argued that the case of the Revenue was entirely uncalled for. He pointed out that for asst. yr.

1997-98 there were 7 agreements under which payments in question had been made. Thereafter, during the year on 29th Aug., 1996, 2 more agreements were made and accordingly there were 9 agreements in question for asst. yr. 1998-99. The assessee had received technical assistance on almost every aspect of its business of food products in India and gained rich returns for money spent.

37. Both during the assessment proceedings for asst. yrs. 1997-98 and 1998-99, the AO called upon the assessee to furnish voluminous information and the assessee diligently complied with his requisitions.

The learned counsel argued that it was totally incorrect to say that the assessee was wanting in any respect in compliance to the requirements of the assessment proceedings for assessment years under consideration. He referred to the voluminous paper books filed by the assessee and submitted that all the evidence and material had been furnished by the assessee before the authorities below and the assessee was not relying upon any information or material that had not been furnished in the course of assessment proceedings and the proceedings before the learned CIT(A).

38. Subsequently, the learned counsel filed before us lists of documents filed with the lower authorities for asst. yrs. 1997-98 and 1998-99, which are as under : Letter dt. 6.10.1999 explaining some of the technological improvements received under the agreements - list of Indian officers who went for foreign training.

Letter dt. 7.1.2000, giving in Annex. E, a list of technicians who visited India during the years 1997 and 1998 Letter dt. 18.1.2000 confirming production of following evidences in the meeting held on 11.1.2000 : Coffee file with written advise/ recommendation, manual, instructions, plans and drawings about Noodles file with written advise/ recommendation, manuals, instructions, plans and drawings about : File with photographs taken Nestle India Chief Engineer of technical details of a MILO production line at Japan File with photograph, description and drawing of 'Lateral Injection Technology' for Coffee collected by Nestle India technical personnel in Indonesia 3 files with list of visitors received, visits made and advise/assistance received by Moga factory covering Nestle intranet as tool to be updated on latest technological developments including access to 'Production Technology Centres' sites Guidelines on Sensory Evaluation packing material including kit with samples of typical off flavours Letter dt. 18.1.2000 confirming handling over of following documents in meeting held on 11.1.2000 Letter dt 8.2.2001 explaining some of the technological improvements received under the agreements - list of Indian officers who went for foreign training.

Letter dt. 19.2,2001 giving a list of technicians who visited India during the years 1997 and 1998 and technical assistance received for Letter dt. 22.1.2002 furnishing, as directed by CIT(A), following evidences 4. GI - General Instructions -

Food Safety, Factory System, Industrial Performance, etc.

5. CP - Control Procedures - Nestle Quality System, Control Procedures, etc.

Letter dt. 18.1.2000 confirming production of Mowing evidences in the meeting held on 11.1.2000 : (These are already at pp. .205 to 207 in paper book of asst. yr.

1997-98 Coffee file with written advise/ recommendation, manual, instructions, plans and drawings about Noodles file with written advise/ recommendation, manuals, instructions, plans and drawings about : File with photograph taken Nestle India Chief Engineer of technical details of a MILO production line at Japan File with photograph, description and drawing of 'Lateral Injection Technology' for coffee collected by Nestle India technical personnel in Indonesia 3 files with list of visitors received, visits made and advise/assistance received by Moga factory covering Nestle Intranet as tool to be updated on latest technological developments including access to "Production Technology Centres" sites Guidelines on Sensory Evaluation on packing material including kit with samples of typical off flavours Letter dt. 18.1.2000 giving product-wise summary of examples of know-how, etc. of the following products 39. The learned counsel argued that voluminous evidences that the assessee produced before the AO as well as before the learned CIT(A) for asst. yr. 1998-99, does not find mention in their orders. He further stated that apart from the documents filed with the authorities as enlisted above, during the course of hearing before the AO and the learned CIT(A), a large number of files and folders pertaining to material received by way of technical assistance from the foreign companies had been produced. The assessee had received planeloads of material and documents by way of technical assistance from the foreign companies. The assessee could, therefore, produce only specimen files and folders and documents for the perusal of the authorities below.

Hence, Mr. C.M. Donati, Managing Director of the assessee-company addressed following letter to the AO on 7th Jan., 2000 : "Further to our telephone conversation, I confirm that since it was not possible for you to receive us today, a fresh meeting is fixed for early next week, and I proposed this should take place at our office.

I invite you to have the meeting here since, for a full and comprehensive presentation on technical assistance, we will need both supporting equipment as well as a number of Nestle India persons to participate and it would be more convenient to do so at the conference room of our office.

May I suggest that the meeting take place at 1600 hrs on Tuesday, 11th Jan., 2000." "First, let the briefing be at my office at the same time. If need be, we will have demonstration at your place. Adjourned to 1600 hrs on 11th Jan., 2000, at my office.

40. Thereafter, in the letter dt. 18th Jan., 2000, addressed to the AO, Mr. Murli, head of the legal and company secretary of the company, submitted to the AO that if even after various material produced and presentation made by the top management of the company, should the AO still desire clarification, the assessee would appreciate the learned AO visiting the assessee's factories and head office where the learned AO could see more detailed evidence of technology in the assessee's operations. Similar letter was addressed on 27th Jan., 2002, to the learned CIT(A) during the course of appellate proceedings for asst. yr.

1998-99. The assessee submitted to him "Know-how and technology being intangible, we request you to visit any one or more of the factories and research centres, to fully satisfy yourself on the state of art technology being used, the manufacture of products with the know-how and assistance received and the intensive and specialized research and development carried." 41. The learned counsel for the assessee referred to 9 agreements entered into by the assessee with Nestek/SPN. He argued that under Industrial Policy of 1991, Government of India delegated the task of approval to RBI. The assessee entered into agreements to manufacture and sale in India Nestle SA branded products under the same brand name, logo and packing, etc. It was in the best interest of the main company at Switzerland as well as the assessee-company that only those products, which were of the highest quality, reached the consumers.

Rigorous conditions were, therefore, imposed on the assessee-company.

He pointed out that these agreements had various parts. Part A related to "Manufacturing Licence". The assessee was granted license during the term of the agreement to use the know-how for the manufacture of the products. The learned counsel pointed out that the assessee was granted only license to use know-how for manufacture of the products, otherwise know-how always remained the property of the parent company. Without this license, the assessee could not produce or manufacture any product that utilized the know-how communicated by Nestle, SA, Switzerland.

Clauses 11 and 12 of the agreement clearly laid down that know-how and any improvement or development thereto communicated to the assessee-company were and would at all times remain the property of foreign companies. The learned counsel emphasized that the assessee was in food products. For that reason and having regard to the extraordinary reputation and value of the brands, the assessee had to undergo exacting standards; therefore, the technical assistance was very vital. Moreover, the technical assistance was for, the quality of the products and, therefore, the assistance was vital for the very basis on which the assessee-company would make profits. He pointed out that Part B of the agreement pertained to "Duties and Obligation of SPN", Part C pertained to "Duties and Obligation of the Assessee", Part D pertained to "Consideration", while part E pertained to "Terms and Termination" and Part F "Miscellaneous Provisions". Remuneration was fixed at the level much below than as permitted by the Industrial Policy. In other words, the foreign company displayed a fair and reasonable approach in that regard. The learned counsel pointed out to "Scope of assistance" under part B and pointed out that technical assistance to be given to the assessee was all pervasive in the operations of the assessee--company. It included oral advice or supply of documents or samples, manuals, plans, papers and/or other material.

The Swiss company undertook to supply to the assessee-company complete technical documentation. The technical assistance was to be provided from Switzerland and in India by way of spot assistance as well as training of the personnel of the assessee-company Having regard to the nature of the agreement, Clause 32 bearing sub-heading "Confidentiality" bound the assessee

to keep secret and confidential all information and documentation and, in particular, the compliance of this provision by the assessee's staff, employees and workers.

42. The learned counsel referred to pp. 57 and 58 of the paper book for asst. yr. 1998-99 and stated that the average of the royalty charged by the parent company world-over was 3-55 per cent. It could not, therefore, be argued that the Swiss company was charging royalty in India at an exorbitant rate. The assessee was a widely held public limited company and had more than 60,000 shareholders. About 2,500 shareholders attended the annual general meeting of the company every year where the annual accounts and major issues of the company were placed and approved. The local shareholders of the company benefited tremendously. A person who held 100 shares in 1970 had received dividend of Rs. 2,66,563 and the value of his holding as a result of bonus shares and attractive right shares was nearly Rs. 19 lakhs. If there were an iota of truth in the allegations made against the company, the same would have certainly impacted the share price of the company. The remuneration which the assessee paid to the parent company was not for any single purpose. The assessee got a bundle of benefits (i) Brand; (ii) know-how; (iii) Technical Up-gradation; (iv) Technical Supervision, and (v) Collaboration and Assistance.

43. Section 9 of FERA, 1973, required an approval of RBI for every payment of foreign exchange. Thus, one prestigious organ of Government of India had already looked into the quantum of remuneration with the anxiety of preserving precious foreign exchange of the country. The approval received by the assessee-company from RBI was a statutory approval. The parent company had been in this line of business for the last 135 years. Nescafe as a product grew and developed over a period of 60 years. In the beginning, it was 12 minutes coffee brew; today it is instant coffee with improved test profile. It was necessary for the assessee to receive continuous technical assistance. The AO did however, not appreciate the need of continuous assistance from the collaborator. He referred to p. 349 of the paper book and pointed out that during the year 1997, the assessee had achieved the record level of exports and had established itself as a leading exporter of Value Added Instant Coffee. The company's products were available in 6,00,000

outlets in 3,000 towns throughout the country, serviced by 3,900 distributors. The assessee exported instant coffee from India to Russia, Hungary, Poland, Taiwan and instant tea to the USA and Japan.

During the year 1997, the company's export was over Rs. 330 crores.

44. The learned counsel pointed out that R&D budget of Nestle, SA, Switzerland, was over Rs. 2,000 crores. The assessee participated in a scheme to reap benefits of the same on payment of a very small amount.

The learned counsel argued that R&D achievements mostly were invisible but were of paramount importance. The efficacy of the same could not be gauged by the profits earned by the assessee in the year of investment itself. To bring home these points, the learned counsel took us through the booklet "Nestle Product Technology Centre Orbe" (PTC Orbe) at pp.

379 to 397 of the paper book. He then took us to paper book p. 398 relating to network of quality control and quality analytical laboratories. With reference to p. 400, it was pointed out that specialists at the headquarters in Switzerland or at product technology research centres wrote technical know-how documents. The documents were validated through industrial usage and were continuously updated. With a strong centralised research and development organization and the very long experience in setting up and operation of factories, Nestle had been able to develop a vast knowledge base, which was essentially proprietary. To be able to impart this knowledge to the Nestle organizations entitled to receive it, Nestle had created the technical instruction system that guided the creation, distribution and management of "know-how" flow. These instructions covered product specific information, like recipes and manufacturing instructions, all operational aspects of factory operations as well as safety, environment protection and quality assurance.

45. The learned counsel then took us through pp. 403 to 404 of the paper book and pointed out that technical instructions were divided in 5 main groups that were :----------Classification code Name---------- GI General Instructions The learned

counsel pointed out that there were several thousand GI, MI, CP, TM and LI and it was physically impossible to produce all of them in the office of the learned AO as well as CIT(A). For that reason, the assessee produced specimen or sample of instructions in various areas under each classification code. However, all the instructions were open to the AO for inspection and assessee requested the AO to visit its factory and office premises. The learned counsel pointed out that GI were divided under two main heads "Company policies, strategies and standards" which covered the areas : Personnel, Quality, Safety, Environment, Hygiene, Packaging, Operations Development, Agriculture, Regulatory and other. Under the head "Systems", GI covered the areas of Factory Management, Production, Maintenance, Recipes and Environment.

46. Manufacturing Instructions were divided in 3 categories viz. "Milk and Nutrition" that covered Non-Concentrated Milk, Condensed Milk, Milk Powder, Cream and Creamers, Infant Formulas, Infant Specialties, Infant Cereals, Clinical Nutrition, Yogurt and Desserts. Under the head "Coffee and Beverages" MI covered Soluble Coffee, Soluble Coffee Mixes, Ready-to-drink Coffee, Powdered Milk, Modifiers and under the sub-head "Food" MI covered Dehydrated Products, Heat Preserved products, Sauces and meal, Accompaniments, Pasta, Shelf-stable Desserts.

47. Control Procedures (CP) were documents that defined the procedures that needed to be implemented to comply with the Nestle Quality System.

They covered all operations, from raw material reception to the release of the finished products. For example, there were procedures relating to Salmonella Monitoring; Installing, Evaluating and Testing Metal Detectors; Proficiency Tests Manual; Quality Monitoring Scheme for drinking water.

48. Technical Manuals (TM) were documents that provided technical guidelines which were not directly related to manufacturing or which applied to different product groups. These covered the area of Processing, Utilities, Maintenance, Automation, Building and Construction, Filling and Packaging, Project Management and Safety.

49. Lab Instructions (LI) were documents that described method for carrying out various quality related tests and analysis, on-line and in the laboratory. These tests covered all Nestle products and all relevant quality criteria and parameters. They were based on internationally recognized methods that had been adapted to Nestle specific equipment and products or developed in-house. These lab instructions were in the areas of General Methods, Raw Materials, specific areas such as Fresh Milk, Instant Drinks, Coffee and Coffee substitutes, Ices, Culinary Products, Meat Products, Canned Foods, Baby Foods, Fruits and Vegetable Juices and Sauces, etc.

50. After having explained the broad network of Instructions, the learned counsel took us specifically through the details of technical instructions that were applied to the assessee's Nanjangud factory alone mentioned in pp. 407 to 472.

51. After technical instructions, the learned counsel gave us examples of "Drawings". He stated that these drawings defined all major details of an installation or even a whole project. The drawings were grouped into process diagrams; manufacturing flow sheets; process flow sheets; equipment details, machine layouts and installation drawings, etc. The learned counsel enumerated the examples of drawings as given from pp.

473 to 485 of the paper book.

52. The learned counsel emphasized R&D aspects of the technical assistance agreement. He pointed out that Nestle as a worldwide group had developed a unique technology in relation to the extraction process called MUCH process. This resulted in a better-finished product out of the same coffee beans. All the assistance, know-how, equipment design and specification, commissioning and post-commissioning assistance was given by Nestle. Also analytical methods and instructions for process control and analysis were provided. The learned counsel enumerated various instructions related to MUCH process at pp. 486 to 489 of the paper book. He further pointed out that Nestle company published an in-house periodical named "Technical Communications". The purpose was to communicate to the managers of technical functions at head offices and factories of the Nestle group. The learned counsel referred to particulars of the publications as given at

pp. 490 to 506 of the paper book. Further, the Nestle followed a system of transferring know-how directly from the persons or organizations that had the information to the one needing it. For this purpose, Nestle had network of markets and factories with the technology centres, research centres, adaptation centres, laboratories and head office. This big investment allowed the instant transfer of documents, drawings and correspondence by e-mail.

The learned counsel referred to the particulars of technical assistance correspondence in relation to coffee as given at pp. 508 to 523 of the paper book. This system was known as 'Nestle Intranet'. The access to Nestle Intranet and links to Nestle Intranet services were made available to all recipients of technical assistance. The learned counsel referred to particulars of Intranet services as enumerated at pp. 524 to 545 of the paper book.

53. The learned counsel emphasized that a major aspect of technical assistance being received by the assessee was visits by technical personnel of the parent company and other advanced Nestle organizations as noted at pp. 546 to 548 of the paper book that enumerated the visits by technical personnel during the period 3rd March, 1995 to 12th July, 2000. Thereafter, the learned counsel mentioned the features of Nestle International Training at pp. 549 to 553 of the paper book. He pointed out that technical managers of the company were trained in various functions and on various sites at Nestle organizations spread all over the world.54. The learned counsel pointed out that all this material and much more had been furnished and produced before the AO for both asst. yrs.

1997-98 and 1998-99. He referred to letters dt. 8th Feb., 2000 and 19th Feb., 2000, addressed to the AO and annexures thereto as given at pp.

554 to 645 of the paper book. He argued that commercial expediency of remuneration for technical assistance had been explained to the AO at considerable length, both orally as well as in writing along with voluminous supporting material. However, the submissions of the assessee did not find place or mention in the assessment orders made by the AO, except cryptic reference to some of the submissions in a single paragraph of the assessment order for asst. yr. 1997-98. The material produced before the AO, among other things, included

reference letters and details of correspondence; technical reports; technical advice; assistance in procurement of materials; issue of new formulae and recipes; assistance for drawing and technical concept; procurement of raw materials and packing materials and reference to special sample analysis; details of visits made by technical personnel to various factories of Nestle India Ltd. in respect of each of the 9 agreements entered into by the assessee. The particulars of the same were indicated on pp. 600 to 645 of the paper book.

55. The learned counsel took us through the Directors' Report of Nestle India Ltd. dt. 26th March, 1992, 25th March, 1993, 19th March, 1997 and 24th April, 1998. He pointed out that technical assistance being received by the assessee-company was always in focus of the annual report submitted by the Board of Directors to the shareholders, financial institutions, creditors and the world at large.

56. The learned counsel emphasized the tremendous value of nutrition in the foods that form our daily diets, Therefore, the science and technology of food was being given high priority and nowhere that was more true than at Nestle who had been in the food business for 125 years. Through constant research and development, Nestle sought to improve the quality of food and thereby quality of life itself. The learned counsel took us through the report of the Directors of the assessee-company relating to structure of Nestle Research; Technological Development; Quality Assurance, Nestle India Access to Global Technology Bank. Referring to these reports, the learned counsel highlighted some examples of technology advancement directly relating to the business of the assessee-company. For example, in 1992 weaning food manufacturing technology was enhanced through the introduction of "Z line" manufacturing process. This process was developed by NESTEC to meet the specific needs of overseas market and was found to meet the requirements of the Indian scenario. As a result, Nestle India was able to introduce weaning foods that ensured improved bio-availability of carbohydrates through the process of enzymation, providing higher nutrition per meal and enhanced digestibility. It was clearly visible achievement of the global Nestle R&D.57. The learned counsel pointed out that coffee-manufacturing facility of the assessee-company at Nanjangud was comparable with the best in the world; as a result agglomerated instant coffee was introduced in India for the first

time.

58. The introduction of Maggi Noodles revolutionized the eating habits in the country and added a new dimension to convenience foods. The Noodle plant was feasible only because of the know-how and expertise received from NESTEC.59. The learned counsel for the assessee pointed out that quality assurance aspect of the assessee-company's product could never be over emphasized. For this purpose, vitamins, and amino-acid analyses were carried to ensure correct proportions in the finished product, Contaminants like affatoxins and pesticide residues were regularly monitored on sensitive raw materials and finished products.

Additionally intensive on-going microbiological analyses were conducted to search for pathogens like salmonella and staph aureus.

60. In the field of packaging, Nestle India introduced for the first time in the country polyester/low density polyethylene. 2 Minute Noodles sachet with reduced oxygen permeability enables consumers to get a fresher product on the shelf. Nestle India also brought about successful shift from traditional rigid tin containers to flexible packs in regard to its milk products, instant foods and weaning foods not only resulted in significant reduction in foreign exchange outflow through imported tinplate but also resulted in cost savings in excess of 35 per cent.

61. Reading from the annual report for the year 1996, the leaned counsel referred to continuous Business Excellence & Common Application (BEGA) Initiative. He pointed out that in a country as diverse as India, supply chain management was critical to rapid growth. The BECA concentrated heavily on streamlining and improving supply chain management. The major benefits included reduction in working capital through lower inventories of finished goods and material, better stock availability, reduction in obsolescence of materials. Further, the Moga Factory was chosen as a pilot plant and the Moga Improvement Team (MIT) was put in place. The team members comprising international experts from Nestle Technical Services (NESTEC) and local staff embarked on a programme in 1996 with the single-minded objective of optimizing production cost while enhancing product quality so as to make Nestle product even more competitive in the market

place. The team identified the following areas for detailed study : A series of small but critically important initiatives ranging from redesigning of laboratories to palletisation of raw materials and improvements in on-line analyses led to significant reduction in raw and packing material utilization, manufacturing and filling losses and labour manhours resulting in substantial savings and improved productivity and machine utilization. The pilot project in Moga having proved successful, the company intended to implement key learnings of the MIT in other factories. During later part of 1996, an international Sales and Marketing Improvement Team (SMIT) undertook a 4 months' SMIT exercise in India as a part of major global initiative of Nestle to enhance sales and marketing productivity on a worldwide basis.

Following three critical areas were identified from the point of view of the growth objectives of the sales : - Expand distribution to reach one million retail outlets on a regular basis; The aim was to access and evaluate various operations with a view to optimize the company's secondary sales from distributor to the retailer. SMIT took step-by-step approach, the team continued to focus solely on actionable solutions that were not only achievable but also sustainable over the long-term. The pilot project having been successful in Chennai, the company intended to implement key learning all over India.

62. The learned counsel slated that training was an integral and indispensable part of Nestle. It was a major investment in the future of the company and imperative because it was an investment in people.

To this end, Nestle India benefited greatly from the training programme offered at the Rive Reine International Training Centre at Vevey, Switzerland. These programmes were an irreplaceable part of Nestle India's overall training plan. In addition to Rive Reine courses, in-house training and development programme within the country received considerable support from the international experts who visited India.

63. During 1996, the plant to manufacture MILO, the world's largest selling Chocolate Energy Food Drink was commissioned at Nanjangud factory. A range of specially developed culinary products was introduced under the MAGGI brand -

dosa and sambhar mixes, pickles and new varieties of soups. Expansion of manufacturing capacity of milkmaid dessert mixes was undertaken at Samalkha factory. A project for enhancement of manufacturing capacity for sweetened condensed milk was implemented at Moga factory. The technical operations at the company's largest factory at Moga and the sales and marketing operations in South India came under scrutiny by two separate international teams.

64. During 1997, Nestle's worldwide Process Improvement Programme was implemented. The assessee received know-how and assistance in the erection and commissioning of a factory at Bicholim, Goa. It was the third new factory commissioned during the last 5 years involving capital investment of over Rs. 350 crores. Technical expertise in various forms enabled the assessee-company to launch more new products during the last four years than had been done in last 30 years. Despite difficult market conditions the assessee succeeded to achieve its objective of doubling turnover every three years - from Rs. 716 crores in 1994 to Rs. 1,435 crores in 1997. At the end of 1997, the company's products were available in over 6,00,000 outlets in 3,000 towns throughout the country, serviced by 3,900 distributors. During 1997, the company launched a record number of new products - more than 30 in the thrust areas of culinary and chocolate and confectionery.

65. The leaned counsel argued that there was no substance in the allegation that the assessee did not comply with various requisitions of the AO. Voluminous material produced before the AO, analysed properly should have convinced the authorities below. There was practically no information that had been called for by the AO but not supplied by the assessee. The assessee-company made offer to the AO and the CIT(A) to visit the company's business and manufacturing establishments in India, and if need be abroad, so as to enhance their perception of the critical need and importance of technology assistance agreements in question. The learned counsel referred to the letter addressed to the AO on 18th June, 2000, and placed on pp. 205 to 245 of the paper book for asst. yr. 1997-98. This letter was followed by number of explanatory communications to the AO from time to time. The learned counsel referred to the detailed note dt. 22nd Jan., 2002, furnished before the learned CIT(A) and placed at pp. 57 to 97 of the paper book

for asst. yr. 1998-99. The learned counsel stated that initially the assessee had some reservation in furnishing product-wise profitability. The assessee was in highly competitive line of business.

It was also controlled by confidentiality clauses of its agreement with parent company. Despite such reservation, the assessee furnished to the AO particulars of product-wise profitability as given on pp. 274 to 279 of the paper book for asst. yr. 1997-98. The learned counsel referred to the following extracts from the assessee's letter dt. 1st Feb., 2000, addressed to the AO during the course of assessment proceedings for asst. yr. 1997-98 : "Without prejudice to all our above submissions and merely for the sake of good order and against the legal advice that we have received, we enclose herewith the desired information about the product-wise profitability for the past 3 calendar years (i.e. 1996, 1997 and 1998). The compilation of information has involved substantial time and effort. Please note that the figures compiled in these statements are based on the accounting principles followed internationally. The statutory accounts prepared in India are, on the other hand, based on the Indian Standards and hence the results of the two would always be subject to reconciliation." 66. The learned counsel for the assessee argued that all the agreements entered into by the assessee had approval from RBI. In addition, two agreements received approval from the Department of Industrial Development also. The assessee was regularly paying research and development cess levied by the Central Government. In the earlier assessment years, deduction as claimed by the assessee had been allowed. In these circumstances, the rule of consistency demanded that the AO should not have entertained any suspicion or doubt against the assessee's claim of deduction in the absence of even an iota of material pointing against the assessee's case. The argument of the AO that royalty paid during this year was disproportionately high was a lame excuse to rake up the settled issues. For this purpose, he applied the incorrect basis of profit during the year. He did not appreciate that expenditure on technical know-how and upgradation does not result into instant gains and takes some time to bear fruits. Taking his argument to logical end would mean that if the business of an assessee resulted into loss during a particular year, it signified that the expenditure incurred on technical know-how and related matters had no Justification at all. The fact of the matter was that profit depended on a

number of factors and, therefore, payment of royalty was ordinarily linked to turnover and not net profit. At any rate, the chart prepared by the AO in this respect was unsound. The same applied to Chart III submitted by the learned CIT(Departmental Representative).

With a view to accuse the assessee of having made exorbitant payments, the percentage was worked out on the basis of the figures of profit after deducting payments of royalty. In all fairless, faulty as the criteria of profit was, the authorities below should have at least applied reasonable methodology. They should have compared the payments with profits of the assessee before those payments. On that basis, the following position emerged :---------- A B C D E F----------Asst. yr. Turnover Royalty Royalty NP before Royalty as NP as (including (excluding tax and tax and charging percentage percentage R&D cess) R&D cess) royalty, tax of NP of turnover and cess---------- 2001-02 1781 62.20 51.56 278.00 18.55 15.612000-01 1551 54.40 43.39 224.40 19.34 14.471999-00 1569 56.70 44.89 186.70 20.04 11.901998-99 1521 58.00 46.27 174.00 26.59 11.441997-98 1253 47.00 37.30 106.90 34.89 8.531996-97 1028 30.00 23.88 79.90 29.89 7.771995-96 751 17.00 11.89 83.40 14.26 11.111994-95 571 9.00 6.20 62.30 9.95 10.911993-94 523 7.90 5.30 54.20 9.78 10.361992-93 420 1.95 1.30 45.45 2.86 10.821991-92 334 1.51 1.01 30,41 3.32 9.103990-91 264 1.20 0.80 22.20 3.59 8.41---------- The learned counsel argued that the payments made during asst. yrs.

1997-98 and 1998-99 constituted only 34.89 per cent and 26.59 per cent of the profits during the year as against 78.37 per cent and 49.95 per cent wrongfully projected by the AO. Asst. yr. 1997-98 was particularly a less successful year from the point of profitability inasmuch as net profit was 8.53 per cent only much below double digit rate of net profit in other years, still the payments made could not be considered to be taking away the major chunk of net profit. The learned counsel argued that the assessee had paid royalty of 3.5 per cent and 5 per cent respectively on domestic and export turnover against the limits of 5 per cent and 8

per cent prescribed by the Government. Had the intention of the assessee been to siphon away the profits of the company for the benefit of the parent company, the assessee should have paid royalty @ 5 per cent and 8 per cent permitted under Government's Industrial Policy.

67. The learned counsel argued that the reasons given by the AO for not accepting RBI approval were again lame excuse. RBI was concerned about expenditure in foreign exchange. With a view to preserve valuable foreign exchange, RBI examined each one of the assessee's agreements so as to ensure that excessive payments were not made to foreign companies by way of remuneration/royalty. Thus, RBI examined assessee's agreements from the same angle as the AO. There was no qualitative difference between the objective of approval by RBI and requirements of income-tax assessment. The learned counsel referred to the judgment of Hon'ble Supreme Court in the case of LIC v. Escorts Ltd. and Ors.

(supra) wherein after considering the approval given by the RBI, Their Lordships held as under : "As we said earlier, under the scheme of the Act, it is the RBI that is constituted and entrusted with the task of regulating and conserving foreign exchange. If one may use such an expression, it is the 'custodian-general' of foreign exchange. The task of enforcement is left to the Directorate of Enforcement, but it is the RBI and the RBI alone that has to decide whether permission may or may not be granted under Section 29(1) of the Act. The Act makes it its exclusive privilege and function. No other authority is vested with any power nor may it assume to itself the power to decide the question whether permission may or may not be granted or whether it ought or ought not to have been granted. The question may not be permitted to be raised either directly or collaterally. We do not, however, rule out the limited class of cases whether the grant of permission by the RBI may be questioned by an interested party in a proceeding under Article 226 of the Constitution, on the ground that it was mala fide or that there was no application of the mind or that it was opposed to the national interest as contemplated by the Act, being in contradiction of the provisions of the Act and the rules, orders and directions issued under the Act: Once permission is granted by the RBI, ordinarily, it is not open to anyone to go

behind the permission and. seek to question it." The learned counsel for the assessee pointed out that the observations of the Hon'ble Supreme Court abovementioned have been noted in the order of Tribunal Mumbai Bench 'A', dt. 6th Sept., 2002 in ITA No.2158/Mum/2000 in the case of the Bombay Burma Trading Corporation Ltd. and it was held that once permission is granted by RBI, ordinarily, it is not open to any one to question it and go behind the permission. The learned counsel of the assessee argued that the same issue was before Tribunal, Pune Bench in the case of Kinetic Honda Motors Ltd. (supra).

In that case, the Tribunal held that the principle laid down in CBDT Circular dt. 6th July, 1968, that when payments are approved by one wing of Government, there is no question of such payment being treated under Section 40A(2)(b) as excessive or unreasonable having regard to legitimate business needs, was applicable with equal force to Section 37(1) also and lightly brushing aside Government approval would be a dangerous precedent and had to be disapproved. The learned counsel referred in this behalf to some more decisions, viz. Tribunal Mumbai Bench decision in the case of Nabulls Chemicals Ltd. ITA 125/Bom/1993, dt. 11th Feb., 2002 and Tribunal Delhi Bench Decision in the case of Glaxo Smith Kline Beecham Asia Ltd., ITA Nos. 2099/Del/2002 and 421/Del/2003 dt. 11th June, 2004. The learned counsel also relied upon the judgment of Hon'ble Delhi High Court reported in CIT v. Shriram Pistons & Rings Ltd (1990) 181 ITR 230 (Del).

68. The learned counsel argued that provisions of Section 40A(2)(b) did not apply on the facts of the assessee's case. Payment by assessee was not to its director or relative of the director. Recipient of royalty, viz. NESTEC Ltd. and Societe Des Produits Nestle SA, did not have substantial interest in the assessee, nor did the assessee or any of its directors or relative of its directors held any substantial interest in NESTEC and SPN. Without prejudice, the leaned counsel argued that the onus was on the AO to find out the fair market value of goods and services and bring on record comparable instances and establish that the expenditure was excessive or unreasonable having regard to the market value of goods or services; the legitimate business needs; benefit derived by or accruing to the assessee therefrom. In the instant case, the learned AO had brought no material worth the name and merely and most unreasonably accused the assessee of not having

established that the expenditure was not hit by the provisions of Section 40A(2)(b). Not only the AO wrongly placed his own burden on the assessee, he ignored plethora of material placed before him. In support of the contention that the burden of proof was on the AO, the learned counsel invited reference to the Tribunal decisions reported in Upvan International v. ITO (1986) 15 ITD 215 (Del); (2001) 72 TTJ (Pune) 72 : (2001) 77 ITD 393 (Pune) (supra); Hathiwala Silk Mills v. ITO (1984) 19 TTJ (And) 284; Shriram Pistons & Rings Ltd. v.IAC (1991) 39 TTJ (Del)' 132; Beta Naphthol (P) Ltd. v. Dy. CIT (1994) 50 TTJ (Ind) 375; Vikshara Trading & Investment (P) Ltd. v. Dy. CIT (1998) 61 TTJ (Ahd) 6; ITO v. J.K.K. Textile Processing Mills (1985) 23 Taxman 27 (Mad)(Mag); Binit Corporation v. ITO (1986) 24 TTJ (And) 571 : (1986) 25 Taxman 238 (Ahd)(Mag) and Rangoon Chemical Works (P) Ltd. v. Asstt. CTT (1998) 100 Taxman 163 (Ahd)(Mag). In addition, he placed reliance upon the High Court judgment reported in Pandit Bros. v. CTT (1954) 26 ITR 159 (Punj) and Voltamp Transformers (P) Ltd. v. CIT (1981) 129 ITR 105 (Guj). The learned counsel argued that it was also trite law that an expenditure legitimately incurred by the assessee cannot be disallowed merely because the AO thought that the assessee could have managed by expending a lesser amount. Support in this respect was derived from the judgments reported in Sanjeevi & Co. v.CIT (1966) 62 ITR 156 (Mad); Amarjothi Pictures v. CIT (1968) 69 ITR 755 (Mad); CIT v. Turner Morrison & Co. (P) Ltd. (1974) 93 ITR 385 (Cal); CIT v. Vijayalakshmi Mills Ltd. (1974) 94 ITR 173 (Mad) and Jamshedpur Motor Accessories Stores v. CIT (1974) 95 ITR 664 (Pat). The learned counsel argued that reasonableness of the expenditure had to be seen from the point of view of the businessman and not that of the Revenue. For this, he relied upon judgments reported in CIT v. Walchand & Co. (P) Ltd. (1967) 65 ITR 381 (SC); J.K. Woollen Manufacturers v.CIT (1969) 72 ITR 612 (SC); Aluminium Corporation of India Ltd. v. CIT (1972) 86 ITR 11 (SC) and CIT v. Panipat Woollen & General Mills Co.

Ltd. (1976) 103 ITR 66 (SC). Reference was also made to the judgment of Hon'ble Delhi High Court in the case of CIT v. Dalmia Cement (Bharat) Ltd. (2002) 254 ITR 377 (Del), that once it was established that there was a nexus between the expenditure and the purpose of business, the Revenue cannot justifiably claim to put itself in the armchair of a businessman and decide how much was reasonable expenditure.

69. The leaned counsel of the assessee argued that the provisions of Section 92 did not apply. Those provisions were attracted where profit of a joint venture was apportioned between the parties. The provision necessarily implied business between two persons. The assessee as a company carried on its business independently. There was no business carried on between the assessee as a resident company and the NESTEC/SPN as a non-resident. As there was no business between them, the question of the course of business being arranged did not arise.

The AO completely misdirected himself in invoking the provisions of Section 92. The learned counsel relied in this aspect on the judgment of Hon'ble Supreme Court in the case of Mazagaon Dock Ltd. v. CIT (1958) 34 ITR 368 (SC) and the judgment of Hon'ble Calcutta High Court in the case of CIT v. Kusum Products Ltd. (1993) 71 Taxman 611 (Cal) Above all, the CBDT Circular No. 14 of 2001 reported in (2001) 251 ITR (St) 65, in para 55.2 clarified that the provisions of Section 92 of the Act as they stood up to asst. yr. 2001-02 did not apply to transactions such as royalty, etc, which are not part of regular business carried on between a resident or a non-resident. The learned counsel argued that assuming without admitting that the provisions of Section 92 applied, the onus under Section 92 to prove that the course of business between the resident and the non-resident, owing to their close connection, was so arranged as to result in less than ordinary profits to the resident assessee in that business was entirely on the AO and such onus had not been discharged in the case of the assessee.

The AO had not led any evidence/material which would show that the assessee would have paid lesser royalty to an unrelated party. The provider of the know-how or the assessee could not have known at the time of entering into the agreements in question as to what would be the quantum of sale or profit of the assessee in the ensuing years. In fact, the assessee discontinued manufacture of two products subsequently as the same were not profitable. In such a scenario, it could not be said that the course of the business was so arranged as to result in less than ordinary profit to the assessee.

70. The learned counsel argued that the learned AO once again misdirected himself when he invoked the provisions of Article 9 of the DTAA. That article of the DTAA between India and Switzerland was relevant for the purpose of determining the income of the non-resident liable to tax in India and had been wrongly invoked by the AO in the case of the assessee who was a resident Indian company.

71. The learned counsel argued that nothing much turned upon the argument that only 2 out of the 9 agreements had been approved by the Department of Industrial Development, Government of India. All the 9 agreements had been approved by RBI The rate of royalty charged in other 7 agreements was not different from the two agreements approved by the Department of Industrial Development. It was not relevant that no royalty was paid in the past. Remuneration paid for services rendered could not be disallowed merely because no remuneration for such services was paid in the past. Reliance in this respect was placed on the judgment of Hon'ble Supreme Court in the case of Shahzada Nand & Sons v. CIT (1977) 108 ITR 358 (SC) and CIT v. Laxmi Cement Distributor (P) Ltd. (1976) 104 ITR 711 (Guj). Reference was also made to Tribunal, Mumbai Bench decision in the case of Nabulls Chemicals Ltd. (supra).

The agreement between the assessee and the foreign company was exhaustive in nature and very clearly spelt out the purposes for which the payment was being made, i.e., comprehensive package of know-how, license and the technical assistance which was provided by the foreign company. To make the grant of license of the know-how more meaningful and beneficial to the assessee, Clause 13 of the agreement provided an exhaustive list of technical assistance services and advices, which had to be provided by the foreign company to the assessee. Clause 13 also ensured that these were continuously available during the term of agreement. Simple reading of Clause 13 made it clear that the foreign company was obliged and bound to make available to the assessee technical assistance services and advice in almost every facet of the manufacturing and marketing operations. The assessee paid the price for the services, which were to be received under the agreement and, therefore, whether it was called 'royalty' or 'fees for technical services' was a point, which had no bearing to the issue on hand.

Voluminous information or details had been produced to explain that technology/upgrades received from time to time resulted into improved quality of various products including coffee. In any case, the assessee would not have been able to manufacture any product had it not paid the royalty, as it would not have been able to use the technology/know-how in that situation. The linking of royalty with profits had no basis and had vitiated the conclusion of the AO.72. In his reply, the learned CIT (Departmental Representative) pointed out that the dispute insofar as it relates to asst. yr. 1997-98 is academic. The AO completed the assessment under Section 143(3) and determined total income after making an addition of Rs. 15 crores on account of part disallowance of royalty. However, he found that the total income thus computed was lower than income under Section 115JA as per the return filed by the assessee himself at Rs. 17,99,29,538. The AO, therefore, completed assessment under Section 115JA at Rs. 17,99,29,540 exactly at the same figure as returned by the assessee.

The . learned CIT (Departmental Representative), therefore, argued that the CIT(A) erred in admitting the assessee's appeal for asst. yr.

1997-98 because disputed demand was nil.

73. The learned CIT (Departmental Representative.) argued that the AO was anxious to know the basis on which quantum of royalty was determined. However, the assessee kept on giving long-winded submissions. By not going to the assessee's factory, the conclusions of the AO were not rendered invalid or insignificant. The provisions of IT Act, 1961, did not provide for such procedure. The prescribed procedure was the proceedings to take place in the office of the AO. Not much significance could be attached to the approval granted by RBI. The wording of approval granted clearly defined that it was exclusively for the purpose of FERA and not intended to be applied for any other purpose.

74. The assessee was in the business of manufacturing the products in question for a long time. Nescafe had become an established brand of the assessee-company in India and the assessee had become thoroughly well versed in manufacturing and marketing of coffee much before the agreements in question were made. The question raised by the AO was what was the point in the 7

agreements during the 1990s. It was important to remember that during that period India did not recognize any intellectual property rights. Moreover, continuous technological information was not one-way traffic. Assessee in India was manufacturing and exporting and gaining experience. Assessee also gave technical know-how that enhanced sale of Nestle worldwide. It was two-way traffic in which both parties benefited.

75. The learned CIT (Departmental Representative) stated that he was not saying that no royalty was payable. He was saying that there should be reasonability in charging royalty. Provisions of Section 92 of the Act empowered the AO to ask this question. How could the royalty be charged at the same rate in all cases Industrial Policy, 1991, had fixed a ceiling and did not lay down a norm. The fact that the Swiss company was not justified in charging royalty at an exorbitant rate was established as the percentage of royalty to the net profit had gone up from 2.53 per cent in the beginning to 78.37 per cent during asst. yr.

1997-98. That too when the assessee had become a full-fledged manufacturer of most of the products in its own right. Fee to be paid now should be in return of what new the assessee would receive from the licensor and not in return of what the assessee had already received in the past. As to the various services to be rendered as enumerated in the agreements, the same were lofty sentiments. The AO asked the assessee to pinpoint what he was receiving. It was assessee's bounden duty to show that to the AO. Specific improvements during the currency of the agreement should have been shown to the AO. However, the assessee only furnished generalised statements.

76. The learned CIT (Departmental Representative) argued that over the course of time, there was substantial increase in turnover. The increased turnover was required to result into increased revenue as well. That did not happen. In percentage terms, the assessee was losing. There was not much force in the contention that royalty at the same rate was being charged in other countries, such as Malaysia.

Malaysia was not comparable because the products had not fully established there.

77. The learned CIT (Departmental Representative) argued that the assessee found a lame excuse in confidentiality clauses of the agreements. Those clauses did not apply to the AO or a Government for that matter. The assessee was under obligation to. reveal everything.

The AO was anxious to know what technology upgrades the assessee had received during the previous year under assessment. R&D being carried out in Switzerland hardly had any connection. What material was produced to show that benefited India. Whatever had come to the assessee was not shown to the AO. R&D Cess Act, 1986, did not prove assessee's case. It was R&D cess in name only as it was linked to voluntary payments of others.

78. The learned CIT (Departmental Representative) argued that the provisions of Section 40A(2)(b) clearly applied because of intimate relationship amongst the shareholders. Holding pattern was self-explanatory. It was payment to the majority shareholder.

Expression 'royalty' was a misnomer. In fact, the payment was for technical services. For that reason, Tribunal, Pune decision in the case of Kinetic Honda (supra) and various other decisions did not apply. Moreover, before ratio of any judgment or decision was treated to be applicable, it was necessary to match colour of the facts of those cases with that of the assessee.

79. The learned CIT (Departmental Representative) argued that in the case of the assessee, mask was required to be lifted and real face was required to be seen. He relied upon the judgment of Hon'ble Supreme Court in the case of State of UP v. Renu Sagar Power Co. Ltd. (supra).

He also relied upon Article 9 of DTAA.80. Earlier years' assessments did not provide a safe guide. Facts of the case of the assessee changed every year. Hence, acceptance of assessee's claim in earlier years did not matter. There was increase in royalty by Rs. 17 crores whereas the increase in the profit of the assessee left behind was only Rs. 10 crores.

81. The learned CIT (Departmental Representative) referred to para 23 of assessment order for asst. yr. 1997-98 and argued that many of those queries had not been answered. The learned AO had summarized in para 24 as to how he was handicapped by want of necessary information from the assessee. At p. 33, the AO had summarized what he had been told by the assessee. The plant which was under commissioning could not be the basis for the payment of royalty.

82. As to the applicability of Section 92, Swiss parties were doing business with the assessee. It could not therefore, be said that the provision was not applicable. In broader sense, both parties were doing business with each other. At any rate, the requirements for the purposes of Section 37(1) were also the same, the expenditure had to be incurred wholly and exclusively for the purpose of business.

83. The learned counsel for the assessee argued that whether a site visit was necessary of not was a judicial decision. Even Tribunal Members had been taking site inspection whenever it became necessary.

The argument that there was no such procedure laid down in the Act was lame excuse. IT Act specifically provided for site visit, even despite the unwillingness or reluctance of the site owner, by way of the provisions of Section 133A. The assessee had in a bona fide manner requested the AO to visit its office and factory premises. The AO insisted upon production of everything related to services received by the assessee under various agreements. There was planeload of material that the assessee had received by way of technical assistance from Switzerland and elsewhere in terms of the agreement. The AO if he genuinely was interested in looking into such material should have readily accepted the assessee's offer. The learned counsel referred to the judgments reported in Webbing & Belting Factory (P) Ltd. v. CIT (1961) 43 ITR 234 (Punj) and United Nilgiri Tea Estates Co. Ltd. v.State of Tamil Nadu (1991) 191 ITR 397 (Mad) at p. 401. He also referred to Tribunal decisions reported in 47 ITD 441 (sic), Puransingh M. Verma and Anr. v. ITO (2001) 72 TTJ (Ahd)(TM) 399 : (2001) 78 ITD 277 (Ahd)(TM) and ITO v. Kanchanlal Manchharam (1988) 32 TTJ (Ahd)(TM) 38 : (1989) 28 ITD 1 (Ahd)(TM).

84. The learned counsel argued that assessment under Section 115JA did not mean that the assessee could not challenge the wrong additions made by the AO in the assessment of total income under the general provisions of the Act. He also referred to Raja of Venkatagiri v. CIT (1955) 28 ITR 189 (AP) and argued that the plea that the appeal before CIT(A) was misdirected could not be argued for the first time before the Tribunal.

85. The learned counsel argued that RBI approval was condition precedent for the assessee to do the business. They qualified their approval as for the purposes of FERA but that did not mean that RBI approval was of no consequence to other proceedings. It was not correct to say that the assessee's facts were distinguishable. The facts of the assessee's case were identical to the facts in the case of Kinetic Honda Motors Ltd. (supra). Moreover, CBDT circular also said the same thing.

86. The learned counsel argued that the assessee was in no position to contribute to technology bank of Nestle in a big way. Compared to the worldwide organization, the assessee was a small fry. It was only the recipient or end user of technical know-how. The assessee had furnished the details of visits inward and outward. The purpose of travel was also given that showed that the assessee was receiving and not giving.

The assessee received improved technology as an ongoing process. Every year the assessee received something or the other. Today excellent coffee could be brewed in 30 seconds. That was not the case 10-15 years ago. Moreover it was not necessary to receive significant technical know-how every year. The assessee had the right to receive as and when technology developed with no extra cost.

87. The learned counsel argued that the assessee produced voluminous material before the AO as was evident from the paper books of the assessee. Before the AO, the managing director and the entire senior management team of the assessee appeared. The minutes of the meeting recorded at paper book p. 206 stated "detailed presentation along with supporting documentary evidence and material." Initially the assessee stated that it could not produce everything but eventually the assessee produced everything it could. The assessee could not

give the statements of accounts of other foreign branches or Nestle SA, Switzerland. Profitability of foreign companies and the evaluation of cost of technical assistance to the assessee were not the information of the assessee but the foreign companies. The AO was calling for extraneous material beyond the control of the assessee, hence no adverse inference could be drawn against the assessee. The assessee did not challenge the power of State but expressed its inability to produce the information not belonging to the assessee. Nucleolus of research assistance, quality of technology and its impact on the assessee's business had been graphically established in the material the assessee produced. From meager investment of Rs. 100 in the share of Nestle, an Indian shareholder came to own Rs. 19,000 in the span of 20 years. How could it be said that the assessee was not benefited by technical assistance. Revenue's case was based entirely on refusing to believe, no matter the evidence. The AO simply ignored mass of evidence produced before him but on his part he did not bring even an iota of material to rebut the evidence. The AO invoked every possible provision. Section 40A(2)(b), Section 92, Article 9 of DTAA without noticing that under all these provisions the burden of proof was on the AO himself and not on the assessee. The learned AO simply required the assessee to prove negative and to prove it to the hilt that the assessee had not overpaid the technology providers. While doing so, the AO also ignored that those provisions were applicable only in the specified situations and not in the case of every payment from one party to the other.

88. The learned counsel argued that there was no substance in the argument of the learned CIT, (Departmental Representative) that the assessee could carry on its business disregarding its obligations as per agreements. The assessee could not treat what he had been given as only right to use as its absolute property. The assessee was bound by contract. The learned counsel referred to the judgment of Hon'ble Delhi High Court in the case of Konrad Wiedemann GmbH & Co. v. Standard Castings (P) Ltd. and Ors. in suit number 1281 of 1984 that breach by an Indian company of terms regarding payment for transfer of know-how and services and non-observance of confidentiality of information was maintainable. In that case the prayer of German company for appointment of a Court receiver to take custody of prototype was allowed.

89. We have carefully considered the rival submissions. We see considerable force in the contention of the learned CIT, (Departmental Representative) that the appeal in relation to asst, yr. 1997-98 is by and large academic because there is no dispute between the assessee and Revenue as to the quantum of the assessed tax liability for asst. yr.

1997-98. However, during the course of assessment proceedings for asst.

yr. 1997-98, the learned AO has examined the question of allowability of the assessee's payments to SPN at considerable length. The learned AO has given a harsh finding that the payments were part of a device followed by the party to siphon away the profits of the assessee-company in the disguise of royalty payment and thereby reducing, among other things, the assessee-company's tax incidence in India. We find that while completing the assessment for asst. yr.

1998-99, the AO has merely adopted the argument, reasoning and basis of disallowance as given in the assessment order for asst. yr. 1997-98. In spite of the assessment order for asst. yr. 1997-98, not finding favour with the learned CIT{A), the succeeding learned CIT(A) has for asst.

yr. 1998-99 sought to differ from his predecessor mainly on the basis of the findings and reasoning of the AO for asst. yr. 1997-98. The learned CIT(A) entertained, in addition to the report of the AO, a report also from the previous incumbent who was then working as Addl.

DIT (Inv.) on the ground that he was the officer who had framed the assessment order for asst. yr. 1997-98. We are, therefore, of the view that, academic or not academic, the assessment order for asst. yr.

1997-98 has to be kept in view while deciding the assessee's appeal for asst. yr. 1998-99. Hence, now that matter for asst. yr. 1997-98 has travelled unto us, we may as well deal with Revenue's appeal for asst.

yr. 1997-98, for whatever impact, our order in relation to that assessment year may have.

90. On perusal of the assessment order for asst. yr. 1997-98 that has formed the bedrock of the assessment order for asst. yr. 1998-99, we find that the learned AO has made part disallowance of the assessee's claim of deduction on account of agreements with SPN on the following grounds : (a) The assessee refrained from furnishing to the AO the full details as asked for and thus not allowing the AO to examine in depth the correctness or otherwise of the assessee's claim of deduction.

(b) The assessee not furnishing the material/evidence in relation to technical assistance actually received so as to justify the huge payment of Rs. 47 crores for asst. yr. 1997-98.

(c) The assessee not explaining as to on what basis the scale of remuneration was agreed upon in the agreements in question and whether any evaluation and analysis of this technical assistance was being made.

(d) Prima facie, the quantum of royalty paid was excessive and unreasonable having regard to the amount of the assessee's business profit.

(e) The assessee was already well established in the business, particularly coffee business, and, therefore, need not have made such large payment for technical assistance.

On this basis, the learned AO for asst. yr. 1997-98, contended that the payments in question were only part of a device to siphon away the profits of the Indian company thereby reducing the profit distributable in India and incidence of tax thereon. The learned CIT(A) for asst. yr.

1998-99 has also drawn the same conclusion that the payments in question were a colourable device on the part of the assessee and, therefore, hit by the judgment of Hon'ble Supreme Court in the case of McDowell & Co. Ltd. v. CTO (supra). However, we find that in the order of the learned CIT(A) for asst. yr. 1997-98, the emphasis is upon his inference that the payments in question were disproportionately high looking at the profits earned by the assessee and the assessee has not been accused of hiding from examination or not furnishing the

information regarding technical assistance actually received.

91. As to the case of the AO that the assessee failed to establish the commercial expediency of payments in question by production of reliable information and evidence, on careful perusal of the assessment order for asst. yr. 1997-98, we find that the learned AO has mainly alleged non-compliance to various requisitions made by way of order-sheet notings in the course of the assessment proceedings. So much so that in the assessment order for asst. yr. 1997-98, while the learned AO has reproduced verbatim his letter dt. 17th June, 1999, and order-sheet notings dt. 20th Sept., 1999, 6th Oct., 1999 and 29th Nov., 1999, the letter dt. 10th Dec., 1999 and order-sheet noting dt. 27th Dec., 1999, he has summarized the assessee's reply and the submissions in one single para 10 of the assessment order. The learned AO has charged the assessee also for not establishing the commercial expediency. During the course of hearing before us, while the learned CIT-Departmental Representative stoutly emphasized this allegation, the learned counsel for the assessee, with equal vehemence, relied upon the voluminous evidence, material and record filed/produced before the AO during the course of the assessment proceedings for asst. yr. 1997-98. We find that in the assessment order (or asst. yr. 1997-98, the learned AO has spelt out in para 22, various queries that according to him were not compiled with by the assessee. We have reproduced the same in para 6 of this order. The learned counsel for the assessee has painstakingly taken us through the letters from the assessee and other evidence, material and record produced during the course of assessment proceedings for asst. yrs. 1997-98 and 1998-99 and the same have been enumerated by us from paras 37 to 65 of this order. On consideration, we find that by and large, the assessee furnished almost entire information, material and evidence as was asked for by the AO. In addition, the assessee also furnished plenty of material giving the AO, for asst. yrs. 1997-98 and 1998-99, a fair view of the kind, quality and significance of technical assistance received and being received by the assessee by virtue of the agreements in question. The assessee informed the learned AO that it could comply with his requisitions and substantiate its claim of deduction by making a full and comprehensive presentation of technical assistance more conveniently at the assessee's own premises where the relevant record was located. During the course of appeal before the learned

CIT(A) for asst. yr. 1998-99 also, the assessee offered that he may visit the assessee's office premises and factories. However, these requests were not acceded to We have, therefore, to see the material and evidence produced by the assessee keeping in view that the assessee was not granted the advantage of first hand demonstration at the assessee's own premises where technical assistance was supposed to be rendered. We, therefore, hold that the learned AO has been less than fair in his observations that the requisite details and supporting material, evidence and information were not furnished by the assessee. We see force in the contention of the assessee that while making such observation, the learned AO ignored and omitted to make a reference to voluminous material placed before him by the assessee. It is true that some of the information asked for was not furnished. The learned counsel for the assessee has informed us that the same was either not in the possession of the assessee or did not exist. The assessee had certain reservation about furnishing the sensitive information regarding the product-wise profitability as the assessee was in highly competitive market of fast moving consumer goods. However, eventually, the assessee furnished even the data pertaining to product-wise profitability. The assessee did not furnish the particulars of profit and balance sheet, etc. of Nestec, SPN, Nestle SA of Switzerland, because the same fell outside the assessee's obligation to supply. Ironically, according to the assessee, all this emphasis on working of profit of the assessee and service providers was irrelevant because the quantum of remuneration could neither be fixed nor adjudged on the yardstick of profit.

92. During the course of hearing before us, considerable arguments were made in relation to the applicability or otherwise of the provisions of Section 40A(2)(b)/s. 927/art. 9 of DTAA, etc. For the purpose of this order, we do not wish to go into the finer technical points relating to these legal provisions. In our view, in the absence of any specific material, evidence or information, the entire exercise undertaken by the AO could have been tempered if due importance was attached by him to the fact that the RBI approvals had been granted in respect of each one of the nine agreements. We see ample authority for the submissions made by the assessee's counsel in this respect as enumerated by us in para 67 of this order. After consideration, we reject the contention that the adverse inference was correctly drawn against the assessee on account of alleged non-compliance to various

requisitions of the AO during the course of the assessment proceedings for asst. yr. 1997-98.

93. We now address ourselves to the question whether the assessee has discharged the initial onus that lay upon him to substantiate its claim of deduction. We may state that irrespective of the question whether the provisions of Section 40A(2)(b) or Section 92 or Article 9 of DTAA could be invoked or not in this case, it is quite clear that the burden to prove under those special provisions is cast on the AO and not upon the assessee. At the same time, under the provisions of Section 37(1), the primary burden to substantiate a claim of deduction of expenditure is on the assessee. According to the learned counsel for the assessee, learned AO/learned CIT(A), if they entertained any doubt, should have accepted the assessee's offer to visit the assessee's factory and office premises. We do not understand as to why the request of the assessee could not be accepted. In our opinion, this request on the part of the assessee was quite reasonable on the facts and in the circumstances of the case. Be that as it may, from the detailed submissions of the learned counsel for the assessee in this behalf during the course of a number of sittings on various dates which we have attempted to summarise from paras 41 to 64 of this order, we are satisfied that the assessee had successfully discharged the burden of proof which lay upon him under the provisions of Section 37(1) of the Act, We, find that the assessee's case is well armed in this respect on account of approval also granted by the RBI to the agreements in question. At any rate, from the facts stated and the evidence/material produced in the assessee's paper book, we are of the view that the technical assistance agreements in question were essential for the purpose of the business of the assessee during the assessment years before us. The assessee appears to have been highly benefited both in respect of profitability as well as growth of its business on account of close association and support from Nestle SA, Switzerland, internationally renowned and leading food processing company.

94. We now come to the question as to whether the quantum of remuneration as agreed upon in the agreements in question and actually paid during the course of the assessment years before us is justified on the facts and in the circumstances

of the case. In other words, whether both the AO in the assessment order for asst. yr. 1997-98 and the learned CIT(A) in the appellate order for asst, yr. 1998-99 justified are in their conclusion that the assessee in collusion with parent company in Switzerland adopted a colourable device whereby the profits of Indian company were siphoned away to be aggrandized by the Swiss company. The learned AO has argued in the assessment order for asst. yr. 1997-98 that from the very fact that no evaluation and analysis of technical assistance had been made at the time of entering into agreements and subsequently to determine the impact of technical assistance on the business of the company, it was clear that these agreements had been entered into with the sole object of diverting profit of the assessee-company. In this context, the learned AO even asked the assessee to produce a certificate from an independent technical agency that the payments were commensurate to actual services received. Besides, both the learned AO in the assessment proceedings for the asst. yr. 1997-98 and the learned CIT(A) in the order for the asst. yr. 1998-99 emphasised that the assessee was already well established and well versed in the business of products in question, and was not new to the business of manufacture and sale of those products and, therefore, the assessee could not by any stretch of imagination be considered to need further technical assistance of the magnitude so as to part with a substantial chunk of its business profit.

95. The authorities below in their orders and the learned CIT (Departmental Representative) in his arguments before us have relied upon certain charts indicating 78.37 per cent and 49.95 per cent of the profit had been paid off by the assessee-company under the agreements in relation to the asst. yrs. 1997-98 and 1998-99 respectively. During the course of hearing before us, the learned counsel for the assessee has attacked the very rationale of the exercise done in these charts by the IT authorities. According to him, the quantum of remuneration could not, in any case, be linked with the profit. The profit was a derivative figure depending on various factors outside the direct and reasonable control of the technical assistance providers. Contracting for a fixed amount of royalty could be disastrous if the product did not click in the market. In the sale-linked agreement, the technical assistance providers interest in the success of the product was highest and ensured maximum assistance was received. Moreover, intangible

benefit of technical assistance could not be gauged by the performance of the same year in which the investment in technology was made. The benefit could be gauged only over sufficiently long-term allowing the technical initiative to bear fruits. That apart, the learned counsel for the assessee pointed out that the working done by the Department was highly unreasonable inasmuch as the payments were compared with the profit of the company after payment of remuneration in question. The learned counsel, therefore, furnished a separate chart to show that even on imperfect and irrational basis of comparison with the profit adopted by the assessing authority, the payments in question constituted only 34.89 per cent and 26.59 per cent of the profits for asst. yrs. 1997-98 and 1998-99, respectively. The learned counsel further argued that the percentage was higher during asst. yrs. 1997-98 and 1998-99 because the net profit as percentage of turnover itself was lower in those assessment years. As to the question that no independent evaluation of the value and utility of technical services were carried out, the learned counsel argued that such was never a practice in a case where highly specialized and restricted technology was imparted.

Technology provided to the assessee by the parent company and its subsidiary had always been and was intended to always remain the property of the parent company and its subsidiaries. The assessee had been given a right to use only that technology for manufacture and sale of products under the parent company's brand name. The technology was highly sensitive and confidential and, therefore, in every agreement, the assessee was bound by confidentiality clause. In such circumstances, to invite an independent agency for evaluation and certification as desired by the AO was unthinkable. As to the basis on which, the quantum of remuneration for technology assistance was fixed, the learned counsel argued that at the time of entering into the agreement, it was not possible to predict accurately the amount of remuneration to be paid to technical assistance providers. That depended on the success of the product launched and actual working of the project in India and subject to several imponderables. It was for that reason that there was no specific working made at the time of entering into agreements in question and insistence of the learned AO on production of the same was not justified. The assessee as well as the technical assistance providers were in the

line of business and had experience for a long time and based on their experience and perception, by mutual discussion, the rate of remuneration was fixed.

It was not possible to physically demonstrate that intangible exercise.

The fact of the matter was that the remuneration was fixed at a very reasonable rate in spite of the Government regulations having permitted payment of remuneration at much higher rate. The justification of remuneration paid was to be seen in the voluminous material and evidence filed by the assessee during the course of the assessment proceedings and the proceedings before us. It was totally inappropriate to test the reasonableness of the remuneration on the yardstick of profit of the year in which the payment was made. This issue required a long-term view to be taken. On careful consideration of the detailed submissions made by the assessee in this behalf and briefly enumerated by us in paras 37 to 65 of this order, we find ourselves in substantial agreement with the assessee. In the first instance, the assessee only had license to use the technology and, therefore, the assessee could not have continued the manufacture of any Nestle brand product without the consent of the parent company. We do not subscribe to the argument of the learned CIT (Departmental Representative) that as intellectual property rights were not recognized in India, the assessee could have snapped ties with the foreign company and carry on its business as before. We also find that the technical assistance provided by the parent company was all pervasive in the operations of the assessee-company and permeated into almost every detail. The assessee-company in India was reaping harvest of fine production technology evolved by the parent company over 125 years by virtue of presence in more than 70 countries. For continuing to harvest the benefit, it was essential for the assessee to have a perennial source of supply of all the technological innovation, advancement and upgrade.

It would not be an exaggeration to say that in modern times, no businessman can afford to be oblivious of the fast moving technology related to his business on the ground of contented with the knowledge and experience already gathered. The assessee did not contribute a single penny to R&D cost of Nestle SA stated to be over Rs. 2,000 crores per year. Nestle India received tested technology and

therefore, did not have to suffer loss of any failed technology or project. The assessee had access to all the required technology available with the parent company not only in respect of manufacturing but also in various other fields like quality control, personnel, staff management, marketing, storage and so on. The kind of technical assistance received by the assessee was of such nature as to sustain its position as number one manufacturer in India in respect of the products being manufactured by it. During the course of hearing before us, the learned counsel for the assessee has given several examples of major technological advancements that had taken place in the area of the assessee's products. He explained to us in detail the major changes that took place in the field of coffee manufacturing and state of art technology that allowed to capture the aroma of fresh coffee in the products of the assessee. The learned counsel dwelt at length on the unique technology in relation to extraction process called MUCH process resulting into better-finished product from the same coffee beans. He made reference to the changes in the manufacturing process of weaning foods that ensured bio availability of carbohydrates through the process of Enzymation to provide higher nutrition in meals and enhanced digestibility. These were just a few examples from out of the many advancements and changes taking place every year. The learned counsel pointed out that during the period under consideration, more products were launched by Nestle than in the immediately preceding two decades.

He also emphasized with considerable justification that several thousand Indian shareholders of the assessee-company were tremendously benefited. An investor who purchased 100 shares in 1970 had grown into shareholding of 3700 shares of the market Value of Rs. 19 lakhs after having received the dividend totalling to Rs. 2,66,653. The learned counsel argued that these aspects were required to be appreciated rather than merely suspecting that the remuneration for technical assistance was nothing but a camouflage to siphon away and repatriate the profits of Indian operations. On careful consideration, we see considerable force and justification in these arguments of the assessee.

96. There is one more important aspect of the case. After all, what is the material against the assessee in the orders of the authorities below Apart from preparing

some charts, no material or evidence has been brought on record by the authorities below to substantiate their allegations against the assessee. As we have pointed out that the assessee only had initial onus to substantiate its claim of deduction of expenditure as laid down under Section 37(1). The burden to prove that the claim of expenditure was a colourable device or a camouflage for diversion of profits rested upon the Revenue. In the order of the authorities below, no material has been brought on record except disbelieving the assessee's explanation and their subjective opinions.

The burden of their order is that the assessee so arranged its course of business that it was left with a less than ordinary profit expected in the assessee's line of business. No one, however, has taken care to specify as to how much that ordinary profit was supposed to be and on what basis the same could be determined. It appears to us that the assessment order for asst. yr. 1997-98 and the learned AO as well as the CIT(A) for the asst. yr. 1998-99 have argued without adequate material that the assessee might have taken the advantage of liberalization of Industrial Policy from the year 1991. In judicial proceedings, suspicion, howsoever strong, cannot take the place of material/evidence. We, therefore, hold that the disallowance of the assessee's claim of deduction on account of remuneration paid for technical assistance is not called for in both the asst. yrs. 1997-98 and 1998-99. We direct accordingly.

97. In the cross-objection, the assessee has disputed the disallowance of provision of pension amounting to Rs. 85,13,668. We find that during the course of hearing before the learned CIT(A), the assessee did not raise any ground of appeal in this regard. Be that as it may, we find that eventually the assessee has been charged tax under Section 115JA only, We, therefore, decline to consider this issue. The same applies to the assessee's cross-objection relating to the disallowance of club fee amounting to Rs. 11,805 as entertainment expenditure.

98. In the assessee's appeal for asst. yr. 1998-99, the ground of appeal No. 2 is the alternative contention of the assessee that corresponding increase in the claim of the assessee of deduction under Section 80HH may be given to the extent the disallowance out of royalty in respect of coffee is sustained. As we have deleted

this disallowance entirely, this alternative contention became infructuous and is accordingly rejected.

99. In the result, for statistical purposes, Revenue's appeal ITA No.4545/Del/2000 and the assessee's cross-objection CO No. 135/Del/2002 are dismissed. The assessee's appeal in ITA No. 2239/Del/2002 is partly allowed.

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