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CASE ANALYSIS : M/S. MANGLORE GANESH BEEDI WORKS VS. COMMISSIONER OF INCOME TAX, MYSORE [CIVIL APPEAL NOS. 10547 – 10548 OF 2011]*

INTRODUCTION

Mangalore Ganesh Beedi Works (MGBW) is a beedi-manufacturing business, which was established in 1940 as a partnership firm. The firm which was reconstituted from time to time contained Clause 16 which related to winding-up of the firm's affairs after its dissolution.
Clause 16 read as follows:

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

Clause 16 provided for an auction sale to be conducted among the partners of the firm on the dissolution of the partnership, where the business of the firm and all the trademarks used in the course of the firm's business would vest in the partner who offers (or an association of two or more partners who jointly offer) to pay the highest price for the business.

The firm was eventually dissolved in December, 1987 by filing a Company Petition in the Karnataka High Court; the High Court appointed an Official Liquidator and passed a winding up order in June, 1991. In its order, the Court fixed Rs. 30 crores as the minimum (reserved) price for the auction.

An auction was duly conducted and the business of the firm passed into the hands of three former partners of the firm, forming an association of persons (hereinafter 'AOP-3') who had bid Rs. 92 crores for the assets of MGBW; the sale took effect on 18th November, 1994.

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MGBW (hereinafter referred to as the 'Assessee') filed income tax returns for the period 18th November, 1994 to 31st March, 1995. The Assessee claimed depreciation under Sections 35A and 35AB of the Act towards acquisition of IP such as trademark, copyright and technical know-how (Section 35A allows deductions for expenditure on acquiring patents and copyrights and section 35AB on acquisition of know-how); alternatively, the Assessee claimed deduction through depreciation on the value of the IPRs by treating them as "plant".

On 30th March, 1998 the Assessing Officer passed an order rejecting all the claims of the Assessee. Subsequently, the order was appealed by the Assessee and the Commissioner of Income-Tax (Appeals) rejected the Assessee's claim for depreciation on IPRs.

The Assessee appealed the order before the Income-Tax Appellate Tribunal (hereinafter 'the Tribunal') which allowed the Appeal.

The Revenue appealed the order of the Tribunal in the Karnataka HC which set aside the Tribunal's findings and restored the order of the Assessing Officer. The Assessee appealed to the Supreme Court.

ISSUED RAISED IN THE CASE

The following issues were raised in the case at hand:

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

JUDGMENT

1. The Supreme Court of India finally laid down that the Intellectual Property Rights which include trademarks, copyrights, etc must be interpreted in the light of reasonable care and be treated as 'plant' within the meaning of Section 43(3) of the Income Tax Act, 1961.
2. The question answered by the Court was that would intellectual property such as trademarks, copyrights and know-how come within the definition of 'plant' in the 'sense which people conversant with the subject-matter with which the statute is dealing, would attribute to it'? The Court stated that for the purposes of a large business, control over intellectual property rights such as brand name, trademark etc. are absolutely necessary. Moreover, the acquisition of such rights and know-how is acquisition of a capital nature. Therefore, it cannot be doubted that so far as an going concern Enterprise is concerned, the trademarks, copyrights and know-how acquired by it would come within the definition of 'plant' being commercially necessary and essential as understood by those dealing with direct taxes.

EVALUATION OF THE CASE

1. As already discussed in brief above, a case was filed by Manglore Ganesh Beedi Works against the Revenue department for not allowing to consider the Intellecutal Property of the enterprise as an element of plant under section 43(3) of the Income Tact Act, 1961

2. They relied upon the following arguments:

- That for the purposes of a large business, control over intellectual property rights such as brand name, trademark etc. are absolutely necessary.
- the acquisition of such rights and know-how is acquisition of a capital nature, more particularly in the case of the Appellant. Therefore, it cannot be doubted that so far as the Appellant is concerned, the trademarks, copyrights and know-how acquired by it would come within the definition of 'plant' being commercially necessary and essential as understood by those dealing with direct taxes.

By denying the trademarks that were auctioned to the highest bidder, the Revenue is actually seeking to re-write clause 16 of the agreement between the erstwhile partners of MGBW. This clause specifically states that the going concern and all the trademarks used in the course of the said business by the said firm and under which the business of the partnership is carried on shall vest in and belong to the highest bidder.

The Act does not clothe the taxing authorities with any power or jurisdiction to re-write the terms of the agreement arrived at between the parties with each other at arm's length and with no allegation of any collusion between them. 'The commercial expediency of the contract is to be adjudged by the contracting parties as to its terms.'

ANALYSIS OF JUDGMENT

This decision of the Hon'ble Supreme Court of India, in which Justice Madan B Lokur and Justice S.A. Bobde set out at length the reasons behind their decision, has come to be considered as an important landmark in the context of the law on the aspect of tax exemption for acquisition of an enterprise which applies for consideration of the enterprises' Intellectual Property like trademarks, copyrights etc within the definition of 'Plant' under the Income Tax Act, 1961.

The essential features of the judgment are as follows:

- Their Lordships, in the instant case, extended the situations where a the Intellectual Property of an enterprise can come within the ambit of Plant and thus rejected the Revenue Department's approach of applying recognized principles to a situation regardless of whether or not it is covered by authority.
- They agreed that the goodwill of the enterprise was not sold off alone but also the know-how of the business, trademarks and copyright of the enterprise and that the requisite relationship of the proximity should also be present to limit what would otherwise result in any form of tangible or intangible asset to come within the ambit of 'Plant' under section 43(3) of the Income Tax Act, 1961.
- The definition of 'plant' in Section 43(3) of the Act is inclusive. A similar definition occurring in Section 10(5) of the Income Tax Act, 1922, was considered in Commissioner of Income Tax v. Taj Mahal Hotel, wherein it was held that the word 'plant' must be given a wide meaning.

It was held: "Now it is well settled that where the definition of a word has not been given, it must be construed in its popular sense if it is a word of every day use. Popular sense means "that sense which people conversant with the subject-matter with which the statute is dealing, would attribute to it".

- In the present case, Section 10(5) enlarges the definition of the word "plant" by including in it the words which have already been mentioned before. The very fact that even books have been included shows that the meaning intended to be given to "plant" is wide. The word "includes" is often used in interpretation clauses in order to enlarge the meaning of the words or phrases occurring in the body of the statute. When it is so used, those words and phrases must be construed as comprehending not only such things as they signify according to their nature and import but also those things which the interpretation clause declares that they shall include. The word "include" is also susceptible of other constructions which it is unnecessary to go into."

- The question is, would intellectual property such as trademarks, copyrights and know-how come within the definition of 'plant' in the 'sense which people conversant with the subject-matter with which the statute is dealing, would attribute to it'? There can be no doubt that for the purposes of a large business, control over intellectual property rights such as brand name, trademark etc. are absolutely necessary. Moreover, the acquisition of such rights and know-how is acquisition of a capital nature, more particularly in the present case. Therefore, it cannot be doubted that so far as the appellant is concerned, the trademarks, copyrights and know-how acquired by it would come within the definition of 'plant' being commercially necessary and essential as understood by those dealing with direct taxes.
- By denying that the trademarks were auctioned to the highest bidder, the Revenue is actually seeking to re-write clause 16 of the agreement between the erstwhile partners of MGBW. This clause specifically states that the going concern and all the trademarks used in the course of the said business by the said firm and under which the business of the partnership is carried on shall vest in and belong to the highest bidder.
- Under the given circumstances, it was difficult to appreciate how it could be concluded by the Revenue that the trademarks were not auctioned off and only the goodwill in the erstwhile firm was auctioned off.
- In D. S. Bist & Sons v. CIT, it was held that the Act does not clothe the taxing authorities with any power or jurisdiction to re-write the terms of the agreement arrived at between the parties with each other at arm's length and with no allegation of any collusion between them. 'The commercial expediency of the contract is to be adjudged by the contracting parties as to its terms.' The issue, looked at from any angle, would lead to the conclusion that the issue in question was required to be answered in the negative, in favour of the appellant and against the Revenue.

THE ECONOMIC PERSPECTIVE

- The Supreme Court of India had to analyses the economic perspective of the judgment it would be delivering in the present matter. If the appellant's claim of including the Intellectual Property Right of the enterprise within the definition of the 'Plant' under section 43(3) of the Income Tax Act, 1961 was not allowed then such a precedent laid down by the Court would result in the indiscrete power being vested to the Revenue authorities with regards together interpretation of the Law.
- By way of this judgment, the Court have laid down one major precedent, that, the Revenue authorities do are not to interpret the law firstly, and secondly, they are not suppose to assume that the claim of the person/enterprise filling its return for certain exemption which is new to the interpretation of law is incorrect in law.
- The main essence of providing exemption to any appellant under the Income Tax Act, 1961 is to provide the appellant certain tax benefits, as seen in the present matter, was to provide ceratin economical benefits. However, the denial of such exemptions by the Revenue department to the appellant was setting a bad precedent for future instances.
- Therefore , even in the current case where this question of economic loss arose , the Judges after referring to various judgments laid down in the cases of Cann v. Willson the dissenting judgment of Denning L.J. in Candler v. Crane, Christmas & Co. and Hedley Byrne & Co. Ltd v. Heller &Partners Ltd. and Smith v. Eric S. Bush , held that it was now

a well established proposition that a negligent statement may, in certain circumstances, render the maker thereof liable for economic loss occasioned thereby to another.

CONCLUSION

After a thorough analysis of the aspect of Intellectual Property Right with respect to 'Plant', it is also imperative to see how the application of the judgment would be applied in India in the future circumstances that come before the Court.