

CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

[A] COMMISSIONER OF INCOME TAX vs. AHMEDABAD MANUFACTURING & CALICO PRINTING CO.

HIGH COURT OF GUJARAT

B.J. Divan C.J. & P.D. Desai, J.

IT Ref. No. 162 of 1975

Decided on 7th August, 1980

TC5R.429

SOURCE : (1983) 139 ITR 806 (GUJ) : (1981) TAX 63(3)-154

Legislation referred to

Section 9(1)(vi), Expln. 2, 1971FA (No.2) 2(4),

Case pertains to

Asst. Year -

Decision in favour of

Assessee

TDS—Payments to non-resident—Payment for obtaining exclusive right to manufacture the products—Was royalty as known to law and to the international commercial world in the context of such agreements—Hence liable to deduction of tax at lower rate of 50% as prescribed by the Finance (No. 2) Act, 1971

Facts

The assessee-company entered into an agreement with a company located in the United Kingdom, and under that agreement, the foreign company agreed to supply to the assessee-company the technical know-how and the assessee-company agreed to pay one per cent of the net sale proceeds of the products mentioned in the agreement which the assessee-company could manufacture under the permission granted under the said agreement. This amount calculated at one per cent of the net sale proceeds was to be paid as "research contribution" under cl. 17 of the agreement. The payment agreed to be made to the foreign company was tax-free, that is, the tax chargeable on these payments was to be borne by the assessee and the foreign company was to receive only the net amount. The ITO worked out the gross contribution at Rs. 1,62,330 and determined tax at 70% thereof at Rs. 1,13,632. According to the assessee, the rate at which tax was deductible on the remittances made in accordance with the provisions of s. 195 read with the Finance (No. 2) Act of 1971 was 50%. The claim of the assessee was that the impugned payments made were "royalties" and as such, the tax to be deducted at source was 50% while the ITO was of the view that the impugned payment was research contribution and as such was covered by the residuary clause in para 2(ii) Part II of Schedule I of the Finance (No. 2) Act, 1971.

Held

It is clear that the payment, though called "research contribution" in cl. 17 of the agreement, was nothing else but the consideration correlated to the extent of exploitation of the secret formulations and patent rights and various other rights belonging to V, by the assessee-company in India and that it was for this exclusive right to manufacture the products that this payment was made and it was nothing else but "royalty" as known to law and to the international commercial world in the context of such agreements. Under these circumstances, the conclusion of the Tribunal that the payment of Rs. 48,698 during the relevant period was royalty, was correct and as such liable to deduction of tax at lower rate of 50% as prescribed in the Finance (No. 2) Act, 1971.

Counsel appeared

K. C. Patel, for the Assessee : G. N. Desai with R. P. Bhatt of M/s. R. P. Bhatt & Co., for the Revenue

DIVAN, C. J.:

In this case, at the instance of the Revenue, the following question has been referred to us for our opinion:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the payments made by the assessee to the foreign company were 'Royalty Payments' and as such liable to deduction of tax at lower rate of 50 per cent as prescribed in the Finance (No. 2) Act of 1971"

2. The facts leading to this reference are as follows :

The assessee- company, the respondent herein, entered into an agreement on August 28, 1961, with M/s Vinyl Products Ltd., a company located in the United Kingdom, and under that agreement, the foreign company agreed to supply to the assessee-company the technical know-how and the assessee-company agreed to pay one per cent. of the net sale proceeds of the products mentioned in the agreement which the assessee-company could manufacture under the permission granted under the said agreement This amount calculated at one per cent. of the net sale proceeds was to be paid as

"research contribution" under cl. 17 of the agreement. The payment agreed to be made to the foreign company was tax- free, that is, the tax chargeable on these payments was to be borne by the assessee and the foreign company was to receive only the net amount. The ITO worked out the gross contribution at Rs. 1,62,330 and determined tax at 70 per cent. thereof at Rs. 1,13,632. According to the assessee, the rate at which tax was deductible on the remittances made in accordance with the provisions of s. 1 of the Act r/w the Finance (No. 2) Act of 1971 was 50 per cent. The claim of the assessee was that the impugned payments made were "royalties" and as such, the tax to be deducted at source was 50 per cent. while the ITO was of the view that the impugned payment was research contribution and as such was covered by the residuary clause in para. 2(ii) Part II of Schedule I of the Finance (No. 2) Act, 1971. This decision of the ITO was upheld in appeal by the AAC. The assessee carried the matter in further appeal to the Tribunal and the main question of controversy before the Tribunal was whether the impugned payments were covered by the expression "royalties" used in the relevant provisions of the Finance (No. 2) Act, 1971, so as to be liable to a deduction of tax at the lower rate of 50 per cent. Since the expression

"royalty" has not been defined in the IT Act, the Tribunal relied upon two decisions, one of the Calcutta High Court in CIT vs. Hindustan General Electrical Corporation Ltd. (1971) 81 ITR 243, and the other in Rolls Royce Ltd. vs. Jeffery (Inspector of Taxes) (1965) 56 ITR 580 (HL), which is

a decision of the House of Lords, and in the light of those decisions; it came to the conclusion that having regard to cl. 17 of the agreement, the impugned payments were royalty payments and as such liable to a deduction of tax at source at the lower rate of 50 per cent. as prescribed in the relevant provisions of the Finance (No. 2) Act, 1971. Thereafter, at the instance of the Revenue, the question hereinabove set out has been referred to us for our opinion.

3. It may be pointed out that the matter did not arise in the assessment proceedings, but, the assessee appears to have addressed a letter on November 16, 1971, to the ITO, Special Investigation Circle IV, Ahmedabad, in connection with the amount of Rs. 48,698 which was paid under cl. 17 of the agreement by the assessee-company to M/s Vinyl Products Ltd., the U.K. company. The letter was written by the assessee-company in regard to the technical research contribution to M/s Vinyl Products Ltd., Surrey, England, for the period from October 1, 1970 to October 31, 1971. According to the ITO's reply dated November 23, 1971, which is annex. A to statement of the case, the tax payable on the gross remittances was worked out as pointed out in the letter. The assessee was requested to confirm the said amount and pay tax at the earliest. The computation, according to the ITO, was in accordance with the letter dated February 18, 1971, in connection with the earlier payment of research contribution, and a challan was enclosed for the necessary payment. According to that calculation, in respect of the amount of Rs. 48,698 which was remitted during the period from October 1, 1970 to March 31, 1971, the gross contribution payable came to Rs. 1,62,330 and 70 per cent., that is, Rs. 1,13,632 was the tax payable thereon. As pointed out above, the U.K. company was entitled to receive Rs. 48,698 being one per cent. of the net sale proceeds of the products, which were manufactured and sold in India and other territories, covered by the agreement in accordance with the terms of the agreement dated August 28, 1961.

4. The relevant provisions of law are as follows:

Under s. 195 of the IT Act, provision is made for tax deduction at source in respect of some of the sums mentioned in that section. Sub-s. (1) of s. 195 provides :

"Any person responsible for paying to a non-resident, not being a company, or to a company which is neither an Indian company nor a company which has made the prescribed arrangements for the declaration and payment of dividends within India, any interest, not being 'interest on securities', or any other sum, not being dividends, chargeable under the provisions of this Act, shall, at the time of payment, unless he is himself liable to pay any income-tax thereon as an agent, deduct income-tax there-on at the rates in force"

5. The proviso to sub-s. (1) is not material for the purposes of this judgment. Under sub-s. (2) of s. 195:

"Where the person responsible for paying any such sum chargeable under this Act (other than interest including interest on securities, dividends and salary) to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the ITO to determine, by general or special order, the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-s. (1) only on that proportion of the sum which is so chargeable"

6. Under the Finance (No. 2) Act, 1971, by s. 2(4) it has been provided:

"In cases in which tax has to be deducted under ss. 193, 194, 194A and 195 of the IT Act at the rates in force, the deduction shall be made at the rates specified in Part II of the First Schedule"

7. The First Schedule, Pt. II of the Finance (No. 2) Act, 1971, is in these terms :

"Rates for deduction of tax at source in certain cases :

In every case in which under the provisions of ss. 193, 194, 194A and 195 of the IT Act, tax is to be deducted at the rates in force, deduction shall be made from the income subject to deduction, at the following rates:.."

Now, below this heading, a Table has been set out and in item (2) it has been provided :

"In the case of a company...

(b) where the company is not a domestic company... (ii) on the income by way of royalties payable by an Indian concern in pursuance of an agreement made by it with the Indian concern after the 31st day of March, 1961, and which has been approved by the Central Government."

the rate of income-tax is 50 per cent. and the rate of surcharge is nil.

"(v) on any other income" the rate of income-tax is 70 per cent. and the rate of surcharge is nil.

Therefore, it is clear, in view of the provisions of the Finance (No. 2) Act, 1961, that, so far as the assessee-company's payments to M/s Vinyl Products Ltd. were concerned, if they amounted to payments of royalty and was thus an income by way of royalty, so far as M/s Vinyl Products Ltd. was concerned, income-tax was payable at 50 per cent. of the income, whereas if they amounted to any other income, and thus fell under the residuary clause, then income-tax was payable at 70 per cent. of the gross income. It is common ground that the case would fall either under cl. (ii) which provides for taxation at 50 per cent. in the case of payment of income by way of royalties, or under cl. (v) which provides for income-tax at the rate of 70 per cent. on any other income.

8. Mr. Desai, appearing for the Revenue, has urged that, in fact, the appeals to the AAC and thereafter to the Tribunal were both incompetent as the AAC had no jurisdiction under the IT Act to entertain the appeal. In this connection, he relied on the provisions of s. 246 of the IT Act, 1961, and contended that since this was not an appealable order as set out in s. 246, no appeal lay to the AAC against the decision of the ITO as set out in the letter dated November 21, 1971, to the assessee. Now we find that this very contention was urged before the Tribunal, and in para. 7 of its order the Tribunal dealt with this contention in these words:

"Before we close, we would like to deal with another contention raised on behalf of Revenue in regard to admissibility of this appeal. Since we have taken the view in the earlier years that an appeal on this point was competent, this contention also fails."

9. Thus the Tribunal rejected the contention urged on behalf of the Revenue that the appeal was not maintainable. However, against this decision of the Tribunal rejecting the contention regarding the maintainability of the appeal, no question was sought for by the Revenue when the application under s. 256(1) was made and the only question on which reference was sought to this High Court was regarding the question of royalties, and, that question actually has been referred to us for our opinion.

10. Mr. Desai, on behalf of the Revenue, when faced with this circumstance, contended that the question that is referred to us speaks of "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding" etc., and he says that since on the question of law, the Tribunal's decision being right in law is being agitated, the question of maintainability of the appeal by the Tribunal would be another aspect of the matter and would be covered by the wide language of the words "right in law" as set out in the question referred to us.

11. In this connection, Mr. Desai relied on the decision of a Division Bench of this High Court in

Shankerlal H. Dave vs. CIT. IT Ref.s Nos. 57 and 82 of 1975 decided by a Division Bench of this Court on 11/12th July, 1977-since reported in 1978 CTR (Guj) 68 : (1980) 124 ITR 733). In that case, on behalf of the assessee, certain questions of fact were sought to be agitated before the High Court because, the decision of the Tribunal was a mixed question of law and fact and in order to arrive at the correct conclusion, the High Court was asked to consider certain aspects of the questions of fact. There-upon on behalf of the Revenue an objection was raised that in view of some decisions of the Supreme Court it was not open to the High Court to do so. This contention urged on behalf of the Revenue in Shankerlal H. Dave's case (supra) was dealt with in this manner by the Division Bench (at p. 749):

"...the learned Standing Counsel has raised various technical contentions to support the conclusions of the Tribunal. His first contention was that this was a case of pure finding of fact and unless that finding of fact is expressly challenged as being perverse or unreasonable and not supportable on the materials on record by a specific question raised in the reference, this Court was bound by that finding of fact. The decision in CIT vs. Madan Gopal Radhey Lal (1969) 73 ITR 652 (SC), where the earlier decision in India Cements Ltd. vs. CIT (1966) 60 ITR 52 (SC), had been relied upon had been marshalled in aid. In these decisions, the Supreme Court had laid down that in a reference under the IT Act the High Court must accept the findings of fact made by the Tribunal and it is for the person who has applied for a reference to challenge those findings first by an application under s. 66(1). If he has failed to file an application under s. 66(1) expressly raising the question about the validity of the findings of fact, he is not entitled to urge before the High Court that the findings are vitiated for one reason or another. Where that principle applies it is not open to the assessee to contend on the question raised that the finding of the Tribunal was not supported by the evidence. These decisions are in the context of pure findings of fact which have to be specifically challenged by raising expressly the question that the finding is perverse or unreasonable and not supported by the evidence on record. This line of decisions has no application whatever where the finding of the Tribunal raises either a pure question of law or a mixed question of law. In the two latter categories of cases no such bar can be invoked that the High Court must accept even such an erroneous finding on mixed question of law and facts or on a pure question of law. The whole distinction is so well settled that it hardly needs any elaboration but as the learned Standing Counsel had vehemently relied on this question in a number of cases, we would point out the settled legal position in the matter."

12. After referring to the decision in Shree Meenakshi Mills vs. CIT (1957) 31 ITR 28 (SC) and G.V. Naidu & Co. vs. CIT (1959) 35 ITR 94 (SC), the Division Bench culled out the ratio in Meenakshi Mills' case (supra) as reiterated in G. V. Naidu's, case (supra) as follows (at p. 602 of 35 ITR):

"on principles established by authorities only such questions as relate to one or the other of the following matters can be questions of law under s. 66(1): (1) the construction of a statute or a document of title ; (2) the legal effect of the facts found where the point for determination is a mixed question of law and facts ; and (3) a finding of fact unsupported by evidence or unreasonable and perverse in nature. ,"

13. On the facts of that particular case in Shankerlal H. Dave's case (supra), it was held that the question before the High Court was a mixed question of law and fact, the question before the High Court in that case being in the following terms: "Whether, on the facts and circumstances of the case, the Tribunal was right in law in disallowing the remuneration paid by the HUF to its Karta, Shri Shankerlal H. Dave, for all the three years under reference ?" This was a mixed question of fact and law and the conclusion of the Tribunal formed part of the mixed question of law and fact; hence the same could be considered by the High Court, and the High Court came to its conclusion on this mixed question of law and fact.

14. In the case before us the question, Mr.. Desai wants to urge, is in regard to the jurisdiction of the AAC and the Tribunal regarding the entertainment of the appeal and since this question of law has not in terms been raised by an application under s. 256(1) and has not been referred to us, it

cannot be said to be covered by the words "right in law" occurring in the question referred to us. If the Revenue wanted to agitate this question, which is a pure question of law, it should have asked the Tribunal to refer the question to us by a specific prayer in that behalf in the application under s. 256(1) and since that was not done, we are not going into the question and we will only deal with the question which is referred to us. Therefore, the first submission made on behalf of the Revenue must fail.

15. As regards the question as to what is meant by the word "royalty" the Tribunal is right when it says that the word "royalty" is nowhere defined and it is in the light of the general legal principles relating to royalty that the question has to be decided, looking to the terms of the agreement entered into between the parties, namely, between the assessee company and Vinyl Products Ltd. of the U.K. The agreement, dated August 25, 1961, is annex. E to the statement of the case and it points out in the second part of the preamble that the company, that is M/s Vinyl Products Ltd., is a manufacturer of certain vinyl polymers and copolymers, in the form of emulsion, solutions and solid resins based on the vinyl monomers such as vinyl acetate, styrene and esters and salts of acrylic and methacrylic acids and others and derivatives of these and similar resins and certain monomers produced by a process of ester interchange such as vinyl caprate and vinyl aterate and others according to certain secret or patent formulations owned or controlled by the company. In this agreement, Vinyl Products Ltd., is referred to as the company where-as the assessee-company is referred to as Calico. The further recital in the preamble is that Calico was desirous of obtaining the benefit of the results of future research and development by the company relating to the products upon the terms and conditions set out in the agreement and was also desirous of acquiring and enjoying the exclusive manufacturing and distribution rights of the products mentioned in Sch. A to the agreement and those products which were being developed by the company, namely, by Vinyl Products Ltd. Under cl. 1, the company granted and conveyed to Calico the sole and exclusive right and licence to manufacture, distribute, sell and exploit the products and improvements, modifications thereof in India and use of any Indian patents owned or to be owned by the company in respect of the said products. Under cl. 2, the company agreed from time to time and at all times to make available to Calico or its fully authorised agents such know-how within the company's knowledge and capability necessary for the use by Calico of vinyl acetate and products to be manufactured in India to the company's standards. Under cl. 3, Calico was to be free to manufacture, sell and exploit their production of vinyl acetate in India and other parts of the world subject to patents and instructions outside the company's control which may affect such sales outside India and the company agreed to use its best endeavours to obtain such agreements with other parties as may be proved necessary to remove any such restrictions to the benefit of Calico. By cl. 4, the company represented and warranted that it had enjoyed and continued to enjoy the sole proprietary rights of manufacture, sale and distribution and exploitation of the products and that it had not entered into any commitments or agreements with any person, firm and company in India and elsewhere for the manufacture of the said products in India. Under cl 5, the company undertook to make available to Calico the benefits of the results of future research and development by the company relating to the products and furnish Calico simultaneously with the execution of the agreement with all and any secret or patent formulations used by or known to the company for the manufacture of the products and as occasion might arise with all and any improvements, modifications and verifications thereof and any new products based on synthetic resins discovered or developed during the course of the agreement and to instruct Calico in the use of such products, their formulations and method of manufacture. Clause 7 stated that where the company was the proprietor of a trade mark registered in India which was used in relation to the said products, the company was bound to produce, if so desired by Calico, a registration of Calico as exclusive registered user of such trade mark in respect of the said products. Under cl. 12 of the agreement, Calico undertook to maintain and preserve the secrecy of the formulations and methods and processing the products and all improvements, modifications and variations thereof. Calico was to designate a representative to receive such information from the company who would be responsible for its safe custody. Calico was to instruct such nominee not to disclose to outside parties any secret information received from the company and to disclose such information to employees of Calico only to the extent necessary for proper conduct of the business and any and all information given by the company was to be strictly limited to Calico. Clause 13 provided that

during the subsistence of the agreement, the company agreed that it Was not to give or disclose to any other person, firm or company in India the benefit of such researches, discoveries or inventions or patents relating to the said know-how and was not itself to use such discovery, inventions or patents in India so as to compete with the Indian company anywhere in the whole of India in any manner whatever. Under cl. 14, the company was to provide facilities in their factory from time to time as might be mutually convenient to train and instruct suitable technicians from Calico in the manufacture, processing and methods or applications of the products, the travelling and living expenses and salaries to be paid by Calico. Under cl. 17, it was provided as follows:

"Calico shall pay to the company 1per cent (one per cent.) on its net sales of the said products (excluding sales of vinyl) as research contribution only provided that the research contribution shall not be payable on the net sales made by Calico during the period of 12 (twelve) months commencing from the date of production. The term 'net sales' as used in this agreement shall mean the actual invoice value of all sales of the said products (excluding vinyl acetate) made by Calico less return allowances and credits, less all discounts, freight, transport, insurance, handling, delivery and all other charges relating to or arising from delivery of goods as are included in the invoice or which are added to the invoice, less all royalties and commissions allowed to agents or distributors, less all taxes imposed or other charges directly made or levied upon the manufacture or sale (excluding other taxes based upon income). Calico undertake to keep true and accurate accounts showing the net value of sales of the products in India and shall render the company every six months within 45 (forty-five) days of the expiry of each six months period a full and accurate statement of the quantity and value of the products sold by them during the preceding six months and within one month of the acceptance of the statement by the company, Calico shall pay contributions due to the company.

No other fee or remuneration shall be payable to the company under this agreement"

16. Under cl. 19 of the agreement, the term and duration of the agreement was to extend from the date of signing of the agreement for a period of 10 (ten) years and thereafter as mutually agreed or unless determined by one year's notice but such notice could not be served before the end of the ninth year of the agreement. This agreement was subject to the approval of the Govt. of India, and it is on record that, in fact, the agreement was approved by the Govt. of India. The question, in the light of the provisions which we have set out hereinabove, is whether the payment of what is referred in cl. 17 as a research contribution, amounted to "royalty"as known to law.

17. In Corpus Juris Secundum, Vol. 77, at p. 542, it has been mentioned:

"Defined generally, the word 'royalty' means a share of the product or profit reserved by the owner for permitting another to use the property ; the share of the production or profit paid to the owner; a share of the product or proceeds therefrom reserved to the owner for permitting another to use the property; the share of the produce reserved to the owner for permitting another to exploit and use the property; a share of the profit, reserved by the owner for permitting another to use the property; the amount reserved or the rental to be paid the original owner of the whole estate"

18. And it has been pointed out in foot-notes that "royalty proper "is a share of product or profits reserved by the owner for permitting another to use or develop his property, and a case of one of the American Courts is referred to in support of this proposition in Corpus Juris Secundum.

19. In "Words and Phrases Legally Defined", Volume 4, at p.354, it has been pointed out:

"'Royalty' (except in the expression 'tonnage royalty') includes a dead rent and any periodical or other payment for minerals got under a mining lease, and 'tonnage royalty' means a royalty calculated by reference to the amount of minerals so got from time to time, or of manufactured articles produced from such minerals, or by any similar method"

20. It has also been pointed out that in Australia, the word "royalty" is most commonly used in connection with the agreements for the use of patents or copyrights and in relation to minerals. In the case of patents a royalty is usually a fixed sum paid in respect of each article manufactured under a licence to manufacture a patented article. Similarly, the publisher of a work may agree to pay the author royalties in respect of each copy of the work sold. Use of the term "royalty" is not, however, limited to patents, copyrights and minerals. The term has been used to describe payments for removing furnace slag from land and to payment for flax cut, the person paying the royalties becoming the owner, of the slag or of the flax. In Australia payments for right to cut and take away timber are commonly described as royalties in the statutes of the States, which relate to this matter.

In the context of the Australian Income-tax Law, it has been pointed out:

"The word 'royalty' is not defined in the Act It is plain that in this context, (i.e., the provisions in the Act which make any amount received by way of royalty, part of the assessable income of the taxpayer) the word does not mean the rights belonging to the Crown *jure coronae*... It seems to me that the word in the present context is used to signify payments made to a taxpayer in which business or commercial usage attaches the name of royalty. A common application of the word in its business or commercial sense is to moneys that are received by a patentee in respect of the use of the patent by a licensee of the patent or by an author from a publisher for the right to publish a literary work. The word 'royalty' is also commonly applied to moneys which the lessee of a mine pays to the lessor for the right to work it ; the amount of the royalty may be fixed by reference to quantities of material won from the mine. Hence in its business or commercial sense the words may be used to refer to moneys which are part of the proceeds of the sale of a capital asset"

21. It has also been pointed out in the context of Australian decisions: ". in its primary and natural sense 'royalties' is merely the English translation or equivalent of *regalitates*, *jura realia*, *jura regia*. To say that the uses of the word are now figurative and represent analogies to the Revenues which some *jura realia* were seen to yield to the Crown does not help much to ascertain the scope of present usage. It may be noted, however, that the modern applications of the term seem to fall under two heads, namely, the payments which the grantees of monopolies such as patents and copyrights receive under licences and, payments which the owner of the soil obtains in respect of the taking of some special thing forming part of it or attached to it which he suffers to be taken. It is not fanciful to trace the extension of the word by analogy from the kind of payments which some of the *Jura regia* enabled the Crown to obtain. We are not concerned with that application of the word which relates to payments to a patentee owner, of a copyright or even of a secret process in respect of articles produced or sold, or books printed or sold or works, performed or exhibited under his licence. What matters here is the parallel though distinct development of the meaning of the word which seems to arise from payments made to the Crown in respect of metals and the like won or taken from the soil. Similar payments to the owners of mines are regarded as royalties and by an extension not difficult to follow payments made in respect of the taking under the agreement or licence of the owner of land of anything which may be considered part of or naturally attached to the soil such as coal, stone, sand, shells, oil and standing timber came to be spoken of as royalties. Warren and piscary and such rights are not heard of amongst us but conceivably there may be things made the subject of royalty which belong to ownership of land that cannot be considered actually to be part of the soil. In the case of monopolies and the like the essential idea seems to be payment, for each thing produced or sold or each performance or exhibition in pursuance of the licence. In the same way in the case of things taken from the land, the essential notion seems to be that the payment is made in respect of the taking of something which otherwise might be considered to belong to the owner of the land in virtue of his ownership. In other words, it is inherent in the conception expressed by the word that the payments should be made in respect of the particular exercise of the right to take the substance and, therefore, should be calculated either in respect of, the quantity or value taken or the occasions upon which the right is exercised"

22. We may point out that according to "Words and Phrases Legally Defined", in Canada, a similar meaning seems to be attached to the word "royalty" At page 356, it is mentioned:

"The term 'royalty' , I think, more properly applies to the interest in production reserved by the original lessor by way of rent for the right or privilege of taking oil or gas out of a designated tract of land, and such interest is not subject to deductions for operation, maintenance, and management charges, by the lessee, and it is for that reason that such an interest is usually referred to as a gross royalty The remaining interest in production which are sold to the public in order to obtain capital, only participate in production after operating; and management expenses and other charges, are deducted and hence are usually referred to as net royalties"

23. In Encyclopaedia Britannica, 1972, Edn., Vol. 19, at p. 676, the word "royalty" is accepted to be:

"the payment made to the owners of Certain types of rights by those who are permitted by the owners to exercise the rights. The rights concerned are literary, musical and artistic copyright, rights in inventions and designs, and rights in mineral deposits, including oil and natural gas. The term originated from the fact that in Great Britain for centuries gold and silver mines were the property of the Crown; such 'royal' metals could be mined only if a payment ('royalty') were made to the Crown. An individual inventor without capital or plant must licence others to manufacture his invention. When owners of rights make arrangements for such exploitation by others, the remuneration they receive in exchange is often in the form of a royalty, usually based on the actual extent of the exploitation"

24. As regards inventions, it has been pointed out:

"As to inventions, a royalty may be said to be a compensation paid under a licence granted by the owner of a patent ('the licensor') to another person ('the licensee') who wishes to make use of the invention, the subject of the patent. The patent remains the property of the licensor. A licence may be exclusive, in which case the patent owner precludes him-self from granting licences to third parties, or non-exclusive, in which case the patent owner may grant licence; to as many persons as he wishes. The granting of licences and the payment of royalties thereunder are purely a matter of contract between licensor and licensee. It is essential that all relevant matters be provided for in the contract, especially the amount of royalties, and the precise method of computing them. A licence may be limited or not, according to the intentions of the parties. It may be limited to certain purposes or to geographical areas or in any other way permissible under the national laws having jurisdiction over the transaction. It will normally be for the full term of the patent.

A royalty may be a single payment covering the whole use of the patent for the whole term, but the more usual practice is to make periodic payments and to relate the amounts of those payments to the actual use of the patent by the licensee. It is common to charge royalties on the basis of a percentage of the price for which the licensee sells the articles or on the basis of the number of the articles made under the patent. Although the amount of royalties is generally a matter of free bargaining between licensor and licensee, in some countries governments preclude their nationals from paying royalties to foreign patent owners in excess of a certain maximum fixed by the government. Some governments also reserve the right to approve the entire licence contract concluded between their nationals and aliens.

Royalty payments may be in exchange for something in addition to the mere use of the invention. The most common example is that wherein the licensor not only grants the right to use the invention but also under-takes to supply the licensee with technical 'know-how', that is to say, information from his own experience on the most efficient and economical way of working the patent. It is estimated that more than 50per cent of licence contracts include 'know-how' provisions.

When applied to industrial designs, the meaning of the word "royalty" is roughly the same as in the case of patented inventions. Designs, depending on their nature or the various national laws, may be protected by patents, copyright or registration. The form of legal protection, however, does little to change the system of royalty payment as described in regard to patents"

25. It is thus clear that in the case of secret processes, patents, special inventions, when right of exploitation is given by the owner of the inventions, patents, etc., to a third party, instead of outright sale, then, for the right to exploit these inventions, secret processes, some amount may be paid and the amount paid may be co-related to the extent of exploitation. It is in this sense, as pointed out by Encyclopaedia Britannica that licence agreements for the exploitation of patents, inventions, etc., are being entered into in modern commercial world and as part of such agreements, even knowledge derived from his own experience and technical know-how for the most economical and efficient user of the patents, inventions, etc , are parted with by the licensor to the licensee.

26. The present agreement between M/s Vinyl Products Ltd., and the assessee-company falls in this category. Firstly, the agreement is for a period of ten years only. Secondly, it is in respect of certain secret or patent formulations owned or controlled by Vinyl Products Ltd. and under the terms of the agreement, Calico is given the sole and exclusive right of licence to manufacture, distribute, sell and exploit the products and improvements, modifications thereof in India and use of any Indian patents owned or to be owned by the company in respect of the said products. It has also been pointed out that where the company, that is, Vinyl Products Ltd., is the proprietor of a trade mark registered in India which is used in relation to the said products, the assessee-company was to be granted the benefit of registration as the exclusive registered user of such trade mark in respect of the said products. Under cl. 12 of the agreement, the grantee, namely, the assessee-company was to preserve the secret processes and not to part with the knowledge of these secret processes to any one else and even the employees of the assessee-company were to be initiated into these secret conduct of the business by the nominated representative of the assessee who was to be given full information regarding the use of secret processes and patents, which were in the knowledge of Vinyl Products Ltd. Though the amounts payable, calculated at the rate of one per cent. on net sales of the products manufactured by the assessee company under the terms of the agreement, is designated as " research contribution", in fact and in substance, it is nothing else but "royalty"as known to law. We have extensively quoted above from the different recognised books of law and Encyclopaedia Britannica, to point out that in the modern commercial world, payments of this kind are known as royalties.

27. That this conclusion of ours regarding international commercial transactions in international commercial world is correct is borne out by a series of agreements which the Govt. of India has entered into with different foreign countries in order to avoid double taxation, between India and the foreign country. Between India and Sweden an agreement was entered into in January, 1959, and in article VII of that agreement between India and Sweden it was provided:

"Royalties derived by a resident of one of the territories from sources in the other territory may be taxed only in that other territory"

"In this article, the term 'royalty' means any royalty or other like amount received as consideration for the right to use copyright, artistic or scientific works, patents, models, designs, plants, secret processes or formulae, trade-marks and other like property or rights, but does not include any royalty or other like amount in respect of the operation of mines, quarries or other natural resources, or in respect of cinematographic films"

28. Similar agreements regarding exemption from double taxation were entered into between India and Denmark, India and Norway, India and Finland, India and Austria, India and Greece, India and the United Arab Republic, India and France and India and Belgium. In each of these agreements, the word "royalty" has been defined to mean any royalty or the like amount received as

consideration for the right to use copyright, models or artistic designs, plans, secret processes, formulae and other like property. Thus the modern international usage in the commercial field also accepts this very meaning of the word "royalty" in the sense of consideration paid from time to time or, may be, even outright, for the exploitation of the rights, inter alia, to the knowledge regarding secret processes, patents, registered trade marks, etc., and also the right to market the products as a result of those exploitations. It must be pointed out that it was in the field of taxation law and in the fields connected with taxation that these agreements were arrived at and, the word "royalty" was thus understood by the contracting parties, namely, the respective countries.

29. It may also be pointed out that by s. 4 of the Finance Act of 1976 which came into force w.e.f. June 1, 1976, the word "royalty" has been defined in s. 9(1)(vi) Expln. 2 as :

"'Royalty' means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains') for...

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property"

30. Now, s. 9 deals with income deemed to accrue or arise in India. Under s. 195, tax on income which has accrued or arisen in India to a foreigner has to be paid but tax has to be deducted at source by the person who is making the payment to that foreigner. This payment of tax has to be made on the basis of the income accrued or arisen to the foreigner in India and that is why the definition in s. 9(1)(vi) Expln. 2 is material for the purpose of income-tax leviable after June 1, 1976. This definition enacted by the Legislature lends support to our conclusion that in the field of international commercial usage, the word "royalty" has now come to acquire this particular meaning which we have attributed to it.

31. In *State of Bihar vs. S. K. Roy*, AIR 1966 SC 1995 at page 1998, the Supreme Court has mentioned that it is a well-recognised principle in dealing with matters of construction that subsequent legislation may be looked at in order to see what is the proper interpretation to be put upon the earlier Act where the earlier Act is obscure or ambiguous or readily capable of more than one interpretation. The Supreme Court accepted the principle laid down in *Ormond Investment Co. Ltd. vs. Belts* (1928) AC 143 at page 156. Similarly, in *ITO vs. Mani Ram* (1969) 72 ITR 203 (SC), the Supreme Court pointed out at pp. 210, 211 of the report:

"Generally speaking, a subsequent Act of Parliament affords no useful guide to the meaning of another Act which came into existence before the later one was ever framed. Under special circumstances, the law does, however, admit of a subsequent Act to be resorted to for this purpose but the conditions under which the later Act may be resorted to for the interpretation of the earlier Act are strict; both must be laws on the same subject and the part of the earlier Act which it is sought to construe must be ambiguous and capable of different meanings"

32. And a passage from the decision of the House of Lords in *Kirkness (Inspector of Taxes) vs. John Hudson and Co. Ltd.* (1955) AC 696 was cited (at p. 211):

"I have looked at the later Acts to which the Attorney-General referred to in order to satisfy myself that they do not contain a retrospective declaration as to the meaning of the earlier Act, they clearly do not, and I do not think that it has been contended that they do. At the highest it can be said that they may proceed upon an erroneous assumption that the word 'sold' in s. 17(1)(a) of the IT Act, 1945, has a meaning which I hold it has not."

33. The subject-matter with which we are dealing in the present case is the rate of income-tax payable on fees to be received in consideration of a grant of licence for the exploitation of a secret

formula and patent rights, and the word "royalty", in the context of which we are considering it, has many meanings and what particular meaning would apply in this context has to be worked out by us. We have looked at the subsequent legislation on the same subject in order to see that the meaning which we are attributing to the word is not in any way in conflict with the subsequent legislative interpretation of the word.

34. Under these circumstances, it is clear that the payment, though called research contribution "in cl. 17 of the agreement, was nothing else but the consideration correlated to the extent of exploitation of the secret formulations and patent rights and various other rights belonging to M/s Vinyl Products Ltd., by the assessee-company in India and that it was for this exclusive right to manufacture the products that this payment was made and it was nothing else but "royalty" as known to law and to the international commercial world in the context of such agreements. Under these circumstances, we hold that the conclusion of the Tribunal that the payment of Rs. 48,698 during the relevant period was royalty, was correct. We, therefore, answer the question referred to us in the affirmative, that is, in favour of the assessee and against the Revenue. The CIT will pay the costs of this reference to the assessee.

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