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**\*IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA Nos. 643/2010, 649/2010 and 680/2010**

CIT ..... Appellant  
Through : Ms. Suruchi Aggarwal, Advocate.

versus

SPICE COMMUNICATIONS LTD ..... Respondent  
Through : Mr. M.S.Syali, Sr. Advocate with  
Ms.Husnal Syali, Advocate.

**CORAM:**

**HON'BLE MR. JUSTICE SANJIV KHANNA**

**HON'BLE MR. JUSTICE R.V.EASWAR**

**ORDER**

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**16.05.2012**

1. These appeals filed by the Revenue under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') in the case of M/s Spice Communications Limited relate to the assessment years 2003-04, 2004-05 and 2005-06. The Revenue is aggrieved of a common order dated 9<sup>th</sup> October, 2009 passed by the Income Tax Appellate Tribunal (hereinafter referred to as 'ITAT') on three grounds. (i) The ITAT has erred in holding that the entire advertisement and sales promotion expenses incurred should be treated as revenue expenditure. Part thereof, namely, 10% was rightly treated as capital expenditure by the Assessing Officer. (ii) The software



expenses of Rs.22,038/- and Rs.3,13,296/- relating to assessment year 2004-05 and 2005-06, respectively have been wrongly treated as revenue expenditure and should have been treated as capital expenditure. (iii) Payments made to Modicom Network and Distacom Communication India Ltd. under the 'management service agreement' and 'technical service and operating agreements' respectively, were entirely capital expenses and the ITAT has erred in holding that only 25% was capital expense and the balance 75% should be treated as revenue expense.

2. On the first issue, the findings recorded by the Tribunal are that the respondent/assessee is in the business of promoting mobile telephonic services since 1997 and that the market was highly competitive and required aggressive marketing. Expenses were incurred to invite customers and promote the cellular mobile service of the assessee. The advertisement and sales promotion expenses were incurred for the purpose of carrying on the business and not for creating a capital asset. Accordingly, it has been held that the CIT(A) was justified in holding that the entire expenditure should be treated as revenue expenditure and the Assessing Officer was not right in treating 10% of the expense as capital expenses incurred towards brand



building. A Division Bench of this Court had an occasion to examine the issue of advertisement expenditure in the case of *CIT v. Adidas India Marketing*, (2010) 195 Taxman 256, wherein it was held as under:-

“4. We find from the order of the ITAT that the Tribunal has discussed in detail the terms of Technical Assistant Agreement dated 14-2-1997, as per which the assessee was provided the technical know-how and was also allowed to use the brand name 'Adidas' on the products manufactured by the assessee, which are to be sold in India, Nepal and Bhutan. The Tribunal observed that merely because the assessee was paying royalty at the rate of 5 per cent to M/s. AIPL would not mean that the assessee could not incur the expenditure on advertisement to popularize the products dealt with by it in Indian market. No doubt, brand name of 'Adidas' is already a well-known brand which belongs to the parent company of the assessee. However, to popularize the said product in India and to promote its sale in the Indian territories, it became essential for the assessee to incur expenditure on advertising to propagate the aforesaid brand name. The benefit thereof had to necessarily accrue to the assessee as well as the main purpose of the advertisement is to augment the sales. The contention of the assessee that it was a commercial practice and commercial expediency has rightly been accepted by the Tribunal. The relevant portion of the judgment of the Tribunal dealing with this aspect is reproduced below :

“17. xxx

*19. In the present case, the expenditure has been incurred by the assessee in the carrying on of its business activities of manufacturing and selling the product under*



*the brand name Adidas. The expenses are thus have the direct nexus with the sales or the business promotion of the assessee. At this stage, it is also pertinent to mention that merely because the assessee-company has been paying royalty to M/s. Adidas A.G. for the use of the brand name Adidas, that by itself cannot be a ground to disallow the assessee's claim on account of advertisement expenses which were made to promote the assessee's business in India and to increase its business and the sales of the products under the brand name Adidas. The assessee was paying royalty for using brand name Adidas to the customers in various parts of India to make them aware about the nature of the products being sold by the assessee at different outlets as per assessee's business strategy. To promote business and commerce by any businessman would certainly come within the expression of commercial expediency and no label of any oblique motive with a view to reduce tax incidence can be fastened. The activity to promote one's sales by advertising the product which were being sold by him are certainly to come within the expression "wholly and exclusively incurred for the purpose of business", which is to be considered and looked into having regard to the realities of business from the point of view of a prudent businessman and not from the point of view of a tax collector.*

*20. In the light of the discussions made above and having found that since the assessee had incurred the advertisement and publicity expense with a view to promote its sale of products under the brand name Adidas which were sold by the assessee, the*



*advertisement expenses incurred by the assessee are to be held as incurred to facilitate the assessee's business, and would thus be eligible for deduction while computing the assessee's profit from business. At this stage, it is also pertinent to note that the expression "wholly and exclusively" used in section 37 of the Act would not mean "necessarily". It is for the assessee to decide whether any expenditure should be incurred to facilitate its business activities. It is also well-settled that even such expenditure incurred voluntarily and not for any necessity by are incurred for promoting the business and to earn profit, the assessee can claim deduction under section 37(1) of the Act. This was so observed by the Hon'ble Supreme Court in the case of Sasson J. David & Co. (P.) Ltd. (supra). We, therefore, reverse the order of the CIT(A) and direct the Assessing Officer to allow the assessee's claim of deduction on account of advertisement and publicity expenses in all the three assessment years."*

3. The aforesaid reasoning and ratio was approved in case of *CIT v. Salora International Limited*, (2009) 308 ITR 199, wherein a Division Bench of this Court opined:

“3. The first issue that is sought to be raised in this appeal pertains to advertising expenditure of approximately Rs 3.08 crores. According to the Assessing Officer, the expenditure were incurred for launching of its products. The Assessing Officer was of the view that such expenditure was of an enduring nature and, therefore, treated one-third as "capital expenditure" and only allowed the two-thirds of the said amount as "expenditure, to the assessee". The



Commissioner of Income-tax (Appeals) allowed the entire amount after treating the expenditure as "revenue expenditure". The findings of the Commissioner of Income-tax (Appeals) were confirmed by the Income-tax Appellate Tribunal by virtue of the impugned order. Particularly, the Tribunal held that there was a direct nexus between the advertising expenditure and the business of the assessee and that the assessee had to incur such expenditure to meet the competition in the Indian market for selling its products in India. A finding was returned that unless the assessee made its products known to the market, its business would suffer. Consequently, the Tribunal held the entire expenditure on advertising to be of a revenue nature and allowed the same. The Tribunal also noted the decision of the Supreme Court in the case of Empire fate Co. Ltd. v. CIT [1980] 124 ITR 1 wherein the Supreme Court held that there could be cases where the expenditure even if it was incurred for obtaining of a benefit of an enduring nature may, nevertheless, be on the revenue account and, in such cases, the test of "enduring benefit" may break down.

4. We are of the view that the decision of the Tribunal on this aspect of the matter does not call for any interference and, therefore, no substantial question of law arises on this aspect.”

4. Subsequently, another Division Bench of this Court, in ITA No. 966/2009 titled as *CIT v. Agra Beverages Industries Private Limited*, decided on 25.1.2011, held as under:

“6. Learned counsels appearing for the appellant have submitted that the agreement entered into between the assessee and the Pepsi clearly shows that it was Pepsi who was to remain owner of the trademark and an



obligation was cast upon the assessee not to take any action which would prejudice or harm the trademark or Pepsi's ownership thereof in any way. It is also stated in the said agreement that the use of the trademark by the assessee enures to the benefit of Pepsi. It is also pointed out by the learned counsels that as per Clause 19 of the agreement, the assessee was to seek prior approval in respect of any advertising and sales promotion which is incurred in the trademark and trade name of Pepsi. The learned counsels also argued that the advertisement and publicity which was done by the assessee, nowhere mentions the name of the assessee and exclusively name of Pepsi appeared therein, i.e. its trademark and trade address etc. were exhibited. From this, it is sought to be argued that by specific agreement in writing the assessee agreed to give advantage to the Pepsi in respect of publicity and advertisement carried out by the assessee for Pepsi's product. In these circumstances, argued the learned counsels, the CIT (A) was justified in apportioning the expenditure and the principles laid down by the Supreme Court in the case of *Sassoon* (supra) would not be applicable. We are unable to accept the aforesaid submission of the learned counsel for the appellant. In *Sassoon* case (supra), the Supreme Court categorically held that when the expenditure incurred for promoting the business to earn profits merely because from the said expenditure some third party has benefited cannot be a reason to disallow the expenditure. Instead of analyzing that judgment in detail, our purpose would be served by referring to a Division Bench judgment of this court in *CIT Vs. Dalmia Cement (B.) Ltd.* [2002] 254 ITR 377, wherein the judgment of Supreme Court in *Sassoon*



case (supra) and some other judgments are taken note of, analysed and the principles laid down therein are succinctly culled out. Examining and interpreting the provisions of Section 37 of the Act, the Court expressed that the true import of the expression “wholly or exclusively” appearing in Section 37 of the Act would not mean “necessarily”. Ordinarily, it was for the assessee to decide whether any expenditure was incurred in the course of its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under relevant provision even if there was no compelling necessity to incur such expenditure. The fact that somebody, other than the assessee is benefitted by the expenditure should not come in the way of an expenditure-being allowed by way of deduction under Section 37 of the Act, if it otherwise satisfies the tests laid down by law.

7. The Court went into the legislative history of Section 37 of the Act and pointed out that though in the Income-Tax Bill, 1961, in the original Section 37, as per the draft, the word “necessity” appeared was ultimately omitted and instead replaced by the word “ordinarily”. Thus, for allowing the expenditure incurred under Section 37 (1) of the Act, the conditions which are to be satisfied are:-

- (a) there must be expenditure,
- (b) such expenditure must not be the nature described in Section 30 to 36 of the Act,
- (c) the expenditure must not be in the nature of capital expenditure or personal expenses of the assessee,
- (d) The expenditure must have been laid out



or exclusively for the purposes or profession.

8. It was clarified by the Division Bench that the word “wholly” refers to quantum of expenditure while the word “exclusively” refers to the motive, objective and purpose of the expenditure. The Court also explained that the term “commercial expediency” is not a term of art and it means anything that serves to promote commercial expediency and includes every means suitable to that end. While examining the issue of deductibility of such expenditure, the Court also laid down the role of the Assessing Officer therein. In no uncertain term, the Court explained that the jurisdiction of the Assessing Officer was confined to “deciding the reality of the expenditure” namely, whether the amount claimed as deduction was factually expended or laid down or whether it was wholly or exclusively for the purpose of the business. The reasonableness of the expenditure could be gone into only for the purpose of determining whether, in fact, the amount was spent. When we apply the aforesaid test to the facts of this case, it becomes manifest that all the ingredients laid down in Section 37 (1) of the Act are satisfied. It is not in dispute that the expenditure is in fact incurred. The Assessing Officer or the CIT (A) did not question the amount incurred by the assessee on the advertisement. It is also not the case of the Revenue that the expenditure is of the nature described in Section 30 to 36 of the Act. The expenditure is not capital expenditure or personal expenditure of the assessee either. It is also clear that the entire quantum of expenditure was for the purpose of business and, therefore, it is wholly for the purpose of business. We are also of the opinion that the



expenditure was exclusively incurred for the purpose of the business and promote the sales by the assessee. Therefore, it was incurred wholly or exclusively for the purposes of business.

9. The agreement entered into between the assessee and the Pepsi shows that the assessee was given a particular territory in Haryana, boundaries whereof are specifically defined in the agreement for the purposes of bottling, selling and distributing of the beverages. This entire territory within which the assessee was to operate, the assessee was not only supposed to bottle the beverages he was also given rights to sell and distribute the project of the Pepsi in the defined territory during the currency of the said agreement. Naturally, therefore, in order to augment its profits in the said territory, it was the business decision of the assessee to advertise and publicize the product for maximizing its sale. The expenditure was thus incurred by the assessee for its own benefit. Clause 18 of the agreement authorized the assessee to undertake appropriate advertising and sales promotion activity for the beverage. If in the process, Pepsi or its trademark also benefited, that would not militate against the assessee as far as claiming the deduction under Section 37 of the Act is concerned, once all the characteristics of the said provision stood satisfied.”

5. In ITA No. 978/2011 titled *CIT v. Mono Motors Ltd.*, decided on 12.12.2011, this Bench held as under:

“4. ...Advertisement expenses when incurred to increase sales of products are usually treated as a revenue expenditure, since the memory of



purchasers or customers is short. Advertisements are issued from time to time and the expenditure is incurred periodically, so that the customers remain attracted and do not forget the product and its qualities. The advertisements published/displayed may not be of relevance or significance after lapse of time in a highly competitive market, wherein the products of different companies compete and are available in abundance. Advertisements and sales promotion are conducted to increase sale and their impact is limited and felt for a short duration. No permanent character or advantage is achieved and is palpable, unless special or specific factors are brought on record. Expenses for advertising consumer products generally are a part of the process of profit earning and not in the nature of capital outlay. The expenses in the present case were not incurred once and for all, but were a periodical expenses which had to be incurred continuously in view of the nature of the business. It was an on-going expense. Given the factual matrix, it is difficult to hold that the expenses were incurred for setting the profit earning machinery in motion or not for earning profits.”

6. Keeping in view the findings recorded by the Tribunal and the nature and character of business of the respondent/assessee, we do not think that any substantial question of law arises on the first aspect.

7. On the second ground, it is noticeable that the amounts involved are small. The Assessing Officer had allowed depreciation @ 60% on the said amounts. The assessee had claimed that the entire amount should be allowed as revenue expenditure. The decision of the Delhi



High Court in the case of *CIT v. GE Capital Services Ltd., (2008) 300 ITR 420 (Delhi)* has been followed by the ITAT. The tribunal has also noticed the nature and type of software acquired, and has recorded that the software in question required frequent up-gradation and purchases. This issue was also examined by this Court in ITA Nos. 1110/2006 and 41/2006 titled as *CIT v. Asahi India Safety Glass Limited* decided on 4.11.2011. In this case it has been held as under:-

“11. Software is nothing but another word for computer programmes, i.e., instructions that make the hardware work. Software is broadly of two types, i.e., the systems software, which is also known as the operating system which controls the working of the computer; while the other being applications such as word processing programs, spread sheets and data base which perform the tasks for which people use computers. Besides these there are two other categories of software, these being network software and language software. The network software enables groups of computers to communicate with each other, while language software provides with tools required to write programmes. (See Microsoft Computer Dictionary, 5<sup>th</sup> Edition “Software” at page 489).

12. The aforesaid would show that what the assessee acquired through Arthur Anderson and Associates was an application software which, enabled it to execute tasks in the field of accounting, purchases and inventory maintenance. The fact that the application software would have to be updated from time to time based on the requirements of the assessee in the context of the advancement of its business and/or its



diversification, if any; the changes brought about due to statutory amendments by law or by professional bodies like the Institute of Chartered Accountants of India, which are given the responsibility of conceiving and formulating the accounting standards from time to time, and perhaps also, by reason of the fact that expenses may have to be incurred on account of corruption of the software due to unintended or intended ingress into the system - ought not give a colour to the expenditure incurred as one expended on capital account. Given the fact that there are myriad factors which may call for expenses to be incurred in the field of software applications, it cannot be said that either the extent of the expense or the expense being incurred in close proximity, in the subsequent years, would be conclusively determinative of its nature. The assessing officer has, in our view, erred precisely for these very reasons.”

8. In view of the findings recorded by the tribunal we do not think that any substantial question of law arises on the second aspect.

9. At this stage, learned counsel for the Revenue has submitted that that in the appeal for the assessment year 2003-04 no substantial question of law has been specifically raised but in one of the grounds of the appeal, namely, (g) it is mentioned as under:-

“(g) BECAUSE the Tribunal and the CIT have erred in holding that there is no mention in the above said I.T. Rules that the application software are outside the ambit of computer software for the purpose of depreciation as prescribed therein. The definition of Computer Software given in the IT rules reads as under:



*“The term ‘Computer Software’ means any computer programme recorded in any disc, tape, perforated media or other information device.”*

As per the above definition, the application softwares are also included in its purview”

It is urged that the assessee had incurred substantial expenditure of Rs. 95,15,191/- in the assesment year 2003- 04.

10. The ITAT has observed that the said expenditure was incurred on purchase and towards rental charges of application softwares which were used by the assessee at different locations. The details/break ups of the said softwares have been mentioned in para 19 of the order of the ITAT. The assessee had paid rental charges of Rs.62,91,135/- for use of software SIMGO platform for prepaid customers. Rental charges should be normally treated as revenue expenditure. There is no justification or ground to hold/ contend to the contrary. With regard to the balance expenses it is noticeable that it relates to antivirus software and other of the self software which requires frequent upgradation. The ground itself observes that the software was application software. The findings of the tribunal do not require interference.

11. On the third aspect, the ITAT has examined the issue in great depth and detail. The Assessing Officer had treated the entire expenditure as capital expenditure. The CIT(A) treated the entire

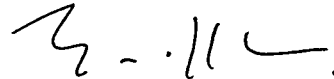


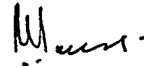
expenditure under the two agreements as revenue expenditure. ITAT examined the relevant clauses of the two agreements and the services, which were required to be undertaken by the Distacom Communication and Modicom Network. After referring to relevant clauses, it was noticed that the payments made were partly towards services, which were capital in nature and partly towards services, which were revenue in nature. We have also examined the clauses of the agreements, which have been quoted in the order passed by the ITAT. This finding of the ITAT is correct. During the course of hearing, learned counsel for the Revenue also accepted part payments made by the respondent assessee under the agreements were revenue in nature. Learned counsel for the appellant however submits that the tribunal has erred in holding that only 25% should be treated as capital expenditure. The figure/percentage should be much higher. We have already noticed that the business of the respondent/assessee was set up in the year 1997. The assessment years in question are seven years after the business was set up and had commenced. In the assessment order nor in the grounds of appeal, there is reference or discussion with reference to any specific or predominant services which were rendered in the assessment year in question. Initial years normally would require substantial capital outlay



and expenditure. However, once services have commenced, expenses are frequently incurred to keep the business/services in operation. Keeping in view the discussions made by the tribunal and the ratio applied therein, we do not find any ground to interfere with the order of the ITAT.

12. The present appeal is accordingly dismissed. No costs.

  
SANJIV KHANNA, J.

  
R.V.EASWAR, J.

MAY 16, 2012

AK.