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* IN THE HIGH COURT OF DELHI AT NEW DELHI

Date of decision: 4th October, 2012

+ ITA 474/2009

COMMISSIONER OF INCOME TAX Appellant
 Through: Mr. N. P. Sahni, Sr. Standing
 Counsel.
 versus

EDS ELECTRONIC DATA SYSTEMS
 (INDIA) PVT. LTD. Respondent
 Through: Mr. M. S. Siyali, Sr. Advocate with
 Mr. Abhimanyu Jhamba and Mr.
 Rahul Sateerja, Advocates.

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V.EASWAR

S. RAVINDRA BHAT, J.: (OPEN COURT)

1. In the present appeal the following substantial questions of law have been urged for consideration: -

“(a) Whether the ITAT was correct in law in deleting addition of ₹2,05,08,030/- made by the Assessing Officer on account of expenditure incurred towards improvement of lease hold premises?”

“(b) Whether the ITAT was correct in law in allowing deduction u/s 10A which was disallowed by Assessing Officer?”

“(c) Whether the ITAT was correct in law in deleting addition of ₹3,14,90,305/- made by Assessing Officer on account of bad debts?”

“(d) Whether the ITAT was correct in law in deleting the interest charged by Assessing Officer u/s 234D of the Income Tax Act, 1961?”

2. The Revenue claims to be aggrieved by the order of the ITAT dated



10.10.2008 in four appeals, heard and disposed of through a common order.

3. The brief facts are that the assessee, which had claimed and was granted the benefit of Section 80HHE during an earlier year, claimed benefit of Section 10A for the assessment year 2001-02. The Assessing Officer considered the returns for that year and by his order framed under Section 143(3) on 31.03.2004 disallowed several items. This included the improvements of leased premises which the assessee claimed under Section 37(1). It had spent ₹2,76,87,887/- towards expenditure for lease hold premises. A sum of ₹2,05,08,030 was claimed as revenue expenditure and the balance was treated as capital expenditure on which depreciation was claimed. The Assessing Officer disallowed this expenditure to the extent of ₹2,05,08,030 and allowed the depreciation claimed on the balance. As regards Section 10A the Assessing Officer was of the opinion that the assessee's claim was impermissible on the ground that the assessee has already secured deduction under Section 80HHE for the assessment year 2000-01 and consequently was not permitted deduction under Section 10A for the subsequent years. The Assessing Officer appears to have taken into consideration the fact that the STP unit was set up in Chennai thus suggesting that it was formed by splitting up an existing unit under Section 80HHE. He held therefore that the unit was not eligible for the deduction by reason of Section 10A (2) (ii) of the Act. The other ground on which the Assessing Officer seems to have disallowed the claim is that by virtue clause (i) of Explanation 2 to Section 10A, the only activity which qualified for the benefit was "computer software development" and that the assessee's activity i.e. programme management services did not fall within the definition so as to be eligible for benefit.

4. The Assessing Officer also disallowed a sum of ₹3,14,90,305/- on account of bad debts claimed by the assessee holding that it was not written off in the accounts of the concerned previous year. The last ground pertains to the interest charged by the Assessing Officer under Section 234D of the Act.

5. As regards Regarding Question (a) learned counsel for the Revenue contended that the Tribunal fell into error in remanding the matter for consideration by the Assessing Officer with the following directions: -



“2.6 Section 30 deals with repairs of a tenanted premises and the current repairs of the own premises. Thus, in terms of this section, the expenditure on repairs of leased premises is deductible in computing the income. In the case of Sarvana Spinning Mills (P) Ltd. (supra), the question was regarding “current repairs” of the own machinery. The Hon’ble Court pointed out that the lower authorities proceeded on the footing that the expenditure was revenue in nature. What was required to be seen was whether the expenditure was on current repairs. Therefore, the whole of the issue was seen in the context of section 31(i) and no opinion was furnished on the applicability of section 37(1). The case before us is not of the own premises, which may be similar to the case of own machinery. We are concerned with tenanted premises, which has been taken on lease by an on-going business. Thus, the ratio of this case is not applicable. In the case of Ayesha Hospitals (P) Ltd. (supra), the business was being carried on from leased premises. The expenditure was incurred on flooring; partitions etc. for the newly extended area of space, leading to increase in the capacity of the hospital. Further, the owners were directors of the assessee company. Yet, relying on the decision of Hon’ble Supreme court in the case of Madras Auto Services (P) Ltd. (supra), it was held that the expenditure incurred on construction of a leased premises by the assessee was deductible as revenue expenditure. This decision may apparently seem to be in contradiction with the decision of Hon’ble Supreme Court in the case of Sarvana Spinning Mills (P) Ltd., but that is not the case, the reason being that in the latter case the Hon’ble Supreme Court refused to express any opinion on applicability of section 37(1). Thus, the ratio of this case comes to the aid of the assessee even when the expenditure incurred by the assessee on the leased premises extended the capacity of the building to be utilized in a more useful manner for the business. in the case of T V S Lean Logistics Ltd. (supra), the expenditure was incurred by the assessee on construction of a building on the lease-hold land. The Hon’ble Court pointed out that the assessee had incurred expenditure on land and the building was not taken on lease. Therefore, the fiction created by Explanation-1 to section 32(1). The ratio of this case is not applicable for the reason that the assessee has taken building on lease and thereafter incurred expenditure thereon. Therefore, the fiction created under Explanation-1 will become applicable in this case. In the case of Hotel Diplomat (supra) the jurisdictional High Court held that the expenditure incurred on constructing new bath-rooms in the leased premises was capital expenditure. We have already seen that the issue regarding brick works had not been examined by the lower authorities and it is not known whether any new structure came



into existence as a consequence thereof. The ratio of this case will be applicable if new space has been created for any particular purpose by way of brick works. In the case of Cultural Enterprises Corporation (supra), the expenditure on renovation of building, replacement of sanitary fittings etc. Although the Tribunal held that this expenditure of ₹35,000/- to be capital in nature, the court held that the expenditure was not capital in nature as it was not proved that substituting sanitary fittings etc. was more advantageous than the pre-existing ones. Since the expenditure was incurred to bring the property to a habitable state, it was held to be deductible in computing the income. However, Explanation-1 was inserted in the Act below section 32 with effect from 1.4.1988, while that case dealt with assessment year 1977-78. Therefore, the question of applicability of the provision could not have been considered by the court. In the case of Core Health Care Ltd. (supra), the Hon'ble Court pointed out that the Legislature had not made a distinction between money borrowed as circulating capital or for fixed capital and, therefore, what was to be seen was whether the capital was used for the purpose of business. The court further pointed out that insertion of Explanation-8 in section 43(1) retrospectively from 1.4.1974 does not alter the aforesaid position, as the Explanation is applicable only to sections 32, 32A, 33 and 41, which deal with depreciation or investment allowance. There is no such concept in section 36(1)(iii). This would mean that if the assessee becomes entitled to the deduction of the expenditure as repairs of the leased premises, the provision of Explanation-1 to section 32 will not come into play as the same deals with depreciation. Thus, we find that the ratio of the case of Ayesha Hospitals (P) Ltd. (supra), pertaining to assessment year 1991-92, squarely covers the case of the assessee except in respect of brick works, which may or may not get covered by the decision of jurisdictional High Court in the case of Hotel Diplomat (supra). In these circumstances, we remand the matter to the AO to find out whether any extra facility was created by way of brick works and connected expenditure, in terms of the decision in the case of Hotel Diplomat, and if yes, the same would be capital expenditure on which depreciation will be deductible. If not, the expenditure would be revenue in nature. Apart from that, the expenditure would be covered by sections 30(a)(ii) in terms of the decision in the case of Ayesha Hospitals (P) Ltd. (supra). Since it is covered under this provision, there will be no question of invoking the provision contained in Explanation-1 to section 32, as it deals with deduction of depreciation and this conclusion will be in line with the decision of Hon'ble Supreme court in the case of Core Health Care Ltd. (supra). Thus, this ground is treated as allowed for statistical purposes.”



6. It was urged that the expenditure in the present case was capital in nature since the assessee derived an enduring benefit. Learned counsel submitted in this regard that by virtue of the Explanation 1 to clause (ii) to Section 32(1) read with Section 30(a)(ii), the amount spent could not be treated as revenue but was capital in nature. Thus the assessee was entitled to only depreciation which was granted by the Assessing Officer. The Tribunal on the other hand by remitting the matter, in fact acted contrary to the enacted provisions.

7. Learned counsel for the assessee relied upon decisions reported as *CIT v. Hi Line Pens Pvt. Ltd.*, (2008) 306 ITR 182 and *CIT v. Ayesha Hospitals P. Ltd.*, (2007) 292 ITR 266 and contended that the expenditure incurred for the improvement of lease hold premises as in the present case was deductible under Section 37(1) of the Act; it was also submitted that if the Revenue's request for remitting the matter for examination of the entire expenditure, including what was allowed by the AO himself, were to be acceded to the assessee would be worse off having regard to the fact that the Assessing Officer himself has allowed its claim and permitted deduction of ₹70 odd lakhs. It is, therefore, submitted that having regard to the limited nature of the remand this Court should not interfere with the findings of the lower authorities as the same would lead to prejudice. The counsel also contended that the findings of the fact were concurrent and no substantial question of law arises.

8. This Court has considered the submissions. As noticed previously, the Tribunal made a limited remand to the lower authorities to determine the exact nature and quantum of brick work which would entitle the assessee to the deduction claimed under Section 37 of the Act which is limited to ₹2.75 crores. Having regard to these circumstances, this Court is of the opinion that no substantial question of law arises from the findings of the CIT (Appeals) and ITAT. The question is answered against the Revenue and in favour of the assessee.

9. Regarding Question (b), As discussed in the preceding paragraph of this judgment the assessee claimed benefit of Section 10A w. e. f. assessment year



2001-02. Concededly its unit was set up in Chennai. It secured the benefit of Section 80HHE for the assessment year 1997-98. The Assessing Officer seems to have vaguely suggested that the assessee ought to have claimed deduction under Section 10A from the assessment year 1997-98 itself. This Court finds no principle of law or factual basis for such an assumption. The assessee's case throughout has been that it sought to open a unit and was granted permission to do so in a Software Technology Park on 27.4.2004 in Chennai; such being the case, the Assessing Officer appears to have adopted a restrictive interpretation of Section 10A to hold that the assessee can claim the benefit under Section 10A only from the inception of its unit under Section 80HHE. No such implied or express provision to support the findings in that regard can be seen from the Act.

10. As regards the finding of the Assessing Officer vis-à-vis the splitting up of the unit, the assessee's claim was that it set up a unit in Chennai for the first time in March, 2000. Besides a mere statement that the setting up of the unit in Chennai amounted to splitting up of an already existing unit, the Assessing Officer does not seem to have recorded any other finding. This Court is of the opinion that the Section 10A(2)(ii) states that the provision is applicable to an undertaking which "is not formed by the splitting up, or the reconstruction of, the business already in existence". The expression "splitting up" and "reconstruction" have to be read along with the word "business". What Parliament seems to have intended here is that the setting up of unit should not be a device in order to secure deduction. This Court here notices that there is a certain stringency in the Section 10A; approval is to be given by a prescribed authority in terms of Section 10A (Explanation 2 clause (vii) to Section 10A). In this case it is not disputed that such approval was given and the unit, set up in the special economic zone termed as a Software Technology Park. Having regard to these essential conditions, the assumption of the Assessing Officer that the existing Section 80HHE unit was in fact split up for the formation of a unit in Chennai which claimed STP benefit was unfounded on facts.

11. The third limb of this question is as to whether the assessee in fact engaged itself in the manufacture of computer software defined in Explanation 2 to Section



10A of the Act. The Assessing Officer had inquired as to what the assessee meant by “programme management services”. The relevant extract of the Assessing Officer’s order in this regard is as follows: -

“The assessee was asked to explain the nature of service provided in this regard because as per the copies of invoices raised by the assessee the nature of service provided is mentioned as “Program Management Services”. The assessee has explained in this regard as under: -

“It is submitted that the ‘program management services’ as mentioned in the invoices raised by the assessee company for the subject assessment year are in the nature of software development eligible for deduction u/s 80HHE or exemption section 10A of the Act, as the case may be. The term ‘project management services’ is merely a nomenclature assigned by the assessee to software development services rendered by the assessee company.”

The reply of the assessee is not acceptable. The assessee has not given the exact nature of service provided by it and how it is eligible to the deduction u/s 10A or 80HHE. The term used by the assessee ‘programme management service’ in its invoices cannot in any way be said to be covered as computer software within the meaning of section 10A.

In view of the detailed reason given supra, no exemption u/s 10A shall be allowed to the assessee as per section 10(2) of the Act.”

12. In appeal, the CIT (Appeals) sought a remand report. He also noticed that the assessee filed a certificate during the assessment proceedings to the effect that the “project management services” rendered by the assessee are actually software development services rendered in and outside India, thus eligible to deduction under Section 10A of the Act. The CIT (Appeals) further noticed that the quarterly return filed by the STP unit, Chennai and the documents filed with it showed cumulative export of software, type of software, name of the country to which the exports were made and that 35 software engineers were employed by it for providing the services. The CIT (Appeals) sought a remand report which was given in 16.02.2005. The CIT (Appeals) noticed that in the remand report the



Assessing Officer had not taken any objection in respect of the compliance of various conditions or that they have not been fulfilled by the assessee under Section 10A. The relevant discussion is at page 36 of the paper-book: -

“Therefore, both the names, i.e. the name of EDS Electronic Data System (India) Private Limited and Electronic Data Systems (India) Private Limited are being used interchangeably and otherwise also are immaterial as far as the claim of exemption u/s 10A is concerned which is in respect of the undertaking of the assessee qualifying the conditions prescribed in the Section. In view of the above facts, the AO is directed to allow the exemption claimed by the appellant. This ground of appeal is allowed.”

13. The above reasoning was upheld by the ITAT. This Court is of the opinion that the view taken by the Assessing Officer, that the nature of services rendered or extended by the assessee were not “computer software”, is contrary to the record. The Assessing Officer’s order has alluded to the CBDT Circular dated 26.09.2000 which extends or explains the services as including back-office; operations; call centres; content development or animation; data processing engineering and design; geographic information system services, human resource services; insurance claim processing; legal databases; medical transcription, pay roll; remote maintenance, revenue accounting, support centres; web-site services etc. It is apparent that the CBDT itself had interpreted the term “computer software” occurring in Explanation 2 to Section 10A of the Act in an expansive rather than a narrow manner as was done in the present case by the Assessing Officer. “Computer software” even otherwise, generically, has to be given a wider interpretation since it implies a system or software which would be capable of catering to different services capable of customization having regard to the peculiar needs of a given situation. In this case the materials placed by the assessee on record reveal that its “program management system” was nothing but a development of software which assisted in management services. The CBDT itself has treated a wide array of services which are assisted by computer software i.e. back office support, call centre, medical transcription, etc. as falling within the rubric of “computer software”. The assessee’s “program management services” which is a method of providing software to achieve a particular end cannot be said



to be excluded from the term “computer software”. This Court accordingly holds that the findings of the Tribunal are sound and do not require any interference.

14. Regarding Question (c): As far as the claim of bad debts is concerned, the Assessing Officer’s observations are as follows: -

“The assessee has claimed deduction of ₹3,14,90,305/- in the computation of total income on account of Bad Debts written off not passed through the profit and loss account. Under the provision of section 36(1)(vii), amount of any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year, is allowable as deduction subject to the following conditions laid down in section 36(2): -

- a) The debt has been taken into account in computing the income of the assessee of the previous year in which the amount is written off or of an earlier previous year, or*
- b) It represents money lent in the ordinary course of business of money-lending which is carried on by the assessee.*

No deduction in respect of bad debt is allowable under section 36(1)(vii) unless it is written off as irrecoverable in the books of the assessee in the previous year in which claim for deduction is made. No evidences have been furnished to establish that the debts have in fact become bad. In view of the same, the claim of the assessee on account of bad debt is hereby disallowed.”

15. The order of the CIT (Appeals) analysed the material available on the record and also the explanation provided by a letter dated 23.03.2004 by the assessee. The relevant discussion is as follows: -

“(ii) Since the amount of ₹3,14,90,305/- was written off in the books of accounts, the same was claimed as bad debts as per provisions of Section 36(1)(vii) of the IT Act. The entries passed as under: -

<i>Profit & Loss a/c</i>	<i>Dr.</i>	<i>AY</i>
<i>To Provision for doubtful debt a/c</i>		<i>2000-01</i>
<i>Provision for doubtful debt a/c</i>	<i>Dr.</i>	
<i>To Debtors a/c</i>		<i>2001-02</i>



From the above entries, it is clear that the amount written off was debited to P&L account and also actually written off in the debtors' account. Therefore, the AO wrongly made the addition. The copy of account of the debtors whose amount has been written off is enclosed to show that actually the amount was written of."

The CIT (Appeals) also held as follows: -

"4.3 The submissions made by the appellant counsel has been found to be correct that the provisions for doubtful debts was created in the AY 2000-01 of ₹3,90,00,978/- which were added back to the computation of income in AY 2000-01. Out of these provisions of bad debts, a sum of ₹3,14,19,305/- has actually been written off during the year in the account of the debtor and therefore, the conditions mentioned in the Section 36(1)(vii) of the Act for claiming the bad debts are satisfied. Therefore, the addition made by the AO on the ground that the amount has not been debited to the P&L account is deleted."

16. This Court is of the opinion that once the CIT (Appeals) went into the records and after satisfying himself about the correctness of the findings by the Assessing Officer, held that the latter had made additions wrongly by not actually seeing that the amount was written off, a finding that was endorsed by the Tribunal. That finding of fact cannot be interfered with by the High Court exercising its jurisdiction under Section 260A of the Act. The Revenue's arguments cannot also be accepted as it would amount to accepting their position, plainly not permitted in an appeal to this Court under Section 260A, which is confined in its consideration to substantial question of law.

17. Regarding Question (d): As far as this question is concerned, the Court notices that the provision came into force on 01.06.2003 and, therefore, was applicable only from the assessment year 2004-05. Consequently, it could not have been applied as it was done by the Assessing Officer in the present case. This Court is fortified by the ruling of this Court in *Director of Income Tax v. Jacobs Civil Incorporated*, 330 ITR 578. This question too is answered in favour of the assessee and against the Revenue.



Since all the questions have been answered in favour of the assessee and against the Revenue, the appeal fails and is dismissed.

S. RAVINDRA BHAT, J

R.V.EASWAR, J

OCTOBER 04, 2012

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