



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

+ ITA 861/2010

% **Date of decision: 15th July, 2010**

Commissioner of Income Tax-IV Appellant
Through: Mr.N.P. Sahni, Standing Counsel
(Income Tax)

versus

M/s DCM Technologies Limited Respondent
Through: None

CORAM:
HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE MANMOHAN

1. Whether reporters of the local papers be allowed to see the judgment? Yes
2. To be referred to the Reporter or not? Yes
3. Whether the judgment should be reported in the Digest? Yes

DIPAK MISRA, CJ

In this appeal preferred by the revenue under Section 260A of the Income Tax Act, 1961 (for brevity 'the Act'), the following substantial questions of law are proposed to be raised:

1. Whether the Income Tax Appellate Tribunal, was justified in law in allowing software expenses to the extent of 25% holding it to be of revenue nature?
2. Whether the order of Income Tax Appellate Tribunal, which is a final fact finding authority, is not perverse in law as it has not gone through the facts properly and merely relied upon the decision of Supreme Court in the case of *Alembic Chemicals Work Co. v. CIT* 177 ITR 377 without appreciating the material on record?
2. The facts which are essential to be stated are that the respondent –



return of income for the assessment year 2002-2003 was filed by it on 29th October, 2002 declaring a loss of Rs.2,85,25,407/-. The profit and loss account was filed along with the said return. Expenditure of Rs.2,93,20,242/- was claimed in respect of software development. It was contended before the assessing officer that the expenses incurred on the development of software were routine revenue expenses being in the nature of staff salary, travel expenses, etc. It was further explained that the said activity of development of software was being carried on a continuous basis and the revenue of the said business had been generated from marketing the developed software. The expenses incurred on software development were, thus, allowable as business expenditure keeping in view the nature of the expenses as well as the character of the business of the assessee-company. It was urged that the expenditure on software development was akin to the research and development activities conducted by the assessee-company in its ordinary course of business for sustaining and enlarging the business operations. The assessing officer accepted the stand of the assessee-company that the expenses on software development were incurred by it in connection with carrying on the business but opined that the softwares developed by the assessee-company were bound to have some value at the end of the previous year and keeping in view the same as well as the marketing potential of the softwares developed by the assessee-company in the subsequent years, the expenditure could be regarded to have enduring effect and, accordingly, treated 25% of the expenditure claimed by the assessee on software



development to be of capital nature and made a disallowance to the extent of Rs.73,30,060/-.

3. Being dissatisfied with the aforesaid order, an appeal was preferred before the CIT(A) and the first appellate authority accepted the submissions urged by the assessee and deleted the addition out of the software development expenses.

4. Grieved by the aforesaid order, the revenue preferred an appeal before the tribunal wherein it was canvassed that the order passed by the assessing officer treating the said expenses of 25% as capital expenditure was quite reasonable and there was no justification on the part of the CIT(A) to interfere with the same. The tribunal, as is evincible from the order impugned, came to hold that the assessee was mainly engaged in the business of development of software and marketing the same and its business receipts mainly comprised of revenue generated from the marketing of software; that for the purpose of development of software, an amount of Rs.2,93,20,242/- was incurred by it during the assessment year in question; that the assessee had furnished before the assessing officer that the amount spent was routine business expenses such as salaries and allowances, travel and conveyance, repairs, professional fees, depreciation, etc; that the assessing officer had accepted that the amount was spent while carrying on its business expenses; that the assessing officer erroneously treated 25% as capital expenditure on the ground that the assessee was likely to generate some revenue in the subsequent years due to the market potentiality of the softwares developed by it and; that the advantage, if treated



to be of enduring nature, was going to operate only in the revenue field and not in the capital field. Being of this view, the tribunal dismissed the appeal preferred by the revenue.

5. Questioning the correctness of the order passed by the CIT(A) which has been concurred with by the tribunal, it is submitted by Mr.Sahni, learned standing counsel, that the tribunal as a final fact finding authority has failed in its duty by accepting the view expressed by the CIT(A). It is urged by him that the decision in *Alembic Chemical Works Co. Ltd. v. Commissioner of Income-Tax, Gujarat* (1989) 177 ITR 377 on which reliance has been placed is not applicable to the case at hand.

6. Mr.Sahni, learned standing counsel for the revenue, has invited our attention to the decisions rendered in *Jonas Woodhead & Sons (India) Ltd. v. Commissioner of Income-Tax* (1997) 224 ITR 342 and *Commissioner of Income-Tax v. Krupp Industries India Ltd.* (2000) 243 ITR 6 (SC). In the said case, the Apex Court was considering whether the tribunal was right in holding that 25% of the amount paid by the assessee as royalty to Jonas Woodhead and Sons was capital expenditure and, therefore, not allowable as revenue expenditure under the provisions of the Income Tax Act, 1961. It is worth noting that the High Court of Madras in *Jonas Woodhead & Sons (India) Ltd. v. Commissioner of Income-Tax, Madras* (1979) 117 ITR 55 (FB) answered the said question in favour of the revenue. The Apex Court referred to the decision in *Alembic Chemical Works Co. Ltd.*(supra) wherein it has been held that in the infinite variety of situational diversities in which



the concept of what is capital expenditure and what is revenue arises, it is not possible to form any general rule even in the generality of cases, sufficiently accurate and reasonable comprehensive, to draw any clear line of demarcation. In the said case, it was held that in respect of whether a particular outlay is capital or revenue, the 'once for all' test as well as the test of 'enduring benefit' may not be conclusive. Their Lordships also referred to the decisions in *CIT v. CIBA of India Ltd.* (1968) 69 ITR 692 (SC); *CIT v. Lucas T.V.S. Limited (No.1)* (1977) 110 ITR 338 (Mad); *CIT v. Sarada Binding Works* (1976) 102 ITR 187 (Mad.); *Agarwal Hardware Works (P.) Ltd. v. CIT* (1980) 121 ITR 510 (Cal); *CIT v. Tata Engineering and Locomotive Co. Pvt. Ltd.* (1980) 123 ITR 538 (Bom.); *Empire Jute Co. Ltd. v. CIT* (1980) 124 ITR 1 (SC) and *Alembic Chemical Works Co. Ltd.* (supra) and eventually came to hold thus:

“It would thus appear that the courts have applied different tests like starting of a new business on the basis of technical know-how received from the foreign firm, the exclusive right of the company to use the patent or trademark which it receives from the foreign firm, the payment made by the company to the foreign firm whether a definite one or dependant upon certain contingencies, the right to use the technical know-how of production or the activity even after the completion of the agreement, obtaining enduring benefit for a considerable part on account of the technical information received from a foreign firm, payment whether made "once for all" or in different instalments co-relatable to the percentage of gross turnover of the product to ultimately find out whether the expenditure or payment thus made makes an accretion to the capital asset and after the court comes to the conclusion that it does so, then it has to be held to be a capital expenditure. As has been held by this Court and already indicated in *Alembic Chemical Work's* case [1989] 177 ITR 377 no single definitive criterion by itself could be



economic realities of business and the varieties of situational diversities the various clauses of the agreement are to be examined. But in the case in hand the High Court having considered the different clauses of the agreement and having come to the conclusion that under the agreement with the foreign firm what was set up by the assessee was a new business and the foreign firm had not only furnished information and the technical know-how but rendered valuable services in setting up of the factory itself and even after the expiry of the agreement there is no embargo on the assessee to continue to manufacture the product in question, it is difficult to hold that the entire payment made is a revenue expenditure merely because the payment is required to be made on a certain percentage of the rates of the gross turnover of the products of the assessee as royalty. In our considered opinion, in the facts and circumstances of the case the High Court was fully justified in answering the reference in favour of the Revenue and against the assessee.”

7. In this context, we may refer with profit to the decision in *Commissioner of Income-Tax v. General Insurance Corporation* (2006) 286 ITR 232 (SC) wherein their Lordships were considering the issue whether the expenditure incurred towards stamp duty and registration fee paid in connection with the increase in authorized share capital would tantamount to capital expenditure. Be it noted, the assessing officer had treated the expenses as capital asset on the ground that it was of durable nature for acquisition of a capital asset and hence, would only be attributable towards capital expenditure. While dealing with the said issue, their Lordships referred the concept of the basic test for determining whether particular expenditure is revenue or capital expenditure. In this regard, the Apex Court opined thus:

We may at the outset indicate that this court has laid down the test for determining whether a particular expenditure is



Ltd. v. CIT [1980] 4 SCC 25; [1980]124 ITR 1(SC). This court after considering the law on the subject in detail observed at page 8 as under page 10):

“The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all embracing formula which can provide a ready solution to the problem; no touchstone has been devised. Every case has to be decided on its own facts keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the courts may be referred to as they might help to arrive at a correct decision of the controversy between the parties. One celebrated test is that laid down by Lord Cave, L.C. in *Atherton (H.M. Inspector of Taxes) v. British Insulated and Helsby Cables Ltd.* [1925] 10 TC 155, 192 (HL) where the learned Law Lord stated:

‘.... *When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.*’[Emphasis supplied]

In short, what has been held in this case is that if the expenditure is made once and for all with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade then there is a good reason for treating such an expenditure as properly attributable not to revenue but to capital. This is so, in the absence of special circumstances leading to an opposite conclusion.”

8. Thereafter, the Apex Court referred to various decisions of Gujarat, Calcutta, Bombay and Andhra Pradesh High Courts and eventually expressed the view that issuance of bonus shares by a company does not result in any



employed remains the same. Issuance of bonus shares by capitalization of reserves is merely a reallocation of the company's funds. Thus, it cannot be held that the company has acquired a benefit or advantage of an enduring nature. The total funds available with the company will remain the same and the issue of bonus shares will not result in any change in the capital structure of the company. Issue of bonus shares does not result in the expansion of the capital base of the company. Expenditure incurred by the company on account of stamp duty and registration fees for the issue of bonus shares is allowable expenditure.

9. In this regard, it is fruitful to refer to the decision in *Commissioner of Income-tax v. Varinder Agro Chemicals Limited* [2009] 309 ITR 272 (P&H) where the question of law arose whether on the facts of the case, the tribunal was justified in holding that computer software expenses were revenue in nature disregarding the meaning of plant under Section 43(3) and the fact that enduring advantage was derived by the assessee by incurring such expenditure. The Division Bench referred to the order of the tribunal and the principles laid down in *Empire Jute Co. Ltd.* (supra) and *Alembic Chemical Works Co. Ltd.* (supra) and then held as follows:

“In *Alembic Chemical Works Co. Ltd.* [1989] 177 ITR 377 (SC), the issue was whether the expenditure on technical know-how under an agreement with a foreign company was revenue expenditure. Answering the question in favour of the assessee, the hon'ble Supreme Court observed (in paragraph 13) that it would be unrealistic to ignore the rapid advances in research and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in fast changing area of science. The state of art is constantly



requisite degree of durability to qualify as enduring capital asset. Question of technical know-how did not amount to new or fresh venture and was for enabling carrying on business in a better way. Referring to *Empire Jute* [1980] 124 ITR 1 (SC); [1980] 4 SCC 25, it was observed that there may be cases where expenditure, even if incurred for an advantage of enduring benefit, may be revenue unless the advantage was in the capital field.

There is nothing to show that the software used by the assessee was of enduring nature and will not become outdated. Since technology is fast changing and day-by-day systems are being developed in a new way, software may be needed like raw material. The view taken by the Tribunal is certainly a possible view.”

10. In the case at hand, the assessee-respondent was engaged in the business of development of software and marketing thereof. The business receipts, as is perceptible from the findings recorded by the CIT as well as the tribunal, mainly consist of revenue generated from the marketing of software developed by it. For such development of software, the amount in question was spent within the year under consideration. The assessee had produced relevant material before the assessing officer to show that the amount expended was in the nature of routine expenses. It is interesting to note that such claim was accepted by the assessing officer as a matter of fact but he had expressed the opinion that the assessee was likely to generate some revenue in the subsequent years due to market potentiality of the softwares developed by it and hence, it has the nature and character of capital expenditure having enduring benefit. The factual backdrop of the cases in which the amount has been treated to be capital expenditure is different. In the case of *Jonas*



furnished the information and the technical know-how but rendered valuable services in setting up of the factory itself and even after the expiry of the agreement, there was no embargo on the assessee to continue to manufacture the products in question and on that basis, a percentage was fixed. The present case is not one where one can say that there is exclusive right to use the patent or trade mark of any foreign company or there is payment of royalty on the gross turnover. Thus, the decision in *Jonas Woodhead & Sons (India) Ltd.* (supra) is distinguishable.

11. In *Commissioner of Income-Tax v. Shriram Bearings Ltd.* (2001) 251 ITR 155 (Cal.), the assessee had entered into an agreement styled “Technical Collaboration Agreement” with Industriewerk Echsofflar, INA Ingenieur Disast GmbH, Federal Republic of Germany (INA). The said agreement provided for the supply of technical know-how that the INA had already developed, being in the same line of business, for a lump sum consideration of Rs.3 lacs and subject to Indian tax sold the same to the assessee. Clause 7 of the agreement postulated that the lump sum amount was to be paid in instalments. The Income Tax Officer treated the said expense as capital expenditure. Eventually, the tribunal allowed the claim of the assessee and treated the expenditure as revenue expenditure. The Division Bench referred to the decision in *Jonas Woodhead & Sons (India) Ltd.* (supra) and came to hold that when the assessee was allowed to use the technical know-how even after the expiry of the period of the agreement, there is no doubt that the assessee had acquired the benefit of enduring nature. In our considered



opinion, the facts in the said decision are quite different from those in the case at hand and hence, distinguishable.

12. In the present case, from the order passed by the CIT(A), it is noticeable that the said authority has taken note of the nature of business of the assessee and also appreciated the stand that the assessee was engaged in the business of development of software and marketing thereof and hence, there was no logic in the finding of the assessing officer that the softwares may not have long life in the following years but some value should be assigned to them at the end of the year. That apart, the first appellate authority has not accepted the reasoning ascribed by the assessing officer that the assessee may not be able to develop the software to its final stage and the expenditure incurred during the year may result in no income. The CIT(A) has also recorded that the assessing officer has not analyzed the material brought on record and added the amount purely on the basis of guesswork which is impermissible. The tribunal, as is evident, has held that the expenses were routine in nature and the addition of 25% could not have been disallowed on the ground that the assessee was likely to generate some revenue in the subsequent years due to the market potentiality of the softwares developed by it. It is worth noting that the tribunal has opined that the very nature of the expenditure was revenue and even if there is any advantage, it would be in the revenue field and not in the capital field. Thus, the conclusion arrived at by the tribunal cannot be said to be flawed inasmuch as there is no material on record that the expenditure was capital expenditure



but akin to the expenditure which would come in the realm of revenue expenditure. Quite apart from the above, the tribunal, in our considered opinion, has correctly opined that the assessing officer has proceeded on the basis of a guesswork to put the expenditure in the compartment of capital expenditure instead of revenue expenditure. Resultantly, the appeal, being sans merit, stands dismissed in limine.

CHIEF JUSTICE

MANMOHAN, J

JULY 15, 2010

nm