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

% Judgment reserved on : 23rd September, 2013
Judgment pronounced on: 10th December, 2013

+ **ITA 313/2013**

CIT - I Appellant

Through Mr. Abhishek Maratha, Sr.
Standing Counsel & Ms.
Anshul Sharma, Advocate.

Versus

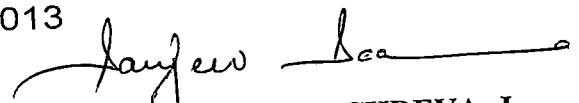
ACL WIRELESS LTD. Respondent
Through Nemo

CORAM:

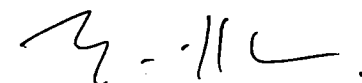
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJEEV SACHDEVA, J.

For order see ITA No. 254/2013


SANJEEV SACHDEVA, J.

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*IN THE HIGH COURT OF DELHI AT NEW DELHI

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+ ITA.254/2013 & 313/2013

CIT - I Appellant

Through Mr. Abhishek Maratha, Sr.
Standing Counsel & Ms.
Anshul Sharma, Advocate.

Versus

ACL WIRELESS LTD.

..... Respondent
Through Nemo

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJEEV SACHDEVA, J.

1. ITA No. 254/2013 pertains to Assessment Year 2003-04 and impugns order of ITAT dated 28.08.2012 & ITA No.313/2013 pertains to Assessment Year 2007-08 and impugns order of ITAT dated 19.10.2012.
2. These appeals have been filed by the Revenue under section 260A of the Income Tax Act, 1961 (for short

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"the Act") impugning the orders ITAT has accepted the appeals of the Assessee and deleted the additions made by the Assessing Officer with regard to product improvement expenses. The Assessing Officer had treated the product improvement expenses as capital expenditure and disallowed equivalent amount as revenue expenditure. ITAT has held to the contrary.

3. The Assessee is a company which is involved in the business of software development. The commercial operations started in the Financial Year 2002-03. The Assessee provides wireless solutions for mobile consumers and enterprises. The software development relates to the field of instant messaging (IM). It employed and functioned with a team of software professionals. They developed new software and were also involved in continuous improvement in the existing software in terms of improvements, speed, usage, storage and providing enhanced features. The Assessee had signed revenue sharing agreements

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with mobile service providers like Airtel, Vodafone, etc.

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4. During the Assessment Year 2003-04, the Assessee had capitalized the product development expenses for the new product (software) launched in the relevant assessment year. However, under the head 'Product Improvement Expenses', the Assessee has claimed Rs.90,37,605/- as revenue expenditure.
5. The Assessee was asked by the Assessing Officer to explain as to why the expenses incurred on product improvement should not be capitalized. In response, it was submitted that the improvement of the software was a regular feature and since the technology of mobile phoning was one of the fastest changing technologies and to keep pace, the Assessee was required to upgrade/improve/modify its product on constant basis. Product improvement was part and parcel of the business of the Assessee.

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The expenses incurred by the Assessee for product improvement did not result in any new product, however modified and new features were added to the existing product depending on market/technology requirements. The Assessee claimed these expenses to be revenue in nature as the same were being incurred in the ordinary course of business. The said expenses were essential to stay in the business of rapidly changing technological world of mobile communications.

6. The Assessing Officer, vide his assessment order dated 23.01.2006, treated the said expenses as capital expenditure on the ground that the software had been capitalized by the Assessee and there was a dedicated team of professionals whose job was to carry out further improvement in the software and the expenses incurred were to enhance the value of the capital asset resulting in enduring benefit. The Assessing Officer thus disallowed the product

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improvement expenses of Rs.90,37,605/- holding them to be capital in nature.

7. The CIT (Appeals), vide his order dated 02.02.2010, dismissed the appeal of the Assessee and confirmed the findings of the Assessing Officer that the expenses incurred by the specialized team were related to product development and resulted in release of a new version of the software with enhanced features over the earlier version. The CIT (Appeals) confirmed the findings of the Assessing Officer that the nature of activity undertaken by the software development team had resulted in creation of new products and assets which were having enhanced features of enduring benefit.
8. Aggrieved by the order dated 02.02.2012 of the CIT (Appeals), the Assessee filed an appeal before the ITAT, who vide the order dated 28.08.2012 have agreed with the contention of the Assessee.

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9. The ITAT noticed that in the immediately preceding assessment year, total expenditure incurred by the Assessee was of Rs.10,68,788/-, which was allowed by the Assessing Officer and in the succeeding assessment year, expenditure of Rs.1,25,76,145/- was also allowed by the Assessing Officer. The ITAT further noticed that the claim of the Assessee of Rs.2,05,43,448/- towards product improvement expenses in the year 2006-07 was also not disallowed. In view of the fact that expenditure in the immediate preceding assessment year and in the immediate succeeding assessment year had been allowed and no disallowance had been made towards product improvement expenses for the Assessment Year 2006-07, the ITAT held that the disallowance made in the year under consideration was not justified.

10. The ITAT also noticed the fact that the software was developed in the earlier year and during the year

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under consideration, improvement was done and on account of which, the Assessee had incurred expenditure towards salary, communication expenses, hosting charges, equipment hire charges, office rent, electrical expenses, legal and professional expenses and consultancy charges. The ITAT held these expenses to be revenue in nature and set aside the findings of the Assessing Officer and CIT (Appeals) that these expenses were capital in nature.

11. The ITAT relied on the decision of the Delhi High Court in the case of **CIT vs. ASAHI INDIA SAFETY GLASS LTD. (2012) 346 ITR 329 (DEL.)** The Delhi High Court relying on various judgments including decisions of the Supreme Court held as under:-

“.....the test of enduring benefit is not a certain or a conclusive test which the courts can apply almost by rote. What is required to be seen is the real intent and purpose of the expenditure

and whether the expenditure results in creation of fixed capital for the Assessee. It is important to bear in mind that what is required to be seen is not whether the advantage obtained lasts forever but whether the expense incurred does away with a recurring expense(s) defrayed towards running a business as against an expense undertaken for the benefit of the business as a whole. In other words, the expenditure which is incurred, which enables the profit-making structure to work more efficiently leaving the source of the profit-making structure untouched, would, in our view, be an expense in the nature of revenue expenditure. Fine tuning business operations to enable the management to run its business effectively, efficiently and profitably ; leaving the fixed assets untouched would be an expenditure in the nature of revenue expenditure even though the advantage may last for an indefinite period. The test of enduring benefit or advantage would thus collapse in such like cases. It would, in our view, be only truer in cases which deal

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with technology and software application, which do not in any manner supplant the source of income or added to the fixed capital of the Assessee."

12. The ITAT also relied on the judgment of the Delhi High Court in the case of *INDO RAMA SYNTHETICS INDIA LTD., (2011) 333 ITR 18 (DEL.)*, wherein the Court has held that the expenditure incurred which was in the nature of salaries, wages, repairs, maintenance, design and engineering fee, etc. and incurred in the normal course of business towards the assignment given to consultants for the purposes of improving operational efficiency and was not towards acquiring any enduring benefit in the capital field but to carry on existing business more efficiently and profitably. It was allowable as business expenditure.

13. The ITAT held that no capital asset had been acquired by the Assessee and the major portion of the expenses on account of salary paid, rent, consultancy

charges, electricity charges, etc. were not for creating any capital asset used for enduring benefit but were incurred in the normal course of business and were thus revenue in nature.

14. Having heard counsel for the revenue and considering the grounds of appeal, we find no merit in the appeal. The findings recorded by the ITAT are factual. The ITAT has held that in the immediately preceding assessment year, total expenditure incurred by the Assessee towards product improvement was of Rs.10,68,788/-, which was allowed by the Assessing Officer and in the succeeding assessment year, expenditure of Rs.1,25,76,145/- was also allowed by the Assessing Officer. Further that the claim of the Assessee of Rs.2,05,43,448/- towards product improvement expenses in the year 2006-07 was also not disallowed.

15. The ITAT has held that in view of the fact that

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expenditure in the immediate preceding assessment year and in the immediate succeeding assessment year had been allowed and no disallowance had been made towards product improvement expenses for the Assessment Year 2006-07, the disallowance made in the year under consideration is not justified.

16. The ITAT has held that the software was developed in the earlier years and during the year under consideration, improvement was done and on account of which, the Assessee had incurred expenditure towards salary, communication expenses, hosting charges, equipment hire charges, office rent, electrical expenses, legal and professional expenses and consultancy charges. These expenses have been held to be revenue in nature.
17. The ITAT has found that no capital asset had been acquired or created by the Assessee. The major portion of the expenses on account of salary paid,

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rent, consultancy charges, electricity charges, etc. were not for creating any capital asset used for enduring benefit but were incurred in the normal course of business and were revenue in nature.

18. The Assessee is engaged in the business of providing wireless solution for mobile consumers and enterprise. The software in issue is in the field of instant messaging which is used in mobile phoning. The product of the Assessee relates to mobile phone communication/messaging. The technology of mobile phoning is rapidly changing and improving day by day. Updates to the existing software are provided virtually on day to day basis. The requirement of mobile users keeps changing rapidly. To keep pace with the rapid changing requirement of mobile users, the software providers are making improvements in the existing software and providing new updates and product features by modifying the existing features and by adding new features to the existing product. The

company which is not able to keep pace with the increasing demands for newer products and features is left behind for not being able to keep pace with the improvements in the industry. Keeping in view the rapid changing requirements, every company in the field of software development specially in mobile phoning has to keep modifying and enhancing their products and provide updates on regular basis. Software upgradation is required to keep and ensure marketability of the said product. Saleability of a software or upgrade lasts only as long as a newer update or upgrade is not available. The period between one upgrade and the other is not substantial one and as such, there may be no enduring benefit of the software. This is clear and apparent from the amounts spent on software improvement.

19. To keep pace with the requirements and ensure product saleability, software development companies have to constantly incur expenditure to upgrade,

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improve and remove problem areas of the software. They have to employ professionals whose job is to continuously upgrade the software and provide newer features and updates on a regular basis. The shelf life of the software without constant improvement would be very small.

20. Expenditure which enables the profit making structure to work more efficiently leaving the source of profit making structure untouched, would be revenue in nature.
21. The facts as noticed herein above show that the Revenue has not disputed the following factual position.
- (A) The Assessee was involved in business of software development.
 - (B) The software developed by the Assessee was used in mobile phones and instant messaging.

(C) The original cost for development of software was capitalised. The quantum of the said development cost was/is not in dispute or under challenge.

(D) The respondent-Assessee incurred product improvement expenses which related to upgradation, improvement, removal of glitches of the existing or already developed software. The quantum of expenses and the nature of character of the expenses incurred i.e. software improvement and upgradation was/is not disputed or questioned by the Revenue.

22. The question raised is whether expenses incurred on upgrading, improving or removing problem areas in an existing old product shall be capitalised or treated as revenue expenditure. The finding of the tribunal is that these upgradations were required constantly and perpetually. The Assessee had to keep pace with the rapidly changing requirements of the mobile phone users. The Assessee was competing with other software providers. Thus, new features, upgrades,

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patches for removing glitches had to be provided, to keep up with matching needs and requirements of the mobile phone users.

23. The aforesaid expenditure did not bring into existence a new asset but rectified and improved the product being sold. It is accepted that there has to be recurring expenditure which has to be incurred in the said business to ensure sale of the software. This expenditure was incurred for removal of obstructions, restrictions or disabilities on the sale and to ensure that there was demand of the said product. These were normal day-to-day expenses for running the business in question and did not create enduring rights or advantage or benefit over a long period time. While determining and deciding a question whether the expenditure is capital or revenue in nature, the determination should be based upon consideration of facts and circumstances and by applying principles of commercial trading and business expediency.

Enduring benefit test is not a universal test and can break down. We find that the said principles have been rightly applied by the tribunal in the facts of the present case to hold that expenditure incurred was revenue in nature and not capital.

24. In case the expenditure is not incurred on the said capital asset the same would become unsalable and obsolete. Therefore to ensure marketability of the existing repeated and constant cost had to be incurred to upgrade and remove glitches etc. In such circumstances in **ALEMBIC CHEMICAL WORKS CO. LTD. v. CIT [(1989) 177 ITR 377 (SC)]** the Supreme Court of India has held as under :-

"The improvisation in the process and technology in some areas of the enterprise was supplemental to the existing business and there was no material to hold that it amounted to a new or fresh venture. The further circumstance that the agreement pertained to a product already in the line of

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the Assessee's established business and not to a new product indicates that what was stipulated was an improvement in the operations of the existing business and its efficiency and, profitability not removed from the area of the day-to-day business of the Assessee's established enterprise.

It appears to us that the answer to the questions referred should be on the basis that the financial outlay under the agreement was for the better conduct and improvement of the existing business and should, therefore, be held to be revenue expenditure. Reference may also be made to the observations of this court in CIT v. Ciba of India Ltd. [1968] 69 ITR 692.

There is also no single definitive criterion which, by itself, is determinative as to whether a particular outlay is capital or revenue. The 'once for all' payment test is also inconclusive. What is relevant is the purpose, of the outlay and its intended object and effect, considered in a common sense way having regard to the

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business realities. In a given case, the test of 'enduring benefit' might break down. In CIT v. Associated Cement Companies Ltd. [1988] 172 ITR 257 (SC) at p. 262, this court said:

"As observed by the Supreme Court in the decision in Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1 (SC), that there may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an Assessee that brings the case within the principles laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test"

25. We may notice that in the immediate preceding

assessment year and in the immediate succeeding assessment year to the year in issue, expenses have been allowed. In the Assessment Year 2006-07, the claim of the Assessee towards product improvement expenditure has not been disallowed. The major portion of the expenses were incurred towards salary paid, rent, consultancy charges, electricity charges, etc., which are not expenses incurred towards creating any capital asset for enduring benefits but are normal day to day expenses and are thus revenue in nature.

26. The finding recorded by the ITAT are factual. Nothing has been pointed out for us to hold that the finding are perverse. In view of the factual findings recorded by the ITAT, no substantial question of law arises for consideration in the present appeal.

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27. In the Assessment Year 2007-08, revenue expenses of Rs.6,86,87,898/- as claimed has been disallowed by

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the Assessing Officer vide order dated 07.12.2009 on the ground that the expenditure is capital in nature.

28. In an appeal by the Assessee, the CIT (Appeals) vide order dated 05.01.2012 held the expenditure to be revenue in nature and deleted the disallowance by the Assessing Officer. The CIT (Appeals) followed the Rule of Consistency since the Assessing Officer had himself allowed this to be revenue in the preceding and succeeding assessment year.
29. The ITAT vide order dated 19.10.2012 has noticed that for the Assessment Years 2004-05 to 2006-07, the Assessing Officer has allowed similar expenditure and for the Assessment Years 2008-09 & 2009-10 also, the Assessing Officer has himself allowed the said expenditure.
30. In the present case, the ITAT had allowed the appeal of the Assessee and treated the said expenditure as revenue. The expenses were incurred in the course

of day to day business operations of the Assessee and the operations being routine in nature by way of providing value added services of the customers. The ITAT noticed that the mobile services required continued upgradation and monitoring and the expenditure in question was incurred as a matter of routine for the business and commercial expediencies of the Assessee's business and as such, the expenses towards product development were allowed as revenue expenditure.

31. The findings are factual. In view of the factual findings and reasoning given by us for the Assessment Year 2003-04 and also in view of the fact that the Assessing Officer has himself allowed similar expenses for the Assessment Year 2004-05 to 2006-07 and 2008-09 and 2009-10, we find no infirmity in the order of the ITAT and find that no substantial question of law arises in the present appeal.

32. The appeals are accordingly dismissed with no orders as to costs.

Sanjeev Sachdeva

SANJEEV SACHDEVA, J.

Sanjiv Khanna

SANJIV KHANNA, J.

10th DECEMBER, 2013
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