IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 27.11.2018

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MR.JUSTICE N.SATHISH KUMAR

Tax Case (Appeal) Nos.73 & 74 of 2011

M/s KGISL Technologies and Infrastructures
Private Limited,[Formerly known as M/s Rite
Choice Technologies Pvt Ltd]
K.G.Campus,
No.365, Thudialur Road,
Saravananpatti,
Coimbatore-641 035. ... Appellant
in both Appeals

-vs-

The Assistant/Deputy Commissioner
of Income Tax,
Company Circle V (4)/IV(5),
Nungambakkam,
Chennai-600 034. ... Respondent
in both Appeals

Common Prayer: Tax Case (Appeal) filed under Section 260-A of the Income Tax Act, 1961 against the order of Income Tax Appellate Tribunal, Chennai 'B' Bench, dated 20.02.2009 in I.T.A.No.501/Mds/2002 for the assessment year 1998-1999 and in I.T.A.No.573/Mds/2001 for the assessment year 1997-1998. The Income Tax Appellate Tribunal Chennai 'B' Bench dated 20.02.2009 in I.T.A.No.573/mds/2001 Assessment year 1997-1998 and I.T.A.No.501/mds/2002 Assessment year 1998-1999 against the Commissioner of Income Tax (appeals)V I.T.A.No.510/2001-2002 dated 18.01.2002 PAN.GIR.No. 360-R Assessment year 1998-1999 against the Commissioner of Income Tax Appeals IV, I.T.No. 132/2000-2001 dated 08.01.2001 G.I.P.No. 360-R Assessment year 1997-1998.

For Appellant
in both Appeals : M/s.Akshita Sakariya
for Mr.P.J.Rishikesh

For Respondent
in both Appeals : Mr.T.R.Senthil Kumar

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COMMON JUDGMENT
(Judgment was delivered by T.S.Sivagnanam, J.)

These appeals filed by the assessee under Section 260A of the Income Tax Act, 1961('the Act' for brevity) are directed against the orders passed by the Income Tax Appellate Tribunal, Chennai, 'B' Bench, dated 20.02.2009 in I.T.A.No.501/Mds/2002 for the assessment year 1998-1999 and in I.T.A.No.573/Mds/2001 for the assessment year 1997-1998 respectively.

2.The appeals have been admitted on 02.03.2011, on the following substantial questions of law:

> "(i) Whether in facts and circumstances of the case, the Appellate Tribunal was right in holding that the expenditure incurred in developing/upgrading the software as capital expenditure?
>
> (ii) Whether in facts and circumstances of the case, the Appellate Tribunal was right to hold that the expenditure incurred in nature when the software on which expenses are incurred neither has an enduring benefit not does it amount to creation of a new asset?
>
> (iii) Whether the Tribunal ought not to have considered the nature of the expenses for the purpose of determining whether it is allowable expenditure or not irrespective of the way it was dealt with by the assessee for the purpose of its accounts?"

3.The assessee filed return of income for the relevant years and claimed expenditure towards development of two types of softwares and they claimed deduction to be a revenue expenditure. The two softwares which were developed by the assessee were called Spectrum 2000 and Options Explorer. The assessee had treated the expenditure towards the product development in capitalizing the same in the books of accounts and while presenting the returns, the expenditure was claimed as revenue expenditure under Section 37(1) of the Act. The Assessing Officer rejected the contentions of the assessee and disallowed the same. Aggrieved by the order, the assessee preferred appeals to the Commissioner of Income Tax (Appeals)-IV (CITA), Chennai. The CITA by orders dated 18.01.2002 and 08.01.2001, allowed the appeals filed by the assessee. Aggrieved by the same, the Revenue preferred appeals before the Tribunal. The Tribunal by common order dated 20.02.2009 allowed the appeals by following the decision of the Hon'ble Supreme Court of India in the case of Hasimara Industries Ltd., Vs. CIT & Another reported in (1998) 230 ITR 927 (SC). Aggrieved by such order, the assessee is before us by way of these appeals which have been entertained to decide the substantial questions

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of law as noted above.

4.The facts which are relevant for disposal of these appeals have been set out in the preceeding paragraphs by way of recapitulation. The assessee had incurred expenditure for development of two of its existing software products. The expenditure incurred by the assessee towards the development of these existing software products were claimed to be a revenue expenditure under Section 37(1) of the Act. The Tribunal has not assigned any specific reasons as to why the assessee is not entitled for deduction but merely followed the decision in the case of Hasimara Industries Ltd.

5.We have perused the said decision and we note from the last paragraph of the decision that the case pertains to an amount of Rs.20 lakhs to be deposited by the assessee therein with the licensor company for the purpose of securing licence under which the assessee had acquired the right to work the licensor's cotton mills. Further it was noted that the deposit was made pursuant to a clause in the leave and licence agreement and had a deposit as required by that clause not been made, the assessee would not have secured the license of the cotton mill. Thus, it was concluded that the deposit was clearly made for the purpose of acquiring a profit-making asset to carry on business in cotton. Therefore, it cannot be held that the deposit was made on the revenue account or that the loss thereof must be treated as a business loss. Thus, it was held that the loss thereof was a loss suffered on the capital account and could not be treated as business loss. In our considered view, the decision in the case of Hasimara Industries Ltd., can have no application to the facts of the present case.

6.The case of the assessee, not disputed by the Revenue is that the assessee incurred these expenditure for developing a existing software. This was with the reason to compete in the market and for the improvement of the existing product. Therefore, the Tribunal erred in applying the said decision and consequently, erred in allowing the appeal filed by the Revenue. The CITA after taking into consideration the facts of the case, in our opinion rightly held that the products are not similar to development of specific new products and it is in respect of the expenditure incurred in improving of the existing product and the work was initiated for securing the market over others in the field of business and the assessee's business is developing of software and expenditure incurred on a project which was perceived to be of great potential cannot be disallowed because such potential has not been realised. Further, it was pointed out that it is not necessary that every expenditure results in taxable income and it cannot be held that unless income is generated, expenditure cannot be allowed.

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7.The above conclusion arrived by us is supported by the decision relied upon by the learned counsel for the appellant in the case of CIT Vs. Southern Roadways Limited, T.C.(A).No.2454 of 2006, dated 07.10.2006, wherein identical question of law was framed for consideration, namely, whether the Tribunal was right in holding that the expenditure incurred on upgradation of software is a revenue expenditure. The Court after taking into consideration that the expenditure incurred by the assessee therein was for upgradation of software, held it to be a revenue expenditure. The Court relied upon the decision of the Hon'ble Supreme Court in the case of Alembic Chemical Works Co. Ltd., vs. CIT reported in (1989) 177 ITR 377 (SC) and also similar view has been taken in T.C.A.Nos.1397 and 1398 of 2005 by judgment dated 20.01.2006 (CIT vs. Southern Roadways Ltd., reported in (2006) 282 ITR 379). The operative portion of the order reads as follows:

> 6. With regard to the second question, viz., whether the expenditure incurred on the upgradation of software is revenue expenditure, the assessee did not claim any expenditure for installation of new computers, but claimed the expenditure for upgradation of existing computers. Further, the Cit vs Southern Roadways Ltd. on 7 October, 2006 expenditure was incurred for improving the efficiency of the existing system with a view to keep pace with improvement of technology and no machinery was brought into existence. Such expenses incurred by the assessee for enhancement of efficiency, in our considered opinion, is nothing but an upgradation of computers for achieving the desired result and, therefore, the same has to be treated as revenue expenditure.
>
> 7. The Apex Court in Alembic Chemical Works Co. Ltd. v. CIT after referring to B. P. Australia Ltd. v. Commissioner of Taxation of the Common Wealth of Australia (1966) AC 224 (PC), held that (page 386): What is capital expenditure and what is revenue are not eternal verities but must needs be flexible so as to respond to the changing economic realities of business. The expression asset or advantage of an enduring nature was evolved to emphasise the element of a sufficient degree of durability appropriate to the context.
>
> 8. It was also held that the phrase "enduring benefit" is not thinking of advantages that are permanent. There is a difference between the lasting and the everlasting.
>
> 9. In the light of the above ratio laid down by the Supreme Court, we are of the view that upgradation of computers by changing certain parts thereby enhancing the configuration of the computers

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for improving their efficiency but without making any structural alterations is not of an enduring nature. The expenditure incurred by the assessee has therefore to be treated as revenue expenditure.

10. Similar view has been taken by this Court in T. C. Nos. 1397 and 1398 of 2005, by judgment dated 20-1-2006 (CIT v. Southern Roadways Ltd. (2006) 282 ITR 379 (Mad)). Accordingly, the second question is answered in the affirmative, against the revenue and in favour of the assessee.

8.In Commissioner of Income Tax vs. The Lakshmi Vilas Bank Ltd. in T.C.A.Nos.210 and 211 of 2018, the substantial question of law framed for consideration was whether the Tribunal was right in hold that software expenditure is to be treated as a revenue expenditure and not as a capital expenditure? The revenue placed reliance on the decision of the Delhi High Court in Bharti Televentures Ltd. vs. Additional Joint Commissioner of Income Tax[2013 (81) DTR 0225] and held that the expenditure was to be treated as a revenue expenditure due to advanced technology, the software becomes obsolete. The Court referred to the decision in the case of Empire Jute Co. Ltd. vs. CIT [1980 (124) ITR 1 (SC)] and also held that the Tribunal in the said case rightly applied the decision in the case of Commissioner of Income Tax vs. Southern Roadways Ltd. [2008 (304) ITR 84 (Mad). The operative portion of the judgment reads as follows:

5.1 For the asst. yr. 1995-96 to 1997-98, the assessee claimed the expenditure incurred on software packages as revenue expenditure, but the same was disallowed by the Revenue. The concept of enduring benefit must respond to the changing economic realities of the business. The expenses incurred by installation of software packages in the present computer world, which revolves on the modern communication technology, enable the assessee to carry on its business operations effectively, efficiently, smoothly and profitably. However, such software itself does not work on a stand-alone basis. It has to be fitted to a computer system to work. Such software enhances the efficiency of the operation. It is an aid in the manufacturing process rather than the tool itself. Therefore, the payment for such application software, though there is an enduring benefit, does not result in acquisition of any capital asset and it merely enhances the productivity or efficiency and hence, has to be treated as revenue expenditure.

5.2 In view of the above, we hold that the Tribunal had rightly held the expenditure incurred

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on software packages as a revenue expenditure. Question No.2 : "Whether in the facts and circumstances of the case, the Tribunal was right in holding that expenditure incurred on construction of compound wall in the place of barbed wire fencing is a revenue expenditure ?"

6.1 This issue relates to the asst. yrs. 1995-96 and 1996-97, during which the claim of the assessee with respect to the expenditure incurred on construction of compound wall in the place of barbed wire fencing as revenue expenditure was disallowed by the Revenue.

6.2 While chalking out the balancing point for deciding the substantial questions of law raised by the Revenue based on the ratio laid down by the House of Lords, Privy Council, the apex Court as well as by other High Courts, referred supra, we have already observed that there cannot be any single rigid formula to find out whether a particular expenditure is revenue in nature or capital and that the expenditure was incurred to obtain a benefit of an enduring nature is not the sole test in every case. Incidentally, we have also referred to the decision of the Bombay High Court in Zenith Steel Pipes Ltd. vs. CIT (supra), wherein it has been held that putting up of a barbed wire fence was a revenue expenditure.

6.3 When an identical question whether the expenses incurred for replacing the old barbed wire fence around the compound by a compound wall is a revenue expenditure or capital expenditure came up for consideration before the Karnataka High Court in CIT vs. B.V. Ramachandrappa & Sons (1991) 97 CTR (Kar) 180 : (1991) 191 ITR 34 (Kar), applying the well-settled principles laid down by the House of Lords, Privy Council, apex Court as well as by the decision of several other High Courts, referred supra, the Karnataka High Court held as follows:

" .. The purpose of the fence around the business premises was to prevent trespassers and thieves from entering into the business premises; the dominant purpose was to safeguard the property in the premises. The materials in the premises were part of the business assets of the assessee. In this context, the compound wall could not be treated in isolation. It was part of the business premises and when only a part of the premises was replaced, prima facie, it would be a case of repair. The identity of the entire asset as a whole was not affected at all. The works carried out contributed to the better and safer utilisation of

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the existing business premises asset. The works effected, when considered in proportion to the entire business premises, did not result in significant replacement so as to alter the character of the business premises. Therefore, the Tribunal was right in holding that the expenditure incurred on replacement of thatched roof with asbestos sheets and barbed wire fence with compound wall was revenue expenditure."

6.4 Of course, our attention was brought to another decision of the Karnataka High Court in Senapathy Synams Insulations (P) Ltd. vs. CIT (2001) 166 CTR (Kar) 277 : (2001) 248 ITR 656 (Kar), where the assessee replaced the existing compound wall with a new foundation and claimed the expenditure incurred on the construction of the wall as revenue expenditure. In the said case, the Karnataka High Court held that the Revenue had rightly treated the expenditure as capital expenditure because the compound wall had been built to provide enduring safety to the assessee. But, we find that the rati laid down by the House of Lords, Privy Council, apex Court as well as by other High Courts, referred supra, was not brought for consideration by the Karnataka High Court while deciding the question raised in the said case.

6.5 Therefore, since the decision of the Karnataka High Court in CIT vs. B.V. Ramachandrappa & Sons (supra), is fully supported by the ratio laid down by the House of Lords, Privy Council, apex Court as well as by other High Courts, referred supra, in our considered opinion, in the case on hand, the Tribunal has rightly held that the expenditure incurred on the construction of the compound wall in the place of barbed wire fencing is a revenue expenditure. Question Nos. 3 and 4 : "Whether in the facts and circumstances of the case, the Tribunal was right that the expenditure incurred on replacement on UPS system is a revenue expenditure ?" "Whether in the facts and circumstances of the case, the Tribunal was right that the expenditure incurred on replacement of printer is a revenue expenditure ?"

7.1 The reasons that weighed this Court in deciding the issue whether the expenditure incurred for replacement of software packages as revenue expenditure as discussed in question No. 1 above, are applicable in all fours to questions 3 and 4 also.

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7.2 That apart, this Court in CIT vs. Southern Roadways Ltd. (2006) 202 CTR (Mad) 279 : (2006) 282 ITR 379 (Mad), applying the ratio laid by the apex Court in the case of Alembic Chemical Works Co. Ltd. vs. CIT (supra), cited supra, held that upgradation of computers by changing certain parts, thereby enhancing the configuration of the computers for improving their efficiency, but, without making any structural alterations is not of an enduring nature and hence, the expenditure incurred by the assessee has to be treated as revenue expenditure. The said view was again followed by this Court in CIT vs. Southern Roadways Ltd. (2007) 288 ITR 15 (Mad).

7.3 In view of the above settled proposition, we hold that the Tribunal has rightly held the expenditure incurred on replacement of UPS and printer as a revenue expenditure. For the foregoing reasons, we find no question of law much less substantial question of law that arises for our consideration in these appeals. Accordingly, the tax case appeals stand dismissed. Consequently, M.P.Nos. 1 of 2007 in Tax Case (Appeal) Nos. 701 to 704 of 2007 are also dismissed.

9.Mr.T.R.Senthil Kumar, learned counsel appearing for the revenue vehemently contended that the assessee had referred to the decision in the case of UCO Bank vs. Commissioner of Income Tax reported in (199) 237 ITR 889 and the said decision would not in any manner apply to the facts of the case.

10.The learned counsel for the revenue is right in his submission because the question which was decided therein was slightly on a different footing while considering as to whether the interest earned on what have come to be known as 'sticky loans' can be considered as income or not until actual realisation. Therefore, reliance placed on the said decision before the Tribunal would not in any manner help the assessee. Further the Tribunal did not refer to the decision but merely extracted a portion of the judgment in the case of Hasimara Industries Ltd. vs. Commissioner of Income Tax and another reported in 1998 230 ITR 927 and allowed the appeal. We have already pointed out that the decision in the case of Hasimara Industries Ltd. would have no application to the facts of the present case. Thus, for the above reasons, we hold that the Tribunal had committed serious error in reversing the order of the Income Tax Appellate Tribunal.

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11.In the result, the appeals filed by the assessee are allowed and the orders passed by the Tribunal are set aside and the order passed by the Commissioner of Income Tax (Appeals) is restored and the substantial questions of law framed for consideration are answered in favour of the assessee.

-s/d-
Assistant Registrar(CCC)

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Sub-Assistant Registrar

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To
1.The Income-tax Appellate Tribunal Bench "B" Chennai.

2. The Assistant Commissioner of Income Tax
Company Circle V(4)
Chennai 34.

3. The Commissioner of Income Tax (appeals)V
Chennai 34.

4. The Deputy Commissioner of Income Tax
Company Circle IV(5) Chennai 6.

+2 Ccs to Mr.P.J.Rishikesh, Advocate sr 81122.
+1 CC to Mr.T.R.Senthil Kumar, advocate sr 81236.

T.C.(A) Nos.73 & 74 of 2011

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