
(2011) 11 KAR CK 0390
In the Karnataka High Court
Case No : Income Tax A. No. 3232 of 2005

Commissioner of Income Tax and Another	APPELLANT
Vs	
Infosys Technologies Ltd. (No. 3)	RESPONDENT

Date of Decision : 04-11-2011

Acts Referred:

Income Tax Act, 1961 — Section 10 A, 80 HHE

Citation : (2012) 349 ITR 598

Hon'ble Judges : V.G. Sabhahit, J;Ravi Malimath, J

Bench : Division Bench

Advocate : E. Sanmathi Indrakumar, for the Appellant; Arvind Datar for M/s. King and Partridge, for the Respondent

Final Decision : Allowed

Judgement

V.G. Sabhahit, J.—This appeal is filed by the Revenue being aggrieved by the order passed by the income tax Appellate Tribunal, Bangalore Bench "A" (hereinafter referred to as "the ITAT") in I.T.A. No. 140/Bang./ 2001 dated July 5, 2005, wherein the appeal filed by the respondent herein has been allowed. The material facts leading up to this appeal are as follows:

The respondent-assessee is carrying on the business of development of software and sale of software packages. The respondent filed a return of income for the assessment year 1997-98. The same was taken up for scrutiny assessment. The Assessing Officer found that the assessee had paid amounts to various clubs to obtain membership. The Assessing Officer held that the payments made are not recurring in nature and proceeded to treat the said payment as a capital expenditure. The claim of the assessee that the same should be treated as revenue expenditure was disallowed. The Assessing Officer further held that the assessee had failed to take into consideration the expenditure incurred in foreign currency when computing the deduction u/s 80HHE of the Act and the claim of the assessee that the expenditure had been incurred for the purpose of marketing only and, therefore, cannot be deducted before granting deduction u/s

80HHE of the Act was rejected. The Assessing Officer further found that there was an error in proceeding to hold that sale of eagle software was not effected from the STP unit and, therefore, profit from such sale is not eligible for deduction u/s 10A of the Act. Being aggrieved by the order passed by the Assessing Officer, the assessee preferred the appeal before the first appellate authority in I.T.A. No. 14/ SR-6/CIT(A)-1/2000-01. The first appellate authority held that the amount paid to various clubs cannot be disallowed as capital in nature and it was held that the said expenditure was revenue expenditure. Further, regarding the deduction u/s 80HHE of the Act, the first appellate authority confirmed the order passed by the Assessing Officer. The first appellate authority held that the said software was effected from the STP unit and such sale is eligible to deduction u/s 10A of the Act and accordingly disposed of the appeal.

2. Being aggrieved by the same, the assessee filed I.T.A. No. 140/Bang./2001 before the income tax Appellate Tribunal and the income tax Appellate Tribunal, by order dated July 5, 2005, allowed the appeal holding that it was not necessary to deduct the expenditure incurred in foreign exchange for the purpose of deduction u/s 80HHE and the foreign exchange expenses incurred by the assessee cannot be treated as having been incurred towards technical service outside India as the same has been incurred towards marketing activity and eagle software is not part of business activity of the assessee-company and, hence, any amount realised on sale of such product is to be treated as trading receipt and not capital receipt and, accordingly, allowed the appeal of the assessee" in part. Feeling aggrieved by the said order passed by the income tax Appellate Tribunal dated July 5, 2005, this appeal is filed by the Revenue.

3. The appeal has been admitted on July 10, 2007, for consideration of the following substantial questions of law:

(1) Whether the appellate authorities were correct in holding that amounts paid to clubs for obtaining membership should be treated as a revenue expenditure and was allowable deduction and not a capital receipt as held by the Assessing Officer ?

(2) Whether the Tribunal was correct in holding that section 80HHE of the Act deduction should be allowed to the assessee without excluding the foreign exchange expenditure incurred by the assessee during the current assessment year ?

(3) Whether the appellate authorities committed an error in holding that eagle software was designed and developed by the assessee-company as regular business activity and thereby it cannot be considered as a capital asset ?

(4) Whether the appellate authorities committed, an error in proceeding to hold that the sale of eagle software was effected from the STP unit and thus the profit from such sale is eligible for deduction u/s 10A of the Act ?

(5) Whether the appellate authorities failed to take into consideration that the project of eagle software was started even prior to approval of the STP unit and corresponding expenditure set up the unit as well as work-in-progress cannot be allowed as per section 10A of the Act as the STP unit has to be newly developed ?

(6) Whether the appellate authorities recorded their finding based on the sale in respect of eagle software and not on corresponding expenditure ?

(7) Whether the Tribunal committed an error in failing to appreciate that the assessee had received the royalty from Canada which was not a subject-matter of tax there and forms the part of the turnover for the purpose of computation of deduction u/s 80HHE of the Act ?

(8) Whether the Tribunal committed an error in proceeding to grant relief in favour of the assessee by holding that the Double Taxation Avoidance Agreement between Canada and India was applicable and the royalty cannot form part of the turnover for the purpose of deduction u/s 80HHE of the Act.

4. We have heard the learned counsel appearing for the appellants and learned counsel appearing for the respondent-assessee on the above stated questions of law.

Reg: Substantial question of law Nos. (3) to (6)

5. The assessee received an amount of Rs. 3,59,00,000 by sale of software system (Eagle Warehouse Management System) developed by the assessee to M/s. Yantra Corporation, USA, which is fully owned foreign subsidiary of the assessee for consideration of US dollars 1 million. Instead of receiving the consideration in cash, they were allotted shares to the extent of 5 million shares of M/s. Yantra Corporation at US dollars 0.20 per share, corresponding value in rupees would come to Rs. 3,59,00,000. The said income was offered as long-term capital gains while computing the total income and set off against the long-term loss of Rs. 4,61,03,206. The said contention of the assessee was rejected by the Assessing Officer in his order dated March 31, 2000, pertaining to the assessment year 1997-98 by holding that the said income received by the sale of software cannot at all be treated as capital receipt. The assessee is doing the business of developing and exporting software and, therefore, the consideration received by the said sale of eagle software amounting to Rs. 3,59,00,000 cannot be termed as long-term capital gains. It is the income received from the business of the assessee and, therefore, it is to be treated as revenue expenditure. However, it was alternatively argued by the assessee that assuming the said income is treated as business income, the same is entitled to exemption u/s 10A of the Act or deduction may be granted u/s 80HHE of the Act. The Assessing Officer held that the said amount was not shown as revenue income and exemption u/s 10A of the Act was not claimed as the assessee offered the consideration amount received by sale of the eagle software as long-term capital gains and adjusted the same towards the long-term capital loss of Rs. 4,61,03,206. Since the foreign currency was not brought into India as the

consideration is received by way, of shares, deduction u/s 80HHE of the Act is also not applicable and it is a trading receipt taxable as revenue and not exempted u/s 10A of the Act and, accordingly, treated the said income as trade receipt and rejected the claim of the assessee for exemption u/s 10A of the Act. The first appellate authority, by order dated December 29, 2000, held that the impugned finding of the Assessing Officer that the assessee is not entitled to exemption as the sale was effected from the STP from Keonics u/s 10A is erroneous and accepted the contention of the assessee that it forms part of the profits and gains of the STP unit and the assessee has opted for certain exemption u/s 10A of the Act in respect of profits and gains for the assessment year 1997-98 and, accordingly, allowed the appeal. Being aggrieved by the said finding, in the appeal filed by the Revenue, the income tax Appellate Tribunal has confirmed the finding given by the first appellate authority and held that the income by the sale of the eagle software is to be treated as trading receipt. However as the product has been sold as the STP unit, the software was the product-of the STP unit and the profit from the sale of the said item is held to be exempted u/s 10A of the Act.

6. The learned counsel appearing for the Revenue submitted that since no exemption was claimed under-section 10A of the Act by treating the amount received as sale of the eagle software as-trading receipt, the question of granting exemption would not arise and even, according to the assessee, since the production of the said" software commenced in 1992 and the STP unit was established in the year 1994, it cannot be said that the" said software was developed in the STP unit and; therefore, the question of granting exemption u/s 10A of the Act would not arise and, therefore, the concurrent finding arrived at by the income tax Appellate Tribunal and the first appellate authority is erroneous and liable to be set aside.

7. The learned counsel appearing for the assessee submitted that though assessee had shown the income received by the sale of the eagle software as long-term capital gain, it was specifically submitted before the Assessing Officer and the first appellate authority that if the said income cannot be treated as long-term capital gain, the same may be treated as trading income and exemption u/s 10A may be granted as the sale of the software is by the assessee as the STP unit and the material produced on record would show that sale has taken place after the STP unit was established.

8. We have given careful consideration to the contentions of learned counsel appearing for the parties and scrutinised the material on record.

9. The material on record would clearly show that the assessee was not at all justified in showing the income of Rs. 3,59,00,000 received by the sale of eagle software as long-term capital gains and the concurrent finding arrived at by the Assessing Officer, the first appellate authority and the income tax Appellate Tribunal to the effect that it is trading income is unassailable. However, the only question is as to whether the profit received from the said transaction should be

exempted u/s 10A is to be decided. The said question is a pure question of fact on which the concurrent finding has been arrived at by the Assessing Officer, the first appellate authority and the income tax Appellate Tribunal. It is clear from the reasoning given by the first appellate authority and the income tax Appellate Tribunal that having regard to the material produced by the assessee, the fact that the said sale took place after the establishment of the STP unit is clearly evidenced and the said fact is also not disputed by the Revenue. However, what is suggested by the Revenue is that the development of the software has started in the year 1994 and, according to the assessee, the said software is not developed in the STP unit and since no exemption has been claimed u/s 10A of the Act, the said exemption cannot be claimed. On scrutiny of the entire material on record, we find that, admittedly, the eagle software was sold by the assessee to M/s. Yantra Corporation which is a wholly owned foreign subsidiary of the assessee for Rs. 3,59,00,000 and the said income has been held to be a trading receipt. The material on record would show that the sale transaction took place after establishment of the STP unit, i.e., during the assessment year 1997-98, four years after the establishment of the STP unit and the fact that the assessee was a STP unit when the sale transaction took place is not in dispute. In view of the fact that the assessee had claimed the income by sale of the eagle software as long-term capital gains, the question of seeking exemption u/s 10A of the Act while filing the return did not arise. If the assessee is entitled to exemption u/s 10A of the Act as the STP unit, having regard to the date of transaction, nature of the transaction and the fact that the assessee is a STP unit the same should not come in the way of holding that the assessee is entitled to the benefit u/s 10A as it has been alternatively argued both before the Assessing Officer and the first appellate authority that if the income is treated as trading receipt, exemption u/s 10A of the Act may be granted. Therefore, the finding on the said question of fact that the assessee being a STP unit is entitled to exemption u/s 10A of the Act in respect of the transaction of the sale of the eagle software as admissible is justified and the said finding is based upon the material on record as we have already held on consideration of the entire material on record that the assessee being a STP unit was entitled to exemption u/s 10A of the Act in respect of the said transaction also. It is also clear from the material on record that the expenditure incurred towards manufacture of the said software has been included in the profit and loss account for the respective assessment years and, according to the statement filed before the appellate authority, nearly 60 employees were engaged from time to time in the development of the software and taking into account the claim that the software was developed over a time from 1992 to 1996, it would be logical to reason that manhour equivalent of at least six months and the expenditure of not less than Rs. 50 lakhs would have been incurred on salary for the development of the software and, therefore, the order passed by the income tax Appellate Tribunal confirming the order passed by the first appellate authority holding that the income received by the sale of eagle software is to be treated as trade receipt and the assessee is entitled to exemption admissible u/s 10A of the Act is justified and does not suffer from any

perversity or arbitrariness so as to call for interference in this appeal. Accordingly, we answer the substantial question of law against the Revenue and in favour of the assessee.

Reg: Substantial questions of law (1).

10. So far as substantial questions of law No. (1) is concerned, the same has already been answered by us in I.T.A. Nos. 2975 of 2005 and connected cases, disposed of on October 21, 2011, (since reported in Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd. (No. 1) wherein the said question is answered against the Revenue and in favour of the assessee upholding the order of the income tax Appellate Tribunal that the said expenditure is revenue in nature.

Reg: Substantial questions of law Nos. (2), (7) and (8).

11. So far as substantial questions of law Nos. (2), (7) and (8) are concerned, the same have already been answered by us in I.T.A. Nos. 2972 of 2005 and connected cases, disposed of on November 4, 2011, (since reported in Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd., wherein the said questions are answered in favour of the Revenue and against the assessee.

12. Accordingly, we pass the following:

ORDER

The appeal is partly allowed. The order passed by the income tax Appellate Tribunal in I.T.A. No. 140/Bang./2001, dated July 5, 2005, in so far as it relates to allowing the deduction u/s 80HHE of the Act in favour of the assessee is set aside and the order of the income tax Appellate Tribunal is confirmed in all other respects.