
(2013) 04 KAR CK 0007
In the Karnataka High Court
Case No : Income Tax A. No. 1192 of 2006

Commissioner of Income Tax and Another	APPELLANT
Vs	
Infosys Technologies Ltd.	RESPONDENT

Date of Decision : 22-04-2013

Acts Referred:

Citation : (2014) 360 ITR 714 : (2014) 223 TAXMAN 469

Hon'ble Judges : N. Kumar, J;B. Manohar, J

Bench : Division Bench

Advocate : E.R. Indrakumar, for E.I. Sanmathi, for the Appellant; K.P. Kumar, for T. Suryanarayana, Advocate for M/s. King and Partridge, for the Respondent

Judgement

N. Kumar, J.—This appeal is preferred by the Revenue challenging the order passed by the Tribunal granting various reliefs to the assessee. The assessee is a leading exporter of software. It filed its return of income on November 27, 1998, admitting a total income of Rs. 3,33,91,389. The return was processed u/s 143(1) of the income tax Act, 1961 (for short hereinafter referred to as "the Act"), on August 23, 2000, accepting the income returned. The case was selected for scrutiny and notice u/s 143(2) of the Act was issued. In response to the notice, details called for were also filed. After going through the various details and explanations offered by the assessee, the assessment was finalized.

2. The assessee paid a sum of Rs. 44.43 lakhs to the National Security Depository Ltd. (NSDL) as one-time custody charges for 80,08,600 shares. Consequent to the introduction of demat, all shareholders have to deposit their shares with depositories. The assessee-company had taken over the liability of payment of Rs. 44.43 lakhs as one-time custody charges. The Assessing Officer has held that the assessee has paid the said amount as a goodwill measure and, therefore, the same is not allowable as deduction u/s 37(1) of the Act. He further held that it cannot be allowed as a revenue expenditure as the assessee derives an enduring benefit from one-time payment of custody charges and is capital nature. Therefore, Rs. 44.43 lakhs was disallowed.

3. The assessee made donations amounting to Rs. 52.34 lakhs and the entire amount was debited to the Keonics unit. In the computation of income, the entire donations paid were added back to the income of the Keonics unit and exemption u/s 10A was claimed on the entire income of the Keonics unit. The assessing authority observed that the entire gross total income of Rs. 30,24,58,224 is the income relatable to units other than the Keonics unit, from which assessee has claimed deduction u/s 80G of Rs. 15 lakhs. Once donations debited in the profit and loss account is added back to the net profit of the Keonics unit, it becomes the income of the Keonics unit on which exemption u/s 10A has been allowed. Hence, claiming of deduction u/s 80G from the gross total income (which does not include section 10A unit's income) amounts to claiming double deduction for single outgo. Section 80G(5A) provides that if a deduction is allowed under that section no other deduction is allowable under any other provisions of the Act for the sums specified in sub-section (2) of section 80G. The contention of the assessee is that the word "deduction" used in the sub-clause does not cover "exemption allowed u/s 10A". In the letter dated December 12, 2000, the assessee contends that the donation is an application of income and there is no such stipulation in section 80G that donation is to be made out of taxable income only. Rejecting the above contentions, the assessing authority held that deduction u/s 80G claimed amounting to Rs. 15 lakhs is not allowed since the donation does not form part of the gross total income.

4. The assessing authority held that, as could be seen from the annual report for the year 1997-98, the assessee has installed traffic signals at the Bannerghatta Circle in Bangalore at a cost of Rs. 7,37,720 which is included in donations of Rs. 52,34,364 added back to the Keonics unit, the income from which is exempt u/s 10A. The assessee, vide letter dated December 12, 2000, submitted that it has an office at the Bannerghatta circle, where 500 employees are working. Due to severe traffic congestion, its employees had to wait for longer time to reach the office resulting in delay in completing the projects. Hence, the traffic signals have been installed to ensure that the employees of the Bannerghatta circle would reach the office in time without facing any traffic problems and, hence, should be allowed as revenue expenses. The assessing authority held that regulating traffic is the lookout of the traffic police and the Government and not that of the assessee. If traffic signals were not there in such a busy circle, the traffic police will be very much available to regulate the traffic. Even assuming that the installation of traffic signals will regulate the traffic better than the traffic police, what the employees of the assessee would have been benefited from the installation of traffic signals will be very remote. Hence, the benefit from the installation of traffic signals derived by the assessee being very remote, the expenditure cannot be allowed u/s 37(1) of the Act. In fact, what the assessee has done is to donate these traffic signals to the State Government which is not allowable as deduction, as donation in kind is not eligible for deduction u/s 80G. Therefore, the said amount was added back as the income of the Keonics unit.

5. A sum of Rs. 1,23,09,815 is debited towards provision for post-sales

customers support. In the unit-wise profit and loss account enclosed to the return of income, Rs. 76,32,363 has been debited to the Keonics (section 10A unit) and Rs. 46,77,452 to others. As could be seen from the assessee's letter dated February 20, 2001, the above provision is made at 2 per cent of the amount billed till the year end in respect of outstanding fixed price projects as at the year end. In the subsequent year, the provision is written back to the income statement and a fresh provision is created. On being asked, what is the amount of actual expenditure debited in provision account in the financial years 1997-98 and 1998-99 towards post-sales customer support, the assessee states that such expenditure gets accounted under the normal heads and there is no specific debit to the warranty provision in any year. Since the provision is written back on the first day of the accounting year and the actual expenses incurred towards the post-sales support are debited to respective heads, it is not possible to give the details called for. However, the assessee claims that the above provision is allowable as deduction in view of various case law cited. Therefore, the assessing authority held that no scientific basis is followed but only an estimate of provision is made at 2 per cent of sale value without any basis. The liability for warranty arises only when a customer makes a claim due to failure in the performance of product sold by the company within a specified time. Before making a warranty claim, the customer should also prove that the failure of the products supplied are due to programme defects and not on account of the customer's mishandling. The making of warranty claim in future and allowing the same is dependent on several factors which are contingent and beyond the scope of a fair estimate. It is not possible to determine with reasonable degree of accuracy that so much of the claim would be made in future and that so much of the same would have to be honoured. Hence, the Assessing Officer held that the above provision made is not ascertainable with reasonable degree of accuracy and is of a contingent nature, which was disallowed.

6. In so far as the amount deductible u/s 80HHE is concerned, the assessee was asked to furnish complete details of expenditure in foreign currency (unit-wise), vide letter dated November 29, 2000. The assessee, vide letter dated March 5, 2001, has stated that the total expenditure pertaining to section 80HHE is Rs. 31,93,41,102 consisting of travel expenses, professional charges and other expenses but did not furnish further break-up of expenditure. Therefore, the entire amount was treated as expenses incurred for providing technical services outside India and, hence, reduced from the export turnover and the total turnover. Thus, he proceeded to frame the assessment order.

7. Aggrieved by the said order, the assessee preferred an appeal to the Commissioner of income tax (Appeals). Though the appeal was partly allowed, the appellate authority confirmed the findings on the aforesaid issues.

8. Therefore, aggrieved by the said order of the appellate authority, the assessee preferred an appeal to the Tribunal. The Tribunal on re-appreciation of the entire evidence on record and taking note of the various judgments relied upon by the

parties held that the charges paid to NSDL having not brought into existence any capital asset and is for the purpose of efficient functioning of the business, it was held as business revenue expenses and allowable as such u/s 37(1) of the Act. After referring to the several judgments including the judgment of a Division Bench of this court, the Tribunal held that the installation of traffic signals at their cost was prompted solely with a view to benefit its employees who were getting repeatedly involved in traffic jams and other hazards, as such they were a distressed lot and, therefore, the said expenditure incurred is laid out wholly and exclusively for the purposes of business and, therefore, allowable as deduction u/s 37(1) of the Act. Similarly, the Tribunal held that section 10A is an exemption section whereas section 80G is a deduction section and, therefore, there would be no double deduction of the same item, even if a benefit under both the sections have been claimed. There has been no double deduction in respect of the same item of expenditure. Therefore, the donation of Rs. 15 lakhs qualifies for deduction u/s 80G and, accordingly, it was allowed. The Tribunal held that the provision made for the warranty liability was an ascertained liability and that it could not be treated as a contingent liability. Since the liability is an accrued liability and the estimate is on sound accounting principle, the liability is allowable. The disallowance of Rs. 46,77,452 was deleted. In so far as the benefit u/s 80HHE is concerned, the Tribunal held that, as the appellate authority has merely followed the order of his predecessor while disallowing the claim which has not been approved by the Tribunal, they directed the assessing authority to follow the order of the Tribunal dated March 31, 2005, while computing the deduction u/s 80HHE.

9. Aggrieved by this order of the Tribunal, the Revenue is in appeal.

10. This appeal was admitted to consider the following substantial questions of law:

(1) Whether the payment of Rs. 44.43 lakhs by the assessee to the National Security Depository Ltd. as one-time custody charges for 80,08,600 shares constitutes a capital expenditure or a revenue expenditure?

(2) Whether the expenditure of Rs. 7,37,720 incurred by the assessee in installing traffic signals at the Bannerghata circle in Bangalore which is included under donations constitutes business expenditure u/s 37(1) of the Act?

(3) Whether claiming a deduction u/s 80G from the gross total income (which does not include section 10A unit's income) amounts to claiming double deduction for a single outgo?

(4) Whether the assessee is entitled to 2 per cent of sale price towards warranty charges and, consequently entitled to claim deductions?

(5) Whether the assessee is entitled to the benefit of deduction u/s 80HHE in a sum of Rs. 31,93,41,102 which is treated as expenditure incurred for providing technical services outside India?

First substantial question of law

11. The Depositories Act, 1996, was enacted by Parliament to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto. In line with developments in the securities industry worldwide and in the wake of the increasing trading volume on the local bourses, there emerged the need to replace the existing settlement and clearing system with "depository system" or a scripless trading system. India has the largest number of listed companies in the world today. It also boasts of a very large investor population and substantial volumes of trade. The present system of settlement based on physical delivery of paper certificates was probably adequate in the past when there was just a handful of investors participating in the transactions of the capital market. The old trading system was plagued by various problems such as, unwarranted delay in transfer of shares, duplicate/fake/forged shares, bad deliveries, court injunction cases, loss in transit/theft/mutilation, disputes on corporate actions, huge transaction cost, longer settlement cycles, poor infrastructure, large paper volumes. All these factors served as barriers to the entry of an investor into the market. This failure gave the idea of setting up of an electronic system with scripless trading and quick settlement cycles. National Securities Depository Ltd. (NSDL) was inaugurated as the first depository in India on November 8, 1996. Holding and handling of securities in electronic form eliminates problems that are normally associated with physical certificates, like mutilation due to careless handling, loss in transit, problems of bad delivery, etc., Today there exists 24 stock exchanges in India, but trading in dematerialized securities occur only at the National Stock Exchange (NSE), the Bombay Stock Exchange (BSE), the Calcutta Stock Exchange (CSE), the Delhi Stock Exchange (DSE).

12. The term "depository" has been defined under the Act. The term "depository" means a place where something is deposited for safekeeping; a bank in which funds or securities are deposited by others, usually under the terms of a specific depository agreement. Though the terms "depository" and "depository in banking" are not synonymous they have come to be used interchangeably in banking. "Depository" means one who receives a deposit of money, securities, instruments, or other property; a person to whom something is entrusted; a trustee, a person or group entrusted with the preservation or safekeeping of something. A depository cannot act as a depository unless it obtains a certificate of commencement of business from the Board (SEBI). All the securities held by a depository shall be dematerialized and shall be in a fungible form. A depository is not a mere custodian of securities but it can be compared to a bank. If an investor wants to utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank. Registration of the depository is required under the SEBI (Depositories and Participants) Regulations, 1996, and is a precondition to the functioning of the depository. Depository and depository participant both are regulated by the

Securities and Exchange Board of India.

13. Clause 2.1.5 of the SEBI (Disclosure and Investor Protection) Guidelines, 2000, reads as under:

2.1.5 Issue of securities in dematerialised form

2.1.5.1 No company shall make public or rights issue or an offer for sale of securities, unless:

(a) the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the public or existing shareholders; and

(b) the company gives an option to subscribers/shareholders/investors to receive the security certificates or hold securities in dematerialized form with a depository.

14. Therefore, after coming into force of the Act, an obligation is cast on each company to enter into an agreement with a depository for dematerialisation of security already issued or proposed to be issued. Therefore, the assessee herein by virtue of the said obligation imposed under law approached the NSDL, vide the letter dated July 21, 1997. In reply to the said letter, the NSDL by their letter dated July 22, 1997, informed them that the total one-time custody charges on 80,80,600 shares work to Rs. 44.43 lakhs and on payment of the said amount they would inform all the depository participants about the arrangement by way of circular on receipt of the first installment. It is, thereafter, the assessee paid Rs. 44.43 lakhs for dematerialisation of securities already issued. It was a one-time payment and, therefore, as the said expenditure was laid out or expended wholly or exclusively for the purpose of its business the said amount was claimed as expenditure u/s 37(1) of the Act. The same was disallowed on the ground that it is the shareholders who were expected to deposit their shares with the depositories and it is they who have to pay custody charges. If the assessee has taken over the liability of the shareholders as a goodwill measure and has paid the said amount as one-time custody charges, the said expenditure income is not allowable u/s 37(1) of the Act. It was also contended that the said payment has an enduring effect and, therefore, it is capital in nature. In support of that contention, the learned senior counsel for the Revenue relies on a judgment of the apex court in the case of Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal, wherein it is held as under (page 45):

This synthesis attempted by the Full Bench of the Lahore High Court truly enunciates the principles which emerge from the authorities. In cases where the expenditure is made for the initial outlay or for extension of a business or a substantial replacement of the equipment, there is no doubt that it is capital expenditure. A capital asset of the business is either acquired or extended or substantially replaced and that outlay whatever be its source whether it is drawn from the capital or the income of the concern is certainly in the nature of capital

expenditure. The question, however, arises for consideration where expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment. Such expenditure can be looked at either from the point of view of what is acquired or from the point of view of what is the source from which the expenditure is incurred. If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If, on the other hand, it is made not for the purpose of bringing into existence any such asset advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. If it was part of the fixed capital of the business it would be of the nature of capital expenditure and if it was part of its circulating capital it would be of the nature of revenue expenditure. These tests are thus mutually exclusive and have to be applied to the facts of each particular case in the manner above indicated. It has been rightly observed that in the great diversity of human affairs and the complicated nature of business operations it is difficult to lay down a test which would apply to all situations. One has, therefore, got to apply these criteria, one after the other from the business point of view and come to the conclusion whether on a fair appreciation of the whole situation the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure in which latter event only it would be a deductible allowance u/s 10(2)(xv) of the income tax Act. The question has all along been considered to be a question of fact to be determined by the income tax authorities on an application of the broad principles laid down above and the courts of law would not ordinarily interfere with such findings of fact if they have been arrived at on a proper application of those principles.

15. The apex court in the case of *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, has held as under:

There may be cases where expenditure, even if incurred for obtaining 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 principle 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. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case. But even if this test were applied in the present case, it does not yield a conclusion in favour of the Revenue. Here, by purchase of loom hours no new asset has been created. There is no addition to or expansion of the profit-making apparatus of the assessee. The income earning machine remains what it was prior to the purchase of loom hours. The assessee is merely enabled to operate the profit making structure for a longer number of hours and this advantage is clearly not of an enduring nature. It is limited in its duration to six months and, moreover, the additional working hours per week transferred to the assessee have to be utilised during the week and cannot be carried forward to the next week. It is, therefore, not possible to say that any advantage of enduring benefit in the capital field was acquired by the assessee in purchasing loom hours and the test of enduring benefit cannot help the Revenue.

16. From the aforesaid two judgments of the apex court, it is clear that if the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand, it is made not for the purpose of bringing into existence any such asset advantage but for running the business or working it with a view to produce the profits it is a revenue advantage. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. There may be cases where expenditure, even if incurred for obtaining 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 principle 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. If the advantage consists merely facilitating the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a

certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case.

17. In the background of this law, when we look at the facts of this case, the assessee has paid the said amount of Rs. 44.43 lakhs as one-time custody charges for 80,08,600 shares to the National Security Depository Ltd. Without such payment, after the Act came into force, the assessee shall not make public or rights issue or other for sale of securities. Therefore, in law, an obligation was cast on the assessee entering into an agreement with the depository for dematerialization of securities already issued or proposed to be issued to the public or the existing shareholders. The advantage which enures to the assessee on account of this depository system is, lot of paper work, manual handling and postage, affixation of stamps would be saved. Transfers are affected through the mechanism provided by the depository system. The expenditure has helped in reducing the cost of handling physical share certificates. The dematerialization has obviated the need for the board of directors to meet and approve the share transfers. It has reduced the risk associated with the physical share certificate, i.e., forgery and loss of certificates. The process of getting the shares in demat form has benefited the company in getting the periodic information, for example, FII holding, promoter holding, holding that trigger acquisition of substantial holding for purpose of application takeover code of the SEBI, etc., at a much faster pace with less administrative hassles and with a lesser cost. The expenditure has been incurred in the normal course of business. Thus, the dematerialization has helped significantly in reducing the administrative costs. Even if certain benefits go to the shareholders, consequently, the assessee has gained goodwill. Therefore, this expenses incurred squarely falls within the phrase "laid out or expended wholly and exclusively for the purpose of business" and, therefore, it shall be deducted in computing the income chargeable under the head of "Profits and gains of business or profession". This is precisely what the Tribunal has held. Therefore, we do not find any infirmity in the said order passed by the Tribunal. Therefore, the said substantial question of law is answered in favour of the assessee and against the Revenue.

Second substantial question of law

18. As is clear from the assessment order, the assessee installed traffic signals at the Bannerghata circle at the cost of Rs. 7,37,720. However, in their balance-sheet it was included under the heading of donations of Rs. 52,34,364 added back to the Keonics unit, the income from which is exempted u/s 10A. It is the case of the assessee that about 500 employees are working at their office at the Bannerghata circle. Due to severe traffic congestion, its employees had to wait for longer time to reach the office, resulting in delay in completing the projects. Hence, the traffic signals have been installed to ensure that the employees of the Bannerghata circle would reach the office in time.

19. The stand of the Revenue is that regulating the traffic is the lookout of the traffic police and the Government and not that of the assessee. If the traffic

signals were not there, in such a busy circle, the traffic police will be very much available to regulate the traffic. The benefit flowing from such installation is very remote. Therefore, it is in the nature of donation and, therefore, if at all they have to claim exemption, they have to claim u/s 80G and not as expenditure u/s 37(1) of the Act.

20. In somewhat a similar situation, in the case of Mysore Kirloskar Ltd. Vs. Commissioner of Income Tax, , the Division Bench of this court distinguishing between the exemption u/s 80G and u/s 37(1) held as under (page 842):

Section 37(1) of the Act:

Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

To be an allowance within section 37(1), barring the exceptions mentioned therein, "the money paid out or away must be paid out wholly and exclusively for the purpose of the business". The assessee can claim the whole of it for deduction in computing the income chargeable under the head "Profits and gains of business or profession".

The basic requirements for invoking sections 37(1) and 80G are, therefore, quite different, but none the less, the two sections are not mutually exclusive. If the contribution by an assessee is in the form of donations of the category specified u/s 80G, but if it could also be termed as an expenditure of the category falling u/s 37(1), then the right of the assessee to claim the whole of it as allowance u/s 37(1) cannot be denied. But such money must be laid out or expended wholly and exclusively for the purpose of business". The word "wholly" refers to the quantum of expenditure and the word "exclusive" refers to the motive, object or purpose of the expenditure.

There is yet one more thing to be remembered while applying section 37(1). The expenditure claimed therein need not be "necessarily" spent by the assessee. It might be incurred "voluntarily" and without any "necessity", but it must be for promoting the business. In other words, if the expenditure has been incurred by the assessee voluntarily, even without necessity, but if it is for promoting the business, the deduction would be permissible u/s 37(1) of the Act. In *Sassoon J. David and Co. Pvt. Ltd., Bombay Vs. Commissioner of Income Tax, Bombay*, , the Supreme Court observed (at pages 275 and 276):

It is relevant to refer at this stage to the legislative history of section 37 of the income tax Act, 1961, which corresponds to section 10(2)(xv) of the Act. An attempt was made in the income tax Bill of 1961 to lay down the "necessity" of the expenditure as a condition for claiming deduction u/s 37. Section 37(1) in the Bill read "any expenditure . . . laid out or expended wholly, necessarily and

exclusively for the purposes of the business or profession shall be allowed...", The introduction of the word "necessarily" in the above section resulted in public protest. Consequently, when section 37 was finally enacted into law, the word "necessarily" came to be dropped. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction u/s 10(2)(xv) of the Act if it satisfied otherwise the tests laid down by law.

Again, the words "for the purpose of business" used in section 37(1) should not be limited to the meaning of "earning profit alone". Business expediency or commercial expediency may require providing facilities like school, hospital, etc., for the employees of their children or for the children of the ex-employees. The employees of today may become the ex-employees tomorrow. Any expenditure laid out or expended for their benefit if it satisfied the other requirements, must be allowed as deduction u/s 37(1) of the Act. It may also be stated, as observed by the Supreme Court in the aforesaid case, that the fact that somebody other than the assessee is also benefited or incidentally takes advantage of the provision made, should not come in the way of the expenditure being allowed as a deduction u/s 37(1) of the Act. But, nevertheless, it must be an "expenditure" allowable as deduction under the Act.

The question that, however, still remains is whether the donation claimed by the assessee for deduction can be said to be an "expenditure" as contemplated u/s 37(1) of the Act. "Expenditure" primarily denoted the ideal of "spending" or "paying out or away". It is something which is gone irretrievably, but should not be in respect of an unascertained liability of the future. It must be an actual liability in praesenti, as opposed to a contingent liability of the future. Some of these principles have been explained by the Supreme Court in *Indian Molasses Co. (Private) Ltd. Vs. Commissioner of Income Tax, West Bengal*, wherein it has been observed (at pages 75 and 76):

The income tax law does not allow as expense all the deductions a prudent trader would make in computing his profits. The money may be expended on grounds of commercial expediency but not of necessity. The test of necessity is whether the intention was to earn trading receipts or to avoid future recurring payment of a revenue character. Expenditure in this sense is equal to disbursement which, to use a homely phrase, means something which comes out of the trader's pocket. Thus, in finding out what profits there be, the normal accountancy practice may be to allow as expense any sum in respect of liabilities which have accrued over the accounting period and to deduct such sums from profits. But the income tax law does not take every such allowance as legitimate for purposes of tax. A distinction is made between an actual liability in praesenti and a liability de futuro which, for the time being, is only contingent. The former is deductible but not the latter.

21. Yet another Division Bench of this court in the case of *Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd.*, held as under (page

596):

So far as the finding of the income tax Appellate Tribunal that contribution of Rs. 6.93 lakhs made towards traffic regulation can be claimed as deduction is also not justified as it is well settled that in order to claim deduction u/s 37 of the Act, the expenditure should be wholly for the purpose of business of the assessee and it is well settled that it is the duty of the police to regulate the traffic and the amount spent towards regulation of traffic can at the most be considered as donation as rightly held by the Assessing Officer and cannot qualify as deduction u/s 37 of the Act. We are also supported by the decision of the Division Bench of this court in *The Commissioner of Income Tax and The Asst. Commissioner of Income Tax Vs. M.N. Swaminathan Since dead by his L.Rs. Neelavathi and L.Rs. (Neelavathi and Others)*, wherein it is held that contribution made to traffic police would not qualify for deduction u/s 37 of the Act. Therefore, the said question of law is answered against the assessee and in favour of the Revenue.

22. In the abovesaid judgment, reliance is placed on the Division Bench of this court in the case of *The Commissioner of Income Tax and The Asst. Commissioner of Income Tax Vs. M.N. Swaminathan Since dead by his L.Rs. Neelavathi and L.Rs. (Neelavathi and Others)*, , it was held as under (page 644 of 322 ITR):

If any payment is made towards the security, towards the business of the assessee, such amount is an allowable deduction, as the amount spent for the maintenance of peace and law and order in the business premises of the assessee as he was running two cinema theatres. But the amount spent in the instant case claimed by the assessee is towards payment made to the police and rowdies. If any payment is made to the police illegally, it amounts to bribe and such illegal gratification cannot be considered as an allowable deduction and similarly, if any amount is paid to a rowdy as a precautionary measure to see that he shall not cause any disturbance in the theatre run by the assessee, the same is also an amount paid illegally for which no deduction can be allowed by the Department. If the assessee had spent the money for the purpose of security, we would have to concur with the view of the Tribunal. However, in the instant case, the payment has been made to the police and rowdies to keep them away from the business premises which payment be held as illegal and such illegal payment cannot be an allowable deduction.

This is not a case where any payment is made to the police or rowdies to keep them away from the business premises, which payment is ex facie illegal and the illegal payment cannot be an allowable deduction u/s 37(1) of the Act. Secondly, the judgment of the Division Bench in the aforesaid *Mysore Kirloskar Ltd.*'s case, was not brought to the notice of the co-ordinate Bench which dealt with the case of the assessee. Moreover, in the said judgment, the question was, a sum of Rs. 6.93 lakhs was contributed towards traffic regulation. It was not an expenditure incurred by the assessee. It was not in the nature of donation made to the police towards traffic regulation. Therefore, in that context, it was held relying on the

judgment of Neelavathi's case, it does not qualify as deduction u/s 37 of the Act.

23. As is clear from the case of Mysore Kirloskar Ltd., the expenditure claimed need not be necessarily spent by the assessee. It might be incurred voluntarily and without any necessity but it must be for promoting the business. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction u/s 37(1) of the Act if it satisfies otherwise the tests laid down by law. Similarly, the words "for the purpose of business" used in section 37(1) of the Act, should not be limited to the meaning of earning profit alone. Business expediency or commercial expediency may require providing facilities like schools, hospitals, etc., for the employees or their children or for the children of the ex-employees. The employees of today may become the ex-employees tomorrow. Any expenditure laid out or expended for their benefit, if it satisfied the other requirements, must be allowed as deduction u/s 37(1) of the Act. Expenditure primarily denotes the idea of spending or paying out or away. It is something which is gone irretrievably but should not be in respect of an unascertained liability of the future. Expenditure in this sense is equal to disbursement which, to use a homely phrase means something which comes out of the traders pocket.

24. Therefore, in the instant case, admittedly the assessee is having their establishment at the Bannerghata circle. Nearly about 500 employees are working in the said unit. There was a severe traffic congestion. The employees had to wait for longer time to reach the office. It seriously affected the business of the assessee, resulting in delay in completing the project. In order to facilitate its employees to reach their establishment safely and early, the assessee has installed traffic signals at the Bannerghata circle. Though it is the responsibility of the State and in particular the Police Department either to install the traffic signal or control the traffic, the fact remains that in the absence of traffic signal or traffic police being positioned at circles, the traffic congestion is a regular phenomenon. It seriously affects the free movement of public and, in the instant case, the employees of the assessee. The assessee also has corporate social responsibility. In this background, in order to discharge their corporate social responsibility which also facilitates their business if the employees were to reach the place early, they thought of incurring the expenditure for installing the traffic signals at the Bannerghata circle. This expenditure is laid out or expended wholly and exclusively for the purpose of business. Therefore, the said expenditure incurred is allowable as deduction u/s 37(1) of the Act. That is precisely what the Tribunal has held. The said finding is in accordance with law and based of legal evidence. Therefore, no case for interference is made out. Hence, the said substantial question of law is answered in favour of the assessee and against the Revenue.

Third substantial question of law

25. The donation of Rs. 15 lakhs is paid out of the Keonics unit, the profit of which is exempted u/s 10A of the Act. While computing the profit of the Keonics

unit, donation paid is added back, as the same is not allowed to be deducted while computing the profit u/s 10A of the Act. Thus, the disallowance in computing the income of the Keonics unit is as per the statutory provisions of the Act, the donation being not considered as expenditure incurred wholly and exclusively for the purpose of business. Therefore, it cannot be said that the donation paid has been allowed as deduction under the Act. The reason being the entire income incurred from the Keonics unit was exempted from payment of tax u/s 10A of the Act. There is no stipulation u/s 80G to the extent that donation is to be paid only out of taxable income of the year. Section 10A is an exemption section whereas section 80G is a deduction section and, therefore, there would be no double deduction in respect of the same item, even if a benefit under both the sections has been claimed. Section 80G(1) provides that in computing the total income of the assessee, an amount equal to whole of the sum or, as the case may be, 50 per cent of the amount paid by way of donation is to be allowed as deduction. As per sub-section (5A) of section 80G where deduction under this section is claimed and allowed for any assessment year in respect of any sum specified in sub-section (2) the sum in respect of which deduction is so allowed shall not qualify for deduction under any other provision for the same or any other assessment year.

26. It is not in dispute that the assessee is entitled to the benefit of deduction u/s 80G. He has not claimed the benefit twice. As the entire income from the Keonics unit is exempted from payment of tax, the debiting of donation in the first instance and adding it back subsequently makes no difference. The entire income was exempted. Therefore, the deduction u/s 80G is claimed from the total income excluding the income of the Keonics unit and in law, the assessee is entitled to the said benefit. The disallowance by the lower authority on the ground of double benefit, on the face of it is incorrect and the Tribunal rightly interfered with the said order and allowed the said deduction. The said order is legal and valid and do not call for any interference. Therefore, the said substantial question of law is answered in favour of the assessee and against the Revenue.

Fourth substantial question of law

27. The Tribunal after referring to the various judgments held that the provision for warranty cannot be treated as contingent liability since the liability is an accrued liability and the estimate is on sound accounting principle, disallowance of Rs. 46,77,452 was held to be incorrect and it was deleted. As the law stands today, as declared by the apex court in the case of Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, , if a provision for warranty is made on the basis of a sound accounting principle, on scientific basis, the said amount is allowable as deduction.

28. In the instant case, when particulars are sought for by the assessing authority to state what is the amount actually debited in provision account for the assessment years 1997-98 and 1998-99 towards post-sales customer

support, the assessee stated that such expenditure gets accounted under the normal head and there is no specific debit to the warranty provision in any year. In the subsequent year, the provision is written back on the first day of the accounting year and the actual expenses incurred towards post-sales customer support are debited to respective heads. The assessee states that it is not possible to give the details called for. This aspect has been completely missed by the Tribunal. It proceeds on the assumption that figures given for warranty is based on sound accounting principle. In fact, in the aforesaid judgment of the apex court before the assessee could be granted the benefit, he has to establish: (a) an enterprise has a present obligation as a result of a past event, (b) it is probable that an outflow of resources will be required to settle the obligation, and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized. For determining an appropriate historical trend, it is important that the company has a proper accounting system for capturing the relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently. Thus, the decision on the warranty provision should be based on a past experience of the company. A detailed assessment of the warranty provisioning policy is required particularly if the experience suggests that warranty provisions are generally reversed if they remained unutilized at the end of the period prescribed in the warranty. Therefore, the company should scrutinize the historical trend of warranty provisions made and the actual expenses incurred against it. On this basis a sensible estimate should be made. The warranty provisions for the products should be based on the estimate at year end of future warranty expenses. Such estimates needs reassessment every year. As one reaches close to the end of the warranty period, the probability that the warranty expenses will be incurred is considerably reduced and that should be reflected in the estimation amount.

29. This exercise has not been done. In fact, the assessee has not maintained a separate account. He is not able to state what is the total amount spent towards the post-sales expenses. In that view of the matter, the finding recorded by the Tribunal cannot be sustained. The proper course would be to set aside the said finding and remand the matter back to the assessing authority, giving an opportunity to the assessee to give the information sought for by the Department keeping in mind the law laid down by the apex court. On such information being given, the assessing authority shall pass appropriate orders on the basis of such information to be furnished by the assessee.

30. In so far as the fifth substantial question of law is concerned, i.e., the deduction u/s 80HHE in a sum of Rs. 31,93,41,102, the Tribunal granted relief to the assessee in view of its earlier order dated March 31, 2005. It is not in dispute that the said order dated March 31, 2005, passed by the Tribunal has been set aside on the said issue and the matter is again remanded back to the assessing authority for fresh assessment in accordance with law. Following the said judgment in I.T.A. No. 2972 of 2005 Commissioner of Income Tax and Another

Vs. Infosys Technologies Ltd., , we set aside the said finding recorded by the Tribunal and remand the matter back to the assessing authority for fresh consideration and in accordance with law.

31. In the light of the aforesaid discussion, we pass the following order:

(i) The appeal is allowed in part.

(ii) On the question of provision for warranty and deduction u/s 80HHE is concerned, the finding recorded by the Tribunal is set aside and the matter is remanded to the assessing authority for fresh consideration.

(iii) In all other respects the order of the Tribunal is affirmed.

The parties to bear their own costs.