**(2011) 11 KAR CK 0388**

**In the Karnataka High Court**

**Case No :** IT Appeal No. 3262 of 2005

Commissioner of Income Tax APPELLANT

Vs

Infosys Technologies Ltd. RESPONDENT

**Date of Decision :** 04-11-2011

**Acts Referred:**
Income Tax Act, 1961 — Section 10 A, 80 HHE

**Citation :** (2012) 18 TAXMAN 76

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

**Bench :** Division Bench

**Advocate :** E. Sanmathi Indrakumar, for the Appellant; Arvind Datar, for the Respondent

**Final Decision :** Partly Allowed

## Judgement

1. 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 ITA No. 140/Bang./2001 dated 5-7-2005 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 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 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 deduction u/s 80HHE of the Act and 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 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 appellate authority in ITA No. 14/SR-6/CIT(A)-1/2000-2001. The 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 appellate authority confirmed the order passed by the assessing officer The appellate authority held that the said software was effected from 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 ITA No. 140/Bang./2001 before the ITAT and the ITAT by order dated 5-7-2005 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 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 ITAT dated 5-7-2005, this appeal is filed by the revenue.

3. The appeal has been admitted on 10-7-2007 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 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 STP unit and thus the profit from such sale is eligible for deduction under Sec. 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 STP unit and corresponding expenditure set up the unit as well as work in progress cannot be

 

allowed as per Sec. 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 turn over for the purpose of computation of deduction under Sec. 80HHE of the Act?

(8) Whether the Tribunal committed an error in proceeding to grant relief in favour of the assessee by holding that Double Taxation Agreement between Canada and India was applicable and the royalty cannot form part of the turnover for the purpose of deduction under Sec. 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 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, correspondent value in rupees would come to Rs. 3,59,00,000/-. The said income was offered as long term capital gain while computing 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 31-3-2000 pertaining to 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, consideration received by the said sale of eagle software amounting to Rs. 3,59,00,000/- cannot be termed as long term capital gain. 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 Eagle software as long term capital gain 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 29-12-2000 held that impugned finding of the assessing officer that the assessee is not entitled to exemption as the sale was effected from STP from Keonics u/s 10A is erroneous and accepted the contention of the assessee that it forms part of the profits and gain of STP unit and assessee has opted for certain exemption u/s 10A of the Act in respect of profit 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 ITAT has confirmed the finding given by the first appellate authority and held that income by the sale of Eagle software is to be treated as trading receipt. However, as the product has been sold as STP unit, the software was the product of STP unit and profit iron 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 u/s 10A of the Act by treating the amount received as sale of 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 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, concurrent finding arrived at by the ITAT and the 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 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 software is by the assessee as STP unit and the material produced on record would show that sale has taken place after 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 gain and the concurrent finding arrived at by the assessing officer, appellate authority and the ITAT 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, appellate authority and ITAT. It. is clear from the reasoning given by the appellate authority and the ITAT that having regard to the material produced by the assessee, the fact that the said sale took place after the establishment of 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 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, Eagle software was sold by the assessee to M/s. Yantra Corporation which 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 STP unit i.e. during the assessment year 1997 98, four years after the establishment of STP unit and the fact that assessee was STP unit when a sale transaction took place is not in dispute. In view of the fact that the assessee that claimed the income by sale of Eagle software as long term capital gain, the question of seeking exemption u/s 10A of the Act while filing return did not arise. If the assessee is entitled to exemption u/s 10A of the Act as 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 assessee is not entitled to the benefit u/s 10A as it has been alternatively argued both before the assessing officer and the 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 sale of 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 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 expenditure incurred towards manufacture of the said software has been included in 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 man-hour 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 ITAT confirming the order passed by the appellate authority holding that the income received by the sale of Eagle software is to be treated as trade receipt and 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 ITA Nos. 2975/2005 and connected cases, disposed of on 21-10-2011 wherein the said question is answered against, the revenue and in favour of the assessee upholding the order of the ITAT that the

said expenditure is revenue in nature.

Reg: Substantial Questions of Law Nos. (2), (7) & (8):

11. So far as substantial questions of law Nos. (2), (7) & (8) are concerned, the same have already been answered by us in ITA Nos. 2972/2005 and connected cases, disposed of on 4-11-2011 wherein the said questions are answered in favour of the revenue and against the assessee. Accordingly, we pass the following:

ORDER

The appeal is partly allowed. The order passed by the ITAT in ITA No. 140/ Bang./2001 dated 5-7-2005 insofar 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 ITAT is confirmed in all other respects.

 