

(2014) 06 KAR CK 0232

In the Karnataka High Court

Case No : I.T. Appeal Nos. 192, 194 and 422 of 2008

Commissioner of Income Tax, Bangalore

APPELLANT

Vs

Infosys Technologies Ltd.

RESPONDENT

Date of Decision : 02-06-2014

Acts Referred:

Income Tax Act, 1961 — Section 10A, 10-A, 195, 201, 40(a)(i)

Citation : (2015) 229 TAXMAN 335

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

Bench : Division Bench

Advocate : K.V. Aravind, Advocates for the Appellant; T. Suryanarayana, Advocates for the Respondent

Judgement

N. Kumar, J.—These three appeals preferred by the revenue is against the same assessee for different years of assessment. ITA 422/2008 relates to the assessment year 2001-02. ITA 192/2008 relates to assessment year 2002-03 and ITA 194/2008 relates to assessment year 2003-04. The substantial questions of law raised by the revenue in ITA 422/2008 read as under:

"(1) Whether the Appellate Authorities were correct in holding that an amount of Rs. 10,39,88,322/- paid to M/s. AT & T and MCI Telecommunications towards down linking charges is an allowable deduction even when no TDS u/s. 195 of the Act has been made and provisions of Section 40(a)(i) of the Act has not been complied with?

(2) Whether the Appellate Authorities were correct in holding that a sum of Rs. 1,15,71,400/- paid to Gartner, USA, Rs. 1,11,196/- paid to Gartner, Australia and Rs. 3,67,032/- paid to Gartner, U.K. (in all 1,20,49,628/-) towards subscription service is an allowable deduction despite the assessee failing to deduct tax at source, u/s. 195 of the Act and contrary to Section 40(a)(i) of the Act?

(3) Whether the Appellate Authorities were correct in holding that expenditure due to exchange rate variation arising in foreign currency and exchange variation

(EEFC) of Rs. 32,61,803/- is not deductible either from export turnover or total turnover when computing deduction u/s. 80HHE of the Act?

(4) Whether the Appellate Authorities were correct in holding that expenditure towards travel expenses, professional charges, maintenance allowance and other expenses in foreign currency of Rs. 8,46,36,076/- is not deductible either from export turnover or total turnover when computing deduction u/s. 80HHE of the Act?

(5) Whether the Appellate Authorities were correct in holding that payments of Rs. 10,39,88,322/- paid to M/s. AT & T and MCI Telecommunications towards down linking charges cannot be excluded from export turnover as well as total turnover for the purpose of computation of deduction u/s. 10A of the Act?

(6) Whether the Appellate Authorities were correct in holding that when computing total turnover the business profits of the entire business of the assessee need not be taken but only that of 80HHE of the Act units should be taken for the purpose of computation of deduction u/s. 80HHE of the Act?

(7) Whether the Appellate Authorities were correct in holding that a sum of Rs. 1,83,20,669/- debited towards provision for post sales customers support service is an allowable deduction when the particulars of the same was not furnished nor method of arriving at it was not disclosed and consequently recorded a perverse finding as the same had not accrued?

(8) Whether the Appellate Authorities were correct in holding that a sum of Rs. 4,25,000/- paid towards club membership fee is an allowable business expenditure when the same is capital in nature?

(9) Whether the Appellate Authorities were correct in holding that a sum of Rs. 8,93,40,000/- received on sale of "Onscan International Notification System" to M/s. Onscan INC., California is a revenue expense not taking into consideration the agreement entered into between the parties which shows that it was a capital asset attracting short term capital gains?

(10) Whether the Appellate Authorities were correct in holding that a sum of Rs. 8,93,40,000/- had been claimed as an expenditure which had been already allowed during the earlier assessment years including A.Y. 2000-01 and consequently recorded a perverse finding?"

2. Some of these questions of law do arise for consideration for the two subsequent years also. Therefore, they are taken up for consideration together and by a common order these three appeals are disposed of.

Question No. 1:

2.1 Whether the appellate authorities were correct in holding that an amount of Rs. 10,39,88,322/- paid to M/s. AT & T and MCI Telecommunication towards down linking charges is an allowable deduction even when no TDS under Section 195 of the Act has been made and provisions of Section 40(a)(i) of the Income-

tax Act has not been complied with?

2.2 In a proceeding initiated against the assessee under Section 201 & (1A) in ITA 532 & 533/B/2002 & ITA 833-837/Bang/2003, the tribunal by an order dated 12.08.2005 held that the assessee was not in default for non-deduction of tax on account of the payment made for down linking charges. Such payment cannot be treated as royalty under Section 9(1)(vii) of the Income-tax Act.

2.3 Following the said judgment, when there was no liability to deduct the TDS in respect of the aforesaid transaction, the tribunal has rejected the case of the Revenue. It is submitted that against the order dated 12.08.2005, the revenue has preferred a Special Leave Petition to the Apex Court. However as on today when it has been held in the aforesaid proceedings, the assessee was not in default for non-deduction of tax as the said payment cannot be treated as a royalty, the authorities were not justified in disallowing the expenditure. Therefore, no fault to be found with the order passed by the tribunal.

2.4 As the said question arises for consideration in all the three appeals, we do not find any justification to interfere with the said order passed by the tribunal and in fact, no substantial question of law do arise for consideration.

Question No. 2:

2.5 Whether the appellate authorities were correct in holding that a sum of Rs. 1,15,71,400/- paid to M/s. Gartner - USA, Rs. 1,11,196/- paid to M/s. Gartner-Australia and Rs. 3,67,032/- paid to M/s. Gartner - U.K. (in all Rs. 1,20,49,628/-) towards subscription charges is an allowable deduction despite the assessee failing to deduct the tax at source under Section 195 of the Act and contrary to Section 40(a)(i) of the Act?

2.6 In all the three appeals, relying on the judgment of the tribunal in ITA 145-148/Bang/04, the tribunal held that the assessee cannot be treated as in default for making the payment to that company and therefore, the contention of the revenue was rejected dismissing the appeals.

2.7 The order of the tribunal in ITA 145-148/Bang/04 was the subject matter of an appeal before this Court in ITA. No. 613-616/06, The Commissioner of Income Tax, International Taxation, Rasthathana Building, Nrupatunga Road, Bangalore and The Income Tax Officer (Intl. Taxation) Ward 19(2), Rasthathana Building, Nrupatunga Road, Bangalore Vs. M/s Infosys Technologies Ltd Plot No. 44 and 97A, 3rd Cross, Electric City Hosur Road, Bangalore-561229, relating to the very same assessee and the very same clients M/s. Gartner. This Court answering the said question of law held as under:

"In IT Appeal Nos. 2804, 2805 and 2807 of 2005 and connected cases, wherein identical contentions had been raised, this Court by separate order passed today, has reversed the decision of the Tribunal in Wipro's case in IT Appeal Nos. 150 to 154 of 2004 dated 30th December, 2004. Therefore, following the reasons assigned in ITA Nos. 2804, 2805 and 2807 of 2005, disposed of by us by a

separate order today, we hold that the order of the Tribunal dated 11th November, 2005 impugned in these appeals, where the Tribunal has relied upon its earlier decision in Wipro Ltd.'s case (supra) in arriving at the conclusion that the payment made by the respondent - assessee to M/s. Gartner, a non-resident company would not amount to royalty, cannot be sustained and the same is liable to be set aside. We answer the substantial question of law framed in all these appeals as to whether the Tribunal was justified in holding that the payment made by the respondent to M/s. Gartner, a non-resident company did not amount to royalty, in the negative in favour of the Revenue and against the assessee and accordingly, pass the following order:

All the appeals are allowed. The order passed by the Tribunal, Bangalore Bench "B", in ITA Nos. 145 to 148/Bang/2004, dated 11 November, 2005 is set aside and the order passed by the appellate authority confirming the order passed by the AO is restored."

2.8 From the aforesaid order, it is clear this Court has set-aside the order passed by the tribunal in ITA 145-148/Bang/04 and held the assessee is liable to deduct tax. Therefore, the findings recorded by the tribunal in all these three appeals relying on the tribunals earlier decision in ITA Nos. 145-148/2004 requires to be set-aside. Accordingly, it is set-aside. However, it is submitted that the assessee has preferred a Special Leave Petition against those orders. Therefore, the assessing authority may pass a consequential order, taking note of the judgment of the Apex Court to be rendered. That would meet the ends of justice. The said substantial question of law is answered in favour of the revenue and against the assessee.

Question No. 3:

2.9 Whether the appellate authorities were correct in holding that the expenditure due to exchange rate variation arising in foreign currency and exchange variation EEFC of Rs. 32,61,803/- is not deductible either from export turnover or total turnover without computing deduction under Section 80HHE of the Act?

2.10 The said question arose for consideration before this Court in the assessee's case reported in 2012 Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd. (No. 4), where it has been held as under:

"We have heard the learned counsel appearing for the parties and scrutinized the material on record. Both the first appellate authority and the Appellate Tribunal have answered the above said substantial question of law in favour of the assessee and against the Revenue. The said concurrent finding arrived at by the authorities is justified as the fluctuation in the valuation of currency which has to be converted to foreign currency has direct nexus to the export of software and can never be included as income from other sources. Wherefore, the said finding does not suffer from any error or illegality as to call for interference in this appeal Accordingly, we answer the fourth substantial question of law also against

the Revenue and in favour of the assessee. Accordingly, we hold that the appeal is devoid of merits".

2.11 As the said issue is already covered by a Judgment of this Court, we do not find any justification to interfere with the order passed by the tribunal.

Question No. 4:

2.12 Whether the appellate authorities were correct in holding that expenditure towards travel expenses, professional charges, maintenance allowance and other expenses in foreign currency of Rs. 8,46,36,076/- is not deductible either from export turnover or total turnover when computing deduction under Section 80HHE of the Act?

2.13 In the assessee's case, this Court in ITA Nos. 2973 c/w 2972, 2974 & 3015/2005 decided on 13.02.2013 [CIT v. Infosys Technologies Ltd. [2013] 32 taxman.com 399/215 Taxman 46 (Kar. - Mag.)] held the Assessing Officer has to examine the material relevant for the period of assessment to be produced by the assessee and to record a finding as to the nature of the activity keeping in view the legal position discussed in the aforesaid judgment and answered the question related to exclusion of expenses strictly keeping in view the kind of amounts sought to be excluded in the case of export turnover being attributable to the export of computer software, in which event, the exclusion being only freight telecommunication charges or insurance attributable to the delivery of the computer software outside India and if it is the case of providing technical services outside India in connection with development of computer software, then the actual expenditure, if any, incurred in foreign exchange in providing technical services outside India should be excluded and therefore, the matter was remanded back to the assessing authority.

2.14 Therefore the order of the tribunal requires to be set-aside and the matter is to be remanded for an enquiry keeping in mind the observations made by this Court in the aforesaid Judgment. Ordered accordingly.

Question No. 5:

2.15 Whether the appellate authorities were correct in holding that payments of Rs. 10,39,88,322/- paid to M/s. AT & T and MCI Telecommunications towards down linking charges cannot be excluded from export turnover as well as total turnover for the purpose of computation of deduction u/s. 10A of the Act?

2.16 A perusal of the order passed by the assessing officer which is produced as Annexure G at page 61, at page 87 - Annexure 2 which deals with computation of deduction under Section 10A, the assessing officer has deducted a sum of Rs. 10,39,88,322/- towards M/s. AT & T and MCI Telecommunication expenses both from export turnover and total turnover and therefore, there is no merit in the said question of law as the assessee has already been granted the benefit.

Question No. 6:

2.17 Whether the appellate authorities were correct in holding that when computing total turnover the business profits of the entire business of the assessee need not be taken but only that of 80HHE of the Act units should be taken for the purpose of computation of deduction u/s. 80HHE of the Act?

2.18 This question arose for consideration before this Court in ITA 521/2007 decided on 19.12.2013 in the case of The Commissioner of Income-tax vs. Sasken Communication Technologies Limited where it has been held that the total turnover of the business referred to under Sub-section (3) of Section 80HHE cannot be construed as the total turnover of the business carried on by the assessee. The total turnover refers only to the business carried on under Section 80HHE viz., the business of software. Therefore, if the assessee is carrying on business of computer software and is exporting such computer software and is also supplying it to the domestic market, then the total turnover of the business includes the total turnover of export and the total turnover in the domestic market. But, merely because the assessee is owning two more units which fall under section 10A, which is also engaged in computer business and is in the export business neither the profit earned by 10A units nor the total turnover of the said 10A units is liable to be included in the total turnover. Therefore, in computing the profits of the said units, the turnover of 10A units could be added to find out the profit from export of computer software under section 80HHE and ... therefore, the said question was held against the revenue and in favour of the assessee.

2.19 Therefore, the order passed by the appellate tribunal granting the benefit to the assessee cannot be found fault with and accordingly, the said issue is also held in favour of the assessee and against the revenue.

Question No. 7:

2.20 Whether the appellate authorities were correct in holding that a sum of Rs. 1,83,20,669/- debited towards provision for post sales customers support service is an allowable deduction when the particulars of the same was not furnished nor method of arriving at it was not disclosed and consequently recorded a perverse finding as the same had not accrued?

2.21 This question arose for consideration in the assessee's case itself before this Court which is decided on 09.12.2011 and reported in Infosys Technologies Ltd. (supra) held as under:

"9. We have given careful consideration to the contention of the learned counsel appearing for the parties and scrutinized the material on record.

10. The material on record would clearly show that the order was passed by the Tribunal on 9.9.2005. Therefore the benefit of the decision of the Hon'ble Supreme Court in Rotork Controls India (P.) Ltd.'s case stated (supra) was not available to the Tribunal. In the said decision, the Hon'ble Supreme Court has laid down the conditions which are required to be satisfied for making claim in

respect of post-sale customer service and has laid down the principles pertaining to the same. In Rotork Controls India (P.) Ltd.'s case stated (supra) the Hon'ble Supreme Court has considered the principles laid down having regard to the facts of the said case and has stated that in each case all the conditions to be satisfied are to be considered.

11. On perusal of the order passed by the Tribunal we find that the above said factors which are required to be satisfied, have not been considered by the Tribunal and the Tribunal has only considered the past experience and the expenses incurred in the previous year, on the basis of which the claim was made. Under the circumstances, the Tribunal being the final authority on the question of fact, is required to consider the claim made by the assessee with reference to the decision in Rotork Controls India (P.) Ltd.'s case stated (supra).

12. Accordingly, we refrain from expressing any opinion on the merits of the case in view of the order of remand proposed to be passed by us. Accordingly, it is unnecessary to answer the substantial question of law and the matter is remitted to the Tribunal by setting aside the finding allowing the claim, confirming the order passed by the appellate authority allowing the claim of Rs. 2,19,18,587/- towards post sales customers support.

Appeal is disposed of accordingly in the light of the principles laid down in Rotork Controls India (P.) Ltd.'s case (supra) and the matter is remanded to the Tribunal to pass fresh orders in accordance with law on the said question. All the contentions on the said question are kept open to be urged before the tribunal".

2.22 In view of the aforesaid judgment, the findings recorded by the tribunal requires to be set-aside and the matter is to be remanded to the tribunal for fresh consideration in terms of the directions issued in the aforesaid case in the assessee's case itself.

Question No. 8:

2.23 Whether the Appellate Authorities were correct in holding that a sum of Rs. 4,25,000/- paid towards club membership fee is an allowable business expenditure when the same is capital in nature?

2.24 This question came up for consideration in the assessee's case itself which is reported in CIT v. Infosys Technologies Ltd. (No. 1) [2012] 349 ITR 582 : [2013] 213 Taxman 50 (Mag.)/30 taxmann.com 351 (Kar.) decided on 21.10.2011, wherein it is held as under:

"Re: Substantial question of law (1) in all the appeals:

The only reason assigned by the Assessing Officer to hold that expenditure incurred towards acquisition of membership of various clubs by the respondent-assessee is that the benefit conferred on the assessee is of enduring nature and therefore, it is a capital expenditure. Further, the appellate authority on consideration of the contention of the learned counsel appearing for the parties,

held that the expenditure incurred towards acquisition of membership of the club is revenue expenditure as the acquisition of membership of the club would only confer certain benefits which cannot be said to be so enduring as to amount to capital expenditure, it would only enable the assessee to avail benefits conferred by the club due to acquisition of membership. In the decision relied upon by the learned counsel appearing for the assessee in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, , the Hon''ble Supreme Court has held that the expenditure towards acquisition of club is not capital expenditure but is revenue expenditure. The Income-tax Appellate Tribunal has confirmed the order passed by the appellate authority. It is well-settled that factors to be borne in mind while considering the question as to whether expenditure is revenue or capital in nature have been laid down by the Hon''ble Supreme Court in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, , which read as under:

(i) It is not a universally true proposition that what may be a capital receipt in the hands of the payee must necessarily be capital expenditure in relation to the payer. The fact that a certain payment constitutes income or capital receipt in the hands of the recipient is not material in determining whether the payment is revenue or capital disbursement qua the payer.

(ii) There may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none, the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the 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.

(iii) What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. The question must be viewed in the larger context of business necessity or expediency.

In the decision relied upon by the learned counsel appearing for the assessee as referred to above, it has been specifically held that acquisition of membership of the club would be revenue expenditure and not capital expenditure and decision of this Court relied upon by the learned counsel appearing for the assessee in *Commissioner of Income Tax and Another Vs. Wipro Systems*, would also show that the amount spent towards the membership acquired by the assessee should

be treated as revenue expenditure. Therefore, the concurrent finding arrived at by the appellate authority and the Income-tax Appellate Tribunal that the expenditure incurred for acquisition of membership of the club is revenue expenditure, is justified and cannot at all said to be perverse or arbitrary so as to call for interference in this appeal. Accordingly, we answer the first substantial question of law in all the appeals against the Revenue and in favour of the assessee."

2.25 In view of the aforesaid judgment, the said substantial question of law is answered against the revenue and in favour of assessee.

Question No. 9:

2.26 Whether the Appellate Authorities were correct in holding that a sum of Rs. 8,93,40,000/- received on sale of "Onscan International Notification System" to M/s. Onscan INC., California is a revenue expense not taking into consideration the agreement entered into between the parties which shows that it was a capital asset attracting short term capital gains?

2.27 The question for consideration is whether the aforesaid consideration received by the assessee is to be treated as a capital gain or a business profit.

2.28 In the assessee's case reported in Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd. (No. 3), , this Court held, such considerations constitute business profit and not capital gain. That was a case where the revenue was contending that it was a business profit and not a capital gain.

2.29 In the instant case, the revenue was considering it as capital gain and not business profit. In view of the aforesaid judgment, the said consideration amount is to be treated as a business profit and rightly the Tribunal held that the assessee is entitled to deduction under Section 10A of the Act treating it as a business profit and therefore, the said issue is held in favour of the assessee and against the revenue.

3. It is submitted that the Question No. 10 would not arise for consideration and the same is not pressed.

4. The following substantial question of law arise for consideration in ITA Nos. 192 and 194 of 2008:

"Whether the Appellate Authorities were correct in holding that expenses in foreign currency should be allowed from export turn over for the benefit of computation for deduction under Section 10A of the Act?"

4.1 The Tribunal in answering this question, has followed its earlier decision in ITA No. 50/B/2001, 793-795, 742 & 732-734/Bang/98 dated 31.3.2000 for the assessment years 1993-94 to 1996-97 and affirmed the order of the CIT (Appeals). The resultant position is deduction of expenditure incurred in foreign currency by the appellant barring the telecommunications charges from export

turn over on the footing that the same relate to technical services rendered outside India, is held not to be in order. However, the deduction of telecommunications charges to the tune of Rs. 13,35,43,266/- from export turn over is held to be in order as the same is in accordance with the Explanation (2) (iv) to Section 10A of the Act. The argument of the revenue is, unless a clear finding is recorded regarding the export turn over arising out of export activity and technical services rendered and the nature of expenses, the Appellate Authorities were not justified in holding that the same cannot be excluded from export turn over.

5. Per contra, learned counsel appearing for the assessee pointed out insofar as deduction under Section 80HHE of the Act is concerned, it relates to both export activity as well as providing technical services outside India and therefore, only in those cases a computation is to be made under each head "the amount of expenditure incurred". The said principal is not an obligation to claim under Section 10A of the Act as, it only deals with export of articles or things or computer software and has no application with the technical services rendered outside the country. Even in respect of export activity, either before the export activity takes place or after expiry activity before the sale is completed, technical services may be necessary. The expenditure incurred in that action cannot be excluded and therefore, he submits, as the claim is under Section 10-A of the Act, the Tribunal was justified in passing the impugned order granting the benefit.

6. Both the Appellate Authorities have not applied their mind to the difference that exist between Section 80HHE and Section 10A of the Act. They have followed the judgment rendered in connection with Sections 80HHE and 80HHC. Therefore, the impugned finding cannot be sustained. It is necessary for the authorities to determine on the basis of the material produced by the assessee as to whether the technical services rendered is post-sales services or pre-sales services and then decide in the light of two statutory provisions and the various decisions on the point whether assessee is entitled to exclusion of the expenditure incurred towards technical services. Therefore, as none other authorities have applied their mind in this regard, it is appropriate to set aside the judgment and remand the matter back to the assessing authority to make the aforesaid computation. The Assessing Authority also shall decide whether the said amount has to be deducted when it is deducted from export turnover whether it has to be deducted from total turn over also in the light of various decisions. The appeals are disposed of. Ordered accordingly.