

FORM NO.(J2)

IN THE HIGH COURT AT CALCUTTA
SPECIAL JURISDICTION (INCOME TAX)
ORIGINAL SIDE

Present:

Hon'ble Justice Girish Chandra Gupta

And

Hon'ble Justice Indrajit Chatterjee

ITA No. 278 OF 2007

INDIAN ALUMINIUM COMPANY LIMITED

Versus

COMMISSIONER OF INCOME TAX- III, KOLKATA

Advocate for the Appellant

Mr. J. P. Khaitan, Sr. Adv.

Mr. Avra Mazumder, Adv.

Advocate for the Respondent

Mr. P. K. Bhowmik, Adv.

Hearing concluded on: February 16, 2016

Judgment delivered on: 18th March 2016

GIRISH CHANDRA GUPTA J. The assessee has come up in appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') against the order of the Income Tax Appellate Tribunal, 'E' - Bench, Kolkata dated 15th December, 2006 in ITA No.443/Kol/2003 for the assessment year 1997-98.

By the order dated 1st August, 2007 a Division Bench of this Court admitted this appeal on the following substantial questions of law:-

(I) Whether on the facts and in the circumstances of the case the Tribunal erred in law in upholding the disallowance of agency commission paid for arrangement of loan, holding it to be capital expenditure?

(II) Whether on a true and proper interpretation of Explanation-8 to Section 43(1) of the Act interest paid on borrowed funds used for acquisition of capital assets by a running concern can be disallowed as deduction under Section 36(1)(iii) of the Act?

(III) Whether on the facts and in the circumstances of the case the Tribunal erred in law in confirming the disallowance of expenditure incurred for software development as capital expenditure?

Mr. J.P. Khaitan, learned Senior Advocate appearing for the assessee, submitted that the question numbers (I) and (II) are covered by the judgments of the Supreme Court in the case of CIT -Vs.- Associated Fiber and Rubber Industries reported in (1999) 226 ITR 471. He added that the proviso to Section 36(1)(iii) was introduced with effect from 1st April, 2004 whereas we are concerned in this case with the assessment year 1997-98. He submitted that this proviso can have no application. In any case, he added that the Supreme Court in the case of Deputy Commissioner of Income Tax -Vs- Core Health Care Ltd. reported in (2008) 298 ITR 194, has held that the proviso has only prospective effect. Therefore, according to Mr. Khaitan, the question nos.(I) and (II) have to be answered in favour of the assessee.

Mr. Bhowmik submitted that this Court had held that the proviso to Section 36(1)(iii) was retrospective in nature. He, however, did not dispute that the said judgment of this Court has been reversed by the Apex Court in M/s. JCT Ltd. Vs. Deputy Commissioner of Income Tax & Anr. reported in (2005) 276 ITR 115.

In that view of the matter question no. (I) and (II) are no longer res integra and are covered in favor of the assessee. Therefore question number (I) is answered in the affirmative and question number (II) is answered in the negative.

Before coming to question no (III) we would like to briefly discuss the facts and circumstances of the case which are relevant for deciding this issue.

The assessee M/s. Indian Aluminium Co. Ltd. is engaged in the manufacture and production of aluminium and related products. During the relevant previous year the assessee incurred an expenditure of Rs.41,08,556/- on software development. **The assessee treated this expenditure as a deferred revenue expenditure in its books of accounts and amortized Rs.2,40,000/- by debiting the same to the Profit and Loss Account of the relevant previous year.** By the order dated 13th March, 2000, the assessing officer completed the scrutiny assessment under Section 143(3) for the assessment year 1997-98. By the aforesaid order the assessing officer inter alia disallowed the expenditure on account of software development by holding that it was a capital expenditure. To be precise the assessing officer held as follows:-

"In respect of (d) above, the assessee has also incurred expenditure on Rs..41,08,556/- on account of software development etc. In connection with mining practices and study on Viniculture on bio-degradable Wastes on experimental basis. It was submitted on behalf of the assessee that the said package helps them in planning the production and bauxite grade control in mines. This software covers geological data processing, mine field surveying, mine excavation planning and grade control. It is developed on windows NT and is run in a batch- mode, never on line. It is a planning tool in the hands of production department of mines. In short this application package helps in gauging proper control for effective mining since it gives statistics of bauxite deposits by way of lithography, surface plane and graphical representations and thus development expenditure for this software is purely revenue. After having considered the submission made on behalf of the assessee, it is found that the amount spent on software development was not for the purpose of facilitating the assessee's existing trading or manufacturing operations or enabling management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched. As can be seen from the submission made on behalf of the assessee, software development was in connection with mining practices and study on vericulture on bio-degradable wastes on experimental basis. This clearly implies that the related expenses on software development were incurred with a view to decide whether an asset or advantage of a permanent nature and not deductible. However depreciation thereon to the extent of Rs.5,13,570/- (being 12.5% on Rs.41,08,556/-) is allowed. Consequently the addition therefore of Rs.2,40,000/- being the amount amortised is deleted."

Aggrieved by the order of the assessing officer the assessee appealed before the Commissioner of Income Tax (Appeals) (hereinafter referred to as the 'CIT(A)'). The CIT(A) by an order dated 30th October, 2002 held in favour of the assessee and deleted the disallowance of the expenditure incurred on software development. To be precise the CIT(A) held as follows:-

"The ratio decidendi laid down in the aforesaid judgement has been reiterated by the Supreme Court In CIT -Vs- Associated Cement Companies Ltd. 172 ITR 257 and again in the case of Alembic Chemical Works Co. Ltd. -Vs.- CIT 177 ITR 377. The Jaipur Bench of ITAT in the case of Business Information Processing Services -Vs.- ACIT 67 TTJ 131 wherein the Tribunal following the ratio laid down by the Supreme Court in the aforesaid decisions held software development expenses as allowable revenue expenditure. It is observed by the ITAT in the same case that software used by the assessee is not or any enduring benefit as assessee has to change these software within a short span of time i.e. 4 months or 6 months and that at times it is of no use at all because it become outdated because of change of system and change of technology. The Tribunal further observed that the time is fast changing day by day, and the new systems are being developed and software is needed like raw material in manufacturing. The Tribunal, therefore held that the software expenses are of purely revenue nature and are allowable in full.

I have carefully considered the submissions of the Ld. Representatives and considered the facts of the case. The Assessing Officer has disallowed the claim of the assessee towards software development on the ground that the expenditure related to software development was incurred in connection with mining practices and study of vermiculture on bio-degradable wastes on experimental basis and it was held to be capital expenditure. On consideration of the facts it reveals that nowhere the assessee states that the software development expenditure was on experimental basis. Actually this package helps in planning the production and bauxite grade control in mines. This software covers geological data processing, mine field surveying, mine excavation planning and grade control. Therefore, it is a planning tool in the hands' of production department of mines. It helps the assessee in gauging proper control for effective mining since it gives statistics of bauxite deposits by way of lithography, surface plan and graphical representations etc. therefore, the advantage obtained by the assessee was in facilitating the assessee's trading operations or enabling the management and control of the assessee's business to be carried on more efficiently or more profitably. As such the decision of the Supreme Court reported in 124 ITR 1 in the case of Empire Jute Co. Ltd. -Vs.- CIT squarely applies in this case.

I, therefore, hold that the Assessing Officer was not correct in disallowing the claim towards software development expenditure. In view of this addition made by the Assessing Officer of an amount .of Rs.41,08,556/- is deleted. The Assessing Officer is also directed to withdraw depreciation allowed on this item. Further, the amortized amount of Rs.2,40,000/- is to be added to the income."

The revenue appealed against the order of the CIT(A) before the Tribunal. The Tribunal by an order dated 15th December, 2002 reversing the order of the CIT(A) held that the expenditure on software development was capital in nature and should be disallowed. To be precise the Tribunal held as follows:-

"At the time of hearing before us, it is submitted by the Ld. D.R. that during the year under consideration the assessee developed new software by incurring the huge expenditure of Rs.41,08,556/- in connection with the mining practices and study of bio-degradable waste on experimental basis. Since the software was developed for the purpose of assessee's business and it will be useful for a long period, thus it would be of enduring benefit to the assessee. Therefore, the A.O. rightly treated the same to be capital expenditure. In support of this contention, the ld. D.R. relied upon the following decisions-

- a) 259 ITR 30 (Raj) - CIT -Vs.- Arawali Constructions Co. P. Ltd.*
- b) ITAT order in assessee's own case for A.Y. 2002-03.*

The learned counsel for the assessee, on the other hand, stated, that the software normally has a very short life and they have to be upgraded periodically. Therefore, the expenditure incurred on the development of software is a revenue expenditure. He also stated that the mining of bauxite is done in the regular course of business for the manufacture of aluminium. Therefore, the expenditure is a revenue expenditure. In support of this contention, he has relied upon the following decisions-

- a) Empire Jute Co. Ltd. -vs.- CIT 124 ITR 1 (SC)*
- b) CIT -Vs.- K & CO. 181 CTR 378 (Del)*
- c) Sumitomo 'Corpn. India (p) Ltd. -vs.- ACIT [(2005) 1 507' 91 (Del)]*
- d) Business Information Processing Services -vs.- ACIT 73 ITD 304 (JP)*
- e) ITC Classic Finance Ltd. -vs. DCIT 112 Taxman 155 (Cal)*

We have carefully considered the rival submissions and perused the material placed before us. During the year under consideration, the assessee has incurred expenditure of Rs.41,08,556/- on account of software development in connection with mining practices and study on verniculture on bio-degradable wastes on experimental basis. The said package helps the assessee in planning the production and bauxite grade control in mines. This software covers geological data processing, mine field surveying, mine excavation, planning and grade control. It is a planning tool in the hands of production department of mines. We find that on the above facts the decision of Hon'ble Rajasthan High Court in the case of Arawali Constructions Co. Pvt. Ltd. (supra) relied upon by the Ld. D. R. would be squarely applicable. In the above case, the assessee, viz. Arawali Constructions Co. Pvt. Ltd. had acquired computer software which is used as technique for mining operation. The expenditure on acquisition of the software was claimed as a revenue expenditure by the assessee. The A.O. treated the same as capital expenditure. The CIT (A) and ITAT held the expenditure to be revenue expenditure. On reference Their Lordships of Hon'ble Rajasthan High Court answered the reference in

favour of the revenue and against the assessee with the following finding:-

"The facts on record are that the payment of Rs.1,38,360/- was not paid for consultancy fee to Hindustan Computers Ltd. in fact, the payment was made for out-right sale of computer software which is used as technique in mining operations. The finding of the Commissioner of Income Tax (Appeals) is that the acquisition of software cannot be treated to be an asset of enduring nature. If the programme is used in one mining to another mining operation why it should not be treated as a capital asset and expenditure on that is capital expenditure. Considering these facts and the decision of their Lordships and a later decision of the Bombay High Court, in our view, the acquisition technical know-how is capital expenditure, therefore, the Assessing Officer has rightly treated the expenditure on acquiring the computer software as expenditure of capital nature and rightly allowed depreciation as per rules.

In the result, we answer the reference in negative, i.e. in favour of the revenue and against the assessee. The reference so made stands disposed of accordingly.

The facts of the case and the facts of Arawali Constructions Co. Ltd. (supra) are identical and therefore, in our opinion, the above decision of the Hon'ble Rajasthan High Court would be squarely applicable.

The Learned Counsel for the assessee has also relied upon the decision of Hon'ble Delhi High Court in the case of K. & Co. (supra). However, we find that in the said case the assessee has incurred the expenditure on maintenance of computers and their upgradation including software. Thus the facts in that case were altogether different because the expenditure was on upgradation of computers including software. Moreover, in the above case, Their Lordships of Delhi High Court did not admit the revenue's appeal holding that no substantial question of law arises. Thus there is no decision on merit by Their Lordships of Delhi High Court. Therefore, the above decision would be of no help to the assessee.

The decisions of the ITAT, Delhi Bench in the case of Sumitomo Corpn. India P. Ltd. -Vs.- ACIT (supra) and Jaipur Bench in the case of Business Information Processing Services -Vs.- ACIT (supra) relied Upon by the assessee support the assessee's case. However, the ITAT Kolkata Bench in the assessee's own case for assessment year 2002-03 (supra) has upheld the disallowance made by the A.O. in this regard. Thus, there are contrary decisions of the ITAT on this point. Moreover, whether an expenditure on acquisition of software is a capital expenditure or a revenue expenditure would depend on the facts of each case. Considering the facts of the assessee's case we are of the opinion that the facts in the assessee's case are identical to the facts of Arawali Constructions Co. P. Ltd. (supra) before the Hon'ble Rajasthan High Court and therefore the said decision of Hon'ble Rajasthan High Court would be squarely applicable. Therefore, respectfully following the same we reverse the order of the CIT (A) on this point and restore that of the Assessing Officer."

Mr. Khaitan submitted that the software developed by the assessee is an application software. He referred to the judgment of the Delhi High Court

in the case of CIT Vs. Asahi Safety Glass Ltd. (Delhi) reported in (2012) 346 ITR 329, wherein a distinction was made between a software meant for use as an operating system and a software meant for an use as a software for application. Mr. Khaitan contended that since this was an application software as was contended before the assessing officer at page 51, this should have been allowed as a revenue expenditure.

Mr. Bhowmik submitted that this is an addition to the capital asset of the assessee and, therefore, is a capital expenditure. He relied on a judgment of the Rajasthan High Court in the case of CIT Vs. Arawali Constructions Co. (P.) Ltd. reported in (2003) 259 ITR 30 following a judgment of the Bombay High Court in the case of CIT Vs. Premier Automobiles Ltd. reported in (1994) 206 ITR 1.

Mr. Khaitan also drew our attention to a judgment in the case of CIT Vs. Southern Roadways Ltd. reported in (2008) 304 ITR 84 (Mad), wherein such expenditure was treated as a revenue expenditure. Identical view, according to him, was taken in CIT Vs. IBM India Ltd. reported in (2013) 357 ITR 88(Karn.)

Mr. Bhowmik submitted that in the case of CIT Vs. Southern Roadways Ltd., Madras High Court has accepted the proposition that the expenditure on account of software provides benefit of an enduring nature. He contended that in that view of the matter there is no scope to contend that the expenditure is revenue in nature.

Mr. Khaitan submitted that benefit of an enduring character should be viewed realistically, regard being had to the rapid changes in the area of computers. In support of his submission, he relied on the judgment in the case of Alembic Chemical Works Co. Ltd. V. CIT reported in (1989) 177 ITR 377 at page 390. He also relied on a judgment in the case of Empire Jute Co. Ltd. Vs. Commissioner of Income-tax reported in (1980) 124 ITR 1. He also drew our attention to the views expressed at page 11 stating that test of enduring benefit is not a certain or conclusive test.

We have heard the arguments advanced at the Bar and perused the record.

The assessee in the instant case is engaged in the manufacture and production of Aluminum and related products. Bauxite is an aluminum ore, which is obtained by the process of mining, from which pure aluminum is manufactured by various industrial processes. Therefore bauxite is a basic raw material for manufacturing aluminum. The software used by the assessee has the following characteristics:-

1. It is an application package developed on Windows NT.
2. It helps the assessee in planning the production and bauxite grade control in mines.
3. It covers geological data processing, mine field surveying, mine excavation planning, and grade control.
4. It is a planning tool in the hands of the production department of mines.
5. It helps in gauging proper control for effective mining since it gives statistics of Bauxite deposits by way of lithography, surface plane and graphic representation.

From the points noted above, it is clear that the software developed by the assessee is an application software and not an operational one.

The assessing officer had disallowed the claim of the assessee on the following grounds:-

1. The amount spent on software development was not for the purpose of facilitating the assessee's existing trading and manufacturing operations or enabling management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched.

2. Expenditure on software development was incurred with a view to obtain an asset or advantage of a permanent nature.

Before proceeding further we would like to clarify an important aspect which appears to have eluded the attention of all the authorities below with the exception of the CIT(A). The assessing officer in the assessment order u/s.143(3) of the Act erroneously came to the following conclusion:-

"...As can be seen from the submission made on behalf of the assessee, software development was in connection with mining practices and study on vericulture on bio-degradable wastes on experimental basis."

This was rightly pointed out by the CIT(A) in his order dated 30th October, 2002 wherein he held as follows:-

"...On consideration of the facts it reveals that nowhere the assessee states that the software development expenditure was on experimental basis."

In Asahi Safety Glass (supra) the assessee was engaged in the business of manufacturing safety glass used in automobiles. The assessee entered into an agreement with Arthur Anderson & Associates for installation of a software application for assistance in areas related to financial accounting, inventory and purchase. According to the said agreement the assessee was also required to enter into a back to back agreement with Oracle Software India Pvt. Ltd., since the software application supplied by Arthur Anderson & Associates worked on Oracle application. The assessee was thus required to pay apart from fee to Arthur Anderson & Associates qua its arrangement with it; license fee to Oracle. The question arose as to whether the aforesaid the aforesaid expenditure incurred by the assessee was in the nature of capital expenditure. The revenue in support of its stand took recourse to the test of enduring benefit. The Delhi High Court rejected the Revenue's contention and held as follows:-

"The revenue in support of its stand has taken recourse to the test of enduring benefit. It is in our view now somewhat trite to say that the test of enduring benefit is not a certain or a conclusive test which the Courts can apply almost by rote. What is required to be seen is the real intent and purpose of the expenditure and whether the expenditure results in creation of fixed capital for the assessee. It is important to bear in

mind that what is required to be seen is not whether the advantage obtained lasts forever but whether the expense incurred does away with a recurring expense(s) defrayed towards running a business as against an expense undertaken for the benefit of the business as a whole. In other words, the expenditure which is incurred, which enables the profit making structure to work more efficiently leaving the source of the profit making structure untouched, would in our view be an expense in the nature of revenue expenditure. Fine tuning business operations to enable the management to run its business effectively, efficiently and profitably; leaving the fixed assets untouched would be an expenditure in the nature of revenue expenditure even though the advantage may last for an indefinite period. Test of enduring benefit or advantage would thus collapse in such like cases. It would in our view be only truer in cases which deal with technology and software application, which do not in any manner supplant the source of income or add to the fixed capital of the assessee. [See *Alembic Chemical Works Co. Ltd. v. CIT*, (1989) 177 ITR 377; *CIT v. J.K. Synthetics*, (2009) 309 ITR 371 at page 412 and *CIT v. Indian Visit.com* (supra)].

9.1. This is the approach which the Supreme Court has applied even in cases where there is a once for all or a lump sum payment. What is to be seen in the facts of this case, as already noticed by us hereinabove, that the assessing officer as a matter of fact has returned a finding that the expenditure undertaken was for overhauling the accountancy of the assessee and to efficiently train the accounting staff of the assessee. The Tribunal, which is decidedly the final fact finding authority has after noticing the material on record observed that the expenditure was incurred under various sub-heads, which included licence fee, annual technical support fee, professional charges, data entry operator charges, training charges and travelling expenses. The final figure was a consolidation of expenses incurred under these sub-heads. The Tribunal, in our view, and rightly so, came to the conclusion that none of these resulted in either creation of a new asset or brought forth a new source of income for the assessee. The Tribunal classified the said expenses as being recurring in nature to upgrade and/or to run the system.

10. In the background of the aforementioned findings, it cannot be said that the expenses brought about in an enduring benefit to the assessee. The assessing officer was perhaps swayed by the fact that in the succeeding financial year, i.e., 1997-98 (assessment year 1998-99), the amount spent was large. First of all, the extent of the expenditure cannot be a decisive factor in determining its nature..

11. Software is nothing but another word for computer programmes, i.e., instructions, that make the hardware work. Software is broadly of two types, i.e., the systems software, which is also known as

the operating system which controls the working of the computer; while the other being applications such as word processing programmes, spread sheets and data base which perform the tasks for which people use computers. Besides these there are two other categories of software, these being network software and language software. The network software enables groups of computers to communicate with each other, while language software provides with tools required to write programmes. (See Microsoft Computer Dictionary, 5th Edition "Software" at page 489).

12. The aforesaid would show that what the assessee acquired through Arthur Anderson and Associates was an application software which, enabled it to execute tasks in the field of accounting, purchases and inventory maintenance. The fact that the application software would have to be updated from time-to-time based on the requirements of the assessee in the context of the advancement of its business and/or its diversification, if any; the changes brought about due to statutory amendments by law or by professional bodies like the Institute of Chartered Accountants of India, which are given the responsibility of conceiving and formulating the accounting standards from time-to-time, and perhaps also, by reason of the fact that expenses may have to be incurred on account of corruption of the software due to unintended or intended ingress into the system – ought not give a colour to the expenditure incurred as one expended on capital account. Given the fact that there are myriad factors which may call for expenses to be incurred in the field of software applications, it cannot be said that either the extent of the expense or the expense being incurred in close proximity, in the subsequent years, would be conclusively determinative of its nature. The assessing officer has, in our view, erred precisely for these very reasons."

The Tribunal in the instant case has held against the assessee by relying on the judgment in the case of Arawali Construction (supra). In that case the assessee company had acquired computer software and claimed the expenditure as revenue expenditure. During the course of assessment proceedings the assessing officer issued notice to the assessee to explain why the expenditure incurred on computer software should not be treated as capital nature. The assessee contended that the software was required for data analysis for purpose of mining activity and the expenditure incurred was debited to Profit and Loss Account. The assessee also made the following submission:-

"This is not an asset, as stated by you during the course of discussion, as the life of this is restricted to shorter period, for a particular time only this thing is required and again they have to get the programme when get another nature of work... whereas software is just a programme and it cannot be called a capital expenditure."

The assessing officer rejected the assessee's contention and held it to be a capital expenditure and allowed depreciation as per rules. In appeal both the CIT and Tribunal held in favor of the assessee and opined that the expenditure incurred on technical know-how is revenue expenditure. The Rajasthan High Court allowed the Revenue's appeal and held as follows:-

"We have seen the aforesaid explanation. The assessee claimed that as the expenditure was debited to the profit and loss account as revenue expenditure and it was a software programme and nothing but a consultancy fee being paid to Hindustan Computers Ltd. The Assessing Officer noticed that in the agreement, nowhere is it stated that the amount has been paid for consultancy fee and in fact it is an out-right purchase of a computer programme which relates to technical know-how. It is an asset of capital nature, therefore, treating it as an asset, he allowed depreciation admissible in the rules.

In appeal before the Commissioner of Income-tax (Appeals), the Commissioner of Income-tax (Appeals) has considered the decision of the Bombay High Court in the case of CIT v. Borosil Glass Works Ltd., [1986] 161 ITR 286 and a decision of the Delhi High Court in the case of Shriram Refrigeration Industries Ltd. v. CIT, [1981] 127 ITR 746, and, allowed the claim of the assessee looking to the nature of expenditure as revenue. In appeal before the Tribunal, the Tribunal has also gone by these decisions and further held that the provisions of section 35AB of the Income-tax Act, 1961, have no application.

In Shriram Refrigeration Industries Ltd. v. CIT, [1981] 127 ITR 746 (Delhi), there was a collaboration agreement, a licence was given to the assessee to manufacture and sell particular items, there was no transfer or parting with secret process and technical knowledge to the assessee, a lump sum payment was made in addition to royalty based on the sale price of the manufactured articles, it was treated as revenue expenditure. When the technical know-how has not been transferred in the case of the Delhi High Court that has no application as in the case of technical know-how, i.e., programme of technical know-how, has been transferred by way of feeding of the programme in computer to make use in the mining operation, therefore, the Delhi High Court has no application.

In CIT v. Borosil Glass Works Ltd., [1986] 161 HR 286, the Bombay High Court has treated acquisition of technical know-how as revenue expenditure. Mr. Mathur brought to our notice the latest decision on this issue whether technical know-how is a capital expenditure or a revenue expenditure. In the case of CIT v. Premier Automobiles Ltd., [1994] 206 ITR 1, wherein the Bombay High Court has taken the view that the technical know-how is a capital expenditure and expenses incurred on

technical know-how are entitled for depreciation under section 32 of the Income-tax Act, 1961.

In *CIT v. Elecon Engineering Co. Ltd.*, [1987] 166 ITR 66 (SC), their Lordships have considered the issue that in an agreement in collaboration if the assessee acquired drawings and patterns for the manufacture of worm reduction gear units and conveyor idlers they were treated as plant or machinery and held that depreciation is allowable in relation to drawings and patterns. The Department has preferred an appeal, the appeal has been dismissed by the Supreme Court. The facts on record are that the payment of Rs. 1,38,360 was not paid for consultancy fee to Hindustan Computers Ltd., in fact, the payment was made for outright sale of "computer software" which is used as technique in mining operations. The finding of the Commissioner of Income-tax (Appeals) is that the acquisition of software cannot be treated to be an asset of enduring nature. **If the programme is used in one mining to another mining operation why it should not be treated as a capital asset and expenditure on that is capital expenditure.** Considering these facts and the decision of their Lordships and a later decision of the Bombay High Court, in our view, **the acquisition of technical know-how is capital expenditure, therefore, the Assessing Officer has rightly treated the expenditure on acquiring the computer software as expenditure of capital nature and rightly allowed depreciation as per rules."**

The Revenue has also relied on the judgment in the case of *CIT v. Premier Automobiles* (supra) where inter alia the following issues arose for consideration:-

"2. Whether, on the facts and in the circumstances of the case, the assessee-company is entitled to depreciation on the price paid for acquisition of drawings, blue prints, specifications, process sheets and technical data from Henry Meadows Ltd. of England being 'plant' within the meaning of section 32 of the Income-tax Act, 1961, for each of the assessment years 1970-71, 1971-72 and 1972-73?

3. Whether, on the facts and in the circumstances of the case, the assessee-company is entitled to depreciation on the expenditure of ₹2,000 incurred by the assessee for the purchase of know-how from Messrs. Ricardo and Co. Engineering Ltd., U.K., while computing its income for the assessment year 1971-72?"

The Bombay High Court held as follows:-

"At the outset, it may be mentioned that it was agreed by counsel for the parties that the questions referred to us at the instance of the Revenue, that is, questions Nos. 2 and 3 above, are covered by the decisions of this court. So far as question No. 2 is concerned, it is covered by the decision of this court in the assessee's own case which is reported in *Premier Automobiles Ltd. v. CIT*, [1984] 150 ITR 28. The entire amount paid by the assessee for acquisition of drawings, blue prints, specifications, process sheets and technical data, etc., in

respect of which depreciation has been allowed by the Tribunal in this case to the assessee, has been held in the above case to be revenue expenditure and allowed as a deduction in the computation of the income of the assessee for the year in which the payment had been made. That being so, it is evident that the assessee cannot get any depreciation on the very same amount which had been allowed as a revenue expenditure. In view of the above decision and the cost of the drawings, blue prints, specifications, etc., itself, having been held to be revenue expenditure, the answer to question No. 2 is self-evident, that is, the assessee is not entitled to depreciation on the price paid by him on acquisition of drawings, blue prints, process sheets and technical data from Henry Meadows Ltd. of England for the assessment years 1970-71, 1971-72 and 1972-73. This question is, therefore, answered in the negative and in favour of the Revenue and against the assessee..

As regards question No. 3, which is referred to at the instance of the Revenue, it is agreed by counsel for the parties that in view of the decisions of the Supreme Court in Scientific Engineering House P. Ltd. v. CIT, [1986] 157 ITR 86 and CIT v. Elecon Engineering Co. Ltd., [1987] 166 ITR 66, this question has to be answered in the affirmative, that is, in favour of the assessee and against the Revenue. We answer this question accordingly."

The Rajasthan High Court in Arawali Construction (supra) has not considered the difference between application software and system software which has been duly emphasized by the Delhi High Court in Asahi Safety Glass (supra). In the instant case the software developed by the assessee is application software which allows it to efficiently carry out mining activity for the extraction of Bauxite. Application software is distinct from system software as it has to be constantly updated due to rapid advancements in technology and increasing complexity of the features.

The distinction between system software and application software was also considered by the Karnataka High Court in CIT v. IBM India Ltd (supra). The issue that arose for consideration was whether the Tribunal was correct in holding that the purchase of software amounting to Rs.33,14,298 should

be allowed as a revenue expenditure. The Karnataka High Court held as follows:-

"The Tribunal, on consideration of the material on record and the rival contentions held, when the expenditure is made not only once and for all but also with a view to bringing into existence an asset or an advantage for the enduring benefit, the same can be properly classified as capital expenditure. At the same time, even though the expenses are once and for all and may give an advantage for enduring benefit but is not with a view to bringing into existence any asset, the same cannot be always classified as capital expenditure. The test to be applied is, is it a part of the company's working expenses or is it expenditure laid out as a part of the process of profit earning. Is it on the capital layout or is it an expenditure necessary for acquisition of property or of rights of a permanent character, possession of which is condition on carrying on trade at all. The assessee in the course of its business acquired certain application software. The amount is paid for application of software and not system software. The application software enables the assessee to carry out his business operation efficiently and smoothly. However, such software itself does not work on stand alone basis. The same has to be fitted to a computer system to work. Such software enhances the efficiency of the operation. It is an aid in manufacturing process rather than the tool itself. Thus, for payment of such application software, though there is an enduring benefit, it does not result into acquisition of any capital asset. The same merely enhances the productivity or efficiency and, hence, to be treated as revenue expenditure. In fact, this court had an occasion to consider whether the software expenses is allowable as revenue expenses or not and held, when the life of a computer or software is less than two years and as such, the right to use it for a limited period, the fee paid for acquisition of the said right is allowable as revenue expenditure and these softwares if they are licensed for a particular period, for utilizing the same for the subsequent years fresh licence fee is to be paid. Therefore, when the software is fitted to a computer system to work, it enhances the efficiency of the operation. It is an aid in manufacturing process rather than the tool itself. Though certain application is an enduring benefit, it does not result into acquisition of any capital asset. It merely enhances the productivity or efficiency and, therefore, it has to be treated as revenue expenditure. In that view of the matter, the finding recorded by the Tribunal is in accordance with law and does not call for any interference. Accordingly, the second substantial question of law is answered in favour of the assessee and against the Revenue."

In the instant case the revenue has relied on the principle of enduring nature to contend that the expenditure incurred by the assessee was of Capital nature. However there are a plethora of judicial pronouncements which go to show that the test of enduring nature is not to be applied

mechanically without taking into account the facts and circumstances of each case. The question regarding the allowability of expenditure on acquisition of software package arose for consideration before the Madras High Court in CIT v. Southern Roadways (supra) wherein the Court held as follows:-

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

The Apex Court in Empire Jute Co. (supra) has cautioned the courts against the application of the test of enduring nature without considering the surrounding circumstances. The Apex Court held as follows:-

"The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all embracing formula which can provide a ready solution to the problem; no touchstone has been devised. Every case has to be decided on its own facts keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the courts may be referred to as they might help to arrive at a correct decision of the controversy between the parties. One celebrated test is that laid down by Lord Cave, L.C., in Atherton v. British Insulated and Halsby Cables Ltd. [10 TC 155 : 1926 AC 205 : 96 LJ KB 336 : 134 LT 289] where the learned Law Lord stated:

"When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

*This test, as the parenthetical clause shows, must yield where there are special circumstances leading to a contrary conclusion and, as pointed out by Lord Radcliffe in Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd. [(1965) 58 ITR 241 (PC) : 1964 AC 948] it would be misleading to suppose that in all cases, securing a benefit for the business would be prima facie capital expenditure "so long as the benefit is not so transitory as to have no endurance at all". **There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, 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.***

In Alembic Chemical Works (supra) the assessee company was engaged in the manufacture of antibiotics including penicillin. With a view to increasing the yield of penicillin, the assessee negotiated with M/s Meiji a reputed enterprise engaged in the manufacture of antibiotics in Japan, which agreed to supply to the assessee the requisite technical know-how so as to achieve substantially higher levels of production. The negotiations culminated in an agreement dated 9-10-1963, whereunder Meiji, in consideration of the "once for all" payment of 50,000 US dollars (then equivalent to Rs 2,39,625) agreed to supply to the assessee the "sub-cultures of the Meiji's most suitable penicillin producing strains", the technical information, know-how and written description of Meiji's process for fermentation of penicillin along with a flow sheet of the process on a pilot plant; the design and specifications of the main equipments in such pilot plant; arrange for the visits to and training at assessee's expense, of technical representatives of the assessee to Meiji's plant at Japan and to advise the assessee in the large scale manufacture of penicillin for a period limited to 2 years from the effective date of the agreement. The assessee claimed that Rs 2,39,625 paid under the agreement to "Meiji" was one laid out wholly and exclusively for the purpose of the business and claimed its deduction as a revenue expenditure. The Income Tax Officer, on the view that the expenditure was

for the acquisition of an asset or advantage of an enduring benefit, held it to be a capital outlay and declined the deduction. The Commissioner and the Tribunal held against the assessee. The High Court also dismissed the assessee's appeal. The Supreme Court while allowing the assessee's appeal held as follows:-

"It would, in our opinion, be unrealistic to ignore the rapid advances in researches in antibiotic medical microbiology and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in this fast changing area of medical science. The state of the art in some of these areas of high priority research is constantly updated so that the know-how cannot be said to be the element of the requisite degree of durability and non-ephemerality to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeonholing an outlay, such as this as capital. The circumstance that the agreement insofar as it placed limitations on the right of the assessee in dealing with the know-how and the conditions as to non-partibility, confidentiality and secrecy of the know-how incline towards the inference that the right pertained more to the use of the know-how than to its exclusive acquisition.

* * *

The improvisation in the process and technology in some areas of the enterprise was supplemental to the existing business and there was no material to hold that it amounted to a new or fresh venture. The further circumstance that the agreement pertained to a product already in the line of assessee's established business and not to a new product indicates that what was stipulated was an improvement in the operations of the existing business and its efficiency and profitability not removed from the area of the day to day business of the assessee's established enterprise.

It appears to us that the answer to the questions referred should be on the basis that the financial outlay under the agreement was for the better conduct and improvement of the existing business and should, therefore, be held to be a revenue expenditure. Reference may also be made to the observations of this Court in CIT v. CIBA of India Ltd. [AIR 1968 SC 1131 : (1968) 2 SCR 696, 705 : 69 ITR 692]

There is also no single definitive criterion which, by itself, is determinative whether a particular outlay is capital or Revenue. The "once for all" payment test is also inconclusive. What is relevant is the purpose of the outlay and its intended object and effect, considered in a common sense way having regard to the business realities. In a given case, the test of "enduring benefit" might break down."

The Apex Court in Alembic Chemicals has recognised the fact that in a field where advancements are taking place rapidly and where technology which was once the state of the art becomes obsolete in a short time, the test

of enduring nature cannot always reliably be applied. Software industry is one such field where advancements and changes happen at a lightning pace and it is difficult to attribute any degree of durability even to system software let alone application software.

In view of the aforesaid discussion, question number (III) is answered in the negative and in favour of the assessee.

The appeal is, thus allowed.

(GIRISH CHANDRA GUPTA, J.)

I agree.

(INDRAJIT CHATTERJEE, J.)