Tax Review/Taxation

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This issue contains:

Kind regards

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Will tax 'relief' trigger investment?

by
Nasir Jamal

Opinion is divided on the potential impact of the Nawaz Sharif government's 'conditional' tax incentives (or amnesty?) package on the country's worsening investment climate.

The 'multi-pronged' tax incentives primarily offer the non-corporate and informal businesses an opportunity to legalise their untaxed wealth by investing it in the economy.

The ruling PML-N plans to increase investment to 20 per cent of the size of the economy in five years to create jobs, alleviate poverty and revive the economy, which has been rattled by severe energy shortages, high credit cost and deteriorating security conditions. Private investment has already dropped to eight per cent of GDP, and net foreign direct investment has hit the bottom.

"It is basically an attempt by the government to stimulate economic growth by encouraging investments by retailers and small manufacturers, who are operating outside the organised corporate sector, in productive sectors to create jobs. It doesn't cover the organised corporate sector," said Gohar Ejaz, a leader of the All Pakistan Textile Mills Association (Aptma).

"The scheme will give businessmen with illegal or untaxed money a chance to legalise their wealth. It, however, is different from previous [money whitening] schemes, because it doesn't offer the beneficiaries a free lunch. They are now required to invest their untaxed money in the productive sectors and create jobs to benefit from it," he said. He was hopeful that the incentives would produce positive results.

The government says the tax incentive package aims at promoting investment, creating jobs, enhancing tax collection, increasing the number of income tax return filers and honouring the taxpayers.

The package has apparently been put together on the demand of the FPCCI, which is overwhelmingly dominated by traders, small manufacturers and others working in the non-corporate sector, and who are said to be paying only a fraction of the taxes they owe.The package says no questions will be asked about the source of investment made in an industrial undertaking or expansion project on or after January 1 next year. Earlier, the government had fixed a minimum size of Rs25 million of investment to qualify for the incentive, but it did away with the ceiling on minimum or maximum investment size to allow more people to take advantage of the scheme.

Provinces will take steps to create 'ease of doing business by consolidating, rationalising and minimising licensing, registration and inspection regimes'. Trade bodies will be facilitated to avail facilities associated with the creation of special economic zones by ensuring acquisition of land through provincial governments.

A Prime Minister's Business Advisory Council and an Agricultural Advisory Council will also be set up to address emerging investment issues.

Almas Hyder, an auto part maker and exporter, was of the view that the new tax incentives will help re-channel funds from property and other unproductive areas into productive areas. "It is not that people are not investing their [black] money. Most have parked their cash in real estate. The tax incentives will help them re-direct those investments into industry," he argued.

He, nevertheless, warned that there are other bigger issues — energy crunch, credit cost, smuggling and law and order situation etc. — that are facing the economy and discouraging potential investors.

"You cannot attract enough investment to put the economy back on the road of progress and create jobs [for three million young men and women entering the market every year] without addressing these issues," he contended.

Yet, not everyone is happy with the scheme or as hopeful of its success as Gohar or Almas.

"This country doesn't have a place for honest taxpayers. It doesn't matter which party is ruling the country; all the policies and incentives are for those who steal taxes from the government. They keep stealing for a few years and then force the government through their political clout to forgive their crime," said a disgruntled businessman, who requested anonymity for personal reasons.

He pointed out that almost the entire tax reform package the PML-N government had introduced in its first budget to widen the tax net and punish tax thieves had been rolled back under pressure from the traders.

"Can you give just one name from amongst major traders from Lahore who would like to invest in manufacturing when they can make easy money by selling smuggled goods at very high margins? Why would anyone want to work hard to pay taxes? Stock brokers have made billions in the last one-and-a-half years. Who has invested in industry or green field projects?"

Another manufacturer, who requested anonymity as well, said the government should also have announced some incentives for the large-scale organised sector, which has been battered by rising cost of doing business because of energy prices and shortages and high interest rates. "Unless the government supports the large-scale industry, it is not going to see private investment rise," he argued.

According to Gohar, the financial conditions of the government will not allow it for some time to invest heavily in the economy and revive it.

"So, it is trying to implement policies that would encourage private investment in productive sectors; although tax amnesty for tax thieves is not a good policy. But the government's decision to link it with job creation should be appreciated. You can say that the government is asking the potential beneficiaries to pay a price for availing the incentives by providing jobs to the unemployed and by agreeing to pay taxes in the future. The ultimate objective is revival of the economy and creation of jobs, one way or the other."

France

French Union Medef Seeks "Urgent" Corporate Tax Cuts

Geoffroy Roux de Bézieux, Vice President of the French employers' union Medef, has underlined the need for the Government to urgently lower the tax burden on businesses in France, within the framework of its 2015 tax reform, not to increase dividends, but, quite simply, to enable businesses to reinvest.

Given that the rate of compulsory levies in France is currently one of the highest in Europe, just behind Denmark, this has resulted in a loss of competitiveness for businesses, in less investment, and in fewer jobs, Roux de Bézieux emphasized, making clear that there is therefore an "urgent need" to lower taxation. Taxation, he declared, should be seen as a "competitiveness weapon."

Under no illusion that there will always be "winners and losers" in any tax reform, Roux de Bézieux nevertheless emphasized that if there is no reduction in the corporate tax burden, then the reform is "doomed to failure." Furthermore, he underscored the importance of maintaining what has already been implemented, namely the CICE competitiveness and employment tax credit and the capital gains reform. Medef has stressed to the Government that these measures must remain in place, he added.

Pointing out that the envisaged overhaul of taxation must take place over time, Roux de Bézieux urged the Government to take the time to reflect and to consult with the country's economic stakeholders, so that by the end of its five-year term in office, entrepreneurs in France will boast that they are once again able to reinvest, to recruit, and to grow. This is what we need, he reiterated.

Stating that France has a social contribution problem, and therefore a problem as regards the cost of labor and competitiveness, in particular in the "exposed" sectors of the economy, Roux de Bézieux called on the Government to lower public spending as a first priority, before subsequently lowering the country's general social contribution (CSG) and value-added tax (VAT). These should be "moderate" tax cuts, to avoid a shock, he maintained, noting that Medef is proposing a 1 percent reduction every year for three years.

French Prime Minister Jean-Marc Ayrault has begun holding a first round of talks with the country's social partners. The Government has already met with unions and with employers' organizations, and is currently in discussions with cross-party members of parliament.

The Government's "ambitious" reform of taxation is designed to ensure that the French tax system is simpler and more understandable for the taxpayer in the future. The first proposed fiscal measures are due to be provided for within the framework of the 2015 finance bill. – *Courtesy tax-news.com*

Belgium

Belgium Will Revise Environmental Taxation in Upcoming Reform

All too aware that Belgium is trailing a long way behind its European Union (EU) partners in terms of environmental taxation, Belgian Finance Minister Koen Geens has reiterated the Government's intention to address the issue, within the framework of the upcoming reform of taxation.

Conceding that Eurostat's 2011 environmental tax figures have once again placed Belgium at the bottom of the EU-27 table, Finance Minister Geens made clear that the Government is currently drawing up plans to overhaul taxation, to shift the tax burden away from labor and on to other sources of income, notably wealth, consumption, and the environment.

According to the latest statistics, environmental tax revenues accounted for just 4.7 percent of income from total taxes and social contributions (TSC) in Belgium in 2011. In fact, environmental tax levels have remained stagnant in Belgium since 2007. Belgium currently applies very low rates of taxation on energy.

Only France fared worse in Eurostat's analysis, placed at the bottom of the table as environmental tax revenues represented a mere 4.1 percent of TSC in 2011. In contrast, Bulgaria, the Netherlands, and Malta ranked top of the EU-27 leader board, with environmental tax revenues amounting to 10.6 percent, 10.1 percent, and 9.6 percent respectively. The vast majority of European countries showed levels of environmental tax revenue in a band ranging from 6 percent to 10 percent of TSC in 2011.

In its recently published study, Eurostat revealed that environmental taxes accounted for 6.17 percent of all revenues from taxes and social contributions in the EU-27 in 2011, amounting to a total of EUR303bn (USD412bn).

Furthermore, Eurostat announced that in 2011 almost 75 percent of all environmental taxes in the EU were made up of energy taxes, while 21 percent comprised transport taxes, and only 4 percent of the EU-27 environmental tax total flowed from pollution and resource taxes, such as taxes on the extraction of raw materials, on measured or estimated emissions to air, and on water, noise, and waste management.

Compared with 1995, environmental tax revenue has increased by more than EUR100bn, or 59 percent. However, as a percentage of GDP and TSC, environmental tax revenue has actually declined.

In comparison to GDP, environmental tax revenue increased during the 1990s reaching a maximum in 1999 of 2.8 percent of GDP. Since then, environmental tax revenue as a percentage of GDP has gradually fallen, reaching a historical minimum of 2.32 percent in 2008. Between 2009 and 2011, it has been steady around 2.39 percent. The distribution of the tax categories has remained roughly the same. – *Courtesy tax-news.com*

Italy

Italian Senate Approves Changes to 2014 Budget

On November 26, by means of a confidence vote, the Italian Senate approved a "maxi-amendment" which completely replaces the proposals originally made by the Government in its draft 2014 Budget in October.

The changes made to the Government's so-called "Stability Law" measures mainly concern residential and industrial local property taxes, and individual income tax deductions.

With the abolition of the controversial local property tax (IMU) on first residences from January 1, 2014, the new "service tax" to fund all local services will now be called IUC (the unified local tax), rather than TRISE. IUC will be formed of IMU (levied on all property owned, except for first non-luxury residences), TASI (a tax on general local services paid by all property owners, with 10 percent to 30 percent payable by lessees) and TARI (the current local tax on environmental and waste services, levied on either the property owner or lessee). The total rate of IMU plus TASI cannot be greater than 1.06 percent of a property's value.

In effect, therefore, while IMU on first residences is being eliminated, the tax will survive beyond this year and remain payable on all other real estate, including luxury and second houses and commercial and industrial properties. On these other properties, IUC will act as an additional tax to their remaining IMU payments.

In addition, for businesses, there will be an increase to 30 percent for the deductibility of IMU against both federal and local corporate income tax in 2014. It is foreseen that the deduction will fall to 20 percent in the succeeding two years.

Another important new facet to the Budget is a restructuring of the proposed annual tax deductions such that their benefit will now be felt by workers with an annual income of up to EUR35,000 (USD47,500), rather than the original proposal of EUR55,000. The maximum annual tax reduction of EUR225 will be concentrated on those workers with a gross annual income of between EUR8,000 and EUR15,000.

For the next three years, there will be an anti-poverty pilot scheme to establish a minimum income, which will be financed by a "solidarity contribution" deducted progressively from annual pensions above EUR90,000.

The Budget will now progress to the Italian lower parliamentary chamber, where it will be subject to approval and possible further changes. – *Courtesy tax-news.com*

PAMA urges FBR to rectify SRO issue

The Pakistan Automotive Manufacturers Association (PAMA) has urged the Federal Board of Revenue (FBR) to rectify a SRO issued in the light of ECC decision which, if not amended, will have severe consequences for consumers and industry alike.

In a letter to chairman FBR the DG-PAMA said motorcycle industry is already working on very thin margins and cannot absorb any such cost increases that are bound to increase already over-burdened consumers.

The anomaly in question will have severe impact on prices of poor man's vehicle, which under foreign exchange and other inputs pressure is already on the rise.

The Economic Coordination Committee (ECC) had decided in last year's review the duties etc after a period of one year, however, the SRO issued depicted as if it is liable to change after one year, therefore the custom authorities have started to charge increased rate of duty i.e 15 percent instead of 10 percent on CKD imports.

The S R O issued last year said '1402(I)/2012.' - In exercise of the powers conferred by section 19 of the Customs Act, 1969 (IV of 1969), the federal government directs that the following further amendment shall be made in its Notification No. S.R.O. 656 (l) /2006, dated the 22nd June, 2006, namely;

In the aforesaid Notification, in the table, against serial No. 11 in column (1), against item (i) in column (3), in column (4), after the figure '15 percent' the words and figure 'but 10 percent for motorcycles for a period of one year (shall be inserted).

According to the letter DG-PAMA Abdul Waheed has asked the chairman FBR to look into a matter requiring his urgent intervention as the consignments are held up at the port on accounts that increased rate of duty is being called upon to be paid as the subject SRO has lapsed on November 30th 2013. It may be seen it was issued for a period of one year on November 30th 2012.

The SRO in question was issued in relation to Protection to Motorcycle Industry in pursuance of ECC decision reproduced below: (Case No. ECC-135114120i2, dated 23 October 2013).

ECC decision: "The Economic Coordination Committee of the Cabinet considered the summary dated 16 October 2013 submitted by ministry of Commerce on 'Protection to Motorcycle Industry in Pakistan' and decided to reduce the tariff to the average of the existing rates and proposed rates [Column 3 & 6 of the table given in para 3. (a) of the summery] subject to the review after one year. The approved rates will be applicable across the board."

DG-PAMA said we understand that the ECC's above decision was "to review after one year" and did not fix the life of SRO as one year As may be seen it only provided a review of the rates which unfortunately did not take place in time. Sadly the SRO implementing the above decision was issued specifying its life as one year, which was not in conformity with the letter and spirit of the ECC decision.

Now, we request that expression "for a period of one year" appearing in the subject notification may be deleted and a new notification may kindly be issued on an urgent basis so that the consignments held at the port are cleared and the industry resumes its operations.

Should the government feel for the review of the rates we would be available whenever it takes place. We hope for your kind immediate intervention for re-issuing the notification strictly in accordance with the ECC decision. Your good self would appreciate that any increase burden of tax at this stage would severely hit the already depressed motorcycle industry in the country. – *Courtesy Daily Times*

Taxing business: FBR reviewing capacity tax on beverage industry

The government is facing an increasing pressure to review a controversial tax regime concerning the beverage industry that threatens revenue collection and force half a dozen companies to shut down operations, industry officials said on Monday.

Federal Board of Revenue's Large Taxpayer Unit (LTU) for the Lahore region has already reported a loss of Rs2 billion during the first quarter since the tax was imposed in July this year, they said.

"We will see companies wrap up operations and the market will be controlled by multinational brands," said a manufacturer of aerated drinks who has cut his capacity by half.

Under the capacity tax, companies producing aerated water drinks have to pay 17% sales tax and 9% excise duty based on the potential of the machines instead of the actual production. This means that tax has to be paid on the number of valves, the nozzles used to fill the bottles.

From Pakola in Karachi to Murree Brewery in Rawalpindi, all the Pakistani beverage makers have been seriously affected with their sales at less than installed capacity.

Some companies have taken stayorders against the tax but continue to remain under constant uncertainty. “We have to scale down production anyway because the decision might hold in future hearings.”

Federal Board of Revenue has taken notice of the situation. Its spokesman Shahid Hussain said that other LTUs have also faced similar losses. “This is not working out to be the way we had hoped for,” he said.

“Revenue loss is not acceptable for the government, since there hasn’t been any improvement; we are considering the tax.” Hussain said. He further added there was an understanding with multinational beverage companies that the tax collection will increase by 25% under the new method.

Multinational brands control 97% of the beverage market. First introduced in 1990, it is widely believed that this method of tax collection was the result of aggressive lobbying by the multinationals. It was rolled back in 1994 but, by then 10 beverages and 13 juice plants had been closed.

The government aims to raise Rs33 billion through the capacity tax in comparison with last year’s Rs28 billion it earned from the beverage industry.

Amrat Beverages, a beverage company that makes drinks like Amrat Cola and Amrat Lime, had the privilege of being the bottler of both top multinationals from 1989 to 2003.

“The market looked so good during the early 2000s that the company decided to come out with its own products,” Mukhtar Ahmed Qadri, Amrat’s director operations, told *The Express Tribune* a few months ago explaining that there was a sudden rush of patriotism. People wanted Pakistani products and the sales picked up, but the situation changed in a matter of a few years. “Project viability was designed considering the sugar price which was at Rs30 per kg. It went up to Rs80, carbon dioxide (CO_2) was available at Rs30 per kg and then we had a gas shortage and it shot up to Rs250,” Qadri said.

The added burden of the capacity tax will make things worse for Amrat, he said. “It is almost impossible to sell anything in northern Pakistan during winters, drinks are not preferred between November and February. With little production, we'll still be paying the tax as though we are running the plant at full capacity."

Small bottlers point out that the entire regime is tilted in favor of the multinational companies. "Those dispensers in restaurants are directly competing with bottles, but they have been exempted because we know which two brands have complete monopoly over this market," said a Punjab-based beverage maker.

As a consequence of the capacity tax regime machines have been dismantled and transported to warehouses at least one kilometer away from the plants. Tax officials are regularly monitoring the implementation of the tax. – *Courtesy The Express Tribune*

Steel sector: tax survey launched in Lahore

A tax survey for physical verification and registration of steel sector has been launched in Lahore to check whether melters and re-rollers are registered with the sales tax department and paying sales tax on the basis of their actual supplies to domestic market.

Sources told here on Monday that the Federal Board of Revenue FBR Member IR-Operations Muhammad Ashraf Khan and Chief Commissioner Inland Revenue, RTO, Lahore Shafqat Mahmud conveyed the decision to the steel sector during the meeting of high-powered special committee in Lahore to resolve the issues of steel industry. Physical survey of all melters etc would be carryout to verify sales tax registration of those operating in steel sector. If units are registered, survey would check whether they are paying sales tax in accordance with the supplies made to the local market. The potential un-registered units would be registered with the sales tax department as per law. The physical survey would be completed in the next 10 days. Sources said that the committee is also checking payment of sales tax by steel sector under Sales Tax Special Procedure and normal tax payment procedure. The committee would also investigate as to how many units are operating under the Sales Tax Special Procedure and their actual contribution in the form of sales tax whereas, how many units are making sales tax payment under normal tax payment procedure.

The meeting was presided over by FBR Member IR Operations and attended by Chief Commissioner Inland Revenue, RTO, Lahore, Mian Ashraf (Chairman of committee) and representatives of re-rolling mills and steel melters. The concerned Commissioner Large

Taxpayer unit (LTU) Karachi dealing in steel sector and tax officers from Gujranwala and Islamabad were also present.

The representatives of the units pointed out that they cannot obtain any invoice on account of local scrap and as such they are unable to pay 4 percent withholding tax. They suggested that the instead of present levy of 4 percent withholding income tax on domestic purchases, 0.65 percent tax per electricity unit be deducted as an un-adjustable withholding tax in their electricity bills on monthly basis. After detailed discussion, it was decided that the special committee will present its working for payment of sales tax by steel sector. Meanwhile, it was also asked that the concerned officers of LTUs and RTOs would submit their working in this regard. In the meeting, a member of the committee from private sector agitated that there are a number of re-rollers and melters operating without payment of sales tax. This was however contested by the concerned officers of the RTOs. It was also decided that the RTO would complete its survey of area where these people are operating without payment of sales tax. Tax department observed that at times associations agitate the issue but once confronted with the facts they do not want to assist tax officials in carrying out physical survey.

The FBR Member IR and Chief Commissioner RTO Lahore assured that nobody would be spared and whatever is due would be recovered without any discrimination in the steel sector, sources added. – *Courtesy Business Recorder*

Agility case at ICSID: Pakistan seeks time extension for filing counter memorial

Pakistan has requested International Centre for Settlement of Investment Disputes (ICSID) to grant extension in time period for filing of counter memorial in case of M/s Agility till appointment of law firm, as the deadline for submitting the documents would expire on December 4, 2013.

Sources told on Monday that the Federal Board of Revenue has yet not finalised the law firm for defending case filed by M/s Agility against Pakistan at ICSID, which involves compensation of $63 million.

The last date for filing of counter memorial by the government of Pakistan with the ICSID is December 4, 2013. As no firm has been finalised to plead the case at ICSID, the FBR has also sought extension in time period from the ICSID for filing of the counter memorial before the tribunal. Pakistani tax authorities wanted at least a few months extension for filing of the counter memorial with the tribunal.

Despite the fact that the last date for filing of counter memorial by the government of Pakistan with the tribunal is December 4, the FBR is still waiting for the response of the Law Division on the appointment of legal firm.

The FBR has already filed a reference with the Law and Justice Division to seek opinion on the appointment of law firm of Ahmer Bilal Soofi to defend FBR before ICSID in the case of M/s Agility vs Government of Pakistan. Law Division has moved the case to the Attorney General of Pakistan (AGP) for opinion.

The Board-in-Council of the FBR has recommended services of the said Law Firm to defend FBR before ICSID. However, appointment of the law firm has not been finalised.

Sources said that the claim filed by M/s Agility is of about $63 million including service charges, demurrages and interest etc. The FBR will try to defend the case to avoid payment of such huge compensation of US $63 million.

Details of the case revealed that the M/s Agility the software developers of the Pakistan Customs Computerised System (PaCCS) has filed a case against the Pakistani tax authorities at the level of ICSID, seeking compensation for its services in Pakistan. The FBR had challenged the jurisdiction of the ICSID for hearing the case of the said company. The Tribunal had issued a decision on jurisdiction against the FBR on February 27, 2013. M/s Agility has also filed a memorial on the merits with the ICSID. Now, the case on “Customs Clearance Services” would be heard by the ICSID on merit. Under current circumstances, the FBR has to immediately hire a law firm for strongly defending its case before the ICSID.

In May, 2005 the Project of PaCCS was launched with (limited functionalities) at Karachi International Container Terminal (KICT) Karachi port for automated and paperless customs clearances. The said company was selected for development of software. The company had the mandate to review the business cycles, reengineer the business procedures and get it translated into software. The duration of the contract was seven months.

The PaCCS, in pilot mode, was later rolled out to two other terminals, ie, PICT and QICT at Karachi port without formal contractual arrangement, with the company. Later the system audit of the PaCCS revealed that the system created as a Pilot had very limited functionalities. In 2010, the FBR asked the company to wind up its operations in Pakistan. The company claimed cost of its services given to the FBR for a period of around four years. – *Courtesy Business Recorder*

C.No.2(2)Tax.Base/2011 Islamabad, the 29th November, 2013

INCOME TAX CIRCULAR NO. 14/2013

Subject: **Extension in date of filing of Income Tax Returns/ Statements for Tax Year 2013.**

In exercise of the powers conferred under section 214A of the Income Tax Ordinance, 2011, Federal Board of Revenue is pleased to extend the date of filing of Income Tax Returns/Statements for the Tax Year 2013 as under:

1. The date of filing of Returns of Total Income/Statements of Final Taxation of companies whose tax year ends any time between the 1st day of July, 2012 to 31st day of December, 2012 due on or before 30th September, 2013 and extended to 30th November, is hereby further extended to **15th December, 2013.**
2. The date of filing of returns by other persons due on 30th September, 2013 and extended to 30th November, 2013, is hereby further extended to **15th December, 2013.**
3. The date of filing of Returns of total Income/Statements of Final Taxation due on 31st August, 2013 and extended to 30th November, 2013, is hereby further extended to **15th December, 2013.**

Islamabad, the 29th November, 2013

Subject: **FED paid @ 16% on import stage on edible oil, vegetable ghee and cooking oil.**

I am directed to refer to PRAL's note dated 19-08-2013 on the subject cited above (copy enclosed) and to say that the in the case of persons manufacturing goods other than edible oil, cooking oil & vegetable ghee, the FED paid on import of edible oils @ 16% is adjustable against the 'output sales tax' being paid on 'sales tax mode' under S. No. 1 and 2 of Table-I of First Schedule to the Federal Excise Act, 2005 read with the Second Schedule and Section 7 ibid.

2. It may be ensured in the system that this amount is only adjustable for persons who are manufacturing taxable products other than edible oils, cooking oil & vegetable ghee and that this adjustment is not admissible for manufacturers of edible oil, cooking oil and vegetable ghee.

(Fahad Ali Chaudhary)
Secretary (ST/FED-L&P)

2013 TRI 1933 (H.C. Del.)

HIGH COURT OF NEW DELHI

Sanjiv Khanna and Sanjeev Sachdeva, JJ.

ITA Nos. 25/2012, 287/2008, 417/2009, 447/2009, 461/2009, 683/2009
Oracle India Private Limited
v.
Commissioner of Income Tax

ITA Nos. 797/2006, 951/2006, 961/2006, 390/2007
Oracle Software India Limited
v.
Commissioner of Income Tax

FACTS/HELD

Section 37(1): Expenditure on acquiring master copy of software subject to obsolescence is deductible as revenue expenditure

1. The assessee entered into a license agreement with Oracle Corp under which it acquired a non-exclusive & non-assignable right to duplicate software products which were owned by Oracle Corp and to sub-license the same to parties in India. The assessee paid recurring royalty of 30% for the said right. In addition to the royalty, the assessee periodically paid an amount towards "expenditure on import of software master copy". The said master copy was used to replicate the software. The assessee claimed that the said master copies were versions of Oracle's new product offerings which had very accelerated obsolescence and that at any point of time it was not possible to say whether the version will be current for one day or one month. The AO allowed a deduction for the recurring royalty but held that the expenditure for acquiring the software master copy was capital expenditure. On appeal, the CIT(A) reversed the AO on the ground that owing to obsolescence, there was no enduring benefit as there were frequent corrections and up-gradation of the software. On appeal by the department, the Tribunal reversed the CIT(A) and held that the expenditure was capital in nature on the ground that the master copy was an asset of enduring benefit. On appeal by the assessee, HELD reversing the Tribunal:

The assessee's claim that the master copies had high accelerated obsolescence and that even at the point of time of import it was difficult to say whether the version would be replaced by a new or updated version after one day or a month had not been disproved. Also the facts showed that there were periodical imports of the master copies and that the average price per copy was minimal. This was not a case where the master copies contained operating or system software, which normally did not require frequent up-gradation or changes. It is also not the case of an assessee which is the end user of software. It is a case where the assessee is required to repeatedly pay for the master copy media in view of frequent newer or updated versions of the application software from time to time. Once newer or better version of the application software is available, the earlier version is not saleable and does not have any market value for the seller i.e. the assessee. Also, as per the "matching concept" in accountancy, while determining whether expenditure is capital or revenue in nature, the question whether the expenditure would create an asset which is of value in further assessment periods and should be amortised (i.e. depreciated) as long as it has value (subject to the statutory provisions) requires to be considered. If the expenditure does lead to creation of an asset but of a limited or short life, it has to be treated as a liability and not as a fixed asset. The said expenditure cannot be valued for price for future financial years (Oracle Software 320 ITR 546 (SC),Ashahi India Safety Glass 346 ITR 329 (Del), G.E. Capital Services 300 ITR 420 (Del), O.K. Play 346 ITR 57 (P&H), IAEC Pumps 232 ITR 316 (SC) referred)

Appeals disposed of.

ITA Nos. 25/2012, 287/2008, 417/2009, 447/2009, 461/2009, 683/2009, 797/2006, 951/2006, 961/2006 & 390/2007.

Heard on: 2nd September, 2013.

Decided on: 25th November, 2013.

Present at hearing: M.S. Syali, Sr. Advocate with Husnal Syali Nagi, Mayank Nagi and Harkunal Anand, Advocates, for Appellant. Sanjeev Sabharwal, Sr. Standing Counsel & Puneet Gupta, Advocate, for Respondent.

JUDGMENT

Sanjiv Khanna, J.–

These 10 appeals by the assessees-Oracle India Private Limited and Oracle Software India Limited relating to Assessment Years 1994-95 to 2004-2005 raise a common substantial question of law and are, therefore, being disposed of by this decision. The substantial question of law as admitted for hearing reads:–

> "Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was justified in holding that media cost paid for the import of a master copy of Oracle Software used for duplication and licensing is an expenditure of a capital nature and as such is not an allowable deduction?"

2. For the purpose of clarity and to notice facts, ITA No. 797/2006, which relates to Assessment Year 1995-96, was treated as a lead case but as noticed below, wherever necessary and required we have referred to facts of assessment year 1994-95.

3. The appellant-assessee incorporated on 18th January, 1993, is a subsidiary of Oracle Corporation, USA. The appellant entered into licence agreement dated 28th May, 1993 with its parent/holding company under which the appellant was granted non-exclusive non-assignable right and authority to duplicate on appropriate carrier media software products mentioned in schedule „A" thereto or other products which may be added to the said list, and sub-licence the same to third parties in India. The appellant could enter into enforceable sub-licensing and services agreement in the prescribed form with third parties users. The holding company retained ownership of the copyright in the software and all associated and applicable intellectual property rights in the products mentioned in schedule „A" or to be added to the said schedule. It was specifically stipulated that nothing contained in the agreement shall confer or deem to confer on the appellant any of the aforesaid rights. The holding company also retained rights to continue to manufacture or distribution activities in the field of software and software products, including the products mentioned in schedule „A" or to be added to the said schedule with full rights to produce, reproduce, duplicate and distribute the said products in India or into India. The agreement stipulated that the appellant shall duplicate and reproduce the software in India and sub-licence the same as per the terms of the sub-licence deed stipulated and with the holding company retaining entire data/intellectual property rights in the software. The appellant was entitled to use the trademark and trade name of the holding company with approval as to the manner of use from the holding company and no royalty or remuneration was to be paid for the said use.

4. The appellant was to pay royalty to the holding company @ 30% of the list price of the licenced products as prescribed in the Indian

Published Price, fixed in consultation with the licensor at the time of the sub- licence or such lesser amount agreed to. Royalty was to be also paid on software products put to internal use. The royalty was payable on quarterly fiscal basis and was subject to deduction of tax at source. The licence agreement was for a period of five years but it appears it was extended for further period relevant to the assessment years in question.

5. In addition to the aforesaid royalty, the appellant had also paid the following amounts to the parent company reflected as expenditure on import of software master copy:–

S No.	ITA	Assessment Year	Expenditure on import of software master copy
1	951/06	1994- 95	94,49,041
2	797/ 06	1995-96	1,02,34,099
3	961/06	1996-97	82,39,876
4	390/07	1997-98	49,87,045
5	287/08	1998-99	72,49,066
6	461/09	1999-2000	45,52,944
7	417/09	2000- 01	20,05,860
8	447/09	2001- 02	17,37,557
9	683/09	2002- 03	4,11,177
10.	25/ 12	2004- 05	14,40,342

6. The aforesaid payments were not made in lumpsum, but on distinct and separate dates in each assessment year on import of the master media from the holding company. To avoid prolixity, we are not reproducing details of import in each assessment year but for the purpose of clarity, we are reproducing details of the said import in the Assessment Year 1994-95:–

“

Invoice No.	Invoice Date	Invoice Value (in IEP)	Bill of Entry No.	Bill of Entry Date	No. of Copies
13896	20/10/93	158.88	264270	18/11/93	2
13962	26/10/93	599.60	264271	18/11/93	25
13910	21/10/93	807.10	264860	19/11/93	24
13307	16/9/93	411.00	264800	11-10-93	20
14619	12-1-93	113.26	274179	27/12/93	2
14942	17/12/93	716.83	274191	27/12/93	10

14698	12-6-93	168.84	274540	28/12/93	15
14745	12-8-93	150.47	275522	31/12/93	3
15045	23/12/93	194.93	275525	31/12/93	4
15044	23/12/93	209.25	275518	31/12/93	2
14821	13/12/93	143.84	275733	31/12/93	4
15287	14/1/94	7381.85	204690	24/1/94	351
15165	1-7-94	2028.38	204703	24/1/94	150
15228	1-11-94	274.59	204705	24/1/94	5
15156	1-7-94	6702.20	205951	29/1/94	700
15191	1-10-94	808.91	204701	24/1/94	110
15336	17/1/94	241.29	206483	31/1/94	10
15385	19/1/94	1282.47	207246	2-2-94	129
15425	21/1/94	740.73	207259	2-3-94	15
15541	26/1/94	324.17	209405	2-11-94	15
15578	27/1/94	234.83	209403	2-11-94	5
15501	25/1/94	327.70	209429	2-11-94	15
15604	28/1/94	401.69	209399	2-11-94	20
15656	31/1/94	192.19	209401	2-11-94	3
15569	27/1/94	344.46	209397	2-11-94	5
16395	3-11-94	326.87	220380	28/3/94	5
14206	11-11-93	208.70	266143	24/11/93	5
14186	11-10-93	535.55	266135	24/11/93	10
Total IEP		**26,030.58**	**Total**		**1664**

"

7. The Assessing Officer held that the aforesaid payments of Rs.94,49,041/- for the Assessment Year 1994-95 and similar payments for the other years described as software master copy and documentation was capital expenditure and not revenue in nature. He referred to the agreement dated 28th May, 1993, which was for a term of five years and observed on interpreting the terms that the appellant had acquired copyright and all other associated and applicable Intellectual Property Rights. He invoked Section 35A and held that on this amount, the appellant was entitled to deduction equal to 1/14th of the expenditure as it was incurred on acquisition of copyright. He held that there was transfer of copyright, in addition to other associated and applicable Intellectual Property Rights by Oracle Corporation, USA to the appellant

company and the appellant had acquired the said rights for the purpose of business.

8. For the Assessment Years 1994-95 to 2004-2005, Commissioner of Income Tax (Appeals) reversed the finding of the Assessing Officer to this extent. For the Assessment Year 1994-95, Commissioner (Appeals) observed that the obsolescence rate in software industry was extremely high and updated version of softwares were developed frequently. Some softwares had a commercial life of only 1 - 2 months and had to be substituted by an upgraded version thereby making the earlier version redundant or useless. Referring to the agreement, he observed that the intellectual property rights in the software were not transferred to the appellant by Oracle Corporation, USA. Royalty was payable to Oracle Corporation, USA based upon the number of copies duplicated from each original master copy sold or sub-licensed to third parties. Large number of master copies were imported every 2-3 weeks. As far as royalty payment was concerned, there was no dispute that it was revenue in nature. Similarly, the cost of procuring the master copy was of recurring nature, which was established and proved beyond doubt from shipment of numerous master copies and the fact that there was no single lumpsum payment. He observed that firstly, master copy updated software had to be procured, which was a recurring expenditure. Secondly, there was no enduring benefit as there were corrections; strides and frequent upgradation of software. Thirdly, the expenditure incurred in question was for conduct of business as an integral part of profit earning process and not for acquisition of assets or right of permanent character. Fourthly, the expenditure in question was in nature of procurement of raw material for the purpose of business and not to procure capital and, therefore, was a part of working capital of the company.

9. After noticing these facts, the Commissioner (Appeals) deemed it appropriate to ask for remand report. The Assessing Officer submitted a report and also appeared in person. Before the first appellate authority, the assessing officer somewhat changed his stance and submitted that the expenditure was in the nature of technical services and know-how but, tax at source had not been deducted. It was accordingly pleaded that if the expenditure was to be allowed as revenue, it cannot be allowed as a deduction as per Section 40(a)(i) of the Income Tax Act, 1961 (herein after referred to as the "Act"). Commissioner (Appeals) did not agree with the Assessing Officer and observed that the expenditure incurred was neither for extension of business nor for substantial replacement of equipment, which related to carrying on or conduct of business and an integral part of profit making process. It was nothing but for procurement of raw material. He overturned the finding of the Assessing Officer that the appellant had acquired right of enduring nature by importing master copies and also rejected the finding that Section 35A was applicable. The price paid for the master copy or royalty payment did not involve transfer

of intellectual property rights and no such rights were acquired by the appellant. The price at which the product was sold did not include the cost of intellectual property right. He noticed that the Assessing Officer in the appellate proceedings for the first time had relied upon Section 40(a)(i) and observed that the cost of the master copy does not constitute technical know-how or royalty under Section 9 of the Act. The transaction in question, i.e., import of master copy was separate and could not be inter-linked with payment of royalty. It was held that the payments made for acquisition of the master copy should be allowed as business expenditure under Section 37 of the Act. Commissioner (Appeals) for the Assessment Year 1994-95 gave a categorical finding that there was no transfer of intellectual property rights and the copyright continued to vest and remain with Oracle Corporation, USA. The master copies were not of enduring nature/benefit as they had to be updated frequently in view of high degree of obsolescence. Price paid for the master copy did not include cost involved in transfer of rights in the software. Royalty was paid towards intellectual property rights of the Oracle Corporation, USA and the cost of the master copy did not include the said price.

10. Tribunal by their order dated 28th October, 2005, which was a common order, relating to Assessment Years 1994-95, 1995-96, 1996-97 reversed the order of the Commissioner (Appeals) and restored the view taken by the Assessing Officer. We would like to reproduce two paragraphs from the said impugned order as the same reflect the core of the findings recorded by the tribunal:–

> "3.4 We have perused the records and considered the rival contentions carefully. The assessee is a 100% subsidiary of Oracle Corporation, USA and is authorised as per the agreement signed to sub-lease the software products developed by the foreign company. For this purpose, the assessee has imported the Master Copy of the softwares as goods under the open general licence scheme of the Export Import Trade Policy. The assesse is making duplicate copies from the Master Copy and selling it to local clients. For importing the Master copy it has paid a lumpsum consideration and is also paying royalty @ 30% of the listed price of duplicate softwares sold locally. The Assessing Officer treated the lumpsum consideration paid for import of the Master Copy as capital expenditure holding that it was an asset of enduring benefits to the assessee.
>
> 3.5 The import of Master Copy with the righty of duplication is definitely an asset of enduring benefit. But whether the expenditure on the acquisition of the same can be considered as capital expenditure or a revenue expenditure has to be examined in the light of judicial pronouncements on the subject. The payment of lumpsum consideration or enduring benefits are not conclusive tests in deciding whether an expenditure is a

revenue expenditure or capital expenditure as held by the Supreme court in the case of M/s Empire Jute company (124 ITR 1) and subsequently reiterated in the case of M/s Alembic Chemical Works (177 ITR 377). It would be pertinent to elaborate these cases which will be useful in understanding the true nature of the expenditure in the instant case."

11. Thereafter, reference was made to the facts and the ratio in the case of *Empire Jute Company* (1980) 124 ITR 1 (SC) and *Alembic Chemical Works* (1989) 177 ITR 377 (SC) and it was observed that imported master copy was used for duplicating copies of software and, therefore, a part of the profit earning apparatus. It was not a case where the appellant had imported some know-how device or device by which copying of software was done more efficiently. Once master copies were held to be a part of profit earning apparatus or source of income, it was immaterial whether the appellant had ownership rights or only right to duplication. Decisions of the tribunal in the cases of sound tracks of film songs and the film music were distinguished as they related to payment of yearly royalty, based on sales of cassettes obtained from master plates. In the said cases, the expenditure was relating to trading operation and no lumpsum payment was made. In the present case also, on royalty there was no dispute but the dispute related to lumpsum payments. Another case was distinguished on the ground that lumpsum payment made for procurement of master plates for producing audio cassette could be treated as revenue expenditure as the sound tracks got duplicated in the process and were used as raw material. The master copies of softwares, it was observed had unlimited life and capable of giving unlimited number of copies. The master copies were not raw material but only a tool to get duplicate copies of software. Further, the mater copies were not procured from third parties but from in-house establishment.

12. Before we dwell upon the questions raised, we would like to point out certain undisputed facts. The Assessing Officer had also denied benefit to the appellant under Section 80-IA on the ground that duplication of software did not amount to manufacture. Section 40(a)(i) was also invoked in respect of royalty payments. The tribunal decided the two issues against the revenue. Revenue preferred appeals before the High Court, but the appeals were dismissed on the two issues vide judgment *CIT v. Oracle Software India Ltd.* (2007) 293 ITR 353 (Delhi) observing that no substantial question of law arose for consideration and Section 40(a)(i) was not applicable.

13. Not satisfied, Revenue preferred further appeals on issue of deduction under Section 80-IA but did not succeed vide detailed decision in *CIT v. Oracle Software India Ltd.* reported as (2010) 320 ITR 546 (SC). The Supreme Court in the said decision has noted that the appellant had imported master media of software from Oracle Corporation, USA for duplicating on blank disc, which were packed and sold in the market

along with the relevant brochure. The appellant had paid lumpsum amount to Oracle software for import of master media. The Supreme Court has further observed that the software in question was application software and not operating software or system software. The software could be categorised as product line application, application solutions and interim applications. The master media was subjected to validation and checking process by software engineers by installing and rechecking the integrity of the master media with the help of the software installed in the fully operational computer. Thereafter the same was inserted in a machine CD blaster and virtual image of the software was created on the internal storage device. This virtual image was replicated to produce or duplicate the software. The virtual image was too large to be shown on screen. The Supreme Court has further observed that softwares were goods as held in *Tata Consultancy Services versus State of Andhra Pradesh*, (2004) 271 ITR 401 (SC). The software copyright might remain with the originator of the programme but the moment copies were made and sold, they would be termed as goods. There was no difference between sale of software programme on CD and sale of music on cassettes/CDs. The intellectual copyrights had got incorporated on the media for the purpose of transfer and, therefore, media cannot be split up. Reference was made to the decision in *Gramophone Company of India Limited versus Collector of Customs*, (1999) 114 ELT 770 (SC) and it was observed that duplication or recording of audio cassettes amounts to manufacture as goods were produced.

14. Before proceeding further, we would like to reproduce the exact reply given by the appellant as recorded in the assessment order for Assessment Year 1994-95 on the issue in question. The same reads as under:–

> "1. Imports master copy of Oracle products under the OGL Classification 85.24 after the full payment of custom duty. These are further replicated in India using the appropriate carrier media by virtue of an agreement OSIPL has with Oracle Corporation.
>
> 2. The master copies are versions of Oracle"s new product offerings which have a very accelerated obsolence. At any point of time it is not capable of determining whether the version will be current for one day or one month. In the life cycle of product if a version is released and improvement is developed the next day the earlier version is obsolete. The master copy/documentation write off policy which Oracle has adopted recognizes the accelerated obsolence and the non-enduring use of master copy/documentation."

(Emphasis supplied)

15. After recording/ reproducing the said reply, the Assessing Officer in the assessment order has not disputed or factually controverted the contents or the assertion made by the appellant. The Assessing Officer accepted and did not contradict the said factual assertion as incorrect, but addition was made by the Assessing Officer on the grounds, namely, (i) in spite of the factual position the expenditure was capital (ii) Section 35A of the Act was applicable and, therefore, the cost paid on master copy was to be amortised/allowed in 14 instalments for the Assessment Year 1994-95. Even if the expenditure was revenue in nature, the same has to be disallowed.

16. We have quoted the finding recorded by the tribunal in paragraphs 3.4 and 3.5 of the order for the Assessment Years 1994-95, 1995-96 and 1996-97. It has been observed that lumpsum payment was made for the master copy and as the appellant also had right of duplication it lead to creation or acquisition of an asset of enduring benefit. It became part of the profit making apparatus and source of income. The Tribunal without disturbing or contradicting the stand of the appellant, on legal principles has held that the expenditure was capital in nature.

17. We have given thoughtful consideration to the said findings, but find that the final conclusion cannot be sustained and should be reversed. Tribunal in the impugned order and the reasoning given therein has not disturbed the finding of the Commissioner (Appeals) or the assertion of the appellant before the Assessing Officer that the master copies were versions of software developed by Oracle Corporation, USA, a new product offerings, which had high accelerated obsolescence and even at the point of time of import it was difficult whether the version would be replaced by a new or updated version after one day or a month. The life cycle of the version released was limited and improvements and further developments were constant and intermittent. The earlier version had a high degree of obsolescence and the master copy, documentation and policy adopted by the appellant recognised that the master copy did not have enduring or long- term benefit.

18. The Right to duplication and import of master copy though connected, cannot and does not show that the expenditure in question was capital in nature. The import of master copy was for the purpose of creating virtual image for the purpose of duplication. The right to duplication was given to the appellant under the agreement dated 28th May, 1993 and was subject to payment of royalty. The payments in question were not for acquiring the right to duplication. This is not the case of the Revenue or the finding of the Assessing Officer or the Tribunal. We have also quoted above the sample data for Assessment Year 1994-95, which shows that there were as many as 28 imports on different dates after October, 1993 indicating the number of master copies imported. The average price per copy was minimal. We have also

noted the findings recorded by the Supreme Court as to the nature and character of the software of which virtual image was created from the master copies. This is not a case where the master copies contained operating or system software, which normally do not require frequent upgradation or changes for consideration or price. Neither are we dealing with a case of an assessee who is the end user of software. We are dealing with the appellant who was required to repeatedly pay for the master copy media in view of frequent newer or updated versions of the application software from time to time. Once newer or better version of application softwares was available, the earlier application softwares were not saleable and did not have any market value for the seller i.e. the appellant. The earlier versions became obsolete and had limited shelf life, as long as the newer version was not available. No one would like to pay or obtain an older version of the same software, when the new or updated version was available.

19. Courts have grappled with the problem of classification of income and expenditure as capital and revenue. The distinction between capital and revenue nature though basic and fundamental to preparation of accounts and income tax, appears to be a never ending concoct and resultant cause of litigation. Even the principles applicable, oscillate and the difficulty also arises on selecting the right principle applicable to facts of the given case. There is divergence and conflict as to the principle which should be applied. Thus, it is not a case of application of principles to facts alone, which is a cause of debate and confusion. The terms “capital” or “revenue expenditure” have not been specifically defined in the Act. They are closely connected with accounting practices, though elucidated and expounded in judicial pronouncements. Most income tax enactments, including the present Act, require and mandate determination of income earned by the appellant during two particular points of time i.e., the assessment year. The income is determined on the basis of principles of accountancy or accounting practices as moderated and subject to mandate/ amendments by the Act. The expression “income” has historically received somewhat derisory and derisive interpretation but as a theoretical as well as practical concept means the income generated during two particular points of time by a person without impoverishment of oneself. (see J.R. Hicks “Value and Capital- An inquiry into some fundamental principles of economic theory, Oxford University Press, London, Second Edition 1946). Alexander making reference to the term income in corporate context has stated: income is “the amount which [a] company can distribute to the shareholders and be as well off at the end of the year as it was at the beginning”. It was observed:–

> “The net income of an entity for any period is the maximum amount that can be distributed to its owners during the period and still allow the entity to have the same net worth at the end

> of the period as at the beginning, after adjusting for the owner‟s contributions. In other words, capital must be maintained before an entity can earn income."

20. The aforesaid definitions are improvements on the conceptualization of the term "income" as assigned by the German economist Georg Von Schanz in 1896, who held that income means the economic power accrued to a given person over a period of time, i.e., the disposing power of a given person during the period in question, without impairing his capital or incurring personal debts. The aforesaid definitions have become subject matter of new thought/ thinking to categorise revenue and capital expenditure based upon market place criteria [see Working Paper "The Classification of capital and revenue in accounting and the definition of income in the market place (Centre for Accounting, Governance and Taxation Research, School of Accounting and Commercial Law, Wellington, New Zealand" at the works referred to therein.) The aforesaid article refers to the notion of capital maintenance or net accretion. The said note also refers to the report on Wheat Committee, 1972 (a special committee of the American Institute of Certified Public Accounts charged with studying how accounting principles should be determined) wherein it has been observed that financial accounting standards and reporting are not grounded in natural laws as are the physical sciences, but must rest on a set of conventions or standards designed to achieve what are perceived to be the desired objectives of financial accounting and reporting.]

21. While interpreting the meaning of "accounting income", the Financial Accounting Standards Board, United States of America formally embodied capital maintenance, or net accretion, notion in its statements of Financial Accounting Concepts (Financial Accounting Standards Board). It has been elucidated as:–

> "An enterprise receives a return only after its capital has been maintained or recovered. The concept of capital maintenance, therefore, is critical in distinguishing an enterprise‟s return on investment from return of its investment. Both investors and the enterprises in which they acquire an interest invest financial resources with the expectation that the investment will generate more financial resources than they invested."

22. In the Framework for the Presentation and Preparation of Financial Statements published by International Accounting Standards Board, an asset has been defined as "a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity" in subsequent accounting periods. The assets are recognised in the balance sheet, when "it is probable that future economic benefits will flow to the entity and the asset had a cost or value that can be measured reliably." The words "income" and "expenditure" have been defined in the said framework as under:–

> "Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants"

23. The word "expense" in the said Framework has been defined as decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities other than those relating to distribution to equity participants. The Framework recognised the principle of matching of costs with the revenues in preparation of financial statements and has stipulated:–

> "Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process is commonly referred to as the matching of costs with revenues........
>
> When economic benefits are expected to arise over several accounting periods and the association with income can be only broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures.........These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.
>
> An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset."

24. Compendium of Accounting Standards by Institute of Chartered Accountants of India defines "income" as encompassing both revenue and gains including unrealized gains. The term "expenses" encompasses the expenditures that arise in the ordinary course of an enterprise as well as losses. Expenses will include depreciation as it is in the form of outflow caused due to depletion of assets. The term "depreciation" and its significance in accounting as elucidated in the Compendium of Accounting Standards are set out below. Adjustment towards capital accounts is when the expenditure includes a future economic benefit associated with the article/ goods which will flow to or from the enterprise. This may be, inspite of the degree of uncertainty regarding future economic benefits and this degree of uncertainty is ascertained on the basis of evidence available when the financial statements are prepared. But, an asset is not recognised in the balance sheet, when expenditure has been incurred in respect of an item, on which it is improbable that economic benefit will flow beyond the current accounting period. Such transactions merit recognition as an expense in the

statement of profit and loss. Thus the term „expenses" as recognized in the profit and loss account will take into account decrease in future economic benefits relating to an asset. Concept of expenses includes decrease in the value of asset. An expense is recognized immediately in the statement of profit and loss account, if expenditure produces no future economic benefit (see paragraphs 73 to 97 of the Compendium of Accounting Standards issued by the Institute of Chartered Accountants of India).

25. Matching of cost with revenues takes into consideration direct association between cost incurred and earning of specific items of income and also includes various components of expenses making up the cost of goods. The term „depreciation" has been defined in the Accounting Standard VI, as a measure of wearing out, consumption or loss of value arising from use of any type, efflux of time, of obsolescence through technology and market changes. But depreciable items are those which are used for more than accounting period and its useful life is over a period during which a depreciable item is expected to be used by the enterprise or number of production of similar units expected to be obtained from use of the asset by the enterprise. Assessment of depreciation is done based upon the three criterions: (1) historical cost or other amounts substituted when the asset has been revalued; (2) expected useful life of the depreciable asset; and (3) estimated residual value. Useful life of depreciable asset may be shorter than its physical life and is determined by several factors including obsolescence due to technological changes, improvements, change in market demand or service output etc. Useful life of depreciable asset is a matter of estimation and is mainly based upon experience with similar type of assets. Determination of residual value, it is stated, is a difficult matter but when insignificant, it should be taken as nil. One of the basis for determining residual value would be realizable value of similar assets.

26. The Act does not define the term „asset" in generality though the term „block of assets" is defined but the said definition is not relevant. Explanation 3 to section 32 states the term asset for the said provision means tangible and intangible assets being know-how, copyrights etc. The Act, however, more appropriately and pertinently defines the term „capital asset" in Section 2(14) as property of any kind, but does not include stock in trade, consumable stores or raw materials held for the purposes of his business or profession. Personal effects and agricultural land etc. are also excluded. The term/expression „expenditure" finds elucidation in Section 37 of the Act and it excludes any expenditure of capital nature or personal expenses. There is substantial authority for the proposition that determination of whether an expenditure is capital or revenue in nature must and should be decided keeping in view the nature of the business, commercial reasons for incurring the said expenses in business and the object for which the expense is incurred.

Emphasis being placed on business and commercial considerations, rather than pure legal and technical aspects. Thus, primacy is given to practical and business point of view and not on juristic classification. The expression „capital or revenue expenditure‟ must be construed in business sense and by applying sound accountancy principles unless there is statutory mandate to the contrary. (see Section 145 of the Act and observations of the Delhi High Court in *CIT v. Virtual Soft Systems Ltd.* (2012) 341 ITR 593).

27. This aforesaid principle of matching, as we shall elucidate below, is of immense importance and significance. When we determine whether an expenditure is capital or revenue in nature, it exposes and brings to forefront the practice and commercial approach from the true and correct perspective and objective; "income" earned should be taxed. This has to be kept in mind as the guiding principle, subject to the statutory mandate which will override. A statement of accounts prepared on the basis of the aforesaid matching principle will generally reflect the true and correct income earned during the specified period. The said determination would be fair, just and equitable both to the appellant and the revenue. An asset is not normally created when a liability is incurred and it does not give benefit or advantage in future accounting periods or beyond a short/ small length of time, in view of the past practice and practical/ commercial reality. The expenses will be revenue in nature if its usefulness will come to an end within the financial year itself or is for limited time and would not have any residual value thereafter. Therefore, while determining whether expenditure is capital or revenue in nature, we must also dwell into the question whether the expenditure, would create an asset which is of value in further assessment periods and should be amortised (i.e. depreciated) as long as it has value. (The last portion is obviously subject to the statutory mandate of an enactment, which may prescribe amortisation or depreciation rates. These being fixed by law will override the accounting principles). Thus, when an expenditure incurred does lead to creation of an asset but of a limited or short life, it has to be treated as a liability and not as a fixed asset. The said expenditure cannot be valued for price for future financial years.

28. A word of caution and a caveat for the aforesaid test, is one of importance as was elucidated by the Supreme Court in *Empire Jute Company Limited versus Commissioner of Income Tax*, (1980) 124 ITR 1 (SC). The said decision highlights advantage of enduring benefit test but nonetheless it was cautioned that the said test may break down and what is material to be considered is the nature of advantage in commercial sense. If the advantage consists of merely facilitating assets in trading operation or enabling the management and conduct of business more efficiently, it would be expenditure on revenue account even though the advantage may be of indefinite future. Thus, in *Alembic Chemical Works Company Limited versus Commissioner of Income Tax*, (1989) 177 ITR

377 (SC) and *Jonas Woodhead and Sons (India) Limited versus CIT*, (1997) 224 ITR 342 (SC), the Supreme Court observed that though the technology had been received but it related to a product already under production and to ensure betterment or of the improvement, it was part and parcel of the existing business and, therefore, the benefits were composite partly revenue and partly capital. However, in the present case we need not apply the caveat. The caveats and caution elucidated would apply as exceptions of the enduring benefit tests. When the enduring benefit test itself justifies the conclusion that the expense is revenue, it would not be proper and appropriate to apply the caveats or exceptions. These secondary tests apply when in spite of the primary test of enduring benefit being in negative, i.e. against the assessee a different conclusion against the revenue is justified. Thus the dictum and in the words of Viscount Cave LC in Atherton v. British Insulated & Helsby Cables Ltd. 10 TC 155:–

> "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."

The said enunciation has been approved by the Supreme Court in *CIT vs. Finlay Mills Ltd.* 20 ITR 475 (SC) and Empire Jute (Supra) and other cases. The term enduring we clarify does not mean permanent, perpetual or everlasting but it refers and indicates that the right acquired must have enough durability to justify it being treated as a capital asset.

29. The view we have taken find support and is in consonance with the view taken by the Delhi High Court in *Commissioner of Income Tax versus Ashahi India Safety Glass Limited*, (2012) 346 ITR 329 (Del) wherein appellant had procured software which was amortised in the books as deferred revenue expenditure but was claimed as a deduction in the income tax income statement. It was observed that the said expenditure along with other expenditures neither created a new asset nor brought forth a new source of income. The expenditure incurred was to upgrade or to run the existing set up. It was to remove deficiencies in the software installed in the earlier years, to modify, customise or upgrade the software. Similarly, in *Commissioner of Income Tax versus G.E. Capital Services Limited*, (2008) 300 ITR 420 (Del) it was observed that the software procured by the assessee in question was not customised software and the software in question required regular upgradation and, therefore, was not of enduring benefit.

30. The Punjab and Haryana High Court in *Chief Commissioner of Income Tax versus O.K. Play India Private Limited*, (2012) 346 ITR 57 has again observed that computer software does not enjoy a degree of

permanence and it could be unrealistic to ignore the stand and repeated upgradation and newer versions which have to be adopted and applied on the payment. In Alembic Chemicals Works Company Limited (supra), lumpsum consideration paid for technical know-how to achieve higher level of production by better technology was held to be of revenue account. This was in spite of the fact that there was enduring benefit, but the Supreme court deemed it appropriate to apply a more liberal test on the consideration that in this age of rapidly advancing technology the contention of the Revenue that the expenditure brought into existing capital asset, should be rejected. The need of the age, the environment and the business consideration mattered and were given due recognition and acceptance. The said view has been followed by the Courts in India. As noticed above, in the present case the appellant is duplicating software and sells the same to generate income. It requires master copies, which have to be updated and upgraded to be able to sell the said software. In case the appellant had imported the said software and sold the same, it would be stock in trade and deductible. However, when the master copies were used for duplication and the software replicated and transferred on the media as a result of the said activities was then sold, the master copy itself might not be stock in trade as such in strict sense, but it did not have a long life and its value and life span was small since it perished and diminished when the upgraded version or a better software in form of the next master copy was imported, for the purpose of duplication. When we accept the said position, the requirement of enduring benefit fails and it cannot be said that any capital asset was acquired or purchased. In these circumstances, we need not apply and go into the other test or caveats. The flaw and the error committed by the tribunal is that they applied other tests or caveats without first ascertaining and determining whether enduring benefit test is satisfied or not. The enduring test may not be the sole, exclusive or universal test but is considered to be the primary test.

31. The Supreme Court in *CIT versus IAEC Pumps limited* (1998) 232 ITR 316 upheld the decision of the tribunal that payment towards royalty was revenue expenditure and was allowable after observing that the licence for use of patents and designs was for a duration of 10 years with the parties having option to renew or extend the licence. The assessee had been only allowed use and there was no transfer of rights. The rights acquired by the assessee were not exclusive and were for a limited period which could be determined earlier also. Payment was dependent upon quantum of items manufactured.

32. Decision in the case of *Commissioner of Income Tax versus Denso India Limited*, (2009) 318 ITR 140 (Del) and submission relying upon Section 35A of the Act is misconceived. The said provision comes into play only when the expenditure incurred is of capital nature and is on the acquisition of patent rights and copyrights. Merely because expenditure

has been incurred for material for duplication without acquisition of proprietary and when the expenditure is not of capital nature, the said Section would not be applicable. In any case, the said provision is not applicable with effect from the 1st day of April, 1998. The view we have taken finds affirmation and support from the decision of the Delhi High Court in Denso India Limited (supra). It supports the case of the appellant as it has been held that depreciation claim in respect of intangible assets would arise only when it is first determined that the expenditure was capital in nature. Reference was made to *CIT v. J.K. Synthetics Ltd.* (2009) 309 ITR 371 (Del) where broad principles have been culled out and some of the principles have been set out in seritum. Decision in *CIT v. Sharda Motors Industrial Ltd.* (2009) 319 ITR 109 (Del) was also referred too.

33. The question of law mentioned above is accordingly answered in favour of the appellant-assessee and against the Revenue.

34. In the assessment year 1997- 98, in ITA No. 390/2007 titled *Orcale India Softwares Ltd vs. CIT Delhi*, two additional questions have been raised, which read as under:–

> "(2) Whether the Assessing Officer could have charged interest on the taxable income of the Assessee under the provisions of Section 234B of the Income Tax Act, 1961 without any specific order to this effect and in spite of the existence of ITNS 50?
>
> (3) If the answer to the question No. (1) is in the affirmative, whether the interest under Section 234B of the Income Tax Act, 1961 has to be charged on the assessed income or the returned income of the Assessee?"

35. Interest under Section 234B is mandatory in nature and has to be paid when the statutory conditions are satisfied. Further, the interest has to be paid on the assessed income [see decision of the Supreme Court in *Commissioner of Income Tax, Mumbai versus Anjum M.H. Ghaswala and Others*, (2001) 252 ITR 1 (SC)]. Tribunal in the impugned order has already directed that interest under section 234B of the Act shall be determined only after ascertaining the taxability. The question Nos. 2 and 3 are accordingly answered in favour of the Revenue and against the appellant.

36. The appeals are accordingly disposed of with no orders as to costs.