

**IN THE HIGH COURT OF KARNATAKA AT
BENGALURU**

DATED THIS THE 8TH DAY OF JANUARY 2016

PRESENT

THE HON'BLE MR. JUSTICE N.K. PATIL

AND

THE HON'BLE MRS.JUSTICE S. SUJATHA

ITA NO.703/2009

BETWEEN

1. The Commissioner of Income-tax
C R Building,
Queens Road
Bangalore
 2. The Asst. Commissioner of Income-tax
Circle-12(1)
C R Building
Queens Road
Bangalore
- ... Appellants

(By Sri K.V. Aravind, Advocate)

AND

M/s. Kshema Technologies Ltd.,
(Merged with Mphasis BFL Ltd.,)
Bagmane Tech Park
Byrasandra
C V Raman Nagar
Bangalore-560 093

... Respondent

(By Sri. T. Suryanarayana, Advocate for
M/s. King and Partridge, Advocate)

This Income-tax Appeal is filed under Section 260-A
of the Income Tax Act, 1961, to set aside the order passed

by the ITAT Bangalore in C.O. No.107/BNG/2008 in ITA No.620/BNG/2008, dated 29.05.2009, confirm the order of the Appellate Commissioner and confirming the order passed by the Assistant Commissioner of Income-tax, Circle-12(1), Bangalore, in the interest of justice and equity.

This appeal having been heard and reserved for orders on 5th January 2016, coming on for pronouncement of judgment this day, **S. Sujatha J.**, delivered the following:

JUDGMENT

This appeal is directed against the order passed by the ITAT, Bangalore in ITA No.620/Bang/2008 dated 29.05.2009, relating to the assessment year 2004-05.

2. The facts in brief are:

The assessee is carrying on the business in the development of computer software and related services. The assessee filed the return of income on 30.10.2004 and claimed deduction under section 10A of the Income Tax Act, 1961 [‘the Act’, for short]. The Assessing Officer held that expenses incurred in foreign currency for providing software development services outside India of Rs.17,80,68,049/- should be excluded from the export turnover while computing

deductions under section 10A of the Act. It is further held that the exchange fluctuation loss of Rs.74,25,340/- should not be considered for reduction from the total turnover for the purpose of computation of deduction under section 10A of the Act. On appeal, the Appellate Commissioner upheld the finding of the Assessing Officer. On further appeal, the Tribunal reversing the orders of the Authorities, held that expenses incurred in foreign currency for providing software development services outside India of Rs.17,80,68,049/- cannot be excluded from the export turnover while computing deduction under section 10A of the Act. The Tribunal further held that the exchange fluctuation loss of Rs.74,25,340/- shall be considered for reduction from the total turnover for the purpose of computation of deduction under section 10A of the Act.

3. Being aggrieved by the said Judgment of the ITAT, Revenue is in appeal under section 260-A of

the Act, raising the following substantial questions of law.

“[i] Whether the Tribunal was correct in holding that expenses incurred in foreign currency for providing software development services outside India of Rs.17,80,68,049/- should be excluded from the export turnover for the purpose of computation of deduction U/s. 10A of the Act?

[ii] Whether the Tribunal was correct in holding that the exchange fluctuation loss of Rs.74,25,340/- should be reduced from the total turnover for the purpose of computation of deduction U/s. 10A of the Act?”

4. Heard Sri. K.V. Aravind, learned counsel appearing for the Revenue as well as Sri. T. Suryanarayana, learned counsel appearing for the assessee.

5. Sri. K.V. Aravind, learned counsel for the revenue firstly contended that expenses incurred in foreign currency for providing software development

services outside India of Rs.17,80,68,049/- has to be excluded from the export turnover for the purpose of computation of deduction under section 10A of the Act, as the services rendered by the assessee relating to the software development has to be construed as technical service, excluded from the export turnover in terms of Explanation (2)(iv) of section 10A of the Act.

6. Secondly, it is contended that the exchange fluctuation loss of Rs.74,25,340/- should be reduced from the total turnover for the purpose of computation of deduction under section 10A of the Act, placing reliance on sub-section [4] of section 10A of the Act.

7. In support of his contention, learned Counsel places reliance on the Judgment of the Apex Court in the case of **'COMMISSIONER OF INCOME TAX - VII v. PUNJAB STAINLESS STEEL INDUSTRIES'** reported in **[2015] 229 TAXMAN 0423 [SC]**.

8. Per contra, learned counsel appearing for the assessee supported the order passed by the Tribunal and invited our attention to the assessment order wherein, the Assessing Officer has considered the activity of the assessee is whether software development or technical service. It is contended that though the Assessing Officer has arrived at a conclusion that the business of the assessee is to develop the software, however, while considering the question whether the expenses incurred in foreign exchange by the assessee is an integral part of the development of computer software or towards rendering technical services, concluded that the expenditure incurred in the foreign currency is for providing technical services outside India.

9. It is further contended that the Appellate Commissioner though admitted that the assessee had exported software developed by it and rendered services relating to the development of software project, is carried away by the activity of the assessee

in deputing its technicians and engineers to provide services outside India and accordingly has given a finding that the expenses incurred in foreign currency are technical services. However, the Tribunal relying on its Judgment of the very same assessee – M/s. Mphasis Limited, allowed the claim of deduction made by the assessee, directed the Assessing Officer not to exclude expenses incurred in foreign currency for providing software development outside India from the export turnover. This Judgment relied on by the Tribunal is confirmed by this court in the case of **‘THE COMMISSIONER OF INCOME TAX AND ANOTHER v. M/S. MPHASIS LIMITED’** [ITA No.1075/2008 connected with ITA No.196/2009 – DD 1.8.2014].

10. It is also contended that the second question raised in this appeal is squarely covered by the Judgment of this court in the case of **‘COMMISSIONER OF INCOME TAX AND ANOTHER v. TATA ELXSI LTD.,’** reported in **[2012] 349 ITR 98 (Karn)]**.

11. We have considered the rival submissions made by the parties and perused the material on record.

12. On substantial question No.1, the Assessing Authority has extensively considered whether the activity carried on by the assessee is software development or technical service. It is an admitted fact, as per the assessment order, the role of the assessee is of developer of software and not a consultant to any project. It is also categorically held by the assessing authority that the purpose of business of the assessee is to develop the software and in such process, expenditure is incurred in foreign currency to provide technical services outside India. Having held so, the assessing authority proceeded to conclude that the nature of expenditure and the nature of business are two different and distinct concepts and as per the statute, what is to be excluded is the expenses in foreign exchange for rendering technical services, though the

same is forming an integral part as embedded in the process of on site development of software. This view is upheld by the Appellate Commissioner.

13. We have perused the relevant provisions of the Act i.e., 'export turnover' as defined under explanation (2)(iv) to section 10A of the Act. The said export turnover as per explanation (2)(iv) to section 10A of the Act means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into, India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India. What is relevant to be noticed as per this provision is that the consideration in respect of export of computer software received in or brought into India by the assessee in convertible foreign exchange is an export

turnover and what is excluded from this clause is [a] freight, [b] telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India [c] expenses, if any, incurred in foreign exchange in providing the technical services outside India. Explanation (3) inserted by Finance Act, 2001 with effect from 1.4.2001 explains that the profits and gains derived from on site development of computer software including services for development of software, outside India shall be deemed to be the profits and gains derived from the export of computer software outside India. Thus, it is clarified by the legislature by inserting explanation (3) to section 10A that the profits and gains derived from on site development of computer software including services for the development of such software outside India is deemed to be the profits and gains derived from the export of computer software outside India. In other words, the services rendered by the assessee relating to the development of computer software is deemed to be

part of export turnover of computer software outside India.

14. An identical issue relating to section 80HHE of the Act was considered by this court in the case of **'THE COMMISSIONER OF INCOME TAX & ANOTHER v. MOTOR INDUSTRIES CO., LTD.,** [in ITA No.776/2007 and connected matters DD 13.6.2014] and this court has held that though the services rendered in deputing the software engineers abroad who among other things have to do testing, installation and monitoring of software supplied to the client, appears to be technical in nature, it does not fall within the clause of providing technical service outside India in connection with the development or production of computer software and accordingly such expenditure cannot be excluded in computing export turnover. To decide the question on hand, the Tribunal has placed reliance on the Judgment passed by the Tribunal in the case of **M/s. Mphasis Limited.** The very same Judgment was subjected to judicial scrutiny before this court in ITA

No.1075/2008 connected with ITA No.196/2009, wherein this court, following the Judgment of ***Motor Industries Co., Ltd.***, [supra], answered the substantial question of law in favour of the assessee and against the revenue. This court has held that the expenditure incurred in the development or production of computer software though is in the nature of technical services, is not so, for the purposes of the Act and the said expenditure cannot be excluded in computing export turnover. Thus, we are of the view that the said Judgment is squarely applicable to the facts of the present case. Accordingly, we answer the first question in favour of the assessee and against the revenue.

15. As regards question No.2, Sri. K.V. Aravind, learned counsel appearing for the revenue has vehemently argued that though section 10A explanation (2)(4) defines 'export turnover' for the purposes of this section, the term 'total turnover' is not defined under this provision; Section 10A of the Act provides for deduction of profits and gains

derived by an undertaking from the export of computer software and such deduction shall be allowed from the total income of the assessee. The learned counsel has placed reliance on the Judgment of the Apex Court in the case of **Punjab Stainless Steel Industries** [supra] to contend that total turnover is the aggregate amount for which sales are effected by the company, referring to the guide to the Company Audit issued by the Institute of Chartered Accountants of India in the year 1980, while discussing sales. The learned counsel contended that the exchange fluctuation loss of Rs.74,25,340/- should be reduced from the total turnover while computing deduction under section 10A of the Act.

16. Section 10A[4] of the Act prescribes a formula to determine the deduction under section 10A of the Act. As per this provision, the said formula is, profits of the business multiplied by export turnover divided by total turnover. In the absence of definition of 'total turnover' under section 10A of the Act, whether the expression, viz., 'export

turnover' would have a different connotation in the application of the same formula, was considered by this court in the case of **Tata Elxsi Limited** [supra], this court while interpreting the term 'total turnover' for the purposes of section 10A of the Act has held that the total turnover is inclusive of the export turnover. Therefore, the formula for computation of deduction under section 10A is laid down as under:

$$\text{'Profits of the business of the undertaking'} \times \frac{\text{Export Turnover}}{(\text{Export turnover} + \text{domestic turnover})} = \text{'Total turnover'}$$

Applying the said principles of law enunciated by this court in the case of **Tata Elxsi Limited** [supra], we are of the view that the arguments advanced by the revenue if, accepted would lead to absurdity. We have no reason to differ from the Judgment of this court which is more particularly rendered in the context of section 10A of the Act. It is also to be noticed that the Judgment relied upon by the revenue in the case of **Punjab Stainless Steel Industries** [supra] is interpreting the term 'turnover' in terms of section 80HHC of the Act.

17. Section 10A of the Act is a beneficial provision. The purpose of section 10A of the Act is also to bring more foreign exchange and to encourage export and as the Government decides to give some benefit to such undertaking which is helping the nation in bringing foreign exchange, the revenue should encourage such traders by giving more benefits as contemplated under the provisions of law as enunciated by the Apex Court.

18. In such view of the matter, we are of the opinion that the second question of law is fully covered by the Judgment of this court in the case of **Tata Elxsi Limited** [supra] and accordingly we answer both the questions of law in favour of the assessee and against the revenue. Ordered accordingly.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

AN/-