

IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 1st DAY OF AUGUST 2012

PRESENT

THE HON'BLE MR.JUSTICE K.SREEDHAR RAO

AND

THE HON'BLE MR. JUSTICE B.MANO HAR

ITA NO.792/2006 C/W ITA NO.790/2006
& ITA.NO.791/2006

ITA.NO.792/2006

BETWEEN:

1. THE COMMISSIONER OF INCOME TAX
CENTRAL CIRCLE,
C.R.BUILDING,
QUEENS ROAD,
BANGALORE.
 2. THE DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE – 12(3),
C.R.BUILDING,
QUEENS ROAD,
BANGALORE.
- ...APPELLANTS

(BY SRI M.THIRUMALESH, ADVOCATE)

AND:

M/S.VEESH INFOTECHNICS LIMITED,
FORMERLY VISHESH INFOSYSTEMS LIMITED,
NO.325, CMH ROAD,

INDRANAGAR,
BANGALORE.

...RESPONDENT

(BY SRI.S.PARTHASARATHI, ADV)

ITA FILED U/S.260-A OF I.T.ACT, 1961 ARISING OUT OF ORDER DATED 02-12-2005 PASSED IN ITA.NO.3787/BANG/2004 FOR THE ASSESSMENT YEAR 2001-02, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL SET ASIDE THE ORDER PASSED BY ITAT BANGALORE IN ITA.NO.3787/BANG/2004 DATED 02-12-2005 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-12 (3), BANGALORE, IN THE INTEREST OF JUSTICE AND EQUITY.

ITA.NO.790/2006

BETWEEN:

1. THE COMMISSIONER OF INCOME TAX
CENTRAL CIRCLE,
C.R.BUILDING,
QUEENS ROAD,
BANGALORE.
2. THE DEPUTY COMMISSIONER OF INCOME-TAX
CIRCLE - 12(3),
C.R.BUILDING,
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BANGALORE.

...APPELLANTS

(BY SRI.M.THIRUMALESH, ADV)

AND:

M/S.VESESH INFOTECHNICS LIMITED,
(FORMERLY VISESH INFOSYSTEMS LIMITED)
NO.325, CMH ROAD,
INDRANAGAR,
BANGALORE.

...RESPONDENT

(BY SRI.S.PARTHASARATHI, ADV)

ITA FILED U/S.260-A OF I.T.ACT, 1961 ARISING OUT OF ORDER DATED 02-12-2005 PASSED IN ITA.NO.3785/BANG/2004 FOR THE ASSESSMENT YEAR 1999-00, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL SET ASIDE THE ORDER PASSED BY ITAT BANGALORE IN ITA.NO.3785/BANG/2004 DATED 02-12-2005 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-12 (3), BANGALORE, IN THE INTEREST OF JUSTICE AND EQUITY.

ITA.NO.791/2006

BETWEEN:

1. THE COMMISSIONER OF INCOME TAX
CENTRAL CIRCLE,
C.R.BUILDING,
QUEENS ROAD,
BANGALORE.
2. THE DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE – 12(3),
C.R.BUILDING,
QUEENS ROAD,
BANGALORE.

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AND:

M/S.VESESH INFOTECHNICS LIMITED,
(FORMERLY VISESH INFOSYSTEMS LIMITED)
NO.325, CMH ROAD,
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BANGALORE.

...RESPONDENT

(BY SRI.S.PARTHASARATHI, ADV)

ITA FILED U/S.260-A OF I.T.ACT, 1961 ARISING OUT OF ORDER DATED 02-12-2005 PASSED IN ITA.NO.3786/BANG/2004 FOR THE ASSESSMENT YEAR 2000-01, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL SET ASIDE THE ORDER PASSED BY ITAT, BANGALORE IN ITA.NO.3786/BANG/2004 DATED 02-12-2005 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-12 (3), BANGALORE, IN THE INTEREST OF JUSTICE AND EQUITY.

THESE ITA'S HAVING BEEN HEARD AND RESERVED AND COMING ON FOR PRONOUNCEMENT OF JUDGEMENT THIS DAY, B.MANO HAR J., MADE THE FOLLOWING:

J U D G M E N T

These appeals are filed by the Revenue under Section 260-A of the Income Tax Act ('the Act' for short), being aggrieved by the order dated 02-12-2005 passed by the Income Tax Appellate Tribunal allowing the appeals in part

and granting the benefit under Section 80-IA and 80-IB of the Act and also allowing litigation expenses to the assessee for the assessment years 1999-2000, 2000-2001, and 2001-2002.

2. Since the common question of facts and law are involved in these three appeals and the Appellate Tribunal has passed the common order. Hence, all the three appeals are taken up together and disposed off by this order.

3. The respondent-assessee is a Company incorporated under the Companies Act doing business in development of Software. It has established a new Industrial Unit at Silvassa, Union Territory of Dadra and Nagar Haveli. The new industry has been established on 13-3-1999 and filed its returns for the assessment year 1999-2000 declaring the total income of Rs.72,32,744/-. In the returns, the assessee claimed deduction under Section 80-IA of the Act to the extent of Rs.60,43,212/- in respect of new industrial undertaking at Silvassa, Union Territory of Dadra and Nagar Haveli. The Assessing Authority accepted the same,

however, it was subsequently reopened under Section 147 of the Act. In the Profit and Loss account, it is shown that the assessee has achieved turnover of Rs.63,75,000/- in respect of Computer Software sales. After deducting the expenses of Rs.3,31,788/- arrived at the profit of Rs.60,43,212/- from this Unit. On reassessment, deduction under Section 80-IA was disallowed.

4. For the assessment year 2000-2001, the assessee filed the Income Tax returns on 30-11-2000 declaring the total income of Rs.1,11,76,800/- and claiming deduction of Rs.1,50,56,903/- under Section 80-IB and Rs.19,00,000/- towards the litigation expenditures. In the Profit and Loss account, it is shown that the assessee has achieved turnover of Rs.2,15,41,550/-. After claiming the expenses of Rs.64,84,647/-, the assessee had achieved profit of Rs.1,50,56,903/- and claimed deduction under Section 80-IB of the Act. The case was selected for scrutiny. Notice was issued under Section 143(2) of the Act calling upon the assessee to furnish necessary particulars. The Assessing

Authority after considering the case pleaded by the assessee denied the benefit under Section 80-IB for Rs.1,50,56,903/- and also litigation expenses of Rs.19,00,000/-.

5. For the assessment year 2001-02, the assessee filed income tax returns on 30-10-2001 declaring total income of Rs.1,66,15,943/- claiming deduction of Rs.1,25,57,672/- under Section 80-IB. The case was selected for scrutiny under Section 143(3) of the Act and notice under Section 143(2) was issued. The Assessing Authority disallowed the claim under Section 80-IB holding that no document has been produced to show that they have manufactured any materials or things. Being aggrieved by disallowing the deduction under Section 80-IB for the assessment year 1999-2000 and also disallowing the deduction under Section 80-IB for the assessment year 2000-2001 and 2001-2002 and also litigation expenditure of Rs.19,00,000/-, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals)-III, Bangalore contending that the order passed by the Assessing Authority and also reopening

the assessment for the assessment year 1999-2000 is contrary to law.

6. The Appellate Authority after considering the matter in detail, by its order dated 8-11-2004 dismissed the appeals holding that no document has been produced by the assessee regarding the sales and purchase of the software. Being aggrieved by the order passed by the Appellate Authority, the assessee preferred three appeals before the Income Tax Appellate Tribunal, Bangalore Bench 'A'.

7. The Appellate Tribunal after considering the arguments addressed by the parties by its order dated 2-12-2005 allowed the appeals in part and dismissed the appeal insofar as it relates to the reopening of the assessment for the assessment year 1999-2000. The Tribunal has clearly held that the assessee has proved that he has been conducting business at Silvassa and earned income and he is entitled for deduction under Section 80-IA and 80-IB of the Act for the assessment years 2000-2001 and 2001-2002. So far as assessment year 1999-2000 is concerned, the

Assessing Authority was directed to adopt the profit shown at 55% instead of 94.8%. Further held that the assessee is entitled for the deduction of amount towards litigation expenditure of Rs.19,00,000/- for the assessment year 2000-2001. The Revenue being aggrieved by the order dated 2-12-2005 passed by the Tribunal has filed these appeals.

8. While admitting the appeals, the following substantial questions of law have been framed:

I T A 790/2006::

“Whether the Tribunal was correct in holding that the assessee would be entitled to claim deduction under section 80-IA of the Act despite the assessee’s SIVASA unit having operated from 13-03-1999 to 30-03-1999 did not produce or manufacture articles or thing as contemplated under Section 80-IA(iv) of the Act as held by the Assessing Officer.

I T A 791/2006::

“Whether the Tribunal was correct in holding that the payment made for acquiring the name of ‘VESESH’ and intellectual properties, copy right, trade mark, brand names etc., would not amount to a capital receipt but would be a revenue expenditure?”

I T A 792/2006::

“Whether the Tribunal was correct in holding g that the assessee would be entitled to claim deduction under Section 80-IB of the Act despite the assessee’s not producing any evidence to show that its production unit “Silvassa” had produced any software?”

9. Sri.M.Thirumalesh, learned counsel appearing for the appellants contended that the order passed by the Appellate Tribunal is contrary to law and the materials available on record. Admittedly, the new industrial Unit was started at Silvassa on 13-3-1999 hiring a premises measuring 825 Sq.Ft., with a very meager investment of Rs.2.06 lakhs on the computers. Within a span of 18 days, the assessee has achieved the turnover of Rs.63,75,000/- and net profit of Rs.60,43,212/- in development of software and sold to its customers. For the Assessment year 2000-2001, the turnover was shown as Rs.2,15,41,550/- and for the assessment year 2001-2002 turnover was shown at Rs.1,82,82,043/- and claimed deduction under Sections 80-IA and 80-IB. Though the assessee contended that they have employed 20 engineers, no documents have been

produced to show that they have engaged 20 employees and the space is not sufficient to keep 20 tables and computers. Further, the electricity meter was installed on 7-9-1999 and 3 phase connection has been given on 14-8-2000. The electricity bill discloses that for a period of 8 months, they have paid only Rs.2,340/-. Further, the assessee does not have regular telephone connection and telephone bill is also very very meager. In spite of directions to the assessee-company, it has failed to furnish the local addresses of the employees, appointment letters issued to them, attendance register and HR files. It is impossible to get the profit margin of 94.8% for the assessment year 1999-2000, 70% for the assessment year 2000-2001 and 58.87% for the assessment year 2001-2002. Usually, software industries would earn the profit margin of 30%. The assessee-company having its Head Office at Bangalore, has obviously diverted the sale profits of the other units to Silvassa Unit to avail 100% exemption under Section 80-IA and 80-IB.

10. Learned counsel has further contended that the benefit of deduction towards litigation expenditure of Rs.19,00,000/- given by the Tribunal is also contrary to law. Rs.19,00,000/- has been paid for acquiring intellectual properties, trade marks and copy right in the name of the 'Vesesh'. The dispute between the assessee-company and one P.R.Seshadri has been amicably settled under Section 73 of Arbitration and Conciliation Act. As per Clause 6, 7 and 11 of the Settlement, it was agreed between the parties that M/s.Seshadri Group will not conduct or do business with the customers of the assessee group. For that, a sum of Rs.19,00,000/- was paid. The said amount cannot be considered as revenue expenditure and it is a capital expenditure. The deduction given by the Tribunal is contrary to law and sought for setting aside the order passed by the Tribunal by allowing these appeals.

11. On the other hand, Sri.S.Parthasarathay, learned counsel appearing for the respondent-assessee contended that the assessee-company established a new industrial Unit

at Silvassa, Union Territory of Dadra and Nagar Haveli and started operating from 13-3-1999. The new Unit developed the software catered to multi-user as against the single user in respect of the product developed at Bangalore. The assessee-company is having more than 99 customers situated at India and abroad countries and the multi-user software attracted many customers and they have earned turnover of Rs.63,75,000/-. The employees are working on shift basis and since there was irregular power supply, the generator was used. Further, the public telephone has been used. In view of that, the bills of telephone and electricity were less. Further, the Sale Tax authorities of Silvassa have given sales tax exemption after verifying the records. Hence, the assessee is entitled for exemption under Sections 80-IA and 80-IB. Further, there is no irregularity in giving deduction with regard to the litigation expenditure of Rs.19,00,000/- with a view to settle the dispute between the parties amicably. The settlement was arrived between the parties and in terms of settlement, a sum of Rs.19,00,000/-

has been paid. It cannot be treated as capital expenditure and sought for dismissal of the appeals.

12. We have carefully considered the arguments addressed by the learned counsel for the parties and perused the orders impugned passed by the authorities below.

13. It is not in dispute that the respondent-assessee has started a new industrial Unit at Silvassa for development of software. The assessee claimed deduction under Sections 80-IA and 80-IB of the Act. However, the said deduction was denied only on the ground that within 18 days of establishment of new industrial Unit, the assessee has shown the profit of 94.8% for the assessment year 1999-2000 with an investment of Rs.2,06,000/- on the computers. It cannot be disputed that new industrial Unit was set up at Industrial Estate, Silvassa, Union Territory of Dadra and Nagar Haveli in March 1999 and got registration with the Directorate of Small Scale Industries and also obtained permission from the Pollution Control Committee. For the

purpose of development of software at Silvassa Unit, different technology i.e. MS access/personal oracle in the back end and in the front end and it was Developer 2000. It was different from the software developed at Bangalore Unit. Further the Sales Tax Authorities of Dadra and Nagar Haveli Union Territory after verifying the records granted conditional exemption certificate. Some of the conditions reads as under:

- (a) The owner of the industry shall issue serially cash/credit memos, for sales of finished goods which will contain name and address of the purchasers, descriptions of the goods sold and its value, exemption certificate number and date, signature of the seller.
- (b) The owner of the industry shall maintain sales and purchase and stock register for the said manufactured product;
- (c) The dealer shall comply with the any other condition or conditions they may be imposed by the Commissioner of Sales Tax, Dadra and Nagar Haveli, administration of Dadra and Nagar

Haveli or Central Government, as the case may be from time to time.

14. The Sales Tax Authorities of Dadra and Nagar Haveli verified the books of accounts and after fulfilling all the conditions imposed, sales tax exemption was given. The Sales Tax Authorities are primarily interested in collecting the sales tax. In the instant case, being fully satisfied by themselves that the assessee has fulfilled all the conditions, the exemption has been given. Hence the contention of the revenue that the assessee has not conducted any business at Silvassa and the assessee has diverted the sales and profit from the other Units cannot be accepted. Further, the software products are different from other commercial products. Development of the software can be undertaken in a short span of time. The specific case of the assessee is that the employees were working on shift basis. The product of the assessee is multi-user and it has attracted the customers and they have huge turnover of more than Rs.63,00,000/- within a short period. Once the software is developed, any number of copies can be made within a short

span of time and sold to the different customers. Apart from that the assessee is in the software business and they have Unit at Bangalore and they have good customers all over India as well as in abroad countries. For the assessment years 2000-2001 and 2001-2002 also they have shown the turnover of Rs.2,15,41,550/- and Rs.1,82,82,043/-. Hence, it is very difficult to doubt the genuineness of the business activities of the software carried on by the assessee at Silvassa. The Sales Tax authorities after verifying the entire records have given exemptions. Hence it is clear that the respondent-assessee has done the business in software at Silvassa and entitled for exemptions under Sections 80-IA and 80-IB.

15. Though the revenue has not challenged the order passed by the Tribunal for the assessment year 2000-2001 insofar as granting deducting under Section 80-IB, during the course of arguments, learned counsel appearing for the revenue sought permission to raise a ground insofar as

deduction under Section 80-IB of the Act. The assessee has no objection for the same. Accordingly, the following additional question of law has been raised for the assessment year 2000-2001 as 1(b):

1(b) *“Whether the Tribunal was correct in holding that the assessee would be entitled to claim deduction under Section 80-IB for the assessment year 2000-2001 also.”*

Since the above issue has already been considered for the assessment year 2001-2002 and held against the revenue, the said reasoning is applicable for the assessment year 2000-2001 also insofar as granting deduction of Rs.19,00,000/- towards litigation expenditure for the assessment year 2000-2001. The settlement/agreement entered into between the respondent-assessee and P.R.Seshadri under Section 73 of Arbitration and Conciliation Act, 1996 clearly discloses that M/s.Seshadri Group will not conduct or do business with the customers of respondent-assessee as per the agreement, the assessee-company will become the owner of intellectual properties

including the copy right, trade marks, brand names of all the products produced by the assessee. For that purpose, an amount of Rs.19,00,000/- has been paid by the respondent-assessee company to M/s.Seshadri Group. At any stretch of imagination that amount cannot be treated as revenue expenditure only to get the brand name and restrain M/s.Seshadri Group from doing business with respondent's customers, Rs.19,00,000/- has been paid. The said amount has to be treated as capital expenditure. Hence, the respondent is not entitled for deduction in the litigation expenditure. The order passed by the Appellate Tribunal allowing deduction of Rs.19,00,000/- as revenue expenditure is contrary to law. The substantial question of law framed in ITA No.790/2006 and 792/2006 are answered against the Revenue. Insofar as the substantial question of law No.1, framed in ITA No.791/2006 is answered in favour of the Revenue and substantial question of law No.1(b) is held against the revenue.

17. Accordingly, we pass the following

ORDER

ITA Nos.790/2006 and 792/2006 filed by the revenue are dismissed. ITA No.791/2006 is allowed in part.

Sd/-
JUDGE

Sd/-
JUDGE

mpk/-*