

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH: BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND
SHRI G. MANJUNATHA, ACCOUNTANT MEMBER**

ITA No.994 & 995/Bang/2019
Assessment Year: 2015-16 & 2016-17

M/s. Adadyn Technologies Private Ltd. Commune Coworks, 139, 1 st Cross road 5 th Block Building, 80 Feet Road Koramangala Bengaluru-560 095 PAN NO : AAAC08283A	Vs.	The ACIT Circle- 1(1)(1) Bengaluru
APPELLANT		RESPONDENT

Appellant by	:	Shri Sudeep Das, A.R.
Respondent by	:	Shri Muzaffar Hussain, D.R.

Date of Hearing	:	20.08.2020
Date of Pronouncement	:	21.08.2020

ORDER

PER G. Manjunatha, Accountant Member:

These two appeals filed by the assessee are directed against separate, but identical orders of the CIT(A)-1 Bengaluru, both dated 21.3.2019 and pertains to assessment year 2015-16 and 2016-17. Since, the facts are identical and issues are common, for the sake of convenience, these appeals were heard together and are being disposed of by this consolidated order.

2. The assessee has more or less raised common grounds of appeal for both the assessment years, therefore, for the sake of brevity the grounds of appeal filed for assessment year 2015-16 are reproduced as under:

1. The Ld. Deputy Commissioner of Income-tax Circle-1(1)(1) ('learned AO) has erred in law and on facts in passing the assessment order in the manner passed by him, and the CIT(A)-1 has erred in sustaining the addition made by the . learned AO. The order passed by the lower income-tax authorities are bad in law and not derived from the instant facts, and liable to be quashed.
2. The learned CIT(A) has erred in –
 - (a) Treating expenditure incurred towards salary cost during the tax year, to be capital in nature;
 - (b) Disregarding the provisions of Accounting Standard 26 and recognized the salary expenditure, incurred towards research of the Company's planned software platform, as capital in nature;
 - (c) Construing the salary costs to be in the nature of capital work-in-progress;
 - (d) Assuming that the platform would eventually give an enduring benefit to the Company, after its development – without giving consideration to the fact that the platform developmental activities were eventually shelved in the subsequent tax year.
 - (e) Disregarding the jurisdictional binding ratio of the Hon'ble Karnataka High Court, while adjudicating the issue.
3. The learned CIT(A) has erred in
 - (a) Treating expenditure incurred towards marketing, which was towards the overall promotion of the products of the Company during the tax year, to be capital in nature.

(b) Assuming that the said marketing expenses, were associated with the platform developmental project – without giving consideration to the fact that the Company has incurred the said marketing expenses towards promotion and renewed brand image, of the Company and with the prospect of attracting potential customers.

3. The brief facts of the case are that the assessee company is engaged in the business of rendering customised internet advertising services for advertisers such as news, financial services and entertainment. It has a subsidiary in USA, Adadyn inc., USA set up in September, 2010, which is engaged in providing marketing and business support services to Adadyn, India. The assessee business model has two streams of income. The first is called pragmatic model and the second is reselling model. The pragmatic business consists of services rendered to international customers and this involves online display, advertisement i.e. optimized via demand side software interfaces and algorithms. It also involves buying and selling advertisement, sales on online software platform such as Appnexus. This may be done manually or by use of

software. Major portion of the revenue of the assessee was from this stream of business. During the financial year 2013-14, Adadyn, India had started a new business like reselling. In this segment, Adadyn, India buys advertisement inventory from the website (Publishers) and resells it to its customers (predominantly Google). In other words, reselling an advertisement space of publisher to customers. A survey u/s 133A of the Income Tax Act, 1961 (herein after called as 'The Act') was carried out in the case of the assessee on 18.7.2017. During the course of survey, the statement of Mr. Nithin Kurian, H.R. Manager was recorded. Further, statement of CEO of assessee company Shri Kurian Gopinath was also recorded on 27.7.2016, where they have admitted that the company has started a new business model, for which it is developing new software platform.

4. The assessee has filed its return of income for assessment year 2015-16 on 28.11.2015 declaring total income of Rs.14,16,63,540/-. The case was selected for scrutiny and during the course of assessment

proceedings, the assessee was asked to explain as to why expenses pertaining to development of software platform shall not be capitalized as it will give an enduring benefit. The assessee vide its letter dated 21.8.2017 submitted that the product that it was developing cannot be termed as an independent product, which can be put to use. It was only working to bring out specific market output by simplifying the business of Appnexus, for less sophisticated client base, who could neither afford to hear specialized Ad operations nor afford to pay license fee for Appnexus. The assessee further submitted that it has spent various expenses including salaries on technical personnel and marketing expenses in USA to gauge the effect of this new software platform. However, due to rapid change of technology and shifting of advertisement from desktop to mobile platform, the software being developed by the assessee was abandoned and closed since the product was very unusable. Further, at no point of time, this new platform was put to use and no depreciation is claimed on the project. Therefore,

expenses incurred for conducting feasibility study of the new software platform cannot be considered as capital expenditure, which gives enduring benefit to the assessee.

5. The A.O. was not convinced with the explanation of the assessee and according to him, the software platform developed by the assessee would give an enduring benefit to the assessee. The assessee is the owner of the software platform being developed and the amount of expenditure made on technical person and in sale and marketing of the software indicated that it is likely to central tool of business of the assessee and should be considered as capital expenditure. Therefore, he opined that expenditure incurred on development of new software platform is in capital nature, which gives enduring benefit to the assessee and thus, needs to be capitalized. Accordingly, disallowed an amount of Rs.6,06,30,146/- being expenditure incurred on salaries for software product development and its marketing.

6. Being aggrieved by the assessment order, the assessee preferred an appeal before the CIT(A). Before the

CIT(A), the assessee reiterated its argument taken before the A.O. along with certain judicial precedents and submitted that expenditure incurred for preparation of feasibility report of a new project, in respect of same business, which is already carried on by the assessee even if it is for expansion of business cannot be treated as capital in nature. The assessee has also taken support from Accounting Standards-26 issued by the ICAI for accounting of expenditure on research and development to argue that in the research phase of a project, an enterprise cannot demonstrate that an intangible asset existed from which future economic benefits are probable. Further, the standards make it very clear that expenditure on research should be recognized as expenditure, when it is incurred.

7. The Ld. CIT(A) after considering the submissions of the assessee and also taken note of factual matrix brought out by the A.O. came to the conclusion that the new software platform being under development during the year is expected to give enduring benefit to the

assessee and being a new intangible product, on which one can recognise the intellectual property in the same. Thus, it can be fairly assumed that the new product, once developed is expected to give enduring benefit to the assessee which was to support and form the back bone of the new line of business of reselling of online digital advertisement space. Thus, expenditure incurred on the project assumes the character of capital expenditure. Accordingly, the Ld CIT(A) was of the opinion that there is no error in the findings accorded by the A.O. in treating the expenditure to be capital in nature. Aggrieved by the CIT(A) order, the assessee is in appeal before us.

8. The Ld.A.R. for the assessee submitted that the Ld. CIT(A) has erred in treating expenditure incurred towards salary cost of technical person involved in development of new software platform and marketing expenses incurred for conducting feasibility study of new software platform is capital in nature, which gives enduring benefit to the assessee without appreciating fact that the new software platform developed by the assessee was never put to use

and the same has been abandoned during next financial year. The A.R. further submitted that expenditure incurred by the assessee towards salary cost were revenue in nature as the entire team was dedicated to make an offering for the North American market SME segment, thus there was no development of any new independent product for this market, accordingly, the salary cost cannot be capitalised. Further, the marketing expenses were incurred in order to show cause the capabilities of Adadyn to the potential customers and this is a clear indication that other expenses were incurred primarily towards attracting potential customers for development of business in general for the company. Further, the expenditure incurred towards marketing of the product is not related to new software platform developed by the assessee. Therefore, the A.O. was incorrect in disallowing marketing expenses on the ground that it is in the nature of capital expenditure. In this regard, he relied upon the decision of Hon'ble Karnataka High Court in the case of

Karnataka State Industrial and Development Corporation
(163 ITR 657).

9. The Ld. D.R. on the other hand, strongly supporting order of CIT(A) submitted that the facts brought out by the A.O. clearly indicate the fact that expenditure incurred by the assessee towards salary cost for software development and marketing expenses is for development of new software platform to be used in market, which definitely can give enduring benefit to the assessee, therefore, whatever expenditure incurred for development of new software platform is in the nature of capital expenditure and hence there is no error in the findings recorded by the A.O. as well as Ld. CIT(A) to disallow such expenditure as capital in nature.

10. We have heard the rival submissions, perused the materials available on record and gone through the orders of the authorities below along with the case laws cited by the assessee. Admittedly, the assessee is in the business of online advertisement, for which it has developed a

software platform, which can be used from desktop. The assessee has incurred various expenditures, including salary and marketing expenses for conducting feasibility study of the new product in USA to gauge the effect of new software platform among customers and also to start popularising this software platform. But due to rapid change of technology and shifting of advertisement from desktop to mobile platform, the software being developed by assessee was abandoned and closed since the product was very unusable. Further, at no point of time, this new platform was put to use. In this factual matrix, if we examine the nature of expenditure incurred by the assessee towards salary paid to personnel for development of new software platform, it is very clear that the software developed by the assessee was never put to use because of change in technology. The question whether expenditure is in the nature of capital expenses, which gives enduring benefit to the assessee arises only when a product is developed and a new asset came into existence. Unless the product developed, comes in the form of a new

product, which can be independently used, then it cannot be said that the product would give enduring benefit to the assessee. In this case, on perusal of facts available on record, it is very clear from facts brought out by the A.O. that actually the assessee is developing a new software platform but such new platform was abandoned during the subsequent financial year due to rapid change in technology and shifting of technology from desktop to mobile platform. The product has never been put to use and no depreciation has been claimed. Further, the expenditure incurred towards development of new software platform was treated as part of revenue expenditure and has never been debited to capital work in progress in the books of accounts. Therefore, we are of the considered view that when the product was in development stage during the year under consideration and the same has never been put to use even in subsequent financial year and finally abandoned, then it cannot be termed that an independent product was came into existence, which gives enduring benefit to the

assessee to treat expenditure incurred on development of said product to be in capital in nature. At best, the expenditure incurred by the assessee towards development of new software platform is in the nature of expenditure incurred for preparation of feasibility of the new project in respect of same business, which is already carried out by the assessee, even if it is for expansion of business and definitely cannot be treated as capital expenditure incurred for development of a new product, which gives enduring benefit to the assessee. This view taken by us is fortified by the decision of Hon'ble High Court of Karnataka in the case of Karnataka State Industrial Development Corporation (supra), where the court clearly held that expenditure incurred on investigation, research and feasibility studies laid out by assessee was revenue expenditure in nature and thus was an allowable deduction.

11. We further noted that as per Accounting Standard-26 prescribed by the ICAI for treatment of expenditure of

research and development expenses, the standard clearly laid down the procedure for accounting of research expenditure, as per which expenditure on research should be recognised as an expenditure when it is incurred. The Accounting standard further states that in the research phase of the project, an enterprise cannot demonstrate that an intangible asset exists from which future economic benefits are probable. Therefore, we are of the considered view that the A.O. as well as the Ld. CIT(A) were erred in coming to the conclusion that expenditure incurred on developing new software platform is expected to give enduring benefit and one can recognise the intellectual property in the same to come to conclusion that expenditure incurred for development of new software platform is capital in nature. Hence, we direct the A.O. to delete additions made towards disallowance of salary expenses incurred for development of new software platform.

12. Coming to marketing expenses; Although the A.O. as well as Ld. CIT(A) has never brought out clear facts with

regard to the nature of marketing expenses incurred by the assessee and its nexus with a new product being developed by the assessee, on perusal of details filed by the assessee, we find that marketing expenses incurred by the assessee has no nexus with new product being developed by the assessee. Further, marketing expenses were incurred in order to show-cause the capabilities of Adadyn to the potential customers and from this it has a clear indication that expenses were incurred primarily towards attracting potential customers and further development of the business in general for the company. When the marketing expenditure incurred towards the overall promotion of the business of the company and there is no direct nexus between the marketing expenses and the new software platform being developed by the assessee, the A.O. as well as Ld. CIT(A) were clearly erred in coming to the conclusion that marketing expenditure is in the nature of capital expenditure. Further, assuming that said marketing expenses were associated with the new platform developmental project, even then said

expenditure is revenue in nature, because the product under development was never put to use and also the same has been abandoned in subsequent financial year. Therefore, we are of the considered view that marketing expenses incurred by the assessee in USA to gauge the effect of new software platform cannot be treated as capital in nature. Accordingly, we direct the A.O. to delete additions made towards marketing expenses as capital in nature.

13. In the result, the appeal filed by the assessee for Asst. year 2015-16 is allowed.

ITA NO 995/Bang/2019- Asst Year 2016-17

14. The facts and issues involved in this appeals filed by the assessee are identical to the facts and issues which we had considered in ITA No.994/Bang/2019 for the A.Y. 2015-16. The reasons given by us in preceding paragraph in ITA No.994/Bang/2019 mutatis mutandis shall apply to this appeal, as well. Therefore, for detailed reasons

recorded in preceding paragraphs, we direct the ld. AO to delete additions made towards disallowances of software development expenses and marketing expenses incurred on new software platform.

15. In the result, appeals filed by the assessee for both assessment years are allowed.

Order pronounced in the open court on 21st Aug'20

Sd/-
(N.V. Vasudevan)
Vice President

Sd/-
(G. Manjunatha)
Accountant Member

Bangalore,
Dated 21st Aug, 2020.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.