

आयकर अपीलीय अधिकरण, 'बी' न्यायपीठ, चेन्नई।
IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH: CHENNAI

श्री रमित कोचर, लेखा सदस्य एवं
श्री धुव्वुरु आर.एल. रेड्डी, न्यायिक सदस्य के समक्ष
BEFORE SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER AND
SHRI DUVVURU R.L.REDDY, JUDICIAL MEMBER

ITA Nos.1406 & 1407/Chny/2015
निर्धारण वर्ष /Assessment Years: 2007-08 & 2009-10

M/s. Pentamedia Graphics Ltd.,
'TAURUS', No.25, First Main Road,
United India Colony,
Kodambakkam,
Chennai-600 024.

v. The Dy. Commissioner of
Income Tax,
Media Circle-I,
Room No.311, 3rd Floor,
New Block, 121, M.G.Road,
Nungambakkam,
Chennai-600 034

[PAN: AAACP 1647 B]
(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/ Appellant by

: Mr. G. Baskar, Advocate and
Mrs.Sree Lakshmi Valli, Adv.

प्रत्यर्थी की ओर से /Respondent by

: Mr. A.Sundararajan, Addl.CIT

सुनवाई की तारीख/Date of Hearing

: 19.11.2019 & 11.03.2020

घोषणा की तारीख /Date of Pronouncement

: 08.05.2020

आदेश / ORDER

PER RAMIT KOCHAR, ACCOUNTANT MEMBER:

These two appeals filed by assessee are directed against common appellate Order dated 23.03.2015 passed by learned Commissioner of Income Tax (Appeals)-14, Chennai (hereinafter called "the CIT(A)"), in ITA No.38/11-12 & 70/13-14 CIT(A)-14 respectively , dated 23.03.2015 for assessment Years (ay's) 2007-08 & 2009-10 respectively , the

appellate proceedings before learned CIT(A) had arisen from separate assessment order(s) , for ay: 2007-08 dated 31.03.2013 passed by learned Assessing Officer (hereinafter called "the AO") u/s.143(3) read with Section 254 of the Income-tax Act, 1961 (hereinafter called "the Act") and secondly for ay: 2009-10 dated 15.12.2011 passed u/s 143(3) of the 1961 Act. There are common issues involved in these appeals and hence these two appeals were heard together and disposed of by this common order. These two appeals are filed late by 4 days and an petition is filed by assessee company explaining the reasons for delay in filing these appeal late by 4 days duly supported by an affidavit executed by Managing Director of the assessee company. The learned DR did not raise any serious opposition to the condonation of delay in filing this appeal late by 4 days. After considering the contentions made before us, we are condoning the delay of four days in filing this appeal late beyond time stipulated under the Income-tax Act, 1961 and admit both these appeals to be adjudicated on merits in accordance with law.

2. The grounds of appeal raised by assessee in memo of appeal(s) filed with the Income-Tax Appellate Tribunal, Chennai (hereinafter called "the Tribunal") for ay: 2007-08 in ITA no. 1406/Chny/2015 and for ay: 2009-10 in ITA No. 1407/chny/2015 respectively , read as under:-

"For AY 2007-08:

1. *The order of the Commissioner of Income Tax (Appeals) dated 23.03.2015, is arbitrary, erroneous, incorrect and contrary to law and facts.*
2. *The Commissioner of Income-tax (Appeals) erred in confirming the order of the lower authority restricting the grant of depreciation to 25% instead of 60% as claimed by the Appellant.*

3. The Commissioner of Income-tax (Appeals) ought to have noted that 'Digital Content' comprises of software that is a tangible asset.

4. The Commissioner of Income-tax (Appeals) erred in making a distinction between 'canned' software and 'customized' software which is irrelevant to decide the issue of grant of depreciation.

5. The Commissioner of Income-tax (Appeals) incorporates the concepts of 'canned' and 'customized' software without noting that there is no such distinction in Appendix I to the Income Tax Rules relating to the grant of depreciation.

6. The reliance of the Commissioner of Income-tax (Appeals) on various technical literature is of no relevance in deciding the present issue. In so far as the issue at hand relates to grant of depreciation on software, nothing turns on whether the software is canned or customized. In fact, the distinction between canned and customized software proceeds from the admitted position that the Digital Content is, prima facie, software, eligible for depreciation at 60% as claimed.

7. The Commissioner of Income-tax (Appeals) erred in not noting that intangible assets have been specifically defined under Part D of the Appendix to the Income Tax Rules as being knowhow, patent, copyright, trade mark, license or commercial rights of similar nature. On the other hand, Appendix I of the Income Tax Rules clarifies in Note 7 thereof that Information Technology Software is eligible for depreciation @ 60%. There is thus no scope or justification in confusing tangible and intangible assets that have been demarcated clearly.

8. The Commissioner of Income-tax (Appeals) erred in relying upon various judgments of Foreign Courts to conclude that software is an intangible asset. He ought to have followed the law laid down by the Supreme Court in the case of Tata Consultancy Services vs. State of Andhra Pradesh to the effect that computer software is a tangible asset. The Commissioner of Income-tax (Appeals) is bound in terms of Article 141 to follow the law laid down by the Indian Supreme Court rather than the judgments of the Foreign Courts that has come to a different conclusion. Likewise, the Commissioner of Income-tax (Appeals) prefers to rely upon the classification of software as intangible asset by the Institute of Chartered Accountants of India ignoring the judgment of the Supreme Court cited (supra). The judgment of the Supreme Court in the Appellants' own case also supports the case of the Appellant and has been distinguished for wholly unacceptable reasons.

Interest

9. The Commissioner of Income Tax (Appeals) erred in confirming levying interest u/s 234B and 234D of the Act. The levies are arbitrary, high and liable to be cancelled.

10. Any other ground that may be raised at the time of personal hearing."

For AY 2009-10:

"General

1. The order of the Commissioner of Income Tax (Appeals) dated 23.03.2015, is arbitrary, erroneous, incorrect and contrary to law and facts.

Depreciation on Digital Content

2. The Commissioner of Income-tax (Appeals) erred in confirming the order of the lower authority restricting the grant of depreciation to 25% instead of 60% as claimed by the Appellant.

3. The Commissioner of Income-tax (Appeals) ought to have noted that 'Digital Content' comprises of software that is a tangible asset.

4. The Commissioner of Income-tax (Appeals) erred in making a distinction between 'canned' software and 'customized' software which is irrelevant to decide the issue of grant of depreciation.

5. The Commissioner of Income-tax (Appeals) incorporates the concepts of 'canned' and 'customized' software without noting that there is no such distinction in Appendix I to the Income Tax Rules relating to the grant of depreciation.

6. The reliance of the Commissioner of Income-tax (Appeals) on various technical literature is of no relevance in deciding the present issue. In so far as the issue at hand relates to grant of depreciation on software, nothing turns on whether the software is canned or customized. In fact, the distinction between canned and customized software proceeds from the admitted position that the Digital Content is, prima facie, software, eligible for depreciation at 60% as claimed.

7. The Commissioner of Income-tax (Appeals) erred in not noting that intangible assets have been specifically defined under Part D of the Appendix to the Income Tax Rules as being knowhow, patent, copyright, trade mark, license or commercial rights of similar nature. On the other hand, Appendix I of the Income Tax Rules clarifies in Note 7 thereof that Information Technology Software is eligible for depreciation @ 60%. There, is thus no scope or justification in confusing tangible and intangible assets that have been demarcated clearly.

8. The Commissioner of Income-tax (Appeals) erred in relying upon various judgments of Foreign Courts to conclude that software is an intangible asset. He ought to have followed the law laid down by the Supreme Court in the case of Tata Consultancy Services vs. State of Andhra Pradesh to the effect that computer software is a tangible asset. The Commissioner of Income-tax (Appeals) is bound in terms of Article 141 to follow the law laid down by the Indian Supreme Court rather than the judgments of the Foreign Courts that has come to a different conclusion. Likewise, the Commissioner of Income-tax (Appeals) prefers to rely upon the classification of software as intangible asset by the Institute of Chartered Accountants of India ignoring the judgment of the Supreme Court cited (supra). The judgment of the Supreme Court in the Appellants' own case also supports the case of the Appellant and has been distinguished for wholly unacceptable reasons.

Disallowance u/s 14A of the Income Tax Act

9. The Commissioner of Income Tax (Appeals) erred in confirming the disallowance of an amount of Rs.57,49,365/- in terms of S.14A r.w.Rule 8D of the Income tax Rules.

10. The Commissioner of Income Tax (Appeals) ought to have noted that the provisions of Sec.14A would apply only in respect of exempt income in relation to which expenditure has been incurred and not to the present case where no expenditure has been incurred at all.

11. The Commissioner of Income Tax (Appeals) ought to have noted, the investments themselves have been occasioned pursuant to an order of the High Court sanctioning a scheme of merger. Hence, the disallowance of notional expenditure has no basis and is liable to be cancelled in full.

Interest

12. The Commissioner of Income Tax (Appeals) erred in confirming levying interest u/s 234 B and 234 D of the Act. The levies are arbitrary, high and liable to be cancelled.

13. Any other ground that may be raised at the time of personal hearing."

3. First we will take up appeal filed by assessee for ay: 2007-08 in ITA no. 1406/Chny/2015. The only limited issue in appeal filed by assessee for ay:

2007-08 to be adjudicated by us is as to rate of depreciation allowable to assessee on 'Digital Content' i.e. whether assessee is entitled for a depreciation @ of 25% or 60%. This is second round of litigation before tribunal and in the first round of litigation before tribunal, the Revenue had filed an appeal with tribunal and the tribunal was pleased to set aside the matter back to the file of the AO in ITA no. 144/Mds/2011, vide order dated 09.09.2011 for re-adjudication of the issue by AO afresh after considering contentions of the assessee, provision of law, case laws etc. by passing an speaking order. In the second round of litigation, the AO vide assessment order dated 31.03.2013 passed u/s 143(3) read with Section 254 of the 1961 Act held that the assessee is entitled for depreciation @ 25% on 'Digital Content' developed by it as the same is 'intangible asset' and the assessee is not entitled for depreciation @ 60% as the said digital content is not computer software. The assessee on its part had contended before the AO in second round of litigation that the assessee is an animation & special effects company using computer as camera and it has produced eight animation films and visual/special effects for more than 500 Indian and international films. The assessee submitted that these animation of special effects are produced using computer software and specially prepared software for the characters, backgrounds and properties which are made specially and then combined using many computers processors to make shots. These are called 'Digital Content' which is available in hard disk/drive of the computer. The assessee submitted that the assessee is an 100% EOU status under EHTP

scheme and is engaged in development of 'Digital Content'/'Animation Software' for utilization in the production of films. The assessee submitted that these are Customized software's and depreciation claimed for software is 60% as per Income Tax Act, 1961. Further, the assessee submitted that the assessee has claimed depreciation on the 'Digital Content' and animation software developed by it and utilized for the purpose of production of films. The assessee submitted that it engages software programmers who write necessary code for the software which is later translated into machine readable form resulting in software that is stored in an information storage device like hard disk. The software relates to various visual effects that are utilized for making of films and it was submitted that this animation software constitutes stock in trade of the assessee which is exploited by it in production of business of animation films. The assessee relied upon Explanation-2 to Sec.10B of the Act, which defined computer software as under:

" 10B.....

Explanation 2 – For the purpose of this Section –

(i) 'computer software' means -

(a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or (b) any customized electronic data or any product or service of similar nature as may be notified by the Board; which is transmitted or exported from India to any place outside India by any means;

The assessee submitted that animation software developed by it satisfies the definition of computer software , being a programme, recorded and stored in an information storage device and utilized in the business of the assessee. The assessee also referred to the judgment in the case of

Commissioner of Customs v. Pentamedia Graphics Ltd., wherein the Hon'ble Supreme Court concluded in context of laws applicable to customs that the 'motion capture animation films' would qualify to be classified as information technology software. Thus, the assessee submitted before the AO that the Digital Content/Animation Software developed by it is of the nature of Application Software used by it in the business of movie production, eligible to depreciation @ 60%.

The assessee also submitted that as per the Accounting Standard-26, the intangible asset is identifiable as under:

"An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Non-monetary assets are assets other than monetary assets.

Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

Not all the items will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation.

Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant.

Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under AS 10, accounting for fixed assets, or as an intangible asset under this standard, judgment is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset."

It was submitted by assessee before the AO in second round of litigation that the 'Digital Content'/ 'Animation Software' developed is in nature of application software which is used by the assessee in the business of movie production and is eligible for depreciation @ 60%.

3.2 The AO rejected the contentions of the assessee and held that the assessee is entitled for depreciation 25% on 'Digital Content' as the same is intangible asset and not computer software, by holding as under, vide assessment order dated 31.03.2013 passed u/s 143(3) read with Section 254 of the 1961 Act:

"14.1 The issue is whether the "Digital Content" acquired by the assessee is eligible depreciation @60% as applicable for computer software or @25% as applicable to intangible assets.

14.2. The issue considered by the Hon'ble Supreme Court is whether the 'Motion capture Animation Files' is computer software and is eligible for exemption from custom duty or not. The Supreme Court has held that the same are computer software after verifying the contents and with relevance to the Customs Act. The Customs Act deals with the goods at the point of entry and the subsequent state of the goods is not relevant to the grant of exemption under the Act. Further, the issue herein is whether the asset is a tangible asset or intangible asset under the Income-tax Act. As the decision of the Supreme Court is on different context and the Supreme Court has not examined with relevance to the Income-tax Act, relying on the same by the assessee/is not correct.

14.3 The assessee company has given certain clips which show the manner in which the animation is produced. It shows first a drawing of caricatures for a particular scene and converting the same to an animation film. It appears that the assessee has misunderstood the query raised in the letter dated 13.03.2013.

The purpose of the query was to see how the assessee company is using the animation in its business. The software which it acquires from outside and uses for its own business as application software without altering the same would be eligible as computer software. The same is like Ms-Office, etc. But, as stated by the assessee company itself the digital content which is developed in-house is used in the business of movie production.

14.4 From the submissions of the assessee, it is clear that it has utilized the software in the production of films but the same was developed by it as Digital content/ Animation software and still owned by it.

14.5 Let us now deal with the difference between the software Developed/acquired and copy of computer software purchased by it: In the case of the first one, the company holds the rights of the said software and sells or gives a copy of the same to its clients, which are separately considered in the trading account. However, the issue is how the same is to be treated in the hands of the assessee company. It is undoubtedly its intellectual property right having enduring benefit, as claimed by itself that it is eligible to use the animation in sequels, etc. For example, the animation on characters like 'Ganesa', Buddha created by the company can be used again and again in various projects. Though these items are in the form of developed software they are intangible assets of the company in the first place. Therefore, it is clear that the software has longer and enduring life period, which has been demonstrated by assessee's own submissions.

14.6 Further, it is to be clearly understood that it is not the case that the company has developed software for a client and sells to it. Here, only copy of software, which is not for a particular client, is sold or implemented for clients. The assessee still holds the rights of the software and also generates revenue. This is precisely the intellectual rights of the assessee. The Income-tax Rules clearly provide for depreciation at the rate of 25% on intangible/ assets which includes Intellectual property rights.

14.7 The fact that software has component of intellectual property rights is relevant from the provisions of Section 72A, which is discussed hereunder:

" A restriction was placed under section 72A on set off of losses for an amalgamated company on amalgamation or a resultant company on demerger in respect of an industrial undertaking. Computer software, telecommunication services, electricity are specifically included in the definition of "industrial undertaking". This specific inclusion provided in the case of software, electricity or in the matter of provision of certain telecommunication services is not for the reason that they are not Industrial Undertaking but since intellectual property rights are involved in them to avoid any ambiguity."

14.8 Therefore, the computer software which have been developed or acquired on acquisition as that of its own, are to be considered only as Intangible assets and allowed depreciation @25%.

14.9 The assessee company has also drawn parallel with the software like Microsoft products, adobe, etc. Even this parallel goes against the contention of the assessee. It has been the universally accepted fact that the Microsoft holds intellectual property rights of its. Properties (software) and only issues copies of the same with the license for its use and it continues to exploit its software with

the rights owned by it. Similar is the case of software, like Photoshop, etc of Adobe."

14.10 It is to be noted herein that section 32 deals with an asset, whether it is tangible or intangible in the first place. The prescribed rates comes into play only once the asset is categorised as tangible or intangible. Animation software developed by the company is eligible for depreciation as applicable to intangible assets since the company holds intellectual property rights and exploits the same.

14.11 In view of the above, it is clear that the assessee company is eligible to claim depreciation @25% only on Digital contents developed by it as the same is held as intangible assets."

4. The assessee being aggrieved by an assessment framed by AO in second round of litigation vide assessment order dated 31.03.2013 passed u/s 143(3) read with Section 254 of the 1961 Act , filed first appeal before Ld.CIT(A). The learned CIT(A) was pleased to dismiss appeal filed by assessee, vide appellate order dated 23.03.2015 by holding as under:

"6. The Decision:

6.1 The appellant raised the following grounds:

"The Assessing Authority ought to have noted that the claim of the Appellant of depreciation at the rate of 60% is in line with Appendix I of the IT Rules that prescribes the said rate in relation to 'computer software'.

The Assessing Authority ought to have noted that the content developed by the Appellant satisfies the definition of "computer software" as set out in the appendix and the Appellant is thus entitled to the rate of depreciation prescribed there under. The judgement of the Supreme Court in thin context supports stand of the Appellant in this regard."

The Appellant relies on Appendix I to the Income Tax Rules where under computers, including computer software are entitled to depreciation at the rate of 60%. 'Computer Software' is defined in the Appendix to mean a computer programme recorded on any disc, tape, perforated media or other information storage devise. It was claimed that the digital content developed by the appellant is essential 'Computer software' in so far as it related to the computer programme that has been recorded on a storage device such as a disc. Further, it was stated that the content developed utilized in the multimedia and entertainment industry and, by its very nature, is a series of software programmes recorded on storage devices.

6.2 Rule 5 permits the percentages specified in the second column of the Table in Appendix I (IT Rules 1962), on the written down value of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year. Part A of the Appendix I deal with the rates for tangible assets. This table (III. Machinery and Plant (5)) prescribes depreciation @ 60% for computers including computer software. Computer software has not been

defined in the Act. But in Note 7 to Appendix I to the IT Rules, it has been explained to include computer program recorded on any disk, tape, perforated media or other information storage device.

6.3 The first issue in the present case is whether the computer software is a tangible or intangible asset and whether the assessee gets ownership right by acquiring / developing the same. In several cases the computer software is acquired off the shelf. The agreement under which software is commonly acquired, the assessee acquires only a licence to use the computer software for their own purpose and there is as such no acquisition of any asset. The intellectual property rights in computer software are recognized and protected by the Copyright Act and as per the provisions of s. 14(b) of the said statute, the use of a computer software under a licence is not exercise of a copyright. The acquisition of computer software under licence could be considered as a purchase of a copyrighted article wherein no copyright right is transferred either as per the Copyright Act or even as per the U.S. Regulations on this subject. The ratio laid down by the Hon'ble Supreme Court in the case of TCS (2004) 271 ITR 401 (SC) holding that computer software put in a medium of disk would be goods may lead to the inference that purchase of such disk is acquiring a tangible asset. If the disk, tape or floppy or other electronic medium in which the software is stored is by itself goods, then the assessee acquires the same, acquires a tangible asset. Computer software has not been defined in the Act, but in Note 7 to Appendix I to the IT Rules, it has been explained to include computer program recorded on any disk, tape, perforated media or other information storage device. Therefore computer software in canned form is goods and a tangible asset by itself. These are covered in Note 7 to Appendix I to the IT Rules and eligible for depreciation @ 60%.'

6.4 Canned software contained in a medium are bought and sold. It is an article of value. It is sold in various forms like floppies, disks, CD-ROMs, punch cards, magnetic tapes, etc. A program containing instructions in computer language is subject-matter of a licence. It has its value to the buyer. It is useful to the person who intends to use the hardware, viz., the computer in an effective manner so as to enable him to obtain the desired results. It indisputably becomes an object of trade and commerce.

'Canned software' means that is not specifically created for a particular consumer. The sale or lease of, or granting a license to use, canned software is not automatic data processing and computer services, but is the sale of tangible personal property.

When the software marketed is canned software being a tangible property would be exigible to sales-tax. These are eligible for depreciation @ 60%.

6.5 But in the present case, the software is not acquired off the shelf. These are highly customized software and are developed by the appellant company. These can't be clubbed with the kind of software purchased to run the hardware. Basically, there are two types of software programs. The first is an operational program which controls the hardware and actually makes the machine run; it is fundamental and necessary to the functioning of the computer hardware itself. Secondly, there is an applicational program which is a type of program designed to perform specific functions, such as preparation of the employee payroll, preparation of a loan amortization schedule, or any other specific job which the computer is capable of performing. Applicational programs instruct the central processing unit of the computer to perform the fundamental computations, comparisons, and sequential steps required to take incoming information and

compute the desired output. [Commerce Union Bank vs. Tidwell 538 SW. 2d 405]. The 60% rate for depreciation is stipulated for i. computer software acquired off the shelf, ii. operational software that controls hardware, iii. where the software is an integral part of the related hardware etc. In these cases these software which are recorded in any medium becomes tangible asset.

6.6 In the present case we are concerned with softwares developed by the assessee, itself. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset [Accounting Standard 26 under definition sl. No. 10]

6.7 The Assessee submitted that it developed software relating to animation graphics and special effects, based on which several animation films have been produced by it, some even nominated for the Oscar Awards. The computer animation and special effects in the form of computer software and are referred to as digital content, stored in the hard disc of the computer.

6.8 The expenditure incurred by the assessee on development of software is capital in nature. The assessee had not incurred expenditure towards any asset which is depreciable under the provisions of Income-tax Act. I place reliance on the decision in the case of Hylam Ltd. v. CIT [1973] 87 ITR 310 (AP) for the proposition that if the expenditure was incurred for initial outlay or acquiring or bringing into existence an asset of enduring nature: for the business of the assessee or for expansion of assessee's business or for substantial replacement, it will be treated capital expenditure.

6.9 **Software:** *A computer software is a set of commands, on the basis of which the computer may be directed to perform the desired function. Software is a series of instructions. While it may be housed in a floppy disc or a CD-ROM or the hard disc of the computer, the item referred to as software is the series of commands that operates the computer. Though the floppy disc, the CD-ROM and the hard disc are each tangible commodities, that could be bought, sold and resold, the software embedded in these media are intangible and fall into a very different category.*

In the book "Software Engineering" by Roger S. Pressman, it has been stated that a software is an instruction that when executed provides desired function and performances. It is stated that a software is composed of programs, data and documents. Each of these items comprises a configuration that is created as part of the software engineering process.

The definitions of "computer programme" in the Copyright Act, 1957 read as follows:

"Computer programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result."

Majority of the US Courts have held that software is an intangible property.

6.10 *The Apex Court referred to the judgments of the American Courts in the cases of Commerce Union Bank v. Tidwell 538 S.W.2d 405; State of Alabama v. Central Computer Services, Inc. 349 So.2d 1156; First National Bank of Fort Worth v. Bob Bullock, 584 S.W.2d 548; First National Bank of Springfield v. Deptt. of Revenue, 421 NE2d 175; CompuServe, Inc. v. Lindley 535 N.E. 2D 360 and*

Northeast Datacom, Inc. v. City of Wallingford, 563 A2d 688 holding that computer software is intangible personal property. [Infotech Software Dealers ... vs Union of India on 24 August, 2010 (Mad) W.P.Nos.3811 & 18886 of 2009]

6.11 In *Commerce Union Bank v. Tidwell* (Tenn. 1976), 538 S.W.2d 405, the Supreme Court of Tennessee held that computer software in the form of magnetic tapes or punch cards is intangible personal property and therefore not subject to that State's sales and use tax. The court reasoned that only information was being created and sold, "and the magnetic tapes which contain this information are only a method of transmitting these intellectual creations from the originator to the user. It is merely incidental that these intangibles are transmitted by way of a tangible reel of tape that is not even retained by the user.

In the case of *First National Bank v. Bullock* (Tex. Civ. App. 1979), 584 S.W.2d 548, the bank obtained licenses to use four programs, that is, software, which instructed the bank's computer to perform deposit and lending functions and process general accounting. The information was contained, on magnetic tapes. The court stated that it would look to the "essence of the transaction" to determine whether the property purchased was tangible or intangible. The court held that, since the information on the tapes could have been communicated in several different ways., and the computer could even have been programmed over the telephone or by hand, the essence of the purchase was not the tapes, but the process which enabled the computer to function. The software was therefore in essence intangible property.

In *St Albans City and District Council v International Computers Ltd* [1997 FSR 251] Sir Iain Glidewell in deciding on whether programs were goods, commented on tangibility. He referred to the software or programs as "the intangible instructions or commands".

6.12 The courts have held that software is intrinsically incorporeal and that it is mere intangible "knowledge" which "rests in the machine. [District of Columbia v. Universal Computer Assoc., Inc., 465 F.2d 615,618 (D.C)]. This has been quoted or paraphrased with approval in other decisions [State v. Central Computer Servs., Inc., 349 So. 2d 1160, 1162 (Ala. 1977), Honeywell Information Sysa., Inc. v. Board of Assessment Appeals, [1980] 7 COMPUTER L. SERV. REP. (BIGELOW) 486, 491 (Colo. Dist Ct. 1975); Nova Computing Servs., Inc. v. Askew, [1980] 6 COMPUTER L. SERV. REP. (BIGELOW) 18, 27 (Fla. Div. Admin. Hearings 1976); *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405, 408 (Tenn. 1976).] Because the tape, disk, card, or other transferring medium may be stored, returned, or destroyed after being used by the vendee machine, the Universal court reasoned that the visible manifestation of software-the medium-is inconsequential to the transaction.

Therefore, the court assumed, the object of the transaction must be intangible "knowledge" because the medium is inconsequential.

6.13 Thus, the software developed by the appellant is therefore in essence intangible property. Thus it will not fall in the categories of 'computer and softwares' indicated in Appendix-1 (Part-A) which deals only with tangible assets. Since the softwares developed by the assessee company is its intangible assets, these are entitled for depreciation as mentioned in Part-B of Appendix -1 which for the relevant AY is 25%.

6.14 Some of the judicial pronouncements are also relevant to mention here.

i. Licence acquired by assessee to use a particular computer software amounted to acquisition of technical know-how and the AO was justified in treating the same as intangible asset eligible for depreciation at 25 per cent for the relevant assessment year; payment was not deductible in its entirety as revenue expenditure. *SUDARSHAN CHEMICAL INDUSTRIES LTD. vs. ACIT* (2008) 114 TTJ (Pune) 131 : (2008) 110 ITD 171 (Pune)

ii. Since the assessee itself has claimed website development expenses as part of block of assets on which depreciation has been claimed and allowed, the same cannot be treated as revenue expenditure. Depreciation @ 25% applicable on intangible assets is allowable on such expenditure software development expenditure *Makemytrip (India) (p.) Ltd. vs. DCIT* (2012) 51 SOT 19 (Delhi) : (2012) 147 TTJ (Del) 231 : (2012) 72 DTR (Del) (Trib) 466.

iii. Assessee being company engaged in business of software development as well as sales and its exports - assessee was eligible for depreciation on intangible assets acquired by it. *DCIT vs. NETVISHIN WEB TECHNOLOGIES LTD.* (2013) 37 CCH 280 AhdTrib.

iv. In the case of *DCIT vs. HONDA SIEL CARS LTD.*(2013) 21 ITR (Trib) 497 (Delhi) : (2013) 142 ITD 783 (Delhi), it is held:

"8.1 The Special Bench farther observed that the rights which an assessee acquires by purchasing the disk or magnetic medium containing the computer software with limited or absolute right to use; the same by itself would satisfy the requirements of the Plant. The assessee's ownership of limited right over the tangible asset is to conclude that the assessee is the owner of the Plant. It was also observed that in the case of *Maruti Udyog Ltd. v. Dy. CIT* (2005) 92 ITD 119, *Radha Krishna Foodland Ltd. ; Escorts Ltd. v. Asstt. CIT* (2006) 8 SOT 167 and *Hero Honda Motors Ltd.*, the conclusion that the expenditure on purchase of computer software was capital proceeded on the footing that the purchase was an outright purchase and that Software was an intangible asset."

6.15 A recent ruling in the case of *Makemytrip (India) Pvt Ltd vs DCIT Circle* [2012] 19 taxmann.com 137 (Delhi), by the Income Tax Appellate Tribunal (ITAT), New Delhi, is pertinent. In this case, the tribunal held that the assessee had claimed website development expenses as capital expenditure and depreciation at the rate of 60 per cent, treating the website as software. However, the Delhi ITAT held that a website cannot be considered as software. Rather, it should be classified as an intangible asset and only 25 per cent of its cost is allowable as depreciation.

6.16 One of the arguments by the assessee is that Supreme Court has considered the identical question of classification of the 'digital content' concluding that the software is liable to be classified as 'Information Technology Software'. This judgement was in assessee's own case relating to issue of customs duty. The Assessing Officer has dealt this argument in his assessment order. The issue considered by the Hon'ble Supreme Court is whether the 'Motion capture Animation Files' is computer software and is eligible for exemption from custom duty or not. The Supreme Court has held that the same are computer software after verifying the contents and with relevance to the Customs Act. The Customs Act deals with the goods at the point of entry and the subsequent state of the goods is not relevant to the grant of exemption under the Act. Further, the issue herein is whether the asset is a tangible asset or intangible asset under the Income Tax Act. As the decision of the Supreme Court is on different context and

the Supreme Court has not examined with relevance to the Income Tax Act, relying on the same by the assessee is not correct.

6.17 I have already dealt with the difference between the software/developed/acquired and copy of computer software purchased by it. In the present case, software developed is its intellectual property right having enduring benefit, as claimed by the assessee that it is eligible to use the animation in sequels etc. These items are in the form of developed software and are intangible assets of the company in the first place.

6.18 According to Accounting Standard 26 (AS-26) issued by the Institute of Chartered Accountants of India (ICAI) also all software that are developed either within an organisation or availed through other sources, and provide enduring benefits enabling earnings in the present and in future, should be treated as intangible capital assets.

In view of above reasonings judicial pronouncements, I held that this software which were developed by the assessee company are entitled for depreciation @ 25%. Hence, the assessment made by the AO in this respect is justified and accordingly, the grounds no. a,b,c,d,e & f set out in the grounds of appeal are dismissed.

In the result, the appeal filed by the appellant is dismissed."

5. Aggrieved by an appellate order passed by learned CIT(A), the assessee has filed an appeal with tribunal. The learned counsel for the assessee submitted that the assessee is a software developer and the issue before the tribunal is whether the assessee is entitled for depreciation @ 25% or 60% on computer software . It was submitted that in first round matter went upto tribunal at the behest of Revenue and the tribunal was pleased to set aside the matter to file of the AO for fresh adjudication of the issue. It was submitted that in second round of litigation both the AO as well learned CIT(A) has decided the issue against the assessee. It was submitted that the assessee developed animation software . Our attention was drawn to Explanation 2 to Section 10B of the 1961 Act and it was submitted that computer software is eligible for deprecation @ 60%. Our attention was drawn to assessment order passed by AO as well appellate order passed by learned CIT(A). It was submitted that in assessee's own case in context of Customs Law, Hon'ble Supreme Court has held in Commissioner of Customs

v. Pentamedia Graphics Ltd., that the 'motion capture animation films' would qualify to be classified as information technology software, in Civil Appeal No. 2576 of 2001 vide judgment dated 09.05.2006. The learned counsel for the assessee also relied upon decision of ITAT, Chennai Benches in ITA no. 107/Mds/2012 in Laser Soft Infosystems Limited v. ITO , vide orders dated 31.01.2013. The assessee's counsel also brought to our notice, order passed by ITAT, Chennai in assessee's own case in first round in ITA no. 144/Mds/2011, dated 09.09.2011. The learned DR on the other hand submitted that animation software is tangible/intangible asset. Our attention was drawn to assessment order para 14.3 /page 15. Our attention was drawn to appellate order passed by learned CIT(A). It was submitted that Digital Content developed by assessee is intangible asset. It was submitted that Hon'ble Supreme Court decision is in context of Customs Laws and has no applicability so far as income tax laws are concerned. The learned DR relied upon appellate order passed by learned CIT(A).

6. We have considered rival contentions and perused the material on record included cited case laws. We have observed that limited issue for our adjudication is as to eligibility of the assessee for depreciation on 'Digital Content' developed by assessee and which is held by assessee as an 'asset' which is used in various films by assessee, is to be allowed at the rate of 60% being computer software or it is to be allowed @25% as an intangible asset. The Revenue is contending that this digital content

developed by assessee is merely intangible asset which entitles assessee for depreciation @ 25% while assessee is contending that the same is computer software and the assessee is eligible for depreciation @ 60%. In any case the effect will be tax neutral as overall depreciation spread over several years will ultimately cannot exceed in all cumulatively cost of the asset. The assessee has contended that it has developed software relating to animation graphics and special effects, based on which several animation films have been produced by it , even some nominated for the Oscar Awards. The computer animation and special effects in the form of computer software are referred to as 'digital content', stored in the hard disc of the computer. Thus, the assessee is claiming that 'digital content' developed by it is essentially computer software in so far as it related to the computer program that has been recorded on a storage device such as a disc. The assessee has claimed that the content developed is utilized in the multimedia and entertainment industry and , by its very nature, is a series of software programme recorded on storage device. As per Rule 5 to Income-tax Rules, 1962, the depreciation in respect of block of assets shall be calculated at percentages specified in Appendix 1 to Income-tax Rules, 1962 on written down value of such block of assets as are used for purposes of the business or profession of the assessee at any time during the previous year . In Appendix 1 to Income-tax Rules, 1962 at Part A under clause III- Machinery and Plant at sub-clause 5 , it is specified that Computers including computer software shall be eligible for depreciation @ 60%. The said also refer to Note Number 7 which clarify that 'Computer

Software' means any computer program recorded on any disc, tape , perforated media or other information storage device. While Part B specifies 'Intangible Assets' which include know-how, patents , copy rights , trade marks , licenses , franchise or any other business or commercial rights of similar nature which shall entitle assessee for depreciation @25%. The assessee has relied upon the decision of Hon'ble Supreme Court in its own case rendered in context of customs laws in Commissioner of Customs, Chennai v. Pentamedia Graphics Limited in Appeal(Civil) 2576 of 2001 dated 09.05.2006, wherein in context of customs notifications as were applicable any kind of data which is capable of being manipulated by means of automatic data processing machine would be covered by the term 'information technology software'. Presently, we are concerned with the 1961 Act and the relevant entry in Appendix I reads as under :

" PART A

TANGIBLE ASSETS

**

**

III Machinery and Plant

(5) Computers including Computer Software
(see note 7 below this table)

(60) "

Note 7 stipulates 'Computer Software' means any computer program recorded in any disc, tape, perforated media or other information storage device. "

Thus, as per note 7, computer software has been given restricted coverage to 'computer program...' vis-à-vis customs notifications referred to by Hon'ble Supreme Court in the aforesaid case in assessee's own case , wherein the said custom notifications referred to 'Information Technology software' means any representation of instructions, data, sound or image including source code and object code , recorded in a machine readable form , and capable of being manipulated or providing interactivity to a user , by means of an automatic data processing machine to be covered by the term 'Information Technology Software' . Thus, the coverage under customs laws was very wide while we are dealing with 1961 Act read with 1962 Rules and coverage of the term computer software is restrictive to computer program which is recorded in any disc , tape , perforated media or other information storage device. Thus, as could be seen that the assessee has developed Digital Content which is held by assessee as an asset and is used in various films etc after being manipulated. This in our considered view cannot be equated with a computer program but what is held by assessee is a digital content which is used by assessee in various films etc. . The computer animation and special effects are digital content which are stored in the hard disc of the computer. This digital content developed by assessee is utilized in the

multimedia and entertainment industry and at best it is a copyrighted intangible asset owned by assessee which is manipulated by assessee to be used in various films etc. but to contend that it is a computer software within the meaning of Appendix 1 will be far fetched as it is not a computer program. If the language in the statute is clear and unambiguous then strict interpretation has to be done and it is well settled that there is no equity in taxing statute. Once the definition is given in the statute itself , then there is no need to refer to other statute and restrictive definition as is given in the 1961 Act read with 1962 Rules shall apply .

In Wikipedia , Computer program is defined as collection of instructions that can be executed by a computer to perform a specific task. Most computer devices require programs to function properly. A computer program is usually written by a computer programmer in a programming language. From the program in its human-readable form of source code, a compiler or assembler can derive machine code—a form consisting of instructions that the computer can directly execute. Alternatively, a computer program may be executed with the aid of an interpreter.

In Wikipedia, Computer Programming is defined as a collection of computer programs, libraries, and related data are referred to as software. Computer programs may be categorized along functional lines, such as application software and system software. The underlying method used for some calculation or manipulation is known as an

algorithm. Computer programming is the process of designing and building an executable computer program to accomplish a specific computing result. Programming involves tasks such as: analysis, generating algorithms, profiling algorithms' accuracy and resource consumption, and the implementation of algorithms in a chosen programming language (commonly referred to as coding). The source code of a program is written in one or more languages that are intelligible to programmers, rather than machine code, which is directly executed by the central processing unit. The purpose of programming is to find a sequence of instructions that will automate the performance of a task (which can be as complex as an operating system) on a computer, often for solving a given problem. The process of programming thus often requires expertise in several different subjects, including knowledge of the application domain, specialized algorithms, and formal logic. Tasks accompanying and related to programming include: testing, debugging, source code maintenance, implementation of build systems, and management of derived artifacts, such as the machine code of computer programs. These might be considered part of the programming process, but often the term software development is used for this larger process with the term programming, implementation, or coding reserved for the actual writing of code.

The scope of 'Information Technology Software' as is referred to in Hon'ble Supreme Court judgment in assessee's own case was in context of Customs Laws which was very wide definition and hence we cannot draw

analogy in the 1961 Act read with 1962 Rules. Thus, to say that digital content developed by assessee can be equated with computer program is far fetched but rather it is a copyrighted material developed by assessee which is stored in computer. This digital content was manipulated by assessee to be used in different films but still it cannot be categorized to a higher pedestal of being termed as 'computer program' rather it still retains the character of copyrighted material being intangible asset and in our considered view, the assessee is eligible for depreciation @ 25% as these copyrighted material developed by assessee being 'Digital Content' which is used by the assessee in various films etc. . Thus, we concur with the view of learned CIT(A) who has passed well reasoned order which we affirm and dismiss the appeal of the assessee on this issue. Thus, ground number 2 to 8 stand dismissed. The ground number 1 and 10 are general in nature and does not require separate adjudication while ground number 9 is consequential in nature. We order accordingly.

7. In the result appeal in ITA no. 1406/Chny/2015 for ay: 2007-08 stand dismissed as indicated above. We order accordingly.

ITA No.1407/Chny/2015 for ay: 2009-10:

8. The first issue in this appeal filed by assessee for ay: 2009-10 concerns with the depreciation on 'Digital Content'. This issue is decided by us against assessee by us while adjudicating appeal for ay: 2007-08 in this common order. Our decision in ITA no. 1406/Chny/2015 for ay: 2007-

08 shall apply mutatis mutandis to appeal in ITA no. 1407/Chny/2015 for ay: 2009-10 so far as depreciation on 'Digital Content' is concerned. Thus, the assessee fails on this issue. Thus, ground number 2-8 stand dismissed. We order accordingly.

9. The second effective issue raised by assessee in its appeal for ay: 2009-10 concerns with disallowance of expenses incurred by assessee in relation to earning of an exempt income by the AO by invoking provisions of Section 14A of the 1961 Act read with Rule 8D(2)(iii) of the 1962 Rules. The AO has disallowed the expenses by invoking Rule 8D(2)(iii) of the 1962 Rules by applying 0.5% of the average investments. The learned CIT(A) has affirmed the decision of the AO. It is no more res-integra that Rule 8D of the 1962 Rule shall be applicable for the impugned assessment year. The only grievance raised by assessee before us is that the assessee has made investments in foreign companies from which dividend income was received during the year under consideration on which the assessee has paid due taxes to the government as the said dividend income was not exempt from tax and was infact chargeable to tax. It is prayed that the said investments in foreign companies be excluded while applying Section 14A of the 1961 Act read with Rule 8D of the 1962 Rules. We find merit in the contention of the assessee that once the income is chargeable to income-tax , Section 14A shall have no applicability. We are restoring the matter back to the file of the AO for verification of the contention of the assessee and re-adjudicate on merits in accordance with law after due

verifications and all such foreign investments on which dividend income has suffered taxation in India shall stand excluded. Second contention of the assessee before us is that the assessee has made investments in certain Indian companies from which no dividend income was received during the year and hence no exemption was claimed. It is prayed that such investments in Indian companies from which no dividend income was received during the year be excluded while computing disallowance of expenditure u/s 14A of the 1961 Act. We find merit in contentions of the assessee that the investments in Indian companies which did not yielded exempt income during the year cannot be included for computing disallowance of expenditure u/s 14A read with Rule 8D of the 1962 Rules and we are restoring the matter back to the file of the AO for verification of the contentions of the assessee and to re-adjudicate the matter on merits in accordance with law. Thus, all those investments in indian companies which did not yielded exempt dividend income during the year shall be excluded while computing disallowance of expenditure u/s 14A read with rule 8D(2)(iii) of the 1962 Rules. The decision of Special Bench of ITAT, Delhi in the case of ACIT v. Vireet Investment Private Limited (2017) 165 ITD 27(Del. SB-trib.) is relevant. This ground number 9-11 are partly allowed for statistical purposes as indicated above. We order accordingly.

10. The ground number 1 and 13 are general in nature and does not require separate adjudication, while ground number 12 is consequential in nature. We order accordingly.

11. In the result , appeal in ITA no. 1407/Chny/2015 for ay: 2009-10 is partly allowed for statistical purposes.

In the result, the appeal filed by assessee in ITA No.1406/Chny/2015 for ay: 2007-08 stand dismissed while appeal in ITA No. 1407/Chny/2015 for ay: 2009-10 stand partly allowed for statistical purposes. We order accordingly.

Order pronounced on the 8th day of May, 2020 in Chennai.

Sd/-

(धुव्वुरु आर.एल. रेड्डी)

(DUVVURU R.L.REDDY)

न्यायिक सदस्य/**JUDICIAL MEMBER**

Sd/-

(रमित कोचर)

(RAMIT KOCHAR)

लेखा सदस्य/**ACCOUNTANT MEMBER**

चेन्नई/Chennai,

दिनांक/Dated: 8th May, 2020.

TLN

आदेश की प्रतिलिपि अग्रेषित/**Copy to:**

1. अपीलार्थी/Appellant

2. प्रत्यर्थी/Respondent

3. आयकर आयुक्त (अपील)/CIT(A)

4. आयकर आयुक्त/CIT

5. विभागीय प्रतिनिधि/DR

6. गार्ड फाईल/GF