

IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

ITA No.461/Bang/2020
Assessment year : 2013-14

M/s Xalted Information Systems Pvt. Ltd. No.31, 3 rd Floor, Xavier Board, Primrose Road, Bengaluru – 560 025. PAN: AAFCS 5024G	Vs.	The Deputy Commissioner of Income Tax, Circle 7(1)(2) Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri S. Parthasarathi, Advocate
Respondent by	:	Smt. R. Premi, Addl. CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	07.10.2020
Date of Pronouncement	:	14.10.2020

ORDER

Per N.V. Vasudevan, Vice President

This appeal by the assessee is against the order dated 31.01.2020 of the CIT(Appeals)-7, Bengaluru relating to assessment year 2013-14.

2. The only issue that arises for consideration in this appeal is as to, whether the revenue authorities were justified in refusing to allow deduction u/s. 80IC of the Income-tax Act, 1961 [the Act] for a sum of Rs.62,13,596.

3. The facts and circumstances under which the appeal arises are that the assessee is a company engaged in telecommunication, software

development and trading in telecommunication hardware required mainly to run their software that are being supplied to the prospective consumers.

4. In the return filed for AY 2013-14, the assessee claimed deduction u/s. 80IC of the Act to the extent of Rs.14,52,171. The order of assessment u/s. 143(3) was passed on 22.2.2016 allowing the claim of assessee. The Pr.CIT-7, Bengaluru passed an order dated 6.2.108 u/s. 263 of the Act setting aside the order of the AO dated 22.2.2016 and directing the AO to re-examine all the relevant facts with regard to deduction u/s. 80IC of the Act and pass a fresh assessment order. It is pursuant to the aforesaid order u/s. 263 of the Act that the AO examined the claim of assessee u/s. 80IC of the Act.

5. U/s. 80IC of the Act, deduction is allowed on the profits & gains derived from an industrial undertaking from the business referred to in section 80IC(2) of the Act viz., manufacture of an article or thing, other than the article or thing mentioned in Schedule 13 of the Act. Assessee was engaged in the manufacture of an article or thing i.e., computer software and was eligible to claim deduction u/s. 80IC of the Act on the profits derived from the said business. The AO noticed that the deduction u/s. 80IC was claimed on income from service fees to the extent of Rs.62,13,596. Since the service fees cannot be equated with manufacture of computer software, the AO held that the assessee is not entitled to deduction on service fees income. The deduction u/s. 80IC was accordingly recomputed by the AO.

6. Before the CIT(Appeals), the assessee gave a break-up of income in the form of service fees received from 3 entities which were as follows:-

Name of the Party	Income from services rendered
Nepal Telecom	16,74,419
SatyamComputer Services Limited	45,00,000
Ericsson. India Private Limited	39,177

The Assessee explained the nature of services provided by it in respect of which deduction u/s.80IC of the Act was claimed and denied b the AO by pointing out that these services were required to be performed for using software developed by the Assessee and supplied to a customer and is part and parcel of the software so supplied. The assessee pointed out that even after supply of the software the Assessee needs to render the services to meet the complete scope of work which includes services like Integration testing, Validation/System testing Acceptance testing; changes requirements, etc. Hence it becomes part and parcel of the software being developed and supplied by the assessee. Hence, the same should be considered while calculation deduction u/s 80-IC of the Act. The Assessee pointed out that services like installation, training, support services etc form integral part of the products supplied by the assessee, therefore have nexus between the products supplied and services provided by the assessee in connection with the said products.

7. The Assessee pointed out that in the case of Contract between the Assessee and Nepal Telecom, the contract is for Supply, Delivery, Installation and Commissioning of the GSM Roaming and NRTRDE System Upgrade with Additional features. It is a Turnkey project for both supply and services to be provided. The Assessee drew attention of the CIT(A) to clause 5.1 which provides for "Delivery, Installation, Testing and commissioning" of the Contract and it clearly demonstrates that the Installation, Testing and Commissioning is considered complete only when

the system is ready in respect for putting into commercial service. The relevant clause is reproduced below for ease of reference.

"The installation of new hardware and software, their testing and commissioning shall be carried out in stages without or with minimum disturbance on the normal operation of existing GSM Roaming System. The installation, testing and the commissioning shall be considered complete only if the system is ready in all respect for putting into commercial service."

The Assessee also referred to clause 7.1 & 7.2 of the agreement with regard to "Payment of Goods" & "Payment of Services". The relevant clauses 7.1 & 7.2 is as follows:-

“7.1 Payment for Goods (Application Software)

a) On Shipment

50% of the Application software shipped shall be made through Irrevocable LC on submission of Original documents

b) On Provisional Acceptance

30% payment of the prices of Application software shall be made through Irrevocable LC within 30 date of issuance of Provisional Acceptance Certificate of the Complete System

c) On Final Acceptance

Remaining 20% payments of the prices of Application software shall be made through Irrevocable within 30 days from the date of issuance of Final Acceptance Certificate of the Complete System

7.2 Payment for Services

a) Payment for training

100% payment for training shall be made upon claim after the successful completion of training.

b) Installation services

i) 80% payment for the installation services shall be made in 2 installments on certification by Nepal Telecom manager of timely completion of works as per project schedule on pro-rata basis.

The payment shall be made before or on issuance of PAC of Application Software

ii) 20% payment shall be made after the issuance of Final Acceptance Certificate of the Complete System”

It was submitted that the above terms of the contract establishes that the supply by itself would not enable the Assessee to receive the full payment. Only on issuance of Provisional Acceptance Certificate and Final Acceptance Certificate the Assessee receives the full payment for supply of the product. Provisional Acceptance Certificate involves activities like installation, testing and from which appellant derives service income. It was submitted that supply and services are interlinked and have nexus to each other, without either one, the system as a whole fails to function.

8. As far as the contract between and M/S.Ericsson India Private Limited is concerned, the Assessee pointed out that the contract is for Supply of products and services. It is a Turnkey project for both supply and services to be provided. Attention was drawn to clause-4 of the Agreement which provides for "Prices, Terms of Payment and Taxes". The said clause reads as follows:-

“Payment terms for supply of products (Hardware and Software)

- 50% of value of supply shall be released on delivery and receipt by Buyer/ Customer within thirty(30) days from the invoice date.
- 15% of the value of supply on completion of validation

- 25% of the supply shall be released on completion of Acceptance test
- Remaining 10% of total purchase order value (Excluding AMC) on Completion of one year after Completion of Acceptance test or against submission of bank guarantee of equivalent amount

Payment terms for Services (Installation and commissioning charges)

- 65% of Validation of products
- 25% of completion on acceptance test
- Remaining 10% on completion of one year after Completion of acceptance test or against submission of bank guarantee of equivalent amount.”

The Assessee submitted that the above clause provides that the supply by itself would not enable the Assessee to receive the full payment, Only on Completion of Validation test and Acceptance Test the appellant receives the full payment for supply of the product. It was pointed out that Validation Test and Acceptance Test involves activities like installation, testing and commissioning from which Assessee derives service income. It was submitted that both supply and services are interlinked and have nexus to each other, without either one, the system as a whole fails to function.

9. As far as contract between the Assessee and Satyam Computer Services Limited., is concerned, the Assessee pointed out that it was a sub-contract agreement to provide Interim Support to Bharat Electronics Limited (BEL)/Mahanagar Telecom Nigam Limited (MTNL). As per the said contract, the Assessee was to provide Technical & Functional support for SP, Mediation & IUC Applications deployed by Assessee in MTNL Mumbai & Delhi :-

- To ensure stability & availability of delivered applications
- To fix operational issues, which are raised in Bug Tracking tool
- To provide fixes, to business critical problems.

10. The services above provided by Assessee were in relation to the Covergent Billing & CRM System of MTNL rolled in Delhi & Mumbai. As a part of Covergent Billing & CRM system, Assessee had delivered. SP, Mediation & IUC Applications vide earlier agreements with IBM India Private Limited for supply of software licenses (Agreement dated 1st June 2006) and agreements with Satyam Computer Systems Ltd for providing services(Agreement dated 7th August 2006). It was submitted that the services provided by Assessee were in relation to the supply of application software already supplied, hence has a close nexus with the product which -required technical & functional support to ensure stability, fix operational issues etc.

11. The Assessee thus submitted that the deduction u/s.80IC of the Act should be allowed on the services fees also as it has a close nexus with the supply of software and hence has to be regarded as part of the profits derived from the eligible business.

12. The CIT(Appeals), however, did not accept the contention of the assessee. The relevant paragraph of the conclusion of the CIT(Appeals) was as follows:-

“..... In the instant case, the AO has no dispute in so far as deduction claimed u/s 80-IC with respect to profits derived from development and sale of software products, licences and services. The dispute is only with regard-to whether-income earned from the impugned service fees qualifies for deduction u/s 80-IC. According to the appellant, service income earned during the year has close nexus with sale of software developed by it. Here it is important to note that service fee income shown by the appellant

has been received from only three customers. The software sales to Nepal Telecom and Ericsson India have been structured as composite contracts involving supply, installation and testing of the software. There is some component of training in the services agreed upon to be rendered. The consideration for sale of product and rendering of services has been separately fixed and also invoiced separately. Just because a composite contract has been entered into and payment terms for supply of product are linked with completion of allied services, it does not mean that services have a nexus with sale of software products. The service activity is separate and independent which can be undertaken by any other company, In today's software industry, there are different companies which are engaged in providing variety of services such as training, consultancy, testing and maintenance, each with its own niche market. These companies may not be developing software of their own but work on software's developed by others. Therefore, service activity undertaken by the appellant including training is an independent activity and service fee towards training and maintenance has nothing to do with revenue from sale of products. Under the agreement with Satyam Computers, the appellant was a subcontractor who had rendered certain services in connection with application software sold in the past by the appellant to BEL/MTNL. From this, as observed above, it is clear that a different company other than the developer of a particular software can undertake maintenance of that software, like in this case Satyam Computers had contracted with BEL/MTNL for rendering services in relation to software supplied by the appellant but has sub contracted that work to the appellant. Thus, service fee earned through this sub contract also does not have nexus with turnover on sale of products.”(underlining for emphasis)

13. In short, the conclusion of the CIT(Appeals) was that service activity was separate and independent and had nothing to do with the supply of software by the assessee. Aggrieved by the order of CIT(Appeals), the assessee is in appeal before the Tribunal.

14. We have heard the rival submissions. The Id. counsel for the assessee drew our attention to an order of ITAT Bangalore Bench in

assessee's own case in *ITA No.821/Bang/2019 for the AY 2014-15, order dated 26.2.2020* wherein on an identical issue of service fees income, the Tribunal allowed deduction to the assessee u/s. 80IC of the Act. The conclusion of the Tribunal was that the supply of software and providing services were inter-linked and had a nexus and therefore the service fees received was to be regarded as profits derived by the industrial undertaking from manufacture of goods. The learned DR relied on the order of the CIT(A).

15. We have given a careful consideration to the rival submissions. In AY 2014-15, identical issue was decided by the ITAT Bangalore Bench by its order dated 26.2.2020. The following were the conclusions of the Tribunal on the issue:-

“15. It is clear from the break-up of service fee received that they were all related to the FMCC & RA project of BSNL which the Assessee had to perform as sub-contractor. In the case of *CIT v. Meghalaya Steels Ltd. & Pride Coke Pvt. Ltd. (2013) 356 ITR 235 (Gau)* it was held that assessee was entitled to deduction u/s 80-IB or 80-IC on transport subsidy, interest subsidy, power subsidy and insurance subsidy as it was held that there is a nexus between the subsidies, on one hand, and the profits and gains derived by, or derived from, the industrial undertakings concerned. The Hon'ble Gauhati High Court in the case of *Torsa Machines Ltd. v. CIT (2017) 154 TR (A) 79 (Gau-HC)*, was concerned with a case wherein the assessee was engaged in business of manufacturing of stone crushing plant and accessories. It claimed deduction under section 80-IC. AO disallowed deduction of claim towards service and erection charges. AO opined that earnings from service and erection charges were not derived from manufacturing business and not eligible for deduction. CIT(A) as well as Tribunal affirmed disallowance. It was held that when the assessee, installed/erected the self-manufactured stone crushing plants and serviced them at the customers site, the amount received from such service was nothing but earnings from the business of manufacturing activity. The Hon'ble Himachal Pradesh High Court in the case of [*Spray*

Engineering Devices Ltd. v. Asstt. CIT & Anr.] IT Appeal No. 39 of 2006 judgment dated 7.11.2009 took the view that when a manufacturer is required by the customer to erect and commission the machinery, the amount received by the manufacturer on this count, is the income derived from the business itself and therefore, the same is eligible for deduction under section 80-IB of the Income Tax Act. The Hon'ble Bombay High Court in the case of CIT v. International Data Management Ltd. (2003) 261 ITR 177 (Bom) had to deal with a case regarding entitlement of deduction under section 80-IC for income, received on account of service and maintenance charge. In the context, the Bombay High Court held that the income received by the assessee which rendered service and maintenance facilities for the clients, has a direct nexus with the main business activity of the assessee.”

16. In the present assessment year, the contracts are with 3 different parties. It is clear from the submissions made before the CIT(A) that the service income in respect of which the Assessee claimed deduction u/s.80IC of the Act had a clear nexus with the supply of software and providing services were inter-linked and therefore the service fees received was to be regarded as profits derived by the industrial undertaking from manufacture of goods. The conclusions of the Tribunal and the cases cited by the Tribunal in the aforesaid decision rendered in AY 2014-15 are clearly applicable to the present AY 2013-14 also. We are therefore of the view that the claim made by the assessee for deduction u/s. 80IC of the Act on service income ought to have been allowed by the AO/CIT(A) and they fell into an error in not allowing the said claim. We therefore hold that the assessee is entitled to claim deduction u/s. 80IC of the Act on service income of Rs.62,13,596.

17. In the result, the appeal by the Assessee is allowed.

Pronounced in the open court on this 14th day of October, 2020.

Sd/-
(B R BASKARAN)
ACCOUNTANT MEMBER

Sd/-
(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 14th October, 2020.

/Desai S Murthy/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.