

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

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER  
AND SHRI GEORGE GEORGE K., JUDICIAL MEMBER

ITA Nos.1516 to 1521/Bang/2019
Assessment years : 2009-10 & 2011-12 to 2015-16

M/s. Alpha Design Technologies Private Limited, No.9, Interface Accolade, Service Road, HAL 2 <sup>nd</sup> Stage, Indiranagar, Bangalore – 560 008. <b>PAN: AAECA 3323P</b>	Vs.	The Income Tax Officer, Ward 1(1)(2), Bangalore.  The Deputy Commissioner of Income Tax, Circle 11(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Prashanth Chandrashekar, CA
Respondent by	:	Shri Kannan Narayanan, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	04.01.2021
Date of Pronouncement	:	27.01.2021

**ORDER**

*Per Bench*

All these files are filed by the assessee against the separate orders of the CIT(Appeals)-1, Bengaluru dated 01.03.2019 for assessment years 2009-10 [passed u/s. 143(3) r.w.s. 263 of the Act] & AYs 2011-12 to 2015-16 [u/s. 143(3) of the Act]. which were heard together and disposed of by this common order for the sake of brevity and convenience.

2. Common grounds of appeal have been raised in these appeals as follows:-

1. The Ld CIT(A) has erred in confirming the disallowance of revenue expenditure of Rs 1,95,00,144 (AY 2009-10), Rs.17,32,84,994 (AY 2011-12), Rs.19,65,08,727 (AY 2012-13), Rs.10,57,08,949 (AY 2014-15) & Rs..12,31,60,586 (AY 2015-16) claimed under section 37 of the Act, by disregarding the fact that the expenditure incurred are of revenue in nature and is spent for the purpose of business activity of the appellant.

The AO has not considered the appellant's claim of Research & Development (R&D Expenditure) to the tune of Rs.14,04,48,321 (AY 2013-14) vide letter dated 23.11.2015. Further, the Id. CIT(A) has ignored the claim made and has not passed a speaking order on the same.

2. The Ld CIT(A) has disallowed the claim as revenue expenditure on a wrong notion that the expenditure are spent for development of new product.
3. The Ld CIT(A) has failed to appreciate the fact that, the appellant is in one line of business and the nature of the business requires huge R&D expense to be relevant in the business field, for being updated and competitive, which do not result in advantage of enduring nature, and hence the R&D expenditure incurred by the appellant are to be allowed as revenue expenditure.
4. The Ld CIT(A) while disallowing the expenditure has failed to recognize the fact that the Hon'ble ITAT in appellant's own case for AY 2007-08 and 2008-09 having the same facts had allowed the R&D expenditure as revenue in nature.
5. In similar cases, the Hon'ble ITAT has ruled that Research & Development Expense is revenue in nature when the same does not result in new product or new line of business. ( ITA 2229 / 2011 ITAT —Hyderabad Dr.Reddy's Laboratories Ltd vs Addl CIT, ITA 584/PN/2011 ITAT — Pune Opus Software Solutions Pvt Ltd vs ACIT, ITA 1711/PN/2012 ITAT Pune DCIT vs Autoline Industries Ltd).

For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and justice rendered.

3. We shall first take up for consideration the appeal for the AY 2009-10. The brief facts of the case are that the assessee company is engaged in the business of manufacture and supply of defense electronics and provision of services to defense establishments. It is submitted that the line of business of the assessee requires huge expense in research and development (R&D) activity to stay relevant in the market and to exhibit to the customer that they have the capability to adopt and modify the products and services as per their demands and needs. As per the accounting policy, these expenditure are accounted as Intangible Assets / Intangible assets under development in the books of accounts, since the R&D activity enhances the know-how, technical knowledge, skill etc., of the assessee and its technical manpower. The major expenditure incurred for R&D are Remuneration to the employees, Rent of the R&D centre, Professional Charges and Purchase of materials. The expenditure incurred on research and development is claimed as expenditure in the return of income due to the following counts:—

- (i) The expenditure on R&D has not created new product or it has not resulted in new line of business.
- (ii) The expenditure incurred are revenue in nature.
- (iii) The expenditure has not resulted in acquisition / construction of a Capital Asset.
- (iv) The expenditure is incurred for the purpose of the business of the assessee.

4. Accordingly, for AY 2009-10 Rs. 1,95,00,144 incurred in this regard has been claimed as business expenditure in its return of income. The return was selected for assessment by issue of notice u/s 148 of the Income Tax Act, 1961 [the Act] and the AO completed the assessment by accepting the returned loss and passed order u/s 143(3) r.w.s 147 of the Act dated 26.03.2014.

5. Subsequently, the Ld Principal Commissioner of Income Tax, Bangalore-I [Pr.CIT] invoking the provisions of section 263 of the Act directed the AO to reframe the assessment and disallow Rs.1,95,00,144 claimed as deferred revenue expenditure as it was prejudicial to the interests of the revenue.

6. Based on the direction of the Pr. CIT, the AO issued notice and completed the assessment by disallowing Rs.1,95,00,144 claimed as R&D expenditure. The assessee brought to the notice of the AO that the ITAT in appellant's own case for AY 2007-08 and 2008-09 in ITA Nos.1384 & 1385/Bang/2013 on the same issue by its order dated 22.01.2015 had ruled in favour of the assessee. However, the AO on the ground that the department has appealed against the aforesaid ITAT order, disallowed the claim of the appellant.

7. Aggrieved, the assessee preferred appeal before the CIT(Appeals). The assessee brought to the notice of the Ld. CIT(A) that in its own case for AY 2007-08 and 2008-09, the Hon'ble ITAT has ruled in its favor on the issue of allowance of expenditure incurred for various R&D projects even though the same are not debited to Profit and Loss account in the financial statements as per the accounting policy of the assessee. The CIT(Appeals), however, rejected the contentions of the assessee and was of the view that the R&D expenditure results in new product. He upheld the action of the AO in treating the R&D expenditure treating it as capital expenditure.

8. As far as the assessee's reliance on the order of Tribunal for AYs 2007-08 & 2008-09 in its own case is concerned, the CIT(Appeals) was of the view that the Tribunal in those cases had considered various sub-heads of input expenditure incurred on these projects and examined the nature of the expenditure individually, while classifying the same into revenue and

capital. While doing so, according to the CIT(A), the Tribunal relied on the remand report of the AO regarding the nature of expenditure and assumed that the claim of the assessee as to its nature i.e., staff remuneration, travel expenditure, professional charges, etc. has not been disputed by the lower authorities and further the Tribunal has assumed that in the remand report, the AO has also not doubted the genuineness of expenditure. However, as per 4 of the remand report which is extracted at page 8 of the impugned order, the CIT(A) was of the view that the AO has given a categorical finding that all these expenses have been incurred for specific projects as inputs and accordingly has given a finding that the entire expenditure on the product development by the assessee is capital in nature. Therefore the AO in the original order as well as in the remand report, had consistently held that the said expenditure incurred for development of the projects is capital in nature. In the remand report, the AO had not conceded as to the bifurcation of the expenses viz., staff remuneration, travel expenditure and professional charge. The AO simply has not questioned the genuineness of the individual input components. The CIT(A) was therefore of the opinion that the ITAT for AYs 2007-08 & 2008-09 had proceeded on a mistaken presumption that the AO agreed that the staff remuneration, travel expenditure and professional charge expenses etc. (other than the materials purchased) incurred as part of product development as revenue in nature.

9. With regard to the Tribunal's observation in the order for AYs 2007-08 & 2008-09 that the CIT(A) had made an analysis of the expenditure and come to a conclusion certain expenditure were for acquiring capital items. The CIT(A) was of the view that the CIT(A) for the AYs 2007-08 & 2008-08 had also given a finding quantifying the revenue expenditure and had listed the input cost heads as revenue and capital for the sake of describing

them, however, he had held it to be one common capital expenditure, while directing the AO to grant depreciation on the same.

10. The conclusions of the CIT(Appeals) were as follows:-

“5.4.11 Considering all the above, I am not convinced, with the appellant’s submission that the expenditure under scrutiny is revenue in nature, reason being, that the expenditure is incurred for creating the new products which fall in the category of new inventions giving rise to intellectual property to the appellant and thus it would be an 'Intangible Asset'. The appellant itself accounted in the books of account under the head 'R & D Project' and carried to the balance sheet directly. This entire expenditure is considered as capital expenditure and categorised as 'Intangible Asset'. Despite the fact of claiming the same as revenue expenditure in the computation of income, these assets remained as assets under the head 'R & D Project' and no adjustment/deletion made in the balance sheet.

5.4.12 Since all the input costs including salaries, Professional charges, materials imported, finance cost, etc., going to develop a new capital asset where in appellant recognises intellectual property, giving rise the enduring benefit to the appellant, they cannot be considered by splitting and examining input cost separately, lest the outcome would totally defeat the very purpose.

5.4.13 Even the appellant in its financials and the AO in the impugned order and also the CIT(A), have dealt the entire expenditure in one basket(incurred towards the creation of new intangible asset (capital product) development).

5.4.14 Thus, I am of the view that-the expenditure incurred for developing the. project proto types by the appellant relating to development of intangible asset cannot be weighed or assessed based on the input costs. It has to be treated as one item only. The expenditure incurred by the assessee on such projects is liable to be treated as capital expenditure as the same has resulted in giving rise to enduring benefit to the assessee by bringing into existence a totally new product upon which the appellant has recognized the intellectual property. The position of the settled law that "the expenditure resulting in advantage of enduring nature is a capital expenditure", is not disturbed or reversed by any judicial fora.”

11. The CIT(A) upheld the disallowance by terming the same as “Capital Outgo” and citing the reason that the said amount was treated as “intangible asset” under the head “Development” in the books of account of the assessee.

12. Against this, the assessee is in appeal before us. The Ld. AR submitted that the assessee had enclosed the following documents for the six assessment years:

- a. Financial Statement for the six assessment years.
- b. Statement of Computation of Income for the six assessment years.
- c. ITRs for the six assessment years.

13. The Assessing Officer disallowed the said claim for each A.Y. as follows:-

A.Y	R & D Expense
2009-10	1,95,00,144
2011-12	17,32,84,974
2012-13	19,65,08,727
2013-14	14,04,48,321
2014-15	10,57,08,949
2015-16	12,31,60,586

14. The Ld. AR submitted that the assessee had not claimed the amount incurred towards R&D as revenue expenditure in the A.Y. 2013-14 in the ITR. It was submitted that the said claim was made by filing a revised computation with the Assessing Officer. The said claim was also made before the CIT(A).

15. Ld. AR submitted that the assessee was in the business of supply of equipments, technology and solutions (especially in Electro Optics field) to Defence Establishments either directly or in collaboration with foreign vendors (as a offset partner) The Ld. AR submitted that the nature of the business in which the assessee was operating required huge investment in

Research and Development and the R&D undertaken by the assessee is not a green field project, i.e., something which is new but the R&D expenditure was incurred for modification, improvement of an existing product or adaption of existing products to meet the requirement of the customers. The assessee was recognized as an approved in-house Research and Development facility by the Department of Science and Industrial Research, Ministry of Science and Technology.

16. The Ld. AR submitted that the assessee's business is wide and encompasses numerous products. According to the Ld. AR, the gestation period (the period when a request for proposal/request for indent is floated culminating into a sale order) is long and can run into several years and the products offered are tested in various conditions. According to the Ld. AR, all this requires constant improvement, modification/adaption to the requirement of the customer and these modifications/adaptions are undertaken during the phase even before the order is secured. The Ld. AR submitted that based on the continuous R&D exposure, the assessee will be able to participate in various request for proposals/request for indents to qualify for submitting the bid and participating in trials of the products/solutions. According to the Ld. AR, the outcome of these processes irrespective of securing the sale order or not is that the assessee gains technical know-how and this technical know-how (repository) helps the assessee to stay relevant in the market and to exhibit to the customer that they have the capability to adopt and modify the products and services as per their demands and needs.

17. The Ld. AR submitted that the assessee had incurred expenditure in the form of remuneration to employees of technical capability, travelling expenses and providing training to them in different spheres of technology used by Defence establishments and the expenditure incurred for these activities primarily includes remuneration to staff, purchase of material,

professional charges paid to consultants and travelling expenses. Thus, it was submitted that the nature of this expense is of revenue.

18. Further, the Ld. AR submitted that the R&D expenditure incurred by the assessee is allowable under section 37, since the said expenditures meet all the conditions contained in section 37, viz. the expenditure are incurred for the purpose of business; they are for personal purpose and is not a capital expenditure.

19. The Ld. AR submitted that the CIT(A) treated the R&D expenditure as capital expenditure for the reason that the said expenditure had resulted in development of new product, the said amount was presented in Balance Sheet as intangible asset under Development and the purpose test has to be applied to test the character of the expenditure as capital or revenue.

20. The Ld. AR reiterated that the assessee incurred these expenditure to modify/improve/adapt the existing products or technology to meet the requirement of the customers and the nature of the business requires the incurring of R&D expenditure, demonstrate technical capabilities to the perspective clients and to secure sale orders. According to the Ld. AR, the incurrence of R&D expenditure does not result in obtaining a benefit of enduring nature (sale orders) always and in many cases, the technical knowledge (repository) is important. The Ld. AR relied on the judgment of the Rajasthan High Court in the case of *CIT vs. Rajasthan Spg. & Wvg. Mills Ltd. (2004) 137 Taxmann 249*. The High Court held as follows:

“16. From the aforesaid judgments of the Supreme Court, it is apparent that merely because the amount spent has been used for construction of a building or structure of permanent nature is not the decisive test for holding the expenses to be capital out-lay or revenue out-lay. The two tests emerging from the aforesaid decisions are that firstly where the building or construction of any permanent structure is brought into existence is by itself not sufficient to hold

the expenses to be capital nature invariably. Where such construction does not result in acquisition of any capital assets to be trade of assessee or the property does not become the property of the assessee, it does result in acquisition of capital assets of the enduring nature by the assessee. Secondly, it is also clearly discernible that if such expenses is incurred for the purpose of business for deriving any benefit whether to preserve the business or to facilitate the running of the business more smoothly or to make business more profitable or to secure any other advantage for the assessee's business or incurring expenditure by seeking exemption from or reduction in incurring of other expenses which would have been ordinarily allowable as revenue expenditure of assessee's business, such expenses are to be treated as having been incurred wholly and exclusively for business of the assessee and revenue expenditure. Such expenses cannot be construed as a capital expenses.

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22. The principle was considered by the Supreme Court in *Empire Jute Co. Ltd. vs. CIT* (1980) 124 ITR 11. In the said case, the Court observed that there may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit may none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consist merely in facilitating the assessee's trading operations or in enabling the management in conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case."

21. Thus, the Ld. AR submitted that the nature of the business in which the assessee operates requires the incurrance of R&D expenditure to be relevant, enrich the technical repository which help in carrying the business more effectively and efficiently. Therefore, it was submitted that the R&D expenditure incurred is not of capital nature.

22. The Ld. AR also relied on the judgment of the Supreme court in the case of *Taparia Tools Ltd. vs. JCIT (2015) 55 taxmann.com 36*, wherein the Apex Court ruled that merely because a different treatment was given in the books of accounts cannot be a factor which would deprive the assessee from claiming the entire expenditure as a deduction. It was held as under:-

“19. In the instant case, as noticed above, the assessee did not want spread over of this expenditure over a period of five years as in the return filed by it, it had claimed the entire interest paid upfront as deductible expenditure in the same year. In such a situation, when this course of action was permissible in law to the assessee as it was in consonance with the provisions of the Act which permit the assessee to claim the expenditure in the year in which it was incurred, merely because a different treatment was given in the books of account cannot be a factor which would deprive the assessee from claiming the entire expenditure as a deduction. It has been determinative or conclusive and the matter is to be examined on the touchstone of provisions contained in the Act (See – *Kedarnath Jute Mfg. Co. Ltd. vs. CIT (1971) 82 ITR 363 (SC)*; *Tuticorin Alkali Chemicals & Fertilizers Ltd. vs. CIT (1997) 227 ITR 172/93 Taxman 502 (SC)*; *Sutlej Cotton Mills Ltd. vs. CIT (1979) 116 ITR 1 (SC)* and *United Commercial Bank vs. CIT (1999) 240 ITR 355/106 Taxman 601 (SC)*.”

23. The Ld. AR submitted that the CIT(A)'s observation that the Tribunal in assessee's own case wrongly proceeded to bifurcate and split the expenses incurred by the assessee into Revenue and Capital, is not proper as the entire expenditure was incurred for a specific purpose.

24. The Ld. AR further relied on the decision of the Tribunal in the case for A.Ys. 2007-08 and 2008-09 wherein a similar issue was considered. On examination of the remand report of the Assessing Officer and the order of the CIT(A), the Tribunal allowed revenue expenditure as such and allow depreciation on the items of capital items present in the R&D expense. The Ld. AR relied on the decision of the Tribunal in the following cases where the Tribunal had ruled R&D expenses as revenue in nature when the same does not result in new product or new line of business:

- i) Opus Software Solutions Pvt. Ltd. vs. ACIT (ITA 584/PN/2011)
- ii) DCIT vs. Autoline Industries Ltd. (ITA 1711/PN/2012) (Pune)
- iii) Dr. Reddy's Laboratories Ltd. vs. Addl. CIT (ITA 2229/Hyd/2011 & 85/Hyd/2013) (Hyderabad).

25. In the case of *Opus Solutions (supra)*, the Tribunal held that expenditure incurred for the development of new product in the line of business carried on by the assessee is in the revenue field since the same would improve the profitability of the assessee and the enduring benefit cannot be regarded to be in the capital field. The Tribunal held as follows:

“10. In our considered opinion, the aforesaid proposition of the Revenue is absolute alien to the business realities under which the assessee is operating. Quite clearly, the assessee is in the business of software development which entails fast technological changes and in that view, there is no permanence attached to any product developed. In fact, it is quite understandable that the business of the assessee is exposed to volatility of new and upcoming technological advances and the products developed by it may not be sustainable over a period of time to compete in the market place. Therefore, in this background one has to examine as to whether the expenditure incurred on development and launching of new products in the same line of business results in an advantage in the revenue field or in the capital field. Hon'ble Supreme Court in the case of *Empire Jute Co. Ltd.(supra)* has held and accepted that the expenditure results in an enduring benefit to the assessee, yet following discussion by the Hon'ble Supreme Court would show that each and every incidence

of enduring benefit would not result in classification of expenditure as a capital expenditure:

“There may be cases where expenditure even if incurred for obtaining an advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may breakdown. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee’s trading operations or enabling the management and conduct of the assessee’s business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be of revenue account, even though the advantage may endure for an indefinite future.”

In the present case, in our view, the expenditure on development of new product in the line of business being carried out by the assessee is an expenditure related to such business and benefit to the assessee is in the revenue field, inasmuch as it seeks to improve the profitability of the assessee and the enduring benefit cannot be regarded to be in the capital field. The parity of reasoning laid down by the Hon’ble Apex Court in the case of Empire Jute Co. Ltd. (supra), as extracted above, clearly supports the stand of the assessee, inasmuch as the expenditure in question merely results in development of new products by the assessee in its existing line of business. Even otherwise, it is noteworthy that none of the expenditures in question are of capital nature and in fact, the expenditure which has been referred to by us in the earlier paragraph clearly are such expenditure , which are incurred in the course of carrying on of business.”

26. Further, the Ld. AR submitted that the Tribunal held that the treatment in the books of accounts does not have interference in the claim of the expenditure as revenue in nature as follows:-

“11. The other objection of the Revenue that the assessee had treated the impugned expenditure as a deferred revenue expenditure in the books of account and claimed it as a revenue expenditure in the computation of income, is of no consequence. The Hon’ble Supreme Court in the case of *Kedarnath Jute Mfg. Co. Ltd* (supra) and also thereafter in the case of *Tuticorin Alkali Chemicals vs. CIT* 227 ITR 172 (SC) and *Sutlej Cotton Mills Ltd. vs. CIT* 116 ITR 1 (SC) has supported the proposition that the entries in the books of account cannot be demonstrative of the true nature of a transaction. The true nature of a transaction is to be assessed not on the basis of the entries in the books of account alone, but having regard to the realities of the transaction. In this view of the matter, the aforesaid objection is of no consequence.”

27. Further, the Ld. AR relied on the decision of the Tribunal in the case of *DCIT vs. Autoline Industries Ltd.* (supra), the Tribunal followed the decision in the case of *Opus Solutions* (supra) and held as follows:-

“10. The assessee for the year under consideration had developed a technique for reducing the weight of machinery, which in turn was approved by M/s. Tata Motors for manufacturing and was used by the assessee for manufacturing the body parts for the said concern. It is an admitted fact that because of the aforesaid expenditure incurred by the assessee in the year 2009-10 being revenue of Rs.4.20 crores received by the assessee in the year 2009-10 being the sharing benefit on account of reduction in weight for the first 1,20,000 vehicles. The first aspect of the issue is that where the assessee had claim the said expenditure by way of deduction in its computation of income? The law on this account of any person or how it is reflected in the balance sheet and/or the Profit & Loss Account is of no consequence, in determining whether the said expenditure is an allowable deduction or not. The law on the issue is that the accounting treatment given by the assessee in its books of account is not determinative whether or not the expenditure is allowable as a deduction. In order to be eligible for deduction, it has to be seen whether the expenditure is revenue in nature, then in such circumstances, the said expenditure is to be capitalized in the hands of the assessee. Looking at the nature of expenditure incurred by the assessee, we are of the view that the same is revenue expenditure allowable as deduction in the hands of the assessee either under the

provisions of section 35(1)(i) or 37(1) of the Act. The expenditure having been incurred by the assessee by way of research, which resulted in reduction in the weight of body parts and also generation of revenue in the hands of assessee to the extent of Rs.4.20 crores cannot be said to be capital expenditure. Even if the expenditure is of enduring benefit, but having not been incurred in the capital field, is to be allowed as deduction in view of the ratio laid down by Pune Bench of Tribunal in *Opus Software Solutions (P) Ltd. vs ACIT(supra)*. As referred by us in the paras hereinabove, the nature of expenditure is not such that it can be said to be capital expenditure and in the absence of product developed by the assessee having been patented, we find no merit in the order of Assessing Officer in this regard. Upholding the order of CIT(A), we dismiss the ground of appeal No. 1 raised by the Revenue.”

28. Further, the Ld. AR submitted that in the case of *Dr. Reddy's Laboratories Ltd. vs. Addl. CIT (supra)*, the Tribunal held that an expenditure for developing new drug in the same line of business of the assessee is to be allowed as revenue expenditure.

29. In view of the above judgments of the Tribunal, the Ld. AR submitted that the R&D expenses incurred for modification/adaption of existing products was claimed as revenue expenditure even though the same was accounted as intangible asset under development in the books of accounts. Hence, applying the ratio laid down in the aforesaid decisions, the Ld. AR submitted that the expenditure has to be allowed as revenue expenditure.

30. For the A.Y. 2013-14, the Ld. AR submitted that the R&D expenditure of Rs.14,04,48,321/- was not claimed in the income tax return. The Ld. AR submitted that both the Assessing Officer and the CIT(A) rejected the claim of the assessee even though the assessee filed a revised computation with the Assessing Officer. The Ld. AR relied on the judgment of the Delhi High Court in the case of *CIT vs. Jai Parabolic Springs Ltd. 172 Taxmann 258* wherein it was held that where a claim not made in the ITR claimed during the appeal proceedings was to be allowed

based on the observation of the Apex Court in the case of *National Thermal Power Co. Ltd. vs. CIT, 229 ITR 383 (SC)*. In view of the above, the Ld. AR pleaded that the Tribunal may direct the Assessing Officer to allow the claim made through the revised computation filed with the Assessing Officer which was not claimed in the ITR for A.Y. 2013-14.

31. The Id. DR relied on the orders of lower authorities.

32. We have heard the rival submissions and perused the record. The assessee in this case is engaged in the business of manufacture and supply of defence electronics and provision of services to defence establishments. The line of business requires investment in R&D activity. The assessee in these assessment years incurred research expenditure treated as capital in nature in financial statements as follows:-

A.Y	Salary Cost	Rent	Travelling expenses	Finance charges	Purchase of materials	Technical fee/ Professional charges	Maintenance and other expenses	Total
2009-10	52,98,797	47,64,800	18,53,541	1,18,588	72,82,587	-	1,81,831	1,95,00,144
2011-12	5,48,55,459	1,49,14,943	1,96,00,420	2,53,73,399	2,93,35,600	1,97,42,385	89,62,788	17,32,84,974
2012-13	7,86,21,614	90,00,000	1,05,18,275	-	7,73,08,394	1,77,98,554	32,61,890	19,65,08,727
2013-14	8,55,26,000	90,00,000	92,15,000	-	2,56,38,821	76,50,000	34,18,500	14,04,48,321
2014-15	3,52,00,000	1,58,50,000	-	-	1,88,08,949	3,58,50,000	-	10,57,08,949
2015-16	75,00,000	-	-	-	5,36,60,585	6,20,00,000	-	12,31,60,586

33. The assessee capitalized this expenditure in the books of account as intangible asset; however, while filing the return of income, the assessee claimed it as deduction as business expenditure, which was disallowed by the lower authorities. The claim of the assessee before us is that it is a revenue expenditure to be allowed while computing the income of assessee.

34. Now the question is, whether this expenditure incurred by the assessee towards R&D should be treated as revenue or capital expenditure? It is a well-accepted legal proposition that no test of universal application can be laid down to determine the question whether an expenditure incurred by the assessee is revenue or capital. It depends on the overall facts and circumstances of each case. Such matters have to be decided from a practical view and on application of the proper principles of law. Courts are of the view that keeping in mind the ground realities of business, AO should consider the purpose of a particular expenditure. A few principles in this regard can be enumerated as under:--

- (i) One of the guidelines for distinguishing revenue expenditure from capital expenditure is that if the expenditure is incurred for obtaining an advantage of enduring benefit it would be capital expenditure. But, the test of enduring benefit is not a certain or conclusive test and it is not to be applied blindly and mechanically. In other words every advantage of enduring nature acquired by an assessee is not covered by the said concept. In a given case, the test of enduring benefit might break down. The idea of once for all payment and enduring benefit are not something akin to statutory conditions; nor are the notions of capital or revenue a judicial fetish. Concepts of capital/revenue expenditure are not eternal verities, but are flexible ones.
- (ii) What is material in this regard is to consider the type, nature and character of the advantage in a commercial sense on one hand and on the other to look in to the aim, intended object, effect of the expenditure and in the larger context of necessity and expediency. Legal rights secured in the process are also relevant in deciding the issue.
- (iii) If the expenditure is related to the carrying on or conduct of the business or is intrinsically connected with the running of a business the expenditure is to be regarded as revenue expenditure even though the advantage may endure for some indefinite future.

- (iv) A payment made with a view to obtain the benefit of technical assistance for running the assessee's business more efficiently so as to earn more profits and 'not by way of transfer of fruits of research once and for all', can be treated as an item of revenue expenditure.
- (v) Expenditure incurred in connection with the profit earning apparatus would be revenue expenditure.
- (vi) Where the advantage is on the capital fixed the expenditure would be treated a capital Expenditure. If the advantage leaves the fixed capital untouched, the expenditure would be on revenue account.
- (vii) Expenditure in the acquisition of a concern would be capital expenditure; expenditure in carrying on the concern would be revenue expenditure.
- (viii) An expenditure cannot be considered to be capital expenditure merely on the ground that the amount involved is large. The quantum of expenditure involved cannot alter the nature and character of the expenditure.
- (ix) The source or manner of the payment are of no consequence in deciding the issue.
- (x) The question whether a particular payment made by an assessee under the terms of an agreement forms a part of capital expenditure or revenue expenditure, would depend upon several factors., namely, whether the assessee obtained a completely new plan with a complete new process and completely new technology for manufacture of the product or the payment was made for the technical know-how which was for the betterment of the product in question which was already being produced; whether the improvisation made is part and parcel of the existing business or a new business was set up with the so-called technical know-how for which payments were made; whether on expiry of the period of agreement the assessee is required to give back the plans and designs which were obtained, but the assessee could

manufacture the product in the factory that has been set up with the collaboration of the foreign firm; the cumulative effect on a construction of the various terms and conditions of the agreement; whether the assessee derived benefits coming to its capital for which the payment was made. If from the terms of the agreement between the parties it transpires that the purpose be the acquisition of an asset/a right of a permanent character was a pre-requisite to the commencement or continuance of the business, the expenditure would be a capital expenditure.

- (xi) If the amount spent was for the purpose of bringing into existence a new asset or obtaining a new advantage, then obviously such an expenditure would fall in the category of capital expenditure.
- (xii) If the amount is spent for preserving and maintaining the present asset in existence, it cannot be said that the expenditure so incurred is capital in nature.
- (xiii) Where the object of incurring an expenditure is to effect a capital structure as a result of which certain incidental advantage flows, the expenditure will be of capital nature. Capital expenditure can be incurred after a company is floated or after it starts its business.
- (xiv) Ordinarily, the word capital expenditure refers to the expenditure which is of a permanent nature or for securing tangible or intangible property, corporeal or incorporeal right.

35. We have carefully gone through the significant accounting policies adopted by the assessee in these assessment years which are as follows:-

- a) AYs 2009-10, 2011-12, 2012-13 & 2013-14 (4 years)

“5. INTANGIBLE ASSET:

The Know-How, Technical Knowledge, Designs and other intellectual properties acquired and developed are stated at cost less

the accumulated amortization and accumulated impairment losses. The cost includes the Purchase price, duties and taxes and any directly attributable expenditure on making the asset ready for its intended use.

The cost of self generated Intangible asset will include the cost of material and services used, the salaries and other employee costs of personnel directly engaged in generating the asset, other directly attributable expenditure and the overheads necessary to generate the asset.

The intangible asset will be amortized over its useful life.”

b) AY 2014-15

“e) INTANGIBLE ASSET:

The Know-How, Technical Knowledge, Designs and other intellectual properties acquired and developed are stated at cost less the accumulated amortization and accumulated impairment losses. The cost includes the Purchase price, duties and taxes and any directly attributable expenditure on making the asset ready for its intended use.

The cost of self generated Intangible asset will include the cost of material and services used, the salaries and other employee costs of personnel directly engaged in generating the asset, other directly attributable expenditure and the overheads necessary to generate the asset.

f) RESEARCH AND DEVELOPMENT COST

Revenue expenditure on research and development is expensed off under the respective heads of account in the year in which it is incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised, if the cost can be reliably measured, the product or process is technically and commercially feasible and the Company has sufficient resources to complete the development and to use and sell the asset. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in the Statement of Profit and Loss as an expense as incurred.

g) AMORTIZATION

Intangible assets are amortised in the Statement of Profit and Loss over their estimated uses lives, from the date that they are available for use based on the expected pattern consumption of economic benefits of the asset. Accordingly, at present, these are being amortised on straight line basis.

An intangible asset is derecognized on disposal or when no future economic benefits are expected from its use and disposal. Losses arising from retirement and gains or losses arising from disposal of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the Statement of Profit and Loss.”

c) AY 2015-16

f) INTANGIBLE ASSET:

The Know-How, Technical Knowledge, Designs and other intellectual properties acquired and developed are stated at cost less the accumulated amortization and accumulated impairment losses. The cost includes the Purchase price, duties and taxes and any directly attributable expenditure on making the asset ready for its intended use.

The cost of self generated Intangible asset will include the cost of material and services used, the salaries and other employee costs of personnel directly engaged in generating the asset, other directly

attributable expenditure and the overheads necessary to generate the asset.

g) RESEARCH AND DEVELOPMENT COST

Revenue expenditure on research and development is expensed off under the respective heads of account in the year in which it is incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised, if the cost can be reliably measured, the product or process is technically and commercially feasible and the Company has sufficient resources to complete the development and to use and sell the asset. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in the Statement of Profit and Loss as an expense as incurred.

h) AMORTIZATION

Intangible assets are amortised in the Statement of Profit and Loss over their estimated uses lives, from the date that they are available for use based on the expected pattern consumption of economic benefits of the asset. Accordingly, at present, these are being amortised on straight line basis.

An intangible asset is derecognized on disposal or when no future economic benefits are expected from its use and disposal. Losses arising from retirement and gains or losses arising from disposal of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the Statement of Profit and Loss.”

36. As seen from the above, the assessee has treated the R&D expenditure as capital expenditure by showing it as intangible assets in its balance sheet. However, it is not known whether the intangible assets

shown by the assessee in its balance sheet includes revenue expenditure or not? In earlier assessment years, the CIT(Appeals) had made analysis of expenditure which are revenue or capital and the revenue expenditure was allowed as deduction. Being so, the Tribunal decided the issue in favour of the assessee in AYs 2007-08 & 2008-09, ITA Nos.1384 & 1385/Bang/2013 in assessee's own case. In those assessment years, the classification of expenditure was shown as follows:-

A.Y.	Capital Expenditure	Revenue Expenditure
2007-08	35,83,346	105,79,544
2008-09	91,68,575	269,98,8243

37. The AO in earlier assessment years treated the above entire expenditure as capital expenditure. The CIT(Appeals) allowed the revenue expenditure as a deduction, however, allowed depreciation on the capital expenditure. Against this, the department went in appeal before the Tribunal. The Tribunal in para 10 of the order held as under:-

“10. In the light of the above position of law, and considering the facts before us, we have no hesitation in directing the AO to allow the claim of assessee to the extent of Rs.1,05,79,544/- for assessment year 2007-08 and Rs.2,69,98,843/- for assessment year 2008-09 as revenue expenditure and allow depreciation on the capital items worth Rs.35,82,436/- for assessment year 2007-08 and Rs.91,68,575/- for assessment year 2008-09 after verifying class of asset in which these fall, as per law. Ordered accordingly.”

38. However, for the assessment year under consideration, the R&D expenditure which was treated as revenue expenditure in its Profit & Loss account is not separately brought on record by the assessee before us. Hence, it is appropriate to remit the issue to the file of the CIT(Appeals) for proper classification of R&D expenditure which is in the nature of revenue expenditure or capital expenditure. Thereafter the portion of revenue

expenditure on R&D to be allowed as business expenditure in these assessment years. On the other hand, the R&D expenditure which is in the nature of capital expenditure has to be disallowed and depreciation to be granted. With these observations, we remit the issue in dispute in all these assessment years to the file of the CIT(Appeals) for fresh consideration.

39. In the result, all the appeals of the assessee are partly allowed for statistical purposes.

Pronounced in the open court on this 27<sup>th</sup> day of January, 2021.

Sd/-  
( GEORGE GEORGE K. )  
JUDICIAL MEMBER

Sd/-  
( CHANDRA POOJARI )  
ACCOUNTANT MEMBER

Bangalore,  
Dated, the 27<sup>th</sup> January, 2021.

*/Desai S Murthy /*

Copy to:

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

By order

Assistant Registrar  
ITAT, Bangalore.