IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE

BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND
MS. PADMAVATHY S, ACCOUNTANT MEMBER

IT(TP)A No.3368/Bang/2018
Assessment Year : 2014-15

M/s. Altisource Business Solutions Pvt. Ltd., Pritech Park, Block Nok.12, 3rd Floor, 5th Floor, B-Wing and 4th Floor, B-Wing, Bellandur Village, Bengaluru-560 103. **PAN : AAACO 9467 A**	Vs.	ITO, Ward – 1(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Smt. Rashmi R, Advocate
Revenue by	:	Shri. V. S. Chakrapani, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	21.06.2022
Date of Pronouncement	:	24.06.2022

O R D E R

Per N V Vasudevan, Vice President

This is an appeal by the assessee against the final Order of Assessment dated 31.10.2018 of ITO, Ward – 1(1)(1), Bengaluru, passed under section 143(3) read with Section 144C(13) of the Income Tax Act, 1961 (Act) in relation to Assessment Year 2014-15.

2. At the time of hearing, the learned Counsel for the assessee pressed for adjudication of only ground Nos.14 and 16 and ground No.19-24. These grounds read as follows:

14. *The learned AO/ learned TPO/ Hon'ble DRP has grossly erred in not rejecting the following companies:*

- *Infosys Ltd.*
- *Larsen & Toubro Infotech Ltd.*
- *Mindtree Ltd.*
- *Persistent Systems Ltd.*
- *R S Software India Ltd.*
- *Thirdware Solutions Ltd.*

16. *The learned AO/ learned TPO/ Hon'ble DRP has grossly erred in rejecting companies that ought to have been accepted as comparable:*

- *Akshay Software Technologies Ltd.*
- *KALS Information Systems Ltd.*
- *Helios & Matheson Information Technologies Ltd.*
- *Sasken Communication Technologies Ltd.*
- *Daffodil Software Ltd.*
- *I2T2 India Ltd.*
- *Maveric Systems Ltd.*

19. *The learned AO/ learned TPO/ Hon'ble DRP erred in not considering the fact that receivables cannot be considered as an international transaction as it does not fall within the purview of capital financing as stated by Sec. 92B of the Act.*

20. *The learned AO/ learned TPO/ Hon'ble DRP erred in not appreciating the fact that TP adjustment cannot be made on hypothetical and notional basis until and unless there is some material on record that there has been under charging of real income.*

21. *The learned AO/ learned TPO/ Hon'ble DRP erred in charging notional interest on receivables without appreciating the fact that the Appellant does not have any cost of debt.*

22. *The learned AO/ learned TPO/ Hon'ble DRP erred in imputing interest on delayed receivables once the primary transaction has been tested.*

23. *The learned AO/ learned TPO/ Hon'ble DRP erred in enhancing the income of the Appellant by imputing interest on outstanding receivables from AEs on ad hoc basis.*

24. The learned AO/ learned TPO/ Hon'ble DRP erred in selecting an ad hoc interest rate while selecting that Comparable Uncontrolled Price ("CUP") Method as the Most Appropriate Method ("MAM") for determining the arm's length interest rate chargeable on receivables having accepted the Transactional Net Margin Method ("TNMM") as the most appropriate method for the primary transaction.

3. In so far as ground Nos.14 and 16 raised by the assessee is concerned, the same is in relation to determination of Arm's Length Price (ALP) in respect of an international transaction of rendering Software Development Services (SWD services) by the assessee to its Associated Enterprises ("AEs"). During the previous year, the assessee rendered SWD services to its AE for which it received a sum of Rs.1,13,04,20,866/-. In view of the provisions of section 92 of the Act, the income from an international transaction i.e., a transaction with AE has to be determined having regard to ALP. The assessee in support of its claim that the price received from AE for rendering SWD services is at ALP, filed a TP analysis adopting TNMM as the most appropriate method for determining ALP. The PLI chosen for the purpose of comparing of the assessee's margin with that of the comparable companies was OP and OC. The OP/OC of the assessee was arrived at 15%. The assessee chose the comparable companies with that of the assessee and claimed that the price received by the assessee from the AE was at arm's length.

4. The TPO to whom the question of determination of ALP was referred to by the AO did not accept the claim of the assessee and rejected the TP analysis of the assessee. The TPO selected the following comparable companies and determined the ALP of the international transaction as follows:

"SWD Segment

		Amounts in Rs. Lakh			
S NO	**NAME OF TAX PAYER**	**OR/SALES**	**OC**	**OP**	**OP/OC (in %)**
1	**Infosys** Ltd.	46,91,700	32,77,700	11,84,200	36.13%
2	Larsen & Toubro Infotech Ltd.	4,54,360	**3,64,619**	**89,741**	24.61%
3	Mindtree Ltd.	2,99,010	2,48,290	5,072	20.43%
4	Persistent Systems Ltd.	1,18,412	87,649	3,07,625	35.10%
5	R S Software (India) Ltd.	35,188	28,321	6,867	24.25%
6	Cigniti Technologies Ltd.	5,563	4,359	1,204	27.62%
7	S Q S India B F S I Ltd.	20,061	16,394	3,667	22.37%
8	Thirdware Solution Ltd.	19,883	13,742	6,140	44.68%
	Average				29.40%

15. DETERMINATION OF ARMS LENGTH PRICE:

Based on the detailed discussion held in various parts of this order, the arm's length price of the international transactions entered into by the taxpayer is computed as under:

15.1. Method Used:

TNMM is used as the most appropriate method by the taxpayer as well as the TPO.

15.2. Comparable:

The comparables are as discussed above. The computation of the PLI of the comparables is as per ***Annexure 'A' & `Annexure B'.***

15.3. Data used

Data pertaining to the FY 2013-14 as mandated under Rule 10B (4).

15.4. Computation of Arm's Length Price:

15.4.1 *The arithmetic mean of the Profit Level indicators is taken as the arm's length margin. Please see* ***Annexure 'A'*** *for details of computation* ***of PLI of the comparable. Based on this,*** *the arm's length price*

of the services rendered by the taxpayer to its AE(s) is computed as under:

SWD Segment

Arm's Length Mean Margin on cost	29.40%
Operating Cost	98,09,01,750
Arm's Length Price(ALP) @ 129.4%	1,26,92,86,865
Price Received	1,16,23,07,899
Variation in Price	10,69,78,966
3% of price received	3,48,69,237
Shortfall being adjustment	0,69,78,966

15.4.2 The above shortfall of Rs. 10,69,78,966/- is proposed as transfer pricing adjustment u/s 92CA in respect of software development segment of the taxpayer's international transactions."

5. The addition suggested by the TPO as above was incorporated by the AO in the draft order of Assessment. The assessee filed objection before the Dispute Resolution Panel (DRP) against the draft Order of Assessment wherein the addition suggested by the TPO was incorporated by the AO. The DRP gave certain directions in so far as it relates to determination of ALP of the international transaction in question. To the extend the assessee did not get relief from the DRP, the assessee is in present appeal before the Tribunal.

6. In so far as ground No.14 is concerned, it can ben seen from the ground of appeal that the assessee has challenged inclusion of 6 companies

as comparable companies out of which the assessee did not press for adjudication of exclusion of R. S. Software India Ltd. In so far as the remaining 5 comparable companies set out in ground No.14 is concerned, learned Counsel for the assessee brought to our notice the decision of the ITAT, Bengaluru Bench, in the case of Salesforce.com Vs. DCIT in IT(TP)A No.3286/Bang/2018, order dated 23.02.2021, for Assessment Year 2014-15. In the aforesaid case, in paragraphs 12 to 20 of the aforesaid order, the aforesaid 5 companies were held to be not comparable with the company engaged in software development services such as the assessee. It is significant to note that the very same 8 comparable companies chosen by the TPO in the case of the assessee in the present appeal and in the case of Salesforce.com (supra) are one and the same and therefore there can be no question of the profile of the assessee being not identical to the profile of the assessee in Salesforce.com (supra). In the aforesaid decision, the Tribunal held in pages 12 to 14 of its order that Infosys Ltd., is functionally dissimilar to the assessee and has a huge brand value and cannot be compared with a small assessee such as the assessee in the present appeal whose turnover was only 116 Crores. In so far as L & T Infotech Ltd., is concerned, in pages 18-20 of its order, the Tribunal held that this company was functionally dissimilar, owns brand value and was engaged in R & D activities besides owning intangibles. In so far Mindtree Ltd., is concerned, in pages 16-18 of the order, it was held that Mindtree Ltd., was functionally dissimilar, owns intangibles and owns huge turnover and was giant company. In so far Persistent Systems Ltd., is concerned, in pages 14-15 of the aforesaid order, the Tribunal held that this company was functionally dissimilar and had investments in IP and undertook R & D activities and there was a lack of segmental information in the financial statements. In so far as Thirdware Solution Ltd., is concerned, in pages 15-16 of the aforesaid

order, Tribunal held that this company cannot be considered as a comparable company because of its high turnover, functional dissimilarity and happening of the extraordinary events during the previous year relevant to Assessment Year 2014-15. Following the aforesaid decisions, we direct exclusion of the above said 5 companies from the final list of comparable companies.

7. In so far as ground No.16 raised by the assessee is concerned, though the assessee has prayed in the aforesaid ground for inclusion of 7 comparable companies in the list of comparable companies, at the time of hearing, learned Counsel for the assessee submitted that it wishes to press for adjudication for inclusion of one company viz., I2T2 India Ltd. In so far as inclusion of this company is concerned, this Tribunal in the case of Salesforce.com India Pvt. Ltd., (supra) accepted in paras 24-26 of its order that this company is functionally comparable with a SWD services providing company and satisfies all filters applied by the TPO. The Tribunal in its order however remanded the comparability of this company to the TPO with the following directions:

> *"22.5 We have perused submissions advanced by both sides in the light of the records placed before us. 22.6 The only reason for excluding this comparable by the authorities below is for the reason that RPT transactions have not been reported in the annual report. We have perused the decision of this Tribunal in case of LG Soft India (P.) Ltd. (supra) wherein on similar reasoning the Ld.TPO excluded this comparable therein and this Tribunal observed as under: "12. We find force in the contentions of Ld. ar. If the annual report of this company does not mention about related party transactions, then the assessee cannot be held responsible to prove a fact relating to a 3rd party, which may or may not exist. We notice from auditors report that the auditor in paragraph 5 (b) of Annexure to the auditors report has mentioned as under:--*

"There are no transactions that are made enterprises exceeding Rs. 5 Lacs in respect of any part who is covered under section 301 of the Act during the financial year." Hence, in the absence of any specific information, there is merit in the contentions of the assessee that the above said company might not have had related party transactions during the year under consideration. Accordingly we do not agree with the reasoning given by Ld. DRP for excluding this company as a comparable. Accordingly we direct the Ld. AO/U.S. include this company."

22.7 Annual report of this comparable has been placed at page 593 of paper book volume 2. It is observed functionally it is providing export of software and services. Annual report placed in paper book does not contain functions performed by this comparable in order to ascertain whether this company is rendering SWD services or not. We therefore, set aside this issue to Ld.AO/TPO for verification. The Ld.AO/TPO shall call for requisite information from this company, a copy of which shall be provided to assessee also. Comparability of this company with assessee shall then be considered by giving proper opportunity to assessee."

8. Following the aforesaid order of the Tribunal, we remand the question of comparability of this company to the AO/TPO for consideration afresh, on the lines indicated by the order of tribunal referred to above.

9. The TPO is directed to compute the ALP in the SWD services segment after affording assessee opportunity of being heard in the light of the directions as given above.

10. In so far as ground Nos.19 to 24 is concerned, the TPO computed interest on delayed receivables in his order as follows:

"18. Computation of interest on delayed receivables

18.1 Vide showcause letter dated 05/10/2017, the tax payer was requested to provide the invoice wise details along with the delay, if any & other details, on/before 13/10/2017. However, the tax payer has not provided any details till the date of this order. In the absence of the same, the average receivables (as reported in the balance sheet- as on 31/03/2013 & 31/03/2014) is considered for analysis, against an interest rate of 4.3836 % (as discussed above) and the computation is as under:

Description	Amount (in Million INR)
Receivable as on 31/03/2013	971.04
Receivable as on 31/03/2014	1225.54
Average Receivables (32,48,50,879+39,72,87,907)/2	1098.29
Interest @ 4.3836	48.145

11. Accordingly, a sum of Rs.4,81,44,640/- was added to the total income of the Assessee on account of determination of ALP in respect of delayed realization of receivables from the AE. Before the DRP, the submission of the assessee in objection No.26 was that delayed receivables cannot be considered as an international transaction. It was also contended that no interest should be separated imputed when the primary transaction has been tested for arm's length margin. It was also contended that interest is not required to be computed and there is no cost of financing for the assessee. It was also contended that as per Circular No.14/2013-14/147 issued by RBI, period of 9 months was allowed as credit period to collect the use on invoices. It was also contended that the TPO erred in adopting CUP method as the most appropriate method in determining ALP. It was contended that the rate of interest was adhoc interest rate without brining on record any comparable uncontrolled transaction to compute the notional

interest on receivables. Several judicial pronouncements were cited before the DRP in this regard.

12. The DRP in this regard following the decisions of ITAT Delhi Bench in the case of Bechtel India Pvt.Ltd. ITA No.6530/Del/2016 dated 16.5.2017 and Techbooks International Pvt. Ltd., in ITA No.240/Del/2015 dated 06.07.2015 rejected the contentions of the assessee. The DRP also held that 30 days was the period of credit allowed to the AE and the late fee of 1.5% p.m. beyond 30 days was the agreed credit period and interest. The assessee has not charged any interest despite substantial delay in payment by the AE and therefore the action of the TPO was justified. The DRP also went further to hold that the libor rate adopted by the TPO was incorrect and substituted the short-term deposit rate of interest of SBI and directed the TPO to compute ALP accordingly which resulted in an enhancement of the addition made by the TPO.

13. Before us, learned Counsel for the assessee submitted that the TPO and the DRP have not adopted proper benchmarking analysis and further submitted that it is settled principle that no adjustment for interest receivables is warranted for debt - free companies. Reliance was placed on the decision of the Hon'ble Delhi Tribunal in case of the **Bechtel India Pvt. Ltd., ITA No. 1478/Del/2015 (Del). This principle has been accepted by the Hon'ble High Court. The SLP filed before the Hon'ble Supreme Court was also dismissed on this point.** Learned DR relied on the order of the DRP. Alternatively, it was submitted that the interest rate adopted by the DRP amounted to enhancement and

there was no notice to the Assessee given by the DRP before making enhancement.

14. We have carefully considered the rival submissions. We find that the Bench marking analysis adopting the rate of LIBOR at 6 months + 400 basis points adopted by the TPO is without any basis. The rate should be adopted after a proper benchmarking analysis. Interest computation if at all should be based on the delay of individual invoices, which has not been done. On the question whether delayed realization of trade receivables from the AE constitutes an international transaction or not, there are conflicting decisions of various benches of the Tribunal, which we shall point out. Sec.92B of the Act defining what is an international transaction was amended by Finance Act, 2012, way of insertion of an Explanation to sec.92B with retrospective effect from 1-4-2002 and the same reads thus:-

> "Explanation- For the removed of doubts, it is hereby clarified then-(i) the expression "international transaction" shall include—
>
> (a) …….
>
> (b) ……..
>
> (c) capital financing, including any type of long-term or short-term borrowing. lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment of receivable or any other debt arising during the course of business: ……"

15. The amendment is to the effect that "international transaction" would specifically include within its ambit. 'deferred payment or receivable or any other debt arising during the course of business' and hence non-charging or under-charging of interest on the excess period of credit allowed to the AE

for the realization of invoices would amount to an international transaction. It was so held by the ITAT Delhi Bench in the case of *Bechtel India Pvt Ltd (in ITA No.6530/De1/2016 dated 16 May 2017).* It is important to note that the Bench while arriving at the said conclusion distinguished its earlier order in the case of *Kusum Healthcare Pvt. Ltd. (supra)* and rejected the contention that interest gets subsumed in the working capital adjustment. The Hon`ble Bombay High court in the case of CIT vs. Patni Computer Systems Ltd, (2013) 215 Taxman 108 (Bom) dealt, inter alia, with the following question of law:-

> "(c) Whether on the facts and circumstances of the case and in law, the Tribunal did not err in holding that the loss suffered by the assessee by allowing excess period of credit to the associated enterprises without charging an interest during such credit period would not amount to international transaction whereas section 92B(1) of the Income-tax Act, 1961 refers to any Other transaction having a bearing on the profits, income, losses or assets of such enterprises?"

16. While answering the above question, the Hon'ble High Court noticed that an amendment to section 92B has been carried out by the Finance Act, 2012 with retrospective effect from 1.4.2002. Setting aside the view taken by the Tribunal, the Hon'ble High Court restored this issue to the file of the Tribunal for fresh decision in the light of the legislative amendment. In the case of *BT e Serv (TS-849-ITAT-2017(DEL)-TP)* the ITAT Delhi Bench held that undoubtedly the receivable or any other debt arising during the course of the business is included in the definition of 'capital financing' as an 'international transaction' as per explanation 2 to section 92B of the Act w.e.f. 01.04.2002 inserted by the Finance Act 2012. Therefore, even the outstanding receivable partake the character of capital financing and

consequently, overdue outstanding is an "international transaction". The natural corollary would be of imputing interest on such "capital financing" if same is not charged at arm's length. The ITAT concluded that if outstanding receivables are within the terms of agreement, then it may be argued that interest on such outstanding is already covered in the sale price of the goods. However, if the agreement does not specify the term of the payment, even then assessee must be given benefit of credit period which is accepted business practice in the trade. The ITAT confirmed 30 days as the normal credit period adopted by the TPO.

17. The foregoing discussion discloses that non-charging or under-charging of interest on the excess period of credit allowed to the AE, for the realization of invoices amounts to an international transaction and the ALP of such an international transaction is required to be determined. In view of the above observations. the reliance placed by the ld. counsel for the assessee on earlier decisions cannot be accepted. Similarly, Considering the above discussion, it is held that deferred trade receivable constitutes international transaction.

18. Having concluded that deferred trade receivables constitute international transaction, we come to the computation of the ALP of the international transaction of 'debt arising during the course of business.' This has two ingredients, viz., the amount on which interest should be charged and the arm's length rate at which the interest should be charged. On this aspect we can take useful guidance from the decision of the ITAT Delhi Bench in the case of Techbooks International (P.) Ltd. v. Deputy Commissioner of Income-tax, Circle-3, Noida [2015] 63 taxmann.com 114

(Delhi - Trib.), wherein the Tribunal laid down guidelines on the manner of determination of ALP, as follows:

> "13.11 Now, we come to the computation of the ALP of the international transaction of 'debt arising during the course of business.' This has two ingredients, viz., the amount on which interest should be charged and the arm's length rate at which the interest should be charged.
>
> 13.12 In so far as the first aspect is concerned, we find that the TPO has taken normal credit period of 60 days and accordingly made addition on account of transfer pricing adjustment for the period in excess of 60 days. In our considered opinion, transfer pricing adjustment on account of interest for the entire period of delay beyond 60 days cannot be treated as a separate international transaction of trading debt arising during the course of business. It is noticed that the assessee entered into an agreement with its AE for realization of invoices within a period of 150 days. This implies that the interest amount on non-realization of invoices up to 150 days was factored in the price charged for the services rendered. Annexure-1 to the TPO's order gives details of the instances of late realization or non-realization of advances up to the year ending. First three and a half pages of this Annexure indicate number of days for which there was delayed realization. Such delay ranges from 175 days to 217 days. The remaining pages disclose no realization of invoices up to 31st March, 2010. When we consider the dates of invoices in the remaining pages, it is manifested that in certain cases these invoices have been raised on 31st August, 30th or September or 31st October, 2009. In all such cases, the period of 150 days already stood expired as on 31st March, 2010 and the assessee ought to have charged interest on the delay in realizing such invoices along with the first three and a half pages in which there is an absolute and identified delay in realization of invoices beyond the stipulated period. When the interest for realization of trade advances up to 150 days is part and parcel of the price charged from the AE, then the delay up to this extent cannot give rise to a separate international transaction of interest uncharged. Rather interest for the period in excess of normally realizable period in an uncontrolled situation upto 150 days needs to be considered in the determining the ALP of the

international transaction of the 'Provision of IT Enabled data conversion services'. This can be done by increasing the revenue charged by the comparable companies with the amount of interest for the period between that allowed by them in realization of invoices and 150 days as allowed by the assessee, so as to bring such comparables at par with the assessee's international transaction of provision of the ITES. To illustrate, if the comparables have allowed credit period of, say, 60 days and the assessee has realized its invoices in 180 days, then interest for 90 days (150 days minus 60 days) should be added to the price charged by the comparables and the amount of their resultant adjusted operating profit be computed. Rule 10B permits making such an adjustment. Sub-rule (2) to rule 10B stipulates that for the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged, inter alia, with reference to the : '(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions …' . Then sub-rule (3) mandates that an uncontrolled transaction shall be comparable to an international transaction if 'reasonably accurate adjustments can be made to eliminate the material effects of such differences'. Applying the prescription of rule 10, it becomes vivid that difference on account of the 'contractual terms of the transactions', which also include the credit period allowed, needs to be adjusted in the profit of comparables. As the TPO has taken the entire delay beyond that normally allowed as a separate international transaction, which position is not correct, we hold that the effect of delay on interest up to 150 days over and above the normal period of realization in an uncontrolled situation, should be considered in the determination of the ALP of the international transaction of 'Provision of IT Enabled data conversion services' and the period of delay above 150 days, namely, 30 days in our above illustration (180 days minus 150 days) should be considered as a separate international transaction in terms of clause (c) of Explanation to section 92B.

13.13 In so far as the question of rate of interest is concerned, we find that this issue is no more res integra in view of the judgment of the Hon'ble jurisdictional High Court in the case of Cotton Naturals (I) (P.) Ltd. (supra), in which it has been held that it is the currency in which the loan is to be repaid which determines the rate of interest and hence the prime lending rate should not be considered for

determining the interest rate. Under such circumstances, we set aside the impugned order and remit the matter to the file of TPO/AO for a fresh determination of addition on account of transfer pricing adjustment towards interest not realized from its AE on the debts arising during the course of business in line with our above observations."

19. We are of the view that the issue with regard to determination of ALP in respect of the international transaction of giving extended credit period for receivables should be directed to be examined afresh by the AO/TPO on the guidelines laid down in the decision referred to in the earlier paragraph, after affording assessee opportunity of being heard. As held in the aforesaid decision the prime lending rate should not be considered and this reasoning will apply to adopting short term deposit interest rate offered by State Bank of India (SBI) also. The rate of interest would be on the basis of the currency in which the loan is to be repaid. We hold and direct accordingly. All issues on determination of ALP of the transaction are kept open.

20. Apart from the TP grounds as above, the assessee has raised one corporate tax issue in the form of ground No.25 which reads as follows:

Corporate Tax

25. Disallowance of software expenditure by treating it as capital in nature.

a. The learned AO/Hon'ble DRP has erred in disallowing software expenditure incurred by the Appellant on the grounds of it being capital in nature.

b. The learned AO/ Hon'ble DRP ought to have appreciated that these software expenses are mainly incurred for short term license with respect to application software. These softwares are purchased to facilitate daily operations or management more efficiently

c. The learned AO has erred by stating that some invoices are pertaining to AY 2013-14 and AY 2015-16 and thus should be capitalised. The learned AO failed to appreciate the fact that only proportionate cost of the softwares has been debited to profit & loss account of AY 2014-15. For e.g., if the software is purchased in October 2012 and the period of license is one year, then half of the price of the software will be charged in FY 2012-13 and balance half will be charged FY 2013-14.

d. The learned AO/Hon'ble DRP ought to have observed that the software expenses charged to the profit & loss account are incurred towards application software, i.e., incurred towards upgradation and customization of existing software and hence, does not result in acquisition of an asset.

e. The learned AO/ Hon'ble DRP ought to have observed that the Appellant does not own any intellectual property rights for the said software. The Appellant cannot sell the software to any third party.

f. The learned AO/ Hon'ble DRP ought to have observed that the software purchased by the Appellant having enduring benefit is already capitalised in its books of accounts and only those which have short term license period were claimed as expense in profit & loss account.

g. The learned AO/ Hon'ble DRP ought to have appreciated that the software purchased by the Appellant does not result in any enduring benefit, and hence, to be allowed as business expenditure under section 37 of the Act.

h. Further, the learned AO/ Hon'ble DRP ought to have appreciated that these expenses are recurring in nature, expended either to upgrade the system or run the system and does not result in creation of fixed asset for the Appellant. Accordingly, such expenditure cannot be capitalized.

i. The learned AO/ Hon'ble DRP erred in not placing reliance on judicial precedents which have held that the expenditure on purchase of software can be treated as revenue expenditure where the life of the acquired software was short, say less than two years.

j. The learned AO/ Hon'ble DRP erred in not placing reliance on judicial precedent which have held that the software license cost is allowed as a revenue expenditure for the following reasons:

i. *If the software acquired by the assessee was primarily in the nature of application software*

ii. *The assessee has only limited right to use the software for the period of validity of the license which has no enduring benefit.*

iii. *The payments made for maintenance and upgradation of the existing software is on account of newer version of the software required in a periodic manner to facilitate functioning.*

iv. *If the advantage obtained by purchase of software was only to facilitate trading operations or management more efficiently, leaving the fixed capital untouched, it would be revenue expenditure even if advantage may endure for a long or indefinite period.*

21. The AO and the DRP held that the software expenses claimed by the assessee was capital expenditure and cannot be allowed as deduction. The revenue authorities however allowed depreciation on software expenses and disallowed the remaining sum. The point for consideration is as to whether the software expenses can be said to be revenue expenditure that has to be allowed as deduction, while computing income from business. Learned Counsel for the assessee submitted that what the assessee purchased was an application software and therefore following the decision of the Hon'ble Karnataka High Court in the case of CIT vs. IBM India Ltd., 361 ITR 210 (Karnataka), the AO allowed deduction of the expenditure as revenue expenditure. In so far as the plea of the assessee is concerned, the factual details as given by the assessee on the nature of expense is as follows:

> *"The Assessee submits that the Company is engaged in the business of providing IT/ ITES services. Hence, as part of its business operations, Company has made certain payments towards purchase and maintenance of software during FY 2013-14.*

The software charges amounting to Rs.3,02,17,150 which are paid for purchase of software which have enduring value have been capitalised in assessee's books for FY 2013-14 - please refer note 9.B of financial statements.

Further, expenses amounting to Rs. 13,75,18,000 which is debited in the profit and loss account relating to software expenses are mainly incurred for short term license ranging for a period of 6 months to 12 months. The amortized cost of such licenses falling in FY 2013-14 have been debited to the profit and loss account and have been claimed as an allowable expenditure under section 37 of the Act.

We wish to submit that the above software expense is a revenue expense and is expended wholly and exclusively for the purpose of the business. The company does not receive any enduring benefit from such licenses and accordingly, has been claimed as a revenue expenditure."

22. The DRP in its order held as follows:

***"2.27.1 Having considered the submissions, we** note that the complete details of these expenditure were not filed before the AO, and the AO could not examine the nature of these expenses. We consider it appropriate to direct the AO to examine the nature of the expenditure debited as software expenses; with reference to invoices, and on verification, if it is found that the expenses incurred were towards renewal of license for application software for a period less than one year, the same May be allowed as revenue expenditure; and in cases where such expenses relate to renewal of license for a period more than one year, such expenditure may be capitalized and depreciation may be allowed on the same at the percentage relevant to block of assets under the category 'intangible assets" and in respect of software embedded to computer depreciation may be allowed' at 60%.*

2.27.2 The assessee is directed to produce all the relevant Invoices within 10 days of receipt of this order. If the assessee fails to furnish the information as above, then no interference is called for in the AO's order.

2.27.3 The above direction is based on our view that payment towards renewal of license being in the nature of license fee' would fail within the category of "intangible assets" and depreciation may be accordingly allowed. In this regard, we like to point out that the Act has not categorized "computer software as separate asset. Computer software embedded in the computer only can be 'characterized under "plant and machinery". On the other hand, "license fee" falls within the clause Intangible asset" as per the provisions of the Act and %lies, It is well settled principle of law that the specific provisions would prevail over the general provisions."

23. In the submissions before the AO/TPO while giving effect to the order the DRP, (submission dated 24.9.2018) the Assessee gave invoices pertaining to software expenses and pointed out that the license period was only one year. These details are available at page 1150 to 1210, besides sample agreement for use of software license which are at pages 1211 to 1267 of the Assessee's paper book filed before us.

24. The AO while giving effect to the directions of the DRP examined the documents filed and came to the conclusion that certain bills did not pertain to AY 2014-15 and period of license was more than 1 year in respect of some of the software. He held that out of the total expenditure of Rs.13,75,18,000 under the head software expenses, a sum of Rs.4,45,39,896 had to be regarded as revenue expenditure and the remaining sum of Rs.9,29,78,104 was regarded as capital expenditure and depreciation of Rs.5,57,86,862 was allowed on the software expenses treated as capital expenditure. Therefore the disallowance ultimately stood reduced to Rs.3,71,91,242/-.

25. The learned counsel for the assessee submitted that the revenue authorities ought to have appreciated that these software expenses are mainly incurred for short term license with respect to application software. Reliance was placed on the decision of the Hon'ble Karnataka High Court

in the case of IBM India Ltd. ITA No.130/2007 order dated 10.4.2013 wherein it was held that (Para-9 of the judgment) payment for application software and not system software it has to be regarded as revenue expenditure. It was submitted that softwares are purchased to facilitate daily operations or management more efficiently. That the learned AO has erred by stating that some invoices are pertaining to AY 2013-14 and AY 2015-16 and thus should be capitalised. The learned AO failed to appreciate the fact that only proportionate cost of the softwares has been debited to profit & loss account of AY 2014-15. For e.g., if the software is purchased in October 2012 and the period of license is one year, then half of the price of the software will be charged in FY 2012-13 and balance half will be charged FY 2013-14. The learned AO/Hon'ble DRP ought to have observed that the software expenses charged to the profit & loss account are incurred towards application software, i.e., incurred towards upgradation and customization of existing software and hence, does not result in acquisition of an asset. The learned AO/ Hon'ble DRP ought to have observed that the Appellant does not own any intellectual property rights for the said software. The Appellant cannot sell the software to any third party. The learned AO/ Hon'ble DRP ought to have observed that the software purchased by the Appellant having enduring benefit is already capitalised in its books of accounts and only those which have short term license period were claimed as expense in profit & loss account. The learned AO/ Hon'ble DRP ought to have appreciated that the software purchased by the Appellant does not result in any enduring benefit, and hence, to be allowed as business expenditure under section 37 of the Act. Further, the learned AO/ Hon'ble DRP ought to have appreciated that these expenses are recurring in nature, expended either to upgrade the system or

run the system and does not result in creation of fixed asset for the Appellant. Accordingly, such expenditure cannot be capitalized. The learned AO/ Hon'ble DRP erred in not placing reliance on judicial precedents which have held that the expenditure on purchase of software can be treated as revenue expenditure where the life of the acquired software was short, say less than two years. The learned AO/ Hon'ble DRP erred in not placing reliance on judicial precedent which have held that the software license cost is allowed as a revenue expenditure for the following reasons:

(i) If the software acquired by the assessee was primarily in the nature of application software

(ii) The assessee has only limited right to use the software for the period of validity of the license which has no enduring benefit.

(iii) The payments made for maintenance and upgradation of the existing software is on account of newer version of the software required in a periodic manner to facilitate functioning.

(iv) If the advantage obtained by purchase of software was only to facilitate trading operations or management more efficiently, leaving the fixed capital untouched, it would be revenue expenditure even if advantage may endure for a long or indefinite period.

26. The learned DR relied on the order of the AO. We have considered the rival submissions. We find that the directions of the DRP was to examine as to whether the software in question were application software or renewal of license for application software for a period less than one year, the same May be allowed as revenue expenditure; and in cases where such

expenses relate to renewal of license for a period more than one year, such expenditure may be capitalized and depreciation may be allowed on the same. There has been no finding by the TPO/AO on whether the software were application software or not. In the decision rendered by the Hon'ble Karnataka High Court in the case of IBM Corporation (Supra), the payment for acquisition of application software were held to be revenue expenditure. Apart from the above, the period of license cannot be the basis to decide whether the expenditure is capital or revenue expenditure. The test to be applied is as to whether the expenditure was incurred to facilitate conduct of business more efficiently in its operation and not in the capital field. The assessee renders software development services and therefore the use of these software was in its operations and not in the capital field and in that view of the matter, we are of the view that the expenditure in question deserves to be allowed in full. The addition sustained is therefore directed to be deleted and the expenditure in question should be allowed as deduction as the expenditure is revenue expenditure allowable as deduction.

27. In the result, the appeal by the assessee is partly allowed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-	Sd/-
(PADMAVATHY S)	**(N.V. VASUDEVAN)**
Accountant Member	**Vice President**

Bangalore,
Dated: 24.06.2022.
/NS/*

Copy to:

1.	Appellants	2.	Respondent
3.	CIT	4.	CIT(A)
5.	DR	6.	Guard file

By order

Assistant Registrar,
ITAT, Bangalore.