

**Business Information Processing Vs. Assistant Commissioner of**

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**Court :** Income Tax Appellate Tribunal ITAT Jaipur

**Decided On :** Apr-26-1999

**Reported in :** (2000)73ITD304(JP.)

**Judge :** C Bokolia, R Gupta

**Appellant :** Business Information Processing

**Respondent :** Assistant Commissioner of

**Judgement :**

1. These are two appeals by assessee against the consolidated order of CIT(A) dated 4-12-1992 relevant to assessment years 1989-90 and 1990-91.
2. The brief facts of the case are that assessee derives income mainly from computer data processing services and sale of computer stationery.

The assessee is mainly doing such work on job work basis for the Organisation who want to out-source the data processing work such as PHED, Education Boards, RFC etc. The direct expenses of the assessee for such work include the payment of job service charges, apart from the expenses like salaries of personnel, data preparation expenses, repair & maintenance of the hardware and cost of stationery. The payment of job service charges, inter alia, comprise of expenditure in relation to development of specific softwares and the programmes which are required to do the job under-taken as per the specifications of the customers. Such programmes are need based and got developed in accordance

with the requirements of specific customers. As per written submission filed by assessee wherein it is mentioned that a programme prepared to perform one particular job cannot be used for other jobs and even for the same job, if there arise substantial difference in the requirements of the customers in the changing situation.

3. During the years under consideration, the assessee incurred job service charges of Rs. 2,93,082 and Rs. 4,51,828 for assessment years 1989-90 and 1990-91 respectively. These expenses were debited to the Profit & Loss Account. These expenses also included the expenses for development of software. During the assessment year 1989-90 the expenses on development of software were made at Rs. 85,000 and during the year 1990-91 the expenses were at Rs. 1,35,000. The Assessing Officer disallowed the claim of these expenses by treating these expenses as capital in nature and he allowed depreciation of 1/3rd on these two amounts. Accordingly, additions of Rs. 56,667 and Rs. 71,111 were made in these two years respectively. While treating these expenses as capital in nature, the Assessing Officer was of the view that programmes once written can be used again and again for preparation of desired reports. It was further observed by him that the programmes can be stored in the storage media and can be put in the library. Small changes can be made in the programme but then it becomes more handy and useful for the purpose of records of the customer. It was further observed by the Assessing Officer that assessee has not submitted any evidence for the claim that the old version of the software are deleted from the machine for ever. It was also observed by the Assessing Officer that even if some changes were made in the Software supplied to PHED then it is not clear that whether the changes in the software were made in assessment year 1989-90 or assessment year 1990-91. Likewise, some more observations were made by the Assessing Officer and then he disallowed the claim of the assessee. While disallowing the claim, the Assessing Officer placed reliance on 125 ITR 29 (sic) (Bom.), Scientific Engg. House (P.) Ltd. v. CIT [1986] 157 ITR 86/[1985] 23 Taxman 66 (SC) and a decision of Jaipur Bench in ITA No.348/JP/88 where it was held that the expenses on technical know-how are capital expenses. The CIT(A) confirmed the findings of the Assessing Officer as it is.

5. We have heard the rival submissions and considered them carefully.

We have also perused the various case laws relied upon by both the parties and considered them carefully. Before proceeding further, we would like to discuss here what software and hardware means.

6. A physical equipment that makes up a computer system is called hardware. Hardware includes input and output device. Input devices are file storage devices, and the memory and the processor and output devices are screen, printers etc.

7. On the other hand, the computer software consists of programmes, which a computer uses to perform a task on the basis of logic supplied by the user. Such software can be either created or purchased and can be modified if there are subsequent changes. Software or computer programme is a device by which desired reports are taken out from the input data, e.g. when examination marks of students are fed into the computer it arranges the same into mark sheet proforma. Various machine language softwares are used to prepare application software. For example, a programme for marks may be made in various machine languages software depending on the hardware used and requirement of user.

Various machine languages are BASIC, COBOL, ORACLE, FOX-PRO, C language etc.

8. With the change of hardware configuration and capability also, software and programme require changes. The software or the programme also require changes if the 'logic' for the desired results is being changed. The change in the legal requirement or other governing regulations also requires modification, substantial amendments or even rewriting of the programmes. Sometimes, the substantial change in reporting requirements call for rewriting the whole programme even without its user for very less time. There are many programmes which prove to be of short life because of loops in the programme, revealed as a result of practical user. Further, certain computer bugs and viruses also makes the programmes out of use. Another reason for uncertain, short and unwarranted life of programmes is fast and vast technological changes in and around computer because of which the programmes are required to be made environment

compatible.

9. From the abovestated different explanation regarding hardware and software, it is clear that the hardware is purchased once i.e. computer shed but software is an equipment which is purchased separately to develop the various programmes and to take the help of the various schemes as required by the users. Of course, there is no doubt that today is the time of user friendly programmes which require change with the changing in users lobby. Thus such need based software programmes are rarely long lasting. The Id. A/R has explained the use of software in detail. It was stated by him that assessee entered into contracts mostly annual or for two years with various entities to develop computer programme as per their requirements/specifications. He also invited our attention on agreements entered with the various parties where the conditions for development of software and other terms are mentioned. It has further stated that as the requirements of the customers of the assessee keeps on changing even during the contract period, it becomes necessary to re-write the programme on various occasions or substantially modify the programmes in order to satisfy the requirements of the customers. It has further stated that as per the past history, the programme in software is needed to be modified on an average within 4 to 6 months period. In support of his contention the Id. A/R has invited our attention on pages 62 to 64 of the paper book filed by him. It has been stated further that similarly, the examination work software is required to be modified frequently whenever there is change in subject, change in passing criterion, rules regarding passing marks, grace marks, change in scheme of paper from 2 years to 3 years etc. and then it was explained that if many changes are required to be made then the programme is to be re-written by deleting the old version of software so as to avoid various confusions created while incorporating the changes.

10. It has also submitted by the Id. A/R that the programmes are developed for the specific use of a particular client. As soon as the contract period ends, the software programme remains of no use to the assessee-company. It has further stated that initially the contracts are usually for a year and is given again on the basis of performance or winning of Tender, and if the work could not be to the satisfaction of the customers, the contract is terminated because the 'time' as well

as 'accuracy' remains the essence of these kind of contracts. It was further stated that whenever the programme is replaced with new one, the old programme loses its utility and is worthless. The assessee has certain programmers also engaged in modification, amendments to the programmes and writing supplementary/smaller programmes. It has been further stated that on account of uncertainties, instead of developing all the programmes in house, it is getting developed through outside agencies. Therefore, the expenses incurred on development of software are of revenue in nature.

11. Shri C. L. Jhanwar, the Id. A/R has further stated that the development of computer software in the present case has direct nexus with assessee's revenue generation and considering the nature of assessee's business, it is not a long lasting expenditure. It is not even an indirect expenses for it like the expenses for development of an accounting software for its own accounts. It is, as per its nature, a direct expenditure. Therefore, he pleaded that these are revenue expenditure in nature. It has been argued that the compatibility of any software depends on the hardware. Both are complimentary for each other. Therefore, whenever there is upgradation in the hardware (which is quite frequent in the modern period of revolution in Information Technology), the software has also to be amended in order to make it compatible to the new version. For example, when Personal Computers were launched, users started replacing Micro Computers, System-4, Horizon-III with Personal Computer, the software has to be scrapped and redesigning is required to run it in new hardware. In support of this argument, the Id. A/R has argued that these are expenses which are undoubtedly in nature of revenue expenditure. Therefore, they should be allowed in full.

12. It has been further argued that the case laws relied upon by the department are distinguishable on facts as all the case laws were in regard to technical know-how wherein the Apex Court as well as Bombay High Court and this bench of the Tribunal has held that the expenditure for acquiring the technical know-how are in nature of capital whereas the assessee's case is different. Here, the software is not of enduring profit or enduring use as they have to be changed within a span of small period i.e. 4 months or 6 months as that software is of no use and that is like a scrap. Therefore, the cases are distinguishable. In support of his contention, the

Id. A/R has placed reliance on CIT v. Ciba of India Ltd. [1968] 69 ITR 692 (SC), CIT v. British India Corpn.

Ltd. [1987] 165 ITR 51/30 Taxman 546 P (SC) and Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377/43 Taxman 312 (SC). In case in Alembic Chemical Works Co. Ltd.'s case (supra) the Hon'ble Apex Court has held - "That the improvisation in the process and technology in some areas of the enterprise was supplemental to the existing business and there was no material to hold that it amounted to a new or fresh venture. The further circumstance that the agreement pertained to a product already in the line of the appellant's established business and not to a new product indicated that what was stipulated was an improvement in the operations of the existing business and its efficiency and profitability not removed from the area of the day to day business of the appellant's established enterprise. The financial outlay under the agreement was for the better conduct and improvement of the existing business and was revenue in nature and was allowable as a deduction in computing the business profits of the appellant".

"It would be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurance and permanence to the technical know-how at any particular stage in this fast changing area of medical science. The state of the art in some of these areas of high priority research is constantly updated so that the know-how cannot be said to be the element of the requisite degree of durability and non-ephemerally to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeon-holding an outlay, such as this, as capital".

14. We have considered other case laws also which was relied upon by the Id. A/R. In case of CIT v. Western India State Motors [1993] 203 ITR 363 (Raj), the Hon'ble Jurisdictional High Court has held that "according to normal accepted principles, a capital expenditure is something which is spent once for all, while the revenue expenditure is that which is to be incurred every year. Replacement of machinery in the usual course of business which is worn out would be to maintain the machinery".

15. In case of Praga Tools Ltd. v. CIT [1980] 123 ITR 773/[1981] 5 Taxman 284 (A.P.) (FB), the Andhra Pradesh High Court has held that "Where the expenditure has a direct nexus, connection or relation to the carrying on of or conducting the business of the assessee, it must be regarded as an integral part of the profit-making process. In such a case, it must be held to be a revenue expenditure".

16. In case of CIT v. Kusum Products Ltd. [1984] 149 ITR 250/19 Taxman 60, the Hon'ble Calcutta High Court has held that "Merely because the benefit overflows to future years, the deduction cannot be denied".

17. In case of R.G.S. Industries v. CIT [1990] 183 ITR 31/51 Taxman 467, the Hon'ble Gauhati High Court has held that "Where the assessee had acquired certain trading benefits which could over-run the year but all the same it was found to be not permanent. Since the advantage was not enduring for indefinite period, it was found that the claim could be allowed as a deduction."

18. In case of Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1/3 Taxman 69 the Hon'ble Supreme Court has held that "There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may nevertheless, be on revenue account and the test of enduring benefit, may break down. 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 the above 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 on revenue account, even though the advantage may endure for an indefinite future."

19. In case in Hinton (Inspector of Taxes) v. Maden & Ireland Ltd. [1960] 39 ITR 357, House of Lords has observed as under :- "There is no principle of accountancy or law which requires that the expenditure which is charged to the P&L a/c should get exhausted in the same year. Expenditure on all consumable used in industry does not always mean that the fallout by way of benefit would not overstep the accounting year. For that reason, it cannot be said that it is not chargeable against revenue of the year. An example of this category of expenditure is repairs to premises and machinery where the benefit certainly over-runs the year."

20.

Likewise, we have also considered other case laws and we find that they all in support of assessee's case. We have also seen the order for Assessment Year 1988-89 in case of assessee itself where the department has allowed the similar claim by holding that the expenses are revenue in nature.

21. In view of all the above discussion, we are of the view that assessee deserves to succeed. We find that software used by assessee are not of any enduring benefit as assessee has to change these software within a short span of time i.e. 4 months or 6 months. We also noted that sometimes they are of no use at all because they become out-dated because of change of system and change of technology. The time is of fast changing and computer system is emerging as a very important component during this period of fast changing era. Day by day the systems are developed in a new way and software are needed like a raw material for use in manufacturing. Therefore, we are of the considered view that these expenses are purely of revenue in nature and they should be allowed in full. We have also discussed the ratio of various valuable decisions and we find that they are in support of assessee's cause. Therefore, also we are of the view that these expenses are revenue in nature. Accordingly, we allow this ground of the assessee in both the years.

22. Ground No. 2 is against sustenance of various additions on account of expenses claimed in Profit & Loss Account. The Assessing Officer disallowed 1/5th of conveyance and car expenses which were to the tune of Rs. 19,872.

23. After hearing rival submissions, we find that there is some weight in the contention of the Id. A/R. During the Assessment Year 1988-89 which was immediately previous year of the relevant assessment year which is under appeal here before us, the sales were to the tune of Rs. 30.50 lacs whereas it has been increased to Rs. 54.71 lacs during the year under appeal. The contention of the Id. A/R is that assessee gets lesser time for personal affair when he is busy more for business purposes. It is evidently clear because of turnover increased from Rs. 30.50 lacs to Rs. 54.71 lacs.

24. Therefore, the percentage disallowed for personal use for Assessment Year 1988-89 should not be adopted during the year under consideration. Expenses

increased on conveyance and car because of more business activity. In view of these facts and circumstances, we are of the view that if a disallowance of Rs. 10,000 is restricted, it will meet the ends of justice for both the sides. We order accordingly.

26. After hearing rival submissions, we find that this addition is rightly made. Accordingly we confirm the same.

27. An addition of Rs. 3,000 was made out of staff welfare expenses which in our view this is not sustainable. Addition in Sales promotion account has been separately made. Therefore, we are of the view that addition on account of staff welfare should not be made separately where all the vouchers are available. Accordingly we delete this addition.

28. The next objection is against sustenance of addition of telephone expenses at Rs. 5,000. We reduce this addition at Rs. 2,000 on the reasons discussed above while disposing of the ground on account of conveyance and car expenses.

29. The next objection is against RST and P.F. This ground was not pressed and accordingly dismissed the same.

30. Ground No. 3 is against sustenance of Rs. 5,000 out of travelling expenses. This ground was not disposed of by the CIT (A). Therefore, the same is restored to the file of CIT(A) for disposing of and after giving an opportunity to the assessee.

32. Similar additions were made for Assessment Year 1990-91. Ground No.1 is similar to the ground No. 1 of Assessment Year 1989-90. Therefore, the same is disposed of as per appeal for Assessment Year 1989-90.

33. Ground No. 2 is against the various disallowances. Car repairing expenses are restricted to Rs. 10,000 on the reasons given in appeal for Assessment Year 1989-90, (supra).

34. Conference and Staff welfare expenses are deleted as we have already discussed this issue as they were made for business expediency.

The telephone expenses is restricted to Rs. 2,000 on the reasoning given in Assessment Year 1989-90, (supra).

35. Next objection is in regard to RST and P.F. which was not pressed.

Accordingly the same is dismissed.

36. Ground No. 3 is against the disallowance of Rs. 5,000 out of travelling expenses which was not disposed of by the CIT (A). The same is restored to the file of CIT (A) for disposing of and after giving opportunity to the assessee.

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