Amway India Enterprises Vs. the Deputy Commissioner of

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Feb-15-2008

Reported in : (2008)111ITD112(Delhi)

Judge : V Gandhi, P Jagtap, N Vasudevan

Appellant : Amway India Enterprises

Respondent : The Deputy Commissioner of

Judgement :

1. This Special Bench has been constituted u/s. 255(3) to dispose of the appeals filed in the case of M/s. Amway India Enterprises and M/s.

SQL Star International Ltd., as well as to dispose of the following important questions which are involved therein: (i) Whether, in the facts and circumstances of the case, the expenditure incurred by the assessee on account of computer software is of revenue nature or capital nature? (ii) If the expenditure incurred on computer software is held to be of capital nature, what would be the rate of depreciation applicable thereon? 2. The factual backdrop which has given rise to the constitution of this Special Bench can be briefly summarized as follows. In the case of M/s Amway India Enterprises, a deduction on account of software expenditure incurred amounting to Rs. 20,04,105/- was claimed by the assessee company in its return of income filed for A.Y. 2001-2002. The said expenditure was claimed to be incurred by the assessee company for acquiring the following software for use in its business: Microsoft Office Project 2000 is used by project managers who need a desktop tool to manage their projects independently. These project managers do not require strong coordination with other project managers. Project 2000 is designed to improve ability to organize work and communicate effectively and succinctly through familiar, easy-to-use tools. The benefit of the software is to better organize and manage work and people to ensure that projects are delivered on time and within budget. It conveys project plans and status effectively and succinctly. It also enhances productivity and effectiveness by learning and applying project management practices easily.

The software is basically platform software, this helps in operating MS Project 2000 Full Packaged Program software on to the serve without which server cannot host MS Project, 2000.

3. Macromedia Dream weaver and Flash: Rs. 35,800/- The Macromedia Dream weaver software includes the following: Macro Media Dream weaver is the industry-leading web development tool, enabling users to efficiently design, develop and maintain standards-based websites and applications. With Dream weaver, web developers go from start to finish, creating and maintaining basic websites to advanced applications that support best practices and the latest technologies.

Web Site designers and developers use Macromedia Flash to accelerate projects while maintaining a high degree of creative control. It provides standard Templates and Components, Macromedia online Resource Library and Speed workflow by directly importing media including digital video, PDF and EPS files. This software also helps in adding interactivity with powerful scripting.

The software helps in compression of size of e-mails sent through the Lotus Notes mailing system. It includes licenses for 150 uses who are using Lotus Notes Mailing system and software license for running on its server.

A user working on Lotus Notes Mailing system wants to send message through email. The email size containing the message in 2 MB (Mega Bytes). The Turbo Gold Software compresses the size of email lesser than 2 MB thus save time and usage cost.

This windows based software is used for recording telephone calls and its cost. The software provides complete detail in case of outgoing calls such as Extension No., Telephone Nos., Time of call and duration of call etc.

6. Bright Star Are Server Advance Edition: Rs. 2,50,000/- The function of software is to keep back up of data. It ensures that the data on the computer system are saved and stored and which may be retrieved in case the computer system is not working or the hard disk in the system gets crashed.

Back Office Server 2000 has 5 server components to take backup of data base such as MS Exchange Server for E-mail back up, MS Windows Server for MS Windows data base and SQL Server for storage of other data base etc. The basic function is to store the data base in respective space contained under the server.

Windows 2000 Server is the multipurpose network operating system for businesses of all sizes. Windows 2000 Server less the user share files and printers reliably and securely. This software helps in choosing from thousands of business applications compatible to run on Windows 2000 Server and build Web applications and connectivity to the Internet.

The Software License grants the right to install Windows 2000 server on the computer after which application software can be installed on it.

There are 100 licenses which have been taken for use of Windows 2000 for 100 users. For each user, a separate license is required for Windows 2000 Platform. As explained above, Windows 2000 is a platform, which helps in running application software such as MS Office at the computer system.

Microsoft Windows XP Professional is the next version of the Windows operating system. Windows XP Professional is designed specifically to optimize productivity using the latest advancements in the digital world and is built on the solid foundation of Windows 2000.

Windows XP Professional provides improved reliability, security, performance and ease of use, setting new standard in efficient and dependable computing Microsoft Windows XP Professional provides an enhanced security infrastructure that defends against viruses, worms, and hackers, along with increased manageability and control for IT professionals and an improved experience for users.

3. It was claimed by the assessee that the expenditure in question has been incurred on obtaining licenses for use of the aforesaid software and since all these software are essentially in the nature of application software, the expenditure incurred was of revenue nature as the same only facilitated in its day to day operations. It was also claimed that the said expenditure did not result in enduring benefit as the life of application software is invariably short and the same was bound to become technically obsolete very fast. This claim of the assessee, however, was not found to be acceptable by the Assessing Officer as, according to him, the said software were part of the plant and machinery of the assessee and gave enduring benefit to it. The Assessing officer also noted that all the application software purchased by the assessee had long-lasting use of more than three-four years and the same, according to him, thus resulted into enduring benefit to it. He, therefore, treated the expenditure incurred by the assessee on acquisition of software as capital in nature an treating the same as part of the plant and machinery, depreciation thereon at the normal rate of 25% was allowed by him in the absence of any specific rate prescribed in the Schedule for the software. The action of the Assessing Officer in treating the software expenditure as that of capital nature was upheld by the learned CIT (A) since he found on verification of the relevant details that the assessee has not upgraded or replaced the

software frequently. He however, directed the AO to allow depreciation at the rate of 60% on the software considering that the rate of depreciation provided on computers for AY 1999-2000 to 2002-03 was 60% and from AY 2003-04 onward, even the computer software was included in the computers to be eligible to claim the depreciation at this higher rate. In AY 2002-03 also, the expenditure incurred by the assessee on acquisition of software was treated as a capital expenditure by the Assessing Officer as well as by the learned CIT (A) for the similar reasons as given in A 60% and from AY 2003-04 onward, even the computer software was included in the computers to be eligible to claim the depreciation at this higher rate. In AY 2002-03 also, the expenditure incurred by the assessee on acquisition of software was treated as a capital expenditure by the Assessing Officer as well as by the learned CIT (A) for the similar reasons as given in AY 2001-02.

However, the depreciation allowed thereon at normal rate of 25% by the AO was confirmed by the learned CIT (A) overlooking the fact that the same was allowed by his predecessor in assessee's own case for AY 2001-02 at the rate of 60%.

4. Against the order of learned CIT (A), an appeals was filed by the assessee before the Tribunal and when the same came up for hearing initially before the Division Bench, the main contention raised by the learned Counsel for the assessee in support of the assessee's case was that by incurring the impugned expenditure, the assessee company had acquired only the license to use the software and there was no outright purchase of software giving ownership to the assessee of the said software so as to treat the same as a capital expenditure. In support of this contention, reliance was placed on behalf of the assessee on the decision of Delhi Bench 'C' of ITAT in the case of M/s. Asahi India Safety Glass (ITA No. 3280/Del/2001, 3287/Del/2001, C.O. No.237/Del/2004 and C.O. No. 268/Del/2004) wherein the expenditure incurred by the assessee on acquisition of application software by way of license to use was allowed as revenue expenditure. It was contended by the learned Counsel for the assessee that the purchase of software and acquisition of license to use the software are two different transactions in law which are not interchangeable.

5. The learned DR, on the other hand, contended before the Division Bench that acquiring a license to use software is the common mode of purchase of software and therefore, the expenditure incurred on such purchase of software giving enduring benefits to the assessee is a capital expenditure as rightly held by the authorities below. In support of this contention, the learned DR strongly relied on the decision of Delhi Bench of ITAT in the case of Maruti Udyog Ltd. 92 ITD 119 wherein it was held that the expenditure incurred on purchase of a software being a capital asset, is always a capital expenditure. He submitted that the nature of software purchased in the present case was similar to the one involved in the case of Maruti Udyog Ltd. (supra) and as such, this issue is squarely covered in favour of the Revenue by the decision of the Tribunal rendered in the said case.

6. After considering the rival submissions, it was noted by the Division Bench that in the case of Maruti Udyog Ltd. (supra) cited by the learned DR, the expenditure on purchase of software was held to be a capital expenditure by the Tribunal relying on the decision of Hon'ble Rajasthan High Court in the case of Arawali Constructions Co.

(P) Ltd. 259 ITR 30 wherein it was held that the software is akin to know-how. Reliance was also placed by the Tribunal on the decision of Hon'ble Supreme Court in the case of Scientific Engineering House Pvt.

Ltd. v. CIT 157 ITR 86 wherein it was held that know-how is part of plant and machinery and the assessee is entitled to depreciation thereon. In this context, the Tribunal observed that the software is an integral part of computer in as much as the computer can function only with the help of software. Further reliance was also placed by the Tribunal on the decision of Hon'ble Supreme Court in the case of Arvind Mills Ltd. v. CIT 197 ITR 422 wherein it was held that the expenditure incurred on capital asset does not lose the character of capital expenditure and does not become a revenue expenditure on the score that the said capital expenditure also ultimately helps in the effective running of the business. The Tribunal thus held that the software being akin to know-how is an intangible capital asset and the expenditure incurred on purchase of software is a capital

expenditure. The Tribunal also referred to the amendment made in the I.T. Rules, 1962 providing for depreciation on software at the rate of 60% with effect from 1.4.2003 and observed that on the basis of the said amendment providing for higher depreciation on software, it could not be said that prior to 1.4.2003, the expenditure incurred on software was a revenue expenditure. The Tribunal held that it was always a capital asset entitled to normal rate of depreciation up to 31.3.2003 which was enhanced to 60% with effect from 1.4.2003 considering the rapid wear and tear. The decision of Bangalore Bench of ITAT in the case of Inspecting Asstt. Commissioner v. Commissioner and General Agency 17 ITD 6 (Bang) was also found by the Division Bench to be of similar effect wherein it was held that cost of software purchased by a computer dealer for the purpose of demonstration and also to provide data processing service to its customers is a capital expenditure. As noted by the Division Bench, it was also held by the Tribunal in the said decision that the software is a technical know-how which has to be purchased by the user of the computer to make effective use of the machine.

7. It was also noted by the Division Bench that in the case of Joint CIT v. City Crop Overseas Software Ltd. 85 TTJ 87, the Mumbai Bench of ITAT, however, held that the expenditure on application software is an allowable revenue expenditure since a software does not have any degree of endurance and permanent due to change of system and change of technology. Similarly, the Chandigarh Bench of ITAT in the case of Bank of Punjab Ltd. v. JCIT 91 TTJ 422, held that the purchase of software is not an expenditure in capital field as the assessee is required to change the software within a very short span of time may be a year or two and they become outdated because of change of system and change of technology. In the case of Asahi India Safety Glass (supra) cited by the learned Counsel for the assessee, a similar issue had arisen for consideration before Delhi Bench of ITAT and when the decision of the Tribunal rendered in the case of Maruti Udyog Ltd. (supra) was relied upon by the learned DR in support of the Revenue's case that the expenditure on purchase of software was a capital expenditure, the Tribunal distinguished the same on the ground that the assessee in the said case had actually purchased a software whereas in the case before it, the assessee had only acquired the right (license) to use the software. The Tribunal thus gave a new dimension to the issue while accepting the contention raised on behalf of the assessee that only the license to use the application software was acquired by the assessee from Oracle in the said case and it was not a case of actual purchase of the software by the assessee. The Tribunal also derived support from the decision of Hon'ble Supreme Court in the case of Alembic Chemical Works Ltd. 177 ITR 390 to hold that the test of enduring benefit is more prone to failure in the case of computer software where the pace of advancement is so rapid that whatever technology is installed today become obsolete within a short time.

8. Having taken note of the aforesaid decisions of the Tribunal relied upon by both the sides in support of their stand on the issue under consideration, it was found by the Division Bench that there were divergent views expressed on the issue relating to the exact nature of expenditure incurred on software being capital or revenue. It was also felt by the Division Bench that there are various aspects which are relevant and material and having a direct bearing on the issue which have not been specifically/elaborately considered in the said decisions rendered by the different Division Benches of the Tribunal while expressing divergent views on the said issue. Since the said issue was expected to occur regularly in many cases, it was felt by the Division Bench that the same may be referred to the Special Bench for decision after taking into consideration all the aspects referred to above as well as other contentions that might be put forth by the parties.

Accordingly, this Special Bench has been constituted by the Hon'ble President for deciding the questions as referred to above at the instance of the Division Bench and also for disposing of the appeals filed in the case of M/s. Amway India Enterprises.

9. Before the Special Bench constituted by the Hon'ble President could sit and hear the appeals filed in the case of M/s. Amway Indian Enterprises, a similar issue relating to allowability of software expenditure arose for consideration before the Division Bench of Tribunal i.e. Delhi 'G' Bench, in the case of M/s. SQL Star International Ltd. The relevant facts involved in the said case were that the assessee company was engaged in the business of software development as well as running a training center to impart specialized training to

the students in software technology. It purchased computer software and claimed the entire cost as depreciation. The assessee contended before the AO that the software which it purchased becomes obsolete in about six months time due to fast changes in technology in the IT Sector and therefore, such expenses are to be considered as revenue expenditure. The management of the assessee company, however, considered it appropriate to claim the expense under the head 'depreciation' because the company had intended to come out with a public issue and to show a healthy balance sheet. In the immediately preceding assessment year also, the assessee company had claimed 20% depreciation on computer software owning to absence of profits.

According to the AO, it was not permissible for the assessee to take a different stand to suit its own need and to manipulate profits for taxation or for coming out with a public issue. The AO further held that the financial position of the company was healthy in the present assessment year and therefore, the management arbitrarily decided to claim 100% depreciation on computer software. The AO also rejected the plea of the assessee that software becomes obsolete in about six months time. The AO further noticed that the assessee had not taken computer software as part of the block of assets and treated them as revenue, expense in the books of account. He, therefore, held that the assessee cannot claim depreciation on the said software. On appeal by the assessee, the CIT (A) held that software becomes obsolete because of technological advancement in the IT sector and also becomes redundant with every project undertaken by the assessee for its software development program. He held that the claim of the assessee that it should be allowed as a revenue expenditure, therefore, deserves to be accepted. Accordingly, the claim of the assessee was allowed by the learned CIT (A) and this relief allowed to the assessee by the learned CIT (A) was challenged by the Revenue in an appeal filed before the Tribunal which came to be heard initially by the Division Bench. Having noted that a similar issue relating to allowability of software expenditure has already been referred to the Special Bench in the case of M/s. Amway India Enterprise, it was thought fit by the Division Bench to make a request to the Hon'ble President for referred the case of M/s. SQL Star International Ltd also to the Special bench which was duly acceded to.

10. Shri Syali, Senior Advocate, appearing for the assessee i.e. M/s.

Amway India Enterprises opened the argument. He contended before us that none of the software purchased by the assessee was a custom made software and all of them had been purchased "off the shelf". He submitted that the assessee was merely a licensee and the right to use the software was subject to the conditions mentioned in the license agreement. According to him, all the software acquired by the assessee was in fact up gradation of the existing software and there was no purchase or acquisition of any new software as such. In support of his contention, he relied on the decision of Hon'ble Delhi High Court in the case of CIT v. G.E. Capital Services Limited (ITA No. 560/2007 dated 10.07.2007) wherein their Lordships of Delhi High Court, while considering the question whether expenditure incurred by an assessee on acquisition of a software was capital or revenue nature, endorsed the view of the Tribunal that in view of Technological changes and the need to upgrade software on a regular basis, software cannot be said to be an asset of enduring nature. The Court further observed that where the expenditure was incurred on purchase of software which is no custom built software, the same requires regular up gradation. The Court ultimately concluded that there was thus no error committed by the Tribunal in taking the view that it did. Our attention was further drawn by Shri Syali to the decision of Hon'ble Delhi High Court in the case of CIT v. K & Co. 181 CTR 378 wherein it was held that an expenditure incurred by the assessee on maintenance of computer ad their up gradation including software is in the nature of revenue expenditure. Shri Syali thereafter distinguished the decision rendered by the Hon'ble Rajasthan High Court in the case of Arawali Constructions Co.(P) Ltd. 259 ITR 30 (Raj). He pointed out that the assessee in the said case had claimed Rs. 1,38,360/- on account of acquisition of a software which represented a computer program purchased from Hindustan Computers Limited. The Hon'ble Rajasthan High Court noticed that the software so purchased was in the nature of a consultancy fees paid to Hindustan Computers Limited for a program specifically developed for data analysis for mining purposes. The AO, however, held that in the agreement, there was no reference to

the payment being in the nature of a consultancy fees and it was an outright purchase of a computer program which was related to technical know-how. He, therefore, concluded that the purchase was of a technical know-how and the same was an asset of capital nature. The learned CIT (A) allowed the claim of the assessee treating the expenditure as revenue and the Tribunal also confirmed the order of the CIT (A). The Hon'ble Rajasthan High Court, however, reversed the order of the Tribunal after concluding that the payment made by the assessee to Hindustan Computers Ltd. was made for outright purchase of computer software which was used as technique in mining operation. The Court further noticed that the Commissioner had held that the acquisition of the software cannot be treated to be an asset of ending nature. The Court, however held that if the program is used in one mining to another mining operation, there was no reason why it should not be treated as a capital asset and the expenditure on acquisition thereof a capital expenditure. The Court finally conclude that the assessee had acquired technical know-how and the expenditure incurred on such acquisition was a capital expenditure. According to Shri Syali the decision in the case of Arawali Constructions Co(P) Ltd. (supra) thus was given on totally different facts in as much as the payment therein was for acquisition of software which was tailor-made to be used in mining operation which represented its earning apparatus whereas in the present case, the assessee was merely a licensee of the software which aware acquired for efficient use of computers for running day to day business.

11. Shri Syali, also pointed out that in the case of Arawali Constructions Co.(P) Ltd. (supra), the CIT (A) as well as ITAT had relied on the decision of Hon'ble Bombay High Court in the case of Borosil Glass Works Ltd. 161 ITR 286 and Hon'ble Delhi High Court in the case of Shriram Refrigeration Industries Ltd. 127 ITR 746 which were found to be distinguishable on facts by the Hon'ble Rajasthan High Court pointing out that the assessee in the said cases merely had a license to sell particular items and that there was no transfer or parting with secret processes and technical know-how to the assessee.

According to him, the final conclusion of the Hon'ble Court was that the assessee having made a payment for outright purchase of computer software which was used a technique in mining operations, there was no reason not to treat it as a capital expenditure. He contended that the purchase of software thus was treated by the Hon'ble Rajasthan High Court in the said case as acquisition of technical Know-how by the assessee and expenditure incurred thereon was held to be capital expenditure.

12. Shri Syali then drew our attention to the decision of Delhi Bench of the Tribunal in the case of Maruti Udyog Ltd. v. DCIT 92 ITD 119 (Delhi). Our attention was drawn to paragraph No.68 of the aforesaid decision and it was pointed out that in the said case, there was admittedly acquisition of a software though purchase. Otherwise expenditure incurred on upgrading of the software was treated as revenue expenditure and allowed. It was also an admitted position that software in that case was a capital asset. He drew our attention to paragraph Nos.68 to 73 and specifically relied on the following observations of the Tribunal made in paragraph Nos.72 & 73:- 72. Rival submission of the parties have been considered carefully.

In our opinion, there is no merit in the submission of learned Counsel for assessee. There is no dispute that expenditure of Rs.1,39,91,022 was incurred on acquisition of software by way of purchase. The expenditure on up gradation and maintenance of software have been classified separately and also allowed by CIT (A) as revenue expenditure. So the only and limited issue for our consideration is whether expenditure on acquisition of software is revenue or capital expenditure.

73. Now the only question is whether purchase of software is a capital asset. There is no dispute that software is a capital asset.

There is no dispute that software is an intangible asset. Hardware, commonly called as computer, is a tangible asset which by itself cannot function. The computer can function only with the help of software. Software is akin to know how as held by the Hon'ble Rajasthan High Curt in the case of Arawali Constructions Co.(P)Ltd. (supra). In this judgment, it has been clearly held that expenditure on purchase of software is a capital expenditure. There is no contrary judgment on this aspect of issue. Hence, it has to be held that software is an

asset. Admittedly, the assessee is not in the business of software. Hence, we are further of the view that software was a capital asset as far as the present assessee is concerned. The Income-tax Rules, 1962 as amended w.e.f. 1-4-2003 rather helps the revenue and not the assessee in as much as it provides for depreciation on software at the rate of 60 per cent.

13. Shri Syali pointed out that in the aforesaid case, there was thus no dispute that the expenditure was incurred on acquisition of software by way of purchase and further that the expenditure on up gradation on maintenance of software was considered separately land allowed by the CIT (A) as revenue expenditure. The Tribunal was basically concerned with case of software by purchaser. Software being an intangible asset, its acquisition was rightly treated as a capital expenditure. He also highlighted the fact that in view of the admitted position that the software were purchased by the assessee, the Tribunal had no occasion to go into the nature of the right acquired by the assessee. It was submitted by him that the facts of the present case, on the other hand, are entirely different in as much as none of expenditure incurred by the assessee was related to acquisition of a capital asset. He contended that in the aforesaid decision, the Tribunal thus had no occasion to consider the distinction between tailor-made software and the software which s purchased "off-the-shelf".

14. Shri Syali then referred to the decision of Hon'ble Supreme Court in the case of Arvind Mills Ltd. v. CIT 197 ITR 422 and explained that the said case is applicable to facts where there is no dispute that asset acquired is a capital asset. Their Lordships have held that merely because a capital asset also facilitates carrying on of business on day to day basis, the expenditure incurred on purchase/acquisition thereof would not become revenue expenditure. He contended that the asset which otherwise is a capital asset does not lose the character of a capital expenditure and does not become a revenue expenditure merely because it facilitates carrying on of business on day to day basis a held by Hon'ble Supreme Court, but this proposition has no application where the asset acquired by the assessee is not a capital asset at all.

15. Shri Syali further argued that apart from two cases above, all other cases relating to acquisition of software were in favour of the assessee as in all those cases, software acquired was held to be a revenue asset. In this connection, Shri Syali drew our attention to the decision of Addl. CIT v. Asahi India Safety Glass 6 SOT 656 (Delhi), especially paragraph No.6 thereof and pointed out that the assessee in the said case had acquired a software package prepared by globally known Oracle Corporation, USA. The Software covers areas of financial accounting, inventory and purchase. The assessee entered into a license agreement with Oracle titled 'Master Software License & Service Agreement'. The Tribunal further noticed that the software which the assessee was to install and implement was neither attached to any machinery used in the production nor was a part of any production process. The Tribunal after examining the various classes of the agreement pointed out that by acquiring the license, the assessee did not income or any tangible asset, much less any asset which provides any new source of income or which arguments the present source of income. The Tribunal ultimately concludes that the expenditure was not in the nature of a capital expenditure. The Tribunal also distinguished the decision in the case of Maruti Udyog Ltd. (supra).

16. Shri Syali then drew our attention to the decision of Delhi Bench of ITAT in the case of Escorts Ltd. v. ACIT 8 SOT 167 (Delhi). As pointed out by him substantial expenditure was incurred by the assessee in the said case on software technological up gradation and computerization which was inclusive of cost of purchase of ERP system.

The Tribunal fund that the ERP business software was acquired by the assessee with unlimited user license and therefore, the expenditure incurred on acquisition of software was by way of an outright purchase.

The Tribunal rejected the plea of the assessee that it was a case of mere up gradation of an existing software. Thereafter, the Tribunal applied the ration laid down in Maruti Udyog Ltd. (supra) as well as Arawali Construction Co.(P) Ltd. (supra). He then referred to the decision of Bangalore Bench of ITAT in the case of IBM India Ltd. v.CIT 105 ITD 1 wherein the expenditure incurred on application software was held to be a

revenue expenditure observing that the said software merely enable the assessee to carry out its business operation efficiently and smoothly. It was also noted by the Tribunal that the software has to be field to a computer system to work and since the same by itself cannot work on standalone basis, it facilitates as an aid to the operation rather than a tool itself.

17. Thereafter, reference was made by Shri Syali to the case of Sonata Information Technology Limited v. Addl. CIT 103 ITD 324 where the Tribunal drew a distinction between acquisition of a copyright and purchase of copyrighted article. Accordingly to the learned Counsel for the assessee, the acquisition of a license to use a computer program is akin to acquisition of a copyright article in contrast to a acquisition of a copyright. Shri Syali submitted that there are different types of computer software. He then referred to the changes made in the Income-tax Rules w.e.f. 1.4.2003. He referred to Appendix I part A-III(5) to the Income-tax Rules as applicable for Assessment Year 200304 to 2005-06 whereby computers including computer software have been specifically classified as an item of asset falling within the block of asset, machinery and plant entitled to depreciation at the rate of 60%. It was submitted by him that merely because an item is listed as a capital asset in the Appendix under the Income-tax Rules, it cannot automatically follow that software is a capital asset. Shri Syali argued that before applying Appendix to the Rues, a finding has to be recorded in terms of Section 32(I)(ii) that software acquired by the assessee is a capital asset entitled only to depreciation. He then explained that aforesaid item of expenditure will only be applicable to tailor- made software for which source code exists or to software which are acquired and treated as part and parcel of computer hardware and a capital asset. However, software acquired under a license on terms and conditions whereby ownership is retained by the licensor and where such software only adds to the efficient running of day to day operation of business, cannot be held to be expenditure of capital nature as they were only copyrighted articles. Reliance was also placed on the decision of Special Bench of Kolkata Tribunal in the case of Peerless Securities Ltd. v. JCIT 94 ITD 89 (SB)(Kol).

18. Mr. O.S. Bajpai, the learned Counsel for the assessee i.e. M/s SQL.

Star International Ltd., at the outset, invited our attention to the provisions of Section 32(1)(ii) and pointed out that as per the said provisions operative from 1.4.1999, assets are classified in two parts i.e. tangible and intangible assets. He submitted that intangible assets are to be of the nature of any business or commercial rights as per the said provisions and such rights again have to be in the nature of capital asset. He submitted that the terms and conditions of the relevant agreement, therefore, need to be seen in order to ascertain whether the acquisition of software by the assessee on license amounts to acquisition of capital assets within the meaning of Section 32(1)(ii). In this regard, he invited our attention to the copy of relevant license agreement placed at page No.12 of his paper book and took us through the relevant terms and conditions of the said agreement. He pointed out that the software acquired by the assessee from Oracle in terms of the said agreement was an application software/program and the license granted to the assessee was a non-exclusive license to be used only for its own purpose as per Clause 2.1.1. He further pointed out that it was also stipulated in the said clause that if there is a limit to the number of users or other restrictions stated on the order form for a program or otherwise imposed upon the license granted pursuant to the said agreement, the license to use that program shall be restricted accordingly. He then invited our attention to Clause 2.1.6 of the said agreement which reads as under:- By virtue of this Agreement CLIENT acquires only the right to use the Program(s), Documentation and the media upon which the Program(s) or Documentation are supplied and provided for in this Agreement and does not acquire any rights of ownership, or any other implied rights whatsoever. All rights, title and interest in or to the Programs or documentation, modifications, enhancements and derivatives shall at all times remain the property of or vest on creation in ORACLE or Oracle Corporation. CLIENT agrees to execute all such documents as may become reasonably necessary for the purpose of vesting or assigning any intellectual property rights in the modifications, enhancements and derivative works to ORACLE or its nominee Relying strongly on the aforesaid restrictions imposed as per the agreement on the licensee acquiring the right to use the application software from Oracle, he contended that there was no acquisition of any asset, much less a capital asset and what was acquired is only a license to use

the software subject to the terms of the license as contained in the agreement between the assessee and Oracle. It was submitted by him that when a person acquires a license, he acquires no asset. In this connection, he drew our attention to the meaning of the term 'license' as given in the Black Law's Dictionary. Since license is not an asset and the condition of grant of depreciation is that the assessee should own an asset, the assessee cannot claim depreciation.

19. Shri Bajpai thereafter submitted that computer software is an intangible asset and falls within the ambit of the Copyright Act.

Intellectual Property Rights in computer software is recognized and protected by the provisions of the Copyright Act. Section 14(a) defines 'Copyright' as the exclusive right subject to the provisions of the Copyright Act to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof namely: (a) in the case of a literary, dramatic or musical work, not being a computer programme.

(i) to reproduce the work in any material form including the storing of it in any medium by electronic means; (ii) to issue copies of the work to the public not being copies already in circulation; (iv) to make any cinematograph film or sound recording in respect of the work; (vii) to do, in relation to a translation or an adaptation of the work any of the acts specified in relation to the work in Sub-clauses (i) to (vi); (ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme: Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental; It was submitted by him that the assessee in using the computer software under a license cannot do any of the acts specified in Section 14(b) of the Copyright Act. Therefore, in law, the assessee did not acquire any intellectual property right either wholly or partially in the copyright on computer software which, at all material points of time, remain only with the owner of the copyright in the computer software. In support of his contention, the learned Counsel relied on the decision of Bangalore Bench of ITAT in the case of Samsung Electronics Company Ltd. v. ITO 94 ITD 91 wherein it was held that in case of application software, the owner retains the copyright and what he transfers under the license agreement is only a copy of copyrighted article. He also relied on the decision of Bombay Bench of ITAT in the case of DCIT v. AII Russia Scientific Research Institute of Cable Industry 98 ITD 69 wherein it was held that outright sale implies unfettered right to use. He also relied on the decision of Delhi Bench of ITAT in the case of Hero Honda Motors Ltd. v. JCIT 103 ITD 157 wherein it was held that when the software is acquired with the limited right of use, the expenditure incurred on such acquisition is a revenue expenditure. Shri Bajpai also cited the following decisions in support of the assessee's case on the issue under consideration:- (i) Business Information Processing Services v. ACIT 239 ITR 19 (AT) (Jaipur):- Held, that the software used by the assessee was not of any enduring benefit as the assessee had to change the software within a short span of time, i.e., four months or six months. Sometimes it was of no use at all because it became out-dated because of changes in the system and changes in technology. Times were fast changing and the computer system was emerging as a very important component during this period. Day by day systems are developed in a new way and software is needed like a raw material for use in manufacturing.

Therefore, these expenses were purely revenue in nature and they should be allowed in full.

(ii) Sonata Information Technology Ltd. v. Addl. CIT 103 ITD 324 (Bang):- Amount paid by assessee for purchase of software was payment for acquisition of copyrighted article and not for any copyright as the assessee had merely obtained the right to distribute the copyrighted material i.e. software, and no copyright was assigned to the assessee by the vendors and therefore, the payment made to foreign concerns was not royalty within the meaning of s. 9 (1)(vi) and assessee was not liable to deduct tax under s. 195.

The application software enables the assessee to carry out its business operation efficiently and smoothly. However, such software itself does not work on standalone basis. The same has to be fitted to a computer system to work. Such software enhances the efficiency of the operation. It is an aid in manufacturing process rather than the tool itself. Thus, for payment of such application software, though there is an enduring

benefit, it does not result into acquisition of any capital asset. The same merely enhances the productivity or efficiency and hence to be treated as revenue expenditure.

(iv) Shriram Refrigeration Industries Ltd. v. CIT 127 ITR 746 (Del):- Any payment made for obtaining access to technical information which does not result in the absolute transfer of technical knowledge is allowable as revenue expenditure.

The contributions made by an assessee to a foreign company to merely enable it to acquire the right to draw for the purpose of carrying on its business as a manufacturer and dealer of pharmaceutical products upon the technical knowledge available from the foreign company for a limited period with stipulation not to divulge the information to third parties and further the return all information and scientific data on conclusion of the agreement is admissible revenue expenditure under s. 10(2) (xv).Alembic Chemical Works Co. Ltd. v. CIT 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. The circumstance that the agreement in so far as it placed limitations on the right of the assessee in dealing with know-how and the conditions as to non portability confidentiality and secrecy of the know how incline towards the inference that the right pertained more to the use of the know how than to its exclusive acquisition.

The improvisation in the process and technology of the enterprise was supplemental to the existing business. The financial outlay under the agreement was for the better conduct and improvement of the existing business and should, therefore be held as revenue expenditure.CIT v. I.A.E.C. (Pumps) Ltd. Business expenditure - Capital or revenue expenditure - Technical Know-how fees - Foreign collaborator granted license to assessee to use its patents and designs - Assessee not acquiring capital asset-Amount paid to collaborator was only license fee and constituted revenue expenditure.CIT v. Kanpur Cigarette (P) Ltd. Business expenditure - Capital or revenue expenditure - Royalty for user of know-how and trademark - Assessee was required to pay royalty charges on the cigarettes manufactured by it under a franchise agreement for the know-how and technical assistance provided by GTC as well as for use of its trade-mark - Tribunal has recorded a finding that the right acquired by the assessee was not exclusive and that it was for a limited period which too could be terminated earlier within the period of agreement and payment was dependant on the quantum of the items manufactured -Payment towards royalty was therefore revenue expenditure.

Right of membership of the Stock Exchange is merely a personal privilege granted to a member and it is non transferable and incapable of alienation; right of nomination of the legal representative and heirs after assessee-member's death having and vested in the exchange as per the Stock Exchange Rules, it was not the property of the deceased defaulter.

20. Shri Sriram Seshadri , Chartered Accountant appearing on behalf of M/s. Tube Investments of India Ltd as Intervener submitted that the assessee in this case is a listed company engaged in the manufacture of cycle, cycle accessories, steel tubes, strips etc. During the previous year relevant to AY 2001- 02, a total expenditure of Rs. 316,38 lacs was incurred by it on implementation of ERP software of Oracle. The said expenditure comprised of license fees of Rs. 104.16 lacs paid for software to oracle and the remaining amount of Rs. 212.22 lacs sent on consultancy payments for implementation of the ERP software package acquire from Oracle on license. He then explained the concept of ERP package by pointing out its usage as well as functioning as follows: (i) Enterprise Resource Planning (ERP) is a software system designed to manage most or all aspects of a manufacturing or distribution enterprise. ERP systems are usually broken down into modules such as financials, sales, purchasing, inventory management, manufacturing etc. The modules are designed to work seamlessly with the rest of the system and should provide a consistent user interface between them. These systems usually have extensive set up options that allow you some flexibility in customizing their functionality to your specific business needs.

(ii) Oracle Corporation licensed the software and the system is implemented by customizing the screen shots

based on the needs of the business and the clients. It is essentially a software system, which is licensed to the user, and any sub-licensing/assignment/time-sharing 3rd party training is prohibited, efforts of reverse engineering, disassembly or decompilation are restricted and Oracle retains all title, copyright and other proprietary right in the program. The Appellant does not get any right except the right to use the program.

(iii) The expenses for licensing of the software and its implementation qualify as 'computer software' in the question framed and placed before the special bench and these expenses also suffer disallowance from the Income Tax Department. The issue of whether the expenses are Capital Expenditure or Revenue Expenditure is contentions with differing decisions from different benches of the honourable Income Tax Appellate Tribunal.

21. Shri Seshadri submitted that the ERP package thus is a software platform which is an integration of multiple software modules available for different specialized activities which works seamlessly across these multiple modules and records all the data relating to each and every activity of all these transactions in a manner that can be viewed across the organization and thus would automatically integrate the various departments of the organization together. He submitted that the said software helps a manufacturer or other businessmen to manage the important aspects of the business more efficiently and effectively including product planning, purchasing, inventory control, providing customer service etc. He submitted that all these functions otherwise also would be performed whether or not ERP system is in place and thus by implementing the ERP software package, the existing organization system is replaced in order to increase its efficiency and effectiveness. He contended that the ERP package thus neither enhances the productivity or capacity of the user nor does it bring into existence any asset of enduring nature in the capital field since it is merely a platform where departmental goals and actions are synchronized towards common organizational objectives. He also contended that the ERP software is provided by Oracle to the assessee as a user only on license basis and such license is a non-exclusive one with many restrictions and prohibitions. In this regard, he invited our attention to Clause 2.1 of the 'Master Software License and Service Agreement' entered into between the assessee and Oracle and pointed out that the rights granted under the said agreement give the user only the license to use the software which cannot be treated as acquisition of any capital asset. He contended that the user thus does not get any right from Oracle except the right to use the software/program as a licensee.

He contended that the expenditure incurred on acquisition of the ERP package thus is purely a revenue expenditure firstly because the expenses so incurred are only for improving the effective management of day to day operations and secondly because the assessee is provided with a limited right by way of a user license for a product with conditions attached to its use. In support of this contention, he relied on the decision of Hon'ble Supreme Court in the case of Empire Jute Co. Ltd. v. CIT 124 ITR 1 wherein it was held that if the expenditure incurred is for obtaining advantage which consists merely in facilitating 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.

22. Shri Ajay Vohra learned Counsel appearing for M/s Indo Rama Synthetics Limited as Intervene, submitted that the assessee in this case is engaged in the business of manufacturing yarns which were used in the textile industry. During the previous year relevant to A.Y.2001-02, it incurred a sum of Rs.2,21,59,648/- in implementation of Systems Applications & Products (SAP), an ERP (Enterprise Resource Planning) software package. The expenses incurred related to acquiring license to use the said software, implementation thereof, training to employees etc. The contention of Shri Ajay Vohra was that the said expenditure was claimed to be deductible under the provisions of Section 37(I) having been incurred by an assessee wholly and exclusively for the purpose of business. The Department, however, treated the said expenditure as of capital nature and disallowed the assessee's claim. He submitted that the Hon'ble Supreme Court in the case of Empire Jute Co. Ltd. v. CIT 124 ITR 1 has laid down the test for determining as to what constitutes capital expenditure in the following terms:- ...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 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....

23. Shri Vohra laid emphasis on the fact that the assessee should obtain an advantage of enduring nature and in addition to getting such an advantage, the capital structure of the assessee should also be enhanced. Only then the expenditure can be considered as a capital expenditure. He drew our attention to the fact that the assessee acquired the software under an agreement from SAP which specifically lays down that the assessee was merely a licensee. He contended that the assessee was not the owner of the software and did not have a dominion or control over the same. He laid emphasis on the fact that to be regarded as owner of the software, the assessee should have right of disposition. Since the assessee in the present case did not have any such right of disposition, he could not be considered as having acquired any enduring advantage. He submitted that the software in question was installed for the purpose of better structuring of the organization and therefore, no benefit in the capital field was accrued to the assessee. Another contention of Shri Vohra was that in view of the above principles explained, it will not make any difference whether the software in question was application software or system software.

It has to be seen in each case as to what right the assessee acquired irrespective of the nature of business of the assessee. Shri Vohra drew our attention to the provisions of Section 14 of the Copyright Act and submitted that to be regarded as the owner of a copyright, the assessee should have acquired any of the rights mentioned in Section 14(1)(b) of the said Act. Referring to the terms of the license agreement, Shri Vohra submitted that the assessee did not derive any rights as specified in the aforesaid Section of the Copyright Act. He highlighted the fact that in terms of the license agreement, copyright in software continued to remain vested with SAP. Shri Vohra drew a distinction between acquisition of software and purchase of a book. He submitted that in case of a book, there is a transfer of ownership of book as a copyrighted article with more rights including the right to transfer the said book whereas in case of software acquired under the license, gets only limited rights with no right to transfer the said license without the consent of the licensor. He drew our attention to the decision of Hon'ble Supreme Court in the case of Tata Consultancy Services v. State of Andhra Pradesh 137 STC 620 wherein the Hon'ble Supreme Court in the context of levy of sales tax of transfer of right to use the software had held that software were in the nature of goods under the Sale of Goods Act and in the light of extended definition of 'sale' as contained in the relevant Sales Tax Law, even transfer of right to use the software was held to be a sale of goods exigible to taxation under Explanation (iv) to Section 2(n) of the Sales Tax Law.

It was contended by him that it is only because of the extended definition of 'sale' as found in the relevant law that the Hon'ble Supreme Court came to the above conclusion. According to him, such extended meaning cannot be ascribed to computer software used by an assessee in the context of Income-tax law.

24. Shri Ajay Vohra then drew our attention to U.S. Regulations on the classification of transactions involving computer programs which are to the following effect:- The U.S. Regs. Envisage four alternatives for the characterisation of software and payments derived therefrom. Transfers of software are characterised by the rights transferred. Depending on the rights transferred, a transfer of software will fall into one of the following categories: (ii) A transfer of a copy of the computer program (a copyrighted article); (iii) The provision of services for the development or the modification of the computer program; or (iv) The provision of know-how relating to computer programming techniques.

Transactions involving the transfer of a computer program (alternatives (i) and (ii) may be distinguished as follows: Transfers of a copyrighted article are transactions in which no copyright right is transferred; in such a case, the transfer is regarded as: (a) a sale or exchange, if all benefits and burdens of ownership are transferred; or (b) a lease of a copyrighted article, if insufficient benefit and burdens of ownership are

transferred.

(a) above, thus being considered a sale of a copyrighted article if it is perpetual, whereas it would be regarded as the lease of a copyrighted article if it is limited in time.

*Transfers of a copyright right are transactions in which a copyright right is transferred; only the following are regarded as copyright rights: (a) The right to make copies of the computer program for the purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease or lending; (b) The right to prepare derivative computer programs based on the copyrighted computer program; (c) The right to make a public performance of the computer program; or 25. Shri Vohra highlighted the fact that even the U.S. Regulations recognize the distinction between a transfer of a copyrighted article and transfer of a copyright. He submitted that in the present case, there was a transfer of only a copyrighted article going by the aforesaid Regulation. He highlighted the fact that even the U.S.Regulations recognize granting of a shrink-wrap license as falling within transfer of a copyrighted article and not transfer of a copyright as such. Our attention was also drawn to the Instructions of Taiwanese Authority on taxation of software sales and their treatment for the purpose of taxation. The gist of the Guidance Notes issued in this regard a given on page 187 of his paper book is extracted below:- o The Taiwanese Ministry of Finance has issued a tax Ruling numbered Tai-Tsai-Shui 9604520730 dated 9 April 2006 (the Ruling) which clarifies the tax treatment of transactions in standardized unmodified software. Previously, there were disputes over the tax treatment of such transactions in the absence of tax law to distinguish a license transaction from a software sale transaction.

o directly sell standard unmodified software to domestic Taiwanese buyers, including programmes downloaded online and installed on computer hardware or compact discs (e.g. shrink-wrapped software) and the buyer is not permitted to reproduce, modify, transfer or publicly display the software, the sale is to be regarded as a sale of goods and the income will be treated in accordance to international trade principles; and o sell standard unmodified software, via domestic Taiwanese distributors including programmes downloaded online or installed on compact discs and the domestic distributor installs the software onto hardware in accordance to the instructions of the final purchaser, the sale is to be regarded as a sale of goods and the income will be treated in accordance to international trade principles. In this situation, the purchaser is not permitted to reproduce, modify, transfer of publicly display the software. It should be noted that the domestic distributor is subject to Taiwanese tax and reporting requirements with regard to any income arising from the sale of software.

In addition to the above, the Ruling provides the characteristics of standardized software and the characteristics of customized, as well as a broad definition for shrink-wrapped and packaged software, as following: o Standardized software refers to software which is ready-made and available for sale to general users and its program is not made or modified for a specified user. Additionally, the purchaser of standardized software is can only acquire the right to install and use the program on an identifiable personal computer or number of computers, and is not permitted to reproduce, modify, reverse engineer, de-compile or disassemble the programme; o Shrink-wrapped software refers to software where the software's owner has drafted a unilateral licensing agreement for the sake of user convenience and the terms are placed on a tangible medium (e.g.

the packaging). Should a user accept the terms, they merely have to unwrap the packaging to have access to the software, Generally, the software is standardized and available for general public use without any modifications: and o Pursuant to this Ruling, payments for standardized unmodified software should be categorized as business profits rather than royalties, and therefore, not subject to the 20% royalty withholding tax.

26. Reference was also made by Shri Vohra to the decision of the Special Bench of ITAT Delhi in the case of Motorola Inc. v. DCIT 95 ITD 269 (Del). Our attention was drawn to paragraph Nos.157 & 158 of the said

judgment wherein the Special Bench has laid emphasis on the fact that in order to find out the nature of right the assessee has acquired, the terms and conditions of the relevant contract are required to be looked into in the light of the provisions of Section 14 of the Copyright Act which deals with the definition of 'copyright' in a computer software. Mr. Vohra submitted that software is equivalent to know how. He drew our attention to several judicial pronouncements where acquisition of know how was treated as a revenue expenditure. The following are the judicial pronouncements :-CIT v. Gujarat Carbon Ltd. His further submissions was that a mere right to use software is as good as a right to use know-how and therefore expenditure on acquiring computer software is to be considered as revenue expenditure. He also brought to our notice the judicial pronouncements of the Hon'ble Madras High Court the case of CIT v. Southern Roadways Ltd. 282 ITR 379 (Mad) wherein the Hon'ble Madras High Court has held that expenditure incurred on software packages was revenue expenditure and that such software enhances the efficiency of the operation and was not an aid in the manufacturing process and therefore there is no enduring benefit or acquisition of any capital asset by an assessee reference was made to the decision of the Madras High Court in the clauses of CIT v. Southern Roadways Ltd. 288 ITR 15 (Mad) laying down identical proposition.

Further attention was drawn to the following decisions CIT v. K & Co.

181 CTR 37 (Del), Business Information Processing Services v. ACIT 73 ITD 304 (Jaipur), Sumitomo Corpn India (P) Ltd. v. ACIT (2005) I SOT 91 (Delhi), JCIT v. Citicrop Overseas Software Ltd. (204) 85 TTJ (Mumbai) 87 and IBM India Ltd. v. CIT 290 ITR (AT) 183 (Bangalore). In all the above decisions, it has been held that expenditure on license to computer software is allowable as revenue expenditure.

27. Explaining the arguments that there was no enduring benefit in the capital field by virtue of expenditure incurred on computer software, Shri Vohra submitted that in view of the technological changes in the present world no enduring benefit can be said to accrue to an assessee.

In this regard, he drew attention to the following observations of the Hon'ble Supreme Court in the case of Alembic Chemical Works Co. Ltd v.CIT (i) It would be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurability 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 could not be said to bear the element of the requisite degree of durability and non-ephemerality 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 pigeonholing and outlay, such as this, as capital.

(ii) In the infinite variety of situational in which the concepts of what is capital expenditure and what is revenue arises, it is well nigh impossible to formulate andy general rule, even in the generality of cases, sufficiently accurate and reasonable comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants; but as masters they tend to be overexacting.

(iii) The question in each case would necessarily be whether the tests relevant and significant in one set of circumstances, arc relevant and significant in the case on hand also, Judicial metaphors are narrowly to be watched, for starting as devices to liberate thought they end often by enslaving it.

The idea of "once for all" payment and "enduring benefit" are not to be treated as something akin to statutory conditions nor are the notions of "capital" or "revenue" a judicial fetish. What is capital expenditure and what is revenue are not eternal verities but must needs be flexible so as to respond to the changing economic realities of business. The expression "asset or advantage of an enduring nature" was evolved to emphasis the element of a sufficient degree of durability appropriate to the context, There is also no single definitive criterion which, by itself, is determinative whether a particular outlay capital or revenue. The "once for all" payment test is also inconclusive. What is relevant is the purpose of the outlay and its intended object and

effect, considered in a commonsense way having regard to the business realities. In a given case, the test of "enduring benefit" might break down.

According to Shri Vohra the test of enduring benefit would break down in the case of acquisition of a license to use software because by acquiring a license to use computer software, assesses does not get any enduring benefit. In this regard he also drew attention to the decision of the Hon'ble Supreme Court in the case of CIT v. Madras Auto Service (P) Ltd. 233 ITR 468 wherein it was held that a tenant effecting improvements to a building with no right of ownership to the improvements and where the owner was to get the benefit of improvement by the tenant, capital expenditure incurred by tenant was held to an expenditure of revenue nature. He pointed out that in the aforesaid decision the tenant had right to enjoy the premises for 39 years but still the court considered the period of use as irrelevant. According to him if was ownership that was material and this has been highlighted in the aforesaid judgment. He thus submitted that even the period of license to use software acquired by an assessee becomes irrelevant. In this regard he also drew attention to the decision of the Delhi High Court the ease of CIT v. Saw Pipes Limited 268 CTR 476 wherein the court held that expenses incurred by an assessed on electric service line for its new units was allowable as revenue expenditure despite the fact that the assessee had a tight of perpetual use of electric lines.

Reference was also made to the decision of Madras High Court and Karnataka I-High Court in the case of CIT v. Gemini Arts (P) Ltd. 254 ITR 201 (Madras), CIT v. HMT Ltd.203 ITR 820 (Karnataka) where upfront payment of premium in connection with the lease for 48 years and 95 years respectively were considered as revenue expenditure.

28. Shri Vohra further explained that the software is a more supplement or replacement of human labour which helps in doing work more efficiently. It is a substitute for a revenue expenditure which would otherwise he allowed as revenue expenditure. He further submitted that Section 32 does not trigger if there is no ownership of software and in this regard drew attention to the provisions of 32(1) where ownership was a condition for allowing depreciation. He submitted that the word "acquired" contemplates acquisition of ownership, In this regard he drew attention to the decision of Hon'ble Supreme Court in the ease of Chiranjit Lal v. Union of India and Devidas Gopalkrishan v. State of Punjab . According to him a license to use computer software does not transfer ownership and therefore provisions of Section 32 are not applicable. He also distinguished the decisions in the case of scientific works (supra) and Arvind Mills (supra) by pointing out that in those eases Assessee acquired rights of ownership. In conclusion, Shri Ajay Vohra submitted that on the facts of his assessee's case implementation fee paid for installation of SAP system can never be considered its capital expenditure. In this regard he relied on the decision of the Chandigarh Bench of the tribunal the case of Glaxo Smithkline Consumer Healthcare v. ACIT ITA No. 379/Chd/2004 (Chd.).

29. Smt Smita Jhingran Ld. CIT DR firstly drew our attention to the scheme of the Act whereby deduction of expenses in acquiring capital assets are to be allowed in a staggered manner. Referring to the provisions of 32, she submitted that w.e.f. 1.4,1998 depreciation was to be allowed on both tangible and intangible assets. w.e.f. 1.4.03 computer and computer software have been treated as plant and tangible assets. According to her, the expression "computer software" is defined in the rules to mean computer programme recorded on any disk tape, perforated media or any other storage device. It was submitted by her that the intent of the legislature was to make the ambit of the words computer software" as wide as possible without any room for any doubt.

Strong reliance was placed by her on the decision of the Delhi Bench of ITAT in the case of Maruti Udyog v. DCIT 92 ITD 119 (Del) where expenditure on purchase of computer software was treated as capital expenditure. She also drew attention to the provision of Sub clause (xi) of Section 36(1) introduced w.e.f. 1.4.99 which enabled assessee to claim expenses in the nature of software to make their computer system Y2K compliant as revenue expenditure. It was submitted by her that but for this amendment, the said expenditure would be only capital expenditure. She highlighted the fact that in the case of the interveners before the special bench, the Assessment. Years involved are prior to 1.4.03. She submitted that the decision

in the case of Aravali Construction (supra) and Escorts Ltd. (supra) would clearly support the stand taken on behalf of the revenue. It was also pointed out by her that the decision of the Delhi High Court in the case of K & Co. (supra) has been considered in the case of Maruti Udyog (supra).

Referring to the case of the assessee M/s AMWAY, she submitted that the software purchased by the assessee in that case gives the assessee a new advantage in so far as the functioning of the organization is concerned. She referred to the decision of the Hon'ble Supreme Court in the case of Balimal Naval Kishore 224 ITR 414 (SC) wherein it was held that where the amount spent was for obtaining a new advantage then the same would be capital expenditure. It was submitted by her that even in the case of an up gradation of software the principle laid down in the case of Balimal Naval Kishore would apply. In this regard reference was made to the decision of the Supreme Court in the case of Saravana Spinning Mills Pvt Ltd. 293 ITR 201 (SC). She also placed reliance on the decision of the Apex court in the case of Arvind Mills v. CIT 197 ITR 422 for the proposition that expenditure incurred on capital asset does not lose the character of capital expenditure and does not become revenue expenditure on the ground that the said capital expenditure also ultimately ensures the effective running of business. According to her software installed once is capable of being used for a couple of years and therefore there is an enduring advantage to an assessee.

According to her license to use software would also be a case of acquisition of software and the distinction sought to be made by the assessee cannot be accepted. It was also submitted by her that the distinction between a copyright and a copyrighted article is not recognized by the income tax act and therefore both copyright and copyrighted articles are covered under Section 32 (1) of the Act. It was also submitted by her that the expression "wholly or partly" used in Section 32(1) would also include within its ambit, a person owing license to use software. It was also submitted by her that to claim depreciation even ownership is not a condition as laid down by the Hon'ble Supreme Court the ease of Mysore Minerals v. CIT 223 ITR 775 (SC) and the Delhi High Court in the case of Balco -292 ITR 600 (Del).

Attention was drawn to the decision of the Pune Bench of the tribunal in the case of Sudharshan chemical industries v. CIT 104 TTJ 28 (Pune) wherein purchase of ERP software was treated as capital expenditure.

30. Shri Devender Shanker, Ld. CIT -DR appeared for the revenue and made submissions in the light of the provisions of the Copyright Act, 1957. His submission was that the definition of capital asset as given in Section 2 (14) of the Act was wide enough to include property of any kind. When an assessee acquires computer software he acquires a capital asset and therefore the expenditure would only be a capital expenditure. Referring to the provision of Section 14 of the Copyright Act, he submitted that reproduction of any literary work in any material form including the storing of it in any medium by electronic means would be a part of the bundle of rights comprised in the larger right of Copyright. According to him when an assessee purchases computer software even on a license basis he would reproduce the work by storing it in his computer and therefore he should be considered as having acquired a copyright in the software. It was therefore submitted by him that even in the case of license to use computer software an assesses acquires Copyright and therefore the expenditure was to be treated as capital expenditure.

31. On the question of expenditure on "Acquisition, up gradation and maintenance of "software", Shri Devender Shankar submitted that in the modern day technology, hardware and software are often acquired separately. Any transaction in software may fall in any of the three broad categories which are;- (i) Disc Operating System: like Windows 97, 2003, 2007 etc. or Linux, (ii) Application Software like Office, Excel, Power Pointwhich operate on operating systems like windows.

(iii) Date Software (like CTR online. ITR etc. or other banking software even movie CDs) which require both the disc operating system as well as the application software defined in (i) and (ii) above for being run on a computer.

The acquisition of a Disc Operating Software or application software from the original owner can be in the form of a "copyright under assignment" or "a license" as a right to use a copyright for the purpose of one's

business. The exact 'nature of transaction' shall depend on the terms of the agreement. The acquisition of a software results in either grant of a copyright or a license. As per the definition in Section 2 (14) of the Income Tax Act it will be a capital asset and accordingly to be treated in terms of Section 32 or Section 35A of the IT act as the case be.

32. Shri Devender Shankar further submitted that up-gradation from a particular Disc Operating software or application software to another particular software may have to be seen whether it tantamount to acquisition of a new software or increasing or improving the speed, efficiency, capacity or overall performance of the software. For example if a person who is already using a disk operating system software windows 91 and wants to upgrade to windows 2003 or windows 2005 he will have to discard the existing windows 97 and upload windows 2003/2005 on his computer by acquiring it a fresh. Similar will be a case when new application software like Office 97, Office 2000 or any such other software is installed by replacing the existing older version. Thus, this kind of up gradation does not lead to up gradation in the real sense but is acquisition of a new software.

33. Shri Devender Shankar further submitted that in case of software like ERP, SAP , Oracle (which are not in the nature of shrink wrap), any up gradation to a newer version has to be-carried out by the original supplier who has the source code of the software with him. If this up gradation results in higher efficiency, higher speed, higher memory and data handling capacity then it will be an acquisition of an enduring benefit and will be in the nature of capital asset. He made a simple comparison to a 'building' where new floors are added to accommodate more people or offices or a ease where extra berths/seats are added to any train or bus to be able to carry more passengers Such an expenditure incurred will result in enduring benefit with regard to a capital asset and be a capital expenditure to be treated in terms of Section 32 or Section 35A of the IT act as the case be.

34. According to Shri Devender Shankar, same of the software installed on servers which may or may have many end users across very large geographical area like software used for central reservation systems, airline booking railway booking, banking, internet software requires certain maintenance on a regular basis so that the software operate without any interruption. For this purpose certain maintenance expenses are incurred which are in fact expenditures for user or for being able to use a capital asset and therefore could be in the nature of revenue expenditure.

35. In rejoinder, Shri M.S. Syali submitted that the argument of the ld. DR that after enactment of Section 32(1) (ii) of the Act. w.e.f.

1.4.98, all intangible assets are capital assets is not correct. In this regard, he referred to the reasons for introduction of Section 32 (1) (ii) as explained in CBDT's Circular No, 772 dated 23.12.98 and submitted that the provision were intended only to widen the scope of allowing depreciation even on intangible and that provision of Section 35A and 35 AB which allowed deduction on account of expenses of capital nature on acquisition of patents, know-how copyright etc. were being deleted because of provision of Section 32 (1) (ii). The provisions of Section 32 are attracted only where there is acquisition of capital asset and where there is a use of such capital asset by an assessee for the purpose of his business. To contend that any intangible asset used by an assessee in his business will be a capital asset will not be correct. In this regard he drew analogy from the provision of Explanation-1 to Section 32 (1) of the Act which permitted an assessee who was a tenant of premises to claim depreciation on capital expenditure incurred in respect of tenanted premises and submitted even in such cases the expenditure must be capital expenditure in nature and it is not any and every expenditure that is covered by the said provisions. As a first step one has to see if the expenditure was capital expenditure or Revenue expenditure. Our attention was drawn to the decision of the Hon'ble Karnataka High Court in the case of CIT v.Rex talkies 148 ITR 560 and CIT v. Haridas Bhagat and Co. Pvt. Ltd. 240 ITR 169 (Mad) for the above proposition. In the case of computer software also one has to see whether the expenditure on Computer Software was capital or Revenue only then the applicability of provision of Section 32(1) (ii) should be seen.

36. It was also submitted by Shri Syali that amendment to the provisions of Section 36 (1) (ix) presupposes that expenditure in question was complete restructuring of computer hardware and software as explained by Board in its circular No. 779 dated 14.9.1999 (para-22 of the circular). In this regard he also submitted that explanation (a) to Section 36(1) (ix) also justifies such interpretation. It was further submitted by him that software does not provide any new advantage to an assessee, which is of an enduring nature. It does not result in acquisition of any new asset. It was submitted by him that the Hon'ble SC in case of Tata Consultancy Service (supra) at page 421 of ITR 271 clearly held that software were "goods" only in the context of the extended definition of "goods" as given in the relevant Sales Tax Law. He submitted that in the case of IBM (supra) the Bangalore Bench of ITAT has held that computer software merely enhances the productivity or efficiency and therefore is revenue expenditure.

Reference in this regard was made to the fact that the Bench rightly distinguished the case of Aravali Constructions (supra) by saying that the said decision was a case of acquisition of know-how. He submitted that the Pune Bench in the case of Sudharshan Chemical (supra) in the context of ERP software followed the decision of Aravali Constructions (supra) without noticing that the said decision related to acquisition of know-how. It was again emphasized by him that ownership is a condition for claiming depreciation u/s 32 and that a mere license to use did not give any ownership. Reference was made in this regard to the decision of the ITAT Special Bench in the case of Motorola inc.

(supra). He also submitted that the decision of the Hon'ble Delhi High Court in the case of BALCO (supra) was in the context of income from House property where the assessee exercised all rights of ownership.

37. On the argument of Ld. DR on Section 2 (14) of the Act defining "capital assets", Shri Syali submitted that all capital expenditure gives raise to capital asset but all capital assets need not result only from incurring of a capital expenditure. It was also submitted by him that the definition of 'capital asset' is relevant only for the purpose of determining capital gains and the same cannot be extended to hold that expenditure incurred on acquiring a capital asset is by itself a capital expenditure.

38. Mr. Ajay Vohra submitted that the expression "wholly or partly" used in Section 32(1) was inserted only with a view to mitigate hardship owing to decision of Hon'ble Supreme Court in the case of Seth Banarasi Das Gupta v. CIT 166 ITR 783 (SC) where it was held that fractional ownership will not be sufficient to claim depreciation and therefore 'mere right to use a software' cannot be said to be ownership wholly or partly being with an assessee.

39. We have considered the rival submissions in the light of material placed on record and the case laws cited at the bar. The issue before us is as to whether expenditure on computer software is revenue or capital in nature. Before we specifically deal with this issue, it would be relevant to dwell upon the general guidelines and principles laid down by the various higher Courts including the Hon'ble Apex Court for deciding the nature of any expenditure whether capital or revenue.

Lord Denning in Heather v. P.E. Consulting Group Ltd. (1972) 48 TC 293 made the following still very pertinent observations at page 321 A: The question revenue expenditure or capital expenditure - is a question which is being repeatedly asked by men of business, by accountants and by lawyers. In many cases the answer is easy; but in others it is difficult. The difficulty arises because of the nature of the question. It assumes that all expenditure can be put correctly into one category or the other: but this is simply not possible. Some cases lie on the border between the two: and this border is not a line clearly marked out; it is a blurred and undefined area in which anyone can get lost. Different minds may come to different conclusions with equal propriety. It is like the border between day and night, or between red and orange. Everyone can tell the difference except in marginal cases; and then everyone is in doubt. Each can come down either way. When these marginal cases arise, then the practitioners - be they accountants or lawyers - must of necessity put them in one category or another. And then, by custom or by law, by practice or by precept, the border is staked out with more certainty. In this area at least, where no decision can be said to be right or wrong, the only safe rule is to

go by precedent. So the thing to do is to search through the cases and see whether the instant problem has come up before. If so, go by it. If not, go by the nearest you can find.Alembic Chemical Works Co. Ltd. v. CIT 177 ITR 377, in the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is almost impossible to formulate any general rule sufficiently accurate and reasonably comprehensive to draw any clear line of demarcation. However, as further observed by the Hon'ble Apex Court in the said case, some broad and general tests have been suggested from time to time in the various judicial pronouncements to ascertain on which side of the line the outlay in a particular case might reasonably be held to fall. As further observed by the Hon'ble Apex Court, these tests are generally efficacious and serve as usual servants and as masters, they tend to be over exacting. There is also no single definitive criterion which by itself is determinative as to whether a particular outlay is capital or revenue and what is relevant is the purpose of the outlay said its intended object and effect considered in a common sense way having regard to the business realities, 41. In the case of British Insulated Helsby Cables Ltd. v. Atherton (1926) AC 205 which is often quoted on the subject, it was held that when an expenditure is made with a view to bringing into existence an asset or an advantage for the enduring benefit of trade, there is very good reason for treating such an expenditure as properly attributable to capital and not to revenue. In Assam Bengal Cement Co. Ltd. v. CIT 27 ITR 34, it was held by the Hon'ble Supreme Court that if the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of the capital expenditure. It was also held that the aim and object of the expenditure thus would determine the character of the expenditure, whether it is a capital expenditure or revenue expenditure. In the case of Sun Newspaper Ltd. & Associated Newspaper Ltd. v. Federal Commissioner of Taxation (1938) 61 CLR 337. Dixon J. observed that there are three matters to be considered to decide the nature of any expenditure - (a) the character of the advantage sought and in this its lasting qualities may play & part, (b) the manner in which it is to be used relied upon or enjoyed and in this and trader the former head, recurrence may play its part and, (c) the means adopted to obtain it i.e. by providing a periodical reward or outlay to cover its use or enjoyment for periods, commensurate with the payment. As observed by Hon'ble Supreme Court in the case of Empire Jute Co. Ltd. v. CIT 124 ITR 1, 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 break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principles 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.

42. In the case of CIT v. Ciba of India. Ltd. 69 ITR 692, the assessee had acquired under the agreement merely the right to draw for the purpose of carrying on its business as a manufacturer and dealer of pharmaceutical products, upon the technical knowledge of the Swiss company for a limited period and since the Swiss company did not part with any asset of its business nor did the assessee acquire any asset or advantage of enduring nature for the benefits of its business, the payment made by the assessee to Swiss company under the agreement was held by the Hon'ble Supreme Court to be towards revenue expenditure observing that the nature of receipt as capital or revenue is not always determinative of the nature of this outgoing in the hands of the person who receives it. Explaining further, it was observed by the Hon'ble Apex Court that the license was for a period of five years liable to be terminated in certain events and since the object of the agreement was to obtain the benefit of the technical assistance for running the business of the assessee the expenditure in question was of revenue nature. In the case of Arvind Mills Ltd. v. CIT (supra), the amount was paid by the assessee for improvement by way of laying down roads, making provision for drainage etc. under the Bombay Town Plan Scheme and as a result of the said expenditure, the assessee got advantage of betterment of the land owned by him which resulted in the increase in valuation of the said land. In these facts and circumstances of the case, it was held by the Hon'ble Supreme Court that simply because such improvement has also resulted in providing better facilities for carrying out the business of the assesses, the betterment charges required to be paid by the assesses do not become revenue expenditure. It was also held by the Hon'ble Apex Court that merely because the said expenditure had ultimately resulted in efficiently carrying on

the business and that process gave aid in running day to day business more efficiently would not make the capital expenditure revenue expenditure.

43. A resume of the aforesaid judicial pronouncements shows that there cannot be any specific or precise test, which can be applied conclusively or universally for distinguishing between capital and revenue expenditure. It is a blurred and undefined area in which anyone can get lost. Different minds may come to different conclusions with equal propriety. The cardinal rule is that the question whether a certain expenditure is on capital or revenue account should be decided from the practical and business view point and in accordance with sound accountancy principles and this rule is of special significance in dealing with expenditure on expansion and development of business.

While dealing with this complex issue, three tests generally applied to decide the nature of expenditure as to whether it is capital or revenue, are the test of enduring benefit, ownership test and functional test. Applying the said tests, expenditure is treated as capital expenditure either when it results in acquisition of capital asset by the assessee as owner thereof or when it results in accrual of advantage of enduring nature to the assessee in the capital field. In the first situation, the ownership test assumes greater significance because the acquisition of capital asset by the assesses as a result of incurring expenditure is a condition. If the expenditure is resulting merely in acquisition or creation of asset without the assessee becoming owner thereof, it cannot be said that the said expenditure is a capital expenditure. The coming into existence of an asset as a result of incurring expenditure alone thus is not sufficient to treat the said expenditure as of capital nature unless the asset coming into existence is also owned by the assesses.

44. In other situation, the expenditure can be treated as capital expenditure only when it results in accrual of advantage of enduring nature to the assesses in the capital field. The relevant tests applied to determine the nature of expenditure in such a situation are the functional tests and the test of enduring benefit. An advantage is to be considered as of enduring benefit if the benefit accruing is not of a transient nature but is of such durability as to justify it being treated as a capital asset. The expression "enduring benefit" has been explained by the Hon'ble Supreme Court in the ease of Assam Bengal Cement Co. Ltd. v. CIT 27 ITR 34 to mean enduring in the way that fixed capital endures. As held by Hon'ble Supreme Court in the case of Empire Jute Co. Ltd. v. CIT -124 ITR 1, there may be cases where expenses, even, if resulting in the advantage of an enduring benefit, may be properly chargeable to revenue account if the advantage consists merely in facilitating the assessee's trading operations or enabling him to manage and conduct his business more efficiently or more profitably while leaving the fixed capital untouched. It is thus necessary that in order to treat any expenditure as capital expenditure, the same should result in accrual of advantage of enduring benefit and such benefit should accrue to the assesses in the capital field. What exactly is meant by accrual of benefit in the capital field is that the said benefit should form part of the profit-making apparatus of the assessors business.

Computer software - Ownership test - Supreme Court decision in the case of TCS 45. For applying the ownership test in the context of computer software, the preliminary issue that arises is whether the computer software is a tangible or intangible asset and whether the assesses get ownership right by acquiring the same. The contention raised on behalf of the assesses before us is that as per the agreement under which software is commonly acquired, the assesses acquire only a licence to use the computer software for their own purpose and there is as such no acquisition of any asset, much less a capital asset. It has also been contended that intellectual property rights in computer software is recognized and protected by the Copyright Act and as per the provisions of Section. 14(b) of the said statute, the use of a computer software under a licence is not exercise of a copyright, it has been contended that the acquisition of computer software under licence at the most could be considered as a purchase of a copyrighted article wherein no copyright right is transferred either as per the Copyright Act or even as per the U.S Regulations on this subject. As regards the decision, of Hon'ble Supreme Court in the case of Tata Consultancy Services v. State of Andhra Pradesh 271 ITR 401, it has been contended that the same was rendered in the context of levy of sales tax and transfer of right to use the software was held to be a sale of goods exigible to sales tax in the light of

extended definition of "sale" as given in Explanation (iv) to Section 2 (n) of the Sales Tax Law. It has been contended that the said decision of the Hon'ble Supreme Court especially rendered in the context of extended definition given in the relevant statute cannot be applied in the context of Income-tax Law.

46. After having carefully perused the judgment of Hon'ble Supreme Court in the case of Tata Consultancy Services (TCS in short) (supra), we find it difficult to agree with the contention raised on behalf of the assesses, it is no doubt true that a transaction of sale of computer software package off the shelf was held to be a sale of "goods" by the Hon'ble Supreme Court in the case of TCS relying, inter alia, on the extended definition given in Section 2(n) of the Andhra Pradesh General Sales Tax Act. 1957. But it was not the only basis on which the decision of the Hon'ble Apex Court was exclusively based.

First and foremost, there was a reference made to the decisions of American Courts rendered in several cases including especially the cases of Commerce Union Bank v. Tidwell reported in 538 S.W. 2d 405; State of Alabama v. Central Computer Service Inc. reported in 349 So.

2d 1156; First National Bank of Fort Worth v. Bub Bullock reported in 584 S.W, 2d 548; First National Bank of Springfield v. Department of Revenue reported in 421 NE 2d 175; Compuserve Inc. v. Lindley reported in 535 N.E. 2d 360 and North East Datacom Inc. et al v. City of Wallingford reported in 563 A 2d 688 and the proposition propounded therein holding the computer software as intangible personal property was summarized by the Hon'ble Supreme Court in the relevant portion of the judgment at page No. 409 & 410 of the Report as under;- The reasoning for arriving at this conclusion is basically that the information contained in the software programs can be introduced into the user's computer by several different methods, namely, (a) it could be programmed manually by originator of the program at the location of the user's computer, working from his own instructions; or (b) it could be programmed by a remote programming terminal located miles away from the user's computer, with the input information being transmitted by telephone; or (c) more commonly the computer could be programmed by use of punch cards, magnetic tapes or discs, containing the program developed by the vendor. It has been noticed that usually the vendor will also provide manuals, services and consultancy designed to instruct the user's employees in the installation and utilization of the supplied program. It has been held that even though the intellectual process is embodies in a tangible and physical manner, that is on the punch cards, magnetic tapes, etc., the logic or intelligence of the program remains intangible property. It is held that it is this intangible property right which is acquired when computer software is purchased or leased. It has been held that what is created and sold is information and the magnetic tapes or the discs are only the means of transmitting these intellectual creations from the originator to the user. It has been held that the same information could have been transmitted from the originator to the user by way of telephone lines or fed directly into the user's computer by the originator of the programme and that as there would be no tax in those cases merely because the method of transmission is by means of a tape or a disc, it remains intangible personal property. It has been held that what the customer paid for is the intangible knowledge which cannot be subjected to the personal property tax.

47. Thereafter, a different view taken by the American Courts in other cases as brought to the notice of Hon'ble Supreme Court on behalf of the assessee was also taken note of and the proposition propounded while taking such a view in the cases of South Central Bell Telephone Co. v, Sidney J. Barthelemy reported in 643 So, 2d 1240, Comptroller of the Treasury v. Equitable Trust Company reported in 464 A, 2d 248, Chittenden Trust Co. v. Commissioner of Taxes reported in 465 A. 2d 1100, University Computing Company v. Commissioner of Revenue for the State of Tennessee reported in 677 S.W. 2d 445 and Hasbro industries, Inc. v. John H.Norberg, Tax Administrator reported in 487 A. 2d 124 was summarized by the Hon'ble Supreme Court at Page Nos. 410 & 411 of the report as follows: In these cases, the courts have held that when stored on magnetic tape, disc or computer chip, this software or set of instructions is physically manifested in machine readable form by arranging electrons, by use of an electric current, to create either a magnetized or unmagnetized space. This machine readable language or code is the physical manifestation of the information in binary form, it has been noticed that at least three program copies exist in a software transaction (i) an original. (ii) a duplicate, and (iii) the buyer's final copy on a memory device. It has been

noticed that the program is developed in the seller's computer then the seller duplicates the program copy on software and transports the duplicates to the buyer's computer. The duplicate is read into the buyer's computer and copied on a memory device. It has been held that the software is not merely knowledge, but rather is knowledge recorded in a physical form having a physical existence, taking up space on a tape, disc or hard drive, making physical things happen and can be perceived by the senses. It has been held that the purchaser does not receive mere knowledge hut receives an arrangement of matter which makes his or her computer perform a desired Function. It has been held that this arrangement of matter recorded on tangible medium constitutes a corporeal body. It has been held that a software recorded in physical form becomes inextricably intertwined with, or pan and parcel of the corporeal object upon which it is recorded, be that a disc, tape, hard drive, or other device. It has been held that the fact that the information can be transferred and then physically recorded on another medium does not make computer software any different from any other type of recorded information that can he transferred to another medium such as film, video tape, audio rape or books. It has been held that by sale of the software programme the incorporeal right to the software is not transferred. It is held that the incorporeal right to software is the copyright which remains with the originator. What is sold is a copy of the software. It is held that the original copyright version is not the one which operates the computer of the customer but the physical copy of that software which has been transferred to the buyer. It has been held that when one buys a copy of a copyrighted novel in a bookstore or recording of a copyrighted song in a record store, one only acquires ownership of that particular copy of the novel or song but not the intellectual property in the novel or song, 48. The decision in the case of Commissioner of Sales Tax v. M.P.Electricity Board 1968 (1) SCC 200 was also considered by the Hon'ble Apex Court. The question in that case was whether Electricity was goods for the purpose of imposition of Sales Tax under the M.P. General Sales Tax Act, 1959 under which the definition of the term "goods" was given to mean all kinds of movable property and included ail materials, articles and commodities. It was held in the case of M.P. Electricity Board (supra) in this context that the term "goods" for the purposes of Safes Tax, cannot be given a narrow meaning and the properties which are capable of being abstracted, consumed and used and/or transmitted, transferred, delivered, stored or possessed etc, are "goods", for the purposes of Sales Tax. In this regard, it was contended, before the Hon'ble Supreme Court on behalf of the assessee in an attempt to distinguish the decision in the case of M.P. Electricity Board (supra) that Software is different from Electricity, inasmuch as, Software is intellectual incorporeal property, whereas Electricity is not. This contention of the assesses, however was not accepted by the Hon'ble Supreme Court observing that in India, the test, to determine whether property is goods, for the purposes of Sales Tax is not whether the property is tangible or intangible or incorporeal. The test is whether the concerned item is capable of extraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed etc. It was observed by the Hon'ble Supreme Court in this context that in the case of software, both canned and unmanned, all of these attributes are admittedly possible.

49. Thereafter, a reference was made by the Hon'ble Supreme Court to its earlier decision in the case of Associated Cement Companies Ltd. v.Commissioner of Customs involved was whether customs duty was leviable on technical material supplied in the form of drawings, manuals and computer discs etc. It was held therein that a computer programme may be copyrightable as intellectual property but that does not alter the fact that once in the form a floppy disc or other medium, the programme is tangible movable and available in the market place. It was also held that the fact that some programs may be tailored for specific purposes need not alter their status as "Goods". While referring to this decision, it was noted by the Hon'ble Supreme Court that the definition of the term "Goods" in the Customs Act is not as wide or exhaustive as the definition of the term "Goods" in the A.P. Sales Tax Act, but despite that, it was held that the decision in the case of Associated Cement (supra) is an authority directly dealing with the question and as held therein, the intellectual property when it is put in a media becomes "Goods".

50. Thus, after taking into consideration the various decisions of American Courts taking different views in the matter, as well as the Court's own decisions in this context rendered, inter alia, in the case of Associated Cement Co. Ltd, v. CIT (supra) wherein the similar issue was decided in the context of Customs Act in which

the definition of the term "goods" given was not as wide or as exhaustive as the definition of the term "goods" given in A.P. Sales Tax Act, its conclusion was recorded by the Hon'ble Supreme Court finally as under:- "In our view, the term "goods" as used in article 366(12) of the Constitution of India as defined under the said Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd. . A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made, and marketed, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (in case of painting) or computer discs or cassettes, and marketed would become ''goods". We see no difference between a sale of a software programme on a CD/ floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Ale is not just of the media which by itself has very little value. The software and the media cannot he split up. What the buyer purchases and pays for is not the disc or the CD. As in the ease of paintings or books or music or films the buyer is purchasing the intellectual property and not the media, i.e., the paper or cassette or disc or CD Thus a transaction sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act. The term "all materials, articles and commodities" includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed, etc. The software programmes have all these attributes." 51. As already noted, a similar contention as raised on behalf of the assessees before us relying on the relevant provisions of the Copyright Act, 1957 was also raised before the Hon'ble Supreme Court in the case of TCS (supra) and while specifically dealing with the same, it was observed by His Lordship Mr. Justice S.B. Sinha, who wrote a separate but concurring judgment as follows:- Reference by Mr. Sorabjee to the provisions of the Copyright Act, in my opinion, was not apposite.

The Copyright Act and the Sales Tax Act are also not statutes in pari materia and as such the definition contained in the former should not be applied in the latter. [see Jagatram Ahuja v. Commissioner of Gift-tax In the absence of incorporation or reference, it is trite that it is not permissible to interpret a word in accordance with its definition in other statute and more so when the same is not dealing with any cognate subject. (see State of Kerala v. Mathai Verghese and Feroze N. Dotivala 52. His Lordship Mr. Justice S.B. Sinha also discussed the other contentions raised on behalf of the assessee as well as the relevant case laws on the point before finally recording his conclusion in the judgment which, as appearing at page 431 of the Report, is extracted below:- A software may be intellectual property but such personal intellectual property contained in a medium is bought and sold. It is an article of value. It is sold in various forms like - floppies, disks. CD-ROMs, punch cards, magnetic tapes, etc. Each one of the mediums in which the intellectual properly is contained is a marketable commodity. They are visible to senses. They may be a medium through which the intellectual property is transferred but for the purpose of determining the question as regard leviability of the tax under a fiscal statute, it may not make a difference. A programme containing instructions in computer language is subject-matter of a licence. It has its value to the buyer. It is useful to the person who intends to use the hardware, viz., the computer in an effective manner so as to enable him to obtain the desired results. It indisputably becomes an object of trade and commerce. These mediums containing the intellectual property are not only easily available in the market for a price but are circulated as a commodity in the market. Only because an instruction manual designed to instruct use and installation of the supplier programme is supplied with the software, the same would not necessarily mean that it would cease to be a "goods'. Such instructions contained in the manual are supplied with several other goods including electronic ones. What is essential for an article to become goods is its marketability.

53. It is also observed that a contention was also raised on behalf of the assessee in the case of TCS that the only property in the literary work of computer software is the source code i.e. the code in which the programmer writes the software which is subsequently converted in machine code for use in physical form. It was contended that the software code and the media on which it happens to be stored have to be viewed

differently and the source code being an information which cannot he touched and the ideas therein being expressed in logical form, the same constitutes intellectual property which its essentially intangible. This contention raised by the assessee again was not accepted by the Hon'ble Supreme Court as is evident from the relevant portion of the judgment which, is extracted below from page No.432 of the Report :- It is not in dispute that when a programme is created it is necessary to encode it, upload the same and thereafter unloaded.

Indian law, as noticed by my learned Brother, Variava, J., does not make any distinction between tangible property and intangible property. A 'goods' may be a tangible property or an intangible one.

It would become goods provided it has the attribute thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of transmitted, transferred, delivered, stored and possessed. If a software whether customized or non-customized satisfies these attributes, the same would be goods.

54. Keeping in view the judgment of Hon'ble Supreme Court in the case of TCS (supra) especially the relevant observations recorded therein as discussed and extracted above, we do not find merit in the contention raised on behalf of the assessee that the said decision was rendered by the Hon'ble Supreme Court relying entirely on the extended definition of the term "goods" given in the relevant statute i.e. A.P. Sales Tax Act. On the other hand, the view of American Court on the issue as well as its own decision rendered in the case of Associated Cement Co.

(supra) in the context of Customs Act wherein the definition of the term "goods'" given was not as wide or exhaustive as the definition of term "goods" in the A.P. Sales Tax Act was taken into account and relied upon by the Hon'ble Supreme Court to hold that a software, whether customised or non-customised, satisfies all the attributes of being a "goods' and as such, the same is capable of being bought and sold and becomes an object of trade and commerce.

55. In our opinion, the ratio laid down by the Hon'ble Supreme Court in the case of TCS (supra) holding that computer software put in a medium of disk would be goods can only lead to the conclusion that purchase of such disk is acquiring a tangible asset. If the disk, tape or floppy or other electronic medium in which the software is stored is by itself goods, then the assessee who acquires the same, acquires a tangible asset. Computer Software has not been defined in the Act, but in Note-7 to Appendix-I to the I.T. Rules, it has been explained to include computer programme recorded on any disc, tape, perforated media or other information storage device. Therefore computer software (whether in canned form or uncanned form) is goods and a tangible asset by itself. The question whether an assessee by purchase of a disk containing software has purchased a capital asset or not should not, therefore, be viewed from the angle of acquisition of any copyright or any of the bundle of rights comprised in such copy right. An assesses purchasing such a software becomes owner thereof. But the test of ownership in the computer software in the light of the question whether the same is capital or revenue cannot be decided on the basis of ownership test alone but has to be seen from the point of its utility to businessman and to see how important an economic or functional role it plays in his business. In other words, the functional test becomes more important and relevant because of the peculiar nature of a computer software and its possible use in different areas of business teaching either capital or revenue field or its utility to a businessmen which may touch either capital or revenue field. The manner in which the computer software is used is again peculiar, General mode is to acquire computer software on a license. That by itself will not be sufficient to conclude that the said expenditure is revenue expenditure, if on application of the functional test, it is found that the expenditure operates to confer a benefit in the capital field. On the other hand, some computer software may have a very limited economic life so as to be treated as capital expenditure, though owned by an assesses.

Whether expenditure on computer software gives an enduring benefit to an assessee: 56. For ascertaining as to whether expenditure on computer software gives an enduring benefit to an assessee, the duration of time for which the assessee acquires right to use the software becomes relevant.

Having regard to the fact that software becomes obsolete with technological innovation and advancement within a short span of time, if can be said that that where the life of the computer software is shorter (say less than 2 years), it may be treated as revenue expenditure. It is also evident from the amendment to the law w.e.f.

1.4.2003 granting 60% depreciation on computer software that even the legislature considers the life of computer software as about two years by providing the higher rate of depreciation @ 60% thereon so as to enable assessee to write off the same to the extent of 84% even when treated as capital asset within a period of two years. An assessee may own a software outright or be a licensee but the same may operate to confer benefit only in the revenue field and therefore is may have to be regarded as Revenue Expenditure. The decision of the Hon'ble Supreme Court, In the case of Empire Jute Co, Ltd. (supra) lays down that it is not every advantage of enduring nature acquired by an assessee that brings the case within she principle laid down in this test (enduring benefit 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 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 on indefinite future. In other words, the functional test would become material and if on application of the same it is found that the expenditure operates to confer benefit in the revenue field, then the same would be revenue, irrespective of the duration of time for which the assessee acquires rights in a software.

The period of advantage in the context of computer software should not be viewed from the point of view of different assets or advantage like tenancy or use of know-how because Software is a business tool enabling a businessmen's ability to run his business.

Whether the expenditure operates to add the profit earning apparatus of the assessee (Functional Test): 57. The advantage which an assessee derives has to be seen. The nature of advantage has to be seen in a commercial sense. If the advantage is in the capital field then the same would be capital expenditure. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of 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, however, if assets/advantage is part of profit earning apparatus, it is capital.

58. The following factors would be relevant to determine whether the advantage Operates in the capital field or revenue field. (i) Nature of Business of the assessee. It is necessary to obtain an understanding of the business function or effect of a concern's software. Software normally functions as a tool enabling business to be carried on more efficiently. The scope, power, longevity of such a tool and its centrality to the functions of the business will all bear on its treatment.

In the case of M/s SQL Star international Ltd. one of the assessees in the cases referred to the Special Bench, the assessee company is engaged in the business of software development as well as running a training center to impart specialized training to the students in software technology. If the software were used in such business to impart training to the students, then the same would be part of the profit making apparatus of the assessee and consequently expenditure on software, capital.

Similarly, example of a travel agent can be cited here as an illustration wherein the expenditure incurred on acquisition of a software for the purpose of enabling the assessee to make booking of air tickets would be a capital expenditure because such a software certainly forms part of the profit-making apparatus of the travel agency business inasmuch as the business of air ticket booking is done with the help of that software.

Another example which can be considered here is that of acquisition of Turbo Gold software for Rs. 17.61 lakhs by one of the assessee in the present case i.e. M/s Amway India Enterprises. As submitted before us, the

said software helps in compression of size of e-mails sent through the Lotus Notes Mailing System and it includes licenses for 150 users who are using Lotus Notes Mailing System and software license for running on its server. If use of this software in the business of the assessee is limited to facilitate merely an effective and fast communication in order to increase its organizational efficiency, the same cannot be treated as forming part of the profit-making apparatus of the assessee. On the other hand, if such software is being used by an assessee engaged in the business of placement agency where the applications from persons seeking jobs are invited through e-mail and are also forwarded to the concerned clients through e- mail, the same may form part of profit-making apparatus of the assessee's business of placement agency and can be treated as a capital asset.

(ii) As a general rule it may be stated that the more expensive the computer software the more it is likely to be a central tool of the business and the more enduring is likely to be its effect adding to the profit earning apparatus. If there are associated capital expenditure like purchase of new computer equipment for running the software developed under a project, then it can be considered as capital expenditure. This is especially the case where the new hardware is not merely desirable but necessary for this purpose.

(iii) Degree of associated organisational change; Similarly the degree of change intended in the way operations are carried out as a result of the Computer software, for example, savings in the number, and changes in the location, of staff used to provide services to customers will have a bearing. The more radical the changes, the more likely the expenditure will be capital. These changes are likely to be most radical when operations previously carried on manually are computerised.

(iv) It has to be borne in mind that computer software industry is of a fast changing nature. Therefore whatever software purchased by an assesses would become outdated much earlier than expected. The assessee has therefore to upgrade his software. An clement of upgrading does not automatically make the expenditure capital. The presence of an element of upgrading, therefore, will not necessarily cause the expenditure in question to be capital.

59. Our conclusions on the issue under consideration thus can be summarized, as under: (i) When the assessee acquires a computer software or for that matter the license to use such software, he acquires a tangible asset and becomes owner thereof as held above relying on the decision of Hon'ble Supreme Court in the case of TCS (supra).

(ii) Having regard to the fact that software becomes obsolete with technological innovation and advancement within a short span of time. It can be said that where the life of the computer software is shorter (say less than 2 years), it may be treated as revenue expenditure. Any software having its utility to the assessee for a period beyond two years can be considered as accrual of benefit of enduring nature. However, that by itself will not make the expenditure incurred on software as capital in nature and the functional test as discussed above also needs to be satisfied.

(iii) Once the tests of ownership and enduring benefit are satisfied, the question whether expenditure incurred on computer software is capital or revenue has to be seen from the point of view of its utility to a businessman and how important an economic or functional role it plays in his business. In other words, the functional test becomes more important and relevant because of the peculiar nature of the computer software and its possible use in different areas of business touching either capital, or revenue Held or its utility to a businessman which may touch either capital or revenue field.60. Having laid down the criteria for determining the nature of expenditure incurred on acquisition of software, whether capital or revenue, we are of the view that these criteria need to be applied to determine the exact nature of expenditure incurred by the assessees in the present cases for acquiring different softwares. Since this exercise is required to be done in respect of each and every software independently having regard to the criteria laid down above, we are of the view that the matter needs to be restored back to the file of the Assessing Officer for doing such exercise. The AO shall examine the question whether expenditure on computer software is capital or revenue in the

light of the criteria laid down above after giving an opportunity of being heard to the assessees. If on such examination, the AO comes to the conclusion that the expenditure is capital expenditure, then the question regarding allowing depreciation will be decided in accordance with the principles laid down in the subsequent paragraphs.

61. We have already discussed as to how computer software is a tangible property. Though a licensee, the person purchasing the disk or other medium containing the software is owner to the extent of the rights comprised in the license. The decision of the Hon'ble Supreme Court in the case of TCS (supra) supports the view that software contained in a disk is tangible property by itself. The use by the assessee of such software in his business is enough to allow the claim for depreciation.

The rights which an assesses acquires by purchasing the disk or magnetic medium containing the computer software with limited or absolute right to use the same by itself would satisfy the requirements of the Plant, The assessee's ownership of limited right over the tangible asset is sufficient to conclude that the assessee is the owner of the Plant. There is therefore no difficulty in allowing depreciation claim at 25% under Section 32(1)(i) read with Appendix-I, Part-A division III (1) to the I.T. Rules, 1962. With effect from 1.4.2003, Computer Software has been classified as a tangible asset under the heading "Plant" in Appendix-I to the IT rules entitled to depreciation at 60%. The assesses would be entitled to depreciation at 60% from 1.4.2003.

62. The argument raised on behalf of the assessees in this context was that the rate of depreciation on computer software from 1.4.1999 should be 60%. The basis of this argument was that depreciation on computers was originally allowed treating them as a plant only at 25%. With effect from 1.4.1999, computers were treated as a different class of asset falling within the description of Plant and depreciation was allowed at 60%. With effect from 1.4.2003, computer software was also included along with computers. The argument of the assesses was that the amendment to the rules was merely clarificatory and therefore, even on computer software w.e.f. 1.4.1999, 60% depreciation should be allowed. We do not agree with the submissions of the assessee in this regard. The amendment is prospective. It is not clarificatory for the reason that computer and computer software are two different items of assets If the legislature wanted to allow depreciation at 60% w.e.f.

1.4.1999 on computer software, it would have said so specifically by making the provisions retrospective. In this regard, we agree with the view expressed by the Delhi Bench of the ITAT in the case of Maruti Udyog Ltd. (supra) wherein similar view has been taken.

63. By the order of reference, the entire appeals in the case of M/s Amway India Enterprises and M/s SQL Star International Ltd, were referred for determination by the Special Bench. The arguments were heard only with regard to the issue of expenditure on Computer Software. There are other issues arising for consideration in these appeals. The some, however, are entirely different and have no interlinking whatsoever with the issue of expenditure on computer software. We, therefore, deem it proper to refer back the cases to the Hon'ble President for placing the appeals before the regular Division Bench for decision in accordance with the ruling of the Special Bench on the issue of expenditure on software and decision on ether issues after hearing the parties.

64. Before parting, it would be out duty to the reasons as to why we have not made any reference to the various decisions which are specifically on the issue of expenditure on computer software. We have already noticed the question whether an expenditure is capital or revenue is dependent on facts and circumstances of a given case. We have also noticed that different minds may come to different conclusions with equal propriety. We, therefore, thought it fit to lay down general guidelines to be applied to individual cases. In the decisions of the Tribunal specifically on the issue, different considerations prevailed for the ultimate conclusion. In the case of Maruti Udyog Ltd. (supra),. M/s Radha Krishna Foodland Ltd. (supra), M/s Escorts Ltd. (supra) and M/s Hero Honda Ltd. (supra) the conclusion that the expenditure on purchase of computer software was capital proceeded on the footing that the purchase was an outright purchase and that Software

was an intangible asset. In the decision in the case of Asahi India Safety Glass (supra), M/s Sonata Information Technology Ltd. (supra) and M/s IBM India Ltd., however it was held that expenditure an purchase of Computer Software was revenue in nature.

Such conclusion was arrived at by the Tribunal on the basis that the assessees were merely licensees of the Software and had not acquired any ownership rights therein. So also the decision in the case of M/s Samsung Electronics Co. Ltd. (supra) and in the case of All Russia Scientific Research Institute Cable Industry (supra). In the case of Business Information Processing Services (supra) the conclusion was based on the premise that Computer Software does not provide enduring benefit because of fast changing technology and therefore, the expenditure in question was revenue expenditure. We have only reconciled the different approach by laying down that all circumstances have to be cumulatively taken into account, 65. The decision of the Hon'ble Rajasthan High Court in the case of Aravali Constructions Ltd. (supra) is again based on the factual conclusion that the software was a program specifically developed for data analysis for minning purposes and the purchase of the software was outright. The business of the assessee was carrying out mining Operations. Therefore, the decision is on the facts of that case. In the ease of G.E. Capital Services Ltd. (supra) decided by the Hon'ble Delhi High Court, the finding of fact by the Tribunal was that the expenditure in question was for up gradation and that the software had a very limited life. It was on these facts that the Hon'ble Delhi High Court concurred with the view expressed by the Tribunal that the expenditure was a revenue nature. In the case of K & Co. (supra) decided by the Hon'ble Delhi High Court, the expenditure in question was on maintenance and upgradation and was held to be revenue in nature. In the case of Southern Roadways Ltd. 288 ITR 15 (Mad.), the expenditure in question was on upgradation of Computer Software and the finding of fact was that the expenditure was incurred only for improving the efficiency of the existing system. The Court has also reiterated the law that there was no single rigid formula to find out whether expenditure was capital or revenue. These decisions of the Hon'ble High Courts have to be considered as laying down general guidelines but in each case the facts and other surrounding circumstances have to be taken into account before applying the ratio laid down therein, 66. The learned Counsel for assessee Mr. Ajay Vohra relied on some judicial pronouncements wherein it was held that expenditure on acquisition of knowhow was considered as expenditure of a revenue nature. His submission was that Computer Software is akin to know-how and therefore, expenditure on acquisition of computer software should also be considered as revenue expenditure. We are of the view that different considerations will apply in testing the nature of expenditure in the context of acquisition of know-how compared to expenditure on acquisition of software because know-how is an intangible asset whereas as held by Hon'ble Supreme Court in the case of TCS (supra), software is a tangible asset.

67. The questions referred to this Special Bench thus are answered accordingly as indicated above. The respective appeals will now be placed for consideration before the regular Bench.