

IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 23rd DAY OF MARCH 2011

PRESENT

THE HON'BLE MR JUSTICE N KUMAR

AND

THE HON'BLE MR JUSTICE RAVI MALIMATHI

INCOME TAX APPEAL 174/2009

BETWEEN:

- 1 THE COMMISSIONER OF INCOME TAX
C.R. BUILDING
QUEENS ROAD, BANGALORE
2. THE ADDL. COMMISSIONER OF
INCOME TAX
LTU, BANGALORE ...APPELLANTS

(BY SRI M V SESHACHALA - ADV)

AND :

- 1 M/S. TOYOTA KRILOSKAR MOTORS PVT LTD
BANGALORE ... RESPONDENT

(BY SRI A SHANKAR & M LAVA - ADV)

ITA filed u/S.260-A of I.T.Act, 1961 arising out of Order dated 14-11-2008 passed in ITA.No.650/Bang/2008, for the Block Assessment Year 2004-2005, praying that this Hon'ble Court may be pleased to formulate the substantial questions of law stated therein and allow the appeal and set aside the order passed by the ITAT Bangalore in ITA No.650/Bang/2008,dated 14-11-2008 and confirming the order of the Appellate Commissioner and confirm the order passed by the Additional Commissioner of Income Tax,(LTU),Bangalore, in the interest of justice and equity.

This appeal coming on for admission this day,
N.KUMAR J., delivered the following:

JUDGMENT

The revenue has preferred this appeal against the order passed by the appellate tribunal holding that provision for warranty is a contingent liability as contended by the revenue and that to use a software as required for a particular period, licence fee has to be paid and the said licence fee is a revenue expenditure and it would not become capital expenditure.

2. The assessee debited a sum of Rs.2,71,09,000/- as software expenses in the profit and loss account which included a sum of Rs.10,30,600/- as licence fee for use of "Lotus Notes". The assessing authority disallowed the said amount as capital expenditure. On appeal, the Commissioner of Income Tax (Appeals) after obtaining a remand report from the assessing authority held that the software becomes obsolete with technological innovation and advancement within a short span of time and where the life of the software is less than two years, it has to be treated as a revenue expenditure and therefore, he set-aside the order passed by the assessing authority. The assessee also claimed deduction in respect of the provision for warranty amounting to Rs.6,04,74,300/-. Taking into consideration

the actual expenditure incurred in the relevant previous year was only Rs.5,81,55,435/-, the deduction was given only to that extent and the remaining amount of Rs.23,19,065/- was added. The assessee challenged the said finding before the appellate authority. The appellate authority held that the entire amount of Rs.6,04,74,500/- is allowable as deduction. Aggrieved by these two findings, the revenue preferred an appeal to the tribunal. Insofar as treating the licence fee for a software as revenue expenditure, the tribunal affirmed the said finding relying on the Special Bench decision of the tribunal. Insofar as the claim of warranty is concerned, though it was held it is not a contingent liability and the assessee is entitled to claim deduction, the tribunal held before such claim is allowed, the authorities have to make sure that there is no double deduction and therefore, to that extent the matter was remanded to the assessing authority. Aggrieved by these two findings, the revenue is in appeal.

3. As rightly pointed out by the authorities, when the life of a computer or software is less than two years and as such, the right to use it is for a limited period, the fee paid for acquisition of the said right is allowable as revenue

expenditure and these softwares if they are licenced for a particular period, for utilising the same for the subsequent years fresh licence fee is to be paid. Therefore, without renewing the licence or without paying the fee on such renewal, it is not possible to use those softwares. In those circumstances, the findings recorded by the authorities that the fee paid for obtaining the software and the licence and for renewing the same is to be construed as only revenue expenditure do not call for interference by this Court.

4. Insofar as claiming the amount set-out towards warranty is concerned, the Apex Court in the case of ROTORK CONTROLS INDIA P. LTD vs COMMISSIONER OF INCOME-TAX reported in (2009) 314 ITR 62 (SC) has held that the principle is that the historical trend indicates that a large number of sophisticated goods were being manufactured in the past and the facts show that defects existed in some of the items manufactured and sold, then provision made for warranty in respect of such sophisticated goods would be entitled to deduction from the gross receipts under section 37. The argument of the revenue is unless in the past there is a cash outflow incurred by the assessee in

pursuance of the warranty, the estimate cannot be made regarding the amount to be claimed as deduction under the heading of 'warranty'. In this case, as there is no such evidence, the assessee is not entitled to the said benefit.

5. The law laid down by the Apex Court makes it clear the historical trend referred to therein is to the question whether in the past there was their any defect in the manufactured goods and not the actual expenditure incurred in rectifying the defect or in substituting the defective product with a defectless product. Assuming that the amount of warranty claiming deduction is actual and not incurred by the assessee, the difference in the amount is taxed in the subsequent year. In that view of the matter and in the light of the law laid down by the Apex Court as aforesaid, the authorities were justified in allowing the warranty claimed as deduction. However, they have made it very clear that there should not be double deduction and for verifying the same, the matter is remitted back to the authorities which in the facts of this case would meet the ends of justice. We do not see any justification to interfere with the said finding passed by the tribunal. Therefore, we do not see any substantial question of law that would arise

for consideration which merits admission of this appeal.

Accordingly, appeal is dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

brt