IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE

Before Shri George George K, JM & Shri B.R.Baskaran, AM

ITA No.451/Bang/2020 : Asst.Year 2012-2013

M/s.LG Soft India Private Limited Embassy Tech Square Sarjapur Outer Ring Road Marathalli Bengaluru – 560 103. **PAN : AAACL3009P.**	v.	The Deputy Commissioner of Income-tax, Circle 4(1)(1) Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.K.R.Vasudevan, Advocate
Respondent by : Sri.Nischal B, Addl.CIT-DR

Date of Hearing : 05.01.2022		**Date of Pronouncement : 06.01.2022**

O R D E R

Per George George K, JM :

This appeal at the instance of the assessee is directed against CIT(A)'s order dated 25.02.2020. The relevant assessment year is 2012-2013.

2. The grounds raised read as follows:-

"1. Disallowance of depreciation under the Income Tax Act ('the Act') - Rs. 3,62,98,140

a) The learned Commissioner of Income-tax Appeals ['CIT(A)'] erred on facts in confirming the disallowance made by the learned Assessing Officer (' AO') in relation to depreciation of Rs.3,62,98, 140 under section 32 of the Act.

b) The learned CIT(A) failed to consider the invoices submitted by the Appellant towards addition to fixed assets of Rs. 6,18,80,241.

c) Notwithstanding the above, the learned CIT(A) erred in concluding that the invoices furnished by the Appellant are not clear / legible.

2. Disallowance of software development expenses- Rs.2,05,05,279

a) The learned CIT(A) erred in law and on facts in confirming the disallowance of Rs.2,05,05,279 made by the learned AO in relation to software development charges.

b) The learned CIT(A) without considering the submissions made by the Appellant, erred in concluding that the expenses incurred under software development as capital in nature.

c) The learned CIT(A) erred in concluding that the software development expenses provides enduring benefit to the Appellant without fully appreciating the facts of the case.

The Appellant craves leave to add, alter, rescind and modify the grounds herein above or produce further documents, facts and evidence before or at the time of hearing of this appeal. For the above and any other grounds which may be raised at the time of hearing, it is prayed that necessary relief may be provided."

3. The assessee has also raised additional ground. The additional ground raised read as follows:-

"Ground no. 3: Deduction in respect of 'education cess on income-tax' and 'secondary and higher education cess on income-tax' for the year under consideration. while assessing the total income of the Appellant

3.1 The Learned Assessing Officer (Ld. AO') and Learned Commissioner of Income-tax Appeals (Ld. CIT(A),), while assessing the total income of the Appellant for the year under consideration, have erred in not allowing a deduction for education cess and secondary & higher education cess (collectively known as 'education cess') for the year under consideration.

3.2 On the facts and circumstances of the case and in law, the Ld. AO and Ld. CIT(A) ought to have allowed a deduction of education cess for the year under consideration, though not claimed as a deduction by the Appellant while filing its return of income. "

We shall adjudicate the issue ground-wise as under.

Disallowance of depreciation of block of computer equipment (Ground 1)

4. The assessee had claimed depreciation on fixed assets amounting to Rs.12,28,67,305 in the return of income. The

break-up of the depreciation on the fixed assets are as under:-

Depreciation on opening Written Down Value (WDV)	Rs.3,44,27,186
Depreciation on additions to fixed assets other than block of `Computer equipment'.	Rs.5,21,41,979
Depreciation on additions to block of `Computer equipment'	Rs.3,62,98,140
Total depreciation on fixed assets	Rs.12,28,67,305

4.1 The assessment order was completed u/s 143(3) of the I.T.Act (order dated 22.02.2016) wherein the Assessing Officer disallowed the entire depreciation of Rs.12,28,67,305. The A.O. held that supporting documents for addition under block of `computer equipments' were not furnished (refer para 2.1 of the assessment order). The assessee filed application dated 22.03.2016 u/s 154 of the I.T.Act. The A.O. passed rectification order dated 26.08.2016, wherein the claim of depreciation of Rs.8,65,69,165 was granted (Rs.3,44,27,186 + Rs.5,21,41,979). However, depreciation pertaining to addition to the block of "computer equipments" amounting to Rs.3,62,98,140 was omitted to be considered.

4.1 Aggrieved by assessment completed u/s 143(3) of the I.T.Act, the assessee filed an appeal to the first appellate authority. During the course of appellate proceedings, the assessee referred to the rectification application filed before the AO, wherein copies of all the invoices were submitted along with the statement of reconciliation to the tax audit report. The CIT(A) called for a remand report from the A.O. The A.O. in the remand report dated 24th August, 2017,

mentioned that invoices for an amount of Rs.6,18,80,241 were not produced and hence conveyed his objections for allowing the claim of depreciation. The CIT(A) called for rejoinder from the assessee. The assessee re-submitted copies of the invoices pertaining to the additions of block of `computer equipments' along with the statement of reconciliation with tax audit report in soft copy. However, the CIT(A) concluded in the impugned order dated 25.02.2020 that the invoices produced were not legible and that no new evidence / bills were produced except what has been produced before the A.O. The relevant finding of the CIT(A) reads as follows:-

> *"12. In view of the above, the matter is decided on merits. I have examined the invoices presented before me were sent to the AO for examination and as seen from the remand report the AO has clearly stated that the invoices for Rs.6,18,80,241/- were not produced. I have also gone through the copies of invoices produced before me and I find that the invoices are either not clear / legible or are already produced before the AO on which AO has commented in his remand report. There are no new or different evidence / bills produced before me except what has been produced before the AO. In view of this, the claim of the appellant is rejected and the addition on account of depreciation on Computer Equipments to the extent of Rs.3,62,98,140/- is sustained."*

4.2 Aggrieved by the order of the CIT(A), the assessee has raised this issue before the Tribunal. The assessee has filed two sets of paper book in total comprising of 1072 pages enclosing therein copies of the submissions made before the A.O., copies of the submissions made before the CIT(A) (including the copies of the invoices of the addition of block of `computer equipments'). The learned AR submitted that legible copies of all the invoices in relation to the addition to

block of computer equipment along with the detailed statement of reconciliation were duly submitted before the A.O. and the CIT(A). However, the same was rejected by the A.O. in the remand proceedings and also by the CIT(A) without any proper reasoning. Therefore, it was requested that evidence / invoices submitted by the assessee may be considered afresh for allowing the claim of depreciation of RS.3,62,98,140 on additions to block of computer equipments made during the relevant assessment year.

4.3 The learned Departmental Representative supported the orders of the Income Tax Authorities. However, the learned DR did not have serious objection for the issue to be restored to the files of the A.O. for examination of the invoices afresh and to take a decision in accordance with law.

4.4 We have heard rival submissions and perused the material on record. The assessee has made addition to the block of computer equipments of Rs.6,18,80,241 and claimed depreciation on the same amounting to Rs.3,62,98,140. The details of the claim of depreciation are as under :-

Additions for a period of 180 days or more in the previous year.	60%	5,91,13,560	3,54,68,136
Amount on which depreciation at half rate to be allowed	30%	27,6,681	8,30,004
Total		6,18,80,241	3,62,98,140

4.5 At the very outset, we notice that the assessment proceedings had commenced by issue of notice u/s 143(2) of

the I.T.Act on 10.08.2013, however, the assessment was taken up at the fag end of the assessment period and notice u/s 142(1)of the I.T.Act was issued only on 07.01.2016. The assessee was granted only two hearing opportunities (dated of hearing on 14.01.2016 and 28.01.2016). Therefore, we are, *prima facie,* of the view that the assessee was not given a proper hearing before the A.O. Inspite of the assessment taken up during the fag end of the limitation period, the assessee had produced sample copies of invoices relating to the additions made under block of "computer equipments" (refer page 911 to 1044 of the paper book). However, the A.O. disallowed the entire depreciation of Rs.3,62,98,140 by stating that the invoices were not reconciled with the tax audit report. The assessee filed rectification application and submitted statement of reconciliation of invoices with the tax audit report along with copies of all the invoices pertaining to the block of computer equipments vide rectification application filed on 22nd March, 2016 (refer page 783 to 861 of the paper book). The A.O., however, did not consider the same and did not grant the claim of depreciation on additions made during the relevant year to the computer equipments. The CIT(A) called for a remand report from the A.O. and the A.O. in the remand report stated that the invoices for an amount of Rs.6,18,80,241 were not produced and conveyed his objections for allowing the claim of depreciation. The A.O., however, in the remand report stated that there is no objection for allowing depreciation on actual amount of invoices furnished and the CIT(A) may decide the issue based

on the records available. The CIT(A) rejected the appeal of the assessee for the reason that the invoices produced are not legible. The legible copies of all the invoices in relation to the additions made to the computer equipments are placed on record (refer pages 185 to 195 of the paper book). Therefore, in the interest of justice and equity, we are of the view that the matter needs to be verified by the A.O. afresh. Hence, the issue raised as regards to the disallowance of depreciation on addition made on block of computer equipments is restored to the files of the A.O. The A.O. is directed to examine the invoices in respect of Rs.6,18,80,241 and if found in order, the A.O. is directed to grant depreciation on the same. It is ordered accordingly.

4.6 In the result, ground 1 is allowed for statistical purposes.

Disallowance of software development expenses Rs.2,05,05,279 (Ground 2)

5. The assessee had incurred software development expenses amounting to Rs.2,05,05,279 and the same was claimed as a revenue expenditure. The A.O. disallowed the software expenses on the ground that no explanation was offered to claim such expenses as revenue in nature (para 4.1 of the assessment order).

5.1 On further appeal, the CIT(A) sustained the disallowance stating that the software development expenses provides enduring benefit and treated the same as a capital

expenditure. The CIT(A) directed the A.O. to allow depreciation on the same (para 22 and 22 of the order of the CIT(A)).

5.2 Aggrieved by the order of the CIT(A), the assessee has raised this issue before the Tribunal. The learned AR submitted that the impugned expenditure represents testing charges and other expenses incurred under various projects undertaken by the assessee during the course of rendering of services to the AEs. The brief nature of software development expenses incurred by the assessee are explained in pages 342 to 343 of the paper book submitted by the assessee.

5.3 The learned Departmental Representative strongly supported the orders of the Income Tax Authorities.

5.4 We have heard rival submissions and perused the material on record. The brief nature of software development expenses are listed out at pages 342 and 343 of the paper book. The assessee is a subsidiary of LG Electronics Inc., Korea. The assessee provides software development and convergence solutions to its holding company from its development centre in India. The assessee is not a product development company. The assessee is mainly into country adaption and model development. It is a part of its parent company's Research & Development (R&D) Centre. The assessee purchases prototypes and builds on the base software developed by LG Korea, tailoring it to the

specifications/ requirements for the Indian consumers. It tests on the various functionalities like GPS, network quality testing etc., in different telecom circles based in India. To test in the various telecom circles, the assessee purchases sim cards of multiple telecom operators to test the various functionalities on their sample phones. On perusal of the details of expenditure (at pages 922 to 925 of the paper book), it is seen that it represents testing charges, purchase of electronic items, etc. The electronic items and testing equipments become redundant on completion of the project or after the use. The said phones are discarded post the testing process. The assessee has also submitted the certificate of destruction (refer pages 162 to 184 of the paper book). The CIT(A), however, without appreciating the business model of the assessee, held that the same software and same testing may not be done every year. It was further held by the CIT(A) that the assessee may test different software in different years and once developed, tested and customized according to a country specification will give an enduring benefit to the assessee. Accordingly, the CIT(A) held that the expenditure incurred on the software development is capital expenditure. The CIT(A) failed to appreciate that the assessee does not test on a single software during the entire year. Further, a software is not customized and deployed on the electronic products and a new product is launched every year and the same is a continuous activity. Since the CIT(A) has not understood the business model of the assessee, it is necessary that the matter needs to be examined afresh by the

A.O. Accordingly, the issue raised in ground 2 is restored to the files of the A.O. The A.O. is directed to examine the expenditure incurred amounting to Rs.2,05,05,279 and come to a conclusion whether it is a capital or revenue expenditure. The A.O. shall afford a reasonable opportunity of hearing to the assessee before a decision is taken in this matter. It is ordered accordingly.

5.5 In the result, ground 2 is allowed for statistical purposes.

Deduction of education cess on Income Tax and Secondary and Higher education cess on Income Tax (additional ground)

6. For the assessment year 2012-2013, the assessee had remitted education cess and secondary & higher secondary education cess (collectively known as `education cess') of a sum of Rs.34,72,811. The assessee omitted to claim the same as an expense in its return of income. In this regard, the assessee filed a petition dated 03.03.2021 for admission of additional grounds seeking deduction of the same while computing the total income chargeable to Income-tax. The learned AR submitted that education cess ought to be allowed as a deduction in view of the judgment of the Hon'ble Bombay High Court in the case of *Sesa Goa Limited v. JCIT [(2020) 423 ITR 426 (Bom.)]*. The learned Departmental Representative present was duly heard.

6.1 We have heard rival submissions and perused the material on record. The issue raised in the additional ground

is a pure legal issue, which does not require any verification of facts. Therefore, we admit the same for adjudication. The Hon'ble Bombay High Court in the case of *Sesa Goa Limited v. JCIT (supra)* had held education cess is an allowable expenditure as the word "cess" is conspicuously absent under the provisions of section 40(a)(ii) of the I.T.Act. The relevant finding of the Hon'ble High Court reads as follows:-

> *"23. If the legislature intended to prohibit the deduction of amounts paid by a Assessee towards say, "education cess" or any other "cess", then, the legislature could have easily included reference to "cess" in clause (ii) of Section 40(a) of the I.T.Act. The fact that the legislature has not done so means that the legislature did not intend to prevent the deduction of amounts paid by a Assessee towards the "cess", when it comes to computing income chargeable under the head "profits and gains of business or profession".*

6.2 The Hon'ble High Court also placed reliance on the CBDT Circular dated 18.05.1967, which clarified that upon omission of the term "cess" from the present section 40(a)(ii) of the I.T.Act, only rates or taxes needs to be disallowed, and hence, education cess ought not to be treated as Income-tax to be disallowed u/s 40(a)(ii) of the I.T.Act.

6.3 The Hon'ble Rajasthan High Court in the case of *CIT v. Chambal Fertilizers and Chemical Limited (D.B. IT Appeal No.52 of 2018 (judgment dated 31.07.2018)* had held education cess is not to be disallowed u/s 40(a)(ii) of the I.T.Act. The relevant finding of the Hon'ble Rajasthan High Court, reads as follows:-

> *"13. On the third issue in appeal no.52/2018, in view of the circular of CBDT where word "Cess" is deleted, in our considered opinion, the tribunal has committed an error in not accepting the contention of the assessee. Apart from the Supreme Court decision referred that assessment year is independent and word Cess has been rightly interpreted by the Supreme Court that the Cess is not tax in that view of the matter, we are of the considered opinion that the view taken by the tribunal on issue no.3 is required to be reversed and the said issue is answered in favour of the assessee".*

6.4 The Mumbai Bench of the Tribunal in the case of Voltas Limited in ITA No.6612/Mum/2018 (order dated 30.06.2020) had admitted additional ground of appeal with regard to the claim of education cess and adjudicated the matter in favour of the assessee, by following the judgment of the Hon'ble Bombay High Court in the case of *Sesa Goa Limited v. JCIT (supra)*. In the light of the aforesaid judicial pronouncements, we hold that education cess is to be allowed as deduction. It is ordered accordingly.

7. In the result, the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced on this 06th day of January, 2022.

Sd/-	**Sd/-**
(B.R.Baskaran)	**(George George K)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Bangalore; Dated : 06th January, 2022.
Devadas G*

Copy to :

1. The Appellant.
2. The Respondent.
3. The CIT(A)-9, Bengaluru.
4. The Pr.CIT-1, Bengaluru.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore