

INCOME TAX : Section 40(a)(i) and (ia) provides for disallowance only in respect of expenditure, which is revenue in nature and therefore, provision does not apply to a case of assessee whose claim is for depreciation, which is not in nature of expenditure but an allowance. Depreciation is not an outgoing expenditure and, therefore, provisions of section 40(a)(i) and (ia) are not applicable

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[2021] 123 taxmann.com 21 (Karnataka)

HIGH COURT OF KARNATAKA

Principal Commissioner of Income Tax

v.

Tally Solutions (P.) Ltd.

ALOK ARADHE AND H.T. NARENDRA PRASAD, JJ.

IT APPEAL NOS. 199, 951, 952 OF 2017

DECEMBER 16, 2020

E.R. Indrakumar, Sr. Standing Counsel and **E.I. Sanmathi**, Adv. *for the Appellant.* **T. Suryanarayana**, Adv. *for the Respondent.*

JUDGMENT

Alok Aradhe J. - These appeals under section 260-A of the Income-tax Act, 1961 (hereinafter referred to as 'the Act', for short) have been preferred by the revenue. The subject matter of I.T.A.No.199/2017 pertains to the Assessment Year 2009-10, whereas, subject matter of I.T.A.No.951/2017 pertains to Assessment Year 2010-11 and 2011-12. The subject matter of I.T.A.No.952/2017 pertains to Assessment Year 2010-11 and 2011-12. Since, in all the appeals, the same substantial question of law arises for consideration, therefore, they were heard together and are being decided by this common judgment. I.T.A.No.199/2017 was admitted by a Bench of this Court *vide* order dated 7-11-2017 on the following substantial question of law:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in deleting the disallowance made under section 40(a)(ia) in respect of depreciation on intellectual property rights by relying upon the decisions which has not reached finality and without appreciating that the assessing officer rightly invoked provisions of section 40(a)(ia) of the Act as the assessee had failed to deduct tax on payments made in respect of purchase of software as required under section 195 of the Act?

2. I.T.A.No.951/2017 was admitted by a Bench of this Court *vide* order dated 5-11-2018 on the following substantial question of law:

"Whether, on the facts and in the circumstances of the case, the Tribunal is justified in setting aside the disallowance of claim of depreciation on purchase of Intellectual Property Rights made by assessing authority under section 40(a)(ia) of the Act as they had failed to deduct TDS on payments made in respect of purchase of intellectual property rights by following its earlier order which has not reached finality and even when the ingredients of section 40(a)(ia) of the Act are satisfied in case of assessee?

3. I.T.A.No.952/2017 was admitted by a Bench of this Court *vide* order dated 25-2-2019 on the following substantial question of law:

"Whether, on the facts and in the circumstances of the case, the Tribunal is justified in setting aside the disallowance of claim of depreciation on purchase of Intellectual Property Rights made by assessing authority under section 40(a)(ia) of the Act as they had failed to deduct TDS on payments made in respect of purchase of intellectual property rights by following its earlier order which has not reached finality and even when the ingredients of section 40(a)(ia) of the Act are satisfied in case of assessee?

4. Facts leading to filing of these appeals briefly stated are that assessee is engaged in business of software development and sale of software product licence, software maintenance and training in software. For the sake of brevity, facts from I.T.A.No.199/2017 are being referred to. The assessee filed the return of income for the Assessment Year 2009-10 after claiming brought forward losses and declared its income as XNIL'. The return of income was processed on 30-10-2010 and the case was selected for scrutiny and notices under section 143(2) and Section 142(1) of the Act were issued. The Assessing Officer by an order dated 27-3-2013 concluded the assessment by making certain additions and disallowed a sum of Rs. 6,70,94,074/- in respect of depreciation on Intellectual Property Rights.

5. Thereupon the assessee filed an appeal before the Commissioner of Income-tax (Appeals) who by an order dated 20-8-2014 allowed the claim of the assessee and held that there being an irrevocable and unconditional sale of Intellectual Property and transfer being absolute, it was an outright purchase of capital asset and therefore, Section 40(a)(ia) of the Act could not be invoked in case of a claim for depreciation. The revenue thereupon filed an appeal before the Income-tax Appellate Tribunal (hereinafter referred to as 'the tribunal' for short). The tribunal by an order dated 29-11-2016 held that since, the amount was capitalized and the same was not claimed as revenue expenditure, the claim of depreciation cannot be disallowed by invoking the provisions of Section 40(a)(ia) of the Act. In the aforesaid factual background, the revenue has filed these appeals.

6. Learned counsel for the revenue submitted that the assessee had purchased the software from non-resident and had claimed depreciation under section 32 of the Act. It is also submitted that aforesaid payment was made towards purchase of software was in the nature of royalty in terms of *Explanation 2* to Section 9(l)(vi) of the Act and since, no TDS was deduction under section 195 of the Act on the aforesaid payment, therefore, disallowance under section 40(a)(ia) of the Act has rightly been made. It is also argued that Section 40 of the Act begins with a *non obstante* clause and has an overriding effect on Sections 3 to 38 of the Act and therefore, in case, any deduction is claimed under section 32 of the Act while computing the income under the head of 'profits and gains of business and profession' can be disallowed if the assessee has not deducted the tax at source.

7. It is also submitted that the intention of the legislature in providing disallowance under section 40(a)(1) of the Act is to ensure prevention of revenue leakage on foreign payments as recovery of tax from non-resident payees is difficult. It is also submitted that the substantial question of law involved in these appeals has already been answered by Supreme Court in *Munjal Sales Corpn. v. CIT* 298 ITR 288 and it has been held that assessee has to satisfy the conditions set out in Section 30 to Section 38 of the Act and it has to establish that the assessee is not hit by Section 40 of the Act. It is urged that in the present case, assessee is not entitled for claiming deduction under section 32 of the Act since, the assessee is hit by Section 40 of the Act due to non deduction of tax at source and substantial question of law deserves to be answered in favour of the revenue.

8. On the other hand, learned counsel for the assessee submitted that Section 40(a)(1) and (ia) of the Act provides for disallowance in respect of amounts claimed as deduction on which tax has not been deducted or paid after deduction under Chapter XVII-B of the Act and the provision does not apply to a

claim for depreciation, which is not in the nature of expenditure but is a disallowance. It is also urged that depreciation is not an outgoing expenditure and therefore, provisions of Section 40(a)(1) or (ia) of the Act are not attracted. It is also urged that depreciation is a statutory deduction available to the assessee on the asset, which is wholly or partly owned by the assessee and used for the purpose of business or profession. It is also pointed out that the Commissioner of Income-tax (Appeals) as well as the tribunal have recorded concurrent findings on the aforesaid issue in favour of the assessee, which do not suffer from any perversity and therefore, the substantial question of law is required to be answered in the negative. In support of aforesaid submissions, reliance has been placed on decision of the Supreme Court in *Nectar Beverage (P.) Ltd. v. Dy. CIT* [2009] 182 Taxman 319 and decision of High Court of Punjab and Haryana in *CIT v. Mark Auto Industries Ltd.* [2013] 40 taxmann.com 482.

9. We have considered the submissions made by learned counsel for the parties and have perused the record. Before proceeding further, it is apposite to take note of relevant extract of Section 40 of the Act, which is reproduced below for the facility of reference:

Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession", —

(a) in the case of any assessee—

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(ia) thirty per cent of any sum payable to a resident], on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :

Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, thirty per cent of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid :

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.

Explanation.—For the purposes of this sub-clause,—

(i)**

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(vi) "royalty" shall have the same meaning as in *Explanation 2* to clause (vi) of sub-section (1) of section 9;

10. Thus, from close scrutiny of Section 40(a)(i) of the Act, it is axiomatic that an amount payable towards interest, royalty, fee for technical services or other sums chargeable under this Act shall not be deducted while computing the income under the head profit and gain of business or profession on which tax is deductible at source; but such tax has not been deducted. The expression 'amount payable' which is otherwise an allowable deduction refers to the expenditure incurred for the purpose of business of the assessee and therefore, the said expenditure is a deductible claim. Thus, Section 40 refers to the outgoing amount chargeable under this Act and subject to TDS under Chapter XVII-B. The deduction under section 32 is not in respect of the amount paid or payable which is subjected to TDS; but is a

statutory deduction on an asset which is otherwise eligible for deduction of depreciation. Section 40(a)(1) and (ia) of the Act provides for disallowance only in respect of expenditure, which is revenue in nature, therefore, the provision does not apply to a case of the assessee whose claim is for depreciation, which is not in the nature of expenditure but an allowance. The depreciation is not an outgoing expenditure and therefore, provisions of Section 40(a)(1) and (ia) of the Act are not applicable. In the absence of any requirement of law for making deduction of tax out of expenditure, which has been capitalized and no amount was claimed as revenue expenditure, no disallowance under section 40(a)(1) and (ia) of the Act would be made. It is also pertinent to note that depreciation is a statutory deduction available to the assessee on a asset, which is wholly or partly owned by the assessee and used for business or profession. The depreciation is an allowance and not an expenditure, loss or trading liability. The Commissioner of Income-tax (Appeals) has held that the payment has been made by the assessee for an outright purchase of Intellectual Property Rights and not towards royalty and therefore, the provision of Section 40(a)(ia) of the Act is not attracted in respect of a claim for depreciation. The aforesaid finding has rightly been affirmed by the tribunal. The findings recorded by the Commissioner of Income-tax (Appeals) as well as the tribunal cannot be termed as perverse.

In view of preceding analysis, the substantial question of law framed by a bench of this court is answered against the revenue and in favour of the assessee.

In the result, the appeals fail and are hereby dismissed.

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