

Existence of depreciation rate in Income-tax Rules for software is not conclusive evidence of the nature of expenditure

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In brief

In a recent decision¹, the Delhi High Court (HC) has held that the mere existence of depreciation rates for software in the annexure to the Income-tax Rule, 1962 (the Rules) wasn't a conclusive evidence to determine the nature of expenditure. Capitalisation of software expenditure had to be seen comprehensively after taking into account the principles laid down by the Supreme Court (SC) in the case of Alembic Chemicals Works Co. Limited².

In detail

Background

- The taxpayer, a banking company, incurred expenditure in acquiring various categories of specialised software for banking and bank-related operations.
- The said cost of acquisition was charged as revenue expenditure.
- During assessment, the tax officer (TO) observed that the software expenses (except AMC) were capital in nature, hence disallowed such expenses.
- On appeal, the Commissioner of Income-tax (Appeal) [CIT(A)] and the Income-tax Appellate Tribunal (Tribunal) upheld

the TO's order.

Issue before the High Court

Whether the CIT(A) and the Tribunal were correct in confirming that the software expenses were capital in nature?

Taxpayer's contention

- The software acquired was specialised and meant for banking and bank-related operations.
- The software was acquired to optimise performance and streamline the efficiency of the bank, and hence, the expenditure was revenue in nature.
- In support of the contentions, the taxpayer relied on the pronouncement of the SC in the case of Alembic

Chemical Works Co. Limited² and the Delhi HC decision in the case of Asahi India Safety Glass Limited³.

Revenue's contention

In accordance with the detailed enquiry regarding the nature and utility of the software undertaken by the lower authorities, the software expenses were to be treated as a depreciable asset for which depreciation rates are set out in Part B of the Schedule to the Rules. Thus, the expenditure could not be treated as revenue in nature.

High Court's decision

- The nature of the articles acquired were licenses, which did not confer any enduring right and could be used for the duration as

¹ ITA Nos. 129/ 2018, 415/ 2017 and 56/ 2018 order dated 17 April 2018

² Alembic Chemicals Works Co. Limited v. CIT [1989] 177 ITR 377 (SC)

³ CIT v. Asahi India Safety Glass Limited [2012] 346 ITR 329 (Delhi)

acquired for by the licensor/
intellectual property owner.

- The taxpayer's objective was to use computer software to maximise its performance and streamline efficiency.
- The mere circumstance that the depreciation rate is provided in part B of the Schedule to the Rules is not conclusive regarding the nature of the expenditure and whether it resulted in an enduring advantage to the taxpayer.
- The nature of expenditure that would have been incurred for

streamlining the functions of the taxpayer, which the software was in fact performing, would have undoubtedly be covered in the revenue stream.

- In view of the above and relying on pronouncements relied by the taxpayer, the appeal was allowed in favour of the taxpayer.

The takeaways

- The pronouncement reiterates that the determination of whether the expenditure is capital or revenue is to be

decided on a case-to case-basis and after considering various aspects, including but not limited to the objective of the expenditure, etc.

- Further, it clarifies that any expenditure cannot be treated as capital expenditure merely on the basis that the depreciation rate is provided in the Schedule to the Rules.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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