IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O. O. C. J.

INCOME TAX APPEAL NO.2207 OF 2009
WITH
INCOME TAX APPEAL NO.2210 OF 2009

The Commissioner of Income Tax-21. ...Appellant.
Vs.
M/s.Information Architects. ...Respondent.
....
Mr. N.A.Kazi for the Appellant.
Mr.S.E. Dastur, Sr.Advocate with Mr.Niraj Sheth and Mr.Rajesh Poojari i/b. MINT & Confrers for the Respondent.
.....

CORAM : DR.D.Y.CHANDRACHUD AND
J.P.DEVADHAR, JJ.

February 9, 2010.

ORAL JUDGMENT (PER DR.D.Y.CHANDRACHUD, J) :

These appeals by the Revenue under Section 260A of the Income Tax Act, 1961 have raised similar questions of law. For convenience of reference, it would be appropriate to set out the questions of law which have been formulated in one of the two appeals which are as follows:

> "(a) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in confirming the order of the CIT(A), in holding that the assessee is eligible for deduction u/s.80HHE of Rs.1.56 crores, disregarding the fact that supply of qualified manpower

services to any person outside India does not amount to rendering any technical services as contemplated u/s. 80HHE?

-(b) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in upholding the order of the CIT(A) in deleting the addition of overseas maintenance allowance of Rs.75.18 lac, disallowed on the ground that the assessee failed to deduct tax at source on such payment as required u/s. 40A of the Act?"

2. In the companion appeal, save and except for a variation in the amount of the deduction claimed under Section 80HHE and in the quantum of the overseas maintenance allowance, the questions of law are the same.

3. The orders of the Tribunal relate to Assessment Years 1998-99 and 2000-01.

4. The assessee entered into an agreement with an entity by the name of Kindle Banking Systems Ltd. (KBS) for rendering Software Development Services. The agreement contained a recital to the effect that the assessee is a Company which inter alia renders services by employing or retaining software professionals possessing software development skills; and personnel duly competent in design and development of software skills. KBS was

a Company based in Dublin, Ireland which required the services of software professionals towards the fulfillment of its ongoing software activities. Under the terms of the agreement, the assessee was to provide through its Consultants software professionals to render services to KBS, in accordance with the scope of the work set out in the contract. For this purpose, the assessee agreed to provide fully trained and qualified Consultants possessing training, skills and expertise necessary to perform work under the contract. The scope of the work under the contract was "to provide analysis, programming and testing skills to Bankmasters Development Projects". Under the agreement, the work that was envisaged was the design, development and testing of software including code maintenance as required by KBS which would be provided at the commencement of the contract and which was to be updated or, as the case may be, modified or revised during the term of the contract. The agreement stipulated the skills and knowledge required in the following areas of a software development lifecycle and in connection with the Bankmaster product. Those were as follows:

> "Structured Development Technique
> COBOL
> UNIX
> BANKMASTER Database Structure
> TPS Operations
> Standard Chartered Bank operations
> Requirement and Problem analysis
> Testing and quality assurance skills."

5. Under the terms of the contract, the employees of the assessee were deputed to the establishment of KBS at Dublin. The assessee was compensated for the services provided by it, under the contract, on the basis of a payment quantified at US $ 3750 for each employee. In addition, the assessee provided to each of the employees deputed to Ireland, a subsistence allowance of IEP 50 for every calender day of work. Though several agreements were entered into between the assessee and KBS, broadly the terms of these agreements were similar and embodied the salient terms which have been adverted to hereinabove.

6. The claim of the assessee to a deduction under Section 80HHE was rejected by the Assessing Officer. During the course of the proceedings for Assessment Year 2000-01, the CIT(A) allowed the benefit of the deduction under Section 80HHE. The decision of the CIT(A) was carried in appeal by the Revenue to the ITAT. For Assessment Year 1998-99, the assessment was sought to be reopened by the Revenue under Section 148. The CIT (A), for Assessment Year 1998-99 held against the assessee against which the assessee carried the matter in appeal before the Tribunal. The ITAT, in respect of Assessment Year 2000-01, dismissed the appeal

filed by the Revenue and confirmed the order of the CIT(A), allowing a deduction under Section 80HHE. In view of the decision for Assessment Year 2000-01, the Tribunal, for Assessment Year 1998-99 followed its earlier decision on merits. The validity of the reopening of the assessment, therefore, became a matter of subsidiary importance and the Assessing Officer was directed to allow a deduction under Section 80HHE.

7. In these appeals, two questions are involved. The first question relates to whether the assessee was entitled to a deduction under Section 80HHE. The second question relates to whether the overseas maintenance allowance paid by the assessee to its employees would qualify for deduction.

8. In order to appreciate the nature of the controversy in the present case, a reference to the provisions of Section 80HHE would be in order. Sub-section (1) of Section 80HHE provides, in so far as it is relevant, as follows:

> "(1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of.-

> (i) export out of India of computer software or its transmission from India to a place outside India by any means;
>
> (ii) providing technical services outside India in connection with the development or production of computer software,
>
> there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction to the extent of the profits, referred to in sub-section (1B), derived by the assessee from such business:
>
> .....
>
> Explanation: For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India."

9. Sub-section (1) of Section 80HHE consists of two parts. The first part, which is clause (i) of sub-section (1), deals with a situation where an Indian Company or a person resident in India is engaged in the business of export out of India of computer software or its transmission from India to a place outside India. The second part, which is clause (ii), deals with a situation where an Indian Company or a person resident in India provides technical services outside India in connection with the development or

production of computer software. The explanation to the provision was inserted with effect from 1st April 2001 by the Finance Act of 2001. The explanation evidently is clarificatory in nature since it is prefaced by the words "for the removal of doubts ...". The explanation was intended to clarify that the profits or gains which may be derived from onsite development of computer software outside India, including services for development of software, shall be deemed to be profits and gains derived from the export of computer software outside India. The deeming fiction under the explanation, qualifies the scope and ambit of clause (i) which deals with the export out of India of computer software. Consequently, where an assessee is engaged in the on-site development of computer software outside India, or in the provision of services for the development of software, that would be deemed to be the export of computer software for the purposes of the provision. The fact that the explanation is clarificatory, is elucidated in a circular issued by the Central Board of Direct Taxes on 12th February 2004.[1]

10. Clause (ii) of sub-section (1) of Section 80HHE deals

1 Circular No.3 of 2004

with the provision of technical services outside India in connection with the development or production of computer software. In order to qualify for the deduction under clause (ii), the assessee must provide technical services and these services must be provided in connection with the development of computer software. The expression 'technical service' not having been defined, the ordinary and commercial understanding of the expression must be adopted. In **Continental Construction Ltd. vs. CIT**,[2] the Supreme Court, while construing the expression 'technical services' in the context of Section 80-O held thus:

> "These services were no doubt technical services as they required specialised knowledge, experience and skill for their proper execution."

The test which was applied by the Supreme Court of what constituted technical services is that the service must require specialized knowledge, experience and skill for proper execution. The Supreme Court observed that where an assessee is a company, any technical services rendered by it can only be through the medium of its employees. Even where a contractor is an individual or firm and not a company, a contract of a significant

2 (1992) 195 ITR 81

magnitude can be executed only through the medium of employees or other personnel engaged by the assessee. It is in the background of the position of law, as elucidated in the judgment of the Supreme Court, that the facts of the present case have to be evaluated.

11. In the present case, the assessee claimed that it had sufficient knowledge and experience in the development of software systems for banks in India and had been doing such work since 1978 with Standard Chartered Bank (SCB). According to the assessee, SCB was using a software called Bank Master Software for its world wide operations and the software did not suit its requirement in India. The assessee claimed to have assisted the Bank on this aspect. The assessee, before taking up the work of KBS, claimed to have developed such systems for SCB, including sub-routines for outward cheque clearing, security management and treasury systems. According to the assessee, its work with KBS involved development of software programmes, trouble shooting and systems support. The Bank Master Software was stated to have a number of operational modules and a continuous process of

monitoring and upgradations was stated to be required. The copyright in all programme modules of the software was held by KBS.

12. The CIT (Appeals), while allowing the deduction, took note of the fact that the assessee was not permitted to retain specific details of several similar tasks undertaken by its technical personnel onsite and that it was not possible to identify each item of work and bill accordingly. Consequently, the only feasible option for fair billing was adopting a man-hour basis. Time sheets maintained by the assessee's employees were verified and certified by KBS and at the end of each month, KBS would fax these time sheets to the assessee. Upon verification, the assessee raised its invoices and received remittances. As a matter of business expediency and to obviate any dispute, the contracting parties agreed that the scope of work, duration and the rate per month be determined. On this basis, the agreement in question was drafted and signed by the assessee and KBS.

13. The Tribunal, on a review of the record held thus: (i)

The personnel deputed by the assessee to Dublin for work onsite with KBS were technically qualified; (ii) The personnel deputed by the assessee were on the rolls of the assessee as its employees and the assessee was not simply loaning the services of the employees; (iii) It was not necessary for the employer, having regard to Section 80HHE, to train employees in the area where such employees were rendering technical services abroad, nor was it necessary for the employer to have developed such technical expertise himself; (iv) The validity of the agreement between the assessee and KBS was a matter between the contracting parties and would not affect the question of deduction under Section 80HHE; (v) The persons sent abroad being technically qualified, they were rendering technical service in connection with the development or production of computer software outside India. Such persons were also engaged in on site development of computer software; and (vi) The amount paid by the assessee as overseas maintenance allowance for the sustenance of its employees was an allowable deduction.

14. In arriving at these conclusions, the Tribunal has adverted to the evidence in a considerable degree of detail. The

Tribunal has inter alia referred to the information furnished by two of the employees of the assessee who had appeared before the Assessing Officer in response to a notice. The information supplied by the employees inter alia referred to their technical qualifications, the nature of their experience, the work which was rendered in Dublin and the nature of the payment received. The work permits issued to the employees were as employees of the assessee. The assessee had furnished Visa- support letters to its employees. The persons sent abroad had filed their returns of income and had declared themselves to be employed by the assessee. One of the employees inter alia stated that he was working as a programmer in the Corporate Service Department for KBS, developing and maintaining software. The employee stated that he was involved in the design and initial development phase of a particular software. The Tribunal had due regard to the nature of the work under the terms of the agreement between the assessee and KBS. The description of the work in the time sheets was also considered by the Tribunal. The work described in the time sheets included coding, processes, programming, BBMIOI, training, investigation, survey, self study, MICR support/delivery,

walkthroughs, testing, statements programme MICR coding etc. The employees examined by the Assessing Officer stated that they were developing new functionalities into the banking software of KBS and maintaining the software. Placing reliance on a publication entitled "Information System Audit Reference Book" of the Institute of Chartered Accountants of India, the Tribunal held that in the context of software, maintenance was nothing but a process of ongoing development which would continue until the system is replaced or discontinued. In this sense, the work which was being done by the employees of the assessee was integral to the ongoing development of software.

15. Counsel appearing on behalf of the Revenue submitted that KBS had a software of its own and that consequently, the work which was being rendered cannot be regarded as amounting to the export of computer software or for that matter, provision of technical services. The submission which has been urged on behalf of the Revenue cannot be accepted. Section 80HHE contemplates a deduction where an Indian Company or a person resident in India is engaged in the business of export out of India of computer

software or in the provision of technical services outside India in connection with the development or production of computer software. On the evidence, as it has emerged from the record of these proceedings, it is abundantly clear that the assessee met the requirement of Section 80HHE. The assessee had a contract with KBS under which the scope of work involved the provision of analysis, programming and testing skills to the Bank Master Development Project. The contract envisaged design, development and testing of software. The assessee was undoubtedly required to depute qualified personnel to Dublin for the purposes of furthering its obligations under the contract. Each of the personnel has been found to be technically qualified to fulfill the requirements of the contract. Essentially, the assessee was engaged in onsite development of computer software outside India and the nature of the work involved inter alia, the provision of technical services in the development of software. The assessee fulfilled the requirement of both clauses (i) and (ii) for the purposes of qualifying for a deduction under Section 80HHE in the facts of these cases. In the circumstances, the Tribunal was not in error in holding that the assessee was eligible for a deduction under Section

80HHE.

16. In so far as Assessment Year 1998-99 is concerned, as already noted earlier, the issues are similar. The Revenue in its grounds in the Memo of Appeal has only urged that the Tribunal had decided the issue in favour of the assessee by following the order pertaining to Assessment Year 2000-01 on an identical issue. The Revenue has stated that the decision for Assessment Year 2000-01 had not been accepted and has been carried in appeal to this Court. For the reasons already adduced, the decision of the Tribunal for Assessment Year 2000-01 cannot be faulted. The appeal for both the years accordingly would fail on the first issue.

17. In so far as the second issue is concerned, it relates to the amounts paid by the assessee to its employees towards overseas maintenance allowance. These amounts were paid towards expenses at the rate of IEP 50 per day per employee. The Tribunal has correctly held that these amounts constitute only reimbursement for the expenses incurred by the employees at a particular amount per day and would not form part of the salary in

the hands of the recipients. Hence the question of applying sub clause (iii) of sub-section (a) of Section 40 would not arise. The view of the Tribunal is correct and would not raise any substantial question of law.

18. For all these reasons, we do not find any merit in the appeals. The appeals are accordingly dismissed.

(Dr.D.Y.Chandrachud, J.)

(J.P.Devadhar, J.)