IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 26TH DAY OF AUGUST, 2022

PRESENT

THE HON'BLE MR. JUSTICE P.S. DINESH KUMAR

AND

THE HON'BLE MRS. JUSTICE M.G. UMA

I.T.A NO.42 OF 2017

BETWEEN:

M/s SUBEX LIMITED
ADARSH TECH PARK
OUTER RING ROAD
DEVARABEESANAHALLI
BENGALURU - 560 037
(REPRESENTED BY ITS MANAGING
DIRECTOR, SRI. SURJEET SINGH
AGED ABOUT 48 YEARS
S/O SRI. THAKUR SINGH) ....APPELLANT

(BY SHRI. CHYTHANYA K.K., SENIOR ADVOCATE A/W
SHRI. SHARATH S, ADVOCATE)

AND:

THE DEPUTY COMMISSIONER OF
INCOME TAX
CIRCLE 12(3)
BENGALURU - 560 001 ...RESPONDENT

(BY SHRI. K.V. ARAVIND, ADVOCATE)

THIS ITA IS FILED UNDER SECTION 260-A OF THE INCOME TAX ACT, 1961 ARISING OUT OF ORDER DATED: 12/08/2016 PASSED IN ITA NO.1430/BANG/2010, FOR THE ASSESSMENT YEAR 2006-2007 PRAYING TO FORMULATE THE SUBSTANTIAL QUESTION OF LAW STATED AND ETC.

THIS ITA, HAVING BEEN HEARD AND RESERVED FOR JUDGMENT ON 02.08.2022 COMING ON FOR PRONOUNCEMENT OF JUDGMENT, THIS DAY, **P.S.DINESH KUMAR J,** PRONOUNCED THE FOLLOWING:-

JUDGMENT

This is a classic case of denial of a legitimate claim of benefit under Section 10A of the Income Tax Act, 1961[1].

2. We have heard Shri. K.K.Chythanya, learned Senior Advocate for the appellant-assessee and Shri. K.V.Aravind, learned Senior Standing Counsel for the respondent-Revenue.

3. Brief facts of the case are, assessee is a public limited company in the business of development and export of software for communication industry. One of it's business units is registered as a Software Technology Park. Assessee filed it's return of income for A.Y[2]. 2006-07 declaring a total income of Rs.2,58,72,868/- and claimed a deduction of Rs.42,79,82,899/- under Section 10-A of the Act.

[1] 'Act' for short
[2] Assessment Year

The AO[3] passed his order on August 31, 2009 under Section 143(3) of the Act. Assessee challenged the same before CIT(A)[4] and the appeal was allowed in part vide order dated October 20, 2010. Assessee challenged CIT(A)'s order before ITAT[5]. By order dated November 13, 2013, in ITA No.1430/Bang/2010, the ITAT has partly allowed the appeal. Assessee is aggrieved by disallowance of deduction of Rs.9,53,10,234/- being the sale of hardware component from export turnover under Section 10A of the Act. This appeal has been admitted to consider the following question of law:

> " *Whether on the facts and in the circumstances of the case, the Honorable ITAT was right in law in excluding Rs. 9,53,10,234/-, being the sale of hardware components, from the export turnover while computing deduction under section 10A of the Income tax Act 1961?*"

4. Shri. K.K.Chythanya, learned Senior Advocate for the appellant mainly contended that:

---

[3] Assessing Officer
[4] Commissioner of Income Tax (Appeals)
[5] Income Tax Appellate Tribunal

- Assessee's case is not a simplicitor case of purchase and sale of hardware. Assessee develops software and installs it in the specified hardware device. What is eventually sold is an indivisible product consisting of software embedded into specified hardware device;
- What is delivered to the customer is a distinct product having separate identity and utility. It cannot be identified either as software or hardware in isolation. Assessee has manufactured a distinct marketable article. By loading software into a hardware device, the hardware device as well as software would transform into a new commodity as a distinct and separate commodity. Therefore, the software developed by the assessee and loaded onto the hardware qualifies to be regarded as a computer software under Section 10A of the Act;
- The term 'export turnover' is defined in Clause (iv) of Explanation 2 to Section 10A of the Act. As per the explanation, 'export turnover' means,

consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into, India by the assessee in convertible foreign exchange;

- Assessee has received sale proceeds from export of hardware components in foreign currency and brought the same into India. Hence, the amount qualifies to be regarded as 'export turnover'.

5. In substance, Shri. Chythanya's argument is, based on customer's requirement, the software developed by the assessee has been loaded onto the hardware and exported. Therefore, denial of the deduction under Section 10A of the Act is not sustainable in law.

6. Opposing the appeal, Shri. K.V.Aravind, for the Revenue mainly contended that:

- benefit under Section 10A of the Act is applicable only where an undertaking is located in a free trade zone or export processing zone or a software technology park;

- in the instant case, assessee has admittedly purchased the hardware and it is not manufactured in the software technology park or any other zones mentioned in Section 10A of the Act. Therefore, assessee shall not be entitled for the benefit under Section 10A of the Act;
- it is recorded by the ITAT (in para 12) that the order for software and hardware were placed separately in the same purchase order with different costs. Therefore, assessee's contention that the hardware portion forms an integral part cannot be accepted;
- The ITAT has recorded another finding of fact that assessee has not established that the software cannot be used without the hardware.

With the above submissions, he prayed for dismissal of this appeal.

7. We have carefully considered rival submissions and perused the records.

8. The specific case of the assessee is, it manufactures software, loads it onto the hardware and exports. The Assessing Officer has recorded in para 4.5 of his order that deduction is allowable only for income derived from export of article/thing/computer software. According to the AO, assessee does not manufacture or produce hardware and hence, meaning of software cannot be stretched to hardware however essential it may be for functioning of the software. He has further recorded that the question is not how inextricably the hardware components are linked to the software exported, but the question was that hardware was not manufactured by the assessee.

9. The CIT(A), in his order[6], while dismissing the appeal, has recorded in para 8.4 as follows:

> " *I have heard the ARs and considered the written submissions. The judicial decisions relied on by the appellant were carefully perused. I am of the opinion that meaning of software cannot be interpreted to include hardware however essential it may be for functioning of computer software. Further, the*

[6] dated 20.10.2010 in ITA No.38/CIT(A)-12(3) CIT(A)-III/2009-10

appellant does not manufacture/produce hardware and but only engages in the trade thereof. "

(Emphasis Supplied)

10. The ITAT, has recorded in para 6 of the impugned order that assessee is not a manufacturer of hardware; that software and hardware were sold separately through different invoices; that on 25.03.2005, software was sold for USD 272,000 and hardware was sold on 19.09.2005 by separate invoice. It has also extracted the purchase order dated March 20, 2005, invoice No.0005-0100 dated March 25, 2005 and invoice No.0006-0059 dated September 19, 2005.

11. It was urged by Shri. Chythanya that both invoices extracted in ITAT's order are in respect of software and not hardware. He pointed out from the purchase order extracted by the ITAT that invoice No.0005 is in respect of software for USD 272,000 and invoice No.0006 is also in respect of software for USD 136,664. He submitted that the ITAT has not applied its mind as both invoices are in respect of software only.

12. We have carefully perused the purchase order and two invoices extracted by the ITAT. Both invoices are in respect of softwares. In our view, based on an erroneous assumption that one of the invoices is in respect of hardware, the ITAT has recorded an incorrect finding in para 7 that the assessee had obtained separate orders for hardware and software at different value. It has noted that a software known as 'ranger fraud management system' was specified at USD 272,000 and a hardware for USD 132,500. According to ITAT, the details of hardware have been separately mentioned in the purchase order and the payment terms were also different. Further, no warranty was stipulated for the hardware. The ITAT has also held that supply of hardware and software being different, assessee's contention that software was sold along with the hardware and that software cannot be used without the hardware had no substance.

13. Shri. Chythanya rightly pointed out that ITAT has noticed in para 11 of it's order that wherever

software and hardware are inextricably connected and software cannot be used without hardware, sale of hardware would be a part of sale of software.

14. We may record that though ITAT has recorded as above in para 11 of it's order, it has not granted the relief. ITAT has distinguished the principle firstly on the ground that order for software and hardware were placed separately in the same purchase order for different costs; secondly, on the ground that invoices of software and hardware were raised separately on different dates; thirdly, on the ground that the mode of payment for software and hardware were different and fourthly on the ground that it was not established that the software could not be used without hardware.

15. It is relevant to record that the ground on which the AO has denied the benefit under Section 10A of the Act is, that the hardware was purchased by the assessee but was not manufactured by it. It is not the case of AO that hardware was not required at all.

On the other hand, the reason for denying the benefit is that assessee had not manufactured the software. The view of CIT(A) is also the same. The ITAT considered altogether different points and held that it was not established that software cannot be used without hardware. This was not the question considered by the Assessing Officer and CIT(A). We may reiterate that ITAT has recorded in para 11 that wherever software and hardware are inextricably connected and the software cannot be used without hardware, the sale of hardware would be a part of software.

16. Shri. Chythanya has relied upon following authorities:

(a) *Sultan Brothers Pvt. Ltd. Vs. CIT*[7]

In this case, assessee was the owner of a building. He let it out fully equipped and furnished to run a hotel. He claimed that entire income should be assessed under Section 10 of the Act or in the alternative under Section 12 of the Act. In respect

[7] (1964) 51 ITR 353(SC)

of building, the AO assessed under Section 9 and in respect of hire received from furniture and fixture, he assessed under Section 12 of the Act. The Tribunal held that allowances under Section 12(4) of the Act could not be allowed as it was permitted only where letting of building was incidental to the letting of furniture and fixtures which had not happened in that case. The High Court held that income from building would be computed under Section 9 of the Act and income from furniture and fixtures under Section 12(3) of the Act and the Apex Court held as follows

> "*It seems to us that the inseparability referred to in sub-section (4) is an inseparability arising from the intention of the parties. That intention may be ascertained by framing the following questions: Was it the intention in making the lease-and it matters not whether there is one lease or two, that is, separate leases in respect of the furniture and the building-that the two should be enjoyed together? Was it the intention to make the letting of the two practically one letting? Would one have been let alone and a lease of it accepted without the other? If the answers to the first two questions are in the affirmative, and the last in the negative then, in our view, it has to be*

held that it was intended that the lettings would be inseparable."

17. If the above principle is applied to the facts of this case, the intention of purchaser was to buy the software and the intention of the assessee was to sell the software. It is to be noted that assessee is not a manufacturer or a dealer in hardware. Software will have to be stored/loaded onto a medium for transmission/use. When compared to the cost of software, the cost of hardware is insignificant. Further, assessee's specific case is, the software and the hardware are inextricably connected. Applying the ratio in the case of *Sulthan Brothers,* we are of the view that the software and the hardware are inseparable.

(b) *Director of Income Tax Vs. Ericsson A.B., Newdelhi*[8]

In this case, Delhi High Court was considering Revenue's appeal against ITAT's finding that it was not permissible for the Revenue to assess the software and the GSM phone supplied by the assessee separately.

[8] (2012)343 ITR 470 DEL (Paras 55, 58 & 61)

The Delhi High Court has held that the software that was loaded on the hardware did not have any independent existence; that the software supply was an integral part of GSM Mobile Telephone System and used by cellular operators for providing cellular services to it's customers; that there could not be any independent use of such software; and that software merely facilitated the functioning of the equipment and it is an integral part thereof.

18. With regard to bifurcation of price in two components, namely consideration for supply of equipments and supply of software, the Delhi High Court has held the payment received by the assessee therein was towards the title and GSM system of which software was an inseparable part incapable of independent use.

19. In the case on hand too, Software could not be exported without loading onto the Hardware. Therefore, in our view software and hardware are inseparable.

(c) Wipro Limited Vs. DCIT[9]

20. In this case, this Court was considering whether the profit derived from the sale of monitor as a part of computer was eligible for benefit under Section 80IB. This Court has held that the monitors which were purchased from outside were used as spare parts in the manufacture of computers sold to customers and the monitor in the computer was not a 'traded commodity' but it was a part of the computer.

21. Facts of the case on hand are similar. In *Wipro Ltd*. monitors were purchased from outside and in this case hardware has been purchased from outside.

(d) *Arun Electrics, Bombay Vs., Commissioner of Sales Tax, Maharashtra State*[10] wherein it is held as follows:

"*The conclusions recorded by the Deputy Commissioner and the Tribunal must be held to be*

[9] (2016) 382 ITR 179 Para 106
[10] (1966) 17 STC 576 SC

based on no evidence. In our judgment, no answer should have been recorded by the High Court on the question framed, for the question whether in respect of a transaction sales tax is exigible may be determined only on the terms of the contract, and not from the invoice issued by the person entitled to receive money under the terms of the contract. The invoice did not represent any transaction, nor did it evidence a contract of work or for sale of goods."

(Emphasis Supplied)

22. Placing reliance on this authority, Shri. Chythanya has rightly argued that invoices do not represent the transaction, but the intention of parties and what is actually sold.

23. ITAT has been swayed by its reasoning that sale had been effected by separate invoices and therefore, assessee is not entitled for the benefit under Section 10A. The ratio in *Arun Electrics* makes it clear that sale by separate invoices is inconsequential and we are in respectful agreement with that view. Therefore, the said reasoning is unsustainable.

(e) *Aspinwall & Co Ltd. Vs. Commissioner of Income Tax, Ernakulam*[11] wherein it is held as follows:

> " 13. *The word 'manufacture' has not been defined in the Act. In the absence of a definition of word 'manufacture' it has to be given a meaning as is understood in common parlance. It is to be understood as meaning the production of articles for use from raw or prepared materials by giving such materials new forms, qualities or combi-nations whether by hand labour or machines. If the change made in the article results in a new and different article, then it would amount to manufacturing activity.* "
>
> *(Emphasis Supplied)*

24. In this case, 'manufacture' has to be understood in common parlance as developing software and loading onto the hardware. Software will be written in binary code and it is intangible. It can be used only when loaded onto a compatible hardware. Therefore, in our view, hardware becomes an integral part of the exported commodity.

---

[11] (2001 251 ITR 323 (SC)

(f) *Puttur Petro Products Pvt. Ltd. Vs. ACIT*[12]

In this case, this Court was considering the activity involving in a LPG bottling plant and has held that once the manufacturing process is complete neither the gas nor the cylinder can be regarded as original commodity and it is recognised in the trade as new and distinct commodity namely, as a 'gas cylinder'. This judgment has been affirmed by the Apex Court in *CIT-I, Mumbai Vs. Hindustan Petroleum Corporation Ltd.*[13]

(g) *CIT, New Delhi Vs. Oracle Software India Ltd.*[14]

In this case, the Apex Court has held as follows:

> *"…. The term "manufacture" implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the above process. If an operation/process renders a commodity or article fit for use for which it is otherwise not fit, the operation/process falls within*

[12] (2014) 221 Taxmann. 43 Para 210
[13] (2017)396 ITR 696
[14] (2010)320 ITR 456 (SC)

the meaning of the word "manufacture". Applying the above test to the facts of the present case, we are of the view that, in the present case, the assessee has undertaken an operation which renders a blank CD fit for use for which it was otherwise not fit. The blank CD, is an input. By the duplicating process undertaken by the assessee, the recordable media which is unfit for any specific use gets converted into the programme which is embedded in the Master Media and, thus, blank CD gets converted into recorded CD by the aforestated intricate process. The duplicating process changes the basic character of a blank CD, dedicating it to a specific use. Without such processing, blank CDs would be unfit for their intended purpose. Therefore, processing of blank CDs, dedicating them to a specific use, constitutes a manufacture in terms of section 80-IA(12)(b) read with section 33B of the Income-tax Act."

25. In the case on hand, software without loading onto the hardware could not be used and the hardware with the software loaded into it would be unfit for the intended purpose.

26. On a careful consideration of the entire material on record and the authorities cited before us, we are of the considered view that the Assessing Officer

framed an incorrect question for his consideration that whether sale of Hardware which is not manufactured by the assessee could be considered as part of export. The CIT(A) also committed the same error. We say so because:

- firstly, the entire case is with regard to eligibility of benefit under Section 10A of the Act towards export of software. The purchase order for the software is, for a total sum of USD 591,164. Out of the said value, the hardware component in USD 132,500. It is not in dispute that software is developed in various computer languages in the binary format. The software requires a medium for its transmission. Therefore, it needs to be installed on a hardware. India has been a premier exporter of software for more than two to three decades. In *Ericsson A.B.* relied upon by the assessee, Delhi High Court has held as back as in 2012 that software supply is an integral part of the GSM Mobile Telephone and there could not be

any independent use of such software. This judgment has been accepted by the Revenue. In that case software was embedded in the system and it would not be used independently. Cases of similar nature must have come for consideration before various Courts. Revenue having accepted the principle in Ericson A.B that software embodied in a hardware cannot be utilized independently, have taken a strange stand in this case that the benefit of Section 10A is not available on hardware component on the fallacious ground that hardware was not manufactured by the assessee;

- secondly, we can take a judicial note of the fact that the software, unless loaded onto a hardware, cannot be used;
- thirdly, it would be incongruous to construe that software can be exported without the hardware because hardware is the medium and therefore forms an integral part of the export;

- fourthly, it is not Revenue's case that export has not taken place. It is also not in dispute that benefit of Section 10A has been extended for software component.

27. In view of above discussion, this appeal merits consideration. Hence the following:

ORDER

(a) Appeal is ***allowed***.

(b) The question of law is answered in favour of the assessee and against the Revenue.

No Costs.

Sd/-
JUDGE

Sd/-
JUDGE

YN/SPS