

आयकर अपीलीय अधिकरण पुणे न्यायपीठ "ए" पुणे में
IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "A", PUNE

सुश्री सुषमा चावला, न्यायिक सदस्य एवं श्री आर. के. पांडा, लेखा सदस्य के समक्ष
BEFORE MS. SUSHMA CHOWLA, JM AND SHRI R.K. PANDA, AM

आयकर अपील सं. / ITA No.619/PN/2014
निर्धारण वर्ष / Assessment Year : 2010-11

Harbinger Systems Pvt. Ltd.,
139, Siddhant Sr. No.97/6,
Paud Road, Kothrud,
Pune - 411038

.... अपीलार्थी/Appellant

PAN: AAACH7400G

Vs.

The Dy. Commissioner of Income Tax,
Circle -1 (2), Pune

.... प्रत्यर्थी / Respondent

अपीलार्थी की ओर से / Appellant by : Shri Nikhil Pathak
प्रत्यर्थी की ओर से / Respondent by : Shri Suhas Kulkarni

सुनवाई की तारीख / Date of Hearing : 21.12.2016	घोषणा की तारीख / Date of Pronouncement: 23.12.2016
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आदेश / ORDER

PER SUSHMA CHOWLA, JM:

This appeal filed by the assessee is against order of CIT(A)-I, Pune, dated 31.10.2013 relating to assessment year 2010-11 against order passed under section 143(3) of the Income Tax Act, 1961 (in short 'the Act').

2. The assessee has raised the following grounds of appeal:-

On facts and in law,

- 1] *The learned CIT(A) erred in holding that the compensation paid of Rs.23,33,278/- to Microsoft Corporation, USA was not allowable as a deduction in view of explanation to Section 37(1).*
- 2] *The learned CIT(A) erred in holding that the compensation paid by the assessee company to Microsoft Corporation was for infringement of the Copyright Act and therefore, the said payment was for an offense and covered by explanation to Section 37(1) and not allowable as a deduction.*
- 3] *The learned CIT(A) failed to appreciate that the payment made by the assessee to Microsoft Corporation was not covered by explanation to Section 37(1) and hence, there was no reason to disallow the said payment while computing the income of the assessee company.*
- 4] *The learned CIT(A) failed to appreciate that the compensation was paid by the assessee to Microsoft Corporation as a part of the Settlement arrangement arrived at between the two parties and it was not a case of that the payment was for any purpose which is an offense or prohibited by law and accordingly, the amount paid should have been allowed as a deduction while computing the income of the assessee company.*
- 5] *The learned CIT(A) erred in holding that the MAT credit to be carried forward u/s 115JAA was to be computed by ignoring the surcharge and, education cess paid on the tax payable u/s 115JB of the Act.*
- 6] *The learned CIT(A) failed to appreciate that the MAT credit should have been computed by considering the tax, surcharge and education cess paid by the assessee on the income computed u/s 115JB of the Act.*
- 7] *Without prejudice to the above grounds, the assessee submits that if the MAT credit is to be considered excluding surcharge and education cess, then, while setting off the MAT credit in the subsequent year, the same should be set off against the tax computed under normal provisions excluding surcharge and education cess.*

3. The issue raised by way of grounds of appeal No.1 to 4 is against the disallowance of Rs.23,33,278/- paid to Microsoft Corporation, USA.

4. The assessee has not pressed grounds of appeal No.5 to 7 and hence the same are dismissed as not pressed.

5. Briefly, in the facts of the case, the assessee was engaged in the business of software development. For the year under consideration, the assessee had furnished return of income declaring total income of Rs.5,28,62,230/-. The Assessing Officer noted that the assessee had debited sum of Rs.35 lakhs as compensation

expenses. The assessee was asked to explain and justify the allowability of the said expenditure. In reply, the assessee pointed out that sum of Rs.35 lakhs was paid to Anand & Anand Lawyer Firm as compensation to Microsoft Corporation, USA and others, pursuant to compromise arrived at and recorded by the order of Hon'ble Delhi High Court on 31.08.2009. It was further pointed out that the said amount was shared amongst the group companies involved in the settlement. The assessee also explained that the said amount was neither an offence nor penalty but sum paid in settlement of an action initiated in the Hon'ble High Court against inadvertent infringement of copyrights of software. It was also pointed out that Explanation under section 37 of the Act does not apply as the expenditure incurred was not for any purpose which was an offence nor it was prohibited by law and was expended wholly and exclusively for the purpose of business. The Assessing Officer observed that expenditure incurred by the assessee was in violation of Indian Copy Right Act, 1957 and where anything was done which was infraction of the law, then Explanation to section 37(1) of the Act is attracted and sum of Rs.35 lakhs was added to the income of the assessee.

6. Before the CIT(A), it was pointed out that the assessee had paid software related compensation cost of Rs.35 lakhs towards out of court settlement. It was further pointed out that the said sum of Rs.35 lakhs was fair assessment of software legalization requirement and also covered litigation and other related costs. The assessee's computer systems were released for business use after the settlement was arrived at and no further damages were claimed. The assessee also pointed out that its share out of total amount paid of Rs.35 lakhs for group companies, was only Rs.23,33,278/-, whereas the Assessing Officer had disallowed the entire compensation of Rs.35 lakhs. The case of assessee before the CIT(A) was that the said amount was paid to safeguard the use of operating software which was essential

for conducting un-interrupted business of the assessee i.e. software development services and where the compensation was paid under mutual agreement towards legalization of software acquirements, the same could not be said to be for infraction of law. Since the expenditure was not incurred for any offence nor it was prohibited by law and was incurred wholly and exclusively for the business expenses, the same was allowable as deduction. Reliance was placed on the ratio laid down by the Hon'ble Delhi High Court in CIT Vs. Desiccant Rotors International Pvt. Ltd. (2011) 245 CTR (Del) 572 and it was pointed out that the Assessing Officer had ignored the said decision. The CIT(A) observed that where the compensation was paid pursuant to settlement with the parties, which was in the nature of amount paid for compounding an offence i.e. violation of the Copy Right Act, then the same was in the nature of penalty for infringement of copyrights of others and the Explanation to section 37(1) of the Act was clearly attracted. Reliance placed on the decision of Hon'ble Delhi High Court in CIT Vs. Desiccant Rotors International Pvt. Ltd. (supra) was found to be not applicable where the payment was made for loss of goodwill and damage to the capital and for terminating cases in US Courts. The CIT(A) thus, upheld the order of Assessing Officer. The alternate plea of assessee that compensation charged to the Profit & Loss Account was only to Rs.23,33,278/- out of total compensation of Rs.35 lakhs paid to Microsoft Corporation and others, was accepted by the CIT(A). The CIT(A) has reproduced the scanned image of relevant portion of Profit & Loss Account, under which Rs.23,33,278/- has been debited and hence, the disallowance was restricted to Rs.23,33,278/-.

7. The assessee is in appeal against the order of CIT(A).

8. The learned Authorized Representative for the assessee pointed out that the assessee was engaged in the provision of software services and was using pirated

version of Microsoft software. A suit was filed against the assessee by Microsoft Corporation and others which was settled by payment of compensation of Rs.35 lakhs by the assessee and other companies. The share of assessee in the total compensation paid was Rs.23,33,278/-. Our attention was drawn to the contents of suit filed and also the Compromise Decree passed by the Hon'ble Delhi High Court, copy of which is placed at page 41 of the Paper Book and the order of the Hon'ble High Court is placed at page 65 of the Paper Book. The learned Authorized Representative for the assessee stressed that there was no dispute that software of Microsoft was used un-authorizedly and there was also no dispute that Microsoft has filed a suit for recovery of compensation from the assessee. The question which arises in the present appeal is whether the same is allowable in the hands of assessee. Our attention was drawn to Explanation (1) to section 37(1) of the Act, wherein it is provided that any expenses, which is an offence or is prohibited by law is not allowable expenditure. It was stressed by the learned Authorized Representative for the assessee that compensation paid was for loss of business by Microsoft and not for any infraction of law and is not any penalty levied in any of the Act. In case it was for infraction of law or penalty levied under different Acts, then the same would be an offence. He stressed that there is no question of levy of penalty between two private parties. With regard to the expression 'prohibited by law', it was pointed out by the learned Authorized Representative for the assessee that speed money, hafta money, etc. would be in the nature of amount prohibited by law. Our attention was drawn to the Kolkata Bench of Tribunal in ITO Vs. M/s. MPR Marketings Pvt. Ltd. in ITA No.1514/Kol/2012, relating to assessment year 2009-10, order dated 14.03.2013 and it was also pointed out that the Hon'ble Delhi High Court had noted the compromise between the parties and had allowed the compensation paid pursuant to the said compromise. It was further stressed by the learned Authorized Representative for the assessee that in case the said compensation paid by the

assessee was prohibited by law, then the Hon'ble Delhi High court would not have so ordered the assessee and since the assessee had made the payments, the same is allowable as deduction.

9. The learned Departmental Representative for the Revenue placed reliance on the orders of Assessing Officer / CIT(A).

10. We have heard the rival contentions and perused the record. The issue which arises in the present appeal is the claim of deduction on account of compensation paid to Microsoft Corporation and others. The assessee was engaged in the business of software development and was carrying on its business on the platform of Microsoft. The said use of Microsoft Windows, etc. was an unauthorized use by the assessee. When the same came to the knowledge of Microsoft Corporation and others, civil suit was filed against the assessee before the Hon'ble High Court of Delhi. As per the settlement of the suit, the assessee and others in the group company were directed to pay compensation to the tune of Rs.35 lakhs. The share of assessee in the said Rs.35 lakhs worked out to Rs.23,33,278/-.

11. The question which arises for adjudication before us is whether the said amount paid by the assessee which is claimed to be in accordance with the terms of settlement between Microsoft Corporation & others and the assessee & its group companies, before the Hon'ble High Court of Delhi, is in infraction of law and hence, hit by Explanation under section 37(1) of the Act or the same is allowable expenditure under section 37(1) of the Act. The assessee had utilized software of Microsoft without any licence / permission and once it came to the knowledge of said concern, a civil suit was filed. The assessee had violated the Copyrights Act. However, ultimately, the matter was settled by way of Compromise decree, under which, the assessee was allowed to use licenced software after the final settlement. The

assessee and others undertook to pay sum of Rs.35 lakhs which would cover litigation and other related costs suffered by Microsoft and others. The computer systems seized by the Commissioner was released for the use of assessee and the assessee undertook to clean / delete the hard drives of seized computer systems of all illegal / pirated / un-licenced software of the Microsoft companies. The said compromise entered into between the parties was approved by the Hon'ble High Court of Delhi vide its order dated 31.08.2009. The question which arises before us is whether the payment made pursuant to the said compromise is for infraction of law or is expenditure which is wholly and exclusively incurred for the purpose of business and is allowable as expenditure in the hands of assessee. The amount which has been agreed to be paid by the assessee and its group companies to Microsoft Corporation and others is on account of contractual liability. It is not the case of payment of any penalty. In any case, the payment on account of penalty would arise where one of the parties is the Government and the connotation of payment of penalty cannot arise when there is an understanding between two private parties. As far as payment which is prohibited by law is concerned, then the same refers to speed money, hafta money, etc., but the same is not to be applied in cases where one party agreed to compensate the other party for loss of its business.

12. In the facts of the present case, use of pirated software by the assessee and its group companies which is the property of Microsoft Corporation and others admittedly, resulted in loss of business of Microsoft Corporation. Where because of civil suit between the parties, there was compromise entered into between the parties for payment of compensation for loss of business and also covering the cost of litigation, then such an amount is to be allowed as business expenditure in the hands of assessee under section 37(1) of the Act. The Explanation to section 37(1) of the Act does not apply to such understanding between the two private parties. The Kolkata Bench of Tribunal in ITO Vs. M/s. MPR Marketings Pvt. Ltd. (supra) has laid

down similar proposition, which has been approved by the Hon'ble High Court of Calcutta and we find support from the said ratio. Accordingly, we allow the claim of assessee and the grounds of appeal No.1 to 4 are thus, allowed.

13. The grounds of appeal No.5 and 6 are not pressed and hence, the same are dismissed as not pressed.

14. The issue in ground of appeal No.7 raised by the assessee is against computation of MAT credit.

15. The facts relating to the issue are that for the year under consideration, the assessee had claimed MAT credit under section 115JAA of the Act. While calculating the tax payable, the assessee had computed the same on the returned income and thereafter, after reducing MAT credit of Rs.79,85,346/- under section 115JAA of the Act, calculated surcharge, income tax and education cess on the balance tax. Whereas the Assessing Officer calculated the surcharge, income tax and education cess on the tax payable before MAT credit of Rs.78,71,786/-. The MAT credit available was ignored for setting off of the same against surcharge and education cess to be paid by the assessee.

16. The CIT(A) while deciding the issue had relied on the ratio laid down by the Delhi Bench of Tribunal in the case of Richa Global Exports (P.) Ltd. reported in 54 SOT 185 and held that surcharge and education cess on the tax payable had to be calculated before allowing MAT credit from the tax payable.

17. The assessee is in appeal before us and the alternate plea raised by the assessee is that where the tax payable has been computed after including surcharge and education cess, then MAT credit should be allowed on the total amount i.e. tax with surcharge and education cess and should not be restricted only to the tax

payable. This issue is decided by the Delhi Bench of Tribunal in the case of Richa Global Exports (P.) Ltd. (supra), wherein the Tribunal held that MAT credit payable under section 115JB is only income tax and does not include surcharge or education cess. Therefore, where it is only income tax that is paid under the provisions of section 115JB of the Act, it is natural that tax credit under section 115JAA of the Act will only be of income tax and not of surcharge and education cess. The said proposition was applied by the CIT(A) in denying the claim of assessee. The assessee has failed to controvert the same and in view thereof, we find no merit in the ground of appeal No.7 raised by the assessee.

18. In the result, the appeal of assessee is partly allowed.

Order pronounced on this 23rd day December, 2016.

Sd/-
(R.K. PANDA)

लेखा सदस्य / **ACCOUNTANT MEMBER**

Sd/-
(SUSHMA CHOWLA)

न्यायिक सदस्य / **JUDICIAL MEMBER**

पुणे / Pune; दिनांक Dated : 23rd December, 2016.

GCVSR

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to :

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. आयकर आयुक्त(अपील) / The CIT(A)-I, Pune;
4. आयकर आयुक्त / The CIT-I, Pune;
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "ए" / DR 'A', ITAT, Pune;
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

वरिष्ठ निजी सचिव / Sr. Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune