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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Decided on : 19.01.2015

\+ **ITA NO.13/2015**

\+ **ITA NO.14/2015**

\+ **ITA NO.15/2015, C.M. APPL.157/2015**

COMMISSIONER OF INCOME TAX-VIII ..... Appellant

versus

MS. KIRAN KAPOOR ..... Respondent

Through : : Sh. Balbir Singh, Sr. Standing Counsel with Sh. Angad Sandhu and Ms. Rubal Maini, Advocates for CIT.

Sh. Mayank Nagi, Advocate, for respondent.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)

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1. The questions of law which the revenue urges in support of these appeals, directed against three orders of the ITAT for AY 2003-04, 2004-05, 2005-06 and 2006-07 are:

(1) Whether the assessee is engaged in activity which can be termed "manufacture" so as to claim benefit of Section 10B of the Income Tax Act, 1961 (hereafter "the Act") and

(2) Whether the activity (of collection, collation, formatting of data and information and its export) fulfils the conditions stipulated in Section 10B(2)(i) of the Act.

2. The brief facts of the case that the assesse, an individual, in her return claimed exemption under Section 10B of the Act to the tune of ₹ 39,32,654. She claimed to be a software exporter to Netherlands. The importer was one Mr. Rolli Janssen B.V. The claim was disallowed by the Assessing Officer (AO) who added back ₹ 39,32,654/- and finalized the assessment. Dissatisfied by the view of the AO, the assessee appealed to the CIT(A), who confirmed those findings. Aggrieved by the order of the CIT(A) the assessee successfully appealed to the ITAT. The revenue is, therefore, in appeal under Section 260-A of the Act.

3. Mr. Balbir Singh, learned counsel for the revenue argued that the ITAT fell into error on both the questions. Stating that the process deployed by the assessee was neither "manufacture" nor did it amount to creation of software, he supported the orders of the AO and CIT(A). He urged that the asseessee was unable to establish that computer software is manufactured or produced by it. He contended that the conditions specified in Section 10B, Explanation 2 (1) viz, *"any customized electronic data or any product or service of similar nature, as may be notified by the CBDT, which is transmitted or exported from India to any place outside India by any means"* had a precondition for a successful claim under the Act. He argued that the ITAT fell into error in disturbing the concurrent finding of the authorities below.

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4. Learned counsel relied upon the terms of the Notification S.O.890(E) dated 26-9-2000, to say that the ITAT failed to uphold the findings of the CIT (A) that the assessee's activities did not fit the description of any of the processes mentioned. It was argued that the mere compilation of data without anything more, could not be said to have resulted in a customized or "legal database". The database had to be such as was capable of use by the customer or client, as software. Else, activity of any description even if it could not be characterised as "manufacture" or "production" would successfully claim benefit under Section 10B.

5. Learned counsel relied on the judgment of the Supreme Court reported as *Commissioner of Income Tax v Gem India Manufacturing Co Ltd* 2001 (249) ITR 307 (SC). It was *inter alia*, held in that judgment that:

> *"There can be little difficulty in holding that the raw and uncut diamond is subjected to a process of cutting and polishing which yields the polished diamond, but that is not to say that the polished diamond is a new article or thing which is the result of manufacture or production. There is no material on the record upon which such a conclusion can be reached."*

Counsel also relied upon the terms of the CBDT circular, which reads as follows:

> *"S.O.890(E) - In exercise of the powers conferred by clause (b) of item (i) of Explanation 2 of section 10A, clause (b) of item (l) of Explanation 2 to section 10B and clause (b) to Explanation to section 80HHC of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby specifies the following Information Technology enabled products or services as the case may be for the purpose of said clauses namely :-*
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> *(l) Back-Office Operations*
>
> *(ii) Call Centres*

(iii) Content Development or animation
(iv) Data Processing
(v) Engineering and Design
(vi) Geographic Information System Services
(vii) Human Resources Services
(viii) Insurance claim processing
(ix) Legal Databases
(x) Medical Transcription
(xi) Payroll
(xii) Remote Maintenance
(xiii) Revenue Accounting
(xiv) Support Centres and
(xv) Web-site Services."

It was submitted that preparation of data for its ready printing use could not amount to manufacture of software, entitling the assessee to claim benefit of Section 10B.

6. The ITAT noticed that in this case, there are four stages for the completion of the assessee's product. The first stage is where the assessee collects the raw material that goes into making of the final files. This comprises mainly of text and photographs. The providers of these materials- depending on the subject of the book- are various authors, photographers, photo agencies. The data is sourced from different places including internet. The ITAT cited a specific work of the assessee, a book titled *"100 Wonders of India"* and noticed that a freelancer, Mr Nirad Grover was engaged for collection of photographs necessary for production of the book. The assessee also relied on an agreement with Mr Nirad Grover and stated that the materials were in an edited state. The next stage in the process is design and

layout. Here the designers use the said material to prepare the layout of the book within the given parameter and specifications of clients. This involves designing and lay out of materials in a manner which fits the size and number of pages given for the particular book. This stage is specialized and the assessee's book designers are experts in the field of making uniquely user friendly layouts. The third stage is the scanning and color correction. For that the images used in the book have to be of a good print quality; and have to go through the "scanning and colour correction" stage. Every photograph (provided to the designers in a hard format) is scanned and digitally colour-corrected; it involves user of software such as *Acrobat Reader* and *QuarkX Press*, manipulation of the date, photographs and colours to remove blemishes so as to make the final product, i.e. the book, appealing to the eyes of the client and customers. A hard copy of the book, *"100 Wonders of India"* was shown to the ITAT to establish the entire transformation process, and present the best results in the final product. The last stage is the embedding of high resolution colour corrected images into the lay out and preparation of the ready to be exported final files (software), on a CD or electronically, onto the servers of their client.

7. Addressing the question whether the assessee could be said to have involved herself in "manufacture" or "produced" any goods or articles, the ITAT relied on the Supreme Court rulings in *Graphic Company India Ltd. v. Collector of Customs* [2001] 1 SCC 549; *CIT v. Tara Agencies* [2007] 292 ITR 444; *Union of India v. Delhi Cloth and General Mills Company Limited* AIR 1963 SC 791 and *CIT vs. Lovesh Jain* 204 Taxman 134(Del) and held as follows:

"17. In the instant case we find that the appellant after collecting raw data and pictures has utilized its expert designing skills in producing a ready to print e-book. Shri Syali in his submissions has neatly narrated the entire sequence of activities carried on by the appellant. The samples produced before us were also shown to the AO, however he has conveniently chosen to remain quite on this aspect. The final product is intended for use of a particular customer and therefore the case under consideration does fit in the category of production of "any customized electronic data" as per the definition of computer software defined in Explanation 2 to section 10B of the Act. The above Third Member decision is germane to the issue before us and therefore it clearly supports the case of appellant. In our considered opinion even if it is said that the appellant has merely customized the data, which was already available and has not created altogether new software then too the appellant cannot be deprived of the benefit of deduction. It is pertinent to note that the definition of "produce" is wider than the term manufacture as held by the Hon'ble Supreme Court in a number of decisions (referred to in Lovesh Jain's case above) and does not require to produce or manufacture altogether a new product; but if the outcome of the process is a different product than the input, it would fall under the definition of 'produce'. In our considered view, whatever form the input data is, so long as the end product is in the form of electronic data which is customised by the appellant for the end use of a particular customer, then benefit of deduction u/s 10B of the Act cannot be denied."

The ITAT also held that the assessee's activity involved data processing and export:

"18. We find that the ld CIT(A) has erred in considering the definition of "Computer Software" as per clause (i) of Explanation 2 to section 10B in a conjunctive manner and not disjunctive manner without considering that word used in between sub-clauses (a) and (b) is "or". The ld CIT(A) has erred in comparing the work done by the assessee with "Computer Programme". Here it is to noted that it is not assessee's case that

its case falls under sub-clause (a) of clause (i) to Explanation 2 to section 10B. It is the consistent stand assessee that its case falls under sub clause (b) of clause (i) to Explanation 2 to section 10B. Here it is to be seen that whether the assessee is engaged in any customization of electronic data. We find that ld CIT(A) has not recorded any finding in this respect in his order. We find also that ld CIT(A) has tested assessee's case u/s 10BB. However we find that counsel for the assessee had submitted that scope of section 10BB is limited in scope as compared to the new definition in new section 10B. In this regard it is to be taken note that post amendment old section 10B requires "processing or management of electronic data" whereas new section 10B is larger in scope and only requires "any customized electronic data". The difference is that old section 10B requires that input data must necessarily be in electronic form where as in new section 10B this requirement is done away with. This interpretation has found favour by ITAT in Accurum's case (Supra) were in at para 9 (of Third Member order) it has been held that "The data which a customer may require, may be gathered either by manual effort or by electronic means, as for example, through internet. By whatever means the data is collected, once it is stored in an electronic form, it becomes a customized electronic data which can be exported to qualify for deduction u/s 10A".

19. The requirement of the provision (Section 10B) is that there should be a customized electronic data and such data should be exported outside India. The data which a customer may require may be gathered either by manual effort or by electronic means, as for example, through internet. By whatever means the data is collected, once it is stored in an electronic form, it becomes a customized electronic data which can be exported to qualify for deduction u/s 10A. The process of actually collecting the data need not be IT enabled. What all is required is that the data collected should be in an electronic form. The exact language of sub-clause(b) of clause (1) of Explanation 2 is "any customized electronic data.

20. Thus we find that Assessee"s business involved export of ready to print books which in the instant case is the "customized electronic data". The nature of activity done by the assessee in the EOU was that of producing designs, drawings, layouts and scanning for the projects of foreign clients on the basis of their parameters and specifications. This activity is done by taking into consideration the data collected by the assessee itself or from clients. Though the steps/stages involved in completion of a particular assignment for the foreign client has been reproduced by the AO at page 2 of the assessment order, still neither the Assessing Officer nor ld CIT(A) have appreciated these aspects in the right perspective."

8. In the decision of this court, reported as *Commissioner of Income Tax vs. Lovesh Jain* 204 Taxman 134(Del), it was held that:

"10. The word "manufacture" can be given, both a wider as well as a narrower connotation. In wider sense, it simply means to make, fabricate or bring into existence an article or product either by physical labour or by mechanical power. Given a narrower connotation it means transforming of the raw material into a commercial product/commodity or finished product which has a new, separate entity but this does not necessarily mean that the material by which the commodity is manufactured must lose its identity. The latter connotation has been accepted and applied with some moderation/clarification in several decisions, keeping in view the context in which the word "manufacture" has been used. The Supreme Court in Graphic Company India Ltd. v. Collector of Customs [2001] 1 SCC 549 and Union of India v. Delhi Cloth and General Mills Company Limited AIR 1963 SC 791 has held that manufacture has to be understood to mean transformation of goods into a new commodity commercially distinct and separate, and having its own character, use and name whether it be the result of one or several processes. However, every change does not result in "manufacture" though every change in an article may be a result of treatment or manipulation by labour or/and machines. If an operation or process that renders a commodity or article fit for use, which it is

otherwise not fit, the change/process falls within the meaning of the word "manufacture".

9. Besides referring to and following the above decision, the ITAT also cited *Commissioner of Income Tax v. Tara Agencies* [2007] 292 ITR 444 (SC) where the Supreme Court, after noticing that the Act did not define *"manufacture"* turned to the definition of that expression in the Central Excise Act, 1944 The relevant extracts of that decision are as follows:

"11. The term manufacture has not been defined in the Income-tax Act, 1961.

12. The term manufacture has been defined in section 2(f) of the Central Excise Act, 1944. Parts (i) and (ii) of section 2(f) read as under:- 2(f). 'Manufacture' includes any process-

(i) incidental or ancillary to the completion of a manufactured product; and

(ii) which is specified in relation to any goods in the Section or Chapter notes of the Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture".

Referring to *Anheuser-Busch Brewing Assn. v. United States* (1907) 52 L Ed. 336 it was held by the ITAT that the concept of "manufacture" was followed in subsequent American, English and Indian cases. The Supreme Court then held that:

"The definition reads as under: Manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labour and manipulation. But something more is necessary."

10. The ITAT also relied upon a Gujarat High Court decision, in *CIT v. Ajay Printers Pvt. Ltd:* (1965) 58 ITR 811 (Guj) where it was held that "manufacture" has a wider and a narrower connotation:

> *"In the wider sense it simply means to make, or fabricate or bring into existence an article or a product either by physical labour or by power. The word "manufacture" in ordinary parlance would mean a person who makes, fabricates or brings into existence a product or an article by physical labour or power. The other shade of meaning which is the narrower meaning implies transforming raw materials into a commercial commodity or a finished product which has an entity by itself, but this does not necessarily mean that the materials with which the commodity is so manufactured must lose their identity. Thus both the words "manufacture" and "produce" apply as well to the bringing into existence of something which is different from its components. One manufactures or produces an article which is necessarily different from its components."*

11. Section 10B of the Act provides as follows:

> *"10B. (1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee.*
>
> *... .....*
>
> *(2) This section applies to any undertaking which fulfills all the following conditions, namely :--*
>
> *(i) it manufactures or produces any articles or things or computer software;*
>
> *(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence :*

> ... .
>
> *Explanation 2.--For the purposes of this section,--*
>
> *(i) "computer software" means--*
>
> *(a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or*
>
> *(b) any customized electronic data or any product or service of similar nature as may be notified by the Board, which is transmitted or exported from India to any place outside India by any means"*

12. In the two decisions of the Supreme Court, the construction placed on the term "manufacture" was a liberal one. The extracts of those decisions are *Deputy Commissioner of Sales Tax v. M/s. Pio Food Packers,* 1980 Supp. SCC 174:

> *"…commonly manufacture is the end result of one or more processes through which the original commodity is made to pass. The nature and extent of processing may vary from one case to another, and indeed there may be several stages of processing and perhaps a different kind of processing at each stage. With each process suffered, the original commodity experiences a change. But it is only when the change, or a series of changes, take the commodity to the point where commercially it can no longer be regarded as the original commodity but instead is recognized as a new and distinct article that a manufacture can be said to take place."*

Again, in *Aspinwall & Co. Ltd v Commissioner of Income Tax* (2001) 251 ITR 323 it was held as follows:

> *"the word manufacture has not been defined in the Act. In the absence of a definition of the 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 combinations 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 a manufacturing activity."

13. The term "manufacture" is of wide import and in numerous occasions was held by the Supreme Court to include a variety of activities. Thus, refining crude oil (*M/s. B.P. Oil Mills Ltd. vs. Sales Tax Tribunal and others* - AIR 1998 SC 3055); extracting oil from oil-seeds (*the Constitution Bench in Devi Das Gopal Krishnan etc. vs. State of Punjab & others,* AIR 1967 SC 1895,); cutting and shearing of metal scrap for use by rolling mills (*Ashirwad Ispat Udyog & Ors vs State Level Committee & Ors* **(**1998 (8) SCC 85,); conversion of coconut husk into fibres (in *Deputy Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam vs. M/s. Coco Fibres,* AIR 1991 SC 378); lamination of paper (*Laminated Packings (P) Ltd. vs. Collector of Central Excise* (1990) 4 SCC 51), were all held to be activities that qualify as "manufacture". In *M/S. Sonebhadra Fuels vs Commissioner,Trade Tax* (2006) 7 SCC 322 the Supreme Court clarified that the term manufacture is of wide import and that:

"the expression 'manufacture' covers within its sweep not only such activities which bring into existence a new commercial commodity different from the articles on which that activity was carried on, but also such activities which do not necessarily result in bringing into existence an article different from the articles on which such activity was carried on. For example, the activity of ornamenting of goods does not result in manufacturing any goods which are commercially different from the goods which had been subjected to ornamentation, but yet it will amount to manufacture.."

14. In the present case Section 10B uses the expression *"manufactures or produces… things or computer software"*. The four stage process of

compiling material, collating the text, designing the layout, scanning, digital image editing (to remove distortion) and final arrangement of the data, ultimately transmitted according to the customer's specification – and ready to be used for printing, (or even e-Book publication) is undoubtedly manufacture or production.

15. The second question is whether assessee's manufacturing activity described earlier results in "computer software". The main thrust of the revenue's contention here was that final product or "thing" does not answer that description because it is not software *per se*, but mere compilation of data. This court is of opinion that this contention is unpersuasive. The expression "computer software" is wide enough to embrace diverse activities. To eliminate any doubt, the reference to *"customized electronic data"* in the second Explanation to Section 10B (2), Parliament enabled the Board (CBDT) to include (by notification) diverse activities – which involve export of software, etc. The Notification relied on in the present case uses the expressions *"(iii) Content Development or animation (iv) Data Processing… (vii) Human Resources Services"* and *"(ix) Legal Databases"*. Here, the very first head *"content development or animation"* describes the process and is wide enough to cover compilation of material or data and its transformation into a ready to print/ ready to publish book. It is also a *"legal database"*. The expression *"legal"* here cannot be confined to databases that cater to law students or legal practitioners or academics; it is again of wide import to include databases *that are legal – as databases.* This court also notices that the term "computer software" is defined by the Copyright Act, 1957 by Section 2 (ffc) as follows:

> *"(ffc)"computer programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result.."*

In the present case, the work which ultimately results as the culmination of the assessee's efforts of compiling, editing, digital designing, etc. "*is transmitted or exported from India to any place outside India by any means"*. It is, therefore, computer software that are produced or manufactured, to qualify for benefit under Section 10B.

16. For the above reasons, the questions of law framed in this case are answered against the revenue and in favour of the assessee. The appeals are consequently dismissed.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

JANUARY 19, 2015