

Exp. incurred on development of a new product is revenue in nature if product was abandoned: HC

Facts of the case - Principal Commissioner of Income-tax-5 v. Trigent Software Ltd. - [2023] (Bombay)

Assessee-company engaged in the business of software development solutions and management. During the previous assessment years, the assessee incurred expenditure for developing new software and treated it as capital work in progress. Since new software development was abandoned in the relevant assessment year, the assessee claimed the entire expenditure as revenue expenditure under "Exceptional Items". During the assessment proceedings, the Assessing Officer (AO) disallowed such a claim and made additions to income accordingly.

On appeal, CIT (A) deleted the additions made by the AO, which the Tribunal further upheld. The matter then reached the Bombay High Court.

Decision of the case :

- The Court held that there could not be any determinative factor to classify any expense as capital or revenue in nature. Such classification depends upon the facts of the case. However, the "enduring benefit test" can be a conclusive test in the given circumstances. If the benefit arising from any expenditure is only on account of trading operations or enabling the management and conducting the business more efficiently, leaving the fixed capital untouched. In that case, such expenditure is considered revenue in nature.
- Further, if the expenses are incurred for establishing a new business, irrespective of the fact that the expenses are materialised, such expenses are considered capital expenditures. If the expenses are incurred for the expansion of the same business, already carried on by the assessee, and results in creation of new assets. In that case, it will be tantamount to capital expenditures. However, if the expenses do not result in the creation of new assets, such expenses are considered revenue expenditures.
- In the instant case, the assessee was engaged in the business of the development of software. The attempt to develop new software was merely an expenditure for the expansion of the same line of business. Since the product did not materialise, no new asset enduring any benefit to the assessee was generated.
- Therefore, the said expenditure will be considered as revenue expenditure and consequently allowed as a deduction from the taxable income.