



R&D expenditure incurred prior to DSIR approval are eligible for weighted deduction under Section 35(2AB) of the Income-tax Act

Background

Recently, the Delhi High Court in the case of Maruti Suzuki India Limited¹ (the taxpayer) held that Research & Development (R&D) expenditure incurred in earlier years is eligible for weighted deduction under Section 35(2AB) of the Income-tax Act, 1961 (the Act) even though Department of Scientific and Industrial Research (DSIR) approved R&D facility subsequently. For availing the benefit under Section 35(2AB) of the Act what is relevant is not the date of recognition or the cut-off date mentioned in the certificate of the DSIR or even the date of approval but the existence of the recognition. A perusal of Sections 35(2AB), 35A and 35AB of the Act indicates that the purpose behind these provisions is to provide impetus for research, development of new technologies, obtaining patent rights, copyrights and know-how.

The High Court observed that if an R&D centre is not recognised it is not entitled to a deduction, but if it is recognised, it is entitled to the benefit. The auditor's certificate on record is categorical that the taxpayer is maintaining separate sets of accounts for the Gurgaon and the Rohtak centres and the necessary details of the expenditure incurred therein have also been submitted as far back prior to the approval and even thereafter. The taxpayer has fulfilled all the necessary conditions for availing the benefit under Section 35(2AB) of the Act. Therefore, it was eligible for weighted deduction under Section 35(2AB) of the Act.

Facts of the case

- The taxpayer is an automobile company in India. It has two Research & Development centres (R&D centres), one at Gurgaon and one at Rohtak, Haryana. On 30 March 2011, the taxpayer made an application to the DSIR² seeking approval for Rohtak R&D Centre under Section 35(2AB) of the Act.

- On 31 October 2011, the taxpayer filed an application for certification of its R&D expenditure with the DSIR claiming that an expenditure of INR395 crores (which included a sum of INR124.78 crores incurred on the Rohtak R&D Centre) has been incurred for Assessment Year (AY) 2011-12. Though the subject line of this application mentioned the Gurgaon centre, the auditor's report accompanying this application gave the break-up of the expenditure incurred for both the Gurgaon and Rohtak R&D centres separately.
- On 30 March 2012, the taxpayer made an application seeking recognition of Rohtak R&D centre accompanied with a requisite application on Form 3CK of the Income-tax Rules, 1962 (the Rules).
- On 26 April 2013, the DSIR informed the taxpayer that it could not consider the claims for recognition of the Rohtak R&D centre, as the said R&D centre was not yet functional, and hence, the taxpayer's application was closed as being premature.
- On January 2014, the taxpayer again submitted an application, to the DSIR seeking recognition for the Rohtak R&D centre as its 'crash test facility' had become operational from November 2013. In the said application, the taxpayer provided certain details³ of Rohtak R&D centre. This was followed up with a further application on 21 February 2014 giving more details of both its R&D centres. On 26 March 2014, the DSIR granted recognition to both the R&D centres.

¹ Maruti Suzuki India Ltd v. Union of India & Anr (W.P. (C) 9306/2015, dated 4 August 2017) – Taxsutra.com

² DSIR is the prescribed authority for the purpose of claim of deduction under Section 35(2AB) of the Act

³ Lay out plan along with a photograph, break-up of indigenous R&D equipments, imported R&D equipments, etc.

- On 31 March 2014, the taxpayer submitted an application in Form 3CK for AY 2011-12 to the DSIR, for approval of the Rohtak R&D centre and annexed therewith the co-operation agreement executed with the DSIR. On 2 February 2015, the DSIR granted its approval⁴ in respect of the Rohtak R&D centre from 1 April 2013 to 31 March 2015.
- Thereafter, the DSIR granted approval in Form 3CL dated 9 March 2015 for AY 2011-12 in respect of the entire R&D expenditure of INR 391.17 Crores, incurred by the taxpayer. This certification, though certifying the entire R&D expenditure of the taxpayer for AY 2011-12, also gave reference of the Gurgaon R&D centre.
- Since by then the taxpayer's Rohtak R&D centre was accorded recognition by the DSIR, on 26 March 2015, the taxpayer sought a clarification from the DSIR that the total amount claimed as R&D expenditure for the AY 2011-12 was INR 395 Crores, which included a sum of INR 124.78 crores incurred on the Rohtak R&D Centre and sought inclusion of the Rohtak R&D centre in the said certification of expenditure.
- On the basis of various decisions, the taxpayer claimed that since the R&D expenditure was incurred by it in AY 2011-12, it is entitled to a deduction in AY 2011-12 itself and thereafter in subsequent years for both its Gurgaon and Rohtak R&D centres, under Section 35 (2AB) of the Act. The taxpayer also relied upon the guidelines for approval in Form 3CM of in-house R&D centres recognised by the DSIR issued in May 2010.
- The stand of the taxpayer was rejected by DSIR. DSIR has issued a corrigendum dated 7 May 2015 amending and modifying the said Form 3CL dated 9 March 2015, whereby the amount of R&D expenditure eligible for deduction under Section 35(2AB) of the Act, relevant to AY 2011-12, was reduced by the said amount of INR 124.78 crores. The DSIR sent a copy of the same to the Director General, Income-tax (Exemptions) on 11 May 2015.
- The said corrigendum is challenged by the taxpayer seeking for a writ of certiorari or any other writ, setting aside and quashing the impugned corrigendum. The taxpayer claimed that it is entitled to deduction under Section 35(2AB) of the Act in respect of the capital expenditure of INR 124.78 crores incurred on the Rohtak unit during the financial year ended 31 March 2011.
- Thereafter, on 20 November 2015, the Dispute Resolution Panel (DRP) relying on the impugned corrigendum directed that the AO should consider the R&D expenditure of the taxpayer only with respect to its Gurgaon R&D centre. The taxpayer was not entitled to a deduction in respect of the capital expenditure incurred for its Rohtak R&D centre.
- Pursuant to the directions of the DRP, the Assessing Officer (AO) passed an assessment order denying any deduction for the AY 2011-2012, in respect of its Rohtak R&D centre. Similarly, for AY 2012-13 and AY 2013-14, the DSIR disregarded for certification of R&D expenditure. Subsequently, the AO passed an order disallowing the said expenditure.

High Court's decision

- A perusal of the correspondence between the taxpayer and DSIR, it indicates that on 31 October 2011, when the Rohtak R&D centre was still being set up, the taxpayer, while applying for certification of R&D expenditure, had submitted the details about its Rohtak R&D centre to the DSIR, and all the relevant documents were also filed therewith. The auditor's report accompanying the letter dated 31 October 2011, has a clear note and further delineates and differentiates the expenditure for the Rohtak centre in a tabular form.
- It was the DSIR which communicated to the taxpayer on 26 April 2013 that the application for the Rohtak R&D centre was premature. This then led to the filing of a second application. Though, the taxpayer made an error in its application for certification of R&D expenditure, by not mentioning the Rohtak R&D centre in the subject line, from the correspondence, it does not appear that there was any intention to mislead the tax department. The taxpayer has candidly informed the requisite details of both the R&D centres since inception.
- Both the R&D centres have been granted recognition, and the entire R&D expenditure was certified for AY 2011-12, but in the certification dated 9 March 2015, only the Gurgaon R&D centre found a mention. The non-addition of the Rohtak R&D centre and instead deletion of the expenditure incurred on the same by way of issuance of the corrigendum dated 7 May 2015, from the certification dated 9 March 2015, is clearly unsustainable. Such an act on behalf of the DSIR results in completely depriving the taxpayer from claiming deductions of R&D expenditure qua its Rohtak R&D centre.
- The legislative intent behind provision to Section 35(2AB) of the Act is to encourage innovation, research and development in India and non-grant of the benefit under Section 35(2AB) of the Act defeats the legislative intent. The auditor's certificate on record is categorical that the taxpayer is maintaining separate sets of accounts for the Gurgaon and the Rohtak centres and the necessary details of the expenditure incurred therein have also been submitted as far back as on 31 October 2011 and even thereafter.

⁴ In Form 3CM

- Even Form 3CM which was issued by the DSIR under cover letter dated 2 February 2015, states both the Gurgaon and the Rohtak R&D centres. Just because the taxpayer sought a correction in the certificate of expenditure which was issued to it, the complete removal of the R&D expenditure of the Rohtak R&D centre in the certification issued by the DSIR is wholly unsustainable.
- The taxpayer has fulfilled all the necessary conditions for availing the benefit under Section 35(2AB) of the Act in view of the settled position in the case of Sandan Vikas⁵ and Claris Lifesciences⁶. The settled position in law is that, for availing the benefit under Section 35(2AB) of the Act what is relevant is not the date of recognition or the cut-off date mentioned in the certificate of the DSIR or even the date of approval but the existence of the recognition.
- If an R&D centre is not recognised, it is not entitled to deduction, but if it is recognised, it is entitled to the benefit. The Gujarat High Court in Claris Lifesciences has rightly observed that the date of approval of the R&D Centre, not being a part of the provision, extending benefit only from the date of recognition 'amounts to reading more in the law which is not expressly provided'.
- Section 35 (2AB) clearly provides that any expenditure incurred by a party on its R&D facility except, insofar as it relates to land and building is liable to be allowed to be claimed as a deduction (twice the amount of expenditure). A perusal of the scheme of the Act especially Sections 35(2AB), 35A and 35AB reveals in no uncertain terms, that the purpose behind these provisions is to provide the impetus for research, development of new technologies, obtaining patent rights, copyrights and know-how.
- Insofar as the Apollo Tyres⁷ is concerned, in the said case, the taxpayer had omitted to apply for approval under Form 3CK, though recognition was granted to its R&D centre. The said Form 3CK consists of the agreement to be entered into with the DSIR, in Part B. The omission by the taxpayer was held against it and the Delhi High Court held that since the taxpayer had omitted to obtain the approval under Form 3CK, it is not entitled to the benefit of Section 35(2AB) since 2004. However, the facts of the present case are different, and there has been no omission by the taxpayer to obtain approvals. The stage for approval arises after the recognition is granted by the DSIR, for which the application was filed right at inception by the taxpayer. Upon obtaining recognition, which was granted on 26 March 2014, the Form 3CK was filed on 31 March 2014.
- In the present case, there has been no lapse of time, unlike in Apollo Tyres wherein the recognition was granted on 31 March 2004, and the Form 3CK application was made only on 21 August 2008. Thus, the present case is distinguishable from the facts in Apollo Tyres.
- It could be true that there are some errors in the taxpayer's application dated 31 October 2011. However, one cannot ignore that since 2011, the taxpayer has been candid with the DSIR about its expenditure for the Gurgaon and Rohtak R&D centres and has given the break-up of the expenditure incurred thereupon. The taxpayer has submitted the auditor's certificate required for the same. It has entered into an agreement with the DSIR as required for sharing of technologies and also repeatedly requested for certification of the expenditure incurred by it.
- Under such circumstances, an isolated error in an application cannot result in the entire benefit itself being refused to the taxpayer resulting in it being deprived of the deduction as permissible under Section 35(2AB) of the Act.
- The High Court held that the taxpayer is entitled to a deduction under Section 35(2AB) of the Act for the expenditure in respect of its Rohtak R&D centre as per the provisions of Section 35(2AB) for AYs 2011-12, 2012-13 and 2013-14. Accordingly, the corrigendum issued by DSIR, dated 7 May 2015 is set aside, and the DSIR is directed to issue a fresh certification in Form 3CL in respect of the expenditure on scientific research on the Rohtak R&D centre.

Our comments

The claim of weighted deduction on R&D expenditure incurred prior to the grant of approval by DSIR is a subject matter of litigation before the Courts/Tribunal.

The Delhi High court in this decision has held that the taxpayer is entitled to claim a deduction under Section 35(2AB) of the Act in respect of expenditure claim of its Rohtak centre for earlier years even though the approval for recognition was granted subsequently by DSIR. The High Court observed that even though there are some errors in the taxpayer's application, one cannot ignore that for a long time the taxpayer has been following-up with the DSIR about its expenditure for the Gurgaon and Rohtak R&D centres. Further, the taxpayer has given the break-up of the expenditure incurred and has also submitted the auditor's certificate required for the same. The taxpayer had repeatedly requested for certification of the expenditure incurred by it.

⁵ CIT v. Sandan Vikas (India) Ltd [2011] 335 ITR 117 (Del)

⁶ CIT v. Claris Lifesciences Ltd [2010] 326 ITR 251 (Guj)

⁷ Apollo Tyres v. UOI [2010] SCC Online Del 1599

The Delhi High Court while distinguishing its earlier decision in the case of Apollo Tyres observed that in that case, the taxpayer had omitted to apply for approval, though recognition was granted to its R&D centre much earlier. Since the taxpayer had omitted to obtain the approval, it was not entitled to the benefit of Section 35(2AB) since 2004. However, in the present case, there has been no omission by the taxpayer to obtain approvals. The stage for approval arises after the recognition is granted by the DSIR, for which the application was filed right at the inception by the taxpayer.

The present decision indicates that where the taxpayer has made an application to the DSIR, the deduction under Section 35(2AB) cannot be denied even for the earlier years.



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