



## Prior to amendments introduced in the Rules, the weighted deduction under Section 35(2AB) cannot be disallowed based on DSIR certification

### Background

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Cummins India Limited<sup>1</sup> (the taxpayer) held that under the pre-amended provisions<sup>2</sup> where the Research & Development (R&D) facility has been approved by the Department of Industrial and Scientific Research (DSIR), the deduction cannot be denied to the taxpayer under Section 35(2AB) of the Income-tax Act, 1961 (the Act) on the basis of Form No. 3CL<sup>3</sup> issued by DSIR. Once the DSIR has recognised the R&D facility, the Assessing Officer (AO) is to look into and allow the R&D expenditure incurred on the in-house facility as a weighted deduction under Section 35(2AB) of the Act.

The amendment made in Rule 6 of the Income-tax Rules, 1962 (the Rules) with effect from 1 July 2016 requires certification of the amount of expenditure from year to year and the amended Form No. 3CL lays down the procedure to be followed by DSIR. Prior to the aforesaid amendment, no such procedure/methodology was prescribed. Therefore, the AO cannot curtail the expenditure and weighted deduction claim under Section 35(2AB) of the Act on the presumption that DSIR has only approved a part of the expenditure in Form No. 3CL.

### Facts of the case

- The taxpayer is engaged in the business of manufacturing and sale of IC engines. During the Assessment Year (AY) 2009-10, the taxpayer had claimed a deduction of INR38.9 million under Section 35(2AB) of the Act being 150 per cent of expenditure incurred of INR25.94 million.

- The taxpayer claimed that under the provisions of Section 35(2AB) of the Act, DSIR is empowered to approve only an R&D facility and not the expenditure. Once an R&D facility was approved by DSIR in Form No.3CM, then the expenditure incurred by the taxpayer has to be allowed under Section 35(2AB) of the Act.
- The AO had granted short deduction under Section 35(2AB) of the Act by INR6,75,000 based on expenditure approved by DSIR in Form No. 3CL. Subsequently, the Dispute Resolution Panel (DRP) upheld the draft assessment order and accordingly, the AO passed final assessment order granting deduction under Section 35(2AB) of the Act short by INR6,75,000.
- Aggrieved, the taxpayer filed an appeal before the Tribunal.

### Tribunal's decision

- Section 35(2AA) of the Act provides granting of approval by the prescribed authority, but the approval to the expenditure being incurred is missing under the said section. Similar is the position in Section 35(2A) of the Act. Further, in Section 35(2AB), it is provided that a facility has to be approved by DSIR, then there shall be allowed deduction of expenditure incurred whether 100 per cent, 150 per cent or 200 per cent as prescribed from time to time.

<sup>1</sup> Cummins India Limited v. DCIT (ITA No. 309/Pun/2014) – Taxsutra.com

<sup>2</sup> Rule 6 of the Income-tax Rules, 1962 amended with effect from 1 July 2016

<sup>3</sup> Form No. 3CL - Report to be submitted by DSIR to the income tax authority specified under Section 35(2AB) of the Act

- Section 35(2) of the Act provides that no deduction shall be allowed in respect of expenditure mentioned in Section 35(1) under any provisions of the Act. Section 35(3) of the Act further lays down that no company shall be entitled to a deduction under 35(1) of the Act unless it enters into an agreement with DSIR for co-operation in such R&D facility.
- The Finance Act, 2015 with effect from 1 April 2016 has substituted and provided that the facility has to fulfill such condition with regard to maintenance of accounts and audit thereof and for an audit of accounts maintained for that facility.
- Under the Rules<sup>4</sup> it is provided that the approval of expenditure under Section 35(2AB) of the Act shall be subject to the conditions that the facilities do not relate to purely market research, sales promotion, etc. The Rules<sup>5</sup> also provide that DSIR shall submit its report in relation to the approval of in-house R&D facility in Form No. 3CL to the DG (Income-tax Exemption) within sixty days of its granting approval. Under the Rules<sup>6</sup>, the company at the relevant time had to maintain separate accounts for each approved facility, which had to be audited annually.
- These Rules<sup>7</sup> have been substituted by IT (Tenth Amendment) Rules, 2016 with effect from 1 July 2016, whereby DSIR has to furnish electronically its report (i) in relation to approval of in-house R&D facility<sup>8</sup> and (ii) quantifying the expenditure incurred on an in-house R&D facility by the company during the previous year and eligible for weighted deduction under Section 35(2AB) of the Act<sup>9</sup>. In other words, the quantification of expenditure has been prescribed vide amendment in the Rules with effect from 1 July 2016. Prior to this amendment, no such power was with the DSIR<sup>10</sup>.
- Under the amended provisions, besides maintaining separate accounts of R&D facility, a copy of audited accounts have to be submitted with DSIR
- The Gujarat High Court in the case of Claris Lifesciences Ltd.<sup>11</sup> has held that weighted deduction is to be allowed under Section 35(2AB) of the Act after the establishment of the facility. However, the section does not mention any cut-off date or particular date for eligibility to claim the deduction. Similarly, the Delhi High Court in the case of Sandan Vikas (India) Ltd.<sup>12</sup> taking note of the decision of the Gujarat High Court observed that cut-off date mentioned in the certificate issued by DSIR would be of no relevance where once the certificate was issued by DSIR. It was sufficient to hold that the taxpayer had fulfilled the conditions laid down in the aforesaid provisions.
- Prior to the amendment, the provisions of the Rules stipulate the filing of audit report before DSIR by the persons availing the deduction under Section 35(2AB) of the Act. However, it did not prescribe any methodology of approval to be granted by DSIR vis-à-vis expenditure from year to year.
- The amendment made in the Rules with effect from 1 July 2016 requires certification of the amount of expenditure from year to year and lays down the procedure to be followed by DSIR<sup>13</sup>. Prior to the aforesaid amendment in 2016, there was no such procedure. In the absence of the same, there is no merit in the order of AO in curtailing the expenditure and consequent weighted deduction claim under Section 35(2AB) of the Act on the presumption that DSIR has only approved part of the expenditure in Form No.3CL.
- The Courts have held that for deduction under Section 35(2AB) of the Act, the first step was the recognition of taxpayer by the DSIR and entering an agreement between the taxpayer and DSIR. Once such an agreement has been executed, under which recognition has been given to the facility, then thereafter the role of the AO is to look into and allow the expenditure incurred on in-house R&D facility as a weighted deduction under Section 35(2AB) of the Act.
- Accordingly, the Tribunal held that the AO cannot curtail the expenditure claimed as deduction under Section 35(2AB) of the Act.

<sup>4</sup> Sub-rule (7A)

<sup>5</sup> Rule 6 - Clause (b) to sub-rule (7A) at the relevant time

<sup>6</sup> Rule 6 - Under clause (c) to sub-rule (7A)

<sup>7</sup> Rule 6 - Clause (b) to sub-rule (7A)

<sup>8</sup> In part A of form No. 3CL

<sup>9</sup> In part B of Form No.3CL

<sup>10</sup> Under the amended rules, DSIR in part A give approval of the facility and in part B quantify the expenditure eligible for deduction under Section 35(2AB) of the Act.

<sup>11</sup> CIT v. Claris Lifesciences Ltd. [2010] 326 ITR 251 (Guj)

<sup>12</sup> CIT v. Sandan Vikas (India) Ltd. [2011] 335 ITR 117 (Del)

<sup>13</sup> The amended Form No. 3CL

## Our comments

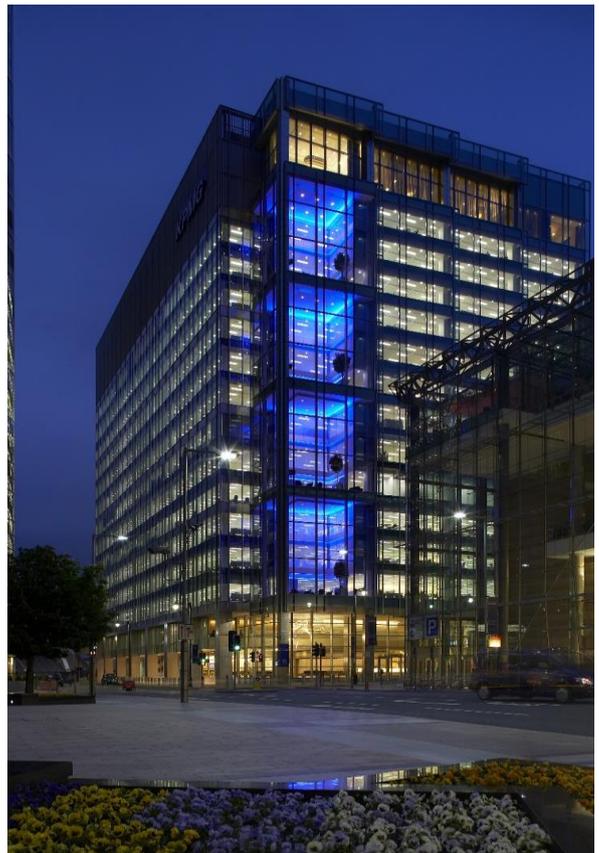
The issue with respect to whether DSIR has the authority to decide the quantum of R&D expenditure entitled to a weighted deduction under Section 35(2AB) of the Act has been a matter of debate before the Courts/Tribunal.

The Hyderabad Tribunal in the case of Electronics Corporation of India Ltd<sup>14</sup> held that the expenditure approved by DSIR in the certificate given by them in Form 3CL alone was to be granted as a weighted deduction. Therefore, neither the tax officer nor the appellate authority can decide on the expenditure which will be entitled to a weighted deduction under Section 35(2AB) of the Act. However, the Mumbai Tribunal in case of Wockhardt Limited<sup>15</sup> held that for the purpose of claiming benefit under Section 35(2AB) of the Act, only the expenditure incurred on scientific research on in-house R&D facility should be allowed without considering the adjustment prescribed by the DSIR.

The Karnataka High Court in the case of Tejas Networks Limited<sup>16</sup> held that where DSIR has certified R&D related expenditure under Section 35(2AB) of the Act, the AO would be out of bounds to examine as to whether such expenditure as certified by DSIR can be allowed or disallowed under Section 35 of the Act. The allowability or otherwise of such expenditure cannot be the subject matter of scrutiny by the AO.

The Pune Tribunal in the present case has held that prior to the amendments made in the Rules with effect from 1 July 2016, the AO cannot curtail the expenditure and consequent weighted deduction claim under Section 35(2AB) of the Act on the presumption that DSIR has only approved part of the expenditure in Form No.3CL.

The present decision was prior to 2016. However, with effect from 2016 the Rules have been amended to provide that DSIR shall furnish its report electronically in relation to the approval of in-house R&D facility, quantifying the expenditure incurred on in-house R&D facility by the company during the previous year and eligible for weighted deduction under Section 35(2AB) of the Act in Form No. 3CL.



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<sup>14</sup> Electronics Corporation of India Ltd. v. ACIT (ITA No. 1106/Hyd/2011) (Hyd)

<sup>15</sup> Wockhardt Limited (2010-TIOL-606-ITAT-MUM) (Mum)

<sup>16</sup> Tejas Networks Limited v. DCIT (Writ Petition No. 7004/2014) (Kar)

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