

TAX FLASH NEWS

17 May 2019

Scientific research expenditure for the period prior to the approval under Section 35(2AB) of the Income-tax Act is eligible for weighted deduction

Recently, the Madras High Court in the case of TVS Electronics Ltd¹ (the taxpayer) allowed the weighted deduction under Section 35(2AB) of the Income-tax Act, 1961 (the Act) on the scientific research expenditure relating to the period prior to the approval granted by the prescribed authority² under Section 35(2AB) of the Act. The High Court observed that the taxpayer cannot be punished for the bureaucratic delay in giving such approval for the year in question, which was in the hands of the department concerned of the Central Government itself. For the prior as well as the post period to the year in question, such approval was very well on the record of the tax department. Therefore, the weighted deduction for the expenditure incurred on the scientific research could not be disallowed by the tax department. Accordingly, the Tribunal rightly held that such scientific research expenditure was allowed under Section 35(2AB) of the Act.

Facts of the case

The taxpayer made an application for an approval of Research and Development (R&D) facility under Section 35(2AB) of the Act. With this application, the taxpayer also enclosed Form 3CK³ along with a detailed note of R&D facility and activity. Further, during the assessment, the taxpayer furnished Form 3CM⁴ approving the in-house R&D facility under Section 35(2AB) of the Act. This approval was dated 19 February 2004 under which reference to the taxpayer's application dated 15 December 2003 was mentioned. It was also

mentioned that the approval was from 1 April 2003 to 31 March 2005. However, in the present case, the relevant Assessment Year (AY) was 2003-04.

The taxpayer contended that the projects in connection with which the expenditure had been incurred require a longer period. Under such circumstances, it was not possible that a part of the same project duration will get weighted deduction while some part will not get the necessary deduction. The taxpayer relied on the decision of Ahmedabad Tribunal in the case of Claris Lifesciences Ltd⁵ for the proposition that once the facility is approved, the entire expenditure incurred on development of R&D facility has to be allowed for weighted deduction. The deduction cannot be restricted only to the expenditure incurred after the date of approval.

The Tribunal held that such scientific research expenditure was allowable under Section 35(2AB) of the Act. The said approval was effective from 1 April 2003 to 31 March 2005. The Tribunal held that approval received for the subsequent years as such should be looked into for earlier years on a retrospective basis.

The tax department contended that since the taxpayer did not produce the requisite approval of the scientific research undertaken for the period in question though such approval was available for the period prior to AY 2003-2004 and for the period subsequent to it, the mandatory condition of producing the approval for the AY in question was not complied with by the taxpayer and, therefore, the Tribunal was incorrect in allowing weighted deduction of expenditure under Section 35(2AB) of the Act.

¹ CIT v. TVS Electronics Ltd [2019] 105 taxmann.com 36 (Mad)

² The Department of Scientific and Industrial Research (DSIR)

³ Form No. 3CK – Application form for entering into an agreement with DSIR for in-house R&D facility and audit of accounts

⁴ Form Ni. 3CM – 'Order of approval of in-house R&D facility under Section 35(2AB) of the Act' issued by DSIR to the taxpayer as well as to the Director General (Income-tax exemption)

⁵ Claris Lifesciences Ltd v. ACIT [2008] 111 TTTJ 902 (Ahd)

High Court decision

The High Court did not agree with the tax department's stand on the allowability of weighted deduction to the taxpayer under Section 35 (2AB) of the Act since the requisite approval for the project on which expenditure was incurred by the taxpayer was approved for the period prior and even subsequent to Assessment Year 2003-2004. The condition of approval stood substantially complied with.

The taxpayer cannot be punished for the bureaucratic delay in giving such approval for the year in question, which was in the hands of the department concerned of the Central Government itself. For the prior as well as the post period to the year in question, such approval was very well on the record of the tax department. Therefore, the weighted deduction for the expenditure incurred on the scientific research could not be disallowed by the tax department. Accordingly, the Tribunal rightly held that such scientific research expenditure was to be allowed under Section 35(2AB) of the Act.

Our comments

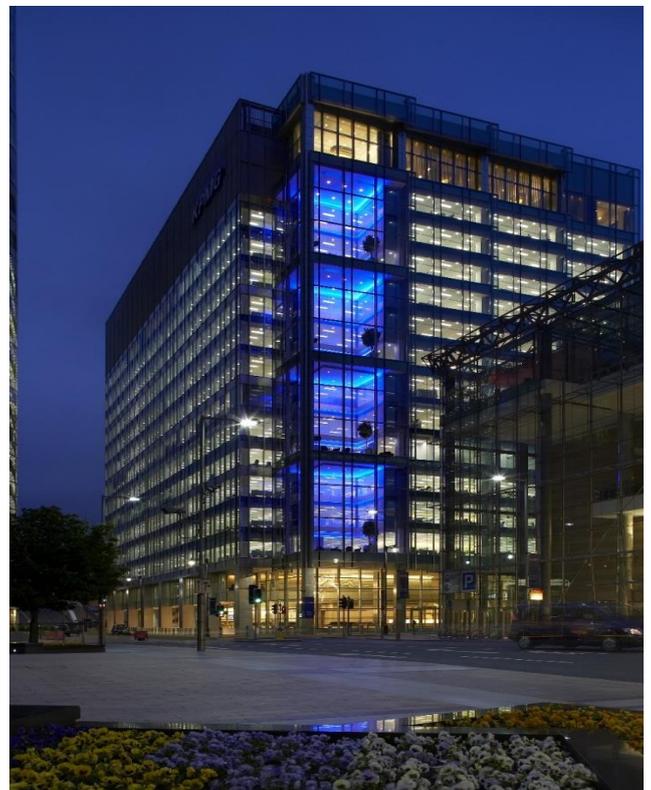
The issue with respect to the claim of weighted deduction on R&D expenditure for the period prior to DSIR approval under Section 35(2AB) of the Act has been a matter of debate before the Court/Tribunal.

The Gujarat High Court in the case of Claris Lifesciences Ltd.⁶ held that the provisions of Section 35(2AB) of the Act nowhere suggest or imply that R&D facility is to be approved from a particular date. In other words, it is nowhere suggested that date of approval only will be cut-off date for the eligibility of weighted deduction on the expenditure incurred from that date onwards. Thus, the entire expenditure incurred by the taxpayer on the development of R&D facility, if approved, has to be allowed for the purpose of weighted deduction. Similarly, the Delhi High Court in the case of Sandan Vikas (India) Ltd.⁷ taking note of the decision of the Gujarat High Court observed that that the taxpayer was eligible to claim weighted deduction on in-house R&D expenditure from the year in which the taxpayer made an application to the DSIR. The High Court observed that the provisions of the Act do not suggest or imply that the cut-off date mentioned in the certificate issued by DSIR will be the cut-off date for the eligibility of weighted deduction on the expenditure incurred on in-house R&D facility to avail benefit of Section 35(2AB) of the Act.

In the present case, the Madras High Court allowed expenditure on scientific research relating to the period prior to the approval under Section 35(2AB) of the Income-tax Act.

As per amended Rule 6⁸ of the Income-tax Rules, 1962 (the Rules), DSIR shall furnish its report 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.

Assuming DSIR may not quantify the expenditure for the period prior to such approval. In such a situation, the tax officer may not allow the prior period R&D expenditure by relying on the Karnataka High Court's decision in the case of Tejas Networks Limited⁹, especially post amendment to Rule 6 of the Rules.



⁸ CBDT Notification No. 29/2016, dated 28 April 2016

⁹ Tejas Networks Ltd. v. DCIT [2015] 60 taxmann.com 309 (Kar)

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

⁷ CIT v. Sandan Vikas (India) Ltd. [2011] 335 ITR 117 (Del)

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