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TAX FLASH NEWS

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Prior to amendments introduced in the Rules, the weighted deduction on R&D expenditure under Section 35(2AB) of the Income-tax Act cannot be curtailed based on DSIR certification

Recently, the Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Crompton Greaves Ltd[1] (the taxpayer) held that under the per-amended provisions[2] 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[3] issued by DSIR.

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

During the Assessment Year (AY 2009-10), the taxpayer incurred in-house scientific research expenditure (capital and revenue) and claimed weighted deduction on the same under Section 35(2AB) of the Act. The said expenditure was incurred for a specific unit of the company and the unit was approved by the DSIR, in Form No. 3CM[4] as per the requirements of Section 35(2AB) of the Act for the period from 28 August 2007 to 31 March 2009.

The auditor of taxpayer certified the genuineness of the said expenditure and its eligibility for weighted deduction under Section 35(2AB) of the Act. The DSIR in Form No. 3CL has quantified the eligible expenditure at INR110.46 million as against INR113.29 million claimed by the taxpayer.

The AO after verifying Form No. 3CM and 3CL observed that the eligible amount as noted by DSIR was less as compared to the deduction claimed by the taxpayer and subsequently disallowed the difference on this basis. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

On reference to Section 35(2AB) of the Act, the Tribunal observed that the operative phrase in the said Section is 'on in-house research and development facility as approved by the prescribed authority'. It is the unit which requires approval of the prescribed authority under the provision. Further, in the Memorandum, explaining the provision of section and the notes on the clauses issued at the time of insertion of Section 35(2AB) in the Act it has been provided that the deduction would be available to the taxpayer's having an approved in-house R&D facility by the prescribed authority. Undisputedly, there was no mention or approval of the quantum of expenditure.

The Ahmedabad Tribunal in the case of Sun Pharmaceutical Industries Ltd.[5] held that the objective of Form 3CL is limited to the forwarding of the intimation of the approval of the unit. Form No. 3CL is

[1] ACIT v. Crompton Greaves- [2019] 111 taxmann.com 338 (Mum)
[2] Rule 6 of Income-Tax Rules, 1962 amended with effect from 1 July 2016
[3] Form No. 3CL - Report be submitted by DSIR to the Income-tax authority specified under Section 35(AB) of the Act.
[4] Form No. 3CM - Order of approval of in-house R&D facility under Section 35(2AB) of the Act

[5] Sun Pharmaceutical Industries Ltd v. Pr.CIT [2017] 162 ITD 484 (Ahd) as affirmed by the Gujarat High Court 250 Taxman 270 (Guj)

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a mere report for intimation of approval of R&D facility. Such aspect stands confirmed by sub-rule (7A) of Rule 6 of Income-tax Rules, 1962 (the Rules) as within subsisting (now amended with effect from 1 July 2016), to provide for quantification of expenditure as well. The Finance Act, 2015 amended Section 35(3) with effect from 1 April 2016, providing for furnishing of reports in the manner to be prescribed. It is, thus, with effect from 1 April 2016 the provision has been made for approval of quantum of expenditure, for the first time.

The Pune Tribunal in the case of Cummins India Ltd.[6] held that 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 was brought in by the Rules with effect from 1 April 2016 wherein, a separate part has been inserted for certifying the amount of expenditure from year to year and the amended Form No. 3CL. It lays down the procedure to be followed by the prescribed authority and prior to the said amendment, no such procedure; methodology was prescribed. Therefore, in the absence of any such procedure or methodology, the expenditure cannot be curtailed, and consequent weighted deduction claimed under Section 35(2AB) of the Act cannot be denied on the summon that the prescribed authority had approved the part of the expenditure in Form No. 3CL.

On perusal of the provisions substituted in Rule 6(7A)(b), as brought in by the amendment effective from 1 July 2016, it indicates that prior to the amendment, i.e., upto 30 June 2016, it was not required to quantify the expenditure and it was only with effect from 1 July 2016 that this mandate has been put in place.

In the present case, the aforesaid amendment was not applicable. Therefore, the non-approval of the expenditure by DSIR does not entitle the tax authority to make the disallowance. Consequently, disallowance made under Section 35(2AB) of the Act was to be deleted.

Our comments

The issue 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 Mumbai Tribunal in case of Wockhardt Limited[7] 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.

However, the Hyderabad Tribunal in the case of Electronics Corporation of India Ltd[8] 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.

The Karnataka High Court in the case of Tejas Networks Limited[9] 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.

Subsequently, Rule 6 has been amended to provide that with effect from 1 July 2016, DSIR shall quantify the amount of expenditure for weighted deduction under Section 35(2AB) of the Act.

The Mumbai Tribunal in the present case has held that prior to amendment in Rule 6, where the R&D facility has been approved by the DSIR, the deduction cannot be denied to the taxpayer under Section 35(2AB) of the Act on the basis of Form No. 3CL issued by DSIR.

[6] Cummins India Ltd. v. DCIT [2018] 96 Taxmann.com 576 (Pune)

[7] Wockhardt Limited (2010-TIOL-606-ITAT-MUM) (Mum)
[8] Electronics Corporation of India Ltd. v. ACIT (ITA No. 1106/Hyd/2011) (Hyd)
[9] Tejas Networks Limited v. DCIT (Writ Petition No. 7004/2014) (Kar)

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