Since R&D facility is approved by DSIR and the taxpayer has complied with the prescribed rules, the AO is bound to allow weighted deduction under Section 35(2AB) of the Income-tax Act

Background

Recently, the Visakhapatnam Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Efftronics Systems Pvt. Ltd1 (the taxpayer) held that the Assessing Officer (AO) is not competent to take any decision relating to claim made by the taxpayer under Section 35(2AB) of the Income-tax Act, 1961 (the Act). The Department of Scientific and Industrial Research (DSIR) alone would be competent to take decision with regard to the correctness or otherwise. Once, the Research and Development (R&D) facility is approved by DSIR and the taxpayer has complied with the prescribed rules, the AO is bound to allow the weighted deduction claimed under Section 35(2AB) of the Act.

Facts of the case

- The taxpayer is in the business of manufacturing and supply of moving display boards, data loggers and electronic systems, etc. to Indian Railways.

- During the course of assessment proceedings, the AO observed that the taxpayer has claimed weighted deduction under Section 35(2AB) of the Act, towards R&D expenditure incurred in their in house R&D facility.

- The taxpayer claimed that it has set up a research and development facility which was approved by DSIR under the provisions of Section 35(2AB) of the Income-tax Act, 1961 (the Act). Goods manufactured by it has been supplied to Indian Railways and Indian Railways is using these products to control and monitor smooth movement of trains and also display of arrival and departure details of trains.

- These equipments were manufactured as per the design supplied by the Research Designs and Standard Organization (RDSO) of the Indian Railways and these equipments were specifically designed for the purpose of Indian Railways.

- The facility has been approved by DSIR after satisfied with the conditions prescribed under the provisions of Section 35(2AB) of the Act, therefore, it has rightly claimed weighted education of 200 per cent under Section 35(2AB) of the Act.

- The AO held that the taxpayer is involved in manufacturing of goods listed in Eleventh Schedule, therefore, it is not eligible to claim deduction under the provisions of section 35(2AB) of the Act.

- Even if an taxpayer’s in house R&D facility approved by the competent authority, but if such taxpayer is involved in manufacture or production of an article or thing as specified in 11 schedule it makes the taxpayer ineligible for making any claim under Section 35(2AB) of the Act.

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1 Efftronics Systems Pvt. Ltd v. ACIT [ITA No.188/Vizag/2015] – Taxsutra.com
Tribunal's ruling

- The taxpayer indigenously developed microprocessor based data logger system with various application softwares for railway signaling, etc. and this data logger is similar to aircraft black box. The data loggers records every event happening in the railways, i.e. operating suits of all these log tracks, points, signals, etc., reads the information to Central place via various types of indication intervention lock wire or wireless and through different interlock methods and at central place.

- This has tremendously improved safety, reliability and punctuality in railways, therefore, the items manufactured by the taxpayer cannot be considered as mere office machines and apparatus as defined under Eleventh schedule.

- Though, the explanations provided to Eleventh schedule, defines office machines and apparatus includes all machines and apparatus used in office establishments, factories, workshops, educational institutions, railway stations for doing office work and for data processing, the items manufactured by the taxpayer cannot be equated with mere data processing machines installed in offices or railway stations.

- The items manufactured by the taxpayer are specialised electronic equipments which needs continuous improvement by way of R&D.

- The taxpayer in his business has established a R&D facility to improve the quality and efficiency of goods manufactured. The R&D facility owned by the taxpayer has been approved by DSIR after fulfilling the conditions prescribed under the provisions of Section 35(2AB) of the Act. Therefore, the AO was not correct in holding that the goods manufactured by the taxpayer are mere office machines or apparatus listed in Eleventh schedule. Therefore, the AO is not correct in disallowing the claim made by the taxpayer under Section 35(2AB) of the Act.

- The Tribunal observed that it is for DSIR to send the approval to the DGIT within such time as prescribed under the rules. In case such approval is not forwarded to the DGIT, it is only a technical mistake for which the taxpayer cannot be penalised. The taxpayer has fulfilled the conditions prescribed under the provisions of Section 35(2AB)(1) of the Act and rules there under, therefore for a technical breach the AO cannot disallow the exemption claimed under Section 35(2AB) of the Act.

- Considering the facts and circumstances of this case and relying on the various decisions\(^2\), the Tribunal observed that the AO was erred in disallowing the weighted deduction claimed by the taxpayer under the provisions of Section 35(2AB)(1) of the Act, despite the taxpayer’s R&D facility was approved by DSIR.

\[^2\] Tejas Networks Ltd. v. DCIT [2015] 233 Taxman 426 (Kar), DCIT v. Famy Care Ltd. [2015] 67 SOT 85 (Mum), DCIT v. Mastek Ltd. [2013] 263 CTR 671 (Gu)
Our comments

The issue with respect to allowability of weighted deduction under Section 35(2AB) of the Act has been a subject matter of debate before the Courts/Tribunal. The Courts\(^3\) have held that DSIR has the authority to decide the quantum of R&D expenditure entitled to the weighted deduction under Section 35(2AB) of the Act. The AO does not have the authority to modify viz. enhance or reduce the quantum of R&D expenditure as determined by DSIR, which is eligible for deduction. On the other hand, the Mumbai Tribunal in case of Wockhardt Limited\(^4\) held that DSIR does not have the authority to quantify the R&D expenditure eligible for weighted deduction under Section 35(2AB) of the Act.

In the instant case, the Visakhapatnam Tribunal relying on various decisions held that once the R&D facility is approved by DSIR and the taxpayer has complied with the prescribed rules, the AO is bound to allow the weighted deduction claimed under Section 35(2AB) of the Act. The AO is not the competent authority to take decision on such claim.

In April 2016, CBDT\(^5\) amended Rule 6 of the Rules to provide that DSIR shall furnish electronically its report 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.

\(^1\) Electronics Corporation of India Ltd. v. ACIT (ITA No. 1106/Hyd/2011), Apollo Tyres Ltd v. Union of India [WP (C) 13338/2009 – Del], Tejas Networks Ltd. v. DCIT [2015] 60 taxmann.com 309 (Kar)
\(^2\) Wockhardt Limited (2010-TIOL-606-ITAT-MUM) (Mum)\(^5\)
\(^3\) CBDT Notification No. 29/2016, dated 28 April 2016