

TAX FLASH NEWS

R&D expenditure certified by DSIR cannot be examined by the tax officer for allowability of such expenditure for the purpose of weighted deduction under Section 35(2AB) of the Income-tax Act

Background

Recently, the Karnataka High Court (High Court) in the case of Tejas Networks Limited¹ (the taxpayer) held that where the Department of Scientific and Industrial Research (DSIR/the prescribed authority) has certified Research and Development (R&D) related expenditure under Section 35(2AB) of the Income-tax Act, 1961 (the Act), the Assessing Officer (AO) would be out of bounds to examine 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 High Court observed that Section 35(3) of the Act indicates that where the AO does not accept the claim of the taxpayer made under Section 35(2AB) of the Act, the AO has to refer the matter to the Central Board of Direct Taxes (CBDT), which in turn, will refer the question to the prescribed authority. The decision of the prescribed authority would be final.

Facts of the case

- The taxpayer is engaged in the business of software development, manufacturing and trading of networking equipments. During the Assessment Year (AY) 2009-10, the taxpayer claimed deduction under Section 35(2AB) of the Act in respect of R&D expenditure. Further, the taxpayer also claimed deduction under Section 35(1)(i) of the Act.
- The AO disallowed a part of the expenditure claimed by the taxpayer.

- The Dispute Resolution Panel (DRP) held that allowability or otherwise of the expenditure will be governed by the express provisions of the Act. The certificate issued by the prescribed authority cannot overrule the express provision of the Act. The mandate of the prescribed authority is limited to certifying to what extent any activity constituted, or any asset is or was being used, fit, for scientific research. Accordingly, such expenditure cannot be allowed under Section 35 of the Act.
- As per the direction of DRP, the AO disallowed the deduction claimed by the taxpayer under Section 35(2AB) of the Act to the extent of INR480 million as against the total deduction of INR890 million claimed by the taxpayer.
- Aggrieved by the order of the AO, pursuant to the DRP's direction, the taxpayer filed a writ petition before the High Court.

High Court's ruling

Maintainability of a writ petition

- The High Court has discretion to entertain or not to entertain a writ petition. However, availability of alternate remedy would be the normal rule for the High Court to refuse to exercise its jurisdiction under Article 226 of the Constitution of India.
- It is not an inviolable rule and the availability of an alternate remedy would not act as a bar for the High Court to exercise the extraordinary power.
- The self imposed judicial restraint, one of which is that of availability of alternate remedy would be a reason for the court not to issue prerogative writs. Exceptions to this general principles are (i) for enforcement of fundamental rights (ii) violation of

¹ Tejas Networks Limited v. DCIT (Writ Petition No. 7004/2014) (Kar) – Taxsutra.com

principles of natural justice (iii) where the order or proceedings under challenge is attacked or being vitiated on the grounds of such authority acting without jurisdiction and (iv) where constitutional validity of a provision in a statute or the statute itself is under challenge.

- The Supreme Court in the case of Whirlpool Corporation² had held that the exercise of jurisdiction by the High Court to entertain a writ petition under Article 226 of the Constitution of India in spite of availability of alternative statutory remedies is not affected, where the authority against whom the writ is sought for is shown to have exercised its jurisdiction, which it had none or had usurped the jurisdiction without any legal foundation.
- When the issue of jurisdiction is under consideration, it cannot be held that writ petition is not maintainable at the threshold. Therefore, subject to the ruling on weighted deduction under Section 35(2AB), the High Court would rule on maintainability of the writ filed by the taxpayer.
- In the present case, the AO had no jurisdiction to sit in judgment over the report submitted by the prescribed authority under Section 35(2AB) of the Act read with Rule 6(7A)(b) of the Income-tax Rules, 1962 (the Rules). Therefore, it was held that the issue of entertaining writ petition on the grounds of alternate remedy would recede to the background. Accordingly, it was held that writ petition was maintainable and cannot be dismissed on the grounds of the petitioner having an alternate remedy of appeal.

Disallowance under Section 35(2AB) of the Act

- As per Rule 6(1B) of the Rules, it would be clear that the prescribed authority for the purpose of Section 35(2AB) is the Secretary, DSIR. The prescribed authority would examine the claim for grant of approval under Section 35(2AB) of the Act.
- On reference to the facts of the present case, it indicates that the application had been filed by the taxpayer with the DSIR for the benefit of Section 35(2AB) of the Act and after calling for documents/information from the taxpayer, and on examination and scrutiny of such documents/information furnished by the taxpayer, the DSIR had granted order of approval in favour of the taxpayer.
- Perusal of Section 35(3) of the Act indicates that where the AO does not accept the claim of the taxpayer made under Section 35(2AB) of the Act, the AO has to refer the matter to the CBDT, which in turn will refer the question to the prescribed authority. The decision of the prescribed authority would be final.

- Neither the AO nor the CBDT is competent to take any decision on any such controversy relating to report and approval granted by the prescribed authority. It is the prescribed authority alone to take a decision with regard to correctness of expenditure under Section 35(2AB) of the Act read with Rule 6(7A) of the Rules.
- The aforesaid view is also fortified by the Gujarat High Court in the case of Mastek Limited³ wherein it was held that whenever a question arises as to whether any activity constitutes or any asset is or was being used for scientific research, the CBDT would have to refer the issue to the prescribed authority whose decision would be final.
- A plain reading of Section 35(2AB) of the Act would clearly indicate that where a company is engaged in the prescribed business, they shall be allowed a deduction of a sum equal to one and a half times of the expenditure so incurred. The word 'shall' used in the relevant provisions would mean that it should be understood in the context in which it is used and there cannot be departure in this regard. The said provision would also indicate that such expenditure as approved by the prescribed authority would be allowed as a weighted deduction.
- There was no dispute to the fact that the DSIR being the prescribed authority in the instant case had issued the report. When the prescribed authority had certified the extent of expenditure which would be allowable, the AO could not sit in the judgment over such certification made by the prescribed authority.
- The allowability or otherwise of such expenditure cannot be the subject matter of scrutiny by the AO. The AO would be out of bounds to examine as to whether such expenditure can be allowed or disallowed under Section 35 of the Act.
- The AO is precluded from examining the correctness or otherwise of the certificate issued by the prescribed authority on the grounds that it is either being contrary to facts or contrary to the express provisions of the Act.
- When the taxpayer files the report issued by the prescribed authority under Section 35(2AB) before the jurisdictional AO and seeks for allowability of such expenditure, the AO should not examine the correctness of the certificate issued by the prescribed authority.

² Whirlpool Corporation v. Registrar of Trade Marks and Mumbai [1998] 8 SCC 1

³ DCIT v. Mastek Limited [2013] 263 CTR 671 (Guj)

- The decision of the prescribed authority in this regard would be final, in as much as, the certification of such expenditure is being examined by an expert body. Such exercise has been outsourced by the tax department under the Act itself. Since the prescribed authority possessed the requisite expertise, it would be in a better position to decide as to whether expenditure claimed by the taxpayer under Section 35(2AB) would fall within the said provision or not.

Our comments

The allowability of R&D related expenditure under Section 35(2AB) of the Act on the basis of DSIR certificate has been a subject matter of litigation before the Courts/Tribunal. The Hyderabad Tribunal in the case of Electronics Corporation of India Ltd⁴ held that the expenditure approved by the DSIR in the certificate given by them in Form 3CL alone was to be granted as weighted deduction. Therefore, neither the tax officer nor the appellate authority can decide on the expenditure which will be entitled to weighted deduction under Section 35(2AB) of the Act. However, the Mumbai Tribunal in case of Wockhardt Limited⁵ 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.

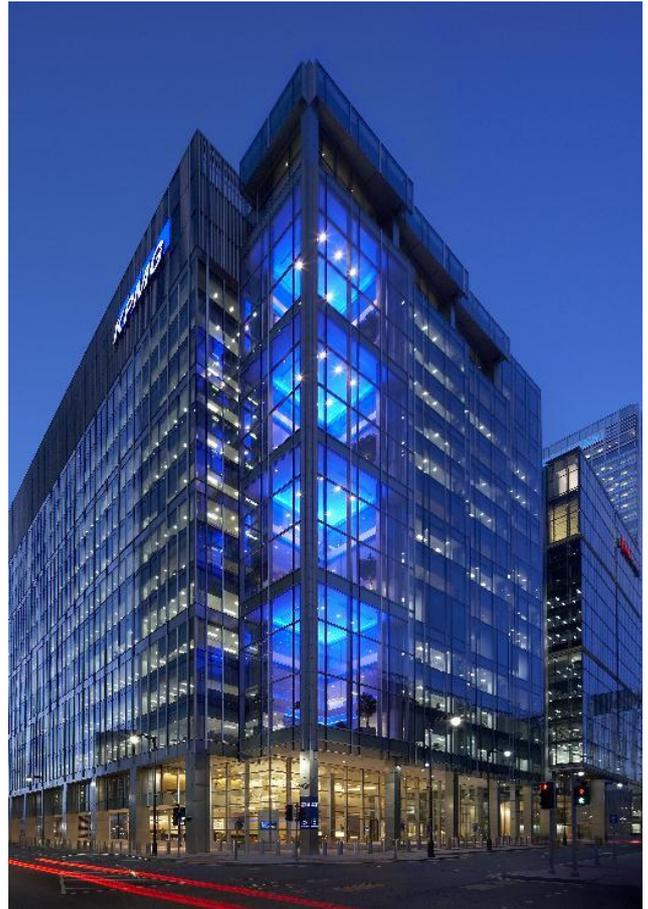
The Gujarat High Court in the case of Cadila Healthcare Ltd⁶ observed that merely because the prescribed authority segregated the expenditure into two parts, namely, those incurred within the in-house facility and those that were incurred outside by itself would not be sufficient to deny the benefit under Section 35(2AB) of the Act. It is not as if that the said authority was addressing the issue for deduction under Section 35(2AB) of the Act. The certificate issued was only for the purpose of listing the total expenditure under the Rules.

In this case, the High Court has relied on the decision of Mastek Limited wherein it was held that whenever a question arises as to whether any activity constitutes or any asset is or was being used for scientific research, the CBDT would have to refer the issue to the prescribed authority, whose decision would be final. The High Court 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.

⁴ Electronics Corporation of India Ltd. v. ACIT (ITA No. 1106/Hyd/2011) (Hyd)

⁵ Wockhardt Limited (2010-TIOL-606-ITAT-MUM) (Mum)

⁶ CIT v. Cadila Healthcare Ltd [2013] 31 taxmann.com 300 (Guj)



Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2015 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International Cooperative ("KPMG International").

This document is meant for e-communications only.

© 2015 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.