



Global Business Tax Alert Sharp Insights

Karnataka High Court rules that the DSIR is the final authority to decide whether or not, an activity constitutes scientific research

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In this issue:

- Synopsis
- Facts
- Issue before the High Court
- Ruling of the High Court
- Comments
- Upcoming Dbriefs – Register
- Contacts

Synopsis

The Karnataka High Court ('the High Court') has held that the Department of Scientific and Industrial Research ('DSIR') is the prescribed final authority to decide whether an activity constitutes scientific research in order for expenses incurred on such activity to be eligible for weighted deduction under section 35(2AB) r.w.s. 43(4) and 35(3) of the Income-tax Act, 1961 ('the Act').

Facts

- Tejas Networks Limited ('taxpayer') is a public limited company engaged in software development, manufacturing and trading of networking equipments. For Assessment Year 2009-10, the tax payer filed the return of income claiming weighted deduction under section 35(2AB) of the Act with respect to Product Development expenditure.
- In support of the deduction claimed, taxpayer submitted the report obtained from DSIR in Form 3CL. The assessee contended that Form 3CL is issued by prescribed authority (i.e. DSIR) and the assessing officer ("AO") is out of bounds to examine its correctness.
- The AO disallowed the deduction under section 35(2AB) without considering Form 3CL contending that the approval given by DSIR is not the sole condition to claim deduction.
- On appeal, the Dispute Resolution Panel ('DRP') upheld the contention of the AO. The DRP held that the certificate of the DSIR cannot overrule the express provisions of the Act and held that when certain expenditure does not come under the purview of section 35, the report of DSIR cannot be considered for such excluded expenditure.
- Aggrieved by the observations of the AO and the DRP, the taxpayer filed a Writ Petition before the High Court under Article 226 and Article 227 of the Constitution of India.

Issue before the High court

- Whether the AO and the DRP have jurisdiction to decide on the allowability of deduction under section 35(2AB) beyond the approval and report issued by DSIR?

Ruling of the High Court

- The AO is precluded from examining the correctness or otherwise of the certificate issued by the DSIR because that will be contrary to the provisions of the Act.
- The High Court referred to the provisions of section 35(3) of the Act which provides that in case any question arises as to whether, and if so, to what extent, any activity constitutes or constituted scientific research, the Central Board of Direct Taxes ('CBDT') **shall** refer such question to the prescribed authority (being the DSIR). The decision of the prescribed authority **shall** be final.
- The word "**shall**" in the above said provision would ordinarily mean that it should be understood in the context in which it is used and there cannot be departure in this regard.
- Referring to the provisions of section 35(3) of the Act, the High Court has held that the exercise of examining the issue on scientific research is outsourced by the Income Tax Authority and the same is done by the prescribed authority, being DSIR.
- The High Court has also held that the Parliament has specifically incorporated section 35(3) of the Act to answer questions in this regard.
- The High Court has held that when section 35(2AB), section 35(3) and section 43(4) of the Act are read harmoniously, the irresistible conclusion that can be drawn is that the AO cannot sit in judgement over the report submitted by the DSIR in Form 3CL.
- Accordingly, the High Court quashed the assessment order to the extent of disallowance of weighted deduction under section 35(2AB) of the Act.
- The High Court also held that in case the AO has any dispute, he may make a reference to CBDT who in turn will refer the matter to the DSIR.

Comments

The Karnataka High Court has held that the DSIR is the prescribed final authority to decide whether any activity constitutes scientific research or otherwise. AO does not have any jurisdiction to go beyond the report of DSIR, though he may refer the issue to CBDT who in turn will refer the matter to the DSIR.

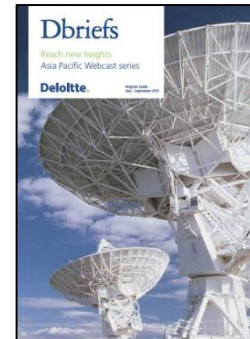
Source: Karnataka High Court decision in the case of Tejas Networks Limited vs. DCIT (Writ Petition No. 7004/2014)

Upcoming Dbriefs - Register

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Tuesday, 28 July, 2:30 PM – 3:30 PM IST

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