



Once the approval by DSIR is granted, the AO cannot verify the prescribed conditions to deny the deduction under Section 80-IB(8A) of the Income-tax Act

Background

Recently, the Gujarat High Court in the case of B.A. Research India Ltd.¹ (the taxpayer) held that once the approval is granted by the Department of Scientific and Industrial Research (DSIR/prescribed authority) and such approval is valid, it would no longer be open for the Assessing Officer (AO) to verify the satisfaction of the conditions prescribed under Rule 18DA of the Income-tax Rules, 1962 (the Rules) in order to deny deduction under Section 80-IB(8A) of the Income-tax Act, 1961 (the Act).

The High Court observed that the power of the AO to verify the claim of deduction is not taken away. He can certainly verify the accounts and deny the deduction which does not arise out of the eligible business and does not form part of the income under Section 80-IB(8A) of the Act. The AO, however, cannot ignore the approval granted by the prescribed authority and hold that the prescribed conditions are not fulfilled by the taxpayer.

Facts of the case

- The taxpayer is a company registered in India and engaged in scientific research activities. During the Assessment Year (AY) 2008-09, the taxpayer claimed a deduction under Section 80-IB(8A) and declared a total income of INR 3.32 lacs.
- The income of the taxpayer, apart from other research activities, also included income from storage of clinical samples.
- The AO alleged that the income from storage of samples was not derived from activities of research and development and, therefore, could not form part of deduction under Section 80-IB(8A) of the Act.
- Subsequently, the Commissioner invoked Revisionary Powers under section 263 of the Act and held that the AO allowed deduction under Section 80-IB(8A) of the Act without verification of the eligibility of the taxpayer to claim such deduction.
- Aggrieved by the order of the Commissioner, the taxpayer filed an appeal before the Income Tax Appellate Tribunal (ITAT/Tribunal). The Tribunal set aside the Order of the Commissioner for fresh consideration. The Commissioner held that the taxpayer is not eligible for deduction under Section 80-IB (8A) as it did not satisfy all the provisions enlisted in Section 80-IB(8A) read with Rule 18DA. It was held that while the taxpayer fulfilled condition (i) and (iii) of Section 80-IB(8A) (i.e. it was registered in India and was approved by the prescribed authority), it failed to satisfy conditions (ii) and (iv) (i.e. scientific and industrial research and development as its main object and fulfilment of conditions prescribed under Rule 18DA).
- The Tribunal held that the prescribed authority was an expert body empowered to grant approval for the purpose of deduction under Section 80-IB(8A) of the Act and the tax authorities cannot decline the deduction ignoring the approval of such authority.
- The Revenue challenged the order of the Tribunal before the High Court.

¹ Principal Commissioner of Income Tax v. B.A. Research India Ltd [(TS-337-HC-2016(GUJ))-Taxsutra.com]

Issue before the High Court

- Whether once approval is granted by the prescribed authority in accordance with Rule 18D (2), can tax authorities examine the fulfillment of the conditions stipulated in Rule 18DA and deny the deduction claimed by the taxpayer?

High Court Ruling

- The High Court observed that the Commissioner completely erred in holding that even though the taxpayer had valid approval of the prescribed authority, the AO still had to examine whether the conditions specified under Section 80-IB(8A)(iv) were fulfilled or not.
- The High Court, based on the following propositions, held that once the prescribed authority upon being satisfied of the fulfillment of the conditions specified in Rule 18DA, grants an approval, the AO is precluded from taking a different view:
 - The requirements of examining the conditions are extremely complex and have therefore, been rightly placed in the hands of an expert body to judge. The prescribed authority is a specialized body having expertise in the field of scientific research and development.
 - Once an authority which is prescribed under the Rules for a specific purpose has been invested with statutory functions, the AO should not be allowed to overrule the decision of the prescribed authority.
 - As per the provisions of sub-rule (2) of rule 18D, extension of approval once granted is subject to satisfactory performance of the company, to be judged on periodic review. There are various other similar indications within the Rules itself.
 - Rule 18DA(3) gives wide powers to the prescribed authority to withdraw the approval if it is found that the same was to avoid payment of taxes by its group companies or companies related to its directors or majority of its shareholders or that any provisions of the Act or the Rules have been violated.
- The task of judging whether the provisions of the Act or the Rules have been violated or not, has also been entrusted to the prescribed authority with matching powers for withdrawal of the approval, if the authority is satisfied about such breach.
- The Revenue contended that the word 'may' as appearing in Rule 18DA(3) is of significance and suggests that even in case of any breach/violation of the Act/Rules, the prescribed authority is not duty bound to withdraw the approval. The High court, refuting the contentions of the tax authorities held that the legislature while clothing the prescribed authority with sufficient powers to withdraw the approval, used the word 'may' rather than 'shall' giving discretion in appropriate cases to the authority not to withdraw the approval. The power of withdrawal of approval rests within the jurisdiction of the prescribed authority and the AO would have any role in the context of verifying requirements relatable to grant, extend or withdraw the approval.
- The High Court having regard to the powers of the prescribed authority held that once the approval is granted by the prescribed authority and such approval is valid, verification of compliance with the conditions prescribed under Rule 18DA is beyond the jurisdiction of the AO.
- In the instant case, the AO disallowed the deduction with respect to sample storage income holding that the same does not form part of the eligible business. The High Court held that the AO would be well within its authority to verify other issues relevant to the claim of deduction and also refuse deduction under Section 80-IB(8A) of the Act in respect of income which does not arise out of the eligible business
- The High Court, however, clarified that the power of the Assessing Officer to verify the claim of deduction is not taken away. However, the AO cannot ignore the approval granted by the prescribed authority and hold that the conditions are not fulfilled by the taxpayer.

Our Comments

The issue as to whether the AO is vested with powers to examine fulfilment of conditions for allowability of deduction under Section 80-IB(8A) when DSIR approval is in place, has been a subject matter of litigation before the Courts/Tribunal.

The Mumbai Tribunal, in the case of Siro Clinpharm² held that the prescribed authority having granted the approval after complete satisfaction of conditions (nature of activity, infrastructure of company and its past record, etc.), the AO could not deny the taxpayers claim for deduction under Section 80-IB (8A). The Bangalore Tribunal in the case of Quintiles Research³ (India) held that any violation of the conditions of Rule 18DA can be looked into only by the prescribed authorities and not by the AO, while completing the assessment.

In the context of Section 35(2AB), the Karnataka High Court⁴ in the case of Tejas Network Limited held that where the DSIR has certified R&D related expenditure under Section 35(2AB) of the Act, the 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. 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. The Gujarat High Court in the case of Mastek Ltd⁵ also held that the decision of the prescribed authority shall be final.

The present decision reiterates that DSIR, being an expert body is entrusted with the powers of granting, extending or revoking the approval. Once approval by DSIR is granted and is valid, the AO is precluded from further verifying the satisfaction of the prescribed conditions. On the issue whether the AO can deny the deduction under Section 80-IB(8A), the High Court observed that AO's power to verify claim of deduction is not taken away and AO can certainly deny deduction for income which does not arise out of the eligible business.



² Siro Clinpharm (P.) Ltd. v. DCIT (2014) 49 taxmann.com 62

³ Quintiles Research (India) (P.) Ltd. v. DCIT (2014) 44 taxmann.com 425

⁴ Tejas Networks Limited v. DCIT (2015) 60 taxmann.com 309

⁵ DCIT v. Mastek (2012) 25 taxmann.com 133 (Guj)

www.kpmg.com/in

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

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