*RESERVED ON 14TH OCTOBER 2026*

**IN THE HIGH COURT OF KARNATAKA AT BENGALURU**

**DATED THIS THE 2ND DAY OF NOVEMBER, 2026**

**PRESENT**

**THE HON'BLE MR. VIBHU BAKHRU, CHIEF JUSTICE**

**AND**

**THE HON'BLE MRS. JUSTICE K.S. HEMALEKHA**

**WRIT APPEAL NO. 2473 OF 2015 (T-IT)**

**BETWEEN:**

1. THE DEPUTY COMMISSIONER OF
INCOME TAX, CIRCLE-12(4)
BANGALORE
RASHTROTHANA PARISHAD BHAVAN
(4TH FLOOR) NO.14/3A
NRUPATHUNGA ROAD
BANGALORE - 560 001

2. THE DISPUTE RESOLUTION PANEL
BANGALORE
RASHTROTHANA PARISHAD BHAVAN
(6TH FLOOR) NO.14/3A
NRUPATHUNGA ROAD
BANGALORE - 560 001

…APPELLANTS

(BY SRI E.I. SANMATHI, ADVOCATE)

Digitally signed by K P SWETHA
Location: High Court of Karnataka

**AND:**

1. M/S TEJAS NETWORKS LIMITED
A COMPANY INCORPORATED UNDER
THE COMPANIES ACT, 1956
HAVING ITS OFFICE AT
PLOT NO.25, 5TH CROSS
J.P. SOFTWARE PARK

ELECTRONIC CITY
PHASE-1, HOSUR ROAD
BANGALORE - 560 100
REPRESENTED BY ITS
MANAGING DIRECTOR
MR. SANJAY NAYAK
S/O SRI SHANKAR NAYAK
AGED ABOUT 49 YEARS

…RESPONDENT

(BY SRI ANNAMALAI S., ADVOCATE &
SRI V. CHANDRASHEKAR, ADVOCATE)

THIS WRIT APPEAL IS FILED UNDER SECTION 4 OF THE KARNATAKA HIGH COURT ACT PRAYING TO SET ASIDE THE ORDER PASSED BY THE LEARNED SINGLE JUDGE IN W.P. NO.7004/2014 DATED 24/04/2015 & ETC.

THIS WRIT APPEAL HAVING BEEN HEARD AND RESERVED FOR JUDGMENT, COMING ON FOR PRONOUNCEMENT THIS DAY, JUDGMENT WAS PRONOUNCED AS UNDER:

CORAM: HON'BLE MR. VIBHU BAKHRU, CHIEF JUSTICE
and
HON'BLE MRS. JUSTICE K.S. HEMALEKHA

**C.A.V. JUDGMENT**

(PER: HON'BLE MR. VIBHU BAKHRU, CHIEF JUSTICE)

1. The Revenue has filed the present intra court appeal impugning an order dated 24.04.2015 passed by the learned Single Judge in Writ Petition No.7004/2014 (T-IT). The respondent [**the Assessee**] had filed the said petition assailing an assessment order dated 31.01.2014 [**impugned assessment order**] passed by

the Assessing Officer [**AO**] under Section 143(3) read with Section 144C(13) of the Income Tax Act, 1961 [**the Act**] for the Assessment Year [**AY**] 2009-10. The Assessee also impugned the demand notice dated 31.01.2014, which was issued consequent to the impugned assessment order.

2. The Assessee is engaged in the business of software development, manufacturing and trading of networking equipment. It had filed the return of income for AY 2009-10 on 29.09.2009 declaring nil income and claiming a loss of ₹7,75,95,922/-. The said return was selected for scrutiny and a draft assessment order dated 27.03.2013 was passed.

3. The Assessee filed its objections against the draft assessment order before the Dispute Resolution Panel [**DRP**]. The said objections were disposed of by the DRP by an order dated 30.12.2013.

4. The principal controversy relates to the weighted deduction claimed by the Assessee under Section 35(2AB) of the Act for a sum of ₹89,35,48,193/-. In addition to the above, the Assessee also claimed a deduction of ₹4,18,08,591/- under Section 35(1)(i) of the Act. The AO rejected the weighted deduction claimed for

research and development [**R&D**] expenditure to the extent of ₹48,41,82,071/-. Additionally, it also disallowed the sum of ₹2,63,68,301/- claimed by the Assessee under Section 35(1)(i) of the Act.

5. The DRP concurred with the AO that any expenditure incurred for product development which results in patent(s) on products or processes would be excluded from deductions under Section 35 of the Act. Additionally, the DRP also concurred with the AO that the jurisdiction of the 'prescribed authority' under Section 35 of the Act was limited to certifying as to what extent an activity would constitute or to what extent an asset was being used for scientific research. However, the question whether such expenditure is allowable would be governed by the express provisions of the Act and the AO's determination of the same was not overruled by the certificate issued by the 'prescribed authority'.

6. In its directions, the DRP also considered the objections raised by the Assessee in regard to other grounds. However, it is not necessary to refer to the same, as the writ petition as well as the present appeal is confined to the question of allowability of deduction under Section 35 (2AB) of the Act. Pursuant to the directions issued by the DRP, the AO passed the final order. As

stated above, the Assessee impugned the said order to a limited extent by filing a writ petition (W.P No.7004/2014), challenging the final order only insofar as it related to the question regarding allowability of deduction claimed under Section 35 (2AB) of the Act.

**PREFATORY FACTS**

7. The Assessee is engaged in developing and selling optical networking products for its worldwide customers. It claims that it carries on R&D activities for developing optical transmission telecommunication equipment. According to the Assessee, the same is a continuous process. The Department of Scientific and Industrial Research, Government of India, Ministry of Science and Technology [**DSIR**] had granted recognition and approval to Assessee's two R&D units – one located in JP Nagar, Bengaluru and the other at Mumbai, Ghatkopur – for the purpose of Section 35(2AB) of the Act in the prescribed form, Form 3CM.

8. During the previous year relevant to AY 2009-10, the Assessee had incurred an expenditure of ₹59.57 crores on R&D activities at the said units. It accordingly claimed a weighted deduction (150% of actual expenditure) amounting to ₹89.35 crores.

9. The Assessee had furnished details of the expenditure incurred by the approved R&D units during the relevant previous year (FY 2008-09) to DSIR. Admittedly, the said audited expenses were examined by DSIR, which is the 'prescribed authority' under Section 35(2AB) of the Act. After examining the same, DSIR had issued a report in the prescribed form (Form 3CL) dated 10.04.2013, addressed to the Director General of Income Tax (Exemptions), New Delhi. Although the Assessee had incurred an expenditure of ₹59.57 Crores, DSIR had, for the purposes of deduction under Section 35(2AB) of the Act, approved the R&D expenditure (excluding land and buildings) to the extent of ₹4601.95 lakhs.

10. Under the head ‘Research and Development Expenses’, the Assessee had debited a sum of ₹43,59,46,126/- to its Proft and Loss Account. Out of the said amount ₹27,85,19,837/- was shown as R&D expenses and the remaining amount of ₹15,74,26,289/- was booked as an expenditure relating to product development. The breakup of the said amount as noted in the impugned assessment order is set out below:

| PARTICULARS | | Amount |
|---|---|---|
| Design, layout, components & prototypes | | 2,60,10,148 |
| Employee cost including salaries & benefits – Product development | Other | 5,75,21,703 |
| Employee Cost including salaries & benefits (STPI Division) | Other | 18,18,25,789 |
| Less: Capitalized during the year | | 10,79,31,621 |
| | Balance | 15,74,26,289 |

11. Out of the total R&D expenditure of ₹43,59,46,126/-, the Assessee had claimed a deduction of ₹4,18,08,591/- as a deduction in respect of R&D expenditure under Section 35(1)(i) of the Act.

12. The Assessee claims that it has four units where it carries on R&D activities - JP Nagar unit, Jayanagar Unit, Ghatkopar Mumbai unit and Noida unit. Out of the aforesaid four units, only two units - units at JP Nagar, Bengaluru and Ghatkopar, Mumbai are approved and recognised by DSIR. The Assessee claimed that an amount of ₹4,18,08,591/- was the expenditure incurred at the Jayanagar and Noida units which were not approved or recognised under Section 35(2AB) of the Act and therefore, the expenditure incurred on scientific research by the said units was not entitled to

weighted deduction. However, the said expenditure was allowable under Section 35(1)(i) of the Act.

13. The Assessee had booked similar expenditure in its return for the earlier AY 2008-09 which was also disallowed principally on the ground that the said expenditure was incurred for development of a new product and the same entails acquiring a distinct technology and know-how which is an intangible asset of the Assessee. The said intellectual property right may be either in the shape of a patent or a secret. Since the R&D expenditure incurred by the approved units results in the Assessee acquiring know-how, the AO was of the view that the said expenditure was in the nature of capital expenditure and thus, not allowable as a deduction. The AO reasoned that the said expenditure could not be considered as an expenditure for scientific research as it was specifically excluded under Section 43(4)(ii) of the Act.

14. The relevant extract of the impugned assessment order which sets out the amount claimed and disallowed by the AO and the reasons for the same, is reproduced below:

> "4.11 The summary of deduction claimed u/s 35(2AB) in respect of Research and Development expenditures recorded by the assessee details of which have been provided vide its written submission dated 25.03.2013 is as under:

| Particulars | Approved Units (Rs.) | Deduction claimed @ 150% (Rs.) |
|---|---|---|
| A. Amount recorded under research and development | 25,45,64,231/- | |
| B. Amount recorded under Product development | 13,95,73,315/- | |
| C. Capitalized in the Books (Lab Equipments and Product Development Expenses) | 11,00,79,095/- | |
| D. Capital Work-in-Progress | 9,14,82,154/- | |
| Total | 59,56,98,795/- | 89,35,48,193/- |

4.12 As discussed in the aforesaid paragraph the expenditures pertaining to product development are not eligible for deduction u/s 35(2AB). As seen from the above table, there are three categories of product development expenditures in respect of which the assessee has claimed deduction u/s 35(2AB) which are discussed as under:

a. Rs.13,95,73,315/- which are treated as revenue expenditures by the assessee but deduction has been claimed u/s 35(2AB). Since the assessee has incurred these expenditures in respect of incompleted projects as the new products have not yet been developed. These expenditure actually represents capital work in progress and does not qualify for deduction as revenue expenditure. The corresponding weighted deduction claimed Rs.20,93,59,970/- is disallowed and added to the total income.

b. Rs.11,00,79,095/- which are treated as capital expenditure by the assessee and deduction has been claimed u/s 35(2AB). These amounts represents Knowhow/Technology ready for use contributing to Increase in revenue and thereby of enduring benefit to the assessee. Accordingly, the

assessee is eligible for depreciation only @ 25% on such expenditure representing Knowhow and such depreciation working out to Rs.2,75,19,770/ But the assessee company has claimed weighted deduction u/s 35(2AB) amounting to Rs.16,51,18,640/- which is held to be not an allowable deduction. Therefore, the balance amount of Rs.13,75,98,870/- (Rs.16,51,18,640/- - Rs.2,75,19,770/-) is disallowed and added to the total income.

c. 2,154/-is treated as capital work in progress by the assessee company. These are also expenditures incurred on incomplete projects as the new products have not yet been developed. These expenditures also represent capital work-in-progress and does not qualify for deduction as revenue expenditure. The corresponding weighted deduction claimed at Rs.13,72,23,231/- is disallowed and added to the total income.

4.13 Thus, an amount of Rs.48,41,82,071/- out of the deduction of Rs.89,35,48,193/- claimed uls 35(2AB) was proposed to be disallowed and added to the retuned income of the assessee company in the draft assessment order.

4.14 Similarly, deduction of Rs.4,18,08,591/- in respect of which the assessee company has claimed 100% deduction u/s 35(1)(i) includes an amount of Rs.2,63,68,301/- which is .recorded as product development expenditure. This amount also represents Capital Work-In-Progress for incomplete projects and no deduction can be allowed now. Therefore, an amount of Rs.2,63,68,301/- was proposed to be disallowed and added to the returned income of the assessee company in the draft assessment order.

4.15 On these two issues, the objections filed by the assessee company before the Ld:DRP, Bangalore were rejected. Therefore the aforesaid amounts of Rs.48,41,82,071/- and Rs.2,63,68,301/- are disallowed and added to the returned income of the assessee company.

(Additional of Rs.48,41,82,071 & Rs.2,63,68,301/)”

## QUESTIONS FOR CONSIDERATION

15. In view of the above, the only questions that fall for consideration in the present appeal are: (i) whether the expenditure incurred by the Assessee is required to be excluded from the scope of Section 35 (2AB) of the Act if the same leads to any intellectual property in respect to which the Assessee can exercise proprietary rights; and (ii) whether the AO has the jurisdiction to determine whether the Assessee has incurred the expenditure on scientific research, which is approved by the 'prescribed authority'.

## REASONS AND CONCLUSION

16. We may at this stage consider it relevant to refer to Section 43 of the Act. The relevant extract of this section is set out below:

> "43. In sections 28 to 41 and in this section, unless the context otherwise requires—
>
> **xxxx xxxx xxxx**
>
> (4) (i) "**scientific research**" means any activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries;]
>
> (ii) references to expenditure incurred on scientific research include all expenditure incurred for the prosecution, or the provision of facilities for the prosecution, of scientific research, but do not include any expenditure incurred in the acquisition of rights in, or arising out of, scientific research;
>
> (iii) references to scientific research related to a business or class of business include—

> (a) any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all businesses of that class;
>
> (b) any scientific research of a medical nature which has a special relation to the welfare of workers employed in that business or, as the case may be, all businesses of that class;

17. The relevant extract of Section 35 of the Act as in force in AY 2009-10, is set out below:

> "35. **Expenditure on scientific research.**—(1) In respect of expenditure on scientific research, the following deductions shall be allowed—
>
> (i) any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business.
>
> *Explanation.*— xxx xxx xxx
>
> (ii) an amount equal to one and one-fourth times of any sum paid to a scientific research association which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research:
>
> Provided that such association, university, college or other institution for the purposes of this clause—
>
> (A) is for the time being approved, in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed; and
>
> (B) such association, university, college or other institution is specified as such, by notification in the Official Gazette, by the Central Government;
>
> (iia) xxx xxx xxx

(iii) an amount equal to one and one-fourth times of any sum paid to a university, college or other institution to be used for research in social science or statistical research:

Provided that such university, college or other institution for the purposes of this clause—

(A) is for the time being approved, in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed; and

(B) such university, college or other institution is specified as such, by notification in the Official Gazette, by the Central Government;

*Explanation.*— xxx xxx xxx

(iv) xxx xxx xxx

(2), (2A) and (2AA) xxx xxx xxx

(2AB)(1) Where a company engaged in the business of bio-technology or in the business of manufacture or production of any drugs, pharmaceuticals, electronic equipments, computers, telecommunication equipments, chemicals or any other article or thing notified by the Board incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal to one and one-half times of the expenditure so incurred.

*Explanation.*—For the purposes of this clause, "expenditure on scientific research", in relation to drugs and pharmaceuticals, shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under any Central, State or Provincial Act and filing an application for a patent under the Patents Act, 1970 (39 of 1970).

(2) No deduction shall be allowed in respect of the expenditure mentioned in clause (1) under any other provision of this Act.

(3) No company shall be entitled for deduction under clause (1) unless it enters into an agreement with the prescribed authority for cooperation in such research and development facility and for audit of accounts maintained for that facility.

(4) The prescribed authority shall submit its report in relation to the approval of the said facility to the Director General in such form and within such time as may be prescribed.

(5) No deduction shall be allowed in respect of the expenditure referred to in clause (1) which is incurred after the 31st day of March, 2012.

(6) No deduction shall be allowed to a company approved under sub-clause (C) of clause (iia) of sub-section (1) in respect of the expenditure referred to in clause (1) which is incurred after the 31st day of March, 2008.

(2B) xxx xxx xxx

(3) If any question arises under this section as to whether, and if so, to what extent, any activity constitutes or constituted, or any asset is or was being used for, scientific research, the Board shall refer the question to—

> (a) the Central Government, when such question relates to any activity under clauses (ii) and (iii) of sub-section (1), and its decision shall be final;
>
> (b) the prescribed authority, when such question relates to any activity other than the activity specified in clause (a), whose decision shall be final.

(4) and (5) xxx xxx xxx"

18. It is relevant to refer to the extract of Rule 6 of the Income Tax Rules, 1962 [**the Rules**]. The same is set out below:

> **"Prescribed authority for expenditure on scientific research.**
>
> 6. (1) For the purposes of clause (i) of sub-section (1) and sub-section (2A) of section 35, the prescribed authority shall xxx Government of India.
> (1A) For the purposes of sub-section (2AA) of section 35, the prescribed authority shall be
>
> (a) in the case xxx case may be;
>
> (b) in the case xxx Government of India.
>
> (1B) For the purposes of sub-section (2AB) of section 35, the prescribed authority shall be the Secretary, Department of Scientific and Industrial Research.
>
> (2) Omitted w.e.f. 30.10.2006
>
> (3) The application for obtaining approval under sub-section (2AA) of section 35 shall be made by a sponsor in Form No.3CG.
>
> *Explanation*: For the purposes of this rule "sponsor" means a person who makes an application in Form No.3CG.
>
> (4) The application required to be furnished by a company under sub-section (2AB) of section 35 shall be in Form No.3CK.
>
> (5) The head of the National Laboratory or the University or the Indian Institute of Technology [or the Principal Scientific Adviser to the Government of India] shall, if he is satisfied that it is feasible to carry out the scientific research programme then, subject to other conditions prescribed in this rule and section 35 (2AA) of the Act, pass an order in writing in Form No.3CH:

**Provided** that a reasonable opportunity of being heard shall be granted to the sponsor before rejecting an application:

**Provided further** that an order under this rule shall be passed within two months of the receipt of the application under sub-rule (1A):]

**Provided also** that the Principal Scientific Adviser to the Government of India may authorize an officer who is not below the rank of a Deputy Secretary to issue such order, after the scientific research programme has been approved by him.

(5A) The prescribed authority shall, if he is satisfied that the conditions provided in this rule and in sub-section (2AB) of section 35 of the Act are fulfilled, pass an order in writing in Form No.3CM:

**Provided** that a reasonable opportunity of being heard shall be granted to the company before rejecting an application.

(6) The National Laboratory, University, Indian Institute of Technology or specified person] shall issue a receipt of payment for carrying out an approved programme of scientific research under sub-section (2AA) in Form No.3CI.

(7) xxx

(7A) Approval of expenditure incurred on in-house research and development facility by a company under sub-section (2AB) of section 35 shall be subject to the following conditions, namely:-

(a) The facility should not relate purely to market research, sales promotions, quality control, testing, commercial production, style changes, routine data collection or activities of a like nature;

(b) The prescribed authority shall submit its report in relation to the approval of in-house Research and Development facility in Form No.3CL to the Director General (Income-tax

> Exemptions) within sixty days of its granting approval;
>
> (c) The company shall maintain a separate account for each approved facility; which shall be audited annually and a copy thereof shall be furnished to the Secretary, Department of Scientific and Industrial Research by 31st day of October of each succeeding year.
>
> Explanation: For the purposes of this sub-rule the expression "audited" means the audit of accounts by an accountant, as defined in the Explanation below subsection (2) of section 288 of the Income-tax Act, 1961;
>
> (d) Assets acquired in respect of development of scientific research and development facility shall not be disposed of without the approval of the Secretary, Department of Scientific and Industrial Research."

19. The AO proceeded on the basis that, since the expenditure incurred resulted in the Assessee generating/developing know-how and technology that would contribute to increasing revenue, it could not be considered as expenditure on scientific research as allowable under Section 35(2AB) of the Act. The AO reasoned that the Assessee would be entitled to depreciation on such expenditure representing know-how. It is thus apparent that the AO does not dispute that the Assessee had incurred the expenditure for scientific research, which was approved by the 'prescribed authority' under Rule 6(7A) of the Rules. However, according to the AO such expenditure could not be considered as expenditure on

scientific research as it was excluded by virtue of Section 43(4)(ii) of the Act.

20. The learned Single Judge rightly held that the AO could not question whether the expenditure incurred by the Assessee, which was approved by the DSIR (‘prescribed authority’) was for scientific research.

21. Rule 6(5A) of the Rules expressly provides that the 'prescribed authority' shall pass an order in Form 3CM if it is satisfied that the conditions provided in the said Rule and in Section 35(2AB) of the Act are fulfilled. Thus, the authority for determining whether the conditions for claiming a weighted deduction under Section 35(2AB) are satisfied is the 'prescribed authority'. The AO cannot review or revisit the approval granted. However, if any question arises as to whether, and if so, to what extent, any activity constitutes or constituted, or any asset is or was being used for, scientific research, the Central Board of Direct Taxes [**the Board**] is required, in terms of Section 35(3) of the Act, to refer the question to the Central Government, if such question relates to any activity under Clauses (ii) and (iii) of Section 35(1) of the Act, and to the ‘prescribed authority’ if such question relates to

any activity other than the activities specified under Clauses (ii) and (iii) of Section 35(1) of the Act.

22. Section 35(3) of the Act also expressly provides that the decision of the Central Government or the 'prescribed authority', as the case may be, would be final. Thus, concededly, if the AO seeks to raise any issue as to what extent an activity constitutes scientific research, the only recourse available for the AO is to seek a reference through the Board to the 'prescribed authority' under Section 35(3) of the Act.

23. It is also apposite at this stage to note that the Revenue does not dispute that the 'prescribed authority' has the exclusive jurisdiction to decide whether any activity, and to what extent, constitutes scientific research. However, the Revenue contends that the 'prescribed authority' cannot decide the correctness and genuineness of the expenditure and that the AO alone must do so. Following this contention, it is contended that the 'prescribed authority' has no jurisdiction to examine the exclusion of certain expenditure under Section 43(4)(ii) of the Act on the ground that the same has been incurred towards acquisition of rights in or arising out of scientific research.

24. We find no merit in the contention that the 'prescribed authority' has no jurisdiction to examine whether certain expenditure is required to be excluded by virtue of Section 43(4)(ii) of the Act on the ground that it is for acquisition of rights in or arising out of scientific research.

25. Rule 6 of the Rules sets out an exhaustive procedure for determining whether the conditions provided under Section 35(2AB) of the Act are satisfied. An Assessee seeking to claim a deduction under Section 35(2AB) of the Act is required to make an application in Form 3CK. The Assessee has to provide all details, including annual production for the past three years, the annual expenditure on scientific research of the company during the past three years, and the breakup of the expenditure on the land and building. Additionally, the Assessee has to disclose the proposed objects of the scientific research and give details of the nature of the existing in-house research and development facilities.

26. Part B of the said Form 3CK contains an agreement between the Assessee and the DSIR, *inter alia,* recording the Assessee's commitment to provide full co-operation to DSIR in carrying out research and development work relating to biotechnology or manufacture or production of the eligible article or thing under

Section 35(2AB) of the Act. The Assessee also undertakes to maintain accounts for both revenue and capital expenditure on scientific research which is required to be annually audited.

27. Clause (iv) of Part B of Form 3CK, which contains the terms of the agreement, is set out below:

> "(iv) the First Party shall maintain separate accounts for both revenue and capital expenditure on scientific research including that on in-house Research and Development facility, which shall be annually audited by an accountant as defined in section 288(2) of the Income-tax Act, 1961, and a copy of which has to be attached with the return of income under sub-section (1) of section 139 to claim deduction under section 35(2AB)"

28. Rule 6(7A) of the Rules expressly provides that the approval of expenditure incurred for in-house research and development would be subject to the condition that the 'prescribed authority' submits a report in the prescribed Form 3CL. Part B[1] of Form 3CL is set out below:

*"Part B*

1. Assessment year
2. Previous year
3. Location of the research and development facility
4. Annual production of the eligible products during the year
5. Details of expenditure: (in Rs. Lakhs)

[1] as applicable with effect from 01.07.2016

A.(i) Land

(*ii*) Buildings

B. Capital expenditure:

(*i*) Equipment

(*ii*) Others

(*iii*) Total

C. Revenue expenditure:

(*i*) Expenditure directly related to research and development

(*a*) …….

(*b*) …….

(*c*) …….

(*ii*) Total

D. Total expenditure on the approved research and development centre (excluding land and building)

E. Details of assets disposed of/transferred

I certify that the above details are true and correct to the best of my knowledge and belief.

……
Signature of Secretary, Department
of Scientific and Industrial Research

Date:……..

Place:…….”

29. The relevant extract of the report in Form 3CL dated 10.04.2013 issued by DSIR in the present case is set out below:

“9. Total cost of in-house research facility, giving break-up of expenditure on land and buildings

| | AY 2009-10 (from 01.06.2008 to 31.03.2009) | AY 2010-11 | AY 2011-12 |
|---|---|---|---|

| | J.P. Nagar (Bangalore) | Mumbai | J.P. Nagar (Bangalore) | Mumbai | J.P. Nagar (Bangalore) | Mumbai | Noida |
|---|---|---|---|---|---|---|---|
| Capital expenditure (other than land and buildings) | 229.44 | - | 338.08 | 1.29 | 500.12 | - | 3.50 |
| Recurring expenditure | 4245.51 | 127.00 | 5448.92 | 180.30 | 6981.88 | 213.88 | 254.87 |
| Total R & D expenditure (excluding land & buildings) | 4601.95 | | 5968.59 | | 7954.25 | | |

> 10. Whether agreement for co-operation and Research and Development facility and for audit of the accounts maintained for that facility entered into **Yes**.
>
> Certified that the above information is true to the best of our knowledge and belief."

30. It is apparent from the above that the 'prescribed authority' is required to report specific details of the expenditure incurred on scientific research, including the break-up of the expenditure on land and building, capital expenditure and revenue (recurring) expenditure.

31. Plainly, there is no scope for the AO to review the expenditure incurred as approved by the 'prescribed authority'.

32. The plain language of Section 35(3) of the Act makes it amply clear that any question as to whether an activity constitutes scientific research, and to what extent, must be decided by the 'prescribed authority'. The use of the word 'shall' indicates that it is

mandatory for the Board to refer such a question, if it arises, to the 'prescribed authority'. It follows that the AO cannot determine whether the expenditure is for scientific research within the definition of Section 43(4) of the Act, or the extent to which it would be eligible for weighted deduction under Section 35(2AB) of the Act.

33. Section 35(2AB) of the Act allows weighted deductions for expenditure on scientific research, except for expenditure in the nature of the cost of any land or building, subject to certain conditions being satisfied.

34. A plain reading of Section 35(2AB)(1) of the Act indicates that a weighted deduction is admissible for all expenditure incurred on scientific research in an in-house research and development facility as approved by the 'prescribed authority', other than expenditure in the nature of the cost of any land or building. Thus, the assumption that capital expenditure other than land and building is excluded is not sustainable on a plain reading of Section 35(2AB) of the Act.

35. The AO is not permitted to undertake a merits review of the approved expenditure to determine whether the same is allowable.

The contention that the AO can re-examine whether the expenditure approved by the 'prescribed authority' falls within the definition of Section 43(4) of the Act is plainly unmerited. The 'prescribed authority' has jurisdiction to decide whether the expenditure is incurred on scientific research for which a weighted deduction is allowed under Section 35(2AB) of the Act. The role of the AO in regard to such approved expenditure is limited.

36. In **The Deputy CIT (ASSTT) v. Mastek Limited**: Tax Appeal No.242/2000 and connected matters, decided on 21.08.2012 and 28.08.2012, the Division Bench of the Gujarat High Court considered the question whether the expenditure incurred was for scientific research. In this regard, the court observed as under:

> "28. We are, however, of the opinion that insofar as the second aspect of the matter is concerned, the Tribunal was perfectly justified in holding in favour of the assessee. Section 35(3) of the Act as noticed requires a reference to be made by the Board to the prescribed authority when a question arises as to whether and if so to what extent, any activity constitutes or constituted or any asset is or was being used for scientific research. The decision of the prescribed authority on such a question would be final. In our opinion, therefore, whenever any such question arises, the Assessing Officer cannot decide the issue but must place the issue before the Board who, in terms of section 35(3) of the Act, would refer the question to the prescribed authority. The decision of the prescribed authority would govern the parties.

> Therefore, if an assessee puts forth a claim of deduction under section 35(1) for expenditure incurred on scientific research and if the Assessing Officer is not inclined to accept such a claim, the question can be stated to have arisen. In such a situation, the Assessing Officer cannot take a decision but must seek the opinion of the prescribed authority, We may hasten to add that only when such a question arises that the reference would be competent. For example, if in a given case, the assessee lodges a claim without any supporting material, it cannot be stated that the question has arisen which would require a reference by the Board. Similarly, if the Assessing Officer accepts the claim of the assessee, no such question can be stated to have arisen. We are, however, unable to accept Shri Bhatt's contention that such a question would arise only when the assessment is finally framed and that thereafter the onus would be on the assessee to seek a reference. No such intention is emerging from section 35(3) of the Act. Whenever an Assessing Officer is not inclined to accept the assessee's case for deduction, we fail to see how at that very stage, the question cannot be stated to have arisen."

37. A similar view is also taken by the Allahabad High Court in **JK Synthetics Limited v. O.S.Bajpai, Income Tax Officer**[2]. In that case, the Assessee had claimed a deduction, out of its total income, of the expenditure incurred on scientific research. The court had referred to Section 35(3) of the Act and observed as under:

[2] 1976 105 ITR 864 All

"21. …. It is apparent that if the Income-tax Officer does not accept the claim of the assessee under Section 35, he has to refer the matter to the Central Board of Direct Taxes and the Board in turn will make a reference to the prescribed authority. The decision of the prescribed authority shall be final. This shows very clearly that neither the Income-tax Officer nor the Board is competent to take a decision on any such controversy. The controversy has to be referred to the prescribed authority which alone is competent to give a decision. Now, in the instant case, the claim of the assessee was referred to the Board and the Board referred the same to the prescribed authority. Admittedly, the prescribed authority had not given its decision before the impugned assessment order was passed. The Income-tax Officer took upon himself to decide the controversy and held that the expenditure claimed by the company was of an ordinary capital nature and did not relate to any research work. Clearly, the Income-tax Officer had no jurisdiction to adjudicate upon the controversy, particularly when the controversy had already been referred to the prescribed authority He was conscious of this difficulty and that is why he added the following rider in paragraph 47 of his order:

"The matter has already been referred to the prescribed authority under Section 35(3) and this disallowance is subject to the finding of the said authority as was in the assessment year 1971-72."

In our opinion, the procedure adopted by the Income-tax Officer was wholly unjustified and without jurisdiction. If, under the law, he has no jurisdiction to adjudicate upon a matter, he cannot take a decision final or provisional and make it subject to the decision of the competent authority. This situation appears to have arisen because of the negligence of the Income-tax Officer to refer the matter to the appropriate authority in time."

38. In **CIT v. F.C.S International Marketing (P) Limited**[3], the Punjab and Haryana High Court observed that if any question arises as to whether, and to what extent, any activity constitutes or constituted scientific research, the AO is duty-bound to refer the matter to the 'prescribed authority'.

39. In the present case, the AO has disallowed the expenditure incurred on scientific research approved by the 'prescribed authority' on the ground that the expenditure had resulted in the acquisition of rights in or arising out of scientific research. The AO has reasoned that the Assessee is not entitled to deduction on the ground that the expenditure resulted in the acquisition of rights in or arising out of scientific research. As discussed above, the jurisdiction to determine whether an expenditure incurred on scientific research is allowable under Section 35(2AB) of the Act is required to be examined by the 'prescribed authority', and the AO cannot undertake a review of the same.

40. We may now examine the merits of the AO's decision that the expenditure approved by DSIR is excluded from the scope of expenditure on scientific research by virtue of Section 43(4)(ii) of

[3] (2006) 155 taxmann.com 362 (Punjab & Haryana)

the Act. The AO's reasoning that any expenditure in scientific research that results in the development of know-how or any technology is excluded from the definition of expenditure in scientific research is plainly erroneous. The purpose of conducting scientific research is to acquire know-how and make technological advancements. An Assessee which is engaged in business would incur such expenditure only for the purposes of advancement of its business.

41. Section 43(4)(ii) of the Act is required to be understood in the correct perspective. It seeks to exclude expenditure that is incurred on acquiring an existing right. Thus, if an Assessee incurs any expenditure on acquiring a patent or rights in a patent from another patentee, which is a result of scientific research, the said expenditure would not be considered expenditure incurred by an Assessee on scientific research. This is so because the expenditure is for acquisition of an asset simpliciter without the Assessee undertaking any scientific research. The expenditure on scientific research is to be understood as expenditure incurred by an Assessee on scientific research and not for acquisition of rights arising out of scientific research. The exclusion under Section43(4)(ii) of the Act covers expenditure for acquisition of

those rights without the Assessee undertaking any scientific research.

42. In **Tata Hitachi Construction Machinery Company Limited v. DCIT, Circle 12 (4), Bangalore**[4], the learned Income Tax Appellate Tribunal (ITAT) had observed as under:

> "4.5.3 ...In our considered view, the objective behind the exclusion clause in Sec. 43(4)(ii) of the Act appears to be that expenditure on scientific research should be incurred on research actually carried out by the assessee in-house and it should not spend money in acquiring rights in or arising out of scientific research carried on by some other person. If the interpretation sought to be urged by Revenue is to be accepted, then the benefit sought to be conferred by the provisions of Sec. 35(1)(iv) of the Act would virtually be denied in all cases by invoking the exclusion clause in Sec. 43(4)(ii) of the Act. Such a consequence would never have been intended by the Legislature. As already stated, the object behind the provisions of Sec. 35 of the Act is to encourage scientific research."

43. In **Resil Chemicals (P) Ltd v. DCIT, Circle-12(4), Bangalore**[5], the learned ITAT had observed as under:

> "18. ...The expenditure that is sought to be excluded u/s. 43(4)(ii) of the Act is an expenditure which the assessee incurs in acquiring rights in or arising out of scientific research already done by

[4] [2018] 93 Taxmann.com 339 (Bangalore-Trib.)
[5] [2014] 51 Taxmann.com 250 (Bang-ITAT)

> somebody. It is possible that the assessee without carrying out the scientific research, acquires rights in scientific research, acquires rights arising out of scientific research done by somebody else and claims cost of acquisition of such rights as expenditure on scientific research. It is this kind of expenditure that is sought to be excluded u/s. 43(4)(ii) in its exclusion clause as “expenditure incurred in acquiring rights in or arising out of scientific research”. It is such type of expenditure carried out by somebody else and such right is acquired by the assessee, such expenditure is sought to be disallowed. The idea behind the exclusion clause in section 43(4)(ii) appears to be that expenditure on scientific research should be on the research actually carried out by the assessee in-house and it should not merely spent money in acquiring rights in or arising out of scientific research carried out by some other person".

44. We concur with the learned ITAT's interpretation of the exclusion clause under Section 43(4)(ii) of the Act.

45. The learned counsel appearing for the Revenue had earnestly contended that the observations in the impugned order are wide and would preclude the AO from examining the Assessee's claim for deduction on account of expenditure incurred for scientific research. However, this apprehension is also unfounded. The AO is clearly entitled to examine the claim once the Assessee put forth the claim for deduction under Section

35(2AB) of the Act. The AO is required to verify that the necessary material for making the claim exists. The Assessee has to produce audited accounts evidencing that the expenditure as claimed was incurred. In terms of Rule 6(7A) of the Rules, the 'prescribed authority' is required to submit a report in relation to the approval in the prescribed form to the Director General Income Tax (Exemptions) within sixty days of granting the said approval. The AO is also required to verify that the claim is confined to expenditure for scientific research as approved by the 'prescribed authority'. However, it is not open for the AO to take a view that the activities undertaken do not constitute scientific research. It is clearly not open for the AO to disallow the expenditure incurred for the scientific research by re-examining whether the activities undertaken by the Assessee fall within the definition of scientific research under Section 43(4) of the Act.

46. It is also contended on behalf of the Revenue that the writ petition was not maintainable against an order of the AO and, therefore, the learned Single Judge erred in entertaining it. The said contention is unmerited. There is no basis to contend that the court lacked the jurisdiction to entertain the petition under Article 226 of the Constitution of India, impugning an assessment order.

The High Courts refrain from exercising jurisdiction where statutory remedies are provided as a matter of self-restraint and not because the court lacks the jurisdiction to entertain such petitions. In the present case, the Assessee may have been relegated to avail of its statutory remedies. However, the learned Single Judge considered it apposite to entertain the petition considering that the question raised involved the AO's jurisdiction to examine whether the expenditure incurred was for scientific research and to disallow the same on the premise that it was anticipated to yield revenue in future years.

47. In view of the above, the impugned order cannot be set aside on the ground that the writ petition was not maintainable.

48. The appeal is, accordingly, dismissed.

**Sd/-**
**(VIBHU BAKHRU)**
**CHIEF JUSTICE**

**Sd/-**
**(K.S. HEMALEKHA)**
**JUDGE**

AHB/KPS