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Court : Income Tax Appellate Tribunal ITAT Allahabad

Decided On : Feb-17-1988

Reported in : (1988)27ITD581(All.)

Judge : E Singh, S Banerjee

Appellant : U.P. Electronics Corpn. Ltd.

Respondent : inspecting Assistant

Judgement :

1. The first ground of appeal by the assessee is that the Commissioner of Income-tax (Appeals) [CIT(A) for short] erred in confirming the disallowance of Rs. 15,83,209 on account of expenditure incurred on research and development which was claimed by the assessee under Section 35.

2. From the orders of the authorities below, it is seen that the assessee-corporation had been set up with the basic object of promoting and developing electronic industries in the State of U.P. It was noted that in the beginning, the Corporation set up a factory at Allahabad and Lucknow to manufacture black and white T.V. sets. With effect from 1-4-1987, certain Corporations were separately established by the State Govt. Factories were transferred to the said Corporations, namely, Uptron, Uptron Digital Systems, Uptron Communications and Instruments Corporation, etc. The claim of the assessee was that all these subsequent Corporations were wholly owned subsidiaries of the U.P.Electronics Corporation, i.e., the assessee. It was also contended that it was only by way of administrative

convenience that the work of research and development was undertaken by the Corporation while the results were actually used by the factories wholly owned subsidiaries.

The assessee, therefore, claimed that the expenditure incurred on research and development was for the purpose of business and deduction was allowable under Section 35 of the Act. The assessee claimed, relief under that section to the extent of Rs, 19,23,250 out of which Rs. 15,83,208 related to the expenditure for the year under consideration as the balance related to the earlier years which were claimed as revenue expenditure but later on written back. The assessing officer examined the accounts and the claim of the assessee in this respect.

According to him, relief can be given if the income was assessed under the head "Business and profession". He noted that the assessee-corporation, on the other hand, derived income from other sources. Even otherwise, the assessing officer was of the view that if the assessee was engaged in the business of investment and sale of investment, etc., the activities of the assessee would be in the nature of holding company and manufacturing activity being carried on by its subsidiary companies and, therefore, the claim cannot be allowed. He referred to the provisions of Section 35 to say that the claim would be allowable if the expenditure was relatable to the business carried on by the assessee. In his opinion, whatever scientific research carried out by the assessee was not related to the business as such. The assessee took the stand that the expenditure was allowable under Section 35 or even otherwise according to Section 35(2A), it would not be necessary that the sponsored research should be related to the assessee's business but the weighted deduction would be allowable if the scientific research was undertaken by a scientific research association or a university as referred to in Section 35(l)(ii) under a programme approved by the prescribed authority. According to the assessee, the main object of the Corporation is to promote and develop electronic industry in the State of U.P. and to prepare project reports for the entrepreneurs and fees were, accordingly, charged. It was indicated that such gross receipt was of Rs. 6,46,300 apart from other items. It was also indicated that the Corporation entered into various agreements with various collaborators outside the country for acquiring know-how for which payments have to be made with the

permission of the Reserve Bank of India. It was the case of the assessee that this technical know-how is developed in its research and development division with the help of machinery and plant purchased for the purpose and debited to the R & D equipment account. It was also submitted before the assessing officer that this technical know-how was passed on to various subsidiaries free of cost as the main object of the Corporation is to promote and develop electronic industry. It was pointed out that it may be that the Corporation did not have any manufacturing activity during the year, but this fact would not debar the assessee from claiming relief. It was specially mentioned that the word "manufacturing" did not exist in the Section. The assessee claimed that such relief was admissible keeping in view the purpose of Sections 28 to 41 and 43 as defined under Section 43(4) (i) and in the circumstances, the claim should be allowed.

3. The assessing officer held that Section 35(2)(a) was not applicable at all as there was no such payment made by the assessee to another Scientific Research Association. It was also pointed out that no instance was given to show that the project reports had been given by the assessee-corporation to the entrepreneurs for which any scientific research was needed. The assessing officer noted certain reasons as to why the claim of the assessee could not be accepted. He stressed the fact that the assessee derived income only from interest, sale of investments, dividends, etc., and no scientific research was needed for such purposes. The assessing officer visited the place of the assessee for making certain enquiries. He noted that the equipments were for testing purposes and in any case they would be required by the subsidiary companies if they have to maintain quality control in the competitive market. He emphasised that such instruments were necessary part for the production of various items by the subsidiary companies and cannot be said to be related to any scientific research. In the circumstances, the assessing officer found that the claim of the assessee should be rejected.

4. The assessee took up the matter before the CIT(A) reiterating the claim. We shall deal with the relevant part of the arguments and discussion made before the CIT(A) for the purpose of our decision.

Amongst other things, the assessee reiterated before us the claim that it has been set up with the basic object of promoting and developing electronic industry in the State as discussed in the preceding paragraphs. The CIT(A) considered the provisions of Section 35. He noticed that the main source of income of the assessee was consultancy charges recovered for the preparation of feasibility reports for setting up electronic industry in the State, The points noted by the assessing officer were taken into account by him. According to him, a subsidiary company is an independent unit and cannot be considered otherwise for the purpose of Section 35 of the Act. In his view, scientific research carried out by the assessee-corporation by no means can be said to be related to the business carried on by the Corporation. He, therefore, held that the case of the assessee was not covered by the said section and the claim of the assessee was rightly rejected by the assessing officer. He declined to interfere. Hence, this appeal by the assessee.

5. It is vehemently urged by the assessee's learned counsel that the authorities below went wrong in rejecting the claim of the assessee without properly appreciating the facts and circumstances of the case vis-a-vis the provisions of Section 35. The asses-see's counsel stresses the purpose as well as the provisions of Section 35. It is argued that even assuming that a sum is paid to a Scientific Research Association, which has an object to undertake scientific research, such sum paid would be qualified to be treated as expenditure on scientific research for the purpose of Section 35 and the expenditure need not necessarily be incurred by the assessee itself. It is also argued that in the instant case, it was the assessee which incurred the expenditure on such research though the result would be passed on to the subsidiary companies for carrying on certain works and it was specifically for such purposes that the Corporation itself was formed. It is urged, therefore, that the claim of the assessee has wrongly been rejected by the authorities below. The assessee's learned counsel stresses the provisions of Section 35 read with Section 43(4)(i) in order to emphasise that even if a payment is made by any assessee to a Scientific Research Association would be qualified for rebate as a "Scientific Research" would mean any activity for the extension of knowledge in the fields of natural or applied science including agricultural, etc. It is, therefore, urged that the claim of the assessee may be

allowed now.

6. The learned Departmental Representative, on the other hand, supports the order of the CIT(A). It is urged that the assessee did not carry on any business apart from deriving income from consultancy charges, etc.

It is also submitted that whether any research and development was carried, such activity did not relate at all to the purpose or activity of the assessee-corporation as it is the subsidiary companies which carries on the business of manufacturing T.V. sets and other electronic items. It is also urged that the subsidiary companies are independent units and, therefore, the CIT(A) has rightly sustained the disallowance. It is argued at length that the assessee's claim has been rightly rejected by the authorities below and the appeal may be dismissed. Reference is made to certain authorities to support the claim of the Revenue.

7. The assessee, on the other hand, placed reliance on the decision of the Hon'ble Bombay High Court in the case of CIT v. National Rayon Corpn. Ltd. [1983] 140 ITR 143. It is submitted that the facts of that Bombay case were similar to those of the assessee's case before us and it was held that the expenditure was allowable under Section 35(1)(i).

Other decisions were also noted in that case, i.e., 69 ITR 692 SC. It was held in that Bombay case that the expenditure on scientific research would be entitled to the relief and research need not be carried on by the assessee itself.

8. We have gone through the orders of the authorities below along with other connected papers placed before us on behalf of the assessee. We have looked into the different authorities cited before us. At the outset, it may be mentioned here that apparently, similar claims under Section 35 had not been made by the subsidiary companies in their individual cases, as there is no indication to the contrary. But as far as the claim of the assessee-corporation is concerned, we find that there is substantial force in the contentions made on behalf of the assessee. If we look at the main objects of the Corporation as spelled out by the memorandum of association, copy of which has been placed before us, it is abundantly clear that the main objects were to promote and develop electronics industry, to establish

companies, associations, etc. for taking over or conducting electronic industrial enterprises of any description and to take over the management of electronic industrial units and to undertake and carry on all kinds of business relating to research, development, manufacture relating to the field of electronics which emphasised on certain particular type of activities as spelled out in the memorandum. There are various clauses amplifying what were the specific and main objects of the Corporation. In our opinion, in the instant case, the assessee-corporation had incurred the expenditure on scientific research and was entitled to the relief admissible under Section 35. Even Section 35(1)(ii) provides that even any sum is paid to a scientific research association which has as its object, the undertaking of scientific research or to a university, etc., would also be allowable provided that such association is for the time being approved by the prescribed authority. Incidentally, it may be mentioned here that the assessee at the first instance before the CIT(A) ralsed an objection that the assessing officer was not competent to adjudicate on the point whether the assessee was carrying on research and development or not and that the matter has to be decided by the Department of Science and Technology, Govt. of India, which alone could determine the point. The CIT(A) in that context gave a finding that the assessee had already been recognised by the Govt. of India, Department of Science and Technology and the period of recognition had been further extended up to 31-3-1985 and the CIT(A) has conclusively found that there cannot be any dispute now that the assessee was carrying on research and development operations. This finding of the CIT(A) has not been controverted by the Revenue before us. The assessment year involved is 1982-83 and the assessee's accounting year ended on 31-3-1982.

9. That apart we have already gone through the memorandum of association as well as the annual reports including the audited balance sheet and other accounts for our consideration. The CIT(A) noted that the assessee's main source of income was consultancy charges which were recovered for the preparation of feasibility reports for setting up electronic industry in the State. In our opinion it was for that purpose that such research and development work was carried on in the field of T.V., telecommunications and other electronic components. In the assessment order, the ITO noted the points mentioned by the assessee that the gross receipts

from that source, i.e., from promotion and development of electronic industry in the State were to the extent of Rs. 6,46,300. The assessee also mentioned that during the year, it paid Rs. 6,72,992 to various consultants on various technical matters as fees and that it had received Rs. 3,03,000 from the State Govt. for preparing feasibility reports. Thus we are of the opinion that the claim of the assessee is based by the facts on records and the details available which were also before the authorities below. Even otherwise, for the sake of argument, it can be said that even if a sum is paid to any Scientific Research Association, such sum would be qualified for rebate under Section 35, of course subject to the condition that such activity was approved by the prescribed authority. As stressed before us by the assessee's learned counsel "scientific research" means any activity for the extension of knowledge in the fields of natural or applied science including agriculture, etc. From whatever view we may take, we find that the claim of the assessee was justified. This part of the order of the authorities below is set aside. The claim of the assessee is allowed.

10. The next ground of appeal is that the authorities below erred in not allowing depreciation on - the capital expenditure of Rs. 15,83,209 which represented cost of machinery and plant used for carrying out research and development. The CIT(A) found no merit in this ground, as according to him the assessee-corporation did not carry on research and development even for its own benefit or as a commercial unit. The claim of the assessee was dismissed.

11. We have heard both the sides at length and we have gone through the orders of the authorities below at length for our consideration. As a corollary to our decision given in the first part of the appeal dealt with by us in the preceding paragraphs, we are of the opinion that the claim of the assessee should have been considered in the proper perspective. Since we have expressed the view that the assessee was entitled to the benefit of Section 35, we are of the view that depreciation as admissible will have to be taken into consideration in respect of such plant and machinery used "for the purpose of research and development. Accordingly, the assessing officer will look into the point and to give admissible relief on account of depreciation, etc., on such items as admissible after clarifying that the prerequisite conditions have been fulfilled. This part of the order of the

authorities below is set aside so that the assessing officer would ascertain the extent of the admissible depreciation as per law after giving the assessee a reasonable opportunity of being heard.

12. The next ground of appeal is regarding charging of interest under Section 139(8) and under Section 217. The CIT(A) took into account the decision of the Allahabad High Court as reported in 124 ITR 708 (sic).

He has given the direction to the assessing officer to allow reduction to the assessee as would be entitled consequent to any relief allowed by the appellate order. No further direction is necessary.

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