**<u>आयकर अपीलीय अधिकरण, विशाखापटणम पीठ, विशाखापटणम</u>**

**IN THE INCOME TAX APPELLATE TRIBUNAL,**
**VISAKHAPATNAM BENCH, VISAKHAPATNAM**

**श्री वी. दुर्गाराव, न्यायिक सदस्य एवं**

**श्री जी. मंजुनाथा, लेखा सदस्य के समक्ष**

BEFORE SHRI V. DURGA RAO, JUDICIAL MEMBER &
SHRI G. MANJUNATHA, ACCOUNTANT MEMBER

आयकर अपील सं**./I.T.A.Nos.188/Vizag/2015**

(निर्धारण वर्ष / Assessment Year: 2011-12)

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| M/s. Efftronics Systems Pvt. Ltd.<br>Vijayawada<br>[PAN: AAACE4879Q] | Vs. | ACIT, Range-2,<br>Vijayawada |
| (**अपीलार्थी** / Appellant) | | (**प्रत्यार्थी** / Respondent) |

आयकर अपील सं**./I.T.A.Nos.216/Vizag/2015**

(निर्धारण वर्ष / Assessment Year: 2011-12)

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| ACIT, Circle-2(1),<br>Vijayawada | Vs. | M/s. Efftronics Systems Pvt. Ltd.<br>Vijayawada |
| (**अपीलार्थी** / Appellant) | | (**प्रत्यार्थी** / Respondent) |

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| अपीलार्थी की ओर से / Appellant by | : | Shri C. Subrahmanyam, AR |
| प्रत्यार्थी की ओर से / Respondent by | : | Shri G. Gurusamy, CIT(DR) |
| सुनवाई की तारीख / Date of hearing | : | 22.09.2016 |
| घोषणा की तारीख / Date of Pronouncement | : | 21.10.2016 |

## आदेश / O R D E R

**PER G. MANJUNATHA, Accountant Member:**

These cross appeals filed by the assessee as well as revenue are directed against order of CIT(A), Vijayawada dated 30.3.2015 and it pertains to the assessment year 2011-12. Since, the facts are identical and issues are common, they are heard together and disposed off, by this common order for the sake of convenience.

2. The brief facts of the case are that the assessee is a company engaged in the business of manufacture and selling electronic moving display boards, data loggers and electronic systems, etc. The assessee has filed its return of income for the assessment year 2011-12 on 14.9.2011 admitting total income of Rs.21,50,620/- under normal provisions and Rs.2,03,94,650/- under the provisions of section 115JB of the Income Tax Act, 1961 (hereinafter called as 'the Act'). The return was processed u/s 143(1) of the Act and subsequently, the case has been taken up for scrutiny assessment and accordingly, notice u/s 143(2) of the Act was issued. In response to notices, the authorized representative of the assessee appeared from time to time and furnished books of accounts and other relevant details called for. During the course of assessment proceedings, the A.O. observed that the

assessee has claimed weighted deduction u/s 35(2AB) of the Act, towards research and development expenditure incurred in their in house R&D facility. Therefore, to ascertain the correctness of the claim made by the assessee, issued notice and asked to furnish the details of R&D facility and nature of research carried out in the R&D facilities along with necessary approvals from the competent authority.

3. In response to show cause notice, the assessee submitted that it is in the business of manufacturing and supply of moving display boards, data loggers and electronic systems, etc. to Indian Railways. The assessee further submitted that it has set up a research and development facility which was approved by the Secretary, Department of Scientific and Industrial Research (DSIR) under the provisions of section 35(2AB) of the Act. The assessee further submitted that the goods manufactured by it has been supplied to Indian Railways and Indian Railways is using these products to control and monitor smooth movement of trains and also display of arrival and departure details of trains. These equipments were manufactured as per the design supplied by the Research Designs and Standard Organization (RDSO) of the Indian Railways and these equipments were specifically designed for the purpose of Indian Railways. It was further submitted that its facility has been approved by the competent authority after satisfied with the

conditions prescribed under the provisions of section 35(2AB) of the Act, therefore, it has rightly claimed weighted deduction of 200% u/s 35(2AB) of the Act.

4. The A.O. after considering the explanations of the assessee held that the goods manufactured by the assessee are listed in the Eleventh schedule, at item no.22 being in the nature of office machines and apparatus such as type writers, calculating machines, cash registering machines, cheque writing machines, intercom machines and tele printers. The A.O. further observed that the goods manufactured by the assessee are nothing but office machines and apparatus listed in Eleventh schedule at item no.22, therefore, any company, which is involved in manufacturing or production of any article or thing, except those specified in the 11 schedule is eligible for weighted deduction u/s 35(2AB) of the Act. But, the assessee is involved in manufacturing of goods listed in Eleventh schedule, therefore, it is not eligible to claim deduction under the provisions of section 35(2AB) of the Act. The A.O. further observed that in view of the above provisions, even if an assessee's in house R&D facility approved by the competent authority, but if such assessee is involved in manufacture or production of an article or thing as specified in 11 schedule it makes the assessee ineligible for making any claim u/s 35(2AB) of the Act. With these

observations, disallowed the claim made by the assessee. Similarly, during the course of assessment proceedings, the A.O. observed that the assessee has failed to deduct TDS in respect of direct expenses. As per the provision of section 194C of the Act, TDS is ought to have deducted on such payments, where the payments exceed Rs.30,000/- during the financial year. Since the assessee failed to deduct TDS, the amount of Rs.3,57,463/- is disallowed under the provisions of section 40(a)(ia) of the Act. Similarly, the A.O. has disallowed bank guarantee charges incurred by the assessee for non-deduction of tax at source under the provisions of section 194H of the Act.

5. Aggrieved by the assessment order, the assessee preferred an appeal before the CIT(A). Before the CIT(A), the assessee reiterated the submissions made before the A.O. The CIT(A) for the reasons recorded, confirmed additions made by the A.O. towards weighted deductions under the provisions of section 35(2AB) of the Act. The CIT(A) further held that one of the conditions laid down u/s 35(2AB) of the Act, that the assessee should be engaged in the business of manufacture or production of any article or thing, except those specified in the 11 schedule. In the present case on hand, as per the information provided by the DRM (S&D), Vijayawada, the instruments manufactured by the assessee are in the nature of office machines and apparatus

being used in railway stations. The assessee failed to provide any convincing material facts on record to the claim that the instruments/articles manufactured does not fall under the Eleventh schedule. As regards disallowance of direct expenses under the provisions of section 40(a)(ia) of the Act, the CIT(A) held that the assessee has failed to deduct TDS on payment made to contractors under the provisions of section 194C of the Act. Since, the assessee failed to deduct TDS, the A.O. has disallowed the amount by invoking the provisions of section 40(a)(ia) of the Act. With these observations, upheld the disallowance made by the A.O. As regards disallowance of bank guarantee charges, the CIT(A) held that since the assessee claims to have made the total payment within the end of the financial year in view of the special bench decision of ITAT, in the case of Merilyn Shipping & Transports Vs. ACIT reported in 136 ITD 23, set aside the issue to the file of the A.O. and directed the A.O. to restrict the disallowance to the extent of amount remains payable at the end of the financial year. Aggrieved by the CIT(A) order, the assessee as well as the revenue are in appeal before us.

6. The first issue that came up for our consideration is rejection of weighted deduction claimed under the provisions of section 35(2AB) of the Act. The facts relating to the issue are that the assessee is in the

business of manufacturing of various electronic systems, data loggers and electronic moving display boards, etc. supplied to Indian Railways. The items manufactured by the assessee company are used for Indian Railways mainly in signaling and safety system for smooth operation and safe running of trains. The other items supplied by the assessee company are (1) track monitoring systems (2) water level monitoring system (3) train information system (4) data loggers (5) wrong operation indication system (6) RRI test, etc. The assessee has established in house research and development facility to continuous improvement of the products manufactured to suit the needs of Indian Railways. The R&D facility is owned by the assessee is approved by the Department of Scientific and Industrial Research, Ministry of Science and Technology, Government of India. During the financial year relevant to assessment year 2011-12, the assessee has incurred an amount of Rs.1,85,88,745/- towards revenue expenditure and a sum of Rs.25,22,566/- under capital expenditure. The assessee has claimed weighted deduction of 200% on total expenditure incurred towards R&D. The expenditure claimed by the assessee has been approved by the Director of Scientific and Industrial Research.

7. The A.O. disallowed the claim of weighted deductions u/s 35(2AB) of the Act, for the reasons that the items manufactured and supplied by

the assessee to Indian Railways are in the nature of office machines and apparatus used in Railway stations for office work and for data processing, therefore, these items are clearly falling in Eleventh schedule. The A.O. further observed that the data loggers, electronic items and electronic moving display boards are nothing but office machines and apparatus, therefore, the assessee is not eligible for claiming deduction u/s 35(2AB) of the Act. The A.O. has made elaborate discussions on the provisions of section 35(2AB) of the Act, Eleventh schedule and items manufactured by the assessee. The A.O. relied upon the letter written by the Railway Manager (S&D) vide his letter dated 28.2.2014 and opined that the items manufactured by the assessee are primarily installed in Railway stations to monitor movement of trains and also signals for smooth movement of trains. The A.O. further observed that the data loggers installed in the railway stations, stores data regarding changes that take place in relays, AC/DC voltages and DC current. According to the A.O., the items manufactured by the assessee i.e. data loggers and electronic moving display boards are falling in Eleventh schedule being office machines such as type writers, calculating machines, cash registering machine which can cheque writing machines, intercom machines and tele printers. The A.O. has taken clue from the Eleventh schedule and stated that the expression

office machines and apparatus includes all machines and apparatus used in office, shops, factories, workshops, educational institutions, railway stations, hotels and restaurants for doing office work and for data processing. Since, the items manufactured by the assessee are in the nature of office equipments, opined that the items are falling within the Eleventh schedule, therefore, assessee is not eligible for deduction u/s 35(2AB) of the Act.

8. It is the contention of the assessee that the goods manufactured by it are specially made items as per the specification provided by the Indian Railways Research Design & Standard Organization (RDSO) and RDSO will design the specification required for certain units to be installed at various railway stations which are assisted in controlling the movement of railways. All the items supplied by us were installed at various railway stations. These items will help the Indian Railways to run the train safely. The data loggers records the signaling relays on a memory and stores events data which is transferred to server installed in signaling test rooms at Divisional Head quarters which are useful for analyzing the failures and accidents. The assessee further contended that the items manufactured by it are used by the Indian Railways for smooth running of trains and to avoid accidents and to data storage,

therefore, by any stretch of imagination, these items can be categorized as office machines listed in Eleventh schedule.

9. The assessee has made elaborate write up on items manufactured. According to the assessee, data loggers consist of various equipments/things like signals, track points, etc. These items are used for safe movement of trains and to coordinate between the pilots for arrival and departure of trains. The coordination is called signaling interlocking. The system provides the status of various digital operations where the signal is ON or OFF, relay is UP or DOWN, the fuse is intact. Further data loggers provides the status of various voltages such as the track circuit voltage, AC voltage, DC voltage or high frequency axle channel voltages with accuracy. It was further submitted that these items were manufactured with a continuous process of research and development to meet the quality and efficiency of the machines to enhance the accuracy level of machines in controlling the movement of trains. The assessee further submitted that its R&D facility has been approved by the competent authority under the provisions of section 35(2AB) of the Act, after scrutinizing thoroughly all the details filed by the assessee. The competent authority has approved the facility and also approved the total expenditure incurred towards research and development. Therefore, the A.O. was not correct in holding that the

items manufactured by the assessee are listed in the Eleventh schedule, accordingly, not eligible for weighted deduction u/s 35(2AB) of the Act.

10. We have heard both the parties, perused the materials available on record and gone through the orders of the authorities below. The A.O. disallowed weighted deduction claimed by the assessee under the provisions of section 35(2AB) of the Act, for the reason that the items manufactured by the assessee are office machines and apparatus listed in Eleventh schedule. The A.O. was of the opinion that goods manufactured by the assessee are nothing but office machines and apparatus, such as type writers, calculating machines, cash registering machines, cheque writing machines, intercom machines and tele printers. The A.O. further was of the opinion that the office machines and apparatus include all machines and apparatus used in offices, shops, factories, railway stations, etc. According to the A.O., these items are primarily a data processing items installed in the railway stations to store the date related to movement of trains. The A.O. further was of the opinion that just because the R&D facility is approved by the prescribed authority, the deductions u/s 35(2AB) of the Act cannot be allowed. The A.O. is required to enquire the correctness of the claim made by the assessee and after satisfied with the explanations offered by the assessee that the goods manufactured by the assessee

are not in the nature of office machines and apparatus as listed in Eleventh schedule. Therefore, opined that just because the R&D facility is approved by the competent authority, deductions cannot be allowed unless the assessee satisfies the conditions prescribed under the relevant provisions to the satisfaction of the A.O.

11. It is the contention of the assessee that the goods manufactured by it are not mere office machines or apparatus listed in Eleventh schedule. The assessee further contended that the goods manufactured by it are specially designed for Indian Railways to monitor safe movement of trains and also display of arrival and departure details of the trains. It is further contended that its facility is approved by the competent authority, i.e. department of Scientific and Industrial Research, Ministry of Science and Technology, Government of India. Once, the R&D facility is approved by the competent authority, the A.O. has no authority to question the allowability or otherwise of the expenditure, unless he referred the matter to the competent authority, in case of any clarification required in this regard. The A.O. did not followed the due procedure under the rules, simply disallowed the claim made by the assessee for the reason that the goods manufactured by the assessee are listed in Eleventh schedule.

12. The only question came up for our consideration is whether on facts and circumstances of the case, the goods manufactured by the assessee are mere office machines or apparatus which are listed in Eleventh schedule item no.22 or an electronic equipments eligible for claiming deduction u/s 35(2AB) of the Act. Before we go into the facts of the present case, let us understand the provisions of section 35(2AB) of the Act. As per the provisions of section 35(2AB)(1) of the Act, where a company engaged in the business of bio technology or any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh schedule, 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 two times of the expenditure so incurred. A plain reading of section 35(2AB)(1) of the Act, makes it clear that to be eligible to claim deduction under the said provision, the assessee should be a company and it should be engaged in research and development facility and to incur expenditure towards such facility and the assessee should be engaged in the business of manufacture or production of any article or thing, except those specified in the Eleventh schedule and finally the R&D facility has to be approved by the

prescribed authority. Admittedly assessee is a company which is engaged in manufacture of electronic display boards, data loggers and electronic systems supplied to Indian Railways. The R&D facility owned by the assessee has been approved by Department of Scientific and Industrial Research, Ministry of Science and Technology, Government of India. The assessee has incurred an amount of Rs.1,85,88,745/- towards revenue expenditure on R&D and a sum of Rs.25,72,566/- towards eligible capital expenditure on R&D. All these facts were not disputed by the A.O. The only dispute is with regard to goods manufactured by the assessee. According to the A.O., the goods manufactured by the assessee are nothing but office machines and apparatus as listed in Eleventh schedule. Therefore, the A.O. opined that despite the R&D facility is approved by the competent authority because of goods manufactured by the assessee, the assessee is not eligible to claim deduction u/s 35(2AB) of the Act.

13. The assessee is involved in the business of manufacture of various electronic moving display boards and supplies to Indian Railways. The items manufactured by the assessee company are used by Indian Railways mainly used for smooth operation and safe running of trains. The other items supplied by the assessee company to Indian Railways are track monitoring, water level monitoring system, train information

system, data loggers, wrong operation indication system and RRI tests, etc. The assessee has submitted detailed write up of items manufactured and supplied to the Indian Railways. According to the assessee, these items are specially designed for Indian Railways as per the specifications given by the Research Designs and Standard Organization (RDSO) of the Indian Railways, which will design the specification required for certain units to be installed at various railway stations which are assisted in controlling the movement of railways. According to the assessee, the data loggers provides study of various digital operations whether the signal is ON or OFF, the relay is UP or DOWN, the fuse is intact. Further, data loggers provide the study of voltage such as the track circuit voltage, AC voltage, DC voltage or high frequency axle channel voltage with accuracy. The assessee indigenously developed micro processor based data logger system with various application softwares for railway signaling, etc. and this data logger is similar to aircraft black box. The data loggers records every event happening in the railways, i.e. operating suits of all these log tracks, points, signals, etc. reads the information to Central place via various types of indication intervention lock wire or wireless and through different interlock methods and at central place, located in the railway station itself different application softwares are provided to perform real

time analysis to only railway personnel recording failures happening in the railways, equipments states, real time simulation, etc. for enabling corrections indeed. This has tremendously improved safety, reliability and punctuality in railways, therefore, the items manufactured by the assessee cannot be considered as mere office machines and apparatus as defined under Eleventh schedule. Therefore, we are of the view that the items manufactured by the assessee are not a mere office machines or apparatus such as type writers, calculating machines, cash registering machines, cheque writing machines, intercom machines and tele printers. Though, the explanations provided to Eleventh schedule, defines office machines and apparatus includes all machines and apparatus used in office establishments, factories, workshops, educational institutions, railway stations for doing office work and for data processing, the items manufactured by the assessee cannot be equated with mere data processing machines installed in offices or railway stations. The items manufactured by the assessee are specially designed as per the specification provided by Indian Railways Research Design and Standard Organisation to suit the needs of the railway stations to control the movement of railways and also monitor safe movement of trains. In our considered view, the items manufactured by the assessee are specialized electronic equipments which needs

continuous improvement by way of research and development. The assessee in his business has established a research and development facility to improve the quality and efficiency of goods manufactured. The R&D facility owned by the assessee has been approved by the competent authority after fulfilling the conditions prescribed under the provisions of section 35 (2AB) of the Act. Therefore, the A.O. was not correct in holding that the goods manufactured by the assessee are mere office machines or apparatus listed in Eleventh schedule not eligible for claiming deduction u/s 35(2AB) of the Act.

14. The Ld. A.R. for the assessee submitted that the A.O. was erred in observing that the DSIR is not the competent authority to decide whether the assessee's claim u/s 35(2AB) of the Act is correct or not. The A.O. observed that, such eligibility should be decided by the assessing authority and the role of the DSIR is only to certify the quantum of expenditure incurred by the assessee in R&D work, which was not questioned. The A.R. further submitted that the A.O. was completely erred in observing that the DSIR role is limited to certifying the quantum of expenditure incurred towards R&D expenditure as, as per the provisions of section 35(2AB) of the Act and Rule 6(1)(b) of the Income Tax Rules, 1962 provides that any assessee applied for approval of its R&D facility before the Secretary, DSIR, Government of India in

form no.3CK, the Secretary DSIR, if he satisfied about the activities of the assessee of other parameters passes an order of approval in form no.3CM. After according sanction of approval, the Secretary, DSIR sends a report to the Director General, Income Tax (Exemptions) in form no.3CM within 60 days of granting approval. When DSIR passes the order of approval, it scrutinizes the application filed by the assessee with necessary details before granting approval after satisfied with the conditions stipulated under the provisions of section 35(2AB) of the Act. Before granting the approval, DSIR looks into various aspects including the products manufactured by the assessee to satisfy the conditions prescribed in section 35(2AB)(1) of the Act. Therefore, the A.O. was completely erred in observing that the role of DSIR is limited to certifying the quantum of expenditure incurred towards research and development, but not to approve the goods manufactured by the assessee.

15. Having heard both the parties, we find force in the arguments of the Ld. A.R. for the assessee for the reason that the provisions of section 35(2AB) of the Act, with relevant rules makes it mandatory for the assessee company to file its application for approval of its in house R&D before the Secretary, DSIR, Government of India. The applicant company should also submit an undertaking as per para-C of form

no.3CK to maintain separate accounts for each R&D centre approved u/s 35(2AB) of the Act by the prescribed authority and to get accounts duly audited every year by an auditor as defined in sub section(2) of section 288 of the Act. The company should enter into an agreement with the prescribed authority (Secretary, DSIR) for cooperation in such research and development facility and for audit of the accounts maintained for that facility as per form given in para-B of Form 3CK. The Secretary, DSIR after satisfied with the details furnished by the assessee and also after complied with the conditions prescribed under the provisions of section 35(2AB) of the Act and rules there under pass an order of approval in form no.3CM by duly intimating such approval to the Director General of Income Tax (Exemption) in form no.3CL within 60 days of granting approval. Once, the R&D facility is approved by the competent authority and assessee has complied with the prescribed rules, the A.O. is bound to allow the deductions claimed u/s 35(2AB) of the Act, if he is satisfied that the assessee's facility is approved by the competent authority. In case the A.O. is having any doubt with regard to the goods manufactured by the assessee or expenditure claimed, the A.O. is bound to refer the matter back to the competent authority through appropriate authority i.e. the Central Board of Direct Taxes (CBDT) and seek clarifications. Thus, it would emerge from above

analysis that neither the A.O. nor the board was competent to take any decision of any such controversy relating to report and approval granted by the prescribed authority as it involved expert view or opinion. It was prescribed authority alone which would be competent to take decision with regard to the correctness or otherwise and its order of approval granted in form no.3CL as prescribed u/s 35(2AB) of the Act read with rule 7A of the Income Tax Rules, 1962. In the present case on hand, on perusal of the facts available on record, we find that the A.O. without following the procedure laid down under rules, simply disallowed the expenditure claimed by the assessee by holding that the goods manufactured by the assessee are mere office machines and apparatus listed in Eleventh schedule. Therefore, we are of the view that the A.O. is not correct in disallowing the claim made by the assessee u/s 35(2AB) of the Act.

16. The next allegation of the A.O. is that the prescribed authority did not submit report in form no.3CL to the Director General, Income Tax (Exemptions) within 60 days of granting approval as required under rule 6(7A)(b) of the Income Tax Rules, 1967, consequently, the assessee is ineligible for claiming exemption u/s 35(2AB) of the Act. The A.O. further observed that the prescribed authority ought to have submitted the approval to the Director General of Income Tax within 60 days,

however, the said approval has been submitted to the Director General beyond the time specified under rule, therefore, the assessee is ineligible for exemption. We do not find any merits in the arguments of the assessee for the reason that it is for the competent authority to send the approval to the Director General of Income Tax (Exemptions) within such time as prescribed under the rules. In case such approval is not forwarded to the Director General of Income Tax (Exemptions), it is only a technical mistake for which the assessee cannot be penalized. In the present case on hand, the assessee has fulfilled the conditions prescribed under the provisions of section 35(2AB)(1) of the Act and rules there under, therefore for a technical breach the A.O. cannot disallow the exemption claimed u/s 35(2AB) of the Act.

17. It is pertinent to discuss the case law relied upon by the assessee. The assessee relied upon the decision of Hon'ble High Court of Karnataka, in the case of Tejas Networks Ltd. Vs. DCIT (2015) 233 Taxman 426. The Hon'ble High Court of Karnataka, under similar circumstances held that the A.O. had no jurisdiction to sit in judgement over report submitted by prescribed authority in form no.3CL as required u/s 35(2AB) of the Act read with rule (7A)(b). The relevant portion of the order is extracted hereunder:

*"A plain reading of section 35(2AB)(1) would indicate that where a company is engaged in the business of biotechnology or any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule 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," such assessee would be entitled to a deduction of a sum equal to one and half times of the expenditure so incurred. The word "Scientific Research" has been defined under subsection (4) of Section 43 of the Act, which is extracted supra and same would indicate expenditure incurred in such scientific research includes all expenditure incurred for the prosecution or the provision of facilities for the prosecution of such scientific research. However, it does not include expenditure incurred in the acquisition of rights in or arising out of scientific research. Such expenditure incurred should be approved by the authority prescribed under Section 35(2AB) of the Act read with Rules framed thereunder.*

*(Para 8)*

*Reading of Section 35 (3) of the Act would clearly indicate that where the assessing officer does not accept the claim of the assessee made under Section 35(2AB), he has to refer the matter to the Board, which inturn, will refer the question to the prescribed authority. The decision of the prescribed authority would be final as could be seen from clause (b) of subsection (3) of Section 35. Thus, it would emerge from above analysis that neither the assessing officer nor the Board is competent to take any decision on any such controversy relating to report and approval granted by "Prescribed Authority" as it involves expert view or opinion. The controversy arising out of certificate issued by the prescribed authority if any, has to be referred to the prescribed authority by the Board on such doubt being raised by Assessing Officer and also on his request. It is the prescribed authority alone which would be competent to take a decision with regard to correctness or otherwise of its order of approval granted in Form No. 3CL as prescribed under Section 35(2AB) of the Act read with Rule 7A of the Rules.*

*(Para 21)*

*A plain reading of Section 35(2AB) would clearly indicate that where a company is engaged in the business of bio-technology or in any business of manufacture or product/on of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) or in-house research and development facility as approved by the prescribed authority, then, they shall be al/owed a deduction of a sum equal to one and a half times of the expenditure so incurred. The word used '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. The said provision would also indicate that such expenditure as approved by the prescribed authority*

*would be entitled for being allowed as a weighted deduction, There being no dispute to the fact that DSIR being the prescribed authority in the instant case, had issued the report in Form No. 3CL - Annexure - M certifying the total R&D expenditure (excluding land and buildings) as prescribed under Section 35(2A6) for a sum of Rs. 4,601.9 lakhs as against the claim of Rs. 5,957 lakhs made by the assessee in the return of income and as such, neither the second respondent nor first respondent could have sat in judgment over the said certificate issued by the prescribed authority. In other words, when the prescribed authority had certified the extent of expenditure which would be allowable, the assessing officer could not have sat in appeal over such certification made by the prescribed authority. The allowability or otherwise of such expenditure cannot be the subject matter of scrutiny by the assessing officer. It would also be required to be noticed that the assessing officer would be out of bounds to examine as to whether such expenditure as certified by the prescribed authority can be allowed or disallowed under Section 35 of the Act. In other words, the assessing officer is precluded from examining the correctness or otherwise of the certificate issued by the prescribed authority on the ground that it is either being contrary to facts or contrary to the express provisions of the Act. It would not be out of context to state that when assessee files the report issued by the prescribed authority, as indicated under Section 35(2AB), before the jurisdictional assessing officer and seeks for allowability of such expenditure, the Assessing Officer would be exceeding in his jurisdiction, if he were to undertake the exercise of examining as to whether the certificate issued by the prescribed authority is within the parameters of statutory provisions of the Act or otherwise. Keeping in mind that such contingency may arise, Parliament has incorporated sub-section (3) to Section 35 of the Act which would be a complete answer to such situations. Thus, if any question arises as to what extent, any activity constitutes or constituted or an asset is or was being used for scientific research, then the Assessing Officer would be required to refer such question to the Board for being referred to the prescribed authority. The decision of the prescribed authority in this regard would be final, inasmuch as, the certification of such expenditure is being examined by an expert body and undisputedly, such exercise has been outsourced by the Revenue under the Act itself, since the prescribed authority being possessed of requisite expertise, it would be in a better position to certify as to whether such expenditure claimed by the assessee under Section 35(2AB) would fall within the said provision or outside. This exercise of examining the correctness of the Certificate issued by the prescribed authority is not available to the Assessing Officer as could be seen from scheme of Section 35 of the Act.*

*It is in this background, sub-section (4) of Section 43 will have to be considered, which defines as to what activities would constitute "scientific research" as indicated under the said Section namely, Section 43(4). As to whether any expenditure incurred in the acquisition of rights in or arising*

*out of scientific research as indicated in clause (ii) of sub-section (4) of Section 43 Is an issue which requires to be examined by the prescribed authority itself and it would not be in the domain of the assessing authority to undertake such an exercise. When Section 35(2AB), Section 35(3) and Section 43(4) of the Act are read harmoniously, the irresistible conclusion that has be drawn would be that assessing officer cannot sit in judgment over the report submitted by the prescribed authority in Form No. 3CL.*

*(Para28)*

*In view of the finding that Assessing Officer - first respondent had no jurisdiction to sit in judgment over the report submitted by the prescribed authority in Form No. 3CL as required under Section 35(2AB) of the Act read with Rule (7A)(b) of Income Tax Rules, 1961, it has to be held that the issue of entertaining the writ petition on the ground of alternate remedy would recede to background and it has to be held that present writ petition would be maintainable in the facts obtained in the present case as discussed herein above and writ petition cannot be dismissed on the ground of petitioner having alternate remedy of appeal.*

*(Para30)"*

18. The assessee relied upon the decision of ITAT, Bombay in the case of DCIT Vs. Famy Care Ltd. (2015) 67 SOT 85. The coordinate bench of this Tribunal, under similar circumstances held that once facility was approved, entire expenditure so incurred on development and research had to be allowed for such weighted deduction u/s 35(2AB) of the Act and thus it would be sufficient to held that assessee has fulfilled the conditions as laid down in section. The relevant portion of the order is extracted hereunder:

*"It was noted that for granting approval u/s 35(2AB) of the Act, the Assessee made application, with the prescribed authority, in accordance with section 35(2A8)(3) r. w Rule 6(4) of the Income-tax Rules, 1962 on 11/12/2007. The prescribed authority approved/granted in-house research and development facility u/s 35(2AB) of the Act on 04/032009 for a period from October 19, 2007 to 31st March 2010 in Form no. 3CM, in accordance with Rule 6(5A) of the Rules. This approval was produced before the Assessing Officer during assessment proceedings i.e. before*

*framing the assessment on 30/12/2011. The prescribed authority sent form no.3CL to the Income-tax Department on 22nd November 2010 (A. Y. 2008-09) in accordance with section 35(2AB)(4) read with Rule 6(7A)(b) of the Rules. As the approval of the entire period was given once i.e. by way of Form no. 3M, thus, in our view, the assessee complied with the conditions for claim of deduction as required u/s 35(2AB) of the Act.*

*If the aforesaid section was analyzed then the deduction shall be a//owed of a sum equal to two times of the expenditure so incurred and the prescribed authority is to submit its report of such approval/facility to the Director General on a prescribed form within specified time, meaning thereby, the authority concerned had to submit the report to the Director General. However, if the totality of facts are analyzed, as mentioned earlier, the assessee made application for such approval on 11/12/2007 with the prescribed authority and such approval was granted on 04/03/2009, therefore, the assessee cannot be denied the claimed deduction u/s 35(2AB) of the Act merely on the ground that the prescribed authority does not submit form no. 3CL in time to the Income-tax Department. The assessee cannot be penalized for the fault, if any, of the Department. The Assessing Officer cannot be expected to be too technical rather was to take practical approach under the facts narrated hereinabove, because, it was beyond the control of the assessee to direct the authority to submit the prescribed form on Form no.3CL to the Department. Section 35(2AB) of the Act, nowhere suggest that the date of approval of research and development facility would be cut off date for eligibility of weighted deduction under this section on expenses incurred from that date onwards; Once facility was approved, entire expenditure so incurred on development of research and development facility had to be allowed for such weighted deduction u/s 35(2AB) of the Act and thus it would be sufficient to hold that assessee had fulfilled the conditions as laid down in the section. Even otherwise, the id. Commissioner of Income tax (Appeals) directed the Assessing Officer to verify the Form No.3CM and 3CL and then allowed weighted deduction, as claimed by the assessee. Tribunal had found no infirmity in the conclusion and the direction in the impugned order. It was affirmed. Finally, the appeal of the Revenue was dismissed."*

19. The assessee relied upon the decision of Hon'ble High Court of Gujarat, in the case of DCIT Vs. Mastek Ltd. (2013) 263 CTR 671. The Hon'ble High Court, under similar circumstances held that if an assessee puts forth a claim of deduction u/s 35(1) of the Act for expenditure incurred on scientific research and if A.O. is not inclined to accept such a

claim, he may seek opinion of prescribed authority and the decision of prescribed authority would govern parties. The A.O. not having obtained decision of prescribed authority though a serious question in present case had arisen was not justified in rejecting assessee's claim for deduction of expenditure incurred for scientific research. The relevant portion of the order is extracted below:

> *The term scientific research in the context of the deduction allowable under section 35(1) of the Act would include wide variety of activities. What is to be ascertained is whether any scientific research was undertaken and not whether such scientific research resulted into the ultimate aim for which such research was undertaken. What the Legislature desired to encourage by granting deduction under section 35(1) of the Act was a scientific research and not necessarily only the successful scientific research undertaken by an assessee.*
>
> *(para 25)*
>
> *Tribunal without discussing full materials on record came to such conclusion which, in our opinion, ought not to have been done. These are matters of extreme scientific complexities. What was the nature of the research undertaken, what was the improvement in the existing software aimed at or desired, whether ultimately the product which was launched by the assessee after undertaking such so called scientific research, was a new product substantially different from the existing one or not were some of the issues on which the Tribunal, in our humble opinion, without bestowing sufficient attention ruled in favour of the assessee. We may caution that such issues of extreme scientific complexities, should not be decided without referring to the full materials on record and appreciating the complexities of the issue on hand.*
>
> *(para 27)*
>
> *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.*

*(para 28)*

*The AO not having obtained such a decision of the prescribed authority though a serious question in the present case had arisen, in our opinion, was not justified in rejecting the assessee's claim for deduction of expenditure incurred for scientific research. The Tribunal in this regard, came to a correct conclusion.*

*(para30)*

*Tribunal itself ought not to have decided this question without the opinion of the prescribed authority, particularly without full discussion on the materials on record. The question No.B is answered by holding that the reference ought to have been sought by the revenue before the Board to the prescribed authority and not having done so, the Tribunal was justified in reversing the orders of the revenue authorities rejecting the Assessee's claim for deduction."*

20. Considering the facts and circumstances of this case and also respectfully following the ratios of decisions discussed above, we are of the view that the A.O. was erred in disallowing the weighted deduction claimed by the assessee under the provisions of section 35(2AB)(1) of the Act, despite the assessee's R&D facility was approved by the competent authority. We further was of the view that the goods manufactured by the assessee are not a mere office machines or apparatus as listed in Eleventh schedule, but they are specially designed electronic equipments meant for use by Indian Railways to monitor smooth movement of trains. The assessee has categorically proved by filing necessary evidences of approval granted by the prescribed

authority and also returns filed annually to the prescribed authority to justify the expenditure incurred towards R&D expenditure. In our considered view, the competent authority has to decide whether a particular expenditure is eligible for deduction u/s 35(2AB) of the Act or not, but not the assessing officer. In the present case, the A.O. without following the due procedure laid down under the provisions of the Act and rules there under, simply disallowed the expenditure claimed by the assessee. Therefore, we direct the A.O. to allow the weighted deduction claimed by the assessee under the provisions of section 35(2AB)(1) of the Act.

21. The next issue that came up for our consideration is disallowance of direct expenses for non-deduction of tax at source under the provisions of section 194C of the Act. The A.O. disallowed an amount of Rs.3,57,463/- for the reason that the assessee ought to have deducted TDS on such payments, however, failed to deduct TDS as required under the provisions of section 194C of the Act. It is the contention of the assessee that the expenditure incurred under the head "direct expenses" have been fully paid within the same financial year and in view of the special bench decision of ITAT, Visakhapatnam in the case of Merilyn Shipping & Transports Vs. ACIT (supra), no disallowance can be made, if the amounts have been fully paid within the same financial

year. We find force in the arguments of the assessee for the reason that the coordinate bench of this Tribunal, in the case of Merilyn Shipping & Transports (supra) under similar circumstances held that no disallowance can be made under the provisions of section 40(a)(ia) of the Act, if the amounts have been fully paid within the same financial year. Therefore, we are of the view that the A.O. was not correct in disallowing direct expenses under the provisions of section 40(a)(ia) of the Act for non-deduction of tax at source. As regards the Ld. D.R. arguments that the department has not accepted the decision of Merilyn Shipping & Transports (supra), we find that the coordinate bench of this Tribunal, in the case of Mukundara Engineers and Contractors Vs. ACIT, has considered the issue and after considering the revenue objection with regard to the special bench decision of M/s. Merilyn Shipping & Transports (supra) and also considering the ratio of Hon'ble A.P. High Court in the case of Janapriya Engineering Syndicate decided the issue in favour of the assessee. The relevant portion is reproduced hereunder:

> "*We have carefully considered the rival submissions and perused the record. Consistent with the view taken by the ITAT Special Bench Visakhapatnam and also in the light of the view expressed by the Hon'ble A.P. High Court in the case of Janapriya Engineering Syndicate, we are of the opinion that the provisions of section 40a(ia) of the Act cannot be made applicable in respect of the amounts already paid before 31st March. In other words, the A.O. is directed to restrict the disallowance to the*

*amounts payable after 31st March. With these observations, ground no.3 of the assessee is treated as* ***partly allowed."***

22. In this view of the matter and also respectfully following the ratio of the coordinate bench, we are of the view that no disallowance can be made u/s 40(a)(ia) of the Act, for the amounts which have been already paid during the financial year. However, the facts relating to paid and payable are not emerging from the records, therefore, we set aside the issue to the file of the A.O. and direct the A.O. to examine the issue paid and payable with reference to books of accounts of the assessee and if the expenditure incurred by the assessee is paid within the same financial year, then the A.O. is directed to delete the additions made u/s 40(a)(ia) of the Act. In other words, the A.O. is directed to restrict the disallowances to the extent the amount remaining payable at the end of the financial year.

23. The next issue that came up for our consideration is disallowance of bank guarantee charges under the provisions of section 40(a)(ia) of the Act for non-deduction of TDS u/s 194H of the Act. The ld. A.R. for the assessee, at the time of hearing submitted that this issue is covered by the decision of ITAT, Visakhapatnam in assessee's own case for the assessment year 2009-10 and submitted that the coordinate bench of this Tribunal, under similar circumstances deleted the additions made by

the A.O. We find that the coordinate bench of this Tribunal in ITA No.205/Vizag/2013 for the assessment year 2009-10 by following the decision of ITAT Mumbai in the case of Kotak Securities Ltd. Vs. DCIT (2012) 14 ITR (Trib) 495 deleted the additions made by the A.O. towards bank guarantee charges. The relevant portion of the order is extracted as under:

> *"2. After hearing rival contentions, we find that the first appellate authority has followed the decision of the Mumbai Bench of the Tribunal in the case of Kotak Securities Limited v. DCIT reported in (2012) 50 SOT 158 (Mumbai) and deleted the disallowance in question.*
>
> *3. The Mumbai Bench of the Tribunal in the case of Kotak Securities Limited (supra) held as follows:-*
>
> > *"There is no principal agent relationship between the bank issuing the bank guarantee and the assessee. When bank issues the bank guarantee, on behalf of the assessee, all it does is to accept the commitment of making payment of a specified amount to, on demand, the beneficiary, and it is in consideration of this commitment, the bank charges a fees which is customarily termed as `bank guarantee commission'. While it is termed as `guarantee commission', it is not in the nature of `commission' as it is understood in common business parlance and in the context of the s.194H. This transaction, is not a transaction between principal and agent so as to attract the tax deduction requirements under s.194H. CIT(A) indeed erred in holding that the assessee was indeed under an obligation to deduct tax at source under s. 194H from payments made by the assessee to various banks. Assessee was not required to deduct tax at source u/s 194H, the question of levy of interest u/s 201(1A) cannot arise.*
>
> *<u>Conclusion</u> :*
> *When there is no principal agent relationship between bank issuing bank guarantee and assessee, transaction between them is not transaction between principal and agent so as to attract tax deduction under s.194H."*
>
> *4. Respectfully following the order in the case of Kotak Securities Limited (supra), we uphold the order of the learned CIT(A) and dismiss the appeal of the Revenue."*

24. Considering the facts and circumstances of the case and also respectfully following the order of the coordinate bench, we direct the A.O. to delete the additions made towards bank guarantee charges.

25. In the result, the appeal filed by the assessee is allowed for statistical purposes and the appeal filed by the revenue is dismissed.

The above order was pronounced in the open court on 21st Oct'16.

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| Sd/- | Sd/- |
| **(वी. दुर्गाराव)** | **(जी. मंजुनाथा)** |
| **(V. DURGA RAO)** | **(G. MANJUNATHA)** |
| **न्यायिक सदस्य/JUDICIAL MEMBER** | **लेखा सदस्य/ACCOUNTANT MEMBER** |

विशाखापटणम /Visakhapatnam:
दिनांक /Dated : 21.10.2016
VG/SPS
आदेश की प्रतिलिपि अग्रेषित/Copy of the order forwarded to:-

1. अपीलार्थी / The Appellant – M/s. Efftronics Systems Pvt. Ltd., 40-15-9, Brundavan Colony, Labbipet, Vijayawada
2. अपीलार्थी / The Appellant – The ACIT, Circle-2(1), Vijayawada
3. प्रत्यार्थी / The Respondent – The ACIT, Range-2, Vijayawada
4. आयकर आयुक्त / The Principal CIT, Vijayawada
4. आयकर आयुक्त (अपील) / The CIT (A), Vijayawada
5. विभागीय प्रतिनिधि, आय कर अपीलीय अधिकरण, विशाखापटणम **/** DR, ITAT, Visakhapatnam
6**.** गार्ड फ़ाईल / Guard file

आदेशानुसार / BY ORDER

// True Copy //

वरिष्ट निजी सचिव (Sr.Private Secretary)
आय कर अपीलीय अधिकरण, विशाखापटणम **/**
ITAT, VISAKHAPATNAM