

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on : 16.12.2019

Pronounced on : 19.05.2020

CORAM

THE HONOURABLE MR.JUSTICE C.SARAVANAN

W.P. Nos. 27545 & 32803 of 2017
and

M.P. Nos. 36144 & 36145 of 2017

M/s.Polaris Financial Technology Ltd.,
Polaris House,
Represented by its Director,
No.244, Anna Salai,
Chennai - 600 006.

(Presently known as M/s.Polaris Consulting &
Services Limited
34, IT Highway, Navallur,
Chennai - 603 103.)

...Petitioner in both W.Ps.

vs

1.The Secretary,
Department of Scientific and Industrial Research
Technology Bhavan,
New Mehrauli Road,
New Delhi - 110 016.

2.The Assistant Commissioner of Income Tax
Corporate Circle V (2),
Aayakar Bhavan,
121, Mahatma Gandhi Road,
Nungambakkam,
Chennai.

...Respondents 1 & 2 in both W.Ps.

3.Head of Department,
Department of Scientific and Industrial Research,
Ministry of Science and Technology,
Government of India, Technology Bhavan,
New Mehrauli Road,
New Delhi - 110 016

...Respondent No.3 in W.P.No. 32803 of 2017

Prayer in W.P. No. 27545 of 2017: Petition filed under Article 226 of the Constitution of India to issue a Writ of Mandamus directing the First Respondent herein to amend its order dated 08.07.2014 to the limited extent of rectifying the retroactive effect of the approval from 01.04.2013 to 31.03.2015, 25.04.2012 to 31.03.2015.

Prayer in W.P. No. 32803 of 2017: Petition filed under Article 226 of the Constitution of India to issue a Writ of Certiorarified Mandamus, calling for the records of the Third Respondent pertaining to the order titled "Discussion with M/s. Polaris Financial Technologies Limited" dated 17.01.2017 and quash the same and consequently directing the First Respondent to consider afresh the Petitioner's Representation dated 07.11.2016.

For Petitioner
(in both W.Ps) : Mr. Srinath Sridevan

For R1 & R3
(in both W.Ps) : Mr. K. Raju
Standing Counsel

For R2
(in both W.Ps) : Mr. Hema Muralikrishnan
Senior Standing Counsel

COMMON ORDER

By this common order both the Writ Petitions are being disposed.

W.P.No.27545 of 2017:

2.W.P.No.27545 of 2017 has been filed, to issue writ of mandamus directing the 1st respondent to amend the approval granted to the petitioner vide letter dated 08.07.2014 in Form No.3CM, for the purpose of Section 35(2AB) of the Income Tax Act, 1961, from 01.04.2013 to 31.03.2015.

3.The petitioner wants the recognition from 25.4.2012, being the date of the application filed by the petitioner for recognition under Section 35(2AB) of the Income Tax Act, 1961.

W.P.No.32803 of 2017:

4.W.P.No.32803 of 2017 has been filed, to issue a writ of certiorarified mandamus, to quash the impugned order dated 17.01.2017 of the 3rd respondent, namely Head of the Department, Department of Scientific and Industrial Research, Ministry of Science and Technology and consequently, to direct the 1st

respondent to consider afresh the petitioner's representation dated 07.11.2016.

5. In impugned order dated 17.01.2017 in W.P.No.32803 of 2017, the 3rd respondent has recorded the minutes of meeting held between the representatives of the petitioner and the officers of the 3rd respondent. It reads as under:-

"The meeting with M/s. Polaris Technologies Ltd., was held earlier also on 09.05.2014.

The issue is that their approval was given from 1st April 2013 and they are asking approval of F.Y 2012-2013 for capital equipment. The list of equipment of 2012-13 include computers, which is not capital equipment. Now, the case is 5 years old and 3CM was approved by the then prescribed Authority. As such the approval for F.Y.2012-2013 cannot be accorded.

Moreover in earlier meeting, the company's CFO had agreed for approval from 01.04.2013."

6. It is the case of the petitioner that the petitioner is engaged in In-House Research and Development of software for banks and financial institutions. According to the petitioner, it offers superior technology solutions through its two specialized divisions/ R&D Centers at Navalur & Siruseri that enable its client an unprecedented operational efficiency in FT (Financial Technology) Services and FT Products and is therefore eligible for recognition/certificate under Section 35(2AB) of the Income Tax Act, 1961 from the 1st respondent.

7. The 1st respondent has filed its counter affidavit only in W.P.No.27545 of 2017. However, no counter has been filed in W.P.No.32803 of 2017. The Income Tax Department has not filed its counter in both the writ petition as is is merely a formal party. Learned Counsel for the Income Tax Department t submits that it will abide by the order of this Court.

8. The petitioner filed an application before the 1st respondent on 25.04.2012 based on certificate given by the 1st respondent to the petitioner's In-House R&D units for the purpose of Notification No.24/2007-Customs dated 01.03.2007 and Notification No.16/2007-Central Excise dated 01.03.2007. The recognition however stipulated as follows:-

"08.The recognition by DSIR does not amount to approval under any section of Income Tax Act. Tax

concessions, rebates, import concessions etc, if any, will be governed by the tax laws in operation from time to time. All such matters should be taken up by the company directly with the concerned authorities."

9. The recognition was subject to conditions stipulated therein.

10. In the light of the above recognition, the petitioner filed an application before the 1st respondent on 25.4.2012 for approval under Section 35(2AB) of the Income Tax Act, 1961.

11. The petitioner enclosed copy of the recognition / certificate given by the 1st respondent to the petitioner for the purpose of aforesaid Notification No.24/2007-Customs dated 01.03.2007 and Notification No.16/2007-Central Excise dated 01.03.2007.

12. Pursuant to the aforesaid application, there were deliberations which culminated in the issue of order of approval in Form No.3CM dated 08.07.2014. The approval has been issued to the petitioner for the period between 01.04.2013 and 31.03.2015.

13. According to the petitioner, the approval should have been for the period commencing from 25.04.2012 and not from 01.04.2013. The petitioner sent several representation. Meanwhile, the aforesaid approval granted to the petitioner for the purpose of Section 35(2AB) of the Income Tax Act, 1961 was extended upto 31.03.2017.

14. According to the petitioner, the approval form 01.04.2013 was contrary to the guidelines for issue of approval in Form No.3CM issued during the month of May 2010. In this connection, a reference was made in paragraph 6(1) of the guidelines of May 2010, which reads as under:-

"6. POLICY FOR APPROVAL

(I) Approval to the in-house R&D centers having valid recognition by DSIR are considered from 1st April of the year in which the application is made in For 3CK."

15. The learned counsel for the petitioner relied on the following decisions:-

i. Maruti Suzuki India Ltd., Vs. Union of India & Another, 2017 SCC OnLine Del 9568.

ii. Bachhittar Singh Vs. State of Punjab and Another,
AIR 1963 SC 395.

16. The 1st respondent has filed its counter affidavit and has raised the preliminary objections stating that the 1st respondent had approved the petitioner in In-House R&D for the period between 01.04.2013 to 31.03.2015 in Form No. 3CM.

17. According to the 1st respondent, at the time of filing application for recognition the in-House R&D units of the petitioner were not functional. The companies desirous of such recognition which require to apply to the DSIR only where R&D was functional at the time of filing such application and therefore question of giving approval retrospectively from 25.04.2012 does not arise.

18. It is submitted that the incentive under Section 35(2AB) is fiscal incentives given on the expenditure incurred on scientific research (not being expenditure in the nature of cost of any land or building) in certain areas specified under Section 35(2AB) of the Income Tax Act, 1961.

19. It is submitted that plain reading of the Section 35(2AB) of the Income Tax Act, 1961, makes it clear that "in-house research and development facility", in respect of which deduction is sought, must be "approved" by the prescribed authority i.e., Secretary, DSIR and no deduction would be allowed to the concerned company unless it enters into an agreement with the DSIR for co-operation in "such research and development facility" and for audit of the accounts maintained for that facility. In this connection, a reference was invited to Section 35(2AB) of the Income Tax Act, 1961.

20. As far as the alleged violation of guidelines of DISR of May 2010 is concerned, it is submitted that to become eligible for approval under Section 35(2AB) of the Income Tax Act, 1961, R&D must be holding valid recognition by DISR.

21. In other words, an in-house R&D unit of a company shall be approved by the DSIR only if it has been granted recognition under the aforementioned DSIR Scheme and such recognition is valid at the time of application for approval. Section 35(2AB) of Income Tax Act, 1961 is applicable only for those companies who are engaged in manufacturing activities.

22. In this connection, a reference was made in paragraph 3, 5 and 6 of the guidelines, which are reproduced below:-

3.

- (i) The R&D centres are holding valid recognition by DSIR;
- (ii) The company has well defined R&D programs;
- (iii) The company maintains proper documentation for the R&D programs taken up;
- (iv) The in-house R&D centre is located in a separate earmarked area/building and has exclusive R&D manpower of its own;
- (v) The R&D centres are exclusively engaged in research and development for production of any article or thing not being an article or thing specified in the list of the eleventh schedule of the Income Tax Act placed at Annexure -VI.

5.

i).....

ii) In case the company has applied to the prescribed Authority for approval of more than one in-house R&D centre under Section 35(2AB) of the I.T Act, each of such centres should have a valid recognition by DSIR.

iii)

iv) The company should also submit an undertaking as per Part C of Form No. 3CK to maintain separate accounts for each R&D centre approved under Section 35(2AB) by the Prescribed Authority, and to get the accounts duly audited every year by an Auditor as defined in sub-section (2) of section 288 of the IT Act, 1961. (The statutory auditors of the Company should audit the R&D accounts. To facilitate this audit separate books of accounts for R&D should be maintained. Also, the statutory auditors should sign the auditors' certificate in the details required to be submitted as per annexure - IV of the guidelines to facilitate submission of Report in Form 3CL.

(v) The company should enter into an agreement with the Prescribed Authority (Secretary, DSIR) for co-operate in such research and development facility and for audit of the accounts maintained for that facility, as per format given in Part B of Form 3CK.

vi) The audited accounts for each year maintained separately for each approved centre shall be furnished to the Secretary, Department of Scientific & Industrial Research by 31st day of October of the succeeding year, along with information as per Annexure - IV of the Guidelines.

6.

i) Approval to the in-house R&D centers having valid recognition by DSIR are considered from 1st April of the year in which the application made in Form 3CK.

ii) Approval is considered co-terminus with DSIR recognition.

iii) For companies not having DSIR recognized in-house R&D centre, approval is considered from the date of recognition.

(iv) In case of firms having signed agreement of co-operation u/s.35 (2AB) with Prescribed Authority for one or more R&D centers approved with DSIR which implies that they have been maintaining separate accounts for R&D:- the R&D centre newly setup by such firms may be approved from the year in which investments on these centers of capital and revenue nature commenced or after the agreement of cooperation was signed, (whichever was later) to enable these companies to claim weighted tax deduction on eligible R&D expenditure of capital and revenue nature on the new centers.

v) In case of firms, not having DSIR recognized R&D centre, but which have applied for approval u/s 35 (2AB) of an in-house R&D center on which they had made capital investments on R&D of more than Rs. one crore, excluding expenditure on land and building, in the financial year preceding the year in which the firm applied to the prescribed authority for the approval capital expenditure on the R&D facility for which approval has been requested (excluding capital expenditure on land and building) incurred from the commencement of said preceding year, provided the company had claimed such capital expenditure in their I.T return for concerned assessment year and the firm/R&D centre fulfils other conditions of approval, and provided the centre was subsequently recognized by DSIR.

vi) In case of firms, having R&D centres already recognized by DSIR and who have applied for approval of an in-house R&D centre u/s 35 (2AB) and who have made capital investment on R&D of more than Rs. one crore, excluding capital expenditure on land and buildings, on such centre in the financial year preceding the year in which the firm applied to prescribed authority for the approval - such capital expenditure incurred in the said preceding year provided the company had

claimed such capital expenditure in their I.T returns for concerned assessment year."

23.It has been further stated that the petitioner was having income only from services provided by it to its clients and therefore petitioner was not be entitled to the benefit of Section 35(2AB) of the Income Tax Act, 1961 as it was no engaged in manufacturing activities.

24.The respondent relied upon the decision of the Delhi High Court in Apollo Tyres Ltd., Kochi Vs. Union of India, 2010 SCC OnLine Del 1599, wherein, it has been held as follows:-

"8. From the aforesaid two provisions of the said guidelines, it was pointed out by Mr.Chandhiok that, in the first instance, the approval to in-house research and development centres having valid recognition by the Department of Scientific and Industrial Research, would, as a normal rule, be considered from the first of April of the year in which the application is made in Form 3CK. He submitted that in the present case, the application in Form 3CK was made on 21.08.2008 and, therefore, in terms of these guidelines, the approval would normally have been granted from 01.04.2008. However, in view of the guideline prescribed in clause (vi) of para 6, a beneficial provision has been made so as to extend the approval of an in-house research and development centre to the previous year, but limited only to capital expenditure (excluding any capital expenditure on land and buildings). It is for this reason, according to Mr.Chandhiok, that the approval in Form 3CM granted on 15.06.2009 has been given with effect from 01.04.2007. It was also pointed out that it is because of these provisions, which are beneficial to the petitioner, that the benefit of weighted tax deduction for the year 2007-08, which is the year prior to the year of application, has been limited to capital expenditure (excluding expenditure on land and building). However, for the period subsequent to 01.04.2008, the petitioner would be entitled to the entire benefit as stipulated under Section 35(2AB), both on the capital expenditure as well as on revenue expenditure, excluding, of course, the capital expenditure on land and building.

9. After having considered the arguments advanced by the counsel for the parties, we are inclined to accept the submissions made by

Mr.Chandhiok on behalf of the respondent. While it may be true that, initially, the petitioner had obtained approval right upto 31.03.2010, but that approval would be relatable only to Section 35(2AB) (1). Before a company is entitled for deduction under the said sub-section (1), it must also enter into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of accounts maintained for that facility. This is specifically stipulated in clause (3) of Section 35(2AB) of the said Act. We find that the agreement was entered into only on 21.08.2008 when the petitioner made the application in Form 3CK. We have already mentioned that part 'B' of the said form comprises of the said agreement. Such an agreement is a condition precedent to the kind of approval, for the purposes of deduction, which the petitioner is seeking. This condition was only met on 21.08.2008. Therefore, the petitioner's plea that it ought to have been granted approval with effect from 01.04.2004 and not with effect from 01.04.2007 is not acceptable.

10. Insofar as the plea that the approval has been granted for the financial year 2007-2008 only for capital expenditure and not revenue expenditure, is concerned, we agree with the submissions made by Mr.Chandhiok that the benefit would not have normally accrued to the petitioner for the financial year 2007-2008 because the approval would normally have been granted only in the year in which the application in form 3CK is made. If that were to be the case, then the petitioner could have got approval only with effect from 01.04.2008. It is only because of the beneficial provisions indicated in the guidelines that the benefit has been extended to the earlier year, being the financial year 2007-08, subject to the condition that such benefit would be limited only to the capital expenditure (excluding the capital expenditure on land and building). Thus, on this ground also, we feel that the petitioner has no case.

25. I have heard the learned counsel for the petitioner, learned Standing counsel for the 1st and 3rd respondents and learned Senior Standing counsel for the 2nd respondent. I have also perused the records.

26. The petitioner has attempted to claim the benefit of exemption/deduction under Section 35(2AB) of the Income Tax Act,

1961 and therefore, the petitioner filed an application on 26.06.2012 in Form No.3CK, to obtain the approval under the aforesaid provisions of the Income Tax Act, 1961.

27.The petitioner relied on the recognition /certificate given by the 1st respondent under Notification No.24/2007-Customs dated 01.03.207 and Notification No.16/2007-Central Excise dated 01.03.2007.

28.Sine qua non for getting approval under Section 35(2AB) of the Income Tax Act, 1961, the company should be engaged in-house research and development facility as approved by the prescribed authority in either:-

"a)in business of bio-technology; or
b) in any business of manufacture or production of any article or thing (not being specified in the list of the Eleventh Schedule of the Income Tax Act, 1961)"

29.Then, such company shall be allowed deduction of a sum equal to one and half times (two time at the relevant time) so incurred. The petitioner company is not engaged in bio-technology.

30.Based on the documents that have been filed and the averments of the petitioner, it appears that the activity of the petitioner prima facie does not come with the broad definition of manufacture in in Section 2(29BA).

31.The definition of 'Manufacture' in Section 2(29BA) of the Income Tax Act, 1961, reads as under:-

"(29BA) "manufacture", with its grammatical variations, means a change in a non-living physical object or article or thing,-

(a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure;"

32.To avail the benefit of exemption/deduction under Section 35(2AB) of the Income Tax, 1961, the petitioner is also required to enter an agreement with the Authority prescribed to research and development facility and fulfils such conditions with regard

to maintenance of accounts and audit thereof and furnishing of report in such manner as may be prescribed as is evident from reading of the aforesaid Section.

33. For a better understanding of the aforesaid provision, the same is reproduced below:-

"35. (1) In respect of expenditure on scientific research, the following deductions shall be allowed-

.....

(2AB) (1) Where a company engaged in the business of bio-technology or in 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 one and one-half times of the expenditure so incurred:

Provided that where such expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility is incurred in a previous year relevant to the assessment year beginning on or after the 1st day of April, 2021, the deduction under this clause shall be equal to 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 co-operation in such research and development facility and fulfils such conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in such manner as may be prescribed.

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

(5) [***]

(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.

34. It is not clear as to on what basis the impugned approval in Form 3CM dated 08.07.2014 was issued to the petitioner even though the petitioner prima facie does not appear to qualify for such deduction under the Income Tax Act, 1961.

35. Since there is no discussion as to how the activity undertaken by the petitioner was engaged in manufacture or production of any article or thing, I am inclined to remit the case back to the 1st respondent in W.P.No.27545 of 2017 (3rd respondent in W.P.No.32803 of 2017) to re-examine the issue.

36. Only in the counter affidavit in W.P.No.27545 of 2017, the 1st respondent has in a round about way stated that the exemption/deduction is available only to a manufacture company and that the income of the petitioner was only from the service provided to its clients, namely banking and financial institutions and therefore, the petitioner was not eligible for deduction.

37. Therefore, the subsequent report dated 04.07.2017 in Form 3CL acknowledging that the petitioner being eligible for exemption/deduction on the expenditure incurred in R&D and that the certificate of recognition granted earlier to the petitioner was valid upto 31.03.2017 also cannot be countenanced.

38. Under these circumstances, I am inclined to set aside the impugned order. Accordingly, the impugned order dated 08.07.2014 in Form No.3CM is set aside and the matter is remitted back to the first respondent in W.P.No.27545 of 2017 (3rd respondent in W.P.No.32803 of 2017) namely, the Head of Department of Scientific and Industrial Research to re-examine the issue again in the light of the express language of Section 35(2AB) of the Income Tax Act, 1961 and pass appropriate orders within a period of three months from the date of receipt of a copy of this order, through videoconferencing, if

situations so warrants on account of continuance of Covid19 pandemic.

39. In case there are no manufacturing activities undertaken by the petitioner, no approval shall be granted to the petitioner. These two writ petitions stand disposed of with the above observation. Connected miscellaneous applications are closed. No costs.

Sd/-
Assistant Registrar

//True Copy//

Sub Assistant Registrar

Arul

To

- 1.The Secretary,
Department of Scientific and Industrial Research
Technology Bhavan,
New Mehrauli Road,
New Delhi - 110 016.
- 2.The Assistant Commissioner of Income Tax
Corporate Circle V (2),
Aayakar Bhavan,
121, Mahatma Gandhi Road,
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- 3.Head of Department,
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W.P. Nos. 27545 & 32803 of 2017
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NR(CO)
RN(16/07/2020)