Allowability of exp. incurred on R&D facilities being debatable issue was outside purview of sec. 154

Summary – The Mumbai ITAT in a recent case of Mahindra & Mahindra Ltd., (the Assessee) held that Issue as to amount of expenditure incurred on development of R&D facilities to be allowed under section 35(2AB) being a debatable issue, was outside purview of section 154

Assembling component parts, whether amounts to manufacturing or not, is a debatable issue, hence, outside purview of section 154

Facts

- The assessee-company was engaged in the business of manufacturing and sale of automobiles, tractors and implements, engine parts and accessories of motor vehicles, rendering service, property development activity, financing and investment and transport.
- For the assessment year under dispute, assessee filed its return of income on 28-10-2005, declaring total income of Rs. 545 crores. The assessee's case was selected for scrutiny and after examining the books of account and various other documents, the Assessing Officer ultimately completed the assessment under section 143(3) *vide* order dated 24-12-2008. While doing so, the Assessing Officer made a number of additions as a result of which the income was determined at Rs. 627 crores. Subsequently, the Assessing Officer finding certain error/mistake apparent from record in the assessment order assumed jurisdiction under section 154 by issuing a notice, proposing to rectify the (*i*) Incorrect computation of capital gain and (*ii*) Incorrect computation of business income.
- The assessee filed his submissions objecting to the initiation of proceeding under section 154, however, the Assessing Officer did not find merit in the submissions of the assessee and passed the order under section 154 making additions/disallowance as proposed which resulted in determination of total income of Rs. 649 crores.
- On appeal, the Commissioner (Appeals), upheld the exercise of power under section 154 by the Assessing Officer in respect of disallowance of provisions for steel price escalation amounting to Rs. 1154.12 lakh and disallowance of weighted deduction under section 35(2AB).
- On appeal to the Tribunal:

Held

- As could be seen from the material on record, in tax audit report the auditors have stated that as per the statement of the company, the provisions for steel price escalation of Rs. 11.54 crore though is not in the nature of contingent liability, however, has been disclosed for the sake of good order. Further, the auditor has stated that the amount of Rs. 11.54 crore represent certain minimum liability which the company expects to consider in response to demands from suppliers of steel for a retrospective upward revision in the price for steel supplied by them for which negotiations are in progress. It is evident from the assessment order; the Assessing Officer has disallowed some of the

provisions debited to the profit & loss account. Whereas, in respect of the provisions made for escalation of steel price, there is no discussion by the Assessing Officer. From the aforesaid facts, it is clear that, though, the Assessing Officer has taken note of the tax auditors' note, and however, he has failed to apply the law correctly. Therefore, to that extent there is a mistake of law apparent on the face of record. As far as the issue relating to the deduction claimed under section 35(2AB), it is to be noted that assessee's claim was allowed in respect of K unit while completing assessment. The Assessing Officer initiated proceedings under section 154, stating that in the absence of approval for K Unit by the prescribed authority, no deduction under section 35(2AB) is allowable. On a perusal of material placed on record, it is noticed that the assessee on 23-12-2004, made an application to the Secretary, Department of Scientific and Industrial Research (DSIR), for approval of its R&D facilities. The said application made in Form No.3CK, demonstrates that the assessee has shown both its factory premises at MIDC, Satpur, Nashik, as well as Akurli Road, Kandivali (E), Mumbai. Undisputedly, DISR has not only approved the R&D facilities of the assessee but it has subsequently been renewed. It is to be noted that *vide* letter dated 23-3-2004, the DSIR has renewed the approval of in-house R&D facilities up to 31-3-2007. A copy of the said renewal letter indicates that such renewal is for its R&D unit at Satpur, Nashik and Mumbai. Similarly, *vide* letter dated 19-10-2007, the DSIR has accorded approval to the R&D facilities at K unit up to 31-3-2010. Further, *vide* letter dated 11-6-2009, the DSIR has granted approval for the research facility both at Satpur, Nashik and Kandivali, Mumbai, from 1-4-2007 to 31-3-2010. These facts on record to certain extent demonstrate that assessee's R&D facility at K unit, was not only existing but was also accorded approval by the prescribed authority. Moreover, in case of *Asstt. CIT* v. *Meco Instruments (P.) Ltd*. [2010] 7 taxmann.com 24 (Mum.), the Tribunal, Mumbai Bench, has held that once, the assessee applies for approval in Form No.3CK and the prescribed authority grants approval on a particular date it will still apply to earlier assessment years. Similarly, in case of *CIT* v. *Claris Life Sciences Ltd*. [2008] 174 Taxman 113/[2010] 326 ITR 251, the Gujarat High Court held that once the R&D facilities are approved, the entire expenditure incurred on development of R&D facilities has to be allowed under section 35(2AB). Thus, keeping in view the factual aspect of the issue and the legal principle laid down in the decisions referred to herein above, it can be held that even if approval of the prescribed authority for the K unit was granted in the year 2009, as observed by the Assessing Officer, however, as per the judicial precedents referred to above, the assessee would still be entitled for weighted deduction under section 35(2AB) for all expenses incurred for developing the R&D facilities. At least, in view of the ratio laid down in the decisions referred to above, the allowability of deduction under section 35(2AB) for K unit is a debatable issue, hence, outside the purview of section 154. Therefore, the Assessing Officer could not have exercised his jurisdiction to invoke the provisions of section 154 in respect of such issue. Therefore, the order of the Commissioner (Appeals) on the issue of validity of rectification proceeding in respect of assessee's claim of deduction under section 35(2AB), is reversed. However, the initiation of proceedings under

section 154 insofar as it relates to disallowance of provisions created for escalation of steel price is upheld. To that extent, the order of the Commissioner (Appeals) is valid.