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Concept Paper on what constitutes R&D for SPMCIL

At the outset it is important to appreciate that there is no specific definition of R&D under section 35 (2AB) of the Indian Tax Laws. For the other two normal commercial activities namely designing and testing are often intricately and sometimes seamlessly intertwined with the R&D activity. What is more a specialized activity which can be legitimately termed as R&D for one organization, on the other hand be a routine normal commercial activity for another organization for which that activity is a regular part of its operations.

The definition of an activity also depends on the industry sector. For instance architectural design of a building is unique and copy right able but cannot be termed as R&D unless the design involves research, development of a prototype involving new patentable feature which can be used in many projects – like the patented 2 ton tripod blocks of concrete that have been used to reclaim the Nariman Point Bay in Mumbai and was later used in the foundations of many buildings/ projects built on the high seas.

Thus the design of the new jig and fixture for a particular printing/packing m/c may be an R&D activity for SPMCIL but for a company whose main business is design and production of jigs and fixtures it would be termed as normal commercial production activity.

Most countries including India also tend to recognize the development of new business methods as an R&D activity. For instance the expenditure – consultancy fees, travel etc incurred on a consultant contracted to develop an efficient R&D management system, potential R&D projects, training of R&D personnel etc would qualify as R&D expenditure for SPMCIL but not for the consultant. There are many other such examples

Generally all the activities relating to the development of a new product (or service) would be classified as R&D activity till the stage of the development of a prototype, including its test marketing/field testing for obtaining feedback to make improvements. However it is a thin line between test marketing and commercial marketing. This is particularly complex for high valued consumer products such as heavy duty truck tyres etc as even for test marketing stage the consumer is not given the product being tested free of charge as the cost is very high or may be charged a nominal amount (50% of the cost of the product).

There are more complicated cases where a new high valued production machine such as a bank note printing press with new security features is designed, and developed as a prototype and tested in the R&D center for 2-3 years to prove its reliability & efficiency before the same is shifted to the production shop for full commercial operations as it is high valued and cannot be left idling in the R&D Centre. Similarly many high valued

instruments that are developed in the R&D Centre are also later transferred to the production shop as on-line testing instruments.

Sometimes the test marketing stage itself may become profitable and the company decides to continue the activity on a prolonged basis but as a commercial activity.

In such cases it is rather difficult to define the exact time when an activity has ceased to be an R&D activity unless the documentation is very precise and consequently to obtain the tax benefits concessions (particularly weighted tax deduction, accelerated depreciation and customs duty exemption) under the Income Tax.

Due to some of the factors mentioned above and other intricacies in dealing with “R&D activity” the National Income Tax Laws of most countries, including India, do not have a specific legal definition. It is left to the concerned nominated Authority/ Agencies, in India it is the DSIR, to interpret and administer the Income Tax Law as to what constitutes R&D, admissible benefits under Section 35 (2AB), for a specific organization.

One also has to understand that the intent and the procedural aspects become important for any project/activity to classify as R&D, such as:

- Intent- Project Objectives
- Formulation/Approval process for an R&D project –Specific Project Number, Budget, Identification of R&D team, Time frame, Testing procedures (field testing), etc.
- Who is doing the development activity.
- Where is the development activity being done.
- What are the R&D infrastructures facilities (capital equipment, testing equipment) required and used for carrying out the development activities.
- Who are the other collaborating institutions/consultants/agencies/market survey/testing/independent testing/certification organizations etc and what is their specific roles.
- Does the project envisage filing of copyright/patents for the developments.

It must be recognized that for R&D activity to be legitimately claimed, procedures and documentation is extremely important as can be seen in the guidelines for approval of In-house R&D centers by the Department of Science and Industrial Research (DSIR) which is the nodal agency specified for all such purposes under the Income Tax Act, the latest copy of which I have sent earlier.

This paper is only for the purpose of discussions and not a policy statement.

It needs to be discussed first at the senior corporate management level and then with the individual Plant General Manager/ Scientific/Design Engineers level before specific guidelines can be formulated as to what constitutes R&D for SPMCIL. In spite of a policy there may still be a few grey areas where local income tax/auditors may differ on a

case to case basis as the treatment of R&D expenditure for Income Tax purposes in our country is still at a nascent stage.

N.K.Sharma