

**Office of Principal Scientific Adviser
to the Government of India**

**Note on R&D Tax Incentives in India
Recent Changes in GST rates, its estimated impact and Way forward**

Objectives:

The objectives of this note are to discuss the following aspects of R&D tax incentives.

- R&D tax incentives – Global Scenario
- R&D tax incentives – Indian Scenario
- Recent changes in GST Rates (July 2022 notifications)
- Estimated Impact on the R&D Ecosystem
- Way forward

R&D Tax Incentives – Global Scenario - An Overview of OECD Countries:

2. Investment in research and development (R&D) is a key factor driving innovation and economic growth. Governments worldwide adopt various financial support instruments to promote R&D by businesses and increasingly rely on tax incentives to incentivize business R&D investment.

3. As per the OECD document on R&D tax incentives database, 2021 edition, 34 of the 38 OECD countries, 22 of 27 EU countries and a number of partner economies (Argentina, Brazil, the People's Republic of China – China henceforth –, the Russian Federation, South Africa and Thailand) offer tax relief for R&D expenditure at central or subnational government level. In the OECD area alone, this corresponds to an increase of more than 50% in the number of countries that provide R&D tax relief to businesses relative to the year 2000, where governments in 20 out of the 38 OECD countries offered this form of support.

R&D Tax Incentives – Indian Scenario - An Overview:

4. India too provides an investor friendly tax regime for R&D. As per Economic Survey 2020-21, India has had a generous R&D tax incentive framework. This framework provides tax incentives in five categories. They are as follows:

- Income tax deduction (100%)
- State Industrial Policies

- Foreign Trade Policy
- Customs duty exemption
- GST exemption

5. Significantly, Finance Act 2016, w.e.f. April 2018, allowed a weighted deduction of 150 per cent of expenditure w.r.t. scientific research on in-house R&D facility as compared to 200 per cent earlier. Finance Act 2016 further allowed for reduction of this deduction to 100 per cent from assessment year beginning on or after April 1, 2021. The Taxation Laws (Amendment) Act 2019 amended the Income Tax Act 1961 and Finance (No. 2) Act 2019, allowing domestic companies the option to pay income tax @22 per cent subject to the condition that they will not avail any exemption/incentive. The effective rate for these companies was made 25.17 per cent inclusive of surcharge and cess. These companies were also not required to pay Minimum Alternate Tax.

6. To put this in perspective, India's R&D tax incentives are comparable with other countries. This is shown as below:

Table 1

Countries	Tax Allowance / Deductions	Tax Credit	Accelerated Depreciation on the R&D assets / Capital	Reduced Tax Rates	Tax Holidays	Tax Deferrals	Tax Exemptions (Excise & Custom duty)	Grants
Brazil	√		√	√				√
China	√		√	√			√	
India	√		√		√		√	√
South Africa	√		√					
Germany								√
Japan		√						
Malaysia	√							√
Republic of Korea		√						
Thailand	√			√				√
USA		√				√		

Source: Economic Survey

7. The above table also indicates that tax exemption on excise and customs duty is an important pillar in the tax incentives framework. With recent changes in GST rates, this incentive is no longer available to ecosystem players.

Recent Changes in R&D Tax Incentives – GST Rate Changes - A Summary:

8. The Department of Revenue (Ministry of Finance, Government of India) has recently withdrawn the benefit of concessional GST rate available to research institutions on procurement of scientific and technical instruments, equipment, accessories, consumables etc. The key changes are summarized below:

Table 2			
SN	Category/ Notification	GST rate up to 17.07.2022	GST rate effective 18.07.2022 (Note 1)
1	Import of goods [Notification No. 51/96-Customs]	Nil	18 %
2	Domestic supplies [Notification No. 47/2017-IGST (Rate)]	5 %	18 %

Note 1: Post withdrawal of exemption, applicable GST rate as per HSN classification should apply. Effective GST rate has been assumed as standard rate of 18%.

Note 2: Customs IGST exemption withdrawn vide Notification No. 42/2022-Customs dated 13 July 2022.

Note 3: GST concessional rate withdrawn vide Notification No. 11/2022-Integrated Tax (Rate) dated 13 July 2022.

9. The impact of these rate changes is on entities who were eligible to claim exemption prior to 18th July 2022. The number of these entities, category wise is as follows:

Table 3	
Private in-house R&D centers	2042
Public Sector In-house R&D Centers	439
Scientific and Industrial Research Organizations (SIROs)	782
Public Funded Research Institutions	619

Source: DSIR Annual Report

Impact Assessment:

10. The overall impact of GST rate change will be on the cost of doing R&D as the R&D units who were earlier eligible to claim exemption can no longer avail them.
11. While the private in house R&D centers may gradually absorb the financial impact of the rate changes, there is limited space for the public funded labs and universities to absorb the impact.
12. In view of this it is necessary to assess the likely impact on the budget of major scientific establishments in the Government of India, as the Government is the major player in the R&D Ecosystem.

Estimated Impact of GST Rate Change on R&D Budget of Scientific Departments:

13. As per the document shared by the Department of Economic Affairs, Ministry of Finance with the O/o PSA, 27 demands have projected the R&D budget of INR. 43103.03 crores for BE 2022-23. Out of these 27 demands, the R&D demands for seven scientific departments who are major stakeholders in the R&D Ecosystem have projected a R&D budget of INR 21962 crore. The department wise allocation of these seven scientific departments is given in the table below:

(All figures in INR Crores)

Table 4

SN	Scientific Departments/Ministries	BE 2022-23
1	Department of Scientific and Industrial Research	5636
2	Department of Biotechnology	2581
3	Department of Science and Technology	5887
4	Department of Agricultural Research and Education	1996
5	Department of Health Research	2057
6	Ministry of Earth Sciences	2607
7	Ministry of Electronics and Information Technology	1198
Total R&D Budget allocation for Scientific Departments		21962

Source - Department of Economic Affairs, Ministry of Finance, Budget Division

14. The primary impact of the GST rate change is on imported equipment as it constitutes a major portion of procurement of scientific equipment. Notwithstanding this, two scenarios are presented below where the impact of GST rate changes on the R&D budget of the Scientific departments is estimated.

Scenario 1

Assumption: Cost of Procurement of Imported and Domestic Equipment consists of 10% of the total R&D Budget (All figures in INR Crores)

Total R&D Budget of seven Scientific Departments (BE 2022-23)	Estimated Cost of procurement of scientific equipment (Prior to 18 th July 2022)	Estimated revised Cost to be incurred by the Department due to GST rate change post 18 th July 2022	Additional estimated cost in procurement due to GST rate changes (18%)	% impact on Total R&D Budget
21962	2196.2	2591.5	395.3	~2%

Scenario 2

Assumption Cost of Procurement of Imported and Domestic Equipment consists of 20% of the total R&D Budget (All figures in INR Crores)

Total R&D Budget of seven Scientific Departments (BE 2022-23)	Estimated Cost of procurement of scientific equipment (Prior to 18 th July 2022)	Estimated revised Cost to be incurred by the Department due to GST rate change post 18 th July 2022	Additional estimated cost in procurement due to GST rate changes (18%)	% impact on Total R&D Budget
21962	4392.4	5183.4	791	~3%

15. The above mentioned analysis shows that the impact of the GST Rate Changes on the R&D Budget of the scientific departments will be at least to the tune of 2% to 3% of their allocated Budget in the F.Y. 2022-23. Ministry wise assessment of impact of GST rate change on their budget has also been compiled based on inputs received so far and placed at Annexure 1.

Way forward and Proposals for Consideration:

16. India aspires to be a global hub for R&D. There is a dire requirement to step up investment in R&D to sustain and enhance the capabilities of the R&D labs. There is a need to ensure that the procurement of R&D equipment is not disrupted due to GST rate changes. This would reassure the international investors as well.

17. In order to maintain the procurement schedule of scientific equipment, consequent to the changes in GST rates, the R&D budget allocation of the scientific departments could be enhanced by 2% to 3% at least in the RE stage. This will enable the departments to pursue their R&D objectives without disruption or delay in procurement of scientific equipment

18. In order to translate this proposal to action, the forthcoming Union Budget circular (F.Y. 2023-24) may contain suitable clause in the R&D section for proposing additional R&D budgetary allocation (RE 2022-23 and BE 2023-24) in view of the recent GST rate changes.

19. This may be taken into consideration by the Ministry of Finance for making suitable provisions at the RE and BE stages for the scientific departments who have suffered a cost escalation due to the GST rate changes.

Annexure 1

Ministry Wise Impact Assessment of GST rate Changes on the R&D Budget
(F.Y. 2022-23)

S. No.	Ministry/Department	Estimated Impact on the R&D Budget (INR Crore)
1	Department of Science and Technology	32.34
2	Council of Scientific and Industrial Research	137.33
3	Indian Council of Medical Research	23
