आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ 'B' अहमदाबाद ।

IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH, AHMEDABAD

BEFORE SHRI PRADIP KUMAR KEDIA, ACCOUNTANT MEMBER
& SHRI MAHAVIR PRASAD, JUDICIAL MEMEBR

आयकर अपील सं./I.T.A. No. 164/Ahd/2018
(**निर्धारण वर्ष /** Assessment Year : 2014-15)

Torrent Pharmaceuticals Ltd., Torrent House, Off. Ashram Road, Ahmedabad 380009	**बनाम**/ Vs.	**DCIT,** Circle-4(1) 2), Ahmedabad
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AAACT5456A		
(अपीलार्थी /**Appellant**)	..	(प्रत्यर्थी / **Respondent**)

अपीलार्थी ओर से /**Appellant by :**	Shri Vartik Choksi, A.R.
प्रत्यर्थी की ओर से / **Respondent by :**	Shri Surendra Kumar, CIT D.R.

सुनवाई की तारीख / **Date of Hearing**	04/06/2018
घोषणा की तारीख /**Date of Pronouncement**	08/08/2018

आदेश/O R D E R

PER PRADIP KUMAR KEDIA - AM:

The captioned appeal has been filed at the instance of the Assessee against the order of the Principal Commissioner of Income-Tax-4, Ahmedabad ('Pr.CIT' in short), dated 15.11.2017 wherein order passed by the Assessing Officer (AO) under s.

143(3) of the Income Tax Act, 1961 (the Act) dated 26.12.2016 concerning assessment year 2014-15 was held to be erroneous in so far as the prejudicial to the interest of the Revenue within the meaning of Section 263 of the Act and thus set aside.

2. The grounds of appeal raised by the Assessee reads as under:-

> *"1. On the facts and in the circumstances of the case, the order passed by the learned Pr.C.I.T. u/s. 263 of the I.T. Act is ab initio void being bad in law.*
>
> *2. On the facts and in the circumstances of the case, the learned Pr.C.I.T. erred in setting aside the assessment order dated 26th December, 2016 and directing the Assessing Officer to pass a fresh assessment order.*

3. The assessee, as per grounds of appeal, essentially challenges the foundation of jurisdiction assumed by the Pr.CIT under s.263 of the Act and contends that the subject assessment order framed under s. 143(3) of the Act passed by the AO cannot be termed as erroneous and prejudicial to the interest of the Revenue which is a condition precedent for usurption of revisional jurisdiction.

4. The relevant facts in brief are that the return of the assessee was subjected to scrutiny assessment for AY 2014-15 and the assessment was completed by the AO under s. 143(3) of the Act vide order dated 26.12.2016 whereby the total income of the assessee was assessed at Rs.715.01 Crores as against the returned income of Rs.584.13 Crores. Thereafter, the Pr.CIT in exercise of his revisionary power, issued show cause notice dated 18.08.2017 under s.263 of the Act requiring the assessee to show cause as to

why assessment so framed u/s.143(3) is not liable to be set aside or modified. It was alleged by the Pr.CIT that the examination of records revealed that the assessment order so passed is erroneous in so far as it is prejudicial to the interest of the Revenue for the reasons that the AO has failed to make adequate inquiries in respect of various issues discussed in the show cause notice and the assessment order was allegedly passed without due application of mind. The show cause notice issued by the Pr.CIT under s.263(supra) is reproduced hereunder for the sake of ready reference:

> *"You have debited a total amount of Rs.55.14 cr. On account of business advancement expenses, which have been allegedly incurred on gifts items distributed to various persons. Out of this Rs.55.14 cr., you have incurred an expenditure of Rs.24.32 cr. On gift items exceeding Rs.1000/- each. On perusal of the records, it is seen that the A.O. has not made any enquiry as regards to whom such gift items were distributed and what was the record maintained. The A.O. has also not enquired as to the proof/evidence of such distribution made to various stake holders. Non enquiry in the matter has rendered the impugned order erroneous and prejudicial to the interest of revenue.*
>
> *ii) You have shown a turnover of Rs.52,126.83 lakh from your Baddi unit and shown a profit of Rs.12,296.55 lakh. The A.O. has failed to apply his mind to the issue and has also failed to make any meaningful enquiry as to what kind of medicines were being manufactured there; whether It was API or whether it was formulation; from where did this plant get the chemistry of molecules if API has been manufactured? If the said unit was FDA/other regulatory authorities approved? And, if yes, who incurred expenses for such approvals? Whether Baddi unit was manufacturing generic medicines or branded generics? If branded, whether these were old brands belonging to the company? What kind of expenses had been incurred on account of business advancement (in India & abroad) and other related expenses. What amount of expenditure was debited to Baddi unit on account of salary/remuneration paid to the higher management and other administrative expenses? If the medicines were exported, what kind and how much of expenditure was incurred and debited to the books of Baddi unit on account of export of such formulations. Similar is the case with your Sikkim unit. Non application of mind in this matter by the A.O. has rendered the impugned order as erroneous and prejudicial to the interest of revenue*

iii) You have debited a total expenses of Rs. 137,41 crores on account of R & D expenses on which a weighted deduction has been claimed. The A.O. has not enquired as to whether separate expenses have been incurred by you on account of quality control & regulatory approvals or whether they have been grouped Into R & D expenses. Non application of mind in this matter by the A.O. has rendered the impugned order as erroneous and prejudicial to the interest of revenue.

You have claimed an expenditure of Rs475,32 lakhs on account of patent expenses/patent related expenses outside India as eligible for weighted tax u/s.35 (2AB) of the I.T. Act, The explanation inserted under clause 1D to Sec.35(2AB) stated that;

Explanation - for the purposed 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).

Thus, the expenditure incurred in relation to patents not relating to the Patent Act, 1970 would not be eligible for such deduction, A/on application of mind in this matter by the A.O. has rendered the Impugned order as erroneous and prejudicial to the interest of Revenue.

iv) You have claimed an expenditure of Rs. 1214.01 lakhs on Clinical Research. The A O has failed to apply his mind and not made any enquiries in this regard as to the nature and details of the expenses incurred - as to whom paid and for what purposes? He has also not enquired if such clinical trials were made for the purpose of regulatory approvals or for R & D work, which would have affected the deduction available u/s.35 (2AB) of the I.T. Act. A/on application of mind and non enquiry in this regard has rendered the impugned assessment order erroneous and prejudicial to the interest of revenue.

v) You have also claimed various expenses on account of labour and job work charges, professional fees, legal expenses and other salary expenses as part of R&D expenses. The A.O. has not made any meaningful enquiry with respect to these expenses as to determine whether all such expenses were related to R&D because of which the impugned order has been rendered erroneous and prejudicial to the interest of revenue.

vi) You have claimed expenses on academic/scientific get together of Rs.9.44 cr., sales promotion expenses of Rs.19,57 crores, business advancement expenses of Rs.1.48 Cr. (other than on domestic). The A.O. has not made any enquiry as regards the incurring of such expenses nor has he applied his mind as to whether such or part of such expenses fell foul of local regulations prevailing in those countries regarding gifting/other payments/expenses incurred on doctors and medical practitioners. Further, the A.O, has also not examined if such

expenses incurred were rightfully belonging to the assessee company and not its foreign subsidiaries which were also engaged in marketing of formulations in other countries. Non application of mind and non enquiry in this regard has rendered the impugned assessment order erroneous and prejudicial to the interest of the revenue."

4.1 The controversy emerging from the show cause notice is broadly summarized as under:

"(i) The assessee debited a sum of Rs.55.14 crores on account of "business advancement expenses" allegedly incurred on gift articles distributed to various persons. The assessee was intimated that the aforesaid amount included Rs.24.32 crores on gift items exceeding Rs.1000 each. The learned Pr. CIT alleged that the Assessing Officer did not make inquiry regarding the persons to whom gifts were given and the record maintained for the same.

(ii) The assessee has shown turnover of Rs.52126.83 lacs from Baddi unit yielding profit of Rs.12296 55 lacs and the Assessing Officer failed to apply his mind to this issue and to make meaningful inquiry regarding the manufacturing process, and goods being manufactured. The learned Pr CIT has alleged that similar is the position with regard to Sikkim unit.

(iv) The assessee has debited expenditure of Rs. 137.41 crores for R & D expenses on which weighted deduction has been claimed. He has observed that the Assessing Officer has not inquired as to whether separate expenses have been incurred on account of quality control and regulatory approvals or whether these expenses are grouped under R & D expenses. The learned Pr. CIT assumed that there was non-application of mind on the part of the Assessing Officer on this issue.

(iv) The assessee has claimed Clinical Research expenditure of Rs. 1214.01 lacs and the Assessing Officer did not apply his mind and did not make inquiry regarding the nature and details of the expenses and the purpose of the expenditure vis-a-vis deduction available u/s.35(2AB) of the Act.

(v) The assessee has claimed various expenses for labour, job-work, professional fees, legal expenses and salary expenses as part of R & D expenses and the Assessing Officer did not make any meaningful inquiry with regard to these expenses.

(vi) The assessee claimed expenses of Rs.9.44 crores on academic / scientific get-together, sales promotion expenses of Rs. 19.57 crores and business advancement expenses of Rs.1.48 crores (other than domestic expenses). The learned Pr. CIT assumed that the Assessing Officer did not make inquiry regarding incurring of such expenses and there was no application of mind

as to whether any part of such expenditure violated the regulations prevailing in those countries where expenses were incurred."

4.2 In response to show cause notice, the assessee filed a detailed reply dated 21.09.2017 to demonstrate that the allegations made in the show cause notice has, in fact, been dealt with after making proper inquiries during the course of assessment proceedings and a very lengthy assessment order running into 102 pages was passed by the AO in this regard. It was also pointed out that the returned income was accompanied by the audited financial statements together with all statutory annexures and notes. The books of accounts were also produced before the AO in the course of the assessment proceedings. It was further pointed out that the AO made various additions/disallowances of substantial nature while accepting the remaining part after thorough scrutiny and application of mind.

4.3 For better appreciation of the version of the assessee before the Revisional Commissioner, the relevant part of the written reply dealing with show cause notice is reproduced hereunder:

"5.1 <u>Regarding Business Advancement Expenses</u>:

I. Vide para no. (i) of the above referred notice, your honor has stated that non inquiry by the Assessing Officer in the matter of Business Advancement expenses has rendered the impugned order erroneous and prejudicial to the interests of the Revenue. Relevant para of the said notice is reproduced as under:

"i). You have debited a total amount of Rs, 55,14 Cr. on account of business advancement expenses, which have been allegedly incurred on gifts items distributed to various persons. Out of this Rs. 55.14 Cr., you have incurred on expenditure of Rs. 24.32 Cr. on gift items exceeding Rs. 1,000/- each. On perusal of the records, it is seen that the A.O. has not made any inquiry as regards to whom such gift items were distributed and

what was the record maintained. The A.O. has also not enquired as to the proof/evidence of such distribution made to various stake-holders. Non inquiry in the matter has rendered the impugned order erroneous and prejudicial to the interest of Revenue."

II. In this connection, the assessee company submits following details in respect of records available with the Assessing Officer, inquiries made by him and replies /details submitted by the assessee company.

(a). Vide submission dated 17.06.2016 the assessee company submitted copy of Audit Report. Based on the verification of the financial statements, the Assessing Officer asked to provide break-up of Selling, publicity and medical literature expenses amounting to Rs. 279.20 crores as appearing in Note No. 21 "OTHER EXPENSES' of Profit & Loss account along with explanation for nature of expenses.

In response to that the assessee company submitted the detailed breakup of selling and Publicity expenses incurred for Domestic Market and other than Domestic Market, detailed explanation for nature of such expenditure along with break-up of Business Advancement expenses into items costing more than Rs. 1000/- and those less than Rs. 1,000/- vide submission dated 10.12.2016. Copy of the said reply is annexed herewith vide ***Annexure-1(A).***

(b). On the basis of verification and examination of details submitted vide above mentioned submitted dated 10.12.2016. the assessee company was asked to show cause as to why expenses accounted under the head of Business Advancement Expenses and Doctors' Sponsorship which are grouped under Selling and Distribution Expenses, should not be disallowed in view of the CBDT Circular No. 5/2012 dated 01-08-2012 which provides for disallowance of deduction pertaining to freebies given to medical practitioners.

In response to that the assessee company submitted following details vide submission dated / 15.12.2016, copy of which is annexed herewith vide ***Annexure-1(b).***

(i). Note on the nature of such expenses - ***Para 1.1 on page 1 and 1.2 on page 4***

(ii). Types of gift items given - ***Para 1.1 (b) on page 2***

(iii). Category of various persons to whom such gift items are distributed - ***Para 1.1(c) on page 2***

*(iv). How such gift items are distributed to various stakeholders by the assessee company -****Para 1.1 (d) on page 3***

(v). Explanation regarding maintaining records in respect of such expenses ***- Para 1.1(d) on page 3;*** *and*

(vi). Justification for allowability of the said expenses viz-a-viz Circular No. 5/2012 - ***Para 2 on page 4****.*

III. The hearings on the above matter were taken up by the Assessing Officer on a number of occasions. Over and above the verification ledger accounts, the Assessing Officer has also viewed certain invoices and/bills, which were made available during the course of the proceedings.

Based on such scrutiny of the aforesaid bills and records of the assesse company and after detailed verification of the bills and invoices on random check basis, the Assessing Officer has made disallowance of 10% of the the entire expenses of Rs. 55.14 crores, after satisfying himself of the fact that the expenses are incurred also for the persons other than Doctors and medical professionals such as associates, business associates, suppliers and such other professionals, etc. as already discussed in the submissions made before the Assessing Officer.

IV. In this connection, it is also important to note that small items costing below Rs.1000/- in each case are also of substantial amount and the balance of the total expenditure comes to Rs.24.32 crores. Further it is submitted that ***the small items costing below Rs. 1000/- in each case, given as a memento, would not be hit by the CBDT circular no. 5/2012. even if they are given to medical practitioners (as per MCI Regulation amended by Notification dated 01-02-2016). Therefore, it can be said that the Assessing officer has made disallowance of Rs. 5,51,37,427 out of expenditure of Rs. 24.32 crores, being expenditure on items exceeding Rs. 1000/- in each case.***
Apart from above, ***the Assessing Officer has also made disallowance of entire expenditure of Rs. 25,99,87,036, being expenses on Academic/ Scientific Grants to Doctors etc.***

V. Therefore, the observation of your honor that the Assessing Officer has not made any enquiry as regards to whom such gifts items were distributed and what was the record maintained, or as to the proof / evidence of such distribution made to various stakeholders, is, apparently, on incorrect understanding of the facts.

The assessee company also submitted list of the items distributed along with the break-up of items costing more than Rs. 1000 and less than that. This indicates that adequate records have been maintained by the assessee company, as to the expenditure incurred by it for the said expense and on products distributed by it.

It was also explained that these items are not distributed on one to one basis by the assessee company itself, rather these items are generally handed over to the marketing staff and other employees of the company, who in-tura distribute them to the respective persons whom they have been directly interacting / dealing with. These items are distributed to the following persons:

* *Distributors,*
* *Wholesalers,*
* *Retailers,*
* *Commission Agents,*
* *Stockiest,*
* *Pharmacies,*
* *Employees,*
* *Professional consultants,*
* *Bankers,*
* *Other Financers,*
* *Lawyers*
* *Permanent Suppliers,*
* *Hospitals, Doctors, others people connected with medical field,*
* *Independent Scientists and*
* *Scientific and Research Associations etc.*

It is submitted that the assessee company maintains the records pertaining to such expenses, however, it is not possible to maintain the list of the persons to whom these items have been distributed by the marketing staff and other employees of the company, especially considering the nature, value and volume of such products.

VI. *On the basis of above, it can be said that* ***it is not a case that there is non-enquiry on the part of the assessing officer in this matter as observed by your honor, but the Assessing Officer has made in-depth inquiries regarding the Business Advancement expenses, which was duly replied by the assessee company during the course of assessment proceedings****. The Assessing Officer has also made certain disallowance as mentioned in para 5.1(III) (supra) for this matter in his assessment order at* ***para 6 on page no. 20-21****.*

Further, as stated above, ***the Assessing Officer has also made disallowance of entire expenditure of Rs. 25.99.87.036/-. being expenses on Academic / Scientific Grants to Doctors etc.***

5.2 ***Regarding Business of Baddi and Sikkim Units****:*

I. *Vide para no. (ii) of the above referred notice, your honor has observed that the assessment order passed by the AO is erroneous and prejudicial to the interest of Revenue by stating that AO has failed to make meaningful inquiry as to:*

- *What kind of medicines being manufactured there (whether API or formulations)*

- *Source of getting chemistry of molecules, if API is manufactured*

- *Source of formula / composition, if formulation is manufactured*

- *Whether the said units required approval from PDA / other regulatory authorities and if yes, who incurred expenses for such approvals?*

- *Whether unit is manufacturing generic or branded medicines? If branded, whether these old brands belong to company?*

- *Expenses incurred for business advancement (in India and abroad)*

- *Expenditure debited to Baddi and Sikkim unit for salary / remuneration to higher management and administrative expenses*
- *If medicines were exported, expenditure incurred and debited to the books of Baddi and Sikkim unit for export of such formulations.*

II. *In this connection, the assessee company submits the following details about the records available with Assessing Officer, inquiries made by him and replies and details submitted by the assessee company:*

(a) *As per the provisions of section 80IC (7) and 80IE(6) read with section 80IA (7), every undertaking claiming deduction under the said provisions is required to get its accounts audited by a Chartered Accountant and furnish the report of such audit in Form no. 10CCB along with the return of income.*

The assessee company had maintained separate books of accounts of its Baddi Unit and Sikkim Unit and the said books of account are audited by a Chartered Accountant as required under the above provisions. The copy of such reports along with the Profit and Loss Account and Balance sheet of Baddi Unit and Sikkim Unit were also available with the Assessing officer.

(b) *Further, vide submission dated 17.06.2016, the assessee company submitted copy of Acknowledgement of Return of income along with the Statement of Total Income, wherein the claim made by the assessee company u/s. 80IC and 80IE was verifiable.*

(c) Basis of Allocation of expenses:

i. On the basis of verification of above documents / details as mentioned in para 5.2 (II) (a) & (b) and explanations provided during the course of hearing, the Assessing Officer asked the assessee company to provide the details regarding expenditure debited to P&L account and the basis of allocation of expenses to Baddi and Sikkim unit.

In this connection, the assessee company explained that ***all Manufacturing & other direct expenses incurred for the Baddi and Sikkim units have been accounted directly in Baddi and Sikkim unit's books of account*** *respectively and expenses which are incurred in common for Baddi, Sikkim & other units of company are allocated on the systematic basis as explained in the said* ***submission dated 10.12.2016****, copy of which is annexed herewith vide* ***Annexure-2(a)***

ii. On the basis of verification of the above submissions, Assessing Officer further asked the assessee company to explain that:

> *why the administrative expenses should not be allocated on the basis of turnover ratio of Baddi & Sikkim Unit, instead of allocation of such expenses made by the assessee company on the basis of number of employees;*

> *why the donation should not be allocated to Baddi & Sikkim unit;*

> *to justify the basis of allocation of R & D expenses (Development cost) to Baddi & Sikkim unit; and*

> *explain as to why the Discovery cost of R & D and Capital expenditure on R & D are not allocated to Baddi and Sikkim units*

In response to this, the assessee company submitted its detailed explanation vide three replies filed on 13.12.2016 on each of the question raised by the assessing officer. Copies of those replies are annexed herewith vide ***Annexure-2(B)(i), 2(B)(ii) and 2(B)(iii).***

(d) Claim for deduction u/s. 80IC and 80IE of the Act:

From the copy of Form 10CCB submitted by the assessee company, the Assessing Officer verified the basic details,

regarding eligibility of claim u/s. 80IC and 80IE of the Act viz.

a. location of the undertaking,
b. commencement of commercial production,
c. articles manufactured or produced i.e. pharmaceutical products (schedule XIV, part C, sr. no. 12) etc.

Thereafter, the AO asked the assessee company to provide the details of other operating income of Baddi & Sikkim Unit and to explain its eligibility for claim u/s. 80IC and 80IE of the Act respectively.

In response to the same the assessee company submitted explanation for eligibility of claim on account of other operating income u/s. 80IC and 80IE of the Act. Copy of the said submissions dated 14.12.2016 and 15.12.2016 is attached herewith vide ***Annexure-2(C) & 2(D)*** *respectively.*

III. After considering the various submissions made by the assessee company and on the basis of various points discussed during the course of assessment proceedings, the assessing officer has in his assessment order made following adjustments:

- *Reallocated the expenditure in the nature of Administrative expenses and there by reduced the amount eligible for the claim of deduction u/s. 80IE of the Act by an amount of Rs. 27,74,99,662/-, (Since, the allocation made by the assessee company to Baddi unit was higher than the amount worked out by Assessing Officer, no adjustment was made to increase the amount eligible for claim of deduction u/s. 80IC of the Act)* ***- para no. 19 at page no. 77-79 of the assessment order****;*

- *Rejected the allocation made by the assessee company in respect of development cost related to R&D Center and reallocated the same on the basis of total turnover ratio, thereby reduced the amount eligible for claim of deduction u/s. 80IC and u/s. 80IE of the Act by an amount of Rs. 1,01,69,860/- and Rs. 18,95,26,218/- for Baddi & Sikkim unit respectively -* ***para no. 15&16 at page no. 54-59 of the assessment order****:*

- *Allocated the Capital expenditure and discovery cost of R&D Centre to Baddi & Sikkim unit, rejecting the contention of the assessee company that no such allocation should be made, thereby*

reduced the amount eligible for claim of deduction u/s. 80IC and u/s. 80IE of the Act by an amount of Rs. 17,83,57,712/- and Rs. 21,86,59,796/- for Baddi & Sikkim unit respectively - ***para no. 15&16 at page no. 54-59 of the assessment order****:*

- *Reduced the amount eligible for deduction on account of other operating income claimed by the assessee company u/s. 80IC and 80IE of the Act by amount of Rs.6,97,68,075/- and Rs. 30,81,029/- respectively -* ***para no. 9&22-23 at page no. 28-38 & 85-99 of the assessment order:***

- *Reduced the claim of deduction u/s. 80G of the Act by Rs. 1,73,65,884/- and 80GGB of the Act by Rs. 1,90,25,206/- by allocating the said donations to Baddi & Sikkim Unit -* ***para no. 18 at page no. 73-77 of the assessment order.***

The amount of expenses / donation allocated by the assessee company and adjus ment made by the assessing officer to expense and the other income claimed by the assessee company u/s 80IC / 80IE and the amount allowed by the assessing officer are summarized as under.

Particulars	*Disallowances made in relation to Baddi Unit*	*Disallowances made in relation to Sikkim Unit*
Reallocation of administrative expenses		*27,74,99,662*
Rea location of Development Cost of R&D	*1,01,69,860*	*18,95,26,218*
Allocation of Discovery cost of R&D	*13,48,79,464*	*16,53,57,112*
Allocation of Capital exp. of R&D	*4,34,78,248*	*5,33,02,684*
Exclusion of other income from eligible profit	*6,97,68,075*	*30,81,029*
Deduction claimed u/s. 80G out of Donation allocated to eligible unit	*78,30,043*	*95,35,841*
Deduction claimed u/s. 80GGB out of	*85,78,209*	*1,04,46,997*

Donation allocated to eligible unit		
Total	*27,47,03,899*	*70,87,49,543*

On the basis of above table, it can be seen that the Assessing Officer has, after thorough examination of all the records / details / information and after in-depth verification of income and expenses, made disallowances of Rs. 27,47,03,899/- in relation to Baddi unit, which eligible for deduction u/s. 80IC and Rs. 70,87,49,543/-, in relation to Sikkim unit, which eligible for deduction u/s. 80IE.

IV. On the basis of above, it can be said that ***it is not a case that there is non-application of mind on the part of the assessing officer in this matter as observed by your honor. On the other hand, there is active application of mind and detailed disallowances***

(a) In this connection, the assessee company submits the Assessing Officer had verified the details of nature of business activities carried out by Baddi and Sikkim units of the assessee company from the details discussed and various documents submitted during the course of assessment proceedings viz. annual audit report of the company, audited financials of respective units, Form 10CCB and Transfer Pricing documentation etc.

(b) Further, in connection with the issues raised by your honor that the Assessing Officer has not inquired as to what kind of medicines are being manufactured at respective units, source of getting chemistry of molecules if API is manufactured, source of formula / composition if formula is manufactured, it is submitted that these details were discussed during the course of assessment proceeding since years. Moreover, details of products manufactured were also available in various audit reports. Merely because the Assessing Officer has not discussed about the same in his assessment order, will not make the said order erroneous. The assessee company fails to understand that when ***the Assessing Officer has examined all the income and expenditure as discussed in para 5.2(11), then what would be the impact which makes the assessment order prejudicial to the interest of the revenue*** *on the basis of answers to above questions as raised by your honor in the show cause notice, which are though already discussed during the course of*

hearing but merely not mention in the assessment order.

(c) ***Further, the Assessing Officer has made in-depth inquiries regarding the amount of expenditure debited to P&L account of Baddi & Sikkim unit of the assessee company, the basis of allocation of various expenses and amount claimed as deduction u/s. 80IC and 80IE of the Act****. Thereafter, not being satisfied by the replies of the assessee company, the Assessing Officer has proceeded to modify the claim of deduction u/s. 80IC & 80IE of the Act on account of other operating incomes and rejected the basis of allocation of expenses of the assessee company to both the eligible units and allocated the expenditure as per his calculations and made certain disallowance in this matter in his assessment order at various para mentioned in point 5 2(111) supra.*

On the basis of the above, the assessee company submits that the notice u/s 263 of the Act issued by your honor on this issue is devoid of any merits as the order passed by Assessing Officer is not prejudicial to the interest of revenue.

5.3 ***Regarding details of expenses on account of Quality Control & Regulatory Approvals. Claim u/s. 35(2AB) for R&D expenses on account of Patent or related expenses outside India. Clinical Research Expenses and Other expenses (being labour, job work charges, professional fees, legal expenses and other salary expenses)***

I. Vide Para no. (iii), (iv) and (v) of the above referred notice, your honor has considered the assessment order passed by the AO as erroneous and prejudicial to the interest of Revenue stating as under:

> *"(iii) You have debited a total expenses of Rs. 137.41 crores on account of R&D expenses on which a weighted deduction has been claimed, The A.O. has not enquired as to whether separate expenses have been incurred by you on account of quality control & regulatory approvals or whether they have been grouped into R&D expenses. Non application of mind in this matter by the A.O. has rendered the impugned order as erroneous and prejudicial to the interest of revenue.*
>
> *You have claimed an expenditure of Rs. 475.32 lakhs on account of patent expenses/patent related expenses outside India as eligible for weighted tax*

u/s 35(2AB) of IT. Act. The explanation inserted under clause ID to section 35(2AB) stated that:

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).

Thus the expenditure incurred in relation to patents not relating to the Patent Act, 1970 would not be eligible for such deduction. Non application of mind in this matter by the A.O. has rendered the impugned order as erroneous and prejudicial to the interest of revenue.

(iv) You have claimed an expenditure of Rs. 1214.01 lakhs on Clinical research. The A.O. has failed to apply his mind and not made any enquiries in this regard as o nature and details of expenses incurred - as to whom paid and for what purpose? He has also not enquired if such clinical trial were made for the purpose of regulatory approvals or for R&D work which would have been affected the deduction av ilable u/s 35(2AB) of the IT. Act. Non application of mind and non inquiry in this regard has rendered the impugned order as erroneous and prejudicial to the interest of revenue.

(v) You have also claimed various expenses on account of labour and job work charges, professional fees, legal expenses and other salary expenses as part of R&D expenses. The A.O. has not made any meaningful inquiry with respect to these expenses as to determine whether all such expenses were related to R&D because of which the impugned order has been rendered erroneous and prejudicial to the interest of revenue."

II. In this connection, the assessee company submits following details of records available with Assessing Officer, inquiries made by him and replies and details submitted by the assessee company:

(a) As per the provisions of section 35(2AB)(3) of the Act read with Rule 6(7A) of the Income tax Rules, in order to claim the deduction u/s. 35(2AB) of the Act, the assessee company needs to maintain separate books of account for its approved R&D facility and

the same is required to be audited annually by a Chartered Accountant and a report for the same is required to be submitted to the prescribed authority i.e. DSIR for each year. It is also provided that the DSIR shall issue its report in relation to the approval of in-house R&D facility in Form No. 3CL. Hence, the assessee company had claimed the deduction u/s. 35(2AB) after complying with all the statutory requirements and the expenditure incurred by the assessee company on R&D activities have also been verified and certified by DSIR.

(b) Vide submission dated 17.06.2016, the assessee company submitted copy of Acknowledgement of Return of Income along with the Statement of Total Income, wherein the claim made by the assessee company u/s. 35(2AB) of the Act was verifiable. Further, during the course of assessment proceedings ***copy of Form 3CM issued by DSIR for approval of the Torrent Research Centre as an in-house research centre and Form 3CL issued by DSIR were also submitted****.*

In order to verify the allowability of claim made by the assessee company, the Assessing Officer had asked the assessee company to submit the necessary details and an explanation as to why the weighted deduction claimed by the assessee company in pursuance of section 35(2AB) should not be restricted to the weighted amount of quantum of deduction certified by DSIR in Form No. 3CL.

(c) In response to the same, the assessee company submitted a detailed explanation as regards following:

i. Torrent Research Centre (TRC) has been approved as an in-house research centre by the prescribed authority i.e. DSIR;

ii. That the assessee company has complied with all the conditions as prescribed u/s 35(2AB) and hence, it is rightly entitled to claim the deduction for expenditure incurred in respect of its approved R&D activities;

iii. Though the Form 3CL does not require or seek information of allowable or disallowable expenditure u/s. 35(2AB) of the Act, the assessee company submitted, as required by Assessing Officer, a reconciliation of the expenses that might have been excluded by DSIR in issuing Form 3CL

based on the basis of disallowance made in preceding years;

iv. Detailed explanation in respect of nature of expenses which have been excluded by DSIR in Form No. 3CL and why the same should not be disallowed while determining the amount eligible for claim of weighted deduction u/s. 35(2AB) of the Act.

*A copy of the above submission dated 12.12.2016 is attached herewith vide **Annexure-3** for ready reference of your honor.*

III. The submission of the assessee company that the amount eligible for deduction u/s. 35(2AB) should not be restricted to the amount certified by DSIR in Form 3CL was rejected by the Assessing Officer and following adjustments were made by him.

(a) The following Disallowances were made by the Assessing Officer on the ground that only the expenditure approved by DSIR is allowable u/s. 35(2AB) of the Act

Particulars	***Rs. (in lacs)***
Amount certified by DSIR as expenses incurred outside approved R&D facility	
Clinical Research Expenses	*1,214.01*
Patent Expenses (Official Fees) outside India	*57.32*
Pa ent Expenses (Consultancy Fees] outside India	*4,09.41*
Interest on Loan	*44.72*
Labour charges / contract manpower / consultancy charges / retainer ship	
Labour & Job work charges	*1,76.32*
Professional Fees in and outside India (Rs. 81.89 lacs spent in India and Rs. 8.59 spent outside India)	*90.48*
Fees and Legal Expenses	*14.73*
Other Studies Expenses	*2,01.32*
(A)	***2,208.31***
Other expenditure not approved by DSIR	
Building related recurring expenses	*104.88*
Municipal Taxes	*12.84*
Salary to Dr. C. Dutt	*274.19*

Employees not having degree in science	*338.55*
(B)	***730.46***
Total [C= (A+B)]	***2,938.77***
200% of capital expenditure (other than building of Rs. 137.50 lacs) (D)	***275.00***
Total amount of Disallowance u/s. 35(2AB) - (C+D)	***3,213.77***

(b) The above table shows that the issues raised by your honor in the show cause u/s 263 of the Act were already inquired by Assessing Officer and ***after rejecting the submissions of the assessee company the said expenses were already disallowed****. In this connection, the assessee ompany further submits that the expenditure on Patents amounts to Rs. 4.67 crores and not Rs. 4.75 crores as mentioned in the above referred show cause notice u/s. 263 of the Act. However, the assessee company submits that an Amount of Rs. 4 75 crores is already disallowed by the Assessing Officer and the same is worked out as under and the same is verifiable from the above table in para III (a):*

Particulars	*Amount Spent in India*	*Amount Spent outside India*	*Total*
Patent Expense (Official Fees)	*6.78*	*57.32*	*64.10*
Patent Expense (Consulting Fees]	*13.44*	*409.41*	*422.85*
Professional Fees	*81.89*	*8.59*	*90.48*
Total	*102.11*	*475.32*	*577.43*

Further, it is also submitted that amount of Rs. 12.14 crores in respect of Clinical Trial Expenses and Rs. 281.53 lacs relating to Labour charges / contract manpower / consultancy charges / retainer ship has also been disallowed by the Assessing Officer in his assessment order.

These details of the disallowances made by Assessing Officer are verifiable from the para 17.4

on page no. 71 to 73 of the Assessment order. On perusal of the same, it can be observed that the Assessing Officer has already made disallowance on account following R & D expenses referred in your notice in the various paragraphs of the notice.

Particulars	*Para no. of notice u/s. 263-dated 18-08-2017*	*Amount 1 disallowed by the Assessing Officer*
Patent Expenses - incurred outside India	*Para (iii)*	*466.75 Lacs*
Expenditure on Clinical Research	*Para (iv)*	*1214.01 Lacs*
Labour and Job-work charges	*Para-(v)*	*176.32 Lacs*
Professional Fees (Rs. 81.89 lacs spent in India and Rs. 8.59 spent outside India)	*Para-(v)*	*90.48 Lacs*
Legal Expenses	*Para-(v)*	*14.73 Lacs*
Salary Expenses :	*Para-(v)*	
Salary to Dr. C Dutt		*274.19 Lacs*
Salary to Employees not having degree in science		*338.55 Lacs*

From the above, it is clear that the expenses referred in para-(Hi), (iv) and (v) are already disallowed by the Assessing Officer in the order passed u/s. 143(3) of the Act Therefore, the said order is ne ther erroneous nor prejudicial to the interest of the revenue

IV. Further, regarding your honor's observation that the Assessing Officer has not made inquiry as to whether separate expenses have been incurred on quality control & regulatory approvals and whether these expenses have been grouped into R&D expenses, the assessee company submits as under:

(a) As stated in para 5.2(II)(c)(i) supra, the assessee company has vide submission dated 10.12.2016, explained that all manufacturing & other direct expenses incurred for each unit have been accounted directly in the respective unit's books of accounts.

In this context, it may also be noted that the R&D center of the assessee company is situated at Village Bhat, Dist. Gandhinagar in Gujarat, whereas the manufacturing facilities of the assessee company are situated at the following locations:

- *Village Indrad, Taluka Kadi, Dist. Mehsana, Gujarat;*
- *Village Bhud, Nalagarh, Baddi, Dist. Solan, Himachal Pradesh; -*
- *32 No. Middle Camp, NH-31A, East District, Gangtok (Sikkim).*

The above information was provided to the Assessing Officer when specific query was raised by him on the same.

(b) In this background, your honor would appreciate that it is not possible to send the goods manufactured in different units and at different locations to R&D facility for quality control and testing purpose. Hence, there does not arise a question that expenditure relating to quality control & regulatory approvals are grouped into R&D expense.

Further, the expenditure on Quality control is part of production cost, as it is incurred at the stage of production only and therefore, it is debited in the books of account of the respective units. As the assessee company is engaged in the business of manufacture and production of pharmaceutical products, ***the Quality testing and approval process are required to be carried out before the finished product is packed before its removal from manufacturing plant****. Accordingly, it is clear that the quality control and testing activities can be carried out at manufacturing plant only.*

(c) At this point, the assessee company also reiterates that ***the expenditure incurred on R&D facility is also verified by DSIR*** *and after verification the DSIR has excluded the expenditure amounting to Rs. 29.39 crores from the amount eligible for deduction u/s. 35(2AB) of the Act which has been duly considered by Assessing Officer as explained in Para 5.3(11) supra.*

On the basis of above, the assessee company submits that ***it is not a case that there is non-application of mind on the part of the assessing officer in this matter as observed by your honor, but the Assessing Officer has made in-depth inquiries regarding the amount of expenditure debited to P&L, reconciliation and justification for the amount not approved by DSIR and on that basis****, not being satisfied by the replies of the assessee company, the Assessing Officer has proceeded to make certain disallowance as mentioned in para III supra of this point. Therefore, the assessee company submits that the notice u/s 263 of the Act issued by your honor on this issue is devoid of any merits, as the order passed by*

Assessing Officer is neither erroneous nor prejudicial to the interests of the revenue.

5.4 ***Regarding Selling & Publicity Expenses (other than domestic)***

II. Vide para no. (vi) of the above referred notice, your honor has observed that the assessment order passed by the AO is erroneous and prejudicial to the interest of Revenue by stating as under:

> *"vi) You have claimed expenses on academic/scientific get together of Rs9.44 Cr., sales promotion expenses of Rs.1.48 Cr., business advancement expenses of Rs.1.48 Cr. (other than on domestic). The A.O. has not made any enquiry as regards the incurring of such expenses nor has he applied his mind as to whether such or part of such expenses fell foul of local regulations prevailing in those countries regarding gifting/other payments/ expenses incurred on Doctors and Medical practitioners. Further, the A.O. has also not examined if such expenses incurred were rightfully belonging to the assessee company and not its foreign subsidiaries which were also engaged in marketing of formulations in other countries. Non application of mind and non inquiry in this regard has rendered the impugned order as erroneous and prejudicial to the interest of revenue."*

II. In this connection, the assessee company submits following details of records available with Assessing Officer, inquiries made by Assessing Officer and replies and details submitted by the assessee company:

(a) During the course of assessment proceedings, the Assessing Officer asked to provide break-up of Selling, publicity and medical literature expenses amounting to Rs. 279.20 crores as appearing in Note No. 21 "OTHER EXPENSES' of Profit & Loss account along with explanation for nature of expenses.
In response to the same, the assessee company submitted the detailed breakup of selling and Publicity expenses incurred for Domestic Market and other than Domestic Market, detailed explanation for nature of such expenditure, along with break-up of Business Advancement expenses giving details of items costing more than Rs. 1000/-and those less than Rs. 1,000/-, vide submission dated 10.12.2016. Copy of the said reply is annexed herewith vide ***Annexure-1(a)*** *supra.*

(b) On the basis of verification and examination of details submitted vide above mentioned submitted dated 10.12.2016, the assessee company was asked to show cause as to why expenses accounted under head of Business

Advancement Expenses and Doctors' Sponsorship, which are grouped under Selling and Distribution Expenses should not be disallowed, in view of the CBDT Circular No. 5/2012 dated 01-08-2012, which provides for disallowance of deduction pertaining to freebies given to medical practitioners.

In response to that the assessee company submitted details vide submission dated 15.12.2016, as mentioned in para 5.1(ii)(b) supra, a copy of which is annexed herewith vide ***Annexure-1(b)*** *supra.*

III. Regarding your honor's above referred observations, the assessee company submits as under:

(a) Your honor has observed that the Assessing Officer has neither made any enquiry as regards the incurring of such expenses nor has he applied his mind as to whether such or part of such expenses fell foul of local regulations prevailing in those countries regarding gifting / other payment / expenses incurred on Doctors and Medical Practitioners.

In this regards, the assessee company submits that as per circular no. 5/2012 it has been provided that the claim of any expenditure incurred in providing freebies in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, shall be inadmissible under section 37(1) of the Act, being expenses prohibited by law. This disallowance shall be made in the hands of such pharmaceuticals or allied health sector industries or other assessee which has provided such freebies and claimed it as a deductible expense in its accounts against income.

In this context, the assessee company submits that the said regulations of Indian Medical Council (MCI) has been issued as per the powers conferred u/s 20A r.w.s 33(m) of the Indian Medical Council Act, 1956 and the said Act is applicable to whole of India, as provided in section \ of the said Act. Accordingly, it can be said that the aforementioned regulation of 2002 are not applicable and binding to medical practitioners outside India. Therefore, there are no provisions which denies the deduction of business expenditure relating to Business Advancements, which is allowable u/s. 37(1) of the Act. Hence, there is no non-application of mind or non-enquiry on the part of the Assessing Officer on this issue.

(b) Further, your honor has observed that the Assessing Officer has not examined if such expenses incurred were rightfully belonging to the assessee company and not its

subsidiaries which were also engaged in marketing or formulations in other countries.

* *In this regards, the assessee company submits that the account of the assessee company has been audited under The Companies Act as well as the same are subject to Tax Audit under the provisions of Income tax Act. All the expenditure debited in its P&L account have been verified by the Auditor as rightfully incurred by the assessee company for its business.*

* *Vide submission dated 17.06.2016, the assessee company submitted copy of Form no. 3CEB, from which the Assessing Officer verified the details of transaction entered into with associated enterprises. During the course of assessment proceedings,* ***the assessee company also submitted the documentation relating to Transfer Pricing****, which provide the basis of all the transactions with associated enterprises and gives all the details which are self-explanatory. Therefore, no further questions were required to be raised.*

* *In this context, the assessee company submits that for providing of market information and regulatory support services in order to promote the Company's business in the respective territory and to act as a legal agent for the Company on all the matters related to regulatory matters in those territories the assessee company has entered into liaison support agreements with certain associated entities.* ***Details of these transactions are reported in the Transfer Pricing Report u/s 92D of the Act in Form 3CEB and Transfer Pricing documentation, which has been submitted during the course of assessment proceedings.***

* *Such expenses on liaison support services are duly incurred by the Assessee Company and payable by it in connection with promoting its business in foreign territories. However, the Assessing Officer has allowed the same after trough verification of Transfer Pricing documentation.*

IV. *On the basis of above, the assessee company submits that the order passed by Assessing Officer cannot be termed as erroneous and prejudicial to the interests of the revenue because the assessing officer has verified the Transfer Pricing report in Form no. 3CEB and the Transfer Pricing documentation."*

4.4 It was thus contended before the Pr.CIT that there was no failure on the part of the AO in making proper inquiries as required in the context of the state of affairs of assessee and no further inquiry was plausible and called for. It was also stated that it could not be said that inquiry was inadequate as complete details were provided to AO and the accounts of the assessee (a listed company) were duly audited and detailed disclosures of various aspects of the financial statements were made and annexed to the audited statement. It was thus contended by the assessee that proposed action of the Pr.CIT is not permissible under s.263 of the Act.

4.5 The Pr.CIT, however, did not accept the defence raised by the assessee on issues raised in the show cause notice. The Pr.CIT, in essence, observed that the assessment was completed by the AO in haste without proper inquiries and verification which were necessary for the purpose of making assessment. Consequently, the Revisional Commissioner set aside the assessment framed under s.143(3) of the Act with directions to re-frame the assessment after conducting requisite inquiries on the issues involved as noticed by him.

5. Aggrieved by the aforesaid Revisionary order of the Pr.CIT under s. 263 which sought to cancel the assessment order, the assessee preferred the appeal before the Tribunal.

6. The learned counsel for the assessee reiterated the aforementioned pleas earlier raised before the Pr.CIT and vociferously exhorted that the assessee is a listed company and is run

by a professional Board. The accounts are exhaustively audited and is subjected to comprehensive internal audit as well as statutory audit. The assessee company is engaged in manufacture and production of pharmaceutical products and is one of the leading and renowned company in the sector. The company has reported generation of revenue from pharmaceutical operations in the vicinity of Rs.4000 Crores on average in last two years. The income returned by the assessee is also to the tune of Rs.584.13 Crores. The learned AR contended that in this backdrop, the action of the AO requires to be evaluated.

6.1 The learned AR thereafter adverted to the specific allegations raised on various issues and submitted that the detailed reply before the Pr.CIT is self explanatory.

6.2 Rebutting the alleged inadequacy in inquiry on expenditure of Rs.24.32 Crores on gift item, the learned AR referred to the submissions made before the Pr.CIT and submitted that the expenditure incurred towards gift is miniscule having regard to the scale of operations. The learned AR referred to page no.46 of the paper book showing break up of business advancement expenses and submitted that most of the items involved are of very small value items costing below Rs.1000/- in each case and only items aggregating to Rs.24.3 Crores cost above Rs.1000/- per item. The requisite details were provided to the AO vide submission dated 17.06.2016 and 15.12.2016 to explain its position. Despite the strong basis available for admission of the entire expenses, the AO still indulged in disallowance of 10% of the entire expenses of Rs.55.14 Crores (including Rs.24.3 Crore)

to cover up the possible expenses incurred for non business purposes and for possible breach of CBDT Circular No.5/2012. The AO had also made disallowance of entire expenditure of nearly Rs.26 Crores being expenses incurred on academic / scientific grants to the Doctors in the nature of sponsorship expenses. It was thus contended that the AO has decided the issue after requisite application of mind and the revenue risks have been addressed far more than what was possibly called for in the circumstances. To expand further, the learned AR contended that it is not the objective of Section 263 of the Act to interfere with the order of the AO in each and every type of situation where the inquiry was not made in the manner expected by the Revisional Officer from a perfectionist point of view. It was contended that the quasi-judicial action of the AO cannot be lightly struck down without showing it to be erroneous and prejudicial to the interest of the Revenue. The AO has concluded the issue having regard to the totality of the facts and thus cannot be branded as erroneous in the name of alleged inadequacy of inquiry.

6.3 The learned AR thereafter referred to the next issue namely inquiry regarding manufacturing process. The learned AR in this regard submitted that a bare reading of show-cause in this regard points out to the fact that the inquiry expected itself is obscure. The learned AR submitted that what kind of inquiry regarding manufacturing process and goods being manufactured was needed, which allegedly lead to erosion of taxes, has not been spelt at all.

6.4 Adverting to item no.3 of the show cause notice, the learned AR for the assessee submitted that requisite details of expenses on

account of quality control and regulatory approvals were placed on the records of the AO and necessary inquiries were made by the AO as noted in the detailed submission before the Pr.CIT. The learned AR thereafter submitted that Torrent Research Centre (TRC) was approved as an in-house Research Centre by the prescribed authority i.e. DSIR. The assessee has filed requisite statutory forms to support the compliance of conditions prescribed under s.35(2AB) of the Act. The AO however did not accept the claim of the assessee *in toto* and substantial disallowance aggregating to Rs.3213.77 Lakhs was made as detailed in the submissions and the assessment order. The advantage of weighted deduction in respect of expenses towards quality control etc. has not been taken. The learned AR submitted that in these circumstances, where the submissions of the assessee were partly rejected after making enquiry, the allegation towards inadequacy in enquiry is totally unsustainable. As submitted, the issue towards separate expenses on quality control and regulatory approvals was also addressed to the AO as pointed out in the written submissions. Thus, non-application of mind of AO to the underlying facts is not discernible.

6.5 Adverting to the clinical research expenditure of Rs.1214.01 Lakhs, the learned AR submitted that clinical research expenses formed part of amount eligible for deduction under s.35(2AB) of the Act and was incurred year after year having regard to the nature of pharmaceutical sector. The AO indulged in re-working of eligible amount of deduction after taking into account the expenditure approved by DSIR and after rejecting the submissions of the assessee company on many aspects. The learned AR

referred to the detailed submissions made before the Revisional Commissioner on what transpired before the AO. The learned AR made para-wise reference to the show cause notice and submitted that the expenditure on clinical research amounting to Rs.1214.01 Lakhs was *inter alia* disallowed by the AO. Similarly, expenses incurred towards labour, job work, professional fees, legal expenses and salary expenses as part of R&D expenses etc. were verified. The learned AR submitted that all such expenses were subjected to objective scrutiny and a part of such expenditure was disallowed by the AO. For instance, Rs.176.32 Lakhs was disallowed out of labour and job work, Rs.90.48 Lakhs out of professional fees and Rs.14.73 Lakhs was rejected out of legal expenses. Therefore, the allegation that the AO acted perfunctorily on the issue is without any basis.

6.6 With reference to expenses claimed on academic/scientific get-together of Rs.9.44 Crores as well as sales promotion expenses of Rs.19.57Crores and business advancement expenses of Rs.1.48 Crores the learned AR responded to by stating that relevant details and records made available to the AO was pointed out to the Pr.CIT in its written reply. It was pointed out to the Pr.CIT that the breakup of such expenses was duly provided. Breakup of business advancement expenses was provided giving details of items costing more than Rs.1000/- and those less than Rs.1000/- also vide submissions dated 10.12.2016. The assessee was also show caused by the AO in the matter with reference to CBDT Circular No. 5/2012. It is after taking into account the reply of the assessee dated 15.12.2016 and after taking note of

documentations relating to transfer pricing, the AO concluded on the expenses incurred. This belies the allegation of Pr.CIT.

6.7 The learned AR after addressing us on the factual aspects as noted above, exhorted that the Revisional Commissioner has totally mis-directed himself in law and has wrongly appreciated the factual aspects. The learned AR submitted that each and every issue raised by the Pr.CIT in its show cause notice were thoroughly examined by the AO as demonstrated in the written submission before the Pr.CIT. There was full application of mind on the part of the AO on all the issues. The learned AR vehemently submitted that huge adjustments to the returned income as a corollary to these factual appreciation *ipso facto* vindicates the fact of proper enquiry and application of mind. The assessment framed resulted in over all additions /disallowances of approximately Rs.131 Crores. A number of written submissions filed before the AO during the course of assessment proceedings were also annexed to the detailed response to the show cause notice issued under s.263 of the Act to shun the suspicion on issues frowned upon. It was thus contended on behalf of the assessee that it was only after requisite inquiry and examination of facts and after objective analysis thereof on each and every issue raised in the show cause notice, the AO had adopted a view for or against the assessee. It was thereafter vehemently submitted that such issues were already subject matter of examination in the scrutiny assessments year-after-year in the past, additions/disallowances flowing from the action of the AO were subjected to judicial scrutiny before the appellate authorities. The learned AR thus submitted that in the light of

factual position explained towards each item, the order of the AO cannot be faulted on the touchstone of Section 263 of the Act.

6.8 Expanding the deliberations further, the learned AR thereafter alleged that the Revisional Commissioner has attempted to wrongfully take shelter of Explanation 2 to Section 263(1) for his actions *de horse* the material facts and long standing background of the assessee. Adverting to Explanation 2 to Section 263(1) relied upon by the Revisional Authority, the learned AR observed that as per the explanatory note provided to in the relevant Finance Bill, 2015 for such insertion, the purpose of the insertion of aforesaid Explanation was to provide clarity on the interpretation of expression 'erroneous in so far as it is prejudicial to the interest of the Revenue'. It was thus contended that the aforesaid Explanation is only clarificatory and does not in any way dilute the substantive requirements of Section 263(1) of the Act. The learned AR relied upon the decision of the co-ordinate bench in the case of Narayan Tatu Rane vs. ITO [2016] 70 taxmann.com 227 (Mum) to throw light on the scope and ambit of Explanation 2 as understood judicially. The learned AR submitted that in view of the decision of the co-ordinate bench (supra) Explanation 2 shall apply only if the assessment order has been passed without making inquiry or verification which a reasonable and prudent Officer would have carried out in such cases. Law does not provide to stretch the inquiries and verification to an extent which may tantamount to oppression and harassment of a tax payer. The AO, in the instant case, has arrived at conclusion after making several rounds of inquiries and

therefore the action of the AO cannot be impugned under s.263 of the Act.

6.9 The learned AR next relied upon the decision of the Hon'ble Gujarat High Court in the case of CIT vs. Arvind Jwellers 259 ITR 502 (Guj) to paddle a plea that provisions of Section 263 of the Act cannot be invoked to correct each and every type of mistake or error committed by the AO. It was claimed that the Revisional Authority has neither demonstrated incorrect assumption of facts nor alleged the incorrect application of law successfully. The learned AR next referred to he decision of the Hon'ble Gujarat High Court in the case of CIT vs. R. K. Construction Co. (2009) 313 ITR 65 (Guj) for the proposition that where the AO has taken a particular view on the basis of evidences produced before him it is not open for the Commissioner, in the revisional proceedings under s.263 of the Act, to take a different view on the same material. The AO in the instant case has specifically examined all the issues raised by Pr.CIT albeit not probably in the manner in which the Pr.CIT would have liked but this cannot be the ground for assumption of jurisdiction under s.263 of the Act. The learned AR thus submitted in conclusion that the assessment order under review cannot be labelled as erroneous in so far as prejudicial to the interest of the Revenue within the terms of Section 263 of the Act in the circumstances so narrated.

7. The learned DR, on the other hand, vehemently supported the action of the Revisional Authority and relied upon the order so passed under s.263 of the Act. As regards, business advancement

expenditure, the learned DR submitted that the AO has not made any inquiry as regards to whom the gifts were distributed and underlying records thereon. Similarly, MCI Regulations and CBDT Circular does not permit distribution of gifts to medical practitioners. This aspect has not been examined at all. Similarly, the learned DR referred to the allocation of common expenses attributable to Baddi & Sikkim Units and submitted that the Pr.CIT has rightly observed that basis of allocation of expenses for determining the true profits eligible for deduction under Chapter VIA was not inquired into. The learned DR objected to the action of the AO towards expenses incurred on R&D expenses and similar expenses and relied upon the order of the Pr.CIT. Other issues raised in the show cause notice were also supported in the light of the order of the Pr.CIT. The learned DR accordingly submitted that the Revisional Commissioner has acted within the four corners of the provisions of the Act and as per the sanction of the law and consequently, the revisional action requires to be upheld.

8. We have carefully considered the rival submissions and perused the revisional order passed by the Pr.CIT under s.263 of the Act as well as other materials referred to and relied upon by the respective parties and case laws cited.

8.1 Supervisory jurisdiction vested under Section 263 of the Act enables the concerned Pr.CIT/CIT to review the records of any proceedings and order passed therein by the AO. It empowers the Revisional Commissioner concerned to call for and examine the records of another proceeding under the Act and if he considers

that any order passed therein by the AO is erroneous in so far as it is prejudicial to the interest of the Revenue, then he may (after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary), pass such order thereon as the circumstances of the case justify, including the order enhancing or modifying the assessment or cancelling the assessment and directing afresh assessment. Thus, the revisional powers conferred on the Pr.CIT/CIT under s.263 of the Act are of very wide amplitude with a view to address the revenue risks which are objectively justifiable.

8.2 In the facts and circumstances of the case, the substantive issue that emerges for adjudication is whether the Pr.CIT under the umbrella of revisonary powers is entitled to upset the finality of assessment proceedings before the AO where the AO has allegedly committed error in passing assessment order without proper verification of expenses and deductions claimed. Implicit in the question is the scope of powers of Revisional Commissioner in the event of alleged inadequacy of enquiry into various aspects of an issue.

8.3 On perusal of the show cause notice (SCN) dated 18.08.2017 issued by the Revisional Commissioner proposing to set aside the assessment order dated 26.12.2016 passed by AO under s.143(3) of the Act, we notice that the Pr.CIT is essentially dissatisfied with the degree of inquiry made in respect of issues raised therein. Firstly, as per para (i) of SCN, the Pr.CIT alleged that inquiry was not made on distribution of gift items to various

individuals which include expenditure incurred of Rs.24.32 Crores on gift items exceeding Rs.1000/- each. Such non-inquiry was alleged to be erroneous and prejudicial to the interest of the revenue. As noted above, the assessee responded by stating that the detailed breakup of business advancement expenses amounting to Rs.55.14 Crores incurred was provided to the AO in pursuance of specific query in this regard. This amount included the impugned expenses towards gift items. The applicability of CBDT Circular No. 5/2012 in this regard was also addressed whereby it was submitted submit that this circular is applicable only where freebies above Rs.1000/- per item were given to the medical practitioners. Despite production of bills and records of the company, the AO embarked upon estimated disallowance of 10% of entire expenses of Rs.55 14 Crores which works out to 5.51 Crores out of expenditure of Rs.24.32 Crores on items exceeding Rs.1000/- per item This apart, as stated, the AO had also made disallowance of entire expenditure of Rs.25.99 Crores being expenses on academic / scientific grants to Doctors. In such scenario, the allegation of the Pr.CIT towards absence of inquiry on the point appears quite shallow. It may be pertinent here to observe that in order to weigh the credence in the allegation of the Revisional Commissioner, one requires to keep in mind the volume and magnitude of transactions involved in a given case. As observed, the Revenue from operations in the instant case is exceeding Rs.4000 Crores. Likewise, the quantum of expenditure incurred is pegged in excess of Rs.3200/- Crore. The profit before tax is in the vicinity of Rs.850 Crores. Therefore, expecting an AO to examine each and every item of income and expenditure and other transactions to the hilt is

fraught with serious constraints and does not appear feasible. Noticeably, the assessee is a listed company and accounts are subjected to multiple audits by expert professionals. The assessment is also carried out on year-to-year basis. In such a scenario, where the AO has rejected substantial amount from the claim of expenditure after reasonably verifying bills and vouchers, the allegation of the Pr.CIT appears misconceived. Ordinarily, it is only in a very gross case of inadequacy in inquiry and lack of application of mind that the order of AO is open to attack as erroneous. In the context of a turnover and scale of operation of this magnitude, the expenditure incurred on business advancement of such amount do not indicate any visible abnormality. This apart, the AO did take cognizance of the issue and made substantial disallowance. Thus, it cannot be outrightly alleged that the AO has omitted to apply its mind to the issue. The allegation thus appears unintelligible. The AO, in our view, has not committed any error in not chasing *will o the wisp* in the absence of any brazen circumstances. The action of the Pr.CIT on this issue of business advancement expenses appears to be guided by the considerations of Revenue alone and thus cannot be viewed with favour.

8.4 The second issue flagged as per para (ii) of the show cause notice concerns examination of certain points in relation to Baddi unit and Sikkim unit. As an adjunct to this allegation, the Pr.CIT also asserted that the AO has failed to apply as to what kind of medicines are being manufactured and whether the units were API or it was formulation etc. We have perused the allegation as reproduced in para 4 of this order. The Pr.CIT essentially opined

that the AO failed to make inquiry regarding the manufacturing process and nature of medicines being manufactured and thus alleged that assessment order is vitiated for this reason. In this connection, we take note of the reply dated 10th December, 2016 placed by assessee before the AO touching the aforesaid issue. As pointed out on behalf of the assessee, the books of accounts of Baddi unit and Sikkim units are maintained separately and the allocation of common expenditure is made on rational basis consistently followed year after year. The AO has examined the issue reasonably and had also posed several queries to the assessee in the course of the assessment proceedings towards basis of allocation of common expenses and R&D expenses and also discovery costs of R&D expenses and capital expenditure on R&D etc. The eligibility for claim of deduction under s.80IC of the Act (Baddi unit) and 80IE of the Act (Sikkim unit) was also verified. Thus, the AO was clearly live to the issue and there was active application of mind in as much as the AO indulged in re-allocation of expenses and re-determination of amount eligible of deduction under s 80IC and 80IE of the Act. Significantly, the AO made disallowance of Rs.27.47 Crores in relation to Baddi unit and Rs.70.87 Crores in relation to Sikkim unit. To dwell further, it is also the case of the assessee that Baddi unit came in existence way back in AY 2006-07 and has been subjected to scrutiny year after year. Thus, there appears no perceptible occasion for the AO to revisit the facts concerning manufacturing process etc. threadbare as raised. The Sikkim unit is also in operation since AY 2012-13 and thus, this is not the first year of operation. We also note that the assessment made on similar basis was accepted in the earlier year as well as in subsequent

assessment years. In such a scenario, it is equally plausible that racking up already settled aspects year after year may not have been found necessary to the wisdom of AO. Although, desirable from the idealistic point of view of Revisional Commissioner, the records suggest that the AO cannot be blamed to have acted in a perfunctory manner. Where the AO has examined the expenditure concerning these units and restricted the deductions claimed thereon, one cannot possibly say that the AO has sleepwalked on the issue. Owing to continuity of operations and in the absence of any strong circumstance which may provoke inquiry as desired by Pr.CIT, conclusion drawn by the AO should not be ordinarily disturbed. Needless to say, the Pr.CIT ought o have make inquiry on the issue himself if so considered expedient to at least prima facie demonstrate in action of the AO which rendered the order erroneous which also caused prejudice to the Revenue. Merely because the expectations of the Revisional Commissioner are purportedly not met, it should not necessarily trigger revisional action under s.263 of the Act in every case. The discretion given to the supervisory authority is expected to exercise in a judicial manner having regard to the totality of facts.

8.5 We shall now turn to the next issue namely non inquiry towards quality control and regulatory approval in relation to R&D expenses on which the assessee has claimed weighted deduction. In this regard, we refer to the reply of the assessee before the Pr.CIT clarifying the issue. The Pr.CIT has not rebutted the explanation of the assessee anywhere. It was pointed out by the assessee before the Pr.CIT that it had already informed the AO vide submissions dated 10.12.2016 filed in the course of

assessment proceedings that all manufacturing and direct expenses incurred for each unit have been accounted directly in the respective books of accounts of given unit. It was clarified that expenditure relating to quality control and regulatory approvals were not grouped into R&D expenses. The quality control has been claimed as an ordinary expenditure in the respective books of various units as it is a part of the production costs. The assessee further clarified that after verification, the approving authority namely DSIR excluded the expenditure amounting to Rs.29.39 Crores from the amount eligible for weighted deduction under s. 35(2AB) of the Act. This aspect was also duly taken note of by AO while framing the asse sment. In view of the unequivocal stand taken by the assessee before the AO as well as before the Pr.CIT, which has not been dislodged at any stage, the allegation towards non-application of mind on the issues of R&D expenses fades into insignificance and does not survive against the assessee. We thus find that the impugned allegation pertaining to R&D expenses also does not hold any water.

8.6 In response to the concern of the Pr.CIT towards patent related expenditure outside India amounting to Rs.475.32Lakhs as not eligible for weighted deduction under s.35(2AB) of the Act, we observe from the reply of the assessee before the authorities below that the aforesaid amount was already disallowed by the AO and therefore the concern of the Pr.CIT is misplaced. It is also noticed that apart from disallowance of patent related expenses, substantial amount out of expenditure on clinical research (Rs.12.41 Crore), labour and job work charges (Rs.1.76 Crore), professional fee (Rs.90.48 Lakhs), legal charges (Rs.14.73

Lakhs) and salary to Dr. C. Dutt (Rs.2.72 Crores) as well as salary to employees not having degree in science (Rs. 3.38 Cores) was disallowed by the AO out of R&D expenses. Therefore, the concern raised by the Pr.CIT as per para (iv) & (v) also was addressed by the AO and allegation of the Pr.CIT on mechanical acceptance of such aspects by AO is on tenuous grounds.

8.7 Vide para (vi) of the show cause notice, the Pr.CIT also alleged deficiency in examination of academic / scientific get together expenses of Rs.9.44 Crores, sales promotion expenses of Rs.19.57 Crores and business advancement expenses of Rs.1.48 Crore (other than an domestic). In this regard, as noticed, it is the case of the assessee that queries were duly raised in this connection and responded to by the assessee vide its submission dated 10.12.2016 before the AO. The eligibility of expenses were examined on the touchstone of CBDT Circular 5/2012 dated 01.08.2012 which provides for disallowance of deduction pertaining to freebies given to medical practitioners. Further, reply dated 15.12.2016 was also filed in relation to the issue. This apart, vide submission dated 17.062016, the assessee company also submitted copy of Form No. 3CEB towards details of transaction entered into with Associated Enterprises. The transactions are also reported in the transfer pricing report under s.92D as well as in transfer pricing documentation during the course of assessment proceedings. It is the case of the assessee that the expenses incurred towards promoting its business in foreign territory were allowed after thorough verification of transfer pricing documentation. The applicability of CBDT Circular No. 5/2012 (supra) on account of items costing less than

Rs.1000/- given as a freebies to medical practitioners is, at best, a debatable issue in view of the language employed the circular. The AO has examined all the aspects and has recorded a conscious finding on each issue. The action of the Revisional Commissioner is not tenable on this score either.

8.8 On a broader reckoning, we note that it is the case of the assessee that the AO has recorded a conscious finding after considering the factual matrix in the given context and in the light of prevailing legal position and having regard to the past history of the case on each and every issue raised by Pr CIT. We notice that the assessment so framed has run into more than 100 pages and has resulted in approximate additions/disallowances of whopping Rs.131 Crore. All the issues raised by the Pr.CIT has been duly touched and certain adjustments have been already carried out by the AO. Besides, the assessee is a Public Limited Company listed on the Stock Exchanges and is reckoned to be a valuable company in the pharmaceutical sector stated to be run by a dedicated team of professional management. The assessment of the assessee is carried out on a year to year basis. Having regard to the staggering turnover and scale of operation, it is virtually impossible for any adjudicating authority to examine and re-examine all the points in a given assessment year to the hilt as perceived by the Pr.CIT. The assessee has filed its detailed counter before the Pr.CIT to address the issues raised in the show cause notice. The Pr.CIT has not given any cogent rebuttal in its order as to how the so called inadequacies in the enquiries made has dented the ultimate outcome in assessment order. The action of the Revisional Commissioner requires to be objectively

justifiable and cannot be a mere *ipse dixit.* The Pr.CIT ought to have made some elementary inquiry himself to unearth alleged error in the order of the AO which caused prejudice to the Revenue. Instead, the Pr.CIT has merely alleged absence of fuller inquiry and non-application of mind without showing any systematic efforts on his part to support the allegations. We are of the firm view that the Pr.CIT was expected to do more in the totality of the facts and context. Thus, it is difficult to agree with the allegation of the Pr.CIT on any of the issues raised in the show cause notice and the revisional Order.

9. The Pr.CIT has drawn support from newly inserted Explanation 2 below Section 263(1) of the Act introduced by Finance Act, 2015 w.e.f. 01.06.2015 for his action. The Explanation 2 *inter alia* provides that the order passed without making inquiries or verification 'which should have been made' will be deemed to be erroneous in so far as it is prejudicial to the interest of the Revenue. It is on this basis, the assessment order passed by the AO under s.143(3) of the Act has been set aside with a direction to the AO to pass a fresh assessment order. It will be therefore imperative to dwell upon the impact of Explanation 2 for the purposes of Section 263 of the Act.

9.1 The aim and object of introduction of aforesaid Explanation by Finance Act, 2015 was explained in CBDT Circular No. 19/2015 [F.NO.142/14/2015-TPL], Dated 27-11-2015 which is reproduced hereunder:

> *"53. Revision of order that is erroneous in so far as it is prejudicial to the interests of revenue.*

53.1 The provisions contained in sub-section (1) of section 263 of the Income-tax Act, before amendment by the Act, provided that if the Principal Commissioner or Commissioner considers that any order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the Revenue, he may, after giving the assessee an opportunity of being heard and after making an enquiry pass an order modifying the assessment made by the Assessing Officer or cancelling the assessment and directing fresh assessment.

53.2 The interpretation of expression "erroneous in so far as it is prejudicial to the interests of the revenue" has been a contentious one. In order to provide clarity on the issue, section 263 of the Income-tax Act has been amended to provide that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal Commissioner or Commissioner.— (a) the order is passed without making inquiries or verification which, should have been made; (b) the order is passed allowing any relief without inquir ng into the claim; (c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or (d) the order has not been passed in accordance with any decision, prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

53.3 Applicability: This amendment has taken effect from 1st day of June, 2015.

9.2 A bare reading of the Circular gives a somewhat impression that the Explanation 2 was inserted for the purpose of providing clarity on the expression 'erroneous in so far as it is prejudicial to the interest of the Revenue'. The Explanation being clarificatory would not lead to dilution of the basic requirements of Section 263(1) of the Act. The provisions of Section 263 although appears to be of a very wide amplitude and more particularly after insertion of Explanation 2 but cannot possibly mean that recourse to Section 263 of the Act would be available to the Revisional Authority on each and every inadequacy in the matter of inquiries and verification as perceived by the Revisional Authority. The Revisional action perceived on the pretext of inadequacy of enquiry in a plannery and blanket manner must be desisted from.

The object of such Explanation is probably to dissuade the AO from passing orders in a routine and perfunctory manner and where he failed to carry out the relevant and necessary inquiries or where the AO has not applied mind on important aspects. However, in the same vain where the preponderance of evidence indicates absence of culpability, an onerous burden cannot obviously be fastened upon the AO while making assessment in the name of inadequacy in inquiries or verification as perceived in the opinion of the Revisional Authority. It goes without saying that the exercise of statutory powers is dependent on existence of objective facts. The powers outlined under s.263 of the Act are extraordinary and drastic in nature and thus cannot be read to hold that an uncontrolled, unguided and uncanalised powers are vested with the competent authority. The powers under s.263 of the Act howsoever sweeping are not blanket nevertheless. The AO cannot be expected to go to the last mile in an enquiry on the issue or indulge in fleeting inquiries. The action of the Revisional Commissioner based on such expectation requires to be struck down.

9.3 The use of expression 'which should have been made' in clause (a) to Explanation 2 to Section 263 of the Act is significant. This impliedly tests the action of AO on the touchstone of reasonableness and rationality in approach. It clearly suggests that context also holds the key in the matter of enquiry. The action of the AO requires to be evaluated contextually. If the aforesaid Explanation is read in a abstract manner *de horse* the test of reasonableness and context, the powers of Revisional CIT would be rendered invincible and

almost every assessment order can be possibly frustrated. A nuanced understanding of Explanation suggests that inadequacy in inquiry ought to be of cardinal nature to ignite the potent powers of review.

9.4 As noted, the assessee is a very big player in the pharma sector and enormity of operation is to be kept in mind. Thus what is relevant is to weigh as to what countervailing circumstances were prevailing which ought to have provoked such enquiry by a reasonable person instructed in law. In the instant case, apart from noticing that each and every issue raised in the notice were subject matter to enquiry in one way or the other, we also cannot remain oblivious of the facts that the financial accounts of the assessee are subjected to various kinds of audits under different Acts and the assessee being a listed company is presumed to function in a disciplined and regulatory environment. In the context of the mammoth scale of operation coupled with regularity of the scrutiny assessment year after year, we find apparent plausibility and sufficient strength in the contentions raised on behalf of the assessee in its defense. Having regard to colossal volume, the serious time and capacity constraints saddled upon AO while raising pitch for deeper examination must be borne in mind.

9.5 We thus find merit in the plea of the assessee that the Revisional Commissioner is expected show that the view taken by the AO is wholly unsustainable in law before embarking upon exercise of revisionary powers. The revisional powers cannot be exercised for directing a fuller inquiry to merely find out if the

earlier view taken is erroneous particularly when a view was already taken after inquiry. If such course of action as interpreted by the Revisional Commissioner in the light of the Explanation 2 is permitted, Revisional Commissioner can possibly find fault with each and every assessment order without himself making any inquiry or verification and without establishing that assessment order is not sustainable in law. This would inevitably mean that every order of the lower authority would thus become susceptible to Section 263 of the Act and, in turn, will cause serious unintended hardship to the tax payer concerned for no fault on his part. Apparently, this is not intended by the Explanation. Howsoever wide the scope of Explanation 2(a) may be, its limits are implicit in it. It is only in a very gross case of inadequacy in inquiry or where inquiry is *per se* mandated on the basis of record available before the AO and such inquiry was not conducted, the revisional power so conferred can be exercised to invalidate the action of AO. The AO in the present case has not accepted the submissions of the assessee on various issues summarily but has shown appetite for inquiry and verifications. The AO has passed the order in great detail after making several allowances and disallowances on the issues involved impliedly after due application of mind. Therefore, the Explanation 2 to Section 263 of the Act do not, in our view, thwart the assessment process in the facts and the context of the case. Consequently, we find that the foundation for exercise of revisional jurisdiction is sorely missing in the present case.

10. Resultantly, the order of the Pr.CIT passed under s.263 of the Act is set aside and cancelled and the order of the AO under s.143(3) is restored.

11. In the result, the appeal of the assessee is allowed.

This Order pronounced in Open Court on 08/08/2018

Sd/-	Sd/-
(MAHAVIR PRASAD)	(PRADIP KUMAR KEDIA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Ahmedabad: Dated 08/08/2018

True Copy

S. K. SINHA

आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-

1. राजस्व / Revenue
2. आवेदक / Assessee
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त- अपील / CIT (A)
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाइल / Guard file.

By order/आदेश से,

उप/सहायक पंजीकार
आयकर अपीलीय अधिकरण, अहमदाबाद ।