

Income Tax Issues Pharma Industry

Presentation By:

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December 21, 2019

Some Key Issues

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Freebies

□ Freebies

- Chronology of events
 - **Finance Act 1998** – Introduction of Explanation to Section 37(1) – (Circular – 772 of 1998 – protection money, extortion, hafta, bribes – to be disallowed)
 - **December 2009** – amendment to the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 – (any Gift, Travel facility, Hospitality, Cash or monetary grant)
 - **August 2012** – CBDT Clarification – Freebies expense not allowable u/s 37(1).

- Explanation 1 to Section 37(1) –

*“expenditure . . . is **prohibited by law** shall not be deemed to have been incurred for the purpose of business or profession”*

Freebies

Key Argument

- IMC guidelines are applicable only to doctors and not pharma companies

Case Laws

- **Aristo Pharmaceuticals v. ACIT (2019) 107 taxmann.com 119 (Mum. Trib.) (A.Y. 2013-14)**
- Glenmark Pharmaceuticals Ltd. v. ACIT & vice versa (2019) (ITA No. 5651/Mum/2017 & ors) (Mum. ITAT)
- Apex Laboratories Pvt Ltd v. DCIT [2019] TIOL 1056 (Mad HC) - no substantial question of law

Secondary Argument

- Assessment Year – prior to the year of CBDT Circular
- Gift of small amount, carries name of the pharma company – marketing expense

S. 35(2AB) - Scientific Research expense

- Background
 - S. 35(2AB) – 150% of expenditure (other than land or building) incurred on scientific research on in-house research and development facility (100% expense from AY 2021-22)
 - It would include
 - Expense on clinical drug trial,
 - Expense for obtaining approval from any regulatory authority; and
 - Expense for filing an application for a patent under the Patents Act, 1970
- Procedural requirements
 - Enters into an agreement with DSIR
 - Furnishes reports and maintain accounts as prescribed by DSIR

S. 35(2AB) - Scientific Research expense

- Forms –
 - Form 3CK – application for entering into the agreement
 - Form 3CM – Order of approval from DSIR
 - Form 3CLA – Annual Report of Expenses incurred by Company to DSIR
 - Form 3CL – Annual Report by DSIR to Income Tax Authority

- Changes (Rule 6 of Income tax Rules, 1962)–
 - Form 3CM, 3CLA and 3CL to be filed **electronically**.
 - Form 3CM & Form 3CL to be submitted within **120 days** (earlier 60 days) from grant of approval / submission of Form 3CLA.
 - Form 3CLA to be filed within the **due date of** filing income tax **return** (earlier 31st October of succeeding year) and has to be certified by **any chartered accountant** (earlier statutory auditor)

S. 35(2AB) - Scientific Research expense

- Expenditure to be excluded as per DSIR Guidelines.

- Example –
 - **Capital Work in Progress** – CIT v. Biocon Ltd. [2015] 375 ITR 306 (Kar. HC)
 - Vehicles purchased for reference & testing purpose will not be admissible.
 - Capital Expenditure in relation to intangible asset
 - Manpower under the category of retainership / trainees/ consultants and manpower on contract.
 - Remunerations paid to the Board of Directors

S. 35(2AB) - Scientific Research expense

▪ Issues

- Expenditure incurred outside the R&D Facility:
 - CIT v. Cadila Healthcare Ltd. [2013] 263 CTR 686 (Gujarat HC)
 - Apollo Tyres Ltd. v. DCIT (2017) 84 taxmann.com 219 (Cochin Trib.)
 - DCIT v. Aurobindo Pharma Ltd. [2018] (ITA No. 1772 & 1773/Hyd/2017) (Hyd. Trib.)
 - Concept Pharmaceuticals Ltd. v. ACIT [2011] 43 SOT 423 (Mumbai Trib) – **Against**
- Income from sale of IP developed by R&D Facility need not be reduced for computation of expenditure allowable u/s 35(2AB):
 - CIT v. Microlabs Ltd. [2016] 383 ITR 490 (Karnataka HC)
- Expenditure even prior to the date of approval of the R&D facility from DSIR is allowable:
 - CIT v. Claris Lifesciences Ltd. [2010] 326 ITR 251 (Gujarat HC)
 - Maruti Suzuki India Ltd. v. UOI [2017] 84 taxmann.com 45 (Delhi HC)
 - CIT v. TVS Electronics Ltd. [2019] 419 ITR 187 (Madras HC)
 - PCIT v. Strides Arcolab Ltd. (2019-TIOL-663-HC-MUM-IT) (Bom. HC) – date of application

S. 35(2AB) - Scientific Research expense

- DSIR cannot reduce expenditure without giving opportunity of hearing to assessee
 - Bosch Ltd. v. DSIR [2017] 293 CTR 355 (Karnataka HC)

- AO cannot deny weighted deduction of expense approved by DSIR –
 - DCIT v. Mastek Ltd. [2013] 263 CTR 671 (Gujarat HC)
 - Tejas Networks Ltd. v. Dy. CIT [2015] 233 Taxman 426 (Kar. HC)
 - Century Seeds Pvt. Ltd. v. DCIT [2018] (ITA No.942/Hyd/2017) (Hyd. Trib.)

- DSIR does not approve expense – does not result in disallowance (prior to amendment to Rule 6 w.e.f. 1-7-2016)
 - ACIT Vs. Torrent Pharmaceuticals Ltd. (2009) (ITA No. 3569/Ahd/2004 & Co. No. 18/Ahd/2005) (Ahmedabad Trib.)
 - Cummins India Ltd. v. DCIT [2018] 96 taxmann.com 576 (Pun. Trib.)
 - Glenmark Pharmaceuticals Ltd. v. ACIT & vice versa (2019) (ITA No. 5651/Mum/2017 & ors) (Mum. ITAT)

S. 35(2AB) - Scientific Research expense

- Expense incurred on refreshments for visiting scientists – Allowed for weighted deduction
 - PCIT v. Sun Pharmaceutical Industries Ltd. [2019] 103 taxmann.com 86 (Guj. HC) – SLP dismissed in PCIT v. Sun Pharmaceutical Industries Ltd. [2019] 103 taxmann.com 87 (SC)
- AO cannot deny weighted deduction merely because DSIR has not submitted form 3CL–
 - CIT v. Sun Pharmaceutical Industries Ltd. [2017] 85 taxmann.com 80 (Gujarat HC)
- Where recognition is accorded to facility – non-receipt of Form 3CM is a procedural lapse – cannot lead to denial of deduction u/s 35(2AB)
 - Minilec India (P.) Ltd. v. ACIT [2018] 93 taxmann.com 213 (Pun. Trib.)

Distributor Arrangement – TDS – 194H

□ Payment made on distributor arrangement – S. 194H/ 194J

- Pharma companies sell medicines to stockist a price less than the MRP
- Whether profit of the stockist is akin to commission or brokerage or professional fees and thereby, Pharma Company is liable to deduct TDS?
- Nature of relationship - principal to principal or principal to agent/manager?
- CIT v. Piramal Healthcare Ltd. [2015] 230 Taxman 505 (Bombay HC) - No payment is made by Pharma Company to stockist. Therefore, TDS provisions will not apply
- PCIT v. Gujarat Narmada Valley Fertilizer and Chemicals Ltd. [(2019) 266 Taxman 19 (Guj. HC)] - Goods sold on principal to principal basis, no service rendered by dealer to Company – Company not liable to deduct TDS u/s 194H

Allocating R&D expense to undertaking claiming Chapter VI-A deduction

❑ Factual issue

- Incremental R&D – Enhancement of drug being manufactured by
- Research of new molecule/drug – No connection with manufacturing of existing unit claiming Chapter VI-A deduction
 - Zandu Pharmaceuticals Works Ltd v. CIT (2012) 80 DTR 322 (Bom HC)
 - ACIT v. Glenmark Pharmaceuticals Ltd. [2019] 102 taxmann.com 438 (Mumbai - Trib.)

❑ Legal Argument – ‘profit derived from the undertaking’

- Expense should also have first degree nexus with the undertaking claiming deduction
 - Liberty India v. CIT [2009] 317 ITR 218 (SC)
- Tantamount to indirect disallowance of S. 35(2AB) claim

Other issues

❑ Citus of an Intangible Asset

- CUB Pty Ltd. v. UOI [2016] 388 ITR 617 (Delhi HC)
- Pfizer Corporation [2004] 271 ITR 101 (AAR –New Delhi)

❑ Depreciation on Goodwill arising in a Business Combination

- CIT v. Smifs Securities Ltd. (348 ITR 302) (SC)
- Mylan Laboratories Limited [TS-691-ITAT-2019(HYD)]
- United Breweries Ltd. (TS-553-ITAT-2016) (Bang. Trib.) – **Against**

❑ Remuneration to doctors – 192 v. 194J

- CIT v. Grant Medical Foundation [2015] 375 ITR 49 (Bombay)
- CIT v. Asian Heart Institute and Research Centre (P.) Ltd. [2019] 262 Taxman 471 (Bombay HC)

❑ S. 56(2)(ix) - Forfeiture of money received as an advance for transfer of capital asset.

- Forfeiture of shares – not covered

Current Trends and Immerging Controversies

Domestic

Taxation Laws Amendment Act, 2019

❑ Corporate Tax Rate

- Domestic Company – tax rate 25.17% - subject to giving up specified deductions, related b/f depreciation/loss and MAT Credit (if any).
 - One time option to add back additional depreciation to the block of asset
- MAT rate reduced to 17.47%
- New Manufacturing Company – 17.16%
 - Income not related to manufacturing or production – 25.17%
 - Expansion of existing business vertical in a new company should be eligible for deduction {should not tantamount to splitting-up or re-construction}
 - Re-structuring on-going expansion to claim the benefit ?
 - Loan -licence agreement – CIT v. Neo Pharma [1982] 137 ITR 879 (Bom HC)

IBC – Resolution Plan for takeover of company

❑ Key points to be considered

- S. 41(1) – cessation of trading liability –
 - Commissioner v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)
- Accounting of waiver of liabilities – S. 115JB
- Restructuring of the Corporate Debtor
 - Carry forward of loss
 - De-merger – S. 2(19AA) ?
- Acquisition of shares & securities
 - S. 56(2)(x) – transferee
 - S. 50CA – transferor
- Drafting of resolution plan
 - Waiver of Income Tax dues
 - Settlement of any on-going litigation

Others

- ❑ GAAR to be analysed for any tax planning arrangement
- ❑ Tax Department is moving towards face less e-assessment
 - Difficulty to increase – importance of drafting skills
- ❑ Gradual reduction in time limit for Assessment
 - AY 2018-19 – September 30, 2020 (TP + 12 months)
 - AY 2019-20 – March 31, 2021 (TP + 12 months)
- ❑ AAR bench functioning in Mumbai

International

BEPS – Multilateral Instrument

- ❑ 93 Countries have signed MLI – US has not signed. Mauritius, Hongkong, Oman, Germany, China (treaty already modified through bilateral negotiation) has not notified treaty with India to be modified through MLI.

- ❑ Some amendment to impact majority of Indian treaties –
 - Modification of preamble of treaty
 - Principle purpose test
 - Exchange of Information

- ❑ Practical consideration
 - Setting up SPV in TFJ
 - Commercial purpose for each transaction/arrangement
 - IP box regime
 - Sun Pharmaceuticals Industries Ltd. v. ACIT [2016] 75 taxmann.com 212 (Gujarat HC)

Some on-going controversies in India

Whether DTAA will apply to dividend distribution tax payable u/s 115-O ?

- Issue pending before various tribunals
- UOI v. Tata Tea Co. Ltd. [2017] 85 taxmann.com 346 (SC) – S. 115-O levies a tax on dividend. Language of DTAA restricts tax on dividend paid to resident of Contracting State – does not specify the assessee liable to pay tax on dividend paid to resident of Contracting State
- Whether a country can circumvent DTAA by simply changing the person being taxed (i.e. in this case company instead of shareholder) ?

May be taxed

- CIT v. P.V.A.L. Kulandagan Chettiar [2004] 267 ITR 654 (SC)
- Notification No. 90/2008, Dated 28-8-2008
- Essar Oil Ltd. v. ACIT [2013] 157 TTJ 785 (Mumbai - Trib.)
- Excessive delegation ?

Others

Limitation of Interest Deduction – Section 94B

- 30% of EBITDA
- Lender NR – AE or debt guaranteed by AE

Attribution of income from intangible Asset

- DEMPE – Development, Enhancement, Maintenance, Protection and Exploitation of Intangibles

Country by Country Reporting & Master File

Questions ?

Thank You