

आयकर अपीलीय अधिकरण "K" न्यायपीठ मुंबई में।

**IN THE INCOME TAX APPELLATE TRIBUNAL "K" BENCH, MUMBAI  
BEFORE SHRI CN PRASAD, JUDICIAL MEMBER AND  
SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A. No.2224/Mum/2017

(निर्धारण वर्ष / Assessment Year: 2012-13)

Actavis Pharma Development Centre Private Limited 21-22, Kalpataru Square, Kondivita Lane, Off. Andheri- Kurla Road, Andheri (East), Mumbai-400 059	Vs.	The Deputy Commissioner of Income Tax-Ward 15(1)(1), Mumbai Room No. 470, 4 <sup>th</sup> Floor, Aayakar Bhavan, M.K. Road, Mumbai-400 020
<b>Appellant</b>	..	<b>Respondent</b>
<b>PAN No. AAFC8485P</b>		

**Assessee by** : Shri Rajan R. Vora, AR

**Revenue by** : Shri Jayant Kumar, CIT-DR

**Date of hearing:** 15-12-2017 **Date of pronouncement :** 09-03-2018

**ORDER**

**PER RAMIT KOCHAR, Accountant Member:**

This appeal filed by the assessee is arising out of an assessment order dated 31.01.2017 passed u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961(hereinafter 'the Act') by learned Assessing Officer (hereinafter called " the AO") in pursuance of directions issued by the Dispute Resolution Panel-I, Mumbai , [in short 'DRP'] dated 26.12.2016 u/s 144C(5) of the 1961 Act disposing of the objections filed by the assessee, wherein the additions to the tune of Rs. 3,80,43,714/- were made by the AO vide TP Adjustments w.r.t. international transactions entered into by the assessee with its Associated Enterprise. The draft assessment was framed by the AO for the assessment year 2012-13 vide



**ITA No. 2224/Mum/2017**

order dated 29-03-2016 passed u/s 143(3) read with section 144C(1) of the Act in pursuance to the order of learned Transfer Pricing Officer, Mumbai (hereinafter called "the TPO") passed u/s 92CA(3) of the 1961 Act. The assessee filed objections with DRP which were disposed of by DRP vide orders dated 26-12-2016. The AO, thereafter, in pursuance to directions of DRP passed an assessment order dated 31.01.2017 u/s 143(3) r.w.s. 144C(13) of the 1961 Act, wherein the additions to the tune of Rs. 3,80,43,714/- were made by the AO vide TP Adjustments w.r.t. international transactions entered into by the assessee with its AE.

2. The grounds of appeal raised by the assessee in the memo of appeal filed with the Income-Tax Appellate Tribunal, Mumbai (hereinafter called "the tribunal") read as under:-

**"General**

1. *erred in assessing total income of the Appellant at Rs 3,89,37,370/- as against returned income of Rs. 8,93,660/-*

**General ground on Transfer Pricing.**

2. *erred in making transfer pricing adjustment of Rs. 380,43,714 in relation to the international transaction of provision of contract research and development services, stability testing and database maintenance services to AEs by the Appellant.*

**Reference to TPO**

3. *erred in making a reference to the TPO in respect of the determination of the arm's length price, without recording satisfaction being*



*statutory requirement with cogent reasons that it was necessary and expedient to refer the computation of ALP to TPO.*

**Procedure under Section 92C(3) not followed**

*4. erred in arriving at the arms length price of the international transactions without appreciating the fact that none of the conditions set out in Section 92C(3) of the Act are satisfied;*

**Rejection of economic analysis undertaken by Appellant**

*5. erred in rejecting the economic analysis undertaken by the Appellant in connection with its international transaction of provision of contract research and development services, stability testing and database maintenance services to AEs by the Appellant.*

**Inappropriate rejection of comparable companies adopted by Appellant**

*6. erred in rejecting IDMA Laboratories Ltd by stating that the functions of analytical and industrial testing undertaken by IDMA are not comparable to the business activities of the Appellant:*

*7. erred in rejecting Dolphin Medical Services Limited by stating that functions of equipment testing, providing diagnostic laboratories services and research are not*



*comparable to the business activities of the Appellant:*

8. *erred in rejecting Vimta Labs Ltd by stating that the said company has incurred continuous losses and also stating that it is engaged in provision of wide variety of services/ activities like environmental services, pre-clinical and clinical analytical testing which are not comparable to the business activities of the Appellant:*

9. *erred in not giving any directions toward the objections filed by the Appellant with reference to rejection of SPAN Diagnostics Ltd by TPO and also erred in rejecting the said company by stating that the business activities of the company are not comparable to the business activities of the Appellant;*

**Inadvertent clerical error in TP Study**

10. *erred in rejecting two comparable companies (i.e. IDMA Laboratories Ltd. and SPAN Diagnostics Ltd.) as non-comparable companies to the Appellant due to inadvertent error made by the Appellant in its transfer pricing study report in accept/reject matrix;*

**Inappropriate acceptance of non-comparable company**



11. erred in accepting Aurigene Discovery Technologies Ltd a non-comparable company as per the Appellant, by stating that the functions of research related to drug discovery is comparable to the business activities of the Appellant;

**Calculation error in margins of comparable companies**

12. erred in wrongly calculating the operating profit margins of following comparable companies and not providing detailed margin calculation of the same:

Biocon Limited; and

Syngene International Ltd

13. erred in not following DRP directions wherein DRP had directed to calculate the margins correctly after providing an opportunity to the Appellant:

**Working capital adjustments**

14. erred in not providing an adjustment to Appellant in relation to differences of working capital employed by the Appellant vis-à-vis comparable companies.

**Risk adjustments**

15. erred in not providing an adjustment to Appellant in relation to differences of risk



*assumed by the Appellant vis-à-vis comparable companies:*

**Levy of interest under section 234B of the Act**

16. *erred in levying interest amounting to INR 53,11,350 under section 234B of the Act:*

**Levy of penalty under section 271(1)(c) of the Act**

17. *erred in initiating penalty under section 271(1)(c) of the Act;*

*The respondent craves, to consider each of the above grounds without prejudice to each other and craves, leave to add, alter, delete or modify all or any of the above grounds”*

3. The brief facts of the case are that the assessee is engaged in the business of providing contract R&D services in respect of generic APIs. The services also involved data base maintenance , statistical analysis and project management in respect of development of such generic APIs. The international transactions as reported by assessee in form No. 3CEB are as under :-



ITA No. 2224/Mum/2017

Sr. No	Nature of Transaction	Name of the AE and Country of the AE with whom it is transacted	Amount of Transaction	Method used by Assessee to determine ALP
1	Provision of contract R&D services to AEs	Actavis Iceland	247,538,905	TNMM
2	Provision of contract R&D services to AEs	Actavis Malta	8,256,315	TNMM
3	Provision of contract R&D services to AEs	Actavis U.K.	6,231,374	TNMM
4	Provision of contract R&D services to AEs	Actavis Elizabeth	1,150,323	TNMM

The assessee was selected as tested party by the TPO based on FAR analysis as it did not own any significant intangibles and its profitability can also be reliably ascertained. The assessee had selected net cost plus margin as Profit Level Indicator (PLI) which was submitted in the Transfer Pricing (TP) study report as under:-

Particulars	Amount (Rs)
<b>Income</b>	
Service income	275,821,122
Other operating income	2,132,898
<b>Total Operating Income</b>	<b>277,954,020</b>
<b>Expenditure</b>	
Consumption of chemicals and consumables	25,846,564
Personnel costs	100,216,015
Other operating expenses	90,193,270
Depreciation	29,695,065
<b>Total Operating Cost</b>	<b>245,950,914</b>
<b>Operating/Net Profit</b>	<b>32,003,106</b>
<b>Operating Profit/Operating Cost (NCP)</b>	<b>13.01%</b>

The assessee had selected the following comparables and the assessee had earned NCP of 13.01% which was claimed to be at arms length range of the comparable weighted arithmetic mean margin of 14.49% , which by the single year update margin of the comparables was 11.09% which fell within 5% as permissible range allowed to the assessee. The details of single year updated margin of the comparables submitted by

the assessee are as under:-

Sr.No.	Company	OPIOC %
1	Biocon Limited - Contract research segment	19.94%
2	Choksi Laboratories Limited	17.83%
3	Dolphin Medical services Limited	8.17%
4	IDMA Laboratories Ltd.	12.58%
5	Span Diagnostics Ltd	3.78%
6	Syngene International Ltd.	25.34%
7	Vimta Labs Limited	-10.04%
	<b>Arithmetic Mean</b>	<b>11.09%</b>

The TPO issued show cause notice vide order sheet entry dated 29-12-2015 which is reproduced as under: -

*"On perusal of the Accept / Reject matrix submitted by the assessee through its transfer pricing study report, it is perused that the following companies does not form part of Accept / Reject matrix. However, the assessee had considered these companies as their set of comparables:-*

Name of the company	SL. No. in the accept/ reject matrix	Remarks
IDMA Laboratories Ltd.	3675	Non-comparable services
SPAN Diagnostics Ltd.	6931	Non-comparable function

Further, it has also been observed that following companies from part of Accept / Reject matrix . However, it has not been considered by the assessee as its sets of comparable for calculation of PLI: -

Name of the company	SL. No. in the accept/ reject matrix	Remarks
Jubilant Chemsys Ltd.	4161	Engaged in comparable activity

1) In this regard, you are hereby show caused as to why companies, namely IDMA Laboratories Ltd. and SPAN Diagnostics Ltd. shall not be excluded from the final set of



*comparables and why company namely Jubilant Chemsys Ltd. shall not be included in the final set of comparables.*

*2) On analyzing the annual report & financial statements of Vimta Labs Limited, it is found that the said company is into continuous losses or it is a loss making company. Hence, you are hereby show caused as to why loss making company namely Vimta Labs Limited [submitted by you vide submission dated 09/12/2015] shall not be excluded from the final set of comparables.*

*3) On careful reading of the director's report to the shareholders in the case of Dolphin Medical services Limited, it has been found that during the year under consideration the company has suffered huge losses due to many intrinsic and extrinsic reasons, which is an extraordinary situation for the company. Hence, you are hereby show caused as to why the said company shall not be excluded from the final set of comparables.*

*4) On studying the Accept / Reject matrix submitted through Transfer Pricing Study Report, it has found that you have excluded Suven Lifesciences Ltd., Sl. No. 7170, on account of insufficient segment information. However, segmental information of the said company shows operating margin @ 73.86%. You are hereby show caused as to why this company shall not be included in the final set of comparables for calculation of PLI.*

*5) It is also found that you have excluded Aurigene Discovery Technologies, St No. 677 from the final set of comparables, with remarks - Non comparables Services. However, the Broad analysis of the nature of activity undertaken by you shows the said company seem to be functionally similar. Hence, you are hereby show caused as to why "Aurigene Discovery Technologies" shall not be considered in your final set of comparables."*



ITA No. 2224/Mum/2017

The TPO after going through the submissions of the assessee accepted the following as comparables: -

Sr. No.	Name of the Comparables	Assessee's remarks	TPO's Remarks	Margin (%)
1.	Aurigene Discovery Technologies Ltd.	Reason for rejection: main business activity of the company is to undertake research relating to drug discovery for its customers and the risk profile of Aurigene Discovery Technologies Ltd. Vis-à-vis the Assessee is different.	Reason for acceptance: The assessee's agreement is for research and development and the comparable company is engaged in undertaking research relating to drug discovery for its customers (i.e. contract R. & D). Accordingly, the said company is functionally comparable and hence selected as comparable for computing arms' length price.	40.82
2.	Biocon Ltd. (segment - Contract research)	Accepted	Accepted. The Contract research segment of the company is considered as comparable. However the margin as computed by the assessee was 19.94%, as computed by this office is 25.66% from the audited financial statements.	25.62
3.	Choksi Laboratories Ltd.	Accepted	Accepted	17.83
4.	Dolphin Medical services Ltd.	Reason for acceptance: the assessee submitted that Dolphin Medico! services Limited has not incurred loss at operating profit level and has earned margin of 8.17% on operating cost.	Reason for rejection: The company is engaged in 2 business divisions: Medical and Software division. The Medical division consists of income from diagnostics, herbal & biotech services, which does not pertain to contract R&D and hence not functionally comparable to the Assessee business. Hence rejected.	-
5.	IDMA Laboratories Ltd.	Reason for acceptance the company is engaged in the business of analytical and industrial testing which is	Reason for rejection: The submission of assessee has been perused, however the	



ITA No. 2224/Mum/2017

		<p>a comparable services to the assessee and assessee had inadvertently done a typographical error in accept reject matrix where the above company was rejected.</p>	<p>same is not acceptable as the company is functionally not comparable to assessee's business. The said company is engaged into business of quality control testing and trading in products. Hence rejected.</p> <p>Nevertheless, the assessee has considered the said company as non comparable services in its accept-reject matrix in its TP study Report vide Sr. No. 3675.</p>	
6.	Jubilant Chemsys Ltd.	<p>Reason for rejection: The assessee submitted that the company is engaged In non-comparable activity. Further, it had inadvertently done a typographical error in accept reject matrix where the above company was mentioned as engaged In comparable activity.</p>	<p>Reason for acceptance: The submission of assessee has been perused, however the same is not acceptable as the company is functionally comparable to assessee 's business. The said Company is a wholly-owned subsidiary of Jubilant Life Sciences Ltd., a global pharmaceutical vertical engaged in collaborative research, development and manufacturing partnerships with global pharmaceutical companies.</p> <p>The company offers Medicinal Chemistry services in Drug Discovery Program for global pharmaceutical and biotech companies.</p> <p>Accordingly, the company is functionally comparable to assessee business and hence is considered as comparable.</p>	26.41



**ITA No. 2224/Mum/2017**

			Nevertheless, the assessee has considered the said company as "Engaged in comparable business activity" in its accept-reject matrix in Its TP Study Report vide Sr. No. 4161.	
7.	Span Diagnostics Limited	Reason for acceptance: the company is engaged in comparable activity and therefore comparable company. The assessee mentioned that it had inadvertently done a typographical error In accept reject matrix where the above company was rejected.	Reason for rejection: The submission of assessee has been perused, however the same is not acceptable as the company is not functionally comparable to assessee's business. As apparent from the audited financial statements, the company is engaged in the business of manufacturing, marketing and trading of diagnostics reagents, diagnostics instruments and allied products. The Company caters to both domestic and international markets. The Company also provides annual maintenance service for diagnostics instruments.  Nevertheless, the assessee has considered the said company as "Non-comparable function" in its accept- reject matrix in its TP Study Report vide Sr. No.6931.	
8.	Suven Life Sciences Ltd.	Reason for rejection: The company has been rejected in the accept reject matrix in the TP Study Report as insufficient segmental information (i.e. SL. No. 7170).  However, this office could procure the financials of the company that the operating	Reason for acceptance: The submission of the assessee has been perused but not accepted.  This company was analysed by this office and the analysis Is provided hereunder:	51.40



		<p>margin as available In the annual report and segmental margin comes to 73.86% on cost and hence, the company should be Included in the final list of comparable companies.</p> <p>As per the assessee, company is not functionally comparable and also has undertaken extra-ordinary activity of amalgamation during AY 2012-13. The assessee also mentioned that margin computed needs to be revised as the expense has been shown separately for R&amp;D amounting to Rs 3304.91 lakhs.</p>	<p>The company has Identified the following 3 segments as reportable segments:</p> <ul style="list-style-type: none"> <li>• Manufacturing (CRAMS)</li> <li>• Services (DDDSS)</li> <li>• Research and Development</li> </ul> <p>Manufacturing (CRAMS) is into Bulk Drugs &amp; Intermediates under contract services products are developed and produced on an exclusive basis under contract manufacturing services. Hence, this segment Is considered as functionally comparable and not Service (DDDSS) as submitted by the assessee.</p> <p>Further, as submitted by the Assessee that R &amp; D expenses need to be reduced from other segment, in response to same it is pertinent to note that the R&amp;D is a separate segment (as per the audited financial statements) and hence the expenses incurred thereon cannot be reduced from any other segments.</p> <p>Further, since the assessee could not provide reasons as to how the amalgamation affects the profitability and how is not comparable to assessee the extra ordinary events cannot be reason for rejections.</p>	
--	--	--	---	--

**ITA No. 2224/Mum/2017**

			<p>Moreover, the amalgamation is effective from 1 January 2012 (i.e. only 3 months during the year under consideration) and hence cannot be considered as basis for extra-ordinary activity.</p> <p>Nevertheless, the assessee has considered the said company as comparable services in its accept-reject matrix in its TP Study Report vide Sr. No. 7170.</p>	
9.	Syegene International Ltd.	Accepted	Accepted. However, this margin as computed by the assessee was 25.34%, as computed by this office is 29.62% from the prowess database.	29.62
10.	Vimta Labs Ltd.	Reason for acceptance: The Company has earned a profit in AY 2010-11 and AY 2013-14 and incurred loss in AY 2012-13 and AY 2011-12. Accordingly, It can be construed that the variation in profitability is due to cyclical business reasons.	Reason for rejection: The company has incurred losses in AY 2011-12 and AY 2012-13 (2 out of 3 years). However, it has earned profit in the 3rd year (i.e. AY 2013-14). Considering the huge fluctuation in the profitability (including loss) trends, abnormal business circumstances during the year under consideration cannot be ruled out. Hence the said company is rejected	
Average operating cost margin of comparables (NCP)				31.96

The TPO after going through the submissions of the assessee accepted the following comparables: -



ITA No. 2224/Mum/2017

Sr No.	Name of the Comparables	Operating Income	Operating Cost	Profit	Margin (%)
1	Aurigene Discovery Technologies Ltd.	1,669,600,000	1,185,600,000	484,000,000	40.82
2	Biocon Ltd. (segment - Contract research)	4,457,000,000	3,547,000,000	910,000,000	25.66
3	Choksi Laboratories Ltd.	152,319,722	129,274,116	23,045,606	17.83
4	Jubilant Chemsys Ltd.	834,400,000	660,100,000	174,300,000	26.41
5	Suven Life Sciences Ltd. (Manufacturing CRAMS segment)	1,916,888,000	1,266,097,000	650,791,000	51.40
6	Syngene International Ltd.	4,170,000,000	3,217,000,000	953,000,000	29.62
NCP earned by the comparable companies					31.96
NCP earned by the Assessee					13.01

Thus, it was observed by the TPO that the assessee has earned NCP margin of 13.01% on the international transactions undertaken with its AE which was lower than comparable NCP at 31.96% and hence, it was observed by TPO that the assessee's transactions with its AE are not at arms length price which was computed by the TPO as under:-

Particulars	Amount in INR
Operating Income	277,954,020
Operating Cost	245,950,914
Operating Profit	32,003,106
NCP earned by the Assessee	13.01%
NCP earned by the comparable	31.96%
Arm's length revenue (Cost+31.96%)	324,556,826
Difference	46,602,804
Adjustment amount on the value of international transaction	46,602,804

The addition of ₹ 4,66,02,804/- was proposed by way of TP adjustment to the value of international transactions entered into by the assessee with its AE, by the TPO vide its orders dated 29-01-2016 passed u/s. 92CA(3) which led the AO to issuing of draft assessment order dated 29-03-2016 passed u/s 143(3) read with section 144C(1) of the Act.

4. Aggrieved by the draft assessment order dated 29-03-2016 passed by the AO u/s 143(3) r.w.s. 144C(1) by the AO, the assessee filed objections with DRP and raised several grounds of objections before the



**ITA No. 2224/Mum/2017**

DRP who vide directions dated 26-12-2006 passed u/s. 144C(5) of the Act granted certain relief which finally led to the assessment order dated 31-01-2017 passed under section 143(3) read with section 144C(13) of the Act which led to TP additions to the tune of Rs. 3,80,43,714/- by way of adjustment to arm lengths price of international transaction entered by assessee with its AE.

4. Aggrieved by the assessment order dated 31.01.2017 passed by the AO u/s 143(3) r.w.s. 144C(13) of the 1961 Act , the assessee has come in second appeal before Tribunal and has raised as many as 17 grounds which are reproduced at para 2 of this order.

5. **Ground No. 1 to 5** - It is prayed by learned Counsel for the assessee that ground No. 1 to 5 are general in nature and does not require separate adjudication. The learned CIT DR did not objected to the dismissal of these grounds bearing number 1 to 5 being general in nature.

After hearing both the sides, we are of the considered view that these grounds of appeal from 1 to 5 being general in nature does not require separate adjudication and hence as conceded by the learned counsel for the assessee, these grounds bearing number 1 to 5 stood dismissed. We order accordingly.

6. **Ground No. 6**- Rejection of IDMA Laboratories Limited(hereinafter called "IDMA") as comparable by Revenue:-

The assessee has claimed to be engaged in the business of providing contract R & D services in respect of generic APIs. The services provided also involves database maintenance , statistical analysis and project management in respect of development of such generic APIs. The assessee included IDMA as comparable in its Transfer Pricing Study Report with OP/OC weighted average margin of 16.32% while the



**ITA No. 2224/Mum/2017**

OP/OC margin for AY 2012-13 was 12.58%. The TPO observed that in accept /reject matrix of TP study , this company 'IDMA' was reflected as having non comparable services vis-a-vis services rendered by the assessee. On being show-caused, the assessee submitted before TPO that this company 'IDMA' is engaged in the business of analytical and industrial testing which is comparable services to the assessee and due to typographical error in accept reject matrix , the company was reflected as an rejected company. This did not go well with TPO and he came to the conclusion that this company 'IDMA' cannot be accepted as comparable as said company is engaged in business of quality control testing and trading in products. It was also held by TPO that in TP study of the assessee itself this company is reflected as rejected company and hence the same cannot be accepted as comparable. The matter reached DRP . The assessee submitted that 'IDMA' is engaged in the business of providing analytical and industrial testing services such as drug testing, chemical testing and microbiological testing to pharma industries which is akin to the services provided by the assessee and such services constitutes 90% of the total revenue. The assessee prayed that this company be accepted as comparable. The DRP after going through the material before it came to the conclusion that the assessee is mainly engaged in contract R & D services to its AEs and testing services represents only a miniscule part of its activities as compared to R & D activities. The DRP while giving above finding had observed that revenue from Activis Iceland is Rs. 24.75 crores and the assessee as per agreement with this party is required to perform contract R & D services . The agreement for analytical testing with this AE in Iceland is only signed on 07-11-2011 which is towards the later part of the financial year. It was observed that the assessee is engaged in business of contract R & D as well analytical testing(primarily in contract R&D) while the comparable is engaged in business of providing analytical and industrial testing services , which led to upholding of rejection of this comparable IDMA by the DRP. Now , the assessee is before the tribunal.



**ITA No. 2224/Mum/2017**

Both Id counsel for the assessee and learned CIT DR has submitted their detailed arguments before us. It is the say of learned counsel for the assessee that its only due to typographic error this company was reflected as rejected company in accept/reject matrix in TP study. It is also say of the learned counsel that as much as 39.55% of the revenue of the assessee for relevant financial year is from stability studies and testing services, while it is the say of the Revenue that there was no error committed by the assessee in the rejection of this company IDMA in TP study and this company IDMA was rightly rejected as comparable and also this is the say of the Revenue that miniscule portion of revenue is derived from stability studies and testing services by the assessee during the relevant financial year as its contract for such services was entered only on 07-11-2011 with Activis, Iceland , AE of the assessee company. We have perused the audited financial statement of the assessee for the financial year ended 31-03-2012 which is placed in paper book/page 114 and we have observed that at para 28 of the said audited financial statements , it is stipulated as under:-

*“28. The company’s sole business segment is to provide research and development services and the Company considers such activities to constitute a single business segment in the context of AS-17 ‘Segment Reporting’ . Similarly , the Company considers Europe as its only geographical segment. The company considers business segment as its primary segment and geographical segment based on the location of customers as the secondary segment.*

*Since the company comprises a single business segment and a single geographical segment, disclosures relating to the primary and secondary segments have not been presented.”*

Thus, on perusal of audited financial statement of the assessee , it is observed that it is only engaged in providing R & D services which is the sole segment in which the assessee is operating. The bifurcation of revenue is not given in segment reporting while claim of the assessee is that around 39.55% revenue is from stability studies and testing



**ITA No. 2224/Mum/2017**

services. The said services towards analytical studies commenced operations vide agreement dated 07-11-2011 by which time eight months in the financial year had already passed.

The analysis of the financial statements of IDMA which is placed in paper book reveals that IDMA is engaged in the business of analytical and industrial testing (page 388/pb) . It is also mentioned at page 391/PB that IDMA is engaged in quality control testing and some trading activities. However, the sale of product in statement of profit and loss (pb/395) is nil while Revenue has originated mainly from sale of services.

There are contrarian facts as averred by rival parties and requires proper investigation by the AO/TPO including analysis of revenue derived and functions performed , risk involved and assets deployed , and in the fitness of the matter , we are inclined to set aside this issue regarding functional analysis of IDMA as comparable with the assessee to the file of the AO/TPO to properly investigate this comparable before arriving at the decision. The assessee is directed to provide all necessary details and information to substantiate its claim of IDMA being comparable with the assessee. The AO/TPO to provide proper opportunity of being heard to the assessee in accordance with principles of natural justice. This ground of appeal no. 6 is allowed for statistical purposes. We order accordingly.

**7. Ground No. 7-** Rejection of Dolphin Medical Services Limited (hereinafter called "Dolphin") as comparable by Revenue:-

The assessee included Dolphin Medical Services Limited as comparable in its Transfer Pricing Study Report with OP/OC weighted average margin of 17.45% while the OP/OC margin for AY 2012-13 was 8.17%. The TPO observed that this company 'Dolphin' had suffered huge losses



**ITA No. 2224/Mum/2017**

due to many intrinsic and extrinsic reasons , which is an extraordinary situation for the said company. The assessee submitted in response to show cause notice before the TPO that on operating profit level , this company Dolphin has not incurred losses but has earned profit margin of 8.17%. The TPO observed that this company is engaged in two business divisions namely medical and software division. The Medical division consists of income from diagnostics, herbal and biotech services , which does not pertain to contract R & D and hence not functionally comparable to the assessee's business and hence this comparable was rejected by TPO. The assessee carried the matter before DRP and submitted that this company Dolphin is engaged in equipment testing, establishing , providing and maintaining diagnostic laboratories and setting up laboratories for medical investigations and research. The assessee further submitted that the business of the assessee is of providing stability testing services, database maintenance, statistical analysis , project management in respect of generic APIs and provides contract development support for off-patent APIs which already exists in the market which is comparable to the services provided by Dolphin. The assessee further submitted that Dolphin has not suffered any loss at operating profit level and had infact earned an healthy margin of 8.17% on operating cost. It was submitted that loss of Rs. 1.14 crores suffered at profit before tax level is mainly on account of interest expenses on loan amounting to Rs. 1.18 crores which is treated as non-operating costs. Thus, it was submitted that operating profit of Dolphin was 8.17% on operating cost. It was thus prayed that Dolphin be included as comparable. The DRP after hearing the assessee arguments rejected the Dolphin as comparable because the said company was held to be functionally different from the assessee company because the assessee was primarily engaged in the business of contract R & D and also analytical testing while the comparable was stated to be engaged in the business analytical and industrial testing services. We have gone through the



**ITA No. 2224/Mum/2017**

submissions of both the parties and perused the material on record. Perusal of the audited financial statements of Dolphin as are placed in paper book reveals that its operations were mainly affected due to the its bank loan with Canara bank being declared as Non Performing Asset, huge marketing costs, old equipments , major repairs and problems with landlords . We have observed that major flow of revenue of Dolphin was from medical diagnostic and other allied services amounting to Rs. 3.75 crores. We have perused the audited financial statement of the assessee for the financial year ended 31-03-2012 which is placed in paper book/page 114 and we have observed that at para 28 of the said audited financial statements , it is stipulated as under:-

*“28. The company’s sole business segment is to provide research and development services and the Company considers such activities to constitute a single business segment in the context of AS-17 ‘Segment Reporting’ . Similarly , the Company considers Europe as its only geographical segment. The company considers business segment as its primary segment and geographical segment based on the location of customers as the secondary segment.*

*Since the company comprises a single business segment and a single geographical segment, disclosures relating to the primary and secondary segments have not been presented.”*

Thus, on perusal of audited financial statement of the assessee , it is observed that it is only engaged in providing R & D services which is the sole segment in which the assessee is operating. The bifurcation of revenue is not given in segment reporting while claim of the assessee is that around 39.55% revenue is from stability studies and testing services which required verification.

There are contrarian facts as averred by rival parties and requires proper investigation by the AO/TPO including analysis of revenue derived and functions performed , risk involved and assets deployed , and in the fitness of the matter , we are inclined to set aside this issue



**ITA No. 2224/Mum/2017**

regarding functional analysis of Dolphin as comparable with the assessee to the file of the AO/TPO to properly investigate this comparable before arriving at the decision including considering extraordinary events such as impact of declaration of bank accounts being NPA and extraordinary expenses incurred by this company Dolphin. The assessee is directed to provide all necessary details and information to substantiate its claim of Dolphin being comparable with the assessee before the AO/TPO in set aside proceedings. The AO/TPO to provide proper opportunity of being heard to the assessee in accordance with principles of natural justice. This ground of appeal no. 7 is allowed for statistical purposes. We order accordingly.

8. **Ground No. 8-** Rejection of Vimta Labs Limited as comparable by Revenue:-

The assessee included Vimta Labs Limited as comparable in its Transfer Pricing Study Report with OP/OC weighted average margin of (-)1.32% while the OP/OC margin for AY 2012-13 was (-)10.04%. The TPO observed that this company 'Vimta' had suffered continuous losses and is an loss making company . The assessee submitted in response to show cause notice before the TPO that this company Vimta has earned profit in AY 2010-11 ad AY 2013-14 but incurred losses in AY 2012-13 and AY 2011-12. The assessee submitted that variation in profitability is due to cyclical business reasons. The TPO observed that this company Vimta has incurred losses in AY 2011-12 and 2012-13 while it earned profit in AY 2013-14. There is a huge fluctuation in profitability (including losses) trends and abnormal business circumstances cannot be ruled out. Thus, this company was rejected as comparable by TPO. The matter reached DRP. The assessee submitted that Vimta is not a persistent loss making company . The operating margins of Vimta Labs Limited were reproduced by the assessee before DRP, as under:

**ITA No. 2224/Mum/2017**

Particulars	AY 2013-14	AY 2012-13	AY 2011-12	AY 2010-11
Operating Revenue	1,09,75,46,255	89,57,43,498	95,70,22,717	88,25,36,096
Operating Cost	86,67,14,717	99,56,91,599	97,11,29,612	81,06,55,795
Operating Profit	23,08,31,538	(9,99,48,101)	(1,41,06,895)	7,18,80,301
OP/OC%	26.63%	-10.04%	-1.45%	8.87%

The assessee submitted that these variations in profits are normal in competitive business environment and same cannot be considered as a reason for rejecting the said company Vimta as comparable. The assessee submitted that this company is not a persistent loss making entity since it is not incurring operating losses for continuous period of three previous years and company cannot be rejected on the grounds that it has incurred losses in current year. The assessee also drew attention to Rule 10B(4) of Income-tax Rules, 1962. It was also submitted that profit as mentioned in rule 10B(4) will also include losses within its purview. It was also submitted that the comparables as detailed below selected by the TPO also suffered from high fluctuation in profit margins and the same should also then be rejected:

Particulars	AY 2013-14	AY 2012-13	AY 2011-12	AY 2010-11
Aurigene Discovery Technologies Limited	50.27%	40.92%	18.69%	18.83%
Jubilant Chemsys Limited	-5.72%	28.25%	16.16%	21.61%
Suven Lifesciences Limited	67.83%	20.35%	5.36%	6.26%



**ITA No. 2224/Mum/2017**

The DRP rejected Vimta as not functionally comparable with the assessee as the assessee is engaged in the business of contract R&D activities of API and analytical testing while Vimta is a company engaged in pre-clinical and clinical analytical in the pharma and food segment and cell and molecular biology, food safety evaluation, etc. It was also observed by DRP that this company Vimta is also engaged in providing environment services like analysis of water, soil, air, waste, source emissions etc.. Thus, in the absence of information as to that Vimta also derived major chunk of revenues from contract R & D in respect of generic APIs, the said comparable Vimta was rejected by DRP as the said company was held to be functionally different. The assessee is now in appeal before the tribunal. Heard both the parties. The assessee is mainly engaged in contract R & D for generic API and also its activities extend to testing and analysis. We have carefully gone through the audited financial statements of Vimta Labs Limited which is placed in paper book filed with the tribunal (page 435-469). Perusal of audited financial statements for the year ended 31<sup>st</sup> March 2012, reveals that this company Vimta is engaged in contract research and testing activities in analytical, preclinical, clinical, clinical diagnostics, cellular and molecular biology and environment assessments. In SWOT analysis, it has described that the preclinical, clinical and analytical contract research and testing activities demand is growing due to growth in biologics and drug discovery projects and it is also mentioned that various multinational contract testing and research organizations are anchoring in India to reduce their service cost which is causing threat to Vimta due to increased competition. It is also mentioned that in-time benefit from various regulatory bodies have direct impact on profitability of Vimta. This is a single segment company in testing and research activities in various discipline. Vimta has four labs in Coimbatore, Vishakhapatnam and Vijaywada. The Revenue from operations is from sale of services (testing and analysis). So far as variations in profitability trend is concerned, reasons for



losses are clearly explained in Chairman and Managing Director Report of Vimta as under:

*“ During the year under review a number of Clinical studies got delayed due to unprecedented regulatory developments in Clinical Research Industry causing inordinate delays in receiving the approvals. Further, the Company had to accept cancellation of some of the studies due to withdrawal by the Customers as they did not want to proceed further resulting in steep decline in top line. It was an aberration . Adding to this , the input costs have gone up significantly resulting in low EBIDTA as compared to previous year.”*

Perusal of the above reasons clearly reveals that these are normal business risks attached to this industry to all players and merely because Vimta has incurred operating losses in the year under consideration , the same cannot be rejected as comparable. The functional profile of Vimta is comparable with the assessee as we have elaborated above and in our considered view, we do not find any justification for exclusion of Vimta as comparable. Thus, we hold that Vimta activities / functions are comparable to the assessee company and the same should be included as comparable. The assessee succeeds on this ground. We order accordingly.

**9. Ground No. 9** Rejection of SPAN Diagnostics Limited as comparable by Revenue:-

The assessee included SPAN Diagnostics Limited as comparable in its Transfer Pricing Study Report with OP/OC weighted average margin of - 9.76% while the OP/OC margin for AY 2012-13 was 3.78%. The TPO observed that in accept /reject matrix of TP study , this company 'SPAN' was reflected as having non comparable functions vis-a-vis services rendered by the assessee. On being show-caused, the assessee submitted before TPO that this company 'SPAN' is engaged in the comparable activity and therefore comparable company . The assessee submitted that due to typographical error in accept reject matrix , the



**ITA No. 2224/Mum/2017**

company was reflected as an rejected company. The TPO after perusal of the audited financial statement of 'SPAN' rejected the contentions of the assessee by holding that this company SPAN is not functionally comparable as it is engaged in the business of manufacturing, marketing and trading of diagnostics instruments and allied products . The said company SPAN also provides annual maintenance services for diagnostic instruments. It was also observed by the TPO that the assessee had itself treated the said company as rejected company in its accept/reject matrix. The matter was carried to DRP by the assessee. The DRP did not gave any directions as to the exclusion of the said company SPAN by TPO as comparable as selected by the assessee. We have perused the audited financial statements of SPAN for the financial year ended 31-03-2012 which is placed in paper book filed by the assessee (pb/page 470-512). Thus, it appears prima-facie that SPAN is not doing any contract R & D or analysis / testing for other companies. The assessee on the other hand is mainly engaged in contract R & D for generic APIs and is also engaged in analysis and testing for its AE. The DRP unfortunately has not given any finding on the functional analysis of this company SPAN. These prima-facie findings of ours need to be verified by the authorities below and assessee is required to rebut these prima-facie findings , which may require investigation into facts. Thus , this issue is restored to the file of the AO for necessary verifications and de-novo determination after considering our preliminary findings . The AO shall grant proper and adequate opportunity of being heard to the assessee before adjudicating this issue in set aside proceedings. This ground no. 9 is allowed for statistical purposes. We order accordingly.

10. **Ground No. 10** is regarding inadvertent clerical error in TP study in accept/reject matrix w.r.t. two companies namely IDMA and SPAN which has been already been adjudicated by us in preceding para's of this order while deciding the inclusion of those comparables and this



ground does not require separate adjudication. This ground stood dismissed. We order accordingly.

11. **Ground No. 11** is regarding inclusion of comparable Aurigene Discovery Technologies Limited by TPO which as per assessee is non comparable company . The TPO observed that the assessee has excluded this company appearing in S.No. 677 of TP study from the final set of comparables with the remarks non comparable services while the broad analysis of the nature of activities undertaken showed that the said company Aurigene is functionally similar. The assessee in response to show cause submitted that the said company's risk profile is different from that of the assessee. The TPO observed that the said company Aurigene is engaged in undertaking research relating to drug discovery for its customers i.e. contract R & D and hence the said company is functionally comparable. The assessee filed objections with DRP. The assessee submitted before DRP that the TPO cherry picked this company and without understanding true nature of services rendered by the assessee to its AE , it treated Aurigene as comparable. The assessee submitted that Aurigene is engaged in undertaking research relating to drug discovery for its customers while the assessee is not engaged in drug discovery. The assessee submitted that Aurigene has different risk profile and it works with established pharmaceutical and biotechnology companies in early stage collaborations to support drug discovery efforts by its partners. The assessee relied on information available on website of Aurigene. The assessee also relied upon its annual statement to wherein revenue was stated to be recognized based on achievement of milestone as per contracts. It was submitted that Aurigene is also entitled for royalty income on future sale proceeds when the product is commercialized. Thus, it was submitted that Aurigene assumes a higher risk whereas the assessee is earning remuneration on a cost plus model wherein it is a risk free entity. Thus, the assessee submitted that Aurigene should not be



**ITA No. 2224/Mum/2017**

included in the final list of comparable companies. The DRP observed that at broad functional level , both the assessee and the company Aurigene are comparable. It was observed by DRP that in TNMM , it is the broad functional comparability which is required to be considered and not the product similarity . Thus, DRP directed TPO/AO to include this company in the final list of comparables. Aggrieved , now the assessee is before the tribunal. Heard both the parties and perused the material on record. We have observed that the said company Aurigene is into drug discovery with its customers. The Revenue is billed on time line basis on achievements of milestones or on actual services. It is claimed by the assessee that the said Aurigene holds proprietary rights over intangibles and is engaged in drug discovery on partnership basis. Thus, revenue model of Aurigene is claimed by assessee to be different then the revenue model of the assessee. The assessee is claimed to be engaged in to contract R & D for generic API and operates on cost plus basis. This is claimed to be low risk area and rewards associated are also comparatively low vis-a-vis Aurigene who it is claimed is into high risk high award revenue model basis with its customers . These contentions of the assessee are no doubt meritorious for Aurigene exclusion but requires verification by authorities below. We are of considered view that this matter needs to be restored to the file of AO/TPO to reconsider this comparable on merits after hearing the assessee. The AO/TPO shall give proper opportunity of being heard to the assessee before re-adjudicating this issue in set aside denovo proceedings. This ground is allowed for statistical purposes. We order accordingly.

### **12.Ground No. 12 and 13**

This ground of appeal raised by the assessee pertain to an error in computation of margins by the TPO/AO w.r.t. Biocon Limited and Syngene International Limited while there is no quarrel so far as inclusion of these two comparables are concerned. The assessee has



**ITA No. 2224/Mum/2017**

computed margins w.r.t. these companies @19.94% and 25.34% respectively while the AO/TPO computed the same @ 25.66% and 29.62% respectively . The assessee raised this issue with DRP and contended that the TPO while calculating the margin of Biocon has not considered the unallocated income/expenses and the correct operating margin should be done post allocation of unallocated income/expenses in the segmental account and after considering the same margin will come to 19.94% and not 25.66% as computed by TPO. While for computing margin of Syngene International Limited , it was submitted that the TPO relied on data base from Prowess while the assessee relied on audited financial statements which was claimed to be more reliable. The DRP noted that the assessee has duly filed an rectification application before TPO and directions were issued by DRP to AO/TPO to examine this issue for computation of correct margins of the two comparable. We donot see any prejudice to the assessee by the aforesaid directions of DRP with which we concur. The directions of DRP to AO/TPO to examine this issue for computation of correct margins of the aforesaid two comparables namely Biocon Limited and Syngene International Limited stood confirmed.We order accordingly.

13.With respect to **ground No. 14** for not providing an adjustment to the assessee in relation to the working capital by the assessee vis-a-vis comparable companies. It was submitted by learned counsel for the assessee that the same is not pressed and the same should be dismissed as not pressed. The learned CIT DR did not raised any objections to the dismissal of the ground no. 14. After hearing both the parties, we dismiss ground no. 14 raised by the assessee. We order accordingly.

14.Similarly, with respect to **ground No. 15** it is submitted by learned counsel for the assessee that the assessee was not provided with risk adjustments for the risk assumed by the assessee vis-à-vis comparable companies. The learned counsel prayed that the same should be



**ITA No. 2224/Mum/2017**

dismissed as not being pressed. The learned CIT DR did not raise any objection to dismissal of this ground. After hearing both the parties, we direct dismissal of this ground no.15 as not being pressed. We order accordingly.

15.With respect to **ground No. 16** , it was submitted that it is concerning levy of interest amounting to ₹ 53,11,350 under section 234B of the Act. It was submitted by learned counsel for the assessee that this ground of appeal is consequential in nature and need to be dismissed. The learned CIT DR has not objected to the dismissal of the said ground of appeal being consequential in nature. After hearing both the parties, we are of the considered view that this ground no. 16 need to be dismissed as consequential in nature and is not required to be adjudicated by us. We order accordingly.

16.With respect to ground No. 17 , it is prayed by the assessee that it is concerning the levy of penalty under section 271(1)(c) of the Act and its adjudication at this stage is premature and hence the same should be dismissed. The learned CIT DR did not objected to the dismissal of this ground. After hearing both the parties, we dismiss this ground of appeal bearing number 17 as premature at this stage .We order accordingly.

**17. In the Result, the appeal of the assessee stood partly allowed as indicated above.**

Order pronounced in the open court on 09-03-2018.

Sd/-  
(CN PRASAD)  
JUDICIAL MEMBER

Sd/-  
(RAMIT KOCHAR)  
ACCOUNTANT MEMBER

Mumbai, Dated: 09-03-2018  
*Sudip Sarkar /Sr.PS*



**ITA No. 2224/Mum/2017**

**Copy of the Order forwarded to:**

1. The Appellant
2. The Respondent.
3. The CIT (A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

BY ORDER,

Assistant Registrar  
**ITAT, MUMBAI**



**ITA No. 2224/Mum/2017**