IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "B", HYDERABAD

BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND
SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER

ITA No.	Asst. Year	Appellant	Respondent
362/Hyd/17	2011-12	Mylan Laboratories Ltd., (formerly Matrix Laboratories Limited), HYDERABAD **[PAN: AADCM3491M]**	Asst. Commissioner of Income Tax, Circle-16(2), HYDERABAD
452/Hyd/17	2011-12	Deputy Commissioner of Income Tax, Circle-16(2), HYDERABAD	Mylan Laboratories Ltd., (Formerly known as Matrix Laboratories Limited), HYDERABAD **[PAN: AADCM3491M]**

For Assessee : Shri K.A. Sai Prasad, AR
For Revenue : Smt. T.H. Vijaya Lakshmi, CIT-DR

Date of Hearing : 27-02-2018
Date of Pronouncement : 09-05-2018

O R D E R

PER BENCH :

These are cross-appeals by Assessee and Revenue for the AY. 2011-12 against the order of the Commissioner of Income Tax (Appeals)-4, Hyderabad, dated 20-12-2016.

2. Brief facts of the case are that, assessee Mylan Laboratories Limited (formerly known as Matrix Laboratories Ltd) is engaged in the business of manufacture of Pharmaceutical Products. For the AY. 2011-12 assessee filed its return of income on 30-11-2011 declaring total income at Rs 3,81,12,15,927/- under normal provisions of the Income tax Act (Act) and Book Profit of Rs. 6,17,63,60,040/- u/s 115JB of the Act.

2.1. Since the assessee transacted with Associated Enterprises (AEs) as defined in Section 92A of the Act, the case was referred to Transfer Pricing Officer (TPO), who issued Transfer Pricing Order dated 12-01-2015 by making an adjustment of Rs. Nil u/s 92CA of the Act. The AO framed Assessment Order u/s 143(3) dated 30-04-2015 taking into account the above Transfer Pricing Order. The AO vide his draft order determined the total income at Rs. 4,10,61,80,902/- under normal computation and at Rs. 6,17,63,60,040/- u/s. 115JB of the Act. Aggrieved by the said order, assessee preferred an appeal before the CIT(A). Before the Ld.CIT(A), assessee contested various additions and the Ld.CIT(A) allowed the appeal partially. Assessee and Revenue are in appeal before us.

3. We have heard the Ld. Counsel and Ld. CIT-DR in detail and perused the paper books placed on record. Their arguments are incorporated issue-wise in this order where ever required.

ITA No. 362/Hyd/2017 (assessee's appeal):

4. Assessee has raised the following grounds:

"2. The CIT(A) erred in upholding the AO's action of, invoking the provisions of section 14A of the Act and disallowing the expenditure of Rs. 5,00,40,155/- by applying the method laid down under Rule 8D.

3. The CIT(A) erred in failing to direct AO to allow the deduction of Rs. 21,45,79,886/- claimed u/s. 10B of the Act in respect of Export Oriented Undertaking (hereinafter referred to as EOU) situated at Jeedimetla.

4. The CIT(A) erred in not directing AO to allow the depreciation @25% amounting to Rs. 3,69,141/- on brought forward written down value of Rs. 14,76,563/- in respect of non-compete fee of Rs. 40 lakhs paid in Asst. Year 2007-08 to Sudhir Vaid in relation to Concord Biotech Limited.

5. The CIT(A) erred in not directing the AO to drop the penalty proceedings initiated u/s. 271(1)(c) of the Act".

Ground Nos. 1 & 6 are general in nature.

5. Ground No. 2: AO noticed that assessee has invested about Rs. 261.79 Crores and shown under the head 'investments' as on 31-03-2011. Assessee-company had shown income of Rs. 35,08,501/- from the said investments and claimed exemption in the computation of income. AO invoking the provisions of Section 14A, asked the assessee to explain why disallowance should not be made under Rule 8D. It was the submission of assessee that assessee has invested in earlier years from own funds and no expenditure has incurred in relation to the income which was claimed exemption. AO,

however, did not agree and considered the interest claim out of the business expenditure at Rs. 3,90,78,855/- and ½% of average value of investments at Rs. 1,09,61,000/-, thereby disallowing an amount of Rs. 5,00,40,155/-.

5.1. Before the Ld.CIT(A), assessee submitted that it did not incur any expenditure for earning exempt income and there was no nexus between the borrowed funds and investments made. Assessee relied on various case law before the Ld.CIT(A), including the facts based on cash flow statements in the annual reports. It also gave an alternate computation to the Ld.CIT(A), wherein the disallowance was restricted to Rs. 3.5 Lakhs. However, Ld.CIT(A) has confirmed by stating as under:

"5.3 I have carefully considered the assessment order and submissions of the appellant. The appellant has relied on the Gujarat's High Court decision in the case of CIT v. Hitachi Home and Life Solutions (I) Ltd. (2014) 41 taxmann.com 540 wherein the Hon'ble High Court held that, where assessee's interest free funds far exceeded investments made for earning exempted dividend income, and AO had also failed to establish nexus between borrowed funds and investments made, no disallowance could be made u/s 14A. But in the latest decision of the Hon'ble ITAT in the case of Prathista Industries Ltd., in ITA No.1302/Hyd/2015 dated 29-04-2016, wherein it was held that, where there is exempted income, the section 14A is applicable. As per the appellant's submission, the appellant itself has explained that the company has not incurred any expenditure for earning exempt income and investments are strategically made in the group of companies for achieving better business results but not for earning exempt income. Therefore, keeping in view of the decision of Hon'ble ITAT in the case of Prathista Industries Ltd., the addition made by the Assessing Officer on this account is justified and therefore the addition confirmed. Even though I have considered the appellant's plea while deciding the appeal for the A.Y. 2010-11 on this issue in favour of the appellant, since that time the above jurisdictional Hon'ble ITAT decision was not available.

Since the same is available now, by applying the same, the addition made by the Assessing Officer confirmed".

5.2. Contesting the above, it was the submission that Ld.CIT(A) gave finding in earlier year that there was no nexus between the borrowed funds and investments made and so, disallowance was deleted in the earlier AY. 2010-11, which was separately contested by Revenue. Even though assessee's main contention was that no expenditure was incurred for earning the exempt income, it was the submission that in the alternate, the disallowance should be restricted to the amount of dividend earned and in no case it should exceed the amount of income claimed exemption i.e., in this case amount of Rs. 35,08,501/-. In support, assessee has relied on the following case law:

a. Pr.Commissioner of Income Tax Vs. Empire Package Pvt. Ltd., [286 CTR 457 (P & H-HC)];
b. Joint Investments Pvt. Ltd., Vs. CIT [372 ITR 694 (Del-HC)];
c. K. Ratanchand & Co., Vs. ITO [45 ITR (Trib) 608 (Ahd-Trib);
d. Pest Control India Pvt. Ltd., Vs. DCIT, ITAT Mumbai dated 31-10-2017;
e. TGV Projects & Investments Pvt. Ltd., Vs. ACIT ITAT, Hyderabad, dated 28-02-2017 (SMC);
f. Avshesh Mercantile (P) Ltd., Vs. DCIT [26 taxmann.com 43 (Mumbai)/(2012) 54 SOT 19];
g. CIT Vs. Oriental Structural Engineers P. Ltd., [35 taxmann.com 210 (Delhi-HC);

h. CIT Vs. Holcim India (P) Ltd., [57 taxmann.com 28) (Delhi)];
i. M/s. Kamadhenu Sukrit Pvt. Ltd., Vs. ITO, ITAT Hyderabad Bench, dated 22-11-2017;

5.3. Ld.DR, however, relied on the orders of the CIT(A).

5.4. We have considered the rival contentions and perused the facts on record and the case law relied upon. As seen from the order of the AO as well as the CIT(A), there is no finding that assessee has incurred any expenditure for earning the said dividend income. There is also no finding that any amount of the borrowed funds have been diverted to investments. In fact it is the contention of assessee that it has had reserves and investments were made in earlier years out of the own funds. As seen from the order of CIT(A) in AY. 2010-11, which was separately dealt with in ITA Nos. 626 and 659/Hyd/2016, there is a finding that there was no diversion of borrowed funds, hence the disallowance of proportionate interest under Rule 8D(2)(ii) does not arise.

5.5. Coming to the disallowance of ½% of average value of investment, some proportionate expenditure can be disallowed but in no case, it should exceed the amount earned claiming exemption. The Hon'ble High Court of Punjab & Haryana in the case of Pr. Commissioner of Income Tax Vs. Empire Package Pvt. Ltd., (supra), answered the question raised by Revenue in negative, wherein the Revenue has raised

'whether in the facts and circumstances of the case, the Hon'ble Tribunal is justified in law to hold the disallowance made u/s. 14A r.w. Rule 8D cannot exceed the exempt income in the absence of any such restriction being there in the relevant section or rule'. Similar opinion was also expressed by the Hon'ble Delhi High Court in the case of Joint Investments Pvt. Ltd., Vs. CIT (supra), wherein the Hon'ble Delhi High Court has clearly held that the proportionate or portion of the tax exempt income surely cannot swallow the entire amount as happened in this case. The Co-ordinate Bench in the case of M/s. Kamadhenu Sukrit Pvt. Ltd., Vs. ITO (supra) relied on another decision in the case of Sahara India Financial Corpn. Ltd., Vs. DCIT [41 taxmann.com 251] (Delhi-Trib) and has held as under:

"8.1. As can be seen from the nature of expenditure, there is no indication even that the above expenditure is expended for earning dividend income. AO without giving any satisfactory reason, just invoked Rule 8D(iii) and disallowed the amount.

9. The Co-ordinate Bench in the case of Sahara India Financial Corpn. Ltd., Vs. DCIT (supra) has held in para 81 as under:

"We have heard the rival contentions and perused the material available on record. It has not been disputed that the administration, expenses and books of account of investment division are separately carried out and maintained by the assessee. No infirmity has been found by the department in this behalf. One of the main issue is on whom lies the onus to establish nexus of available funds with free and taxable income. Similarly courts have held that a finding in objective terms about assessee working being unsatisfactory is to be recorded by AO in the order. Chandigarh Bench of the Tribunal in the case of Punjab State Co-op. & Marketing Fed. Ltd. (supra) has held that in any case the disallowance u/s 14A cannot exceed tax free income of the assessee. If mechanical method of rule 8D is applied, it leads to manifestly absurd results in as much as for tax free income of Rs.68,37,583/- disallowance of Rs.2,16,51,917 (enhanced by CIT(A) at Rs. 2,19,47,772) is made u/s 14A which is way too much than the exempt income. As the interpretation of provisions of sec. 14A r/w rule 8D is leading to unanticipated absurdities which cannot be the intention of legislature. Under these circumstances help of external aids

of construction for interpretation of statute is called for. Looking at the varying interpretation offered by various courts and benches of tribunal in relation to sec. 14A, it is quite arduous to precisely decide the issue. In given facts and circumstances without going into all the issues, in our view it is appropriate to take guidance from Chandigarh bench judgment in the case of Punjab State Co-opt Marketing Fed. Ltd. (supra) holding that the disallowance of expenditure in any case cannot exceed the income earned. In our view this judgment takes a holistic view that disallowance in terms of sec. 14A can be maximum to the extent of exempt income, there is no dispute that in this case which is at Rs. 68,37,583/-. This judgment implies that reasonable expenditure less than the exempt income can be disallowed. In our considered opinion, in the interest of justice, it will be reasonable to estimate and disallow, 50% of exempt) income (Rs.68,37,583/-) as relatable to exempt income u/s 14A r/w rule 8D. We do not go into various plea taken by both sides offering diverse views based on judicial citations. This ground of the assessee is partly allowed".

10. Respectfully following the above principles, as the disallowance made by AO has resulted in absurd situation of disallowing genuine other business expenditure, on which assessee earned more than Rs. 19 Lakhs income (as against Rs. 8,100/- of dividend), I am satisfied that the disallowance u/s. 14A should be restricted to the income earned of Rs. 8,100/-. AO is directed accordingly".

5.6. Respectfully following the principles laid down in various judgments of the Hon'ble High Courts and the decisions of the Co-ordinate Benches, we are of the opinion that the disallowance under Rule 8D cannot exceed the dividend income earned and claimed as exempt. Therefore, the disallowance worked out under Rule 8D(iii) being administrative expenditure is restricted to the amount of dividend earned. AO is directed to modify accordingly. Ground is partly allowed.

6. <u>Ground No. 3</u>: This ground pertains to the issue of claim u/s. 10B. Assessee has claimed deduction u/s. 10B to an extent of Rs. 21,45,79,886/- in respect of Export Oriented Undertaking situated at Jeedimetla. The claim was

questioned in proceeding u/s. 263 for AY.2005-06 and assessee has filed Writ Petition before the Hon'ble High Court. AO, consistent to the stand taken in earlier years, disallowed the claim. Ld.CIT(A) following the order of ITAT in assessee's own case for AY. 2008-09 has allowed the claim, by stating as under:

"7.3 I have carefully considered the assessment order and the submissions of the appellant. In this regard, the Hon'ble ITAT vide its order in ITA No.66/Hyd/2013 dt.10-01-2014 in the appellant's own case for the A.Y. 2008-09 held as under:

> *"The Assessing Officer following the orders u/s 263 for the A. Y. 2005-06 held that the unit is not newly established undertaking and was existing prior to the incorporation of provisions of section 10B and the conditions are not fulfilled and further that unit is not located in export process zone. Even though the Hon'ble AP High Court merely directed the CIT(A) to examine the approvals granted to the eligible units of the assessee in terms of the policy regulations laid down by Central Government, the CIT-IV, however, seems to have raised new ground for denying exemption and the same has been once again disputed by the assessee before the Hon'ble High Court in WP No.1398 of 2011. The Assessing Officer following the orders in earlier years did not allow the claim of the assessee u/s. 10B. The DRP, however, noticed that the issue is subject to revisional proceedings by the CIT and the writ petition is pending before the Hon'ble High Court of AP. Since the matter is contested at the Higher Forum legally, the DRP considered it fit not to interfere with the stand of the Assessing Officer but however, directed the Assessing officer to follow the judgment of the Hon'ble High Court of AP as and when issue was decided. It further suggested that demand on account of disallowance of deduction be kept in abeyance till the decision of the Hon'ble High Court of AP. The assessee has raised this issue before us but submitted that the matter is subjudice. Since the DRP has already given clear directions on this issue, we uphold the directions of the DRP with an observation that the AO should follow the same as and when that issue is decided by the Hon'ble High Court of AP. This ground is considered as allowed for statistical purposes".*

7.4 Therefore the Assessing Officer is directed to follow the above direction of the Hon'ble ITAT for this year also and the ground of appeal is allowed for statistical purposes".

6.1. After considering the rival contentions, we are of the opinion that there is no need to interfere with the direction of the CIT(A). Since the matter is subjudice, the AO is directed to follow the decision of the Hon'ble High Court as when it is rendered. Till such time, the claim of 10B will be considered allowed and the demand if any cannot be claimed from assessee. In fact, there can not be any grievance to assessee on the direction of Ld. CIT(A) who allowed the ground. Ground is considered allowed.

7. Ground No.4: This ground pertain to disallowance of 25% amounting to Rs. 3,69,141/- on WDV of Rs. 14,76,563/- in respect of non-competing fee paid in AY. 2007-08 to Mr. Sudhir Vaid. At the outset, it was fairly admitted that the order of CIT(A) is in compliance to the order of the ITAT in earlier year and the matter is pending before the Hon'ble High Court as far as this claim is concerned. Since the order is in compliance to the order of ITAT in earlier year, we do not find any reason to interfere with the direction of CIT(A). In view of that Ground No. 4 is rejected.

8. Ground No.5: This ground is with reference to the penalty proceedings initiated u/s. 271(1)(C) of the IT Act. There cannot be any grievance on initiation of proceedings u/s 271(1)(c), unless it results in levy of penalty. There is no need to adjudicate the ground as it is academic in nature. Ground is rejected.

9. In the result, appeal of assessee is partly allowed.

ITA No. 452/Hyd/2017 (Revenue's appeal):

10. Revenue in its appeal has raised the following grounds:

> *"1. On the facts and in the circumstances of the case, and in law, the CIT(A) erred in deleting the AO to examine and allow deduction u/s. 35(i)(i) in respect of expenditure that is not certified by the DSIR for weighted deduction.*
>
> *2. On the facts and in the circumstances of the case, and in law, the CIT(A) erred in allowing depreciation on non-compete fee.*
>
> *3. The appellant prays that the order of the CIT(A) on the above grounds be set aside and that of the Assessing Officer be restored".*

Ground No. 4 is general in nature.

11. Ground No.1: This ground pertains to the claim of deduction u/s. 35(1)(i) and (iv) of the Act. Assessee claimed weighted deduction u/s. 35(2AB) at Rs. 122,85,16,846/-. After considering the expenditure, DSIR has approved the amount of Rs. 119,89,16,476/-. Thus, the claim of excess weighted deduction at Rs. 2,96,00,370/- has been made by the AO in the assessment order.

11.1. Before the Ld.CIT(A), it was submitted that the amount of Rs. 1,48,00,185/- was not considered by the DSIR for weighted deduction, but same is required to be allowed

under Sub-Section (1) of Section 35 of the Act as expenditure incurred for scientific research in respect of business carried on. Assessee relied on the Co-ordinate Bench decision in its own case for AY. 2008-09, dt. 10-01-2014, wherein the Co-ordinate Bench has held that expenditure which is not allowable u/s. 35(2AB) is allowable u/s. 35(1). Ld.CIT(A) has allowed the claim as under:

> *"6.3 I have carefully considered the submissions of the appellant. The Hon'ble ITAT vide its order in ITA No.66/Hyd/2013 dt. 10-01-2014 for the A.Y. 2008-09 in the appellant's own case with regard to the above issue held as under:*
>
> > *"Since the entire claim of the assessee was rejected summarily without examining the fact, we are of the opinion that this expenditure of Rs. 56,35,712/- in respect of R&D Expenditure is to be considered u/e 35(1), if not for the weighted deduction u/e 35(2AB). Assessing Officer is directed to examine the necessary expenditure and allow the claim. This ground is allowed for statistical purposes".*
>
> *6.4 Hence, respectfully following the Hon'ble ITAT decision on the above said ground, the Assessing Officer is directed to examine the necessary expenditure and allow the claim and the ground of appeal is allowed for statistical purpose".*

11.2. Since the order of CIT(A) is consistent with the view taken by the ITAT in assessee's own case in earlier year, the issue of which is pending before the Hon'ble High Court on Revenue appeal, we do not find any reason to interfere with the order of the Ld.CIT(A). Revenue ground on this issue is accordingly rejected.

12. <u>Ground No. 2</u>: This ground is on allowance of depreciation on non-compete fee. Assessee has claimed payment of Rs. 200 Lakhs to Medispan Ltd., by

Medicorp Technologies India Ltd., in AY. 2002-13 and Rs. 40 Lakhs paid to Mr. Sudhir Vaid in relation to Concord Bio Tech Ltd., in AY. 2007-08. Assessee was claiming depreciation on WDV values in respect of these amounts. This issue was crystalised by the orders of ITAT in earlier years and the ITAT has allowed the depreciation on the non-compete fee in respect of Rs. 200 Lakhs paid in AY. 2002-03 on which, the depreciation claimed during the year was at Rs. 14,76,563/-. Ld.CIT(A) following the order of ITAT in earlier year, allowed the amount by stating as under:

"9.3 I have carefully considered the submissions of the appellant and the assessment order. The Hon'ble ITAT vide its order in ITA No.66/Hyd/2013 for the A.Y. 2008-09 with regard to above issue held as under:

With regard to issue of 7(a) it was held as under:

Since, ITAT has already ordered the depreciation to be allowed in A.Y. 2002-03, consequently, depreciation has to be allowed by the Assessing Officer in this year. He is empowered to take rectification proceedings in case that order was not upheld by the Hon'ble High Court. In view of this, to that extent of claim of depreciation amounting to Rs. 8,89,893/- on brought forward written down value, Assessing Officer is directed to allow the depreciation after verifying the WDV figures. Accordingly ground is allowed.

With regard to issue of 7 (b) it was held as under:

After considering the submissions, we are of the opinion that the cases against the assessee are more in number and there is a consistent view of the ITAT in not allowing the depreciation on non-compete fee. This issue 'which was originally considered in the case of Tecumse India Pvt. Ltd., Addl.CIT 5 ITR TRIB 50(Del.) wherein the proposition canvassed by the assessee that non-compete fee is revenue acquisition of business has been held that non-compete fee for the same was incurred for the initial outlay of the business.

Following the above principles and the decision of the Hon'ble Delhi High Court in the case of Hindus tan Coco Beverages Pvt. Ltd. 331 ITR

192(Del.), wherein it was held that, it is clear that 'business or commercial rights of similar nature' are not manufactured or produced over-night, but are brought into existence by experience and reputation. The non-complete fee is outcome of an agreement entered into between two parties. It does not represent any intangible asset, such as, know-how, patents, copyrights, trade marks, licences, franchises, etc.

Therefore, in view of decision of the Hon'ble Delhi High Court, non-compete agreement would not create an asset of intangible nature eligible for depreciation u/e 32(1)(ii) of the Act.

The decision of the ITAT, Chennai Bench 'A' in Arekema Peroxides India (P) Ltd., Vs. ACIT vide ITA No.2212/Mad/2006 dated 13-01-2012 is prior to the decision of the Hon'ble Delhi High Court where it renders no help to the assessee. Therefore, we are not in agreement with the arguments of the assessee that non-compete fee is an intangible asset to which provisions of section 32(1)(ii) of the Act are applicable. Therefore, in our considered opinion, the depreciation cannot be allowed on amount of non-compete fee.

As can be seen from the above, the Tribunal has distinguished the decision in the case of Medicorp relied by the assessee itself, which is reported at (2010) 2 ITR (Trib.) 367 (Chennai). In view of this, we are of the opinion that the depreciation cannot be allowed on an amount of non-complete fee, which was in fact paid to the Managing Director of the Company for not taking any employment. This cannot be considered u/s 32(1) as an intangible asset. Accordingly, the claim of depreciation on the item(a) is not allowed and to that extent ground is rejected.

9.4 The Assessing Officer is directed to follow the decisions of the Hon'ble ITAT as above and calculate allowable depreciation for ground 6(a) which is allowed. With regard to ground 6(b) which is rejected, so the addition made confirmed".

12.1. The issue on depreciation on non-compete fee pertaining to Mr. Sudhir Vaid is contested in assessee's appeal which was dealt with separately. As far as the Revenue ground is concerned, this ground pertains to the amount allowed on the WDV on non-compete fee paid to Medicorp Technologies India Ltd. Since this issue is in conformity with the Co-ordinate Bench orders in earlier years, we do not find any reason to

interfere with the said order. Moreover, it is to be noted that Revenue did not contest this issue in AY. 2010-11 in Revenue appeal. Keeping that also in mind, we do not find any merit in Revenue ground raised.

13. In the result, appeal of Revenue is dismissed.

14. To sum-up, appeal of assessee is partly allowed and appeal of Revenue is dismissed.

Order pronounced in the open court on 9th May, 2018

Sd/-	Sd/-
(P. MADHAVI DEVI)	**(B. RAMAKOTAIAH)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, Dated 9th May, 2018

TNMM

Copy to :

1. Mylan Laboratories Limited (Formerly known as Matrix Laboratories Limited), Plot No. 564/A/22, Road No. 92, Jubilee Hills, Hyderabad.

2. The Asst. Commissioner of Income Tax, Circle-16(2), Hyderabad.

3. CIT(Appeals)-4, Hyderabad.

4. Pr.CIT-4, Hyderabad.

5. D.R. ITAT, Hyderabad.

6. Guard File.