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

BEFORE SMT P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER

ITA No. 1582/Hyd/2017 and C.O. No. 37/Hyd/2017
A.Y.: 2012-13

Dy. Commissioner of Income-tax, Circle – 17(2), Hyderabad.	vs.	M/s United States Pharmacopeia India Pvt. Ltd., Hyderabad. PAN – AAACU 7542 C
(Appellant)		(Respondent/Cross Objector)

Revenue by : Shri M.H. Naik
Assessee by : Shri R. Vijayaraghavan

Date of hearing 01-06-2017
Date of pronouncement 08-06-2017

O R D E R

PER S. RIFAUR RAHMAN, A.M.:

This appeal is preferred by the revenue against the order of the learned Commissioner of Income-tax(Appeals) - 5, Hyderabad dated 27/07/2016 for AY 2012-13 and the assessee also filed C.O. against the said order of CIT(A).

2. Briefly the facts of the case are that the assessee is engaged in research and analytical testing of pharmacopeia and other related processes. It filed its return of income on 30/11/2012 declaring an income of Rs. 2,87,95,190/-. The AO made an adjustment of Rs. 7,00,457/- u/s 92CA(3). He also disallowed lease premium paid of Rs. 1,77,15,937/- treating the same as revenue expenditure. The total income was assessed at Rs. 4,72,11,584/-.

3. Aggrieved by the order of AO, the assessee preferred an appeal before the CIT(A).

4. As regards adjustment of Rs. 7,00,457/- u/s 92CA(3), the CIT(A) upheld the action of the AO. As regards the disallowance of an amount of Rs. 1,77,15,937/- on account of lease premium, the CIT(A) deleted the disallowance following the decision of his predecessor in assessee's own case for AY 2010-11 as well as the decision of the ITAT in assessee's own case in AY 2010-11 wherein the coordinate bench dismissed the appeal of the revenue upholding the decision of CIT(A).

5. Aggrieved by the order of the CIT(A), the revenue is in appeal before us raising the following grounds of appeal:

> *"1. The Ld. CIT (A) erred both on facts and in law in holding that the lease rent paid of Rs. 1,77,15,937/- is allowable as Revenue expenditure.*
>
> *2. The Ld. CIT (A) erred in law in ignoring the decision of the Hon'ble Supreme Court in the case of M/ s. Panbari Tea Ltd. 057 ITR 0422 (1965) wherein the Hon'ble Supreme Court held that the lease rent paid is Capital Expenditure.*
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> *3. The Ld. CIT (A) erred in law in ignoring the decision of Hon'ble Supreme Court in the case of Durga Das Khanna 072 ITR 0796 (1969) wherein the Hon'ble Apex Court had specifically decided that the lease premium received is a Capital Receipt in the hands of the recipient and the corresponding payment is a Capital Expenditure in the hands of the payer.*
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> *4. The Ld. CIT(A) erred in not appreciating the fact that the issue is not a settled matter because the decision of the Hon'ble ITAT in assessee's case for A.Y. 2010-11 was contested by the Department before the Hon'ble High court and the appeal is still pending for disposal."*

6. Considered the rival submissions and perused the material on record. We find that similar issue came up for consideration before the coordinate bench of this Tribunal in assessee's own case for AY 2011-12, wherein the coordinate bench has dismissed the grounds raised by the revenue by observing as under:

"6. Considered the rival submissions and perused the material facts on record. The facts relating to this ground are that during the year the assessee company had entered into a lease agreement with IKP Knowledge Park IKP. As per the terms of the lease deed, IKP had leased out vacant land for a period of 33 years, for which one time consideration, which was referred to as lease premium, of Rs. 68,87,500/- was paid by the company. Further, an annual lease rental varying from Rs. 10,985/- to Rs. 2,55,125/- had been agreed between both the parties. When the AO asked the assessee as to why the said lease premium cannot be treated as capital expenditure, the AR of the assessee submitted that the lease premium was paid for acquiring the land on lease and the lease of land is solely for the purpose of the business of the company. Further, he submitted that the lease premium was paid as an advance rent which is non-refundable in nature and, therefore, the lease premium is allowable as business expenditure in the year of payment. Rejecting the submissions of the assessee, the AO held that the amount paid being in the nature of onetime payment for acquiring lease rights for 33 years, i.e. rights over asset of enduring nature, the payment was capital in nature. Following his decision in AY 2010-11, the AO disallowed the said amount treating the same as capital in nature. On appeal, the CIT(A) deleted the disallowance.

6.1 In ground No. 2, the revenue has raised that ld. CIT(A) has ignored the decision of Apex Court in the case of M/s Panbari Tea Ltd. (supra) in which the lease rent paid is held to be capital expenditure. In the above case, the assessee has received premium to the extent of Rs. 2,75,000/-. The same was payable at the time of execution of the deed Rs. 45,000/- and balance of Rs. 1,80,000/- was payable in 16 half yearly instalments. The question was whether such instalments towards premium was a revenue or capital receipts. It was held, on those facts, that it was capital receipts. The Hon'ble Court observed that the real test of a salami or premium is whether the amount paid, in lumpsum or in instalments, is the consideration paid by the tenant for being let into possession. When the interest of the lessor is parted with for price, the price paid is premium. From the above, it is clear that the receipt of premium whether in lumpsum or instalments is immaterial, it is the intention of the party and the price paid for parting of the possession. In the given case, the assessee has paid the one time premium. Hence, this case is materially distinguishable from the present case, hence, cannot be applied.

6.2 Further, revenue has raised in Ground No. 3 that ld. CIT(A) has ignored another decision of Apex Court in the case of Durga Das Khanna (supra) in which lease premium received is a capital receipt in the hands of recipient and corresponding

payment is a capital expenditure in the hands of the payer. On careful reading of the above decision, the lessees agreed to pay under lease Rs. 55,200/- to the lessor towards the cost of erecting the cinema house. The lease did not contain any condition or stipulation from which it could be inferred that the sum had been paid by way of advance rent, nor was there provision for its adjustments towards rent or any repayment. It was held that in the absence of any material on record to that effect, the sum paid to the lessor was in the nature of a premium. In the given case, the assessee has paid the premium but as per the above ratio, the payment of premium was treated as capital receipt in the hands of lessor i.e. recipient. The contention of revenue that the premium received was treated as capital, the payment should also be treated as capital is not proper. It depends upon the facts of each case. In the given case, the Hon'ble Gujarat High Court has considered the facts which are similar to the facts of the assessee and adjudicated it as revenue in nature. We relied on the above ratio and adjudicated in the assessee's own case in AY 2010-11, which is extracted as under:

> *"10. With regard to ground No. 3, CIT(A) had not followed the decision of the jurisdictional High Court in the case of Mrs. G. Seetha Kamraj Vs. CIT, we find from the record that in the present case, the assessee had entered into an agreement with ICICI Knowledge Park for lease of vacant land for 33 years for an annual lease amount varying from Rs. 16,901/- to Rs. 1,47,298/-. The assessee had also paid a one time consideration as lease premium of Rs. 99,03,750/-. In the present case, the assessee had paid the above sum as lease premium and claiming the same as revenue expenditure . Whereas in the case referred by the revenue in the ground is distinct from the present case as the assessee (Mrs. G. Seetha Kamraj) took on lease for 99 years a building from her husband and as per terms of the lease, assessee paid Rs. 5000 as premium for obtaining the lease and was to pay monthly rent of Rs. 300/-. The lease had also a right to create sub-lease and she created a sub-lease in favour of 3rd party. The assessee received a lumpsum of Rs. 4,30,000/- as consideration. It was stated to adjustable against monthly rent of Rs. 367.83. Ld. AO assessed the same as capital gain. The same was upheld by the Hon'ble High Court that on the facts and circumstances, construing the sub-lease agreement and holding the deposit of Rs. 4,30,000/- received by the assessee was a consideration for granting sub-lease of the assessee's rights and not a payment of monthly rent in advance and as such was liable to tax as short term capital gains. In the present case, assessee had made the payment as*

premium and not received to consider the G. Seetha Kamraj's case as they are not similar. Hence, we cannot consider G. Seetha Kamraj's case in the present case as the same is not similar. However, the AR had relied on the various decisions which are presented before the CIT(A). These cases are similar to the present case in particular, the case of DCIT Vs. Sun Pharmaceuticals India Ltd. (329 ITR 479 (Guj.) are similar to the assessee's case. It was held by the Hon'ble Gujarat High Court, dismissing the revenue appeal, that the tribunal had found that the land in question was not acquired by the assessee. Merely, because the deed was registered, the transaction in question would not assume a different character. The lease rent was very nominal. By obtaining the land on lease, the capital structure of the assessee did not undergo any change. The assessee only acquired a facility to carry on business profitably by paying nominal lease rent. The lease rent paid by the assessee to GIDC was allowable as revenue expenditure. In the present case, the assessee acquired the land on lease for 33 years, the capital structure did not undergo any change. The assessee has merely acquired the facility to carry on business profitably by paying nominal lease rent. The lease rent paid by the assessee was allowable as revenue expenditure. By relying on the above judgment, we are inclined to accept the order of CIT(A) and accordingly the grounds raised by the revenue are dismissed."

As the issue under consideration is similar to AY 2010-11 and the ld. DR did not bring any contrary decision in this regard, following the decision of coordinate bench in AY 2010-11, we uphold the order of the CIT(A) in deleting the disallowance made by the AO towards lease premium paid by the assessee following the order of ITAT in AY 2010-11 and dismiss the grounds raised by the revenue."

As the issue under consideration is materially identical to that of AY 2011-12, following the decision therein, we uphold the order of CIT(A) and dismiss the grounds raised by the revenue in this regard.

7. In the result, appeal of the revenue is dismissed.

C.O. No. 05/Hyd/2017

8. In C.O. the assessee has raised the following objections:

Transfer pricing adjustment on account of reimbursement of expenses received from Associated Enterprises ("AEs")

1. That on the facts and circumstance of the case and in law, the learned Commissioner of Incometax (Appeals) _ 5 ("CIT(A)"] erred, both in facts and in law, in confirming the transfer pricing adjustment of Rs. 700,457 with respect to reimbursements received from its AEs.

2. That on the facts and circumstances of the case and in law, the learned CIT(A) erred in confirming the ad-hoc mark-up of 10% on salary recharged to the AEs, as applied by the learned AO / TPO while computing transfer pricing adjustment.

3. That on the facts and circumstances of the case and in law, the learned CIT(A) erred in confirming the erroneous conclusion drawn by the learned AO / TPO that the reimbursements have not been routed through the books of accounts.

4. The Respondent craves, to consider each of the above grounds of cross-objection without prejudice to each other and craves leave to add, alter, delete or modify all or any of the above grounds of cross-objection."

9. Briefly the facts are that it was mentioned in the TP document that during the year Dr. Srini Srinivasan, employee of USP LLC was transferred to the rolls of USP India in June 2010 as a Whole Time Director. Dr. Srini had oversight responsibility for scientific business and infrastructure operations of certain USP affiliates (USP China and USP Brazil) while he was employed in USP LLC., Dr. Srini continued oversight responsibility of these affiliates from USP India. His responsibilities include overseeing the construction process, involvement in staff recruitment, capital procurement, oversight of budgeting, establishing and maintaining relations with key stakeholders etc. USP India recharged the apportioned salary and other direct expenses of Dr. Srini incurred by USP India to respective USP affiliates on a cost to cost basis.

9.1 When the AO/TPO asked the assessee as to why a mark-up of 10% be not charged on the services rendered in the nature of reimbursement, the assessee replied that Shri Srini has acted in fiduciary capacity and the company is not the full beneficiary of the

services of Shri Srini. Hence the expenditure related to the cost of Shri Srini was recharged to the AEs, for whose benefit he was working. After considering the submission of the assessee, the TPO observed that the receipt of reimbursement had not been routed through books of account and no independent party would render such services without any mark up. He further observed that even otherwise, recovery of expenses always forms part of operating cost in the case of independent comparable companies. In the present case, the payments were direct and not in the nature of third party payments. TPO, therefore, held that these expenses incurred by the assessee and subsequently reimbursed by AEs were to be added to the operating revenues as well as the operating cost for the purpose of aggregation of transactions and determining arm's length price under TNMM. Accordingly, TPO computed the arm's length prices as under:

Reimbursement received	Rs. 70,04,568
Arm's length price of reimbursement @10%	Rs. 77,05,025
Adjustment on reimbursement	Rs. 7,00,457

The TPO, thus, concluded that the arm's length price of reimbursements received was Rs. 77,05,025/- and the shortfall of Rs. 7,00,457- was treated as adjustment u/s 92CA of the Act and the total income of the assessee enhanced accordingly u/s 92CA(3) of the Act.

10. Aggrieved by the order of TPO/AO, the assessee carried the matter in appeal before the CIT(A) and contended that reimbursements received by the Assessee cannot be construed as operational in nature as alleged by the Ld. TPO. The reimbursements received by the Assessee were not connected to the principal transactions of providing services to AE and therefore, cannot be considered as part of services rendered by the Assessee to the AE. He submitted that it merely acted as an intermediary/facilitator in the entire transaction. Therefore, the Assessee submitted that it is a pure

cost-to-cost reimbursement and hence application of mark-up is not proper in the instant case. In support of the Assessee's contention that reimbursements should be not subjected to mark-up, it relied on various case laws.

11. After considering the submissions of the assessee, the CIT(A) upheld the action of TPO by observing as below:

> *"The receipt of reimbursement has not been routed through books of account. I agree with the TPO that no independent party would render such services without any mark up. The recovery of expenses always forms part of the case of independent comparable companies. In the present case, the payments are direct and not in the nature of third party payments. Thus, these expenses incurred by the taxpayer and subsequently reimbursed by AEs are to be added to the operating revenue as well as the operating costs for the purpose of aggregation of transactions and determining arm's length price under TNMM. The taxpayer has made payments towards the operations and on the employees as also are operational in nature and therefore cannot be excluded. The margin of the taxpayer is quantified at 12.98%. Thus. mark-up of 10% made by the TPO/AO is reasonable. Thus, there is shortfall of Rs 7,00,457 as the arm's length price of reimbursements received is Rs. 77,05,025/- as determined by the TPO. Thus I hold that of addition of Rs.7,00,457/- is justified."*

12. Considered the rival submissions and perused the material on record. Similar issue came up for consideration before the coordinate bench of this Tribunal in assessee's own case for 2011-12 vide C.O. No. 05/Hyd/2017 and the coordinate bench vide its order dated 27/10/2017 held as follows:

> *"11. Considered the rival submissions and perused the material facts on record. Dr. Srini Srinivasn, employee of USP LLC was transferred to the rolls of USP India in June 2010 as a whole time Director. Dr. Srini had oversight responsibility for scientific business and infrastructure operations of certain USP affiliates (USP China and USP Brazil) while he was employed in USP India, His responsibilities include overseeing the construction process, involvement in staff recruitment, capital procurement, oversight of budgeting, establishing and maintaining relations with key stakeholders etc. USP India recharged the apportioned salary and other direct expenses of*

Dr. Srini incurred by USP India to respective USP affiliates on a cost to cost basis.

11.1 TPO has suggested that 10% mark up should be applied. The same was upheld by the ld. CIT(A) by observing that the receipt of reimbursement has not been routed through books of account. Since the ld. CIT(A) has found that the transaction was not routed through the books, we are inclined to remit this case back to the file of AO with a direction to verify the transaction. In case, the transactions are not routed through the books, the action of TPO may be sustained. Otherwise, it is normal practice in the multinational companies to utilize the expertise of the various executives in the group companies. In this case, Dr. Srini Srinivasan was employed in USP India and his expertise in the management of construction, recruitment, capital procurements, budgeting etc., were utilized by the other sister concerns. Certain portion of his CTC was charged to the other sister concerns. The concept of utilizing the expertise with other independent companies are not heard of in the market nor encouraged in the normal business. Since there are no comparable cases in the market, and also it is the business decision of the assessee to share the employee cost with other sister concerns on cost to cost basis. Accordingly, the addition of markup should be deleted. For the limited purpose of verification of transaction whether the transactions are routed through books, it is remitted to the AO. Accordingly, ground raised in C.O. is allowed for statistical purposes.

As the cross objections raised by the assessee in this AY are materially identical to that of AY 2011-12, following the decision therein, we remit the issue to the file of the AO with a direction to decide the issue in line with the direction of ITAT in AY 2011-12. Accordingly, CO is allowed for statistical purposes.

13. In the result, revenue appeal is dismissed and the C.O. filed by the assessee is allowed for statistical purposes.

Pronounced in the open court on 8th June, 2018

Sd/-	**Sd/-**
(P. MADHAVI DEVI)	**(S. RIFAUR RAHMAN)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, Dated: 8th June, 2018

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Copy to:-

1) DCIT, Circle – 17(2), 9th Floor, Signature towers,
Opp. Botanical Garden, Kondapur, Hyd – 500 084
Hyderabad.
2) M/s united States Pharmacopecia India Pvt. Ltd., Lab No. 7 to 10,
Phase III, ICICI Knowledge Park, Genome Valley, Hyderabad - 78
3 CIT(A) - 5, Hyderabad
4) Pr. CIT - 5, Hyderabad
5) The Departmental Representative, I.T.A.T., Hyderabad.
6) Guard File.