

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH : E : NEW DELHI

BEFORE SHRI R.K. PANDA, ACCOUNTANT MEMBER
AND
SHRI KULDIP SINGH, JUDICIAL MEMBER

ITA No.6092/Del/2015
Assessment Year: 2011-12

Kee Pharma Ltd.,
3rd Floor, A-8,
Naraina Industrial Area Phase-II,
New Delhi.

Vs ITO,
Ward-14(3),
New Delhi.

PAN: AAACK0120C

(Appellant)

(Respondent)

Assessee by	:	Shri Ashish Goel & Shri Himanshu Aggarwal, CAs
Revenue by	:	Ms Rinku Singh, Sr. DR
Date of Hearing	:	04.04.2019
Date of Pronouncement	:	16.04.2019

ORDER

PER R.K. PANDA, AM:

This appeal filed by the assessee is directed against the order dated 2nd September, 2015 of the CIT(A)-5, Delhi relating to assessment year 2011-12.

2. The only effective ground raised by the assessee reads as under:-

“On the facts and circumstances of the case, the learned CIT(A) has erred both on facts and in law in confirming the action of the Id. A.O. treating the amount incurred on account of research & development expenses of Rs.47,15,000/- as capital expenditure instead of revenue expenditure as claimed by the assessee.”

3. Facts of the case, in brief, are that the assessee is a company engaged in the business of manufacturing and trading of pharmaceuticals. It filed its return of income on 22nd September, 2011 declaring total income of Rs.1,42,670/-. The Assessing Officer during the course of assessment proceedings observed that the assessee has debited an amount of Rs.46,93,531/- under the head 'Research & development charges.' The Assessing Officer asked the assessee to file a note on research & development expenses to which the assessee replied as under:-

“Kee Pharma Ltd. had entered into on an Agreement for Sale of Design for the Process to manufacture the drug Atorvastatin, with CBZ Chemicals Ltd., a UK based company, in May 2009. Under the Agreement, a total consideration of US \$ 5,50,000/- would be payable by Kee Pharma Ltd, to CBZ Chemicals Ltd., in several stages, the payments being milestone linked. Kee Pharma Ltd. would do research and development activities on the Design to develop a unique patentable process which would ultimately lead to the production of the drug Atorvastatin. The patent for the process so developed would also be filed by Kee Pharma Ltd. in its own name. Under the schedule of payments; as detailed in the Agreement; vide Clause 4.d.i, an amount of US \$ 1,00,000/- was payable to CBZ by Kee Pharma Ltd.”

4. From the reply furnished by the assessee, the Assessing Officer inferred that the design for the process to manufacture the drug ultimately make the company able to produce the drug in the forthcoming years and the benefit of the same will go on beyond the present financial year. He, therefore, asked the assessee to explain as to why the purchase of design should not be treated as capital expenditure. The assessee reiterated that the expenses should be allowed as revenue expenditure. However, the Assessing Officer was not satisfied with the explanation given by the assessee. According to him, the assessee company has paid for the procurement of design for the process of manufacturing of the drug and the assessee company is engaged in the business of manufacturing of drug. Therefore, the design so procured would be

beneficial for more than one year. He, therefore, treated the expenditure as capital in nature and allowed depreciation @ 25% as applicable to intangible assets. The Assessing Officer accordingly made addition of Rs.35,36,250/- to the total income of the assessee.

5. Before the CIT(A), it was argued that research and development is an ongoing process in a pharmaceutical company and it does not bring into existence any new assets, but, only helps the assessee to carry out business operations in a more efficient manner. The assessee furnished copies of drug agreement for sale of design for the process to manufacture the drug Atorvastatin dated 18th May, 2009.

6. However, the Id.CIT(A) was not satisfied with the arguments advanced by the assessee. Relying on the decision of the Hon'ble Delhi High Court in the case of *CIT vs. J.K. Synthetics Ltd. reported in 309 ITR 371 (Del)*, he held that the Assessing Officer was justified in treating the R&D expenditure as capital in nature. While holding so, he further noted that in view of the 'absolute transfer of all technical knowledge to the assessee, the right of the assessee to sell/resell/licence the design or the process to a third party as well as the exclusive right conferred on the assessee by the said agreements' the impugned payments are to be held in the nature of capital expenditure. The argument of the assessee that similar expenditure of Rs.20,59,826/- incurred in the F.Y. 2008-09 relevant to assessment year 2009-10 was accepted by the Assessing Officer and no disallowance was made in the order passed u/s 143(3), was

rejected by the CIT(A) on the ground that the principle of *res judicata* does not apply to income-tax proceedings and every year is independent.

7. Aggrieved with the order of the CIT(A), the assessee is in appeal before the Tribunal.

8. The Id. counsel for the assessee strongly opposed the order of the CIT(A). He submitted that the decision relied on by the Id. CIT(A) in the case of J.K. Synthetics Ltd. (supra) in fact supports the case of the assessee. The Id. counsel drew the attention of the Bench to clause (1) para 38 of the order which has been reproduced by the CIT(A) and which reads as under:-

“(i) the expenditure incurred towards initial outlay of business would be in the nature of capital expenditure, however, if the expenditure is incurred while the business is on going, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring benefit for the business, if that be so, it will be in the nature of capital expenditure. If the expenditure, on the other hand, is for running the business or working it, with a view to produce profits, it would be in the nature of revenue expenditure.”

9. He submitted that the Hon'ble High Court has laid down the test for certain expenditure to be classified as capital in nature only when the expenditure incurred towards initial outlay of business. Further, if the expenditure is incurred while the business is ongoing, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring nature for the business. If the expenditure is for running the business or working it with a view to produce profits, it would be in the nature of revenue expenditure. Referring to the decision of the Hon'ble Delhi High Court in the case of *CIT vs. Priya Village*

Roadshows Ltd., reported in 332 ITR 594 (Del), he submitted that the Hon'ble High Court in the said decision, following various decisions has held that when expenditure incurred for preparation of feasibility report of a new project is in respect of the same business which is also carried on by the assessee even if it is for expansion of business, namely, to start a new unit which is same as earlier business and there is a unity of control and a common fund, then, such expenditure is to be treated as revenue expenditure. He accordingly submitted that since the assessee in the instant case is already in the business of manufacturing and trading of pharmaceuticals and similar expenditure was allowed in the past by the Assessing Officer in the order passed u/s 143(3) and 143(1), therefore, in view of the decision of the Hon'ble Delhi High Court in the case of CIT vs. Priya Village Roadshows Ltd. (supra), the expenditure has to be allowed as revenue expenditure. He accordingly submitted that the order of the CIT(A) be set aside and the ground raised by the assessee be allowed.

10. The ld. DR, on the other hand, heavily relied on the order of the CIT(A). She submitted that by incurring huge expenditure on R&D, the assessee has created a capital asset of enduring benefit, therefore, the CIT(A) was fully justified in upholding the action of the Assessing Officer in treating the same as capital expenditure and allowing depreciation on the same.

11. We have considered the rival arguments made by both the sides and perused the orders of the authorities below. We find the Assessing Officer treated the expenditure of Rs.46,93,531/- incurred by the assessee as research and development charges as

capital in nature as against revenue in nature treated by the assessee on the ground that the design procured by the assessee company will be beneficial to the assessee for more than one year. We find the Id.CIT(A), relying upon the decision of the Hon'ble Delhi High Court in the case of J.K. Synthetics Ltd. (supra) upheld the action of the Assessing Officer. It is the submission of the Id. counsel for the assessee that the assessee is an existing company engaged in the business of manufacturing and trading of pharmaceuticals and it has not made any investment in the initial outlay of business and has not made any payments for purchase of any plant or other similar assets. It is also the argument of the Id. counsel for the assessee that in view of the decision of the Hon'ble Delhi High Court in the case of Priya Village Roadshows Ltd. (supra), the expenditure incurred for preparation of feasibility report of a new project which is in respect of same business already carried on by the assessee, even if it is for expansion of business, namely, to start a new unit which is same as earlier business and there is unity of control and common fund, then, such expenditure has to be treated as a revenue expenditure.

12. We find merit in the above argument of the Id. counsel for the assessee. It is an admitted fact that the assessee was already in the business of manufacturing and trading of pharmaceuticals. Similar expenditure was incurred in the two preceding assessment years also. From the copy of the assessment order for assessment year 2009-10 passed u/s 143(3) on 5th December, 2011, a copy of which is placed at page 69-75 of the paper book, we find the Assessing Officer has not made any addition by

treating the expenditure of Rs.20,59,826/- as capital in nature. Similarly, in the assessment year 2010-11, although the assessee has claimed similar expenditure, no addition has been made even though the order is passed u/s 143(1). There is nothing on the record to suggest that action u/s 147 or 263 have been initiated for the two preceding assessment years. The expenditure incurred is also not doubted by the Revenue and the same has been incurred in the regular course of business i.e., for the purpose of manufacturing pharmaceuticals. We find an identical issue had come up before the Hon'ble Delhi High Court in the case of Priya Village Roadshows Ltd. (supra). In that case, the assessee-company, which was already involved in the business of running cinemas, was pursuing owners of a cinema hall for taking over the cinema for conversion into a multiplex and operation and management thereof. In order to carry out technical and financial feasibility, the assessee availed services of an architect and paid him certain amount as fee in the preceding year. However, the project was not found to be financially and technically viable. The assessee, therefore, decided to drop the project and amount spent was claimed as revenue expenditure. Similarly, there was another proposal before the assessee to take over one single screen cinema for the purpose of conversion into a four-screen cinema complex. Detailed technical feasibility was carried out and building plans were prepared with the help of engineers and architects, who were paid remuneration. On subsequent market research, the assessee preferred to retain single-screen cinema and proposal of conversion of the said cinema into a multiplex was shelved. That expenditure was also claimed as revenue expenditure by the assessee. The revenue authorities held such

expenditure to be capital expenditure on the ground that expenses were incurred for creating new assets. On appeal, the Tribunal held that the expenses on new project development were allowable as business expenditure under section 37. The Revenue filed appeal before the Hon'ble High Court and the High Court decided the issue in favour of the assessee and against the Revenue by observing as under:-

“10. A harmonious reading of the aforesaid two judgments of this Court, namely, Triveni Engg. Works Ltd. (supra) on the one hand and Modi Industries (supra) on the other, would clearly demonstrate that one has to keep in mind the essential purpose for which such an expenditure is incurred. If the expenditure is incurred for starting new business which was not carried out by the assessee earlier, then such expenditure is held to be of capital nature. In that event it would be irrelevant as to whether project really materialised or not. However, if the expenditure incurred is in respect of the same business which is already carried on by the assessee, even if it is for the expansion of the business, namely, to start new unit which is same as earlier business and there is unity of control and a common fund, then such an expense is to be treated as business expenditure. In such a case whether new business/asset comes into existence or not would become a relevant factor. If there is no creation of new asset, then the expenditure incurred would be of revenue nature. However, if the new asset comes into existence which is of enduring benefit, then such expenditure would be of capital nature.

11. When we keep in mind the aforesaid fine distinction, the conclusion on the facts of this case becomes obvious. The expenditure was incurred in respect of same business which is already carried on by the assessee. Two projects which were undertaken were for the expansion of same business, namely, one for taking over Savitri Cinema for conversion into multiplex and operation and management thereof and other for conversion of Priya Cinema into four-screen multiplex. Payments were made to the consultants for preparing feasibility reports in respect of both the projects. However, ultimately projects were not found to be financially and technically viable and were shelved. Thus, we find that no new asset came into existence, which was the basis adopted by the AO for treating the expenditure as capital expenditure but wrongly.

12. In the present case both the ingredients are satisfied, namely :

- (i) the feasibility study conducted by the assessee was for the same and existing business with a common administration and common fund, and
- (ii) the study was abandoned, without creating any new asset.

13. We note two judgments of other High Courts taking this view in identical circumstances. One case is decided by Gauhati High Court which is reported as Dy. CIT vs. Assam Asbestos Ltd. (2003) 185 CTR (Gau) 223 : (2003) 263 ITR 357 (Gau). In that case the assessee was in the business of manufacturing asbestos sheets. Contemplating to set up a mini cement plant, which was the same line of business activity of the assessee, a feasibility report was prepared. However, the project could not be undertaken as Government refused to grant required permission. The Court opined that no new capital asset came into existence and the expenses incurred on preparation of the feasibility report, same line of business, were in the nature of revenue expenditure. Rajasthan High Court had also occasion to deal with this issue in the case of Maharaja Shri Umaid Mills Ltd. vs. CIT (1988) 68 CTR (Raj) 187 : (1989) 175 ITR 72 (Raj). There also the expenditure incurred in obtaining survey and feasibility report for setting up polyethylene plant for manufacturing packing material was treated as revenue expenditure as the new venture was interconnected and formed part of existing business.

14. In these circumstances, we answer the question in the affirmative, i.e., against the Revenue. As a consequence, this appeal is dismissed.”

13. Since the assessee in the instant case was already in the business of manufacturing and trading of pharmaceuticals and the expenditure was incurred in the regular course of business i.e., for the purpose of manufacturing pharmaceuticals, therefore, no new asset is being developed and the expenditure in our opinion has to be treated as revenue in nature. The order of the CIT(A) on this issue is accordingly set aside and the ground raised by the assessee is allowed.

14. In the result, the appeal filed by the assessee is allowed.

The decision was pronounced in the open court on 16.04.2019.

Sd/-
(KULDIP SINGH)
JUDICIAL MEMBER

Sd/-
(R.K. PANDA)
ACCOUNTANT MEMFBER

Dated: 16th April, 2019

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Copy forwarded to

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asstt. Registrar, ITAT, New Delhi