IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE

BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER
AND
Ms. PADMAVATHY S, ACCOUNTANT MEMBER

IT(TP)A No.611/Bang/2021
Assessment year : 2016-17

Novo Nordisk India Pvt. Ltd., Plot No.32, 47-50, EPIP Area, Whitefield, Bangalore- 560 066. **PAN: AAACN 7425M**	Vs.	The Additional/Joint/ Deputy/Assistant Commissioner of Income Tax/ITO, National Faceless Assessment Centre, Delhi.
APPELLANT		RESPONDENT

Appellant by	:	Smt. Shreya Loyalka, CA
Respondent by	:	Shri Muzaffar Hussain, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	04.08.2022
Date of Pronouncement	:	10.08.2022

O R D E R

Per Padmavathy S., Accountant Member

This appeal by the assessee is against the order of the AO, National Faceless Assessment Centre, Delhi passed u/s. 143(3) r.w.s. 144C(13) dated 20.9.2021 for the assessment year 2016-17.

2. The assessee raised grounds pertaining to the following issues:-

(i) Disallowance of discount expenses (Ground Nos. 4 to 7)
(ii) Disallowance of ESOP expenses (Ground Nos. 8 to 10)
(iii) Non-granting of deduction u/s. Chapter VIA (Ground 11)

(iv) Transfer Pricing matters (Grounds 12 & 13)
(v) Education cess & Secondary high education cess (Ground 16)

3. Grounds No.1 to 3 are general in nature and do not warrant separate adjudication. Ground Nos. 14 & 15 are consequential. Ground No.16 is not pressed in the light of statutory amendments. Hence these grounds are dismissed as such.

4. The assessee is engaged in the marketing and distribution of diabetes care products, growth hormone products and Haemostasis related products. The assessee filed the return of income for AY 2016-17 on 29.11.2016 returning an income of Rs.37,89,21,500. The case was selected for scrutiny and notice u/s. 143(2) was served on the assessee. Since the assessee had international transactions with its Associated Enterprises (AEs), reference was made to the Transfer Pricing Officer [TPO], who made a TP adjustment of Rs.93,44,92,380. The AO passed a draft assessment order incorporating the TP adjustment, besides making disallowance of ESOP expenses and discount expenses. The assessee raised objections before the DRP, who confirmed the order of the AO. Consequently final assessment order was passed, against which assessee is in appeal before the Tribunal.

Disallowance of discount/rebate/sales commission u/s. 40(a)(ia)

5. The assessee is engaged in marketing, purchase and distribution of insulin and related products in India. The assessee does marketing and distribution of pharmaceutical products in India through third party distributors viz., Abbott India Ltd. and Med India Ltd. on a principal to principal basis wherein the distributors purchase the products from the assessee and onward sell the products to various stockists/retailers etc. During the year under consideration, the assessee has debited a sum of

Rs.39,68,93,620 under the head 'discounts'. The assessee was asked to submit the details of the same by the AO. The AO examined the agreements entered into by the assessee with the third party distributors and upon analysing the various clauses of the agreements came to the conclusion that the payments made by the assessee to the distributors is not in the form of 'discount' instead it is "sales commission". Accordingly the AO was of the view that tax has to be deducted at source from the commission u/s. 194H. Since the assessee has not deducted the tax at source, the AO made a disallowance of 30% of the amount debited to the P&L account amounting to Rs.11,90,68,086 (i.e. 30% of Rs.39,68,93,620) u/s. 40(a)(ia). The DRP confirmed the disallowance made by the AO.

6. Before us, the ld. AR submitted additional evidence with regard to the following :-

(i) Detailed break up of discount amount / rebate/sales commission debited to P&L account.
(ii) Details of TDS on sales commission with copies of Form 16A.
(iii) Copies of Form 26A evidencing inclusion of discount income/rebate by the distributors – Abbott India & Med India.

7. The ld. AR prayed submitted that various arguments were raised before the lower authorities that the payments made by the assessee is a 'discount' and not 'commission' since the relationship between the assessee and the distributors is on a principal-to-principal basis. The additional evidence would substantiate that no disallowance u/s. 40(a)(ia) is warranted even if the TDS provisions are applicable on these payments. Further he submitted that the evidence of tax deduction wherever applicable and details of Form 26A was submitted before the DRP which was not taken into consideration. He therefore prayed for admission of additional evidence.

8. The ld. DR objected to the admission of additional evidence and relied on the orders of the lower authorities.

9. We have considered the rival submissions and perused the material on record. The additional evidence now submitted goes to the root of the issue and therefore for proper adjudication of the issue and in the interest of substantial justice, the additional evidence is admitted and taken on record.

10. In the additional evidence, the ld. AR submitted the break up details of the discount which is reproduced below:-

Sl. No	Particulars	Amount (INR)	Amount (INR)
1	Sales commission on which TDS is deducted under section 194H (list of Form 16A in relation to deduction **of TDS** enclosed as **Annexure 2**)		6,70,70,460
2	Discount amount/ rebate/ credit notes to distributors		
	Abbott India Limited		
	- Discount on account of early payment	16,00,51,562	
	- Credit notes on account of breakage & expired products	10,39,75,885	26,40,27,447
	Form 26A from Abbott India for Rs. 26,40,27,447 enclosed as Annexure **3**		
	Med India		
	- Credit notes for onward discount given to institutional buyers		3,42,53,413
	Form 26A from Med India for Rs. 3,42,53,413 enclosed as Annexure 3		
3	**Other entries/ transactions**		
	Ineligible input service tax/ VAT credit written off	89,30,210	
	Year end provision on sales commission on which TDS deducted and deposited in subsequent year	84,13,454	
	Year end accrual for breakage & expired products	1,89,93,073	
	Reversal of excess accrual/ provision	-50,00,000	
	Other discount/ rebate/ credit notes issued	2,05,563	3,15,42,300
	Amount debited to P&L account		**39,68,93,620**

11. With regard to sales commission (sl.no.1) above, it is submitted that tax has been duly deducted and Form 16A to substantiate the same. Regarding the discount amount (sl.no.2), it was submitted that Form 26A supports the claim that the payees have included the payments in their total income and tax has been duly paid. In connection with other entries

(sl.no.3), the ld. AR submitted that ineligible VAT/Service tax were written off in the normal course of business. With regard to year end provision, he submitted that these are reversed in the subsequent year when tax is deducted. The breakage and expired products are written off as these products are no longer saleable.

12. In the light of the above submissions and evidence, we are of the considered view that the additional evidences were not examined by the revenue and therefore the issue needs to be look at afresh by the AO. We therefore remit the issue back to the AO to consider the additional evidence and examine the issue afresh and decide the allowability in accordance with law. Needless to say that the assessee be given an opportunity of being heard. This ground is allowed for statistical purposes.

Disallowance of ESOP

13. The assessee has incurred an expense of Rs.3,23,11,416 in connection with Employee Stock Option (ESOP] offered to the eligible employees of the assessee. The AO disallowed the same on the ground that ESOP expenditure is fictitious and notional in nature. The DRP confirmed the order of the AO.

14. The ld. AR submitted that ESOP is offered by Novo Nordisk A/S, the parent company of the assessee with a view to motivate and encourage employee retention and to compensate employees dedication and efforts. The impugned expenditure offered to employees is recharged by the parent company to the assessee and accordingly is eligible for deduction u/s. 37 of the Act. He relied on the decision of the coordinate Bench of this Tribunal in assessee's own case for AY 2006-07 reported in 63 SOT 242 (Bang. Trib.) and also on the following cases:-

(i) Biocon Ltd. [2020] 121 Taxmann 351 (Kar)

(ii) People Strong HR Services (P) Ltd. [2022] 134 taxmann.com 351 (Del Trib.)
(iii) Accenture Services P. Ltd. [ITA No.4545/Mum/2008]

15. The ld. AR also drew our attention to the fact that the DRP in AYs 2012-13 & 2013-14 has allowed the ESOP expenses by placing reliance on the decision of the Tribunal in assessee's own case for AY 2006-07 (supra).

16. The ld. DR relied on the orders of the DRP.

17. We have considered the rival submissions and perused the material on record. We notice that the coordinate Bench of this Tribunal in assessee's own case for AY 2006-07 has considered the issue of ESOP expenditure and held that –

> "18. We have considered the rival submissions. It is clear from the facts on record that there was an actual issue of shares of the parent company by the assessee to its employees. The difference, between the fair market value of the shares of the parent company on the date of issue of shares and the price at which those shares were issued by the assessee to its employees, was reimbursed by the assessee to its parent company. This sum so reimbursed was claimed as expenditure in the profit & loss account of the assessee as an employee cost. The law by now is well settled by the decision of the Special Bench of the ITAT Bangalore in the case of Biocon Ltd. v. Dy. CIT [2013] 35 taxmann.com 335 and other connected appeals, by order dated 16.07.2013, wherein it was held that expenditure on account of ESOP is a revenue expenditure and had to be allowed as deduction while computing income. The Special Bench held that the sole object of issuing shares to employees at a discounted premium is to compensate them for the continuity of their services to the company. By no stretch of imagination, we can describe such discount as either a short capital receipt or a capital expenditure. It is nothing but the employees cost incurred by the company. The substance of this transaction is disbursing compensation to the employees for their

services, for which the form of issuing shares at a discounted premium is adopted.

19. In the present case, there is no dispute that the liability has accrued to the assessee during the previous year. The only question to be decided is as to whether it is the expenditure of the assessee or that of the parent company. We are of the view that the observations of the CIT(A) in para 5.6 of his order that these expenses are the expenses of the foreign parent company is without any basis and lie in the realm of surmises. The foreign parent company has a policy of offering ESOP to its employees to attract the best talent as its work force. In pursuance of this policy of the foreign parent company, allowed its subsidiaries/affiliates across the world to issue its shares to the employees. As far as the assessee in the present case which is an affiliate of the foreign parent company is concerned, the shares were in fact acquired by the assessee from the parent company and there was an actual outflow of cash from the assessee to the foreign parent company. The price at which shares were issued to the employees was paid by the employee to the Assessee who in turn paid it to the parent company. The difference between the fair market value of the shares of the price at which shares were issued to the employees was met by the Assessee. This factual position is not disputed at any stage by the revenue. In such circumstances, we do not see any basis on which it could be said that the expenditure in question was a capital expenditure of the foreign parent company. As far as the assessee is concerned, the difference between the fair market value of the shares of the parent company and the price at which those shares were issued to its employees in India was paid to the employee and was an employee cost which is a revenue expenditure incurred for the purpose of the business of the company and had to be allowed as deduction. There is no reason why this expenditure should not be considered as expenditure wholly and exclusively incurred for the purpose of business of the assessee.

20. We fail to see any basis for the observation of the CIT(A) that the obligation to issue shares at a discounted price to the employees of the Assessee was that of the foreign parent company and not that of the Assessee. Admittedly, the shares were issued to employees of the Assessee and it is the Assessee

who has to bear the difference in cost of the shares. The expenditure is necessary for the Assessee to retain a health work force. Business expediency required that the Assessee incur such costs. The parent company will be benefitted indirectly by such a motivated work force. This will be no ground to deny the deduction of a legitimate business expenditure to the Assessee as laid down by the Hon'ble Supreme Court in the case of Sassoon J. David& Co. (P.) Ltd. (supra).

21. The reference by the CIT(A) to the provisions of Sec.40A(2)(b) of the Act is again without any basis. The price of the shares of NNAS is arrived at by applying the average market price for the period 3rd October, - 17the October, 2005 in the Copenhagen Stock Exchange. The price so arrived at and the price at which shares are issued to the employees of the Assessee is the benefit which the employees get under the ESOP. The Assessee or its parent company can never influence the stock market prices on a particular date. There is no evidence or even a suggestion made by the CIT(A) in his order. There is no basis to apply the provisions of Sec.40A(2)(b) of the Act.

22. With regard to the decision of the ITAT in the case of Accenture Services (P.) Ltd. (supra), we find that the facts of the case of Accenture Services (P.) Ltd. (supra)are identical. In the case of Accenture Services (P.) Ltd. (supra), the facts were that the assessee company incurred certain expenses on account of payments made by it for the shares allotted to its employees in connection with the ESPP. The AO had disallowed Rs. 9,06,788/- incurred by the assessee on the ground that this expenditure is not the expenditure of assessee company but that expenditure is of parent company and the benefit of such expenditure accrues to the parent company and not assessee. The CIT(A) deleted the addition made by the AO. The CIT(A) found that the common shares of Accenture Ltd. the parent company, have been allotted to the employees of ASPL, the Indian affiliate/Assessee and not to the employees of the parent company. The CIT(A) also found that though the shares of the parent company have been allotted, the same have been given to the employees of the Assessee at the behest of the Assessee. The CIT(A) thus held that it was an expense incurred by the assessee to retain, motive and award its employees for their hard work and is akin to the salary costs of

the assessee. The same was therefore business expenditure and should be allowable in computing the taxable income of the assessee. The tribunal upheld the view of the CIT(A). It can be seen from the decision in the case of Accenture Services (P.) Ltd. (supra) that the shares of the foreign company were allotted and given to the employees of affiliate in India at the behest of the affiliate in India. The CIT(Appeals), however, presumed that the facts in the instant case of the assessee was that the shares were allotted to the employees of the affiliate in India at the behest of the foreign company. This is not the factual position in the assessee's case, as the assessee had on its own framed the NNIPL ESOP Scheme, 2005, to benefit its employees. NNAS may have a global policy of rewarding employees of affiliates with its shares being given at a discount and that policy might be the basis for the Assessee to frame ESOP. That by itself will not mean that the ESOP was at the behest of the parent company. In any event the immediate beneficiary is the Assessee though the parent company may also be indirect beneficiary of a motivated work force of a subsidiary. We are of the view that the factual basis on which the CIT(Appeals) distinguished the decision of the Mumbai Bench of ITAT in the case of Accenture Services (P.) Ltd. (supra) is erroneous.

23. With regard to the observations of the CIT(Appeals) that the ESOP actually benefits only the parent company, we are of the view that the expenditure in question is wholly and exclusively for the purpose of the business of the assessee and the fact that the parent company is also benefited by reason of a motivated work force would be no ground to deny the claim of the assessee for deduction, which otherwise satisfies all the conditions referred to in section 37(1) of the Act. The decision of the Hon'ble Supreme Court in the case of Sassoon J. David & Co. (P)Ltd. (supra) and the Hon'ble Karnataka High Court decision in the case of Mysore Kirloskar Ltd. (supra) clearly support the plea of the assessee in this regard.

24. We are of the view that in the facts and circumstances of the present case, the expenditure in question was wholly and exclusively for the purpose of the business of the assessee and had to be allowed as deduction as a revenue expenditure.

> 25. For the reasons given above, we direct the expenditure be allowed as deduction."

18. Respectfully following the above decision of the Tribunal, we hold that the ESOP expenditure is incurred for the purpose of business and therefore eligible for deduction u/s. 37 of the Act. The disallowance in this regard is therefore deleted. The ground of the assessee is allowed.

Transfer Pricing adjustment

19. The assessee has entered into bilateral APA with the CBDR on 26.6.2020 for the international transactions undertaken with its AEs whereby the year under consideration is covered under a rollback period. Accordingly, the assessee filed a modified return giving effect to the margins agreed as per APA. The TPO passed an order giving effect to the DRP directions in this regard with the following observations:-

> "Since all the transactions are covered under APA, all the above mentioned adjustments made by the TPO amounting to Rs. 93,44,92,380/- are also fall under the ambit of APA.
>
> 4.5 It is found that the taxpayer has filed the modified return for the AY 2016-17 on 29.09.2020 (Acknowledgement No. 597099891290920), which is the year under consideration. Hence, the taxpayer has filed the modified return within 3 months from the end of the month in which APA has been signed.
>
> 4.6 It is also found that the taxpayer has filed the modified return for the FY 2016-17 (AY 2017-18), which is the first of the previous years for which the agreement has been requested for in the application, on 29.09.2020 (Acknowledgement No. 597193511290920).
>
> The taxpayer has informed that the payment of additional taxes as per the APA has been made while the modified return was filed for AY 2016-17.

> 4.8 The taxpayer has mentioned that all the appeals pending before the appellate bodies have been withdrawn regarding the covered transactions as per APA, for all the assessment years covered under APA, for which appeals had been filed earlier. For the AY 2013-14 & AY 2014-15, appeals were withdrawn by the taxpayer regarding the matters covered under APA. No other appeals are pending for the covered years before any appellate body in these matters.
>
> 4.9 Hence the Assessing Officer is kindly requested to complete the assessment proceedings for the AY 2016-17, in the lights of above facts and in accordance with the section 92CD(4) of the Income Tax Act and Rule No. 10RA of the Income Tax Rules."

20. The ld. AR submitted that the AO in the final assessment order has considered the income as per modified return, but has inadvertently added the TP adjustment of Rs.93.44 crores. He submitted that the TP adjustment is covered by the APA and that the assessee has filed the modified return and hence the addition towards TP adjustment is erroneous. It is also submitted that a petition for rectification in this regard is filed on 11.10.2021 before the AO, but no response is received till date.

21. We have considered the rival submissions and perused the material on record. We notice that the assessee has filed a modified return [at pg. 297 to 331 of PB] with an enhanced income of Rs.67,91,30,400 giving effect to the margins agreed in APA; as against the original return at Rs.37,89,21,500 [pg.332 of PB]. The AO in the final assessment order has taken the total income as per modified return, but has added the TP adjustments once again [pg.11 of AO's order]. Considering the fact that the TP adjustment is covered by the APA, the AO's computation is not correct. We therefore direct the AO to rectify the mistake deleting the TP adjustment.

Non-grant of deduction u/s. 80G

22. The assessee claimed a sum of Rs.18,33,75,000 being 50% of eligible donations made during the year under consideration u/s 80G of the Act. The AO in the final assessment order considered the total income as per modified return after deduction u/s. 80G, but in the computation sheet he has considered the same as NIL thereby not allowing 80G deduction to the assessee. The ld. AR therefore prayed for a direction in this regard.

23. On perusal of the final assessment order, we find that the AO has considered the total income after Chapter VIA deduction at Rs.67,91,30,400 after considering 80G deduction at Rs.18,33,75,000. However, in the computation sheet the deduction under Chapter VI is at NIL. We direct the AO to consider the 80G deduction appropriately. This ground of the assessee is allowed.

24. In the result, the appeal by the assessee is partly allowed.

Pronounced in the open court on this 10th day of August, 2022.

Sd/-	Sd/-
(GEORGE GEORGE K.)	(PADMAVATHY S.)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Bangalore,
Dated, the 10th August, 2022.
/*Desai S Murthy* /

Copy to:
1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.