IN THE INCOME TAX APPELLATE TRIBUNAL
"F" BENCH, MUMBAI

BEFORE SHRI. B.R. BASKARAN, ACCOUNTANT MEMBER AND
SHRI. SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA no.1271/Mum./2024
(Assessment Year :2018–2019)
&
ITA no. 1270/Mum./2024
(Assessment Year :2021–2022)

DCIT (CC)-2(4)
802, 8th Floor, Old CGO Annexe Building, M.K. Road, Marine Lines, Mumbai – 400020. ……………. Appellant

v/s

Macleods Pharmaceuticals Limited
304 Atlanta Arcade, Marol Church Road, Andheri East, Mumbai – 400059. ……………. Respondent
PAN-AAACM4100C

Assessee by :Shri Ashok Bansal
Revenue by :Shri. Ankush KapoorCITDR

Date of Hearing – 02/09/2024	Date of Order – 10/10/2024

O R D E R

PER SANDEEP SINGH KARHAIL, J.M.

The present appeals have been filed by the Revenue challenging the common impugned order dated 15/01/2024 passed under section 250 of the Income Tax Act, 1961 ("*the Act*") by the learned Commissioner of Income Tax (Appeals)-48, Mumbai, ["learned CIT(A)"], for the assessment years 2018-19 and 2021-22.

2. Since both appeals pertain to the same assessee and involve a similar issue arising out of a similar factual matrix, these appeals were heard together and are being decided by way of this consolidated order. With the consent of the parties, the Revenue's appeal for the assessment year 2018-19 is taken up as a lead case and the decision rendered therein shall be applicable *mutatis mutandis* to the appeal for the assessment year 2021-22. The Revenue has raised similar grounds in both appeals, therefore the ground raised in ITA no.1271/Mum./2024is reproduced as follows:–

> *"Whether on the basis of facts and circumstances of the case and in law, the Ld.CIT(A) has erred in holding that allocation of R & D expenditure by the Assessing Officer among 801E units and non 801E units on the basis of percentage of sales of respective units to the total sales is baseless and totally unwarranted, considering that no evidence was produced by the assessee company to justify that expenditure incurred on R&D had no nexus with the products manufactured in the 801E units."*

3. The sole grievance raised by the Revenue is against the deletion of the allocation of Research and Development (R&D) expenditure to the units eligible for deduction under section 80-IE of the Act.

4. The brief facts of the case pertaining to this issue, as emanating from the record, are: The assessee is engaged in the business of manufacturing and dealing in pharmaceutical products, namely tablets, capsules, liquids, injectables, etc. For the assessment year 2018-19, the assessee filed its return of income on 29/11/2018 declaring a total income of Rs.274,07,25,380. The return filed by the assessee was selected for scrutiny and statutory notices under section 143(2) and section 142(1) of the Act were issued and served on the assessee. During the year under

consideration, the assessee claimed a deduction in respect of manufacturing units at Sikkim under section 80-IE of the Act. During the assessment proceedings on perusal of the details furnished by the assessee, it was noticed that the assessee has claimed a weighted deduction under section 35(2AB) of the Act on account of R&D expenses. Accordingly, the assessee was asked to show cause as to why the R&D expenses should not be allocated to various manufacturing units including the units eligible for deductions under section 80-IE of the Act. In response, the assessee submitted that the assessee's R&D activities are not directly related to the manufacturing units as the R&D division is working on future products and future innovations and launches and not present products manufactured by the manufacturing units. Accordingly, it was submitted that R&D expenditure has no relevance to the working of the qualifying undertakings and the said expenditure is on futuristic research and the result of research is always uncertain. Thus, it was submitted that none of the items of research was forming part of the qualifying undertakings. The Assessing Officer ("*AO*") vide order dated 06/04/2021 passed under section 143(3) of the Act did not agree with the submissions of the assessee and held that the assessee has not submitted any substantive supporting reasons and documents to establish beyond doubt that the future products and future innovations will not be manufactured in the exempted units during the year under consideration. It was further submitted that there is also no documentary evidence available to prove that the amount spent on research to improve upon its existing products to compete in the market and also to bring in new

enhancement to the existing category of products has not been done from the standalone R&D centres.The AO further held that as a result of research and development work carried out by the assessee, it has benefited by way of better acceptability by customers and the development of bulk drugs that were earlier imported by the assessee company. The AO also held that the research expenditure incurred by the assessee is inextricably linked with the business of the assessee, including the business relating to products that are manufactured in the units entitled to deductions under Chapter VIA of the Act. Accordingly, the AO concluded that it would be logical to allocate an appropriate part of the expenditure to various units for computing the profits derived from an eligible unit for the purpose of deduction under section 80-IE of the Act. As a result, the allowable deduction under section 80-IE of the Act was reduced by Rs. 80,46,24,067.

5. The learned CIT(A), vide impugned order, following the judicial precedents in the case of the assessee for the assessment years 2009-10 and 2010-11 allowed the ground raised by the assessee on this issue. The relevant findings of the learned CIT(A) are reproduced as follows: –

> *"7. In Ground No. (2), the appellant has contested the action of the AO in makingaddition of Rs. 80,46,24,067/- on account of disallowance of deduction claimed u/s.80IE of the Act.*
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> *7.1 I have carefully considered the relevant and material facts on record, in respect of the issue raised in these Grounds of appeal, as brought out in the assessment order and submissions made during appeal proceedings. During theappellant proceedings, the appellate has submitted that on the same issue ofapportionment of R&D expenditure between eligible units and non-eligible units, the Hon'ble ITAT has allowed the appeal in appellant's own case for AY 2009-10 in ITA No. 7167/ MUM/2017 dated 14.09.2021. The relevant findings of Hon'ble ITAT, at para 21 of the appellate order, are reproduced as under:*

> *"21. Following the above decision, we hold that the allocation of R & D expenditure by the assessing officer among 80IB and 80IC units and non 80IB and 80IC units on the basis of percentage of sales of respective units to the total sales is baseless and totally unwarranted. Thus, we direct the Assessing Officer to recompute the income under normal provisions of the Act without any allocation of R& D expenditure among 80IB/80IC and non 80IB/80IC units."*

7.2 Further, following above decision, the ITAT has allowed the appeal of the appellant in ITA No. 7770/ Mum/2019 dated 10.05.2022 for AY 2010-11 also on similar issue.

7.3 Respectfully following the decision of the ITAT, in appellant's own case in earlier assessment years, this issue is decided in favour of the appellant.Accordingly, this ground of appeal is allowed."

Being aggrieved, the Revenue is in appeal before us.

6. During the hearing, the learned Authorised Representative ("*learned AR*") submitted that the issue under consideration had been decided in favour of the assessee by the Tribunal in the preceding assessment years. Further in order to substantiate its claim that none of the products developed in its R&D unit were manufactured in the Sikkim unit, which is entitled to claim deduction under section 80-IE of the Act during the year under consideration, the learned AR placed on record an affidavit executed by the Managing Director of the assessee company. Along with the affidavit, the assessee has also annexed a list of products developed in the R&D centre during the relevant financial year. Further, vide its submission dated 02/09/2024, the assessee also placed on record the list of products manufactured in the eligible Sikkim unit. Accordingly, based on the aforesaid documents, the learned AR submitted that none of the products manufactured in the Sikkim unit were developed in the R&D centre during the year under consideration.

7. On the contrary, the learned Departmental Representative submitted that during the assessment proceedings, the assessee did not submit any substantive supporting documents to establish that the products developed in the R&D unit will not be manufactured in the exempted units during the year under consideration.

8. We have considered the submissions of both sides and perused the material available on record. The assessee is a pharmaceutical manufacturer and has a total of 8 manufacturing facilities, namely 5 in Daman, one each in Palghar, Sarigam and Baddi. The assessee's Baddi unit is eligible for deduction under section 80-IC and the Sikkim unit is eligible to claim deduction under section 80-IE of the Act. Further, the assessee also has two R&D centres at Andheri East, Mumbai which are both approved by the Department of Scientific and Industrial Research. As per the assessee, its corporate policy requires it to spend about 5% of its gross revenue on R&D for the purpose of development of new ideas and drugs. Further, its R&D units are housed in separate buildings and are standalone, independent units having separate financial statements. As per the assessee, its R&D activities are not directly related to its manufacturing units as the R&D division is working on future products and future innovations and launches, not present products manufactured by the manufacturing units. Hence, the R&D expenditure has no relevance to the working of the qualifying undertakings during the year under consideration. As is evident from the record, the Revenue did not agree with the submissions of the assessee and

treated the R&D expenditure to be inextricably linked with the business of the assessee including the business relating to the products that are manufactured in the unit for which deductions were claimed under section 80-IE of the Act.

9. In order to substantiate its claim that the products developed in its R&D units are different from the products manufactured in the eligible units during the year under consideration, the assessee has placed on record the list of products. From the perusal of the lists placed on record by the assessee in respect of the products developed in the R&D centre during the year under consideration, we find that the same is completely unrelated to the list of products manufactured and sold by the Sikkim unit of the assessee (eligible unit under section 80-IE). Moreover, it is pertinent to note that products in the R&D undergo a process of 6 to 10 years before these formulations or drugs undergo manufacturing at the eligible unit. This aspect is equally important to any improvement in the existing products or any enhancement to the existing category of products as the same requires years of testing and multiple approvals/accreditations by the concerned department/authority for mere change in the composition of the medicine. It is pertinent to note that pharmaceutical products cannot be equated with any other off-the-shelf products since they require years of testing before the commercial launch and that too if the development is successful. Thus, we find no merit in the findings of the AO that the products developed in the R&D unit were manufactured in the eligible units during the year under consideration. Even though the research expenditure may have some

linkage with the products ultimately manufactured in the eligible units, however the same cannot lead to the conclusion that the expenditure incurred on R&D during the year under consideration is for the products manufactured in the eligible units during the year under consideration. Thus, we find no basis in the general assumption adopted by the AO while allocating R&D expenditure for computing the deduction claimed under section 80-IE of the Act.

10. We find that a similar issue has been coming up for consideration before the coordinate bench of the Tribunal in the assessee's own case for the preceding years, wherein a similar allocation of R&D expenses was made by the Revenue while computing the deduction under Chapter-VIA of the Act. In the latest order in the assessee's own case for the assessment years 2011-12 and 2012-13, in Macleods Pharmaceuticals Ltd v/s DCIT, in ITA No. 5092 and 5093/Mum./2018, the coordinate bench of the Tribunal while deciding the issue in favour of the assessee observed as follows: –

> *"17. We have heard rival submission of the parties on the issue indispute and perused the relevant material on record. The Ld. CIT(A) has held that research and development carried out with assessee has been applied for manufacturing in units eligible for deduction under section 80IB and 80IC ofAct. Before us the Ld. Counsel of the assessee has filed a detailed list of items manufactured by the units eligible under section 80IB and 80IC of the Act and also the formulations/items underdevelopment in research and development units. Both these lists are placed on record. Further, the rebuttal of the assessee on finding of the CIT(A) is reproduced as under:*
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> > *"One of the purpose of R&D in a company like the Appellant (Macleods) is to develop new variants of formulations from existing resources available in the form of API or bulk drugs. If the existing API or bulk drugs are not used for development of new medicines then more than 98% of pharmaceuticals R&D will stop working and there are multiple number of ingredients which are present in almost all types of medicines. Hence the observation that some of the bulk drugs*

which are already used in eligible units are being tested in R&D for different variant is completely misplaced.

Secondly, we had given details of two activities of R&D before LAO and CIT(A) wherein details bulk drugs developed at R&D and formulations developed at R&D were given. It was clearly mentioned that bulk drugs developed at R&D were used tomanufacture the same at our Sarigam API unit which was not eligible for any tax incentive. Formulations were manufactured at Palghar, Premier, Daman and Baddi units and out of these Baddi unit was an eligible unit for 100% tax incentive. HoweverBaddi unit only manufactured formulations and did not produce any bulk drugs

As regards specific names being given in Appeal order, werespectfully submit as under:

a) Olloxacin: The appellant manufactured tablets containing this API Ofoxacin at its eligible unit. However, there was no agile eialed io any tablet containingOfloxacin at itsR&D unit.

b) Levofloxacin: Our R&D unitwas developing a tabletcontainingLevofloxacinwhichwasapprovedbyregulators but manufacturing of the same did not start.Our eligible unit was manufacturing anoral syrup that contained Levofloxacin. Appellant has been manufacturing this orai syrup since more than 10 years and the R&D unit was not undertaking any activity related to thissyrup.

c) Azithromycin: The appellant manufactured tablets containing this API Azithromycin at its eligible unit.However, there was no activity related to any tablet containing Azithromycin at its R&D unit.

d) Ethionamide:The appellantmanufacturedtabletscontainingthis API Ethionamide at its eligible unit.However, there was no activity related to any similar tablet containing Ethionamide as API at its R&D unit.

e) Rifampicin: The appellant manufactured tablets and capsules containing this APIRifampicin at its non-eligible unit. However, there was no activity related to any similar tablet containing Rifampicin as API at its R&D unit.

f) Isoniazid: The appellant did not manufacture any formulation containing this API at its eligible unit. There was no activity related to any formulationcontaining Isoniazid as API at its R&D unit.

g) Ethambutol: The appellant did not manufacture any formulation containing thisAPI at its eligible unit. There was development effort for a combination drug containing Ethambutol as one of the API at its R&D unit.

h) Paracetamol: The appellant manufactured a tablet having combination of Nimesulide and Paracetamol at its eligible unit. However in R&D we tried to develop a new tablet having Sustained

> *Release (SR) of Paracetamol having 665mg of Paracetamol which was designed tocompletely different fromcombination. However, the LAO has failed to appreciate that the new tablet being developed at R&D was not approved by regular and hence was never manufactured till date."*

18. On perusal of list of products manufactured in eligible units and drug under development and R & D units, we find that products manufactured under the units eligible for 80IB and 801C unit are totally unrelated with the product under development in R&D units. In some cases, variant of formulation like injectable form etc. have been under development in R & D Units, which are different from tablet of same drug manufactured in eligible / non-eligible units. Moreover, in research and development units the formulations or the drugs developed, firstly, undergo a process of 4 to 5 years, before those formulations or drugs undergo manufacturing. From the submission filed before the lower authorities, which have been filed before us also, it is verified that at least in the current assessment year, the research anddevelopment expenditure incurred is not related to the units eligible for deduction under section 80IB and 80IC of the Act.The Ld.CIT(A) has made a general comment that drugs manufactured in exempted unit and research carried out in R&D unit are in respect of the same items. The Ld. CIT(A) has not pointed out as to which drugs or formulation under development in R&D unit has been manufactured by particular unit eligible under 80IB or 80Ic of the Act. Accordingly, the finding of the Ld. CIT(A) being contrary to facts, same are set aside and the disallowance for deduction under Section 80IB and 80IC of the Act corresponding to the allocation of R&D expenditure is hereby deleted."

11. Therefore, in view of the facts and circumstances of the present case as noted above, we find no infirmity in the impugned order passed by the learned CIT(A) in deleting the allocation of R&D expenditure to the units eligible for deduction under section 80-IE of the Act. Accordingly, the impugned order on this issue is upheld and the sole ground raised in the Revenue's appeal for the assessment year 2018-19 is dismissed.

12. Since similar ground has been raised by the Revenue in its appeal for the assessment year 2021-22, our findings/conclusions as rendered in the Revenue's appeal for the assessment year 2018-19 shall apply *mutatis mutandis*. Accordingly, the sole ground raised by the Revenue in its appeal for the assessment year 2021-22 is dismissed.

13. In the result, the appeal by the Revenue for the assessment years 2018-19 and 2021-22 are dismissed.

Order pronounced in the open Court on 10/10/2024

Sd/- **B.R. BASKARAN** **ACCOUNTANT MEMBER**	**Sd/-** **SANDEEP SINGH KARHAIL** **JUDICIAL MEMBER**

MUMBAI, DATED: 10/10/2024