

IN THE INCOME TAX APPELLATE TRIBUNAL “J” BENCH MUMBAI

**BEFORE SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER
AND
SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER**

ITA Nos. 3471 to 3474/MUM/2024

Assessment Years: 2013-14, 2014-15, 2015-16 and 2016-17

Deputy Commissioner of Income Tax, Central Circle -2(4), Mumbai	Vs.	Macleods Pharmaceuticals Ltd., 304, Atlanta Arcade, Marol Church Road, Andheri East, Mumbai-400059 (PAN : AAACM4100C)
(Assessee)		(Respondent)

Present for:

Assessee : Shri Ashok Bansal, CA
Revenue : Shri Pankaj Kumar, CIT DR

Date of Hearing : 10.10.2024
Date of Pronouncement : 28.10.2024

ORDER

PER BENCH:

These four appeals filed by the Revenue are against the orders of Ld. CIT(A)-57, Mumbai, vide order nos. ITBA/APL/S/250/2024-25/1064330361(1), ITBA/APL/S/250/2024-25/1064330672(1), ITBA/APL/S/250/2024-25/1064330873(1) and ITBA/APL/S/250/2024-25/1064330361(1), dated 24.04.2024 passed against the assessment order by Dy. Commissioner of Income-tax, Central Cir.2(4), Mumbai, u/s. 153A r.w.s. 143(3) and 144C(3) of the

Income-tax Act (hereinafter referred to as the “Act”), dated 04.09.2018 for Assessment Years 2013-14, 2014-15, 2015-16 and 2016-17.

2. In all these four appeals, two common grounds are involved which include, first relating to allocation by ld. Assessing Officer of R & D expenditure by the Assessing Officer among 80IB/IC units and non 80IB/IC units on the basis of percentage of sales of respective units to the total sales. The second ground is in respect of transfer pricing adjustment made for specified domestic transactions (SDT) pursuant to clause(i) of section 92BA which was omitted by Finance Act, 2017 w.e.f. 01.04.2017 which the ld. CIT(A) held to be applicable retrospectively by placing reliance on the decision in case of PCIT vs. Texport Overseas Pvt. Ltd. by Hon'ble High Court of Karnataka [2020]114 taxman.com568 (KAR).

3. Since both the issues involved in these four appeals by the Revenue are common, we adjudicate upon them by passing this consolidated order.

4. We first take up appeal for Assessment Year 2013-14 and the observations and findings herein shall apply *mutatis mutandis* to all the other three appeals.

5. Brief facts of the case are that assessee had claimed deduction u/s.80IB amounting to Rs.40,63,14,401/- and deduction u/s.80IC amounting to Rs.293,01,01,173/-. Assessee claimed deduction u/s.80IB in respect of manufacturing plant located at Daman Phase I & II and claimed deduction u/s.80IC in respect of manufacturing plant at Baddi. Assessee claimed weighted deduction u/s.35(2AB) of the Act on Research & Development expenses. Ld. Assessing Officer

apportioned the Research & Development expenses to the manufacturing units including the units eligible for deduction u/s.80IB and 80IC, on the basis of percentage of sales to total sales of the assessee. Id. Assessing Officer was of the view that by incurring Research & Development expenditure, assessee was benefitted by way of better acceptability by consumer and customer is development of bulk drugs. Research & Development expenditure was inextricably linked with the manufacturing business of the assessee. Its research activity improved the existing products to compete in markets and also brought in the existing categories of products. Further, there was no evidence from which it could be established that Research & Development expenditure had no nexus with the products manufactured by eligible units. Therefore, Id. Assessing Officer apportioned Research & Development expenses in the ratio of respective sales of manufacturing units to the total sales of the assessee.

5.1. During the appellate proceedings, assessee submitted that the apportionment of Research & Development expenses to eligible unit by the Id. Assessing Officer was in contrast to the consistent stand taken by the Department in scrutiny assessments for earlier years. Assessee relied upon the decision of the Coordinate Bench of ITAT, Mumbai in its own case for Assessment Years 2009-10, 2010-11, 2011-12 and 2012-13. Assessee further relied upon the decision in the case of M/s. Zandu Pharmaceutical Works Ltd. vs. CIT in ITA No. 8 of 2007 by the Hon'ble Jurisdictional High Court of Bombay. It further submitted that smaller Research & Development facilities at each manufacturing unit carried out R&D activities related to existing products manufactured by that respective units and such R&D expenses were not claimed as weighted deduction. Assessee also submitted the details of year-wise formulation development by R&D department and various products manufactured

by the manufacturing unit to the ld. Assessing Officer during the assessment proceedings. These details indicated that R&D expenditure were totally unrelated to the present manufacturing activity of the assessee. Assessee also relied upon the decision of Hon'ble Supreme Court in the case of CIT vs. Sterling Foods and Pandian Chemicals Ltd. vs. CIT in which it was held that there must be a direct nexus between industrial undertaking and expenses sought to be apportioned. Thus, assessee submitted that the R&D expenses should not be apportioned between the different manufacturing units including units eligible to claim deduction u/s.80IB and 80IC of the Act.

5.2. Assessee submitted a copy of the order of the Coordinate Bench of ITAT, Mumbai for AYs. 2009-10, 2010-11, 2011-12 and 2012-13 in its own case. From perusal of the order, it is seen that the issue has been decided on merits in AY.2009-10 and the same has been followed in subsequent years. While deciding the ground related to apportionment of R&D expenses to various manufacturing units, the Coordinate Bench has held that allocation of R&D expenditure to units eligible for deduction u/s.80IB and 80IC, on the basis of percentage of sales of respective units to the total sales was baseless and totally unwarranted. For ready reference, the relevant para of the order for AY. 2009-10 are reproduced as under:

"19. Coming to allocation of R & D expenses, the assessee contended before the lower authorities that its Research and Development activities are not directly related to its manufacturing units as the research and development divisions is working on future products and future innovation and launches and not for the present products manufactured by the assessee in its units. It was contended that Research and development expenditure had no relevance to the working of qualifying undertakings. Further, R & D expenses are on futuristic research and the result of research is also uncertain. It was also contended that none of the items of the research was forming part of qualifying undertakings and none of the qualifying undertakings thus benefit from the present research. It was also contended that research in the field of biotech or bulk drugs will be wholly unrelated even for theoretical reckoning from impugned qualifying undertakings. Details of products manufactured by the units and products on which R & D is

undertaken were on records which shows that they are completely independent from each other. Assessee placed reliance on the Zandu Pharmaceuticals Works Ltd., v. CIT [350 ITR 366] and various other decisions in support of his contention that R & D expenditure incurred in head office cannot be allocated to the units. We observe from the Assessment Order that the Assessing Officer predominantly stating that R & D expenditure incurred by the assessee is inextricably linked with the business of the assessee including the business relating to products which are manufactured in the units for which deduction u/s. 80IB and 80IC were claimed. However, nothing has been brought on record to suggest that the R & D expenditure incurred by the assessee benefitted the existing units where claims u/s. 801B and 80IC were made. We observe that when the details of products manufactured by the units and products on which R & D is undertaking by the assessee were placed on record before the Assessing Officer to show that they are completely independent from each other, the Assessing Officer completely failed to bring on record that R & D expenditure in fact benefitted the existing units and thereby it is necessary to allocate the R & D expenditure among 801B and 80IC units and non 801B and 80IC units on the basis of percentage of sales on respective units to the total sales. We further observe that even after allocation of expenses among 801B eligible and non-eligible units the taxable income from the assessment under consideration remained the same as the tax was assessed under book profits u/s. 115JB of the Act and not under normal provisions of the Act.

20. Almost identical issue has come up before the Hon'ble Jurisdictional High Court in the case of Zandu Pharmaceuticals Works Ltd., v. CIT (supra) wherein the Hon'ble Bombay High Court held that unless expenditure incurred on research and development work relates to units eligible for deduction under section 80-IA, same cannot be apportioned to the said units. While holding so the Hon'ble Bombay High Court held as under: -

9. There is no dispute that the assessee is entitled to the benefits of the provisions of sections 80HH, 80-1 and 80-IA. Section 80-1 provides that where the gross total Income of an assessee includes any profits and gains derived from an Industrial undertaking, there shall be allowed., in computing the total income of the assessee, a deduction from such profits and gains an amount equal to twenty per cent, thereof. Section 80-IA provides that where the gross total income of an assessee includes any profits and gains derived from any business of an industrial undertaking, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount specified therein. Section 80HH provides that whether the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, there shall be in accordance with law and subject to the provisions of the section be allowed in computing the total income of the assessee a deduction from such profits and gains of an amount equal to 20 per cent, thereof.

10. While computing the profits and gains of the concerned undertaking, only expenses relating thereto can be deducted. In other words, the expenses must be Incurred, for and on behalf of the concerned undertaking. The expenses attributable to any other unit or the head office expenses which have no relevance to the industrial undertaking, cannot be deducted in respect of the said undertaking while computing the profits and gains of the undertaking.

11. In *CIT v. Sterling Foods* [1999] 237 ITR 579/104 Taxman 204 (SC); following question was considered by the Supreme Court (Page 581):

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the receipt from the sale of import entitlements could not be included in the income of the assessee for the purpose of computing the relief under section 80HH of the Income-tax Act, 1961?"

12. The question, therefore, was converse to the one before us. The Supreme Court held as under (page 584):

"Crude petroleum is refined to produce raw naphtha. Raw naphtha is further refined, or cracked to produce the said products. This is not controverted. It seems to us to make no difference that the assessee buys the raw naphtha from others. The question is to be judged regardless of this, and the question is whether the intervention of the raw naphtha would justify the finding that the said products are not 'derived from refining crude petroleum'. The refining of crude petroleum produces various products at different stages. Raw naphtha is one such stage. The further refining, or cracking, of raw naphtha results in the said products. The source of the said products is crude petroleum. The said products must, therefore, be held to have been derived from crude petroleum.

We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government whereunder the export entitlements become available. There must be, for the application of the words 'derived from', a direct nexus between the profits and gains and the industrial undertaking. In the instant case, the nexus is not direct but only incidental. The industrial undertaking exports processed seafood. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to constitute a profit and gain derived from the assessee's industrial undertaking."

13. The Supreme Court held that there must be for the application of the words "derived from" a direct nexus between the profits and gains and an industrial undertaking. Sections 80-1 and 80-IA also use the expression "derived from". If there must be a direct nexus between the profits and gains and an industrial undertaking, it must follow equally that there must be a direct nexus between an industrial undertaking and the expenses which are sought to be apportioned/attributable to it. Expenses which do not relate to an industrial undertaking/unit under consideration and they relate to other units or to the head office of the assessee, cannot be taken into consideration while computing the deduction under the said provisions.

14. Ms. Khan's reliance upon a judgment of the Division Bench of the Madras High Court in *Bush Boake Allen (India) Ltd. v. Asstt. CIT* [2005] 273 ITR 152 is well founded. In that case, the assessee claimed a deduction under sections

80HH and 80-1. The Assessing Officer allocated certain expenditure on research and development pertaining to the Chittoor unit. It was submitted by the assessee that the amount so included did not pertain to the Chittoor unit inasmuch as the research and development undertaken at the Madras unit had no connection with the products manufactured in the Chittoor unit. The Chennai High Court held that the question had not been dealt with by the authorities. It was held that the apportionment of the expenses on the activities of the research and development to the Chittoor unit merely on the presumption that the products manufactured at the Chittoor unit also had the benefit of the research made at the Chennai R & D department, was not proper. It was further held that the authorities had proceeded on the presumption that any technology about new flavours and essences would automatically be utilized in the Chittoor unit without examining whether the R & D carried out in Chennai s of use to the unit at Chittoor. The matter was, therefore, remanded to ascertain whether the R & D undertaken related to the products manufactured in the Chittoor unit.

15. We are in respectful agreement with the judgment, the basis of which is that unless the expenditure incurred on the R & D work relates to the undertaking/unit in question, the same cannot be apportioned to it.

16. Mr. Suresh Kumar submitted that any research and development activity carried out by the head office would automatically ensure to the benefit of the units/industrial undertakings. He submitted that the head office itself does not manufacture any medicines, the benefit of the research and development would be utilized for manufacturing the products and the products would obviously be manufactured by the units.

17. The submissions proceeds on an erroneous basis and does not take into consideration the facts of the case at all. As we noted earlier, in the present case, the said R & D activities were in relation to the new drugs. There is nothing to indicate that in the event of the assessee deciding to commercially exploit the benefits of the R & D work, the products would be manufactured by the said units. The fallacy in the submissions proceeds on the hypothetical basis that the said products would be manufactured by each of the units or any one of them.

18. The fallacy also arises on account of an erroneous presumption that the benefit of any R & D activity can only be exploited by an enterprise utilizing the same in its manufacturing activities. That is not so. An enterprise in always assign the benefit thereof to a third party. It can always grant a licence in respect of any patent or design to a third party. In that event, the other units would not derive any benefit in respect thereof. The resumption of a nexus between the R & D activities and the units is not well founded."

21. Following the above decision, we hold that the allocation of R. & D expenditure by the Assessing Officer among 8018 and 80IC units and non 8018 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 801B/80-IC and non 801B/80IC units."

5.3. In the present case, there is no change in the facts and circumstances regarding apportionment of R&D expenses to various manufacturing units on the basis of the turnover to the respective unit of total sales when compared with the facts and circumstance of AYs. 2009-10 to 2012-13. The Coordinate Bench of ITAT, Mumbai had taken a consistent stand in the case of the assessee in earlier years that R&D expenses were not required to be apportioned to various units, including units eligible to deduction u/s.80IB and 80IC, on the basis of sales of respective units to total sales.

6. Per contra, ld. CIT DR could not bring anything contrary to the submissions made by the assessee.

7. Respectfully, following the decision of the Coordinate Bench of ITAT, Mumbai in the case of the assessee for AYs. 2009-10 to 2012-13 and also there being no material change in the facts and circumstances of the case for the present year, apportionment of R&D expenses by the ld. Assessing Officer on the basis of sales of respective units to total sales, including eligible unit was not warranted. Accordingly, ld. Assessing Officer is directed not to apportion Research & Development expenses to various units including the eligible units claiming deduction u/s.80IB and 80IC on the basis of sales of respective unit to total sales. Ld. Assessing Officer is directed to allow deduction u/s.80IB and 80IC without apportionment of R&D expenses to the eligible units.

8. In the result, ground no.1 of the Revenue is dismissed.

9. For ground no.2, facts of the case are that assessee purchased goods amounting in aggregate to Rs.84.38 crores from Oxallis Labs which is treated to be an Associated Enterprise (AE) of the assessee. A

reference u/s. 92CA was made by the ld. Assessing Officer to the ld. Transfer Pricing Officer (TPO) in respect of these stated specified domestic transaction of trading purchases made by the assessee. Ld. TPO worked an adjustment of Rs.63,59,860/- in respect of arms length price trading purchases made by the assessee from Oxallis Labs. In this respect, assessee contested that clause (i) of section 92BA had been omitted by the Finance Act, 2017 w.e.f. 01.04.2017, i.e., from Assessment Year 2017-18. According to the assessee after this amendment, transaction of purchase of goods from Oxallis Labs are no longer covered by the definition of specified domestic transactions and are therefore outside the purview and scope of section 92CA(3). Assessee placed reliance on the decision of Coordinate Bench of ITAT, Bangalore in the case of Texport Overseas (P) Ltd. vs. DCIT in IT(TP)A No.1722/Bang/2017, dated 22.12.2017 which has been upheld by Hon'ble High Court of Karnataka in the case of PCIT vs. Texport Overseas Pvt. Ltd. (supra). According to the assessee, omission of clause (i) of section 92BA is applicable to the year under consideration which is further fortified by the decision of Coordinate Bench of ITAT, Mumbai in the case of DCIT vs. Hind Aluminium Industries Pvt. Ltd. in ITA No.1904/Mum/2023, dated 30.10.2023.

9. Per contra, ld. CIT DR could not bring anything contrary to the submissions made by the assessee.

10. We have heard both the parties and perused the material on record. Facts in the case of the assessee are similar to decision of Coordinate Bench of ITAT, Mumbai in the case of Hind Aluminium Industries Pvt. Ltd. as well as decision of Hon'ble High Court of Karnataka in the case of Texport Overseas Pvt. Ltd. (supra)

11. In the decision of Hon'ble High Court of Karnataka in the case of Texport Overseas Pvt. Ltd. (supra), it was held that clause (i) of section 92BA having been omitted by Finance Act, 2017 w.e.f. 01.04.2027 from statute, the resultant fact is, it had never been passed and hence decision taken by the ld. Assessing Officer under effect of section 92BA and reference made to ld. TPO u/s. 92CA was invalid and bad in law.

12. The relevant paras of the decision of the Hon'ble High Court of Karnataka are reproduced as under:

"... 5. Having heard learned Advocates appearing for parties and on perusal of records in general and order passed by tribunal in particular it is clearly noticeable that Clause (i) of section 92BA of the Act came to be omitted w.e.f. 01.04.2019 by Finance Act, 2014. As to whether omission would save the acts is an issue which is no more res integra in the light of authoritative pronouncement of Hon'ble Apex Court in the matter of Kolhapur Canesugar Works Ltd. v. Union of India AIR 2000 SC 811 whereunder Apex Court has examined the effect of repeal of a statute vis-a-vis deletion/addition of a provision in an enactment and its effect thereof. The import of section 6 of General Clauses Act has also been examined and it came to be held:

"37. The position is well known that at common law, the normal effect of repealing a statute or deleting a provision is to obliterate it from the statute-book as completely as if it had never been passed, and the statute must be considered as a law that never existed. To this rule, an exception is engrafted by the provisions of section 6(1). If a provision of a statute is unconditionally omitted without a saving clause in favour of pending proceedings, all actions must stop where the omission finds them, and if final relief has not been granted before the omission goes into effect, it cannot be granted afterwards. Savings of the nature contained in section 6 or in special Acts may modify the position. Thus the operation of repeal or deletion as to the future and the past largely depends on the savings applicable. In a case where a particular provision in a statute is omitted and in its place another provision dealing with the same contingency is introduced without a saving clause in favour of pending proceedings then it can be reasonably inferred that the intention of the legislature is that the pending proceedings shall not continue but fresh proceedings for the same purpose may be initiated under the new provision."

6. In fact, Co-ordinate Bench under similar circumstances had examined the effect of omission of sub-section (9) to Section 10B of the Act w.e.f. 01.04.2004 by Finance Act, 2003 and held that there was no saving clause or provision introduced by way of amendment by omitting sub-section (9) of section 10B. In the matter of General Finance Co. v. ACIT, which judgment has also been taken note of by the tribunal while repelling the contention raised by revenue with regard to retrospectivity of section 92BA(i) of the Act. Thus, when clause (i) of Section 92BA having been omitted by the Finance Act, 2017, with effect from

01.07.2017 from the Statute the resultant effect is that it had never been passed and to be considered as a law never been existed. Hence, decision taken by the Assessing Officer under the effect of section 92B1 and reference made to the order of Transfer Pricing Officer-TPO under section 92CA could be invalid and bad in law.

7. It is for this precise reason, tribunal has rightly held that order passed by the TPO and DRP is unsustainable in the eyes of law. The said finding is based on the authoritative principles enunciated by the Hon'ble Supreme Court in Kolhapur Canesugar Works Ltd. referred to herein supra which has been followed by Coordinate Bench of this Court in the matter of M/s. GE Thermometrias India Private Ltd., stated supra. As such we are of the considered view that first substantial question of law raised in the appeal by the revenue in respective appeal memorandum could not arise for consideration particularly when the said issue being no more res integra..."

13. Further, in the case of DCIT vs. Hind Aluminium Industries Pvt. Ltd., similar view was taken by placing reliance on the decision of Coordinate Bench of ITAT Delhi in the case of Yorkn Tech Pvt. Ltd. vs. DCIT in ITA No.635/Del/2021, dated 18.08.2021. In this decision, reliance was placed on the decision of Hon'ble High Court of Karnataka in the case of Texport Overseas Pvt. Ltd. (supra) and various other decisions of Hon'ble Supreme Court to hold that once a provision in the statute has been omitted without any saving clause in the Act, then it is treated as if provisions never existed when such provisions are challenged before the court. Accordingly, reference to ld. TPO for specified domestic transactions were held invalid and no transfer pricing adjustment could be made on such transactions. Therefore, respectfully following the decision of Hon'ble High Court of Karnataka and other referred decisions of the Coordinate Benches, reference made by the ld. Assessing Officer to the ld. TPO with respect to specified domestic transactions u/s.92BA(i) is held to be invalid. Consequent transfer pricing adjustment made by the ld. TPO thus, does not survive. Accordingly, transfer pricing adjustment of Rs.63,59,860/- made in respect of specified domestic transactions on purchases from Oxallis Labs by the assessee is deleted. Ground, thus raised by the Revenue in this respect, is dismissed.

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

15. The result above applies to all the three other appeals, accordingly, all the four appeals of the Revenue are dismissed.

Order is pronounced in the open court on 28 October, 2024

Sd/-
(Pavan Kumar Gadale)
Judicial Member

Sd/-
(Girish Agrawal)
Accountant Member

Dated: 28 October, 2024

MP, Sr.P.S.

Copy to :

- 1 The Assessee
- 2 The Respondent
- 3 DR, ITAT, Mumbai
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BY ORDER,

(Dy./Asstt.Registrar)
ITAT, Mumbai