



PHARMA INDUSTRY

ISSUES IN INCOME-TAX

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Major Issues

- Freebies
- Scientific Research Expense
- Stockist
- Restructuring
- Remuneration to Doctors – 192 v. 194J



FREEBIES

Freebies

■ Chronology of Events –

- **Finance Act 1998** – *Introduction of Explanation to Section 37(1)* – (Circular – 772 of 1998 – protection money, extortion, hafta, bribes – to be disallowed)
- **December 2009** – amendment to the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 – (any Gift, Travel facility, Hospitality, Cash or monetary grant)
- **August 2012** – CBDT Clarification – Freebies expense not allowable u/s 37(1).

Freebies

- Explanation 1 to Section 37(1) –

- “expenditure . . . is **prohibited by law** shall not be deemed to have been incurred for the purpose of business or profession”

- Case laws

- Favour

- DIT v. PHL Pharma (P.) Ltd. [2017] 163 ITD 10 (Mumbai - Trib.)

- Seminars. Lectures, sponsor knowledge upgrade course, gift article embossed with brand logo (low cost items), free samples
- IMC Regulations not applicable to Pharmaceutical company
- CBDT Circular cannot have retro-spective application.

Freebies

- Favour
 - Max Hospital v. MCI [WPC 1334/2013, dated 10-1-2014] (Delhi HC)
 - Medical Council of India has jurisdiction to take action only against the medical practitioners and not to health sector industry.
 - CIT v. K.M. Jain, Tobacco Products (P.) Ltd [2012] 340 ITR 99 (Madhya Pradesh HC)
 - There is no provision that payment of ransom is an offence. In absence of that, the Explanation to section 37(1) cannot be invoked.
 - CBDT Circular cannot have retrospective application –
 - Syncom Formulations (I) Ltd. [IT Appeal Nos. 6429 & 6428 (Mum.) of 2012, dated 23-12-2015]
 - UCB India (P.) Ltd. v. ITO [IT Appeal No. 6681 (Mum.) of 2013, dated 13-05-2016]

Freebies

- Against
 - Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT [2013] 353 ITR 388 (Himachal Pradesh HC)
 - Assessee to satisfy the assessing officer that the expense is not in violation of the Medical Council Regulations.
 - ACIT v. Liva Healthcare Ltd. [2016] 161 ITD 63 (Mumbai - Trib.)
 - Foreign Trip to doctors (Assessment year 2009-10)
 - Similar view
 - DCIT v. OCHOA Laboratories Ltd. [2017] 85 taxmann.com 168 (Delhi - Trib.)
 - Apex Laboratories (P.) Ltd. v. ACIT [2017] 164 ITD 81 (Chennai - Trib.)

Freebies

- Against (prior to circular)
 - CIT v. Kap Scan and Diagnostic Centre (P.) Ltd. [2012] 344 ITR 476 (P&H HC)
 - Commission paid by diagnostic center to private doctors for referring patients.
 - CIT v. Pt. Vishwanath Sharma [2009] 316 ITR 419 (Allahabad HC)
 - Commission to Government doctors for prescribing specific medicines.
 - Commission to Private doctors was allowed by ITAT and was not challenged by income tax department.

Freebies

- Thinking out loud -

- Capitalise expense for development or promotion of brand and claim depreciation ?

- Dr. T.A. Quereshi v. CIT [2006] 287 ITR 547 (SC)

- Seizure of stock-in-trade (heroin) is a business loss allowable u/s 28(i) - Explanation to 37(1) is not applicable.

- 1st IMC should take action against the doctor to trigger the Explanation ?

- DHFL Venture Capital Fund v. ITO [2016] 157 ITD 60 (Mumbai - Trib.)

- Dispute was whether in absence of any adversarial finding by SEBI, can the assessing officer form a view that a condition stipulated by SEBI has not be complied with, thereby assessee is not entitled to the benefit of Section 10(23FB) - Tribunal has decided against the tax department.

The image features a bright yellow background with two dark brown L-shaped brackets. One bracket is positioned in the top-left corner, and the other is in the bottom-right corner. Centered between these brackets is the text "SCIENTIFIC RESEARCH EXPENSE" in a bold, black, sans-serif font, arranged in two lines.

SCIENTIFIC RESEARCH
EXPENSE

Scientific Research Expense

■ Background –

- S. 35(2AB) – 150% of expenditure (other than land or building) incurred on scientific research on in-house research and development facility.

■ It would include

- Expense on clinical drug trial,
- Expense for obtaining approval from any regulatory authority; and
- Expense for filing an application for a patent under the Patents Act, 1970

■ Pre-requisite –

- Enters into an agreement with Department Of Scientific & Industrial Research (DSIR)
- Furnishes reports and maintain accounts as prescribed by DSIR.

Scientific Research Expense

■ Forms –

- Form 3CK – application for entering into the agreement
- Form 3CM – Order of approval from DSIR
- Form 3CLA – Annual Report of Expenses incurred by Company to DSIR
- Form 3CL – Annual Report by DSIR to Income Tax Authority

■ Changes (Rule 6 of Income tax Rules, 1962)–

- Form 3CM, 3CLA and 3CL to be filed **electronically**.
- Form 3CM & Form 3CL to be submitted within **120 days** (earlier 60 days) from grant of approval / submission of Form 3CLA.
- Form 3CLA to be filed within the **due date of filing income tax return** (earlier 31st October of succeeding year) and has to be certified by **any chartered accountant** (earlier statutory auditor)

Scientific Research Expense

- Expenditure to be excluded as per DSIR Guidelines (updated in July 2017) –
 - **Capital Work in Progress** – {CIT v. Biocon Ltd. [2015] 375 ITR 306 (Kar. HC)}
 - **Vehicles purchased for reference & testing purpose will not be admissible.**
 - Capital Expenditure in relation to intangible asset
 - Expenditure of general nature (e.g. Interest, lease, overhead)
 - Manpower under the category of retainership / trainees/ consultants and manpower on contract.
 - Remunerations paid to the Board of Directors

- Power to prescribe exclusion ?
 - CIT v. Sirpur Paper Mills [1999] 237 ITR 41 (SC)
 - ACIT v. Torrent Pharmaceuticals Ltd [ITA No.3569/Ahd/2004] (Ahm. Trib.)

Scientific Research Expense

■ Issues –

- Expenditure incurred outside the R&D Facility –
 - Concept Pharmaceuticals Ltd. v. ACIT [2011] 43 SOT 423 (Mumbai Trib) – **Against**
 - CIT v. Cadila Healthcare Ltd. [2013] 263 CTR 686 (Gujarat HC) – **Favour**

- Income from sale of IP developed by R&D Facility need not be reduced for computation of expenditure allowable u/s 35(2AB) –
 - CIT v. Microlabs Ltd. [2016] 383 ITR 490 (Karnataka HC)

- Expenditure even prior to the date of approval of the R&D facility from DSIR is allowable –
 - CIT v. Claris Lifesciences Ltd. [2010] 326 ITR 251 (Gujarat HC)
 - Maruti Suzuki India Ltd. v. UOI [2017] 84 taxmann.com 45 (Delhi HC)

Scientific Research Expense

■ Issues -

- DSIR cannot reduce expenditure without giving opportunity of hearing to assessee -
 - Bosch Ltd. v. DSIR [2017] 293 CTR 355 (Karnataka HC)

- AO denying weighted deduction of expense approved by DSIR -
 - DCIT v. Mastek Ltd. [2013] 263 CTR 671 (Gujarat HC)
 - Tejas Networks Ltd. v. Dy. CIT [2015] 233 Taxman 426 (Kar. HC)

- AO cannot deny weighted deduction DSIR has not submitted form 3CL-
 - CIT v. Sun Pharmaceutical Industries Ltd. [2017] 85 taxmann.com 80 (Gujarat HC)



OTHER ISSUES

Stockist

■ Issue

- Pharma companies sell medicines to stockist a price less than the MRP.
- Whether profit of the stockist is akin to commission or brokerage or professional fees and thereby, Pharma Company is liable to deduct TDS ?
- CIT v. Piramal Healthcare Ltd. [2015] 230 Taxman 505 (Bombay HC)
 - No payment is made by Pharma Company to Stockist. Therefore, TDS provisions will not apply.
- Nature of relationship (principal to principal) or (principal to agent/manager) ?

Restructuring

- Demerger –
 - S. 2(19AA)(iii) – all assets and liabilities are transferred at book value
 - Ind AS 103 – assets and liabilities acquired pursuant to business combination are to be recorded at fair value (other than common control business combination)

- Possible views –
 - Condition prescribed in S. 2(19AA)(iii) is not applicable to companies following Ind AS.
 - Ind-AS companies can also account at book value instead of fair value (Para 19 of Ind AS 1).
 - De-merger is not exempt u/s 2(19AA).

- No such requirement (accounting at book value) in case of amalgamation.

Restructuring

- Citus of an Intangible Asset
 - CUB Pty Ltd. v. UOI [2016] 388 ITR 617 (Delhi HC)
 - Pfizer Corporation [2004] 271 ITR 101 (AAR –New Delhi)

- Depreciation on Goodwill arising in a Business Combination
 - CIT v. Smifs Securities Ltd. (348 ITR 302) (SC)
 - United Breweries Ltd. (TS-553-ITAT-2016) (Bang. Trib.)

- Allocation of value to intangible

Remuneration to Doctors

■ Issue -

- TDS - S. 192 (employee) v. S. 194J (professional)

- High Court rulings on the subject -
 - M/s Escorts Heart Institute , , , v. DCIT (2017-TIOL-2260-IT) (Rajasthan)
 - CIT v. Ivy Health Life Sciences (P.) Ltd. [2016] 380 ITR 242 (Punjab & Haryana)
 - CIT v. Teleradiology Solutions (P.) Ltd. [2016] 67 taxmann.com 346 (Karnataka)
 - CIT v. Grant Medical Foundation [2015] 375 ITR 49 (Bombay)
 - CIT v. Manipal Health Systems (P.) Ltd. [2015] 279 CTR 153 (Karnataka)
 - CIT v. Yashoda Super Speciality Hospital [2014] 365 ITR 356 (Andhra Pradesh)
 - CIT v. Apollo Hospitals International Ltd. [2013] 359 ITR 78 (Gujarat)



THANK YOU