IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL NO. 752 of 2012

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COMMISSIONER OF INCOME TAX-I....Appellant(s)

Versus

CADILA HEALTHCARE LTD....Opponent(s)

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Appearance:

MR BHATT, SR. ADV WITH MRS MAUNA M BHATT, ADVOCATE for the Appellant(s) No. 1

MR MUKESH PATEL WITH MR RK PATEL, ADVOCATE for the Opponent(s) No. 1

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CORAM: **HONOURABLE MR.JUSTICE AKIL KURESHI**
and
HONOURABLE MS JUSTICE SONIA GOKANI

Date : 20/03/2013

ORAL ORDER

(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)

Leave to amend the questions of law.

Tax Appeal is admitted for consideration of following substantial questions of law:

"A. Whether the Appellate Tribunal has substantially erred in holding that the legal and professional expenses incurred were for expansion or extension of business already in existence and not capital in nature, when the assessee incurred the said expenditure on expert opinion for manufacturing different pharma products than the existing products in Uttaranchal state?

F. Whether the Appellate Tribunal has substantially erred

in holding that the assessee is eligible for deduction u/s.80IC on the entire profit of 86% including the amount of profit which the company was already earning (80%) from marketing of the same products after purchase from P2P manufacture, despite the fact that increase in profit to the company in those products was only 6% after it started manufacturing the said products at Baddi Unit?

G. Whether the Appellate Tribunal has substantially erred in holding that the Assessing Officer has no right to determine the fair market value of goods, when there is no-inter-corporate transfer of goods, despite the clear provisions of section 80IA(8), which apply to 'intro-corporate transfer of goods' from eligible business to other non-eligible business of the assessee?"

L. Whether the Appellate Tribunal has substantially erred in deleting the addition of Rs.1,18,84,177/- quantified as disallowance expenditure u/s.14A, despite the specific provisions of clause (f) of Explanation-I to 115JB?"

Learned counsel Shri RK Patel waives service of notice of admission on behalf of the respondent-assessee.

We notice that the Revenue has proposed additional questions also. Some of these questions, we have not included since they are more in the nature of contentions in connection with the questions already admitted.

Some questions, we do not find, are required to be admitted. We would advert only those questions one after another.

The Revenue has suggested following questions :

"B. Whether the Appellate Tribunal has substantially erred in holding that Product Registration expenses are revenue in nature, when the 'Product Registration expenses made to Drug Regulatory Authorities in various countries give enduring benefit of exporting the registered drugs for many years?

C. Whether the Appellate Tribunal has substantially erred in holding that Trademark Registration fee and Patent fee (Rs.37,92,606/0 and Rs.1,15,49,880/-) are revenue expenses, when the expenses were incurred for registration of Trademark in that country and also for registration of Patent, which are intangible assets under section 32(1)(ii) of the Act?"

These questions pertain to the expenditure incurred by the assessee towards product registration before the Drug Regulatory Authorities and registration of trademark and patent fees. It is the case of the Revenue that such registration gives enduring benefits and therefore should have been treated as capital expenditure and not revenue in nature. The Tribunal clubbed these expenditure for common consideration and in the impugned judgment held that pharmaceutical products manufactured by the assessee are to be registered with the local authorities as also medical association in India. Such products were in existence and nothing new were acquired by the assessee in the process. The Tribunal, therefore, held that the expenditure only enable the assessee to run the existing business smoothly and therefore, it cannot be stated that the assessee acquired any tangible or intangible assets.

With respect to patent and trademark registration, the Tribunal held that for protection of result of the research of the assessee, such patent had to be registered. It was observed that enduring benefit is not the only criteria. The same must be coupled with acquisition of asset.

With respect to the expenditure incurred for production registration charges, we agree with the view of the Tribunal that the assessee did not acquire any new asset. As per the rules and regulations, it was essential that the product, before marketing, would be registered with the regulating authorities. Any expenditure in the process would not be stated to ensure procurement of a new asset to the assessee. We

are informed that a Division Bench of this Court in the case of **CIT v. Torrent Pharmaceuticals Ltd**, (2013) 29 taxmann.com 405 (Gujarat) also in somewhat similar facts had upheld the decision of the Tribunal.

With respect to the expenditure for trademark and patent, learned counsel for the respondent-assessee rightly pointed out that such issue was examined by the Supreme Court in the case of 20 ITR 475, wherein it was held and observed as under:

> "In our opinion, the contention urged on behalf of the appellant must fail. It is not contended that by the Trade Marks Act a new asset has come into existence. It was contended that an advantage of an enduring nature had come into existence. It was argued that just as machinery may attain a higher value by an implementation causing greater productive capacity, in the present case the trade mark which existed before the Trade Marks Act acquired an advantage of an enduring nature by reason of the Trade Marks Act and the fees paid for registration thereunder were in the nature of capital expenditure. In our opinion, this analogy is fallacious. The machinery which acquires a greater productive capacity by reason of its improvement by the inclusion of some new invention naturally becomes a new and altered asset by that process. So long as the machinery lasts, the improvement continues to the advantage of the owner of the machinery. The replacement of a dilapidated roof by a more substantial roof stands on the same footing. The result however of the Trade Marks Act is only two-fold. By registration, the owner is absolved from the obligation to prove his ownership of the trade mark. It is treated as prima facie proved on production of the registration certificate. It thus merely saves him the trouble of leading evidence, in the event of a suit, in a Court of law, to prove his title to the trade mark. It has been said that registration is in the nature of collateral security furnishing the trader with a cheaper and more direct remedy against infringers. Cancel the registration and he has still his right enforceable at Common Law to restrain the piracy of his trade mark. In our opinion, this is neither such an asset nor an advantage so as to make payment for its registration a capital expenditure. In this connection it may be useful to notice that expenditure incurred by a company in defending title to property is not considered expense of a capital nature. In Southern (H M Inspector of Taxes) v. Borax

Consolidated Ltd., 10 I. T R. Sup. 1, it is there stated that where a sum of money is laid out for the acquisition or the improvement of a fixed capital asset it is attributable to capital but of no alteration is made in the fixed capital asset by the payment, then it is properly attributable to revenue, being in substance a matter of maintenance, the maintenance of the capital structure or the capital asset of the company. In our opinion, the advantage derived by the owner of the trade mark by registration falls within this class of expenditure. The fact that a trade mark after registration could be separately assigned, and not as a part of the good will of the business only, does not also make the expenditure for registration a capital expenditure, That is only an additional and incidental facility given to the owner of the trade mark. It adds nothing to the trade mark itself."

No contrary decision is brought to our notice. In our opinion, therefore, both these questions are not required to be considered.

Revenue has also suggested following question :

"D. Whether the Appellate Tribunal has substantially erred in holding that the expenses incurred outside the approved R&D facility would also get weighted deduction based on the word under "on in house" interpreting contradictorily to the finding of coordinate bench in Concept Pharmaceuticals Ltd v. ACIT (ITAT, Mum) reported at 43 SOT 423?"

We may record that question 'E' in the appeal memo is an additional question which has an element of above noted question. We have, therefore, not separately reproduced the same in this order. The issue is whether the assessee who has incurred expenditure for scientific research, which was not in the in-house facility, could be covered for deduction under section 35(2AB) of the Income Tax Act, 1961.

More or less, facts are not in dispute. The assessee carried out scientific research in its facility approved by the prescribed authority. It

incurred various expenditure including on clinical trials for developing its pharmaceutical products. These clinical trials were conducted outside the approved laboratory facility. The Revenue holds a belief that such expenditure not having been incurred in the approved facility cannot form part of the deduction provided under section 35(2AB) of the Act. The Tribunal observed that the term 'in-house' used in section 35(2AB) of the Act must be viewed in the context of which it has been used. If by utilizing the staff or resources of an organization, research is conducted within the organization rather than through utilization of external use of resources or staff, it can be stated to be an in-house research. On such basis, the Tribunal rejected the Revenue's contention that merely because an expenditure which was not incurred in the in-house facility cannot be discarded for the weighted deduction under section 35(2AB) of the Act. Learned counsel for the Revenue, however, strongly relied on the certificate issued by the Prescribed Authority, which segregated the expenditure in two parts, that incurred in in-house facility and that incurred outside.

In our opinion, the Tribunal committed no error. Section 35(2AB) of the Act provides for deduction to a company engaged in business of bio-technology or in the business of manufacture or production of any article or thing notified by the Board towards expenditure of scientific research development facility approved by the prescribed authority. Such deduction at the relevant time was one-and-a-half times expenditure which has now been increased to twice the eligible expenditure. We may notice that explanation to section 35(2AB)(1) which was introduced by the Finance Act 2001 with effect from 1.4.2002 reads as under:

> "Explanation – For the purposes of this clause, "expenditure on scientific research" in relation to drugs and pharmaceuticals, shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under any Central, State or Provincial Act and filing an application for a patent under the Patents Act, 1970 (39 of 1970)."

Such explanation thus provides that for the purpose of said clause, i.e. clause (1) of section 35(2AB), expenditure on scientific research in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under the Central, State or Provincial Act and filing an application for a patent under the Patents Act, 1970.

The whole idea thus appears to be to give encouragement to scientific research. By the very nature of things, clinical trials may not always be possible to be conducted in closed laboratory or in similar in-house facility provided by the assessee and approved by the prescribed authority. Before a pharmaceutical drug could be put in the market, the regulatory authorities would insist on strict tests and research on all possible aspects, such as possible reactions, effect of the drug and so on. Extensive clinical trials, therefore, would be an intrinsic part of development of any such new pharmaceutical drug. It cannot be imagined that such clinical trial can be carried out only in the laboratory of the pharmaceutical company. If we give such restricted meaning to the term expenditure incurred on in-house research and developoment facility, we would on one hand be completely diluting the deduction envisaged under sub-section (2AB) of section 35 and on the other, making the explanation noted above quite meaningless. We have noticed that for the purpose of the said clause in relation to drug and pharmaceuticals, the expenditure on scientific research has to include

the expenditure incurred on clinical trials in obtaining approvals from any regulatory authority or in filing an application for grant of patent. The activities of obtaining approval of the authority and filing of an application for patent necessarily shall have to be outside the in-house research facility. Thus the restricted meaning suggested by the Revenue would completely make the explanation quite meaningless. For the scientific research in relation to drugs and pharmaceuticals made for its own peculiar requirements, the Legislature appears to have added such an explanation.

In the case **The Deputy CIT v. Mastek Limited**, in Tax Appeal No.242 of 2000 and connected matters, a Division Bench of this Court had touched on the aspect of what can be termed as scientific research. In the context, certain observations made by the Bench may be of some relevance.

> "25. It can thus be seen that the term scientific research in the context of the deduction allowable under section 35(1) ofthe Act would include wide variety of activities. It can also be appreciated that every scientific research need not necessarily result into the ultimate goal with which it may have been undertaken. Often times in the field of research and invention, the efforts undertaken may or may not yield fruitful results. What is to be ascertained is whether any scientific research was undertaken and not whether such scientific research resulted into the ultimate aim for which such research was undertaken. It can be easily envisaged that the scientific research undertaken often times would completely fail to achieve desired results. That by itself does not mean that no scientific research was undertaken. What the Legislature desired to encourage by granting deduction under section 35(1) of the Act was a scientific research and not necessarily only the successful scientific research undertaken by an assessee."

We are, therefore, of the opinion that the Tribunal committed no error. Merely because the prescribed authority segregated the expenditure into two parts, namely, those incurred within the in-house

facility and those can were incurred outside, in our opinion, by itself would not be sufficient to deny the benefit to the assessee under section35(2AB) of the Act. It is not as if that the said authority was addressing the issue for deduction under section 35(2AB) of the Act in relation to the question on hand. The certificate issued was only for the purpose of listing the total expenditure under the Rules. Therefore, no question of law arises.

(AKIL KURESHI, J.)

(MS SONIA GOKANI, J.)

(vjn)