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

BEFORE SRI MAHAVIR SINGH, JM AND SRI RAJESH KUMAR, AM

ITA No. 8614/Mum/2011

(A.Y. 2007-08)

Strides Shasun Limited (formerly known as Strides Arcolab Limited) 201, Devavrata, Sector 17, Vashi, Navi Mumbai-400 703	Vs.	The Asst. Commissioner of Income Tax Circle 10(3), Mumbai
Appellant	..	**Respondent**
PAN No. AADCS8104P		

Assessee by : Percy J. Pardiwala & Nitesh Josi, ARs'

Revenue by : Jayant Kumar & V. Jenardhanan, DR's

Date of hearing: 12-03-2018 **Date of pronouncement :** 08-06-2018

O R D E R

PER MAHAVIR SINGH, JM:

This appeal by the assessee is arising out of the order of Dispute Resolution Panel-II, Mumbai, [in short 'DRP'] in Objection No. 74 dated 28-09-2011. The Assessment was framed by the Assistant Commissioner of Income Tax-10(3), Mumbai (in short 'ACIT') for the assessment year 2007-08 vide order dated 18-10-2011 under section 143(3) read with section 144C(13) of the Income Tax Act, 1961(hereinafter 'the Act').

2. The first issue in this appeal of assessee is against the order of DRP and AO disallowing the claim of deduction made by assessee under

section 10B of the Act on export profit earned by its unit. For this assessee has raised following ground No. 1: -

> *"Ground No.1: Disallowance of deduction under section 10B of the Income-tax Act, 1961 (Act) for Strides Technology & Research Division' ("STAR") unit for Rs. 142228,544/-*
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> *1. The Honorable Dispute Resolution Panel (Hon'ble DRP") and the Learned Assessing Officer (Ld. AO') erred in disallowing deduction under section 1OB of the Act on export profits earned by the STAR unit on the basis that the Appellant is merely granting the license to manufacture products by utilizing the Dossier' and the activity of preparation of dossier cannot be treated as manufacture or production of an article or thing' without appreciating facts of the case.*
>
> *Without prejudice to the above, the Hon'ble DRP and Ld. AO failed to appreciate the fact that the activities of STAR unit fall under information technology enabled products or services for the purpose of deduction under section 10B as notified by CBDT vide Notification No SC 890(E) dated 26/09/2000."*

3. Brief facts are that the assessee is engaged in the business of manufacturing & trading of pharmaceuticals. The assessee claimed deduction under section 10B of the act on three EOU units eligible. The AO during the course of assessment proceedings required the assessee to explain as to why the claim of deduction under section 10B of the Act be not disallowed in respect of contract manufacturing and research division No. 152/6 and 154/16. According to the claim of assessee, the

items produced are pharmaceuticals business process outsourcing facility in R&D, Analytical Method Development, stabilities studies, clinical studies, valuation method etc. For this the assessee claimed deduction for an amount of ₹ 14,22,28,554/-. The AO asked the assessee to furnish the details of items manufactured by assessee's contract manufacturing and research division including various agreements for export entered into by the said unit of the assessee. The assessee furnished the details but according to the AO, assessee's activity constituted development of generic version of pharmaceuticals product as pro-type and compiling of the data relating to such product as dossier, which is used for getting sanction from regulatory authorities and assessee claimed that it is producing the dossier which is to be considered as goods and hence it falls within the definition of manufacture or production of article or thing and thus the same is eligible for claim of deduction under section 10B of the Act. The AO rejected the claim of the assessee by observing in Para 6.5 as under: -

> *"6.5 The above submission of the assessee has been carefully considered and the same, cannot be accepted for the following reasons:*
>
> > *The assessee's activity comprises of development of a 'process' which is neither an article of thing, but only a method of manufacturing a product and what is important and central to the whole thing is the process and not the 'compilation of data', which is termed technically as a "Dossier", which the assessee claims to.be a 'Good' or 'Article'. And what the assessee is selling is not the 'process of manufacture' but only is granting license in respect of manufacture of Pharmaceutical products by utilizing the said*

process in certain territories in return for which the assessee is paid the fees, on which the assessee is claiming deduction u/s 1OB. Since the granting of such a license to manufacture and sell within a territory, using the process developed by the assessee is what the activity on which the assessee is earning income, the same can by no stretch of imagination be treated as manufacture or production of an article or thing and export thereof.' Hence the assessee's claim of deduction u/s 1OB of Rs.14,22,28,544/- in respect of its Conti-act Manufacturing & Research Division' (STAR unit), was proposed to be disallowed."

4. The DRP also rejected the objection of the assessee vide Para 3.3. and 3.3.1 as under: -

"3.3 We have considered the draft assessment order and the assessee's submissions. As we see, the assessee has sought to establish that the preparation of the dossier tantamount to production of article or thing in terms of Section 10B of the Act. The Assessing Officer has on the other hand examined the issue on the template of the immediate source of the fee in question and has then held that the immediate source of the free being for granting of the license and the dossier being only a process and not the source of the receipt of the fee, deduction is not allowable. Considering these two positions, we agree with the Assessing Officer. As we see, the preparation of the dossier is only a regulatory and intermediary

process and not an end - product in itself in so far as the assessee's main obligation is concerned. As the contracts indicate, the assessee is finally not selling the dossier (which is only a process of manufacture) but is granting the license in respect of the manufacture of pharmaceutical products by utilizing the process in certain territories. The deliverable under the contracts is granting of the license and not the preparation of the dossiers. For example, the agreements are titled 'License and Supply Agreement', 'Co-operation and Supply Agreement', Development, Licensing and Supply Agreement' and these titles are tell-tale. It is clear, what the assessee is ultimately obligated to provide is the license for manufacturing a product by using a process. The immediate nexus of the income on which deduction u/s 108 has been claimed is thus with the license and not with the dossier. Consequently, the immediate nexus being with the license, the issue to be examined remains whether or not license is a product in terms of Section 10B.

3.3.1 Tested on this, in no case can license be treated as 'manufacture or production of an article or thing and export thereof 'and accordingly, the nexus of the receipt of the fee being with the right (license) which is not a product or manufacture of an article or thing, the deduction is not allowable. It is now established law that to be eligible for deductions and exemptions, the 'first degree nexus' with the eligible income is sine-qua-non. This stands eloquently propositioned by the Apex Court in its decision in the case Liberty India vs. CIT 317 ITR 218. Enumerating in the context of eligibility of DEPB

income for deduction u/s. BOIB, the Apex Court has laid down the principle that any income beyond the first degree nexus between the profits and the undertaking would constitute an independent source of income and would not be eligible for the deduction. While coming to this decision, the Apex Court has taken into account various judicial precedents which have evolved from time to time in the matter. Accordingly, we find that relevant \issue here is not whether or not dossier is a product or manufacture of article or thing but what is the final deliverable with which the fee received (the eligible income) has the first degree nexus. The assessee's arguments in this regard are deficient in that the assessee has sought to justify that the right that are created do not exist at the time of filing the dossier and take shape only after the dossiers are filed. This is a lame justification as the contract right at the beginning makes it clear that the assessee is obligated to sell the rights or license. Once the contract stipulates this, it only becomes a matter of procedure and process when ultimately the customer can become the owner of the license. The fact remains that the customer is compensating the assessee for the license and not for the intermediary regulatory procedures and processes. Taking into account the foregoing, we find the denial of deduction u/s. 10B justified."

Aggrieved, now assessee is in second appeal before Tribunal.

5. Before us, the learned Counsel for the assessee explained that the assessee is registered and approved EOU and he referred to Page 38 of assessee's paper book, wherein license issued by customs department is

enclosed. This approval is issued vide order No. 176/2004 dated 15.09.2004 under section 65 of the customs Act, 1962 and unit is permitted to manufacturer as under: -

> *"1. The unit is permitted to make use of imported capital goods viz., Plant and Machinery Components, Consumables etc. required for the manufacture of Pharmaceutical Business Process Outsourcing Facility in Research and Development, Analytical Method Development, Stability Studies, Clinical Studies, Validation Method Etc., Under 100% EOU scheme. The unit is also permitted to use indigenously available materials and other items in the manufacture with the permission of the Customs Officers.*
>
> *2. The entire quantity produced using of imported non-duty paid goods and materials should be exported with permissible wastage and wastes arising out of in bond manufacturing operations shall be disposed of as provided under Section 65 of the Customs Act, 1962.*
>
> *3. The manufacture and other operations may be carried out during day time between the Regular working days of the factory. Working beyond the stipulated period should be with the permission of the Superintendent of Customs."*

Further the learned Counsel referred to page 50-53 of assessee's paper book, wherein the assessee has been certified as manufacturer of the product, *"pharmaceuticals business process outsourcing facility in R and D, Analytical Method Development, stability studies, clinical studies, validation method etc. valid upto 17-08-2009".* The Assistant

Development Commissioner Cochin Special economic zone, Ministry of Commerce and Industry, vide order dated 18-08-2004 allowed permission under 100% export oriented unit for manufacture and export of pharmaceuticals business process outsourcing facility in R and D Analytical Method Development, Stability Studies, Clinical Studies, Validation Method etc. and specifically mentioned all items of production as above. According to the learned Counsel a brief write up of how units are eligible for deduction under section 10B of the Act with a documentary evidences were filed before the AO and also DRP and the relevant reads as under: -

> *"The R&D center at Bangalore, STAR (Strides Technology and Research) is the pharmaceutical research center of the Strides Group.*
>
> *The focus is on the following:*
>
> - *Development of manufacturing process of existing as well as new products*
> - *Analytical services / studies in the development of new product*
> - *Packaging development*
> - *Microbiological testing*
> - *Clinical supplies manufacturing*
>
> *Key activities at STAR include identification and characterization of the reference drug, technical information on drug product, regulatory review. pre-formulation studies, formula development, analytical method development, analytical method validation, packaging development, scale up from lab scale,*

stability studies, bioequivalence studies, preparation and submission of technical dossier amongst others.

Dosage form capabilities at STAR include tablets, soft gel capsules, hard gel capsules, lyophilized injectable, dry powder parenteral, liquid injectable, ointments and liquids.

The unit was setup as a 100% EOU and registered with the Office of the Development Commissioner, Cochin Special Economic Zone. The Unit has been registered as an EOU w.e.f. 01.09.2004. We are enclosing the following documentary evidence in support of our claim:

d. Letter of Permission - LoP No. 01/42/2004 :PER: EOU:KR:CSEZ/6819 dt. 18/08/2004

e. Green card No 770 dt. 01.09.2004

The Unit has not been formed by splitting up, or the reconstruction, of a business already in existence. Further, facility was setup with new machinery / equipment, which was not used previously for any purpose.

The unit commenced operations in March 2005. The deduction us 1OB is available for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things. Consequently, deduction u/s 10 8 is available for Assessment Year 2007-08."

6. The learned Counsel for the assessee also drew our attention to the copies of agreement filed at pages 290 to 396 of assessee's paper

book i.e. in regard to Aspen Pharmacare Holdings Limited (in short 'ASPEN'). The learned Counsel for the assessee also drew our attention to page 297 of the assessee's paper book wherein agreement with ASPEN and clause 1.3.27 and 1.3.28 of the agreement clearly states the data prepared by assessee which reads as under: -

> *"1.3.27 STRIDES DATA' means the data prepared by STRIDES in relation to each of the PRODUCTS. In the case of the Republic of South Africa this shall be in the form of the data pack required by the MCC for the registration of the PRODUCT concerned. In the case of the United Kingdom, this shall be in the form of a CID (Common Technical Document) dossier as required by the MHRA for the registration of the PRODUCT concerned, it shall also include such supporting data and reference documents which may be required from time to time by the REGULATORY AUTHORITIES in the United Kingdom and the Republic of South Africa;*
>
> *1.3.28 SADC means the Southern African Development Community as constituted at the SIGNATURE DATE;"*

7. The learned Counsel for the assessee further stated that product development activities include collecting and correlation of various data inputs by conducting stability studies and bio-equivalent studies. It is therefore incorrect to state that there is no compilation of data' as concluded by AO. The compilation of data is essential for the Dossier. The Product Development Activity is a process related activity. The final outcome of the development activity is in the form of a "Dossier, which is a culmination of manufacturing of exhibit batches. The Dossier

documents the detailed method followed in the manufacture of a product, right from sourcing the raw material to the final product manufactured. The Dossier explains how the development activity has been carried out along with details of production of a product at every stage at STAR Facility as well as data relating to stability studies and bioequivalence studies. Although the end product is Dossier, the major activity involved is manufacturing which takes place at the STAR Facility. The Dossier would not be complete without manufacture of exhibit botches. The Dossier is prepared for a particular product for certain markets or all. For each market, a separate Dossier is prepared and is generally required to be supported by additional activity and data besides manufacturing of exhibit/commercial batches. Although the broad parameters for preparation and approval of 'Dossiers' are same for various countries / territories, there could be some changes in the preparation of 'Dossiers' in view of Regulatory requirements for the countries involved. Further, the assessee may sell the Dossiers to customers. With the sale of Dossier, the ownership passes on to the Buyer. Based on the approval of Dossier, the Buyer has to approach the Regulatory authorities to sell the Product in the Territory. The right to manufacture continues with the facility/entity which has manufactured the Product, as stated in the Dossier. It is incorrect to state that selling of Dossier is 'license to manufacture'. As explained above, the right to manufacture continues with the facility/entity which has manufactured the Product, in this case the assessee itself. In case the right to manufacture is to be given to the buyer, he has to go through the process of what is referred to as 'site transfer' in pharmaceutical parlance. In the cases referred above, the right to manufacture continues to remain with the Assessee.

8. On the other hand, Ld CIT Dr argued that the AO and DRP has considered this issue and noted that the assessee has tried to establish that the preparation of the dossier tantamount to production of article or

thing in terms of Section 10B of the Act. The AO noted that the immediate source of the fee being paid for granting of the license and the dossier being only a process and not the source of the receipt of the fee, deduction is not allowable. Considering these two positions, he argued that the preparation of the dossier is only a regulatory and intermediary process and not an end - product in itself in so far as the assessee's main claim is concerned. As the contracts indicate, the assessee is finally not selling the dossier, which is only a process of manufacture, but is granting the license in respect of the manufacture of pharmaceutical products by utilizing the process in certain territories. The deliverable under the contracts is granting of the license and not the preparation of the dossiers. Ld CIT Dr explained the same with the help of example that the agreements are titled 'License and Supply Agreement', 'Co-operation and Supply Agreement', Development, Licensing and Supply Agreement' and these titles are tell-a-tale. It is clear, what the assessee is ultimately obligated to provide is the license for manufacturing a product by using a process. The immediate nexus of the income on which deduction u/s 10B of the Act has been claimed is thus with the license and not with the dossier. Consequently, the immediate nexus being with the license, the issue to be examined remains whether or not license is a product in terms of Section 10B of the Act. According to him, in no case can license be treated as 'manufacture or production of an article or thing and export thereof 'and accordingly, the nexus of the receipt of the fee being with the right (license) which is not a product or manufacture of an article or thing, the deduction is not allowable. It is now established law that to be eligible for deductions and exemptions, the 'first degree nexus' with the eligible income is sine-qua-non. He cited the case law of Hon’ble Supreme Court in the case Liberty India vs. CIT 317 ITR 218. Enumerating in the context of eligibility of DEPB income for deduction u/s. 80IB of the Act, the principle is that any income beyond the first degree nexus between the profits and the undertaking would constitute an independent source of

income and would not be eligible for the deduction. While coming to this decision, the Court has taken into account various judicial precedents which have evolved from time to time in the matter. Accordingly, he argued that in the present case the relevant issue here is not whether or not dossier is a product or manufacture of article or thing but what is the final deliverable with which the fee received i.e. the eligible income has the first degree nexus. The assessee's arguments in this regard are deficient in that the assessee has sought to justify that the right that are created do not exist at the time of filing the dossier and take shape only after the dossiers are filed. This is a lame justification as the contract right at the beginning makes it clear that the assessee is obligated to sell the rights or license. Once the contract stipulates this, it only becomes a matter of procedure and process when ultimately the customer can become the owner of the license. The fact remains that the customer is compensating the assessee for the license and not for the intermediary regulatory procedures and processes. Accordingly, the denial of deduction u/s 10B of the Act is justified.

9. We have heard rival submissions on this issue and gone through facts and circumstances of the case. The facts of the case are that the assessee company is engaged in the business of manufacturing and marketing of pharmaceutical products. The assessee has four 100% Export Oriented Units (EOU) registered with the Office of the Development Commissioner, Cochin Special Economic Zone. Sterile Products division is a non deduction unit being expiry of 10 years of EOU benefit period, which is into manufacture of pharmaceutical products and the other three units called Oral Dossage 'Forms (ODF), Beta Lactum Division (BLD) and Research & Development Division (STAR). ODF is into manufacture of solid/oral dosage form, manufacture of HIV / AIDS, and anti TB drugs. Further, the plant has a dedicated Anti-TB facility. BLD is into manufacture of Dry Powder Injections and tablets and capsules.

STAR is into the activity of development of generic version of products by re-formulating an existing innovator product. During the course of the assessment stage and during objection stage before DRP the assessee was asked to furnish the details of items manufactured and exported by assessee's "Research and Development Division", and the assessee was also, requested to furnish the various agreements for exports entered into by said unit of the assessee. The assessee furnished copies of such agreements entered into with various parties and authorities below negated the claim of the assessee.

10. We find from the facts of the case that STAR is a registered and approved EOU carrying on their operation relating to pharmaceuticals business process outsourcing facility in research and development, analytical method development, stability studies, clinical studies, validation methods etc. Going by the activities of the assessee, we find that R&D is a process of continuous production and development and at any time around 150 products are in different stages of development. STAR develops generic version of products by re-formulating an existing innovator product. This re-formulated generic version of the product is initially produced/ manufactured in the R & D facility as a "prototype". Subsequently, all the technical and other data relating to such product is compiled in the form of a "dossier" and submitted to the regulatory authorities. On receipt of approval, the product is sold as a generic version in the market on commercial terms. The assessee reformulates an innovator product into generic version which involves compiling of the 'Dossier' and submitting the same to the Regulatory Authorities. The Product Development Activity is a process related activity. The final outcome of the said activity is in the form of a 'Dossier". The dossier is the culmination of various activities which are primarily manufacturing of development and exhibit batch duly supported by data collection, stability studies and bio-equivalence studies. The Dossier documents the detailed

method followed in the manufacture of a product, right from sourcing the raw material to the final product manufactured. In other words, the dossier explains how the development activity is carried out along with details of production of a product at every stage. Although the end product is dossier, the major activity involved in creating is manufacturing which starts from the R & D Facility and ultimately takes place in the plant, the production normally takes place at the R&D unit up to the development batches and thereafter, the exhibit batch manufacturing takes place in the regular production plant under supervision of the R&D team. The dossier is prepared for a particular product and the same is sold, for certain markets or all. For each market, a separate dossier is prepared and is generally required to be supported by additional activity and data besides manufacturing of exhibit and commercial batch. The process of preparing dossier cannot be completed without completing the process of manufacture of exhibit batches. The Exhibit batch is a commercial size batch which is a final product and is in a finished form capable of being sold. Exhibit batch belongs to the customer. Further, the assessee sells the dossier to customers. The cost associated with developing of dossier is borne by Assessee and the customer does not give any grant or subsidy for the same. The cost incurred is recovered from the customer which is a commercial price for sale of dossier. In case the contract provides for payment of advance, the advances paid will be adjusted against the final price for realization. However, the company treats the gross amount as income. Further, some of the contract provides that in case the registration/approvals are not obtained from the concerned regulatory authorities, any advance money received will be refunded to the customer.

11. The case law cited by the assessee of co-ordinate Bench of this Tribunal of Bangalore Bench in the case of DCIT vs. Syngene International Ltd. (2015) 64 taxmann.com 222 (Bangaloer-Trib), wherein

the decision of Hon'ble Supreme Court in the case of CIT vs. N.C. Budharaja & Co. (1993) 204 ITR 412 (SC) and the decision of Hon'ble Delhi High Court in the case of CIT vs. HLS India Ltd. [2011] 335 ITR 292 (Delhi) and Hon'ble Madras High Court in the case of CIT vs. N. Venkatraman [2000] 245 ITR 73 (Madras) was considered and finally held that the processing of date or information will tantamount to manufacture or production of article or thing. The Tribunal in Para 19 to 25 held as under:-

> *"19. A reading of the above agreement does show that there was substantial research work intended by both the parties. But the question is what would evolve out of the research. Is assessee's client paying only for doing the research or for the end results? If the payments are indeed for the end results can such results be classified as manufacture or production of article or thing? There is no dispute that the billings done by the assessee on its clients were based on the manhours spent by its chemists on the job, at agreed rates. That such payments were made only based on the contractual expectation of the end result is clear form clause B of the agreement reproduced above. The end result of the research work done by the assessee could be one among the following three alternatives*

(i) *A speciality compound which is useful and to be used by the clients as a building block for other compounds of use in industry*

(ii) *A speciality compound which turns out to be no good, due to lack of required properties*

(iii) *No compound but only certain research documentation in the nature of experimental records and laboratory notebooks, showing the results of the research which in turn show what has been empirically achieved.*

In respect of the first two scenarios, doubtlessly there is a production or manufacture in the nature of compounds. The compounds may be useful or useless but it is an end result of the process of research undertaken by the assessee. Such compounds, irrespective of its ultimate utility, was something different from the ingredients which were used to create it. That for the purpose of Section 10A, definition of the term manufacture is having a much wider ambit than its normal connotation and takes its colour from Chapter IX of Exim Policy is clearly brought out by Hon'ble Kerala High Court in the case of Girnar Industries (supra). This view has been affirmed by Hon'ble Jurisdictional High Court in the case of Tata Elxsi v. ACIT [IT Appeal No. 411 of 2008, dated 20-10-2014].

20. However the third scenario requires a deeper analysis. To decide whether the research documentation can be said to be the result of production and whether they can fall within the meaning of an article or thing calls for a good understanding of those terms as it has come out of the judicial wisdom of higher courts . The first and foremost of these is the judgment of the Hon'ble Apex court itself in the case of CIT v. N C Budharaja & Co. [1993] 204 ITR 412/70 Taxman 312. The question before their Lordship was whether a dam can be considered as an article or thing manufactured or produced in the context of a claim for investment allowance. The meaning of the term produce used in juxtaposition manufacture was analysed. It was held that the former term got the colour of the latter and took in bringing into

existence new goods by a process which may or may not amount to manufacture. Testing the case before us on the touchstone of this proposition laid down by Hon'ble Apex court the question to be answered by us is whether the compounds or research documentation were 'produced'.

21. Though the term manufacture is defined in Section 2(29BA) of the Act, production is not. According to Oxford English Dictionary, production means amongst other things, that which is produced, a thing that results from any action process or effort, a product of human activity or effort. In the case of the assessee here, there are processes of research, efforts put in by assessees scientists, and products which are in the nature of compounds or research documentation. Such products were different from the ingredients that went to its making.

22. Though the term produce gets colour of the term manufacture as held by Hon'ble apex court in the case of N.C. Budharaja & Co.(supra), the next question is whether all the ingredients that are necessary to constitute manufacture should necessarily be there for production also. The obvious answer is no, since otherwise legislature would not have wasted their energy by adding that term in juxtapostition with the term manufacture. This is elucidated by the judgment of Hon'ble Calcutta High Court in the case of CIT v. Air Survey Co. of India (P.) Ltd. [1998] 232 ITR 707. The question before Hon'ble Calcutta High Court was whether business of surveying, mapping and aerial

photography which resulted in photographs was production of article or thing. Revenue had rejected assessee's claim for investment allowance on the ground that the activity of the assessee could not be called as manufacture or production and that in the nature of the assessee's business no thing or article was produced as such. The Tribunal, in appeal, however, reversed the aforesaid finding and allowed the relief in favour of the assessee by holding that the activity of the assessee was such that it would fall within the purview of the expressions "manufacture" or "production" and that the ultimate photographs which came to be produced as a result of the business activity of the assessee came within the expressions "article" or "thing". This view was upheld by Hon'ble Calcutta High Court.

23. Research conclusions can be considered as documentations of the analysis and steps done during the research process. Or in other words the end result is the analysis and presentation of data in a desired format. Hon'ble Madras High court had an occasion to consider the issue as to whether data processing done with the help of computer resulting in end product which was analysis and presentation of data in prescribed format was a product of new article in the case of CIT v. Comp-Help Services (P.) Ltd. [2000] 246 ITR 722 (Mad.). Claim of the assessee was for investment allowance. Their Lordships held as under at paras 4 to 9 of the judgment.

> *'4. When data is processed with the aid of computers and the processing involves*

complicated steps which can only be performed with speed in a computer and the end-product is the analysis and presentation of data in the desired format such as balance sheet, it can be said in broad terms that there is production. It was pointed out by the Supreme Court in the case of CIT v. N.C. Budharaja & Co. & Anr. (1993) 114 CTR (SC) 420 : (1994) 204 ITR 412 (SC) : TC 25R.185 that the word "production" has a wider connotation than the word "manufacture".

While every manufacture can be regarded as production, every production need not amount to manufacture. It was further observed by the Court that the word "production" or "produce" when used in juxtaposition with the word "manufacture" takes in bringing into existence new goods by a process which may or may not amount to manufacture and that it takes in all the by-products, intermediate products and residual products which emerge in the course of manufacture of goods. It was also held by the Court that the expressions "manufacture" and "produce" are normally associated with movables—articles and goods big and small - but they are never employed to denote construction activity of the nature involved in construction of a dam or a building.

5. The word "production" in s. 32A(ii) therefore, comprehends processing activity and the word "article" in that provision

includes movables. The data processing computers involves processing and therefore, capable of being regarded as part of process of production. The balance sheet, sales analysis, statements, etc. obtained as a result of processing are movables and are different from the data that was initially fed into the computer though based upon the data so fed in. The use to which end-product is put is different from the one to which raw data is put at the time it is fed into a computer. The end-product obtained as a result of data processing such as balance sheets etc. are therefore, capable of being regarded as new articles.

6. The data processing activity is an organised activity. The machines have to be operated by employing persons trained for that purpose. The employee and employer relationship in running a data processing company inevitably exists as between those who operate the system and the company which runs the business. The term "industry" is not defined in s. 32A of the Act, and is therefore, required to be understood in the sense in which the word is ordinarily understood. The term "industry" is a term of wide amplitude. "Industry" as used in s. 32A refers to the industries which are engaged in the manufacture or production of goods or articles or things. The balance sheets and other documents obtained as a result of the operation of the data processing system

being articles which are obtained by processing amounts to production. The data processing company must be held to be an industrial company engaged in the production of articles.

7. In the case of CIT v. IBM Word Trade Corporation (1981) 130 ITR 739 (Bom) : TC 28R.211 the Bombay High Court elaborately examined as to what a computer is and what is does, for the purpose of deciding as to whether it is merely an office machine or some thing more. The Court held that in view of the varied functions which the computer "system" is capable of performing data processing machines, cannot be classified as "office appliances" and are eligible for development rebate under s. 33(1) of the IT Act.

8. In the case of CIT v. Datacons (P) Ltd. (1985) 47 CTR (Kar) 162 : (1985) 155 ITR 66 (Kar) : TC 24R.231 the Karnataka High Court held that when as a result of data processing, balance sheets, stock accounts, sales analysis, etc. are printed as per the requirements of the customers, processing was involved and therefore, the data processing company is an industrial company entitled to the concessional rate of taxation under s. 2(7)(c) of Finance No. 2 Act, 1977. The Court further observed that the activities involved in a data processing company would

clearly fall within the concept of goods, though not manufacture of goods.

9. In the case of CIT v. Peerless Consultancy Services (P) Ltd. (1990) 90 CTR (Cal) 73 : (1990) 186 ITR 609 (Cal) : TC 24R.235, the Calcutta High Court also held that a data processing company is an industrial company for the purpose of Finance Act, 1981.'

24. Hon'ble Delhi High Court also had had also considered the issue whether processed data can be termed as something manufactured or produced in the case of CIT v. HLS India Ltd. [2011] 335 ITR 292/199 Taxman 194 (Mag.)/11 taxmann.com 83 (Delhi). The question there was whether wire line logging services, where electrical, acoustic, radioactive and electromagnetic analysis of rock is done to assess the potentiality for oil production would tantamount to manufacture of production of articles or things. Their Lordships held as under at para 31 of the judgments after considering the Apex court judgments in the case of N.C. Budharaja & Co. (supra) and CIT v. Oracle Software India Ltd. [2010] 320 ITR 546/187 Taxman 275.

'31. Having analyzed the submissions of learned counsel of both the parties and the material available for our perusal and the cited case law, we find force in the submissions of Mr. Vohra, learned counsel for the assessee. No doubt, the raw material i.e. the primary input in the impugned activity is the "information" but can

we equate this "information" with something which is being copied from there in toto. Whether the characteristics regarding which the information is being sent back to computers on surface from logging tools working inside the down hole can be compared to a characteristic which is available and readable without conducting highly technical scientific tests and calculations down inside the borehole. Even after the geo-physical and petro-chemical properties of the rocks have been measured, further scientific processing is required to be done by dedicated softwares on the computers. It is only after the abovesaid process, the readable and usable data in the form of logs is provided to technical experts to determine the potentiality and other technical and commercial characteristics of the oil well. Can we say, when a latent physical property of the rocks, which was otherwise unreadable and thus unusable, has been changed by way of sophisticated scientific tests and calculations into scientific data which subsequently has been further changed into logs printed on the papers or recorded on the magnetic tapes, that the character and identity of end product and final product is not distinct. We are unable to uphold such a proposition. It is a clear case where the legal proposition that "If an operation/process renders a commodity or article fit for use for which it is otherwise not

fit, the operation/process falls within the meaning of the word 'manufacture' applies. At this juncture, we re-emphasize on the observations made by his Lordship S.H. Kapadia, J. (as his Lordship was then) in CIT v. Oracle Software India Ltd. (supra) that the Department needs to take into account the ground realities of the business and sometimes over simplified tests create confusion, particularly, in modern times when technology grows each day.'

25. The assessee here had done research using sophisticated machinery and the end product was either research documents in the nature of experimental records or compound. Just because these were intermediary things which would find use only in later stages of development of industrially useful chemicals and formulations would not disentitle the assessee from saying that it was producing an article or thing. The agreement entered by the assessee with its customers clearly show that the parties expected definite results , be it in the nature of new or improved compounds or in the nature of research documentation and each step that assessee had to take for achieving this result was also set out. Such results were to be given to its customers. The activities done by the assessee used sophisticated equipment and methodologies resulting in speciality compounds and documentations. The payments effected by the clients, though based on manhour spent were for such results. Hon'ble Madras High court had again in the case of CIT v. N. Venkatraman [2000] 245

ITR 73/[2002] 123 Taxman 1035 clearly held that the nature of the state of the what is produced, i.e. whether an intermediary or final product, could not be criteria for deciding whether an assessee was manufacturing or producing an article or thing."

12. From the facts of the present case, it is clear that the fundamental requirement in all the agreement is creation of dossier, which is compilation of the relevant technical education to enable manufacture of product. Dossier has all the attributes of product being an article or thing and it is creation specifies the requirement of a production. In fact, creation of dossier entails the actual production of the formulation initially in the laboratory and therefore upto a batch size. In similar circumstances Hon'ble Supreme Court in the case of Scientific Engineering House Pvt. Ltd vs. CIT (1986) 157 ITR 86(SC) held that the compilation of technical knowhow is an article to be considered as capital asset eligible for deduction for depreciation. Similarly, the Mumbai Tribunal also in the case of ISBC Consultancy Services Ltd. Vs. DCIT (2002) 88 ITD 134 (Mum) held that the customization of software amounted to manufacture and entitled to deduction under section 10A of the Act. In view of the above given facts and circumstances, we are of the view that the assessee is entitled to deduction under section 10B as it has established that the relevant conditions of section 10B that there must be a production of article or thing and export of such article or thing and consideration thereof brought into India within the time permissible under the foreign exchange regulations are fulfilled and accordingly allowable. We allow this issue of assessee's appeal.

13. The next issue in this appeal of assessee is against the order of DRP and the AO in not computing the deduction under section 10B of the Act undertaking wise and thereby not allowing the deduction in respect of

Beta lactam Division (BLD) and Star Unit. For this assessee has raised the following ground No. 2:-

> *"Ground No. 2: Deductions under section 10B to be computed undertaking-wise.*
>
> *Without prejudice to the Ground 1 above, and notwithstanding the inadvertent errors made by the appellant in the return of income lie claiming section 1OB deduction on the basis of consolidated/ profits after setting off profits and losses of 10B units as against undertaking wise deduction and claiming deduction at 90% of profits. The Hon'ble DRP and Ld. AO erred in:*
>
> *• Not computing section 10B deduction undertaking wise and thereby. not allowing deduction in respect of Beta Lactam Division (BLD) which is a recognized EOU as well as a 106 manufacturing unit Restricting deduction under section 10B at 90% on the profits of eligible units as claimed by the Appellant instead of 100% of tax profits earned by the respective eligible units."*

14. At the outset, the learned Counsel for the assessee stated that the assessee company has made an error in the return of income by computing the deduction under section 10B of the Act on consolidated basis and not unit wise and thereby resulting in set off of losses of ODF Unit against the income of BLD Unit and Star unit. According to him, the Revenue has restricted the claim of deduction upto 90% based on the understanding that the deduction is available only for 90% of the profit from the AY 2003-04 onwards. The learned Counsel for the assessee stated that the restrictions of deduction upto 90% of profit was only applicable for AY 2003-04 having regard to the Use of ward "for" in the

second proviso to section 10(B)(1) of the Act. The learned Counsel for the assessee referred to the second proviso to section 10(b)(1) of the Act which reads as under: -

> *"Special provisions in respect of newly established hundred per cent export-oriented undertakings.*
>
> *10B. (1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee :*
>
> *Provided that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to the deduction referred to in this sub-section only for the unexpired period of aforesaid ten consecutive assessment years :*
>
> *Provided further that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software:*

Provided also that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, 2012 and subsequent years :

Provided also that no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under sub-section (1) of section 139."

15. In view of the above provision, the learned Counsel for the assessee referred to the decision of Hon'ble Supreme Court in the case of CIT vs. Yokogawa India Ltd. [2017] 77 taxmann.com 41 (SC), wherein the entire proviso is considered and finally held as under: -

"16. From a reading of the relevant provisions of Section 10A it is more than clear to us that the deductions contemplated therein is qua the eligible undertaking of an assessee standing on its own and without reference to the other eligible or non-eligible units or undertakings of the assessee. The benefit of deduction is given by the Act to the individual undertaking and resultantly flows to the assessee. This is also more than clear from the contemporaneous Circular No. 794 dated 9.8.2000 which states in paragraph 15.6 that,

"The export turnover and the total turnover for the purposes of sections 10A and 10B shall be of the undertaking located in specified zones or 100% Export Oriented Undertakings, as the case may be, and this shall not have any material relationship with the other business of the assessee outside

these zones or units for the purposes of this provision."

17. If the specific provisions of the Act provide [first proviso to Sections 10A(1); 10A (1A) and 10A (4)] that the unit that is contemplated for grant of benefit of deduction is the eligible undertaking and that is also how the contemporaneous Circular of the department (No. 794 dated 09.08.2000) understood the situation, it is only logical and natural that the stage of deduction of the profits and gains of the business of an eligible undertaking has to be made independently and, therefore, immediately after the stage of determination of its profits and gains. At that stage the aggregate of the incomes under other heads and the provisions for set off and carry forward contained in Sections 70, 72 and 74 of the Act would be premature for application. The deductions under Section 10A therefore would be prior to the commencement of the exercise to be undertaken under Chapter VI of the Act for arriving at the total income of the assessee from the gross total income. The somewhat discordant use of the expression "total income of the assessee" in Section 10A has already been dealt with earlier and in the overall scenario unfolded by the provisions of Section 10A the aforesaid discord can be reconciled by understanding the expression "total income of the assessee" in Section 10A as 'total income of the undertaking'.

18. For the aforesaid reasons we answer the appeals and the questions arising therein, as formulated at the outset of this order, by holding that

though Section 10A, as amended, is a provision for deduction, the stage of deduction would be while computing the gross total income of the eligible undertaking under Chapter IV of the Act and not at the stage of computation of the total income under Chapter VI. All the appeals shall stand disposed of accordingly."

16. Accordingly, the learned Counsel for the assessee argued that although the assessee company has made inadvertent error in the return of income for AY 2007-08, the same can be adjudicated by the AO after verification of facts in view of the decision of Hon'ble Bombay High Court in the case of CIT vs. Pruthvi Brokers & Shareholders [2012] 349 ITR 336 (Bombay). On this aspect the learned Sr. Departmental Representative only relied on the order of DRP and that of the Assessing Officer.

17. After considering the submissions of the assessee and going through the facts of the case, we direct the AO to recompute the deduction as claimed by assessee under section 10B in term of the decision of Hon'ble Supreme Court in the case of Yokogawa India Ltd. (supra). The second proviso to section 10B(1) of the Act was only for assessment year 2003-04 and not for other years. The AO will verify the facts of the case and accordingly, will allow the claim of the assessee. This issue of assessee's appeal is set aside to the file of the Assessing Officer.

18. The next issue in this appeal of assessee is against the order of DRP and AO in disallowing the claim of deduction under section 10B of the Act for the unbilled Revenue recorded by Star Unit. For this assessee has raised the following grounds: -

"3. The Hon'ble DRP and Ld AO erred in disallowing section 106 deduction for the unbilled revenue

recorded by the STAR unit on the following grounds without appreciating facts of the case:

- the unbilled revenue is recognized on the milestones achieved by the Appellant based on the generally accepted accounting policies and principles.

- accrued revenue is not received in convertible foreign exchange since no invoices are raised by the Appellant for the same.

4. The Hon'ble DRP and Ld AO failed to appreciate the fact that substantial portion of unbilled revenue has been received in convertible foreign exchange as advances' and the balance amount within the prescribed time limit under the foreign exchange control regulations, the prescribed limit being effective from the date of invoice and not from the date of accrual of revenue.

5. Without prejudice to the above, if it is contended the unbilled revenue/ income has not accrued to the Appellant. the entire profits of STAR unit should not be taxed."

19. Brief facts are that the assessee is engaged in the business of manufacturing and trading of pharmaceuticals. The assessee has 100% EOU units, Sterile Products a non 10B unit and three 10B Units called Oral Dosage Forms (ODF), Betalactam Division (BLD) and Contract Manufacturing & Research Division (STAR). During the course of assessment proceedings AO required the assessee to finish the details of the unbilled revenue of STAR unit, and accordingly party wise details of the same were provided. It was also submitted that these represent

'Development Revenue recognized' for which no invoices have been raised. It was further submitted that the revenue has been recognized based on a technical estimates of the stage of work. During the course of assessment proceedings, the Assessee submitted a write up on how the units are eligible for 10B Deduction & also submitted a write up off activities done at R&D center, Copies of Agreements of Unbilled Debtors, list of debtors, Copies of EOU Agreements, were submitted and accordingly claimed deduction under section 10B of the Act.

20. The AO has considered the entire unbilled revenue as income and disallowed the claim of deduction under section 10B of the Act. According to AO, the export turnover as well as total turnover is unbilled Revenue recorded on the basis of internal accounting policy on reaching its own has created mile stones without raising invoices. According to AO, the assessee has recognized the Revenue even before it has accrued. Hence, he held that since no invoices has been raised, the question of receiving invoices money in convertible foreign exchange does not arise and the claim of deduction under section 10B of the Act cannot be allowed. The DRP also held that the Revenue from sale of goods is recognized when all significant risk and research of ownership stand transferred to the buyers and there is no uncertainty as regards to the consideration to be derived from such a sale. Invoicing is the acknowledgement of the initial performance of the sale and its acceptance by the buyer. Approval of sale as per terms and conditions, when there being no invoices, the transaction cannot be said to have completed. Accordingly, the DRP confirmed the action of the Assessing Officer.

Aggrieved, assessee is in appeal before Tribunal.

21. Before us, the learned Counsel for the assessee argued that it is following progressive billing approach for recognition of Revenue. For this

purpose, a detailed note was enclosed in paper book 2 volume 1 at pages 79 to 85 explaining the difference stages of development of a dossier and the milestones adopted by it for accrual of income based on progress achieved. Apart from this, the learned Counsel for the assessee argued that the assessee company has raised invoices on its customers as per terms and conditions agreed in the agreement with them and consequently the invoices have also been realized within the period of 6 months thereafter. It was also explained that compliance with the relevant statutory provisions of RBI and FEMA has been complied with and guidelines have also been met with for each of the invoices since the assessee has brought into India the foreign exchange within 6 months of the invoices being raised and accordingly, there was full compliance with the requirement of section 10B of the Act. The learned Counsel for the assessee has made another alternative argument before us with a view that in case income has not accrued and hence, not entitled for deduction under section 10B of the Act, then, the income cannot be assessed in the hands of the assessee in the absence of its accrual. He also argued that since the income has been assessed, which has been assessed as stated above, is based on accepted accounting principles, the Tribunal can direct the AO to verify whether the consideration has been received within 6 months of raising of the invoices and allow the deduction as claimed for the year under consideration. The learned CIT Departmental Representative has made submissions that the DRP and the AO has rightly not allowed the claim of deduction but he agreed to the alternative submissions of the assessee that the income cannot be assessed in the absence of its accrual in the year under consideration and since the income has been assessed the AO can be directed to verify whether consideration has been received within 6 months of raising of the invoices and in that case, income can be considered and deduction can be allowed as claimed in the year.

22. We have considered the issue and are of the view that income has not accrued as agreed by both the sides. Hence, the assessee is not entitled for deduction under section 10B of the Act on unbilled Revenue recorded on the basis of internal accounting policy but we are also of the view that the income also cannot be assessed in the absence of its accrual. The AO is directed to delete the addition wherever income has not accrued but added by the AO, after verification of the factual position. The AO can also verify where consideration has been received within 6 months of raising of the invoice, the AO can allow the deduction as claimed in the year. In view of these directions, we set aside this issue to the file of the Assessing Officer.

23. The next issue in this appeal of assessee is against the order of DRP and AO in reworking of deduction under section 10B of the Act.

24. At the outset, the learned Counsel for the assessee stated that he has instructions from the assessee not to press this issue and hence the same is dismissed as not pressed.

25. The next issue in this appeal of assessee is against the order of DRP and AO in disallowing the claim of weighted deduction under section 35(2AB) of the Act. For this assessee has raised the following ground No. 5: -

> *"7. The Hon'ble DRP and Ld. AO erred in disallowing the claim of weighted deduction under section 35(2AB) of the Act on the ground that the Appellant has failed to submit Form No. 3CL and Form No 3CM without appreciating the fact that the application is pending before the Prescribed Authority i.e. Department of Scientific and Industrial Research (DSIR) and submission of Form No. 3CL*

and Form No. 3CM is only a procedural requirement which is beyond the control of the Appellant."

26. Briefly stated facts are that the assessee during the assessment year has incurred the following expenses in respect of R&D activity.

Revenue expenditure - Rs. 22,95,66,925

Capital expenditure - Rs. 4,45,87,047

The above expenses have been incurred by the 'STAR' unit in respect of various Research and Development projects undertaken by it. The unit has incurred Rs. 22,95,66,925/- being the revenue expenditure and the balance Rs. 4,45,87,047/- being capital expenditure, which has been capitalized in the books of account and depreciation u/s 32 of the has not been claimed on the same. As Per the provisions of section 35(2AB) of the Act, certain companies are eligible for a weighted deduction of 150% of the expenditure incurred in respect of any scientific research. The assessee claimed that the AO has neither questioned eligibility of the Company to claim the weighted deduction nor the fact of incurring the expenditure This is apparent from the fact that the AO has allowed 100% deduction in respect of the expenditure incurred. What the AO has contended in disallowing the weighted deduction claim is the non-submission of Form 3CM arid Form 3CL. The DRP also confirmed the action of the AO. Aggrieved, assessee came in appeal before Tribunal.

27. The learned Counsel for the assessee stated that it has fulfilled all the conditions to claim weighted deduction in respect of expenditure claimed under section 35(2AB) of the Act. The assessee submitted following details before the lower authorities and even now before us:-

1. Copy of letter issued by department of scientific and industrial research renewing the

recognition of In-house R & D unit upto 31.03.2010 and extension upto 31.03.2015.

2. Copy of application made to the secretary, DSIR for certification of the expenditure under section 35(2AB) of the Act.

3. Auditors certificate certifying the R& D Expenditure

4. R & D expenses certified by Managing Director.

28. It was stated that the delay in issuing Form No. 3CM and report in Form No. 3CL by the DSIR' due to their administrative reasons and Tribunal in assessee's own case for AY 2002-03 in ITA No. 1727/Mum/2006 vide order dated 16.12.2015 allowed the claim of the assessee after following the decision of Gujarat High Court in the case of CIT vs. Claris Lifesciences ltd. 326 ITR 251 (Guj), wherein it is held as under:

"3.4. We have gone through the submissions made by both the sides as well as facts of the case and the position of law emerging out from the decisions relied upon by the parties before us. The brief facts are that deduction u/s 35(2AB) was claimed by the assessee in respect of research and development expenses incurred at New Mangalore and KRS Gardens research centre. Application was made with DSIR dated 28.03.2001, copy of which is enclosed at pages 37 to 68 of the paper book. The recognition of the research unit was granted by the DSIR vide its letter dated 03.07.2002 for New Mangalore unit (copy available at P.B. 68) and letter dated 04.12.2002 for KRS Gardens research unit (

copy available at page no.69 of the paper book). In view of these facts, it clearly emerges out that assessee had made the applications well in time. Thereafter, granting of approval by the competent authority was not in the control of the assessee. It has been further brought to our notice that there was no delay on the part of the assessee in supplying any information to the approval authority, if and when asked by it. In other words, the delay, in the given facts, cannot be attributed to the assessee. In fact, the assessee had no say in this regard. It is further noted by us that the approval has been granted by the competent authority after taking the application of the assessee as a base. In our considered view, under these circumstances, the approval would relate back to the date of the application. In other words, under these circumstances, it can be taken as if the approval was granted on 28.03.2001 i.e. the date of application made by the assessee. Thus, in our view, the grievance raised by the Revenue on this issue is not sustainable. It is further noted by us that this issue is no more res-integra. We can take help of judgment of Hon'ble Delhi High Court in the case of CIT vs. Sandan Vikas (India), (supra) wherein their lordships have held, following the judgments of Hon'ble Gujarat High Court in the case of CIT vs. Claris Lifesciences Ltd. (supra), that assessee would be eligible for deduction even if the approval is granted by the competent authority subsequent to the expiry of the previous year. The relevant portion of the judgment is reproduced below:

"The Assessing Officer, however, refused to accord the benefit of the aforesaid provisions of weighted deduction to the assessee on the ground that recognition and approval was given by the DSIR in February/September 2006, i.e., in the next assessment year and, therefore, the assessee was not entitled to the benefit. The CIT(Appeal) accepted this view of the Assessing Officer and dismissed the appeal, however, the Income Tax Appellate Tribunal (hereinafter referred to as "the Tribunal") has come to the conclusion that the assessee would be entitled to weighted deductions of the aforesaid expenditure incurred by the assessee in terms of the Section 35(2AB) of the Act and in coming to this conclusion, the Tribunal has relied upon the judgment of Gujarat High Court in Commissioner of Income Tax v. Claris Lifesciences Ltd., 326 ITR 251(Guj). We have gone through the aforesaid judgment of the Gujarat High Court and find that Gujarat High Court detailed in nouncertain terms that the cut-off date mentioned in the certificate issued by the DSIR would be of no relevance. What is to be seen is that the assessee was in indulging in R&D activity and had incurred the expenditure thereupon. Once a certificate by DSIR is issued, that would be sufficient to hold that the assessee fulfils the conditions laid down in the aforesaid provisions. The discussion, which is undertaken by the

Gujarat High Court while interpreting the aforesaid provisions, is extracted below: "7. .....The lower authorities are reading more than what is provided by law. A plain and simple reading of the Act provides that on approval of the research and development facility, expenditure so incurred is eligible for weighted deduction. 8. The Tribunal has considered the submissions made on behalf of the assessee and took the view that section speaks of: (i) development of facility; (ii) incurring of expenditure by the assessee for development of such facility; (iii) approval of the facility by the prescribed authority, which is DSIR; and (iv) allowance of weighted deduction on the expenditure so incurred by the assessee. 9. The provisions nowhere suggest or imply that research and development facility is to be approved from a particular date and, in other words, it is nowhere suggested that date of approval only will be cut-off date for eligibility of weighted deduction on the expenses incurred from that date onwards. A plain reading clearly manifests that the assessee has to develop facility, which presupposes incurring expenditure in this behalf, application to the prescribed authority, who after following proper procedure will approve the facility or otherwise and the assessee will be entitled to weighted deduction of any and all expenditure so incurred. The Tribunal has, therefore, come to the conclusion that on

plain reading of section itself, the assessee is entitled to weighted deduction on expenditure so incurred by the assessee for development of facility. The Tribunal has also considered Rule 6(5A) and Form No. 3CM and come to the conclusion that a plain and harmonious reading of Rule and Form clearly suggests that once facility is approved, the entire expenditure so incurred on development of R&D facility has to be allowed for weighted deduction as provided by Section 35(2AB). The Tribunal has also considered the legislative intention behind above enactment and observed that to boost up research and development facility in India, the legislature has provided this provision to encourage the development of the facility by providing deduction of weighted expenditure. Since what is stated to be promoted was development of facility, intention of the legislature by making above amendment is very clear that the entire expenditure incurred by the assessee on development of facility, if approved, has to be allowed for the purpose of weighted deduction. 10. We are in full agreement with the reasoning given by the Tribunal and we are of the view that there is no scope for any other interpretation and since the approval is granted during the previous year relevant to the assessment year in question, we are of the view that the assessee is entitled to claim weighted deduction in respect of the entire expenditure

incurred under Section 35(2AB) of the Act by the assessee." 3. We are in full agreement with the aforesaid approach of the Gujarat High Court. No substantial question of law, therefore, arises. The appeal is dismissed."

3.5. It is noted by us that similar view has been taken by Hon'ble Madras High Court in the case of CIT vs. Wheels India Ltd. (supra). Thus, keeping in view the clear position of law and the facts of this case, stand of the Revenue on this issue is rejected. The other issue raised by the AO in disallowing the deduction was that no agreement has been entered as contemplated by section 35(2AB). In this regard also we have noted that the assessee has made requisite compliance as has been required by the prescribed competent authority and compliance of all the procedural requirements has been examined by the competent authority while granting approval. In our considered view, we should look substantive compliance of the provisions. Documentation in any particular format and its approval in a particular manner is not object of this action. In any case, all these aspects have been examined by the competent authority while granting approval, thus the AO should not have denied benefit of deduction on his whims and fancies. We find that the assessee has rightly placed reliance on the judgment of coordinate bench in the case of ACIT vs. Meco Instruments (supra) and Sri Biotech Laboratories India Ltd., supra, in support of his claim."

29. In view of the above order of Tribunal in assessee's own case and even in AY 2003-04 in ITA No. 641/Mum/2007 and in AY 2004-05 in ITA

No. 4063/Mum/2010 order dated 29.04.2016, same deductions were allowed exactly on identical facts, respectfully following a consistent view and the given facts of the case, we direct the AO to allow the claim of deduction. This issue of assessee's appeal is allowed.

30. The next issue in this appeal of assessee is against the order of DRP and AO in disallowing a portion of rental expenditure on the ground that the rent paid to related parties is unreasonable in view of the provisions of section 40A(2)(b) of the Act. For this assessee has raised the following ground No. 6 as under:-

> *"8. The Hon'ble DRP and Ld. AO erred in disallowing a portion of rental expenditure on the ground that the rent paid to related parties is unreasonable without considering the factors relevant for determining the rental value of the property (such as quality of construction, the prevalent rate in the neighbourhood areas, period of lease agreement, terms of agreement with the landlord amongst others).*
>
> *Without prejudice to the above, the Hon'ble DRP and Ld AO erred in disallowing the portion of rent as unreasonable only from non 10B units instead of disallowing the same from 10B units and non 10B units on the basis of actual rent paid."*

31. Briefly stated facts are that the AO and DRP has considered that the sum of ₹ 1,26,05,528/- being rental expenditure claimed by assessee and rent paid to related parties is unreasonable in term of section 40A(2)(b) of the Act and therefore, disallowed the same. The assessee explained before the lower authorities that the differential rent paid to Chayadeep properties Pvt. Ltd. and K Narayanraju & K Bhaskaraju was

based on quality of construction and further Chayadeep properties Pvt. Ltd. to whom the assessee paid this rent was declared as rental income, on the same amount and there is no tax evasion. The assessee before us explained that the fact that the rentals in 1995 in Bilekahalli, Bannerghatta Road, Bangalore was very low. The Bilekahalli area with no significant development was generally considered as an outskirt of Bangalore. The development in this area took place with the coming up of Wockhardt (now Fortis) and Apollo Hospitals from 2004 onwards and the rentals started rising in the area. Subsequently, Bilekahalli became part of Bangalore Municipal limit. In case of Chayadeep, the entire cost of building was borne by lessor, whereas only cost of bare structure was borne by Mr. Narayan Raju / Mr. Bhaskar Raju. The rest of the cost of building was borne by the assessee. The cost of construction in 2005 (Chayadeep) was far higher compared to the year 1995 (Mr. Narayan Raju/ Mr. Bhaskar Raju). It had increased three fold in the ten years. The class of building (structure) and the quality of the structure in case of Chayadeep is far superior compared to that of the buildings extensively used in case of chayadeep Properties. Consequently, the cost per sq. ft. for the building in case of Chayadeep is significantly higher. No security deposit was given to Chayadeep, whereas interest free security deposit of ₹ 10 lakhs was paid to Mr. Narayan Raju and Bhaskar Raju in 1995 and has remained so. The initial rentals in case of Mr. Narayan Raju/Mr. Bhaskar Raju was very low and was frozen in the first 7 years. In view of the above, the learned Counsel for the assessee claimed the expenses but the AO and DRP has not agreed that the submissions and disallowed the rental expenditure paid by assessee to Chayadeep Properties Pvt. Ltd. Aggrieved, now assessee is in appeal before Tribunal.

32. We have heard the rival contentions and gone through the facts and circumstances of the case. We find from the facts of the case that the entire cost of the construction of the building was borne by the related

party as against only the cost of construction of bare structure by the outside party. The rental agreements with Outside party were entered into in May 2001 and the terms of the agreement were that the agreements were initially for a period of 7 years until October 2008 and rent payable in respect of the property was fixed with an option on the part of the owner increase up to a maximum of 15% once in 3 years. The amount of rent payable as agreed upon were at the then prevailing rates in that locality and since the locality where the property is situated were not so developed at that point in time the rentals fixed were considerably low. Thus the owner had no option but to change only such amount of rent as per the terms of the Agreement. Whereas, the rental agreements with related party were entered into during August 2004 in case of one property and June 2006 in case of two other properties.

33. We find from the facts of the case that the lower authorities failed to appreciat the facts that the significant portion of the property belonging to the related party are used for R&D and Corporate Office which houses the Corporate Office Finance, HR, R&D. SCM, Planning departments. This it is be rented out to any third party without any modification. This can as it is be rented out to any third party without any modification this had a central superior quality construction and utilization for corporate office structure of related party building compared to outside party building which is used for manufacturing plant. The rental agreements with outside party were entered into in May 2001 and the rents were fixed for initial 7 years. Whereas, the rental agreement with related party were entered into during August 2004 in case of one property and June 2006 in case of two other properties.

34. In view of the above facts, we are of the view that the rent paid is not falling within the mischief of section 40A(2)(b) of the Act and seems

reasonable. We allow the claim of the assessee and this issue of assessee's appeal is allowed.

35. The next issue in this appeal of assessee is against the order of DRP and AO in disallowing the expenditure of premium of redemption of foreign currency convertible bonds (FCCB). For this assessee has raised the following ground No. 7:-

> *"9. The Hon'ble DRP and Ld AO erred in disallowing the expenditure of premium on redemption of FCCB on the ground that:*
>
> • *Such expenditure is capital in nature without appreciating that the premium on FCCBs are equivalent to interest on loans and the FCCB funds were utilized wholly and exclusively for the purpose of business;*
>
> • *The premium on redemption of FCCB is only a notional expenditure and contingent liability without appreciating the fact that the Appellant has actually redeemed the FCCBs in April 2010 as per the terms stipulated in the offer document."*

36. The assessee claimed 1/5th of FCCB premium amounting to ₹ 12,80,23,824/- and 1/5th of the FCCB issued expenses amounting to ₹ 98,97,774/- as deduction. The AO noticed from the annual report of the assessee that it has adjusted an amount of ₹ 5,04,08,369/- under the head expenses related to issue of FCCB in the balance sheet against securities premium account in AY 2006-07. The AO required the assessee to explain how it is allowable as revenue expenditure. The AO after considering the explanation of the assessee noted that the FCCB issued is capital expenditure in nature and cannot be allowed under

section 37 of the Act. According to AO, the premium of redemption is neither due nor incurred during the year and it is just a provision for liability arising in future. Accordingly, the AO disallowed the claim of deduction and the assessee carried the matter to DRP, who also confirmed by holding that the FCCB premium of redemption is just a provision for liability arising in future and therefore agreed that the AO i.e. premium of redemption cannot be allowed as deduction because the expenditure is neither fructified or ascertained. Aggrieved, now assessee is in appeal before Tribunal.

37. We have heard the rival contentions and gone through the facts and circumstances of the case. The learned Counsel for the assessee explained the facts that the assessee company has issued FCCB (listed in Singapore Stock Exchange) to the extent of US $ 40 million. These bonds carry an interest rate of 0.5% p.a. and are redeemable on April 19, 2010 at 136.78 percent of the Principal amount. Further, these bonds are convertible into shares by Bond holders on or after May 18, 2005. The total issue expenses relating to the issue of FCCB is USD $ 10,77,926 claimed in equal installments over a period of 5 years. Further, we find that these Bonds may be redeemed only in full, at any time on or after 18th April 2008 but before April 19th 2010 with a redemption premium of 68% p.a. As on 31' December 2005 the additional amount (including exchange fluctuation) which is payable on redemption was provided for under Debenture Redemption Reserve with a corresponding adjustment to Securities Premium. Further, none of the bonds were offered for conversion as on 31st March 2007. Further, the FCCB issue expenses have been allowed as a deduction in the Company's own case for the AY 2006-07. Based on GAAP principles, the premium needs to be accrued; consequently the liability has been accrued in the books in the year of receipt of FCCB funds. Premium on redemption amounting to USD 16 Million has been accrued in the financials for the year ending 31 December 2005 based on the office circular. The liability is crystallized in the year of issue; however, it is discharged in the year of redemption.

38. In view of these facts, we are of the view that when a Company issues FCCB, it incurs a liability to pay a larger amount than what is borrowed and such higher amount payable by the Company will be for the purpose of its business in order to generate funds for its business activities. The amounts so obtained are used by the Company for the purposes of its business. Hence the liability to pay the additional amount would therefore be revenue expenditure. The additional amount is nothing but an interest computed at 6.8% p.a. We find that the assessee also relied on the decision of Hon'ble Bombay High Court in the case of CIT vs. SM Holding and Finance Pvt. Ltd. 2003 264 ITR 370 Bombay. Before the Hon'ble Bombay High Court in the question raised was regarding the claim of 1/5th of premium of redeemable debentures and the question referred before the Hon'ble High Court was as under: -

> *"Whether, on the facts and in the circumstances of the case and in law, the Hon'ble Tribunal has erred in deleting the addition of Rs. 54,75,000 made on account of 1/5th (1/10th) of premium on the redeemable debentures without considering the fact that no liability had accrued during the year under appeal and it was a contingent liability which was payable only after the expiry of 10 years and directed the Assessing Officer to follow the decision of Supreme Court in the case of Madras Industrial Investment Corporation Ltd. v. CIT [1997] 225 ITR 802(SC) where facts of the case are different from those of Supreme Court's decision?"*

And Hon'ble High Court has held in Para 5 as under:-

> *"5. We do not find any merit in the above arguments advanced on behalf of the Department. Firstly, we have gone through the records and proceedings (R & P). In the entire R & P, there is nothing to indicate*

alterations of terms and conditions during the subsistence of the issued convertible debentures during the assessment year in question. Secondly, in the annual reports of the company and also in the audit reports given by the auditors, it has been certified that zero interest unsecured redeemable convertible debentures of Rs. 100 each redeemable after 10 years at a premium of 100 per cent had been issued during the assessment year in question. There is no reason for us to discard this note of the auditor. Even in the assessment order, no reasons have been given by the Assessing Officer for discarding this note of the auditors. Lastly, we may point out that even assuming for the sake of argument that the borrower had a discretion to change the terms of the issued debentures, there is nothing in the record to show that during the assessment year in question the borrower had exercised such a discretion. In the absence of factual matrix, we have no option but to confirm the judgment of the Tribunal. In our view, the judgment of this Court in the case of Taparia Tools Ltd. (supra) is applicable to this case. In our view, the judgment of the Supreme Court in the case of Madras Industrial Investment Corpn. Ltd. (supra) is also applicable."

39. In view of the above facts, we are of the view that the assessee has rightly claimed the liability as expense and we allow the same. This issue of assessee's appeal is allowed.

40. The next issue in this appeal of assessee is against the order of DRP and AO in disallowing the expenses relatable to exempt income

under section 14A of the Act. For this assessee has raised the following ground: -

> *"10. The Hon'ble DR and Ld AO erred in disallowing 5% of total interest and salary expenditure under section 14A of the Act without appreciating the fact that the Appellant has not incurred any such expenditure and there is no separate administrative set up for earning such exempt income and Investments were made out of internal accruals and not out of any borrowings,*
>
> *The Hon'ble DRP and Ld AO ought to have appreciated the fact that the substantial portion of investments held as on 31 March 2007 was in foreign subsidiaries and dividend income from \ overseas entities are taxable in India."*

41. At the outset, the learned Counsel for the assessee stated the fact that dividend received is ₹ 600 and which was claimed as exempt. The learned Counsel for the assessee stated that the assessee has no objection in case disallowance is restricted exempt income in view of the decision of the Hon'ble Delhi High in the case of Cheminvest Ltd. vs. CIT (2015) 378 ITR 33 (Delhi). The decision of Delhi High Court in the case of Cheminvest Limited (*supra*), reads as under: -

> *"23. In the context of the facts enumerated hereinbefore the Court answers the question framed by holding that the expression „does not form part of the total income" in Section 14A of the envisages that there should be an actual receipt of income, which is not includible in the total income, during the relevant previous year for the purpose of disallowing any expenditure incurred in relation to the said*

income. In other words, Section 14A will not apply if no exempt income is received or receivable during the relevant previous year."

42. We find that the issue before us for adjudication is very limited as argued by the learned Counsel for the assessee that the exempt income is only to the tune of ₹ 600/- and the disallowance should be restricted to that only. To this proposition the learned CIT Departmental Representative also agreed that the matter is covered in view of the Delhi High Court decision in the case of Cheminvest Ltd. (supra). As the issue is covered by the decision of Hon'ble Delhi High Court that the disallowance cannot exceed the exempt income. Respectfully, following the Hon'ble Delhi High Court in Cheminvest Ltd., we restrict the disallowance under section 14A at ₹ 600/- i.e. to the extent of dividend income. We direct the AO accordingly.

43. The next two interconnected issues in this appeal of assessee are as regards to the levy of interest under section 234B and 234D of the Act. At the outset, the learned Counsel for the assessee drew our attention to ground No. 10 and 11 which reads as under:-

"Ground No 10: Levy of interest under section 234B of the Act - Rs 43,693,090

11. The Hon'ble DRIP and Ld AO erred in levying interest under section 234B of the Act which is consequential in nature.

Ground No 11: Levy of interest under section 234D of the Act Rs 1,688755

12. The Hon'ble DRP and Ld AO erred in levying interest under section 234D of the Act which is consequential in nature."

44. He stated that charging of interest under section 234B and 234D is consequential in nature and AO will charge interest as per the provisions of the Act at the time of giving appeal effect to the order of the Tribunal. As the issue is consequential, we direct the AO to charge interest as per law.

45. The next issue in this appeal of assessee is against the order of DRP and AO upholding the transfer Pricing adjustment amounting to ₹ 23,03,061/- made by the TPO under section 92CA of the Act. For this assessee has raised the following ground No. 12:-

> *"Ground No 12: Transfer pricing adjustments*
>
> *13.1. The Dispute Resolution Panel (DRP) and the Assessing Officer (AO) have erred in upholding the transfer pricing adjustment amounting to INR 2303,061 made by the learned Transfer Pricing Officer (TPO) u/s 92CA of the Income Tax Act (the Act).*
>
> *13.2. The DRP. TPO and AO have erred in imputing notional interest on the outstanding advance balances and upholding the above transfer pricing adjustment.*
>
> *14. The DRP TPO and the AO have erred in characterizing the year end debit balances of advances which has been incurred / paid in the ordinary course of business operations as loan and in doing so failed to understand the business rationale behind such advances and distinguish between a loan and an advance transaction.*
>
> *13.4. The DRP, TPO and AO have failed to appreciate that only real income can be brought*

within the ambit of taxation. In this case, no income has been earned or can be said to have been earned by the Appellant and imputing hypothetical interest on the balances outstanding would be unwarranted and unjustified.

13.5 Without prejudice to the argument of the Appellant that no interest should be charged on the advances, the DRP. TPO and AO have erred in arbitrarily applying interest rate on the advances outstanding."

46. The learned Counsel for the assessee stated that this issue is covered in regard to adjustment of such notional interest and according to him the same cannot exceed the LIBOR plus 300 in view of assessee's own case of ITAT's for AY 2004-05 in ITA No. 4063/Mum/2010 and CO. No. 61/Mum/2010 order dated 29.04.2016, wherein Tribunal at page 29 para 39 and 40 has directed the AO to apply LIBOR rate of 1.698% + 300 basis point on interest relating to advancement of interest free loans / extended credit facility to the oversee AE. The relevant Para 39 and 40 of the Tribunals order in assessee's own case reads as under: -

"39. We have considered the submissions of the parties and perused the material available on record. As far as the contention of the learned Authorised Representative that the interest free advances to the overseas subsidiary on account of reimbursement of expenditure is not an international transactions and the transfer pricing provisions are not applicable, we are not convinced with the same. On a reference to section 92B of the Act, it is observed that after amendment effected vide Finance Act, 2012, with retrospective effect from 1st April 2002, the definition of international transactions

as provided under the Explanation (i) to section 92B, has been expanded to include the following transactions.

> *—Explanation.—For the removal of doubts, it is hereby clarified that— (i) the expression —international transaction‖ shall include—*
>
> *(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;*
>
> *(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;*
>
> *(c) capital financing, including any type of long-term or shortterm borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;*
>
> *(d) provision of services, including provision of market research, market development,*

marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

40. On a plain reading of clause (c) of Explanation– (i) to section 92B, it is evident that any type of advance payment or deferred payment or receivable or any other debt arising during the course of business including capital financing would come within the scope of —International Transaction‖. Thus, the assessee having incurred expenditure on behalf of its overseas A.Es which are receivables from the A.Es comes within the meaning of —International Transactions‖. Therefore, contention of the learned Authorised Representative that receivables on account of expenditure incurred on behalf of A.E. are not international transaction or no computation can be made is not acceptable in view of specific statutory provisions. The next contention of the learned Authorised Representative is, the assessee has long standing business relation with the subsidiary and as a result of investment / advances made, assessee has derived benefit as substantial sales have been recorded from the geographical locations where the subsidiaries are

situated. In our view, plea of business / commercial expediency are not applicable to such type of transactions. Under the transfer pricing provisions, it has to be seen whether a particular transaction between the related parties is at arm's length. Therefore, it has to be seen whether under similar circumstances, assessee would have entered into such transaction with unrelated parties. If the facts on record suggest that the assessee would not have entered into such type of transactions with unrelated parties, then the transaction between the related parties cannot be considered to be at arm's length. There is no dispute to the fact that while the assessee has incurred cost by availing credit facility it has advanced interest free funds by not charging interest on the expenditure incurred on behalf of the subsidiaries. Therefore, certainly, a benefit has accrued to the subsidiary on account of the assessee whereas a part of the profit base of the assessee on account of cost incurred on credit facility has been shifted to the subsidiary which otherwise could have been avoided if the surplus funds were available with it. In these circumstances, the principle of commercial expediency would not come into play. Therefore, in our view, as the assessee has not charged interest on outstanding receivables from the overseas subsidiaries, arm's length price of the same has to be determined. Having held so, it is necessary to quantify the rate of interest of such transaction. It is observed, the Transfer Pricing Officer has applied the average interest rate of domestic credit facility availed by the assessee. However, it is seen from the material on

record, the entire expenditure incurred by the assessee on behalf of the overseas subsidiary are on foreign currency (dollar), therefore, domestic PLR rate in terms of Indian rupee cannot be applied. It has been brought to our notice through the working submitted before the Departmental Authorities that the average cost of borrowings to the assessee is 4.84%. The learned Authorised Representative has also submitted a working showing the average LIBOR rate of financial year 2002–03 at 1.698%. In a number of decisions, different benches of the Tribunal have consistently held that in such type of international transaction, domestic PLR rate cannot be applied and the rate of interest has to be quantified either with reference to LIBOR or EURIBOR depending upon the country and currency in which the transaction has taken place. Considering the facts of the present case, we are of the considered opinion that LIBOR rate of 1.698% plus 300 basis point would be the appropriate interest rate applicable to the international transactions relating to advancement of interest free loan / extended credit facility to the overseas A.E. Accordingly, we direct the Assessing Officer / Transfer Pricing Officer to compute the interest on the interest free advances paid to the A.E. Ground no.5, is partly allowed."

47. The learned Departmental Representative has also stated that the issue is also been dealt with in earlier and exactly on the same lines, the directions can be given.

48. We find that the issue is squarely covered and respectfully following and taking a consistent view, we direct the AO to compute the

disallowance by taking LIBOR rate plus 300 basis point. We direct the AO accordingly.

49. **In the result, the appeals assessee is partly allowed for statistical purposes.**

Order pronounced in the open court on 08-06-2018.

Sd/-	Sd/-
(RAJESH KUMAR)	(MAHAVIR SINGH)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Mumbai, Dated: 08-06-2018
Sudip Sarkar /Sr.PS

Copy of the Order forwarded to:

1. The Appellant
2. The Respondent.
3. The CIT (A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

Assistant Registrar
ITAT, MUMBAI