IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "B", HYDERABAD

BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER AND
SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER

I.T.A. No. 1604 & 1605/HYD/2016
(A.Ys. 2011-12 & 2012-13)

DCIT, Central Circle-1(2), Hyderabad.	Vs	Aurobindo Pharma Limited, Hyderabad. **[PAN: AABCA 7366 H]**
(Appellant)		**(Respondent)**

For Assessee : Shri C.P. Ramaswami
For Revenue : Smt. Alka Rajvanshi Jain,
CIT - DR

Date of Hearing : 19.07.2018
Date of Pronouncement : 20.07.2018

O R D E R

PER B. RAMAKOTAIAH, AM

These are Revenue appeals against the common of Ld. CIT(A)-11, Hyderabad, dated 24.08.2016. The only issue in these appeals is with reference to weighted deduction allowed by Ld. CIT(A) on the clinical trials conducted outside the 'in-house R & D facility' which was disallowed by A.O. on the reason that the same was not certified by Prescribed Authority (DSIR) in Form 3CL.

2. Revenue has raised the followed grounds which are common for both the years:-

> "1. The CIT(A) erred in allowing the weighted deduction u/s 35(2AB) of the IT Act, 1961 in respect of the expenditure incurred in connection with the Bio Analytical and Bio Equivalence studies which is an expenditure incurred outside the "in-house" R & D Expenditure relying on the decision of the Hon'ble Gujarat High Court in the case of Cadila Healthcare Ltd.

2. The CIT(A) ought to have observed that the issue has not reached finality by way of Apex court has remitted the issue back to Gujarat High Court for fresh adjudication.

3. The CIT(A) erred in allowing expenditure towards Rates & Taxes and Travelling Expenses in connection with Clinical Drug Trials including Bio Analytical and Bio Equivalence studies conducted which also form part of expenditure incurred outside the 'in-house' R & D.

4. The CIT(A) ought to have considered the fact that rates & Taxes and Travelling Expenses in connection with Clinical Drug Trials forms part of expenditure incurred outside the 'in-house' R & D Facility and the issue is squarely covered in question of law involved for the purpose of law involved for the purpose of weighted deduction u/s 35(2AB) in the case of Cadila Healthcare Ltd which is still pending before Hon'ble Gujarat High Court."

3. Brief facts are that assessee has claimed weighted deduction u/s 32(2AB) in the computation of income and A.O. on examination of the claims with reference to the Form 3CL, issued by the Competent Authority, while allowing weighted deduction to the extent permitted by competent authority. He disallowed excess weighted deducted for both the years as under:-

In A.Y. 2011-12	Rs. 26,32,50,000/-
In A.Y. 2012-13	Rs. 34,00,02,000/-

4. Before the Ld. CIT(A) it was contended that as per the provisions of Section 35(2AB) it is very clear that the expenditure incurred by the company on its in-house scientific research and development facility duly approved by DSIR, is eligible for weighted deduction. Expenditure on Bio Analytical and Bio Equivalence Studies is part of clinical drug trials and is must for obtaining the product approvals. Further, the company's in-house R&D facilities are duly approved by the prescribed authority DSIR and Form No. 3CMs were already submitted, during the course of assessment proceedings and the expenditure is wholly and exclusively incurred by the company on its duly approved in-house research facilities. As far as Form NO. 3CL is concerned, it is only a

report to be submitted by the prescribed authority to the Director General (Income Tax Exemptions). Simply because DSIR has not reported a particular amount it should not be disallowed when the expenditure incurred by the company is wholly and exclusively for and on its Approved Facility. It is expressly provided in the Explanation to clause (1) of section 35(2AB) I that the expenditure on clinical drug tails in relation to drugs & pharmaceuticals is part of scientific research expenditure eligible for weighted deduction. For conducting Bio Analytical and Bio Equivalence Studies it requires hospital type facility and hence normally these studies will be conducted in outside facility duly approved for this purpose. In view of the above, it was submitted that the expenditure on Bio Analytical and Bio Equivalence Studies which forms part of clinical drug trials and which is must for product / process research and as this expenditure incurred wholly and exclusively incurred for scientific research and development the said amount is entitled for weighted deduction along with other Research Expenditure. It was further contended that this view is supported by the judicial pronouncement in the case of CIT Vs Cadila Healthcare Ltd by the Gujarat High Court wherein it was held that merely because the prescribed authority segregated the expenditure in two parts, viz; those incurred within the in-house facility and those incurred outside by itself would not be sufficient to deny the benefit to the assessee under section 35(2AB) of the Act. Thus, expenses incurred on drug trial outside the approved R&D facility would also be entitled to weighted deduction under section 35(2AB).

5. Ld. CIT(A) has analysed the facts and law on the issue and allowed the claim stating as under:-

> "8. The facts of the case and the grounds of the assessee Company are carefully considered. The Assessing Officer noticed that the claim made for R&D Expenditure in the return of income was more than the amount indicated in the certificate given in Form 3CL. At this point the

A.R. filed a revised statement of expenditure on Scientific Research in the light of the Form 3CL. The subsisting variance was attributed to Bio-Equivalence Studies done outside the in-house R & D facility which is, therefore. necessarily outside the purview of Form 3CL Which reflects in-house R&D Expenditure alone. The assessee held that in the light of the decision of CIT v. Cadila Health Care Ltd [2013] 214 Taxman 672, this expenditure too is eligible for weighted deduction u/s.35(2AB). The Assessing Officer was not in agreement, having regard to the language of clause (1) which refers to revenue expenditure II on in-house research and development facility as approved by the prescribed authority ... " The Assessing Officer, however, held that the assessee would be eligible for the normal deduction u/s.37 pf the Income-tax Act. Thus, after allowing normal deduction @ 100% in respect of expenditure on R & D incurred outside the in-house facility, the Assessing Officer identified a sum of Rs. 2,632.50 lakhs in A.Y.2011-12 & Rs.3,400.02 lakhs in A.Y.2012-13 as excess expenditure claimed u/s. 35(2AB) and added it to the assessable income.

8.1 It is seen from the Statement of Facts that the assessee does not dispute the methodology and quantification of this amount of Rs.2,632.50 lakhs & Rs.3,400.02 lakhs. It is stated that this amount comprises of Rs.24,59,59,344/- spent on Bio Equivalence Studies and Rs.1,72,91,656/- spent on Rates & Taxes, Travelling Expenses, etc., pertaining to Research Units in A.Y.2011-12. For A.Y.2012-13 it is similarly submitted that these figures are Rs.32,71,70,605/- and Rs.1,28,31,395/-, respectively. It is the claim of the assessee that the expenditure on Bio Equivalence Studies is an integral part of the activities of the in-house R&D facility as supported by the Gujarat High Court decision in the case of Cadila Health Care Ltd. supra, and other expenses (of Rs.1,72,91,656/- and Rs.1,28,31,395/-) are eligible u/s. 35(2AB) in so far as they are revenue expenses actually incurred in respect of the research facility, and relied for this purpose on the case of Intas Pharmaceuticals Ltd v. DCIT 2015 TaxPub(DT) 3549 (Ahd-Trib).

8.2 On a careful consideration of the above it is seen that the factual matrix considered by the Gujarat High Court in the above cited decision of Cadila Health Care Ltd. is identical to the case on hand. Their Lordships agreed with the ITAT / that segregation of revenue expenditure into 2 parts viz., those incurred within the in-house facility and those incurred outside merely because the prescribed authority maintained such segregation of expenditure would not be correct, having regard to the language as well as intent of Section 35 (2AB). It held -

"It is not as if that the said authority was addressing the issue for deduction ujs.35(2AB) of the Act in relation to the question hand. The certificate issued was only for the purpose of listing the total expenditure under the Rules."

In fact the case of the assessee on the legal aspect of the claim is supported by the explanation placed below clause (1) whereby expenditure incurred on clinical drug trial by pharmaceutical companies is expressly made eligible for consideration as expenditure

on scientific research in the context of Section 35(2AB). The case of the assessee that Bio-Equivalence Studies - also referred to clinical trials, are an intrinsic and necessary part of development of a new drug has to be accepted. The clinical drug trial sanctioned by the Explanation inserted below Section 35(2AB)(1) could not possibly have been carried out in an in-house facility. To require so would amount to an impossibility of performance.

8.3 It is seen that the Assessing Officer disallowed the above amount of Rs.2,632.50 Iakhs and Rs.3,400.02 lakhs on the premise that expenditure incurred has to be confined to the in-house facility. It is however, seen from the above that field trials connected to the activities of the approved in-house R&D facility have to be seen as eligible for the weighted deduction contemplated by Section 35(2AB). However, the Assessing Officer has not identified the components of the expenditure disallowed and whether they have been actually incurred for the stated purpose. It is seen from the Form 3CM dated 23.12.2011 issued by the Department of Scientific & Industrial Research according approval to the in-house R&D facility of the assessee company that the objectives of the Scientific Research taken up by this facility are stated to be as under:

"3. Objectives of the scientific research to be conducted by in-house Research and Development facility: To develop generics equivalent to innovators product for regulated markets; To develop dosage forms and value added generics; To develop platform technologies and novel patentable formulations."

Apart from the legal nature of reasons for the disallowance, the Assessing Officer has not gone into the fact of whether expenditure claimed can be seen as having been incurred on clinical trials tbat seek to further the above stated research objectives for which the assessee company-has- been recognised as an approved facility for the purposes of Section 35(2AB). The two tests for a factual ascertainment of this matter would be

(i) if any part of the expenditure incurred on Bio-Equivalence Studies undertaken by it is attributable to contract research undertaken for other parties, the said weighted deduction is not admissible; and,

(ii) the terms of engagement with the Clinical Research Organisations employed for carrying out the Bio-Equivalence Studies conducted has to be correlated with the stated research objectives of the assessee before the DSIR as listed above.

In other words the assessee's claim for weighted deduction will have to be considered with reference to the object it sub-serves rather than the location of the expenditure whether in-house or outside. The weighted deduction claimed on Bio Equivalence Studies disallowed by the Assessing Officer will, therefore, now be allowed to the extent supported by the verification described above.

8.4 As noted above the sum of Rs.2,632.50 lakhs (Rs.3,400.02 lakhs in A.Y. 2012-13) added by the Assessing Officer includes a sum of Rs.1,72,91,656/- (Rs.1,28,31,395/- in AY. 2012-13) on other expenses like Rates & Taxes, Travelling Expenses, etc. The Ld. AR.

> relied upon the case of Intas Pharmaceuticals Ltd supra for the proposition that any revenue expenditure incurred in respect of the approved R&D facility is eligible for the weighted deduction. It is seen that the Hon'ble ITAT relied upon its earlier decision in the case of ACIT v. Torrent Pharmaceuticals Ltd, ITA No. 3569/Ahd/2004 dt.13.11.2009 in the context of the fact that there was no dispute that the assessee had actually incurred the impugned expenditure on building repairs and maintenance. In this light of the matter this amount of Rs.1,72,91,656/- (Rs.1,28,31,395/- in AY. 2012-13) will be examined for broad account heads and the fact of which research unit the expenditure pertains to. To the extent it is a revenue expenditure pertaining to the approved R&D facility the assessee is eligible for weighted deduction. Alternatively, the claim will be allowed in terms of section 37 if actually incurred. Subject to this factual verification the claim is allowed."

6. It was the submission of the Ld. CIT-DR that the decision relied upon by the Ld. CIT(A) was set-aside by the Hon'ble Supreme Court as the Court has not considered Revenue question that ITAT has not followed the decision in the case of Concept Pharmaceuticals Ltd vs. ACIT (43 SOT 423). Referring to the above decision, it was the submission that the coordinate Bench did not allow the weighted deduction on expenditure incurred outside the R & D facility. Ld. CIT-DR relied on the grounds raised.

7. In response, Learned Counsel for the Assessee referred to the decision of the Hon'ble Gujarat High Court in the case of CIT v. Cadila Health Care Ltd [2013] (214 Taxman.com 672) to submit that the issue has been crystallised in favour of the assessee and Hon'ble Supreme Court has referred further three questions which were not answered and that does not affect the decision already given and the order of Gujarat High Court has not been set-aside. He further referred to the Explanation-2 to section 32(2AB) and relied on the following case law:-

(i) ITAT Ahmedabad decision in the case of Intas Pharmaceuticals Ltd v. DCIT (ITA Nos. 807/Ahd/2010 and others, dated 14.08.2015);

(ii) CIT vs. Cadila Healthcare Ltd (214 Taxman 0672);

(iii) SRI Biotech Laboratories India Ltd vs. ACIT (36 ITR (Trib) 88);

(iv) CIT vs. Claris Lifesciences Ltd (326 ITR 251) (Guj) and

(v) CIT vs. Sandan Vikas (India) Ltd (335 ITR 117) (Guj)

8. Referring to the decision of Concept Pharmaceuticals Ltd (supra) it was submitted that the later decision of the ITAT has analysed the Explanation to section 32(2AB) which was approved by the Gujarat High Court. Since the decision has not considered the Explanation given, the decision need not be followed. It was further contended that when there are two possible views, the one which is in favour of the assessee should be followed as held by the Hon'ble Supreme Court in the case of CIT vs. Vegetables Products Ltd (88 ITR 192) (SC). It was the submission that the Hon'ble Supreme Court has referred additional three questions to Gujarat High Court and has not stayed or set-aside the judgment already given, on which the Ld. CIT(A) relied upon. He also submitted that the objects of the assessee R & D facility as stated in Form 3CM has been analysed by the Ld. CIT(A) and even though the expenditure was incurred outside for field trials, the expenditure has to be considered for the purpose of 'in-house' research. He supported the order of the Ld. CIT(A).

9. We have considered the rival contentions and perused the case law placed on record. In the decision of Concept Pharmaceuticals Ltd (supra) the Coordinate Bench did not allow the expenditure spent outside the R & D unit but the Bench has not considered the explanation introduced with reference to 'Clinical Trials'. By very nature, the Clinical Trials cannot alone be done within research facility as they require cooperation from the Medical Doctors, Hospitals, Volunteers and patients, therefore such expenditure has to be necessarily spent outside the facility, but for the purpose of 'in-house' research. This issue was

examined by the Coordinate Bench which was subject matter of appeal before the Gujarat High Court and Gujarat High Court has approved the same. As seen from the order of the Supreme Court in Special Leave to Appeal (C) No. 770/2015, dated 13.10.2015, the grievance of Revenue with reference to non-framing of three questions were considered by the Hon'ble Supreme Court as those three questions are considered to be 'substantial question of law' and referred to the Hon'ble High Court to hear the aforesaid three questions of law. However, the judgment already passed by the Gujarat High Court has not been set-aside. As Ld. CIT(A) has followed the Coordinate Bench decision, which was approved by the Gujarat High Court and as no contrary High Court judgment has been placed on record, we approve the order of the CIT (A) and reject the Revenue contentions.

10. In the result, both Revenue's appeals are dismissed.

Order pronounced in the open court on 20th July, 2018.

Sd/-	Sd/-
(CHALLA NAGENDRA PRASAD)	**(B. RAMAKOTAIAH)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, Dated: 20th July, 2018

OKK, Sr.PS

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