IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 726 OF 2017

The Pr. Commissioner of Income Tax-7 .. Appellant

v/s.

M/s. Merck Ltd. .. Respondent

Mr. Suresh Kumar for the appellant
Mrs. A. Vissanji a/w Mr. S.J. Mehta for the respondent

CORAM : M.S. SANKLECHA &
NITIN JAMDAR, J.J.

DATED : 16th SEPTEMBER, 2019

P.C.

1. This appeal under Section 260A of the Income Tax Act, 1961 (the Act) challenges the order dated 31st March, 2016 passed by the Income Tax Appellate Tribunal (Tribunal). This appeal relates to Assessment Year 2010-11.

2. The Revenue urges only the following re-framed questions of law for our consideration :-

> *"(a) Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in granting adjustment of 10% on account of quality difference and deleting the addition made by TPO / AO by applying CUP to*

arrive at ALP in respect of Bisoprolol Fumerate without giving adjustment for quality as claimed by the assessee ?

(b) Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in deleting adjustments in respect of technical consultancy fees ?

(c) Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in deleting disallowance on share buyback expenditure without appreciating that it is a capital expenditure and not allowable u/s. 37 of the Income Tax Act, 1961?

(d) Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in confirming deletion of disallowance in respect of sales promotion and conference expenses incurred without appreciating that these expenses does not render any benefit to the assessee company and are against ethics?

(e) Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in confirming deletion of disallowance in respect of sales promotion and conference expenses incurred prior to date of amendment in the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 i.e. 10-12-2009 without adjudicating the issue ?

3. ***Regarding Question (a) :-***

(a) The respondent is in the business of manufacturing, trading and marketing of drugs and pharmaceuticals. During the previous year relevant to the subject assessment year, the respondent imported

Bisoprolol Fumarate an active pharmaceutical ingredient (API) used to manufacture pharmaceuticals formulations. These imports were made by the respondent from an Associate Enterprise (AE) in Switzerland. The respondent sought to arrive at the Arms Length Price (ALP) of the import of Bisoprolol Fumarate on the basis of Transactional Net Margin Method (TNMM) and contended that the imports of Bisoprolol Fumarate from its AEs at Rs.66,702/- per kg is the ALP and no adjustment is called for. This the Transfer Pricing Officer (TPO) did not accept TNMM method as the most appropriate method. The TPO adopted Comparable Uncontrolled Price (CUP) method as the most appropriate method to determine the ALP of the imported API. On application of CUP, the TPO determined the ALP at Rs.36,831/- per kg and ALP for purchase of 345 kgs was adjusted at Rs. 1.27 crores and the transfer pricing adjustment of Rs.1.03 crores was made being the excess amount paid.

(b) Being aggrieved, the respondent carried the issue in appeal to the Tribunal. The impugned order of the Tribunal held that the application of CUP method to the facts of this case is the most appropriate method to determine the ALP. In fact, this was so conceded by the respondent in view of the binding decision of the co-ordinate bench of the Tribunal in the case of ***Serdia Pharmaceuticals India Pvt. Ltd. Vs. ACIT, (2011)***

44 SOT 391. However, it was the contention of the respondent that even if CUP method is applied to determine the ALP, there has to be an adjustment given on account of the quality of the API imported from its AE which would affect in determination of ALP. In fact, the Tribunal found that in the Assessment Year 2011-12, the TPO had himself has allowed a quality adjustment of 10% in respect of the API imported by the respondent from its AE in Switzerland. The impugned order has placed reliance upon Rule 10B(1)(a)(ii) which *inter alia* provides that the price of the comparable uncontrolled transaction "*is adjusted to account for difference, if any ….. which could materially affect the price in the open market*". It was on the above basis that the impugned order held that while determining the ALP of the imports done from its AE in Switzerland, there shall be an adjustment of the ALP on account of better quality of imported API to the extent of 10%.

(c) We are unable to understand the Revenue's grievance with regard to the finding of the Tribunal. The application of CUP method was what was canvassed by the Revenue and accepted by the Tribunal. Thus, there could be no grievance with regard to the application of CUP method. Similarly, the adjustment on account of quality as claimed by the assessee was allowed. This adjustment was in terms of Rule 10B(1)(a)(ii) of the Income Tax Rules. It is a fact of which judicial note can be taken that wherever even two products are identical, yet on account of perception there could be difference of the price in the open market. This has to be factored in while determining the ALP as has been recognized in the aforementioned rule 10B(1)(a)(ii) of the Income Tax Rules. Moreover, the TPO himself has accepted this price adjustment on account of perception of quality by allowing the adjustment at 10% in the Assessment Year 2010-11.

(d) In the above view, the question (a) as proposed does not give rise to any substantial question of law. Thus, not entertained.

4. Regarding question (b) :

(a) The respondent had made a payment of Rs. 3 crores to its one AE viz. M/s. Merck KGaA in terms of consultancy agreement between the above AE and itself. The agreement provided that the AE will give technical consultancy in various areas to the respondents for the above consideration. The TPO on facts found that the respondent did not avail of any services under the above agreement and thus determined the ALP at Nil.

(b) The impugned order of the Tribunal holds that under the consultancy agreement, the respondent was entitled to receive a package of services on as and when required basis. Thus, even if the assessee may not have received all the services, yet the respondent has a right to receive these services. Thus, relying upon a decision of its co-ordinate bench in *AWB India Ltd. Vs. DCI* (2015) 152 ITD 570 it held that if a package of services is made available on requirement basis, the value of services cannot be taken as Nil, so long as the agreement is not a sham.

(c) It is an agreed position between the parties that in the respondent's own case for Assessment Year 2003-04, a similar issue had arisen viz. package of services being available under the agreement on as and when required basis. This Court by an order dated 2nd August, 2016 (CIT Vs. Merck Ltd. Writ Petition No.272 of 2014) held the fees paid for on bouquet of services as and when required, would be similar to retainer agreement. It is agreed by the Revenue that the above order dated 8th August, 2016 of this Court in the respondent's own case will equally apply to the present facts.

(d) In the above view, the question as proposed does not give rise to any substantial question of law. Thus, not entertained.

5. Regarding question (c) :-

(a) The impugned order of the Tribunal deleted the dis-allowance of expenses incurred in share buyback. This by following the decision of

Delhi High court in ***CIT Vs. Selan Exploration Technology Ltd. (2010) 188 Taxmann 1.*** In the above case, it was held that share buyback expenditure incurred by the respondent did not result in a benefit of an enduring nature as after the buyback the capital employed had gone down. Thus, the expenditure incurred has not resulted in bringing into existence any new asset, thus was not in the nature of the capital expenditure. On the aforesaid basis, the Delhi High Court held that once it is held that the expenditure is not capital in nature, then, the expenditure is allowable under Section 37 of the Act as a revenue expenditure as it was incurred for the benefit of existing shareholders in the ordinary course of business.

(b) The learned Counsel appearing for the parties are agreed that the issue stands concluded by the decision of this Court in ***Commissioner of Income Tax Vs. Aditya Birla Novo Ltd. 79 Taxmann.com 210***, and ***Commissioner of Income Tax Vs. Hindalco Industries Ltd.*** (Income Tax Appeal No.1846 of 2010) decided on 7th August, 2012 against the Revenue and in favour of the respondent.

(c) In the above view, this question as proposed does not give rise to any substantial question of law. Thus, not entertained.

6. Regarding question (d) :-

(a) The expenditure on account of sales promotion and conference expenditure was disallowed by the Assessing Officer on the ground that there was no evidence of benefit to the respondent assessee from these activities.

(b) On appeal, the Tribunal held that so long as the expenses have been incurred wholly and exclusively for the purpose of business, whether necessary or not are to be allowed as expenditure. In support, it placed reliance upon the decision of the Supreme Court in the case of ***CIT Vs. Chandulal Keshavlal & Co. 38 ITR 601*** and ***Sasoon J. David & Co. Vs. Commissioner of Income Tax, 180 ITR 261*** wherein it has been held that the expenditure incurred voluntary on account of commercial expediency and wholly and exclusively for the purpose of trade, then it is allowable expenditure. The Court in the above case observed that it is pertinent to note that the words “wholly and exclusively” used in Section 37 of the Act does not mean “necessarily”. Thus, it is for the assessee to decide whether the expenditure should be incurred in the course of his business and once it is found that it is incurred wholly and exclusively for the purposes of business, then it is deductible under Section 37 of the Act. It further records that it is relevant to note that an attempt was made to introduce the word “necessity” in Section 37 of the Income Tax Bill of 1961. However, this had led to public protest and resulted in dropping the word "necessity" when the Income Tax bill of 1961 was passed into the Income Tax Act, 1961. Thus, the view of the Tribunal on this issue cannot be faulted as it is in accord with the Supreme Court decisions referred to hereinabove.

(c) In the above view, this question as proposed does not give rise to any substantial question of law. Thus, not entertained.

7. Regarding question (e) :-

(a) The impugned order of the Tribunal looking at the smallness of the amount, did not think it fit to adjudicate the issue. In fact, the impugned order of the Tribunal records that the Revenue has not contested the issue before it.

(b) In view of the above, as the Revenue has not urged this issue of disallowance of expenses before the Tribunal, it cannot now be urged by the Revenue before us. This Court in ***Commissioner of Income Tax Vs. Mahalaxmi Glass Works Co. 318 ITR 116*** held that if a concession is made before the Tribunal, then on that issue no substantial question of law arises.

(c) In the above view, this question does not give rise to any substantial question of law. Thus, not entertained.

8. In the above facts and circumstances, the appeal is dismissed.

(NITIN JAMDAR, J.) **(M.S. SANKLECHA, J.)**