Executive Summary

Pharmaceuticals industry has witnessed robust growth in last five-six years, taking its turnover from ₹ 71,000 crore in 2007 to ₹ 1,21,015 crore in 2013 and thereby making it a vital economic sector with corresponding potential for the Government revenue. Government provides support to this sector by way of various area based tax exemptions, weighted deductions on expenses towards Research and Development (R&D) and other deductions against business profits in the Income Tax Act 1961 (Act), concessional rate of excise duties, State VAT etc. It is important to ensure that such fiscal incentives given to this sector under the Act are allowed as per prescribed conditions and seek assurance that proper machinery to exercise necessary checks/controls in the area of probable misuse of these provisions relating to tax concessions exists and operates effectively.

We conducted Performance Audit on "Assessment of Assessees in Pharmaceuticals Sector" with the objectives to focus on whether (a) the exemptions and deductions allowable to Pharmaceutical Sector have been allowed as per entitlement (b) the administrative and procedural adequacy for taxation of pharmaceutical sector exists (c) the allowance of deduction of Research and Development expenditure to the assessees in Pharmaceuticals Sector has contributed to the growth in industry as well as in tax revenues.

The Performance Audit covered assessments completed during the period from 2010-11 to 2013-14 and up to the date of audit (September 2014) of assessees dealing in Pharmaceuticals sector. In case of major audit observations assessment records of previous assessment years were also checked/linked wherever found necessary. We held an entry conference with CBDT in July 2014 wherein we explained the audit objectives, scope and the main focus areas of audit examination.

We requisitioned 3,432 assessment records from the assessment units of the Income Tax Department (ITD) located all over India. However, the ITD produced and we audited 2,868 assessment records (83.57 *per cent*). This report contains 246 cases where we have pointed out deficiency in the system or in the compliance with the laid down provisions involving total tax effect of ₹ 1,348.44 crore.

We found that the ITD did not maintain data of incentives given to the Pharmaceuticals Sector and hence the impact of such incentives could not be assessed. The ITD also did not maintain database of the assessee in the Pharmaceuticals sector ignoring its importance for planning and decision making (Para 2.2 – 2.3).

We noticed in 22 cases in six states[1] involving tax effect of ₹ 570.59 crore where weighted deduction on expenses towards R&D was allowed without verifying the claims from the form 3CL /3CM issued by DSIR or from the website of DSIR who is the competent authority to grant approval of such claims. We further noticed that due to date of filing of return preceding the date of approval of R&D expenditure, as claimed in the return, by DSIR, such claims are allowed by the ITD before/ without its approval. We further noticed that the assessees have not paid TDS by taking advantage of exclusion clause of Section 194C in respect of contract manufacturers by treating these contracts as supply contracts (Para 2.4 - 2.6).

We pointed out in 17 cases involving tax effect of ₹ 8.51 crore where assessees took advantage of ambiguous provisions related to salary and interest payment to its partners by not providing the same in the partnership deed and thereby taking undue benefit of Section 80IC deduction. We also noticed that ITD does not have any mechanism to correlate & verify carried forward of losses/depreciation especially of the unit availing 80IC deductions. ITD also does not have any mechanism to correlate & verify the turnover declared in Income Tax returns with the turnover declared in Central Excise returns which is part of the same Ministry (Para 2.7 to 2.9).

We noticed in 36 cases involving tax effect of ₹ 55.10 crore in seven States[2] where the expenditure towards gifts/freebies to medical professionals were allowed despite being prohibited by law/not related to business (Para 3.1.1-3.1.4).

We also pointed out in 171 cases in 17 States[3] involving tax effect of ₹ 714.24 crore, of general nature, which included mistakes in allowing business expenditure, R&D expenses, and allocation of such expenses among the units benefitting from such research and development, inconsistency in assessments, irregularities pertaining to international transactions, arithmetical errors etc (Para 3.2).

With a view to streamline the assessment of assessees in the Pharmaceuticals sector, we have made recommendations relating to systemic issues, misuse of the ambiguities in the legal provisions / lacuna in the Act, lapses by the ITD which are placed under "Summary of Recommendations" and at the end of each chapter.

1 Maharashtra, Delhi, Tamil Nadu, Andhra Pradesh, Bihar, Karnataka
2 Andhra Pradesh, Gujarat, Karnataka, Maharashtra, New Delhi, Tamil Nadu and Uttaranchal
3 Andhra Pradesh, Assam, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Maharashtra, Madhya Pradesh, New Delhi, Pudduchery, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal.