CHAPTER III: Compliance Issues

3.1 Introduction

The Act prescribes the admissibility of expenditures, allowances/deductions to the assessees including assessees of Pharmaceuticals Sector. As per guidelines issued (May 2014) by Department of Scientific and Industrial Research (DSIR) for in-house Research & Development (R&D) centres, the Secretary of DSIR has been designated as Principal Authority for the purposes of Section 35 (2AB) of the Act. The Principal Authority approves the R&D Expenditure in Form 3CM/3CL prescribed by the Act. DSIR is required to send approval of R&D expenditure in Form 3CL to DGIT (Exemption) to help AOs in ascertaining the genuineness of the claim of assessees. Besides, there are regulatory bodies like Medical Council of India (MCI) and National Pharmaceuticals Pricing Authority (NPPA) who from time to time, issue instructions/guidelines to regulate the expenses related to Pharmaceuticals Sector like Freebies, Expenditure on Gifts, Physician samples etc.

During the Performance Audit, we came across compliance issue as follows:

Table 3.1 : Compliance issues with tax effects

(₹ in crore)

Issues	Cases	Tax Effect
Section A: Inadmissible expenses related to Pharmaceuticals Sector in compliance to the instructions/guidelines issued by DSIR and Bodies like MCI and NPPA.	36	55.10
Section B: Compliance issues in the Pharmaceuticals Sector	171	714.24
Total	**207**	**769.34**

Section – A

Inadmissible expenses related to Pharmaceuticals Sector

We noticed 36 cases, involving tax effect of ₹ 55.10 crore in seven States[12] relating to allowance of expenses where instructions/guidelines of regulatory bodies were not followed by AOs. In these cases, AOs did not disallow or partially disallowed expenditure towards gifts, freebies and physicians sample to medical professionals by companies in Pharmaceuticals sector despite these being made irregular by regulatory bodies or were not related to business. Table 3.2 shows summary of categories of mistakes in assessment and their tax effect. Details of these cases are dealt in this Chapter.

Table 3.2: Nature of mistakes with its tax effect

	Nature of Mistakes and Para Number of the Report	Cases	Tax effect (₹ in crore)
1.	Expenditure on gifts and other freebies to medical professionals (Para 3.1.1)	21	45.43
2.	Break up of expenditure on freebies / gifts not taken from sales promotion expenses (Para 3.1.2)	11	-
3.	Expenditure on physicians sample (Para 3.1.3)	3	1.57
4.	Penalty by National Pharmaceuticals Pricing Authority (Para 3.1.4)	1	8.10
	Total	**36**	**55.10**

AOs allowed expenditure on gifts, travel facilities, hospitality, cash or monetary grant despite being made irregular by the Act, Medical Council of India, CBDT/Judicial pronouncement.

3.1.1 Allowance of expenditure towards gifts, freebies etc. to Medical Professionals

As per explanation to Section 37(1) of the Act, any expenditure for a purpose which is an offence or which is prohibited by law is not an allowable business expense. MCI vide its regulations[13] of 2002 provided that medical practitioners should prescribe generic drugs as far as possible. It inter-alia prohibited them to solicit or receive any commission, gifts etc. for any approval or recommendation, endorsement of any medicine or drug for advertisement purpose or for referring or recommending any patient any medical, surgical or other treatment. Vide amendment dated 10 December 2009, Pharmaceutical companies were specifically prohibited to give any consideration in the nature of gifts, travel

12 Andhra Pradesh, Gujarat, Karnataka, Maharashtra, New Delhi, Tamil Nadu and Uttaranchal
13 Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002

facilities, hospitality, cash or monetary grants etc. CBDT issued a circular[14] in 2012 and clarified that such expenses would not be allowable. Judicial pronouncement[15] also clarified that this circular had retrospective effect.

We noticed 21 cases in five states[16] in which the AO had allowed the expenses which were in the nature of freebies given to Doctors involving tax effect of ₹ 45.43 crore (see box 3.1).

Box 3.1: Illustrative cases of non/partial disallowance of expenses on freebies.

a. **Charge : CIT-VIII, Mumbai**
Assessee : Macleods Pharmaceuticals Limited
Assessment Year : 2009-10
PAN : AAACM4100C

We noticed that AO out of ₹ 58.71 crore spent on gifts, facilities etc. to medical practitioners, disallowed only ₹ 21.75 crore pertaining to period 9 December 2009 to 31 March 2010 considering that effective date for such disallowance would be date of amendment (viz. 9 December 2009) in the MCI Regulations. Stand of the AO was not proper as the said amendment was clarificatory in nature and hence expenses on such freebies being in the nature of offence and prohibited by law were fully disallowable for the earlier years as well, in terms of the explanation to Section 37(1) which is effective retrospectively from 01 April 1962. This omission resulted in under assessment of income of ₹ 36.96 crore involving potential tax effect of ₹ 11.09 crore. Reply is awaited (October 2014).

b. **Charge : CIT –IV, Ahmedabad**
Assessee : Troika Pharmaceuticals Limited
Assessment Year : 2010-11
PAN : AABCT0228K

We noticed that AO allowed ₹ 7.48 crore spent by assessee on Doctors travelling expenses along with spouse, gift articles distributed etc. which resulted in under assessment of income by the same extent with short levy of tax of ₹ 2.54 crore. Reply is awaited (October 2014).

14 No. 5/2012 [F. No. 225/142/2012-ITA.II], dated 01 Aug 2012
15 Confederation of Indian Pharmaceuticals Industry Vs. CBDT (Himachal Pradesh High Court)
16 Gujarat, Karnataka, Maharashtra, New Delhi, Tamil Nadu

c. Charge : CIT-LTU, Mumbai
Assessee : IPCA Laboratories Limited
Assessment Year : 2009-10
PAN : AAACI1220M

We noticed that the assessee incurred expenditure of ₹ 32.91 crore on Heart Touching Celebration, Sponsorship of Doctors and corporate /brand recall items. These expenses were not allowable being in the nature of freebies. This resulted in underassessment of income to the same extent involving tax effect of ₹ 11.19 crore. In the same charge in case of another assessee Wyeth Limited (AY 2008-09), the CIT(A) enhanced disallowances of expenses of this nature from one third to total such expenses. Reply is awaited (October 2014).

d. Charge : CIT-Central, Bangalore
Assessee : Vascular Concepts Pvt. Limited
Assessment Year : 2008-09 to 2010-11
PAN : AAACM8353R

The assessee debited sum of ₹ 4.73 crore, ₹ 6.21 crore and ₹ 7.49 crore for respective AYs totalling to ₹ 18.43 crore towards Doctor's domestic and foreign travelling expenses including hotel bookings, gifts. These expenses were not allowable being in the nature of freebies. However the AO allowed the same. This resulted in under assessment of income to the same extent involving tax effect of ₹ 6.26 crore. The ITD stated (October 2014) that the assessment under Section 153A is time barring in this case on 31 March 2015 and audit objection will be looked into during the course of assessment.

e. Charge : CIT-Salem, Chennai
Assessee : B. Mohankumar
Assessment Year : 2009-10 to 2011-12
PAN : AIVPM2483C

The assessee debited sum of ₹ 2.70 crore, ₹ 4.71 crore and ₹ 4.94 crore for respective AYs totalling to ₹ 12.35 crore towards interpretation charges/Doctor's fees visiting the hospital established by the assessee for promoting the usage of medicines to the patients. These expenses were not allowable in view of the judicial pronouncement in the case of Confederation of India Pharmaceuticals Industry Vs CBDT (Himachal Pradesh High Court 353 ITR 388 dated 26/12/2012). However, the AO allowed the same. This resulted in under assessment of income to the same extent involving tax effect of ₹ 4.11 crore.

f.	**Charge**	**: CIT-V, Delhi**
	Assessee	**: Ozone Pharmaceuticals Limited**
	Assessment Year	**: 2011-12**
	PAN	**: AAACO0056H**

The assessee debited an amount of ₹ 2.11 crore towards purchase of sales promotion material for Doctors as mentioned in the assessment order. These expenses were not allowable being in the nature of freebies. However, the AO allowed the same. This resulted in under assessment of income to the same extent involving tax effect of ₹ 70.17 lakh.

The ITD in reply (August 2014) stated that payments were made for material consisting of small Ayurvedic items like soaps, face wash gels etc. used for medical camps, blood donation camps, annual award functions, sales promotion meetings etc. held for promoting sales with the assessee company stockists.

The reply of the ITD was not acceptable as in the assessment order itself it was mentioned that assessee vide its reply dated 24 February 2014 stated that sales promotion products were purchased from Ozone Ayurvedics to be used as sales promotional material for Doctors which is in violation of provisions of Indian Medical Council Regulations 2002.

Thus, the AOs have not adopted uniform approach in disallowance against freebies given to Doctors and uniform treatment for effective date from which such payments, as prohibited against law or not related to business, were disallowable.

AOs allowed the expenditure on sales promotion which included prohibited expenses on freebies

3.1.2 Break up of expenditure on freebies / gifts not taken from sales promotion expenses

Pharmaceuticals companies routinely incur expenses on freebies and gifts to the medical professionals. Hence, during scrutiny assessment proceedings, the AOs seek break up of sales promotion expenses, identify expenses on freebies and disallow the same. By not doing so, such expenses are allowed as a part of sales promotion expenses.

We noticed 11 cases in Uttaranchal and Maharashtra in which the AOs had allowed the expenses on freebies given to Doctors included in sales promotion without examination of the detailed breakup (see box 3.2).

Box 3.2: Illustrative cases of non disallowance of expenses on freebies due to not seeking break up of sales promotion expenses

a. **Charge : CIT– LTU, Mumbai**
Assessee : Glenmark Pharmaceuticals Limited
Assessment Year : 2009-10 and 2010-11
PAN : AAACG2207L

The assessee claimed and AO allowed expenditure on account of sales promotion of ₹ 55.66 crore and ₹ 91.96 crore for AY 2009-10 and 2010-11 respectively. The detailed breakup of these expenses was not available to verify the expenditure incurred on freebies. Reply is awaited (October 2014).

b. **Charge : CIT– LTU, Mumbai**
Assessee : IPCA Laboratories Limited
Assessment Year : 2007-08 and 2008-09
PAN : AAACI1220M

The assessee incurred sales and marketing expenses of ₹ 28.64 crore and ₹ 41.80 crore in AY 2007-08 and 2008-09 respectively but expenses of gift and other freebies given to Doctor was not identified. However, in the AY 2009-10, we noticed that out of ₹ 58.95 crore of sales and marketing expenses, ₹ 32.43 crore was spent on various freebies. Reply is awaited (October 2014).

c. **Charge : CIT Dehradun**
Assessee : Suncare Formulations Pvt. Limited
Assessment Year : 2009-10
PAN : AAICS9967M

The assessee debited ₹ 30.94 lakh in P&L Account as marketing and distribution expenses, besides advertising and travelling & conveyance expenses. The assessee accepted the fact that the marketing policy of the company included distribution of samples to Doctors and hospitals; however AO did not disallow the extent of prohibited expenses on freebies included in the above expense by ascertaining breakup of the same. Reply is awaited (October 2014).

Despite the fact that such prohibited expenses by Pharmaceuticals companies to Doctors are a routine industry practice, the AOs did not disallow expenses on freebies by seeking details of such expenses under the head sales promotion expenses.

AOs did not disallow expenditure on physicians samples given free of cost to medical practitioners

3.1.3 Non / partial disallowance of expenditure towards physicians samples

As the physicians samples are given free to medical practitioners and it influences the decision of medical practitioners in prescribing medicines in favour of branded medicines instead of generic ones, hence it was in the nature of offence of law and therefore was disallowable.

We noticed three cases in Maharashtra in which the AO had allowed the expenses on physician samples given free to Doctors involving tax effect of ₹ 1.57 crore (see box 3.3).

Box 3.3: Illustrative cases of non-disallowance of expenses on physicians samples

a.

Charge	**: CIT- VII, Mumbai**
Assessee	**: Solvay Pharma India Limited**
Assessment Year	**: 2008-09**
PAN	**: AABCD0322J**

The assessee incurred expenses of ₹ 2.24 crore on physicians sample given free of cost to medical practitioners which was not disallowed by the AO. This resulted in under assessment of income by the same extent involving tax effect of ₹ 76.18 lakh.

b.

Charge	**: CIT– X, Mumbai**
Assessee	**: Flamingo Pharmaceuticals Pvt. Limited**
Assessment Year	**: 2009-10 and 2010-11**
PAN	**: AAACF4211B**

The assessee incurred expenses of ₹ 1.45 crore and ₹ 92.46 lakh for AY 2009-10 and 2010-11 respectively on physicians sample given free of cost to medical practitioners which was not disallowed by the AO. This resulted in under assessment of income by the same extent involving tax effect of ₹ 49.39 lakh and ₹ 31.42 lakh respectively. In these cases our contention to treat the expenses on physicians sample as freebies and hence disallowable was supported by the CIT (A) – 19, Mumbai Order in the case of Dupen Laboratories Pvt. Limited for AY 2010-11 in the CIT Charge IX, Mumbai, wherein it was held that although the physicians sample is not specifically included in the list of expenses prohibited by MCI, it was in the nature of freebies only and hence disallowable. Reply is awaited in both the cases (October 2014).

The AOs did not disallow the expenditure on account of physicians samples, supplied free of cost to Doctors, which influence them to prescribe the branded medicines instead of generic ones and impedes their independent judgment.

AOs did not disallow expenditure towards penalties levied by National Pharmaceuticals Pricing Authority which is prohibited by law.

3.1.4 Non disallowance of expenditure towards penalty by National Pharmaceuticals Pricing Authority

As per Explanation to Section 37 of the Act, any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. We noticed one case in Andhra Pradesh in which the AO had allowed the expenses on the penalty levied by NPPA involving tax effect of ₹ 8.10 crore (see box 3.4).

Box 3.4: Illustrative case of non-disallowance of penalty by NPPA

Charge	**: CIT-I, Hyderabad**
Assessee	**: Dr. Reddy's Laboratories Limited**
Assessment Year	**: 2006-07**
PAN	**: AAACD7999Q**

We noticed in November 2011 that the AO allowed the expense of ₹ 15.43 crore paid by the assessee towards penalty levied by NPPA which was not allowable. In reply the ITD initially did not accept the objection (December 2012) stating that the amount was not a penalty but recovery of overcharge amount. However, subsequently remedial action was completed (March, 2014) in which entire claim was disallowed stating that the same is infraction of law. This involved under assessment to the same extent with short levy of tax of ₹ 8.10 crore. Reply is awaited (October 2014).

Section - B

Compliance issues in Pharmaceuticals sector

3.2 Introduction

In the assessment of assesses in Pharmaceuticals Sector, we noticed mistakes relating to administration of concessions/exemptions/deductions, quality of assessment, income escaping assessment, Transfer Pricing etc. The present chapter deals with audit issues relating to deficiencies in applying the provisions of the Act and relevant rules/judicial pronouncements by the AOs during assessments of assessees in Pharmaceuticals Sector**.** We noticed 171 cases, in 17 States[17] where the provisions of the Act were not followed correctly, with a tax effect of ₹ 714.24 crore. Table 3.3 shows summary of broad categories of mistakes in assessment and their tax effect. Details of these cases are dealt in this Chapter in subsequent paragraphs.

Table 3.3 : Nature of mistakes with its tax effect

Nature of Mistakes and Para Number of the Report	Cases	Tax effect (₹ in crore)
1. Allocation of R&D/common expenses (Para 3.2.1)	15	121.21
2. Allowance of concessions/exemptions/deductions / rebate/relief (Para 3.2.2)	26	158.89
3. Setting off of carried forward business loss/depreciation (Para 3.2.3)	28	27.77
4. Allowance of business expenditure (Para 3.2.4)	22	47.69
5. Allowance of R&D expenses (Para 3.2.5)	14	77.40
6. Allowance of expenses on which TDS was not deducted/deposited (Para 3.2.6)	7	5.91
7. Inconsistency in assessment (Para 3.2.7)	3	149.93
8. Arithmetical errors in computation of income and tax (Para 3.2.8)	15	14.65
9. Assessment of Income under special provisions (Para 3.2.9)	6	6.11
10. Assessment of Income under normal provisions (Para 3.2.10)	16	84.21
11. Classification and computation of capital gains (Para 3.2.11)	1	00.74
12. Irregularities in International Transactions (Para 3.2.12)	5	7.58
13. Others (Para 3.2.13)	13	12.15
Total	**171**	**714.24**

17 Andhra Pradesh, Assam, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Maharashtra, Madhya Pradesh, New Delhi, Pudduchery, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal.

Research & Development and common expenditure are required to be allocated to the beneficiary units either on actual basis or on the basis of their sales turnover ratios. AOs allowed the same without ascertaining the proper allocation.

3.2.1 Allocation of R&D / other common expenses

Section 37 of the Act provides for the deduction of business expenses from the income of the assessee, to arrive at the gross profit. Depending upon the benefit accrued from any expense to a specific unit or more than one unit or all the units of the assessee, the particular expense is required to be allocated to the beneficiary unit(s) either on actual basis or on the basis of their sales turnover ratios.

We noticed 15 cases in Andhra Pradesh, Maharashtra and Tamil Nadu in which the AOs had allowed the allocation of common and R&D expenses without proper examination of the same involving tax effect of ₹ 121.21 crore (see box 3.5).

Box 3.5: Non/partial allocation of R&D / other common expenses

a.	**Charge**	**: CIT-LTU, Mumbai**
	Assessee	**: Glenmark Generic Limited**
	Assessment Year	**: 2009-10**
	PAN	**: AACCG9820D**

The allocation of weighted deduction on expenses on R&D was to be done in sales turnover ratio among the units beneficiary of the R&D. Out of total weighted deduction of ₹ 212.73 crore on capital and revenue expenses on R&D, the assessee allocated weighted deduction of only ₹ 154.40 crore with respect to revenue expense under Section 35 (2AB) of the Act with ₹ 13.13 crore allocated to Goa unit (eligible for deduction) and ₹ 141.27 crore to other units (not eligible for deductions). However, as per sales turnover ratio ₹ 106.34 crore was required to be allocated to Goa unit. Omission to do so resulted in short allocation of ₹ 93.20 crore.

Further, remaining weighted deduction of ₹58.33 crore with respect to revenue expenses under Section 35(1)(i)} and capital expenses under Section 35(1)(iv) and 35(2AB) of the Act was not allocated at all which works out to ₹ 40.37 crore to Goa unit in the above mentioned ratio. Thus, the above resulted in underassessment of ₹ 133.57 crore (₹ 93.20 + ₹ 40.37) involving tax effect of ₹ 45.33 crore. Reply is awaited (October 2014).

b. Charge : CIT Central, Hyderabad
Assessee : Hetero Drugs Limited
Assessment Year : 2009-10
PAN : AAACH5071K

The assessee claimed corporate overhead expenditure of ₹ 98.19 crore which was not apportioned to all the units based on the turnover. The assessee allocated ₹ 81.36 lakh instead of ₹ 14.10 crore which resulted in excess claim of deduction under Section 80IC of ₹ 13.29 crore involving understatement of income to the same extent with consequential short levy of tax of ₹ 4.52 crore. The ITD did not accept the objection stating that there was no such provision in the Act for such allocation. The reply was not acceptable as nature of expense was common for both eligible and non eligible units. Moreover, this is a general principle that all the corporate overheads expenditure which are common to eligible and non eligible units are to be apportioned and no provision is required in the Act. Reply is awaited (October 2014).

c. Charge : CIT LTU, Mumbai
Assessee : Glenmark Pharmaceuticals Limited
Assessment Year : 2007-08 to 2010-11
PAN : AAACG2207L

The assessee used incorrect[18] sales turnover ratio for allocation of weighted deduction of R&D expenses, which was lesser than the correct one, and the AO accepted the same. The difference in the ratio during these years ranged from 0.93 *per cent* to 3.15 *per cent*. Owing to this, out of total weighted deductions of ₹ 319.15 crore, an amount of ₹ 156.96 crore was allocated to the eligible units (80IB unit at Goa and 80IC unit at Baddi) instead of ₹ 167.36 crore for the above years. The lesser allocation of weighted deduction for R&D expense, on account of lower turnover ratio, resulted in total under assessment of ₹ 10.40 crore for the above AYs, with consequential short levy of tax of ₹ 3.50 crore. Reply is awaited (October 2014).

This indicated that the ITD has not put in place a foolproof system to ensure that common expenses or weighted deductions from R&D, which the exempted / non exempted units and multi locational units benefit from, were allocated properly to all the beneficiary units and undue exemptions /deductions /concessions were not claimed.

18 Instead of taking ratio between turnover of manufactured sales of individual unit and that of all the units, it used ratio between manufactured sales of individual unit and gross sales (inclusive of turnover of traded goods) of all the units. As the benefit of R&D was used only by manufactured goods and not the traded goods, the same was required to be excluded from working of ratio. The correct ratio would be higher than the incorrect one.

AOs allowed concessions/deductions/rebate/relief to assessees without verifying the conditions specified in the provisions of the Act.

3.2.2 Allowance of concessions/deduction/rebate/relief

Chapter VIA and Section 10 provide for certain deductions in computing total income of an assessee subject to fulfilment of certain conditions specified therein. Section 80IB/80IC provide for 100 *per cent* and 30 *per cent* deductions, respectively for first five AYs and next five AYs, in respect of profits and gains from undertaking under these Sections.

We noticed 26 cases in 13 states[19] in which the AO had allowed the concessions/deduction/rebate/relief without proper examination of the same involving tax effect of ₹158.89 crore (see box 3.6).

Box 3.6: Excess or irregular concession /exemption /Deduction/rebate /relief

a. **Charge** **: CIT-II Indore**
Assessee **: Plethico Pharmaceuticals Limited**
Assessment Year **: 2006-07 to 2009-10**
PAN **: AABCP3063G**

We noticed that in the assessment completed under Section 143(3) /153A, the Auditor whose name was appearing on the accounts certification of assessee's eligible SEZ unit at Kandla, stated on oath that he had not audited the same. Hence exemption allowed to the assessee amounting to ₹ 68.03 crore, ₹ 80.88 crore, ₹ 121.46 crore and ₹ 127.50 crore for the AY 2006-07 to 2009-10 respectively was not in order as the report in form 56F furnished by the assessee was not given by that Accountant. Hence as per Section 10A(5) of the Act, exemption was required to be withdrawn which was not done. The omission to do so resulted in total underassessment of ₹ 397.87 crore with short levy of tax of ₹ 134.74 crore. Reply is awaited (October 2014).

b. **Charge** **: CIT-II Chandigarh**
Assessee **: Venus Remedies Limited**
Assessment Year **: 2011-12**
PAN **: AAACV6524H**

The assessee commenced operations in October 2005 and initial AY was 2006-07. Hence, for the instant AY the assessee was eligible for deduction of ₹ 4.87 crore at 30 *per cent* of profit instead of ₹ 16.24 crore claimed at 100 *per cent* of profit. However, the ITD did not restrict the deduction claimed by the assessee resulting in excess allowance of deduction of ₹ 11.37 crore with under assessment to the same extent involving tax of ₹ 3.78 crore. Reply is awaited (October 2014).

19 Andhra Pradesh, Assam, Goa, Haryana, Himachal Pradesh, Karnataka, Maharashtra, Madhya Pradesh, New Delhi, Punjab, Tamil Nadu,, Uttar Pradesh, West Bengal

c.	**Charge**	**: CIT Central-III, Mumbai**
	Assessee	**: Indoco Remedies Limited**
	Assessment Year	**: 2010-11**
	PAN	**: AAACI0380C**

The AO during scrutiny assessment, incorrectly adopted profit of eligible unit (80IC unit) as ₹ 41.70 crore instead of ₹ 40.01 crore which resulted in excess deduction of ₹ 1.69 crore. Further while making allocation of weighted deduction[20] on R&D expenses between the eligible and ineligible units in the sales turnover ratio it allocated only ₹ 3.99 crore instead of ₹ 7.13 crore to eligible unit, resulting in excess deduction of ₹ 3.13 crore. Thus the AO computed allowable deduction of ₹ 35.31 crore and restricted to available profit of ₹ 34.62 crore. However, on the basis of above discussion admissible deduction was ₹ 30.69 crore only. This resulted in excess allowance of deduction of ₹ 3.93 crore (₹ 34.62 crore - ₹ 30.69 crore) involving tax effect of ₹ 1.18 crore. Reply is awaited (October 2014).

Thus, the ITD was not having a system of built in checks to ensure that deductions /concessions/exemptions/rebate/relief are thoroughly scrutinized before being allowed by the AOs.

AOs allowed setting off/carry forward of depreciation/business loss/capital loss in contravention of the provisions of the Act.

3.2.3 Setting off /carry forward of depreciation/business loss/ capital loss

Section 72 provides for carry forward of loss for set-off in the following AYs where the loss is not wholly set off against income under any head of the relevant year to the extent it is not set off.

We noticed in 28 cases in 11 states[21] in which the AO had allowed business expenditure in contravention to the laid down provisions involving tax effect of ₹ 27.77 crore (see box 3.7).

20 The total weighted deduction available for allocation was of ₹ 18.27 crore. However, the AO allocated only ₹ 10.22 crore between eligible and ineligible units.

21 Andhra Pradesh, Goa, Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh, New Delhi, Rajasthan, Tamil Nadu and West Bengal

Box 3.7: Irregularities in allowing setting off of business loss and carry forward of depreciation and business / capital loss

a. **Charge : CIT-Central, Hyderabad**
Assessee : Gayatri Bio-organics Limited
Assessment Year : 2011-12
PAN : AAACG7384A

The AO allowed business loss of ₹ 12.09 crore pertaining to AY 1999-2000 to 2002-2003 to be carried forward even though the period of eight years were elapsed resulting in underassessment to the same extent involving potential tax effect of ₹ 3.63 crore. The ITD had not accepted the observation but passed order under Section 157 (July 2014).

b. **Charge : CIT I Delhi**
Assessee : Bausch & Lamb Eye care (India) Pvt. Limited
Assessment Year : 2009-10
PAN : AABCB7362G

The AO completed assessment in October 2013 determining an income of ₹ 19.96 crore after setting off brought forward business losses and unabsorbed depreciation of ₹ 11.70 crore (₹ 9.48 crore + ₹ 2.22 crore) for the assessment year 2007-08. We observed that the losses of ₹ 11.70 crore were not available to be set off as the assessee was assessed at an income in the AYs 2007-08 and 2008-09. Hence, no losses were available to be set off in the assessment year 2009-10. The mistake resulted in incorrect set off of losses of ₹ 11.70 crore involving short levy of tax effect of ₹ 3.98 crore. Reply is awaited (December 2014).

c. **Charge : CIT – Panaji**
Assessee : Wallace Pharmaceuticals Pvt. Limited
Assessment Year : 2009-10
PAN : AACW1667Q

The assessee was having profit of ₹ 14.43 crore from its 80IC unit and loss of ₹ 12.66 crore from its non 80IC unit. Thus the assessee computed its total income at ₹ 1.78 crore and the total taxable income as nil after allowing deduction of profit of the 80IC unit, restricted to total income.

However, the ITD made additions of ₹ 6.20 crore in the returned income and determined total taxable income at ₹ 6.20 crore and computed tax accordingly. Aggrieved by it, the assessee applied for rectification under Section 154 stating that 80IC deduction available being more than the assessed income, taxable income would be nil with no tax liability.

The AO rectified the order, but instead of determining total taxable income as *nil*, it determined loss of ₹ 6.45 crore by erroneously reducing ₹ 12.66 crore from the assessed income of ₹ 6.20 crore. This resulted in under assessment of ₹ 6.45 crore involving potential tax of ₹ 1.94 crore.

The ITD has accepted (October 2014) the objection and rectified the mistake under Section 154 on 14 October 2014.

This indicated that the AOs allowed setting off/carry forward of depreciation/business loss/capital loss without doing proper scrutiny of the details available / required for the purpose, which was in contravention of the provisions of the Act.

AOs allowed expenditure not related to the business in violation of the Act.

3.2.4 Allowance of business expenditure

Section 37 provides that any expenditure not related to business is not to be allowed as business expense. We noticed in 22 cases in nine states[22] in which the AO had allowed business expenditure in contravention to the laid down provisions involving tax effect of ₹ 47.69 crore (see box 3.8).

Box 3.8 Incorrect allowance of business expenditure

a. **Charge** **: CIT Central, Pune**
Assessee **: Twilight Litaka Pharma Limited**
Assessment Year **: 2012-13**
PAN **: AAACL4246J**

The computation of income filed by the assessee revealed that its total business income was of ₹ 10.35 crore and the total taxable income was *nil* after allowing 80IC deduction of ₹ 34.25 crore, restricted to total income. The AO disallowed the 80IC deduction claimed by the assessee on the ground that the assessee during search and seizure in this case had himself submitted, that he was engaged in transactions which were mere book entries, circulating in nature and not genuine and accordingly the AO erroneously determined the taxable income at ₹ 34.25 crore instead of ₹ 10.35 crore.

Further we noticed that the AO had allowed write off of ₹ 51.61 crore debited in the profit and loss account without verifying the genuineness of the same, which consisted of (i) ₹ 15.03 crore on account of "Exceptional Item-Inventories written off" for which no further break up /details was available either in annual report or in the assessment records; and (ii) ₹ 36.58 crore on account of "Bad Debts written off" claimed by the assessee which was to be disallowed on the same ground that transactions were not genuine.

[22] Gujarat, Karnataka, Kerala, Maharashtra, New Delhi, Pudduchery, Tamil Nadu,, Uttar Pradesh, West Bengal

As per audit, keeping in view that 80IC deductions were disallowed by the AO, assessed income should have been ₹ 61.96 crore (₹ 10.35 + ₹ 51.61) instead of ₹ 34.25 crore. This resulted in under assessment of income by ₹27.71 crore involving tax effect of ₹ 8.99 crore. Reply is awaited (October 2014).

b. Charge : CIT-Puducherry
Assessee : DXN Herbal Manufacturing India (P) Limited
Assessment Year : 2008-09
PAN : AABCD4141M

The assessee had paid ₹ 2.97 crore as additional excise duty under protest during the previous year 2007-08 (AY 2008-09) and had claimed the same as deduction under Section 43B in the computation of income. However, the assessee had not claimed any expenditure in this regard in the books of accounts. As per Section 43B, the deduction is allowable only when the same has been incurred and actually paid by the assessee. As neither the liability has been incurred nor the same has been claimed as expenditure in profit and loss account, the same was required to be disallowed. This resulted in under assessment of income of ₹ 2.97 crore involving tax effect of ₹ 1.01 crore.

The ITD stated (November 2014) that even though the assessee made the payment under protest, it was served with a demand notice from the Excise Department. Hence it is a valid statutory liability which is allowable under Section 43B on payment before the due date of filing of return. The reply is not acceptable because the ITD has not produced the copy of demand notice from Excise department to substantiate that the liability is incurred.

Thus the AOs allowed business deductions which should not have been allowed as per provisions of the Act and Rules and CBDT instructions issued from time to time.

AOs allowed R&D expenditure without satisfying the conditions mentioned in the DSIR guidelines.

3.2.5 Allowance of R&D expenses

The DSIR guidelines, for approval of claim of weighted deduction under Section 35(2AB) of the Act delineates various conditions for eligibility of capital and revenue expenses on R&D. Any expense not satisfying the conditions mentioned therein are to be excluded before computing weighted deduction on R&D expenses.

We noticed in 14 cases in five states[23] in which the AO had allowed deductions on R&D expenses in contravention to the laid down provisions involving tax effect of ₹ 77.40 crore (see box 3.9).

[23] Andhra Pradesh,Gujarat, Karnataka, Maharashtra, New Delhi

Box 3.9 Incorrect allowance of R&D expenses

a. Charge : CIT LTU, Mumbai
Assessee : Glenmark Pharmaceuticals Limited
Assessment Year : 2009-10 to 2010-11
PAN : AAACG2207L

The DSIR guidelines, for approval of claim of weighted deduction under Section 35(2AB) of the Act, specifically provide to reduce *interalia* income from contract research from the total expenditure (excluding land and building) on the approved R&D centre.

The AO during scrutiny assessment allowed the weighted deduction, as claimed by the assessee under Section 35(2AB) of the Act, on expenditure on approved in house research and development facility. However, while computing net expenditure on R&D, instead of reducing "income from contract research", amounting respectively to ₹ 52.32 crore and ₹ 46.11 crore, from the gross R&D expenditure, it reduced the "*expenses* towards contract research" amounting to ₹ 36 crore and ₹ 31.07crore.

This resulted in excess claim of R&D expenditure of ₹ 16.32 crore and ₹ 15.04 crore and corresponding weighted deduction (at the rate of 150 *per cent*) of ₹ 24.47 crore and ₹ 22.56 crore respectively involving total tax effect of ₹ 15.99 crore. Reply is awaited (October 2014).

b. Charge : CIT V Delhi
Assessee : Ranbaxy Laboratories
Assessment Year : 2007-08
PAN : AAACR0127N

The assessee claimed weighted deduction on expenditure of ₹ 412.20 crore (₹ 374.31 crore + ₹ 37.89 crore) incurred on in house R&D at the rate of 150 *per cent* which comes to ₹ 618.30 crore under Section 35(2AB) in the computation of income. Further audit noticed that an amount of ₹ 42.35 crore incurred on Clinical Trial expenses conducted outside approved facilities (as per Form 3CL issued by DSIR) includes in the revenue R&D expenses for claiming deduction under Section 35(2AB). As the expenditure incurred on outside Clinical Trial of ₹ 42.35 crore was not an allowable expenditure under the provisions of Section 35(2AB). As such weighted portion of ₹ 21.17crore should have been disallowed. The mistake resulted in excess claim of weighted deduction to the tune of ₹ 21.17 crore resulting in under assessment of income to the same extent involving tax of ₹ 6.35 crore. Reply is awaited (December 2014).

Thus the ITD was not having an effective mechanism for examination of eligibility of R&D expenses and its correct value.

AOs allowed expenses on which either the Tax was not deducted at source or if deducted then not deposited before the specified due date.

3.2.6 Mistake in allowing expenses on which TDS was not deducted / deposited

As per Section 40(a)(ia), any interest, commission or brokerage (rent, royalty), fees for professional or technical services or amounts payable to a contractor or sub-contractor etc., as detailed therein, on which tax is deductible at source (TDS) and has not been deducted or, after deduction, has not been paid on or before the specified due date, such amounts shall not be allowed as expense in computing the income.

We noticed in seven cases in five states[24] in which the AO had allowed expenses on which TDS was either not deducted or deducted but not deposited violating the laid down provisions involving tax effect of ₹ 5.91 crore (see box 3.10).

Box 3.10 Mistake in allowing expenses on which TDS was not deducted /deposited

Charge	**: CIT-I, Guwahati**
Assessee	**: Candida Enterprise**
Assessment Year	**: 2010-11 to 2011-12**
PAN	**: AADFC9889N**

The assessee debited ₹ 1.01 crore & ₹ 1.24 crore respectively towards Service Charges in the P/L Accounts. However, no documentary evidence in support of deduction of TDS and payment thereof to the Government Account within the prescribed time limit was available in the Assessment Records. Therefore, as per the provision of Section 40(a)(ia) of the IT Act, the whole amount was not an allowable deduction. This resulted in under-assessment of total income of ₹ 2.25 crore involving tax of ₹ 95.66 lakh. Reply is awaited (October 2014).

This indicated that the provision for disallowance of expenses in cases where TDS has either not been deducted or deducted but not deposited is not being applied by the AOs properly.

24 Assam,Gujarat, Madhya Pradesh, Tamil Nadu, West Bengal

AOs did not maintain consistency in allowing or disallowing particular expenses in subsequent years.

3.2.7 Inconsistency in assessment

AOs are required to take a consistent stand in respect of allowance or disallowance with respect to certain aspect. Disallowance made in a particular AY must be sustained in the following AYs unless decided otherwise by the department.

We noticed in three cases of an assessee in Maharashtra that consistency in giving treatment of a particular disallowance was not observed by the AO involving tax effect of ₹ 149.93 crore (see box 3.11).

Box 3.11: Inconsistency in assessment

Charge	**: CIT Central-IV, Mumbai**
Assessee	**: Rajat Pharmachem Limited**
Assessment Year	**: 2006-07, 2008-09 and 2009-10**
PAN	**: AAACR6464N**

Section 68 of the Act provided for addition of the sum in the total taxable income, if that sum is found credited in the books of an assessee and the assessee either offers no explanation about the nature and source thereof or the explanation offered by him is not satisfactory in the opinion of the AO.

The AO completed scrutiny assessment (May 2011) of the assessee, *ex parte* under Section 144 read with Section 153A of the Act for the AYs 2003-04 to 2009-10. In this case, search and seizure was conducted in assessee's premises wherein it was observed that the books of accounts were not maintained in proper and correct manner as provided by law. It was manipulated and was not having evidences supporting transactions and hence the same was rejected. The assessee was asked to furnish year wise list of debtors and creditors with complete details including proof of creditworthiness of creditors, which the assessee had failed to provide. Hence the AO made additions, in the income, of amount of new sundry creditors shown. However such additions were made in respective AYs up to 2005-06 only and similar additions of new sundry creditors amounting to ₹ 99.02 crore, ₹ 98.56 crore and ₹ 186.34 crore were not done for AYs 2006-07, 2008-09 and 2009-10 respectively. Omission to do so, resulted in under assessment of ₹ 383.92 crore.

Further it was noticed that in the Balance Sheet with respect to AY 2008-09 (FY 2007-08), sundry creditors at the year end is shown as ₹ 198.12 crore, however in the balance sheet of the next FY viz. 2008-09, in the column reflecting details of the previous FY (viz. 2007-08) for comparison, the same has been shown as ₹ 256.26 crore instead of ₹ 198.12 crore. Owing to this inflated reflection, the differential amount of ₹ 58.14 crore was also required to be added in the income with respect to AY 2009-10. Thus, the total underassessment in this case was of ₹ 442.06 crore involving tax effect of ₹ 149.93 crore. Reply is awaited (October 2014).

AOs committed arithmetical errors in assessments despite provisions in the Act and CBDT's instructions in this regard.

3.2.8 Arithmetical errors in computation of income and tax

Section 143(3) provides that AOs have to determine and assess the income correctly. Different types of claims together with accounts, records and all documents enclosed with the return are required to be examined in detail in scrutiny assessments. CBDT has also issued instructions from time to time in this regard.

We noticed in 15 cases in nine states[25] in which the AO made arithmetical errors involving tax effect of ₹ 14.65 crore (see box 3.12).

Box 3.12: Arithmetical errors in computation of income and tax

a.

Charge	**: CIT –Central, Bangalore**
Assessee	**: The Himalaya Drug Company**
Assessment Year	**: 2005-06**
PAN	**: AADFT3025B**

We noticed that the refund of ₹ 2.85 crore issued earlier was not added back while computing the total demand payable by the assessee resulting in short computation of demand of ₹ 4.00 crore. The ITD accepted the audit objection and the rectification order under Section 154 was passed in November 2013.

b.

Charge	**: CIT-III, Kolkata**
Assessee	**: Allied Resins & Chemicals Limited**
Assessment Year	**: 2008-09**
PAN	**: AACCA8557D**

We noticed that AO in the assessment order made several disallowances amounting to ₹ 4.95 crore. The AO instead of adding the same amount deducted it from total income which resulted into under-assessment of income of ₹ 9.90 crore with consequential potential tax effect of ₹ 2.97 crore. The ITD rectified the mistake under Section 154 as pointed out by Audit (August 2014).

c.

Charge	**: CIT-I, Hyderabad**
Assessee	**: Dr. Reddy's Research Foundation Limited**
Assessment Year	**: 2008-09**
PAN	**: AABCR1733M**

We noticed that during the assessment of the assessee company under Section 143(3) r.w.s. 147 of the Act on 10 March 2014, the refund issued of ₹ 1.69 crore under Section 154 of the Act on 25 April 2011 was not considered while computing the total demand payable by the assessee. This resulted in short demand of ₹ 2.11 crore including interest. The ITD has stated (July 2014) that audit objection is acceptable.

25 Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Madhya Pradesh, New Delhi, Pujab, Rajasthan, West Bengal

This indicated that the quality of assessment, in many cases, suffered from arithmetical errors despite instructions of the CBDT from time to time.

Despite specific provisions in the Act the AOs did not assess the income under special provisions.

3.2.9 Assessment of Income under special provision

Section 115JB provides for levy of MAT at prescribed percentage of the book profit if the tax payable on total income under the normal provisions is less than such percentage of the book profit arrived at after certain additions and deletions as prescribed.

We noticed in six cases in five states[26] in which the AO had not assessed income under Section 115JB properly involving tax effect of ₹ 6.11 crore (see box 3.13).

Box 3.13 Income not assessed under special provision

a. **Charge : CIT I Delhi**
Assessee : Ayurvet Limited
Assessment Year : 2009-10
PAN : AAECA4056B

The AO determined the income as *nil* under normal provisions. Hence the assessee had to pay tax on book profit of ₹ 5.86 crore under special provisions of the Act. Further audit noticed that an amount of ₹ 35.00 lakh in respect of provision for bad debts debited to the profit and loss account was also required to be added in book profit. Neither the assessee nor the AO determined the tax under Section 115JB. Omission to do so resulted in total under assessment of ₹ 6.21 crore involving tax effect of ₹ 70.40 lakh. Reply is awaited (December 2014).

b. **Charge : CIT LTU, Mumbai**
Assessee : IPCA Laboratories Limited
Assessment Year : 2009-10
PAN : AAACI1220M

Income accrued or arising from any business carried by an entrepreneur in Special Economic Zone (SEZ) is not to be counted while computing book profit for the purpose of computation of Minimum Alternate Tax (MAT). Further as clarified by various court judgments[27] such income from SEZ is exempted under Section 10AA of the Act and hence shall not be considered as a part of computation of total income under normal provisions as well.

26 Gujarat, Maharashtra, Madhya Pradesh, New Delhi, West Bengal

27 (Scientific Atlanta vs. ACIT 129 TTJ 273 (Che)(SB), CIT vs. Yokogawa India Ltd. 341 ITR 385 (Kar), CIT vs. Black & Veatch Consulting 348 ITR 72 (Bom), CIT vs. TEI Technologies 78 DTR 225 (Del)and other judgements)

The assessee considered loss of ₹ 15.29 crore in its SEZ unit at Pithampur in computing book profit for the purpose of MAT and the AO allowed the same which was not allowable. This resulted in underassessment to the same extent involving tax effect of ₹ 1.73 crore. Further the assessee, in the computation of total income under normal provisions also, had considered the above mentioned loss and the AO accepted the same. As the tax payable by the assessee in this case was minimum alternate tax, the MAT credit available to the assessee was excess by the same amount of ₹ 1.73 crore.

Subsequently when the assessee makes further payment of ₹ 1.73 crore under MAT as pointed in audit, fresh MAT credit would not be available to the assessee, as he was already having excess credit to that extent. Reply is awaited (October 2014).

This indicated that in many cases, income under Section 115JB was not being assessed as per the provisions contained therein.

AOs did not assess the income of the assesses under normal provisions of the Act though the same was not specifically exempted.

3.2.10 Assessment of Income under normal provision

Section 5 provides that the total income of a person for any previous year includes all income from whatever source derived which is received or deemed to be received or which accrues or arises during such previous year unless specifically exempted from tax under the provisions of the Act.

We noticed in 16 cases in eight states[28] in which the AO had not assessed the income under normal provisions of Act involving tax effect of ₹ 84.21 crore (see box 3.14).

Box 3.14 Income not assessed under normal provision

a.

Charge	**: CIT II Vadodara**
Assessee	**: Sun Pharmaceutical Industries Limited (SPIL)**
Assessment Year	**: 2008-09 to 2010-11**
PAN	**: AADCS3124K**

The assessee company (SPIL) received ₹141.72 crore from the partnership firm Sun Pharmaceutical Industries (SPI) stating that it was remuneration from the firm and claimed exemption under Section 28(v) on this income stating that the firm has already added this amount to its income. We observed from the details of partnership deed that the income so received was in the nature of service charges for technical, marketing and distribution assistance and certain other functions performed on behalf of SPI (Firm).

28 Assam, Gujarat, Karnataka, Kerala, Maharashtra, Punjab, Rajasthan, West Bengal

Hence the above income of SPIL, not being in the nature of remuneration but a service charge was required to be taxed. Omission to do so resulted in under assessment of income of ₹ 141.72 crore involving tax effect of ₹ 48.17 crore. Reply is awaited (October 2014).

b. Charge : CIT Central-III, Kolkata
Assessee : Nixil Pharmaceuticals Specialties Limited
Assessment Year : 2010-11
PAN : AABCN6977H

The details of the investment in the Balance Sheet of assessee revealed that as on 31 March 2010 another company Basil International Limited had ₹24.33 crore invested in the assessee company. Whereas the investment details of Basil International Limited reflected only ₹ 9.44 crore in equity shares of the assessee. As there was no sale of shares reflected during the year in the accounts of the assessee, the excess amount so reflected was deemed to be an income from undisclosed source under Section 69. This resulted in under assessment of ₹ 14.89 crore involving tax effect of ₹ 4.24 crore. Reply is awaited (October 2014).

c. Charge : CIT –LTU, Bangalore
Assessee : Biocon Limited
Assessment Year : 2010-11
PAN : AAACB7461R

We observed that the AO, while computing the total income in the assessment, did not consider income from other sources of ₹ 8.83 crore. This resulted in short computation of income to the same extent involving a tax effect of ₹ 3 crore.

The ITD has stated (December 2014) that the case has been re-opened under Section 147 of the Act and notice under Section 148 dated 1.10.2014 has been issued to the assessee directing him to file a revised return.

This indicated that in many cases, income under normal provisions of the Act was not being assessed despite instructions of CBDT issued from time to time.

Assessing Officers made incorrect classification and computation of capital gains.

3.2.11 Classification and computation of capital gains

Section 45 of the Act provides that any profits or gains arising from the transfer of a capital asset be chargeable to income tax under the head capital gains.

Section 50B of the Act provides that any profits or gain arising from the slump sale shall be chargeable to income tax as capital gains arising from the transfer of long term capital asset.

We noticed in one case in Mumbai in which the AO had not assessed the income under capital gains properly involving tax effect of ₹ 0.74 crore (see box 3.15).

Box 3.15: Incorrect classification and computation of capital gains

a.	**Charge**	**: CIT LTU, Mumbai**
	Assessee	**: Glenmark Pharmaceuticals Limited**
	Assessment Year	**: 2009-10**
	PAN	**: AAACG2207L**

The assessee had sold two of its Generic units at Ankaleshwar and Goa on 01 April 2008 under Business Transfer Agreement for ₹ 750 crore. However while debiting cost of business from this sale consideration, to work out the long term capital gains, it considered book value of Capital Work-in-Progress (CWIP) of these units as ₹ 54.91 crore. Whereas the closing balance of CWIP, as on 31 March 2008 was ₹ 51.66 crore only, as reflected in the notes to fixed assets schedule in the Balance sheet. This resulted in under assessment of long term capital gains of ₹ 3.25 crore involving short levy of tax of ₹ 73.65 lakh. Reply is awaited (October 2014).

3.2.12 International Transactions

Section 92D read with 92E of the Act provided that every person who has entered into an International Transaction had to keep and maintain information and documents prescribed and to obtain and furnish a report in form 3CEB before the prescribed date, from an accountant in this regard. Further as per Section 271AA of the Act, failure to keep and maintain such information and or to report such transaction as required, or maintaining/furnishing incorrect information or document would attract penalty at the rate of two *percent* of the value of the international transaction entered into.

We noticed five cases in Maharashtra involving errors in the Transfer Pricing functions or in giving effect of the same by the ITD involving tax effect of ₹ 7.58 crore (see box 3.16).

Box 3.16: Irregularities in respect of Transfer Pricing

a.	**Charge**	**: CIT LTU, Mumbai**
	Assessee	**: Glenmark Generic Limited**
	Assessment Year	**: 2009-10**
	PAN	**: ACCG9820D**

Section 92D read with 92E of the Act provided that every person who has entered into an International Transaction had to keep and maintain information and documents prescribed and to obtain and furnish a report in form 3CEB before the prescribed date, from an accountant in this regard. Further as per Section 271AA of the Act, failure to keep and maintain such information and or to report such transaction as required, or maintaining/furnishing incorrect information or document would attract penalty at the rate of two *per cent* of the value of the international transaction entered into.

We noticed that the assessee had shown total international transaction of ₹ 111.11 crore in the Profit & Loss Account on account of payment towards the share of the company towards one time additional sales allowances given to customers by Glenmark Generics Inc., USA. The same was also certified by the Tax Audit Reporter in Form 3CD. However, the same was neither reported in Form No. 3CEB by the assessee nor Transfer Pricing Officer or AO took cognizance of the same. This resulted in non-reporting of international transaction in Form No. 3CEB by ₹ 111.11 crore attracting penalty at 2 *per cent* amounting to ₹ 2.22 crore. Reply is awaited (October 2014).

b. Charge : CIT-VIII Mumbai
Assessee : Pfizer Limited
Assessment Year : 2010-11
PAN : AAACE3334M

The AO allowed expenses of ₹ 18.38 crore debited to the profit and loss account, paid by the assessee to its associated enterprises. However, in Form 3CEB the accountant certified transactions with associated enterprises of ₹ 10.46 crore only. This resulted in excess claim of expenditure of ₹ 7.92 crore over and above what was certified by the accountant in form 3CEB, leading to under assessment of income to the same extent involving tax effect of ₹ 2.69 crore. Reply is awaited (October 2014).

3.2.13 Other cases

We also noticed 13 cases in five states[29] of miscellaneous nature such as allowance of provisional expenses, mistake in levy of interest, allowance of bogus purchase expenses etc. involving tax effect of ₹ 12.15 crore (see boxes 3.17-3.20).

Box 3.17: Illustrative cases on miscellaneous mistakes

Mistake in allowing provisions for expenses

As per Section 37, any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". Hence any provision made is not an allowable expenditure.

a. Charge : CIT LTU, Mumbai
Assessee : Glenmark Pharmaceuticals Limited
Assessment Year : 2008-09, 2009-10 & 2010-11
PAN : AAACG2207L

We noticed that the assessee has provided an amount of ₹ 2.03 crore for AY 2008-09, ₹ 4.58 crore for AY 2009-10 and ₹ 3.46 crore for AY 2010-11 on account of "Provision

29 Kerala, Punjab, Madhya Pradesh, Maharashtra, West Bengal

for Gratuity and Leave Encashment". As per Section 37 of the IT Act any provision made is not an allowable expenditure. Therefore, this should have been disallowed and added to the total income of the assessee while computing income under the normal provision of the Act. But neither the assessee nor the department has added this income. This resulted in under assessment of income to the extent of ₹ 10.08 crore with consequent short levy of tax of ₹ 3.43 crore. Reply is awaited (October 2014).

b. **Charge** **: CIT Trivandrum**
Assessee **: Kerala Medical Service Corporation**
Assessment Year **: 2010-11**
PAN **: AADCK4029M**

We noticed that provision for Income Tax amounting to ₹ 1.42 crore debited to P&L Account was not added back while computing total income. The mistake resulted in under assessment to the same extent involving short levy of tax of ₹ 48.11 lakh. The ITD accepted the objection.

Box 3.18: Illustrative cases on miscellaneous mistakes

Allowance of bogus purchase expenses

As per Section 37 any expenditure incurred by an assessee for any purpose which is an offence or which prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.

Sales Tax Department of State of Maharashtra, in the course of their investigation had unearthed a massive scam in which they had found that some dealers were issuing invoices without actual sales/purchase transaction, which is nothing but hawala transaction. Thereafter, they started publishing the list of such hawala dealers on the website of Sales Tax Department of the Government of Maharashtra. Purchases made from such bogus dealers are not admissible deduction for the assessees.

Charge **: CIT-VIII, Mumbai**
Assessee **: Hiran Orgochem Limited**
Assessment Year **: 2009-10**
PAN **: AAACH0977J**

The AO completed scrutiny assessment without verifying the name of one of the dealers viz. Utkantha Trading Pvt. Limited, from whom the assessee had shown purchases of ₹ 13.20 crore, appeared in the list of bogus dealers on the website of sales tax department of Government of Maharashtra and hence these expenses were not allowable. Omission to do so, resulted in under assessment to the same extent involving potential tax effect of ₹ 3.96 crore.

ITD in its reply did not accept the objection stating that audit had relied on third party information. Reply of the ITD was not acceptable as the name of the dealers appeared in the list of bogus dealers on the website of Sales Tax Department of Government of Maharashtra and the ITD itself uses information from this website for disallowances of purchases bogus in nature. Further it has been judicially held[30] that records maintained by various State / Central Government authorities are important piece of evidence.

Box 3.19: Illustrative cases on miscellaneous mistakes

Non deposition of tax

a. Charge : CIT-II Chandigarh
Assessee : Venus Remedies Limited
Assessment Year : 2011-12
PAN : AAACV6524H

The assessee company declared dividend of ₹ 2.74 crore for the AY 2011-12 on 30.09.2011. As per provisions of the Section 115(O), the additional tax of ₹ 44.16 lakh was required to be deposited before 15 October 2011. The assessee had not deposited the tax. This had resulted in the company becoming a defaulter with outstanding arrears of tax demand of ₹ 44.16 lakh. Reply is awaited (October 2014).

Mistake in levy of interest

b. Charge : CIT Central-IV, Mumbai
Assessee : Rajat Pharmachem Limited
Assessment Year : 2008-09
PAN : AAACR6464N

The AO completed scrutiny assessment *ex parte* under Section 144 read with Section 153A of the Act in May 2011. In this case, assessee neither filed return under Section 139(1) nor filed under Section 153A of the Act. The AO determined total income of the assessee at ₹ 283.98 crore on which tax was leviable of ₹96.52 crore. We noticed that interest under Section 234A leviable on @ of 1 *per cent* for 32 months (01.10.2008 to 31.05.2011) worked out to ₹ 30.89 crore, however, AO had levied only ₹ 29.92 crore. Hence, there was short levy of interest under Section 234A of ₹ 96.52 lakh. Reply is awaited (October 2014).

30 Motipur Sugar Factory(P) Ltd. vs. CIT (1974) 95 ITR 401-Pat (HC), Seetarama Mining Co. Vs CIT (1968)68 ITR1 (AP) HC

Box 3.20: Illustrative cases on miscellaneous mistakes

Excess or levy of interest on refunds

f. **Charge** **: CIT-IV, Kolkata**
Assessee **: Organon (India) Limited**
Assessment Year **: 2007-08**
PAN **: AAACI6949R**

The AO levied interest of ₹ 1.37 core instead of ₹ 16.78 lakh under Section 234D. The mistake resulted in excess levy of interest of ₹ 1.20 crore under Section 234D. The ITD rectified the mistake under Section 154 in September 2012. Reply is awaited (October 2014).

3.3 Conclusion

To evaluate the contribution in the tax revenue and existence of proper machinery/system to exercise necessary controls over the compliance of the provisions of the Act, we conducted the study on the assessees in Pharmaceuticals Sector. In addition to the system weaknesses like non-maintenance of sector wise data and non existence of mechanism for cross verification of turnover declared in the Income Tax Return and Excise Return, we pointed out non compliance of the instructions/guidelines of the regulatory bodies like Medical Council of India (MCI), National Pharmaceuticals Pricing Authority (NPPA) and Department of Scientific and Industrial research (DSIR).

In our Audit report we also suggested to bring clarity in instructions issued by the Central Board of Direct Taxes (CBDT) so that divergent view are not taken by the Assessing Officers and there is a consistency in the assessments and litigation is avoided.

3.4 Recommendations

a. CBDT may issue instruction to clarify the nature of expenses to be treated as freebies including physician's samples. Further, a suitable mechanism may be devised for the assessees claiming deduction of such expenses, to provide details of expenses in the nature of freebies from the sales promotion expenses

The Ministry stated (January 2015) that what constitutes 'Freebies' is prescribed in guidelines of the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, as amended on 10th December, 2009, and therefore, any alteration/addition/deletion in the

said guidelines can only be effected by that body. The Ministry further stated (January 2015) that in each case issue is decided by the AO on its merits and remedial action is available with AOs The Ministry further stated that making details of expenses in the nature of freebies in ITR will make it bulky.

Audit is of the view that the AOs are taking divergent views due to lack of clarity in the CBDT instructions in this regard therefore, the Ministry may take appropriate action so that AOs take consistent action in future.

b. CBDT may clearly specify the effective date of disallowance of expenses towards freebies to put the disputed and varied interpretations in this regard to rest.

The Ministry stated that the circular of CBDT dated 01 August 2012 was merely clarificatory in nature and AOs make any disallowance of freebies on the basis of existing/amended guidelines of MCI and no intervention is required on this issue.

Audit is of the view that absence of effective date in the circular may lead to divergent views of the AOs and finally lead to litigation. Therefore, the date from which the instructions of the CBDT will be effective should be specifically mentioned in every instruction/circulars i.e. prospective or retrospective.

c. The Ministry may introduce a standard form, to be filed either with return or with the assessment records, indicating allocation of all common expenses or weighted deductions alongwith the basis and working of such allocation.

The Ministry stated (January 2015) that this is a compliance issue and is to be dealt with on case to case basis. AOs are empowered to call for all such details during the scrutiny assessments.

Audit is, however, still of the view that there is a need to indicate the basis of allocation of common expenses in the assessment records.

d. The Ministry may adhere with the conditions of the DSIR in general and submission of audited accounts of the R&D facility with the return filed by the assessee in particular at the time of assessment to see the eligibility of R&D expenses and quantification thereof.

The Ministry stated (January 2015) that DSIR would be consulted for revision of the existing format of audit certificate for capturing information like allocation of expenses etc from the view point of Income-tax proceedings. The Ministry further stated (January 2015) that the feasibility of e-enabling the audit certificate for filing will also be examined by the ITD.

New Delhi **(MANISH KUMAR)**
Dated: 5 March 2015 **Principal Director (Direct Taxes)**

Countersigned

New Delhi **(SHASHI KANT SHARMA)**
Dated: 5 March 2015 **Comptroller and Auditor General of India**