

**ASSESSMENT OF ASSESSEES IN PHARMACEUTICAL
SECTOR**

[Action Taken by the Government on the Observations/Recommendations of
the Committee contained in their 136th Report (16th Lok Sabha)]

MINISTRY OF FINANCE (DEPARTMENT OF REVENUE)

**PUBLIC ACCOUNTS COMMITTEE
(2019-20)**

ELEVENTH REPORT

SEVENTEENTH LOK SABHA



**LOK SABHA SECRETARIAT
NEW DELHI**

PAC NO. 2192

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PUBLIC ACCOUNTS COMMITTEE (2019-20)

(SEVENTEENTH LOK SABHA)

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MINISTRY OF FINANCE (DEPARTMENT OF REVENUE)



Presented to Lok Sabha on:

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LOK SABHA SECRETARIAT
NEW DELHI

March, 2020 /Phalguna, 1941 (Saka)

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- I Minutes of the 12th sitting of the Public Accounts Committee (2019-20) held on 12th March, 2020.
- II Analysis of the Action Taken by the Government on the Observations/Recommendations of the Public Accounts Committee contained in their One Hundred and Thirty-Sixth Report (Sixteenth Lok Sabha)

**Not appended to the cyclostyled copy of the Report*

COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE

Shri Adhir Ranjan Chowdhury - Chairperson

MEMBERS

LOK SABHA

2. Shri T. R. Baalu
3. Shri Subhash Chandra Baheria
4. Shri Sudheer Gupta
5. Smt. Darshana Vikram Jardosh
6. Shri Bhartruhari Mahtab
7. Shri Ajay (Teni) Misra
8. Shri Jagdambika Pal
9. Shri Vishnu Dayal Ram
10. Shri Rahul Ramesh Shewale
11. Shri Rajiv Ranjan Singh alias Lalan Singh
12. Dr. Satya Pal Singh
13. Shri Jayant Sinha
14. Shri Balashowry Vallabhaneni
15. Shri Ram Kripal Yadav

RAJYA SABHA

16. Shri Rajeev Chandrasekhar
17. Prof. M. V. Rajeev Gowda
18. Shri Naresh Gujral
19. Shri P. Bhattacharya*
20. Shri C. M. Ramesh
21. Shri Sukhendu Sekhar Ray
22. Shri Bhupender Yadav

SECRETARIAT

1. Shri T. G. Chandrasekhar - Joint Secretary
2. Shri M.L.K Raja - Director
3. Smt. Anju Kukreja - Deputy Secretary

* Elected w.e.f. 10 February, 2020 in lieu of vacancy caused due to resignation of Shri Bhubaneswar Kalita from Rajya Sabha on 05 August, 2019.

INTRODUCTION

I, the Chairperson, Public Accounts Committee (2019-20), having been authorised by the Committee, do present this Eleventh Report (Seventeenth Lok Sabha) on Action Taken by the Government on the Observations/Recommendations of the Committee contained in their One Hundred and Thirty-Sixth Report (Sixteenth Lok Sabha) on " **Assessment of Assesseees in Pharmaceutical Sector** ".

2. The One Hundred and Thirty-Sixth Report was presented to Lok Sabha/laid in Rajya Sabha on 5th February, 2019. Replies of the Government to all the Observations/Recommendations contained in the Report were received. The Public Accounts Committee considered and adopted the Eleventh Report at their Sitting held on 12th March, 2020. Minutes of the Sitting are given at Appendix I.

3. For facility of reference and convenience, the Observations and Recommendations of the Committee have been printed in thick type in the body of the Report.

4. The Committee place on record their appreciation of the assistance rendered to them in the matter by the Office of the Comptroller and Auditor General of India.

5. An analysis of the action taken by the Government on the Observations/Recommendations contained in the One Hundred and Thirty-Sixth Report (Sixteenth Lok Sabha) is given at *Appendix-II*.

NEW DELHI;
13 March, 2020
23 Phalgun, 1941 (*Saka*)

ADHIR RANJAN CHOWDHURY
Chairperson,
Public Accounts Committee

REPORT

PART - I

This Report of the Public Accounts Committee deals with the Action Taken by the Government on the Observations and Recommendations of the Committee contained in their One Hundred and Thirty-Sixth Report (16th Lok Sabha) on "**Assessment of Assesseees in Pharmaceutical Sector**".

2. The One Hundred and Thirty-Sixth Report (16th Lok Sabha) which was presented to Lok Sabha/laid in Rajya Sabha on 5th February, 2019, contained 8 Observations and Recommendations. Action Taken Notes in respect of all the Observations and Recommendations have been received from the Ministry of Finance (Department of Revenue) are broadly categorised as follows:

- | | |
|--|---|
| (i) Observations/Recommendations which have been accepted by the Government:

Para Nos. 1-8 | Total: 8
Chapter - II |
| (ii) Observations/Recommendations which the Committee do not desire to pursue in view of the replies received from the Government:
Para Nos. NIL | Total: NIL
Chapter - III |
| (iii) Observations/Recommendations in respect of which replies of the Government have not been accepted by the Committee and which require reiteration:
Para Nos. NIL | Total: NIL
Chapter - IV |
| (iv) Observations/Recommendations in respect of which Government have furnished interim replies:
Para Nos. NIL | Total: NIL
Chapter -V |

3. The One Hundred and Thirty-Sixth Report of the Committee was based on Audit review of assessment of assesseees in Pharmaceutical Sector. Audit had observed plethora of deficiencies in systemic issues as well as compliance issues relating to assessment of assesseees in this sector. It contains non-maintenance of data of incentives given to Pharmaceutical sector, non- maintenance of data of assesseees in this sector, allowing of weighted deduction on expenses towards R&D without verifying the claims from the form 3CL/3CM issued by D/O Scientific & Industrial Research who is the competent authority to grant approval of such claims, non-payment of TDS by assesseees, taking undue benefit of section 80 IC deduction, absence of any mechanism

for ITD to correlate and verify carry forward of losses/depreciation especially of the unit availing 80IC deductions, absence of any mechanism for ITD to correlate and verify the turnover declared in Income Tax Returns with the turnover declared in Central Excise Returns, allowing expenditure towards gifts/freebies to medical professionals, non-evolving a system of sector-wise data for tax planning, misuse of the ambiguities in the legal provisions/lacunae in the Act etc. The Committee had accordingly given their Observations/Recommendations in their One Hundred and Thirty-sixth Report.

Gist of Committee's Observations/Recommendations

4. Some of the important Observations/Recommendations made by the Committee in their 136th Report (16th Lok Sabha) are as under:

- 1) The Committee recommended that henceforth a comprehensive data of Pharmaceutical sector be maintained. The Department of Scientific and Industrial Research and National Pharmaceutical Pricing Authority should capture PAN details of the sector to facilitate its linking with ITRs.
- 2) Action should be taken against the assessing officers who allowed weighted deduction on expenses towards R&D without verifying the claims from the Form 3CL/3CM issued by DSIR.
- 3) Ministry should issue clear instructions to ensure that the Pharmaceutical companies deduct the TDS on payments to contract manufacturers.
- 4) The Committee recommended that not only the cases highlighted by the Audit but also similar such cases in the field should be thoroughly inquired into so as to find out as to how and why such lapses occurred, to what extent they were bonafide mistakes and exemplary stern action taken against the officers concerned.
- 5) Ministry should look into the reasons for failure on the part of the Internal Audit wing for detecting lapses leading to huge revenue loss to the exchequer and take suitable steps so as to ensure that this wing performs efficiently in exercising effective control to find out mistakes in assessment and thereby to prevent leakage of revenue.

5. The Action Taken Notes furnished by the Ministry of Finance (Department of Revenue) have been reproduced in the relevant chapters of this Report. In the succeeding Paragraphs, the Committee have dealt with the action taken by the Government on some of their Observations/Recommendations which need reiteration or merit comments.

I. Allowance of R&D expenditure without approval from Department of Scientific and Industrial Research (DSIR) **(Recommendation Para No. 4)**

6. In their 136th Report, the Committee had found 22 cases in six States involving tax effect of ₹ 570.59 crore where weighted deduction on expenses towards R&D was allowed without verifying the claims from the Form 3C/3CM issued by Department of Scientific and Industrial Research (DSIR) which is the competent authority to grant

approval of such claims. In this regard, the Committee had desired to be apprised of the action taken against the assessing officers who allowed such deduction without verification in the aforesaid 22 cases resulting in loss to the exchequer.

7. The Ministry of Finance (Department of Revenue) in their Action Taken Note have submitted as follows:

"Regarding 22 cases, explanation have been called in 16 cases in which audit objection has been accepted by the Department."

8. Upon noticing that weighted deductions on R&D expenses was allowed without verifying the claims from the form 3C/3CM, the Committee had desired that the action may be taken against the Assessing Officers who allowed such deductions. In this regard, the Committee are informed that out of 22 cases, explanation has been called in 16 cases in which Audit objection has been accepted by the Department. While appreciating the action initiated by the Income Tax Department by way of seeking explanation of Assessing Officers in 16 cases, the Committee desire to know details of further action taken in the remaining 6 cases. The Committee also recommend that stringent action should be taken against such Assessing Officers who are found guilty so as to convey a strong message to all departmental officers and thereby avoid such losses to the exchequer. The Committee would like to be apprised of the action taken in this regard.

II. Deduction of TDS in respect of contract entered by assessee company with a manufacturing company for manufacture of products
(Recommendation Para No. 5)

9. Section 194C of the Act provides for deduction of TDS at the rate of two percent from the payment to the contractor for carrying out any work in pursuance of a contract between the contractor and an assessee. The Committee are constrained to observe that the Pharmaceutical companies, by just not supplying raw materials directly to the contract manufacturers, treated such contracts as supply contracts and did not pay TDS taking advantage of exclusion clause of Section 194C. Since entire control of manufacturing process remained with the Pharmaceutical companies which made it akin to works contract only, attracting TDS, the Audit recommended that the CBDT should consider issuing instructions to bring under the ambit of section 194C of the Act such work contracts where the entire control of manufacturing process vests with the assessee companies. In reply thereto, the Ministry stated (January 2015) that implementation of C&AG suggestion would require legislative change in Section 194C as it is possible that some assessees may take advantage of the definition of work contract as defined in Section 194C. The Committee were distressed to note that despite the issue being pointed out by the C&AG way back in 2015, no concrete steps have been taken thus far by the Ministry in this direction. Since a large number of potential tax payers can be identified in the Pharmaceutical sector, non-deduction of TDS in these cases resulted into huge revenue loss to the exchequer. Since the case pointed out by the Audit are only test checked and only tip of the iceberg, the net tax

effect would be much. The Committee, therefore, recommended that the Ministry should take legal advice on the matter and amend the Section 194C of the IT Act, if required, at the earliest besides issuing clear instructions to ensure that the Pharmaceutical companies deduct the TDS on payments to contract manufacturers.

10. The Ministry of Finance (Department of Revenue) in their Action Taken Note have stated as follows:—

"A. In this regard, it is stated that the matter was examined and it is found that Explanation III to Section 194C before amendment vide Finance (No. 2) Act, 2009 defined "work" as:

"Explanation III: For the purpose of this section, the expression "work" shall also include-

- (a) Advertising;
- (b) Broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
- (c) Carriage of goods and passengers by any mode of transport*** other than by railways;
- (d) Catering"

B. Above definition of "work" did not differentiate between "work contract" and "Contract of sale". In order to remove the ambiguity in the above issue, an amendment was made vide Finance (No. 2) Act, 2009 to the definition of "work" contained in Explanation to Section 194C which is now read as:

"(iv) "work" shall include –

- (a) Advertising;
- (b) Broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
- (c) Carriage of goods and passengers by any mode of transport*** other than by railways;
- (d) Catering;
- (e) Manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from such customer, but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person other than such customer"

C. Explanatory notes to the Finance (No. 2) Act, 2009 circulated vide O.M No. 142/13/2010-SO (TPL), dated 03rd June, 2010, with regards to definition of "work" it was mentioned that:

"49.4 Clarification regarding "work" under section 194C

A) There is ongoing litigation as to whether TDS is deductible under section 194C on outsourcing contracts and whether outsourcing constitutes work or not. To bring clarity on this issue, it is provided that "work" shall not include manufacturing or supplying a product according to the requirement or

specification of a customer by using raw material purchased from a person other than such customer as such a contract is a contract for 'sale'..."

D. As can be observed, the amendment in the definition of "work" was already carried out in order to bring clarity on the issue of "work contract" vis-à-vis "contract for sale" which was a subject matter of several litigations. The difference between work contract and contract for sale has been very clearly discussed in the Explanatory Notes to the Finance (No. 2) Act, 2009. It has now been observed by C&AG that this is still being misused. This was examined in the Ministry and it was felt that further amendment is not proper as we need to maintain difference between "work contract" and "contract for sale". It is also noted that provisions of TDS do not impose final tax liability which is on the person doing the contract manufacturing and the income would, in any case, get taxed in the hands of the recipient manufacturer. However, if a monitoring mechanism is put in place to get information about such taxpayers above a threshold, it will prevent possible misuse. The proper monitoring mechanism which can be incorporated in the law is currently being examined."

11. The Committee in their 136th Report had noted that the Pharmaceutical companies, by just not supplying raw materials directly to the contract manufacturers, treated such contracts as supply contracts and did not pay TDS taking advantage of exclusion clause of section 194C. The Committee had, therefore, recommended that the Ministry should take legal advice on the matter and amend Section 194C of the IT Act. In this regard, the Ministry of Finance (Department of Revenue) submitted that the amendment in the definition of 'work' was already carried out in order to bring clarity on the issue of work contract vis-a-vis contract for sale. The Ministry have also stated that further amendment is not proper as they need to maintain the difference between 'work contract' and 'contract for sale'. The Ministry are of the view that, if a monitoring mechanism is put in place to get information about such tax payers above a threshold, it will prevent possible misuse. The Committee are constrained to observe that they have not been provided with the details of the efforts made for incorporating provisions enabling proper monitoring mechanism in the law. The Committee, therefore, recommend initiation of a vigorous action to establish a strong monitoring mechanism to keep a check on such cases at regular intervals. The Committee also believe that with the use of an effective monitoring mechanism, prevention as well as pursuit of these cases will be easier, faster and more decisive.

III. Allowance of expenditure towards gifts, freebies etc. to Medical Professionals
(Recommendation Para No. 7)

12. The Committee were constrained to observe that in 36 cases, involving tax effect of ₹ 55.10 crore in seven States where the expenditure towards gifts/freebies to medical professionals were allowed despite being made irregular by the Income Tax Act, Medical Council of India regulations, CBDT/Judicial pronouncement etc. Out of 36

cases, the Committee found 21 cases in five States (Gujarat, Karnataka, Maharashtra, New Delhi, Tamil Nadu) 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. Further, in 11 cases in Uttaranchal and Maharashtra the AOs had allowed the expenses on freebies given to doctors included in sales promotion without examination of the detailed breakup. The Committee also 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. Again, in one case in Andhra Pradesh the AO had allowed the expenses on the penalty levied by National Pharmaceutical Pricing Authority (NPPA) involving tax effect of ₹ 8.10 crore.

13. While deploring such an unhealthy practice in the Income Tax Department, the Committee recommended that not only the cases highlighted by the Audit but also similar such cases in the field should be thoroughly inquired into so as to find out as to how and why such lapses occurred, to what extent they were bonafide mistakes and exemplary stern action taken against the officers concerned. The Committee were perturbed to note that the AOs were taking divergent views for disallowance of expenses in the nature of freebies as CBDT had not clearly specified in its circular the effective date of disallowance of such expenses. Since the failure to mention the effective date in the circular by the CBDT led to divergent views of the AOs on a same issue result in litigation and finally to loss of revenue, the Committee desired that the Ministry should take immediate corrective action in this regard.

14. The Ministry of Finance (Department of Revenue) in their Action Taken Note have stated as under:

"With reference to the findings of the Hon'ble PAC that the failure to mention the effective date in the circular by the CBDT led to divergent views of the AOs on a same issue result in litigation and finally to loss of revenue, it is stated that the circular No.5/2012 issued by the CBDT was only clarificatory in nature and therefore, even before the issuance of the said clarificatory circular, as per the provisions of section 37 of the Income-tax Act, 1961, such freebies given to the doctors by the Pharma companies were required to be disallowed by the A.O as the said expenditure are prohibited by law. In this context, it is also submitted that it may not be fruitful to specify that the said circular no.5/2012 will be applicable retrospectively now as the period of limitation for taking any remedial action under section 148 of the Act is only within six years from the end of the relevant assessment year. Therefore, remedial action is not possible in cases belonging to assessment year 2012-13 and years prior to it now. However, it is submitted that the observations made by the Hon'ble PAC will be duly considered while issuing clarificatory circulars in future. Out of 36 cases mentioned in above recommendation, in 12 cases explanation has been called where audit objection has been accepted by the department."

15. **The Committee, in their 136th Report (16th Lok Sabha) had found that in 36 cases in seven States the expenditure towards gifts/freebies to medical professionals involving a tax effect to the extent of ₹ 55.10 crore were allowed**

despite being made irregular by the Income Tax Act, Medical Council of India regulations, CBDT/Judicial pronouncement etc. The Committee, therefore, recommended that these cases should be thoroughly inquired into so as to find out as to how and why such lapses occurred, to what extent they were bonafide mistakes and exemplary action taken against the officers concerned. Now, the Committee have been informed that out of 36 cases, explanation of Assessing Officers has been called in 12 cases where Audit objection has been accepted by the Department. In view of the fact that a significant amount of tax is involved in these cases, the Committee recommend that expeditious and stern action should be taken against the Assessing Officers concerned as mere calling for explanation would not result in avoidance of such cases in future.

NEW DELHI;
13 March, 2020
23 Phalguna, 1941 (*Saka*)

ADHIR RANJAN CHOWDHURY
Chairperson,
Public Accounts Committee