IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad ' B ' Bench, Hyderabad

Before Smt. P. Madhavi Devi, Judicial Member
AND
Shri .B. Ramakotaiah, Accountant Member

ITA Nos.359 & 361/Hyd/2013
(Assessment Years:2008-09 & 2009-10)

Dy. Commissioner of Income Tax, Circle 16(1) Hyderabad	Vs	M/s. Neuland Laboratories Ltd Hyderabad PAN: AAACN 9531 E

ITA Nos.420 & 421/Hyd/2013
(Assessment Years:2008-09 & 2009-10)

M/s. Neuland Laboratories Ltd Hyderabad PAN: AAACN 9531 E	Vs	Dy. Commissioner of Income Tax, Circle 16(1) Hyderabad

For Assessee:	Shri M.V. Anil Kumar
For Revenue:	Shri P. Soma Sekhar Reddy, DR
Date of Hearing:	15.09.2016
Date of Pronouncement:	05 .10.2016

O R D E R

Per Smt. P. Madhavi Devi, J.M.

The above appeals are cross appeals by both the assessee as well as the Revenue for the A.Ys 2008-09 and 2009-10 respectively. As common issues are arising in both the years, the appeals were heard together and are disposed of by this common and consolidated order.

2. Brief facts of the case for the A.Y 2008-09 are that the assessee company, engaged in the business of manufacturing and trading of bulk drugs and intermediates, filed its return of income relevant to the A.Y declaring 'Nil" income. During the assessment proceedings 143(3) of the I.T. Act, the AO observed that the assessee has not deducted the tax at source on sales commissions total of which comes to Rs.11,77,368. Therefore, he disallowed the said sum u/s 40(a)(ia) of the I.T. Act and added it to the total income of the assessee. Thereafter, he proceeded to consider the assessee's payment to M/s. A.M. Pappas & Associates LLC and observed that the consultancy charges of Rs.1,57,45,921 have been paid to the said company in respect of an agreement termed as Master Services Agreement dated 1.11.2003. As per the terms of the agreement with AM Pappas & Associates, the following services were to be rendered:

i) in its conversion to a drug discovery and development technology company by implementing the comprehensive, long term strategic plan covering a 10 to 12 year period.

ii) to dispatch doctor Jeffrey Collins Vice President A.M.P. & A's Transaction Advisory Group and if possible one additional project team member to the company's location in Hyderabad.

iii) Make recommendation concerning specific co-development partnerships with external pharmaceutical companies to obtain access to specific early-stage compounds identity.

iv) Assist in the planning and designing of the companies R&D facility which may include serving as a liaison with an appropriate architectural firm./

3. AO observed that out of the above, only a few of the functions/services are to be rendered in connection with the management services agreement and that many of the functions are required to be carried out in India by the said Consultant. Therefore, he was of the opinion that the services to be rendered are in the nature of technology services to be rendered in India and clearly fall within the scope of the provisions of section 9(1)(vi) and 9(1)(vii) of the I.T. Act, 1961 and therefore, assessee is liable to deduct tax at source u/s 195(2) of the I.T. Act. For coming to this conclusion, he placed reliance upon the following decisions:

a) Mangalore Refinery & Petrochemicals Ltd vs. DCIT (2008) 113 ITD 85 (Mum.Trib)

b) Re Rajiv Malhotra (2006)284 ITR 564 (AAR)

c) South West Mining Ltd (2005) 278 ITR 233 (AAR)

d) Leonhardt Andra Und Partner GmbH vs. CIT (249 ITR 418)

e) Steffen, Robertson & Kristen Consulting Engineers & Scientists vs. CIT (230 ITR 206).

4. He further observed from the terms of the agreement that the consultancy is for rendering these services in India as there is clear cut clause which says that certain personnel will be sent to India for conducting relevant studies and rendering advisory services. He also observed that the place of activity is in India, as the main intention was setting up of an advanced R&D facility and conducting of advanced research activity and providing guidance for industry's best practices for marketing the

company's products and also to assist the assessee company in acquiring manufacturing rights within an agreed time frame. Therefore, according to the AO, the situs of the agreement is in India and the assessee is liable for deduction of tax at source u/s 195 of the Act which was not done. Therefore, he invoked the provisions of section 40(a)(i) and denied the claim of deduction of Rs.1,57,45,921 and brought the entire sum to tax for both the A.Ys.

5. Thereafter, the AO also observed that the assessee claimed deduction of a sum of Rs.37,78,11,222 u/s 35(2AB) of the I.T. Act for the A.Y 2008-09. He observed that the assessee has set up a new R&D facility during the year for which the deduction was claimed at two places i.e. Units at Bonthapally and Pashamylaram Villages. Therefore, the assessee was asked to furnish copies of the 3CM and 3 CL forms and details of expenditure with respect to claim of deduction u/s 35(2AB) of the Act. He also observed that the expenditure consists of mainly construction of building and setting up of R&D facilities for which various equipments have been purchased. From the details furnished, the AO also observed that a steroid project and R&D pilot plant are being constructed under the head "R&D Civil CWIP" and additions have been made to R&D building and Plant & Machinery at Bonthapally village, apart from additions of R&D building and Plant & Machinery at Pashamylaram Village. He observed that the revenue expenditure, consists of R&D expenses, materials and consumables, power & fuel, professional charges paid and other misc. expenses and the expenditure at Bonthapally Unit @ 100% is Rs.6,37,77,345, whereas the

expenditure @ 100% at Pashamylaram Village where a pilot plant is being set up is Rs.13,62,79,117.

6. On perusal of the bills and vouchers produced during the assessment proceedings, the AO observed that the assessee has furnished copy of Form 3CM dated 31.10.2007 in which it is stated that the R&D facility is approved for the purpose of section 35(2AB) from 1.4.2005 to 31.3.2009 and that it is pertaining to only Bonthapally Village Unit. He further observed that Form No.3CM from the prescribed authority for the other Unit at Pashamylaram Village has not been produced so as to examine the fulfillment of conditions contained in section 35(2AB) of the Act. He observed that as per the language used in section 35(2AB), not only the in House Research & Development facility but also the expenditure shall be approved by the prescribed authority for the purpose of section 35(2AB). Since the assessee has not furnished evidence that the expenditure has also been approved by the authority, he disallowed the entire expenditure including the weighted deduction claimed by the assessee i.e. Rs.5,96,87,946 on which the weighted deduction @ 150% worked out to Rs.8,95,31,769. Thereafter, he proceeded to consider whether the assessee has fulfilled the conditions laid down in section 35(2AB) of the Act. As regards the approval of the prescribed authority in respect of qualifying expenditure to be certified in Form No.3CL is concerned, he observed that Form 3CM produced by the assessee only relates to Bonthapally Village and therefore, he allowed the claim @ 100% of the expenditure relating to Bonthapally village only which worked out to Rs.6,37,77,345. As regards assessee's claim of deduction u/s

35(2AB) relating to Pashamylaram village, he disallowed the same i.e. a sum of Rs.31,41,33,877 and brought it to tax.

7. Aggrieved, assessee preferred an appeal before the CIT (A) who partly allowed the same. Against the relief granted by the CIT (A), the Revenue is in appeal before us, while the assessee is in appeal against the denial of the claim by the CIT (A). The CIT (A) after considering the assessee's contentions has confirmed the disallowance of the sales commission u/s 40(a)(ia) of the Act for making the payment without TDS. As regards the disallowance u/s 40(a)(ia) of the consultancy charges to M/s AM Pappas & Associates LLC without making TDS also, he confirmed the order of the AO. However, as regards the assessee's claim of deduction u/s 35(2AB) of the Act is concerned, he has taken into consideration the certificates produced by the assessee i.e. Form 3CM and 3CL certificates and has allowed the claim of the assessee. Against the disallowances confirmed u/s 40(a)(ia), the assessee is in appeal before us, while against granting of relief u/s 35(2AB) of the Act, the Revenue is in appeal before us.

8. It is the case of the Revenue that the CIT (A) has ignored the findings of the AO that Form No.3CM mentions only one Unit, whereas the CIT (A) has granted relief with regard to both the Units. The learned DR supported the orders of the AO while the learned Counsel for the assessee supported the orders of the CIT (A) and has also drawn our attention to the written submissions filed before the CIT (A) and also the documents i.e. Forms 3CM and 3CL filed before the CIT (A). As seen from these two certificates, we find that the certificates have been obtained subsequently i.e. dated 31.10.2012 wherein both the units are

mentioned in the certificate and also the expenditure on land and building as well as the revenue expenditure has also approved by the prescribed authority. We find that the CIT (A) has accepted the certificates without any verification of the same. In view of the same, we deem it fit and proper to remit the issue to the file of the AO only to verify the veracity of these forms and to allow the deduction u/s 35(2AB) of the Act accordingly. Thus, the Revenue's grounds of appeal against allowing of deduction u/s 35(2AB) in respect of both the Units and also the revenue expenditure are remitted to the file of the AO and the Revenue's appeals for both the years are treated as allowed for statistical purposes.

9. As regards assessee's appeals are concerned, we find that they are against the disallowance u/s 40(a)(ia) of the Act of the following two items for the A.Y 2008-09:

i) Sales commission of Rs.11,77,368

ii) Consultancy charges paid to M/s AM Pappas & Associates LLC for a sum of Rs.1,57,45,951.

10. As far as the sales commission is concerned, the assessee had submitted before the CIT (A) that the amount is the sum paid to the Directors and is not sales commission but his salary and as salary includes commission as per section 17, the provisions of section 40(a)(ia) are not applicable. We find that except making a claim, the assessee has not furnished any further information/evidence before the CIT (A) and also before us. In view of the same, we do not find any reason to interfere with the order of the CIT (A). Thus, assessee's ground of appeal No.1 is rejected.

11. As regards 2nd item disallowed u/s 40(a)(ia), the undisputed facts are that the assessee had entered into an agreement with M/s. AM Pappas & Associates LLC for rendering of certain services to the assessee vide Master Agreement dated 1.11.2003. The AO has held it to be the 'fees for technical services' and the CIT (A) has confirmed the same. Before us, the learned Counsel for the assessee submitted that the assessee had made detailed submissions before the CIT (A) submitting that all the services under the agreement are rendered outside India and also the payments were made outside India and therefore, provisions of section 195 of the Act are not applicable to such payments. He further submitted that the assessee had clearly submitted that the said company is in the business of development of companies products and venture and charges paid to the said company is its business income and since the recipient company is not have a PE in India, the business income is not taxable in India under Article VII of DTAA between India and USA. Thus, according to him, the said payment is not covered by the provisions of section 195 of the Act and disallowance u/s 40(a)(ia) is not called for. The learned Counsel has filed the copies of the written submission filed before the CIT (A). On going through the said submissions, we find that the assessee has made detailed submissions as to why the payment is not taxable in India and also as to why the TDS provisions are not applicable to the said payment and we also find that the CIT (A), though, has reproduced the assessee's contentions in brief at Para 6.2 of his order has not given any reason as to why he is not accepting the assessee's contentions. When the assessee makes submissions on the nature of the services and also as to whether the services have

been rendered in India, we are of the opinion that it is the duty of the authority to consider and verify the veracity of the same, before coming to any conclusion as to taxability of the same in India. Before bringing to tax any income, the nature of the income has to be determined and only on the basis of such conclusion can the income be brought to tax in India. If the payment of consultancy charges are in the nature of 'fees for technical services' or 'royalty', then it would be taxable in India irrespective of the situs of the services. But if it is business income of the recipient, then even if it is earned in India, it would be taxable only if the recipient has a PE in India. It is also to be seen that where the provisions of DTAA are applicable to an assessee, then i.e. Income Tax Provisions or the DTAA whichever are beneficial to the assessee are to be made applicable. We find that none of the authorities below have gone into the exact nature of the services and also as to whether the services has been rendered inside or outside India. Without determining the nature of the services, we are of the opinion that the same cannot be brought to tax in India and the TDS provisions u/s 195 of the Act can be made applicable. In view of the same, we deem it fit and proper to set aside the findings of the AO and to remand the issue to the AO for de novo consideration in accordance with law and reconsideration as above.

12. In the result, assessee's appeal is partly allowed and the Revenue's appeal is allowed for statistical purposes.

13. For the A.Y 2009-10, the assessee is in appeal against the confirmation of the disallowance made by the AO of Rs.1,48,48,290 u/s 40(a)(ia) of the Act for non deduction of tax at

source from the payments made to M/s AM Pappas & Associates LLC. We have already adjudicated this ground of appeal for the A.Y 2008-09 and for the reasons given therein, this appeal is also set aside to the file of the AO for de novo consideration in accordance with the above direction.

14. In the Revenue's appeal, we find that the only ground is against allowing of deduction u/s 35(2AB) of the Act and for the detailed reasons given in the Revenue's appeal for A.Y 2008-09, the Revenue's appeal is set aside to the file of the AO for verification of the certificates/Forms 3CM and 3CL filed by the assessee and to allow the deduction u/s 35(2AB) of the Act in accordance with law.

15. In the result, both the assessee's and Revenue's appeals are allowed for statistical purposes.

Order pronounced in the Open Court on 5th October, 2016.

Sd/-	**Sd/-**
(B. Ramakotaiah)	**(P. Madhavi Devi)**
Accountant Member	**Judicial Member**

Hyderabad, dated 5th October, 2016.

Vinodan/sps

Copy to:

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3 CIT (A)-V Hyderabad
4 CIT – IV Hyderabad
5 The DR, ITAT Hyderabad
6 Guard File

By Order