

आयकर अपीलिय अधिकरण, हैदराबाद पीठ में
IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "A", HYDERABAD

BEFORE
SHRI RAMA KANTA PANDA, ACCOUNTANT MEMBER
&
SHRI K.NARASIMHA CHARY, JUDICIAL MEMBER

आ.अपी.सं / ITA No. 786/Hyd/2016
(निर्धारण वर्ष / Assessment Year: 2009-10)

M/s. Aurobindo Pharma Ltd., Hyderabad [PAN No. AABCA7366H]	Vs.	Deputy Commissioner of Income Tax, Central Circle-1(2), Hyderabad
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अपीलार्थी / Appellant

प्रत्यर्थी / Respondent

निर्धारिती द्वारा/Assessee by: Shri P.V.S.S.Prasad, AR
राजस्व द्वारा/Revenue by: Shri Solgy Kottaram, CIT-DR

सुनवाई की तारीख/Date of hearing: 28/07/2022
घोषणा की तारीख/Pronouncement on: 18/08/2022

आदेश / ORDER

PER K. NARASIMHA CHARY, JM:

Aggrieved by the order dated 19/04/2016, passed by the Learned Deputy Commissioner of Income Tax, Central Circle-1(2), Hyderabad ("Ld. AO") in the case of M/s. Aurobindo Pharma Ltd., ("the assessee") for the assessment year 2009-10, under section 143(3) r.w.s. 153A r.w.s. 144C(13) of the Income Tax Act, 1961 (for short "the Act"), consequent to the

directions of Hon'ble Dispute Resolution Panel, Bengaluru ("DRP"), assessee filed this appeal.

2. Brief facts of the case are that the assessee is engaged in manufacturing and sale of bulk drugs, Active pharmaceutical Ingredients (APIs) and other pharmaceutical products. For the assessment year 2009-10 the assessee filed the return of income declaring total income of Rs. 59,03,71,958/-, which was subsequently revised on 6/2/2010 declaring the same amount, but by including short term capital loss on realisation of yield enhancement certificates amounting to Rs. 28.98 Crores. Though originally a reference under section 92CA of the Act was made on 20/5/2011, pursuant to the search that took place in assessee's case on 10/2/2012 the pending proceedings stood abated, and a fresh reference under section 92CA of the Act was made to the Learned Transfer Pricing Officer (TPO) on 3/1/2014. Ld. TPO by order dated 29/1/2015 determined the Arms Length Price ("ALP") of the international transaction at Rs. 27,39,76,704/- on account of adjustment in respect of writing off of accrued interest on loans and writing off of bad debts.

3. Consequently a draft assessment order was passed on 31/3/2015 under section 153A read with section 143(3) and 92CA of the Act, proposing total taxable income at Rs. 1,18,98,83,470/- under normal provisions of the Act and at Rs. 1,86,01,39,324/-under MAT provisions towards book profit. Aggrieved thereby, assessee filed objections before the Ld. Dispute Resolution Panel (DRP). Ld. DRP vide directions dated 12/11/2015 upheld the proposed the reserves of Rs. 26,76,45,854/- after taking into account the correct amount of bad debts.

4. Assessee is therefore before us in this appeal stating that the authorities below did not approach the issue in the proper perspective and without properly benchmarking the alleged international transaction, the addition was proposed and confirmed. Assessee placed reliance on the decision as reported in *Henkel Chembond Surface Technologies Ltd Vs. ACIT* (2021) 125 taxmann.com 65 (Mumbai Trib) and *Kellogg India (P) Ltd Vs. DCIT* (2019) 108 taxmann.com 223 (Mumbai Trib) for the principle that the transfer pricing adjustment proposed without resorting to any transfer pricing exercise as per any of the methods prescribed in section 92C (1) to determine the ALP, is bad in law and has to be deleted.

5. Second line of argument advanced on behalf of the assessee is that the assessee provided loans to its Associated Enterprises (“AEs”) for interest by showing the same in the P&L Account on accrual basis, such an interest income in the past was assessed as business income in the earlier years under the head “business income” and was accepted by the Department, and therefore once the interest income was offered on accrual basis, which was debited in the P&L Account as business income and was accepted by the Department, if it is written off as irrecoverable in the accounts in the year, the same has to be allowed as bad debt under section 36(1)(vii) of the Act, in terms of the decision of the Hon’ble Apex Court in the case of *TRF Ltd Vs. CIT* (2010) 323 ITR 397 (SC). For the same principle reliance is placed on the decisions reported in *PCIT Vs. Shreno Ltd* (2021) 127 taxmann.com 813 (Gujarat HC) and *Pranava Electronics (P) Ltd Vs. DCIT* (2021) 124 taxmann.com 242 (Karnataka HC). He also placed reliance on the decision reported in *Harshad J Choksi Vs. CIT* (2012) 349 ITR 250 (Bom) to support his point that if an expenditure is incurred in

relation to the business, if it is held to be not deductible as bad debt under section 36(1)(vii) of the Act, still the same is deductible as business loss incurred in the course of carrying on the business.

6. Per contra, it is the submission on behalf of the Revenue that as rightly pointed out by the Ld. TPO and also the Ld. DRP that the assessee had an option to get the accrued interest on loan converted to equity, which in fact they had done in case of loan itself. Merely because in the earlier assessment years, the interest was declared by debiting the same to the P&L Account, it does not mean that the Ld. TPO is precluded from examining the same in the perspective of determining the ALP. He invited our attention to the observations of the Ld. TPO that inasmuch as the assessee reported in form 3 CEB that the writing off of the accumulated interest on the loans and bad debts as international transaction, it is not open for the assessee now to claim the same as business loss.

7. We have gone through the record in the light of the submissions made on either side. Aurobindo (Datong) Biopharma Company Limited is a 100% wholly owned subsidiary of the assessee, manufacturing 6 APA, a derivative of Pen G and is the main ingredient of SSPs and cephalosporin drugs, and the company started commercial production in 2003 with annual production capacity of 1500 metric tons. Purpose of the assessee setting up the said unit was to ensure continuous uninterrupted supplies of raw material to parent company, namely, assessee. As on 31/3/2008 the foreign loan from the assessee to the said entity was US\$ 22.61 M. In the year under consideration the product pricing was deteriorated substantially due to stiff competition in the market and the company went into losses. Assessee, however, converted US\$ 4.96M loan into equity. In

these circumstances the assessee had taken a decision to write off the accumulated interest from loans, which was already offered as an income and is subject to transfer pricing scrutiny. The assessee was to receive a sum of Rs. 3.15 crores from its subsidiary Zao Aurobindo Pharma, Russia which is also not doing well and incurring losses. Assessee wrote off the bad debts which were already offered as part of sales during the earlier years.

8. In respect of both these amounts which were written off by the assessee, Ld. TPO had taken the objection that the assessee could have converted these receivables to equity, as was done in the case of loans advanced to Aurobindo (Datong), and in the unrelated commercial phenomena working at arm's length, an enterprise would have made all efforts to recover the dues, and the assessee more particularly being the an AE of these two entities could have effectively recovered the amounts or at least could have converted these written off amounts to equity, which the assessee did not do. Ld. TPO, therefore, treated the ALP of these two transactions at nil and proceeded to make the addition of Rs. 23,61,44,423/- on account of the accrued interest written off and Rs. 3,51,01,431/- bad debts written off (correct amount is Rs. 3,15,01,431/-).

9. It is pertinent to note here that the Ld. TPO did not make any adjustment in respect of the international transactions in respect of which the assessee adopted the Transactional Net Margin Method (TNMM) and Comparable Un-controlled Price (CUP) Methods. For determination of the ALP of the writing off transactions, Ld. TPO did not refer to any method contemplated under section 92C (1) of the Act. He simply stated that any unrelated commercial enterprise working at arm's length would have

made all efforts to recover all its dues. In *Henkel Chembond Surface Technologies Ltd (supra)* it is held that where the Ld. TPO did not resort to any transfer pricing exercise as per any of methods prescribed in section 92C(1) of the Act and determine the ALP of the transaction at nil, transfer pricing adjustment with respect to the transaction needs to be deleted. In *Kellogg India (P) Ltd (supra)* it is held that where the Ld. TPO rejected the benchmarking of assessee with some general observations, then it is for the Ld. TPO to provide the basis/reasoning on which he founded an acceptable, and the Ld. TPO should benchmark the transaction by applying any of the prescribed methods, but without applying any prescribed method if Ld. TPO simply determines the ALP of the transaction as nil, such an approach of the Ld. TPO is not in accordance with the statutory provisions and, therefore, unsustainable. The view taken in these 2 decisions is squarely applicable to the facts of the case.

10. As a matter of fact, even the defect pointed out by the Ld. TPO is that the assessee did not exercise the option of converting the accumulated interest and the bad debts into equity. We fail to understand how merely conversion of the accumulated interest and bad debts into equity would amount to their recovery. It is the settled principle of law that the Revenue officers cannot sit in the armchair of the businessman, while taking the decisions basing on the business expediency.

11. Further in the case of *Shreno Ltd (supra)*, the Hon'ble Gujarat High Court held that where the assessee wrote off the outstanding interest on advances paid to its subsidiary as irrecoverable when the net worth of subsidiary eroded, assessee's claim of bad debt was to be allowed without expecting the assessee to prove that debts had actually become bad. In

Pranava Electronics (P) Ltd (supra) the Hon'ble Karnataka High Court held that writing off of irrecoverable loan in books of account is sufficient to claim the deduction for bad debts under section 36(1)(vii) of the Act, and the assessee is not required to be in money lending business to claim the said deduction.

12. It's not out of place at this juncture to refer to the observations of the Hon'ble Bombay High Court in the case of Harshad J Choksi (supra), wherein it was held that if an amount cannot be deducted as a bad debt in view of non-compliance of the conditions precedent as provided under section 36(2) of the Act, the same will not prevent the assessee from claiming deduction of the same as business loss incurred in the course of carrying on the business.

13. It is not in dispute that the interest that is written off was in fact shown in the P&L Account on accrual basis and such interest income was assessed as business income in the earlier assessment years, or that the bad debts written off were already offered as part of sales during the earlier assessment years. It is also not in dispute that when the interest in the earlier years was offered as business income, the same was accepted by the Department. In these circumstances, it is not known how the writing off of such amounts would affect the ALP of the transaction.

14. Apart from that, it is also not in dispute that the Ld. TPO did not refer to any particular method prescribed in section 92C(1) of the Act. When the Revenue accepted the TNMM in respect of the sales and purchases, and CUP method in respect of the interest received on loans and reimbursement of expenses, the writing off of these two amounts are

subsumed into the transactions of receipt of interest on loans, and it does not necessitate any separate benchmarking. Viewing from any angle, we find it difficult to sustain the addition made on account of the writing off by the assessee of the dues from Aurobindo (Datong) Bio Pharma Co. Ltd., China and bad debts from ZAO Aurobindo Pharma Ltd., Russia and accordingly allow the grounds of appeal.

15. In the result, appeal of the assessee is allowed.

Order pronounced in the open court on this the 18th day of August, 2022

Sd/-
(RAMA KANTA PANDA)
ACCOUNTANT MEMBER

Hyderabad,
Dated: 18/08/2022

Sd/-
(K. NARASIMHA CHARY)
JUDICIAL MEMBER

TNMM

Copy forwarded to:

1. M/s.Aurobindo Pharma Limited, C/o.Prasad & Prasad Chartered Accountants, Flat No.301, MJ Towers, 8-2-698, Road No.12, Banjara Hills, Hyderabad.
2. Deputy Commissioner Income Tax, Central Circle-1(2), Hyderabad.
3. The Dispute Resolution Panel (DRP), Bengaluru.
4. The Director of Income Tax (IT & TP), Hyderabad.
5. The Addl. Commissioner of Income Tax (Transfer Pricing), Hyderabad.
6. DR, ITAT, Hyderabad.
7. GUARD FILE

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