THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 24.01.2013

+ W.P.(C) 6728/2011

RANBAXY LABORATORIES LTD ... Petitioner

versus

DEPUTY COMMISSIONER OF INCOME TAX AND ANR ... Respondents

Advocates who appeared in this case:
For the Petitioner : Mr M. S. Syali, Sr Advocate with Mr V. P. Gupta, Mr Mayank Nagi and Mrs Husnal Syali Nagi
For the Respondents : Mr Abhishek Maratha with Ms Anshul Sharma

CORAM:-
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE R.V.EASWAR

JUDGMENT

BADAR DURREZ AHMED, J (ORAL)

1. By way of this writ petition, the petitioner is challenging the notice dated 29.03.2010 issued under Section 148 of the Income Tax Act, 1961 (hereinafter referred to as 'the said Act'), whereby the Assessing Officer has proposed to re-open the assessment for the assessment year 2003-04. Earlier, the assessment had been framed under Section 143(3) by virtue of an assessment order dated 28.03.2004.

2. The purported reasons for re-opening the assessment for the assessment year 2003-04 are as under:-

> "Reasons for the belief that income has escaped assessment:
>
> Incorrect allowance of deduction in respect of royalty received from foreign enterprise.
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> The assessment of M/s Ranbaxy Laboratories Ltd. for the assessment year 2003-04 was completed u/s 250/143(3) 01.08.2004 determining an income of ₹ 3,10,79,46,649/- after allowing deduction under Section 80-O. It was later observed that the deduction was allowed on gross receipts of ₹ 49,96,75,364/- without deducting the proportionate expenses to such income after considering the total expenses debited to the relevant profit and loss account allocated on pro-rata basis between the receipts from foreign enterprise and other income the admissible deduction worked out to ₹ 2,69,82,469/- against ₹ 9,99,35,082/- allowed by the department. The incorrect allowance of deduction resulted in under assessment of income of ₹ 7,29,52,603/- involving tax effect of ₹ 2,68,10,082/,-
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> Incorrect allowance of deduction in respect of export profits
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> The assessment of M/s Ranbaxy Laboratories Ltd. for assessment year 2003-04 was completed u/s 143(3) 250 on 01.08.05 determining on income of ₹ 3107946649/-. It was later observed that while computing the deductions trade discount and R&D (Capital) expenses was not incurred in the indirect cost. The omission resulted in excess allowance of deduction of ₹ 45741309 involving tax effect of ₹ 16809930/-.
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> Incorrect allowance of deduction in respect of profit and gains from newly established undertakings.
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> The assessment of M/s Ranbaxy Laboratories Ltd. for the assessment year 2003-04 was completed u/s 250/143(3) on 01.08.05 determining an income of ₹ 3,10,79,46,649/-. It was

later observed that while claiming deduction under section 80 IB, the assessee had apportioned allowed by AO and was 30 percent of R&D (Revenue) expenses and 75 percent of head office expenses in the separate accounts of individual undertaking in the ratio of sales whereas 100 percent expenses were required to be apportioned. The omission resulted in excess allowance of deductions of ₹ 29,00,11,919/- involving tax effect of ₹ 10,65,79,380/-.

Incorrect allowance of deduction in respect of profit and pains from newly established industrial undertakings.

The assessment of M/s Ranbaxy Laboratories Ltd. for the assessment year 2003-04 was completed u/s 250/143(3) on 1.08.05 determining an income of ₹ 3,10,79,46,649/-. It was later observed that while allowing deductions under section 80 IB, the assessee had apportioned allowed by AO and was 30 percent of R&D (Revenue) expenses and 75 percent of head office expenses in the separate accounts of individual undertaking in the ratio of sales whereas 100 percent expenses were required to be apportioned. The omission resulted in excess allowance of deductions of ₹ 17,20,35,049/- involving tax effect of ₹ 6,32,22,880/-.

Incorrect allowance of non-business expenditure.

The assessment of Ranbaxy Laboratories Ltd. for the assessment year 2003-04 and 2004-05 was completed u/s 250/143(3) and 154/143(3) on 27.4.04 and 5.4.05 determining an income of ₹ 3,63,45,44,931/- and ₹ 3,10,79,46,649/- respectively. It was later observed that as per 3 CD report annexed to the return, an amount of ₹ 10,77,769/- and ₹ 27,95,827/- for the assessment years 2003-04 and 2004-05 were debited to the profit and loss account on account of 'expenditure incurred at clubs' which were allowed as deduction. As the said expenditure were personal in nature and not related to the assessee's business, the entire amount should have been disallowed. Omission to do so resulted in under

assessment of income of ₹ 38,73,596/-. Involving tax effect of ₹ 13,99,081/-. From the preceding paras it is evident that the assessee has failed to disclose all material facts truly and fully that were necessary for assessment. Here it is relevant to mention the explanation 1 in section 147 that states that "production before the AO of account books or other evidence from which material evidence could with the diligence have been discovered by the AO will not necessarily amount to disclosure with the meaning of the foregoing proviso".

3. After receipt of a copy of the said purported reasons on 10.08.2010, the petitioner filed its objections on 06.09.2010. Detailed objections comprising of about 48 pages were given by the petitioner explaining each of the purported reasons. However, the Assessing Officer did not accept the objections and rejected the same by virtue of an order dated 29.07.2011/ 01.08.2011. The said order reads as under:-

"Order against Objection for issuing notice u/s 147 r.w. sec.148 of the Income Tax Act, 1961 in the case of M/s Ranbaxy Laboratories Ltd. for A.Y. 2003-04.

Assessment in the case of M/s Ranbaxy Laboratories Ltd. for the A.Y 2003-04 was completed on 26.03.2004 u/s 143(3) at an income of Rs.315,80,98,132/- under normal provision and Rs.270,59,86,259 u/s 115313 of the Income Tax Act. The income was further revised vide order u/s 250/143(3) dated 30.03.2006 at Rs.310,72,35,131/- under normal provisions and at Rs.570,19,15,570/- u/s 115313. The case was reopened u/s 147 read with section 148 of the Act. The Assessing officer had reasons to believe that income has escaped assessment and recorded the reasons in writing for reopening of assessment. Notice u/s 147 read with section 148 of the Act dated 29.03.2010 was served upon the assessee. The assessee

complied with the notice and asked for a copy of reasons recorded. The reasons vide letter dated 10.08.2010 were supplied to the assessee on 16.08.2010.

Vide its letter dated 06.09.2010, the assessee filed objections and the same are discussed as under:-

1. Assessee raised the objection that there was no fresh material on the basis of which belief was formed by AO that some income has escaped assessment. Assessee's objection is not acceptable as the AO had fresh material in the form of Audit Memos which were analyzed by the AO and only after properly recording the reasons for the same, AO issued notice u/s 148 of The Act. The Hon'ble Apex Court in the case of CIT Vs P.V.S. Beedies Ltd. 237 ITR 13, has held the reopening done u/s 147, on the basis of factual error pointed out by the Audit, as valid in law.

2. Assessee raised the objection that each of the items mentioned in the reasons recorded were duly considered by the AO while passing the order u/s 143(3). These items were specifically claimed as deduction in the Return of income and similar claims were also made in earlier years and the same were allowed in earlier years. The assessee objected that reasons recorded by the AO reflect a change of opinion.

Assessee's objection is not acceptable as after the conclusion of assessment proceedings, AO had fresh material, from the Revenue Audit and the reasons recorded cannot be termed as change of opinion. The reasons of reopening have been recorded in detail while arriving at reasons to believe that income has escaped assessment. Excerpts of referred case law by Supreme Court in the case of CIT Vs PVS Beedies is reproduced below:-

"We are of the view that both the Tribunal and the High Court were in error in holding that the information given by the internal audit party could not be treated as information within

the meaning of section 147(b) of the IT Act. The audit party has merely pointed out a fact which has been overlooked by the ITO in the assessment The dispute as to whether reopening is permissible after the audit party expresses an opinion on a question of law is now being considered by a larger Bench of this Court. There can be no dispute that the audit party IS entitled to point out a factual error or omission in the assessment. Reopening of the case on the basis of a factual error pointed out by the audit party is permissible under law. In view of that we hold that reopening of the case under section 147(6) in the facts case was on the basis of factual information given by the internal audit party and was valid in law."

3. Next issue raised by the Assessee relates to pendency of proceedings u/s 154 at the time of issue of notice u/s 148 on the issues mentioned in the reasons recorded for reopening.

Assessee's objection is not acceptable as the proceedings u/s 154 stands automatically filed once proceedings u/s 147 are initiated as elaborated in the G.P. Aggarwal Vs. ACIT (1994) 208 ITR 795 (Allahabad). Section 154 of the Act is applicable only for mistakes apparent from record and accordingly, the issues raised vide notices u/s 154 dated 06.10.2005 and 16.11.2005 stood automatically filed after issue of notice u/s 148.

Assessee has further raised objections against the specifics issue mentioned in the reasons for reopening. Apart from the objections discussed earlier, Assessee has taken a common plea that the deductions have been allowed in earlier years and the facts remaining the same, the same cannot be the basis for reopening. Since the principle of Res Judicata is not applicable to Income Tax proceedings, the objection is not acceptable.

In view of the same the objections filed by the assessee are rejected and area held to be devoid of any merits."

4. Mr Syali, the learned senior counsel appearing on behalf of the petitioner, submitted that the impugned notice dated 29.03.2010 under Section 148 of the said Act is invalid inasmuch as it has been issued beyond the period of four years and there has been no failure on the part of the petitioner to fully and truly disclose all material facts necessary for the assessment. Mr Syali also submitted that although the purported reasons merely state that there was failure on the part of the assessee to fully and truly disclose all material facts necessary for the assessment, the reasons do not disclose as to which facts were not pointed out by the assessee for the purposes of the assessment in respect of the assessment year 2003-04. He further submitted that even the order dated 29.07.2011/ 01.08.2011 rejecting the objections, does not point out as to which fact was not disclosed by the assessee which was necessary for his assessment under Section 143(3) of the said Act. He also submitted that all the points, which have been sought to be raised in the purported reasons, had been considered by the Assessing Officer at the time of the original assessment and what is sought to be done by issuance of the said notice under Section 148 is merely a review of what has already been examined and would, in any event, amount to nothing but a mere change of opinion.

5. Mr Syali took us through the purported reasons and demonstrated as to how each of them had been considered by the Assessing Officer at the time of

the original assessment. He, first of all, took us to the purported reason of incorrect allowance of deduction in respect of royalty received from foreign enterprises. This was an issue with regard to the deduction under Section 80-O of the said Act in respect of gross receipts from the foreign enterprise in convertible foreign exchange without considering expenses on a *pro rata* basis. The learned counsel for the petitioner pointed out that a specific claim in the return supported by a certificate in Form No. 10HA along with copies of FIRC/TAR/ accounts had been submitted by the assessee. A copy of the list of enclosures to the return has been annexed at page 53 of the paper book and we find that serial No. 18 has a specific reference to certificates in Form 10HA in support of deduction claimed under Section 80-O. Thus, according to Mr Syali, there was a complete disclosure on the part of the assessee. Moreover, the Assessing Officer had raised a specific query in his detailed questionnaire issued on 27.02.2004, wherein question No. 23 was as under:-

> "23. Details of expenses incurred during the year for earning royalty income eligible for deduction u/s 80-O. Why not the deduction u/s 80-O should be allowed on net income after deducting expense incurred during the year to earn such royalty."

A specific and detailed reply was given to this query by a letter dated 19.03.2004 and it had been specifically dealt with in Annexure-C to the said letter, which was a detailed note on the deduction under Section 80-O on

royalty income. Although a reference had been made to the Bombay High Court decision in the case of ***CIT v. Asian Cable Corporation: 262 ITR 535*** for the proposition that deduction under Section 80-O is allowable on the gross amount received in convertible foreign exchange, the assessee had taken an alternative plea in paragraph (f) of the said note to the effect that only expenses which were directly or indirectly related to earning of income could be deducted provided the same had been incurred during the year in question. It was the plea of the petitioner that there was no direct expenditure during the year relating to earning from the foreign enterprise. The point that was made by the learned counsel for the petitioner was that the issue of deduction under Section 80-O was specifically considered by the Assessing Officer and the query which was raised had been replied to in detail. It was after considering the reply given by the assessee that the Assessing Officer had allowed the deduction in the assessment order on 28.03.2004. Thus, it was contended that not only had the assessee disclosed all the material facts that were necessary for the claim of the deduction under Section 80-O of the said Act but that the Assessing Officer had also raised a specific query with regard to the same and it is only after receipt of a detailed reply from the assessee that the deduction was allowed.

6. Similarly, with regard to the purported reason of incorrect allowance of deduction in respect of export profits, a specific claim had been made by the assessee in the return duly supported by the report of the Chartered Accountant/ Tax Audit Report/ accounts. The list of enclosures to the return of income which we have referred to above, mentions the audit report under Section 80HHC(4) of the Act at serial No. 15. Thus, the claim was specifically supported by the audit report which was annexed to the return. In any event, a specific query was also raised in the said questionnaire dated 27.02.2004 by virtue of question No. 20, which reads as under:-

> "20. Please justify the deduction made on export profits u/s 80HHC. Also explain why the entire research & development expenditure were not considered as a part of indirect cost while computing the said deduction. Also confirm as to whether 90% of interest income credited to Profit & Loss Account has been disallowed as per explanation (baa) below section 80HHC(4B) of the Act, while computing business income for deduction u/s 80HHC."

A specific reply was also given by the petitioner/ assessee in the following terms:-

> "7. As regards deduction made on export profits u/s 80HHC, your goodself has asked to explain as to why the entire Research & Development expenses were not considered as a part of indirect cost, while computing the said deduction. Your goodself has also desired to know as to whether the 90% of

> interest income has been disallowed as per explanation (baa) below Section 80HHC (4B) of the Act, while computing business income for deduction u/s 80HHC. In this respect, we would like to submit that deduction u/s 80HHC in respect of profits and gains derived from exports of traded and manufactured products is computed in accordance with the provisions of Section 80HHC(3). The R&D expenditure is incurred by the assessee for discovery of, new drugs and the same is not related directly or indirectly to the export activity, which relates to existing products. Accordingly the expenditure incurred on R&D has not been deducted from profits and gains as an indirect cost. It is confirmed that while computing business income for the purposes of deduction u/s 80HHC, 90% of the interest amounting to Rs.5,15,51,926 has been reduced from the business income as provided in explanation (baa) below section 80HHC(4B) of the Act."
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> "15. The details of discount allowed are enclosed. The trade discounts are allowed to the dealers against the sale price and deducted from the bill. The cash discount is allowed for timely payment. The other discounts are also allowed as per the pharma industry practice to boost the company's sales and therefore, the same is allowable as a business expenditure."

7. Thereafter, it was pointed out by Mr Syali that there was discussion of the claim under Section 80HHC in the assessment order itself in paragraphs 5.5 and 5.6 of the said assessment order. The claim was ultimately allowed, as indicated in paragraph 6 of the assessment order as per annexure-A thereto. Therefore, it was contended by Mr Syali that here also, the assessee had fully disclosed all the material facts and the Assessing Officer had also applied his mind to the point in issue.

8. We find that there are similar submissions made with regard to the purported reasons for incorrect allowance of deduction in respect of profit and gains from newly established undertakings, both on the capital account as well as on the revenue account and the research and development expenses both on the capital account as well as on the revenue account as also the question of apportionment insofar as the research and development expenses and head office expenses on the revenue account are concerned. These were also specifically claimed by the assessee in his return as also indicated in the tax audit report and accounts submitted along with the return. Specific queries had been raised in respect of these items also which had been answered by the assessee in detail and it is only thereafter that the Assessing Officer had completed the assessment on 28.03.2004.

9. The last purported reason for re-opening has been indicated to be the incorrect allowance of non-business expenditure. Essentially, this relates to the expenditure incurred on clubs, which, according to the purported reasons, ought not to have been allowed as a deduction,

whereas, the Assessing Officer in the first round had allowed the same as a deduction.

10. Mr Syali pointed out that in the tax audit report in Form 3-CD at serial No. 17(d), the expenditure incurred on clubs has been specifically mentioned and the break-up with regard to the expenditure on entrance fee and subscriptions as also cost for club services and facilities used have also been specified. Therefore, according to Mr Syali, there has been no failure to disclose the said expenditure at clubs. Furthermore, Mr Syali invited our attention to the document at page 249, which is a reply given by the Assessing Officer to the Deputy Director (Revenue Audit) in respect of the audit memo No. 56 dated 06.09.2005 for, *inter alia*, assessment year 2003-04. The said audit memo was as under:-

> "Audit scrutiny revealed that as per 3CD report annexed to the return an amount of Rs.10,77,769 and Rs.27,95,827 for A.Y. 2003-04 and 2004-05 were debited to the profit & loss account on account of expenditure incurred at clubs and were allowed as deduction. As the said expenditure were personal in nature / not related to assessee's business, the entire amount should have been disallowed. Omission to do so resulted in under assessment of income of Rs.38,73,596 involving tax effect of Rs.13,99,081."

In response to the said audit memo, the Assessing Officer submitted his reply to the Deputy Director (Revenue Audit) on 10.02.2006 which, *inter alia*, reads as under:-

> "In this connection, it is pointed out that the assessee company is engaged in the business of manufacturing and sale of various types of pharmaceutical products. The business necessarily requires advertisement, publicity through different platforms. One of these platforms is club where executives and officers of the company develop contacts with potential customers. The assessee company is a corporate member of some of the clubs to promote its business interest through its employees. As per the tax audit report u/s 44AB filed by the assessee, these expenses mainly represent club subscription fee. Secondly, the assessee's employees in terms of their appointment are also required to become members of clubs and payment of subscription is included *in* the amount having been paid under a contractual obligation. The club fee paid is considered by the assessee as additional compensation and tax at source has been deducted out of the employee's salary on the same. Such expenses are taxed as perquisites in the hands of employees and therefore, the additional compensation paid to the employees under a contractual obligation has been rightly allowed as a business deduction. Thus the clubs expenses incurred for promoting company business is not a personal expense of the company. The Hon'ble courts including the Bombay High Court in the case of Oits Elevator Co. (India) Ltd. vs. CIT, 195 ITR 682 and Gujarat High Court in the case of Gujarat State Export Corporation Ltd. vs. CIT, 209 ITR 649 have also held that payment of club fee made to promote business interests is allowable as a business expenditure.
>
> In view of the above, the objection is not accepted and the same may kindly be dropped."

11. It is apparent that the Assessing Officer has defended himself by virtually stating the case of the petitioner. This also raises doubts as to whether the Assessing Officer could, on the one hand, have had reasons to believe that there was escapement of income when on the very same point on the other hand he had virtually defended the petitioner in his response to the audit memo No. 56.

12. For all these reasons, the learned counsel for the petitioner submitted that the notice under Section 148 was bad in law and was liable to be quashed.

13. Mr Maratha appearing on behalf of the respondents, vehemently supported the re-opening of the assessment in respect of the assessment year 2003-04 and submitted that there was failure on the part of the assessee to fully and truly disclose all material facts which were necessary for assessment. He strongly relied upon the 4th reason, that is, of club expenses by stating that the assessee had not disclosed this at the time of the assessment. On a pointed query, Mr Maratha could not show as to which particular information or material fact had not been disclosed by the assessee at the time of the original assessment proceedings. He

only sought to place reliance on Explanation 1 to Section 147 which reads as under:-

> "Explanation 1: Production before the Assessing Officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will not necessarily amount to disclosure within the meaning of the foregoing proviso."

However, we do not see as to how Mr Maratha could place reliance on the said Explanation. Insofar as all the purported reasons other than the reason pertaining to club expenses are concerned, specific queries had been raised and the Assessing Officer had considered the material placed by the petitioner before him. As regards club expenses, Mr Maratha states that since no specific query had been raised, Explanation 1 would get triggered. We do not agree with this submission. This is so because the club expenses were specifically mentioned at serial No. 17(d) of the tax audit report in Form No. 3CD which was annexed along with the return. This was a clear statutory disclosure on the part of the assessee with regard to the claim of club expenditure. It was not a piece of evidence which was hidden in some books of accounts from which the Assessing Officer could have possibly, with due diligence, discovered the same. On the contrary, this was material which was placed before the

Assessing Officer along with the return which the Assessing Officer was duty bound to go through before completing the assessment. Clearly this does not fall in the category of material which is referred to in Explanation 1 to Section 147 of the said Act.

14. Having considered the matter at length, we find that this is clearly not a case of failure on the part of the assessee to fully and truly disclose all material facts necessary for the assessment. This is of material significance because the notice under Section 148 has been issued after expiry of four years from the end of the relevant assessment year. Therefore, the notice is time barred. Apart from this, we also feel that it amounts to a mere change of opinion. On both counts, the petitioner is entitled to succeed. Consequently, the impugned notice dated 29.03.2010 is quashed and all proceedings pursuant thereto are also quashed. The writ petition is allowed. There shall be no order as to costs.

BADAR DURREZ AHMED, J

R.V.EASWAR, J

JANUARY 24, 2013
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