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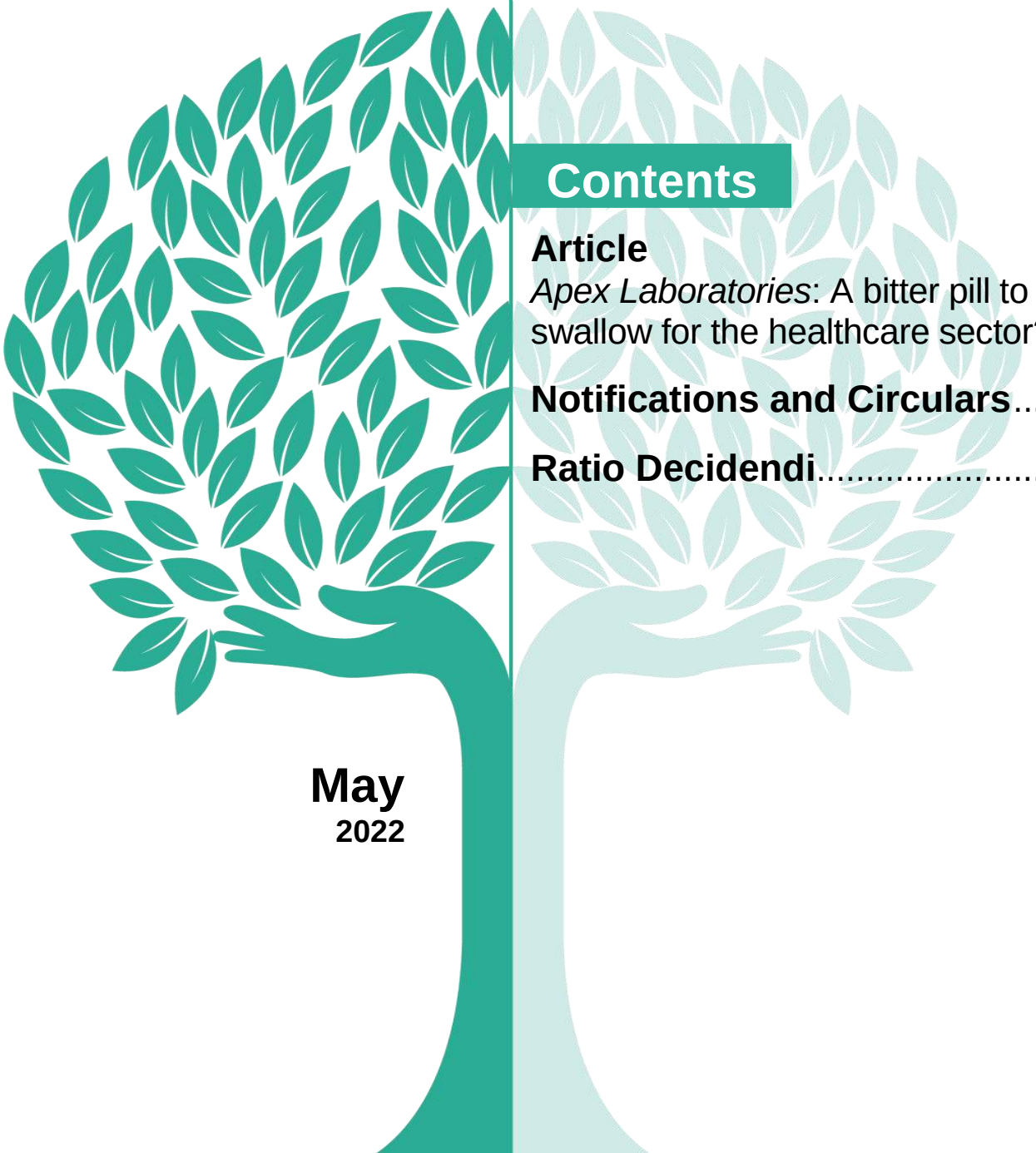

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Apex Laboratories: A bitter pill to swallow for the healthcare sector?

By **Tanmay Bhatnagar**

The controversy

A contentious issue that has seen much litigation in the recent past is regarding the claim of expenditure under Section 37 of the Income-tax Act, 1961 ('**IT Act**') incurred by pharmaceutical companies on gifting of freebies to doctors.

The cause for controversy behind this claim has been the notification[1] dated 10 December 2009 whereby the Medical Council of India ('**MCI**') amended the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 ('**MCI Regulations**') to prohibit medical practitioners from receiving any kind of gifts, travel facilities, hospitality or monetary grants from the pharmaceutical and allied health sector industry.

Explanation 1 to Section 37 of the IT Act disallows the deduction on account of any expenditure incurred by an assessee for any purpose which is an offence, or which is prohibited by law. However, the consistent position taken by pharmaceutical companies has been that the prohibition imposed by the MCI was applicable only to medical practitioners and not to them. Thus, the Explanation 1 to Section 37 would not apply to them.

On the contrary, the income-tax department ('**Department**'), as is evident from Circular No. 5/2012 dated 1 August 2012, took the view that any expense incurred in advancing freebies to medical practitioners in violation of the amended MCI Regulations would be inadmissible under Section 37 of the IT Act. This dispute led to contrary judgments across different High Courts and a lack of certainty regarding the correct position of law on the issue.

Amendments were proposed to Section 37 of the IT Act, *vide* Finance Bill, 2022, to provide that expenditure incurred for any purpose which is an offence shall include provision of benefit or perquisite the acceptance of which is in violation of any law, rule etc. governing the conduct of the person accepting the benefits. Although, the scope of the proposed amendment was wide, the freebies provided by pharmaceutical companies were the direct target of the amendment. Even before the amendments could be brought into effect from 1 April 2022, the Supreme Court pronounced its judgment on this issue.

The SC decision - Apex Laboratories (P.) Ltd. case

The Supreme Court in a recent judgment[2] has denied the claim of expenditure by pharmaceutical companies providing freebies to doctors by holding that the narrow interpretation of Explanation 1 to Section 37 of the IT Act relied upon by pharmaceutical companies would defeat the very purpose behind its insertion. It took the view that one arm of the law cannot be utilized to defeat the other arm of law since doing so would be opposed to public policy.

The Court, thus, held that the actions of pharmaceutical companies were clearly 'prohibited by law'. It observed that since doctors

[1] Notification No. MCI-211(1)/2009 (Ethics)/55667.

[2] Apex Laboratories (P.) Ltd. v. CIT, Order dated 22nd February 2022 in Civil Appeal No. 1554 OF 2022.

have a quasi-fiduciary relationship with their patients, it is a matter of public importance to ensure that their actions are not manipulated by the lure of freebies from pharmaceutical companies. The gifting of freebies results in a perpetual publicly injurious cycle of expensive drugs being foisted upon patients by doctors over generic alternatives, thereby driving up drug prices.

The Court also held that doctors and pharmaceutical companies play complementary and supplementary roles to each other in the medical profession. Therefore, a comprehensive view must be adopted to regulate their conduct. Since medical practitioners are forbidden from accepting such gifts, the donor pharmaceutical companies are also prohibited from giving them.

In addition to being opposed to public policy, the Supreme Court also took the view that the agreement between pharmaceutical companies and doctors for gifting freebies for boosting sales of prescription drugs was also violative of Section 23 of the Contract Act, 1872 since the consideration for the same was forbidden by law.

The fallout

While one may feel that the dust has finally settled on this issue, some new challenges may potentially crop up for the sector. The first issue is regarding the retrospectivity of the disallowance under Section 37 of the IT Act where litigation is still pending. While the CBDT Circular *vide* which the Department had stated that disallowance must be made under Section 37 of the IT Act of expenditure on account of freebies given to doctors was issued in 2012, the amendment of the MCI Regulations took place in 2009. By virtue of the Supreme Court's decision, the judicial authorities may disallow similar expenses incurred before the issuance of CBDT Circular.

Another issue is that while the amended MCI Regulations allow medical practitioners to work for pharmaceutical and allied healthcare industries in advisory capacities or to participate in research projects funded by pharmaceutical and allied healthcare industries, the acceptance of gift, travel facilities and hospitality is strictly prohibited. The question which may now arise is whether a pharmaceutical company will be allowed the claim of expenditure under Section 37 of the IT Act if it is incurred for making travel or hospitality arrangements pursuant to an affiliation.

For example, if a pharmaceutical company makes arrangements of conveyance or stay at such a location for the medical practitioners to seek consultancy services from the practitioner, would expenditure incurred for such facilities also be a prohibited expenditure? Similar issues could come up where a pharmaceutical company offers food coupons or a per diem allowance to a medical practitioner working as a consultant or researcher. Situations such as these may involve expenditure for *bona fide* reasons of furthering the professional engagement between a medical practitioner and a pharmaceutical company. Yet, the Department may seek to disallow of these expenditures citing the Supreme Court judgment. The liability of pharmaceutical companies to withhold tax under Section 194R (which will come into effect from 1 July 2022) in relation to these incidental facilities could also become a subject matter of dispute.

Conclusion

The Supreme Court's decision in the case of *Apex Laboratories (P.) Ltd.* has inextricably linked the operations of the IT Act with that of the MCI Regulations. Given the fact that the companies operating in this sector work closely with heath care practitioners, the contracts between the parties are likely to invite a closer

scrutiny from the tax department. The pharmaceutical and allied health sector companies should ensure that they maintain adequate proofs to satisfy the tax officer that the expense incurred towards health care professional is for furtherance of business and in compliance of MCI Regulations. The healthcare sector itself may need a comprehensive health check to identify and fix problems.

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Notifications and Circulars

Application for obtaining an advance ruling amended

The CBDT has, *vide* Notification No. 49/2022, amended Rule 44E of the Income-tax Rules, 1962, which prescribes the manner and form of the application for obtaining advance ruling. The amended Rule 44E requires the applicants to digitally sign the application, the verification appended thereto and the annexures to the application and in any other case, communicate through his registered e-mail address. The CBDT has also amended the relevant forms i.e., Form 34C, Form 34D, Form 34DA, Form 34E and Form 34EZ to that effect.

Mandatory filing of return of income by persons other than company or a firm

In addition to the conditions mentioned under seventh provision to sub-section (1) of Section 139 of the IT Act, the CBDT has notified additional conditions *via* Notification No. 37/2022.

The newly inserted Rule 12AB of the Income Tax Rules, 1962 lays down the following additional conditions wherein every person (other than the company or firm) will be required to mandatorily file return of income:

a. If his total sales/ turnover/ gross receipts, in the business exceeds INR 60 lakh during the previous year, or

b. If his total gross receipt of profession exceeds INR 10 lakh during the previous year, or

c. If his aggregate TDS/ TCS during the previous year is INR 25,000 or more (INR 50,000 or more in case of an individual resident in India who is of the age of 60 years or more), or

d. the deposit in one or more savings bank account of the person, in aggregate, is INR 50 lakh or more during the previous year.

Form for filing of updated return under Section 139(8A) notified

Sub-section (8A) of Section 139 of the IT Act has been inserted *vide* Finance Act, 2022 with effect from 1 April 2022. Sub-section (8A)

provides for filing of updated return of income within a period of twenty-four months from the end of the assessment year for which the updated return of income is proposed to be filed ('**relevant assessment year**'). The updated return of income under sub-section (8A) of Section 139 of the IT Act can be filed for A.Y. 2020-21 and subsequent assessment years.

Now, the newly inserted Rule 12AC of the IT Rules prescribes Form ITR-U to file updated return of income which must be verified electronically under digital signature or electronic verification code, as the case maybe. Notification No. 48, dated 29 April 2022 has been issued for the purpose.

Ratio Decidendi

Reassessment notices issued under the old regime deemed to be issued under Section 148A of the new re-assessment regime

Various High Courts had quashed the reassessment notices issued under Section 148 of the old regime after 1 April 2021 ('impugned notices') on the ground that they should have been issued under the substituted provisions of Section 147 to Section 151 of the Income-tax Act, 1961. Aggrieved, the Department went into appeal against such High Court decisions before the Supreme Court.

The Supreme Court observed that the impugned notices should have been issued under the substituted provisions. However, if the impugned notices are quashed, it would make the revenue remediless, and the object and purpose of reassessment proceedings would be frustrated. The Revenue was under the *bona fide* belief that the unamended provisions continued to be enforceable in view of Explanation in Notification No. 20 and 38 dated 31 March 2021 and 27 April 2021 which intended to extend the applicability of unamended provisions till 30 June 2021. Accordingly, the Supreme Court modified the impugned judgements of High Courts as under:

a) The impugned notices issued under Section 148 shall be deemed to have been issued under the newly inserted Section 148A of the Act and all such notices will be treated as show cause notices in the terms of Section 148A(b). The Assessing officers have been provided thirty days from the date of the judgement to provide the respective assessee with information and material relied upon by the revenue and the assessee have been provided two weeks to furnish reply against the same.

b) The requirement of conducting an enquiry is dispensed as a one-time measure for all the impugned notices.

c) The Assessing Officers shall thereafter pass an order in terms of Section 148A(d) i.e., order, passed after considering the materials and replies of the assessee, stating whether the case is a fit case for reassessment or not. Subsequently, after following the procedure as required under Section 148a, may issue notice under the substituted Section 148.

d) The Apex Court has further stated that all the defences available to an assessee under Section 149 and Finance Act 2021 and under the Act will continue to remain available.

The Supreme Court has further exercised its powers under Article 142 of the Constitution of India to hold that its judgement would be applicable **PAN INDIA** and all the orders passed by various High Courts on similar issue are set aside and shall stand modified in terms of its present judgement. Further, its judgement shall also govern all the writ petitions on similar issue, pending before various High Courts. [*Union of India & Ors.* v. *Ashish Agrawal* – Judgement dated 4 May 2022 in Civil Appeal No. 3005/2022, Supreme Court]

Processing of return under Section 143(1) based on tax audit report but contrary to judgement of jurisdictional High Court is illegal

Based on the tax audit report which was submitted online it was found that the payment towards the employee's contribution for the provident fund were made after the due dates provided in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Accordingly, Assessing Officer CPC, Bangalore issued a communication to the assessee proposing disallowance of the delayed payments under Section 36(1)(va) in intimation under Section 143(1). The Assessee-Company replied to the communication by placing reliance on the jurisdictional High Court's judgment wherein it has been stated that the payments made after the due date under respective statute but before the filling of the income tax return are allowed as deduction in the computation of business income. Ignoring all pleas of the Assessee, the Assessing Officer disallowed the delayed payments in the intimation. Further, the Assessee did not succeed in the rectification proceeding and an appeal before the CIT(A). Finally, the Assessee-Company preferred an appeal before the ITAT.

The Tribunal observed that Section 143(1) has gone through significant changes leading to material differences in the scheme of processing. It analysed the mechanism of Section 143(1) to observe that the first and second proviso of the section mandates that adjustments shall be made under the section only after a communication regarding the same has been made to the assessee and the response of the assessee is considered. The ITAT further stated that in the facts of the case the AO has casually assigned reasons which are purely on a standard template without even striking of the inapplicable portion. That ITAT relied on the judgement of the Supreme court wherein it was stated that a quasi-judicial order, without giving reasons for arriving at such a decision is contrary to the way the functioning of the quasi-judicial authorities is envisaged. Lastly the Tribunal held that whatever the auditor states in its report is just his opinion and it can neither bind the auditee nor can it override the judgement of the jurisdictional High Court. The Tribunal held that while preparing the tax audit report, the auditor is expected to report the information as per the provisions of the IT Act and the auditor has done that in the present case. However, that information ceases to be relevant in view of the law laid down by the jurisdictional High Court. Thus, the impugned adjustment under Section 143(1) being contrary

to the law laid down by the High Court was deleted. [*Kalpesh Synthetics Pvt. Ltd.* v. Deputy Commissioner – TS-324-ITAT-2022(Mum)]

Supreme Court stays observation of High Court declaring faceless assessment as non-est under Section 144B(9)

The Assessee received a notice to show cause as to why an assessment should not be completed as per the draft assessment order. The Assessee submitted its reply along with the quantitative details asked in the show cause notice within 4 days and asked for a personal hearing. With complete disregard to the submission made by the Assessee, the Assessing Officer passed the assessment order which was an exact reproduction of the draft assessment order except one sentence, wherein it stated that the assessee has not given any justification for non-furnishing of quantitative details in form 3CD.

Aggrieved by the impugned assessment order, the Assessee preferred a writ petition against it. The High Court held that the impugned assessment order was passed without considering the two replies submitted by the Assessee and without providing an opportunity of hearing to the Assessee. Accordingly, the Court set aside the impugned assessment order and the notice of demand on the ground that it violates Section 144B(9) of the IT Act, which provides that if the procedure under Section 144B is not followed the proceedings will be rendered non-est. Further at paragraph 9 of the order, the Hon'ble High Court has asked to get the order to be circulated to everybody in the finance ministry and has provided a warning that if such assessment orders are further passed the High Court will impose substantial costs on the concerned assessing officer which can be recovered from their salary.

Against the said order of the Hon'ble High Court, the department preferred an appeal before the Hon'ble Supreme Court. The Department pointed to the Hon'ble Supreme Court that subsection (9) to section 144B, on which the Hon'ble High Court has relied in its judgement, has been omitted by the Finance Act, 2022 with effect from 1 April 2021. Therefore, the Department argued that the benefit of sub-section (9) to Section 144B cannot be provided to the Assessee. The Supreme court allowed the SLP of the department and further stayed the observation made by the High Court at paragraph 9 of its judgement. [*NFAC* v. *Mantra Industries Ltd*. – [2022] 137 taxmann.com 210 (SC)]

Monetary limit for departmental appeals – Tax effect of an appeal is the original amount challenged and not the amount reduced by lower authorities

Assessee was issued a notice under Section 271(1)(c) for concealment of income in tune of around INR 98 lakh and a penalty of INR 29 lakh was levied on the Assessee. Both the Assessing Officer and the Assessee went on appeal to Commissioner (Appeals). CIT(A) reduced the quantum of concealed income to INR 19 lakh and consequently the penalty was reduced to INR 6 lakh. On further appeal, the Tribunal quashed the order on the grounds that the impugned order was without jurisdiction. On appeal before the High Court of Rajasthan, the Court set aside the order of the Tribunal, and the penalty of INR 6 lakh was restored.

Aggrieved by the order of the High Court, the Assessee preferred an appeal before the Supreme Court. The assessee contended that in terms of the CBDT Circular No. 21 of 2015, dated 10 December 2015, departmental appeal cannot be filed before High Court if the tax effect is less than INR 20 lakh and since in the present case the tax effect was only INR 6 lakh pursuant to the order of CIT(A), the appeal filed by department

needs to be quashed. The Supreme Court observed that since the Revenue had assailed the entire penalty amount of INR 29 lakh before the Hon'ble Tribunal and the Hon'ble High Court, such amount has to be considered for purpose of computing the tax effect and not the reduced penalty pursuant to CIT(A) order. Since the penalty of Rs. 29 Lacs was greater than the minimum tax effect of Rs. 20 Lacs required for filing departmental appeal, the appeal filed by department before High Court was valid. Accordingly, the present appeal filed by the assessee was dismissed in favour of revenue. [*Late Shri Gyan Chand Jain* v. *CIT* - [2022] 137 taxmann.com 323 (SC)]

TDS under Section 194C not applicable to assessee hiring vehicles to carry out its transportation business

In the present case, Assessee was in transportation business and was the owner of two cars and a truck which were used in its hiring business. Assessee obtained transport contracts from various corporates and carried out the whole work for transportation of goods. Since the vehicles owned by it were not sufficient to run the transport business, the Assessee hired vehicles from multiple vehicles owners and earned certain sum as gross transportation receipts. Out of these receipts, the Assessee incurred transport related expenses in form of truck hire charges, driver salary and vehicle repairing expenses which were paid to the vehicle owners.

It was Assessing Officer's case that the Assessee was liable to deduct TDS under Section 194C of the Act on the sum paid by it to the vehicle owners and accordingly added the entire amount to the income of the Assessee under Section 40(a)(ia). On appeal by the Assessee, CIT(A) upheld AO's observations.

Before the ITAT, the Assessee argued that its business was merely as an agent working in the transport business and in the course of this business, the Assessee collected payments from the corporations and made the requisite payments to truck owners after deducting some percentage as its commission.

The ITAT observed that in carrying out the entire work of transportation of goods, all the risk and rewards were on the Assessee and the vehicle/truck owners were not responsible for any risk or damages, etc. The ITAT observed that the vehicle owners were merely paid the hire charges and other incidental expenses like driver salary and vehicle repairing expenses. The ITAT also observed there was no verbal or written contract / agreement between the Assessee and the vehicle/truck owners. The Assessee was merely earning certain commission income. Based on the said observations, the ITAT held that the whole transportation work was carried on by the Assessee by hiring vehicles and therefore provisions of Section 194C of the Act were not attracted. Accordingly, the additions made under Section 40(a)(ia) of the Act were deleted. [*Ajay Dahybhai Patel* v. ITO – TS-314-ITAT-2022(SUR)]

No deemed registration under Section 12AA if registration not granted within six months – Supreme Court approves Allahabad High Court Full Bench judgment

The question posed before the court was whether on non-deciding the application for registration under Section 12AA (2) of the Income Tax Act, 1961 within a period of six months, there shall be deemed registration or not.

Referring to the decision of the High Court of Allahabad in the case of *CIT* v. *Muzafar Nagar Development Authority* [ITA 348 of 2008], the Supreme Court held that there is no specific provision in the Act providing that on non-deciding the registration application under

Section 12AA(2) within a period of six months there shall be deemed registration. The Court was of the view that the Full Bench of the High Court had rightly held that even if in a case where the registration application under Section 12AA is not decided within six months, there shall not be any deemed registration. Accordingly, the SLP was dismissed. [*Harshit Foundation Sehmalpur Jalalpur Jaunpur* v. Commissioner – TS-319-SC-2022]

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