***** **THE HIGH COURT OF DELHI AT NEW DELHI**

% Judgment delivered on : 01.04.2009

ITA No. 192/2009

YUM! RESTAURANTS (INDIA) PRIVATE LIMITED ..... Appellant

versus

COMMISSIONER OF INCOME TAX ..... Respondent

Advocates who appeared in this case:

For the Appellant	:	Mr C.S. Aggarwal, Sr. Advocate with Mr Prakash Kumar, Advocate
For the Respondent	:	Ms Prem Lata Bansal, Mr Mohan Prasad Gupta & Mr Sanjeev Rajpal, Advocates

CORAM :-

HON'BLE MR JUSTICE VIKRAMAJIT SEN
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. This is an appeal preferred by the assessee-company under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') against the judgment dated 31.01.2008 passed by the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal') in ITA No. 3234/Del/2005 pertaining to assessment year 2001-02.

2. The assessee-company is aggrieved by the disallowance of a sum of Rs 27,61,882/- on account of accrued marketing expenditure, which is in the nature of, incentive paid by the assessee-company to

its franchisee calculated at 2% of the sales made by the franchisee for the period December, 2000 to March, 2001.

2.1 The other issue with which the assessee-company is aggrieved is the disallowance of a sum of Rs 44,44,002/- by the Assessing Officer. The claim of the assessee-company arose on account of the contributions towards advertising, marketing and promotional activities (hereinafter referred to as the 'APM activities') made by the assessee-company towards wholly owned subsidiary.

3. In order to deal with aforementioned issues of the appeal the following facts require to be noted:

3.1 The assessee-company which is a private limited company was incorporated on 17.03.1994 under the Companies Act, 1956. The main business of the assessee-company was to develop and manage franchisees for running restaurants. The assessee-company had obtained licences from Kentucky Fried Chicken International Holdings, Inc. (in short 'KFC') and Pizza Hut International LLC (in short 'PHILLC'). Thus the franchisees operate restaurants under a sub-licence arrangement with the assessee-company.

3.2 On 05.10.1998, the assessee-company which was formerly known as Tricon Restaurants (India) Pvt Ltd had filed an application with the Government of India, Ministry of Industry, Department of Industrial Policy and Promotion, Secretariat for Industrial Assistance (SIA), Foreign Collaboration, to set up a wholly owned step-down subsidiary to manage retail restaurants business, for development, promotion at local store level, regional level and national level. While granting approval the SIA noted the broad framework within which the proposed subsidiary would manage and operate its

business in India. The SIA noted that the franchisees and the assessee-company would make contributions of fixed percentage of their respective revenues to the proposed new company on a regular basis. The proposed new company would be a non-profit enterprise governed by the principle of mutuality and no part of the contribution or other income would enure to the benefit of the contributor. It was envisaged that the contributions shall be optimally utilized by the proposed new company to economise the cost of advertising and promotion so as to cater to specific needs of the franchisees in order to facilitate the franchisees to concentrate on restaurant operations and management. The trade-marks, trade-names, service names and service marks of KFC and PHILLC were to be made available to the proposed new company for 'nil' consideration. The SIA granted approval subject to, as stated above, the new proposed company being a non-profit enterprise which would not repatriate its dividends.

3.3 Accordingly on 08.06.1999, a wholly owned subsidiary of the assessee-company, namely Tricon Restaurant (Marketing) Private Limited was incorporated. Its name was changed to Yum! Restaurants (Marketing) Private Limited (in short 'YRMPL').

3.4 In accordance with the purpose with which YRMPL was incorporated a tripartite agreement between the assessee-company, YRMPL and the franchisees were executed. One such agreement, dated 01.09.2000, executed with a franchisee known as Pizzeria Pure Foods Restaurants (India) Pvt Ltd is appended as Annexure 10 at pages 287 to 299 of the paper book. The sum and substance of this tripartite agreement is that the wholly owned step-down subsidiary, that is, YRMPL would open a brand fund account in various banks for

the purpose of carrying out 'APM activities' in order to further the business operations of KFC and PHILLC restaurants run by the franchisees by establishing and creating co-operative advertising brand funds. The tripartite agreement, as per clause 3.1, mandates that the franchisee shall pay 5% of its revenue for a particular month as an advertising contribution into a bank account of the brand fund established by YRMPL by the 10th day of the following month. Apart from the above, the franchisee was also required to spend an additional 1% of the revenue in the manner directed by the assessee-company and/or YRMPL in writing from time to time on such local store marketing, advertising, promotional and research expenditure proposed by the franchisees and approved in advance by the assessee-company and/or YRMPL during the relevant accounting period. In the event the franchisees was unable to spend the entire amount, the unspent amount was to be paid to YRMPL on a written demand of YRMPL which, in turn, would spend it on regional or national level advertising, promotional & research expenditure conducted by at its own discretion.

3.5 Furthermore, under clause 4.1 of the tripartite agreement the assessee-company at the request of YRMPL at its own sole and absolute discretion would make contributions to YRMPL in respect of the AMP activity during any accounting period which it may deem appropriate to support. The said clause 4.1 made it clear that the assessee-company had no obligation to pay any such amount if it chose not to contribute. The clause being relevant, the same is extracted below:-

> *"Tricon may at the request of TRIM, but subject to Tricon's sole and absolute discretion pay to TRIM any such amount(s) as it may deem appropriate to*

support the AMP activities during any accounting period. For the avoidance of doubt, it is clarified and agreed between the parties that Tricon shall have no obligation to pay any such amount if it chooses not to do so."

3.6 Clauses 8.4 & 8.5 of the tripartite agreement are also relevant. As per clause 8.4, YRMPL was entitled to retain any surplus amount left in any of the brand fund accounts at the end of the accounting year to be spent in the following accounting year. Alternatively, YRMPL subject to the approval of its Board of Directors could refund the surplus to its franchisees in the same proportion in which the franchisees had initially contributed monies towards advertising. In the event there was a deficit in any of the brand fund accounts the deficit was to be carried over to the next accounting period which was to be met out of advertising contributions made by the franchisees including franchisees for that accounting period. Clause 8.5 provided that the object of the agreement was only to carry out the marketing activities of the brands for the purposes of mutual benefit of the franchisees. No profits were intended to be earned and dividends were to be declared by YRMPL. The two clauses being relevant are same are extracted below:-

"8.4 In the event there is any surplus left over in any of the Brand Funds at the end of an accounting period, TRIM shall be entitled to retain the surplus to be spent on AMP activities during the following accounting period. Alternatively, TRIM may, subject to the approval of its Board of Directors refund the surplus amounts to the franchisees including Franchisee in the same proportion as the actual advertising contribution made by each franchisee including franchisee in that accounting period.

On the other hand, if there is a deficit in any of the brand funds at the end of an accounting period, the deficit will be carried forward to the next accounting period and be met out of the advertising contribution paid by the franchisees including franchisee for that accounting period. For the avoidance of doubt, it is

agreed between the parties that Tricon and/or TRIM shall not be obliged to fund the deficit.

8.5 It is clearly understood and agreed between the parties that the only objective of TRIM is to coordinate the marketing activities of the brand including the mutual benefit of the franchisees including the franchisee. It is envisaged that no profits will be earned and no dividends will be declared by TRIM."

3.7 The assessee-company in order to accelerate the growth of PHILLC brand in India introduced an incentive scheme in April, 2001. Apart from the other terms and conditions of the scheme the assessee-company offered that in the event the franchisees were to commence construction or operation of business on or from three additional outlets by 30.11.2001 the assessee-company would reimburse advertising contributions made by them to the extent of 2% of sales of their outlets for a period 01.12.2000 to 30.11.2001. This clause was incorporated in a letter dated 04.04.2001. The same being relevant is extracted below:-

"April 4, 2001

Mr Rohit Amin
Dodsal Corporation Limited
Ram House, 4, Ghaiwadi Industrial Estate,
Goregaon (W), Mumbai – 400 062.

AND

Dodsal Indmag Limited
Ram House, 4, Ghaiwadi Industrial Estate
Goregaon (W), Mumbai – 400 062.

Re: Development incentive for accelerated growth of Pizza Hut in India.

Dear Rohit,

xxxx

xxxx

1. *xxxx*
2. *Marketing support*

> *You shall at all times continue to spend 1% of gross sales (net of sales tax) of all your outlets of LSM and contribute 5% of such sales to Tricon Restaurants Marketing Private Limited.* ***If you commence construction of or operations/ business at or from 3 additional outlets by November 30, 2001, we will reimburse you for your advertising contribution made*** *to the extent of 2% of sales of all your outlets for the period December 1, 2000 to November 30, 2001."*

3.8 It is in this background that the assessee-company filed a return of income for the assessment year 2001-02 on 31.10.2001. The assessee's case was picked up for scrutiny. Accordingly on 18.10.2002 a notice under Section 143(2) of the Act was issued to the assessee-company. In response to the notice the representatives of the assessee-company attended the office of the Assessing Officer and submitted their explanations to the queries raised by the Assessing Officer. In so far as disallowance of Rs 27,61,882/- towards accrued marketing expenditure was concerned the Assessing Officer was of the view that the scheme which accelerated the growth of Pizza Hut in India was evolved and communicated only on 01.04.2001 and hence it was not possible for the assessee-company to predict as to which of the franchisees would be in a position to meet the target set by the assessee-company as on 30.03.2001. In these circumstances the Assessing Officer came to the conclusion that the expenses related not to the current period but to the following period, that is, the next financial year.

4. As regards the second issue disallowance of a sum of Rs 44,44,002/- out of the contribution made by the assessee-company towards APM activities to its subsidiary YRMPL- the Assessing Officer noted the following facts:

4.1 The assessee-company had contributed a sum of Rs 1.15 crores to YRMPL. The assessee-company divided the expenses under two heads, namely, advertising and sales promotion, in respect of which it claimed Rs 27,48,394/-, and contribution towards APM Activities under which it claimed Rs 87,86,318/-.

4.2 Since the amount of Rs 27,48,394/- shown under advertising and sales promotion was related to payments made to advertising agencies like O&M and HTA etc. the same was allowed by the Assessing Officer. In so far as the balance sum, that is, the contribution in the sum of Rs 87,86,318/- towards APM Activities was concerned, the Assessing Officer relying upon clause 4.1 of the tripartite agreement, referred to hereinabove, observed that the assessee-company had no obligation to contribute the amounts to YRMPL. His analysis in paragraph VI.7.4 and VI.7.5 would show that even though the YRMPL had received Rs 2.64 crores as contribution it had spent only Rs 2.19 crores and hence had shown the balance Rs 44.44 lacs as unspent monies under the head 'current liabilities'. Even while the assessee-company claimed as an expense the unspent money shown in the account of YRMPL - it clearly did not pertain to the assessee-company but to its franchisees. The Assessing Officer was of the view that in the circumstances the YRMPL had excess funds lying with it then where was the need of the assessee-company to make a contribution to YRMPL. The Assessing Officer was of the view that the amount of Rs 44,44,002/- was required to be disallowed for the reason that the situation in the instant case is no different than, when an assessee makes a provision for brand advertising in a given year, no deduction is allowed for a provision made in that regard unless the amount is spent. In the instant case the assessee-

company instead of making the provision itself had set up an intermediary in the form of a wholly owned subsidiary, that is, YRMPL and was claiming as an expense contributions towards advertising made to YRMPL even though decidedly on facts YRMPL had not spent the entire amount contributed to it. The Assessing Officer resorted to the provisions of clause 4.1 to hold that there was no obligation created in terms of the tripartite agreement on the assessee-company to contribute. In these peculiar facts the Assessing Officer disallowed the claim of the assessee-company.

5. Aggrieved by the same the assessee-company preferred an appeal to the Commissioner of Income Tax (Appeals) [hereinafter referred to as the 'CIT(A)']. The CIT(A) rejected the assessee's appeal. It sustained the order of the Assessing Officer.

6. In a further appeal to the Tribunal by the assessee-company the Tribunal sustained the orders of the authorities below. In so far as the first issue is concerned regarding claim of the assessee-company with regard to accrued marketing expenditure in the sum of Rs 27,61,882/- towards incentive payable to franchisees at the rate of 2% of the sale for the period December, 2000 to March, 2001, the Tribunal held that since the provision made for expenses would be utilized only when the contingency happens, and in this case, the result, as to whether the provisions of the accelerated development scheme of April, 2001 were adhered to, would be known only in the subsequent financial year, the liability had not arisen during the year under consideration.

6.1 In so far as the second issue is concerned the Tribunal came to the conclusion, upon reading of the tripartite agreement, in

particular, clause 4.1, that the payment made under it to its wholly owned subsidiary, that is, YRMPL was purely voluntary. It further observed that there was no demonstrable expediency and nor was the assessee-company able to show how the said contribution had benefited its business. It also noted that the Assessing Officer had found as a matter of fact that out of the total contribution of Rs 2.64 crores received by YRMPL Rs 2.19 crores had been spent which had been allowed to the subsidiary. Thus keeping these facts in mind the Tribunal came to the conclusion that the said excess amount had to be disallowed in view of the assessee's failure to prove that contribution had been paid by the assessee-company in the course of carrying on its business or for reasons of commercial expediency.

7. Having heard the learned counsel for the parties we are of the view that on both the issues the impugned judgment deserves to be sustained. In the instant case, as is evident, from the facts as stated above the assessee-company has created an intermediary in the form of a wholly owned subsidiary, that is, YRMPL to carry on a 'co-operative advertising' on the behalf of its franchisees and franchisees of the assessee-company, based on a contributions received from the franchisees which is equivalent to 5% of the gross sale under the tripartite agreement. This tripartite agreement was, as indicated above, executed between the assessee-company, YRMPL and its franchisees in September, 2000. Thereafter the assessee-company in order to incentivise in development of Pizza Hut brand in India at an accelerated pace formulated a scheme in April, 2001, whereby it offered to reimburse contributions made towards advertisement to the extent of 2% of the sales of the franchisees outlets for the period 01.12.2000 to 30.11.2001 provided they commenced construction or

operations/business at or from three additional outlets by 30.11.2001. In this background it is quite clear that the incentive scheme came to the knowledge of the franchisees only in April, 2001, therefore, the assessee's claim with respect to accrued marketing expenditure amounting to Rs 27,61,882/- in our view, was not sustainable in the financial year ending on 31.03.2001. The assessee-company could not have in the assessment year under consideration predicted the liability on this account when the scheme came to be formulated only in April, 2001.

7.1 As regards the second issue it is clear that the assessee-company had tried to claim as an expense towards APM activities an amount which could not have been directly claimed, by setting up an intermediary in the form of YRMPL. The learned counsel for the assessee-company, Mr C.S. Aggarwal, Sr. Advocate has submitted that it is for the assessee-company to decide what is in its best business interest. There is, according to him, no dispute that the assessee-company had contributed a sum of Rs 1.15 crores out of which a sum of Rs. 27,48,394/- has been allowed being monies actually spent towards advertising carried out by advertisers such as O&M and HTA etc. whereas out of the remaining sum of Rs 87,86,318/- a sum of Rs 44,44,002/- has been disallowed even though there is no dispute that for the purpose of APM Activities the said sum has been contributed under the tripartite agreement by the assessee-company to its wholly owned subsidiary YRMPL. He further submitted that the wholly owned subsidiary YRMPL has received during the relevant period total contribution, which includes contribution from franchisees, as well as, the assessee-company; amounting to Rs 2.64 crores out of which YRMPL has spent Rs 2.19

crores leaving a sum of Rs 44,44,002/- as unspent which is shown in its books as current liabilities by YRMPL. In these circumstances the learned counsel submits that there was no reason for the authorities below to disallow out of Rs 87.86 lacs a sum of Rs 44.44 lacs paid as contribution to YRMPL. In order to buttress his submission the learned counsel also cited the judgment of the Supreme Court in the case of ***CIT vs Dhanrajgirji Raja Narasingirji; (1973) 91 ITR 544 at page 550*** as well as the judgment of the Supreme Court in the case of ***S.A. Builders vs CIT; (2007) 288 ITR 1 at page 14***. The learned counsel for the Revenue Ms Prem Lata Bansal, in opposition, relied upon the orders of the authorities below.

8. As is evident from the facts detailed out by the authorities below the assessee-company under the tripartite agreement, in particular, clause 4.1 was under no obligation whatsoever to contribute any money to its wholly owned subsidiary YRMPL. The facts as found also show that whatever was spent by the assessee-company by way of advertisements towards liability to advertisers such as O&M and HTA etc. was allowed. Furthermore, the facts also reveal that the total contributions received during the period by YRMPL was Rs 2.64 crores out of which it had admittedly spent Rs 2.19 crores and the balance Rs 44.44 lacs remained unspent. The point to be noted is that what the assessee-company in law could not have claimed directly, that is, by making a provision for advertising expenditure could it then be allowed to claim an amount as an expense merely on account of the fact that it had set up an intermediary in the form of a wholly owned subsidiary. In our opinion as rightly held by the authorities below, it cannot be so. For any expenditure to be permitted as deduction under Section 37(1) of

the Act the twin conditions which are required to be fulfilled are that the expenditure in issue should not be of a capital nature, and that, it should have been expended wholly for the purposes of business. It is well-settled that the expression 'for the purposes of business' in Section 37 of the Act has been held to mean an expenditure which is voluntary in nature and commercially expedient. In the present case the Tribunal has returned a finding of fact that the assessee-company has not been able to prove that the contributions to the subsidiary were made in the course of business or on account of commercial expediency. The principle laid down by the two judgments of the Supreme Court in our view would not apply to the facts obtaining in the present case.

9. We find no fault with the impugned judgment. The findings returned are pure findings of fact. No substantial question of law has arisen for our consideration. Resultantly the appeal is dismissed.

RAJIV SHAKDHER, J

April 01, 2009 **VIKRAMAJIT SEN, J**

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