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

\+ **INCOME TAX APPEAL NO. 310/2014**

Date of decision: 1st August, 2014

THE COMMISSIONER OF INCOME TAX-II

..... Appellant

Through Mr. Sanjeev Sabharwal, Sr. Standing Counsel & Mr. Ruchir Bhatia, Jr. Standing Counsel.

versus

JUBILANT FOODWORK PVT. LTD.,

..... Respondent

Through Mr. Vikas Srivastava & Mr. Jatinder Pal Singh, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J. (ORAL)

Revenue in this appeal, which pertains to Assessment Year 2003-04, and arises out of order dated 24th October, 2013 in ITA No. 183/Del/2011, has raised two issues.

(i) Whether entire franchise fee was revenue expenditure or the Assessing Officer had rightly treated 25% of the franchise fee as capital expenditure?

(ii) Whether entire expenditure incurred on advertisement was revenue expenditure under Section 37 of the Income Tax Act,

1961 (Act, for short) or the Assessing Officer was right in holding that the 25% of the advertisement expenditure should be capitalised?

2. On the first aspect, the Assessing Officer had relied upon decision of the Madras High Court in ***Commissioner of Income Tax, Tamil Nadu-II versus Southern Switchgear Limited***, (1984) 148 ITR 272 (Madras), which we feel is clearly distinguishable. In the said case, the assessee had entered into a collaboration agreement with a foreign company under which later had provided technical aid and information for manufacture of low tension and high tension switchgear etc. and the right to sell the said products. The foreign company had also agreed to post the Indian assessee with latest and modern developments in the said fields, including transformers. As per the agreement, the Indian assessee had agreed to pay lumpsum amount of 20000 Sterling in five equal instalments of 4000 Sterling each. In these circumstances, it was held that 25% of the payment made was capital in nature, while balance 75% was revenue expenditure in the hands of the Indian assessee. Aforesaid decision of the Madras High Court was affirmed by the Supreme Court in ***Southern Switchgear Limited versus Commissioner of Income Tax and Another***, (1998) 232 ITR 359 (SC). The facts found by the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal in the present case after referring to the agreement entered into between the respondent-assessee and the USA

based party are entirely distinct and different. The respondent-assessee had paid a lumpsum consideration of $200000, which was capitalised and was not treated as revenue expenditure. We are not concerned and there is no dispute raised by the Revenue on the said payment. We are only concerned with the franchise fee fixed @ 3% of the entire sale, i.e., the turnover of the assessee in India. The said fee was payable in terms of franchise agreement dated 27th March, 1995 as long as the respondent-assessee continued to utilise and use the trademark 'Dominos'. It was payable annually and was not a lumpsum payment, though the last factor alone may not be determinative whether the payment was revenue and capital. When we read the order of the tribunal and the factual findings recorded above, it is apparent that the respondent-assessee did not acquire any right in the trademark 'Dominos', which it was using for the purpose of selling their products/goods. The trademark was not owned and did not belong to the respondent-assessee. Upon termination of the agreement or on failure to pay franchise fee, the respondent-assessee would lose the right to use the said trademark, which was/is owned by M/s Dominos Pizza International, Inc. USA. It is, therefore, evident that the rights under the agreement acquired by the respondent-assessee could be lost during the tenure of the agreement itself and the respondent-assessee was utilising the goodwill and the trademark, which was owned by a third party. Commissioner of Income Tax (Appeals) has rightly relied upon decision of the Delhi High

Court in ***CIT versus J.K. Synthetics***, (2009) 309 ITR 371 (Delhi) wherein the following tests have been culled out after examining several decisions of the Supreme Court and High Courts:-

> "(i) the expenditure incurred towards initial outlay of business would be in the nature of capital expenditure, however, if the expenditure is incurred while the business is on going, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring benefit for the business, if that be so, it will be in the nature of capital expenditure. If the expenditure, on the other hand, is for running the business or working it, with a view to produce profits, it would be in the nature of revenue expenditure;
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> (ii) it is the aim and object of expenditure, which would, determine its character and not the source and manner of its payment;
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> (iii) the test of "once and for all" payment i.e., a lump sum payment made, in respect of, a transaction is an inconclusive test. The character of payment can be determined by looking at what is the true nature of the asset which is acquired and not by the fact whether it is a payment in „lump sum" or in an instalment. In applying the test of an advantage of an enduring nature, it would not be proper, to look at the advantage obtained, as lasting forever. The distinction which is required to be drawn is, whether the expense has been incurred to do away with, what is a recurring expense for running a business, as against, an expense undertaken for the benefit of the business as a whole;
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> (iv) an expense incurred for acquisition of a source of profit or income would in the absence of any contrary circumstance, be in the nature of capital expenditure. As against this, an

expenditure which enables the profit making structure to work more efficiently leaving the source or the profit making structure untouched, would be in the nature of revenue expenditure. In other words, expenditure incurred to fine tune trading operations to enable the management to run the business effectively, efficiently and profitably leaving the fixed assets untouched would be an expenditure of a revenue nature even though the advantage obtained may last for an indefinite period. To that extent, the test of enduring benefit or advantage could be considered as having broken down;

(v) expenditure incurred for grant of License which accords „access‟ to technical knowledge, as against, „absolute‟ transfer of technical knowledge and information would ordinarily be treated as revenue expenditure. In order to sift, in a manner of speaking, the grain from the chaff, one would have to closely look at the attendant circumstances, such as:-

(a) the tenure of the Licence.

(b) the right, if any, in the licensee to create further rights in favour of third parties,

(c) the prohibition, if any, in parting with a confidential information received under the License to third parties without the consent of the licensor,

(d) whether the Licence transfers the "fruits of research" of the licensor, "once for all",

(e) whether on expiry of the Licence the licensee is required to return back the plans and designs obtained under the Licence to the licensor even though the licensee may continue to manufacture the product, in respect of, which access to knowledge was obtained during the subsistence of the Licence.

(f) whether any secret or process of manufacture was sold by the licensor to the licensee. Expenditure on obtaining access to such secret process would ordinarily be construed as capital in nature;

(vi) the fact that assessee could use the technical knowledge obtained during the tenure of the License for the purposes of its business after the Agreement has expired, and in that sense, resulting in an enduring advantage, has been categorically rejected by the courts. The Courts have held that this, by itself, cannot be decisive because knowledge by itself may last for a long period even though due to rapid change of technology and huge strides made in the field of science, the knowledge may with passage of time become obsolete;

(vii) while determining the nature of expenditure, given the diversity of human affairs and complicated nature of business; the test enunciated by courts have to be applied from a business point of view and on a fair appreciation of the whole fact situation before concluding whether the expenditure is in the nature of capital or revenue."

3. Similar view was also expressed by the Delhi High Court in ***Commissioner of Income Tax versus Salora International Limited***, (2009) 308 ITR 199 (Delhi). The Commissioner of Income Tax (Appeals) and the tribunal have rightly come to the conclusion that; (i) no new asset came into existence on account of payment of franchise fee and (ii) the rights under the agreement were only for the tenure of the agreement and no enduring benefit was derived by the assessee. Further, it was not an expenditure incurred for acquisition of source of profit, but enabled the respondent-assessee to run the business profitably. The fixed assets of the assessee remained untouched and no enduring asset came into existence.

As already noted above, the brand or the trademark in question was not owned by the respondent-assessee.

4. We have also examined the order passed by the Assessing Officer. Other than relying upon the decision of the Madras High Court in the case of ***Southern Switchgear Limited*** (supra), there is no discussion relating to the factual matrix to justify his conclusion that 25% of the franchise fee should be treated as capital expenditure. No facts were highlighted and stated to justify the conclusion. In view of the aforesaid reasoning, we are not inclined to issue notice on the first question/issue raised by the appellant-Revenue.

5. The second issue is also covered against the appellant-Revenue by decision of the Delhi High Court in ***Commissioner of Income Tax versus Salora International Limited***, (2009) 308 ITR 199 (Delhi) in which it was held that the expenditure on advertising was of revenue nature. In another decision of this Court in ***Commissioner of Income Tax versus Monto Motors Limited*** (ITA No. 978/2011 decided on 12th December, 2011) it has been observed:-

> "3. The CIT (A) deleted the said addition as it was pointed out that the expenses on advertisement, sales promotion were incurred after the assessee had already started marketing the product. It was pointed out that as the sales were sluggish and not up to the expectations and as business of selling motor bikes was a competitive business the respondent had decided to advertise and undertake sales promotion. He accordingly held that the respondent was entitled to treat the aforesaid expense as a revenue expense. The aforesaid findings were upheld by the Income Tax Appellate Tribunal (Tribunal, for short).
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> 4. In view of the factual matrix which is available on record and as the Assessing Officer has not dealt with the factual matrix in detail we are not

inclined to admit the present appeal. The advertisement expenses as per the findings of both the CIT (Appeals) and the Tribunal were not of capital nature. Advertisement expenses when incurred to increase sales of products are usually treated as a revenue expenditure, since the memory of purchasers or customers is short. Advertisement are issued from time to time and the expenditure is incurred periodically, so that the customers remain attracted and do not forget the product and its qualities. The advertisements published/displayed may not be of relevance or significance after lapse of time in a highly competitive market, wherein the products of different companies compete and are available in abundance. Advertisements and sales promotion are conducted to increase sale and their impact is limited and felt for a short duration. No permanent character or advantage is achieved and is palpable, unless special or specific factors are brought on record. Expenses for advertising consumer products generally are a part of the process of profit earning and not in the nature of capital outlay. The expenses in the present case were not incurred once and for all, but were a periodical expenses which had to be incurred continuously in view of the nature of the business. It was an on-going expense. Given the factual matrix, it is difficult to hold that the expenses were incurred for setting the profit earning machinery in motion or not for earning profits."

6. In view of the above, the appeal is dismissed.

SANJIV KHANNA, J.

V. KAMESWAR RAO, J.

AUGUST 01, 2014
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