$~R-14,15 & 16

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

Date of decision: 24th November, 2014.

\+ **ITA 1297/2010**

COMMISSIONER OF INCOME TAX ..... Appellant
Through Mr. N.P. Sahni, Sr. Standing Counsel with Mr. Nitin Gulati, Jr. Standing Counsel.

versus

DISCOVERY COMMUNICATION INDIA ..... Respondent
Through Mr. Piyush Kaushik, Advocate.

ITA 1101/2011

CIT ..... Appellant
Through Mr. N.P. Sahni, Sr. Standing Counsel with Mr. Nitin Gulati, Jr. Standing Counsel.

versus

DISCOVERY COMMUNICATION INDIA ..... Respondent
Through Mr. Piyush Kaushik, Advocate.

ITA 489/2013

THE COMMISSIONER OF INCOME TAX -IV..... Appellant
Through Mr. N.P. Sahni, Sr. Standing Counsel with Mr. Nitin Gulati, Jr. Standing Counsel.

versus

DISCOVERY COMMUNICATION INDIA ..... Respondent
Through Mr. Piyush Kaushik, Advocate.

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

SANJIV KHANNA, J. (ORAL)

Revenue has filed these appeals under Section 260A of the Income Tax Act, 1961(Act, for short) relating to assessment years 2002-03, 2003-04 and 2004-05 in the case of the respondent-assessee, Discovery Communication India. In the three appeals the following questions were framed for hearing and adjudication:-

ITA 1297/2010 (Assessment Year 2002-03)

> "a) Whether the Income Tax Appellate Tribunal (in short "tribunal") was correct in law and on facts in affirming the order of Commissioner of Income Tax (Appeals) [in short "CIT(A)"] whereby the CIT(A) has deleted the addition of Rs. 2,61,54,952/- added by the Assessing Officer inter alia on the ground that there was no obligation on the part of the assessee to incur huge advertisement expenses?
>
> b) Whether the tribunal while deleting the disallowance made by the Assessing Officer was correct in law and on facts in ignoring the fact that the assessee has acted as agent of the foreign company for booking advertisement?"

ITA 1101/2011 (Assessment Year 2003-04)

> "(1) Whether the Income Tax Appellate Tribunal was correct in law and on fact in affirming the order of CIT (A), whereby the CIT(A) has deleted the addition of Rs.67.15 lacs made by the Assessing Officer while disallowing the proportional advertisement expenses?
>
> (2) Whether the order of the Income Tax Appellate Tribunal, which is a final fact authority, is not perverse as it has not gone through the facts

properly and merely relied on its own order for the A.Y. 2002-03?"

ITA 489/2013 (Assessment Year 2004-05)

"Whether the Assessing Officer was right in making addition of Rs.1,24,18,732/- on account of disallowance of proportionate advertisement expenditure?"

2. The respondent-assessee is a company and during the years in question was a subsidiary of M/s. Discovery Channel Mauritius (98% shares), M/s. Discovery Communication, LLC, USA (1% shares) and M/s. Discovery Productions Inc., USA (1% shares).

3. The respondent-assessee was engaged in the business of distribution, marketing and production of high quality educational and entertainment satellite television programmes for satellite television Channels i.e. Discovery and Animal Planet.

Assessment Year 2002-03

4.1. In the return of income filed for assessment year 2002-03, the respondent-assessee had declared 'nil' income after setting off brought forwards losses of Rs.4,85,39,897/-. This return was subsequently revised but again declaring 'nil' income after adjustment of brought forward losses of Rs.4,82,34,363/-.

4.2. During the period relevant to the assessment year 2002-

03, the respondent-assessee had shown programmes sourcing fee of Rs.5,20,91,937/-, facilitation fees of Rs.1,28,75,927/-, subscription fees of Rs 23,46,50,460, agency commission and marketing commission fee of Rs.3,69,91,065/-, programming revenue of Rs.65,00,000/- and other income of Rs.54,75,642/-.

4.3. The Assessing Officer observed that the assessee had shown gross advertisement revenue of Rs.15,12,06,722/-, but only 15% i.e., Rs.2,30,26,266/- had been credited to the profit and loss accounts as commission earned on advertisement revenue and the balance amount had been paid/repatriated to the foreign associated enterprises abroad. He opined and considered that the advertisement expenses to the tune of Rs.2,61,54,952/- were exorbitant, as the assessee had declared taxable advertisement receipts of Rs.2,30,26,266/-. Advertisement expenses of Rs. 2,61,54,952, he observed were unjustified as the assessee had retained 15% of the total advertisement sale revenue and not the entire or 100% of the advertisement revenue. He rejected the contention of the assessee that advertisements expenses incurred were relatable to earning subscription fee of more than Rs. 23.46 crores, the major source of income/receipt. The Assessing Officer held that the subscription revenue collected from the cable operators did not

require advertisement expenses. Accordingly, 100% or the entire advertisement expenditure of Rs.2,61,54,952/- was disallowed as non-business expenditure or as expenditure not relateable to the respondent-assessee's business, but business of the associated enterprises resident abroad.

ITA 1101/2011 (Assessment Year 2003-04)

5.1. The respondent-assessee filed a return declaring 'nil' income. In the profit and loss account, the assessee had disclosed programme sourcing fee of Rs.4,22,48,648/-, superscription fees of Rs.3,74,99,0580/-, agency commission of Rs.4,59,53,913/-, marketing income of Rs.14,62,341/- and other income of Rs.13,71,488/-. The Assessing Officer noticed that that advertisement sale commission of Rs.2.78 crores was earned, whereas the assessee had claimed advertisement expenses of Rs.2,37,57,000/-. Rs.2.78 crores was only 15% of the total receipts and the balance 85% had been transferred or paid to the related or associated enterprise abroad. He rejected the assessee's submission that advertisement expenditure was relatable to subscription revenue of Rs.37.49 crores and the said expenditure had to be incurred in terms of the licence agreement, which required the assessee to publicize and increase the reach and viewership of the two channels. The advertisement

expenses, he held, had direct nexus with the advertisement revenue. The Assessing Officer then observed that as the assessee had retained 15% of the advertisement revenue as sale commission and the balance 85% had been repatriated or paid to the associated enterprises abroad, therefore advertisement expenses of Rs.2.37 crores should not be entirely disallowed. This, he observed, would be unreasonable, therefore advertisement expenses of Rs.67.15 Lacs were disallowed.

ITA 489/2013 (Assessment Year 2004-05)

5.2. For the assessment year 2004-05, the assessee had filed return declaring income of Rs.17,87,44,860/-. In the profit and loss accounts, the assessee had shown programme sourcing receipt of Rs.2,54,16,606/-, superscription fees of Rs.39,89,28,282/-, agency commission of Rs.7,03,47,271/-, marketing fee of Rs.5,86,783/- and other income of Rs.1,00,16,153/-. The Assessing Officer noticed that the assessee had shown advertisement sale commission of Rs.5,32,44,990/-, which was only 15% of the gross advertisement receipts. He referred to the assessment order for the assessment years 2002-03 and 2003-04 and held that 85% of the advertisement receipts had been transferred to the associated enterprises abroad. The assessee had pleaded and urged that it

was under a contractual obligation as per the license agreement to publicize and promote the two channels, and had earned subscription revenue of Rs.39.89 crores, which was directly relatable to the advertisement expenses of Rs.3.10 crores, but the Assessing Officer did not agree. The assessing officer quantified the disallowance at Rs 1,24,18,732, as advertisement expenses relatable to 85% of the advertisement sale receipts transferred to the associated enterprises abroad.

First Appeal and Order of the Tribunal.

6. The respondent-assessee succeeded in the first appeal before the Commissioner of Income Tax (Appeals). Appeals filed by the Revenue stand dismissed by the Income tax Appellate Tribunal (Tribunal, for short) vide its impugned orders.

Factual findings as recorded by the tribunal and the legal effect of said findings on merits:-

7. The comprehensive and perspicuous finding of the appellate authorities is that advertisement expenditure was incurred in terms of the license agreement granting the distribution rights to the assessee by the associated enterprise, Discovery Asia Inc. Under this agreement, the respondent-assessee had procured right to distribute the signals of Discovery

Channel and Animal Planet Channel and right to collect revenue arising or generated from distribution. Accordingly, the assessee had received subscription revenue of Rs 23.46 crores, Rs. 37.49 crores and Rs. 39.89 crores from the cable operators in the three assessment years. The agreement mandated and required that the assessee to develop and expand viewership of the Discovery Channel and Animal Planet Channel, which had started with a status of a "free to air channel" and made transition to a "pay channel". Increased viewership obviously meant increased subscription revenue and earnings. It was manifest and self-evident that the assessee would have undertaken publicity, advertisement and incurred expenditure on increasing awareness and greater market retention, penetration and expansion. Thus, the finding of the appellate authorities was that advertisement expenditure was related to and had direct nexus with the licence agreement for distributorship and subscription fee collection.

8. There was a separate agreement between the respondent-assessee and associate enterprises under which the assessee had acted as an advertisement sale representative. As an advertisement sale representative, the assessee was entitled to 15% of the gross receipts as its income for the services rendered and performed by them. The balance 85% was transferred to the

associated enterprise abroad.

9. The Assessing Officer's enigmatic and equivocal pronouncement that the entire advertisement revenue should have been retained as income is mere an incantation. The programmes were prepared and aired in India by the foreign associate enterprise, which had incurred expenditure or paid for the software and airing them. The finding that the entire or 100% expenditure on advertisement expenses were incurred for higher and increased advertisement revenue, is fanciful and reflects a spirit of creativity than realism. Unintendedly, the Assessing officer, as noticed below, impeached and transgressed into the domain of international transaction price fixation, without realising that the Transfer Pricing officer had accepted the price. The Assessing Officer, as noticed below under section 37(1) of the Act, cannot go into the question of reasonableness of advertisement or any other expense.

9.1. The Assessing Officer, thus, fallaciously and wrongly held that the entire expenditure, on advertisement, incurred by the assessee related only to the advertisement sales commission or receipt and was not incurred to increase subscription fee by promoting the two channels. Noticeable, the entire subscription fee was retained by the assessee and nothing was repatriated or

paid to the associated enterprises abroad.

Section 37 (1) of the Act.

10. Under Section 37(1) of the Act any expenditure not being in the nature of expenditure described in Sections 30 to 36 of the Act, has to be allowed as a deduction in computing income chargeable under the head "Profit and Gains from Business and Profession", if the following conditions are satisfied: (a) it is not capital expenditure; (b) it is not personal expenditure; and (c) it should be expended wholly and exclusively for the purpose of business.

10.1. The first two conditions are negative in nature, while the third condition or requirement is positive. It is not the case of the Revenue that the expenditure on advertisement was capital or personal in nature. The expression 'expenditure' denotes idea of spending or paying out. It is not the case of the Revenue that the expenditure was not incurred or was not genuine, but fictious.

10.2. The question raised is whether the expenditure was wholly and exclusively for the purpose of assessee's business. The words 'wholly and exclusively' though not synonymous, and are sufficiently wide, but are not restricted to expenditure solely incurred for the purpose of earning of profits. For an amount spent as an admissible expenditure under Section 37(1), the

same should be for the purpose of business and not for the purpose of earning income. (see ***Sree Meenakshi Mills Ltd. vs. CIT*** (1967) 63 ITR 207 (SC) and ***CIT vs. Birla Spinning and Weavings Ltd.*** (1971) 82 ITR 166 (SC). In ***CIT v. Malayalam Plantations Ltd. [1964]*** 53 ITR 140 (SC), it has been observed :

> "The expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits". Its range is wide : it may take in not only the day to day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business."

Thus, any expenditure which is laid down for business which in the present case consisted of distribution of channels and earning of subscription revenue, advertisement agency commission etc. would be wholly and exclusively for the purpose of business.

10.3. Whether an expenditure was wholly and exclusively incurred or laid out for the purpose of business of profession, must be determined from the angle and as per the assessee's perspective and choice. It is subjective. What one assessee may want to incur, another may not like to incur the same or similar

expenditure. The quantum may also differ and vary. Section 37(1) does not curtail or prevent an assessee from incurring an expenditure which he feels and wants to incur for the purpose of business. Expenditure incurred may be direct or may even indirectly benefit the business in form of increased turnover, better profit, growth etc. As long as the expenditure incurred is "wholly and exclusively" for the purpose of business, the Assessing Officer cannot by applying of his own mind, disallow whole or a part of the expenditure. The Assessing Officer cannot question the reasonableness by putting himself in the arm-chair of the businessman and assume status or character of the assessee. However, exception can be created by a statutory provision like Section 40A(2), when the revenue as per the statutory mandate may have jurisdiction to examine the issue of price/consideration. For incurring advertisement expenditure, in the relevant years, there were no statutory stipulations.

10.4. When expenditure is incurred for assessee's own business, the mere fact that the expenditure would inure or benefits a third party or the third party incidentally obtains some advantage, would not affect or distract from the finding that the expenditure was wholly and exclusively was for assessee's business. For example, a retail trader may advertise different products which

may incidentally benefit the manufacturers, but this does not mean that advertisement expenditure fails to meet the requirement of "wholly and exclusively". Law in this regard is well settled. Relevant would be to refer to authoritative pronouncement of the Supreme Court in ***CIT* v. *Chandulal Keshavlal& Co., Petlad,* [1960] 38 ITR 601**, observing: -

> "In deciding whether a payment of money is a deductible expenditure one has to take into consideration questions of commercial expediency and the principles of ordinary commercial trading. If the payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may inure to the benefit of a third party (Usher's Wiltshire Brewery Ltd. v. Bruce [6 Tax Cas 399]. Another test is whether the transaction is properly entered into as a part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business; and it is immaterial that a third party also benefits thereby (Eastern Investments Ltd. v. CIT [(1951)SCR594]. But in every case it is a question of fact whether the expenditure was expended wholly and exclusively for the purpose of trade or business of the assessee. In the present case the finding is that it was laid out for the purpose of the assessee's business and there is evidence to support this finding."

In ***CIT* v. *Royal Calcutta Turf Club,* [1961] 41 ITR 414**, Supreme court followed the earlier judgment in *Chandulal Keshavlal(supra)* to hold : -

> "The question as to whether the expenses of running the school for jockeys is deductible has to be decided taking into consideration the circumstances of this case. The business of the respondent was to run race meetings on a commercial scale for which it is necessary to have races of as high an order as possible. For the popularity of the races run by the respondent and to make its business profitable it was necessary that there were jockeys of requisite skill and

experience in sufficient numbers who would be available to the owners and trainers because without such efficient jockeys the running of race meetings would not be commercially profitable. It was for this purpose that the respondent started the school for training Indian jockeys…… Therefore any expenditure which was incurred for preventing the extinction of the respondent's business would, in our opinion, be expenditure wholly and exclusively laid out for the purpose of the business of the assessee and would be an allowable deduction. This finds support from decided cases. In CIT v. Chandulal Keshavlal & Co. [(1951) SCR 594] this Court held that in order to justify a deduction the disbursement must be for reasons of commercial expediency; it may be voluntary but incurred for the assessee's business; and if the expense is incurred for the purpose of the business of the assessee it does not matter that the payment also enures to the benefit of a third party."

In ***Sassoon J. David and Co Pvt Ltd, Bombay v. CIT, Bombay, (1979) 3 SCC 524,*** the Supreme Court has held: -

"**21.** The next contention urged on behalf of the Department was that since Davids and Tatas were indirectly benefited by the retrenchment of the services of the employees of the Company and payment of compensation to them and since there was no necessity to retrench the services of all the employees, the expenditure in question could not be treated as an expenditure laid out wholly and exclusively for business purposes of the Company. It has to be observed here that the expression "wholly and exclusively" used in Section 10(2)(*xv*) of the Act does not mean "necessarily". Ordinarily it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under Section 10(2)(*xv*) of the Act even though there was no compelling necessity to incur such expenditure. It is relevant to refer at this stage to the legislative history of Section 37 of the Income Tax Act, 1961 which corresponds to Section 10(2)(*xv*) of the Act. An attempt was made in the

> Income Tax Bill of 1961 to lay down the 'necessity' of the expenditure as a condition for claiming deduction under Section 37. Section 37(1) in the Bill read "any expenditure ... laid out or expended wholly, necessarily and exclusively for the purposes of the business or profession shall be allowed ...." The introduction of the word "necessarily" in the above section resulted in public protest. Consequently when Section 37 was finally enacted into law, the word 'necessarily' came to be dropped. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction under Section 10(2)(*xv*) of the Act if it satisfies otherwise the tests laid down by law."

11. As per the findings recorded by the Tribunal and the Commissioner of Income Tax (Appeals), the respondent assessee was engaged in the business of distribution of television channels and had retained 100% of the subscription fee. As per the agreement between the respondent assessee and the associated enterprise, it was the obligation and the duty of the respondent assessee to advertise and promote the channels. Similarly, the assessing was acting as a selling agent for advertisements to be aired on the channels. It was entitled to retain 15% of the gross-receipts as income and pass on or transfer 85% of the gross receipts to the foreign enterprises.

12. Thus, one of the functions being performed by the assessee was to advertise and promote the channels and to earn subscription revenue. Another function was to secure/procure

advertisements. The assessee earned 15% commission for the last mentioned function. The assessee was earning revenue in view of the said functions being performed. Expenditure incurred on advertisement was clearly relateable and laid out for the purpose of business of the respondent assessee and was not extraneous or unconnected with the same. Consequently, it could not have been disallowed as was done by the Assessing Officer on the ground that it was not laid or incurred wholly or exclusively for the purpose of business.

Difference between expenditure incurred and price paid for functions performed.

13. The Assessing Officer has failed to notice the difference between expenditure incurred by the assessee towards advertisement and publicity and the price paid to the assessee by the associated foreign enterprise for services rendered etc. The first relates to expenditure or an outgoing paid for the business. The second relates to income or price paid for the transactions between the respondent assessee and the associated enterprise and which would constitute an international transaction. The second aspect is linked and connected with the income earned i.e. price paid for the service rendered, goods sold etc. An international transaction with an associated enterprise can be

subjected to transfer pricing adjustment under Chapter X of the Act read with the applicable rules by the Transfer Pricing Officer by applying functions performed, risk assumed and the asset deployed, criteria/principle. The Transfer Pricing Officer is required to select appropriate method specified in section 92C of the Act and determine/compute the arm's length price. In the present case, the Transfer Pricing Officer did not make any adjustment and has accepted the transfer pricing between the respondent assessee and the related enterprises i.e. the compensation paid or retained by the respondent assessee in view of the functions performed, risk assumed and asset deployed etc.

14. Once, we hold that one of the functions to be performed by the respondent assessee was to incur advertisement and promotion expenditure, then the expenditure incurred for the said purpose should be allowed under section 37(1) of the Act, as incurred wholly and exclusively for purpose of the said assessee. In such cases, as in present case, disallowance made by the Assessing Officer treating the advertisement expenditure as non-business expenditure must fail and flounder. However, adequate compensation/price should be paid for the same by the associated enterprise, with reference to the functions, risk and

assets. In case, the respondent-assessee was not being paid adequate consideration or compensated by its associated enterprise, necessary adjustments could have been made by the Transferring Pricing Officer in accordance with the Act. It is an accepted position that the Transfer Pricing Officer did not deem it appropriate and proper to make any adjustment in respect of these international transactions. The price received by the assessee for the international transaction was accepted by the Transfer Pricing Officer.

15. In view of the aforesaid discussion, it is held that advertisement and promotion expenditure was rightly treated, by the tribunal, as one of the functions which the respondent assessee was mandated and required to perform for the purpose of his business and would, therefore, be allowable as a business expenditure under Section 37(1) of the Act.

16. In view of the aforesaid legal position, the question No.1 in all the three appeals is answered in favour of the respondent-assessee and against the revenue. The question No.2 in ITA Nos. 1297/2010 and 1101/2011 is also answered in favour of the respondent-assessee and against the appellant-Revenue.

The appeals are disposed of. No order as to costs.

SANJIV KHANNA, J.

V. KAMESWAR RAO, J.

NOVEMBER 24, 2014
NA