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

% Judgment delivered on : 01.04.2009

**ITA No. 1433/2008**

**YUM! RESTAURANTS (MARKETING) 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. 3235/Del/2005 pertaining to assessment year 2001-02.

2. The only issue which arose in this case is with respect to the taxability of Rs 44,44,002/- being excess amount of income over expenditure. The said surplus had arisen on account of advertisement

contributions received from the holding company of the asse company which remained unexpended.

2.1 The broad facts with respect to the above case have been delineated in the connected appeal entitled Yum! Restaurant (India) Pvt Ltd vs CIT; being ITA No. 192/2009, which was heard alongwith the present appeal. Judgment was reserved in both the appeals.

3. Briefly, the parent company, that is, Yum! Restaurant (India) Pvt Ltd (in short 'YRIPL') formerly known as Tricon Restaurants India Pvt Ltd was incorporated on 17.03.1994. The YRIPL had a licence arrangement with Kentucky Fried Chicken International Holdings, Inc. (in short 'KFC') and Pizza Hut International LLC (in short 'PHILLC'). The YRIPL sought permission from the Government of India, Ministry of Industry, Department of Industrial Policy and Promotion, Secretariat for Industrial Assistance (SIA), Foreign Collaboration, for setting up a wholly owned step-down subsidiary to manage retail restaurant business, for advertising and promotion at local store level, regional level and national level. By a letter dated 05.10.1998, SIA granted approval to YRIPL to set up a step-down wholly owned subsidiary on the basis of a broad framework indicated by YRIPL. The broad framework being that the proposed new subsidiary company would be a non-profit enterprise which would be governed by the principles of mutuality. The wholly owned subsidiary, as indicated by YRIPL, was being set up to carry out and economise the cost of advertising and promotion by catering to the specific needs of its franchisees in order to enable them to concentrate on restaurant operations and management. The approval was granted on the condition that the subsidiary would be a non-profit enterprise and that it would not repatriate its dividends out of the country.

3.1 Upon receiving the requisite permission the assessee-com[illegible] was incorporated on 08.06.1999.

3.2 In September, 2000 the YRIPL, the assessee-company, as well as, the franchisees entered into tripartite agreements. Under the agreement the assessee-company received contributions from the franchisees as well as the franchisees of the YRIPL to the extent of 5% of the gross sales in order to carry on co-operative advertising. The agreement also envisaged that the purpose of incorporating the assessee-company was really to carry the marketing activities of each of the brands of which YRIPL was a licensee for the mutual benefit of the franchisees. The entire activity of the assessee-company was to be carried out on no-profit basis and that the assessee-company was obliged not to repatriate any dividends. The broad purpose of the agreement is best encapsulated in the following clauses:-

> *"2.2 TRIM will establish and operate Brand Funds in respect of each brand for the purpose of allocating and using the advertising contribution received from franchisee and other franchisee of Tricon operating Restaurants under the Brands. TRIM will allocate the advertising contribution received from the franchisees including franchisee for each restaurant to the respective Brand Funds established for that brand. It is agreed between the parties that the advertising contribution paid into a brand fund will be used for the AMP activities relating to that brand.*
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> *3.1 As and from the Effective Date, franchisee will pay the advertising contribution of 5% of Revenue for a particular month into the bank account of the brand fund established by TRIM by the 10th day of the following month. Details of the bank account of each brand fund set up by TRIM will be notified to franchisee by TRIM from time to time. Notwithstanding the aforesaid the executive committee of any Brand (constituted under Article 7 of this Agreement) may, by a three fourth majority, which shall be binding on all franchisees of Tricon including the franchisee, require the franchisee to pay the advertising contribution in advance. For the avoidance of doubt it is clarified and agreed that while recommending advance payment of advertising contribution the chairman will not have a*

*Franchise will spend an additional 1% of Revenues, in the manner directed by Tricon and/or TRIM in writing from time to time, on such local store marketing, advertising, promotional and research expenditure proposed by franchisee and approved in advance by Tricon and/or TRIM during the relevant accounting period, in accordance with the requirements and guidelines set out in the manuals, provided that if franchisee fails to spend the full amount as directed by Tricon and/or TRIM franchisee will pay the unspent amount to TRIM within the period specified in a written demand from TRIM. Upon receipt of the unspent amount TRIM will spend the amount on regional and/or national advertising, promotions or research expenditure conducted by TRIM in its discretion……."*

**4.1** ***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 amounts if it chooses not to do so.***

*xxxx*

*xxxx*

*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 brands 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."*

3.3 It is in this background that on 31.10.2001 the assessee-company filed its return for assessment year 2001-02. On 27.08.2002 the assessee's return was processed under Section 143(1) of the Act. On 24.10.2002 the assessee's case was picked up for scrutiny and a notice under Section 143(2) of the Act was issued to the assessee-company. During the course of scrutiny, queries were raised with the representatives of the assessee-company; whereupon it was revealed that the assessee-company had an excess income over expenditure amounting to Rs 44,44,002/-. However, the gross total income had been declared as 'nil'. The income and expenditure account as recorded in the order of the Assessing Officer read as follows:-

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|---|---|
| *"INCOME* | |
| *Advertising contribution from franchises, Holding company and key associates* | *26469546* |
| *EXPENDITURE* | |
| *Advertising, Marketing and Promotional Expenditure* | *21256032* |
| *Preliminary expenses* | *454992* |
| *Administrative and other expenses* | *190272* |
| | *21901296* |
| *Excess of expenditure carried forward from the Previous year* | *(124248)* |
| *Excess of income/ (Expenditure) over (expenditure)/income carried forwarded to the Balance sheet (included under current Liabilities)"* | *4444002* |

3.4 With the return the assessee-company had appended the notes broadly indicating that it was operating on principles of mutuality and on 'no-profit' basis. The note further read that there was a complete identity between the contributors and the receipts of the fund, that is, the assessee-company. The assessee-company rendered services exclusively to the franchisees and that the franchisees had exclusive

right over the surplus. The outlet of the franchisee did not derive any profit from the funds. The funds of the assessee-company could only be used for meeting expenses on their behalf or be returned to them.

4. The Assessing Officer examined the case laws and the details submitted by the assessee-company. The Assessing Officer after examining the contents of the SIA approval granted vide letter dated 05.10.1998 and the contents of the tripartite agreement returned the following finding of facts:

> *"It was seen from the details filed by the assessee company that in terms with the approval SIA as per clause 3 as reproduced above in para VI.1, YRIPL and the franchisees will contribute fixed percentage of their revenues to the proposed new company i.e. assessee.* ***Whereas clause 4.1 of the Tripartite operating agreement as reproduced above in para VI.2, provides that YRIPL has no obligation to contribute any amount which is contradictory to the terms of approval of SIA.***
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> *Separate funds were to be maintained for KFC and Pizza Hut brands.* ***Further as per clause 5.1 as reproduced above in para VI.2 of the operating agreement provides that bank account of each brand fund established by assessee-company will be notifying to the franchisee and the franchisee will paying the advertising contribution of 5% of revenues for a particular month into such bank account. However, it was seen brand funds was established by assessee-company. In fact, YRIPL continued to receive the advertising contribution from the franchisee as was being done by it prior to setting up of assessee-company. This findings shows that assessee-company has been used as a tool to evade tax on excess of income over expenditure incurred in during the previous year. A chart giving complete details of contributions receivable by assessee-company and amounts actually received by assessee-company and YRIPL is being enclosed as Annexure 'A'.*** *This annexure shows that most of the contribution has been received by YRIPL which is against terms of SIA approval and even the clauses of Tripartite operating agreement.*
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> *VI.5 Single Ledger Account- assessee-company and YRIPL – considered as one entity-*
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> *Information under Section 133(6) was called from all the franchisees.* ***The information received from such franchisees is analyzed in the ensuing paras below. In their books of account, the franchisees have one ledger***

***YRIPL/assessee-company. For them it is single entity They have not maintained any separate account of assessee-company.*** *A few instances are discussed below.....*

*....**The assessee-company was also informed about non submission of details by Pepsi Foods Ltd. vide order sheet entry 05.03.2004. It is pertinent to mention here that as per details of contributions filed by the assessee company M/s Pepsi Food Ltd's Marketing Contributions of Rs 32.70 lacs was received by YRIPL.***
***All the above findings make it clear that the assessee company was not operating in terms with the SIA approval**."*

***"It was seen from the details of accrued marketing filed by the assessee company during the course of assessment proceedings u/s 143(2) of the Income Tax Act, 1961 in the case of M/s Yum! Restaurants India Pvt Ltd pending before this office that not all the franchises are paying 5% of their revenues**: e.g. M/s Devyani International Private Limited and Specialty Restaurants were paying contribution @ 4% instead of 5% as prescribed in the Tripartite agreement. **All the participants to the so called brand fund or so called 'mutual concern' should have been contributing equally or an equal proportion**.*
*It is further seen that as for clause 3 of SIA letter as reproduced in para VI.1 of this order the franchisees and YRIPL were required to make contribution of affix (a fixed percentage) of their respective revenue. However, as per clause 4.1 of Tripartite operating agreement as reproduced in para VI.2 of this order YRIPL is under no obligations to payable any contribution if it chooses not to do so which is totally in contradiction to SIA letter."*

4.1 From the aforesaid the Assessing Officer came to the conclusion that the assessee-company was not operating in terms of the SIA approval.

5. Based on these findings the Assessing Officer brought to tax a sum of Rs 44,44,002/- which was an excess of income over expenditure by rejecting the claim that it was a mutual concern.

6. Aggrieved by the same the assessee-company filed an appeal before the Commissioner of Income Tax (Appeals) [hereinafter referred to as the 'CIT(A)]. The CIT(A), after analyzing all the facts and the case laws in issue, was of the view that all the participants in the module set

up by the assessee-company were business concerns and the purpo setting up of fund was a commercial purpose. The CIT(A) observed that the advertising, marketing and promotional activities (hereinafter referred to as the 'APM activities') being a critical component of running a successful business venture, it is intrinsically linked to profit on sales of franchisees, that is, the contributors. It could not be said that the contributors activity was immune from the taint of 'commerciality' and that unlike a club the assessee-company was not set up for social intercourse nor was a set up for cultural activity where the idea of profit or trade does not exist. What was essential was that there should not be any dealing with the outside body which results in benefit which promotes some commercial/business venture. He further held that though the form taken up to conduct its activity resembles a mutual concern, it could not however be denied that the contributions were made undoubtedly for business considerations. The CIT(A) being of the view that the underlying purpose was solely for commercial consideration and excess of income over expenditure should be brought to tax.

7. Being aggrieved, the assessee-company preferred an appeal to the Tribunal. The Tribunal by the impugned judgment dismissed the appeal of the assessee-company after noting the facts of the case as well as the principle of mutuality invoked by the assessee-company to sustain its stand that the said excess of income over expenditure was not taxable. The Tribunal noted that in the present case the principle of mutuality was not applicable on account of the fact that apart from **contributions received from various franchisees contributions to the extent of 32.70 lacs had also been received from Pepsi Foods Ltd as also from YRIPL, who were neither franchisees nor**

**beneficiaries.** As per the tripartite agreement it noted contributions were received from YRIPL, that is, the parent company which was not under any obligation to pay. Therefore the essential requirements of a mutual concern were missing. This was especially so that since Pepsi Food Ltd and YRIPL who was a contributor to the fund did not benefit from the APM activities. Thus the Tribunal held that the principles of mutuality being not applicable to the excess of income over expenditure was required to be taxed.

8. Having heard the learned counsel Mr C.S. Aggarwal, Sr. Advocate for the assessee-company and Ms Prem Lata Bansal for the Revenue we are of the view that the judgment deserves to be sustained. The principle of mutuality as enunciated by the Courts in various cases is applicable to a situation where the income of the mutual concern is the contributions received from its contributors. The expenses incurred by the mutual concerns are incurred from such contributions and hence on the principle that no man can do business with himself, the excess of income over expenditure is not amenable to tax. However, in the present case the authorities below have returned a finding of fact that the fund as contributors such as Pepsi Food Ltd which do not benefit from the APM Activities. Moreover, the principle of mutuality is applicable to those entities whose activities are not tinged with commercial purpose. As a matter of fact in the instant case the parent company i.e., YRIPL which has also contributed to the brand fund is under the agreement under no obligation to do so. The contributions of YRIPL are at its own discretion. Thus, looking at the facts obtaining in the present case, it is quite clear that the principle of mutuality would not be applicable to the instant case. This was the only stand taken by the appellant before the authorities below. In these circumstances we

are of the opinion that the impugned judgment of the Tribunal doe call for interference. The authorities below have returned pure findings of fact which are not perverse to our minds. No substantial question of law arises for our consideration. Resultantly, the appeal is dismissed.

**RAJIV SHAKDHER, J**

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

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