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

Date of decision: 14th November, 2014.

\+ **ITA Nos. 536/2014, 537/2014 & 588/2014**

COMMISSIONER OF INCOME TAX DELHI (CENTRAL) -III
..... Appellant
Through Mr. Balbir Singh, Sr. Standing Counsel with Mr. Abhishek Baghel, Advocate.

versus

HARI CHAND SHRI GOPAL ..... Respondent
Through

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

SANJIV KHANNA, J. (ORAL)

We have heard learned counsel for the Revenue at some length, but do not find any ground or reason to interfere with the impugned order dated 3rd January, 2014 in view of the facts of the present case.

2. The respondent herein is an individual and the assessment years involved are 2003-04, 2004-05 and 2005-06. Search and seizure action under Section 132 of the Income Tax Act, 1961 (Act, for short) was carried out on the Gopal Zarda group including M/s. Gopal Corporation Ltd.

3. The respondent-assessee was not subjected to search and seizure operations but subsequently on a satisfaction note recorded by the

Assessing Officer of M/s. Gopal Corporation Ltd., proceedings unc Section 153C of the Act were initiated.

4. Order under Section 153C of the Act, refers to agreements between respondent assessee and M/s S. Gopal & Co. and M/s Flakes N Flavourz and the factual position that the said companies had paid and the respondent assessee had received royalty of Rs.54,63,751/-, Rs.63,57,509 and Rs.1,56,07,563/- for the assessment years 2003-04, 2004-05 and 2005-06, respectively. On the quantum of royalty received, there was no dispute and the Assessing Officer did not make any addition. The Assessing Officer, however, observed that the respondent assessee had incurred substantial expenditure on advertisements and legal and professional fee that was not justified and exorbitant as it constituted a substantial percentage of the receipts by way of royalty. We are not reproducing the finding of the Assessing Officer in detail as it is quoted in paragraph No.6 below.

5. The stand of the respondent assessee was that expenditure on advertisement etc. was in fact and actually incurred. The quantum should not be disputed as payments were made to unrelated third parties like Zee Telefilms, News Television India Ltd., SET India Ltd. etc. The said expenditure was towards sales promotion, brand building, brand awareness etc. of incense sticks, namely, Joie Agarbatti and not for tobacco products. The agreements with M/s S. Gopal &

Co. and Flakes-N-Flavourz was not in respect of Joie Agarbatti incense sticks but in respect of tobacco and related products. Thus, there was no co-relation between two agreements and the advertisements or the brand building expenditure incurred. The Assessing Officer did not agree and in the order under Section 153C held that only 1% of the expenditure towards brand building expenditure etc. should be allowed and balance 99% should be disallowed as it was not relatable to business activity of the respondent-assessee.

6. The Commissioner of Income Tax (Appeals) dealt with the issue in great depth and detail. Discussing the reasoning given by the Assessing Officer and the factual matrix, the Commissioner of Income Tax (Appeals) came to the following conclusion in ITA No.537/2014 for the assessment year 2003-04:-

> "However even on merits it is seen that the entire addition to income has been based on the premise that the expenditure claimed on account of advertisement expenses for Rs. 40,22,736/- (this is 1/5th of the total expense of Rs.2,01,13,684/- spent on advertisement by the appellant of it's new product Joie Agarbatti and Incense stick in FY 2000-01) was not justified to be allowed as this expenditure should have been incurred by the assessee's (Parties) who has entered brand lease agreement with the appellant firm. The reason being that when the assessee is entitled to a fixed percentage of turnover there is no apparent reason why the appellant should incur such expenditure on advertisement which is about 73% of the royalty receipts (Rs. 54,63,571) in the year under consideration. The AO is of the view that the reason

for booking the above advertisement expenses in case of the assessee firm is apparently to inflate profit of the brand lease holder companies that is M/s. S. Gopal and Company; M/s Flakes and Flavourz and M/s Gopal Corporation ltd. which are being run in industrially backward area and are entitled to claim of deduction u/s 80 IB of the IT Act. It has thus been concluded that the advertisement expenditure in the appellant's case is basically an arrangement for claiming deduction u/s 37(1) and consequently only 1% of the such expense has been allowed and the balance 99% which works out to Rs. 39,82,509/- has been disallowed holding the same as advertisement expense not solely and exclusively for the business.

The basic contention of the appellant is that the above presumption of the AO is factually incorrect and is based on conjecture and surmises. That the appellant received royalty from M/s S Gopal & Co. and M/s Flakes and Flavourz during the year which was against brand lease agreement for Tobacco & Tobacco related products and had not entered into any brand lease agreement for use of the trade mark and copyright license for Joie brand incense Sticks. In this connection the appellant has enclosed the copy of reply filed by him before the AO (in response to the questionnaire issued on 05.10.10 and 29.10.10) where the said fact was submitted before the AO also. The appellant has also enclosed copy of the Trade Mark & Copyright License Agreement dated 26.07.1999 which it had entered with M/s S Gopal & Co. as also the Trade mark and Copyright license agreement dated 19.01.04 which it had entered with M/s Flakes and Flavourz. It has been submitted that in both these agreements the "Trade Mark and copyright License" between the appellant and these parties is with regard to providing technical knowhow, experience and expertise in selecting curing, maturing, processing blending and formulating, chewing tobacco mouth fresher, kiwam and pan chatni. The argument being made by the appellant is thus that there was no trade mark/copy right agreement between the appellant and the parties from whom the royalty has been received during the year with reference to user of the trade mark/copy right

> license in case of Joie Agarbattie. Thus the appellant has argued that there did not arise question of not debiting the advertisement expenses for advertising Joie Agarbattie, the brand for which was being owned by the appellant and the trade and Copyright license of which had not been parted with to a third party. To put it differently, the assessee has not debited the advertisement expenses of other parties in its own books, as the user of trade mark license of joie Agarbattie had not been granted in favour of these parties during the year. The appellant has also submitted details of advertisement expenditure incurred by these entities in the respective years.
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> I have gone through the contention of the appellant as also the trade mark & Copyright license agreement which it has entered with M/s S. Gopal & Co. & M/s Flakes and Flavourz and from the same it is noted that there is no reference to grant of license for user of the Joie Agarbatti brand in these agreements and therefore the question that the expenses of these concerns have wrongly/incorrectly booked in case of the appellant is not found to be substantiated. I also find substance in the contention of the appellant that the claim of the said expense of Rs. 2,01,13,684/- in equal portion in 5 assessment year beginning with AY 2000-01 is not prejudicial to the interest of revenue and am in agreement with the submission that the decision of Hon'ble ITAT Ahmadabad in case of M/s Aqua Mineral P. Ltd. Vs. Cit 96 ITD 417 are based on different set of facts and are not applicable to the facts of the instant case. In a result the disallowance made for Rs. 39,82,509/- in case of the appellant is directed to be deleted as no evidence has been brought on record by the AO that the said firms M/s S Gopal & Co and M/s Flakes and Flavourz were engaged in the manufacturing of joie brand of incense sticks."

7. In these circumstances, Revenue preferred appeals before the Tribunal. The Tribunal in the impugned order noticing the facts found by the Commissioner of Income Tax (Appeals) observed that the

Departmental Representative has not been able to substantiate t findings of the Assessing Officer. It was also observed that none of the documents contained any incriminating evidence/material.

8. During the course of hearing before us, we asked the learned counsel for the Revenue to examine and point out, whether the findings recorded by the Commissioner of Income Tax (Appeals) on merits were correct and justified.

9. We also notice that the Assessing Officer has not observed or held that the expenditure was not incurred by the respondent-assessee. It has been accepted that the expenditure in fact was incurred. The undisputed factual position which emerges from the appellate orders is that the expenditure incurred on advertisement/brand building was in respect of Joie Agarbatti and incense sticks. The expenditure was not incurred for brand building/advertisement of tobacco products etc., in respect of which royalty payments were received. Whether or not advertisement or brand building expenditure should have been incurred for Joie Agarbatti and incense sticks was the prerogative and right of the assessee and the Assessing Officer cannot question and challenge the same except when the challenge is permitted and allowed by a statutory provision. Reasonableness and whether the assessee was wise and prudent in incurring the expenditure, is not within the domain of examination by the assessing officer, unless permitted and allowed

under the statute. Expenditure can be disallowed under section 37(1) the Act, if it is held that it was not wholly and exclusively for business and not by adopting subjective standard of reasonableness. [See ***Commissioner of Income Tax vs.Walchand and Co. Private*** Ltd (1967) 65 ITR 381, ***J.K Woollen Manufacturers vs. Commissioner of Income Tax***, (1969) 72 ITR 612]. Section 40A(2) of the Act has not been invoked and there is no provision which stipulates that advertisement and brand building expenses could be restricted or partly allowed.

10. In view of the aforesaid factual position, we do not think that it is a fit case to issue notice as it will be a futile exercise as factually incorrect findings were recorded by the Assessing Officer leading to the additions and the findings recorded by the Commissioner of Income Tax (Appeals) have not been set aside and adversely commented upon by the Tribunal. In fact, the Tribunal has accepted the factual findings and has based their decision in view of the said facts. In these circumstances, we need not examine the question as to whether any document belonging to the respondent-assessee was found during the course of search and whether Section 153C of the Act was rightly invoked. In this regard, we also record that there has been amendment to Section 153C by the Finance (No.2) Act, 2014 with effect from 1st October, 2014. The said issues are left open to be

decided in an appropriate case.

11. The appeals are accordingly dismissed.

SANJIV KHANNA, J.

V. KAMESWAR RAO, J.

NOVEMBER 14, 2014
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