Bombay High Court The Commissioner Of Income Tax -11 vs N.G.C. Network (India) P. Ltd on 13 October, 2014 Bench: S.C. Dharmadhikari Shiv

itxa538.12

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.538 OF 2012

The Commissioner of Income-Tax-11,
Aayakar Bhavan, M.K. Road,
Mumbai 400 020 .. Appellant.
Vs.
N.G.C. Network (India) P. Ltd.

Star House, Dr.E. Moses Road,
Mahalaxmi, Mumbai 400 011 .. Respondent.

Mr. P.C. Chhotaray for the Appellant.
Mr. Porus Kaka, Senior Advocate i/b Atul Joshi for the respondent.
ig CORAM : S.C. DHARMADHIKARI &
A.K. MENON , JJ.

RESERVED ON : 25TH SEPTEMBER, 2014

PRONOUNCED ON : 13TH OCTOBER, 2014

JUDGMENT (Per A.K. MENON, J.)

1. This appeal seeks to challenge the order of the Income Tax Appellate Tribunal dated 29th July, 2011 being a confirmatory order recording formation of a majority view pursuant to the order passed by the Third Member dismissing the appeal filed by the revenue. The Appellant seeks to raise following questions :- "(a) Whether in the facts and circumstances of the case and in law, the Hon'ble ITAT is justified in confirming the order of the CIT(A) deleting the itxa538.12 disallowance of Rs.4,14,20,843/- made by the Assessing Officer out of advertisement and publicity expenses incurred by the Assessee ?

(b) Whether in the facts and circumstances of the case and in law, the Hon'ble ITAT was justified in not taking cognizance of the transfer pricing provisions because, the expenditure incurred by the Assessee by way of advertisement and publicity expenses, substantially benefited the two foreign principals and the Assessee did not receive any compensation on that account from the foreign principals and whether upon the aforesaid consideration, the Hon'ble ITAT was justified in not upholding the order of the Assessing Officer ?

(c) Whether in the facts and circumstances of the case and in law, the Hon'ble ITAT was justified in rejecting the alternative claim of the Revenue that the huge advertisement and publicity expenses should be treated as deferred revenue expenditure since, the benefit of the expenditure spread over future years ?

2. It will be convenient to narrate few facts which led upto present appeal : The respondent - assessee is a company incorporated in India and engaged in the business of distribution of T.V. channels popularly known as National Geographic and History Channel. The assessee - NGC Network (India) P. Ltd. also itxa538.12 acts as airtime advertising Sales Representative for its principals NGC Network Asia LLC ("NGC Asia") which operates the National Geographic Channel and Fox International Channels (US) Inc. ("FOX") which owns and operates "the History channel". The Assessee has paid fixed fees to "NGC Asia" and "FOX" in consideration for being appointed as distributor of the two channels. The distribution fees are paid by way of lump sum amounts. The assessee being distributor was entitled to enter into agreements with re-distributors, cable networks and other media distributors (collecting operators) to ensure that the contents of channels are viewed by the consumers. The assessee collects subscription fees for such re-distributors. The consumer would pay the subscription fees to view such channels.

3. The "Advertising Sales representation agreements" (Ad-sales agreement) under which the Respondent - assessee was appointed as advertising sales

agents came into effect on 1st July, 2004. Under the Ad-sales agreements, the assessee would solicit advertisers, who wish to advertise "on air" during the telecast of the aforesaid channels in their capacity as agents of the principals, namely, N.G.C. Asia and FOX. By way of agency commission the assessee would earn 15% of the net billed advertising charges collected by the Respondent and balance 85% was remitted by the assessee to the foreign principals. itxa538.12

4. The assessee filed return of income during 2005-06 on 30th October, 2005 declaring total income of Rs.4,85,16,730/- and also filed form 3CEB in view of there being international transactions with Associated Enterprises, namely, the foreign principals. The items mentioned in 3CEB were referred to Transfer Princing Officer, who by his order dated 23rd October, 2008 passed under section 92CA(3) of the Income-Tax Act accepted the arm's length price declared by the assessee.

5. During the assessment proceedings, the assessing officer observed that the assessee's expenditure under head "Advertising and Publicity Expenses" of Rs.6,21,31,262/- was claimed as deduction under section 37(1) of the Income Tax Act. On being queried about the said expenses the respondent-assessee sought to justify the expenses by reiterating the need for vide publicity to ensure channel's recall in the minds of viewers which would lead to increased demand and viewership and therefore, higher subscription fees for enhancing and maintaining existing level of the subscription revenues. The assessee contended that promotion of the programmes of the channel by way of such advertising and publicity increases popularity of the programme which would result in higher demand for advertising spots on the channel resulting in high advertising revenue and itxa538.12 consequent increase in commission of the assessee. Thus, the assessee contended that there is direct nexus between advertising and promotions of the Channels and increase in advertising revenue and entailing increased commission.

6. The Assessing Officer, it appears, noted that the Respondent had incurred expenses towards advertising and publicity which benefited not only the assessee but also the foreign principals i.e. aforesaid "NGC Asia" and "FOX". That the assesee did not disclose such benefit to the members as part of form 3CEB. Accordingly, it was held that the entire expenditure under head "Advertising and Promotion" amounting to Rs.6,21,31,262/- was not allowable as deduction under section 37(1) of the Act. He restricted allowable deduction under section 37(1) to only 33.33% of the total amount of Rs.6,21,31,262/- which is to a sum of Rs.2,07,10,419/-.

7. Being aggrieved by the order dated 11th December, 2008 passed by the Assessing Officer the respondent-assessee preferred an appeal before the Commissioner Income Tax (Appeals) on 13th January, 2009. The Commissioner Income Tax (Appeals) allowed the appeal holding that entire ex-

penditure is allowable under section 37(1). The Commissioner of Income-Tax (Appeals) observed that since expenses were made to Indian residents they itxa538.12 were not covered in Form 3CEB as section 92 covers only international transactions. Being aggrieved by the order of the Commissioner of Income-Tax (Appeals) the appellant filed an appeal before the Appellate Tribunal. Two members of the tribunal passed separate orders, one allowing the appeal and the other dismissing it. The accountant member upheld the order of the Commissioner of Income-Tax (Appeals) and whereas judicial member allowed the appeal of revenue. The matter was therefore referred by the President to the third member. The third member vide order dated 17th June, 2011 concurred with the accountant member and thereby upheld the decision of the Commissioner of Income-Tax (Appeals). Pursuant to that a confirmatory order was passed by the Appellate Tribunal on 29th July, 2011. The Revenue is in appeal against this order.

8. Mr.Chottaray, learned counsel appearing on behalf of the Appellants submits that the order of the tribunal is unsustainable by reason that the respondent-assessee did not disclose in Form 3CEB, the fact that the respondent's principal "NGC Asia" and "FOX" would derive benefit from the expenditure towards advertisement and publicity claimed as deduction under section 37(1). That, it had been so disclosed, the Transfer Pricing Officer would have taken a different view and the assessee should have offered the test of arm's length price and therefore enabled a itxa538.12 proper decision to be taken by transfer pricing officer. He submitted that in case of Star India (P) Ltd. the assessment officer had disallowed 100% of the advertisement expenses for the assessment year 1999-2000 since the expenses were incurred for and on behalf of Star HongKong and the Commissioner of Income- Tax had upheld disallowance to the extent of 80%. The two members of the tribunal were not divided in their judgments. In that case the judicial member granted relief to the Appellant relying on the Supreme Court decision in the case of Sassoon J. David and Co. Ltd. vs. Commissioner of Income-Tax, Bombay Vol.118 ITR 261 whereas the Accountant Member supported contention of the revenue relying upon decision of Supreme Court in Sassoon J. David (supra). Mr.Chottaray further submitted that the assessee had not expended any amount under the head advertisement and promotion of NGC Asia but are still deriving benefit therefrom. In the circumstances according to Mr.Chhotaray it is not permissible to allow the deduction. Firstly, because the benefit accruing to the foreign principals was not disclosed in Form 3CEB and secondly, because despite such benefit foreign principal had not contributed towards the costs of advertising, publicity and promotion.

9. Mr.Chhotaray relied upon the order of the Transfer Pricing Officer pertaining to assessment year 2008-09 to show that itxa538.12 the expenses have been debited under head Advertising and Publicity in the Profit and Loss Account of the Assessee without disclosing the benefits to foreign

principals which according to him ought to have been disclosed. This was fourth year of the assessment under section 92CA(3) of the Act. The first one was assessment year 2004-05 followed by 2005-06 with which we are presently concerned. At page 2 of the order of the Transfer Pricing Officer it records that the assessee has recorded international transactions with two of its associates, namely, principal "NGC Asia" and "FOX". The transactions recorded did not disclose

benefit accruing to foreign principals. He then relied upon the

decision of the Delhi High Court in Maruti Suzuki India Ltd. vs. Transfer Pricing Officer in support of his submission that arms length price has to be determined and relied upon conclusion at item (viii). 10. The said judgment observes that expenditure incurred by domestic entity, which is an associated enterprise of a foreign entity on advertising, promotion and marketing of its products using foreign trade mark logo does not require any payment or compensation by the owner of the foreign trade mark/logo to the domestic entity on account of use of the foreign trade mark/logo in the promotion, advertising and marketing undertaken by it, so long as the expenses incurred by the domestic entity do not itxa538.12 exceed the expenses incurred by similarly situated and comparable independent domestic entities. Further that the expenses incurred by a domestic entity which is a associated enterprise of a foreign entity a similarly situated and comparable independent domestic entity needs to suitably compensate the domestic entity in respect of the advantage obtained by it in the form of brand building and increased awareness of its brand in the domestic market. 11. The facts in this case largely arise out of change of logo which amounted to sell of brand to the domestic entity. In that case the Transfer Pricing Officer observed that Maruti has paid royalty to Suzuki in year 2004-05 whereas no compensation had been paid by Maruti to Suzuki on account of deemed sale of that trade mark. Later, the order of the Transfer Pricing Officer was under challenge and the Court came to the conclusion that the order passed by the Transfer Pricing Officer was not based on any evidence and it is in this context that the court came to the conclusion set out above. The conclusion in the said judgment cannot be applied to the facts of the present case. In any event as rightly pointed out by Shri Kaka, this judgment is set aside by the Hon'ble Supreme Court. 12. Mr.Chhotaray then relied upon the judgment of Gujarat High Court in Commissioner of Income-Tax, Baroda vs. itxa538.12 Navsari Cotton and Silk Mills Ltd. Vol.135 ITR 546 in support of his contention that in order to qualify for deduction under section 37(1) certain conditions must be satisfied which included positive and negative tests inasmuch as expenditure must be in the nature of revenue and not capital expenditure. It must be laid out or expended wholly and for the purpose of business and it must not be of the nature described in section 30 to 36 and section 80VV. One of the negative tests according to the judgment which is relied upon by Mr.Chhotaray is that the expenses must not be unreasonable and out of proportion. 13. In this respect he submits that in the case at hand the sum expended on the publicity

and promotions exceeded amount of revenue earned, therefore, the same cannot be allowed as a deduction. This submission of Mr.Chhotaray cannot be accepted for the simple reason that the amount of expenses incurred may be at times larger than actual revenue. 14. Mr.Chhotaray also relied upon decision of Supreme Court in case of D. B Madon vs. Commissioner of Income Tax Vol.192 ITR 344 to support his submission that it is always open to the High Court to follow its earlier decision and answer the question of law one way or other according as whether the view taken in the earlier commends itself to the Court or whether in its itxa538.12 opinion earlier view needs to be reconsidered. It is not necessary that a similar question of law is to be answered in particular way. Mr.Chhotaray therefore submits that questions of law may be answered in favour of the revenue. 15. Mr.Kaka, learned Senior Counsel appearing on behalf of the respondent-assessee submitted that contentions of the appellant are misconceived. He submitted that the respondent- assessee has acquired distribution rights of two channels on exclusive basis after paying due consideration and that it is entitled to thereafter earn profits in its business of distribution. He submitted that in the business of TV channels it is necessary to promote the channels in order to ensure higher viewership and that higher viewership alone brings in advertising interest. He submitted that apart from the business of distributing channels, the respondent-assessee was also engaged in selling of advertising time on channels. The sale proceeds of which are required to be shared with the foreign principals, who are owners/controllers of the channel and channel content. He submitted that as consideration for selling airtime to advertisers/other advertising agencies the respondents earned commission at 15% of the value of advertising time sold. After retaining the 15% commission, the sum equivalent to 85% is paid over to the foreign principals. In order to generate sales of advertising time, it is necessary for the itxa538.12 respondents to publicize and promote channel and its contents thereby ensuring higher viewership which then brings in advertise interest in the channels. 16. Mr.Kaka further submitted that the amount spent towards advertising and publicity of the channels is for benefit of the assessee who holds distribution rights for the channels. But for promotion of channel, the distribution rights will not generate sufficient returns since the promotion and publicity alone help garner higher viewership which would entail higher distributor interest which in turn will ensure higher distribution income from operators who are the end subscriber/viewer. Operator who are assured of higher viewership would be willing to pay higher fees to acquire the distribution rights and the promotion and publicity help generate better viewership. He further contended that the expression "wholly and exclusively" used in section 37 does not mean "necessarily". He submitted that if somebody else other than assessee is also benefited from the expenditure, the deduction under section 37 should not be affected. He relied upon the decision of the Supreme Court in Sassoon J. David (supra) and submitted that merely because foreign principal was benefited by advertising, promotion and publicity it will not prevent the respondent-assessee from claiming benefit of deduction under section 37(1). itxa538.12 17. Mr.Kaka also relied upon the decision in Maruti Suzuki India Ltd. vs. Additional Commis-

sioner of Income Tax in Civil Appeal No.8457 of 2010 reported in (2011) 198 Taxman 102 SC wherein it was held that the compensation of arms length price that the Transfer Pricing Officer had decided the issue pursuant to directions of the High Court in that case and that the findings of the Transfer Pricing Officer were conclusive. The assessee had not challenged the order of the Transfer Pricing Officer. The High Court further directed the Transfer Pricing Officer to decide the matter in accordance with law and directed the Transfer Pricing Officer who has already issued fresh show cause notice to proceed with matter in accordance with law uninfluenced by the observations/directions given by the High Court in the impugned judgment. Thus the Supreme Court found it to be conclusive. 18. In the instant case the order of Transfer Pricing Officer is not under challenge. The question of law raised did not relate to the order of the Transfer Pricing Officer which is final. In the circumstances Mr.Kaka submits that there is no warrant for interference and the questions must be answered in favour of the assessee. itxa538.12 19. Having considered rival contentions we are in agreement with Mr.Kaka. The main grounds on which the revenue has questioned the order of the tribunal are (a) non disclosure in form 3CEB of the fact that the principal is also a beneficiary of the advertising expenses; (b) that the advertising and promotional expenses are not wholly for the benefit of the assessee but it also benefited the principal who was an associated enterprise; (c) that advertising and publicity expenses were far higher than the amount of revenue earned and lastly, that although foreign principals i.e. Associated Enterprise benefited from advertising and publicity no compensation was paid by the foreign principals to the assessee to avail of such benefits. 20. It is not possible to accept the Revenue's contentions for the following reasons : Firstly, the contention that there was no proper disclosure of the benefit before the Transfer Pricing Officer cannot now be a reason to entertain the questions and the order of Transfer Pricing Officer is final. It was admitted position that the assessee is a agent of foreign principal and would naturally benefit from advertising carried on by agent in India. However, these benefits were not ascertainable. The contention of the assessee that the benefits were not ascertainable or taxable in view of extra territory appears to be correct and justified. In the instant case we find that the assessee has not suppressed any information. itxa538.12 It has offered to tax its income from both business, namely, distribution business as well as advertisement and promotion business. In the assessment year in question, the Assessing Officer has proceeded to grant 33.33% of the total advertising expenses as allowable deduction. We do not find any justification for such restriction of the same. Furthermore, the Appellant's case during argument that the fact of the foreign principal benefiting had been disclosed in the Form 3CEB and the Transfer Pricing Officer 'could' have taken a different view. Admittedly therefore the Transfer Pricing Officer had followed a possible view which cannot now be faulted. 21. The contention that the expenditure should have been wholly and exclusive for the purpose of business of the assessee under section 37(1) read with provisions of section 40A(2) as being excessive and unreasonable does not appeal to us. There can be no doubt in the instant case, that in view of decision of the Supreme Court in Sassoon David (supra)

it cannot be said that the expenditure was not wholly or exclusively for benefit of the assessee. The mere fact that foreign principals also benefited does not entail right to deny deduction under section 37(1). Furthermore, it is seen that all the amounts earned by the assessee were brought to tax, especially in view of the fact that the payment of expenses were made to Indian residents and there itxa538.12 payments were not required to be included in form 3CEB since Section 92 which governs the effect of form 3CEB covers only international transactions. Furthermore, it is seen that the respondents income from subscription fee is variable and through commission received on the advertising sales is 15% of the value of Ad-sales. The Assessing Officer's contention that the assessee received fixed income is not justified and there is certainly, in our view, a direct nexus between the amount spent on advertising and publicity, and the appellant's revenue. 22. Advertisers who advertise on these channels act through media houses and advertising agencies and they work to media plans designed in the manner so as to maximise value for the advertiser. They will evaluate expenditure with channel penetration in the market place inasmuch as only channels with high viewership would justify the higher advertising rates which is normally sold in seconds. Merely having high quality content will not ensure high viewership. This content has to be publicized. The great reach of the publicity, the higher chances of larger viewership. The larger the viewership, the better chances of obtaining higher advertisement revenue. The higher advertisement revenue, the higher will be commission earned by the respondent-assessee. Accordingly, we have no doubt that there is a direct nexus between advertising expenditure and revenue albiet the fact itxa538.12 that there may be a lean period before revenue picks up notwithstanding high amount spent on such publicity. This justifies the higher expenditure vis-a-vis revenue noticed by the department. 23. It is also not necessary that the foreign enterprises must compensate the Indian agent for the benefit it receives or it may receive from the advertisement and promotion of its channels by agent in India. The agent in India earns commission from ad- sales and distribution revenue, both of which have sufficiently compensated the assessee. We would not expect the revenue to determine the sufficiency of the compensation received by the agent and as such we do not find any justification in this ground either. In the circumstances we answer questions of law (a), (b) and (c) in the affirmative in favour of the assessee and against the revenue. In the result the appeal is dismissed. No order as to costs. (A.K. MENON,J.) (S.C. DHARMADHIKARI,J.)