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

\+ **ITA No.926/2011**

Reserved on: 21st March, 2012
% *Date of Decision: 19th April, 2012*

COMMISSIONER OF INCOME TAX .....Petitioner
Through: Mr. Sanjeev Rajpal, Sr. Standing Counsel.

Versus

CAREER LAUNCHER INDIA LTD. ....Respondents
Through: Mr. Ajay Vohra with Ms. Kavita Jha and Mr. Vijay Kumar Punna, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

R.V. EASWAR, J.:

For orders see ITA 939/2010.

R.V.EASWAR, J

SANJIV KHANNA, J

APRIL 19, 2012
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Signature Not Verified
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By:AMULYA

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

\+ **ITA No.939/2010**
\+ **ITA No.911/2011**
\+ **ITA No.926/2011**

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R.V. EASWAR, J.:

These are three appeals filed by the CIT under sec.260A of the Income Tax Act, hereinafter referred to as "the Act", against the orders passed by the Income Tax Appellate Tribunal, hereinafter referred to as "the Tribunal", for the assessment years 2004-05, 2005-06 and 2006-07. The Tribunal has passed a separate order on 26th June 2009 for the assessment year 2004-05 in ITA No.1047/DEL/2008, whereas for the assessment years 2005-06 and 2006-07 it has passed a

common order on 27th December, 2010 in cross-appeals filed by the assessee and the revenue in ITA Nos.4024 & 4925/DEL/2009 and ITA Nos. 523 & 524/DEL/2010.

2. On 28th July, 2011, this court framed the following substantial questions of law in respect of the assessment year 2005-06 in ITA No.911/2011:

> "I. Whether the respondent was not liable to deduct the tax at source for the relevant year on account of the payment made by it to its franchisees under Section 194C of the Act, as held by the ITAT in the impugned order?
>
> II. Whether the assessing officer did not rightly reject the claim of the respondent making the addition of Rs.6,38,64,018/- to income of the respondent for the relevant year on account of non-deduction of TDS in terms of section 40(a)(ia) of the Act?
>
> III. Whether the ITAT has rightly deleted the addition of Rs.33,22,000/- made by the assessing officer on account of disallowance of bonus paid to its directors without payment of the dividend in terms of section 36(1)(ii) of the Act?
>
> IV. Whether the claim of the respondent for paying interest of Rs.22,07,188/- in the relevant year to the Noida Authority on account of purchase of land was allowable as revenue expenditure u/s 36(1)(iii) of the Act?"

3. On 14th November, 2011, the following substantial questions of law were framed by this court for the assessment year 2006-07 in ITA No.926/2011: -

"(1) Whether the respondent had failed/ neglected to deduct tax at source under Section 194C and accordingly Section 40(A)(ia) of the of the (sic.) Income Tax Act, 1961 is attracted?

(2) Whether the Income Tax Appellate Tribunal is right in deleting addition of Rs.37,44,000/- made by the Assessing Officer on account of disallowance of bonus paid to the Directors in terms of Section 36(1)(ii) of the Income Tax Act, 1961?"

4. As regards the assessment year 2004-05 (ITA No.939/2010), the following substantial questions of law were framed by order dated 20th September, 2010:

"1. Whether the Tribunal is correct in allowing non-compete fee of Rs.5,40,000 payable by the assessee to Mr. Vijay Kalyan Jha and Mr. Sujit as revenue expenditure solely on the basis of agreement period and the mode of payment?"

2. Whether ITAT was correct in law in allowing interest of Rs.22,07,188/- paid by the assessee to Noida Authority for purchase of land as revenue expenditure?"

5. We first take up the question of deductibility of the interest paid to Noida Authority on the unpaid installments of the price payable for purchase of land. This question arises, as already noticed, in the assessment years 2004-05 and 2005-06.

6. The brief facts in connection with the question are these. The assessee is a company. It carries on business in providing education and training for various preparatory examinations such as IIM, IIT,

Fashion designing courses etc. In the financial year 2002-03 it was allotted institutional land measuring 20,000 sq.ms. in Noida, near Delhi, by the Greater Noida Authority. The price of the land was Rs.1.70 crores which was to be paid in instalments along with interest at the rate of 20% per annum. The assessee capitalised the interest in its books of account, but in the returns filed for these years claimed it as deduction in computing its income from business.

7. In the course of the assessment proceedings the AO required the assessee to justify the claim in view of the proviso to section 36(1)(iii) of the Act inserted with effect from 1-4-2004. According to the proviso, any interest paid on borrowings made for expansion or extension of the existing business was not to be allowed as a deduction for the period from the date of borrowing till the asset acquired out of the borrowed funds was first put to use. The assessee submitted that it was not a case of expansion or extension of the existing business and that the land was acquired for the purpose of the business being carried on by it and therefore the proviso was not attracted. It was alternatively claimed that if the interest was not allowable under sec.36(1)(iii) in view of the proviso, it was allowable under sec.37(1) as expenditure incurred or laid out wholly and exclusively for the purpose of the business. It was claimed that though acquisition of the land may amount to acquisition of a capital asset, the interest paid did not represent capital expenditure and was allowable.

8. These submissions were rejected by the AO who disallowed the expenditure. The CIT(A) upheld the disallowance for the assessment year 2004-05. On further appeal the disallowance was deleted by the Tribunal. Following the order of the Tribunal, the CITA) allowed the claim for the assessment year 2005-06. The revenue carried the matter in appeal to the Tribunal, which, following its earlier view, confirmed the decision of the CITA). That is how the question is before us for both the years at the instance of the revenue.

9. There are three conditions for the allowance of interest under sec.36(1)(iii). They are: (i) the assessee should have borrowed capital; (ii) that the capital should have been borrowed for the purpose of the business and (iii) interest should have been paid on the borrowing. In the case of ***Bombay Steam Navigation Ltd. v CIT***, (1965) 56 ITR 52 it was held that in order to claim allowance in respect of interest, there should be borrowing of capital and that unpaid purchase price of an asset does not amount to borrowing of capital, though a debt may be created. It was observed that every borrowing gives rise to a debt, but every debt does not amount to borrowing. In these premises, the interest paid on the unpaid purchase price of a capital asset was held not deductible under sec.10(2)(iii) of the 1922 Act which is similar to sec.36(1)(iii) of the 1961 Act. On the basis of this judgment, it seems to us that the claim of the assessee must fail. The interest was paid to Noida Authority not in respect of any capital borrowed from that Authority, but on the price of the plot remaining unpaid as per the

provisions of the lease deed. There being no "capital borrowed", the interest is not allowable as a deduction. In this view of the matter, it is not necessary to consider whether the proviso to Section 36(1)(iii) is applicable or not.

10. Counsel for the assessee however put forth the alternative claim, based on the very same judgment of the Supreme Court, that the interest was allowable under the residuary section 37(1) as expenditure incurred wholly and exclusively for the purpose of the business as the acquisition of the land from Noida Authority was an integral part of the conduct of the business. In Bombay Steam Navigation (supra) it was no doubt held that the interest, if it is not allowable under Section 10(2)(iii) of the 1922 Act can be considered for deduction under Section 10(2)(xv) of that Act, provided it was incurred as an integral part of the profit-earning process of the business and not for acquisition of an asset or a right of a permanent character. In that case the assessee-company was formed for the purpose of taking over the assets from the Scindias with which its business was to be carried on. It was in that connection agreed with the Scindias that a part of the payment would be made immediately and the balance of Rs.51.56 lakhs would be treated as unpaid price, to be discharged in future with interest. The debt which gave rise to the interest liability was incurred in connection with the very taking over of the business from the Scindias and thus formed an integral part of the profit-earning process of the business. Such a nexus is missing in

the case before us. It has not been shown that the incurring of the debt in favour of the Noida Authority was an integral part of the profit-earning process of the assessee's business, which is that of preparing students to take competitive examinations held by IIM, IIT etc., in the same manner in which the Bombay Steam Navigation Company incurred the debt in favour of the Scinidas, which was closely and inextricably linked with the taking over of the business from the Scindias and to be carried on by the Bombay Steam Navigation Company. Moreover, the debt was created by the assessee in favour of the Noida Authority for acquisition of a capital asset, viz., land, and therefore the interest on the debt cannot be allowed as business expenditure.

11. It is not necessary to discuss the authorities cited by the learned counsel for the assessee. ***JCT vs DCIT***, (2005) 276 ITR 115 (Cal.) and ***Deputy CIT v. Core Health Care Ltd.***, (2008) 298 ITR 194 (SC) are cases in which there was an act of borrowing of capital and not a mere incurring of a debt otherwise than by way of a borrowing. The judgment of the Punjab & Haryana High Court in ***CIT v. Sunil Kumar Sharma***, (2002) 254 ITR 103 has no doubt distinguished the judgment of the Supreme Court in Bombay Steam Navigation Co.Ltd. (supra) but the decision of the High Court was rendered in the context of computation of the property income and not income from business. It did not arise under Section 36(1)(iii).

12. The alternative claim of the assessee for allowance of the interest liability under Section 37(1) is thus not accepted. The expenditure represents capital expenditure. It is part of the price paid for the Noida land; it is an adjunct to the price and hence part of it. It is therefore not allowable as a deduction under Section 37(1).

13. We accordingly answer the substantial questions of law No.2 for the assessment year 2004-05 and No.IV for the assessment year 2005-06 in favour of the revenue and against the assessee.

14. The next question that is common to the assessment years 2005-06 and 2006-07 relates to the allowance of the bonus paid to directors of the assessee-company.

15. In the assessment proceedings for the assessment year 2005-06, the AO took the view that sec.36(1)(ii) was applicable to the payment of bonus of Rs.32,22,000/- to the directors of the company and it was to be disallowed because it would have been payable to the directors as dividends had it not been paid as bonus. The assessee explained that the payment of bonus was supported by board resolutions, that the directors were full-time employees of the company drawing salary, that all of them were management graduates from IIM, Bangalore and therefore it would not be correct to say that the bonus would have been payable as dividends so as to attract section 36(1)(ii). It was submitted that dividends were not being paid in the guise of bonus and in support of the claim it was pointed out that the payment of bonus

was not in any way related to the shareholding of the directors. The relevant shareholding details and the bonus payment in respect of each director were given to the AO which he has reproduced in paragraph 3 of the assessment order.

16. These submissions were however rejected by the AO who held that on a proper reading of the section it was clear that if the company could have declared dividend on the shareholding but had not done so, then any payment of bonus/commission to the directors was hit by the section. He noted that no dividend was declared by the company despite substantial profits. According to him, the company was avoiding 13.5% dividend distribution tax and some more tax on income since individuals pay 5% less tax than companies, and thus the total tax avoided came to about 20% because of the payment of the bonus to the directors. He therefore disallowed the entire payment of bonus.

17. In the assessment year 2006-07, for substantially the same reasons the AO disallowed the entire bonus payment of Rs.37,44,000 to the directors.

18. The CIT(A) in his consolidated order for the two years upheld the disallowance. In the further appeals preferred by the assessee before the Tribunal, it was held, agreeing with the assessee, that if the assessee had paid dividend on the shareholding of the directors then such payment would have been more than the bonus paid and

therefore sec.36(1)(ii) was not applicable. The Tribunal referred to two directors specifically and noted that having regard to their shareholding, they would have been entitled much higher amounts as dividends than the amounts paid to them as bonus. It also recorded a finding that none of the directors would have received bonus as dividend in case bonus was not paid. It also noted that the payment of bonus was supported by a board resolution.

19. The revenue's contention that the Tribunal erred in allowing the bonus payment to the directors cannot be accepted. It has not disputed the facts viz., (a) that the payment was supported by board resolutions and (b) that none of the directors would have received a lesser amount of dividend than the bonus paid to them, having regard to their shareholding. Further, the directors are full-time employees of the company receiving salary. They are all graduates from IIM, Bangalore. Taking all these facts into consideration, it would appear that the bonus was a reward for their work, in addition to the salary paid to them and was in no way related to their shareholding. The bonus payment cannot be characterised as a dividend payment in disguise. The Tribunal has found that having regard to the shareholding of each of the directors, they would have got much higher amounts as dividends than as bonus and there was no tax avoidance motive. The quantum of the bonus payment was linked to the services rendered by the directors. It cannot therefore be said that

the bonus would not have been payable to the directors as profits or dividend had it not been paid as bonus/commission.

20. The issue has been considered by this Court in ***AMD Metplast Pvt. Ltd vs DCIT*** (2012) 341 ITR 563 in the light of the judgment of the Bombay High Court in ***Loyal Motor Service Co. Ltd vs CIT*** (1946) 14 ITR 647. It was observed that the judgment of the Bombay High Court (supra) does not assist the revenue and that so long as the bonus or commission is paid to the directors for services rendered and as part of their terms of employment it has to be allowed and sec.36(1)(ii) does not apply.

21. Having regard to the above legal position and the factual findings recorded by the Tribunal, we are unable to say that the Tribunal erred in holding that the bonus payment was allowable u/s.36(1)(ii) of the Act. The substantial questions of law are answered in the affirmative, against the revenue and in favour of the assessee for both the years.

22. The next issue, which is common to the assessment years 2005-06 and 2006-07 relates to the applicability of Section 40(a)(ia) of the Act. According to the Section any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work including supply of labour for carrying out any work, on which tax is deductible

at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in Section 139(1) of the Act is not deductible in computing the business income of the assessee.

23. Since the facts are common for both the years, we are referring to the facts for the assessment year 2005-06. As already noted, the assessee is a company engaged in providing education and training for various preparatory examinations like IIM, IIT, fashion designing etc. These services are provided across the country through education centres run by the assessee itself or by its franchisees. While completing the assessment, the Assessing Officer noted that the assessee had debited a sum of ₹6,38,64,018/- to the profit and loss account as payment made to franchisees. On a perusal of the agreement between the assessee and one of its franchisees, which was apparently taken as a specimen agreement, the Assessing Officer took the view that the payment made by the assessee came within the provisions of Section 194(C) of the Act as a payment made for carrying out a work in pursuance of a contract and accordingly the assessee ought to have deducted tax from the payment at the applicable rates. He further took the view that since the assessee failed to deduct the tax as contemplated by Section 194C, the amount cannot be allowed as a deduction in view of the embargo placed by Section 40(a)(ia).

24. The assessee's submission was that the agreement was not a pure and simple agreement for carrying out any work within the meaning of Section 194C, that it was an agreement for permitting the payee to utilize the name and copyright of the assessee in the study material and in running the coaching centres, that there were mutual rights, duties and obligations envisaged by the agreement, that a holistic appraisal of the agreement would show that it is a business arrangement and contemplates a sharing of the profits from the business between the assessee and the franchisee, that the franchisee was neither a contractor nor a sub-contractor for carrying out any work for the assessee and that in these circumstances the assessee was not responsible for deducting any tax under Section 194C. It was therefore submitted that the Section 40(a)(ia) was not applicable and the payment should be allowed as a deduction in computing the business income of the assessee. These submissions were not accepted by the Assessing Officer. He held that the words "any work" appearing in section 194C were defined in an inclusive manner. He opined that the agreement entered into between the assessee and the franchisee was a contract enforceable in law and it is in the nature of a service contract. According to the Assessing Officer, the assessee and the franchisee cannot be said to be partners in any business. He also relied on the Clause in the agreement that the entire fees were collected from the students by the franchisee and deposited in the bank account of the assessee, which militated against the claim of the

assessee that the arrangement was a composite arrangement providing for mutual duties and obligations. He also negatived the assessee's claim that the parties to the agreement were not acting as agents for each other. According to him the franchisee was acting on behalf of the assessee as he was using the trade name of the assessee for providing education to the students. For these reasons, the Assessing Officer held that Section 194C read with 40(a)(ia) applied. He accordingly, disallowed the payment of ₹6,38,64,018/-.

25. For the same reasons he disallowed the payment of ₹11,24,07,079/- made by the assessee in the assessment year 2006-07.

26. The assessee appealed to the CIT(Appeals) who disposed of the appeals by a common order dated 16.11.2009. The CIT(Appeals) examined the agreement between the assessee and the franchisee and noted that the franchisee has to provide various services to the assessee in accordance with the agreement and that the assessee retained overall control of the educational centres. The arrangement was not a joint venture arrangement and both parties were independent contractors. The franchisee had no power to appoint the assessee in any manner nor represent the assessee. The words "any work" have been widely defined in Section 194C and the services rendered by the franchisee fell within the definition. According to the CIT(Appeals) the franchisee carried out specific work for the assessee in terms of the agreement and also collected the fees on behalf of the

assessee and deposited them in the assessee's bank account. Thereafter, the assessee made payment to the franchisee and this payment was for the work carried out by the franchisee in terms of the contract. Accordingly, he held that the Assessing Officer was right in disallowing the payments. He thus dismissed the assessee's appeals on this point for both the years.

27. The assessee carried the matter in further appeal before the Tribunal, which also passed a common order for both the years on 27th December, 2010. The Tribunal had before it the sample agreement dated 1.10.2007 between the assessee and M/s Sphere Academy of Ahmedabad. It appears that a statement was made before the Tribunal on behalf of assessee that all the agreements with the franchisees are identically worded. In view of the statement, the Tribunal proceeded to decide the appeals on the basis of the aforesaid agreement, taking it as representative of all the agreements entered into by the assessee with the franchisees. Before us also, the arguments proceeded on the basis of a specimen agreement dated 1.10.2005 entered into between the assessee and M/s Career Solutions of Trivandrum and it was agreed by both the sides that this agreement may be taken as representative of all the agreements between the assessee and its various franchisees.

28. The Tribunal, after noting the various clauses of the agreement, held that the tenor and purport of the various terms of the agreement

were that it was not a case where the licensee was doing any work for the assessee even within the wider meaning of the term "any work" as defined in Section 194C or the meaning of the word "work" as understood in common parlance. According to the Tribunal it was only a case of the assessee running a study centre through various licensees or franchisees and sharing the profits with them. It opined that the agreement has to be read as a whole and on doing so it became clear that the agreement is not for making any payment to the licensee for any work done for the assessee and that it was a case of sharing of fees for carrying out respective obligations under a contract. In coming to this conclusion the Tribunal referred to the judgment of this Court in ***CIT v NIIT Limited*** (2009) 318 ITR 289 and found that the facts were similar and though there were some differences in the terms of the agreement between the cited case and the assessee's case, read as a whole, it was clear from the agreement that it was a composite agreement providing for mutual obligations and duties, embodying a business arrangement and cannot be broken into various components as suggested by the Revenue. The Tribunal found that in the cited case also the fees collected from the students were deposited in the account of the assessee (in that case) and thereafter it was shared between the assessee and the franchisees in accordance with the terms and conditions of the license agreement. The ratio of the judgment of this Court in NIIT's case (supra) was found applicable to the present case. In this view of the matter, the

Tribunal agreed with the assessee's contention that the payment was not made by the assessee to the licensee/franchisee for any work and therefore neither Section 194C nor Section 40(a)(ia) was applicable. The Assessing Officer was accordingly, directed to allow the payments.

29. It is against the aforesaid decision of the Tribunal that the Revenue has come in appeal under Section 260A before us. We have gone through the model or specimen agreement dated 1.10.2005 between the assessee and M/s Career Solutions of Trivandrum, a copy of which was filed before us in the course of the hearing. The agreement is a comprehensive agreement. It provides for several aspects of the arrangement. The preamble narrates that the assessee is engaged in the business of offering professional learning to the members of the public for becoming proficient in competitive entrance examinations, personality development related programmes as per norms and methods developed by it and that the assessee also owns or has access to various copyrighted material, preparatory information and substantial body of technical knowhow relating to the location, design and operation of professional learning centres. It further states that the assessee (described in the agreement as the licensor) has established a high position regarding quality of services available at the learning centres run by it and recognizes the benefit to be run it. The licensee or the franchisee, it is further stated in the preamble, "recognizes the benefit to be derived from being identified

with and licenses by the licensor and being able to utilize the Trade Names, Designs and Copyrighted material, which the licensor is in possession" and that the "licensor wishes to make its learning commercially available to the public at large". With this understanding between them, it was the desire of the licensee to be licensed on a limited basis to use the trade names, designs, copyright and technical knowhow in connection with the operation of the professional learning centres. The preamble thus gives the background of the main object of the arrangement between the assessee and its licenses/franchisees. If the preamble is any guide, it seems to us that the parties proceeded to enter into a business arrangement between themselves for their mutual benefit and the methodology adopted was to exploit the knowhow and copyrighted material available with the assessee by running learning centres in different parts of the country.

30. We may now take a brief survey of the various terms and conditions of the agreement. The territories of the franchisees were defined and they were prohibited from operating beyond the marked territories. It was agreed (clause 3) that the grant of the license is limited in the sense that it is given to the licensee only for the permitted use, which means the running of the learning centres and for the purpose of marketing the right to use the technical knowhow and the copyrighted material owned by the assessee. It was also agreed that after the termination of the agreement, the licensee shall not make

any claim to the trademark "Career Launcher India Ltd." or "CL" and the similar trade names or use in similar trademark or trade name or to confuse the public. Clause 4 provided for the obligations of the licensee. The licensee had to provide at its own cost the equipment, furniture and fixtures at the premise approved by the licensor for occupying the learning centre. The infrastructure shall not be used by the licensee for any other purpose. The licensee can market and sell only such courses as are covered by the agreement. The licensee shall only be the custodian of all technical reference material, transpiracies, coordinator guides, audit and the tapes, video tapes, CDs etc. and they will be used by the assessee for the purpose of conducting the classes in the learning centre. The licensee shall keep them in trust for the licensor i.e. the assessee. It was also provided that the licensee will implement the fee structure laid down by the licensor, which shall be subject to audit by the licensor. It was further provided that the licensee will receive and collect all fees on behalf of the licensor and shall deposit such collections into the licensor's bank account specified by it and such deposit shall be made directly into the bank account of the licensor on the day on which they are collected. Collections made after the banking hours of the day shall be deposited into the account on the very next day. Another important obligation of the licensee was to maintain a record of the costs of materials, wages and direct operating expenses which shall be made available to the licensor in a form and at a frequency determined by the licensor.

The licensee was obliged to also submit a profit and loss statement and a balance sheet of its business to the licensor for the preceding financial year within a period of 90 days from the end of the year. The licensee was obliged to make available all the material stocks and collateral stocks, student attendance records, feedback reports, books of accounts, etc. for the audit to be conducted by the licensor. The licensor was also at liberty to inspect the premises of the learning centre run by the licensee.

31. Clause 5 provided for "financial consideration". It stated that in consideration of the licensor agreeing to provide the technical knowhow belonging to the licensor and the trade name for use at the professional learning centre, the licensee agrees to pay the licensor at the signing of the agreement a certain amount of fee as mentioned in Annexure 5 to the agreement. The fee was to be non-refundable and non-adjustable and was valid for a period of 3 years from the date of the first receipt. Clause 5.6 is important and it provided for "recurring franchise fees" in addition to the deposit mentioned above. This clause provides that the licensee shall pay recurring franchise fees to the licensor at 25% of the net revenue earned from the operations. The net revenue meant gross revenue minus service tax as applicable.

32. Clause 6 made detailed provisions regarding the services to be provided by the licensor. The licensor shall provide all confidential, all procedural manuals to the licensee. It shall also give marketing

and advertising advice and research data developed by it which may be helpful to the licensee in running the centre. Any special techniques or instructions or new services as may be developed by the licensor and considered to be helpful to the licensee shall also be provided. The licensor is obliged to join and assist the licensee in designing the course-scheduling, the technique, business ethics, conduct of classes, tests, examinations, certifications etc. The materials and services which are not covered by the technical knowhow fee were to be charged extra. In particular, the licensee had to separately pay the licensor for application forms, procedures, publicity material, prospectus, student ID cards, guides and charts, technical reference material, student guide folders etc. Clause 7 provides for "operational standards". The various sub-clauses make detailed provisions relating to design and décor of the building, equipment, signs, manuals, cleanliness and so forth. Generally these are treated as the obligations of the licensee. The licensee is also to comply with the laws relating to health, cleanliness, compensation to workmen and their working conditions.

33. Clause 8 provides for "limitations of license". The gist of it is that the licensee cannot have any right or interest in the licensor's trademarks, designs, copyrights, trade names or the goodwill belonging to it and that the licensee shall maintain confidence and secrecy of their secrets and procedures. Clause 10 provides for the obligation of the assessee to take out a policy of insurance to cover

itself against certain kinds of loss/damage as specified by the licensor in the project implementation manual. The licensor's name is to be added as additional insured in the insurance policy. Copies of the insurance policies have to be provided by the licensee to the licensor.

34. There are various other provisions made in the agreement regarding indemnification, consequences of default, change in the ownership of licensee etc. Clause 13 provides for an administrator to be appointed by the licensor at the professional learning centre run by the licensee in the event of non-payment of any monies due from the licensee, default in payment of any other charges, non-adherence or violation of any terms and conditions agreed upon and prolonged disruption of the infrastructure which in the opinion of the licensor is not justified. The licensee, in case an administrator is appointed by the licensor is obliged to provide him adequate working space and is also liable to bear the cost of the posting of the administrator. The licensee shall reimburse the licensor the salary paid to the administrator. Clause 17 provides for "arbitration and jurisdiction". The annexures to the agreement contain the details which are required to be mentioned therein by the various clauses of the agreement.

35. There can be no dispute with regard to the general proposition that in ascertaining the true effect of a document it has to be read as a whole and in the context of the surrounding circumstances. The assessee is undoubtedly in the business of imparting coaching or

learning for the purpose of competitive examinations such as those conducted by the IIT, IIM etc. It has developed expertise in the same which has fructified into some kind of a knowhow or a trademark or trade name or reputation. It is noteworthy that the income declared by the assessee was ₹4,80,26,060/- for the assessment year 2005-06 and ₹6,84,27,841/- for the assessment year 2006-07. The income declared by the assessee itself is an indication of its success and popularity in the field. It is not therefore surprising that others wanted to associate themselves with the assessee's business. It is equally understandable that the assessee was willing to enter into some arrangements with such persons so that the learning centres, as they are called in the agreement, can be opened in several places of the country with the blessings or association of assessee for the mutual benefit of all the parties concerned. Such arrangements are not uncommon in the business world which is a well known fact. These are loosely called "franchisee agreement". In the agreement entered into by the assessee in the preset case, the words "licensor" and "licensee" are used respectively to denote the assessee and the franchisee, who has associated itself with the assessee's success story and has opened learning centres using the trade name of the assessee. The substance of the agreement however, is that it is a business arrangement under which both parties hope to benefit. It would be myopic to view the agreement divorced from the nature of the assessee's activities and the business realities.

36. Let us examine the real nature of the agreement between the assessee and the franchisees and consider the question whether the agreement or contract is for "carrying out any work" by the franchisee, so as to attract the provisions of section 194C relating to tax deduction at source and consequently the disallowance under Section 40(a)(ia) of the Act. On a careful consideration of the issue, it seems to us that it would not be possible to view the agreement as a contract for carrying out any work by the franchisee. The terms of contract which we have referred to show that the arrangement consists of mutual obligations and rights. It is not a simple case of an agreement under which a person is engaged to carry out any work for the other. The essence of the contract appears to us to be one under which the trade name or reputation or knowhow belonging to the assessee in the business of running learning centres, where students are coached for writing competitive examinations, is permitted to be made use of by the franchisees in different places for a monetary consideration. In the case of a contract for the carrying out of any work as is envisaged by Section 194C, there cannot be any use of a person's trade name or goodwill or knowhow by the other. The contract envisaged by the Section would be one under which one person merely renders certain services to the other person for consideration. It is no doubt true that the word "work" has been defined in a broad and inclusive manner in the Section. Nevertheless its essential feature remains the same namely that it should be a work

carried out by one person for another. The terms of the contract between the assessee and its franchisees in the case before us do not satisfy this condition. The income tax authorities have erroneously interpreted the contract as one for carrying out a work by the franchisee for the assessee. It is not a simple case of the assessee engaging certain other person to conduct the learning centres for which they were to be paid. The agreement is much more complex and reflects a business arrangement, as opposed to a simple contract for carrying out a work. The agreement provides for the supervision and control by the assessee of the manner in which the learning centres are conducted by the franchisees. The records and books of account as also the premises from which the learning centres are carried on are subject to inspection and audit by the assessee. The materials for the learning centres are to be supplied by the assessee for which separate charges are to be paid by the franchisee. It is essentially a case of the assessee permitting its goodwill/knowhow/trade name to be utilized by the franchisees.

37. In consideration of the assessee permitting the use of its trade name by the franchisees for the purpose of running the learning centres, the franchisee/licensee is obliged to pay under clause 5.6 of the agreement, recurring franchise fees to the licensor at 25% of the net revenue which means gross revenue the service tax as applicable. This is in addition to the non-refundable deposit to be made by the licensee with the assessee. The fees are to be collected by the

licensees/franchisees from the students for and on behalf of the assessee. Strict control is exercised by the assessee, in terms of clause 4.6 of the agreement, over the collection and deposit of the fees. The licensee is bound to deposit the collections received on a particular day directly into the licensor's bank account on that day itself. Any collections made after the banking hours shall be deposited at the commencement of the banking hours on the following working day for the bank. The licensee is to issue receipts on behalf of the licensor. There was some debate before us as to whether this clause would militate against the contention of the assessee that the contract is not one for carrying out any work. It appears to us that the clause has been incorporated into the agreement only as a measure of exercising control over the collections made by the licensees and it does not in any manner discredit the claim of the assessee that the contract is not one for carrying out any work. Both the parties-the assessee and the licensees-have entered into this arrangement only in their mutual interest and for mutual gains. It is a simple case of the assessee permitting the use of its trade name or reputation by the licensees for a consideration. There are several other clauses in the contract, which we have already referred to, which have been incorporated in the interest of both the parties to the contract. They ensure proper compliance of the arrangement and the mutual rights and obligations. These clauses, in our view, have been included only

to protect the interest of both the sides and to ensure smooth functioning of the business arrangement.

38. The income tax authorities, we cannot help observing, have not been able to show clearly how the contract between the assessee and the franchisees can be interpreted to be one for carrying out any work by the licensees. They have failed to appreciate that merely because some work is to be carried out by the licensees in conducting the learning centres it cannot be said that the agreement embodies a contract for carrying out a work. The inclusive definition of the word "work" given in clause (iv) of the Explanation below section 194C gives a clue to the interpretation of the word, notwithstanding that it is an inclusive definition. The clause is as under :

> "(iv) "work" shall include –
> (a) advertising;
> (b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
> (c) carriage of goods or passengers by any mode of transport other than by railways;
> (d) catering;
> (e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer, but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer."

39. A perusal of the extended definition of the word "work" shows that it covers a simple case of engaging a person to render services of the kind mentioned in the definition. Otherwise every composite transaction which also has an element of work will be covered. Clause (e) is illustrative that this is not the intention of the legislature. A case of an arrangement under which both sides have joined together by mutual arrangement and to share the profits of the joint enterprise carried on by them is not covered by the definition. They mutually undertake the profit making activity with a stipulation to divide the gains of their collective efforts. The work is undertaken jointly by them for third parties who pay consideration which is shared. Parties do not work for each other. Therefore, the mere fact that the definition of the word "work" is an extended or inclusive definition does not automatically justify the conclusion of the income tax authorities that the activities carried on by the licencees of the assessee in running learning centres amount to the carrying out of any work for the assessee in pursuance of the contract.

40. In ***Commissioner of Gift-Tax vs. N. S. Getti Chettiar***, (1971) 82 ITR 599, Hegde J. elucidated the function of an inclusive definition in the following words (at page 605): -

> "*As observed in Craies on Statute Law (sixth edition, page 213), an interpretation clause which extends the meaning of a word does not take away its ordinary meaning. An*

interpretation clause is not meant to prevent the word receiving its ordinary, popular and natural sense whenever that would be properly applicable, but to enable the word as used in the Act, when there is nothing in the context or the subject-matter to the contrary, to be applied to some things to which it would not ordinarily be applicable."

41. We are not referring in detail to the judgment of this Court in CIT Vs. NIIT Ltd. (supra) cited on behalf of the assessee because that case was concerned with the provisions of Section 194I of the Act. However, on going through the judgment we find that there are observations therein to the effect that a franchisee agreement cannot be broken up into several parts to bring it within the TDS provisions and that the dominant intention of the parties to the agreement should be respected and given effect to, as gathered from the composite agreement. It is significant to note that in that case the assessee (NIIT) was engaged in the business of providing computer education and training through its own centres and also through franchisees, who were providing NIIT courses under licenses from the assessee. The other terms of the franchisee agreement, which have been referred to in the judgment, show that as in the present case, in that case also the NIIT was to provide the relevant course material and expertise in providing computer education to the franchisees, that it was the responsibility of the franchisees to set up infrastructure facilities such as class room, equipment, furniture, administrative set up etc. and also to operate and manage the education centre on day-to-day basis etc.

In that case it was also one of the terms of the franchisee agreement that fees collected from the students by the franchisees were to be deposited in the account of the assessee and were thereafter to be shared with the franchisees in accordance with the franchisees in accordance with the franchise/license agreement. On these facts, it was held by the Division Bench of this Court that the dominant intention of the parties, gathered from a composite reading of the entire agreement as a whole, was to conduct business and share the profits. The ratio of this judgment equally applies to the facts of the present case despite the fact that a different TDS provision has been invoked by the income tax authorities in the present case.

42. For the above reasons we hold that the conclusion arrived at by the Tribunal cannot be disturbed. The Tribunal was right in law in holding that the provisions of Section 194C and section 40(a)(ia) are not applicable to the facts of the case. We accordingly, answer the substantial question of law in favour of the assessee and against the Revenue for both the years.

43. In respect of assessment year 2004-05 in ITA No.939/2010 there is another substantial question of law which has to be decided. This is in respect of the non-compete fee of ₹5,40,000/- payable by the assessee to Mr. Vijay Kalyan Jha and Mr. Sujit as revenue expenditure. The substantial question of law framed by this Court is somewhat restrictive in the sense that it appears to limit the scrutiny

by this Court of the order of the Tribunal only on two aspects (a) the period of the agreement and (b) on the mode of payment.

44. The brief facts in this connection are that the assessee paid a sum of ₹5,40,000/- during the relevant accounting year as non-compete fees to Mr. Vijay Kalyan Jha and Mr. Sujit. The stipulation was that they should not enter into a business similar to the assessee's business up to 31.12.2005. The Assessing Officer was of the view that the amount represented capital expenditure and accordingly called upon the assessee to justify the claim. It was explained by the assessee that the amount represented proportionate amount for 9 months during the relevant previous year which ended on 31.3.2004 and that it was paid under an agreement with the two persons. A copy of the agreement was also filed with the Assessing Officer. It was claimed that the non-compete fee was paid in respect of a very short period of non-competition and therefore the assessee cannot be said to have derived any enduring advantage. It was thus claimed that the payment represented revenue expenditure.

45. These submissions did not find favour with the Assessing Officer. He perused the agreement and found that Mr. Vijay Kalyan Jha and Mr. Sujit were to be paid a sum of ₹15 lakhs over a period from 1.3.2003 to 30.11.2003 and that out of the total amount, 60% amounting to ₹9 lakhs shall be paid both for services rendered by them as faculty, trainer etc. and the balance of ₹6 lakhs shall be

treated as payment of non-compete fee for their agreeing not to enter the same business as was being carried on by the assessee till 31.12.2005. He referred to several authorities and held that in the light of these authorities, the elimination or warding off of competition over some length of time resulted in an enduring advantage to the assessee and therefore the payment amounted to capital expenditure.

46. On appeal the CIT(Appeals) upheld the disallowance. In the further appeal to the Tribunal, it was contended that the payment was necessitated for the smooth running of the assessee's business and was hence revenue expenditure. The Tribunal on a perusal of the agreement entered into between the assessee on the one hand and Mr. Vijay Kalyan Jha and Mr. Sujit on the other, held that these persons had agreed not to enter the MBA Education Preparation market either individually, jointly or in association with other persons, either in the capacity of running their own business or joining any other competitor in the faculty, managerial or consulting capacity for a period of 3 years ending on 31.3.2005. The Tribunal further noticed that from 1.1.2004 to 30.12.2004 Mr. Vijay Kalyan Jha was to deliver 400 hours of classes and was required to design and develop contacts with the assessee. The payment for this was fixed at ₹3,20,000/-. Similarly, Mr. Sujit was also to be available to the assessee for taking 425 hours of classes for the period from 1.5.2004 to 30.9.2004 and also require to design and develop contacts for the assessee, for which he was to

be paid ₹2,02,500/-. These payments were to be made in monthly installments over a period of time. After noticing the provisions of the agreement the Tribunal held that the period involved, during which Mr. Vijay Kalyan Jha and Mr. Sujit were not to compete with the assessee in any manner was only a short period of 12 months and therefore there could be no enduring benefit enuring to the assessee. In this view of the matter, the Tribunal directed the Assessing Officer to allow the payment as revenue expenditure.

47. It may be seen from the above that the Tribunal gave two primary reasons for allowing the expenditure as revenue expenditure. First, that the period for which the assessee sought to eliminate competition from Mr. Vijay Kalyan Jha and Mr. Sujit was only 12 months which was too short a period to be considered as conferring an enduring benefit to the assessee. Second, the Tribunal relied on the fact that the non-compete fee was to be paid to the above persons in equal installments over a period of time. In the case of Mr. Vijay Kalyan Jha, the payment of ₹3,20,000/- was to paid in 10 equal monthly installments of ₹32,000/- each from 1.3.2004 to 1.12.2004. In the case of Mr. Sujit, the payment was ₹2,02,500/- which was to be paidin 5 equal monthly installments of ₹42,500/- each from 1.6.2004 to 1.10.2004.

48. These reasons given by the Tribunal, though may appear to be too brief, are however germane to the conclusion that there was no

enduring advantage received by the assessee by making the payment of non-compete fees. It is necessary to keep the nature of the assessee's business in mind before judging the allowability by the payment. The assessee is engaged in the business of running learning centres for preparing/coaching students to face competitive examinations held by IIM, IIT, Institute of Information Technology etc. In conducting the classes for the students, the assessee has to rely on faculty members of repute. Mr. Vijay Kalyan Jha and Mr. Sujit were such faculty members, who were engaged by the assessee. It is also necessary for the assessee to ensure that the faculty members do not compete with its business because that would affect the business. It cannot be disputed that the popularity and success of the learning centres run by the assessee is in a large measure due to the efficiency, knowledge and reputation of the faculty members. If the faculty members leave the assessee and decide to set up their own learning centres, that is most certain to affect the assessee's business. It was therefore, in the interest of the assessee's business that it ensured that for some period of time, such faculty members do not compete with it in the same business. It is with this end in view that the assessee made the payment to Mr. Vijay Kalyan Jha and Mr. Sujit. The period for which these persons could not compete with the assessee has been found by the Tribunal to be a short period of 12 months. This is not an irrelevant consideration taken into account by the Tribunal. The fact that the payment was made in monthly installments is not decisive

of the question; even if it had been made in a lump sum that would have made little difference to the conclusion, having regard to the short period of 12 months during which the above two persons were prohibited from competing with the assessee's business. In our opinion, it cannot be disputed any more that payment to ward off competition for a limited period should be held to be revenue expenditure and not capital expenditure. If that is so, the fact that the payment was made in a lump sum or in installments hardly matters. We are therefore, satisfied that in coming to the conclusion that the payment of ₹5,40,000/- was a revenue expenditure, the Tribunal has not ignored any relevant material or taken into account irrelevant material. The Tribunal was certainly entitled to take note of the entire conspectus of the facts of the case and in particular the period during which the faculty members were prohibited from competing with the assessee's business. In this view of the matter we answer the substantial question of law framed vide order dated 20.9.2010 in the affirmative, in favour of the assessee and against the revenue.

49. In the result, the first three substantial questions of law in ITA No.911/2011 answered in favour of the assessee and against the Revenue and the forth substantial question of law is answered against the assessee and in favour of the Revenue.

50. In ITA No.926/2011 both the substantial questions of law are answered in favour of the assessee and against the Revenue. In ITA

No.939/2010 question No.1 is answered in favour of the assessee and against the Revenue and question No.2 is answered in favour of the Revenue and against the assessee. The appeals are disposed of as above. There will be no order as to costs.

R.V.EASWAR, J

SANJIV KHANNA, J

APRIL 19, 2012
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