IN THE INCOME TAX APPELLATE TRIBUNAL
"C'' BENCH: BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER

ITA No.3242/Bang/2018
Assessment Year : 2009-10

LMG Brands India Pvt. Ltd. 5th Floor, 77 Town Centre Building No.3, West Wing, Off HAL Airport Road, Yemalur, Bengaluru 560 037. **PAN NO : AAECM2693J**	**Vs.**	ACIT Circle-11(5) Bengaluru
APPELLANT		**RESPONDENT**

ITA No.3293/Bang/2018
Assessment Year : 2009-10

Deputy Commissioner of Income-tax Circle-4(1)(1) Bangalore	**Vs.**	LMG Brands India Pvt. Ltd. 5th Floor, 77 Town Centre Building No.3, West Wing, Off HAL Airport Road, Yemalur, Bengaluru 560 037.
APPELLANT		**RESPONDENT**

C.O. No.9/Bang/2019 (Arising out of ITA No.3293/Bang/2018)
Assessment Year : 2009-10

LMG Brands India Pvt. Ltd. 5th Floor, 77 Town Centre Building No.3, West Wing, Off HAL Airport Road, Yemalur, Bengaluru 560 037.	**Vs.**	Deputy Commissioner of Income-tax Circle-4(1)(1) Bangalore
APPELLANT		**RESPONDENT**

Appellant by	**:**	Shri Sharath Rao, A.R.
Respondent by	**:**	Shri Pradeep Kumar, D.R.

Date of Hearing	**:**	14.06.2021
Date of Pronouncement	**:**	25.06.2021

O R D E R

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

The cross appeals filed by both the parties and the cross objection filed by the assessee are directed against the order dated 24.9.2018 passed by Ld. CIT(A)-4 Bengaluru and they relate to the assessment year 2009-10.

2. The assessee is in appeal before us on the following issues:-

a) Disallowance of claim of shortage of inventory.

b) Disallowance of expenditure relating to exceptional items.

3. The revenue is in appeal before us challenging the deletion of disallowance of franchisee fees. The assessee has also filed cross objection supporting the order passed by Ld. CIT(A) in granting relief to the assessee in respect of franchisee fee.

4. The assessee is a private limited company and is engaged in the business of selling readymade garments and accessories on retail basis through its show rooms. The A.O. completed the assessment of the year under consideration by making disallowance of three claims, referred above. The ld. CIT(A) granted relief in respect of addition relating to franchisee fees and confirmed the additions related to other two items. Hence, both the parties are in appeal before us on the issue decided against each of them by Ld. CIT(A).

5. We shall take up the appeal filed by the revenue first. The only issue urged by the revenue relates to the deletion of disallowance of franchisee fee. The assessee claimed a sum of Rs.2,50,42,421/- under the head "Franchisee fees". The assessee submitted that it is dealing with garments of various brand and accordingly obtained exclusive franchisee rights from them. It was submitted that the franchisee fees is paid as a percentage of sales turnover of the relevant branded merchandise sold by the assessee, as per the relevant agreement entered with them. It was also submitted that these brand holders have not transferred any business or commercial rights with enduring benefits to the assessee. Accordingly, it was submitted that the expenses claimed by the assessee is revenue in nature and deductible. The A.O did not agree with the contentions of the assessee and accordingly disallowed the above said amount.

6. The Ld. CIT(A) observed that the franchisers have not transferred any rights in the trade market or any other I.P. to the assessee. Further, he noticed that the assessee has neither obtained any new asset nor acquired any right, which are freely transferable. He also noticed that the usage of brand rights by the assessee is restricted to the period of agreement and for the purpose of sale of franchiser's product. He also noticed that the franchisee fee is not one time payment but a recurring fee directly related to the sales effected by the assessee. Accordingly, the Ld. CIT(A) held that the decision rendered by Hon'ble Delhi High Court in the case of CIT Vs. Jubilant Woodwork Pvt. Ltd shall apply, wherein it was held that when no new asset comes into existence on account of payment of franchisee fee and further where the rights under the agreement are only for the tenure of the agreement, then no enduring benefit would be derived by the assessee Following the above said decision

rendered by Hon'ble Delhi High Court, the Ld. CIT(A) deleted the disallowance.

7. We heard the parties on this issue. The ld. A.R. submitted that an identical issue was considered by the coordinate bench in the assessee's own case for the assessment year 2008-09 (In ITA No.3291/Bang/2018 and the Tribunal allowed the claim of the assessee vide its order dated 20.9.2020).

8. `We notice that an identical issue has been examined by the coordinate bench in the assessee's own case and the claim of the assessee was allowed with the following observations:-

"We have heard the rival contentions, perused and carefully considered the material on record. In this case, the assessee entered into various Agreements with various parties as discussed earlier which is the payment of franchisee fees as follows :

1.	*Bossini Garment Limited*	*5% of Gross Sales*
2.	*Josef Seibel Asia Pacific Limited*	*Euro 2 per pair of footwear sold*
3.	*Vincciladies Specilities Centre Sdn Bhd*	*2% of Net Sales*
4.	*Basic Properties BV (Kappa)*	*5% of Net retail turnover or 10% of net wholesale turnover.*

The above payments based on certain percentage of sales by the assessee. The parties with whom the assessee has entered into Agreement has not transferred any business or commercial rights with enduring benefits to the assessee. The assessee cannot be said to have any enduring benefit by entering into these agreements. These are in the nature of day to day operations of the assessee's business. Being so, the CIT(Appeals) justified in allowing the expenditure as revenue expenditure. This position is fortified with the decision in the case of Jonas Woodhead & Sons Ltd. Vs.CIT 224 ITR 342 wherein it has been held that -

" The Courts have applied different tests like starting of a new business on the basis of technical know-how received from the foreign firm, exclusive right of the company to use the patent or trademark which it receives from the foreign firm, the payments made by the company to the foreign firm whether a definite one or dependent upon certain contingencies, right to use the technical know-how of

production or the activity even after the completion of the agreement, obtaining enduring benefit for a considerable part on account of the technical information received from a foreign firm, payment whether made "once for all" or in different instalments co-relatable to the percentage of gross turnover of the product to ultimately find out whether the expenditure or payment thus made makes an accretion to the capital asset and after the Court comes to the conclusion that it does so then it has to be held to be a capital expenditure. No single definitive criterion by itself could be determinative and, therefore, bearing in mind the changing economic realities of business and the varieties of situational diversities the various clauses of the agreement are to be examined. The Tribunal having considered the different clauses of the agreement and having come to the conclusion that under the agreement with the foreign firm what was set up by the assessee was a new business and the foreign firm had not only furnished information and the technical know-how but rendered valuable services in setting up of the factory itself and even after the expiry of the agreement there is no embargo on the assessee to continue to manufacture the product in question, it is difficult to hold that the entire payment made is a revenue expenditure merely because the payment is required to be made on a certain percentage of the rates of the gross turnover of the products of the income as royalty. In the facts and circumstances of the case the High Court was fully justified in answering the question whether the Tribunal was right in holding that 25% of the amount paid by the assessee as royalty was capital expenditure in favour of the Revenue and against the assessee. —Jonas Woodhead & Sons (India) Ltd. vs. CIT (1979) 10 CTR (Mad) (FB) 150 • (1979) 117 ITR 55 (Mad) (FB) : TC 16R.1270 ***affirmed."***

6.Further the co-ordinate bench of this Tribunal in the case of DCIT Vs. TTK Health Care Limited, the Hon'ble Bench of Chennai in ITA 1921/Mad/2016 Dt.8.9.2016 held in para 5 that when the assessee has not become ownership rights of trade mark and the such licenses are remained the property of the licensee, the assessee has not derived any enduring benefit. Therefore expenses are to be treated as revenue expenditure, not capital expenditure. The Id. AR relied on the decision In the case of TTK LIG Ltd. Vs. ACIT in ITA Nos.1791 to 1796/Mad/2011 Dt.31.10.2012. Further the Hon'ble Madras High Court in the case of CIT Vs. TVS Ltd 110 ITR 338 (Madras) held that when the payment made by the assessee to a company was in the nature of license fees which constitute an item of allowable expenditure in the computation of profit and gains and it cannot be a capital expenditure. In our opinion, the findings and reasons given by the CIT(Appeals) to allow the claim of the expenses in regard to franchisee on the Agreement entered by the assessee is a revenue expenditure and it cannot be construed as a capital expenditure. Hence the appeal of revenue is dismissed."

9. We notice that the view expressed by Ld CIT(A) is consistent with the view taken by the coordinate bench in AT 2008-09.

Accordingly, we do not find any infirmity in the decision rendered by Ld. CIT(A) on this issue.

10. In the cross objection, the assessee is supporting the decision rendered by Ld. CIT(A) on this issue. Since we have upheld the view taken by Ld. CIT(A) on this issue, the cross objection filed by the assessee shall become infructuous.

11. We shall now take up the appeal filed by the assessee. The first issue relates to disallowance of Rs.1,15,83,476/- relating to claim of shortage of inventory. The assessee explained before the A.O. that the shortage of inventory has been found when the physical inventory of apparels & accessories was verified by the auditors with the book stock in various show rooms/warehouses located all over India. It was noticed that there was shortage of inventory in many items and there was excess inventory in some of the items. The net value of shortage/excess of inventory was quantified at Rs.1,15,83,476/-. It was explained before the AO that the assessee is in the retail trade and the shortage usually occur on account of shop lifting, pilferage in merchandise during transit, theft of inventories, internal damages caused to the box etc. It was explained that the above said amount represented cumulative figure of shortages noticed in various stores/warehouses. The assessee also submitted that it is a normal feature in the retail trade and rate of losses due to shop lifting, pilferage, theft by employees, etc. have been estimated at 3% of total sales. In support of the same, the assessee furnished a report printed by India today and also by Rediff.com.

12. The A.O., however, took the view that the amount of Rs.1,15,83,476/- is huge amount and the assessee has failed to provide the exact details of inventory of shortages. Further, the

assessee has not filed any FIR for theft or shop lifting. The A.O. also did not accept the newspaper report furnished by the assessee. Accordingly, he disallowed the claim of shortage in inventory of Rs.1,15,83,476/-.

13. In the appellate proceedings, the Ld. CIT(A), in principle, accepted the observations of the A.O. However, he also accepted the fact that the retail business is prone to issues of shop lifting, pilferage, damages, etc. He noticed the shortage of inventory claimed by the assessee worked out to 1.97% of the total sales effected during the year. Accordingly, he took the view that the disallowance of entire claim is unreasonable. Accordingly, the Ld. CIT(A) directed the A.O. to restrict the disallowance to 50% of the amount of loss claimed by the assessee.

14. Before us, the ld. A.R. submitted that the assessee is engaged in retail trading of garments and it has got showrooms/warehouses all over India. As part of audit exercise, it is usual practice to take physical inventory of stocks of various items and compare the same with book stocks. The inventory taking work was carried out by auditors of the assessee company in all the retail showrooms as well as in the warehouses. The net amount of shortage noticed by any showrooms was Rs.56.37 lakhs and the net amount of shortage noticed in the warehouses was Rs.56.46 lakhs, both aggregating to Rs.115.83 lakhs. The Ld. A.R. submitted that the entire report of the shortages store-wise, apparel-wise, accessories-wise have been furnished to the A.O. and the same is placed from page nos.307 to 765 of the paper book. Accordingly, he submitted that the A.O. was not correct in mentioning that the assessee has not furnished the details. The Ld. A.R. invited our attention to the above said pages to buttress his point that stock taking has been done meticulously and

the shortages/excess stock has been noticed in respect of each item of apparel/accessories.

15. We also notice from the report that there are shortages as well as excess stocks and the net amount of difference resulted in shortage of stock, which was valued at Rs.115.83 lakhs. We notice from the report that the physical inventory has been taken in all stores and warehouses and the difference between physical stock and book stock has been noticed meticulously in respect of each item of apparel and the accessory. Thus, it is not a single case of theft, as presumed by the AO, which may warrant filing of FIR. The shortage noticed is as low as Rs.68/-. The Ld CIT(A) has also appreciated that the retail trade is prone to such pilferages, shoplifting etc., resulting in such kind of shortages of stock. Hence, on the facts and circumstances of the case, we are of the view that there is no reason to suspect the claim of the assessee. Accordingly, we are of the view that there is no reason to restrict the disallowance to 50% as done by Ld. CIT(A). In our view, in the facts and circumstances of the case and also considering the detailed report of shortages of stock, the entire claim of the assessee should have been allowed as deduction. Accordingly, we set aside the order passed by Ld. CIT(A) and direct the A.O. to delete the disallowance relating to shortage of inventory.

16. The next issue relates to disallowance of expenditure on exceptional items amounting to Rs.86,97,395/-. The A.O. noticed that the assessee has debited the profit & loss account with expenditure on exceptional items of Rs.7,31,75,961/-. Out of the above amount, the assessee had voluntarily disallowed an amount of Rs.6,44,78,566/-. With regard to the remaining amount of Rs.86,97,395/- the assessee did not furnish the details before the A.O. Hence, the AO disallowed the remaining amount of

Rs.86,97,395/- claimed by the assessee. Before Ld. CIT(A), the assessee furnished explanations with regard to the claim of above said claim. However, the Ld. CIT(A) refused to admit the explanations on the reasoning that the assessee failed to furnish details before A.O. and further observed that no reasonable cause was shown under rule 46A in order to admit the explanations of the assessee. With regard to the explanations furnished by the assessee also, the Ld. CIT(A) drew adverse inference and accordingly confirmed the disallowance.

17. Before us, the ld. A.R. submitted that the assessee has collated the details relating to the above claim and major portion of the above said claim amounting to Rs.74.31 lakhs related to forfeiture of rent deposits on cancellation of lease during lock-in period. He submitted that this disallowance should also be deleted, since details are available.

18. However, we notice that the assessee has not furnished explanation/details before the A.O. and the ld. CIT(A) has also not admitted the explanations furnished by the assessee, meaning thereby, no tax authority has examined the details relating to the claim. Hence, in the interest of natural justice, we are of the view that the assessee should be provided with one more opportunity to properly explain its case. Accordingly, we set aside the order passed by ld. CIT(A) on this issue and restore the same to the file of the A.O. for examining it afresh by duly considering the information and explanations that may be furnished by the assessee. After affording adequate opportunity of being heard, the A.O. may take appropriate decision in accordance with law.

19. In the result, the appeal filed by the assessee is treated as allowed. The appeal of the revenue and cross objection of the assessee are dismissed.

Order pronounced in the open court on 25th June, 2021.

Sd/-	**Sd/-**
(N.V. Vasudevan)	**(B.R. Baskaran)**
Vice President	**Accountant Member**

Bangalore,
Dated 25th June, 2021.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.