IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I', NEW DELHI

BEFORE SHRI SAKTIJIT DEY, VICE-PRESIDENT
AND
SHRI M. BALAGANESH, ACCOUNTANT MEMBER

ITA No. 7937/Del/2018
Assessment Year: 2014-15

Jubilant Foodworks Ltd., Plot No. 1A, Sector-16A, Noida. **PAN: AABCD1821C** (Appellant)	Versus	DCIT, Circle-1, Noida. (Respondent)

Assessee by	:	Sh. Ajay Vohra, Sr. Advocate Sh. K.M. Gupta, Advocate Sh. Shruti Khimta, A.R.
Revenue by	:	Sh. Rajesh Kumar, CIT-DR

Date of hearing : 11.07.2023
Date of pronouncement: 06.10.2023

ORDER

Captioned appeal by the assessee arises out of the final assessment order dated 10.10.2018 passed under section 143(3)/92CA(3)/144C(5) of the Income-tax Act, 1961 pertaining to assessment year 2014-15, in pursuance to directions of learned Dispute Resolution Panel (DRP).

2. In addition to main grounds, vide letter dated 16.09.2021, the assessee has raised an additional ground, being ground No. 9, on the issue of claim of deduction of education cess and secondary and higher education cess. However, at the time of hearing, Shri Ajay Vohra, learned Sr. Counsel appearing for the assessee, on instructions, did not press the additional ground. Accordingly, the additional ground is dismissed.

3. Reverting back to the main grounds, ground No. 1 is a general ground, hence, does not require adjudication.

4. In ground No. 2, the assessee has challenged addition of Rs.26,15,651/- made on account of transfer pricing adjustment on franchise fee paid by the assessee.

5. Briefly, the facts relating to this issue are, the assessee is a resident corporate entity and stated to be engaged in the business of manufacturing and sale of Pizza and other food items through retail outlets taken on lease across the country. The assessee had entered into a franchise agreements with Dominos Pizza Overseas Franchising BV/Dominos Pizza International Franchising Inc, under

which, the assessee was granted exclusive right to develop and operate Dominos Pizza delivery stores in India, Nepal, Sri Lanka and Bangladesh using Dominos systems and marks. In exchange of such exclusive right granted under the agreement, the assessee pays franchise fee of 3% of net sales of its stores in India and store opening fee of US Dollar 5000 per store.

6. The assessee has entered into another agreement with Dunkin Donuts Franchising LLC, wherein, the assessee has been granted the right to develop and operate Dunkin Stores in India using the name 'Dunkin Donuts'. For grant of such right, the assessee pays franchise fee of 3.5% of net sales of its stores in India and store opening fee of USD 4500 per store.

7. In terms with such agreements, in assessment year under dispute, the assessee paid franchise fee @3% of net sales to Dominos Pizza and @ 3.5% to Dunkin Donuts. The assessee benchmarked the payment of franchise fee to the aforesaid entities by adopting Comparable Uncontrolled Price (CUP) method as the most appropriate method and in the transfer pricing study report claimed the transaction relating to franchise fee to be at arm's length.

On a reference made by the Assessing Officer, the Transfer Pricing Officer (TPO) proceeded to examine the arm's length nature of the aforesaid transactions. While doing so, the TPO rejected assessee's benchmarking and concluded that the franchise fee paid at 3% and 3.5% are not at arm's length. Accordingly, he reduced the rate of franchise fee to 1.5% in respect of both the transactions and proposed an adjustment of Rs.32,18,49,836/-. The adjustment so proposed was added to the income of the assessee while framing draft assessment order. Against the draft assessment order, the assessee raised objections before learned DRP. While considering the objections of the assessee, learned DRP observed that the payment of franchise fee/royalty @ 3% of net sales to Domino's Pizza can be considered to be at arm's length, as two other comparables having similar business in Indian territory are paying royalty @ 4%. However, in so far as payment of franchise fee/royalty to Dunkin Donuts is concerned, learned DRP scaled it down to 3% by stating that the usage name of the brand and its operation in India is similar to Dominos Pizza. Hence, the same rate can be adopted. As a

result of directions of learned DRP, the adjustment was scaled down to Rs.26,15,651/-.

8. Pertinently, there is one more issue related to the aforesaid adjustment. Before TPO and learned DRP, the assessee had challenged the adjustment on a preliminary issue that the transfer pricing provisions are not attracted, as the disputed transactions are with parties who do not qualify as Associated Enterprises (AEs) in terms of section 92A of the Act. However, both the TPO and learned DRP rejected the aforesaid contention of the assessee. In terms with the directions of learned DRP, assessment order was finalized.

9. Before us, learned Sr. Counsel appearing for the assessee, reiterated the stand taken before the departmental authorities that in terms of section 92A of the Act, the assessee had no AE relationship with Dominos Pizza and Dunkin Donuts. It was submitted that at the time of entering into the franchise agreements, both the entities were unrelated parties, hence, cannot be considered to be AEs of the assessee. Drawing our attention to section 92A of the Act, learned Sr. Counsel submitted that the conditions enshrined in sub-sections (1) and (2) have to be cumulatively satisfied. He submitted, neither the

overseas entities participate directly or indirectly in the management, control or capital of the assessee nor there are any persons or intermediaries who participate directly or indirectly in the management, or control or capital of both the assessee and other two entities. He submitted, since, the conditions of sub-section (1) are not fulfilled, neither Dominos Pizza nor Dunkin Donut can be considered as AEs of the assessee. Thus, he submitted, in absence of any AE relationship, transfer pricing provisions are not applicable. He submitted, in case of one of the entities, i.e., Dominos Pizza, the Tribunal after taking note of the franchise agreement has held that the assessee cannot be treated as PE of Dominos Pizza. He further relied upon a decision of Hon'ble Karnataka High Court in case of PCIT vs. Page Industries Ltd. (ITA No. 285 of 2017). He submitted, merely because the assessee has treated Dominos Pizza and Dunkin Donuts as AEs in the transfer pricing study report, it cannot be prevented in raising the issue relating to existence or otherwise of AE relationship. In support, he relied upon the decision of ITAT, Special Bench in case of DCIT vs. Quark Systems Ltd. (2010) 4 ITR (T) 606. Thus, he submitted, there being no AE relationship between the

assessee and the concerned entities at the time of entering into franchise agreements, the transfer pricing provisions would not apply.

10. Without prejudice, learned Sr. Counsel submitted that the decision of learned DRP to determine arm's length rate of franchise fee paid to Dunkin Donuts @ 3% is without any rational basis, as it was done in a purely adhoc manner without following any approved method. He submitted, the assessee has benchmarked the payment of franchise fee to Dunkin Donuts by applying CUP method and has selected independent comparables having similar transactions, who have paid royalty/franchise fee at higher rates of 4%, 5% and 7%. Thus, assessee's comparability analysis has substantial basis as against adhocism adopted by the TPO and learned DRP. Finally, he submitted, in assessee's own case for assessment year 2012-13 and 2013-14, the first appellate authority has accepted payment of franchise fee/royalty to Dunkin Donuts and the Revenue has not preferred any appeal.

11. Learned Departmental Representative submitted that since, the assessee itself has treated Dominos Pizza and Dunkin Donuts as its AEs and reported the transactions in the TP study report, now the

assessee cannot turn back and claim no AE relationship with these two entities. He submitted, since assessee's business is wholly dependent on two foreign entities and they have management control over the assessee, conditions of section 92A(1) are satisfied. Proceeding further, he submitted, since the assessee is engaged in the manufacture and processing of goods, which is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences etc. of the two entities, the conditions of section 92A(2) are also satisfied. Therefore, the aforesaid two entities have to be considered as AEs.

12. On merits of the issue, learned Departmental Representative submitted, since the roles and responsibilities under both the agreements with Dominos Pizza and Dunkin Donuts are similar, the rate of franchise fee/royalty should also be similar. Therefore, since the assessee had paid franchise fee/royalty @ 3% to Dominos Pizza, the same rate should also be applied to the transactions with Dunkin Donuts.

13. We have considered rival submissions in the light of decisions relied upon and perused materials on record. At the outset, we deem

it appropriate to address the issue on merits. Thereafter, if deemed necessary, we will touch upon the issue relating to existence or otherwise of AE relationship between the assessee on the one side and Dominos Pizza and Dunkin Donuts on the other.

14. As far as merits of the issue is concerned, we have already discussed the facts in detail in the earlier part of the order. However, to reiterate briefly, the assessee has entered into two franchise agreements with Dominos Pizza and Dunkin Donuts for using brand names, trademarks etc. For availing such rights, the assessee pays franchise fee/royalty @ 3% of net sales to Dominos Pizza and 3.5% of net sales to Dunkin Donuts. Though, the Assessing Officer determined the ALP of franchise fee/royalty paid to both the entities at 1.5%, however, learned DRP reversed the decision of the TPO and determined the ALP of franchise fee/royalty at 3% of net sales in respect of both Dominos Pizza and Dunkin Donuts. Meaning thereby, the dispute with regard to ALP of franchise fee/royalty payment to Dominos Pizza stands resolved. Whereas, the issue survives in respect of franchise fee/royalty paid to Dunkin Donuts, as in place of 3.5% of net sales paid by the assessee, learned DRP has reduced it

to 3% of net sales. The reason ascribed by learned DRP while doing so is, since the agreements with Dominos Pizza and Dunkin Donuts are similar and the transactions are of similar nature, there should be parity in payment of franchise fee/royalty as well.

15. As can be seen from the observations of the TPO, though, he has stated that the determination of arm's length price (ALP) of franchise fee/royalty at 1.5% is by applying CUP method, however, such claim remains unsubstantiated, as no details or basis for arriving at such a CUP has been provided by the TPO. Identical is also the case with learned DRP determining the ALP of franchise fee/royalty at 3%. Neither of the departmental authorities has provided any basis how they have arrived at the CUP of 1.5% or 3% respectively. On the contrary, on a perusal of the TP study report of the assessee, it is very much clear that the assessee has undertaken an analysis under CUP method and brought valid comparables including a comparable dealing in donuts, paying royalty at 4% of net sales. Both the TPO and learned DRP have determined the ALP of franchise fee/royalty paid to Dunkin Donuts on a purely adhoc basis without bringing on record any comparability analysis under CUP. Merely because the

assessee has paid franchise fee/royalty at 3% to Dominos Pizza, cannot be the singular reason to determine ALP of franchise fee/royalty paid to Dunkin Donuts, as there are various factors, which differentiate the rate of franchise fee/royalty between Dominos Pizza and Dunkin Donuts - one of the crucial factors being while Dominos Pizza entered into agreement in 2009, the agreement with Dunkin Donuts was entered in 2011. Thus, by the time, the agreement with Dunkin Donuts was entered, Dominos Pizza had already established itself as a brand name in India. It is further relevant to observe, in assessee's own case in assessment years 2012-13 and 2013-14, the franchise fee/royalty paid at identical rates have been accepted by the first appellate authority. Learned Sr. Counsel appearing for the assessee has made a statement at Bar that the orders passed by the first appellate authority have attained finality, as the Revenue has not preferred any further appeals.

16. Be that as it may, on analysis of entire facts and materials available on record, we are of the considered opinion that the assessee has clearly established the arm's length nature of franchise fee/royalty paid to Dunkin Donuts at 3.5% of the net sales under CUP

method. Whereas, there is absolutely no basis provided either by TPO or learned DRP while reducing the rate of franchise fee/royalty to 1.5% and 3% respectively. In view of the aforesaid, we direct the Assessing Officer to delete the addition of Rs.26,15,651/-.

17. In view of our decision on merits, we refrain from delving into the issue whether Dominos Pizza and Dunkin Donuts have AE relationship with the assessee, as in the present appeal it will be a purely academic exercise. However, the issue is kept open. This ground is partly allowed.

18. In ground No. 3, the assessee has challenged the disallowance of Employee Stock Option Plan (ESOP) expenses amounting to Rs.16,36,94,868/-.

19. Briefly, the facts are, the assessee had implemented two ESOP Schemes during the year under consideration. In the return of income filed for the assessment year under dispute, though, the assessee did not claim any deduction on account of ESOP expenditure, however, in course of assessment proceedings, the assessee claimed the deduction on account of ESOP expenditure, since the employees

exercised their option. The Assessing Officer disallowed assessee's claim of deduction firstly, on the ground that it is not an admissible expenditure and secondly, the assessee had not claimed it in the return of income. In this context, the Assessing Officer relied upon the decision of Hon'ble Supreme Court in the case of Goetz India Ltd. vs. CIT (2006) 284 ITR 323 (SC). Against the aforesaid decision of the Assessing Officer, the assessee raised objections before learned DRP. However, learned DRP upheld the decision of the Assessing Officer.

20. Before us, learned counsel appearing for the assessee submitted that though in the return of income the assessee had not claimed the deduction on account of ESOP expenditure, however, in course of assessment proceedings, the assessee did make the claim of deduction and furnished all requisite details relating to ESOP expenses. He submitted, without examining the issue on merits, assessee's claim has been rejected merely because it was not made in the return of income. He submitted, the issue is no more *res integra*, as the admissibility of the expenditure has been decided in favour of the assessee by the decision of the ITAT Special Bench, in

case of Biocon Ltd. vs. DCIT (LTU) 35 taxmann.com 335(SB). He submitted, following the aforesaid decision of the Special Bench, in assessee's own case in assessment years 2012-13 and 2013-14, the Tribunal has held that the deduction claimed on account of ESOP expenditure is admissible. However, since the issue was raised for the first time before the Tribunal, it was restored back to the Assessing Officer for factual verification. He submitted, since in the impugned assessment year, the assessee had made the claim before the departmental authorities and furnished all relevant details, the deduction claimed has to be allowed.

21. Learned Departmental Representative relied upon the observations of the Assessing Officer and learned DRP.

22. We have considered rival submissions in the light of decisions relied upon and perused materials on record. Undisputedly, in the return of income filed for the impugned assessment year, the assessee did not claim deduction on account of ESOP expenses. However, in course of assessment proceedings, the assessee claimed the deduction. The Assessing Officer has disallowed the deduction on two grounds, firstly, it is inadmissible expenditure and

secondly, it was not claimed in the return of income. In our view, neither of the reasonings of the Assessing Officer are acceptable. Though ESOP expenses were used to be treated as capital expenditure earlier, however, in case of Biocon Ltd. (supra), Special Bench of the Tribunal has held that it is an admissible expenditure. Following the aforesaid decision of learned Special Bench, the coordinate Bench in assessee's own case for the assessment year 2012-13 and 2013-14 has accepted assessee's claim that ESOP expenses are allowable. However, since the issue was raised for the first time before the Tribunal, the claim of the assessee was restored back to the Assessing Officer for factual verification. In the facts of the present appeal also, though learned Sr. Counsel appearing for the assessee has submitted before us that all relevant and necessary details relating to ESOP expenses have already been furnished before the Assessing Officer and learned DRP, therefore, assessee's claim can be allowed at this stage, however, we find that neither the Assessing Officer nor learned DRP have examined assessee's claim factually with reference to the documentary evidences brought on record by the assessee, as, they have simply rejected assessee's

claim primarily on the ground that the claim was not made in the return of income.

23. Though, in principle, we hold that the assessee is entitled to claim deduction of ESOP expenses under section 37(1) of the Act, however, assessee's claim has to be factually verified not only with reference to the ratio laid down in the decision rendered by Special Bench of Tribunal in the case of Biocon Ltd. (supra), but various other details such as date of vesting of stock, exercise of option by the concerned employees etc., which are crucial factors to determine the issue. Accordingly, we direct the Assessing Officer to allow assessee's claim of deduction, subject to factual verification. This ground is allowed.

24. In ground No. 4, the assessee has challenged disallowance of lease hold improvement expenditure of Rs.50,09,22,082/-.

25. Briefly, the facts are, in the return of income filed for the impugned assessment year, the assessee had claimed deduction of Rs.58,93,20,096/- on account of lease hold improvement expenditure. In course of assessment proceedings, the Assessing

Officer called upon the assessee to justify the claim. In response, the assessee furnished a detailed reply supporting its claim. After examining the submissions of the assessee and the details furnished, the Assessing Officer was of the view that entire expenditure claimed by the assessee is of capital nature, hence, cannot be allowed as deduction. While disallowing the claim of the assessee, he allowed depreciation @ 15%. In other words, he allowed deduction for an amount of Rs.8,93,98,014/- and disallowed balance amount of Rs.50,09,22,082/-. The assessee contested the aforesaid disallowance before learned DRP. After examining the issue in the context of facts and materials on record, learned DRP held that out of total expenditure of Rs.58,93,20,096/- claimed in the return of income, Rs.31,57,81,593/- are to be treated as Revenue expenditure and the balance amount may be treated as capital expenditure and depreciation to be allowed thereon. However, while framing the final assessment order, the Assessing Officer without implementing the direction of learned DRP, again disallowed the amount of Rs.50,09,22,082/- as was done in the draft assessment order.

26. Before us, learned counsel for the assessee submitted that the issue is squarely covered by the decision of the Tribunal in assessee's own case in assessment year 2012-13 and 2013-14.

27. Learned Departmental Representative relied upon the observations of learned DRP.

28. We have considered rival submissions and perused materials on record. At the outset, we must observe, though out of the total expenditure claimed of Rs.58,93,20,096/-, the Assessing Officer had disallowed an amount of Rs.50,09,22,082/-, however, while disposing of the objections of the assessee, learned DRP has granted substantial relief by allowing deduction of Rs.31,57,81,593/- as revenue expenditure. Though, in the final assessment order, the Assessing Officer had failed to implement the directions of learned DRP by reducing the disallowance, however, subsequently, the Assessing Officer has passed rectification order implementing the directions of learned DRP. Thus, the disallowance stands reduced to Rs.27,35,38,503/-, on which depreciation has been allowed.

29. Before we proceed to decide the issue, it is necessary to deal with the expenditure claimed by the assessee. As discussed earlier in the order, the assessee is engaged in the business of manufacturing and sale of Pizza, Donuts and other food items from its retail outlets across the country. To run its business operations smoothly, the assessee takes rental spaces on operating lease in various cities. After taking on lease such rented spaces, the assessee has to provide specific ambience and outlook as per guidelines and yardstick fixed by the franchise and as regulated under the franchise agreement. Therefore, the assessee has to incur these expenses in relation to the retail outlets-whether existing or newly operated. Out of the total expenses incurred during the year amounting to Rs.80,57,47,488/-, the assessee itself has capitalized an amount of Rs.21,64,27,392/- and the balance amount of Rs.58,93,20,096/- was claimed as revenue expenditure. Though, the Assessing Officer has disallowed the entire amount, however, learned DRP has granted partial relief by reducing the disallowance to Rs.27,35,38,503/-. The expenses considered to be capital in nature by learned DRP are expenses on civil work, wood work, aluminium work, false ceiling

work, mild steel work, electrical work, sanitary fixtures, CI soil, waste water and vent pipes and fittings, external sewage etc. On detailed analysis of nature of expenditure, it is observed that these expenses are not of enduring nature so as to treat them as capital expenditure. The civil work are such as thick plaster on walls, cement concrete flooring providing vitrified ceramic tiles on walls, tiles on floors, polishing etc. Wood work includes door frames, lamination work, fixing ply etc. Aluminium work includes fixing aluminium sections, aluminium door shutters, aluminium door frame, fixing of toughened glass door shutter etc. False ceiling work includes application of POP, gypsum board false ceiling etc. Thus, on overall consideration of facts and materials available on record, it is evident that these expenses cannot be termed as capital expenditure, as they do not give any enduring benefit to the assessee. In fact, identical nature of expenditure incurred by the assessee towards lease hold improvement have been allowed by learned first appellate authority in assessment year 2012-13 and 2013-14 and the decision of learned first appellate authority has been confirmed by the coordinate Bench while deciding Revenue's appeals in ITA No. 6558/Del/2018 and

612/Del/2019 in order dated 08.12.2021. Due to parity of facts between the assessment years 2012-13 and 2013-14 and the impugned assessment year, we are inclined to allow assessee's claim of deduction in its entirety. Therefore, we direct the Assessing Officer to delete the disallowance sustained by learned DRP. This ground is allowed.

30. Ground No. 5, being premature at this stage and ground No.8, being a general ground, are dismissed.

31. In the result, appeal is partly allowed.

Order pronounced in the open court on 06/10/2023.

Sd/-	Sd/-
(M. BALAGANESH)	**(SAKTIJIT DEY)**
ACCOUNTANT MEMBER	**VICE-PRESIDENT**

Dated: 06.10.2023
*aks/-

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Assistant Registrar
ITAT New Delhi