Form No. J(2)

IN THE HIGH COURT AT CALCUTTA

Special Jurisdiction [Income Tax]
ORIGINAL SIDE

ITAT No.18 of 2017
With
GA No.181 of 2017

PRINCIPAL COMMISSIONER OF INCOME TAX-4, KOLKATA
Versus
SHALIMAR CHEMICAL WORKS LTD.

BEFORE:
The Hon'ble JUSTICE ANIRUDDHA BOSE
AND
The Hon'ble JUSTICE MOUSHUMI BHATTACHARYA

Heard on : 08.06.2018 & 11.06.2018.
Judgement on : 12.06.2018.

For the Appellant : MR.ANIMESH KANTI GHOSAL, SR ADVOCATE,
MR.SOUMITRA MUKHERJEE **ADVOCATE.**

For the Respondent : MR.SOMNATH BANERJEE, **ADVOCATE,**
MS.SWAPNA DAS, ADVOCATE.

Aniruddha Bose,J.: In the assessment order out of which this appeal arises, the Assessing Officer had disallowed deductions claimed by the assessee as expenses in respect of three heads and it is this dispute which forms subject of controversy in this appeal. The first head related to selling expenses of a sum of Rs.4,19,23,214/- whereas the second was sales promotional expenses of Rs.88,85,919/-. The other head was in respect of packaging material purchases for a sum of Rs.4,04,12,991/-. The assessee is involved in the business of manufacture of coconut oil, spices, mustard oil and other grocery items and these deductions were claimed by it for the assessment year 2008-09.

2. The assessing officer found that the assessee had failed to establish the genuineness of the transactions on the basis of which deduction was claimed for selling expenses and sales promotional expenses. It was also the view of the assessing officer that in any event, since there was no tax deduction at source in respect of these expenses, the entire sum was to be added to income of the assessee and taxed as such. On the question of deduction claimed for purchase of packaging materials, the assessing officer declined to accept the assessee's contention that there was outright sale of such materials. The assessing officer proceeded on the basis that the packaging materials were obtained through an arrangement which constituted works contracts and payment thereof required tax deduction at source under Section 194C of the Income Tax Act, 1961. On that provision not being adhered to, again the entire expenditure was disallowed under Section 40(a)(ia) of the Act.

3. The assessing officer had referred to certain features of the arrangement through which the packaging materials were being supplied and came to the conclusion that it was not a principal to principal transaction simpliciter but there was close involvement of the assessee in

execution of the contract which transformed the nature and character of such transactions into works contract. The assessee went up in appeal against this assessment order and was successful before the Commissioner of Income Tax (Appeals), being the First Appellate Authority. So far as treating the claim of the assessee that there was outright purchase of the packaging materials, the First Appellate Authority held:-

"I have considered the submission of the appellant and perused the assessment order. On perusal of profit and loss account for the year under consideration it is observed that the appellant company has debited sum of Rs.4,04,12,991/- under the head "packing material purchase". The A.O. has disallowed the aforesaid sum by invoking provisions of Sec.40(a)(ia) because he was of the opinion that the appellant company was required to deduct tax u/s.194C of the Act. He made the aforesaid opinion for the reason that the packing material purchased by the appellant company was as per the specifications given by him to its suppliers. The packing material supplied by the suppliers as per the specifications given by the appellant company could only be used by the appellant company and in case of any excess etc., the suppliers cannot sell the material to any other customer. In case of any defect in the material with reference to the specifications provided by the appellant company, the suppliers have to destroy such defective printing material having no value at all. In view of these facts, the A.O. was of

the opinion that the purchases made by the appellant company from its suppliers of packing material tantamount to work contracts and not contract for sale. Hence, on the payments made for purchase of packing material, the appellant company was required to deduct the tax u/s.194C of the Act. On the other hand, it was argued by the appellant company that the provisions of section 194C are not applicable on purchase of packing material because there was no work contract and it has simply asked to its suppliers to supply the packing material of specific sizes and specific printing thereon. The appellant company has purchased the packing material from these suppliers on which the Excise Duty and VAT was paid by the Company. The packing material was not supplied by the appellant company but it was purchased by the suppliers and they manufactured the material as per the appellant's specification which was purchased by the appellant company. Hence, it was contract for sale and not contract for work. The appellant company has not given any job work to the suppliers of the packing material and the right of ownership of the packing material was only transferred to the appellant company, once, it was purchased by him from the suppliers. Under the circumstances, there was no obligation under the law to deduct the tax u/s.194C of the Act and consequently there is no application of provisions of section 40(a)(ia)." (quoted verbatim)

4. The Tribunal confirmed this finding of the First Appellate Authority, holding, inter alia:-

> *"After careful consideration and examination of the submissions made by both the parties. The Ld.AR of the assessee has submitted two paper books running into pages from 1 to 415 and 1 to 355 respectively. We find that as per the AO, the assessee has violated the provisions of section 40(a)(ia) viz a viz section 194C of the Act as there exist a works contract for the Job work. However the assessee claims that there is contract for sale hence the question of TDS does not arise. In the case the assessee has submitted sample bills to AO at the time of assessment proceedings and the AO, on careful scrutiny of the bills, finds that there exist a work contract so held the transactions a "work" as described in explanation III to section 194C of the Act. accordingly. However, the sub-clause (iv) of the Explanation to Section 194C of the Act reads 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 materials 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.

So the definition as defined by the Act clearly shows that the present transaction does not fall in the category of the work because here the material was not supplied by the assessee for the printing of packaging materials. In several cases the different tribunals and court has held the such transactions as contract for sale and out of the preview of section 194C of the Act."

5. The Tribunal, in its decision referred to several decisions on this point delivered by the Income Tax Appellate Tribunals of different jurisdictions and held:-

"So from the aforesaid judicial pronouncement, it is clear that a work does not include where supply of a product according to requirements or specification of a customer by using materials purchased from a person other than the customers. Hence, the provision of Sec.194C does not attract to the present case. The case cited by the Ld.DR is not applicable as it was decided in the context of the provisions of Bombay Sales Tax Act 1959 and it has no nexus with the

provisions of section 194C of the Act and consequently there was no application of provisions of section 40(a)(ia) of the Act. Hence, this ground of Revenue's appeal is dismissed." (quoted verbatim).

6. The next issue relates to two sets of transactions on which the assessee has been held liable to tax, over which assessee wanted deduction. The assessing officer had disallowed the deduction claimed towards sales promotional expenses of Rs.88,85,919/- and selling expenses of Rs.4,19,23,214/-The assessee's contention was that these expenses were in the nature of incentives to promote sale by the distributors. The assessing officer questioned genuineness or existence of the recipients of the said sums. It was also the view of the Assessing Officer that even if the recipients were there, the entire sum in respect of which deduction was claimed ought to have been added back to the income of the assessee for failure to deduct tax at source in terms of Section 194H of the Act. The assessing officer wanted to treat such expenses as commission or brokerage in the alternative. The First Appellate Authority rejected the finding of the assessing officer that the recipients were not genuine, holding that there was no record or material before the assessing officer to come to such a finding. One of the reasons for which the assessing officer had concluded that the recipients were not genuine was that the addresses of the distributors

who were beneficiaries of the incentives were not given and particulars of the incentive scheme was also not disclosed

In course of hearing before us, learned counsel for the assessee has taken us through the assessment order, as annexed to the stay petition. There is an attachment to the assessment order at page 24 of the stay petition. The attached page carries the heading "NOTE. NOT FOR THE ASSESSEE" and records :-

> *"Notices u/s.133(6) issued to verify the transactions undergone by the assessee during the F.Y. 2007-08 relevant to the A.Y.2008-09. In some cases reply in response to the aforesaid Notices are yet to be received. Since the current proceeding is getting barred by limitation on 31.12.2010, the order is passed without reply being considered in response to Notices u/s.133(6). If any discrepancy noted in future, appropriate action would be taken as per I.T.Act."*

Through this note, learned Counsel for the assessee sought to establish that addresses of the distributors were available as otherwise, such notices could not be sent.

7. The First Appellate Authority opined on this issue:-

> *"….The details of handling and distribution charges, the incentive charges and the sales promotion expenses were furnished before the A.O. and in fact, in the very beginning of the assessment order, the A.O. himself as mentioned that A.R. of the assessee*

appeared from time to time, produced various details and documents as per requisition along with books of accounts viz. cash book, ledger, bank book, bills and vouchers relating to expense which are examined by him. The A.O. did not pointed out any defect or discrepancy in the details and documents filed before him and also did not find any defect in the books of account and bills and vouchers produced before him for examination. In spite of that the A.O. has made several remarks in the assessment order. It is observed from the assessment order that the additions on account of selling expenses and the sales promotion expenses has been made even without issuing a show cause notice and allowing an opportunity to the appellant company of rebuttal because the assessment order is silent on this aspect of allowing of an opportunity to the appellant company. On careful consideration of the facts and totality of the circumstances I am of the opinion that there is no reason or material on record to doubt the genuineness of the payment of incentive, its business expediency or its incurring of wholly and exclusively for the purpose of business. There is also no material on records to treat the transactions as collusive, manufactured, manipulative and fictitious in nature as held by the A.O. I am also of the opinion that there is no material on record to hold that the money have been fraudulently withdrawn by the appellant company. Though, the A.O. has quoted a number of *judicial pronouncements but none of them supports the view the A.O. on the facts and circumstances of the case." (quoted verbatim)*

8. Turning to the second limb of Revenue's stand in respect of the same heads that the payments made ought to have been subjected to tax deduction at source as per the provisions of Section 194(H) of the Act, the Commissioner found :-

"As mentioned above, in the assessment order the A.O. has taken an alternate plea that aforesaid expenses aggregating to Rs.5,08,09,133/- are disallowable u/s.40(a) (ia) of the Act because the assessee has failed to deduct the tax u/s.194H of the Act. On perusal of details of selling expenses amounting to Rs.4,19,23,214/- it is observed that it consists of target incentives of Rs.2,81,21,535/- and handling and distribution chares of Rs.1,38,01,679/-. The sales promotion expenses of Rs.88,85,919/- consists of purchase of items from various parties for the purpose of distribution to its clients and customers in order to boost the sales of the appellant company. Hence, in any case the provision of section 194H are not applicable on handling and distribution charges as well as the sales promotion expenses. The only question remains as to whether the target incentives amounting to Rs.2,81,21,535/- can be termed as commission or brokerage within the meaning of provisions of section 194H of the Act. As per the trade practice and in order to boost the sales, the

appellant company has come out with and declared various schemes during the year according to which if a dealer or distributor who purchases the goods from the appellant company is able to achieve the sales targets, such dealer and distributors will be entitled for certain percentage of incentives. Such incentives are given to the dealers and distributors by issuing credit notes which are adjusted against the subsequent purchases by the dealers and distributors. The dealers and distributors of the appellant company make the purchases against the payment and the sales bills are issued by the appellant company. Once, the goods are sold by the appellant company to the dealers and distributors, the right of ownership of such goods is transferred to the buyer and after that such buyer is free to deal with goods in the manner he likes. The appellant company do not have any right or control over the goods sold to the dealers and distributors and all the stocks belongs to the buyers. The unsold stock is not taken back by the appellant company from the dealers. The appellant company has paid the target incentives to the dealers only for the reason that the sale of appellant company may increase. The target incentive is never paid in cash and the credit notes issued in lieu of incentives cannot be redeemed in cash. They have to be adjusted against the subsequent purchases. Hence, in view of above facts, it cannot be said that *there was relationship of principal and agent between the appellate company and the distributors. In facts, the transactions were between seller and buyer and on principal to principal basis. The provisions of section 194H are applicable in the cases where the transactions are on principal to agent basis. For example, in the case of Delhi Milk Scheme Vs. CIT reported in 301 ITR 373 (Del.) it was held by the Hon'ble Delhi High Court that the concessionaries, were only agents and TDS is to be deducted on payment made to them u/s. 194H in the light of the fact that milk booth belonged to the assessee who did not charge any rent from the concessionaries, unsold milk was taken back and the concessionaries were prohibited from selling any other produce, or any other brand. Sales collections were made by clerk of the assessee on daily basis with the concessionaries being paid a reward as commission for their services. Thus, in the case of Delhi Milk Scheme (Supra), the payees of the reward were only facilitating the assessee to sell the milk on its behalf and the ownership of milk was not transferred to the concessionaries and the unsold milk was taken back by the assessee. Under these circumstances, it was held by the Hon'ble court that the concessionaries were rendering services to the assessee and payment of reward to them was in the nature of commission which was liable for deduction of tax u/s.194H of the Act.*

However, as mentioned above, the facts in the case of appellant company are totally different because it has made sales of its products to the dealers and distributors and the right of ownership of goods transferred from appellant to the distributors." (quoted verbatim)

9. Upon distinguishing the various authorities which were referred to by the Revenue, the First Appellate Authority held :-

> *"In view of facts of the case, as discussed above, and the principles laid down in various judicial pronouncements (Supra) it is to be held that there was no relationship of principal and agent between the appellant company and its dealers and distributors to whom target incentives were paid by him. The only relationship between the appellant and the dealers and distributors was of seller and buyer and all the transactions took place in the capacity of principal to principal and hence the payment of target incentives made by the appellant company through credit notes cannot be termed as 'commission or brokerage' as stipulated in sec 194H of the Act. It is to be held that the appellant company was not liable to deduct the tax on target incentives, handling and distribution charges and sales promotion expenses*

> *u/s. 194H and consequently, there was no application of provisions of section 40(a)(ia) of the Act and hence the A.O. was not justified in making the disallowance aggregating of Rs.5,08,09,133/- on account of target incentives, handling and distribution charges and sales promotion. The disallowance so made is directed to be deleted. The ground nos.1 & 2 are allowed."*

10. The Tribunal accepted the findings of the First Appellate Authority on the counts we have referred to in the preceding paragraphs. The Tribunal has analysed the provision of Section 194C and has given a specific finding that the said provision was not attracted in the subject case. So far as the assessee's claims for deduction in respect of packaging material expenses, sales promotional expenses as well as selling expenses, the Tribunal accepted the findings of the First Appellate Authority. Before the Tribunal, it was urged on behalf of the Revenue that the distributors to whom incentives were paid could not be sent notices under Section 133(6) as the assessee had not provided complete address. This submission was made in support of Revenue's stand that the recipients thereof were not genuine. But in the appendage to the assessment order, to which we have referred to earlier, there is specific reference to such notices being sent. The Tribunal further found that there was no violation of Section 194H of the Act as the transactions involved were all purchases and sales. There was no actual transaction

between the parties for the target incentives and only credit notes were provided to the distributors who had achieved the target which they could redeem at the time of subsequent purchases.

11. We affirm the decision of the Tribunal that such transactions were outside the purview of the TDS provisions. We accept the reasoning given by the First Appellate Authority and the Tribunal, which was based on factual analysis of the transactions. We do not find any perversity in such analysis and the findings based on such analysis which could persuade us to engage in re-appreciation of facts at this stage. We, accordingly, find that there is no question of law involved in this appeal and we dismiss the appeal. The stay petition also stands dismissed.

12. There shall be no order as to costs.

(ANIRUDDHA BOSE, J.)

(MOUSHUMI BHATTACHARYA, J.)

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