

TAX FLASH NEWS

Discount/incentive given by a distributor to dealers and retailers for postpaid and prepaid connections is commission and is subject to withholding of tax

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Jai Shreee Enterprises¹ (the taxpayer) held that discount/incentive given by a distributor to dealers or retailers for postpaid as well as prepaid connections is commission. Therefore, such commission is subject to withholding of tax under Section 194H of the Income-tax Act, 1961 (the Act).

Facts of the case

- The taxpayer, a registered partnership firm was deriving income from the trading of SIM cards of prepaid connections and sale of recharge coupons of a telecom company.
- The taxpayer used to give discounts/scheme and incentives to wholesalers and retailers as per directions of the telecom company and the said disbursed discount/incentives were claimed by the taxpayer from the telecom company.
- The Assessing Officer (AO) observed that the taxpayer had debited discount/incentives of INR1.58 million in its Profit and Loss account out of the commission amounting to INR1.61 million received during the year.

- The AO held that the commission paid by the taxpayer to dealers and retailers was liable for withholding of tax. The expenses claimed on account of disbursement of discount/incentives of INR1.58 million were against the commission and were not allowable on account of non-deduction of tax. Accordingly, the claim of INR1.58 was disallowed by the AO and the same was added to the income of the taxpayer.
- The Commissioner of Income-tax (Appeals) [CIT(A)] observed that the telecom company deducted tax under Section 194H of the Act on the payments of INR1.61 million as the payments are in the nature of brokerage or commission paid to the taxpayer.
- The CIT(A) held that the incentives paid by the taxpayer to dealers and retailers is in the nature of commission and liable for withholding of tax under Section 194H of the Act. The CIT(A), however, segregated the payments below INR2,500 and above INR2,500 and held that in respect of aggregate of payments above INR2,500, provisions of Section 194H are applicable and the taxpayer was under legal obligation to deduct tax on such payments made.

Tribunal's ruling

- The Tribunal observed that the AO had made additions since the commission given by the telecom company to the taxpayer is not against the discount or incentives, but service rendered by the taxpayer under the scheme.

¹ ITO v. Jai Shreee Enterprises (ITA No. 4479/Del/2011) – Taxsutra.com

- The question whether the taxpayer is dealing with postpaid or prepaid is immaterial. In both postpaid and prepaid connections, the taxpayer or the distributor has to deduct tax at source as per the decision of the Delhi High Court in the case of the Idea Cellular².
- The Tribunal endorsed the finding of the CIT(A) to the extent that that the payment made by the taxpayer to its sub-distributors constituted commission and tax had to be deducted at source on such payment. The Tribunal further observed that the telecom company deducted tax under Section 194H of the Act, on the payment of INR1.61 million as the payments are in the nature of brokerage or commission paid to the taxpayer.
- The Tribunal held that the taxpayer in its submission has admitted the fact that payment to the extent of INR1.58 million were in the nature of commission, which were passed on to dealers and retailers. The CIT(A) has correctly observed that incentives are in the nature of 'commissions' which was passed on to dealers/retailers. Accordingly, it has been held that this amount of discount/incentive alone attracts provision of TDS under Section 194H of the Act.
- The CIT(A) had given relief to the taxpayer of INR0.9 million, because the discounts/incentives/ commission disbursed was less than INR2,500 and directed an addition of INR0.3 million because the discounts and incentives to the dealers were more than INR2,500. However, since an opportunity to the AO was not given before providing the aforesaid relief, the matter was remanded back to the AO to examine and verify whether the commission/ discount/incentive given by the taxpayer to its dealers are correct.

Similarly, an issue with respect to withholding of tax on commission paid by telecom companies to distributors, has also been a subject matter of debate before the Courts.

The Calcutta High Court in the case of Bharti Cellular Ltd⁴ held that the discount given by the telecom company at the time of sale of SIM cards or recharge coupons to the distributors is commission for the services rendered to the taxpayer. Therefore, the telecom company was subject to withholding of tax on the commission under Section 194H of the Act.

However, the Karnataka High Court in the case of Bharti Airtel Ltd.⁵ held that SIM cards and prepaid recharge coupons sold by a telecom operator to distributors at a discounted Maximum Retail Price was not in the nature of commission or brokerage since sale of a SIM card by a service provider to a distributor involves sale of right to services. Further, the relationship between a taxpayer and a distributor would be that of principal and principal and not principal and agent. Therefore, the telecom operator was not liable to withhold any tax at source.

In this decision, the Delhi Tribunal relied on the decision of the Delhi High Court in the case of Idea Cellular where it was held that amount of discount offered by the telecom company to its distributors was in the nature of commission subject to withholding of tax under Section 194H of the Act.

Our comments

The Delhi Tribunal in the instant case has held that discount/incentive given by a distributor to dealers or retailers for postpaid as well as prepaid connections is commission, and subject to withholding of tax under Section 194H of the Act.

The Chandigarh Tribunal in the case of Smart Distributors³ held that since the payment made to the dealers by the taxpayer was on account of service rendered in the course of selling and activation of SIMs, it was in the nature of commission or brokerage liable for withholding of tax under Section 194H of the Act.

² CIT v. Idea Cellular [2010] 325 ITR 148 (Del)

³ ITO v. Smart Distributors [2014] 62 SOT 13 (Chandigarh)

⁴ Bharti Cellular Ltd. v. ACIT [2011] 244 CTR 185 (Cal)

⁵ Bharti Airtel Ltd. v. DCIT [2015] 372 ITR 33 (Kar)

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