



Tax Flash News

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In the absence of a principal-agent relationship, the discount offered by the telecom company to its SIM card distributor is not 'commission' for the purposes of tax deduction at source

The Supreme Court in the case of *Bharti Cellular Limited*¹ held that there is no principal-agent relationship between the telecom company and its distributor. Discount offered by the telecom company on its SIM² cards or recharge coupons to the distributors is not a commission for the purposes of tax deduction at source. Further, the distributor receives income from the customer and not from the telecom company.

Facts of the case

- The taxpayer was a mobile telephone service provider (telecom company).
- It offered post-paid and prepaid mobile connections to the end-users/ customers. This case was related to the business operations under the prepaid model where the customers were required to pay for the services in advance.
- The telecom company sells the start-up kit containing the SIM card, recharge vouchers, and top-up cards, at a discount on the printed price ('discounted price') to the distributor.
- The distributor pays the discounted price in advance regardless of, and even before, the prepaid products being sold and transferred to the retailers or the actual customer.
- The distributor was free to sell the prepaid products at any price ('sale price') below the price printed on the pack.
- The difference between 'sale price' and 'discounted price' was the distributor's profits.

- The right, title, or interest in the prepaid products were not passed on to the distributor. However, the distributor was solely responsible and liable for the safety and storage of prepaid products. The telecom company was not liable for any loss, pilferage or damage to the kits.
- The issue before the Supreme Court was whether the telecom company was liable to deduct tax at source under section 194H of the Income-tax Act, 1961 (the Act) on the difference between 'sale price' and 'discounted price'.
- The Supreme Court analysed whether (a) the relationship between the telecom company and the distributor is that of a principal and an agent (b) whether there was any direct or indirect payment of commission by the telecom company to the distributor.
- The Revenue argued that the relationship between the telecom company and the distributor was like a principal and an agent, and the difference between 'discounted price' and 'sale price' was commission or brokerage.
- The Revenue referred to the expression 'payment received or receivable directly or indirectly by a person acting on behalf of the other person' in section 194H and argued that even if the distributor receives payment in the form of income from the customer, the telecom company will be required to deduct tax at source under section 194H. The Revenue relied on the Supreme Court's decision in *Singapore Airlines Limited*³.

¹ *Bharti Cellular Limited v. ACIT* (Civil Appeal No. 7257 of 2011) – Source: Taxsutra.com

Note: Various appeals were filed in this appeal before the Supreme Court

² Subscriber Identification Mobile card

³ *Singapore Airlines Limited v. CIT* [2022] 449 ITR 203 (SC)

Supreme Court decision

Principal-agent relationship

- Section 182 of the Indian Contract Act, 1872 determines whether or not the relationship between the parties is that of a principal and an agent.
- There are four essential tests to establish a principal-agent relationship: (a) an agent has the legal power to alter his principal's legal relationship with a third party, (b) the principal exercises a certain degree of control over the conduct of the agent, (c) the task entrusted by the principal to the agent should result in a fiduciary relationship (d) the agent should be liable to render its accounts to the principal.
- The following are the characteristics of an independent contractor:
 - An independent contractor intends to make the maximum profits possible (and is not restricted to receive prearranged remuneration).
 - The money received from the end-customers belongs to the independent contractor and forms part of such independent contractor's property in the event of his bankruptcy or liquidation.
 - An independent contractor is not required to render accounts of the business, as it belongs to him and not his employer.
 - The independent contractor is free from control on the part of his employer and is only subject to the terms of his contract.
- A franchisee is a kind of distributor whose operations are closely regulated. Yet, the relationship may in a given case be that of an independent contractor. They are not liable to the manufacturer in the way an agent might be for failure of duty, nor do their contracts with other parties. Their contractual or tortious liability is different from the manufacturer's liability on account of warranty.
- In the instant case, the contractual obligations of the distributor do not reflect a fiduciary character of the relationship, or the business being done on the account of the telecom company.
- The title in the kit could not be transferred to the distributor as this was mandated by the licence issued to the telecom company by the Department of Telecommunication. The right to use the SIM card and its possession is handed over to the end-user.

Credit or payment of the income

- The obligation to deduct tax at source is fixed by the statute itself, that is, on the date of actual payment by any mode, or at the time when income is credited to the account of the distributor, whichever is earlier.
- The income of the distributor, being the difference between the sale price and the discounted price, was paid or credited to the account of the distributor when it sold the prepaid product to the customer. Thus, the sale price, and accordingly the income, is determined by the distributor and the customer.
- Accordingly, the telecom company does not, at any stage, either pay or credit the income by way of commission or brokerage to the distributor on which tax at source is to be deducted.

Payment received or receivable directly or indirectly by a person acting on behalf of other person

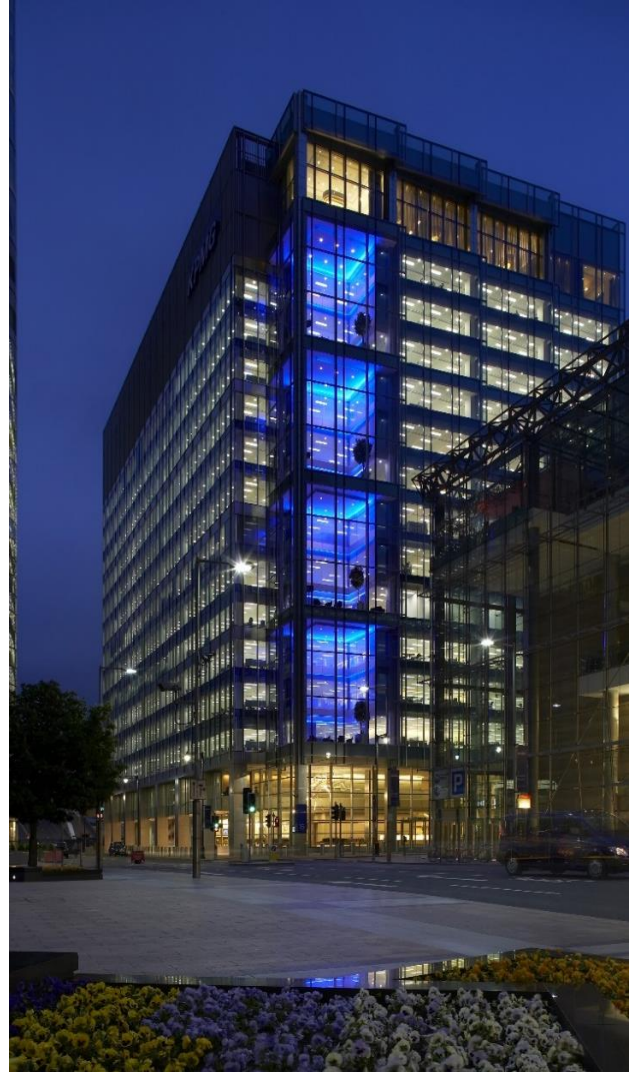
- The expression 'direct or indirect' used in section 194H is no doubt meant to ensure that 'the person responsible for paying' does not dodge the obligation to deduct tax at source, even when the payment is indirectly made by the principal payer to the agent payee.
- However, the deduction of tax at source in terms of section 194H is not to be extended to apply to business transactions, where the telecom company is not the person responsible for paying or crediting income.
- The word 'indirectly' does not create an obligation where the main tax deduction provision does not apply.
- In the present case, the telecom company neither paid nor credited any income to the distributor.
- The telecom company was not privy to the transactions between the distributor and the customer. It was impossible for the telecom company to deduct tax at source under section 194H on the difference between the 'sale price' and the 'discounted price'.
- Reliance by the Revenue on the decision in the case of *Singapore Airlines Limited* was distinguished by the Supreme Court as the question as to whether there was a relationship of a principal and an agent was not in dispute in that case as the airline was already deducting the tax on the standard commission. The dispute was on the airline's liability to deduct tax at source on the supplementary commission, which was the difference between the actual fare charged by the agent and the net fare charged by the airline and the data for which was supplied to the airline and hence it was feasible for the airline to deduct taxes basis such information.

- The argument of the Revenue that the telecom company should periodically ask for this information/data and thereupon deduct tax at source was rejected as far-fetched, imposing unfair obligation and causing inconvenience to the telecom company and was beyond the statutory mandate.
- The distributor was not the trustee who was to account for the payment to the telecom company as the principal. The payment received was the gross income earned by the distributor because of its efforts and work, and not a remuneration paid by the telecom company.

In view of the above discussion, the Supreme Court held that the telecom company was not under a legal obligation to deduct tax at source under section 194H.

Our comments

The telecom companies after a long-drawn litigation have finally got relief from the Supreme Court from the tax deduction requirement on discount given to their distributors. The judgment by the Supreme Court would also help other service providers operating in similar models to evaluate their tax deduction responsibility vis-à-vis discounts given to their distributors.



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