CONNECTION

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Section 194H - Commission v/s Discount

1. Introduction:

The main motive of company or a business concern behind offering discounts to dealers on purchase price is to multiply its sales by manifolds. Hence the discount which seems to be opportunity cost for company selling the goods becomes bonanza for the dealers purchasing more quantity of the said goods. Moving ahead if we talk about the commission which is also the customary feature of some specific industries like Newspaper, Stamp Vendor, Distribution, Telecom, Airline, FMCG etc. It is evident from the nature of these industries that the existence and smooth functioning of their business cannot be even anticipated without commission to dealers. The very purpose again to give such commission is to induce dealers to sell more and more quantity of goods or provide services on behalf of company.

When company gives such commission to dealers or agents, then such transactions attracts section 194H of Income-tax Act, 1961 but on other hand when discounts are given to dealers, then company claim deduction. Now the issue before us is to understand how a discount turns into commission or vice-versa depending upon different circumstances? In most of the litigations the points which boggle the mind of tax authorities and assessees are as follows:

- Whether Discount can be considered as commission in case of sec 194H?

- Whether the Withholding tax implications arise on payment to dealers?

- Whether the additional discount/incentive linked with business volumes given by companies through credit notes would attract implications of sec 194H?

- What is the relationship between Company and its dealers?

It is imperative to note that to make the provisions of section 194H applicable which governs the payment of commission, some requisites need to be complied with. These requisites are the essence of section 194H and accordingly explained in detail in the following points:

2. Person receiving commission not discount for rendering services:

As per the words 'commission' and 'discount' are defined and explained asunder:

Commission: The recompense, compensation or reward of an agent, salesman, executor, trustee, receiver, factor, broker, or bailee, when the same is calculated as a percentage on the amount of his transactions or on or the profit to the principal. A fee paid to an agent or employee for transacting a piece of business or performing a service. Compensation to an administrator or other fiduciary for the faithful discharge of his duties.

Discount: In general sense, an allowance or deduction made from a gross sum on any account whatever. In a more limited and technical sense, the taking of interest in advance.

Based on the above stated meanings and the general understanding of these terms, it can be said that commission is a compensation given for services rendered by an agent in fiduciary relationship. On the other hand, a discount is only an allowance for a prompt payment.

2.2 Distinguish between commission and discount as per Legal pronouncement and judgments.

'The expression "commission" has no technical meaning but both in legal and commercial acceptance of the term it has definite significance and is understood as an allowance for service or labour in discharging certain duties such as for instance of an agent, factor, broker or any other person who manages the affairs or undertake to do some work or render some service to another.

Mostly it is a percentage on price or value of upon the amount of money involved in a transaction. It can be for a variety of services and is of the nature of recompense or reward for such services.

"**Rebate**", on the other hand, is a remission or a payment back and of the nature of a deduction from the gross amount. It is sometimes spoken of as a discount or a drawback. The dictionary meaning of the term includes a refund to the purchaser of a thing or commodity of a portion of the price paid by him. It is not confined to a transaction of sale and includes any deduction or discount from a stipulated payment, charge or rate. The repayment need not be immediate. It can be made later and in case of persons who have continuous dealings with one another it is nothing unusual to do so.'

"The guiding factor to decide whether the amount is commission or discount depends on transfer of ownership"

2.3 Meaning of commission or brokerage as per section 194H of Income-tax Act, 1961

194H. Commission or Brokerage

Any person who is not individual or HUF and who is responsible for paying any income by way of commission or brokerage to a resident shall, at the time of credit of such income, deduct income-tax thereon at the rate of ten percent.

The following points may be noted in this regard that the provisions of Section 194H are applicable on commission or brokerage earned in relation to services rendered by a person acting on behalf of another person. Thus, the payment received or receivable, directly or indirectly, must be by a person, acting on behalf of another person:

for services rendered on behalf of another person (not being professional services), or

for any services in the course of buying or selling of goods.

3. There should be a principal/agent relationship between the two parties:

The most important question which arises on detailed analysis is how to distinguish between 'principal to principal' and 'Principal to agent relationship'?

To determine P2P relationship we need to rely on following factors:

3.1 Status of contract between parties (i.e. contract for sale or contract for agency)

3.2 Independent status of the Dealer

3.1 Legal precedent defining the difference between 'Contract for Sale' and 'Agency'

_ Bhopal Sugar Industries Ltd V. STO [1977] 40 STC 147, In the decision of the Hon'ble Supreme Court it is held that there is a distinction between a contract of sale and a contract of agency, by contract of agency, agent is authorized to sell or buy on behalf of the principal.

The essence of a contract of sale is the transfer of title of goods for a price paid or promised to be paid. The transferee in such a case is liable to the transferor as a debtor for the price to be paid and not as agent for the proceeds of the sale.

The essence of agency to sell is the delivery of the goods to a person who is to sell them, not as his own property but as the property of the principal who continues to be the owner of the goods and will therefore be liable to account for the sale proceeds.

3.2 Independent status of the Dealer

It is important to note that in a 'Principal to Principal' relationship, the status of the Dealer is independent i.e. the Dealer is able to take all commercial decisions relating to his business but on other hand in 'Principal to agent' relationship an agent always works on the instructions and set of rules and regulations laid down by his principal.

The Hon'ble Supreme Court of India, in case of Bhopal Sugar Industries Ltd vs. sales tax officer 40 STC 42, has observed that in a principal to principal relationship, the dealer bears all the losses (e.g. leakage, evaporation etc). In a principal to agent relationship, the dealer has an indefeasible right to be reimbursed / indemnified by the principal for the losses.

4. The payments should have been given in lieu of services rendered:

The last issue before us is to adjudge that payments should have been given in lieu of services rendered. If payments are not made on account of services rendered or person giving the commission has not received any services then the provisions of section 194H cannot be made applicable. This view was taken by D.C.I.T. V/s. ShriSurendra Mohan Mukhija (ITA no.4552/Del/2011). In this case it was held that the assessee gave discounts to the purchasers of flats on account of pre-launch booking to attract the potential customers in the market. Such discounts cannot be treated as distribution of commission income as assessee do not received any services in lieu of such commission. Hence on this basis, the entire disallowance of expenses cannot be done under section 40(a)(ia) on account of discounts given to purchasers and the provisions of these sections are not attracted here.

5. Issues:

After getting collective understanding of the meanings of different terms as per various sources and case-laws refereed above, now we can dispose-off those hiccups and problems which come while identifying discount income.

5.1 Discount

Business concern offers discounts to dealers on dealers purchase price and it is often offered to those dealers who are out rightly purchasing the goods from that business entity, such payment would merely represent a discount or rebate given on purchase price. When the dealer is purchasing goods on outright basis and ownership has been transferred, then question of commission do not arises. On contrary, if goods

are sold on principal to agent basis and the entire ownership is still with the principal then such discount given may be considered as commission.

In nutshell, the guiding factor which actually decides that whether commission has been given or discount is the transfer of ownership.

Such a view was taken in two cases i.e. in Ahmedabad Stamp vendors Association vs. Union of India (Gujarat HIGH COURT) and Assistant Commissioner of Income tax vs. M/s. Idea Cellular Ltd. (ITAT Hyderabad)

5.2 Cash Discount:

As a business/industry practice a cash discount is given to persons who make an advance/prompt payment of cash (consideration) for the goods purchased. Such discount is, therefore, given only to those dealers who purchase the goods from a business concern for further sale on their own and makes the advance payments or the make payments within stipulated period of time agreed upon earlier.

In such case, since this discount is paid on an outright sale of products, the discount cannot be held as a commission and hence there is no requirement of withholding tax on such payment. This view was taken by Fosters India (P.) ltd. (ITAT – PUNE)

5.3 Distributor Incentives:

Where it is quite evident from the agreement that the goods are sold to dealers on principal to principal basis and an entity provides various incentives linked with business volumes in a month/ quarter/ half year/ year to the dealers, then there is no need of withholding tax on such incentives. It is so because these incentives and schemes are offered to dealers who are out rightly purchasing the goods from that entity. Such view was taken in National Panasonic India (P.) Ltd. v. Deputy Commissioner of Income-tax (ITAT – DELHI)

5.4 When payment for fixed space is made through credit note.

Let us assume a business concern has tied up for the defined space in an outlet of a trade partner for display its products. For such space it will issue Credit Note or make payments for monthly fixed amount for this space tie up. Commercially it will not be viable for any dealer to take the space on rent and bear the amount of this rent from the amount earned through sale of products of that business concern, therefore it make practically impossible for an entity to find any dealer for its products if they themselves don't bear the rent amount. So, in order to compensate the dealer for their rent cost an entity may pay them the rent

"Commission is a compensation to an administrator for faithful discharge of his duties, whereas discount is an allowance for prompt payment"

amount either through credit note or by making payments in installments.

Thus such payments or reimbursements do not constitute rendering of any services by dealer in the course of selling goods. Therefore, there may not be any withholding on such sums.

6. Conclusion:

According to various legal precedence's, and distinguishes of different terms which comes on top of surface, it is clear that the transaction, in issue, would fall within the provisions of Section 194H only if there is:

A principle-agent relationship between the Company and Dealer;

The payments made by Company to the Dealer, who is a resident is an income by way of commission;

The income by way of commission should be paid by Company to the Dealer for services rendered by the Dealer or for any services in the course of buying or selling of goods;

The income by way of commission may be received or be receivable by the Dealer from the Company either directly or indirectly; and

The obligation to deduct tax at source arise only at the point when income by way of commission is credited to account of the dealer or when such payment is made by way of cash, cheque or draft or by any other mode, whichever is earlier.

FDI in Multi Brand Retail

After passing of 51% FDI in multi- brand retail in Lok Sabha, many big foreign players in retail sector have got the entry to extend their business operations in one of the world's largest consumption driven economy. The big Indian players can give the competition to foreign players because of its brand value, availability of funds to expand their business or they can be a partner with them, but will have major impact on those who are operating their small business for their living.

Although the Government has imposed condition that it is mandatory for the foreign players to have 30% local sourcing from small retailers but there is no clarity that how it will work. Also it will not be beneficial for all the SME's because of the existence of massive number of retailers in unorganized sector.

So they have to work from now to avoid the harmful impact which can have on their standard of living. Some little efforts can be made like

1) They can do survey around their business area to know about consumer's preference of daily usage products & accordingly stores them, so that they will always be in a position to satisfy their customer's demand.

2) Be aware of the new products launched in the market & keep the availability of some of its sample/product, so that they will not loose the new customer's of that product.

3) Should start home delivery services, subject to quantity ordered, so as to maintain better relationship with their customers.

4) As per the financial viability of business, they can give small gifts on purchasing of larger quantity of items & can also have yearly lucky draw of regular customers.

5) Small retailer should also build up strong networking with others retailers in the area, in order to have more information about different products, customer needs, pricing etc.

6) Should take feedback from their regular customers on time to time basis & make improvement thereof.

Section 77 - Buyback of Shares

SECTION 77 restricts the buy-back of own shares from the market by the company or its subsidiaries/parent company. This restriction was imposed on the companies to ensure that these companies do not indulge in unfair and mal trade practices by unnecessarily blowing up their share prices in the market and misleading the investors by giving the misconception that their shares are doing well in the market by adopting techniques of speculation. Thus, the restriction imposed by the concerned section was fairly reasoned by the law making authorities in the interest of the investors and as per the guidelines of SEBI for investor protection.

Later on, there felt a need to relax these restrictions imposed on the companies as it even restricted the companies i.e. the sick units from adopting their last resort of rescue on reconstruction to do away with their immense liabilities and improvise their market conditions in order to sustain competition and survive the same. So Sec.77A came up from the law making body as a rescue to these sick units. But, the new section which sort to provide relief to these units had many loopholes in it in spite of the list of regulations announced along with the new section to prevent any unfair advantage taken of the relief provided through sec.77A as had thought of previously. The companies announced large buybacks at a lucratively high price generally a price higher than the current market price of those shares.

This led to a misconception to the investors that the shares in the market are under priced and thus the new price at which the shares were announced to be bought back became the base price below which no investor was ready to sell of his share to the other. Thus the companies by announcing a high buyback price for shares had succeeded in making it their market price of shares. After which most of the companies dint abide by their words of buy back and just bought a meagre fraction of the amount announced or sometimes even nothing was bought. This practice becomes a very easy tool to boost up your market prices in the market and earning goodwill too with practically zero investment or costing. It is being commonly practiced without being much noticed neither is it acted against by the officials as they are well within the regulations issued under the section. It is called HOLLOW BUY-BACK OF SHARES.

SEBI has noticed this being practiced in the stock markets and thus has issued certain minimum limitation on amount of buyback to ensure that the company actually carries out the buyback announced but it does not ensure the completion of the entire amount announced. Moreover this minimum limitation is also not made mandatory yet it is just an informal guideline suggested by SEBI and can be made mandatory only since the section is amended.

There is an alarming need for the section to be amended to the soonest so that the companies do not resort to such practices any further. To secure the interests of the investors it requires thorough scanning of the law to detect and rectify the loopholes as the one highlighted in the above article to protect all the investors which is the basic need in stock markets currently after the advent of FDI in the nation to make the foreign investors feel secure in the Indian market.

"Thorough scanning of law will detect & rectify the loopholes in the system & will protect the basic needs of the investors"

MCA Update

Ministry of Corporate Affairs acknowledges that services on MCA 21 are not of the fullest satisfaction of the stakeholders for last few days. The Ministry is seized of the matter and taking all necessary steps for smooth functioning of MCA21. Further that Ministry will consider appropriate & due waiver of the additional fee or any other issue being faced by stakeholders due to non-filing of information because of problems in MCA21 system in last few days.

MCA21
Ministry of Company Affairs
Government of India

Goods & Service Tax

While the country's economic growth for 2011-12 has been revised downwards to 6.2% from 6.5%, Reserve Bank of India has also now cut the GDP growth estimate for 2012-13 to a low of 5.5%. The coming budget offers yet another opportunity to provide a dynamic momentum, a clear policy vision approach and a commitment to take the nation ahead. Only time will tell us how much and how far it can be explored.

On Goods and Service Tax (GST) front, there is a news to cheer about. The Empowered Committee of State Finance Ministers which met for two days on 28-29 January, 2012 cleared the major hurdles in introduction of GST. However, we are not still sure as to whether it could come in 2014 or even later. Now the onus is on the Parliament to quickly clear the Constitutional Amendment Bill, 2011 which is now almost two years old.

The Centre and the states last week crossed one major hurdle in the way of Goods & Services Tax (GST) by agreeing to a compensation formula for the Central Sales Tax (CST).

A sub-committee of the Centre and states recommended 100 per cent compensation to states for a cut in CST from four per cent to two per cent for 2010-11, 75 per cent for 2011-12 and 50 per cent for 2012-13, respectively and as a result, Centre will now have pay Rs 34,000 as CST arrears to states.

By nature, CST is in contrast with GST since the former is imposed on inter-state movement of goods while the latter creates the common Indian market. So, CST is expected to be out of the system, once GST comes. A provision for the compensation is likely to be made in the upcoming Budget.

The Central Government has now agreed to make changes to the Constitution Amendment Bill for GST. In a deviation from its earlier stand, it gave consent to a phased roll-out of GST like the Value Added Tax (VAT). This means that only willing states could embrace the new indirect tax system from the beginning.

States will have the flexibility to opt out of GS. Instead of its earlier proposal for a uniform GST rates across the country, the Union Government has also agreed to have a floor rate of taxation with a narrow band. Thus, GST rates could be in a range or a band to provide flexibility to states. There is also a broad consensus on GST design. States which don't want GST can opt out and a provision will be inserted in the Bill.

Thus, GST now seems to be a reality if not in 2014, it may surely be in place after the next general election. The key lies in broad consensus, on simple tax law and commitment of states to a tax law which will be a water shed tax reform of the century. The GST will be a win-win proposition for all- government, trade & industry and consumers.

SEBI Approval for Merger, Demerger

Companies wishing to get listed after the merger or demerger will now need prior SEBI approval. The move by the regulator was to ensure protection of minority shareholders' interest. A circular put up on the SEBI Web site said that such companies looking for exemptions in the past have been submitting inadequate information."In the recent past, SEBI has received applications, seeking exemption, containing inadequate disclosures, convoluted schemes of arrangement, exaggerated valuations, etc. SEBI is of the view that granting listing permission or exemption from the requirements based on such applications may not be in the interest of minority shareholders," the circular said.

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Cost Audit Update

In continuation of MCA's General Circular Nos. 8/2012 dated May 10, 2012 [as amended on June 29, 2012], 18/2012 dated July 26, 2012 and 43/2012 dated December 26, 2012, it has been decided that all cost auditors and the companies concerned are allowed to file their Cost Audit Reports and Compliance Reports for the year 2011-12 [including the overdue reports relating to any previous year(s)] with the Central Government in the XBRL mode, without any penalty, within 180 days from the close of the company's financial year to which the report relates or by February 28, 2013, whichever is later.