IN THE HIGH COURT OF KERALA AT ERNAKULAM

ITA No. 1742 of 2009

1. VODAFONE ESSAR CELLULAR LIMITED ... Petitioner

Vs

1. THE ASSISTANT COMMISSIONR OF INCOME ... Respondent

For Petitioner: SRI. A. KUMAR

For Respondent: SRI. JOSE JOSEPH, SC, FOR INCOME TAX

The Hon'ble MR. Justice C.N.RAMACHANDRAN NAIR
The Hon'ble MR. Justice P.S.GOPINATHAN

Dated: 17/08/2010

O R D E R

C.R.

C.N.RAMACHANDRAN NAIR &
P.S.GOPINATHAN, JJ.

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I.T.A. Nos.1742, 1759, 1761, 1762, 1763,
1764, 1773 and 1780 of 2009

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Dated this the 17th day of August, 2010.

JUDGMENT

Ramachandran Nair, J.

The questions raised in the eight connected appeals filed by the very same assessee pertaining to the assessment years 2004-2005 to 2007-2008 are the same and, therefore, the appeals were heard together and we proceed to dispose of the same by this common judgment. The assessee is a mobile cellular operator which succeeded to the business of Hutchison Essar Cellular Ltd. which had taken over the business of BPL Mobile Cellular Ltd. which was one of the companies which started mobile cellular operations in Kerala. Assessee carries on business of rendering mobile telephone services to the customers through appointment of distributors in the State. Assessee has two types of transactions. Under the first category assessee gives connections to customers and charges them on monthly basis by raising bills for the calls made in a month, in the succeeding month. The connections are given to the customers through distribution of Sim Cards which on insertion in the hand set (mobile phone) of the customer and on activation by the assessee only gives connection to the assessee's mobile network through the towers. Under the Telecom Regulations, connection can be given only on customer producing identity, proof of address etc. Under the distribution agreement, the distributor gets customers for the assessee and all work in relation to collection of document of identity of the customer, delivery of Sim Cards for giving connection to the customer, collection of charges etc., are done by the distributor and the assessee pays certain charges to the distributor for all services rendered in regard to this service called "post paid services". The assessee treats the payment to the distributors for the services rendered under the "post paid scheme" as commission within the meaning of Section 194H of the Income Tax Act (hereinafter called "the Act") and tax is deducted at source and is being remitted to the department. However, so far as payments made for services rendered by the distributors under the prepaid scheme are concerned, appellant took the stand that the supply of Sim Card, Recharge coupons etc., under the prepaid scheme is sale of goods at discounted price by the assessee and besides the discount given at the time of sale of these items, assessee is not paying any commission or crediting any commission in the account of the distributors and so much so, assessee is not liable to deduct and remit tax at source in terms of Section 194H of the Act. The Assessing Officer on examination of the distribution agreement and after examining the nature of service rendered by the distributor in regard to procurement and enlistment of customers and other services, found that there is no difference between the services rendered by the distributor under the "post paid" and under the "prepaid" schemes and so much so, he found that assessee was liable to recover and pay tax on the commission paid, though styled as discount by the assessee in the agreements with distributors.

Since the assessee committed default in deduction of tax at source and remittance of the same on the commission paid under the prepaid scheme to the distributors, the Assessing Officer treated the assessee as an assessee in default and demanded tax in terms of Section 201(1) of the Act. For the further consequence that is, delay on the assessee's failure to deduct and remit tax in time, the Assessing Officer levied interest through separate orders under Section 201(1A) of the Act. Accordingly two sets of separate orders are issued both under Section 201(1) and 201 (1A) of the Act against the assessee for the assessment years 2004-2005 to 2007-2008 which led to these appeals. All the lower authorities including the Tribunal consistently found against the assessee both on facts and on questions of law and accordingly these appeals are filed before us wherein the substantial and the only question arising for consideration is whether the so-called "discount" given by the assessee to the distributors for the various services rendered by them under the prepaid scheme of getting connections and serving the subscribers of mobile phones amounts to "commission" within the meaning of Section 194H of the Act. If the answer to this question is in the affirmative, i.e. if this court holds that the discount given for the so-called sale of service products effected by the assessee is "commission" paid for services rendered by the distributor in the course of mobile operations by the assessee-company, then certainly there is violation of Section 194H and so much so, the impugned orders issued under Sections 201 (1) and 201(1A) are unimpeachable as they are only consequential orders for default. We have heard Senior counsel Sri. S. E. Dastur appearing for the assessee and Standing Counsel appearing for the respondent-department.

2. Before proceeding to consider the various arguments raised by the appellant-assessee, we are constrained to refer to the Division Bench judgment of this court rendered in a sales tax case filed by BPL Mobile Cellular Ltd., whose business in Kerala is ultimately taken over by the assessee-company. In the judgment in the said case i.e. W.P.(C) No. 29202/2005, this court noticed that for the same transaction i.e. sale of Sim Cards and Recharge coupons through distributors under the "prepaid scheme", the assessee's predecessor namely, BPL Cellular Ltd. along with Public Sector company BSNL contested sales tax liability stating that transaction does not involve sale of goods, but is only rendering of services. In fact, this court after referring to judgment of the Supreme Court in BSNL & ANOTHER V. UNION OF INDIA & OTHERS reported in (2006) 145 STC 91 upheld the assessee's contention holding that there is no sale involved in Sim Cards or Recharge coupons attracting sales tax and the transactions are for rendering mobile services because only through Sim Cards the customer can avail the mobile services from the assessee and Recharge coupons are nothing but air time charges paid by customers in advance for availing mobile services from the assessee. In other words, the finding of this court was that there is no intrinsic value for neither the Sim Cards nor the Recharge coupons and the entire collections are only for rendering mobile services by the assesee. However, what has happened is that when the assessee took over the business of the earlier operator, assessee entered into another set of distribution agreement wherein the distributors were given freedom to charge any amount for Sim Cards and Recharge coupons at below maximum retail price (MRP). In other words, if distributors so choose, they are permitted to pass on part of the discount or commission received by them to retailers or customers. But for this, the terms of the distribution agreement as seen from records remain unaltered even after assessee succeeded to the business of the previous company. Before the Income Tax Appellate Tribunal as well as before the Assessing Officer, the assessee canvassed the position that under prepaid scheme assessee is selling the products namely, Sim Cards and Recharge coupons etc. at a discounted price to the distributors and besides the discount given at the time of sale against advance payment, assessee is neither paying any commission or charges, nor crediting any amount in the account of the distributors. Before the Tribunal, assessee heavily relied on the decision of the Delhi Bench of the Income Tax Appellate Tribunal in the case of IDEA Cellular Ltd. which was in favour of the assesee and the department relied on the decision of the Kolkata Bench of the Income Tax Appellate Tribunal in the case of Bharati Cellular Ltd. However, the decision of the Delhi Bench of the Tribunal in the case of IDEA Cellular Ltd. was later reversed by the Delhi High Court and the said decision in COMMISSIONER OF INCOME TAX V. IDEA CELLULAR LTD. is reported in (230) CTR (Del.) 43. On going through the said judgment of the Delhi High Court, we find that the issue raised in that case is exactly the same raised by the assessee before us which is the claim that the benefit given to the distributor is only discount and not commission. However, we find that the Delhi High Court has accepted our finding in the abovereferred decision that supply and delivery of Sim Cards and Recharge coupons do not amount to sale or purchase of goods, but are only for rendering services and consequently the Court upheld the department's claim of applicability of Section 194H of the Act. It is not known whether the order of the Kolkata Bench of the Income Tax Appellate Tribunal in favour of the Department in ASST. COMMISSIONER OF INCOME TAX V. BHARATHI CELLULAR LTD. reported in (2007) 105 ITD 129 (KOL.) is confirmed by the High Court or not. Therefore, the position as of now is that the findings of this court in the sales tax case in the case of BPL Cellular Ltd. to which assessee succeeded, the judgment of the Delhi High Court in IDEA Cellular Ltd.'s case referred above and the decision of the Kolkata Bench

of the Income Tax Appellate Tribunal in the case of Bharati Cellular Ltd., are squarely against the assessee and no other decision directly on the point is brought to our notice. However, since Senior counsel Sri.Dastur appearing for the appellant-assessee challenged the correctness of the above decisions, we proceed to consider all the contentions raised.

3. Relying on the various clauses in the distribution agreement, the counsel for the assessee contended that assessee is making sale of Sim Cards and Recharge coupons at discounted price and against advance payment made by the distributors and the assessee is neither paying any commission or charges to the distributors nor crediting commission or charges in the account of the distributors. However, Standing Counsel appearing for the Income Tax Department controverted this factual position canvassed by the assessee and brought to our notice the findings of the Tribunal contained in para 59 of their order. For the sake of precision, we feel it would be better to extract the finding of fact by the Tribunal with regard to accounting entries instead of stating it in our own words. Accordingly we extract hereunder the findings of the Tribunal on the accounting entries which are the following:

> "The assessee company is crediting the sales account by the gross amount and not by net proceeds. For example, the MRP of a pre-paid card is Rs.100/-; margin availed by the distributor is Rs.20/-. The net proceeds available to the assessee is Rs.80/-. Let us see how the assessee is accounting for the above. When the SIM Card is given to the distributor, the assessee company is crediting the sales account for an amount of Rs.100/-. Assessee is debiting the cash account with Rs.80/- being the cash paid by the distributor. Assessee company is debiting the commission account for Rs.20/-. This is the margin enjoyed by the distributor. As far as the assessee company is concerned, it has given a commission of Rs.20/-. On delivery of a pre-paid card of Rs.100/-, assessee is adjusting the payment of commission through accounts and invoice. In the first instance sale is accounted for Rs.100/-; the second cash is accounted for Rs.0/-; and the third commission is accounted for Rs.20/-. It shows that as far as the sale is concerned, it is Rs.100/- and the assessee has given a commission of Rs.20/- to the distributor and the net cash proceeds is Rs.80/-. Instead of treating the sale at the net value of Rs.80/-, the assessee is accounting the sales at the gross value of Rs.100/- and thereafter debiting an expenses account for commission paid of Rs.20/-. Therefore, in the facts and circumstances of the case and in the light of the finding of the Hon'ble jurisdictional High Court in the case of M/s.BPL Mobile Cellular Ltd. (Writ Petition No.29202 of 2005) that the essence of the contract between the assessee and the distributor is that of service, we find that the distributors are acting as agents of the assessee company and the margin enjoyed by the distributors are the commission/brokerage allowed by the assessee company.

Counsel for the assessee sought to substantiate the position contrary to the above finding of the Tribunal by reference to the distribution agreement which assessee has with the distributors. It is stated in the agreement that distributors are free to charge any amount from the subscribers or retailers below the MRP. In other words, distributors are not bound to sell the goods namely, Sim Cards or Recharge coupons at the MRP to treat the discount as charges or commission received or receivable by the distributors. Relying on this clause in the agreement, the contention of the Senior counsel is that even if tax is recovered at source on the discount amount, it may be on an amount that may not ultimately be realised by the distributor at the time of their sales to consumers or to retailers wherein they are free to pass on part of the discount received by them i.e. by selling the products at below the MRP. In this context Standing Counsel for the Department referred to Section 197 of the Act whereunder the payee is entitled to apply to the department for obtaining payment without deduction of tax or with deduction at rates lower than what is provided in the statute. We are in full agreement with this contention of the department because if it is commission on which TDS is payable under Section 194H, the distributors can approach the department and get certificates to receive discount or commission without deduction or with deduction at lower rates. Therefore, we are unable to accept the contention of the Senior counsel that the possibility of distributors selling the products at below MRP leading to higher recovery of tax will stand in the way of assessee recovering tax at source or collecting tax from the distributors on the discount passed on to them at the time of sale of the products, if the transaction is subject to deduction at source under Section 194H of the Act. Further, it is common knowledge that recovery of tax at source is not the actual tax payable by the recipient who is free to claim refund of TDS amount with interest, if excess tax is recovered under TDS Scheme.

4. The main question to be considered is whether Section 194H is applicable for the "discount" given by the assessee to the distributors in the course of selling Sim Cards and Recharge coupons under prepaid scheme against advance payment received from the distributors. We have to necessarily examine this contention with reference to the statutory provisions namely, Section 194H which is extracted hereunder for easy reference:

> "S.194H. Any person, not being an individual or a Hindu undivided family, who is responsible for paying, on or after the 1st day of June, 2001, to a resident, any income by way of commission (not being insurance commission referred to in section 194D) or brokerage, shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of ten per cent:
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> .....
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> Explanation:- For the purposes of this section,--
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> (i) "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities;
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> ....."

What is clear from Explanation (i) of the definition clause above is that commission or brokerage includes any payment received or receivable directly or indirectly by a person acting on behalf of another person for the services rendered. We have already taken note of our finding in BPL Cellular's case abovereferred that a customer can have access to mobile phone service only by inserting Sim Card in his hand set (mobile phone) and on assessee activating it. Besides getting connection to the mobile network, the Sim Card has no value or use for the subscriber. In other words, Sim Card is what links the mobile subscriber to the assessee's network. Therefore, supply of Sim Card, whether it is treated as sale by the assessee or not, is only for the purpose of rendering continued services by the assessee to the subscriber of the mobile phone. Besides the purpose of retaining a mobile phone connection with a service provider, the subscriber has no use or value for the Sim Card purchased by him from assessee's distributor. The position is same so far as Recharge coupons or E Topups are concerned which are only air time charges collected from the subscribers in advance. We have to necessarily hold that our findings based on the observations of the Supreme Court in BSNL's case in the context of sales tax in the case of BPL Cellular Ltd. squarely apply to the assessee which is nothing but the successor company which has taken over the business of BPL Cellular Ltd. in Kerala. So much so, there is no sale of any goods involved as claimed by the assessee and the entire charges collected by the assessee at the time of delivery of Sim Cards or Recharge coupons is only for rendering services to ultimate subscribers and the distributor is only the middleman arranging customers or subscribers for the assessee. The terms of distribution agreement clearly indicate that it is for the distributor to enroll the subscribers with proper identification and documentation which responsibility is entrusted by the assessee on the distributors under the agreement. It is pertinent to note that besides the discount given at the time of supply of Sim Cards and Recharge coupons, the assessee is not paying any amount to the distributors for the services rendered by them like getting the subscribers identified, doing the documentation work and enrolling them as mobile subscribers to the service provider namely, the assessee. Even though the assessee has contended that the relationship between the assessee and the distributors is principal to principal basis, we are unable to accept this contention because the role of the distributors as explained above is that of a middleman between the service provider namely, the assessee, and the consumers. The essence of a contract of agency is the agent's authority to commit the principal. In this case the distributors actually canvass business for the assesssee and only through distributors and retailers appointed by them assessee gets subscribers for the mobile service. Assessee renders services to the subscribers based on contracts entered into between distributors and subscribers. We have already noticed that the distributor is only rendering services to the assessee and the distributor commits the assessee to the subscribers to whom assessee is accountable under the service contract which is the subscriber connection arranged by the distributor for the assessee. The terminology used by the assessee for the payment to the distributors, in our view, is immaterial and in substance the discount given at the time of sale of Sim Cards or Recharge coupons by the assessee to the distributors is a payment received or receivable by the distributor for the services to be rendered to the assessee and so much so, it falls within the definition of commission or brokerage under Explanation (i) of

Section 194H of the Act. The test to be applied to find out whether Explanation (i) of Section 194H is applicable or not is to see whether assessee has made any payment and if so, whether it is for services rendered by the payee to the assessee. In this case there can be no dispute that discount is nothing but a margin given by the assessee to the distributor at the time of delivery of Sim Cards or Recharge coupons against advance payment made by the distributor. The distributor undoubtedly charges over and above what is paid to the assessee and the only limitation is that the distributor cannot charge anything more than the MRP shown in the product namely, Sim Card or Recharge coupon. Distributor directly or indirectly gets customers for the assessee and Sim Cards are only used for giving connection to the customers procured by the distributor for the assessee. The assessee is accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor for the assessee. Therefore, the distributor acts on behalf of the assessee for procuring and retaining customers and, therefore, the discount given is nothing but commission within the meaning of Explanation (i) on which tax is deductible under Section 194H of the Act. The contention of the assessee that discount is not paid by the assessee to the distributor but is reduced from the price and so much so, deduction under Section 194H is not possible also does not apply because it was the duty of the assessee to deduct tax at source at the time of passing on the discount benefit to the distributors and the assessee could have given discount net of the tax amount or given full discount and recovered tax amount thereon from the distributors to remit the same in terms of Section 194H of the Act. This proposition is supported by the decision of the Supreme Court cited by Standing Counsel for the respondent in J.B.BODA AND CO. PVT. LTD. V. CENTRAL BOARD OF DIRECT TAXES reported in (1997) 223 ITR 271 wherein the Supreme Court has held as follows. "A two-way traffic is unnecessary. To insist on a formal remittance first and thereafter to receive the commission from the foreign reinsurer, will be an empty formality and a meaningless ritual, on the facts of this case." Standing Counsel for the department referred to our decision in COMMISSIONER OF INCOME TAX V. DIRECTOR, PRASARBHARTI, DOORDARSHAN KENDRA reported in (2010) 189 TAXMAN 315 wherein this court held that Prasarbharti/Doordarshan Kendra was liable to deduct tax on the commission retained by advertising agencies, no matter, the commission was not paid by Doordarshan but was allowed to be retained by the advertising agencies who recovered total advertising cost and remitted only net amount to the Prasarbharti. We, therefore, do not find any merit in the contention of the assessee that recovery of tax is not permissible at the time of giving discount on the delivery of products to the distributors.

5. In view of our finding in the BPL Cellular's case in the context of demand arising under the Sales Tax Act, the mobile service providers are exonerated from sales tax liability and are liable to pay service tax to the Central Government under the Finance Act, 1994. In view of the finality attained to the sales tax case through the above judgment, it would be futile for the assessee or for that matter any mobile service provider, to contend that the charges received for supply of Sim Cards and Recharge coupons are not for services rendered but amounts to sale of goods on which admittedly assessee is not paying any sales tax to the State Government. It is strange to note that assessee takes self-contradictory stand before the Sales Tax Authorities of the State and before the Central Income Tax Authority, both to resist tax-compliance.

6. Senior counsel appearing for the assessee has relied on several judgments, particularly two decisions of this court in M.S.HAMEED V. DIRECTOR OF STATE LOTTERIES reported in (2001) 114 TAXMAN 394 (KER.) and KERALA STATE STAMP VENDORS ASSOCIATION V. OFFICE OF THE ACCOUNTANT GENERAL reported in (2006) 150 TAXMAN 30 (KER.), the decision of the Gujarat High Court in AHMEDABAD STAMP VENDORS ASSOCIATION V. UNION OF INDIA reported in (2002) 124 TAXMAN 628 (GUJ.), and the decision of the Bombay High Court in COMMISSIONER OF INCOME TAX V. QUTAR AIRWAYS in I.T.A. No.99 of 2009 dated 26.3.2009. The first decision of this court pertains to sale of lottery tickets wherein this court held that the commission given by way of discount at the time of sale of lottery tickets is not a commission on which tax is deductible under Section 194G of the Act. The second decision of this court pertains to sale of stamp paper by the licensed stamp vendors wherein also the finding of this court following the decision of the Gujarat High Court in AHMEDABAD STAMP VENDORS' case is that the transaction is sale of goods and so much so, no deduction of tax is called for under Section 194G of the Act. So far as the lottery ticket is concerned, the transaction is different and the Supreme Court has held that the transaction is sale of goods and so much so, the decision rendered by this court has no application in regard to commission paid by the assessee to the distributors in the form of discount which we have found to be in essence and substance for rendering services. The next judgment relied on by the petitioner which is in KERALA STAMP VENDORS ASSOCIATION case rendered by one of us (C.N.Ramachandran Nair, J.), relates to sale of stamp paper by the licensed vendors. Here again, this court by relying on decision of the Gujarat High Court in AHMEDABAD STAMP VENDORS case held that the transaction is a sale. On a reconsideration of this judgment, we feel this court's judgment may require reconsideration

because consideration received by the stamp vendors for the stamp paper does not really represent it's value but is nothing but stamp duty. Value of each stamp paper may be fifty paise or even a rupee, whatever be it's quality, but what is collected depends on the amount stamped thereon which is nothing but stamp duty recovered by the State from the ultimate user in terms of the Stamp Act. Rightly or wrongly this court held that the transaction is sale because loss of stamp paper is to the account of the stamp vendors, if it is lost in their custody. The Government also treats the transaction as sale of goods and specific exemption is granted from payment of sales tax in terms of provisions of the Sales Tax Act. Therefore, the finding that Section 194H is not applicable is on the specific finding in that case that the transaction is sale of goods, whereas in this case following the Division Bench judgment of this court we have found that the distributor is paid commission in the form of discount for services rendered to the assessee. Therefore, none of these decisions relied on by the assessee applies to the facts of this case which is payment of commission by way of discount for services rendered by the distributor. Senior counsel for the assessee has in support of his contentions relied on the following decisions of the Supreme Court also, ADDITIONAL COMMISSIONER OF INCOME TAX V. SURAT ART SILK CLOTH MANUFACTURERS ASSOCIATION reported in (1980) 121 ITR 1, KEDARNATH JUTE MANUFACTURING CO. V. COMMISSIONER OF INCOME TAX reported in 82 ITR 363, COMMISSIONER OF INCOME TAX V. MOTORS 7 GENERAL STORES (P) LTD. (1967) 66 ITR 692, COMMISSIONER OF INCOME TAX V. AJAX PRODUCTS LTD. (1965) 55 ITR 741, COMMISSIONER OF INCOME TAX V. B.C.SRINIVASA SETTY (1981) 128 ITR 294, TUTICORIN ALKALI CHEMICALS & FERTILIZERS LTD. V. COMMISSIONER OF INCOME TAX (1997) 227 ITR 172 and decisions of House of Lords in INLAND REVNUE COMMISSIONERS V. WESLEYAN GENERAL ASSURANCE SOCIETY reported in (1948) 16 ITR 101 and another decision in REVENUE COMMISSIONERS V. DUKE OF WESTMINSTER reported in (1936) A.C. 1. However, on going through these judgments we do not find any of the judgment has any direct application to the facts of this case. The very scheme of deduction of tax at source under the Income Tax Act is to trace recipients of income and their accountability to the department for payment of tax on various transactions. In fact, major portion of the income tax collection is through recovery of tax at source and but for the mechanism, there would have been massive evasion of tax by the recipients of various kinds of income. The trend in legislation is to increase coverage for recovery of tax at source and on a steady basis various services are brought under the TDS scheme so that tax evasion is avoided. We have already taken note of the provision under Section 197 of the Act which mitigates against hardship if any in recovery of tax in as much as a payee is entitled to approach the department and apply for certificate to receive any amount which would be otherwise subject to deduction of tax at source without recovery of any tax or on recovery at lesser rates. We are of the view that the grievance if any against recovery of tax by the assessee is on the distributors, and they are already on the roles of the department because assessee is making deduction of tax at source for payment of commission made under the post paid scheme. As already pointed out, if distributors have any grievance against assessee recovering tax for the commission paid in the form of discount in respect of prepaid services, any such distributor is free to approach the department for getting his grievance redressed by filing an application under Section 197 of the Income Tax Act. However, we make it clear that this is not the ground on which we have held the assessee liable for recovery of tax at source under Section 194H which is only because we have clearly found that the discount paid to the distributors is for service rendered by them and the same amounts to "commission" within the meaning of that term contained under Explanation (i) to Section 194H of the Act. The impugned orders issued under Section 201(1) and 201(1A) of the Act are only consequential orders passed on account of default committed by the assessee under Section 194H and, therefore, those orders were rightly upheld by the Tribunal. We, therefore, dismiss all the appeals filed by the assessee.

C.N.RAMACHANDRAN NAIR
Judge

P.S.GOPINATHAN
Judge