IN THE INCOME TAX APPELLATE TRIBUNAL "B" BENCH KOLKATA

BEFORE SHRI SANJAY GARG, JUDICIAL MEMBER
AND SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER

ITA No.1703/Kol/2018
Assessment Year: 2005-06

Deputy Commissioner of Income-Tax, Circle-11(1), Kolkata	Vs.	Dey's Medical (U.P) Pvt. Ltd. 18, Deodhar Street, 2nd floor, Kolkata-700019. (PAN: AAACD7989A)
(Appellant)		**(Respondent)**

Present for:

Appellant by : Shri P. P. Barman, Addl. CIT, Sr. DR
Respondent by : Shri J. P. Khaitan, Sr. Advocate & Shri P. Jhunjhunwala, Advocate

Date of Hearing : 31.08.2023
Date of Pronouncement : 29.11.2023

O R D E R

PER GIRISH AGRAWAL, ACCOUNTANT MEMBER:

This appeal filed by the revenue is against the order of Ld. CIT(A)-10, Kolkatadated 24.05.2018 passed against the assessment order by JCIT, Range-II, Allahabad u/s. 143(3) of the Income-tax Act, 1961 (hereinafter referred to as the "Act"), dated 31.12.2007, for AY 2005-06.

2. Grounds raised by the revenue are reproduced as under:

"1. That on the fact and in the circumstances of the case the Ld.CIT{A) erred in deleting the addition made by the A.O on account of disallowance of sales promotion expenses u/s 40(a)(ia) for non deduction of TDS u/s 194C by inappropriately accepting contention of the assessee that such disallowance should be qualified for non deduction u/s 194C.

2. That on the fact and in the circumstances of the case the Ld.CIT(A) erred in deleting the disallowances made by the A.O on account of handling and collection charges u/s 40(a)(ia) for non deduction of TDS

u/s 194C by inappropriately accepting contention of the assessee that such disallowance should be qualified for non deduction u/s 194C.

3. That on the fact and in the circumstances of the case the Ld.CIT(A) erred in deleting the addition on account of sales promotion expenses. Ld.CIT(A) inappropriately accepting such sales promotion expenses by inappropriately accepting the business purpose of the associate company.

4. That on the fact and in the circumstances of the case the Ld.CIT(A) erred in deleting the addition on account of distribution expenses without verifying the creditworthinessof such expenses.

5. That on the fact and in the circumstances of the case the Ld.CIT(A) erred in deleting the addition on account of bonus to sales promoters without verifying the creditworthiness of such expenses.

6. That on the fact and in the circumstances of the case the Ld.CIT(A) erred in deleting the addition on account of stock destruction expenses by inappropriately acceptingcontention of the assessee where as no such stock destruction was pointed out in thenotes to annual report by the auditors."

3. Before adjudicating various issues which emanate in this appeal, the general submission placed by the assessee is taken note of, as it throws important light on the nature of business and the backdrop in which various additions/disallowances were made by the Ld A.O in the assessment of the assessee.

3.1. Assessee was engaged in the business of manufacturing and sale of pharmaceutical formulations (tablets, capsules and liquids) and hair oil. It is a private limited company duly incorporated under the Companies Act, 1956. Books of account of the relevant previous year were duly audited under the Companies Act, 1956. Audit u/s 44AB of the Acthad also been carried out and the report was furnished as specified in that section of the Act.

3.2. Assessee was incorporated in the State of Uttar Pradesh and it has a full-fledgedmanufacturing facility at Naini, Allahabad. Assessee belongs to DEY's group - a Kolkata based pharmaceutical and

cosmetic manufacturing group of companies. The said DEY's group has the following three companies in its fold.

1. Dey's Medical Stores Pvt. Ltd. in Kolkata (in short 'DMSPL')
2. Dey's Medical Stores (Mfg) Ltd. in Kolkata (in short 'DMSML')
3. Dey's Medical (U.P.) Pvt. Ltd. at Naini, Allahabad (U.P.)(assessee)

3.3. As explained by the assessee, it was set up in Allahabad (U.P.) to augment the capacity for distribution of products in Northern Part of India and to avail the state incentives offered by U.P. Government besidesother normal commercial advantages. Assessee did not have its own marketing set up and other logistic supports since it could easily share the marketing and logistic infrastructure of theother group companies, being part of DEY's group.Accordingly, all the after-production activitiesi.e. marketing and distribution were looked after by the other two group companies, viz. DMSPL and DMSML, as they were already having an efficient and well established marketing and distribution set-up/network.

3.4. Furthermore, it is stated that assessee had been manufacturing products (medicines and hair oil) under brand and know how owned by DMSPL and DMSML. It is in this background of business operations of the assessee, we proceed to adjudicate on the grounds raised by the revenue.

3.5. Assessee filed its return of income on 26.10.2005, reporting a total income of Rs. 57,90,580/-. Return was selected for scrutiny. An order u/s 143(3) has duly been passed by the Ld. A.O. after making certain additions/disallowance, amounting to Rs.4,36,31,699/- which are as follows:

1. For non-deduction tax u/s 194C read with section – 40(a)(ia) : on payments towards Sales promotion expenses (paid to DMSPL and DMSML) — Rs. 2,86,88,459/-

2. For non-deduction of tax u/s 194C read with section – 40(a)(ia) : on payments towards handling & collection charges (paid to DMSPL) — Rs. 48,19,050/-

3. For non-deduction of tax u/s 194C read with section – 40(a)(ia) : on payment for Souvenir Advertisements — Rs. 85,000/-

4. Disallowances under Sales Promotion Expenses :

(i)	Payments to preferred Customers under Trade scheme :	Rs.	4,78,826/-	
(ii)	Payments to preferred Customers towards rural/interior coverage :	Rs.	1,04,899/-	
(iii)	Reimbursements of Draft Commission :	Rs.	1,34,242/-	
(iv)	Reimbursements on account of display Expenses :	Rs.	3,99,050/-	
(v)	Special discounts to preferred customers :	Rs.	9,98,348/-	Rs. 21,15,365/-

5. Disallowance under distribution Expenses :

(i)	Reimbursements of expenses To C & F Agents : (Coco Cool Hair Oil)	Rs.	8,23,367/-	
(ii)	Reimbursement of expenses To C & F Agents : (KK Hair Oil)	Rs.	2,59,946/-	Rs. 10,83,313/-

6. For non-deduction of tax u/s 194C read with section – 40(a)(ia) : on payments towards Sales promotion expenses (paid to Trinetra Super Retail Ltd.) — Rs. 16,90,059/-

7. Addition on account of issue of free/ Bonus quantity to customers : — Rs. 31,50,453/-

8. Addition on account of claim For goods rejected (on estimate) : — Rs. 20,00,000/-

Total Additions : Rs. 4,36,31,699/-

3.6. Assessee has placed on record several documents and evidences to substantiate its claim which *inter alia*includes copy of agreement with DMSPL dated 14.07.2004 and another agreement with DMSML dated 01.04.2004. These two agreements need to be looked into for arriving at the decision on the issues raised in the appeal. We take up the issues seriatim as noted above.

4. First disallowance is in respect of sales promotion expenses paid by the assessee to DMSPL and DMSML amounting to Rs.2,86,88,459/- which has been disallowed by applying section 40(a)(ia) for non-deduction of tax at source. Details of the said expenses are tabulated as under:

Name of the party	Head	Date	Amount (Rs)	Remark
M/s Dey's Medical Stores Manufacturing Ltd	Sales Promotion Exp.- medicine products	31.03.2005 (Journal Entry)	40,19,068/-	Paid as per the agreement with the company for advertising expenses. 19% of Net sales realization.
M/s Dey's Medical Stores Pvt. Ltd	Sales Promotion KKH Oil	31.03.2005 (Journal Entry)	1,89,60,902/-	Paid as per the agreement with the company for advertising expenses. 10% of Net sales realization
M/s Dey's Medical Stores Pvt. Ltd	Sales Promotion KKH Oil	31.03.2005 (Journal Entry)	57,08,489/-	Paid as per the agreement with the company for advertising expenses. 3% of Net sales realization

4.1. The above tabulated sales promotion expenses were paid to two companies under the same group as below:

Dey's Medical Stores P. Ltd. (DMSPL) : Rs.2,46,69,391/-
Dey's Medical Stores Manufacturing Ltd. (DMSML) Rs. 40,19,069/-
Rs. 2,86,88,459/-

4.2. Before us, Ld. Counsel for the assessee submitted that sales promotion charges paid were in fact sharing of expenses actually incurred by DMSPL and DMSML in pursuance of agreements entered

into in this regard. It was a business strategy of the Group to use common marketing and sales promotion infrastructure for attaining efficiency by ensuing better capacity utilization.Copies of agreements have already been submitted for information and record which prescribed for share of expenses by the assessee. According to the ld. Counsel, agreements do not suggest that theyare works contracts and therefore applicability of section194C for the purposes of disallowance u/s 40(a)(ia) cannot be permitted in law. He submitted that actual expenses were incurred by DMSPL and DMSML in course of their normal carrying out of marketing and sales promotion activities and in applicable cases TDS were done by the said group companies in accordance with the provisions of the Act.

5. Per contra, Ld. CIT, DR while supporting the order of Ld. AO has submitted that assessee had a contracted agreement with DMSML and DMSPL to carry out its work like advertisement, salespromotion of products manufactured by it. This is covered under the definition of works contract under section 194C on which TDS is applicable. Since no TDS was made while making payment to the two companies, disallowance of expenses under section 40(a)(ia) was invoked by Ld. AO.

5.1. According to him, assessee worded thesepayments as "*reimbursement of expenses*" being at a certain percentage of the sales figure of the product that was promoted and advertised. Ld. CIT(A) was convinced on the claim of assessee that the payments were in the nature of reimbursement on which TDS was not applicable. He overlooked the fact that the assessee did not have its own marketing set-up for sales of these products, as admitted by assessee itself in the letter dated 27/11/2007. Ld. CIT DR submitted that 'reimbursement is compensation paid for money already spent'. Reimbursement is dependent on actual figure of expenditure already made. It cannot be

a fixed percentage of sales. As per Oxford Advanced Learner's Dictionary, *reimbursement is the act of paying back money to somebody which they have spent or lost; the amount that is paid back.* Amount paid to DMSPL and DMSML was predetermined as a percentage of sales and not as sums payable which had been actually spent by these two companies for executing the terms of contract with the assessee. Thus, ld. AO rightly held that these sums paid by assessee to the two group companies are not in the nature of reimbursement rather contract payments. Since TDS was not made while making these payments, section 40(a)(ia) was invoked to disallow these expenditures made in the garb of the term 'reimbursement' to avail the dual advantage of reducing profit of the assessee and TDS burden on the payees. He thus submitted that disallowance made by the ld. AOought to be restored.

6. We have heard the rival contentions and perused the material available on record.Admittedly, it is undisputed that assessee had only manufacturing facilities and was operating under license from the two companies, viz. DMSPL and DMSML. It is also a fact that assessee paid DMSML on account of sales promotion activities @ 19% of net sales realization of medicine products manufactured by the assessee. Similarly, assessee paid to DMSPL for advertising and marketing activities of Keo Karpin Hair Oil (KKHO) @ 10% net sales realization of KKHO and also @ 3% on net sales realization for marketing of the products.

6.1. We also take note of the submission made by the assessee that these payments were in fact sharing of expenses actually incurred by the two companies pursuant to the agreements entered into this regard. Assessee has claimed that such an arrangement was made as part of its business strategy to use common marketing and sales promotion infrastructure for attaining efficiency and better capacity

utilization. It is argued that the two companies have done TDS when they actually incurred the expenses on sales promotion and marketing and therefore when assessee is paying back these expenses to the two companies, they do not warrant TDS again as they are nothing but reimbursement. We do not ascribe to the aforesaid argument since payments made by the assessee to the two companies are by way of a fixed percentage of the net sales realization of the respective products manufactured by it but promoted and advertised by the two companies. It is equally important to note the fact that these two companies have their own products for which also, they do the sales promotion, marketing and advertising activities and it is no where discernible as to which specific part of the activity is for the assessee out of the entire exercise undertaken by the two companies. There is no one-to-one linking of the expenses incurred by these two companies and subsequently paid back by the assessee to them. The direct nexus is missing and this is corroborated by the submission of the assessee itself when it stated that arrangement is for '*sharing of expenses.*'

6.2. Moot point before us on the issue under consideration is to ascertain what would amount to reimbursement of expenses in the given facts and circumstances. In this respect, we find force in the submissions made by the ld. CIT DR as narrated above. We note that reimbursement is dependent on actual figure of expenditure already made and is identifiable with the assessee directly. It cannot be a fixed percentage of sales.We also refer to the terms and conditions contained in the agreements entered into by the assessee with the two companies under which these payments have been made. Agreement with DMSML dated 01.04.2004 is extracted below:

AGREEMENT made this 1st day of April Two Thousand Four between DEY'S MEDICAL (UP) PVT. LIMITED, a company incorporated under the Companies Act, 1956 and having its Registered Office at 2/B, Beli Road, Allahabad 211 002 (hereinafter referred to as the "Company") and DEY'S MEDICAL STORES (MANUFACTURING) LIMITED, a company incorporated under the Companies Act, 1956 and having its registered office at 6/D, Nelly Sengupta Sarani, Kolkata 700 087 (hereinafter referred to as the "Sales Promoter").

Whereas the Company has been engaged in the manufacture of drugs and medicines.

AND WHEREAS the Company is manufacturing pharmaceutical products under its own brand name.

AND WHEREAS the Company is having no arrangement and facility at present to carry out the sales promotion of the products manufactured by them.

AND WHEREAS the Sales Promoter has been promoting the products of the Company.

AND WHEREAS the parties intend to continue the arrangement.

NOW, THEREFORE, in consideration of the premises and mutual promises and covenants therein contained, it is hereby agreed to by and between the parties hereto as follows:-

1. The Sales Promoter shall arrange for printing of necessary literature, etc. as may be required, for presentation to the medical profession and others by mutual consultation.

2. The Sales Promoter shall arrange for advertisement as may be required from time to time to be processed by mutual consultation.

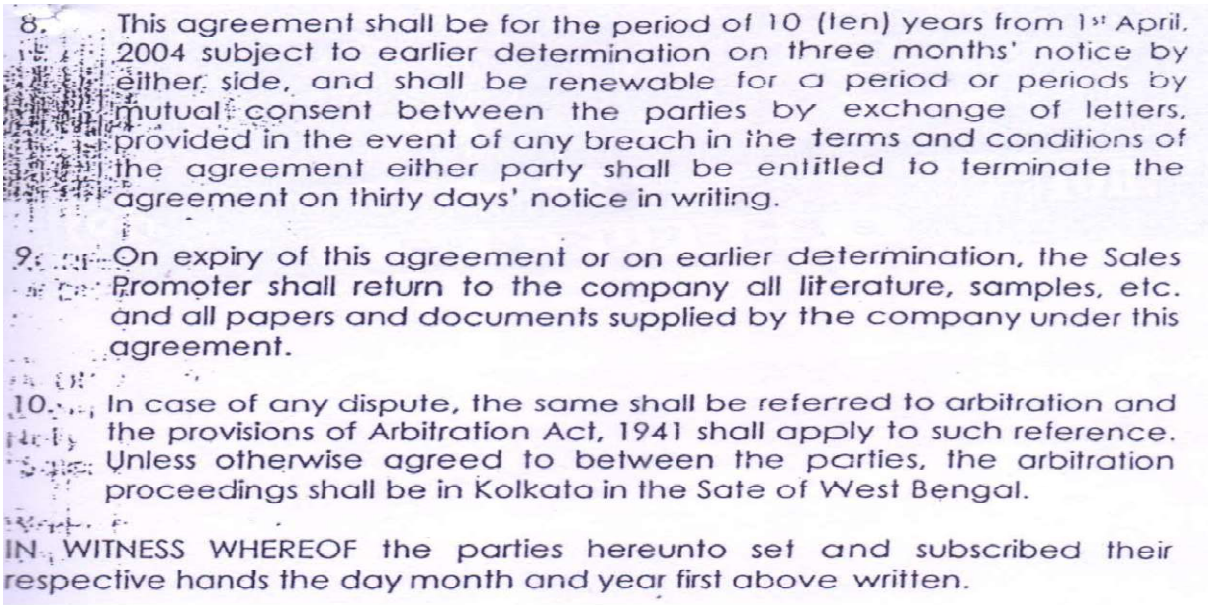
3. The Sales Promoter will make all endeavours for promotion and detailing of the products amongst the medical profession through its medical representatives.

4. The Sales Promoter will arrange for booking orders from doctors, chemists, etc. for execution of the orders by the Company or its Stockists.

5. The company shall make over adequate free samples of the products as may be mutually agreed upon, to the Sales Promoter for distribution to the medical profession.

6. The company shall as far as feasible manufacture adequate quantities of the products for distribution through its distributors, wholesellers and retail chemists, so that the products are available in the market on demand.

7. Sales Promoter will look after sales promotion/advertisement of the products covered by this agreement along with its own similar products, if any, for which the Company shall be liable to pay to the Sales Promoter @ 19% (as amended vide letter dated 31st March, 2000) of its net sales of such products, i.e. Wholesale Price Less Distributors' Commission, if any. However, the said percentage may be determined and be varied by way of mutual consent through exchange of written communications by the parties at the commencement of every year only if there is presence of continuous rising trend in sales promotion expenditure.



8. This agreement shall be for the period of 10 (ten) years from 1st April, 2004 subject to earlier determination on three months' notice by either side, and shall be renewable for a period or periods by mutual consent between the parties by exchange of letters, provided in the event of any breach in the terms and conditions of the agreement either party shall be entitled to terminate the agreement on thirty days' notice in writing.

9. On expiry of this agreement or on earlier determination, the Sales Promoter shall return to the company all literature, samples, etc. and all papers and documents supplied by the company under this agreement.

10. In case of any dispute, the same shall be referred to arbitration and the provisions of Arbitration Act, 1941 shall apply to such reference. Unless otherwise agreed to between the parties, the arbitration proceedings shall be in Kolkata in the Sate of West Bengal.

IN WITNESS WHEREOF the parties hereunto set and subscribed their respective hands the day month and year first above written.

6.3. Similarly, clause 7 from the agreement dated 14.07.2004 with DMSPL is also extracted below for ease of reference:

> *"The Company shall look after advertisement/sales promotion/other expenses of the products covered by this agreement along with its similar products for which the Licensee shall pay to the Company, every year, 10% (Ten percent) of the net sales realisation (NSR) of such products, i.e. Wholesale Price Less Commission of Preferred Customers/Stockists. In addition to this, the Licensee will also pay to the company, every year, 3% (three percent) of the net sales realisation (NSR) towards marketing expenses incurred in relation to the sale of the said products, which include the salary and travelling expenses of all marketing personnel."*

6.4. From the above, it is noted that sales promotor i.e. the two companies are engaged in promoting/marketing and advertising for their own similar products along with that of the assessee as stated in clause 7 of these agreements. Thus, an arrangement has been setup by way of these agreements to recoup part of the total expenses incurred by the two companies as a percentage of net sales realization of the respective products without any direct identification of the specific expense incurred for and on behalf of the assessee for its products. Further, these clauses have the provision of varying the percentage if there is a rising trend in sales promotion expenditure. Certainly, such expendituresarenot variable in nature having a linear relationship with the sale of products. These expenses are not

incurred on per unit basis in actual. Varying the percentage on the sales realization for making the payment to claim them as reimbursement of sales promotion, marketing and advertising expenses in no way fits into the frame of our understanding of reimbursementsince itis necessarily dependent on actual figure of expenditure with one-to-one correlation for the benefit accruing to the assessee, more particularly when these two companies are selling their own similar products.

6.5. On the argument by the assessee that the two companies have done TDS when they made payments does not in any way absolve the assessee from not doing TDS while it is making payment to the two companies since the nature of these payments is by way of a fixed percentage of the net sales realization of the products sold though nomenclature used is that of 'reimbursement of expenses'. Payment by the assessee to the two companies is not dependent onand directly linked to the actual incurrence of the expenditure by them.

6.6. We note that ld. CIT(A) has placed reliance on the judicial precedents wherein the expenditure reimbursed are actually incurred and identifiable as well as specific with the payer for the purpose of reimbursement which is not a fact in the present case.In the case before us, the assessee is paying the amounts to the two companies at a fixed percentage of the net sales realization of the products.

6.7. We also find that basis of making payment by the assessee is the 'net sales realization'. For arriving at the 'net' figure, adjustments relating to sales return or defects and the like are made. Thereafter, a given percentage is applied to compute the amount to be paid by the assessee. To our mind, sales return or defects etc. cannot go to reduce the claim of expenses towards sales promotion, marketing and advertising. These expenses when incurred are irrespective of actual sales occurring or not, whether sales returns are there or not.

Accordingly, claim of the assessee that the payments made by it to the two companies are reimbursement of sales promotion, marketing and advertising expense is not justified.

6.8. Considering the facts and circumstances of the present case and in view of the discussion made above, we uphold the disallowance made by the ld. AO u/s 40(a)(ia) of Rs. 2,86,88,459/-. Accordingly, ground no. 1 by the revenue is allowed.

7. Ground no. 2 taken by the revenue relates to the deletion of disallowance on account of handling and collection charges u/s. 40(a)(ia) of the Act for non-deduction of TDS u/s. 194C of the Act. Brief facts as observed by the Ld. AO are that the assessee company paid handling and collection charges to DMSPL, amounting to Rs.48,19,050/- under agreement as handling, storing and collection agent. In its submission sated 18.06.2007, assessee mentioned the services in terms of agreement dated 14.07.2004 which are as under:

> i. Receiving and carrying products of the assessee company and storing them in godowns/stores licensed for keeping products of company.
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> ii. Delivery of such products to stockiest appointed by the assessee company against their order.
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> iii. To prepare and submit invoices/companies form to the respective purchasers against such deliveries and to take such action on behalf of Assessee Company for delivery and dispatch of such products as per the instruction of the assessee company. Products of the company sold though DMSPL while acting as handling and storing agent shall always be on assessee company account.
>
> iv. To keep party wise record of all sales of the assessee company and to collect sales of the assessee company and to collect sales

proceed from the respective purchasers and deposit the sales proceed to the assessee's company bank account.

7.1. For such a work as handling and storing agents, assessee company was to pay a remuneration of 1.5% of the net sales at the end of every month, as stated in clause 2(f) of the agreement. Additional 1% was charged as remuneration for providing service as collection agent in terms of clause 3(d) of the said agreement. This agreement was signed as the assessee company had godowns only in four states and for sales in respect of its products needed godowns and storing facilities etc which DMSPL could offer. According to ld. AO, this again is a works contract for which a certain percentage was paid. Hence the payment that were made to DMSPL were liable to be covered u/s 194C of the Act and tax should have been deducted at source, which was not done. Ld. AO thus disallowed as per the provisions of section 40(a)(ia) and added it to the total income.

6. Before us, Ld. AR of the assessee submitted that the amount was paid to DMSPL in terms of the agreement for sharing of handling and collection expenses actually incurred by DMSPL - a member of Dey's Group. It is already submitted that assessee did not have any marketing infrastructure of its own and as the assessee used to manufacture products under brand owned by DMSPL, it was a group strategy to allow DMSPL to share its handling and collection infrastructure (under overall marketing set up) under an arrangement as spelt out in the agreement. DMSPL can be categorized as an agent of the assessee in the matters of handling and collection on behalf of the assessee. The expenses were actually incurred by DMSPL in carrying out of its overall handling and collection processes under the major function of Marketing and Distribution. And as the expenses were actually incurred by DMSPL, TDS in appropriate cases were deducted by DMSPL in accordance with the applicable provisions of

the Act. The agreement had just provided for the details of the arrangement and sharing of expenses incurred by DMSPL. According to the ld. AR, agreement, therefore, can never be said to be a works contract and hence the applicability of section - 194C and section - 40(i)(ia) did not arise.

7. Per contra, Ld. CIT, DR while supporting the order of the Ld. AO submitted that assessee paid handling and collection charge to the group company DMSPL under an agreement dated 14.7.2004. For this contracted work, assessee was to pay 1.5% of every month's net sales as handling and storage charges and 1 % of net sales of every month as services for acting as a collection agent. Though the contracted work is clearly in the nature of contract, as given in section 194C, no TDS was made from such payment to DMSPLand hence AO disallowed the expenditure under section 40(a)(ia).

7.1. According to ld. CIT DR though the two companies viz. DMSPL and DMSML are of Dey's Medical group, they are separate legal entities and DMSPL had carried out some work of the assessee, as agreed upon, and the money received by it from the assessee, by whatever name it may be called, is an income in the hands of DMSPL on which TDS is applicable as per section 194C, and failure on the part of the assessee to make TDS while making the payments to it makes assessee liable to the provisions of section 40(a)(ia). According to him, money paid to DMSPL was predetermined as a percentage of sales and not as sums payable which had been actually spent by the company for executing the terms of contract with the assessee. Thus, the AO rightly held that these sums paid by assesseeto the group company are not in the nature of reimbursement rather contract payments. Since TDS was not made while making these payments section 40(a)(ia) was invoked by the AO to disallow these expenditures made in the garb of the term 'reimbursement' to avail the dual

advantage of reducing profit and TDS burden on the payees. It was prayed that the decision of the Ld. CIT(A) on this count be dismissed and that of the AO be restored.

8. We have heard the rival contentions and perused the material available on record. This issue is akin to the issue dealt in ground no. 1 above since assessee is making payment to DMSPL a fixed percentage of the net sales realization under the nomenclature of reimbursement of handling and storage and collection service charges. These expenses incurred by DMSPL are not being reimbursed on a one-to-one basis which are specifically identified as to incurred for the assessee. The terms and conditions of the agreement dated 14.07.2004 mentions about a fixed percentage of claim by DMSPL which is dependent on the 'net sales realization' for services of handling and storing agent and on the 'amounts collected and deposited' for the services as collection agent. The relevant clauses from the said agreement are reproduced for ease of reference:

> *"The Agents for their services as Handling & Storing Agents as aforesaid shall be entitled to a remuneration of 1 ½ (one and half percent) of the net sales (wholesale price less distributors/stockists' discount, if any) of such products payable by the Company every month by the end of the month following."*

8.1. Considering the facts and circumstances of the present case and in view of the discussion made above including the one for ground no. 01, we uphold the disallowance made by the ld. AO u/s 40(a)(ia) of Rs. 48,19,050/-. Accordingly, ground no. 2 by the revenue is allowed.

9. Ground no. 3 relates to deletion of addition of Rs.21,15,365/- under various heads of 'Sales Promotion Expenses'. The matter has been dealt by the Ld. AO as under:

> *"The assessee claimed to have paid following sums to preferred customers of the company under the head Sales Promotion Expenses.*

Preferred customer of the company	*Sales Promotion KKH Oil (Trade scheme)*	*Rs.4,78,826/-*
Preferred customer of the company	*Sales Promotion KKH Oil (Interior Coverage Exp.)*	*Rs.1,04,899/-*
Preferred customer of the company	*Sales Promotion KKH Oil (Display Exp.)*	*Rs.3,99,050/-*
Preferred customer of the company	*Sales Promotion KKH Oil*	*Rs.1,34,242/-*

Since the assessee was under agreement with M/s Dey's Medical Stores (P) Ltd that all the sales promotion will be undertaken by them in respect of their product and they were charging heavy amount as 10% of Net Sales Realization for sales promotion/advertisement and 3% of Marketing expenses the assessee was asked vide hearing dated 17.12.07 that as per the agreement all the expenses on sales promotion are to be borne by the Principal Company and not the assessee, then how the expenditure under this head if claimed by you.

The assessee's reply 24.12.07 does not cover on this point. It focuses merely on the fact that sales promotion expenses are high in the field of cosmetic products and these strategies are required to enhance sales. Schemes may vary from state to state depending on the marketing trend, nature, income, age group etc. The assessee's reply is general in nature and not at all convincing. Even if the general point is accepted about requirement of high sale promotion expenses the moot question here was that the assessee was not responsible for any other sale promotion expense after its agreement with M/s. DMSPL, wherein it was required to pay certain fixed amount based on its sales to the Company M/s. DMSPL.

The assessee vide letter dated 12.12.2007 furnished certain circulars in support of its claim of Trade Discount, draft commission and display expense scheme. These schemes are launched by M/s DMSPL and discussed below in short :

> *1) Trade scheme - vide circular issue I under the Signature of Shri Alak Mukherjee, General Manager Marketing Consumer Products Division of M/s Dey's Medical Stores (P) Ltd dated 29.04.04 this scheme was launched. Under the scheme the preferred customers that achieve primary and secondary sale target were to be reimbursed 3% of the Invoice value. The scheme gives the Modus operandi and the clause (v) of the said is reproduced:*
>
> > *"After completion of trades scheme, all Sr. ASM/ASMs must submit territory wise. Preferred customer wise statement showing primary/Secondary achievement against the allotted target duly checked/verified to the respective branches through DGMS (N)/ZSMs for issuing credit note latest by July 2004."*
>
> *Clearly the total amount that was to be paid under the scheme was to be borne by M/s DMSPL only and not the assessee company. Hence the amount claimed under this head ofRs. 4,78,826/- is disallowed and added back to the assessee's income.*
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> *2) The evidence as claim for 'Interior Coverage Expense' is another Inter Office Memo issued by Shri Alak Mukherjee, General Manger,*

Marketing Consumer Products Division of dated M/sDey's Medical Stores (P) Ltd dated 06.01.05. The last line of the Memo mentions:

> *"After disbursement the above amount may be debited to 'Sales Promotion Head 2004-05' which please note.*
>
> *Nowhere does it mention that the amount is to be borne out by the assessee company. In fact it was to be borne by M/s DMSPL only. Hence the entire amount claimed as Interior Coverage expense of Rs.1,04,899/- is added back to the assessee's income."*

3. Similarly assessee claimed reimbursement of payment on account of display in 937 outlets of 39 towns of MP amounting to Rs.3,99,050/-. The evidence produced is an Inter Office Memo issued by Shri Alak Mukherjee, General Manger Marketing Consumer Products Division of dated M/s Dey's Medical Stores (P) Ltd dated 09.03.05. Here also M/s DMSPL mentions that

> *"Vide our letter dated 15.10. 04 we have sanctioned Rs. 4.5 lakhs for conducting display for KKHO in various towns of MP… Now you are requested to reimburse the payment to the respective preferred customer…"*

Clearly this expense was also borne out by M/s DMSPL and not the assessee company. Hence the entire amount of Rs.3,99,050/- is added back to the income of the assessee.

4. Assessee also paid and claimed as it as its own expense, certain draft commission that was paid to its preferred customers. It totalled Rs.1,34,242/-. This draft commission was first claimed to be part of special discount given to the preferred customers. But subsequently vide submission de tee 12.12.07 a clarification was issued and the assessee claimed that it was a reimbursement of draft commission to the tune of 0.25% of the total draft amount through credit note. It also furnished some invoices where in such bank commission was allowed and the invoice value was reduced by this amount.

But the issue remains the same. The circular for allowing such a commission that was furnished with submission dated 07.12.07 was again issued by the same person Shri Alak Mukherjee, who works for M/s DMSPL and not for the assessee company. This payment is a part of remuneration allowed to the preferred customers and made part of Sales Promotion. Hence as per the agreement, the entire amount has to be borne by M/s SMSPL and not the assessee. The assessee company was to make a lump sum payment as per the agreement and once that amount is debited in the account, no further allowance under this head is allowable.

It must be remembered that although the two companies are intricately linked to each other, they remain separate legal entity and the accounts of one cannot be such that one of them takes extra burden and incur expenses on behalf of the other. Hence the entire amount of Rs.1,34,242/- is disallowed and added back to the assessee's income.

5. The assessee also claimed an expense of Rs. 9,98,348/- as special discount offered to preferred customers. No evidence regarding any policy to allow such a discount was ever submitted. The assessee claimed that a circular issued by Shri Alak Mukherjee, M/s. DMSPL as evidence of allowing the said discount vide submission dated 07.12.07.

But the same circular was shown as evidence of Trade discount. The assessee did furnish some invoices wherein special discount was allowed to these customers. But there is no evidence that this expense was required to be made by the assessee company especially in regard with the agreement with M/s. DMSPL wherein all sale promotion expenses are to be made by M/s. DMSPL and the assessee was only to make a lump sum payment. As already discussed in above pares the expense was also to be reimbursed by M/s DMSPL to assessee company and assessee company cannot reduce its profits by allowing somebody else's expenses in its accounts.

Hence, total addition after disallowance in this paragraph is Rs.4,78,826/- + Rs.l,04,899/-+ Rs.3,99,050/- + Rs.l,34,242/- + Rs.9,98,348/-= Rs.21,15,365/-."

10. Before us, Ld. Counsel for the assessee submitted that Ld. A.O. was wrong in interpreting the agreement with DMSPL. These expenses were distinct and independent expenses incurred by DMSPLin relation to the assessee. All expenses were verifiable and had to be incurred to survive in the competitive market of Hair Oil (KK Hair Oil).Details were furnished before the Ld. A. O. in course of assessment proceedings vide submission dated 07.12.2007 and dated 12.12.2007. Required supporting were also furnished by way of annexure to the said submissions dated 07.l2.2007 and dated 12.12.2007. According to the ld. AR, these expenses have been adjusted from the invoices of customers and have one-to-one correlation with the product of the assessee sold and incurring of these expenses. Sample invoices to demonstrate the same are placed in the paper book.

11. Per contra, Ld. CIT, DR while vehemently supporting the order of Ld. AO submitted that the assessee had shown expenses on sales promotion attributed to preferred customers of the assessee company in relation to its product Keo Karpin Hair Oil. Various schemes were named through inter-office memos and the schemes were allegedly conducted by the group company DMSPL and expenses were shown to be incurred by them. DMSPL then asked the assessee company to reimburse the amount to the 'preferred customers'. This expenditure

was over and above the contract for advertisement, sales-promotion of products manufactured by assessee.

12. We have heard the rival contentions and perused the material available on record. Admittedly, there is no dispute on the incurrence of these expenses which have been in fact incurred by DMSPL for and on behalf of the assessee. These expenses have been adjusted from the invoices raised on the customers for the sale of products. Sample invoices in this respect evidently demonstrate such a fact. We are in agreement with the submission made by the ld. AR in this respect. Since, ld. AR has demonstrated one-to-one correlation of the incurring of expenses and their adjustment from the invoices raised on customers, we do not find any reason to disallow the same for which ld. AO has made the addition. Accordingly, claim of the assessee in this respect is allowed. Ground no. 4 taken by the Revenue is dismissed.

13. Ground no. 4 relates to deletion of addition of Rs.2,59,946/- under the heads of 'Reimbursement of Distribution Expenses to C&F Agents', for Keo Karpin hair oil.

13.1. The matter has been dealt by the Ld. AO as under:

> *"Payments were found to have been made to M/s. Narang Distributors and M/s. Gawri Marketing under the head Distribution expenses. These parties were shown as C&F Agent of KKHO. As per the agreement with these parties filed along with the reply dated 18.06.07, no payment under the head distribution expenses were required to be met by the assessee company. Almost all the expenses were to be met by the C&F Agent in lieu of the 2.5% of the Net invoice value Commission. The assessee was asked to explain why these payments were made. No proper explanation was given; no evidence in support of this claim was adduced. No entries in the books of accounts were seen. Hence entire amount of Rs.2,59,946/- is added back to the income of the assessee."*

13.2. Before us, Ld. AR submitted that these were reimbursement of expenses to C & F Agents of KK Hair Oil. List of C & F agents were submitted in course of assessment proceedings vide submission dated 12.12.2007. Factual details were also filed vide submission dated

24.12.2007. Ld. A.O. had thoroughly examined the distribution expenses ledger. Copies of C&F Agreements are placed on record.According to the ld. AR, it was not correct that the details and evidences were not produced in course of assessment proceedings.

14. Per contra, Ld. CIT, DR placed reliance on the finding of the Ld. AO on this issue.

15. We have heard the rival contentions and perused the material available on record.Expenses were incurred by the C&F Agents in terms of the agreement entered into with the assessee. These expenses were then reimbursed for which all the required details were placed on record. On going through the same, we do not find any reason to sustain the addition of Rs.2,59,946/- which is deleted. Accordingly, ground no. 4 taken by the revenue is dismissed.

16. Ground no. 5 taken by the revenue relates to deletion of addition of Rs.31,50,453/- on account of claim of Bonus.

16.1. The matter has been dealt by the Ld. AO. as under:

"The assessee was asked to produce the copy of ledger account to M/s. Dey's Medical Stores P. Ltd. and M/s. Dey's Medical Stores (Mfg) Ltd. Ltd on 19.12.07 these were produced. It was found from the ledger account that the assessee company had allowed certain amount of Bonus for the financial years 04-05 and 03-04 details as below:

Date	*Narration*	*Amount credited*
31.03.05 Journal entry	*Amt. credited to DMSP Bonus allowed 04-05*	*Rs.17,74,010/-*
31.03.05 Journal entry	*Amt. credited to DMSP Bonus allowed 03-04*	*Rs. 13,76,443/-*
	Total	*Rs.31,50,453/-*

The assessee was asked to explain these entries vide order sheet entry dated 19.12.07. The assessee vide its letter submitted on 24.12.07 stated that these figures represent the credit given to M/s DMSPL in respect of bonus quantities against sale of medicine products in West Bengal. Vide submission dated 27.12.07 the assessee claimed that it allows free bonus quantities against purchases made by the customers under specific free bonus schemes. Such schemes are offered on specific products for specific periods and depend on

the quantity booked for purchases by the customers. Regarding the claim of Bonus for FY 2003-04 it stated that M/s DMSPL claimed this quantity in F. Y 2004-05 and the same was booked in the F. Y 2004-05. The assessee also furnished a self made quantitative account of products given. It was found that almost 10% of the total quantity of medicines billed was claimed as bonus. Surprisingly, the assessee also claimed purported Bonus for F. Y 2003-04. As per its version, these were debited this year as M/s DMSPL claimed it this year. This is a prima facie unacceptable explanation. The assessee follows Mercantile system of accounting. Any such expense either paid directly to M/s DMSPL or to the stockiest as part of any scheme should have been known to the assessee.

The assessee claimed the payment as part of scheme to give bonus to the customers. But no evidence of any such scheme like circular/memo/advertisement was adduced to support its claim. No Bills/vouchers etc. were adduced to support the claim of such bonus or free sample. It must be brought out that the last hearing was fixed for 27.12,07 wherein this expense was required to be explained.

Further vide explanation dated 18.06.07 while explaining the Annexure-3 of the Tax Audit Report regarding Other issues under the head 'Formulations'. The assessee had submitted that Other issue is a term which is used by the assessee to represent certain issues from goods manufactured during the year or goods in opening stock of the year. Such issues, mainly include free trade offer, destroyal of date expired goods and goods damaged or lost in the transit. ..... '.

The assessee then went on to explain what the free trade offer was and what was date of expiredand breakage during transit.

The agreement between assessee company and M/s. DMSPL dated 14th July 2004 requires the agents to 'maintain books, records and documents for all transactions relating to receipts and issues of the products of the company handled by them and shall send such periodical returns to the company in such manner and in such form as may be directed by the company. Clearly periodic details/statements about transactions should have been available and be part of the books of the assessee. No such details as furnished by the Agents claiming such amount as bonus was furnished. Here it is found that the entire amount is debited in the last day through a Journal entry. Further the assessee claims that for the F. Y 2003-04 claims were made in F.Y2004-05 and were debited on the last day 31.03.05. This is an unacceptable situation.

Lastly, for sales promotion the assessee company through the company M/s DMSPL has already launched various schemes in the form of trade discounts/Interior Coverage Expenses/Draft Commission. There is no evidence of giving material in free to anyone in this regard. Hence the entire amount of bonus so claimed is disallowed. Further all the expenses in regard to sales promotion of medicines were actually to be spent by M/s DMSML and as per the agreement, the assessee company was to pay 19% of the sales realization for this purpose. So any expense under the head was not to be borne by the assessee. Similarly, position stands true for the claim of bonus for F. Y 2003-04. In any case, the expenditure of Rs.13,76,443/- pertained to F. Y 2003-04 and if was genuine should have been claimed in that particular F. Y only."

17. Before us, Ld. AR submitted that the amount was credited to DMSPL towards free issues of products given by DMSPL under various schemes on behalf of assessee company. Details were furnished in course of assessment proceedings vide submission dated 24.12.2007. This bonus given to sales promoterswere against medicine sales. Ld. A.O. had disallowed on grounds that such bonus issues were not required to be made. Ld. AR referred to a detailed reply on this issue filed in the course of assessment proceeding to justify the claim of the assessee. Relevant extracts from the same are reproduced for ease of reference:

> *"1. For distribution of company's medicine products in the states where the company does not have its own godown or necessary license under the Drugs Act but M/s Dey's Medical Stores Pvt. Ltd. do have branches, goods are sold to M/s Dey's Medical Stores Pvt. Ltd. for resale to company's stockist as may be instructed by the company.*
>
> *For our medicine .products we allow free bonus quantities against purchases made by our customers under specific free bonus schemes. Such schemes are offered only for specific products for specific periods and the bonus quantum depends on the quantity hooked for purchases by our customers during the period for which the offer is valid.*
>
> *Such free bonus quantities are included in relevant invoices of sales against which free bonus quantities are offered and for these bonus quantities the assessee company does not receive any sales consideration.*
>
> *During the F.Y. 2003-04 and 2004-05, such bonus quantities were allowed to customers in the states where the assessee company had its own depots but no such bonus quantities were claimed by M/s Dey's Medical Stores Pvt. Ltd against sales made by them. Hence, the .entire quantities sold by M/s Dey's Medical Stores Pvt. Ltd. during these years were included in sales of the assessee company.*
>
> *Later on M/s Dey's Medical Stores Pvt. Ltd. claimed the bonus on sales made by them during the above years and as per the policy of the company the same was allowed to them. Hence, the value of such bonus quantities were credited to M/s. Dey's Medical Stores Pvt. Ltd. and the proportionate sales promotion expenses in relation to the value of such bonus quantities were debited to the account of M/s. Dey's Medical Stores Manufacturing Ltd."*

18. Per contra, Ld. CIT, DR while supporting the order of Ld. AO submitted that the assessee allowed free bonus quantities against purchases made by customers under specific free bonus schemes.

19. We have heard the rival contentions and perused the material available on record.Admittedly, DMSPL has supplied the products as bonus in accordance with the sales promotion policy adopted by the assessee, from time to time. Free bonus quantities are included in the relevant sales invoices against which no sales revenue is collected. For these supplies of free bonus quantities, assessee has reimbursed DMSPL for which a detailed chart has been placed on record at page 858 and 859 in the paper book to demonstrate the quantities billed with bonus quantity for both the FY i.e. 2003-04 and 2004-05. We also note that ld. AO has stepped into the shoes of the assessee as a businessman to question the business decision which is certainly not warranted. Further, ld. CIT(A) has noted that this issue has already been held in favour of the assessee in AY 2003-04 at the first appellate stage against which Revenue did not prefer an appeal before the Tribunal. Considering the overall factual matrix as noted hereinabove, we find no reason to interfere with the finding given by the ld. CIT(A) on this issue of deleting the addition made by the ld. AO. Accordingly, ground no. 5 taken by the revenue is dismissed.

20. Ground no. 6 relates to deletion of addition of Rs.20,00,000/- on account of claim of stock destruction expenses.

20.1. The matter has been dealt by the Ld. AO as under:

> *"The assessee claimed as Rs.26,72.489/- as the amount of goods rejected by M/s. DMSPL 2004-05 through a Journal entry passed on 31.03.2005. No details as what were these goods that were rejected except the fact that medicines that pass expiry date are destroyed and claimed as expenses. In the field of medicines such destruction is part of business but then that has to be properly accounted with. Proper verifiable evidence of what stock was destroyed itemise and date wise has to be maintained. Similar stock construction/breakage loss was debited in the books of the assessee at its depots was also made. The audit report did not give any detail of such destruction. Nor was this stock destruction was pointed out in the notes to Annual Report by the Auditors. In fact in the case of depots the amount of such destruction is not known as its nowhere reflected in the accounts.*
>
> *In the absence of any proper record evidence, Rs.20,00,000/- is added back to the income of the assessee under this head on estimate."*

20.1. Before us, Ld. Counsel for the assessee submitted that date expired medicines were destroyed as per normal practice of pharmaceutical industry. Details were furnished in course of assessment proceedings vide submission dated 24.12.2007. This had been a routine for all medicine companies. Every branch of the assessee company had adequate records and procedure for the destruction of date expired medicines. It was not an extraordinary item required to be included in the annual audited accounts of the assessee company and the Ld. A. O. went wrong having such an observation that audit report should have incorporated such destruction. Ld. AO had failed to understand the accounting procedure vis-a-vis the arrangements between the assessee company and DMSPL. Further, ld. AR submitted that Ld. AO had made disallowance on ad-hoc basis of Rs.20,00,000/- out of the total claim, which is without any basis. According to the ld. AR, all the records were available which were routinely maintained and could have been verified by asking for direct confirmation from DMSPL. However, the same have been placed on record and are verifiable. He thus stated that disallowance suffers from irregularity and hence liable to be deleted.

21. Per contra, Ld. CIT, DR submitted that no details or evidence of what was destroyed was made available to the ld. AO. He placed reliance on the finding given by the ld. AO.

22. We have heard the rival contentions and perused the material available on record.Admittedly, assessee has claimed Rs.26,72,489/- on account of date expired goods. Against this claim, ld. AO has disallowed an amount of Rs.20,00,000/- on an ad-hoc basis by observing that there was no proper evidence for the claim made by the assessee. Before us, ld. AR demonstrated from the records placed in the paper book, all the details maintained in this respect. He referred

to page 634 to 641 which contain details of stock statement including details of items destroyed, breakage, sample, bonus, shortage. Further, he referred to a certificate issued by the Chartered Accountant firm for the damaged/expired items which were destroyed in their presence for one of the branches of DMSPL, placed at page 860 of the paper book. We also note that claim of items towards date expiry and destruction thereon is a normal and routine business claim in the line of business in which assessee is engaged in. Further, ld. CIT(A) has noted that this issue has already been held in favour of the assessee in AY 2003-04 at the first appellate stage against which Revenue did not prefer an appeal before the Tribunal. Considering the overall factual matrix as noted hereinabove, we find no reason to interfere with the finding given by the ld. CIT(A) on this issue of deleting the addition made by the ld. AO. Accordingly, ground no. 6 taken by the revenue is dismissed.

23. In the result, appeal of the Revenue is partly allowed.

Order is pronounced in the open court on 29th November, 2023

Sd/-	Sd/-
(Sanjay Garg)	(Girish Agrawal)
Judicial Member	Accountant Member

Dated: 29th November, 2023

JD, Sr. P.S.
Copy to:

1. The Appellant:
2. The Respondent:.
3. CIT(A), Kolkata-21. 4. CIT
5. DR, ITAT, Kolkata Bench, Kolkata

//True Copy//

By Order

Assistant Registrar
ITAT, Kolkata Benches, Kolkata