IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 05TH DAY OF JANUARY, 2012

PRESENT

THE HON'BLE MR. JUSTICE D.V.SHYLENDRA KUMAR

AND

THE HON'BLE MR.JUSTICE H S.KEMPANNA

ITA NO.1262/2006

BETWEEN

1. THE COMMISSIONER OF INCOME TAX
CENTRAL CIRCLE, C R BUILDING
QUEENS ROAD
BANGALORE

2. THE INCOME TAX OFFICER
TDS – III/SURVEY,
C.R. BUILDING, QUEENS ROAD,
BANGALORE ... APPELLANTS

(BY SRI. M THIRUMALESH – STANDING COUNSEL)

AND

NOVA NORDISK PHARMA INDIA LTD
NO 14/2, RAJESH CHAMBERS
BRUNTON ROAD, BANGALORE 25

... RESPONDENT

(BY SRI. HARISH V S – ADV. FOR
M/S HARISH & CO..)

THIS ITA IS FILED U/S.260-A OF I.T.ACT, 1961 ARISING OUT OF ORDER DATED 22-03-2005 PASSED IN ITA NO. 668/BANG/2002 FOR THE ASSESSMENT YEAR

1997-98, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW, ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, BANGALORE IN ITA NO.668/BANG/2002 DATED 22-03-2005 CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE INCOME TAX OFFICER, TDS-III SURVEY, BANGALORE AND ETC.,.

THIS ITA COMING ON FOR FINAL HEARING THIS DAY, SHYLENDRA KUMAR J., DELIVERED THE FOLLOWING:

JUDGMENT

The appeal by the Revenue u/s.260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') against the order dated 22.3.2005 passed by the Income Tax Appellate Tribunal, Bangalore Bench in ITA No.688/Bang/02 and posing the following substantial questions of law for our answer :-

1. Whether are Appellate Authorities were correct in holding that the transactions entered into between the assessee and the TPL is a contract for sale and not contract for work, when the entire transaction under the agreement were in the nature of work contract, and T.D.S. was deductible?

2. Whether the Appellate Authorities committed an error in terming the transactions entered into between

the assessee and the TPL as contract for sale of goods when on examination of the agreements and the transactions, work entrusted to TPL was only a work contract and not contract for sale of goods and consequently provisions of section 194 (c) of the Act were applicable?

2. The appeal had been admitted on 10.9.2007 to examine these two questions.

3. The respondent had been put on notice and is represented by counsel M/s.Harish and Co., but unfortunately at the time of hearing of the appeal we had the benefit of hearing only Sri.Thirumalesh, learned Standing Counsel appearing for the appellant-Income Tax Department.

4. The assessee is an Indian Company and assessment year is 1997-98. The assessee company markets pharmaceutical products and one of its products had been got prepared from M/s.Torrent Pharmaceuticals Limited, a product which perhaps was being used as insulin in medically presentable form,

raw material for the manufacture of this product was being supplied to M/s Torrent Pharmaceuticals Ltd. by a foreign company by name NOVA Nordisk, Denmark.

5. It also transpires that the assessee company was a subsidiary of M/s NOVA Nordisk Singapore but had no direct contract or relationship with the Indian manufacturer, but under another agreement between the Indian manufacturing company and the raw material supplying foreign company, the product produced by the use of raw material for manufacture of the product was stipulated to be exclusively supplied sold to the assessee company and the manufacturing company was under a compulsion that the entire product or the output of the consumption of the raw material supplied to the manufacturing company should be in turn sold only to assessee company in India.

6. One of the conditions in the agreement between the raw material supply foreign company and the Indian

manufacturing company was that even if the agreement should expire or the transaction should come to an end and if some surplus product is left over with the manufacturing company, the product so left over should not be sold out side in the market, but necessarily be sold to the assessee company.

7. In the agreement between the assessee company and its supplier a price fixation formula had been worked out and it was stipulated therein and that was called as conversion charges. The assessee company was to pay the supplier/manufacturing company 19% of the landing cost of the raw material, consumed into the production of the product. This is the interrelation linking the three companies viz, the raw material supplying foreign company, the raw material receiving Indian manufacturing company and the product buying assessee company. The Indian manufacturing company manufactured the products making use of the raw material supplied by the foreign raw material supplier company.

8. There was another agreement between the assessee company and the manufacturer company also which provides for supply of technical know-how for the manufacture of the product, but at no cost and know-how to be exclusively utilised for converting the raw material received by the Indian manufacturing company from the raw material supplying foreign company.

9. There was yet another agreement between the assessee company and the manufacturer/supplier company known as trade mark licence agreement under which the product manufactured by the supplier/manufacturing company was to be labelled with the name of the assessee company for marketing and the entire manufactured product was to be restored to the buying company viz. the assessee company, in the event of termination of the contract.

10. While these are the relevant conditions for the purpose of resolving the dispute particularly, the question arising in the context of the provisions of

Section 194C of the Act because of which proviso the respondent-Company is treated as an assessee, an assessee so deemed because of the default committed in not deducting the commensurate amount in respect of the payments made by the assessee company in favour of the Indian Manufacturing company which was as per the provision at 2% of the total amounts paid by the assessee company to the supplying company.

11. This amount was worked out to be at a sum of Rs.5,10,49,267/- by the assessing officer applying the formula of multiplying payments made by the assessing company to the supplier company using the multiplier 19/119 as being the value of conversion charges which alone was taken to be a payment by the assessing company towards the manufacturing cost or conversion charges paid by the assessee to the manufacturing company though the actual payments include the price of the raw materials, but that amount having been paid by the supplier directly to the foreign raw material supplier company, that was not included in the value of

payments by the assessee company for the purpose of computing the amount that was required to be deducted under Section 194C of the Act.

12. But the price of the raw material having been paid by the supplier company to the raw material supplying foreign company, the income tax officer was of the view that a reading of the agreement between the assessing company and the supplier company and the agreement between the supplier company and the raw material supplying foreign company has linked one another and ultimately the manufacturing company being required to supply the entire product produced by utilising the raw material procured from abroad only to the assessee company, it cannot be held that it was a contract for sale of a product in the sense it was a sale of a product, but it was only a contract for manufacturing and therefore, was of the opinion that there was an obligation on the part of the assessee company to effect deduction of tax at source and there being a failure on the part of the assessee company

while noticed that the tax liability had been met by the manufacturing company being an assessee under the Act and having independently filed its return, but at the same time the assessee company being not absolved of the liability of the provisions of Section 201(1A) of the Act proceed to compute the interest in terms of the statutory provisions and worked out to be 7,60,570/- starting from 1.4.1997 till the date of the order under the provisions of Section 201(1A) of the Act which was on 30.7.2001.

13. It is aggrieved by this order the assessee carried the matter in appeal to the Appellate Commissioner. The Appellate Commissioner examining the agreement between the assessee and its supplier company and being of the view that in terms of the Board circular No.681 of 83/84 dated 8.3.1984 which is also applicable to the assessment year 1997-98, in terms of his order dated 8.2.2002 opined that the assessee company not having supplied the raw material, the price paid by the assessee company has to be

construed only as a price for the sale of the product and not a contract for manufacturing and therefore, Section 194C is not attracted and in this view of the matter set aside the order of the assessing authority.

14. The revenue carried the matter further to the Tribunal, but without success as the Tribunal also affirmed the order of the Appellate Commissioner being of the view that, in terms of the Board circular the assessee being not the supplier of the raw material was not under any obligation to deduct any tax at source u/s.194C of the Act and therefore, dismissed the appeal in terms of the order dated 22.3.2005.

15. It is aggrieved by this order of the Tribunal, the present appeal by the Revenue posing the questions as indicated above for our consideration.

16. Appearing on behalf of the Revenue, Sri.Thirumalesh, learned Standing counsel has drawn our attention to the orders, the relevant clauses in the agreement particularly, Articles 3 and 4 of the

agreement between the assessee company and the supplier company which reads as under :-

ARTICLE 3: PURCHASE AND SALE OF INSULIN FORMULATIONS

3.1. During the terms, the supplier shall supply to the buyer and the buyer shall purchase from the Supplier, Formulations meeting the applicable requirements contained, and as more particularly specified in Appendix 2 on the following basis.

a) The supplier shall supply and the buyer shall purchase. Formulations manufactured from the Insulin Crystals strictly in accordance with the Know how licensed to the supplier by the buyer under the Know how License Agreement, and strictly in accordance with the Current Good Manufacturing Practice(CGMP) as being defined by the relevant authorities in the territory from time to time.

b) The supplier's selling price to the Buyer for the Formulations shall be determined in accordance with conditions stipulated in Appendix – 4.

ARTICLE – 4 : PAYMENT TERMS

4.1. Payment of the purchase price for each consignment of Formulations shall be made by the

Buyer within thirty (30) days from the date of invoice, which should be issued simultaneously with the supply of formulations.

4.2. Any amount due under this agreement from the Buyer that is not paid when due shall bear interest at a rate per year equal to eighteen (18) percent upto the date of final payment.

The terms of the agreement between the manufacturing company and the foreign raw material supplying company reading as under :-

That this agreement between TPL and NNAS would be co-terminus with the following separate agreements:-

i) "Insulin Formulation Supply Agreement" between the purchaser (i.e., TPL) and NNPL whereby TPL was to supply specified formulations to NNPIL which were formulated using crystals supplied by NNAS and know-how supplied by NNPIL.

ii) "Know-how Licence Agreement" between the purchaser and NNPIL whereby the "know-how" to manufacture such formulation was

transferred from NNPIL to TPL for no apparent consideration.

iii) "Trade Mark Licence Agreement" between the purchaser and NNPIL.

17. Drawing our attention to the relevant terms of the three agreements Mr.Thirumalesh, learned counsel for the revenue submits that the Appellate Commissioner as well as the Tribunal have adopted a very simplistic approach in adopting the Board circular without even applying their mind as to applicability of the notification in a situation of the present nature; that the present situation was not one of a simple agreement between the manufacturer and its buyer or, the seller of goods and buyer of manufactured goods by the very raw material supplied, but this was a rather complicated interlinking arrangement amongst the three parties viz. the assessee company, its supplier the manufacturing company and the foreign raw material supplier company and that the terms of agreement between the raw material supplying company virtually, dictating terms to

the raw material receiving Indian manufacturing company to supply the entire product, manufactured by the utilisation of the raw materials and applying the technical know-how as supplied by the assessee company, this was not a case of the supplier or the manufacturer having produced an independent product out of its own ability or on its own but being guided, regulated and restricted in the marketing of the product only in favour of the assessee company and more so, the price fixation mechanism as stipulated under the agreement taking care of the value with reference to the quantity and quality of the product produced with the supplied raw material, the situation is not one governed by the Board circular and the Appellate Commissioner and the Tribunal ignoring the facts and circumstances of the case as had been discussed by the Income Tax Officer, have simply set aside the order passed by the Assessing Authority on the premise of the board circular. The situation does not fit into the board circular. It called for a proper view to be taken

independent of the circular. This was a clear case where there was payment made by the assessee to the supplier in respect of a property supplied to it and on specifications and therefore, the orders passed by the Appellate Commissioner and the tribunal is to be set aside and the order passed by the Assessing Authority is to be restored.

18. We have bestowed our attention to the submission made at the bar and also perused the orders passed by the Assessing Authority as well as of the Appellate Commissioner, Income Tax Appellate Tribunal and also the provisions of Section 194C and Section 201 of the Act.

19. Section 194C of the Act is an enabling provision A provision introduced into the parent Act for the purpose of advance recovery of income tax and in certain circumstances in a situation where payment is made by a person for carrying out any work in pursuance of a contract between the contractor and the

person then, an obligation is imposed on such person responsible for payment to deduct an amount equal to 2% and the consequence of failure to so deduct and remit to the account of the revenue are spelt out in Section 201 of the Act. We are particularly concerned with Section 201(1A) of the Act which provides for levy of simple interest at 15% p.a. during the relevant year on the ground not so deducted and it is this sum which is levied by way of interest, which is the bone of contention in this appeal.

20. Section 194C applies to all such situations where there is a contract of the nature as is indicated in this Section and in existence between a person and the company etc. Here the person is an assessee company and 'company' as indicated in Section 194C (1d) is the supplier company.

21. On a perusal of all the agreements which have a bearing on the transaction of sale of the product or sale or supply of the product by the

supplier/manufacturer of the assessee company, we find this is not simply a situation of a product manufactured to the specifications of the assessee, being sold to the assessee at the price fixed by the supplier but this is a situation where a product manufactured out of raw materials supplied by a foreign company who had direct interest in the assessee company so manufactured to the specification of the assessee company utilising the technical know-how supplied by it also labelling the product with the brand name of the assessee and suppiying the entire product only to the assessee company and not to anyone else and it is throughout to be held as a specific contract for manufacturing of a particular product notwithstanding the fact that the supplier had paid the price for the raw-material directly to the foreign company which supplied the raw material to the manufacturer, but had interest in the assessee company in India while bearing the trade mark of the foreign supplier, but having a definite communication and in such a situation one has to

really look into the real nature of the transaction that emerges on the conjoint reading of the three agreements and the assessing officer in fact having undertaken this exercise and having arrived at the conclusion that the assessee company is one who fits into the definition and situation contemplated u/s.194C of the which on an examination is found is a proper reasoned approach and in consonance with the statutory provision. We answer the questions posed for our examination in the negative and in favour of the revenue.

22. We are also of the view that the situation contemplated u/s.194C of the Act i.e. the payment being carrying out any work which is to improve the situation of such nature and of course preceded between the contract between the assessee and the manufacturer company.

23. In the circumstance, we hold that it was a situation where the provisions of Section 194C of the Act applied to the assessee and is clearly attracted to

the present situation. The assessing authority has rightly applied the provisions of Section 194 of the Act to the present situation and has very correctly estimated the interest payable in terms of Section 201(A) and the Appellate Commissioner and the Tribunal are in error in taking the contrary view particularly, in the facts and circumstances of the case and therefore, the orders passed by the Appellate Tribunal and the Appellate Authority are both set aside and the order passed by the Assessing authority is restored.

The appeal is allowed. However, the parties to bear their own cost.

Sd/-
JUDGE

Sd/-
JUDGE

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