

**(2006) 08 AHC CK 0284**

**Allahabad High Court**

**Case No:** None

Commissioner of Income Tax

APPELLANT

Vs

Kothari Carpets

RESPONDENT

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**Date of Decision:** Aug. 10, 2006

**Acts Referred:**

- Income Tax Act, 1961 - Section 256(1), 35B(1)(b)(iv)

**Hon'ble Judges:** Vikram Nath, J; R.K. Agrawal, J

**Bench:** Division Bench

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### **Judgement**

1. The Income Tax Appellate Tribunal, Allahabad has referred the following question of law u/s 256(1) of the Income Tax Act, 1961(hereinafter referred to as "the Act") for opinion to this Court:

Whether, on the facts and circumstances of the case, the Income Tax Appellate Tribunal was legally correct in holding that the expression "maintenance of agency" meant an act of continuing the relationship of principal and agent in terms of Section 35B(1)(b)(iv) of the Income Tax Act, 1961?

2. The reference relates to assessment year 1981-82. Briefly stated the facts giving rise to the present reference are as follows:

3. The respondent assessee is a manufacturer and exporter of hand-knotted carpets. With a view to maintain and increase its exports in Europe, it had entered into an agency agreement with M/s. Ingeborg Unadcath of Hamburg. It will be necessary to quote the relevant provisions of this agreement as under:

It has been agreed between both the parties as follows:

1. The first party "KC are the manufacturers of Indian hand-knotted carpets who have agreed to appoint the second party as "AGENTS" Export Promotion Sole Selling Agents in whole of Europe including the United Kingdom for a period of five years.

2. The "AGENTS" will secure orders for export of hand-knotted carpets from first class customers.

3. "KC will manufacture and export the orders submitted and confirmed.

4. It has been decided that a commission of 5 per cent will be paid to "AGENTS" at the same time where the documents are paid by the customers. "KC will give irrevocable instructions each time to their bankers to pay 5 per cent commission to the "AGENTS" from the proceeds.

5. "AGENTS" will not charge any other expenses such as telegram, post, travelling etc. and they are only entitled as mentioned above to the 5 per cent commission. Commission will be paid on the invoice value.

6. "AGENTS" will guide "KC about the trend of the European market, from time to time give new designs for developments.

7. "KC will ensure execution of the orders, maintain standard of the quality as per the contract and/or as per the samples approved by the customers.

8. This agreement will be extended automatically for further five years if not terminated by one year's or the earliest or, latest to be given by 31-12-1982.

4. The respondent assessee paid a commission of Rs. 3,68,312 based on 5 per cent of the F.O.B. invoice value of the orders actually procured by the agent and shipment made by the respondent assessee on that basis. It claimed relief u/s 35B on this expenditure, which was allowed by the Income Tax Officer. The deduction allowed on this account worked out to Rs. 1,22,771.

5. The Income Tax Officer had made some other disallowances also. Against this, the respondent assessee appealed to the Commissioner (Appeals). The Commissioner (Appeals) also noticed that the Income Tax Officer had allowed relief u/s 35B of the Act as mentioned above. He required the respondent assessee to point out the relevant provisions in the Act under which it was entitled to the required relief. It was submitted before him that the relief had been claimed and allowed u/s 35B(1)(b)(iv) of the Act. This section reads as under:

35B(1)(a) Where an assessee, being a domestic company or a person a (other than a company) who is resident in India, has incurred after the 29-2-1968 but before 1-3-1983 whether directly or in association with any other person, any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) referred to in Clause (b), he shall, subject to the provisions of this section, be allowed a deduction of a sum equal to one and one-third times the amount of such expenditure incurred during the previous year:

Provided that in respect of the expenditure incurred after the 28th day, 1972 but before 1-4-1981, by a domestic company, being a company in which the public are substantially interested the provisions of this clause shall have effect as if for the

words "one and one third times" had been substituted.

(b) The expenditure referred to in Clause (a) is that incurred wholly and exclusively on:

(iv) maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities.

6. It was contended before the Commissioner (Appeals) that the respondent assessee had maintained an agency for the promotion of its sale of carpets outside India and, therefore, it was also entitled to relief on the expenditure incurred in such maintenance. The Commissioner (Appeals) was of the view that the respondent assessee had actually not maintained any agency outside India. According to him, maintenance represented meeting the entire expenditure. To support his view, he gave the examples of maintenance of a car or an office or a garden. According to him, the respondent assessee could not be said to have maintained any agency inasmuch as it was required to pay only a fixed sum on the F.O.B. invoice value of orders booked by that Agent and shipped by the respondent assessee and it was not obliged to make additional reimbursement of any loss likely to be sustained by the Agent or was also not entitled to the refund of any amount, if not so spent. He, therefore, held that the respondent assessee had actually not maintained any agency and was, therefore, not entitled to deduction u/s 35B of the Act. After giving the respondent, assessee an opportunity of being heard, he enhanced the income by Rs. 1,22,771.

7. Feeling aggrieved, the respondent assessee preferred an appeal before the Tribunal. The Tribunal has decided the issue in the following words:

(8) We have carefully considered the submissions placed before us. We are inclined to agree with the stand of the respondent assessee. There is no doubt that the word "agency" occurring in Clause (iv) of the section referred to above can only mean an agency as defined in the Contract Act. It is a relationship between the principal and an agent. An agent is a person employed to do any act for the principal or to represent the latter in dealings with third persons. As per Section 185 of the Contract Act, no consideration is necessary to create an agency. In the light of this interpretation, it cannot be denied that the German firm was the agent of the respondent assessee. The second question which arises is what is the meaning of the word "maintenance." As shown above, the words "maintain" and "maintenance" have different connotations. However, in connection with an agency that only mean keeping the latter in working order or to carry it on. The expression "maintenance of an agency", therefore, means an act of continuing the relationship of principal and agent for which, as stated above, no consideration is necessary. We find that as per the agreement dated 11-11-1977, this relationship had been maintained by the respondent assessee with the German concern in the year under appeal also. As contended before us, the option was with the respondent assessee either to

maintain a branch outside India or to maintain an office outside India or to maintain an agency outside India. Obviously in the case of maintaining a branch or an office, the burden of meeting the entire expenditure would have been upon the respondent assessee. The respondent assessee, however, chose to maintain only an agency. In order to maintain an agency, his responsibility was not to meet its expenses, but to keep the relationship with the German firm in tact or to carry it on. This is what the respondent assessee has done. The respondent assessee, therefore, has maintained an agency outside India in terms of Clause (iv) of the section. This view also finds support from the various decisions cited at the Bar. We do not agree with the view of the Commissioner (Appeals) that the legal meaning of maintenance of an "agency" can be compared with the use of the word "maintenance" in common parlance as in connection with a garden or a car etc. That concept is wholly outside the scope of Clause (iv) of Section 35B.

(9) u/s 35B, the respondent assessee would be entitled to relief on the expenditure which, among others, is incurred wholly and exclusively on the maintenance of an agency. There is no doubt that the respondent assessee has spent a sum of Rs. 3,68,312 on the maintenance of the agency. How that amount has been worked out is not relevant for the purpose. As stated above, it was worked at 5 per cent on the F.O.B. invoice value of the orders booked by the agent and shipped by the respondent assessee. The respondent assessee is therefore, clearly entitled to relief u/s 35B on the above amount as was allowed by the Income Tax Officer.

8. We have heard Shri R.K. Upadhyay for the revenue and Shri Suyesh Agarwal holding brief of Shri R.R. Agarwal on behalf of the respondent assessee.

9. The learned Standing counsel submitted that for claiming weighted eduction u/s 35B(1)(b)(iv) of the Act, the respondent assessee ought to have maintained the agency outside India and as in the present case, it had only paid 5 per cent of the contract value as commission to the M/s. Ingeborg Unadcath of Hamburg, it cannot be said that it had maintained any agency outside the India. Reliance has been placed upon a Division Bench of this Court in the case of *Fashion Carpet Co. v. CIT* (IT Reference No. 17 of 1993, dated 5-8-2005 and also of Supreme A court decision in the case of [Aravinda Paramila Works Vs. Commissioner of Income Tax,](#)

10. Shri Suyesh Agarwal, learned Counsel for the respondent assessee, however, submitted that on a true and proper interpretation of the various clauses of the agency agreement, it would be established that the assessee was maintaining the agency outside India for promotion of its sales, and therefore, it is entitled for weighted deduction u/s 35B(1)(b)(iv) of the Act. He further submitted that the word "maintenance" has to be given a wider meaning for which he relied upon a decision of the Madras High Court in the case of [Commissioner of Income Tax Vs. Southern Sulphates and Chemicals Private Ltd.,](#) According to him, the order of the Tribunal does not call for any interference.

11. We have given our anxious consideration to the pleas raised by the learned Counsel for the parties and we find that under the terms of the agreement, there was no requirement or obligation of the respondent assessee to maintain the agency of M/s. Ingeborg Unadcath of Hamburg outside India. What was required, is that the respondent assessee would pay 5 per cent of the contract value as commission in respect of the contract order procured by the said foreign agency. The Apex Court in the case of Aravinda Paramila Works (supra) has held that in order to qualify for weighted deduction u/s 35B(1)(b)(iv), the agency is required to be maintained outside India by the assessee and not by anybody else. The aforesaid decision has been followed by this Court in the case of Fashion Carpet Co. (supra). Reliance placed upon the decision of the Madras High Court in the case of Southern Sulphates & Chemicals (P.) Ltd. (supra) is misplaced and is of no help to the respondent assessee in view of the clear dictum laid down by the Apex Court in the case of Aravinda Paramila Works (supra).

12. In this view of the matter, we are of the considered opinion that the respondent assessee was not entitled for weighted deduction u/s 35B(1)(b)(iv) of the Act as it was not maintaining the foreign agency.

13. We, accordingly, answer the question referred to us in the negative, that is, in favour of the revenue and against the assessee.

14. There shall be no order as to costs.