

SUPREME COURT OF INDIA

Philips India Ltd.

Vs.

Collector of Central Excise, Pune

(S Bharucha and S Majmudar JJ.)

19.02.1997

JUDGMENT

S.P. BHARUCHA, J.

1. The appellant manufactures audio equipment at a factory at Pune. It was served with a show cause-cum-demand notice on 3rd December, 1986, by the Collector of Central Excise alleging that the assessable value of the goods manufactured by it during the period 1983 to 1986 had not been correctly determined inasmuch as the appellant had claimed inadmissible deductions from the price realised from its dealers on account of, amongst others, "normal trade discount although a substantial part thereof represented advertisement expenses and expenses on after sales service which were includible in the assessable value. The demand in this behalf was upheld as representing 2% of the trade discount. The Tribunal was moved in appeal. It noted the terms of agreement entered into between the appellant and its dealers and dismissed the appeal. In regard to the service rendered by the dealers during the guarantee period, the Tribunal observed that there was nothing on record to show that the expenses incurred by the dealers on this account were reimbursed by the appellant and, upon this basis it said, "Obviously, the dealer was to meet these expenses out of the discount offered by the manufacturer to him". In this behalf the Tribunal also quoted senior officers of the appellant who had said that the costs of such service were to come out of the dealers' discount. Insofar as advertisement expenses were concerned, the Tribunal laid emphasis on the fact that advertisement by the dealers was mandatory, and it had to be carried out at the dealers' own expense. It noted, however, that the advertisement cost was, in fact, shared between the appellant and the dealers half and half. The Tribunal said that "the dealers, to the extent they were obligated to

provide after sale service to the products of Peico, free of charge, under agreement, were acting as agent of their suppliers. Further, insofar as they were incurring expenditure on advertising the products of their suppliers under agreement, and not out of their own free will for the purpose of their own business, they were not acting independently and that part of the discount which could be attributable to such activities was not a normal trade discount, for the purposes of Section 4 of the Act." The Tribunal upheld the finding of the Collector that the appellant was not eligible "for the deduction on account of that portion of normal trade discount as described by them, to the extent of 2% of the discount attributable to after sales service and advertisement incurred by the dealers on behalf of the assessee".

2. Learned Counsel for the appellant drew attention to the judgment of a Division Bench of the High Court at Madras in *Standard Electric Appliances, Tuticorin v. Superintendent of Central Excise, Tirunelveli and Ors.* . The court said that it was common knowledge that when a consumer purchased an article from a dealer, in the case of service facilities he looked to the dealer and not to the manufacturer. For replacement of defective parts also he looked to the dealer from whom he had purchased and, notwithstanding the fact that the wholesale dealer might ultimately have the parts replaced by it reimbursed from the manufacturer, the service facilities were provided by the wholesaler with a view to earn goodwill and attract customers. The advertising of a product by the wholesaler was one of the well-known methods by which the wholesaler attracted customers and if, as a result of increasing its business, the demand for the product of the manufacturer also increased, the advertising by the manufacturer could not be said to be for and on behalf of the manufacturer.

3. In *Union of India v. Mahindra and Mahindra Ltd.* , the High Court at Bombay emphasised the relationship between the parties, being of buyer and seller on principal to principal basis. The court observed that the manufacturer and its distributor had a mutual interest in maximising the sale of the products. The provisions in the contract between them relating to advertising and the like were in furtherance of this desire on the part of both the manufacturer and its distributor and in no way affected the real nature of the transaction which appeared to be of sale on principal to principal basis.

4. It is not in dispute that the agreements between the appellant and their dealers are genuine agreements entered into an arms length, that they are as between principal and principal and that the payments contemplated therein are made. The relevant clauses of the agreement are:

(6) All Company's products to be supplied under this Agreement shall be paid for in cash upon delivery. All taxes (Central or State), levies, imposition, octroi and duties which may be assessed on the Company in respect of the sale of the Company's products or levied on the said sales shall be borne by the Dealer and the Dealer shall indemnify and keep indemnified the Company against any claim, demands, proceedings, costs, charges and expenses in respect of such imposition, taxes and duties.

(16) The Dealer will be informed from time to time of the Company's products which are available and of their current list prices together with the terms of supply and prices applicable to the dealer. The Company shall be at liberty to intimate to the dealer the maximum prices at which the dealer shall sell the products. The dealer shall, however, be free to charge prices lower than those.

(18) The Dealer undertakes strictly to comply with the terms of guarantee of free service for the company's products laid down by the Company from time to time regardless of where the purchase has been made and further undertakes that it shall not charge the customer for any repairs to any Philips receivers during the prescribed guaranteed service period.

(19) The Dealer undertakes to maintain an efficient service station duly equipped in every respect to the satisfaction of the Company at all times and will assume full responsibility for the servicing or repairs in respect of the sets and the Company's products. The Dealer shall comply in this respect with whatever instructions may be given from time to time by the Company.

(24) The Company reserves the right to exercise control and supervision at any time over all repairs of Philips receivers and in case repairs are considered by the Company to be of an unsatisfactory nature, the Company will be free to correct such repairs at the cost and expense of the Dealer.

(26) The dealers shall carry out at their own expense advertisement campaign to promote sales of the Company's products.

(34) Nothing in this Agreement shall constitute or be deemed to constitute the Dealer as agent of the Company for any purpose whatsoever and the relationship between the parties hereto is that of vendor and purchaser.

5. It seems to us clear that the advertisement which the dealer was required to make at its own cost benefited in equal degree the appellant and the dealer and that for this reason the cost of such advertisement was borne half and half by the appellant and the dealer. Making a deduction out of the trade discount on this account was, therefore, uncalled for.

6. As to the after sales service that the dealer was required under the agreement to provide, it did of course enhance in the eyes of intending purchasers the value of the appellant's product, but such enhancement of value enured not only for the benefit of the appellant; it also enured for the benefit of the dealer for, by reason thereof, the dealer got to sell more and earn a larger profit. The guarantee attached to the appellant's products specified that they could be repaired during the

guarantee period by the appellant's dealers anywhere in the country. Thus, though one dealer might have to repair goods sold by another dealer and incur costs in that regard, he also had the benefit of having the goods he sold reparable throughout the country. The provision as to after sales service, therefore, benefited not only the appellant; it was a provision of mutual benefit to the appellant and the dealer.

7. We think that in adjudicating matters such as this, the Excise authorities would do well to keep in mind legitimate business considerations.

8. We cannot help but observe that the reduction of the trade discount by two percentage points would not have occurred to the adjudicating authorities, being an unlikely estimate, but for the fact that the 2% here realised Rs. 50 lacs and odd.

9. The appeal is allowed. The judgment and order under appeal is set aside. There shall be no order as to costs.