IN THE HIGH COURT AT CALCUTTA

SPECIAL JURISDICTION (Income Tax)
(Original Side)

Reserved on : 11.12.2025.

Pronounced on : 18.02.2026

ITAT 160 OF 2024

With

IA No. GA 1 of 2024

DEYS MEDICAL (U.P.) PRIVATE LIMITED

...Appellant

-Vs-

PRINCIPAL COMMISSIONER OF INCOME TAX, CENTRAL-2, KOLKATA

...Respondent

Present:-

Mr. J.P. Khaitan, Sr. Adv.
Mr. Pratyush Jhunjhunwala, Adv.
Ms. Sruti Datta, Adv.
Ms. Sakshi Singhi, Adv.

...for the appellant

Mr. Prithu Dudhoria, Adv.
Ms. Sukanya Dutta, Adv.

..... for the Respondents

Coram: THE HON'BLE JUSTICE RAJARSHI BHARADWAJ,
And
THE HON'BLE JUSTICE UDAY KUMAR

Rajarshi Bharadwaj, J:

1. This appeal is directed against the order of the Income Tax Appellate Tribunal (hereinafter referred to as the "Tribunal"), Kolkata Bench "B", dated

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November 29, 2023, in Income Tax Appeal No. 1703/Kol/2018, relating to the assessment year 2005-06. The appellant challenges the Tribunal's partial confirmation of the Assessing Officer's disallowance of reimbursement claims aggregating to Rs. 2,86,88,459 towards sales promotion, advertisement and marketing expenses and Rs. 48,19,050 towards handling, storing and collection expenses, under Section 40(a)(ia) of the Income Tax Act, 1961 (hereinafter referred to as "the said Act").

2. The appellant is a unit of the Dey's Medical Stores Group, involved in the manufacture of products including Keo Karpin Hair Oil (cosmetic products) and certain medicines. The Group comprises the appellant, Dey's Medical Stores Private Limited ("Cosmetics Manufacturing Company") and Dey's Medical Stores (Manufacturing) Limited ("Medicine Manufacturing Company").

3. The appellant operates manufacturing facilities in Allahabad, Uttar Pradesh, set up in compliance with government incentives and utilizes the infrastructure, marketing and sales promotion services of the Cosmetics and Medicine Manufacturing Companies on a reimbursement basis for expenses incurred.

4. The facts in a nutshell are that the appellant, pursuant to agreements dated April 1, 2004 and July 14, 2004, reimbursed the Cosmetics Manufacturing Company and the Medicine Manufacturing Company substantial sums towards various expenses incurred on its behalf. Specifically, the appellant reimbursed Rs.1,89,60,902/- towards advertisement expenses and Rs.57,08,489/- towards marketing staff expenses to the Cosmetics Manufacturing Company. These reimbursements were calculated as percentages of net sales realization of the appellant’s product being Keo Karpin Hair Oil, 10% for advertisement and 3% for marketing staff expenses. Additionally, Rs.40,19,068/- was reimbursed to the Medicine Manufacturing Company towards sales promotion expenses for pharmaceutical products sold under the appellant’s brand, computed at 19% of net sales.

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5. Besides these payments, the appellant also reimbursed Rs.48,19,050/- to the Cosmetics Manufacturing Company for handling, storage and collection services related to the appellant's warehouses in the states of Uttar Pradesh and Madhya Pradesh. This amount was determined as 2.5% of net sales realization, divided into 1.5% for handling and storage and 1% for collection expenses. Both the Cosmetics and Medicine Manufacturing Companies treated these reimbursements as income in their taxable accounts and deducted tax at source (TDS), wherever applicable, compliant with provisions of the said Act.

6. During scrutiny, the Assessing Officer disallowed these reimbursed expenses under Section 40(a)(ia), holding that the appellant had failed to deduct TDS on payments made to the related entities and thus, these payments were disallowable as expenses in the appellant's hands.

7. On appeal, the Commissioner of Income Tax (Appeals) reversed this decision, accepting that these payments constituted reimbursements for expenses incurred by the group companies and thus did not attract TDS obligations on the appellant.

8. However, the revenue, herein the respondent challenged this finding before the Tribunal, which partially upheld the assessing officer's disallowance relating to sales promotion, advertisement, marketing expenses and handling and collection charges. Owing to which the present appeal is preferred by the appellant against this partial confirmation of disallowance by the Tribunal.

9. The Learned Counsel appearing for the appellant submits that the payments amounting to Rs.2,86,88,459/-, which comprises of advertisement, sales promotion and marketing expenses, along with Rs.48,19,050/- towards handling, storing and collection charges, were purely reimbursements and did not constitute income or expenditure in the appellant's hands that would attract tax deduction at source under Section 194C or any other provision of the said Act. The appellant submits that in ***Zephyr Biomedicals v. Joint CIT*** reported in***(2020) 428 ITR 398,*** it was held:

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*"**14.**...what is important is that the Income-tax is a tax payable in respect of "total income" of the previous year of every person. Further, such Income-tax shall have to be deducted at source or paid in advance, where it is so deductible or payable under any of the provision of the Income-tax Act. From this, it follows that unless the paid amount has any "income element" in it, there will arise no liability to pay any Income-tax upon such amount. Further, in such a situation, there will also arise no liability of any deduction of tax at source upon such amount."*

10. It is further submitted that both the Cosmetics Manufacturing Company and the Medicine Manufacturing Company carried out the relevant activities using their infrastructure and personnel not only for their own products but also for the appellant's products. The expenses incurred were common in nature and were apportioned rationally as percentages of net sales, based on proven historical data. This method of apportionment represents a scientifically accepted and recognized approach accounting for the joint use of resources.

11. The Learned Counsel emphasizes that tax was duly deducted at source by the payee companies on the payments they made in connection with these activities. This compliance by the recipient companies absolves the appellant from any obligation to deduct tax at source on the reimbursed amounts, since the underlying payments had already undergone TDS deduction downstream.

12. The appellant challenges the Tribunal's interpretation of the law, particularly its insistence on a direct item-by-item correlation between the expenses incurred and the reimbursements made. Such a requirement, according to the appellant, ignores the commercial rationale and the reasonable apportionment methodology mutually agreed upon by the parties. The rigid approach adopted by the Tribunal is criticised as disconnected from business realities.

13. Moreover, it is submitted that the recipients have included these reimbursements in their taxable incomes and have paid the applicable taxes, which negates any justification for disallowing these amounts under Section 40(a)(ia) of the said Act.

14. The appellant contends that the disallowance upheld by the Tribunal is therefore arbitrary, erroneous and perverse, both in fact and in law. Therefore, the appellant prays for the order to be set aside accordingly.

15. The Learned Counsel appearing for the revenue submits that the appellant failed to deduct tax at source while making payments amounting to Rs. 3,35,07,509, which falls under the ambit of Section 194C or other applicable provisions of the said Act. It is submitted that these payments cannot be treated as mere reimbursements because they were calculated as percentages of the appellant's turnover without an exact or direct correlation to the actual expenses incurred by the payee companies.

16. The revenue submits that due to the absence of tax deduction at source by the appellant, the disallowance of these payments under Section 40(a)(ia) is fully justified. The Learned Counsel further submits that the appellant's claim of reimbursement lacks validity in the absence of clear, documented linkage between the reimbursed amounts and the underlying expenses, thereby invalidating the appellant's defense.

17. It is submitted by the revenue that strict adherence to the deductibility requirements of the statute is essential to maintain the integrity of the tax collection process. Therefore, the amounts reimbursed should be disallowed to uphold revenue principles and to serve as a deterrent against tax evasion and non-compliance with TDS provisions by the appellant.

18. It is further submitted that the Ld. CIT(A) erred in deleting the addition on account of sales promotion expenses by inappropriately accepting the business purpose claimed through the associate company, without verifying the genuineness or commercial expediency of such expenditures.

19. The reasons which weighed with the Tribunal in arriving at the aforementioned conclusion are as follows:

"***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, sales promotion of products manufactured by it. This*

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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 these payments "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. AO ought to be restored."*

20. Having heard the learned counsel for the parties and perused the records, this Court observes that the Tribunal's reasoning in upholding the Assessing Officer's disallowance under Section 40(a)(ia) of the Income Tax Act, 1961, is both well-founded and comprehensive in its analysis. The Tribunal's decision was based on a detailed evaluation of the nature of the payments made by the appellant to its group companies, DMSML and DMSPL, totaling

Rs.3,35,07,509/-. These payments were disallowed primarily because the appellant failed to deduct Tax Deducted at Source (TDS) at the prescribed rates, as mandated by law.

21. The Tribunal carefully scrutinized the appellant's assertion that these payments were merely reimbursements and it clarified that such a characterization was unfounded. Instead, the Tribunal concluded that these were, in fact, contractual payments for specific services related to advertising, sales promotion, handling, and storage—activities that are explicitly covered under the provisions governing payments for contracted work. This distinction is crucial, as it directly influences the applicability of the statutory provisions under which the disallowance was made.

22. The core issues before this Court revolve around the legality and appropriateness of the Tribunal's approach, particularly whether invoking Section 40(a)(ia) was justified given the true nature of these payments and the manner in which they were calculated. A key point of contention is whether these payments, which were determined as fixed percentages of the net sales rather than actual expenses incurred, fall within the scope of Section 194C. Additionally, the Court considers whether the disallowance was warranted in a scenario where the recipients of these payments had duly accounted for and paid taxes on the amounts they received, thereby raising questions about the timing and manner of TDS deduction.

23. This Court is of the opinion that the Tribunal correctly applied the provisions of Section 40(a)(ia) in conjunction with Section 194C. The payments under scrutiny were not reimbursements for expenses that had already been incurred and substantiated through bills or vouchers, rather, they represented contractual consideration for services specifically, activities like advertising, sales promotion, handling and storage that were agreed upon as fixed percentages of the net sales. This contractual arrangement, as acknowledged by the appellant through a letter dated November 27, 2007, explicitly recognized the appellant's lack of its own marketing infrastructure and its reliance on

contractual agreements with DMSML and DMSPL to provide these services. These agreements clearly encompassed activities that fall within the definition of *"work"* as outlined under the relevant provisions, including advertising, broadcasting, telecasting and similar services, which are recognised as contracted work under the relevant legal explanations.

24. Furthermore, the Tribunal rightly emphasized that the payments did not correspond to actual, verifiable expenses incurred by the recipients. Genuine reimbursements are characterized by their nature as payments made post-facto, directly linked to specific, documented expenses supported by bills, vouchers or other tangible evidence. In contrast, the payments in question lacked such detailed documentation and instead appeared to be structured as fixed commissions or service fees, amounts that are inherently not reimbursements but contractual consideration for services rendered. While commercial arrangements often involve apportioning costs based on historical data or arm's-length negotiations, such practices cannot override the statutory requirement to deduct TDS at the time of payment or credit when the transactions are contractual in nature and fall within the scope of Section 194C.

25. As held by the Supreme Court in ***Shree Choudhary Transport Co. v. Income tax Officer*** in *(**Civil Appeal no. 7865 OF 2009**):*

*"**15.1.** Indisputably, it was the responsibility of the appellant to transport the goods (cement) of the company; and how to accomplish this task of transportation was a matter exclusively within the domain of the appellant. Hence, hiring the services of truck operators/owners for this purpose could have only been under a contract between the appellant and the said truck operators/owners. Whether such a contract was reduced into writing or not carries hardly any relevance. In the given scenario and set up, the said truck operators/owners answered to the description of "sub-contractor" for carrying out the whole or part of the work undertaken by the contractor (i.e., the appellant) for the purpose of Section 194C(2) of the Act."*

26. This Court also draws support from well-established legal principles that distinguish genuine reimbursements from contractual payments. Genuine reimbursements are typically post-facto, directly linked to specific expenses incurred and supported by appropriate evidence. Conversely, payments that are predetermined percentages of sales, with no direct connection to actual costs incurred, are more akin to commissions or service fees, which are subject to TDS obligations under the relevant provisions. This distinction is vital in determining the applicability of TDS provisions and ensuring compliance with statutory mandates.

27. Additionally, this Court underscores that the primary obligation to deduct TDS rests with the payer at the time of making the payment or credit, regardless of whether the payee subsequently deducts TDS on their own downstream transactions. The legislative intent behind these provisions is to establish a robust mechanism for revenue collection at the source, thereby preventing tax evasion and promoting compliance. Allowing the downstream TDS compliance by the recipients to substitute the upstream obligation of the payer would undermine this purpose and create potential avenues for tax avoidance, which the law explicitly aims to prevent.

28. It is also pertinent to note that the fact the recipients included these amounts in their income and paid the applicable taxes does not absolve the appellant of its statutory obligation to deduct TDS at the time of payment. The obligation under Section 40(a)(ia) is a substantive statutory requirement, independent of the subsequent tax compliance by the payees. Reliance on certificates from Chartered Accountants or affidavits asserting that taxes had been paid does not suffice to negate the requirement for actual TDS deduction at the source, especially when there is no direct, itemized linkage between the payments made and the taxes paid.

29. This Court further emphasizes that the purpose of TDS is to ensure that tax is collected at the point of origin, i.e., at the time of payment or credit rather than relying solely on the subsequent compliance of the payees. The

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disallowance under Section 40(a)(ia) serves as a deterrent against non-compliance and is essential for maintaining the integrity and effectiveness of the tax collection system. Permitting the appellant to escape its TDS obligations merely because the recipients have voluntarily paid taxes would defeat the very objective of the statutory provisions and weaken the enforcement mechanism.

30. Therefore, this Court is convinced that the Tribunal's reasoning was sound, well-reasoned and supported by the record evidence. The payments in question, being contractual and not genuine reimbursements, squarely fall within the scope of Section 194C. The failure to deduct TDS in these circumstances justifies the disallowance under Section 40(a)(ia). The appellant's arguments to the contrary lack merit and do not withstand scrutiny.

31. For the foregoing reasons, this Court finds no grounds to overturn the Tribunal's order. The order, which upheld the disallowance of Rs. 2,86,88,459/- towards sales promotion, advertisement and marketing expenses, as well as Rs.48,19,050/- towards handling, storage and collection charges under Section 40(a)(ia), is hereby affirmed. The questions framed being ….

a) Whether the Tribunal was justified in law in upholding the invocation of section 40(a)(ia) of the Income Tax Act, 1961 for disallowance of the reimbursement of sales promotions, advertisement and marketing expenses aggregating to Rs.2,86,88,459/- and of handling, storing and collection expenses of Rs.48,19,050/- because the amount reimbursed was quantified as a percentage of the net sales realization (since the payee companies dealt with not only the appellant's but also their own identical products) and its purported findings in that behalf are arbitrary, unreasonable and perverse?

b) Whether section 40(a)(ia) can be invoked for disallowing reimbursement of expenditure from which tax had been duly deducted tax at source, wherever applicable, by the companies which incurred the expenditure in the first instance?

c) Whether and in any event any disallowance under section 40(a)(ia) of the Act can be made in the appellant's case when the recipients had duly included the amounts reimbursed in their income and had paid income tax on their taxable income and the decision of the Tribunal rendered without considering or deciding the said contention of the appellant fully supported by materials on record including certificates of Chartered Accountants and affidavits is arbitrary, unreasonable and perverse?

are held to be in positive and in favour of the revenue.

32. The application being GA 1 of 2024 is disposed of.

33. There shall be no cost as to order.

34. Urgent certified copy, if applied for, be supplied upon compliance with requisite formalities.

(RAJARSHI BHARADWAJ, J)

(UDAY KUMAR , J)

Kolkata

18.02.2026
PA(BS)