

LK ANALYSIS SC JUDGEMENT-FRANCHISEE/ DISTRIBUTORS ARE INDEPENDENT CONTRACTORS



INTRODUCTION

The Hon'ble Supreme Court in its recent judgment in the matter of Bharti Cellular Limited vs. Assistant Commissioner of Income Tax and Anr. [2024 SCC Online SC 198] ("**Judgement**") has analyzed various aspects of distributorship | franchise ("**Distributor**") and agency.

It held that the Distributor is an independent contractor, and their income is not a commission or brokerage and therefore, is not subject to TDS.

JUDGMENT

Distributors are Independent Contractors

Background: The Bharti Cellular Limited ("**Company**") is a cellular mobile telephone service provider, who have entered into distribution agreement with multiple distributors. In this case, the distributor purchases the start-up kits and recharge vouchers of the specified value at a discounted price from the Company and sells them accordingly. The Hon'ble Supreme Court considered a vital issue in this matter regarding the tax treatment of income of distributorship or franchise vis-à-vis agency given their legal status. The Hon'ble Supreme Court held that distributor is an independent contractor which sells goods on his account to customers, or third parties and its income is in the nature of profit or loss and not of brokerage or commission and therefore, it is not subject to TDS. In this regard, the Hon'ble Supreme Court has analyzed the legal status of Distributor vis-a-vis agency.

ISSUES

Post this judgment:

- **Whether the restrictive clauses under distribution agreement would be considered to be void?**
- **What will be the respective construct of Distributor/ Franchise Agreement?**

Some of the important observations of the Hon'ble Supreme Court are as under:

- The Distributor acts individually in their own power i.e., buys goods and sells them in their own territory.
- Distributor does not create any relationship of third party with the principal and also not liable to the manufacturer or supplier in the way unlike an agent who might be liable for failure of duty.
- Distributor's contractual liability is different from manufacturer's liability on account of warranty/ guarantee, statutory liability or even obligation towards third party which purchases goods or services from it.
- The agent is liable to render accounts to the principal as the business is done on principal's account. The agent is entitled to remuneration from principal.
- The Hon'ble Supreme Court held that in order to decide over any distributorship/ franchise or agency one would need to look into the arrangement depicting the independence of the Distributor.

ANALYSIS

The Judgment has examined the relationship between the manufacturer/ franchisor with distributor/ franchise in detail and has highlighted independence as one of the vital characteristics.

In the Judgement, the Hon'ble Supreme Court has recognized the business requirements of certain terms and conditions under the distribution agreement relating to the manner in which the manufacturer/ seller/ franchisor conducts its business. However, at the same time such clauses should not creep into the independence of Distributor.

Even though the Judgement has not specifically highlighted these terms and conditions but some of the contractual terms one should be mindful of are as under:

- Exclusivity or territoriality
- Specifications such as infrastructure specifications, minimum order quantity, staff, etc.
- Non-compete or non-solicit.
- Information rights
- Approvals & Reviews: Appointment of retailers/ outlets, marketing and promotional campaigns, sales & targets, use of intellectual property (including trademarks) etc.



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