* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **Income Tax Appeal No. 1167/2011**

Reserved on: 21st October, 2011
% Date of Decision: 8th November, 2011

The Commissioner of Income Tax Delhi-IV, New Delhi ....Appellant
Through Mr. Sanjeev Sabharwal, Advocate.

Versus

EON Technology P. Limited …Respondent
Through Mr. Salil Aggarwal and
Mr. Prakash Chand, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R. V. EASWAR

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporter or not ? Yes.
3. Whether the judgment should be reported in the Digest ? Yes.

SANJIV KHANNA, J.

Revenue in the present appeal under Section 260A of the Income Tax Act, 1961, (Act, for short) has raised the following substantial question of law:-

> "Whether Income Tax Appellate Tribunal has erred in upholding the order of the CIT(A) deleting the addition of Rs.33,36,068/- made by the Assessing Officer under section 40(a)(i) of the Income Tax Act, 1961?"

2. The respondent assessee EON Technology Pvt. Ltd. is a private limited company engaged in business of development and export of

software. During the relevant assessment year 2007-08, the assessee had paid commission of Rs.33,36,068/- to its parent/holding company EON Technologies, U.K., (ETUK, for short) on the sales and amounts realized on export contracts procured by ETUK for the respondent assessee. There is no dispute about the nature and on what account commission has been paid. The quantum etc. and the fact that ETUK was entitled to said payment is not doubted or disputed.

3. The contention and question raised by the Revenue is that the commission income of Rs.33,36,068/- earned by ETUK had accrued in India or was deemed to accrued in India and, therefore, the respondent assessee was liable to deduct tax at source and as there was failure, the said expenditure should be disallowed under Section 40(a)(ia) of the Act. The relevant portion of the assessment order reads:-

> "There are express provisions of the IT Act that provide for taxation of any part of income that accrues or arises or deemed to accrue or arise in India. When one states 'accrual of income' it is basically an absolute concept when both the situs and receipt of such income is within the territories of the country. However, if such conditions are not met fully and completely, then the deeming concept comes into play. As per previous judicial pronouncement, it has been clearly established that income can be said to be received when it reaches the assessee but it can be said to have "accrued" or "arisen" immediately when the right to receive the said income becomes vested in the assessee. By performing the functions as envisaged in the agreement, the ETUK has earned the right to receive the income, thereby attracting the provisions of section 5 of the Act. It has further been stated vide various judicial pronouncement including in the case of CIT Vs. Punjab Tractors Cooperative Multipurpose Society Ltd that in the case of rendering of services, income

> would accrue at the time of such rendering of services. As per the agreement of ETUK is the sole selling and marketing agent for the assessee, which means ETUK is rendering the service of selling which has enabled him to earn the right to receive the income from ET India, i.e. the assessee. Since such receipts situs/origin in India, this portion of income becomes liable to be taxed in India. It shall not out of place to mention that the place of accrual of income is the place where right to receive that income arises with the corresponding liability of the prayer to make the payment of the same there. The assessee's statement that since no operation/business are carried out in the taxable territories of India then the income accruing abroad through on any business connection in India cannot be deemed to accrue or arising in India, does not hold any water as the source of such income arising to ETUK is its business connection with the assessee company in India i.e. the source is situate wholly and completely within territories of India.
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> Another contention of the assessee regarding that that this commission payment is remitted directly to ETUK and is therefore not received in India is also not tenable since receipt and right to receive are two distinct concepts both of which cannot be used interchangeably. Here the ETUK may not have received the amount in India but due to its business connection in India, ETUK has earned the right to receive this income "deemed to accrue" and thereby becoming liable to be taxed in India of the portion that accrues or arises in India."
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> (emphasis supplied)

4. The reasoning of the Assessing Officer is confusing, laconic and not clear. In the first paragraph of the assessment order quoted above it has been held that the right to receive income by ETUK had situs or origin in India. It is stated that the place of accrual of income was in India as payment was made from India and, therefore, it is deemed to be received in India. In the first paragraph towards the end, the Assessing Officer has held that that the source of income by way of

commission earned by ETUK has business connection with the respondent-assessee in India i.e. the source was situated wholly and completely within the territory of India. The second paragraph refers to business connection and principle of deemed accrual.

5. Thus, on one hand, it was held that the commission income paid to ETUK had accrued or arisen in India and the said ETUK had right to receive income in India, since the situs/origin is in India but it is also averred that ETUK had business connection with the respondent assessee in India.

6. Concept of deemed accrual of income is different from income accruing, arising or received in India. When income accrues, arises or is received in India by a non resident, it is taxable in India. Income which is deemed to accrue or arise in India under the Act is taxable in India even though such income has not actually accrued, arisen or received in India.

7. To appreciate the legal position, Section 5(2) of the Act is reproduced below:-

> "Section 5 (2): Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which –
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> (a) Is received or is deemed to be received in India in such year by or on behalf of such person; or

> (b) Accrues or arises or is deemed to accrue or arise to him in India during such year.
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> Explanation 1 : Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.
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> Explanation 2 : For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

8. It is apparent from the Section 5(2) of the Act that total income of previous year of a person, who is a non-resident, is chargeable to tax in India if it is received or is deemed to be received in India or accrues or arises or is deemed to accrue or arise to him in India. Explanation 1 to the said section stipulates that income accruing or arising outside India shall not be deemed to be received in India within the meaning of the said section by reason of the fact that it is taken into account in the balance sheet prepared in India. Explanation 1 is a complete answer to the observations of the Assessing Officer that commission income had accrued, arisen or was received by ETUK in India because it was recorded in the books of respondent assessee in India or was paid by the respondent assessee situated in India. This aspect has been also examined below while dealing with the question of deemed accrual.

9. Section 9 of the Act postulates and states when incor... is deemed to arise in India. The Assessing Officer has not mentioned any specific provision of Section 9 but it appears that he had invoked Section 9(1)(i) of the Act which for the sake of convenience is reproduced below:-

> **"9. Income deemed to accrue or arise in India**.—(1) The following incomes shall be deemed to accrue or arise in India—
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> (*i*) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.
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> *Explanation 1.*—For the purposes of this clause—
> (*a*) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;
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> (*b*) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;
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> (*c*) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India;
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> (*d*) in the case of a non-resident, being—
> (1) an individual who is not a citizen of India; or
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> (2) a firm which does not have any partner who is a citizen of India or who is resident in India; or
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> (3) a company which does not have any shareholder who is a citizen of India or who is resident in India, no income

shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India;

Explanation 2.—For the removal of doubts, it is hereby declared that 'business connection' shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business:

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status. "

10. For the said provision to apply, the Assessing Officer was required to examine whether the said commission income is accruing or arising

directly or indirectly from any business connection in India. The Assessing Officer has not dealt with or examined the said aspect but has merely recorded that the payment made to ETUK was taxable in India because of its "business connection". The Assessing Officer did not elaborate or has not discussed on what basis he had come to the conclusion that "business connection" as envisaged under Section 9(1)(i) existed. On this aspect, we may note that the respondent assessee had submitted that ETUK was a non resident company and did not have any permanent establishment in India. ETUK was not rendering any service or performing any activity in India itself. These facts are not and cannot be disputed. Explanation 2 has not been invoked or relied upon by the Revenue. Factual matrix in respect of Explanation 2 has not been referred to or examined by the Assessing Officer and is not on record.

11. Commissioner of Income Tax (Appeals) relied upon two circulars issued by the Central Board of Direct Taxes being Circular No. 23 dated 23rd July, 1969 and Circular No. 786 dated 7th February, 2000, reported in [2000] 241 ITR 132 (St.). The relevant portion of the said circulars, for the sake of convenience are quoted below:-

> **Circular No.23 dated 23.07.1969**
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> "Foreign Agents of India Exports-Where a foreign agents of India exporter operates in his own country and his commission is usually remitted directly to m/him and is,

therefore, not received by him or on his behalf in India. Such an agent is not liable to income-tax in India on the commission"

Circular No.786 dated 07.02.2000

"As clarified earlier in circular No.23 dated 23-7-1969 (see under section (5) where the non-resident agent operates outside the country, no part of his income arises in India, and since the payment is usually remitted directly abroad, it cannot be held to have been received by or on behalf of agent in India. Such payments were therefore, held to be not taxable in India. This clarification still prevails. In view of the fact that the relevant sections [section 5(2) and section 9] have not undergone and change in this regard. No tax is therefore deductible under section 195 from export commission and other related charges payable to such a non-resident for services rendered outside India."

12. On the said aspect we may refer to the decision of the Supreme Court in ***C.I.T. vs. Toshoku Limited,*** (1980) 125 ITR 525 (SC). This case relates to the assessment year 1962-63. The Indian assessee had paid commission to two foreign companies through whom they had procured export orders. Questions arose; what was the effect of the entries in the books of accounts of the Indian assessee which had resulted in debit and credit entries on account of commission and secondly, whether procurement of export orders by the foreign companies for the Indian company had resulted in a business connection. Two contentions were rejected by the Supreme Court inter-alia recording as under:-

"It cannot be said that the making of the book entries in the books of the statutory agent amounted to receipt by the assessees who were non-residents as the amounts so credited in their favour were not at their disposal or control. It is not possible to hold that the non-resident

> assessees in this case either received or can be deemed to have received the sums in question when their accounts with the statutory agent were credited, since a credit balance, without more, only represents a debt and a mere book entry in the debtor's own books does not constitute payment which will secure discharge from the debt. They cannot, therefore, be charged to tax on the basis of receipt of income actual or constructive in the taxable territories during the relevant accounting period.
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> In the instant case, the non-resident assessees did not carry on any business operations in the taxable territories. They acted as selling agents outside India. The receipt in India of the sale proceeds of tobacco remitted or caused to be remitted by the purchasers from abroad does not amount to an operation carried out by the assessees in India as contemplated by cl. (a) of the Explanation to s. 9(1)(i) of the Act. The commission amounts which were earned by the non-resident assessees for services rendered outside India cannot, therefore, be deemed to be incomes which have either accrued or arisen in India. The High Court was, therefore, right in answering the question against the department."

13. The aforesaid decision is a complete answer to the contention raised by the Revenue and as mentioned in the assessment order that commission income had accrued and arisen in India when credit entries were made in the books of the respondent assessee in favour of the ETUK and the said income towards commission was received in India. As noticed above, the stand of the Revenue is contrary to the two circulars issued by the CBDT in which it is clearly held that when a non-resident agent operates outside the country no part of his income arises in India, and since payment is remitted directly abroad, and merely because an entry in the books of accounts is made, it does not mean that the non-resident has received any payment in India. This

fact alone does not establish business connection. In Circular No. 786 dated 7th February, 2000, it has been stated that in such cases, the Indian assessee is not liable to deduct TDS under Section 195 of the Act from the commission and other related charges payable to such a non-resident having rendered service outside India.

14. The term "business connection" has been interpreted by the Supreme Court to mean something more than mere business and is not equivalent to carrying on business, but a relationship between the business carried on by a non-resident, which yields profits and gains and some activities in India, which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India [***CIT Vs. R.D. Aggarwal and Company*** (1965) 56 ITR 20 (SC), ***Carborandum & Co. Vs. CIT*** (1977) 2 SCC 862 and ***Ishikawajma-Harima Heavy Industries ltd. Vs. Director of income Tax, Mumbai*** (2007) 3 SCC 481]. The test which is to be applied is to examine the activities in India and whether the said activities have contributed to the business income earned by the non-resident, which has accrued, arisen or received outside India. The business connection must be real and intimate from which the income had arisen directly or indirectly. The question of business connection, therefore, has to be decided on facts found by

Assessing Officer (or in the appellate proceedings). In the present case, facts found by the Assessing Officer do not make out a case of business connection as stipulated in Section 9(1) (i) of the Act. There is hardly any factual discussion on the said aspect by the Assessing Officer. He has not made any foundation or basis for holding that there was business connection and, therefore, Section 9(1)(i) of the Act is applicable. Appellate authorities, on the basis of material on record, have rightly held that "business connection" is not established.

15. The scope and ambit of Section 195 of the Act has been explained by the Supreme Court in ***GE India Techonology Centre (P) Ltd. vs. CIT*** (2010) 327 ITR 456. In the said case the expression "any other sum chargeable under the provisions of the Act" in Section 195 of the Act was elucidated and explained. It was held that if payment is made in respect of the amount which is not chargeable to tax under the provisions of Act, tax at source (TDS, for short) is not liable to be deducted. Decision of Supreme Court in ***Transmission Corporation of Andhra Pradesh vs. CIT,*** (1999) 239 ITR 587 (SC), operates and is applicable when the sum or payment is chargeable to tax under the provisions of the Act. In such cases, TDS has to be deducted on the gross amount of payment made and not merely on the taxable income included in the gross amount. The said decision would not apply in case

payment is made but the said sum in entirety is not chargeable or exigible to tax under the provisions of the Act. The said distinction has been rightly understood by the first appellate authority and the ITAT and correctly applied by them.

16. It will be appropriate to refer to the following observations of the Supreme Court in the ***Commissioner of Income Tax, New Delhi Vs. Eli Lilly and Company (India) Private Ltd.,*** (2009) 15 SCC 1, wherein it has been observed :-

> "**60.** Under the 1961 Act, total income for the previous year is chargeable to tax under Section 4. Section 4(2) inter alia provides that in respect of income chargeable under Section 4(1), income tax shall be deducted at source where it is so deductible under any provision of the 1961 Act. Section 192(1) falls in the machinery provisions. It deals with collection and recovery of tax. That provision is referred to in Section 4(2). Therefore, if a sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted. *The sum which is to be paid may be income out of different heads of income* mentioned in Section 14, that is to say, income from *salaries*, income from house property, profits and gains of business, capital gains and income from other sources.
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> **61.** The scheme of the TDS provisions applies not only to the amount paid, which bears the character of "income" such as salaries, dividends, interest on securities, etc. but the said provisions also apply to gross sums, the whole of which may not be income or profits in the hands of the recipient, such as payment to contractors and sub-contractors.
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> **62.** The purpose of TDS provisions in Chapter XVII-B is to see that the sum which is chargeable under Section 4 for levy and collection of income tax, the payer should deduct tax thereon at the rates in force, if the amount is to be paid to a non-resident. The said TDS provisions are meant for tentative deduction of income tax subject to regular

assessment. (See *Transmission Corpn. of A.P. Ltd.* v. *CIT*, SCC pp. 273-74, para 10 : ITR pp. 594-95.)"

(emphasis supplied)

It was thereafter lucidly clarified:-

"73. *On the question as to whether there is any interlinking of the charging provisions and the machinery provisions under the 1961 Act*, we may, at the very outset, point out that in *CIT* v. *B.C. Srinivasa Setty* this Court has held that:

"*10*. … the charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section."

We may add that, the 1961 Act is an integrated code and, as stated hereinabove, Section 9(1) integrates the charging section, the computation provisions as well as the machinery provisions. (See Section 9(1)(*i*) read with Sections 160, 161, 162 and 163.)

74. In the present case, it has been vehemently urged that TDS provisions being machinery provisions are independent of the charging provisions whereas as held by this Court in *B.C. Srinivasa Setty*, the 1961 Act is an integrated code.

75. To answer the contention herein we need to examine briefly the scheme of the 1961 Act. Section 4 is the charging section. Under Section 4(1), total income for the previous year is chargeable to tax. Section 4(2) inter alia provides that in respect of income chargeable under sub-section (1), income tax shall be deducted at source whether it is so deductible under any provision of the 1961 Act which inter alia brings in the TDS provisions contained in Chapter XVII-B. In fact, if a particular income falls outside Section 4(1) then TDS provisions cannot come in.

76. Under Section 5, all residents and non-residents are chargeable in respect of income which accrues or is deemed to accrue in India or is received in India. Non-residents who are not assessable in respect of income accruing and received abroad are rendered chargeable

under Section 5(2)(*b*) in respect of income deemed by Section 9 to accrue in India."

(emphasis supplied)

17. After referring to ***Eli Lilly*** (supra) in ***GE India Technology Centre Private Limited*** *(supra)*, it has been held:

> **"17.** Section 195 appears in Chapter XVII which deals with collection and recovery. As held in *CIT* v. *Eli Lilly & Co. (India) (P) Ltd.* the provisions for deduction of TAS which is in Chapter XVII dealing with collection of taxes and the charging provisions of the IT Act form one single integral, inseparable code and, therefore, the provisions relating to TDS applies only to those sums which are "chargeable to tax" under the IT Act. It is true that the judgment in *Eli Lilly* was confined to Section 192 of the IT Act. However, there is some similarity between the two. If one looks at Section 192 one finds that it imposes statutory obligation on the payer to deduct TAS when he pays any income "chargeable under the head 'Salaries'". Similarly, Section 195 imposes a statutory obligation on any person responsible for paying to a non-resident any sum "chargeable under the provisions of the Act", which expression, as stated above, does not find place in other sections of Chapter XVII. It is in this sense that we hold that the IT Act constitutes one single integral inseparable code. Hence, the provisions relating to TDS applies only to those sums which are chargeable to tax under the IT Act.
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> **18.** If the contention of the Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department would be entitled to appropriate the monies deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the IT Act by which a payer can obtain refund. Section 237 read with Section 199 implies that only the recipient of the sum i.e. the payee could seek a refund. It must therefore follow, if the Department is right, that the law requires tax to be deducted on all payments. The payer, therefore, has to deduct and pay tax, even if the so-called deduction comes out of his own pocket and he has no remedy whatsoever, even where the sum paid by him is not a sum chargeable under the Act. The interpretation of the Department, therefore, not only requires the words "chargeable under the provisions of the Act" to be

> omitted, it also leads to an absurd consequence. The interpretation placed by the Department would result in a situation where even when the income has no territorial nexus with India or is not chargeable in India, the Government would nonetheless collect tax. In our view, Section 195(2) provides a remedy by which a person may seek a determination of the "appropriate proportion of such sum so chargeable" where a proportion of the sum so chargeable is liable to tax."

18. In view of the aforesaid discussions, it has to be held that there is no error in the findings recorded by the Commissioner of Income Tax (Appeals) which have been upheld in the impugned order by the ITAT. We do not find any merit in the present appeal and the same is dismissed. No costs.

(SANJIV KHANNA)
JUDGE

(R. V. EASWAR)
JUDGE

November 8th, 2011
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