Why representation before courts are critical

-Gagan Kumar*

The Authority for Advance Rulings ("**AAR**"), in a recent ruling titled "*SKF Boilers and Driers Pvt. Ltd*" ("**Boilers Case**"), discussed and decided the liability of non resident agents ("**NR Agents**") to pay tax on the commission earned by such NR Agent ("**Commission**") on an order involving export of Rice Par Boiling and Dryer Plants ("**Plant**s") out of India.

Facts of the case

An Indian company, SKF Boilers and Driers Pvt. Ltd. ("**Applicant**") is a manufacturer and supplier of the Plants. The Applicant received an export order for the Plants from a company in Pakistan, through 2 (two) NR Agents. Post completion of the Order, the Commission became payable to the NR Agents.

Issue involved

The principal question involved in the Boilers Case was:

Whether the income of the NR Agents can be deemed to accrue or arise in India in accordance with Section 5 (2) (b) read with Section 9 (1) (i) (collectively, "**Relevant Provisions**") of the (Indian) Income Tax Act, 1961 ("**Act**").

Findings of the AAR

The AAR, after examining the Relevant Provisions along with the facts of the Boilers Case, observed that it is the 'situs' of the income that would be relevant in deciding whether the Commission would be taxable in India. The AAR observed that, though the NR Agents rendered service outside India and the Commission was payable outside India, the right to receive such Commission arises in India as the order is executed by the Applicant in India. On the above reasoning, the AAR held that the Commission to the NR Agents would qualify to be income deemed to accrue and arise in India and would be taxable under the Act.

It is interesting to note that before AAR, no one appeared on behalf of applicant. In the ensuing paragraphs, we are discussing the contentions which the counsel of Applicant might have taken to make his point.

(a) **Reliance on the AAR ruling in the case titled "*Rajiv Malhotra*".**

The AAR relied on its previous ruling titled *Rajiv Malhotra,* AAR no. 671 of 2005 ("**Malhotra Case**"), to arrive at its findings. It is important to point out that, though the Malhotra Case also analysis the Relevant Provisions of the Act, its facts were substantially antithetical to the Boilers Case. In the Malhotra Case, the facts revolved around organisation of a show in India, in which a foreign entity (solicited and arranged by the non resident of the show's organiser) would participate and the non resident's right to receive commission would only arise once foreign entity participates in India and makes payment for such participation to the organiser in India, whereas in the Boilers Case, the services were rendered outside India and the Commission was also payable outside India. In other words, the facts of the Boilers Case do not contain any

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activity attributable to the NR Agent which took place in India, as against the facts of the Malhotra Case, where the show took place in India and the non resident agents right to receive commission arose only once the organiser received payment in India from the participating foreign entity solicited by the non resident agent. Thus, the AAR's reliance on the Malhotra case may not be correct.

(b) "**Situs" of income**

In its ruling, the AAR asserted the importance of the "situs" of income for deciding the taxability of the Commission. It is apt to point out that India follows the concept of "Source Based Taxation" for non residents. In other words, under the Act, non residents are taxed only on income that has its source in India. Several judicial pronouncements, including *Indian Aluminium Co. Ltd. v. Commissioner of Income Tax*, (1983) 140 ITR 114 (Cal), have observed that income arises only at a place where services are rendered, meaning thereby that the "situs" of income would be the place of service. Drawing a parallel from this observation to the facts of the Boiler Case, it may be said that the "situs" of income of the NR Agents would be the place where the purchaser company of the Plant was solicited or arranged, which was outside India. Hence, the observation of the AAR that "situs" of income was in India owing to the fact that that the order for the Plants was executed in India may not be correct.

(c) **Meaning of "Business Connection"**

Section 9 (1) (i) of the Act contemplates the situations when income is deemed to accrue or arise in India, which includes all income accruing or arising, whether directly or indirectly through a business connection. A Supreme Court ruling of *Commissioner of Income Tax, Punjab v. R.D. Aggarwal & Company*, AIR 1965 SC 1526, has held that a business connection predicates an element of continuity between the business of the non resident and the activity in India and a stray or isolated transaction is normally not to be regarded as a business connection. Application of the above observation to the facts of the Case would result in the inevitable conclusion that in the absence of the continuing relationship between the NR Agent and the Applicant, the Commission payable to the NR Agent may not even qualify to be income accruing or arising in India on account of a business connection. Hence, the Commission payable to the NR Agent may not even be within the ambit of Section 9 (1) (i) of the Act, which has been interpreted and deliberated upon by the AAR while deciding the Boilers Case.

(d) **Income reasonably attributable to operations carried out in India**

Explanation (a) to Section 9 (1) (i) of the Act ("**Explanation**") provides that in case of a business of which all operations are not carried out in India, the income of such business deemed to accrue of arise in India shall only be such part of the income as is reasonable attributable to operations carried out in India. The Supreme Court, in the case titled *C.I.T, Andhra Pradesh v. Toshuku Limited, Guntur and Others*, AIR 1981 SC 148 ("**Toshuku Case**"), has held that commission amounts earned by non resident agents for their service rendered outside India (such service being sale of a product exported from India) do not come within the amplitude of the Explanation and cannot be deemed to income accruing or arising in India. In other words, the Supreme Court held that none of the operations of the non resident agents could be considered to be carried out in India for the purposes of the Act. A similar view was also taken by the Apex Court in the case of *Carborandum Co. Vs CIT, 108 ITR 335*. In fact, the hon'ble Supreme Court observed that even if the non resident has a business connection, the income cannot be taxed in India since no

service was rendered in India. An analogy from these cases can be drawn to contend that the Commission payable to the NR Agent outside India for their services rendered outside India do not qualify to be income which can be subjected to tax under the Act.

(e) **Withdrawal of the Circular**

In the Boiler Case, the revenue had raised another contention that the Commission payable to the NR Agent would be taxable in India on account of the fact that circular no. 786, dated February 7, 2000 ("**Circular**") had been withdrawn. Numerous judgements, including *UCO Bank v. C.I.T, West Bengal*, AIR 1999 SC 2082, have held that the objective of a circular issued by the Central Board of Direct Tax ("**CBDT**") is to ensure proper administration of the Act and also to tone down the rigor of law for the benefit of the assesses, wherever required. However, it has been clarified that a circular cannot pre-empt a judicial interpretation of a provision of the Act. In the case of *DCIT v. Divis Laboratories Ltd*., IT Appeal nos. 601 to 604 (Hyd) of 2009 ("**Divis Case**") a similar contention of withdrawal of the Circular was made by the revenue. However, the Income Tax Appellate Tribunal while interpreting Section 9 of the Act and placing reliance on the Toshuku Case, observed that a non resident agent of an Indian entity whose commission is remitted to him outside India is not liable to payment of tax in India on the commissions received. From the above, it emerges that withdrawal of the Circular does not alter the consistently followed judicial interpretation of Section 9 of the Act, which, *per se*, appears to exclude commissions payments, such as those payable to the NR Agent, from any tax implication under the Act. Ergo, reliance on the Divis Case can be made to contend that withdrawal of the Circular would not have the consequence of the Commission being drawn within the ambit of taxability under the Act.

In nutshell, if the AAR had benefit of arguments from applicant's side also, the outcome of the ruling may be different.