"C.R"

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT

THE HONOURABLE MR.JUSTICE K.VINOD CHANDRAN

&

THE HONOURABLE MR.JUSTICE T.R.RAVI

TUESDAY, THE 13TH DAY OF OCTOBER 2020 / 21ST ASWINA, 1942

I.T.A.No.257 OF 2014

*** [(AGAINST THE ORDER IN ITA.NO.282/2013 DATED 29.11.2013 OF THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH, KOCHI RECEIVED BY THE APPELLANT ON 10.12.2013).**

*** APPELLANT/ RESPONDENT IN ITA:**

M/S. DEVICE DRIVEN (INDIA) PVT. LTD.,
GROUND FLOOR, PADMANABHAM, TECHNOPARK,
KARIYAVATTOM, THIRUVANANTHAPURAM,
REP BY ITS DIRECTOR, MS.INDU LAKSHMY LAL

*** RESPONDENT/ APPELLANT IN ITA:**

THE COMMISSIONER OF INCOME TAX,
AAYAKAR BHAVAN, KOWADIYAR,
THIRUVANANTHAPURAM-695003]

*** CAUSE TITLE AMENDED.**

AMENDED CAUSE TITLE:

****(AGAINST THE ORDER IN C.O.NO.9/COCH/2013 DATED 29.11.2013 ARISING OUR OF I.T.A.NO.282/COCH/2013 OF THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH, KOCHI, RECEIVED BY THE APPLLANT ON 10.12.2013).**

**** APPELLANT/ CROSS-OBJECTOR IN I.T.A.:**

M/S. DEVICE DRIVEN (INDIA) PVT. LTD.,
GROUND FLOOR, PADMANABHAM, TECHNOPARK,
KARIYAVATTOM, THIRUVANANTHAPURAM – 695 011,
REP BY ITS DIRECTOR, MS.INDU LAKSHMY LAL.

BY ADVS.
SRI.M.GOPIKRISHNAN NAMBIAR
SRI.P.BENNY THOMAS
SRI.K.JOHN MATHAI
SRI.JOSON MANAVALAN
SRI.KURYAN THOMAS

**** RESPONDENT/ RESPONDENT IN CROSS OBJECTION IN I.T.A:**

**THE COMMISSIONER OF INCOME TAX,
AAYAKAR BHAVAN, KOWADIYAR,
THIRUVANANTHAPURAM-695003**

** **CAUSE TITLE AMENDED VIDE ORDER DATED 13.10.2020 IN I.A.NO.1/2020 IN I.T.A.NO.257/2014.**

R1 BY ADV. SRI.P.K.RAVINDRANATHA MENON, SENIOR COUNSEL, GOVT. OF INDIA

(TAXES), R1 BY SRI.JOSE JOSEPH, SC FOR INCOME TAX

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON 24-09-2020, THE COURT ON 13-10-2020 DELIVERED THE FOLLOWING:

K. Vinod Chandran & T.R.Ravi, JJ.

I.T.A.No.257 of 2014

Dated, this the 13th day of October, 2020

JUDGMENT

Vinod Chandran, J.

The appeal raises the question whether the commission paid to a non-resident, in the particular facts arising herein, is taxable under the Income Tax Act, 1961 ['IT Act' for brevity].

2. The appellant, a hundred percent Export Oriented Unit, is a Private Limited Company engaged in development and export of software. For the assessment year 2009-10, the appellant filed a return declaring a total income of Rs.17,204/-, after claiming deduction under Section 10B in respect of profit from export of software. Under Section 143(1) the return was processed and the payments made to Mr.Balaji Bal, a resident of Switzerland, who also was a Director of the Company, was disallowed under Section 40(a)(i) of the Act. The dis-allowance under Section 40(a)(i) was on the ground that the commission paid was fees for technical services on which tax is deductible at source, which the assessee failed to deduct. The amount shown as commission paid to the non-resident was added to

the total income of the Company.

3. On appeal, the first appellate authority concurred with the Assessing Officer with respect to the dis-allowance; but, however, allowed deduction under Section 10A. The Department approached the Tribunal and the assessee filed a cross objection. The Department's appeal was allowed and the Assessing Officer was directed to consider the deduction under Section 10A. The cross objection of the assessee was rejected. The assessee is now not concerned with the remand made, since the Assessing Officer has allowed the deduction. The assessee is aggrieved with the order of the Tribunal affirming the dis-allowance under Section 40(a)(i).

4. Sri.Raja Kannan, learned Counsel for the appellant, refers to Section 9(1)(vii) and Section 195 of the Act. It is the specific case of the appellant-assessee that the recipient of the commission is a non-resident, not taxable under the Act of 1961. It is admitted that the non-resident was also a Director of the assessee-Company, but the commission was paid under Annexure-B Commission Agency Contract. On a reading of the various terms of the contract, it is submitted that the activity carried on by the non-resident, in terms of the contract, was outside

India; specifically in the territories of the European Union, North America and Middle East. The activities carried on under the contract would not fall under the definition of 'fees for technical services' as seen from Explanation 2 of Section 9(1)(vii). It is also argued that even if it falls under Explanation 2, it is exempted under sub-clause (b) of Section 9(1)(vii). To buttress the above contention, ***C.I.T. v. Toshoku Ltd.*** [***(1980) 125 ITR 525 (SC)***] is relied on. It is pointed out that the activity of the non-resident for which he was paid the commission was entirely outside India and the income had no territorial nexus with India, as has been held in ***Ishikawajima-Harima Heavy Industries v. Director of I.T.*** [***(2007) 288 ITR 408 (SC)***]. Though an explanation was brought into Section 9 in the year 2010 with retrospective effect from 01.06.1976, in ***Jindal Thermal Power Co. Ltd. v. Deputy CIT (TDS)*** [***(2010) 321 ITR 31 (Karn)***] the Karnataka High Court held that the effect of the Supreme Court decision in ***Ishikawajima*** had not been obliterated. Insofar as how the explanation has to be construed, reliance has been placed on ***Sedco Forex International Drill Inc. v. CIT*** [***(2015) 279 ITR 310 (SC)***].

5. Section 195 casts a liability on the person making a payment to a non-resident to deduct tax at source

only when it is a sum chargeable under the provisions of the Act, as has been held in ***GE India Technology Centre (P) Ltd. v. CIT*** [***(2010) 10 SCC 29 = (2010) 327 ITR 456 (SC)***]. A non-resident is not taxable in India and the payment is made for services not coming within the definition of 'fees for technical services'. The activities for which the payment was made having been carried out entirely outside India, there is no tax chargeable on the commission paid even by virtue of the deeming provision. The appellant hence has no obligation to deduct tax at source, is the argument. Even otherwise, the Direct Taxation Avoidance Agreement ['DTAA' for brevity] between India and Switzerland, where the non-resident is located, absolves the entire liability to income tax in India. To further the contention of the payment not being a part of the technical services as per the DTAA, a Division Bench judgment of this Court in ***US Technology Resources (Pvt.) Ltd. v. CIT*** [***(2018) 407 ITR 327 (Ker)***] is relied on. To advance the case of no liability under the DTAA, the decision in ***C.I.T. v. P.V.A.L. Kulandagan Chettiar*** [***(2004) 267 ITR 654 (SC)***] has also been relied on.

6. Sri.P.K.Ravindranatha Menon, learned Senior Counsel appearing for the respondent, would specifically

refer to the Explanation added in the year 2010, which has retrospective effect from 1976 onwards. The Explanation was specifically introduced to get over the decision in *Ishikawajima*. The Explanation furthers the deeming provision under Section 9 to make it applicable, whether or not the non-resident has rendered services in India. There is no ground available to the appellant to escape from its liability to deduct tax at source on the ground that the activity of the non-resident was outside India. The enduring benefit of the services rendered by the non-resident was enjoyed by the assessee's business and, hence, the commission earned by the non-resident is income accrued within India. To further assert the taxability the 'source rule' as dilated upon in *GVK Industries Ltd. v. ITO* [*(2015) 371 ITR 453 (SC)*] is urged. It is argued that interpretation of Section 9(1)(vii) invoking the 'source rule' is purposeful and indicative of the provision being understood synonymous with its object. The source of payment was read as where the payer is located, is the compelling argument of the Revenue.

7. The assessee, who is the appellant herein, has filed the appeal against the Cross Objection. The assessee does not challenge the order of the Tribunal in the

Department's appeal remanding the matter to the Assessing Officer for consideration as to the allowance under Section 10A. The Assessing Officer is said to have allowed the claim.

8. The questions of law arising in the appeal are:

i) Whether on the facts and in the circumstances of the case the Appellate Tribunal was justified in upholding the order of the Appellate Commissioner, that the payments made by the appellant to Shri Balaji Bal, attracts Sec.40(a)(ia) of the Income Tax Act and therefore not deductible from the income of the appellant?

ii) Whether the Appellate Tribunal erred in holding that the appellant is liable for deduction of tax at source, under section 195 of the Income Tax Act, without a specific finding as to how the receipts of Shri Balaji Bal, would attract charge of Income Tax in India, going by the provisions of the Indian Income Tax Act, and the provisions of the India-Switzerland Double Taxation Avoidance Agreement?

iii) Whether the Appellate Tribunal erred in not considering the application of Article 14 of the India-Switzerland Double Taxation Avoidance Agreement, with reference to the material brought on record by the appellant and to have accepted the version of the department, made without any material evidence?

iv) Is not the finding of fact by the Appellate Tribunal erroneous and perverse?

9. The question as to whether Article 14 of the India-Switzerland DTAA is applicable need be considered only if the first two questions are answered in favour of the Revenue, finding the non-resident and the specific receipt taxable under the IT Act, as income received or deemed to be received or accrued, or arose or deemed to arise in India. The taxability will depend upon the interpretation of Section 5(2) read with Section 9(1)(vii)(b).

10. The admitted facts are as herein after stated. The non-resident, who was paid commission by the appellant herein, was a Director of the appellant company, but the payment made was not in that status. A Commission Agency Contract [Annexure-B] was entered into by the appellant and the non-resident, by which the latter was appointed as Commission Agent in the territories of European Union, North America and Middle East; all outside India. The appellant had procured orders from these outside territories by reason of the activities carried on by the non-resident commission agent. The assessee had received income in such business generated by the non-resident

Commission Agent in those territories, outside India, and in terms of Annexure-B agreement, payments were made to the Commission Agent amounting to Rs.55,51,605/-. The non-resident was a resident of Switzerland. The appellant did not deduct any tax under Section 195 from the commission paid to the non-resident on the ground that it is not taxable.

11. We have already detailed the various contentions of the appellant and the Revenue herein before. The first contention of the assessee is that there is no technical element in the appointment of the agent and even if for argument sake, there is said to be a technical element, the nature of the agency does not change *per se* and the commission paid would not come under the definition of 'technical services' as has been provided in Explanation-2 of Section 9(1)(vii). As per the Explanation, 'fees for technical services' for the purpose of clause (vii) means any consideration for rendering any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but excludes construction, assembly, mining or like project or the salaries; the latter of which does not fall under the said clause. Admittedly the services carried on under the

Commission Agency Contract is not one falling under any of the exclusions provided in Explanation-2. A similar contention was dealt with by a Division Bench of this Court in *US Technology Resources*. Therein, the services offered were (i) management decision-making (ii) financial decision-making, (iii) legal matters and public relation activities, (iv) treasury services and (v) risk management services. Reading the Explanation, it was found that the said services would come within the ambit of 'technical services' as consultancy services. The Explanation does not confine the technical services to those which are strictly technical in nature.

12. Annexure-B contract specifically defines the role of the Commission Agent, which is stated to be concerned with 'marketing', 'pre-sales' and 'sales' support, which essentially comprises general counsel, assistance and support in areas of a wide range, a few of which were enumerated as clause 2.1 to 2.7, which are extracted here under:

> **"2.1 Sizing up market situations and business opportunities in the region.**
>
> **2.2 Assisting and supporting DEVICEDRIVEN (INDIA) in developing and bundling an appropriate marketing mix and service offering for the Region.**

2.3 Identifying specific target -prospects and making preliminary introductory contacts.

2.4 Securing meetings with target-prospects for DEVICEDRIVEN (INDIA) to make credential presentations and marketing pitches.

2.5 Review DEVICEDRIVEN (INDIA)'s proposals for target-prospects and provide advice and assistance where appropriate to help secure project.

2.6 Hold periodic meetings with DEVICEDRIVEN (INDIA) to track project progress and status.

2.7. COMMISSION AGENT shall assist in all payment collection from the Client".

The duties enumerated herein above would clearly indicate that there is an element of managerial function coupled with all encompassing consultancy services and also purely technical services too. The appellant cannot raise a contention that the services of the non-resident do not fall under the scope of 'technical services' as spoken of in Section 9(1)(vii) and defined in Explanation-2.

13. The further contention taken is as to the activities carried out by the commission agent, who is a non-resident, to be covered under the exception to clause (b) of Section 9(1)(vii). The ground, in a nutshell, is that the non-resident was appointed as an agent for marketing the goods (software) of the appellant, in three territories falling outside India. The commission payable

to the non-resident, as per the contract was only with respect to such business canvassed by the non-resident from those three outside territories. When such business is carried out by the appellant on the basis of the services of the non-resident agent, commission is paid to the extent of that spoken of in the contract agreement. The commission, as is seen from Annexure-B, is 15% of the contracts/projects executed by the appellant on the basis of the marketing services rendered by the commission agent. The income derived by the appellant from the marketing services rendered by the commission agent is sourced from the three territories which are outside India. The activities of the non-resident agent are confined to those territories outside India. In such circumstances, the commission paid is ‘fees payable in respect of services for the purposes of making or earning any income from any source outside India’ is the compelling argument, which we find favour with. The income derived by the appellant is un-disputedly from the three territories mentioned in the agreement, which are admittedly outside India. In this context, we have to notice the various decisions on which reliance was placed by both sides.

14. *Toshuku Ltd.* is identical to the facts of this case but sub-clause (vii) of Section 9(1) was not dealt with. The non-resident, respondent in that case, was appointed by a dealer in tobacco in the State of Andhra Pradesh, as exclusive sales agent in Japan, of tobacco exported by the dealer. Likewise, a non-resident business house was appointed for the same purpose in France. The question arose whether the commission amounts sent to the Japanese company and the French business house were assessable under Section 161 of the IT Act. The Hon'ble Supreme Court dealt with the provisions of the IT Act, specifically Sections 5(2), 9(1)(i), 160, 161 and 163. Section 5(2) of the Act deals with the chargeability of the income of a non-resident. The above provisions were dealt with in the following manner:

> **"The relevant provisions of the Act on which reliance is placed before us are Sections 5(2), 9(1)(i), 160, 161 and 163. Section 5(2) of the Act which deals with the chargeability of the income of a person who is a non-resident under the Act provides that subject to the provisions of the Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived (a) which 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 in India during such year. Explanation 1 to Section 5(2) of the Act declares that an income arising abroad can not be deemed to be received in India for the purpose of that section by reason only of the fact that it is included in a balance sheet prepared in India. Section 9(1)(i) of the Act provides that 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 shall be deemed to accrue or arise in India. The *Explanation* to this clause provides that 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 and 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".

[Underlining by us for emphasis]

15. It was found that un-disputedly the assessees, who were the respondents therein, rendered services as selling agent to the statutory agent outside the taxable territories (India). The mere fact that the commission

payable to those assessees, non-residents, were shown in the balance sheet of the dealer in India would not by itself bring it under the total income of the non-resident as is specified by Explanation-1 to Section 5(2). The decision in ***P.V.Raghava Reddi*** *v.* ***CIT*** [***(1962) 44 ITR 720 (SC)***] was distinguished. In ***Raghava Reddi***, Mica being not directly importable by a Japanese buyer, it had to be exported to a Japanese State organization. An agent was appointed in Tokyo, which agent, as per the agreement itself made it a condition that due to difficulties in their country the Indian party to the contract shall credit the commission amounts to their (Tokyo agent's) account and disburse it in accordance with the instructions of the Tokyo agent. It was found that the character of the money changed from a debt, as shown in the balance sheet, to a deposit, which attracts the application of Section 4(1)(a) of the IT Act.

16. As far as ***Toshuku Ltd.*** is concerned, all its operations were carried out outside India. Clause (a) of the Explanation to Section 9(1)(i) provides that in the case of a business of which all operations are not carried out in India, the income of the business deemed under that clause to arise or accrue in India shall be only such part

of the income as is reasonably attributed to the operations carried out in India. It was held so by their Lordships:

> "In the instant case, the non-resident assessee 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 assessee 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".
>
> [underlining by us for emphasis]

17. The appellant had also argued that there is no territorial nexus based on ***Ishikawajima***, which however was countered by the Department based on the Explanation substituted by Finance Act, 2010 with retrospective effect from 01.06.1976. The learned Senior Counsel had also specifically referred to ***GVK Industries Ltd.*** to buttress their argument, which is countered by the learned Counsel for the appellant with ***Jindal***. By placing reliance on ***GVK Industries Ltd.,*** it is urged by the Revenue that the

'source rule' as discussed therein makes it mandatory that the income of the recipient is to be charged or becomes chargeable in the country where the source of payment is located. On the other hand, the appellant relies on the decision in *Jindal* to argue that the Explanation as substituted by Finance Act 2010 does not take away the effect of *Ishikawajima*. Before we deal with the Explanation, we would just look at the facts and law declared in the decisions.

18. *Ishikawajima* considered a turnkey project, wherein there were a number of parties who were obliged to carry out different parts of the contract. With respect to the non-resident Ishikawajima, the contract involved offshore supply & services, onshore supply & services as also construction and erection. There was no dispute raised with respect to onshore supply & services and construction and erection, which were admitted to be taxable. The dispute was with respect to the amounts received or receivable by the non-resident from the resident for those offshore supply & services. The non-resident claimed that the comprehensive contract of onshore and offshore activities, is a divisible contract. Those activities attributable to be carried out within India would be

taxable and those outside India would be non-taxable. The contention of the Revenue was that the contract being an integrated and composite one, the assessee was liable to pay tax. Their Lordships of the Hon'ble Supreme Court found that in construing a contract, the terms and conditions are to be read as a whole keeping in view the intention of the parties. The applicability of the tax laws though dependent on the nature of the contract, the contract itself cannot be construed based on the taxing provisions. There was no doubt that the offshore supplies and services, as is clear from their description itself, were offshore. The Department had rendered its opinion against that, only on the premise that offshore supplies and services were intimately connected with the turnkey project. Looking also at the provisions of the DTAA, it was held that the business connection as spoken of in Section 9(1) and the permanent establishment as stated in DTAA should not be mixed up.

19. It was categorically found in *Ishikawajima* that '*the services which are the source of the income that is sought to be taxed, has to be rendered in India, as well as utilized in India, to be taxable in India*' (sic. para 91). It was held:

"...Whatever is payable by a resident to a non-resident by way of fees for technical services, thus, would not always come within the purview of section 9(1)(vii) of the Act. It must have sufficient territorial nexus with India so as to furnish a basis for imposition of tax. Whereas a resident would come within the purview of section 9(1)(vii) of the Act, a non -resident would not, as services of a non -resident to a resident utilized in India may not have much relevance in determining whether the income of the non-resident accrues or arises in India. It must have a direct live link between the services rendered in India. When such a link is established, the same may again be subjected to any relief under the DTAA. A distinction may also be made between rendition of services and utilization thereof".

20. ***Jindal*** again was a case in which the resident entered into a contract with three companies, two of which were companies registered outside the territory of India. The question was also as to the services rendered by the foreign company (non-resident) to the Indian company. The Division Bench of the Karanataka High Court held that ***Ishikawajima*** still held the field. The contract between the foreign company and the resident Indian company was found to have three aspects, one, technical services involving overall conceptualization of the plant, the technical

logistics and designs, etc., in which the foreign Company did not have any role to play. The job of the foreign company was to execute the contract as conceptualized, which was to be done only offshore and outside India. But, with respect to start up services and overall responsibility, which was envisaged as the responsibility of the foreign companies, that component was found to be taxable.

21. *Ishikawajima*, *Jindal* and also *US Technology Resources*, considered the question as to whether the payment made by a resident to a non-resident entity was taxable or not on the basis of the income derived by the resident company attributable to any activity carried on within India, by the non-resident thus deeming such income to be accruing or arising or deemed to have accrued or arisen within India. The Hon'ble Supreme Court and the Karnataka High Court while dealing with the issue considered the provision under Section 9(1)(vii)(c). With all respect at our command, we have to notice that the applicable provision should have been clause (b) of Section 9(1)(vii). In the decision of this Court too, one of us [KVC.J] committed the same mistake of extracting clause (c) instead of clause (b). We notice that in Kanga &

Palkhivala's 'The Law and Practice of Income Tax', Eleventh Edition 2020 by Aravind P Datar, dealing with Section 9 at paragraph 32 with the nominal heading 'Taxability and Territorial Nexus – The Uncertainty Continues', has stated:

> **"A serious mistake in this decision was that the Supreme Court referred to and interpreted S.9(1)(vii)(c) when the applicable clause was S.9(1)(vii)(b). This renders the decision *per incuriam* but need not be discussed further as the *Ishikawajima* decision is no longer good law after two successive amendments in 2007 and 2010".**

22. We, however, do not subscribe to the view of the learned author in the authoritative text since clause (b) and clause (c) are two sides of the same coin. Even if clause (b) was noticed there would not have been a different interpretation possible. As we noticed, Section 5(2) expands the scope of total income. With respect to a non-resident, it *inter alia* includes all income from whatever source derived, accruing or arising or is deemed to accrue or arise, to him in India during such year. By clause (vii) of Section 9(1), income by way of fees for technical services is deemed to accrue or arise in India if the conditions therein are satisfied. As per sub-clause (a) of clause (vii), any fees payable by the Government becomes the income accruing or arising in India as provided in

Section 5(2). Sub-clause (b) deems fees for technical services payable by a resident to be income accruing or arising in India, except where the fees are payable in two situations as provided in the very same sub-clause itself. Those exceptions are – when the fees payable for technical services (i) is in respect of services utilized in a business or profession carried on by such person (resident) outside India or (ii) when it is payable for the purposes of making or earning any income from any source outside India. Clause (c) deems fees for technical services by a resident, to be income arising or accruing in India only when either (i) the fees are payable in respect of services utilized in a business or profession carried on by such person in India or (ii) when the fees are payable for the purposes of making or earning any income from any source in India.

23. We extract Section 9(1)(vii):

> **"9. Income deemed to accrue or arise in India-**
> **(1) The following income shall be deemed to accrue or arise in India--**
>
> **xxx xxx xxx**
>
> **(vii) income by way of fees for technical services payable by--**
>
> **(a) the Government; or**
>
> **(b) a person who is a resident, except where the fees are payable in respect of services utilised in a**

business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.

Explanation 1.--For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Explanation 2.--For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

24. In other words clause (b) excludes any fees for technical services payable by a resident to a non-resident, (i) on account of a business or profession carried out outside India or (ii) for the purposes of earning an income from a source outside India. When fees are so payable by a resident to a non-resident it is taken away from the charge

to tax under the IT Act. Similarly clause (c) makes any payment by a non-resident to a resident to be taxable when the technical fees paid by the non-resident to the resident is with respect to (i) a business or profession carried on in India or (ii) for the purpose of making or earning any income from any source in India. This is essentially the territorial nexus that has been highlighted in ***Ishikawajima***.

25. We do not think that any Explanation could meddle with the inclusion or the exceptions provided in the main provision. Be that as it may, prior to looking at the Explanation, we also look at ***GVK Industries Ltd.***, again an instance of a resident company having engaged a consultant non-resident as Financial Advisor to its project to be set up in Andhra Pradesh. The non-resident rendered professional services from Zurich and the resident company obtained finances, both from the IDBI for its Rupee loan requirement and part of its foreign currency loan requirement from one international financier in the USA. On facts it was found that the non-resident company did not have a place of business in India. The Revenue did not have a case that the income had actually arisen or received by the non-resident in India. The conclusion of the High Court

that the 'success fee' received by the non-resident, on financial facilities being obtained by the resident company, was not taxable under Section 9(1)(i) as the transaction or activity did not have any business connection was approved. The remaining question was as to whether the payment made by the resident to the non-resident would be taxable under Section 9(1)(vii)(b). The Explanation as it was inserted by the Finance Act, 2007 and the Finance Act, 2010 was specifically referred to. It was stated so in paragraph 22:

> "22. The principal provision is clause (b) of section 9(1)(vii) of the Act. The said provision carves out an exception. The exception carved out in the latter part of clause (b) applies to a situation when fee is payable in respect of services utilised for business or profession carried out by an Indian payer outside India or for the purpose of making or earning of income by the Indian assessee, i.e., the payer, for the purpose of making or earning any income from a source outside India. On a studied scrutiny of the said clause, it becomes clear that it lays down the principle what is basically known as the "source rule", that is, income of the recipient to be charged or chargeable in the country where the source of payment is located, to clarify, where the payer is located. The clause further mandates and

requires that the services should be utilised in India".

26. Dilating on the ‘source rule’ and the two principles behind it; ie: 'situs of residence' and 'situs of source of income’, it was found that the source rule is in consonance with the nexus theory and does not fall foul of the said doctrine on the ground of extra-territorial operation. Emphasizing the doctrine of source rule, the charge to tax was held to be arising in the country where the income or wealth is physically or economically produced. It was held that the payment of 'success fee' hence was taxable. It was found in paragraph 28 that the 'success fee' does not fall in any of the exclusions of Explanation-2. The resident company having not found anybody capable of extending professional services within India, had approached the non-resident for their services. To understand the scope of services, the letter of the non-resident offering their services to the resident company was re-produced. A resolution of the Board of Directors approving the appointment of the non-resident was also extracted. From the aforesaid extracts; the obligations of the non-resident were found to be : development of comprehensive financial model, to tie up the rupee/foreign

currency loan requirement of the project, assess export credit agencies world wide and obtain commercial banks support on the competitive terms and assist the appellant company in loan negotiations and documentation. Their Lordships first considered whether the documents would fall under managerial, technical or consultancy services as spoken of in Explanation-2. It was found that the enumerated functions would fall under the concept of consultancy services. Undoubtedly from the given facts in that case, the result of the technical services of the non-resident, which is the financial facilities were utilized by the resident company in India. This makes the 'success fee' taxable under Section 5(2) read with Section 9(1)(vii)(b).

27. We find, in the present case, a clear distinction from ***GVK Industries Ltd.*** As we observed, the non-resident agent was appointed for the purpose of generating business from three territories, which are European Union, North America and Middle East. The activities of the non-resident were only in those territories from which territories he was generating business for the appellant-resident. The responsibility of the non-resident agent as per the contract was also to

facilitate the marketing of the products of the resident company, a fully Export Oriented Unit. The services of the non-resident agent was in those outside territories to provide free sales support as well as expertise for projects to be executed at the customer site or at the resident's company centre in Thiruvananthapuram. Essentially there is no activity carried on by the non-resident within India. There could be a question raised insofar as the sales expertise provided by the agent, for the execution of contracts at the Thiruvananthapuram centre of the resident company. This again is only for the purpose of sales effected in the foreign countries. The business generated by the non-resident agent is executed by the resident company, which is a software developer either at the foreign site or at its centre at Thiruvananthapuram. The site where the development is carried out is not crucial for taxation, since the income generated is out of the sale carried out in the foreign territory. The source of income decides the taxability. The income generated by the resident company by reason of the sales canvassed by the non-resident agent, in the territories of European Union, North America and Middle East are income sourced from those countries. This clearly falls under the

second exception as provided under clause (b) of Section 9(1)(vii). The amounts payable to the non-resident by the resident company is by way of fee for technical services; payable for the purpose of making or earning income from a source outside India. There can be no taxability on such income, which has been clearly excluded from the deeming fiction as provided by Section 5(2) read with Section 9(1)(vii).

28. The further contention is with respect to the Explanation added by Finance Act, 2010, which is extracted hereunder:

> Explanation.--For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under Clause (v) or Clause (vi) or Clause (vii) of Sub-section (1) and shall be included in the total income of the non-resident, whether or not,--
> (i) the non-resident has a residence or place of business or business connection in India; or
> (ii) the non-resident has rendered services in India."

Clause (i) is with respect to residence, place of business or business connection which has no relevance insofar as determining the total income taxable under Section 9(1)(vii)(b) or the exceptions provided therein. Clause (ii) of the Explanation speaks of the income deemed to arise in

India whether or not a non-resident has rendered services in India. It does not in any manner interfere with the exceptions in sub-clause (b) of clause (vii), which deals with services utilized in a business or profession carried on by a resident outside India or services for the purpose of making or earning income from any source outside India. If the services are utilized in India, then necessarily the mere fact that the non-resident has always been acting from abroad does not absolve him from the charging section under the IT Act is the purport of Clause (ii) of the Explanation. Again we notice ***GVK Industries Ltd***., wherein the consultancy services offered by the non-resident was from Zurich alone. However, the finances obtained by the resident company was utilized in India for setting up a gas based power project at Andhra Pradesh. In such circumstances, without reference to whether the non-resident has rendered services in India, the fees payable by the resident to the non-resident for consultancy services would be taxable under the IT Act.

29. In this case, there is no utilization of the services rendered by the non-resident agent within India. The projects executed by the resident company even within India was for sale to the foreign buyer and it cannot be

said that merely for reason of the execution in India the service was utilized in India. The software developed in India was also for export; the appellant being a 100% EOU. The services rendered by the non-resident agent was for facilitating sale in the three outside territories. The services rendered for effecting exports by the appellant company to foreign buyers, makes the foreign countries the source of income. The execution of the project within India would not attract income tax since the income is derived from the sale of the product outside the territories of India and the execution is only to obtain such income from territories outside India. As has been declared by the Hon'ble Supreme Court in *Sedco Forex International Drill Inc.*, *"an explanation to a statutory provision may fulfill the purpose of clearing up an ambiguity in the main provision or an explanation can add to and widen the scope of the main section"*. The Explanation cannot be found to have taken away or curtailed the effect of the clear exceptions provided by sub-clause (b) of Section 9(1)(vii).

30. Since we have concluded that the commission paid to the non-resident in the present case is not taxable under the IT Act by virtue of Section 5(2) read with Section 9(1)(vii)(b), there is no scope for finding any

liability on the resident company to deduct tax from source, from payments made by them to the non-resident. We rely on ***GE India Technology Centre***, wherein it was categorically held that *"the plain words of Section 195(1) which is in clear terms lays down that tax at source is deductible only from 'sums chargeable' under the provisions under the IT Act, i.e., chargeable under Sections 4, 5 and 9 of the IT Act"* (sic. para 24). We hold question No's.1 and 2 in favour of the assessee and against the Revenue. We decline to answer question Nos.3 and 4 in view of our answer to the first two questions granting substantial relief to the assessee.

The appeal stands allowed and the assessment order to the extent it attempts to hold the payment made by the resident-company/assessee/appellant, to the non-resident agent as income deemed to arise or accrue in India would stand set aside. Parties are left to suffer their respective costs.

Sd/-
K.VINOD CHANDRAN
JUDGE

Sd/-
T.R.RAVI
JUDGE

Vku/-

APPENDIX

APPELLANT'S ANNEXURES:-

ANNEXURE A	**TRUE COPY OF THE REGISTRATION LETTER OF STPI NO.STPT/IMSC/563/P/2006-07/07 DTD.14.08.2006 REGISTERED BY THE APPELLANT WITH STPI, THIRUVANANTHAPURAM.**
ANNEXURE B	**TRUE COPY OF THE COMMISSION AGENCY CONTRACT (CAC) BETWEEN THE APPELLANT AND MR.BALAJI BAL DATED 01.12.2007.**
ANNEXURE C	**TRUE COPY OF THE ASSESSMENT ORDER DATED 08.12.2011, ISSUED TO THE APPELLANT BY THE INCOME TAX OFFICER, WARD 1(1), THIRUVANANTHAPURAM FOR THE ASSESSMENT YEAR 2009-10.**
ANNEXURE D	**TRUE COPY OF THE APPELLATE ORDER DATED 22.02.2013 ISSUED TO THE APPELLANT BY THE COMMISSIONER OF INCOME TAX (APPEALS), TRIVANDRUM.**
ANNEXURE E	**TRUE COPY OF THE COMMON ORDER DATED 29.11.2013 ISSUED TO THE APPELLANT BY THE APPELLATE TRIBUNAL IN ITA.NO.282/COCH/2013 AND C.O.NO.09/COCH/2013.**
ANNEXURE F	**TRUE COPY OF THE CIRCULAR NO.23 DATED 23.07.1969 ISSUED BY THE CENTRAL BOARD OF DIRECT TAXES (CBDT).**
ANNEXURE G	**TRUE COPY OF THE CIRCULAR NO.786 DATED 07.02.2000 ISSUED BY THE CENTRAL BOARD OF DIRECT TAXES (CBDT).**
ANNEXURE H	**TRUE COPY OF THE STATEMENT SHOWING THE COMPUTATION OF SALES COMMISSION PAID TO MR.BALAJI BAL.**
ANNEXURE I	**TRUE COPIES OF THE RELEVANT PAGES OF THE PASSPORT OF MR.BALAJI BAL, SHOWING THAT HE WAS NOT PRESENT IN INDIA DURING THE F.Y.2008-09 FOR 183 DAYS.**
ANNEXURE J	**TRUE COPY OF THE STATEMENT SHOWING THE CORRECT NUMBER OF DAYS THAT MR.BALAJI BAL STAYED IN INDIA FROM 2005 TO 2010.**
ANNEXURE K	**TRUE COPY OF THE INDO-SWISS DTAA (FULL PAGE)**

DEALING WITH INDEPENDENT PERSONAL SERVICES.

ANNEXURE L TRUE COPY OF THE SWORN AFFIDAVIT DATED 06.03.2013 OF MS.INDU LAKSHMY LAL, THE DIRECTOR OF THE APPELLANT COMPANY FILED BEFORE THE LEARNED CIT(A).

ANNEXURE M TRUE COPY OF THE RELEVANT PAGES OF THE COMMENTARY ON ARTICLE 14 OF THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES.

RESPONDENT'S ANNEXURES:- NIL. [TRUE COPY]