

Commissioner of Income-Tax, Punjab

Vs

R. D. Aggarwal and Co. and Another

Civil Appeals Nos. 808 and 809 of 1963

(S. Subha Rao, J. C. Shah, S. M. Sikri JJ)

06.10.1964

JUDGMENT

SHAH J. -

R. D. Aggarwal and Company - called for the sake of brevity "the assesseees" - are a registered firm having their place of business at Amritsar in the State of Punjab. The assesseees carry on business as importers and as commission agent of non-resident exporters with two of whom we are concerned in these appeals. These two non-resident exporters, Comptoirs Lainiers Osterieth S. A. Anvers (Belgium) and Filature Tessitura Di Tollengno Biella (Italy) are exporters and manufacturers of worsted woollen yarn. The assesseees communicate orders canvassed by them from dealers in Amritsar to the non-residents for a acceptance; if a contract results and price for the goods purchased is paid by the Amritsar dealer to the non-resident exporter the assesseees become entitled to commission varying between 1-1/2 and 2-1/2 per cent. of the price.

By letter dated March 24, 1951, the assesseees were appointed "sole agents" for the Italian Company "for sale" of worsted woollen yarns in the Indian territories terminable by one month's notice. The assessee had to "maintain the existing customers" and to secure new customers "conforming to their general terms of sales", and were to receive 2- 1/2 per cent. "concluded by the mediation" of the assesseees or directly by the Italian company with the customers. The Belgian company appointed the assesseees their representative for the whole of India on condition that the latter did not represent any other Belgian mill or yarn producer and did not sell Belgian yarn in India on their own account.

In proceedings for assessment of tax in the reassessment year 1952-53 the Income-tax Officer, "C" Ward, Amritsar, computed the income of the assesseees by adding Rs. 54,558 being 5 per cent. of the net total value of yarn sold by the non-resident companies to Indian merchants in the previous year, because in his view there subsisted business connections between the non-resident exporters and the assesseees. The orders passed by the Income-tax Officer were confirmed in appeal by the appellate assistant commissioner and also by the Income-tax Appellate Tribunal.

The Income-tax Appellate Tribunal submitted a statement of case to the High Court of Punjab on the following two questions :

"(1) Whether the relationship between the assessee and the non- resident fell within the meaning of the expression 'business connection' as used in section 42(1) of the Indian Income-tax Act ?

(2) If the answer to the (second) question is in the affirmative whether on the facts

and in the circumstances of this case any profits or gains accrued or arose or could be deemed to have accrued or arisen to the non-resident on account of the business connection of the non-resident with the assessee during the previous year under consideration ?"

The High Court answered the first question in the negative and declined to answer the second question. With special leave, Commissioner of Income-tax has appealed to this court against the opinion of the High Court in the these two cases.

Section 42(1) of the Income-tax Act and two related sections 40(2) and 43(1) may first be set out. section 40, in so far as it material, by sub-section (2) provides :

"Where the... agent of any person not resident in the taxable territories... (such person being hereinafter in this sub-section referred to as a beneficiary) is entitled to receive on behalf of such beneficiary, or is in receipt on behalf of such beneficiary of any income profits or gains chargeable under this Act, the tax, if not levied on the beneficiary direct, may be levied upon and recovered from such... agent... in like manner and to the same amounts as it would be leviable upon and recoverable from the beneficiary if in direct receipt of such income, profits or gains..."

Section 40(2) is an enabling section providing machinery for assessment and recovery of tax from an agent of a non-resident in the taxable territories on income taxable under the act which the agent is entitled to receive or in fact receives on behalf of the principal if tax be not levied on the principal direct. The clause, it may be noticed, deals with charge to tax on income which the agent is entitled to receive or in fact receives on behalf of a non-resident beneficiary.

Section 42, in so far as it is material, provides :

"(1) All income, profits or gins accruing or arising whether directly or indirectly, through or from any business connection in the taxable territories... shall be deemed to be income accruing or arising within the taxable territories, and where the person entitled to the income, profits or gains is not resident in the taxable territories, shall be chargeable to income-tax either in his name or in the name of his agent, and in the latter case such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income- tax :

(2) where a person not resident or not ordinarily resident in the taxable territories, carries on business with a person resident in the taxable territories and it appears to the income-tax Officer, that owing to the close connection between such person the course of business is so arranged that the business done by resident person with the person not resident or not ordinarily resident produces to the resident either or profits or less than the ordinary profits which might be expected to arise in that business, the profits derived therefrom or which may reasonably be deemed to have been derived therefrom, shall be chargeable to income-tax in the name of the resident person who shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax.

(3) In the case of a business of which all the operations are not carried out in the taxable territories, the profits and gains of the business deemed under this section to

accrue or arise in the taxable territories shall be only such profits and gains as are reasonably attributable to that part of the operations carried out in the taxable territories".

It may be observed that sub-sections (2) and (3) illustrate special cases of business connections and do not purport to limit the connotation of that expression.

Section 43, by the first paragraph, provides :

"Any person employed by or on behalf of a person residing out of the taxable territories, of having any business connection with such person, or through whom such person is in the receipt of any income, profits or gains upon whom the Income-tax officer has caused a notice to be served of his intention of treating him as the agent of the non-resident person shall, for all the purposes of this Act, be deemed to be such agent : ..."

This section authorises the Income-tax Officer to appoint a person as statutory agent of a non-resident, and to assess him as agent of a non-resident in respect of the income of the non-resident in the taxable territories.

The only question that falls to be determined in these appeals is whether there was in the two cases between the non-resident companies and the assessee such a relation as may be called "business connection" in the taxable territories. If the answer to this question be in the affirmative, the assessee would as statutory agent be chargeable to tax on behalf of the non-resident companies on the profits and gains reasonably attributable to those parts of the operation which were carried on in the taxable territories.

The expression "business" is defined in the Act as any trade, commerce, manufacture or any adventure or concern in the nature of trade commerce of manufacture, but in the Act contains no definition of the expression "business connection" and its precise connotation is vague and indefinite. The expression "business connection" undoubtedly means something more than "business". A business connection in section 42 involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories 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 the taxable territories : a stray or isolated transaction is normally not to be a business connection. Business connection may take several forms : it may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent,

A relation to be a "business connection" must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the non-resident. But it must in all cases be remembered that by section 42 income, profits or gain which accrues or to a non-resident outside the taxable territories is sought to be brought within the net of the income-tax law, and not income, profits or gain which accrues or arises or is deemed to accrue or arise within the taxable territories. Income received or deemed to be received, or accruing or deemed to be accruing or arising within the taxable territories in the previous year is taxable by section 4(1)(a) and (c) of the Act, whether the person earning is a resident or non-resident. If the agent of a non-resident receives that income or is entitled to receive that income, it may be taxed in the hands of the agent by the machinery provision enacted in section 40(2). Income not taxable under section 4 of the Act of a

non-resident becomes taxable und

Important cases which have arisen before the courts may be briefly reviewed, not for evolving a definition applicable generally to all cases, but with a view to illustrate what relation between the non-resident and the activity in the taxable territories which contributes to the earning of income may or may not be regarded as business connection.

In *Commissioner of Income-tax v. Remington Typewriters Co. (Bombay) Ltd.* a company incorporated under the Indian Companies Act, 1913, which was a subsidiary of an American company was deemed for the purposes of the Indian Income-tax Act to be the statutory agent of the latter company and was charged to tax under section 42(1) in respect of profits made by that company upon machines exported to the taxable territories and in respect of dividends received from the Indian company, although the assessee-company was not an agent for the American company under section 40, as it has not received the profits and gains in question. In that case, in consideration of transfer of the good will of the American company in a specified territory in Indian shares were allotted by the assessee-company to the American company. In respect of those shares dividend was paid to the American company by the assessee-company : the American company also sent machines to the assessee-company for sale within the territory. The profits ma

In *Commissioner of Income-tax v. Currimbhoy Ebrahim and Sons Ltd.* advance of a loan by a non-resident was held not to be a business connection. *Currimbhoy Ebrahim and Sons Ltd.*, a private limited company carrying on business as managing agents of various companies and as dealers in cloth, borrowed a loan from the Nizam of Hyderabad and executed a document in Bombay and as security for repayment of the loan deposited shares in joint stock companies and created an equitable mortgage of immovable properties in British India. The loan was to be repaid in Hyderabad, then an Indian State. The taxing authorities treated the private company as agent in the taxable territories of the Nizam within the meaning of section 43 of the Indian Income-tax Act, and assessed to tax the interest on the loan which the taxing authorities regarded as profits or gain which must be deemed to have accrued or arisen to the Nizam, though or from a business connection or property in British India within the meaning of section 42(1) of the

In *Bangalore Woollen, Cotton and Silk Mills CO. Ltd. v. Commissioner of Income-tax* the assessee, a company registered in the Indian State of Mysore, carried on the business of manufacturing woollen, cotton and silk goods at Bangalore. The assessee's managing agents had their head office at Madras in British India. Under the managing agency agreement, the agents bought raw materials and other articles or things required for the purpose or use of the assessee and sold and disposed of goods manufactured by the assessee. Manufactured goods were also sold in the Mysore State and deliveries were effected in that State, but the agents collected the price of the goods sold in British India and Credited it in their books to the account of the assessee as they also acted as bankers of the assessee. It was held by the Income-tax Officer that the assessee-company was liable to pay tax under the Indian Income-tax Act under two heads : (1) on the profits attributable to the sale proceeds received in British India, and (2)

In *Abdullahai Abdul Kadar v. Commissioner of Income-tax* the assessee acted as commission of a non-resident and entered into transactions within the taxable territories on behalf of the non-resident, but he was not the sole commission agent of the non-resident, who did business through other agents as well. The assessee also purchased cloth on behalf of other constituents. It was held that there was a business connection, because it was not predicated of a business connection that the broker must be exclusively retained by the assessee. *Chagla C.J.*, in dealing with the provisions of

section 42(1), observed :

"... the language used by the legislature is very wide; any business connection is not necessarily that business connection which is constituted by a permanent and exclusive agency : On the other hand a mere casual connection a connection which has no continuity, would also not be a business connection as contemplated by the legislature under section 42. Therefore, in order that the agency which constitutes a connection between a non-resident and the assessee should be a business connection as contemplated by section 42 there must be an element of continuity in the agency. An isolated transaction through an agent, or even a connection for a short period, would not necessarily constitute business connection."

Then there is a decision of this court : Anglo-French Textile Company Ltd. v. Commissioner of income-tax. The Assessee - a company incorporated in the United Kingdom - owned a spinning and weaving factory at Pondicherry in French India. The assessee had appointed another limited company in Madras as its constituted agent for the purpose of its business in British India. During the relevant year of account no sales of yarn or cloth manufactured by the assessee-company were effected in British India but all the purchases of cotton required for the factory at Pondicherry were made by the agents in British India and no purchases were made through any other agency. In that case, it was held, that the assessee-company had a business connection in British India within the meaning of section 42 and a portion of the profits of the non-resident attributable to the purchase of cotton in British India could be apportioned under section 42(3).

In Hira Mills Ltd. v. Income-tax Officer, Cawnpore a non-resident company carried on business of manufacturing cloth at Ujjain in the Indian State of Gwalior and sent cloth to Cawnpore in British India. Goods were sold by the company's salesman at Cawnpore and the sale proceeds were collected by him at Cawnpore. In these transactions, income accrued or arose to the company in British India within the meaning of section 4(1). The company goods were also marketed in British India through brokers who were not the company's employees and who were not canvassing orders exclusively for the company. Offers of purchase sent by brokers to Ujjain were not in any special form. They were either accepted or rejected by the company at Ujjain, but all contracts were for delivery "F.O.R Ujjain." Goods were generally consigned to "Self" at the place of destination and the merchants took delivery after paying the invoiced price plus freight and insurance to broker or banker in British India in exchange of endorsed railway rec

The distinction between Abdullabhai Abdul Kadar's case and the Hira Mills' case may be noticed. In the former the commission agents had purchased cloth in the taxable territories for the non-resident and in the latter the agents did not purchase or sell goods for the non-resident : they merely canvassed orders which were in the nature of offers and communicated them to the non-resident who had the option to accept or reject the offers. The sale took place outside the taxable territories, and in the view of the Income-tax Appellate Tribunal "presumably also, the goods were paid for at Ujjain." the court was on the question framed and referred not called upon to consider whether because of payment of the invoiced price plus insurance and freight to a broker or banker in British India, and delivery in exchange of endorsed railway receipts, the case fell within section 4(1)(a) or section 4(1)(c).

Turning to the facts of the present case, as found by the revenue authorities contracts for the sale of goods took place outside the taxable territories price was received by the non-resident outside the taxable territories, and delivery was also given outside the taxable territories, No. operation such as

procuring raw materials, manufacture of finished goods sale of goods or delivery of goods against price took place within the taxable territories : the assessee merely procured orders from marchats in Amritsar for purchase of goods from the non-resident companies. the orders were offers which the assessee had no authority to accept on behalf of the non-residents. Some commercial activity was undoubtedly carried on by the assessee in the matter of procuring orders which resulted in contracts for sale by the non-residents of goods to merchants at Amritsar. But on this account no business connection of the assessee with the non-resident within the taxable territories resulted. The activity of the assessee

In that view of the case these appeal must fail and are dismissed with costs. One hearing fee.

Appeals dismissed.

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