M/S Electronics Corporation of India Limited

Vs

Commissioner of Income Tax and Another

Civil Appeal Nos. 2697-99 of 1989

(CJI R. S. Pathak, Rangath Misra, M. N. Vankatachaliah JJ)

02.05.1989

JUDGMENT

PATHAK, C.J. –

1. Special leave granted.

2. These appeals by special leave are directed against the dismissal by the Andhra Pradesh High Court of writ petitions filed by the appellant.

3. The appellant, Messrs Electronics Corporation of India Limited, entered into a memorandum of understanding with a Norweigian company at Paris. This was followed by an agreement datd May 2, 1986 executed at Hyderabad. Under that agreement the Norwegian company was to provide technical know-how and technical services, including facilities for the training of personnel, to the appellant in connection with the manufacture of computers. The consideration for the technical know-how and technical services was represented by Norwegian currency NOK32 millions equivalent to about Rs. 575 lakhs. Eighty five percent of the consideration was to be paid from credit provided by Norwegian authorities and the balance 15 per cent was to be paid out of free foreign exchange made available by the State Bank of India, London Branch. It is not in dispute that the agreement had received the careful consideration of the Reserve Bank of India and of the Central Government.

4. The appellant approached the Income Tax Officer for the grant of a 'No Objection Certificate' as contemplated under Section 195(2) of the Income Tax Act, 1961, to enable it to remit the instalments due without any obligation to deduct any income tax at source, but the request was denied. On December 23, 1986 the appellant made an application to the Commissioner of Income Tax for a direction to the Income Tax Officer, but the Commissioner rejected the application. The Commissioner took the view that having regard to Section 9(1)(vii) and Section 195 of the Income Tax Act, 1961, the payment constituted income which was deemed to accrue or arise in India and was liable to deduction of tax at source.

5. The appellant filed a writ petition against the order of the Commissioner, and assailed the constitutional validity of Section 9 (1)(vii) of the Act. It was urged before the High Court that Parliament was not competent to enact Section 9(1)(vii) of the Act inasmuch as the provision possesses as extra-territorial operation without any nexus between the persons sought to be taxed and the country seeking to tax. It was further contended that even after the introduction of Section 9(1)(vii) by the Finance Act of 1976 with effect from June 1, 1976, the requirement of a business connection of a foreign company was required, and the case was governed by Corborandum Co. v.

CIT ((1977) 2 SCC 862 : 1977 SCC (Tax) 391 : (1977) 108 ITR 335). It was also urged that after the introduction of the Explanation by the Finance Act of 1977 with effect from April 1, 1977 Section 9(1)(vii) creates an invidious discrimination among companies which had entered into a foreign colaboration agreement prior to April 1, 1976 and those who have done so after that date, and that therefore Article 14 was violated. The High Court repelled all the contentions of the appellant and dismissed the writ petition. A similar writ petition was filed by the appellant against an order of the Commissioner of Income Tax declining to direct the grant of a 'No Objection Certificate' in relation to disbursement made under a licence agreement with Messrs Control Data Indo-Asia Company, U.S.A., and the writ petition was dismissed by the High Court for the reasons which had found favour with it in the earlier case.

6. It is contended by learned counsel for the appellant that Section 9(1)(vii) of the Income Tax Act is ultra vires inasmuch as it enables the levy of income tax on the Norwegian company in the one case and the American company in the other in circumstances which appear to show that the statute operates extra-territorially without the need for any nexus between anything done in India and the person sought to be taxed. Section 9(1)(vii) declares :

> "9(1) The following incomes shall be deemed to accrue or arise in India -
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> (vii) income by way of fees for technical services payable by -
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> (a) the government; or
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> (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 persons outside India or for the purposes of making or earning any income from any source outside India; or
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> (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;
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> Explanation. - 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"."

7. It seems that the revenue is proceeding on the basis that the foreign company is liable to tax and that therefore the petitioner is obliged to deduct at source the tax payable by the foreign company. We are informed that the services are rendered by the foreign company in the nature of training abroad to personnel belonging to the appellant, and that payment to the foreign company is also effected abroad. The revenue rests its case on Section 9 (1)(vii)(b) of the Act, and the question is whether on the terms in which the provision is couched it is ultra vires.

8. Now it is perfectly clear that it is envisaged under our constitutional scheme that Parliament in India may make laws which operate extra-territorially. Article 245(1) of the Constitution prescribes the extent of laws made by Parliament. They may be made for the whole or any part of the territory of India. Article 245(2) declares that no law made by the Parliament shall be deemed to be invalid

on the ground that it would have extra-territorial operation. Therefore, a Parliamentary statue having extra-territorial operation cannot be ruled out from contemplation. The Operation of the law can extend to persons, things and acts outside the territory of India. The general principle, flowing from the sovereignty of State. The apparent opposition between the two positions is reconciled by the statement found in British Columbia Electric Railway Company Limited v. King ((1946) AC 527) :

> "A legislature which passes a law having extra-territorial operation may find that what it has enacted cannot be directly enforced, but the Act is not invalid on that account, and the courts of its country must enforce the law with the machinery available to them.

In other words, while the enforcement of the law cannot be contemplated in a foreign State, it can nonetheless, be enforced by the courts of the enacting State to the degree that is permissible with the machinery available to them. They will not be regarded by such courts as invalid on the ground of such extra-territoriality.

9. But the question is whether a nexus with something in India is necessary. It seems to us that unless such nexus exists Parliament will have no competence to make the law. It will be noted that Article 245(1) empowers Parliament to enact law for the whole or any part of the territory of India. The provocation for the law must be found withing India itself. Such a law may have extra-territorial operation in order to sub-serve the object, and that object must be related to something in India. It is inconceivable that a law should be made by Parliament in India which has no relationship with anything in India. The only question is then whether the ingredients in terms of the impugned provision indicate a nexus. The question is one of substantial importance, Specially as it concerns collaboration agreements with foreign companies and other such arrangements for the better development of industry and commerce in India. In view of the great public importance of the question, we think it desirable to refer these cases to a Constitution Bench, and we do so order.

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