IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 12TH DAY OF MARCH, 2021

PRESENT

THE HON'BLE MR. JUSTICE SATISH CHANDRA SHARMA

AND

THE HON'BLE MR. JUSTICE V.SRISHANANDA

ITA NO.223/2018

BETWEEN:

1. PR. COMMISSIONER OF
INCOME TAX-5
BMTC COMPLEX
KORAMANGALA
BANGALORE

2. DEPUTY COMMISSIONER
OF INCOME TAX
CIRCLE-5(1)(2), BANGALORE

…APPELLANTS

(BY SRI.SANMATHI E.I., ADV.,)

AND:

M/S.PUMA SPORTS INDIA P., LTD.,
NO.509, CMH ROAD, INDIRANAGAR
BANGALORE-560 038
PAN: AADCP7081J

… RESPONDENT

(BY SRI.NAGESWAR RAO, ADV.,)

THIS ITA IS FILED UNDER SEC. 260-A OF INCOME TAX ACT 1961, ARISING OUT OF ORDER DATED: 28.09.2017 PASSED IN IT (TP)A NO.1611/BANG/2017, FOR THE ASSESSMENT YEAR: 2013-14 AND PRAYING TO DECIDE THE FOREGOING QUESTION OF LAW AND/OR SUCH OTHER QUESTIONS OF LAW AS MAY BE FORMULATED BY THE HON'BLE COURT AS DEEMED FIT AND SET ASIDE THE APPELLATE ORDER DATED: 28.9.2017 PASSED BY THE INCOME TAX APPELLATE TRIBUNAL, 'A' BENCH, BANGALORE IN

APPEAL PROCEEDINGS NO.IT(TP)A NO.1611/BANG/2017 FOR ASSESSMENT YEAR:2013-2014 AND ETC.

THIS ITA HAVING BEEN HEARD AND RESERVED ON 26.02.2021, COMING ON FOR 'PRONOUNCEMENT' OF JUDGMENT THIS DAY, ***SATISH CHANDRA SHARMA J.,*** DELIVERED THE FOLLOWING:

JUDGMENT

The present appeal is arising out of the order dated 28.09.2017 passed by the Income Tax Appellate Tribunal, Bangalore in case No.IT(TP)A No.1611/Bang/2017 (M/s. Puma Sports India Private Ltd. Vs. DCIT, Bangalore).

2. The facts of the case reveal that the assessee-Company is engaged in the business of wholesale trading and had international transactions. The assessee had filed return of income for the assessment years 2013-14 for the sum of Rs.24,69,36,680/-. The assessing authority passed an order under Section 143(3) read with Section 144(C)(13) of the Income Tax Act, 1961 (hereinafter referred to as 'Act') by making transfer pricing adjustment for Rs.4,16,65,106/- on the basis of the order passed under Section 92CA of the Act dated 24.10.2016. The assessing authority also made other additions. The assessee's objections were not considered by the Dispute Resumption Panel and therefore, an appeal was

filed before the Income Tax Appellate Tribunal, Bangalore (hereinafter referred to as 'Tribunal'). The Tribunal has allowed the appeal by granting relief to the respondent-assessee in respect of disallowance made under Section 40(a)(1) of the Act by following its earlier decision delivered in the case of M/s. Exotic Fruits Pvt. Ltd. Vs. ITO (ITA Nos.1008 to 1013/Bang/2012 dated 4.10.2013). In the aforesaid cases, it was held that the income of the non-residents by way of commission cannot be considered as accrued or arisen or deemed to accrue or arise in India as the services of such agent were rendered/utilized outside India and the commission was paid outside India. The department being aggrieved by the order of the Appellate Tribunal, dated 28.9.2017, has preferred the present appeal on the following grounds:

(a) It has been contended that the Tribunal has erred in law and facts in setting aside the disallowance made under Section 40(a)(1) of the Act for the sum of Rs.7,29,13,934/- by holding that the income of the non-residents by way of commission cannot be considered as accrued or arisen or deemed to accrue or arise in India as the services of such

agents were rendered or utilized outside India and the commission was also paid outside India.

(b) It has been further contended that the Tribunal has erred in law and facts in holding that Associated Enterprises (AE) rendered outside India in the form of placing the orders with manufacturers and the commission to Associated Enterprises was remitted to them abroad.

(c) It was further contended by the revenue that the Tribunal has erred in following its earlier decision in the case of *M/s. Exotic Fruits Pvt. Ltd.* (supra) by holding that TDS is not deductible from commission payment to foreign agent in the present case especially when the assessee failed to deduct TDS in view of specific provision of Section 5(2)(b) read with Section 9(1)(i) of the Act and the expenses made by the assessee without deducting the TDS are not at all permissible keeping in view Section 40(a)(i) of the Act.

3. The appeal has been admitted on the following substantial questions of law:

> *"Whether on the facts and in the circumstances of the case, the Tribunal is right in setting aside the disallowance made under Section 40(a)(1) of the Act for the sum of*

Rs.7,29,13,934/- by holding that the income of the non-residents by way of commission cannot be considered as accrued or arisen or deemed to accrue or arise in India as the services of such agents were rendered or utilized outside India and the commission was also paid outside India ?"

4. Heard the learned Counsel appearing for the parties and perused the record.

5. Learned Counsel for the appellants-Income Tax department has placed reliance upon a judgment delivered by the Hon'ble Supreme Court in case of ***GVK INDUSTRIES LTD. AND ANOTHER VS. INCOME TAX OFFICER AND ANOTHER*** reported in ***371 SC ITR 453*** and his contention is that in the light of the aforesaid judgment, the Tribunal has erred in law and fact in allowing the appeal. He has vehemently argued before this Court that the assessee has failed to deduct TDS in view of specific provision of Section 5(2)(b) read with Section 9(1)(i) of the Act and the expenses made by the assessee without deducting the TDS are not at all allowable as per the provisions of Section 40(a)(i) of the Act. He has also contended that the income of non resident by way

of commission is to be considered as accrued or arisen or deemed to accrue or arise in India.

6. On the other hand, learned Counsel for the respondent-assessee has supported the order passed by the Tribunal and has placed reliance upon the following judgments:

1. Commissioner of Income Tax, Andhra Pradesh Vs. M/s. Toshoku Ltd. Guntur and Others reported in 1980 (Supp). SCC 614
2. GE India Technology Centre Private Limited Vs. Commissioner of Income Tax and Another reported in (2010)10 SCC 29
3. The judgment in ITA Nos.1008 to 1013/Bang/2012 decided on 04.10.2013 (M/s. Exotic Fruits Pvt. Ltd. Vs. Income Tax Officer)
4. The judgment in R/Tax Appeal No.281 of 2019 decided on 30.07.2019 (The Principal Commissioner of Income Tax-2 Vs. Ferromatic Milacron India Pvt. Ltd.)
5. The judgment in T.C.(A) No.789 of 2013 decided on 22.07.2014 (The Commissioner of Income Tax, Chennai Vs. Faizan Shoes Pvt. Limited)
6. The judgment in R/Tax Appeal No.290 of 2018 decided on 09.04.2018 (Principal

Commissioner of Income Tax Rajkot-1 Vs. Nova Technocast Pvt. Ltd.)

7. The undisputed facts reveal that M/s. Puma sports India Pvt. Ltd. is a subsidiary of Austria Puma Dassler GmbH. The assessee is engaged in the trading of sports gear mainly footwear, apparel and accessories. The purchases by assessee consist of import from related parties and unrelated third parties as well as domestic purchase from the local manufacturers. The assessee is also engaged as a sourcing agent in India for footwear and apparels. It identifies the suppliers who can provide the required products as per the specifications and standards required by World Cat Limited, Hong Kong, which is the global sourcing agent for Puma Group and for performing such services, it receives the commission of 3% of FOB price. The facts of the case make it very clear that the Dispute Resumption Panel proceeded in the matter on the basis of the *situs* in India because right to receive the commission accrued in India when the assessee receives the imported goods. In the present case, the Associated Enterprises have rendered services outside India in the form of placing the orders with manufacturers and the commission to Associated Enterprises was remitted to them abroad.

8. The commission that becomes payable after receipt of goods accrued when services were rendered in the form of placing orders with the manufacturers. Therefore, the Tribunal was justified in holding that the income of income of the non-residents by way of commission cannot be considered as accrued or arisen or deemed to accrue or arise in India as the services of such agent were rendered/utilized outside India and the commission was paid outside India. It is nobody's case that the Associated Enterprises rendered services inside India in the form of placing orders with the manufacturers. Undisputedly, the services were rendered outside India and the commission was paid outside India and therefore, the Tribunal was justified in holding that the TDS is not deductible from commission payment to a foreign agency on foreign soil.

9. This Court has carefully gone through the judgment delivered in the case of *GVK Industries Ltd.* (supra). In the aforesaid case, a Non-Resident Company had acted as a consultant to assessee-*GVK Industries Ltd.* (supra). It had skill, acumen and knowledge in specialized field. It provided

consultancy services to the assessee and it was held by the Hon'ble Supreme Court that the amount paid as fee was taxable under the head 'fee for technical services'. The Apex Court in the aforesaid case, at paragraphs-20 to 24 has held as under:

> *20. At this juncture, it is demonstrable that NRC is a Non-Resident Company and it does not have a place of business in India. The revenue has not advanced a case that the income had actually arisen or received by the NRC in India. The High Court has recorded the payment or receipt paid by the appellant to the NRC as success fee would not be taxable under Section 9(1)(i) of the Act as the transaction/activity did not have any business connection. The conclusion of the High Court in this regard is absolutely defensible in view of the principles stated in C.I.T. V. Aggarwal and Company (1965) 56 ITR 20, C.I.T. V. TRC (1987) 166 ITR 1993 and Birendra Prasad Rai V. ITC (1981) 129 ITR 295. That being the position, the singular question that remains to be answered is whether the payment or receipt paid by the appellant to NRC as success fee would be deemed to be taxable in India under Section 9(1)(vii) of the Act. As the factual matrix would show, the appellant has not invoked Double Taxation Avoidance Agreement between India and Switzerland. That being not there, we are only concerned whether the "success fee" as termed by*

the assessee is "Fee for technical service" as enjoined under Section 9(1)(vii) of the Act. The said provision reads as follows:

"9. Income deemed to accrue or arise in India - (1) The following income shall be deemed to accrue or arise in India –

(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".]

21. Explanation to the Section 9(2) was substituted by the Finance Act 2010 with retrospective effect from 1.6.1976. Prior to the said substitution, another Explanation had been inserted by the Finance Act, 2007 with retrospective effect from 1.6.1976. The said Explanations read as under:

"As amended by Finance Act, 2010 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.]

As amended by Finance Act, 2007

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

22. The princip0al 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 utilized 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 utilized in India.

23. Having stated about the "source rule", it is necessary to appropriately appreciate how the concept has developed. At the time of formation of "League of Nations" at the end of 1920, it comprised of only 27 countries dominated by the European States and the United States of America. The United Nations that was formed after the Second World War, initially had 51 members. Presently, it has 193 members. With the efflux of time, there has been birth of nation States which enjoy political independence and that has led to cross-border and international trade. The State trade eventually has culminated in formulation of principles pertaining to international taxation jurisdiction. It needs no special emphasis to state that the said taxation principles are premised to promote international trade and to allocate taxation between the States. These rules help and further endeavour to curtail possibility of double taxation, tax discrimination and also to adjudicate resort to abusive tax avoidance or tax evasion practices. The nation States, in certain situations, resort to principle of "tax mitigation" and in order to protect their citizens, grant benefit of tax abroad under the domestic legislation under the bilateral agreements.

24. The two principles, namely, "Situs of residence" and "Situs of source of income" have witnessed

divergence and difference in the field of international taxation. The principle "Residence State Taxation" gives primacy to the country of the residency of the assessee. This principle postulates taxation of world-wide income and world-wide capital in the country of residence of the natural or juridical person. The "Source State Taxation" rule confers primacy to right to tax to a particular income or transaction to the State/nation where the source of the said income is located. The second rule, as is understood, is transaction specific. To elaborate, the source State seeks to tax the transaction or capital within its territory even when the income benefits belongs to a non-residence person, that is, a person resident in another country. The aforesaid principle sometimes is given a different name, that is, the territorial principle. It is apt to state here that the residence based taxation is perceived as benefiting the developed or capital exporting countries whereas the source based taxation protects and is regarded as more beneficial to capital importing countries, that is, developing nations. Here comes the principle of nexus, for the nexus of the right to tax is in the source rule. It is founded on the right of a country to tax the income earned from a source located in the said State, irrespective of the country of the residence of the recipient. It is well settled that the source based taxation is accepted and applied in international taxation law."

10. However, the facts of the aforesaid case are distinguishable as in the present case, the services were rendered by Associated Enterprises outside India. The consultancy was not at all utilized in India. In case the argument canvassed by the learned Counsel is accepted, it will certainly amount to violation of double taxation treaty. On the other and, the Hon'ble Supreme Court in case of *Toshuku Ltd.* (supra) while dealing with non-resident commission agent has held that if no operations of business are carried out in the taxable territories, the income accruing or arising abroad through or from any business connection in India cannot be deemed to accrue or arise in India. The Apex Court in paragraphs 12 and 13 of the aforesaid judgment has held as under:

> *"12. The second aspect of the same question is whether the commission amounts credited in the books of the statutory agent can be treated as incomes accrued, arisen, or deemed to have accrued or arisen in India to the non-resident assessees during the relevant year. This takes us to section 9 of the Act. It is urged that the commission amounts should be treated as incomes deemed to have accrued or arisen in India as they, according to the Department, had either accrued or arisen through and from the business connection in India that existed between the non-resident*

assessees and the statutory agent. This contention overlooks the effect of clause (a) of the Explanation to clause (i) of sub-section (1) of section 9 of the Act which 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 that 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. If all such operations are carried out in India, the entire income accruing therefrom shall be deemed to have accrued in India. If, however, all the operations are not carried out in the taxable territories, the profits and gains of business deemed to accrue in India through and from business connection in India shall be only such profits and gains as are reasonably attributable to that part of the operations carried out in the taxable territories. If no operations of business are carried out in the taxable territories, it follows that the income accruing or arising abroad through or from any business connection in India cannot be deemed to accrue or arise in India. (See Commissioner of Income-tax, v. R. D. Aggarwal & Co. and M/s. Carborandum Co. v. C.I.T., which are decided on the basis of section 42 of the Indian Income-tax Act, 1922, which corresponds to Section 9(1)(I) of the Act.)

13. 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 clause (a) of the Explanation to section 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.

11. In case of *GE India Technology Pvt. Ltd.* (supra), the Hon'ble Supreme Court was dealing with remittance of royalty of purchase prices of subsidiary delivered by the foreign party. It was held that if the payment is made by the resident to the non-resident was an amount which was not chargeable to tax in India, then no tax is deductible at Source even though the assessee had not made an application under Section 195(2) of the Act. A reliance has also been placed upon the judgment delivered in the case of *Exotic Fruits Pvt. Ltd.* (supra) and the judgment delivered by the Income Tax Appellate Tribunal is in favour of the assessee.

12. Keeping in view the totality of the circumstances of the case, this Court is of the considered opinion that in the present case the Associated Enterprises has rendered services out of India in the form of placing orders with the manufacturers who are already outside India. The commission was paid to Associate Enterprises out of India. No taxing event has taken place within the territories of India and therefore, the Tribunal was justified in allowing the appeal of the assessee.

13. Hence, the substantial question of law is answered in favor of the assessee and against the department.

The net result is that the appeal stands dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

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