A landmark judgement of the Supreme Court in relation to Section 9 of the Income-Tax Act, 1961

- *By S.K. Tyagi*

Recently, the Supreme Court has rendered a landmark judgement, dated 4.1.2007, in the case of *Ishikawajima-Harima Heavy Industries Ltd. Vs. DIT [2007] 288 ITR 408 (S.C.): 207 CTR 361(S.C.).* This judgement has thrown new light in respect of the expression '*Income deemed to accrue or arise in India*', as contemplated under section 9 of the Income-Tax Act, 1961 (the Act). The Apex Court, in this judgement has provided a totally different interpretation regarding the tax-treatment of fees for technical services, as per the provisions of section 9(1)(vii) of the Act. Besides, the Apex Court has also provided clear-cut meanings of the terms, '*business connection*' and '*permanent establishment*'. In addition, the Apex Court has also provided some valuable insights as regards the provisions of Double Taxation Avoidance Agreement (DTAA), particularly the DTAA between India and Japan.

In this case, the assessee company provided services to persons resident in India. It is a non-resident company incorporated in Japan. It formed a consortium along with five other enterprises. The consortium was awarded by Petronet, a turnkey project for setting-up a liquefied natural gas (LNG) receiving, storage and re-gasification facility in Gujarat. The aforesaid company was to develop, design, engineer, procure equipment, materials and supplies, to erect and construct storage tank including marine facility (jetty and island breakwater) for transmission and supply of LNG to purchasers, to test and commission the facilities, etc. The contract involved: (i) off-shore supply, (ii) off-shore services, (iii) on-shore supply, (iv) on-shore services and (v) construction and erection.

In this judgement, the Supreme Court has considered in detail the provisions of sections 5(2) and 9(1) of the Act and also the provisions of the DTAA between India and Japan. The most significant part of the aforesaid judgement is in respect of the tax-treatment of fees for technical services payable to a non-resident, as contemplated under section 9(1)(vii) of the Act.

It has been held in this connection that the provisions of S.9(1)(vii) of the Act, relating to fees for technical services, must be read with S.5 thereof, which takes within its purview the territorial nexus, on the basis whereof, tax is required to be levied, namely, (a) resident; and (b) receipt or accrual of income.

What is relevant is receipt or accrual of income as would be evident from a plain reading of S.5(2) of the Act. In a case of this nature, interpretation with reference to the nexus to tax-territories will also assume significance. Territorial nexus for the purpose of determining the tax liability is an

internationally accepted principle. It may, therefore, not be possible to give an extended meaning to the words, '*Income deemed to accrue or arise in India*', as expressed in S.9 of the Act.

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 S.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 S.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.

It is evident that S.9(1)(vii), read in its plain sense, envisages the fulfilment of two conditions: services which are source of income sought to be taxed in India must be (i) utilized in India, and (ii) rendered in India. In the present case, both these conditions have not been satisfied simultaneously.

So far, the normally accepted view in this regard has been that if the technical or consultancy services in the context of S.9(1)(vii) of the Act, are utilized in India, then the fees payable for the same are liable to tax in India, irrespective of the place where such services are rendered. Thus, fees for such services are considered to be liable to tax in India even if such services are rendered outside India.

The Apex Court has totally reversed the aforesaid view and has clearly held that in the context of S.9(1)(vii), fulfilment of two conditions is envisaged. The services which are source of income sought to be taxed in India, must be utilized in India and also rendered in India. Both the aforesaid conditions must be satisfied simultaneously.

Therefore, if the technical or consultancy services, though utilized in India, are rendered outside India, the fees for the same will not be liable to tax in India within the provisions of S.9(1)(vii) of the Act.

In this context, it may, however, be noted that regarding the question of taxability of the amount received for off-shore services, the Supreme Court has inadvertently referred to the provisions of S.9(1)(vii)(c), as the same was not relevant in the facts of the case. But the aforesaid inadvertent reference to section 9(1)(vii)(c), does not dilute the significance of the aforesaid judgement.

In this regard, it may be noted that though initially a reference is inadvertently made to S.9(1)(vii)(c) on page 444 of the report (in ITR), later on reference has been made to S.9(1)(vii) on pages 444 and

445 of the report. On page 445 of the report, it has been clearly held that the provisions of section 9(1)(vii) are to be read with section 5 of the Act, which takes within its purview the territorial nexus on the basis of which tax is required to be levied. Further, it has been held that having regard to the internationally accepted principle and DTAA, it may not be possible to give an extended meaning to the words, '*Income deemed to accrue or arise in India*', as contemplated under section 9 of the Act. Section 9 of the Act also lays down that 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 S.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. Thereafter, in the following sub-para on page 444 itself, it has been observed-

'*It is evident that section 9(1)(vii), read in its plain sense, envisages the fulfilment of two conditions: services, which are source of income sought to be taxed in India must be (i) utilized in India and (ii) rendered in India. In the present case, both these conditions have not been satisfied simultaneously'*.

Afterwards, in the summary relating to off-shore services on page 447 of the report in clause (1), it has been clearly laid down that sufficient territorial nexus between the rendition of services and territorial limits of India is necessary to make the income taxable. Further in clause (3), it has been clearly laid down that section 9(1)(vii) of the Act cannot be given a wide meaning. Thereafter, in clause (5), it has been laid down that for section 9(1)(vii) to be applicable, it is necessary that the services not only be utilized within India, but also be rendered in India or have such a '*live link*' with India that entire income from fees as envisaged in article 12 of the DTAA become taxable in India. Further, in clause (10), it has been held that the location of the source of income within India could not render sufficient nexus to tax that income from that source.

In view of the aforesaid reasons, no ambiguity has been left by the Apex Court in holding that if the technical or consultancy services, though utilized in India, are rendered outside India, the fees for the same will not be liable to tax in India within the provisions of section 9(1)(vii) of the Act.

In addition, the other significant features of the aforesaid judgement may briefly be summarized as follows:-

1. The fact that the contract was **signed in India** is of no material consequence, since all the activities in connection with the off-shore supply were outside India and therefore, cannot be deemed to accrue or arise in India. So far, the Income-Tax Department has been clinging to the view that if a contract is signed in India, then the income generated in India as a result thereof, will be liable to tax in India.

2. There exists a distinction between a '*business connection*' and a '*permanent establishment*'. As the permanent establishment cannot be said to be involved in the transaction, the aforementioned provision will have no application. The permanent establishment cannot be equated to a business connection, since the former is for the purpose of assessment of income of a non-resident under a Double Taxation Avoidance Agreement, and the latter is for the application of S.9 of the Income-Tax Act.
3. Once a transaction is excluded from the scope of taxation under the Income-Tax Act, the question of application of the provisions of DTAA would not arise.
4. Sufficient territorial nexus between the rendition of services and territorial limits of India is necessary to make the income taxable in India.
5. The location of the source of income within India would not render sufficient nexus to tax the income from that source.
6. The existence of permanent establishment would not constitute sufficient '*Business connection*' and the permanent establishment would be the taxable entity. The fiscal jurisdiction of a country would not extend to taxing the entire income attributable to the permanent establishment. There exists a difference between the existence of a business connection and the income accruing or arising out of such business connection.
7. A legal fiction in a taxing statute should be construed on the basis of the object sought to be achieved.

The aforesaid judgement also covers a number of other issues connected with the tax-liability of non-residents in India. Therefore, the same will always prove highly useful for ascertaining the tax-liability of non-residents in India.

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