M/S. Carborandum Co vs C.I.T., Madras on 11 April, 1977

Equivalent citations: 1977 AIR 1259, 1977 SCR (3) 475, AIR 1977 SUPREME COURT 1259, 1977 2 SCC 862, 1977 TAX. L. R. 650, 1977 2 SCJ 266, 1977 3 SCR 475, 47 TAXATION 123, 1977 SCC (TAX) 391, 1977 2 ITJ 175, 1977 (108) ITR 335, 1977 U P T C 442, 108 I T R 335, 1977 47 TAXATION 123

Author: N.L. Untwalia

Bench: N.L. Untwalia, P.N. Bhagwati, Syed Murtaza Fazalali

PETITIONER:
M/S. CARBORANDUM CO.

Vs.

RESPONDENT:
C.I.T., MADRAS

DATE OF JUDGMENT11/04/1977

BENCH:
UNTWALIA, N.L.
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UNTWALIA, N.L.
BHAGWATI, P.N.
FAZALALI, SYED MURTAZA

CITATION:
1977 AIR 1259 1977 SCR (3) 475
1977 SCC (2) 862
CITATOR INFO :
R 1981 SC 148 (12)
RF 1989 SC1707 (5)

ACT:
Income-tax Act, 1922 ---S. 4(1)(e)--Distinction between concept of actual accrual and notion on deemed accrual--ReferenceIncome-tax Act, 1922-- New facts neither raised nor considered by the Tribunal cannot be entertained by the High Court at reference stage.
Income-tax Act, 1922--S. 42--Scope and applicablity of 'business connecttion'.

HEADNOTE:
The appellant a foreign company within the meaning of

of 7 (5A) Income Tax Act, entered into an agreement with M/s. Carborandum Universal Ltd., having its registered office at Madras on June 22, 1955 and rendered certain technical and knowhow services. In view of the said services it was to 'receive from the Indian company an annual service fee equal to 3 per centum of the net sale proceeds of the products manufactured by the latter.

During the year of account relevant to the assessment year 1957-58 the appellant company received a sum of Rs. 95,762/- from the Indian company as its service fee. A good slab of it was deducted at source on account of incometax and super-tax. The appellant company fried its return of income for the year in question with an application for refund of the entire tax deducted at source. The income tax officer took the view in his assessment order that 5% of the technical fee paid to the American company was earned by it in India and only that small amount was assessable to income-tax and directed the refund of major portion of the tax deducted at source to the assessee company. The Commissioner of Income-tax in exercise of his revisional powers under s. 33B of the Act took the view that at least 75% of the technical fee earned by the assessing company during the year of account had accrued or .arisen in India even though the technical information was supplied by the assessee company from outside India and the technical personnel furnished by the assessee company to the Indian company although worked under the control of and was paid for by the latter inasmuch as the situs of the services so rendered was in India. Treating the technical fee in the nature of royalty paid, it directed the Income-tax Officer to revise the assessment on the basis that 75% of it should be taken as income accruing or arising in India to the assessee company. On appeal, the Appellate Tribunal set aside the said order and restored that of the Income-tax Officer even though it was of the view that even 5% of the technical fee could not be taken as income of the assessee. company taxable under the Act. The Tribunal held that the use of the technical assistance and know-how given by the American Company and made use of by the Indian Company in the taxable territory could not make the former liable to payment of income tax on the amount of technical fee received by it nor was it any royalty. It also rejected a new stand taken by the Revenue that the assessee company must be deemed to be working in conjunction with the Indian Company in the manufacture of its products. On reference u/s. 66(1) of the Act the Revenue. took another new plea that the agreement clearly established a business connection between the two companies and as such technical fee received by the assessee company had accrued or arose from such business connection assessable to income-tax u/s. 4(1)(c) read with s. 42 of the Act. The objection of the assessee. company to the entertainment of the new point at the reference stage that it did not arise out of the Tribunal's order

was over-ruled by the High Court on the ground that the question referred to was in general terms and comprehensive enough to embrace within its ambit the point of applicability of s. 42(1) of the Act to the transactions in question.

Upholding the stand taken on behalf-of the Revenue the High Court answered the question referred to it in its favour against the assessee company. On appeal by certificate the appellant contended:

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(1) That the High Court could not go into the matter of business connection between the two companies when such a question was never raised or in issue at any earlier stage;

(2) That the High Court was wrong in rounding the tax liability of the assessee company on the basis of the alleged business connection. Its finding or view in that regard is wholly erroneous.

(3) That even assuming that the High Court was right in its view of basing the tax liability of the assessee company on the alleged business connection, it failed to examine the question of apportionment under s. 42(3) of the Act.

(4) That s. 42(3) and apportionment under s. 42(5) in determination of the tax liability of the assessee company in pursuance thereof could not be more than the liability to pay tax on 5% of the total technical fee as found by the Income-taxOfficer and upheld by the Tribunal,

HELD: (1) The technical service fee received by the assessee company from the Indian company during the accounting year relevant to the assessment year 1957-58 did not accrue or arise in India. Since 5% of the technical service fee was brought to tax by the I.T.O. and no appeal was filed against it on behalf of the assessee company, the technical fee in excess of 5% was not taxable. [484 B-D]

(2) The High Court did not keep in view the distinction between the concept of actual accrual and the notion of deemed accrual evidenced from s. 4(1)(c) & s. 42 but mixed the one with the other while answering the reference in question. The income assessable to income tax under s. 4(1)(c) is of two kinds viz. (1) accruing or arising in the taxable territories and (ii) deemed to accrue or arise to the non-resident in the taxable territory. The concept of actual accrual or arising of income in the taxable territories, although not depending upon the receipt of the income in the taxable territories is quite distinct and apart from the notion of deemed accrual or arising of the income. [481 A-B].

(3) The High Court was wrong in entertaining at the reference stage on the basis of the alleged general and compendious nature of the question referred to it by the

Tribunal the new point based upon the theory of business connection, which was neither raised before the Tribunal nor considered by it; nor did it arise on the findings of fact recorded by it. [481 F-G]

Commissioner of Income Tax, Bombay v. Scindia Steam Navigation Co. Ltd. 42 ITR 589, followed.

(4) The High Court went wrong in its approach to the question raised before it and did not quite correctly appreciate the scope and applicability of section 42 of the Act. On a plain reading of sub-sections (1) and (3) of section 42, it would appear that income accruing or arising from any business connection in the taxable territories-even though the income may accrue or arise outside the taxable territories--will be deemed to be income accruing or arising in such territory, provided operations in connection with such business, either all or a part, are carried out in the taxable territory. If all such operations are carried out in the taxable territory, sub-section (1.) would apply and the entire income accruing or arising outside the taxable territory but as a result of the operations in connection with the business giving rise to the income would be deemed to accrue or arise in the taxable territories. If, however, all the operations are not carried out in the taxable territories, the profits and gains of the business deemed to accrue or arise in the taxable territories shall be only such 'profits and gains are reasonably attributable to that part of the operations carried out in the taxable territories. Thus comes in the question of apportionment under subsections(3)of section 42 [482 C-F]

Commissioner of Income Tax, Punjab v. R.D. Aggarwal & Co. and Anr.56 ITR 20, referred to.

(5) In the instant case the High Court was wrong in its view that activities of the foreign personnel lent or deputed by the American company amounted to a business activity carried on by that company in the taxable territory. The service rendered by the American company in that connection was wholly and

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solely rendered in the foreign territory. No part of the activity or operation could be said to have been carried on by the American company in India, even if there was any business connection between the earning of the income in the shape of the technical fee by the American company and the affairs of the Indian company. In the absence of such a sustainable finding, the provisions of section 42 of either of sub-section (1) or of sub-section (3):were not attracted at all. In order to rope in the income of a non-resident under the deeming provision it must be shown by the Department that some of the operations were carried out in India in respect of which the income is sought to be assessed. [483 E-H]

Commissioner of Income Tax, Madras I v. Carborandum Co. 92 ITR 411 overruled.

C.I.T. Bombay City IV. Tata Chemicals Ltd. 94 ITR 85,

approved.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 89 of 1975.

(From the Judgment and Order dated the 4th May 1973 of the Madras High Court in Tax Case No. 183 of 1967). N.A. Palkhivala, R. Balasubramanian, LB. Dadachanji, A.C. Moneses, Mrs. A.K. Verma, C.R. Dun, Ravinder Narain and O.C. Mathur, for the appellant.

R.M. Mehta, and R.N. Sachthey, for the respondent. K.R. Ramamani and 1. Ramamurthi, for the Intervener. The Judgment of the Court was delivered by UNTWALIA, J. This is an appeal by certificate from the decision of the Madras High Court in a Reference made by the Income-tax Appellate Tribunal under section 66(1) of the Income Tax Act, 1922--hereinafter referred to as the Act. M/s Carborandum Co..of the United States of America--hereinafter called the American' Company or the Assessee Company, is: the appellant. The Central Board of Revenue has declared it a Company under section 2(5A) of the Act. It has specialized in the manufacture of bonded abrasive and coated abrasive products. For the improvement and advancement in the line of its manufacture, it has a Re- search Wing also. The results of the research are incorpo- rated in pamphlets prepared from time to time. The Assessee Company entered into an agreement dated June 22, 1955 with M/s Carborandum Universal Ltd.--hereinaf- ter called the Indian company, having its registered office at Madras. As per the terms of the agreement the American Company was to render and did render to the Indian Company certain technical and know-how services of the following nature :-

(i) furnishing of technical information and know-how" with respect to the manufacture of bonded abrasive and coated abrasive products;

(ii) providing technical management including factory design and lay out, plant and equipment production, purchase of.. mate-

rials, manufacturing specifications and quali- ty of product;

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(iii) furnishing comprehensive technical information of all developments in the manu- facture of the special products;

(iv) providing the Indian company With a resident factory manager for starting the plant and superintending its operations during its initial production stages, as also other technical personnel necessary for the operation of the plant;

(v) training Indian personnel to replace the foreign technical personnel as quickly as possible.

In lieu of all the services aforesaid, as per the agreement, the American company was to receive from the Indian company an annual service fee equal to 3 per centum on the net sale proceeds of the products manufactured by the latter each year.

During the year of account relevant to the assessment year 1957-58 the assessee company received a sum of Rs. 95,762/- from the Indian company as its service fee. A good slab of it was deducted at source by the Indian company on account of income-tax and super-tax payable .on the said sum. The American company filed a Return of income for the year in question with an application for refund of the entire tax deducted at source. The Income-tax Officer took the view in his assessment order that 5% of the technical fee paid to the American company was earned by it in India and Only that small amount was assessable to income-tax. Consequently, he directed the refund of a major portion of the tax deducted at source to the assessee company. The Commissioner of Income-tax in exercise of his power under section 338 of the Act revised the order of the Income-tax Officer and took the view that at least 75 % of the techni- cal fee earned by the assessee company during the year of account had accured or arisen in India. In the main, the basis of his order was that even though the technical infor- mation was supplied by the assessee company from outside India, the information received by the Indian company was put to use only in the taxable territory and the technical fee paid by it was mainly on account of such use. The Commissioner was also of the view that the technical person- nel furnished by the assessee company to the Indian company although worked under the control of and was paid for by the latter, the situs of the services so rendered was in India. Treating the technical fee in the nature of royalty paid, it directed the Income-tax Officer to revise the assessment on the basis that 75% of it should be taken as income accruing or arising in India to the assessee company. The American company went up in appeal to the Appellate Tribunal from the revisional order of the Commissioner. The Tribunal Set aside the said order and restored that of the Income-tax Officer, even though it seems to be of the view that even 5% of the technical fee could not be taken as income of the assessee company taxable under the Act. But since the assessee company had not gone .in appeal because of the smallness of the amount of tax payable on the basis of 5%, the Tribunal was obliged to maintain the order of the Income-tax Officer.

The Tribunal took some new materials into consider- ation at the appellate stage in order to ascertain the true nature of the service rendered by the American company to the Indian company as per the term of the agreement and the place of rendering such service. The findings of the Tribunal are:

> (1) The American company rendered service to the Indian company for the starting of the factory in India in the shape of exami-

nation of the factory design and lay out prepared by the latter and sending its advice by post. These services were not proved to have been rendered in India.

(2) The pamphlets and bulletins incorporating the results of research made by the American company were also furnished to the Indian company by post and thus. the said service was also rendered outside India. (3) That the services of the .foreign technical personnel were made available to the Indian company by the American company outside the country. The former employed such

person- nel in India on the basis of the various agreements of employment entered between the Indian company and such personnel. They were the employees of the Indian company under its Control for their day-today working. (4) The training of the Indian per-

sonnel directly by the employees of the asses- see company was imparted outside India.

The Tribunal did not agree with the views of the Commissioner that the payment of the teChniCal fee of 3% was dependent upon the use of the information in India or on the volume and extent of such use. The use of the technical assistance and knowhow given by the American Company and made use of by the Indian Company in the taxable territory could not make the former liable-to payment of income tax on the amount of technical fee received by it nor was it any royalty. A new stand taken before the Tribunal on behalf of the Revenue that the assessee company must be deemed to be working in conjunction with the Indian company in the manufacture of the products in question was also rejected.

The Commissioner of Income-tax--the respondent in this appeal, asked for a reference and the Tribunal referred the following question of law for the opinion of the High Court:

> "Whether on the facts and in the circumstances of the case, the technical fee in excess of 5 per cent received by the asses- see company from the Indian company during the account year relevant to the assessment year 1957-58 has accrued or arisen in India?"

Before the High Court on behalf of the Revenue the point of conjunction between the American company and the Indian company in the manufacture of abrasive products was put in the fore-front.

Finding this stand unsustainable in face of the agreement between the two companies and in absence of any other mate- rial in support of it, the High Court rejected this stand outright. It, however, felt persuaded to permit the Revenue to change its stand even at the reference stage and to urge that the agreement Clearly established a business connection between the two companies; the technical fee received by the assessee company had accrued or arose from such business connection and hence it was assessable to income tax under section 4(1) (c) read. with section 42 of the Act. The objection of the assessee company to the entertainment of the new point at the reference stage that it did not arise out of the Tribunal's order was over-ruled by the High Court on the ground that the question referred was in general terms and comprehensive enough to embrace within its ambit the point of applicability of section 42(1) of the Act to the 'transactions in question.1 Upholding this stand taken on behalf of the Revenue the High Court answered the ques- tion referred to' it in its favour and against the assessee company. Hence this appeal.

Mr. N.A. Palkhivala, learned counsel for the appellant company urged the following four points in support of this appeal :--

> (1) That the High Court could not go into the matter of business connection between the two companies when .such a question was never raised or in issue at any earlier stage. (2) That the High Court was wrong in founding the tax liability of the assessee

company on the basis of the alleged business connection.

Its finding or view in that regard is wholly erroneous.

(3) That even assuming that the High Court was right in its view of basing the tax li-

ability of the assessee company on the alleged business connection, it failed to examine the question of apportionment under section 42(3) of the Act.

(4) That apportionment under section 42(3) and determination of the tax liability of the assessee company in pursuance thereof could not be more than the liability to pay tax on 5% of the total technical fee as found by the Income-tax Officer and upheld by the Tribunal. Certain other companies have intervened in this appeal and some argument was advanced on their behalf too in sup- port of the main argument of Mr. Palkhivala, Section 4(1) of the Act provides :--

> "Subject to the provisions of this Act, the total income of any previous year of any person includes all income, profits and gains from whatever source derived which--
> .....
>
> (c) if such person is not resident in the taxable territories during such year, accrue or arise or are deemed to. accrue or arise to him in' the taxable territories during such year :"

The income assessable to income tax, therefore, is of two kinds viz (i) accruing or arising in the taxable territories and (ii) deemed to accrue or arise to the non-resident in the taxable territory. The concept of actual accrual or arising of income in the taxable territories, although not dependent upon the receipt of the income in the taxable territories, is quite distinct and apart from the notion of deemed accrual or arising of the income. The High Court does not appear to have kept this distinction inview and mixed the one with the other while deciding the reference in question. Section 42 of the Act concerns itself with a deemed accrual or arising of the income within the taxable territories. Under sub-section (1) "All income, profits or gains 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 re- spect of such income-tax :" If the whole of the deemed income can be roped in for the levy of tax under section (1) of section 42, no question of any apportionment arises. If not, sub-section (3) is attracted. It says. :-- .

> "In the case of 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

territo- ries."

In Commissioner of Income-Tax, Bombay v. Scindia Steam Navigation Co. Ltd.(1) it has been pointed out that when a question of law was neither raised before the Tribunal nor considered by it, it will not be a question arising out of its order notwithstanding that it may arise on the findings given by it. In the instant case the question of law based upon the theory of business connection was neither raised before the Tribunal nor considered by it, nor did it arise on the findings of fact recorded by it. The High Court, therefore, was wrong in entertaining this new point at the reference stage on the basis of the allegedly general and compendious nature of the question referred to it by the Tribunal. But we do not propose to rest our judgment only on this technical aspect of the matter as we find that even on merits the assessee company has a good case to succeed before us.

The High Court agreed with the Tribunal that the techni- cal information furnished by the assessee company by post was a.service which could not be said to have been rendered in India; putting it to use in India is not relevant as opined by the Commissioner. But in regard to the fact of the foreign technicians having been l.employed by the (1)42 I.T.R. 589.

Indian company on payment of salary in India, it took the view that the service was rendered in India as foreign technicians were deputed by the assessee company. In the opinion of the High Court it did amount to some activity or service in India. Then the High Court proceeds to say:"

> Therefore, we are of the view that the assessee having rendered at least some services in India which amounts to a business activity the technical fee should be taken to have accrued through or from its business Connection in India."

Even though, according to the High Court, the finding aforesaid was sufficient to rope in the entire receipts of the assessee company as income having accrued or arisen in India as a result of its business connection, it felt obliged to make the apportionment to the extent of 75% because of the apportionment so made by the Commissioner. In our judgment the High Court went wrong in its approach to the question raised before it and did not quite correctly appreciate the scope and applicablity of section 42 of the Act.

On a plain, reading of sub-sections (1) and (3) of section 42 it would appear that income accruing or arising from any business connection in the taxable territories---even though the. income may accrue or arise outside the taxable territories--will be deemed to be income accruing or arising in such territory provided operations in connection with such business, either all or a part, are carried out in the faxable territories. If all such opera- tions are carried out in the taxable territories, sub-sec- tion (1) would apply and the entire income accruing or arising outside the taxable territories but as a result of the operations in connection with the business giving rise to the income would be deemed to accrue or arise in the taxable territories. If, however, all the operations are not carried out in the taxable territories the profits and gains of the business deemed to accure 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. Thus comes in the question of apportionment under sub-section (3) of section

42. In Commissioner of Income-lax Punjab v. B.D. Aggarwal and Co. and another,(1) Shall J, as he then was, speaking for this Court said at page 24:

> "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 ferri- tories which contributes directly or indirect- ly to the earning of these profits or gains. It predicates an element of continuity. be- tween the business of the non-resident and the activity in the taxable territories: a stray or isolated transaction is normally not to be regarded as a business connection.Business. connection may take several forms: it may include carrying on a part of the main busi- ness or activity incidental to the main busi- ness of the non-resident through an agent, or it may merely be a relation between the busi- ness of the nonresident and the. activity in the taxable territories, which facilitates or' assists the carrying on of that business. In each case the' question whether there is a business connection (1) 56 I.T.R. ,20.
>
> from or through which income., profits or gains arise or accrue to non-resident must be determined upon the facts and circumstances of the case."

The learned Judge says further "A relation to be a "business connec-

tion" must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the nonres- ident. But it must in all cases. be remem-

bered that by section 42 income, profit or gain which accrues or arises to a non-resident outside the taxable territories is sought to be brought within the net of the income-tax law, and not income, profit 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 arising 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 enti- tled 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 under section 42 (1) if there subsists a connection between the activity in the taxable territories and the business of the non-resident, and if throug or from that connection income directly or indirectly arises."

The High Court was wrong in its view that activities. of the foreign personnel lent or deputed by the American compa- ny amounted to business activity .carried on by that company in the taxable territory. The finding of the Tribunal in that regard was specific and clear and was unassailable in the reference in question. The American company has made the services of the foreign personnel available to the Indian company outside the taxable territory. The latter took them as their employees, paid their salary and they worked under the direct control of the Indian company. The service rendered by the American company in that connection was wholly and solely rendered in the foreign territory. Even assuming, however, that there was any business connec- tion between the earning of the income in the shape of the technical fee by the American company and the affairs of

the Indian company, yet no part of the activity or operation could be said to have been carried on by the American compa- ny in India. And in absence of such a sustainable finding by the High Court the provision of section 42, either of sub-section (1) or of sub-section (3), were not attracted at all. The judgment of the High Court under appeal reported in Commissioner of Income-Tax, Madras-J, v. Carborandum Compa- ny(1) is not correct. It has rightly been pointed out by the Bombay High Court in Commissioner of Income-Tax Bombay City I v. Tara Chemicals Ltd.(2) with reference to the similar or almost (92 I.T.R. 411.

94 I.T.R. 85 identical provisions in section 9(1) of the Income-tax Act, 1961 that in order to rope in the income of a non-resident under the deeming provision it must be shown by the Depart- ment that some of the operations ,were carried out in India in respect of which the income is sought to be assessed. The finding of fact recorded by the Tribunal being against the department in that connection the Bombay High Court refused to call for a reference.

For the reasons stated above we hold that on the facts and in the circumstances of the case the technical service fee received by the Assessee company from the Indian company during the accounting year relevant to the assessment year 1957-58 did not accrue or arise in India nor could it be deemed to have accrued or arisen in India. But since 5 % of the technical service fee was brought to tax by the Income Tax Officer and no appeal was filed against it 'on behalf of the Assessee-Company, we cannot interfere with. the addition of this 5% but if must be held that the technical leo in excess of 5 % was not taxable. We accordingly allow the appeal, set aside the judgment of the High Court and answer the question referred by .the Tribunal in favour of the assessee and against the Revenue. The Commissioner will pay the costs of the appeal as also of the reference to the assessee.

S.R. Appeal allowed.