

PETITIONER:
COMMISSIONER OF INCOME-TAX, PUNJAB

Vs.

RESPONDENT:
R. D. AGGARWAL & COMPANY

DATE OF JUDGMENT:
06/10/1964

BENCH:
SHAH, J.C.
BENCH:
SHAH, J.C.
SUBBARAO, K.
SIKRI, S.M.

CITATION:
1965 AIR 1526 1965 SCR (1) 660
CITATOR INFO :
R 1977 SC1259 (15)
R 1981 SC 148 (12)
R 1981 SC1047 (10)
R 1987 SC1234 (3,4,6,10)

ACT:
Income-tax Act, 1922 (11 of 1922), s. 42(1)-"Business connection", meaning of-Assessee canvassing orders for nonresidents in taxable territories without authority to accept orders-No other part in transaction -Relation with nonresident whether amounts to business connection Income intended to be taxed under s. 42(1)-Nature of.

HEADNOTE:
The assessees were a firm carrying on business as importers and commission agents. They communicated orders canvassed by them from dealers in India to non-residents for acceptance; if a contract resulted and the price was paid by the Indian dealers to the non-resident exporters the assessees became entitled to a commission. In assessment proceedings the income of the assessees was computed by the addition of 5% of the net total value of the sale effected by the non-resident exporters in the previous year, because in the Income-tax Officer's view there subsisted a 'business connection' between the non-resident dealer and the assessees. The appellate authorities upheld the said view. The High Court however held that there was no 'business connection' within the meaning of s. 42(1) between the assessees and the non-resident exporters. The Commissioner of Income-tax appealed to the Supreme Court by special leave.

HELD (i) Section 42(1) of the Indian Income-tax Act, 1922, seeks to tax those profits of a non-resident which arise or accrue to him outside the taxable territories through or from a "business connection" within the taxable territories. [665 C-E].

(ii)"Business connection" which is not defined in the Act, may as several forms : it may include carrying on a part of the main business activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business 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 from or through which income profits and gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case. [664 H; 665 B].

(iii) The expression "business connection" postulates a real and intimate relation between trading activity carried on outside the taxable territories and trading activity within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading capacity. In the present case, the activity of the assessee in procuring orders was not as agents of the nonresident it, the matter of sale of goods manufactured by the latter nor of procuring raw materials in the taxable territories for their manufacturing process. Their activity only led to the making of offers by merchants in the taxable territories to purchase goods manufactured by the non-residents assesseees. [669 G-H; 670 A].

Commissioner of Income-tax v. Remington Typewriters Co. Bombay Ltd. L.R. 58 I.A. 42, Commissioner of Income-tax, Bombay Presidency and Aden v. Currimbhoy Ebrahim and Sons Ltd. L.R. 63 I.A. 1, Bangalore Woollen, Cotton and Silk Mills Co. Ltd. v. Commissioner of Income-tax Madras, (1950) 18 I.T.R. 423, Abdullabhai Abdul Kadar v. Commissioner of Income-tax Bombay City, (1952) 22 I.T.R. 241, Anglo-French Textile

661

Company Ltd. v. Commissioner of Income-tax, Madras, [1953] S.C.R. 454 and Hira Mills Ltd. Cawnpore v. Income-tax Officer, Cawnpore, (1946) 14 I.T.R. 417, considered.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 808 and 809 of 1963.

Appeals by special leave from the judgment and order dated October 5, 1960, of the Punjab High Court in Income-tax Reference Nos. 11 and 13 of 1958.

K. N. Rajagopala Sastri, R. H. Dhebar and R. N. Sachthey, for the appellant. Veda Vyasa and B. P. Maheshwari, for the respondents.

The Judgment of the Court was delivered by Shah J. R. D. Aggarwal & 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 agents or 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 Filaturae 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 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 % 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 assesseees had to "maintain the existing customers" and to secure new customers "conforming to their general terms of sales", and were to receive 21 per cent

commission on the net cash amounts arising from the accepted business "concluded by the mediation" of the assesseees or directly by the Italian Company with the customers. The Belgian Company appointed the assesseees their representatives 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 assessment year 1952-53 the Income-tax Officer, 'C' Ward, Amritsar computed the income of the assesseees by adding Rs. 54,558 being 5% of net total value of yarn sold by the non-resident companies 662

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 S. 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 nonresident 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, the Commissioner of Income-tax has appealed to this Court against the opinion of the High Court in these two cases.

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

"Where the . . . agent of any person not resident in the taxable territories (such person being hereinafter in this subsection 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 amount 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

663.

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, insofar as it is material, provides:

"(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 respect of such income-tax :

Provided.....

Provided further

Provided further

(2) Where a person not resident or not ordinarily resident in the taxable territories, carried 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 persons the course of business is so arranged that the business done by the resident person with the person not resident or not ordinarily resident produces to the resident either no 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."

LISup.165-17

664

It may be observed that sub-ss. (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, or 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 nonresident 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 assesseees such a relation as may be called "business connection, in the taxable territories. If the answer to this question be in the affirmative, the assesseees would as statutory agents be chargeable to tax on behalf of the non-resident Companies on profits and gains reasonably attributable to those parts of the operations 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 or manufacture, but 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 S. 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 regarded as 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 or it may merely be a relation between the business of the non-

665

resident 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 from or through which income, profits or gains arise or accrue to a nonresident must be determined upon the facts and circumstances of the case.

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 s. 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 s. 4 (1)(a) & (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 s. 40(2). Income not taxable under s. 4 of the Act of a non-resident becomes taxable under s. 42(1) if there subsists a connection between the activity in the taxable territories and the business of the non-resident, and if through or from that connection income directly or indirectly arises.

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.(1) 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 s. 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

(1) L.R. 58 I.A. 42.

666

under s. 40, as it had not received the profits and gains in question. In that case, in consideration of transfer of the goodwill of the American Company in a specified territory in India 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 made by the American Company by sale of the machines and dividends received by the American Company from the assessee Company were held taxable on the ground that there existed a business 'connection.

In Commissioner of Income-tax Bombay Presidency and Aden v. Currimbhoy Ebrahim and Sons Ltd.(1) advance of a loan by a non-resident was held not to be a business connection. Currimbhoy Ebrahim & 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 S. 43 of the Indian Income-tax Act, and assessed to tax the interest on the loan which the taxing authorities regarded as profit or gain which must be deemed to have accrued or arisen to the Nizam, through or from a business connection or property in British India within the meaning of S. 42(1) of the Act. The Judicial Committee held that the loan transaction was an isolated transaction. There being nothing to show that the Nizam had at any time any interest, direct or indirect, in the respondent Company, there was no business connection in British India within the meaning of s. 42 of the Act between the Company and the Nizam and the interest on the loan did not constitute a profit or gain accruing or arising to the Nizam, directly or indirectly, through or from any business connection or property in British India, chargeable to income-tax in the name of the Company.

In Bangalore Woollen, Cotton and Silk Mills Co. Ltd. v. Commissioner of Income-tax, Madras (2) the assessee a Company registered in the Indian State of Mysore carried on the business of manufacturing woollen, cotton and silk goods at Bangalore. 'Me

(1) L.R. 63 I.A. 1. (2) (1950) 18 I.T.R. 423.

667

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- (i) on the profits attributable to the sale proceeds received in British India and (ii) on the profits that accrued or arose outside British India to the assessee by reason of business connection in British India. The High Court of Madras held that the managing agents purchased in British India raw materials required for the business continuously for several years, received the sale proceeds of manufactured goods in British India and credited in their books to the account of the Company acting as bankers, met all the expenditure from out of the collections in their hands, paid for the purchase, made also other payments referred to in the managing agents' accounts. This was a clear case of a business connection in British India in respect of income which accrued or arose to the assessee outside British India.

In *Abdullahai Abdul Kadar v. Commissioner of Income-tax Bombay City*(1) the assessee acted as commission agent of a nonresident and entered into transactions within the taxable territories on behalf of the non-resident, but he was not the sole commissions 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 s. 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.

(1) (1952) 22 I.T.R. 241.

668

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, Madras*(1). The assessee 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 yam 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 s. 42 and a portion of the profits of the non-resident attributable to the purchase of cotton in British India could be apportioned under s. 42(3).

In Hira Mills Ltd., Cawnpore v. Income-tax Officer, Cawnpore(2) 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 s. 4(1). The Company's 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 a broker or banker in British India in exchange of endorsed railway receipts. On

(1) [1953] S.C.R 454.

(2) (1946) 14 I.T.R. 417.

669

the facts the Allahabad High Court held that there was no business connection in British India.

The distinction between Abdullahhai Abdul Kadar's case(1) and the Hira Mills' case (2) 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 sales 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 s. 4(1)(a) or s.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 nonresidents 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 good or delivery of goods against price took place within the taxable territories : the assessee merely procured orders from merchants 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 nonresidents of goods to merchants at Amritsar. But on this account no business connection of the assessee with the non-residents within the taxable territories

resulted. The activity of the assesseees in procuring orders was not as agents of the non-residents in the matter of sale of goods manufactured by the latter, nor of procuring raw materials in the taxable territories for their manufacturing process. Their activities led to the making of offers by merchants in the taxable territories to purchase goods manufactured by the non-residents which the latter were not obliged to accept. The expression "business connection" postulates a real and intimate relation between trading activity

(1) 22 I.T.R. 241.

(2) 14 I.T.R 417.

670

carried on outside the taxable territories and trading activity within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity. In this case such a relation is absent.

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

Appeals dismissed.

671