Understanding the Concept of Business Connection

By- Ananya Kapoor

Section 5, 6 and 9 (inter-play)

- **Scope of total income.**
- **5.** (1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—
- (*a*) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (*b*) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
- (*c*) accrues or arises to him outside India during such year :
- **Provided** that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6)* of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.
- (2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—
- (*a*) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (*b*) accrues or arises or is deemed to accrue or arise to him in India during such year.
- *Explanation 1.*—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.
- *Explanation 2.*—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

Section 90- DTAA and Income Tax Act, 1961

- **Agreement with foreign countries or specified territories.**
- **90.** (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—
- (*a*) for the granting of relief in respect of—
- (*i*) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or
- (*ii*) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or
- (*b*) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, [95][*without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory)*,] or
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or
- (*d*) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,
- and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.
- (2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

Section 9

- **Income deemed to accrue or arise in India.**
- **9.**(1) The following incomes shall be deemed to accrue or arise in India :—
- [27](*i*) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.
- *Explanation 1*.—For the purposes of this clause—
- (*a*) in the case of a business [28]**[***, other than the business having business connection in India on account of significant economic presence,***]** of which all the operations are not carried out in India, the income of the business deemed under this 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 ;
- (*b*) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export ;
- [* * *]
- (*c*) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India ;
- (*d*) in the case of a non-resident, being—
- (*1*) an individual who is not a citizen of India ; or
- (*2*) a firm which does not have any partner who is a citizen of India or who is resident in India ; or
- (*3*) a company which does not have any shareholder who is a citizen of India or who is resident in India,
- no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India;
- (*e*) in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf.
- Explanation 2. —For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—
- (*a*) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are—
- (*i*) in the name of the non-resident; or
- (*ii*) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- (*iii*) for the provision of services by the non-resident; or
- (*b*) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
- (*c*) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:
- **Provided** that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business :
- **Provided further** that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

CIT Vs. R.D. Aggarwal &Co. [1965] 56 ITR 20 (SC)[06-10-1964]

Brief Facts-

- R.D. Aggarwal & Co. (“Assessees”), acted as an importers and as commission agent for non-resident exporters who were the manufacturers of worsted wollen yarn of belgum and Italy.
- Subsequently, the assessees 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 assessees had to "maintain the existing customers" and to secure new customers "conforming to their general terms of sales", and were to receive commission on the net cash amounts arising from the accepted business "concluded by the mediation.

CIT Vs. R.D. Aggarwal &Co. [1965] 56 ITR 20 (SC)[06-10-1964]

Brief Facts-

- The Belgian company appointed the assessees 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.
- ITO, computed the income of the assessees by adding Rs. 54,558 being 5 per cent, of the net total value of yarn sold by the non-resident companies to Indian merchants in the previous year, because in his view their subsisted business connections between the non-resident exporters and the assessees.

CIT Vs. R.D. Aggarwal &Co. [1965] 56 ITR 20 (SC)[06-10-1964]

Hon’ble SC Ruled

- 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 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 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.

CIT Vs. R.D. Aggarwal &Co. [1965] 56 ITR 20 (SC)[06-10-1964]

Hon'ble SC Ruled

- 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-resident and the activity in the taxable territories, which facilitates or assists the carrying on of that business.
- 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.
- In the instant case, contracts for the sale of goods took place outside the taxable territories, price was received by the non-residents outside the taxable territories, and delivery was also given outside the taxable territories.

CIT Vs. R.D. Aggarwal &Co. [1965] 56 ITR 20 (SC)[06-10-1964]

- Turning to the facts of the instant case, as found by the revenue authorities,
- contracts for the sale of goods took place outside the taxable territories,
- price was received by the non-residents 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 goods 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 assessees had no authority to accept on behalf of the non-residents.
- Some commercial activity was undoubtedly carried on by the assessees in the matter of procuring orders. which resulted in contracts for sale by the non-residents of goods to merchants at Amritsar. But on this account no business connection of the assessees with the non-residents within the taxable territories resulted.
- The activity of the assessees 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 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 was absent.

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[2012] 347 ITR 192 (Delhi)- DHC
Rolls Royce Singapore (P.) Ltd. vs. ADIT

- The assessee was a Singaporean company. Its principal activities were sale of spare parts for oil-field equipments and engines and turbine compressor systems and electronic retrofit projects and services rendered in connection with repair and overhauling of such equipments. The major clients of the assessee in India included ONGC, GAIL, etc… it had not declared any income for supply of equipments made to the Indian clients on the ground that it had no PE in India and, therefore, its business income from supply of spare parts was not chargeable to tax in India.
- The Assessing Officer observed that the assessee had an executive agent in India in the form of ANR, whose only source of income in India was from the assessee, and ANR was responsible to the assessee and was not doing any activities other than what were directed by the assessee. The Assessing Officer, therefore, had taken a view that the assessee had a business connection or PE in India in the form of ANR. The Assessing Officer, therefore, held that by reason of existence of business connection and source of income and PE in India, the assessee was liable to pay tax in respect of income earned on supply of spare parts as business profit.

[2012] 347 ITR 192 (Delhi)- DHC
Rolls Royce Singapore (P.) Ltd. vs. ADIT

- On appeal, the assessee contended that ANR was an independent entity and was not related to the assessee-company at all; ANR had various other clients from where it was earning the revenue and the assessee was not the sole customer; ANR did not have the power to negotiate and conclude the contracts on behalf of the assessee-company and the transactions between ANR and the assessee-company were on principal-to-principal basis, and, therefore, ANR could not be treated as an independent agent, or PE of the assessee company.
- **HELD**
- *What was to be seen was that the 'activities' of ANR are devoted wholly or almost wholly on behalf of the assessee. According to the assessee, ANR had many other activities and was doing business for many other parties. Agency of the assessee held by ANR was only one of those many activities.*
- *This contention of the assessee is not accepted by the Tribunal as according to the Tribunal, the assessee had not stated as to the extent of services rendered by ANR to other companies as well as the amount of commission earned by ANR from them.*
- *The particulars of other clients and commission earned by ANR from them was within the knowledge of ANR but the assessee did not chose to collect the same and provide it to the Assessing Officer. The Tribunal further observed that the assessee failed to furnish all such details on requisition by the Assessing Officer.*

[2012] 347 ITR 192 (Delhi)- DHC Rolls Royce Singapore (P.) Ltd. vs. ADIT

- *It was disputed by the assessee contending that there was no such requisition made and the assessee was never asked to furnish such information. The fact remains that it was the contention of the assessee that it was not the sole client of ANR and the activities of ANR were not devoted wholly or almost wholly on behalf of the assessee. The assessee produced a communication dated 18-1-2007 addressed to it by ANR confirming that ANR had rendered services and had earned commission from companies other than the assessee during the financial year 2003-04 and that the assessee was not its only source of income during the year. After this letter was produced, the Assessing Officer did not ask for further information. The revenue could not show anything to the contrary or dispute the fact that the Tribunal has gone on the wrong premise that the assessee failed to furnish all such details even after requisitioned by the Assessing Officer. It could not be denied that there was no such requisition made and the assessee was never asked to furnish any such information. On this wrong premise, the Tribunal has arrived at wrong conclusion. [Para 45]*
- *However, the question whether ANR has income from other clients as well and the extent of such income is very relevant to decide as to whether the criteria stipulated in article 5(9) is satisfied or not. Since the Assessing Officer did not look into the matter from this angle and the Tribunal also disposed of the issue deciding against the assessee on wrong premises, for this limited issue matter needs to be remanded to the Assessing Officer. The Assessing Officer shall decide the question of applicability of article 5(9) as to whether ANR was providing services to companies other than the assessee as well and had substantial income from those other companies and whether the company stipulated in article 5(9), namely, ANR was wholly or almost wholly working on behalf of the assessee will have to be determined afresh by the Assessing Officer. [Para 46]*
- *The assessee is permitted to file the evidence in the form of Income-tax return or otherwise on this issue. However, onus would be on the assessee to show that ANR had been rendering services and earning commission from other companies on the basis of which it cannot be said that the ANR devoted wholly or almost wholly on behalf of the assessee. These matters are, thus, remanded to the Assessing Officer for fresh adjudication. [Para 47]*

Volkswagen Finance (P.) Ltd. Vs. ITO (Int'l Tax) [2020] 79 ITR(T) 447 (Mumbai - Trib.) (19.03.2020)

Brief Facts

- The assessee, an Indian company jointly with its group entity, Audi India, planned an event in Dubai for launch of Audi A-8L facelift model in the Indian market.
- Around 150 people, mostly prospective Indian customers and journalists were flown to Dubai for their participation in the event.
- Consideration was paid to a US resident celebrity for making an appearance at the event.

Volkswagen Finance (P.) Ltd. Vs. ITO (Int'l Tax) [2020] 79 ITR(T) 447 (Mumbai - Trib.) (19.03.2020)

Brief Facts

- The assessee and Audi India received full rights to use free & non-exclusive promotional usage of all the event footage/material, films/stills/interviews, etc. of the launch.
- The assessee did not withhold any taxes on payments made to celebrity for the appearance on the grounds that the event was not held in India, and hence, the income did not accrue or arise in India.
- The AO held that the payment was taxable in India as royalty u/s 9(1)(vi) as well as under Article 12 of the Indo-USA DTAA. Accordingly, the taxpayer was required to withhold tax.

Volkswagen Finance (P.) Ltd. Vs. ITO (Int’l Tax) [2020] 79 ITR(T) 447 (Mumbai - Trib.) (19.03.2020)

Tribunal Observation

- The Audi A8L facelift launch event in Dubai was India-centric. The event was for the purpose of promoting business in India which generates enquiry of potential customers in India who in turn would like to purchase Audi cars in India and finance the same from the Assessee. It was for this reason that the Assessee was a part of this event.
- While the event physically took place in Dubai (UAE), the predominant benefits was by way of below-the-line publicity on internet, press releases, news reports, social media of Audi 8L facelift in India.

Volkswagen Finance (P.) Ltd. Vs. ITO (Int’l Tax) [2020] 79 ITR(T) 447 (Mumbai - Trib.) (19.03.2020)

Tribunal Observation

- The target audience was in India, the potential customers were in India, the intended benefits were in India, and yet the event was in Dubai UAE. The use of this event, as a tool of marketing, was only in India.
- The entire expenses of the event were treated as business expenses and claimed as deduction which essentially implies that the expenses have been incurred "wholly and exclusively for the purposes of business" of the assessee and the business of the assessee is only in India.
- In light of above, ITAT held that all the benefits accrued to the taxpayer in India, and it was on account of these benefits that the international celebrity was paid for his participation in the Dubai event.

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<u>Tribunal Held</u>

- ITAT held that the business connection is intangible, as it is a relationship rather than an object, but it is significant business connection which has resulted in income accruing and arising to the non-resident. The income thus, based on facts, accrued and arose by reason of business connection in India.
- There is also no dispute about the position that all expenses are borne by the assessee, and its associate Audi India, and claimed as a deduction under section 37(1). Once the expenses for holding this event is in connection with business in India, it is only a natural corollary thereto that income from participation, in this event, to a non-resident has a business connection in India.

Volkswagen Finance (P.) Ltd. Vs. ITO (Int’l Tax) [2020] 79 ITR(T) 447 (Mumbai - Trib.) (19.03.2020)

Tribunal Held

- We need not influenced by the observations in available judicial precedents on what constitutes business connection in India, for the simple reason that none of these judicial precedents deals with a situation like one that we are dealing with, and, as very aptly put by Hon'ble Supreme Court in R.D. Agarwal's Co. case (supra), that the review of the judicial precedents is "not for evolving a definition applicable generally to all cases but with a view to illustrate what relations between the non-resident and activity in the taxable territories which contributed to the earnings of the income may or may not be regarded as business connections".

Volkswagen Finance (P.) Ltd. Vs. ITO (Int’l Tax) [2020] 79 ITR(T) 447 (Mumbai - Trib.) (19.03.2020)

Tribunal Held

- That none of the judicial precedents had an occasion to examine an intangible business connection, and, there is thus, no guidance available on this issue.
- In light of the above discussion, it is viewed that the income embedded in payment to the international celebrity, for participation in Dubai A8L launch event, was taxable in India.