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**DIRECTOR OF INCOME TAX (INTL. TAX.)-II ....Appellant**

Versus

**PANALFA AUTOELEKTRIK LTD.** ...Respondent

**CORAM:**  
**HON'BLE MR. JUSTICE SANJIV KHANNA**  
**HON'BLE MR. JUSTICE V. KAMESWAR RAO**

**SANJIV KHANNA, J.**

The present appeal by the Revenue, which arises out of proceedings under Section 195/197 of the Income Tax Act, 1961 ('Act', for short), relating to assessment year 2010-11 on an application filed by Panalfa Autoelektrik Ltd. (assessee, for short), requires adjudication of the following substantial question of law:-

“Whether the ITAT was right in holding that the commission paid to M/s. Agenta World Trading and Consulting Establishment for procuring export orders, is not fee for technical services under Section 9(i)(vii) of the Income Tax Act, 1961?”

2. For the sake of clarity, we record that the impugned order passed by the Income Tax Appellate Tribunal ('Tribunal', for short) is dated 25<sup>th</sup> October, 2013 and was passed in ITA 4654/Del/2012.

3. The assessee made an application dated 16<sup>th</sup> February, 2010 under Section 195(2) for authorization to remit Euro 1,40,055.53 as

commission for arranging export sales and realizing payments to M/s. Agenta World Trading and Consulting Establishment, a non-resident company registered in Liechtenstein. There is no Double Taxation Avoidance Agreement between India and Liechtenstein and, therefore, in the present appeal we are only concerned with the question of receipt, accrual or deemed accrual of the said income in India as per the mandate of the Act.

4. The Assessing Officer relying upon the decision of the Authority for Advance Rulings in ***In Re: M/s. Wallace Pharmaceuticals P. Ltd.*** [2005] 278 ITR 97 (AAR) held that the commission payment to the non-resident company on procuring orders was taxable as ‘fee for technical service’ under sub-clause (b) to Section 9(1) (vii) of the Act. The initial direction that the tax should be deducted at source @ 20% recorded in the order dated 4<sup>th</sup> May, 2010, was modified/reduced to 10% vide order dated 8<sup>th</sup> November, 2010 after recording that deduction at a higher rate would not be applicable in the present case.

5. The Commissioner of Income Tax (Appeals), however, reversed the aforesaid finding holding that the commission payment in the present case was not in the nature of ‘fee for technical service’ and he distinguished the decision in the case of ***Wallace Pharmaceuticals P. Ltd.*** (supra). The said finding has been affirmed by the Tribunal in the impugned order.

6. In order to appreciate the controversy, we would first like to refer and interpret Sections 5(2), 9(1)(i) and 9(1)(vii) of the Act, though, the Assessing Officer in the present case had not invoked Section 9(1)(i) of the Act. The relevant provisions read as under:-

**“5. Scope of total income.—**

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(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.

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**9. Income deemed to accrue or arise in India.**—(1) The following incomes shall be deemed to accrue or arise in India—

(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 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;

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*Explanation 4*—For the removal of doubts, it is hereby clarified that the expression “through” shall mean and include and shall be deemed to have always meant and included “by means of”, “in consequence of” or “by reason of”.

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(vii) income by way of fees for technical services payable by—

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(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

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*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”.”

7. Section 5(2) states that total income of a person, who is a non-resident, includes income from all sources which (a) is received or deemed to be received in India in such year by or on behalf of such person; (b) accrues or arises in India; or (c) is deemed to accrue or arise in such year in India. Explanation 1 of the aforesaid section clarifies that income accruing or arising out of India shall not be deemed to be received in India by reason of the fact that it is taken into account in a balance sheet prepared in India. We are required to decide, whether the commission paid to non-resident would be income deemed to be earned in India.

8. Section 9, as is clear from the heading itself, does not deal with income which is received or accrued or has arisen in India but deals with income which does not fall under any of the aforesaid categories. Section 9 creates a deeming fiction of income which is not received in India or accrues or arises in India but is deemed to accrue or arise in India. While interpreting a deeming clause, the courts have to be cautious that they should not expand the scope beyond what is mandated and required by the deeming clause. The deeming clause by its very nature enacts a fiction to treat what is unreal as real and, therefore, unless the situation is covered under the language of the provision, its scope should not be expanded and widened beyond what is clearly apparent and perceivable. In such cases, purpose should be

ascertained why the legal fiction is created and then full effect should be given to it without being boggled down or bidden when it comes to the inevitable corollaries, because we imagine the unreal as real.

9. Section 9(1)(i) brings to tax income of a non-resident accruing or arising, whether directly or indirectly, through and from any business connection in India, or through or from any property in India etc.

10. What is meant by ‘business connection’ has been interpreted by the Supreme Court in the case of **CIT, Punjab versus R.D. Aggarwal and Co.** [1965] 56 ITR 20 and subsequently in **Barendra Prasad Ray versus ITO** [1981] 129 ITR 295. We need not dwell on the said aspect in detail for several reasons, though Circular No. 23 dated 23<sup>rd</sup> July, 1969 issued by the Central Board of Direct Taxes would not be applicable as it stands withdrawn with effect from 22<sup>nd</sup> October, 2009 vide Circular No.7 of 2009. Firstly, the Assessing Officer had not invoked the said provision; secondly, as per Explanation 1 clause (a) to Section 9, in case of a business of which all operations are not carried out in India, only such part of income as is reasonably attributable to the operations carried out in India is deemed to be accrued or arisen in India under clause 9(1)(i). By Finance Act, 2012, Explanation 4 has been added with retrospective effect from 1<sup>st</sup> April, 1962, clarifying the expression “through” to have always meant and included, “by means of”, “in consequence of” or “by reason of”. There is no finding by the Assessing Officer and there is no allegation that a non-resident was carrying on any operation whatsoever in India. Thus, there is no question of attributing any income to operations carried on by the non-resident in India. No such argument has been addressed.

11. The Assessing Officer in his order under Section 195/197 of the Act has relied upon the judgment in the case of **Wallace Pharmaceuticals P. Ltd.** (supra), which has been distinguished on facts by the first appellate authority and the Tribunal. The factual matrix, including the agreement between the assessee and the non-resident and the terms, have not been spoken of by the Assessing Officer. These have been referred to and examined by the Commissioner of Income Tax (Appeals). But first, we examine Section 9(1)(vii) of the Act.

12. In the present case, clause (b) to Section 9(1)(vii) would be applicable as the respondent-assessee, the payer was a resident of India. The exceptions carved out under clause (b) are not applicable as it is not the case of the respondent-assessee that the fee paid was in respect of services to be utilised in business or profession carried out by the payer outside India, or for the purpose of making or earning of any income from any source outside India. The respondent-assessee's manufacturing unit was in India and it would be proper to hold that the source of income would be the manufacturing unit of the respondent-assessee in India, even if the sale proceeds were on account of exports.

13. The main question and issue, which would arise is whether the payment made to the non-resident would be covered under the expression, "fee for technical services" as defined in Explanation 2 quoted above. There are three categories of technical services as per Explanation 2; managerial services, technical services and consultancy services, and it includes provisions for services of

technical and other personnel albeit there are specific exclusions, but we are not concerned with the same in the present appeal.

14. The expressions “managerial, technical and consultancy services” have not been defined either under the Act or under the General Clauses Act, 1897. The said terms have to be read together with the word ‘services’ to understand and appreciate their purport and meaning. We have to examine the general or common usage of these words or expressions, how they are interpreted and understood by the persons engaged in business and by the common man who is aware and understands the said terms. The expression “management services” was elucidated upon by this Court in ***J.K. (Bombay) Limited versus CBDT and Another***, [1979] 118 ITR 312 in the following terms:-

“6. It may be asked whether management is not a technical service. According to an Article on “Management Sciences”, in 14 Encyclopaedia Britannica 747, the management in organisations include at least the following:

“(a) discovering, developing, defining and evaluating the goals of the organization and the alternative policies that will lead toward the goals,

(b) getting the organization to adopt the policies,

(c) scrutinizing the effectiveness of the policies that are adopted,

(d) initiating steps to change policies when they are judged to be less effective than they ought to be.”

Management thus pervades all organisations. Traditionally administration was distinguished from management, but it is now recognised that management has a role even in civil services. According to the Fontana Dictionary of Modern Thought, page 366, management was traditionally identified with the running of business. Therefore, management as a process is practised throughout every organization from top management through middle management to operational management.”

Recently this Court in ***CIT versus Bharti Cellular Limited and Others***, [2009] 319 ITR 139 had observed:-

“The word "manager" has been defined, inter alia, as: "a person whose office it is to manage an organization, business establishment, or public institution, or part of one; a person with the primarily executive or supervisory function within an organization, etc., a person controlling the activities of a person or team in sports, entertainment, etc."

It is, therefore, clear that a managerial service would be one which pertains to or has the characteristic of a manager. It is obvious that the expression "manager" and consequently "managerial service" has a definite human element attached to it. To put it bluntly, a machine cannot be a manager.”

Reference can be also made to the decision of the Authority for Advance Rulings in ***In Re: Intertek Testing Services India Private Limited***, [2008] 307 ITR 418, wherein it was elucidated:-

“First, about the connotation of the term “managerial”. The adjective “managerial” relates to manager or management. Manager is a person who manages an industry or business or who deals with administration or a person who organizes other people’s activity [New Shorter Oxford Dictionary]. As pointed out by the Supreme Court in *R. Dalmia v. CIT* [1977] 106 ITR 895, “management” includes the act of managing by direction, or regulation or superintendence. Thus, managerial service essentially involves controlling, directing or administering the business.”

15. The services rendered, the procurement of export orders, etc. cannot be treated as management services provided by the non-resident to the respondent-assessee. The non-resident was not acting as a manager or dealing with administration. It was not controlling the policies or scrutinising the effectiveness of the policies. It did not perform as a primary executor, any supervisory function whatsoever. This is clear from the facts as recorded by the Commissioner of

Income Tax (Appeals), which have been affirmed by the Tribunal. The Commissioner of Income Tax (Appeals) has quoted excerpts of the agreement between the respondent-assessee, who has been described as 'PAL', and the non-resident, who has been described as 'AGENTA'. The relevant portions thereof read as under:-

“2. Appointment

(1) PAL hereby appoint AGENTA as its commission agent for sale of its products within the territory to the purchaser(s) during the terms of this agreement, subject to and in accordance with terms and conditions set out herein and AGENTA agrees to and accepts the same.

(2) It is agreed by and between the parties that AGENTA'S representations and acts on behalf and for PAL viz-a-viz any third party shall be legally binding on PAL only when the same are authorized by virtue of a written and signed authorisation executed by PAL in favour of AGENTA.

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4. Commission

(a) PAL agrees and AGENTA accepts that the amount of commission payable to it shall be the difference between consideration which PAL receives in terms of the purchase contract/order from the purchaser(s) and the pre determined guaranteed consideration settled and agreed between the parties, as described in Annexure 1 annexed hereto;

(b) The parties agree that all the taxes applicable and required to be deducted in India to the transaction contemplated herein at the date of execution of this agreement and at any time in future during the terms of this agreement shall be deducted from the commission (as described herein above) before the same is paid and transferred to the bank account of AGENTA (herein referred to as the commission payable)”

16. The non-resident, it is clear was appointed as a commission agent for sale of products within the territories specified and subject to and in accordance with the terms set out, which the non-resident accepted. The non-resident, therefore, was acting as an agent for

procuring orders and not rendering managerial advice or management services. Further, the respondent-assessee was legally bound with the non-residents' representations and acts, only when there was a written and signed authorization issued by the respondent-assessee in favour of the non-resident. Thus, the respondent-assessee dictated and directed the non-resident. The Commissioner of Income Tax (Appeals) has also dealt with quantification of the commission and as per clause 4, the commission payable was the difference between the price stipulated in the agreement and the consideration that the respondent-assessee received in terms of the purchase contract or order, in addition to a pre-determined guarantee consideration. Again, an indication contra to the contention that the non-resident was providing management service to the respondent-assessee.

17. The Revenue, which is the appellant before us, has not placed copy of the agreement to contend that the aforesaid clauses do not represent the true nature of the transaction. The Assessing Officer in his order had not bothered to refer and to examine the relevant clauses, which certainly was not the right way to deal with the issue and question.

18. It would be incongruous to hold that the non-resident was providing technical services. To quote from ***Skycell Communications Ltd. and Anr. Vs. Deputy Commissioner of Income Tax and Ors.*** (2001) 251 ITR 53 (Mad), the word 'technical' has been interpreted in the following manner:-

“Thus while stating that “technical service” would include managerial and consultancy service, the Legislature has not set out with precision as to what would constitute “technical” service to render it “technical service”. The meaning of the word “technical” as given in the *New Oxford Dictionary* is adjective 1. of or relating to a particular subject, art or craft or its techniques: technical terms (especially of a book or article) requiring special knowledge to be understood: a technical report. 2. of involving, or concerned with applied and industrial sciences: an important technical achievement. 3. resulting from mechanical failure: a technical fault. 4. according to a strict application or interpretation of the law or the rules: the arrest was a technical violation of the treaty.

Having regard to the fact that the term is required to be understood in the context in which it is used, “fee for technical services” could only be meant to cover such things technical as are capable of being provided by way of service for a fee. The popular meaning associated with “technical” is “involving or concerning applied and industrial science”.”

19. The said term was also interpreted by this Court in case of ***Bharti Cellular Limited and Others*** (supra) where emphasis was laid on the element of human intervention, but we are not concerned with the said aspect in the present case. The non-resident had not undertaken or performed “technical services”, where special skills or knowledge relating to a technical field were required. Technical field would mean applied sciences or craftsmanship involving special skills or knowledge but not fields such as arts or human sciences (see paragraph 24 below).

20. The moot question and issue is whether the non-resident was providing consultancy services. In other words, what do you mean by the term “consultancy services”? This Court in ***Bharti Cellular***

**Limited and Others** (supra) had referred to the term “consultancy services” in the following words:-

“14. Similarly, the word “consultancy” has been defined in the said Dictionary as “the work or position of a consultant; a department of consultants.” “Consultant” itself has been defined, inter alia, as “a person who gives professional advice or services in a specialized field.” It is obvious that the word “consultant” is a derivative of the word “consult” which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Consult has also been defined in the said Dictionary as “ask advice for, seek counsel or a professional opinion from; refer to (a source of information); seek permission or approval from for a proposed action”. It is obvious that the service of consultancy also necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant.”

The AAR in the case of **In Re: P.No. 28 of 1999**, reported as [1999] 242 ITR 208 had observed:-

“By technical services, we mean in this context services requiring expertise in technology. By consultancy services, we mean in this context advisory services. The category of technical and consultancy services are to some extent overlapping because a consultancy service could also be technical service. However, the category of consultancy services also includes an advisory service, whether or not expertise in technology is required to perform it.”

21. The word ‘consultant’ refers to a person, who is consulted and who advises or from whom information is sought. In Black’s Law Dictionary, Eighth Edition, the word ‘consultation’ has been defined as an act of asking the advice or opinion of someone (such as a lawyer). It may mean a meeting in which parties consult or confer. For consultation service under Explanation 2, there should be a provision of service by the non-resident, who undertakes to perform it, which the acquirer may use. The service must be rendered in the form

of an advice or consultation given by the non-resident to the resident Indian payer.

22. In the present, case commission paid for arranging of export sales and recovery of payments cannot be regarded as consultancy service rendered by the non-resident. The non-resident had not rendered any consultation or advice to the respondent-assessee. The non-resident no doubt had acquired skill and expertise in the field of marketing and sale of automobile products, but in the facts, as notice by the Tribunal and the Commissioner of Income Tax (Appeals), the non-resident did not act as a consultant, who advised or rendered any counseling services. The skill, business acumen and knowledge acquired by the non-resident were for his own benefit and use. The non-resident procured orders on the basis of the said knowledge, information and expertise to secure “their” commission. It is a case of self-use and benefit, and not giving advice or consultation to the respondent-assessee on any field, including how to procure export orders, how to market their products, procure payments etc. The respondent-assessee upon receipt of export orders, manufactured the required articles/goods and then the goods produced were exported. There was no element of consultation or advise rendered by the non-resident to the respondent-assessee.

23. Decision in the case of *M/s Wallace Pharmaceuticals Private Limited* (supra) is clearly distinguishable as in the said case the non-resident consultant had to perform several services in the nature of attending meetings on mutually agreeable dates and providing advice and counseling, which were in the nature of consultancy services as they entailed support from a product team, compliance with all legal

and administrative formalities, including registration and marketing strategy, creation of entry into new markets, development and distribution channels, etc. The work being rendered was in the nature of services as a consultant to the Indian assessee. It included an element of advice and was certainly recommendatory in nature.

24. The OECD Report on e-commerce titled, *Tax Treaty Characterisation Issues arising from e-commerce: Report to Working Party No.1 of the OECD Committee on Fiscal Affairs* dated 01<sup>st</sup> February 2001, has elucidated:-

*“Technical services*

39. For the Group, services are of technical nature when special skills or knowledge related to a technical field are required for the provision of such services. Whilst techniques related to applied science or craftsmanship would generally correspond to such special skills or knowledge, the provision of knowledge acquired in fields such as arts or human sciences would not. As an illustration, whilst the provisions of engineering services would be of a technical nature, the services of a psychologist would not.

40. The fact that technology is used in providing a service is not indicative of whether the service is of a technical nature. Similarly, the delivery of a service via technological means does not make the service technical. This is especially important in the e-commerce environment as the technology underlying the internet is often used to provide services that are not, themselves, technical (*e.g.* offering on-line gambling services through the internet).

41. In that respect, it is crucial to determine at what point the special skill or knowledge is used. Special skill or knowledge may be used in developing or creating inputs to a service business. The fee for the provision of a service will not be a technical fee, however, unless that special skill or knowledge is required when the service is provided to the customer. For example, special skill or knowledge will be required to develop software and data used in a computer game that would subsequently be used in carrying on the business of allowing consumers to play this game on the internet for a fee. Similarly, special skill or knowledge is used to create a

troubleshooting database that customers will pay to access over the Internet. In these examples, however, the relevant special skill or knowledge is not used when providing the service for which the fee is paid, *i.e.* allowing the consumer to play the computer game or consult the troubleshooting database.

42. Many categories of e-commerce transactions similarly involve the provision of the use of, or access to, data and software (see, for example, categories 7, 8, 9, 11, 13, 15, 16, 20 and 21 in annex 2). The service of making such data and software, or functionality of that data or software, available for a fee is not, however, a service of a technical nature. The fact that the development of the necessary data and software might itself require substantial technical skills is irrelevant as the service provided to the client is not the development of that data and software (which may well be done by someone other than the supplier) but rather the service of making the data and software available to that client. For example, the mere provision of access to a troubleshooting database would not require more than having available such a database and the necessary software to access it. A payment relating to the provision of such access would not, therefore, relate to a service of a technical nature.

#### *Managerial services*

43. The Group considers that services of a managerial nature are services rendered in performing management functions. The Group did not attempt to give a definition of management for that purpose but noted that this term should receive its normal business meaning. Thus, it would involve functions related to how a business is run as opposed to functions involved in carrying on that business. As an illustration, whilst the functions of hiring and training commercial agents would relate to management, the functions performed by these agents (*i.e.* selling) would not.

44. The comments in paragraphs 40 to 42 above are also relevant for the purposes of distinguishing managerial services from the service of making data and software (even if related to management), or functionality of that data or software, available for a fee. The fact that this data and software could be used by the customer in performing management functions or that the development of the necessary data and software, and the management of the business of providing it to customers, might itself require substantial management expertise is irrelevant as the service provided to the client is neither managing the client's business, managing the

supplier's business nor developing that data and software (which may well be done by someone other than the supplier) but rather making the software and data available to that client. The mere provision of access to such data and software does not require more than having available such a database and the necessary software. A payment relating to the provision of such access would not, therefore, relate to a service of a managerial nature.

#### *Consultancy services*

45. For the Group, "consultancy services" refer to services constituting in the provision of advice by someone, such as a professional, who has special qualifications allowing him to do so. It was recognised that this type of services overlapped the categories of technical and managerial services to the extent that the latter types of services could well be provided by a consultant."

We broadly agree with the aforesaid observations. However, in the case of selling agents, we add a note of caution that taxability would depend upon the nature of the character of services rendered and in a given factual matrix, the services rendered may possibly fall in the category of consultancy services. Paragraphs 41 and 42 do not emanate for consideration in the present case, and effect thereof can be examined in an appropriate case [However, see ***Commissioner of Income Tax vs. Estel Communication P. Ltd.*** (2009) 318 ITR 185 (Del) and ***Skycell Communications Ltd.*** (supra)].

25. Thus, the technical services consists of services of technical nature, when special skills or knowledge relating to technical field are required for their provision, managerial services are rendered for performing management functions and consultancy services relate to provision of advice by someone having special qualification that allow him to do so. In the present case, the aforesaid requisites and required necessities are not satisfied. Indeed, technical, managerial and consultancy services may overlap and it would not be proper to

view them in water tight compartments, but in the present case this issue or differentiation is again not relevant.

26. In view of the aforesaid discussion, the substantial question of law mentioned above has to be answered in favour of the respondent-assessee and against the appellant-Revenue. The appeal is accordingly dismissed. There will be no order as to costs.

**(SANJIV KHANNA)**  
**JUDGE**

**(V. KAMESWAR RAO)**  
**JUDGE**

**September 18<sup>th</sup>, 2014**  
**VKR/NA/kkb**