Reportable

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 7796 OF 1997

GVK Industries Ltd. & Anr. ... Appellants

Versus

The Income Tax Officer & Anr. ... Respondents

J U D G M E N T

Dipak Misra, J.

The appellant No. 1 is a company incorporated under the Companies Act, 1956 for the purpose of setting up a 235 MW Gas based power project at Jegurupadu, Rajahmundry, Andhra Pradesh at an estimated cost of Rs.839 crores and the appellant No. 2 is a director of the company. The main object of the appellant company is to generate and sell electricity.

2. With the intention to utilize the expert services of qualified and experienced professionals who could prepare a scheme for raising the required finance and tie up the required loan, it sought services of a consultant and eventually entered into an agreement with ABB – Projects & Trade Finance International Ltd., Zurich, Switzerland, (hereinafter referred to as "Non-Resident Company/NRC"). The NRC, having regard to the requirements of the appellant-company offered its services as financial advisor to its project from July 08, 1993. Those services included, inter alia, financial structure and security package to be offered to the lender, making an assessment of export credit agencies world-wide and obtaining commercial bank support on the most competitive terms, assisting the appellant loan negotiations and documentation with lenders and structuring, negotiating and closing the financing for the project in a coordinated and expeditious manner. For its services the NRC was to be paid, what is termed as, "success fee" at the rate of 0.75% of the total debt financing. The said proposal was placed before the Board meeting of the company on August 21, 1993 and the Board

of Directors approved the appointment of the NRC and advised that it be involved in the proposed public issue of share by the company. The NRC rendered professional services from Zurich by correspondence as to how to execute the documents for sanction of loan by the financial institutions within and outside the country. With advice of NRC the appellant-company approached the Indian Financial Institutions with the Industrial Development Bank of India (IDBI) acting as the Lead Financier for its Rupee loan requirement and for a part of its foreign currency loan requirement it approached International Finance Corporation (IFC), Washington DC, USA. After successful rendering of services the NRC sent invoice to the appellant-company for payment of success fee amount i.e., US $.17,15,476.16 (Rs.5.4 Crores).

3. As the facts would unfurl after the receipt of the said invoice the appellant-company approached the concerned income tax officer, the first respondent herein, for issuing a 'No Objection Certificate' to remit the said sum duly pointing out that the NRC had no place of business in India; that all the services rendered by it were from outside India;

and that no part of success fee could be said to arise or accrue or deemed to arise or accrue in India attracting the liability under the Income-tax Act, 1961 (for brevity, 'the Act') by the NRC. It was also stated as the NRC had no business connection Section 9(1)(i) is not attracted and further as NRC had rendered no technical services Section 9(1)(vii) is also no attracted. The first respondent scanning the application filed by the company refused to issue 'No Objection Certificate' by his order dated September 27, 1994. Being dissatisfied with the said order passed by the first respondent the appellant-company preferred a revision petition before the commissioner of Income-tax, Hyderabad, the second respondent herein, under Section 264 of the Act. On March 21, 1995 the second respondent permitted the appellant-company to remit the said sum to the NRC by furnishing a bank guarantee for the amount of tax. The company took steps to comply with the said order but afterwards on October 25,1995 the revisional authority revoked the earlier order and directed the company to deduct tax and pay the same to the credit of the Central Government as a condition precedent for issuance of the 'No

Objection Certificate'. Thus, the order passed by the first respondent was affirmed and resultantly the revision petition was dismissed.

4. The non-success in revision compelled the company to approach the High Court in W.P. No. 6866 of 1995 for issue of writ of certiorari for quashing of the orders passed by the Income-tax officer and that of by the revisional authority. In the writ petition, the stand and stance put forth before the authorities were reiterated.

5. On behalf of the revenue a counter affidavit was filed contending, inter alia, that the NRC was very actively associated not only in arranging loan but also in providing various services which fall within the ambit of both managerial as well as consultancy services.

6. A reference was made to the letter dated July 8, 1993 wherefrom it is evident that NRC is a financial advisor with a worldwide experience and has been engaged in India and requested that it be appointed as "financial consultant" for the project. The company responded by appointing the NRC as the financial advisor vide its letter dated 2.8.1994. On behalf of the revenue, the proceedings of the Board of

Directors meeting was highlighted stating that they disclosed that the NRC was appointed not only to arrange for the loan but also to render several other financial and general services and also to involve itself in the public issue of the company and on that bedrock it was urged that it squarely falls within the ambit of Section 9(1)(vii)(b) of the Act. It was also averred that NRC is a financial segment of the ABB which is participating in the equity of the appellant company besides IFC, Washington. The further stand of the revenue was that Section 5(2) read with Section 9(1)(i)(vii) (b) will apply to the remittance to be made by the company to the NRC as the income would be deemed to have accrued or arisen in India and hence, the Indian company was liable to deduct tax at the prescribed rate before remitting any money to the NRC. The order passed by the authorities below were supported on the foundation that there is a business connection between the NRC with the company in India and the voluminous correspondence between the two wings discloses the said connection. It was also contended that the services rendered by the NRC were not a one time affair as alleged, for the company itself had acted on behalf

of the NRC for processing, negotiating and obtaining loans from IDBI India and IFC, Washington. Emphasis was laid on the fact that the company had contracted the NRC not only for the limited purpose of getting loan but also for the further participation in its business activity which was evincible from the correspondence made between the two and, therefore, the income will accrue or deemed to have accrued or arisen to the NRC in India within the provisions of the Act. Justifying the order of revocation by the Commissioner of Income-tax, it was set forth that order dated 21.03.1995 was only an interim order and the final order came to be passed on 25.10.1995 by which the revision was dismissed. It was asserted by the revenue that the services of the NRC, as demonstrable from the material brought on record, was rendered within India and, therefore, the company is obliged in law to deduct income-tax before remitting "success fee" to the NRC. On this premise, the denial of 'No Objection Certificate' (NOC) was sought to be justified.

7. A rejoinder affidavit was filed by the appellant company asseverating that the NRC is an independent unit and is, in a

way, subsidiarised by ABB. That apart, merely because expert advice was obtained, it could not be said that it pursued the application for loan/financial assistance on behalf of NRC and further the advisory services were rendered from outside India. The stand of the revenue that there has been an admission by the company to the effect that there was business connection with the NRC by the company, was controverted. It was put forth that the company was always the principal directly concerned with the making of application for financial assistance for the project and pursuing the same; that the NRC did not have any office or establishment in India at any relevant point of time; that it operated from Zurich; that there was no business connection between the company and the NRC; and that the success fee did not accrue or arise to the NRC in India and hence, no income is deemed to have accrued or arisen to NRC in India. In addition to the aforesaid it was urged Section 9(1)(i) and Section 9(1)(vii) have to be read together and in that case the stand of the revenue was absolutely unjustified and assuming Section 9(1)(vii) of the Act is read in isolation, the plain interpretation could not be

applicable regard being had to the nature of service rendered by NRC. It was also pleaded that merely because the amount of success fee was paid by the appellant-company to NRC in India for the services rendered from outside India, the income of NRC would not deemed to have accrued or arisen in India.

8. The High Court framed the following two issues for consideration:

> "(1) Whether 'success fee' payable by the petitioner-company to the NRC or any portion thereof is chargeable under the provisions the Act; and
>
> (2) Whether the petitioner-company is entitled to 'No Objection Certificate'."

9. The High Court referred to clause (b) of sub-section 2 of Section 5 and Section 9 of the Act and adverted to the expression 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 from any asset or source of income in India or through the transfer of a capital asset situate in India and thereafter referred to Section 163(1)(b) which uses the expression "business connection" and thereafter referring to various

authorities, culled out the principles as to what the expression “business connection” conveys. It observed that expression “business connection” is too wide to admit of any precise definition though it has some well known attributes; that whether there is a business connection between an Indian company and a non-resident company is a mixed question of fact and law which is to be determined on the facts and circumstances of each case; that the essence of “business connection” is existence of close, real, intimate relationship and commonness of interest between the NRC and the Indian person; that in a case where there is control of management or finances or substantial holding of equity shares or sharing of profits by the NRC of the Indian company/person, the existence of close/intimate relationship stand substantiated; and to constitute business connection, there must be continuity of activity or operation of the NRC with the Indian company/person and a stray or an isolated transaction is not enough to establish a business connection.

10. After culling out the principles, the High Court referred to the contents of the correspondence, the nature and

extent of services which the NRC had undertaken under the agreement, the resolution passed by the Board of Directors which had perused the letter dated July 8, 1993 addressed by the NRC stipulating the scope of services to be undertaken by NRC; the decisions of the Board to pay a fee to NRC and came to hold thus:

> "On a careful reading of the letter of proposal of the NRC and the extract of resolution of the Board of Directors of the petitioner-company, it is clear to us that it was no part of the services to be provided by the NRC to manage public issue in India to correspond with various agencies to secure loan for the petitioner-company, to negotiate the terms on which loan should be obtained or to draft document for it. The NRC has only to develop a comprehensive financial model, tie up the rupee/foreign currency loan requirements of the project, assess export credit agencies worldwide and obtain commercial bank support, assist the petitioner-company in loan negotiations and documentation with the lender. It appears to us that the service to be rendered by the NRC is analogous to draw up a plan for the petitioner-company to reach the required destination indicating roads and highways, the curves and the turns; it does not contemplate taking the petitioner-company to the destination by the NRC. Once the NRC has prepared the scheme and given necessary advice and assistance to the petitioner-company for obtaining loan, the responsibility of the NRC is over. It is for the petitioner-company to proceed on the suggested lines and obtain loan from Indian or foreign agencies. On the petitioner-company obtaining loan, the NRC becomes entitled to 'success fees'."

11. The High Court scanned the letters with due consideration and opined that the business connection between the petitioner company and the NRC had not been established. Thereafter, the writ court adverted to the proposition whether success fee could fall within clause (vii) (b) of Section 9(1) of the Act. Interpreting the said provision, the High Court opined that:

> "Thus from a combined reading of clause (vii) (b) Explanation (2) it becomes clear that any consideration, whether lump sum or otherwise, paid by a person who is a resident in India to a non-resident for running any managerial or technical or consultancy service, would be the income by way of fees for technical service and would, therefore, be within the ambit of "income deemed to accrue or arise in India". If this be the net of taxation under Section 9 (1) (vii) (b), then 'success fee', which is payable by the petitioner-company to the NRC as fee for technical service would be chargeable to income tax thereunder. The Income-tax officer, in the impugned order, held that the services offered by the NRC fell within the ambit of both managerial and consultancy services. That order of Income-tax officer found favour by the Commissioner in revision. In the view we have expressed above, we are inclined to confirm the impugned order."

12. At this juncture, it is necessary to note that a contention was advanced before the High Court by the assessee that the NRC did not render any technical or

consultancy service to the company but only rendered advise in connection with payment of loan by it and hence, it would not amount to technical or consultancy service within the meaning of Section 9(1)(vii)(b) of the Act. While not accepting the said submission, the High Court observed that for the purposes of attracting the said provision, the business of the company cannot be divided into water-tight compartments like fire, generation of power, plant and machinery, management, etc. and to hold that managerial and technical and consultancy service relate to management, generation of power and plant and machinery, but not to finance. Elaborating further, the High Court observed that advice given to procure loan to strengthen finances may come within the compartment of technical or consultancy service and "success fee" would thereby come within the scope of technical service within the ambit of Section 9(1)(vii)(b) of the Act. Being of this view, the High Court opined the assessee was not entitled to the "No Objection Certificate".

13. Be it stated, the constitutional validity of Section 9(1)(vii)(b) of the Act was challenged on the ground of

legislative competence and violation of Article 14 of the Constitution. The Court referred to the earlier Division Bench decision in ***Electrical Corporation of India Ltd. V. C.I.T.*** rendered in W.P. No. 105/1987 on March 24, 1987 and also took note of the fact that the said case was quoted with approval in ***Electrical Corporation of India Ltd. V. C.I.T.***[1] In the ultimate eventuate, High Court rejected all the contentions advanced by the assessee-company and dismissed the writ petition.

14. Being aggrieved, the petitioner company approached this Court. When the matter came up for consideration before a two-Judge Bench of this Court, which taking note of the far-reaching issues of constitutional purport and the fact that they were earlier referred to in the case of Electrical Corporation of India Ltd. (supra), which was ultimately withdrawn, it, by order dated 28.11.2000, referred the instant matter to a larger Bench. On 13.7.2010, the matter again came up for consideration before a three-Judge Bench and vide its order of the same date, the matter was referred to the Constitution Bench, which answered the reference as per decision on 1.3.2011 reported in (2011) 4 SCC 36. The

[1] (1990) 183 ITR 43 (SC); [(1989) Supp. 2 SCC 642]

issue before the Constitution Bench stated by the Court is thus:

> "It is necessary for purposes of clarity that a brief recounting be undertaken at this stage itself as to what was conclusively decided in *ECIL* and what was referred to a Constitutional Bench. After conclusively determining that clauses (1) and (2) of Article 245, read together, impose a requirement that the laws made by Parliament should bear a nexus with India, the three-Judge Bench in *ECIL* asked that a Constitutional Bench be constituted to consider whether the ingredients of the impugned provision i.e. Section 9(1)(*vii*) of the Income Tax Act (1961) indicate such a nexus."

15. Before the Constitution Bench the appellant withdrew its challenge to the constitutional validity of Section 9(1)(vii)(b) of the Act and elected to proceed on the factual matrix as to the applicability of the said provision. However, as the learned Attorney General pressed upon for reconsideration, the decision in three-Judge Bench in ECIL case, the larger Bench considered the validity of the requirement of a relationship to or nexus with territory of India as a limitation on the powers of Parliament to enact laws pursuant to clause (1) of Article 245 of the Constitution. The Court adverted to the ratio in ECIL, took note of propositions of the learned Attorney General and the principles relating to interpretation of the Constitution, textual analysis of Article

245, analysed the constitutional topological space of Article 245 and the wider structural analysis of Article 245 in the context of Article 260 and came to hold thus:

> "It would appear that the concerns of the learned Attorney General may have been more with whether the ratio in *ECIL* could lead to a reading down of the legislative powers granted to Parliament by Article 245. A thorough textual analysis, combined with wider analysis of constitutional topology, structure, values and scheme has revealed a much more intricately provisioned set of powers to Parliament. Indeed, when all the powers necessary for an organ of the State to perform its role completely and to effectuate the constitutional mandate, can be gathered from the text of the Constitution, properly analysed and understood in the wider context in which it is located, why should such unnecessarily imprecise arrogation of powers be claimed? To give in to such demands, would be to run the risk of importing meanings and possibilities unsupportable by the entire text and structure of the Constitution. Invariably such demands are made in seeking to deal with external affairs, or with some claimed grave danger or a serious law and order problem, external or internal, to or in India. In such circumstances, it is even more important that courts be extra careful."

16. Thereafter, the Court reiterated the two questions it had set out in the beginning. The first question reads thus:

> "(*1*) Is Parliament constitutionally restricted from enacting legislation with respect to extra-territorial aspects or causes that do not have, nor expected to have any, direct or indirect, tangible or intangible impact(s) on or effect(s) in or consequences for:

(*a*) the territory of India, or any part of India; or

(*b*) the interests of, welfare of, well-being of, or security of inhabitants of India, and Indians?"

Answering the same, the Court observed:

"The answer to the above would be yes. However, Parliament may exercise its legislative powers with respect to extra-territorial aspects or causes—events, things, phenomena (howsoever commonplace they may be), resources, actions or transactions, and the like—that occur, arise or exist or may be expected to do so, naturally or on account of some human agency, in the social, political, economic, cultural, biological, environmental or physical spheres outside the territory of India, and seek to control, modulate, mitigate or transform the effects of such extra-territorial aspects or causes, or in appropriate cases, eliminate or engender such extra-territorial aspects or causes, *only when* such extra-territorial aspects or causes have, or are expected to have, some impact on, or effect in, or consequences for: (*a*) the territory of India, or any part of India; or (*b*) the interests of, welfare of, well-being of, or security of inhabitants of India, and Indians."

And thereafter:

"Whether a particular law enacted by Parliament does show such a real connection, or expected real connection, between the extra-territorial aspect or cause and something in India or related to India and Indians, in terms of impact, effect or consequence, would be a mixed matter of facts and of law. Obviously, where Parliament itself posits a degree of such relationship, beyond the constitutional requirement that it be real and not fanciful, then the courts would have to enforce such a requirement in the operation of the law as a

matter of that law itself, and not of the Constitution."

17. The second question that was posed by the Constitution Bench is as follows:

> "(*2*) Does Parliament have the powers to legislate "for" any territory, other than the territory of India or any part of it?"

The aforesaid question was answered thus:

> "The answer to the above would be no. It is obvious that Parliament is empowered to make laws with respect to aspects or causes that occur, arise or exist, or may be expected to do so, within the territory of India, and also with respect to extra-territorial aspects or causes that have an impact on or nexus with India as explained above in the answer to Question 1 above. Such laws would fall within the meaning, purport and ambit of the grant of powers to Parliament to make laws "for the whole or any part of the territory of India", and they may not be invalidated on the ground that they may require extra-territorial operation. Any laws enacted by Parliament with respect to extra-territorial aspects or causes that have no impact on or nexus with India would be ultra vires, as answered in response to Question 1 above, and would be laws made "for" a foreign territory."

After the reference was answered, the matter was directed to be listed before the appropriate Bench.

18. We have heard Mr. U.A. Rana, learned counsel for the appellants and Mr. Arijit Prasad, learned counsel for the respondents.

19. At the very outset, it is necessary to mention as the challenge to the constitutional validity of the provision has been withdrawn, and the same accordingly has not been gone into by the Constitution Bench, there is no necessity to dwell upon the same. The crux of the matter is whether, in the obtaining factual matrix, the High Court was justified in concurring with the view expressed by the revisional authority that the assessee-company was not entitled to "No Objection Certificate" under the Act as it was under the obligation to deduct the tax at source pertaining to payment to the NRC as the character of success fee was substantiated by the revenue to put in the ambit and sweep of Section 9(1)(vii)(b) of the Act.

20. At this juncture, it is demonstrable that NRC is a Non-Resident Company and it does not have a place of business in India. The revenue has not advanced a case that the income had actually arisen or received by the NRC in India. The High Court has recorded the payment or receipt paid by the appellant to the NRC as success fee would not be taxable under Section 9(1)(i) of the Act as the transaction/activity did not have any business connection. The conclusion of the High

Court in this regard is absolutely defensible in view of the principles stated in ***C.I.T. V. Aggarwal and Company***[2], ***C.I.T. V. TRC***[3] and ***Birendra Prasad Rai V. ITC***[4]. That being the position, the singular question that remains to be answered is whether the payment or receipt paid by the appellant to NRC as success fee would be deemed to be taxable in India under Section 9(1)(vii) of the Act. As the factual matrix would show, the appellant has not invoked Double Taxation Avoidance Agreement between India and Switzerland. That being not there, we are only concerned whether the "success fee" as termed by the assessee is "Fee for technical service" as enjoined under Section 9(1)(vii) of the Act. The said provision reads as follows:

> "**9. Income deemed to accrue or arise in India** – (1) The following income shall be deemed to accrue or arise in India --
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> (*vii*) income by way of fees for technical services payable by—
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> (*a*) the Government ; or
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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

[2] (1965) 56 ITR 20
[3] (1987) 166 ITR 1993
[4] (1981) 129 ITR 295

purposes of making or earning any income from any source outside India ; or

(*c*) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

[Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.]

[*Explanation* 1.—For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.]

[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".]

21. Explanation to the Section 9(2) was substituted by the Finance Act 2010 with retrospective effect from 1.6.1976. Prior to the said substitution, another Explanation had been

inserted by the Finance Act, 2007 with retrospective effect from 1.6.1976. The said Explanations read as under:

> "As amended by Finance Act, 2010
>
> *Explanation.*— For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (*v*) or clause (*vi*) or clause (*vii*) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—
>
> (*i*) the non-resident has a residence or place of business or business connection in India; or
>
> (*ii*) the non-resident has rendered services in India.]
>
> As amended by Finance Act, 2007
>
> Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India."

22. The principal provision is Clause (b) of Section 9(1)(vii) of the Act. The said provision carves out an exception. The exception carved out in the latter part of clause (b) applies to a situation when fee is payable in respect of services utilized for business or profession carried out by an Indian payer outside India or for the purpose of making or earning of income by the Indian assessee i.e. the payer, for the purpose

of making or earning any income from a source outside India. On a studied scrutiny of the said Clause, it becomes clear that it lays down the principle what is basically known as the "source rule", that is, income of the recipient to be charged or chargeable in the country where the source of payment is located, to clarify, where the payer is located. The Clause further mandates and requires that the services should be utilized in India.

23. Having stated about the "source rule", it is necessary to appropriately appreciate how the concept has developed. At the time of formation of "League of Nations" at the end of 1920, it comprised of only 27 countries dominated by the European States and the United States of America. The United Nations that was formed after the Second World War, initially had 51 members. Presently, it has 193 members. With the efflux of time, there has been birth of nation States which enjoy political independence and that has led to cross-border and international trade. The State trade eventually has culminated in formulation of principles pertaining to international taxation jurisdiction. It needs no special emphasis to state that the said taxation principles are

premised to promote international trade and to allocate taxation between the States. These rules help and further endeavour to curtail possibility of double taxation, tax discrimination and also to adjudicate resort to abusive tax avoidance or tax evasion practices. The nation States, in certain situations, resort to principle of "tax mitigation" and in order to protect their citizens, grant benefit of tax abroad under the domestic legislation under the bilateral agreements.

24. The two principles, namely, "Situs of residence" and "Situs of source of income" have witnessed divergence and difference in the field of international taxation. The principle "Residence State Taxation" gives primacy to the country of the residency of the assessee. This principle postulates taxation of world-wide income and world-wide capital in the country of residence of the natural or juridical person. The "Source State Taxation" rule confers primacy to right to tax to a particular income or transaction to the State/nation where the source of the said income is located. The second rule, as is understood, is transaction specific. To elaborate, the source State seeks to tax the transaction or capital within its

territory even when the income benefits belongs to a non-residence person, that is, a person resident in another country. The aforesaid principle sometimes is given a different name, that is, the territorial principle. It is apt to state here that the residence based taxation is perceived as benefiting the developed or capital exporting countries whereas the source based taxation protects and is regarded as more beneficial to capital importing countries, that is, developing nations. Here comes the principle of nexus, for the nexus of the right to tax is in the source rule. It is founded on the right of a country to tax the income earned from a source located in the said State, irrespective of the country of the residence of the recipient. It is well settled that the source based taxation is accepted and applied in international taxation law.

25. The two principles that we have mentioned hereinabove, are also applied in domestic law in various countries. The source rule is in consonance with the nexus theory and does not fall foul of the said doctrine on the ground of extra-territorial operation. The doctrine of source rule has been explained as a country where the income or

wealth is physically or economically produced. [See **League of Nations, Report on Double Taxation by Bruins, Einaudi, Saligman and Sir Josiah Stan (1923)**]. Appreciated on the aforesaid principle, it would apply where business activity is wholly or partly performed is a source State, as a logical corollary, the State concept would also justifiably include the country where the commercial need for the product originated, that is, for example, where the consultancy is utilized.

26. From the aforesaid, it is quite vivid that the concept of income source is multifaceted and has the potentiality to take different forms [See **Klans Vogel, World-wide V. Source Taxation of Income – Review and Revision of Arguments (1988)**]. The said rule has been justified by Arvid A. Skaar in Permanent Establishment; Erosion of Tax Treaty Principle on the ground that profits of business enterprise are mainly the yield of an activity, for capital is profitable to the extent that it is actively utilised in a profitable manner. To this extent, neither the activity of business enterprise nor the capital made, depends on residence.

27. The purpose of adverting to these aspects is only to highlight that the source rule has been accepted by them in the UN Commentaries and the Organisation of Economic Corporation and Development (OECD) Commentaries. It is well known that what is prohibited by international taxation law is imposition of sovereign act of a State on a sovereign territory. This principle of formal territoriality applies in particular, to acts intended to enforce internal legal provisions abroad. [See **the Introduction in Klaus Vogel on Double Taxation Convention, South Asean, Reprint Edition (2007)**]. Therefore, deduction of tax at source when made applicable, it has to be ensured that this principle is not violated.

28. Coming to the instant case, it is evident that fee which has been named as "success fee" by the assessee has been paid to the NRC. It is to be seen whether the payment made to the non-resident would be covered under the expression "fee for technical service" as contained in Explanation (2) to Section 9(1)(vii) of the Act. The said expression means any consideration, whether lumpsum or periodical in rendering managerial, technical or consultancy services. It excludes

consideration paid for any construction, assembling, mining or like projects undertaken by the non-resident that is the recipient or consideration which would be taxable in the hands of the non-recipient or non-resident under the head "salaries". In the case at hand, the said exceptions are not attracted. What is required to be scrutinized is that the appellant had intended and desired to utilize expert services of qualified and experience professional who could prepare a scheme for raising requisite finances and tie-up loans for the power projects. As the company did not find any professional in India, it had approached the consultant NRC located in Switzerland, who offered their services. Their services rendered included, inter alia, financial structure and security package to be offered to the lender, study of various lending alternatives for the local and foreign borrowings, making assessment of expert credit agencies world-wide and obtaining commercial bank support on the most competitive terms, assisting the appellant company in loan negotiations and documentations with the lenders, structuring, negotiating and closing financing for the project in a coordinated and expeditious manner.

29. In this context, it would be appropriate to reproduce the letter dated 8.7.1993 addressed by the NRC. It reads as follows:

> "We propose the following scope of services to be performed by ABB PTF:
>
> Assisting GVK Industries Limited ("GVK") in putting together the financial structure and security package to be offered to the lenders;
>
> Evaluating the pros and cons of various lending alternatives, both for the local and the foreign borrowings;
>
> Developing a comprehensive financial model to evaluate the project and to perform various sensivity studies;
>
> Preparing a preliminary information Memorandum to be used as the basis for placing the foreign and local debt;
>
> Accessing Export Credit Agencies world wide obtaining commercial bank support on the most comprehensive terms;
>
> Assisting GVK in loan negotiations and documentation with lendors; and
>
> Structuring, negotiating and closing the financing for this project in a coordinated and expeditious manner.
>
> We propose a compensation structure based only on success. As an exception, ABB PTF does not propose either any retainers or any reimbursement for travel and other expenses incurred by ABB PTF.

> The success fee will be 0.75% of the total debt, payable at financial closing."

30. The said letter was placed before the Board of Directors of the appellant company in its meeting held on August 21, 1993. The relevant part of the resolution passed by the Board is extracted hereinbelow:

> ".....It was explained to the Directors that ABB-PTF's scope of service for the project include:
>
> Developing a comprehensive financial model;
>
> Tying up the rupee/foreign currency loan requirements of the project;
>
> Assessing Export Credit Agencies worldwide and obtaining commercial banks support on the most competitive terms;
>
> Assisting GVK in loan negotiations and documentation with lenders.
>
> For the above scope of service ABB PTF would be paid a fee of 0.75% of the loan amount which is payable only on successful financial closing. The Directors while approving this arrangement, advised that ABB-PTF should also be involved in the public issue of the company."

31. From the aforesaid two documents, it is clear as crystal that the obligation of the NRC was to:

(i) Develop comprehensive financial model to tie-up the rupee and foreign currency loan requirements of the project.

(ii) Assist expert credit agencies world-wide and obtain commercial bank support on the most competitive terms.

(iii) Assist the appellant company in loan negotiations and documentation with the lenders.

32. Pursuant to the aforesaid exercises carried out by the NRC, the company was successful in availing loan/financial assistance in India from the Industrial Development Bank of India (IDBI) which acted as a lead financier for the rupee loan requirement. For foreign currency loan requirement, the appellant approached International Finance Corporation, Washington D.C., USA and was successful. In this backdrop, "success fee" of Rs.5.4 crores was paid to the NRC.

33. In this factual score, the expression, managerial, technical or consultancy service, are to be appreciated. The said expressions have not been defined in the Act, and, therefore, it is obligatory on our part to examine how the said expressions are used and understood by the persons engaged in business. The general and common usage of the said words has to be understood at common parlance.

34. In the case at hand, we are concerned with the expression "consultancy services". In this regard, a reference

to the decision by the authority for advance ruling ***In Re. P.No. 28 of 1999***[5], would be applicable. The observations therein read as follows:

> "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."

35. In this context, a reference to the decision in ***C.I.T. V. Bharti Cellular Limited and others***[6], would be apposite. In the said case, while dealing with the concept of "consultancy services", the High Court of Delhi has observed thus:

> "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

[5] (1999) 242 ITR 280
[6] (2009) 319 ITR 139

> provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant."

36. In this context, we may fruitfully refer to the dictionary meaning of 'consultation' 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 means a meeting in which a party consults or confers and eventually it results in human interaction that leads to rendering of advice.

37. As the factual matrix in the case at hand, would exposit the NRC had acted as a consultant. It had the skill, acumen and knowledge in the specialized field i.e. preparation of a scheme for required finances and to tie-up required loans. The nature of activities undertaken by the NRC has earlier been referred to by us. The nature of service referred by the NRC, can be said with certainty would come within the ambit and sweep of the term 'consultancy service' and, therefore, it has been rightly held that the tax at source should have been deducted as the amount paid as fee could be taxable under the head 'fee for technical service'. Once the tax is payable paid the grant of 'No Objection Certificate'

was not legally permissible. Ergo, the judgment and order passed by the High Court are absolutely impregnable.

38. Consequently, the appeal, being devoid of merit, stands dismissed. However, in the facts and circumstances of the case there shall be no order as to costs.

.....J.
[SUDHANSU JYOTI MUKHOPADHAYA]

.....J.
[DIPAK MISRA]

NEW DELHI
FEBRUARY 18, 2015.