

IN THE HIGH COURT OF KARNATAKA AT BANGALORE

Dated this the 7th day of March, 2013

PRESENT

THE HON'BLE MR. JUSTICE N KUMAR

AND

THE HON'BLE MR. JUSTICE B. MANOHAR

ITA No. 976 of 2008

c/w

ITA Nos. 978, 979, 982 of 2008;

ITA Nos.341, 342, 343 & 344 of 2009

In ITA No.976 of 2008

BETWEEN:

1 The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

2 The Assistant Commissioner of
Income Tax
International Taxation
No.14/3A, 6th Floor
Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Patridge, Advs.)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 28-05-2008 passed in ITA No.60/Bang/2007 for the Assessment year 1999-2000 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.60/Bang/2007 dated 28-05-2008 confirm the order of the Appellate Commissioner and confirm the order passed by the Assistant Commissioner of Income Tax, International Taxation, Circle-19(1), Bangalore.

In ITA No.978 of 2008

BETWEEN:

- 1 The Commissioner of Income Tax
 International Taxation
 No.14/3A, 6th Floor
 Rashthrothana Bhavan
 Nrupathunga Road
 Bangalore – 560 001
- 2 The Assistant Commissioner of
 Income Tax
 International Taxation
 No.14/3A, 6th Floor

Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Patridge, Advs.)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 28-05-2008 passed in ITA No.61/Bang/2007 and 228/BNG/2007, for the Assessment year 2000-2001 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.61/Bang/2007 and 228/BNG/2007 dated 28-05-2008 and modify the order of the Appellate Commissioner and confirm the order passed by the Assistant Commissioner of Income Tax, International Taxation, Circle-19(1), Bangalore.

In ITA No.979 of 2008

BETWEEN:

1. The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001
- 2 The Assistant Commissioner of
Income Tax
International Taxation

No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
O M/s. King & Patridge, Advs.)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 28-05-2008 passed in ITA No.62/Bang/2007 and 229/Bang/2007, for the Assessment year 2001-02 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.62/Bang/2007 and 229/Bang/2007, dated 28-05-2008 confirm the orders of the Assistant Commissioner of Income Tax, International Taxation, Circle-19(1), Bangalore.

In ITA No.982 of 2008

BETWEEN:

1. The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001
2. The Assistant Commissioner of
Income Tax

International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

(By Sri K.V. Arvind, Advocate)

...Appellants

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Partridge, Advocates)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 28-05-2008 passed in ITA No.63/Bang/2007 for the Assessment year 2002-03 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.63/Bang/2007 dated 28-05-2008 confirm the orders of the Assistant Commissioner of Income Tax, International Taxation, Circle-19(1), Bangalore.

In ITA No.341 of 2009

BETWEEN:

1. The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001
2. The Deputy Commissioner of
Income Tax

International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Partridge, Advocates)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 02-01-2009 passed in ITA No.1210/Bang/2008 for the Assessment year 2006-07 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.1210/Bang/2009 dated 02-01-2009 confirming the order of the Appellate Commissioner and confirm the order passed by the Deputy Commissioner of Income Tax, International Taxation, Circle 1(1), Bangalore.

In ITA No.342 of 2009

BETWEEN:

1. The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001
2. The Deputy Commissioner of
Income Tax

International Taxation
No.14/3A, 6th Floor
Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Partridge, Advocates)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 02-01-2009 passed in ITA No.1209/Bang/2008 for the Assessment year 2005-06 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.1209/Bang/2008 dated 02-01-2009 confirming the order of the Appellate Commissioner and confirm the order passed by the Deputy Commissioner of Income Tax, International Taxation, Circle1(1), Bangalore.

In ITA No.343 of 2009

BETWEEN:

1. The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

2. The Deputy Commissioner of
Income Tax
International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Partridge, Advocates)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 02-01-2009 passed in ITA No.1208/Bang/2008 for the Assessment year 2004-05 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.1208/Bang/2008 dated 02-01-2009 confirming the order of the Appellate Commissioner and confirm the order passed by the Deputy Commissioner of Income Tax, International Taxation, Circle1(1), Bangalore.

In ITA No.344 of 2009

BETWEEN:

1. The Commissioner of Income Tax
International Taxation
No.14/3A, 6th Floor
Rashthrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

2. The Deputy Commissioner of
Income Tax
International Taxation
No.14/3A, 6th Floor
Rashtrothana Bhavan
Nrupathunga Road
Bangalore – 560 001

...Appellants

(By Sri K.V. Arvind, Advocate)

AND:

Nike Inc
India Liaison Office
49/1, Khanija Bhavan
Race Course Road
Bangalore – 560 001

...Respondent

(By Sri Kumar, Senior Counsel for
M/s. King & Partridge, Advocates)

This ITA filed U/s. 260A of I.T. Act, 1961 arising out of order dated 02-01-2009 passed in ITA No.1207/Bang/2008 for the Assessment year 2003-04 praying to (i) formulate the substantial questions of law stated therein, (ii) allow the appeal and set aside the order passed by the ITAT, Bangalore in ITA No.1207/Bang/2008 dated 02-01-2009 confirming the order of the Appellate Commissioner and confirm the order passed by the Deputy Commissioner of Income Tax, International Taxation, Circle1(1), Bangalore.

These ITAs coming on for hearing this day,

N. KUMAR J., delivered the following:

J U D G M E N T

The Revenue has preferred these appeals challenging the order dated 28.05.2008 passed by Income Tax Appellate Tribunal, Bangalore allowing the appeal filed by the assessee.

2. These eight appeals are taken up for consideration together as a common question of law is involved between the same parties but in respect of different assessment years and therefore, they are disposed of by this common order.

3. The assessee is a world known name or brand in sports apparels. It has its main office in USA. It has various associated enterprises or subsidiaries in various parts of the world. The assessee from its office in USA arranges for all its subsidiaries all over the world the various brands of sports apparels for sale to the various customers. The arrangement is through procurement by manufacture from the manufacturer, who directly dispatches the apparels to the various subsidiaries spread all over the world. The assessee with a view to spread its wings mainly from the point of view of procurement of various apparels by manufacture with the assistance of various

manufacturers from the various parts of the world approached the Reserve Bank of India to allow it to open a liaison office in India. In the application for permission by the RBI, the assessee had categorically stated that the liaison office will not undertake any activity of trading, commercial or any industrial nature or enter into any business contracts in its own name without the previous approval of the RBI. It was also committed that the assessee will not charge commission or fees or remuneration in regard to any of the services rendered by it in India. The third commitment was that the entire expenditure of liaison office in India will be borne by the assessee from US by sending funds through regular banking channels to India. It was also undertaken that the liaison office in India shall not borrow or lend without the prior approval of RBI. The RBI granted permission to the assessee under Section 29(1)(a) of the Foreign Exchange Regulation Act for opening of a liaison office in India. The RBI in its permission issued on 16.10.1997 had clearly indicated the restrictions on the functioning as a liaison office as per the commitments submitted by the assessee to the RBI. In its approval the RBI had directed the assessee to file an annual certificate from the

auditors that it had not earned any income in India, details of remittances received from abroad supported by inward remittance certificates, certified copy of the audited final accounts of the office in India, annual report of the work done by the office in India giving details of actual export or import and the number of staff engaged/appointed etc. along with their duties. The restrictions further were that the liaison office will not render any consultancy or any other services directly/indirectly with or without any consideration. The further restriction was that the liaison office will not have signing or commitment powers except that are required for normal functioning as liaison office. Accordingly, the assessee opened the liaison office and employed persons in various categories defining qualifications for each post and this was with reference to its main activity of purchase or procurement of apparels from India for the purpose of export by those manufacturers directly to the various subsidiaries of the assessee spread at various places in the world. For all these activities in India, the liaison office was receiving funds through banking channels from USA. The liaison office in India has no source of income not only because it had so

committed to RBI and its liaison office did liaison between the manufacturers and its Head Office in USA to help procurement of various apparels at the instance of the Head Office in USA for export by the manufacturers through the liaison office or directly to the various subsidiaries spread at various places. The assessee carried all the activities such as designing, marketing and distribution of authentic athletic footwear, apparel, equipment and accessories for a wide variety of sports and fitness activities. Its products are sold worldwide through subsidiaries and other distributors also. The assessee does not carry on any manufacture by itself. It engages various manufacturers all over the world on a job to job basis and makes arrangements with its subsidiaries for purchasing the manufactured goods directly and pay for the same to the respective manufacturers. With a view to ensure quality of its various products in India through its liaison office, it employed various people like merchandiser, product analyst, quality engineer, apparel product integrity manager, fabric controller, transport specialist, etc. In order that from every point of view the quality is maintained, supply of the merchandise is made as per schedule as are concerned with the selection of the

fabric, mixture of threads, manufacturing process, cleanliness, cleaning and many more, the various staff attached to the liaison office create awareness in the staff of the manufacturer. The rate or price for each apparel is negotiated with manufacturer. The quality of each apparel is also indicated. The samples so developed are forwarded to the US office. The liaison office only proposes and gives its opinion about the reasonability of the price and all related issues etc., the US office decides about the price, quality, quantity, to whom to be shipped and billed. The local manufacturer in India is conveyed of the decision by the office in USA and once it is accepted, the local manufacturer carries on his activity. The liaison office keeps a close watch on the progress, quality, etc., at the manufacturing workshop. The liaison office also keeps a watch on the time schedule to be followed and renders such assistance as may be required in the dispatch of the goods including the actual buyer and the place for export.

4. A survey was conducted under Section 133A of the Income Tax Act, 1961 (for short hereinafter referred to as 'the Act') in the premises of Nike Inc. – Liaison Office on 21.12.2002. The activities carried on by the company through

its office in India were verified. As return of income for the year was not filed by the assessee company, detailed reasons were recorded under Section 147 and notice under Section 148 of the Act was issued on 30.03.2004. In response to the said notice, the assessee company filed return of income on 05.05.2004 declaring Nil income. The assessee contended that its activity is to carry on activities that are ancilliary and auxiliary to the activities of its Head Office and other group companies and to act as a communication channel between the Head Office and parties in India. It further contended that in terms of explanation (b) to Section 9(1)(i) of the Act, no income is deemed to accrue or arise in India to a non-resident from operations that are confined to the purchase of goods in India for the purposes of export. Further, in terms of Central Board of Direct Taxes Circular No.20 dated 07.07.1964 a non-resident will not be liable to tax in India on any income attributable to operations confined to purchase of goods in India for export, even though the non-resident has an office or an agency in India for the purpose, or the goods are subjected to any manufacturing process before being exported from India. Therefore, they contended that no income shall be deemed to

accrue or arise in India to NIKE Inc., as its operations are to purchase of goods in India for the purposes of export, even though it has a Liaison Office to facilitate sourcing of products from Indian suppliers.

5. The assessing authority, relying on the sworn statement of Mr. Atul Ujagar, Director, NIKE Inc., - India Liaison Office and after looking into the list of employees and their designations held that the activities of the assessee is actually beyond its activities as required as a liaison office. The assessee Company gets the goods manufactured through various factories by providing various data like the availability of raw materials, list of suppliers of raw materials, cost of raw materials etc., helps the factories/contractors in getting the work done by its audit/quality checks, sends the goods directly to the place of consumption (not necessarily USA). Thus, a part of the entire business is done in India, more specifically by Apparel Product Integrity Department and the quality checks, through the India Liaison office. Therefore, the income accrues or arises or deemed to arise in India in view of Clause (b) of Sub-Section (2) of Section 5 of the Act and therefore, he

concluded by holding that the income of the assessee is chargeable to tax to the extent of income, which is attributable to the activities done in India or accruing or arising in India on its behalf by its Liaison office. Then, proceeded to levy tax at 5% of the export value and he concluded that 5% of the export value could reasonably be considered as income attributable to India operation i.e., income accruing or arising in India to the assessee. Aggrieved by the said order, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals). The appellate authority proceeded on the footing that it is an admitted fact that the assessee is not involved in the purchase of goods in India for the purpose of export, which involves transfer of title of goods purchased from the seller to the purchaser. It held that since the assessee is not involved in purchase, it is not entitled to the exemption enumerated in Section 9(1) of the Act and proceeded to uphold the order of Assessing Officer, thereby, dismissing the appeal.

6. Aggrieved by these two orders, the assessee preferred an appeal to the Tribunal. The Tribunal, on reconsideration of the entire material on record and after referring to the statutory

provisions and also referring to the judgments relied on, held that it is a case of assessee purchasing the goods for the purpose of exports. In the absence of there being any prima facie contract between the assessee and the local manufacturer, the only relationship is that of buyer's agent and the local manufacturer knows the assessee only as the agent of the buyers. The local manufacturers know that the agent of the buyer, i.e., the assessee, has placed the orders on it with a view to buy the goods in the course of export and as directed, export it to various affiliates of the assessee. Therefore, the Explanation (1)(b), purchase for the purpose of export clearly applies to the assessee and hence, no income is derived by it in India through its operations of the liaison office in India. Accordingly, the Tribunal upheld the contention of the assessee and set-aside the order of the Appellate Authority as well as the original authority and granted relief to the said authority. The cross-appeals filed by the Revenue for the two assessment years were dismissed. Aggrieved by the said order, the Revenue is in appeal.

7. These appeals were admitted on 10.07.2009 to consider the following substantial question of law:

Whether the Tribunal was correct in holding that the Activities carried on by the assessee of identifying exclusive manufacturer for its products, thereafter designing the products, supervising the manufacture of these products, controlling the quality of the products being manufactured and thereafter marketing the products did not amount to income accruing or arising in India u/s. 5(2) read with Section 9(1)(i) of the Act and the same was exempted as per Clause (b) of Explanation 1 to Section 9(1)(i) of the Act?

8. The learned counsel appearing for the Revenue, assailing the impugned order contends that the nature of activity carried on by the liaison office of the assessee in India extended the scope of a liaison office and contravened the terms of the licence granted by the RBI. It is the assessee, who identified the manufacturers in India, who placed orders, who sent their experts to train the employees in India, procured raw material for manufacturing the goods agreed to their specification and then their affiliates were supplied the manufactured goods. Therefore, the income accrued or deemed to accrue to the assessee in India is within the meaning of clause (b) of Sub-Section (2) of Section 5 of the Act. To be

eligible for exemption under Clause (b) of Sub-Section (1) of Section 9 of the Act, the assessee should have purchased the goods in India for the purpose of export which is not done. Therefore, the Tribunal committed a serious error in holding that the purchase of goods by the affiliates, amounts to purchase of goods by the assessee and that the said purchase is for the purpose of export, the assessee is entitled to the benefit under the aforesaid provision. Therefore, he submits that the impugned order requires to be interfered with.

9. Per contra, the learned Senior counsel appearing for the assessee submitted that the assessee has set up a liaison office in India. The liaison office is expected to identify the manufacturers and assist the affiliates of the assessee to purchase manufactured goods from the manufacturers in India according to the specifications provided by them. The entire expenditure of the liaison office is met by the income transmitted from America to India. No contract between the assessee and its affiliates or buyers is entered in India and no part of any amount is paid by such affiliates to the assessee in India and therefore, no amount has accrued or arisen or is deemed to have accrued or arisen in India so as to attract

liability to tax under Section 5(2)(b) as contended by the Revenue. The transaction in question clearly demonstrates that it is a case of purchase of goods for the purpose of export. Even if it is held that any income has accrued in India, the liability to pay tax is not attracted as rightly held by the Tribunal in view of Clause (b) of Explanation 1 to Section 9(1)(i).

10. Section (5) of the Act deals with scope of total income. Sub-Section (1) of Section 5 of the Act deals with sources of income which a person earns which is liable to tax. Sub-Section (2) of Section 5 of the Act deals with the income of a non-resident. It reads as under:

(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.

11. Section 9 of the Act deals with deemed income, which is accrued or arisen in India which reads as under:

9. (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 ;

(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 ;

[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, unless his activities are limited to the purchase of goods or merchandise for 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.

As is clear from Section 9 of the Act, it refers to four types of incomes which shall be deemed to accrue or arise in India. They are:

- (i) all incomes accruing or arising whether directly or indirectly, through or from any business connection in India;
- (ii) through or any property in India; or

- (iii) *through or from any asset or source of income in India; or*
- (iv) *through the transfer of a capital asset situated in India.*

12. In the instant case, we are concerned with the income accruing or arising from business connection. Till 2004, the word business connection had not been defined. However, by Finance Act, 2003, explanation (2) was inserted which came into effect from 01.04.2004. However, as is clear from the opening words of explanation (2), it was inserted for removal of doubts. In other words, it is clarificatory in nature and it is brought into statute by way of insertion and therefore, it is retrospective in nature as it is only explaining the meaning of the word 'business connection', which is found in Clause (i) of Sub-Section (1) of Section 9 of the Act.

13. The explanation (1) to Sub-Section 2 of Section 5 of the Act explains what the Legislature meant when they introduced a deeming provision regarding accrual or arising of income in India. It categorically states that the income accruing or arising outside India shall not be deemed to be accrued in India within the meaning of the said Section by

reason only of the fact that it is taken into account in a balance sheet prepared in India. Therefore, if an income accrues or arises outside India, it shall not be deemed to accrue or arise in India, even if the said income is shown in a balance-sheet prepared in India.

Explanation 1(b) to Section 9(1)(e) had a proviso which read as under:

“Provided that the non-resident has no office or agency in India for the purpose and the goods are not subject to any kind of manufacturing process before being exported from India.”

12. By Finance Act, 1964 with effect from 01.04.1964, the said proviso was deleted. The effect of this amendment is that in respect of the Assessment Year 1964-65 and subsequent years, a non-resident will not be liable to tax in India on any income attributable to operations confined to purchase of goods in India for export, even though the non-resident has an office or agency in India for the purpose, or the goods are subjected by him to any manufacturing process before being exported from India.

14. The Apex Court in the case of **Anglo-French Textile Company Limited -vs- Commissioner of Income-Tax, Madras** reported in **1953 ITR Vol.XXIII Page 101** explaining the meaning of the word “Business Connection” held :

“Activities which are not well-defined or are of a casual or isolated character would not ordinarily fall within the ambit of the word “Business Connection”. Distribution of profits on different business operations or activities ought only to be made for sufficient and cogent reasons and the observations made here are limited to the facts and circumstances of the case”.

“An isolated transaction between a non-resident and a resident in British India without any course of dealings such as might fairly be described as a business transaction does not attract the application of Section 42, but when there is a continuity of business relationship between the person in British India who helps to make the profits and the person outside British India who receives or realizes the profits, such relationship does constitute a business connection”.

15. Again, the Apex Court in the case of **Commissioner of Income-Tax, Punjab –vs- R.D.Agarwal and Company and another** reported in **1965 ITR Vol.LVI page 24**, held:

“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. 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. In each case, the question whether there is a business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case”.

“A relation to be a “business connection” must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the non-resident. But it must in all cases be remembered that by Section 42 income, profit or gain which accrues or arises to a non-resident outside the taxable territories is sought to be brought within the net of the income-tax law, and not income, profit or gain which accrues or arises or is deemed to accrue or arise within the taxable territories. Income received or deemed to be received, or accruing or arising or deemed to be accruing or arising within the taxable territories in the previous year is taxable by Section 4(I)(a) and (c) of the Act, whether the person earning it’s a resident or non-resident. If the agent of a non-resident receives that income or is entitled to receive that income, it may be taxed in the hands of the agent by the machinery provision enacted in Section 40(2). Income not taxable under Section 4 of the Act of a non-resident becomes taxable under Section 42(I) if

there subsists a connection between the activity in the taxable territories and the business of the non-resident, and if through or from that connection income directly or indirectly arises”.

16. In the background of this legal position when we examine the facts of this case, the assessee is not carrying any business in India. They have established a liaison office. The object of establishing the said office is to identify the manufacturers, give them the technical know-how and see that they manufacture goods according to their specification which would be sold to their affiliates. The person who purchases the goods pays the money to the manufacturer, in the said income, the assessee has no right. The said income cannot be said to be a income arising or accruing in the Tax Territories vis-a-vis the assessee. In fact, the evidence on record shows that Nike, USA bears the entire expenses of the liaison office. The buyer who is a non-resident may in turn pay some consideration to the assessee outside India, the contract between the assessee and the buyer if at all is entered outside India. Therefore, even if any income arises or accrues to the assessee, it is outside India. Therefore, explanation (1) to sub-section (2) of Section 5

expressly states income accruing or arising outside India shall not be deemed to be received in India within the meaning of the Section. However, under Section 9, all income accruing or arising whether directly or indirectly through or from any “business connection” shall be deemed to be accrued or arises in India. Now by Explanation (2) “business connection” has been explained which includes any business activities carried out by a person who acting on behalf of the non-resident as an habitual exercise in India. An authority to conclude Contracts on behalf of non-resident unless his activities are limited to the purchase of the goods or merchandise for the non-resident. If the said definition is read with Clause (b) of Explanation 1 to Sub-Section (1) of Section 9 in the case of a non-resident, no income shall be deemed to accrue or arise in India to him whether directly or indirectly through or from any “business connection”, which are confined for the purpose of export. In the first place, the assessee is not purchasing any goods. The assessee is enabling the manufacturers to purchase goods of a particular specification which is required by a foreign buyer to whom the manufacturer sells. As the orders are placed by the assessee with the manufacturer and the goods are

manufactured according to their specification which is the requirement of the buyer and even if it is held, though the goods are supplied to the buyer, it is deemed to be supplied to the assessee, the whole object of this transaction is to purchase goods for the purpose of export. Once the entire operations are confined to the purchase of goods in India for the purpose of export, the income derived therefrom shall not be deemed to accrue or arise in India and it shall not be deemed to be an income under Section 9 of the Act. If we keep the object with which the proviso to clause (b) of Explanation 1 to Sub-section (1)(i) of Section 9 of the Act was deleted, the object is to encourage exports thereby the Country can earn foreign exchange. The activities of the assessee in assisting the Indian manufacturer to manufacture the goods according to their specification is to see that the said goods manufactured has an international market, therefore, it could be exported. In the process, the assessee is not earning any income in India. If at all he is earning income outside India under a contract which is entered outside India, no part of their income could be taxed in India either under Section 5 or Section 9 of the Act. In that view of the matter, the order passed by the Tribunal does not

suffer from any infirmities, which calls for interference.
Therefore, the substantial question of law framed in this case is
answered in favour of the assessee and against the Revenue.

Accordingly, appeals are ***dismissed***.

**SD/-
JUDGE**

**SD/-
JUDGE**

SPS/dh