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INCOME DEEMED TO ACCRUE OR ARISE IN INDIA: ANALYSIS OF SECTION 9[EXCEPT SECTION 9(1)(I)] OF THE INCOME TAX ACT, 1961

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~INTRODUCTION~

Tax is considered to be the cost of living in a society. The government levies a tax to make sure that it is able to meet the needs of the people, and it is also the basic source of income of the government. Section 9 of the Income Tax Act, 1995 was designed as an aggregating provision since it amalgamated several independent provisions which had been scattered across the Indian Income Tax Act, 1922. These provisions were collected and put together under the head of 'incomes deemed to accrue or arise inIndia'.[1] The section enacts into law a "source rule" of taxation deeming different kinds of incomes,from interest and dividend to salary and royalty, to 'accrue or arise' in India for the purpose of taxation.[2] However, it is pertinent to note that these incomes do not accrue or arise in India *per se*.Hence, through the employment of a legal fiction, these different forms of income have been drawninto the tax net by the legislature due to their significant link with India.[3]

While covering income that is deemed to accrue or arise in India, this section does not additionallyinclude income that actually does accrue or arise in India since "a fiction is not needed to create asituation which exists in reality.[4] It is also to be noted that section 9 does not alter the entity with respect to whom the income arises. Rather, the legal fiction is used to shift only the "situs of accrualof the income."[5]

Section 9 is a particularly relevant provision because it states the categories of income which are deemed to accrue or arise in India. This is of significance because only income which accrues or arisesor is deemed to accrue or arise in India is liable to tax. This section is inclusive in nature since it provides for taxation to be imposed upon both residents and non-residents. Since this section alsotaxes non-resident corporations, the validity of this section has been challenged by many who contend that it is ultra vires the Indian Constitution as it is arguably outside the legislative competence and contravenes fundamental rights. Nevertheless, the vires and constitutional validity of section 9 has been confirmed and upheld by several Supreme Court and High Court decisions.[6]

Originally, Section 9 of the Income Tax Act, 1961 as it was then drafted, dealt only with a few restricted categories of taxation – business connection, transfer of assets, income from property, dividend and

salary. In 1976, however, with the enactment of the Finance Act, Section 9 of Income Tax Act was amended, to additionally include the following categories – interest, royalty and fees for technicalservices. This was criticized by Nani Palkhivala on the grounds of the addition proceeding on a grossly inadequate territorial nexus and that these additions were ultra vires.

Through this analysis of section 9, we seek to analyze the different provisions of section 9, barringsection 9(1)(i), by examining sub-clauses (ii), (iii), (iv), (v), (vi) and (vii) of section 9 (1) of the IncomeTax, 1995. These sections will be studied in relation to relevant provisions of the income tax act, juxtaposed against the

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[1] KANGA AND PALKHIVALA, THE LAW AND PRACTICE OF INCOME TAX 367 (9th ed. 2004).
[2] Id.
[3] Id.
[4] CIT v. Oriental Co. Ltd., (1982) 137 ITR 777
[5] Supra note 1
[6] AH Wadia v. CIT, (1949) 17 ITR 63

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background of relevant case laws.

~SECTION 9(1)(II) & (III): INCOME UNDER THE HEAD "SALARIES" ~

Section 9(1)(i) provides that income which falls under the head "Salaries" is deemed to accrue or arise in India if it is earned in India.[7] It further explains that the nature of income referred in this clause is for a) service rendered in India and b) the rest period or leave periods succeeded or preceded by services rendered in India and forms part of the service contract of employment and shall be accordingly, regarded as income earned in India.[8] The provision therefore, creates an artificial place for accrual of income under the head "Salaries".

Income under the head "Salaries" has been dealt with under Section 15, 16 and 17 of the Income Tax Act, 2021. Section 15 provides the basis of charge of salary income[9] while Section 16 provides for deductions from salary income.[10] There are three deductions that are made by the virtue of Section 16. First is a Standard Deduction as mentioned under section 16 (ia), Entertainment Allowance as under section 16 (ii) and Professional Tax [Section 16 (iii)]. Finally, Section 17 provides for the meaning of terms "salary", "perquisites" and "profits in lieu of salary".[11]

Section 17 (1) basically defines the term "Salary" as Payment received, on termination of employment, in lieu of notice, would be taxable as salary. Salary includes wages, any annuity or pension, any gratuity, any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages, any advance of salary, any payment received in respect of any period of leave not availed by him i.e., leave salary or leave encashment, provident fund, the contribution made by the Central Govt. or any other employer in the previous year to the account of an employee under a pension scheme referred to in Section 80CCD.[12]

SECTION 15 provides that salary can charges either on "due" or on "receipt" basis, whichever comes earlier and has been laid down in the broadest terms. The provision requires an establishment of employer-employee relationship for the purposes of taxing this income.[13] In ***CIT v. Navajbai***, it was provided that it is not necessary that a person who holds an office and is paid remuneration by the virtue of that office brings about an employer-employee relationship for the purpose of Section 15.[14] In ***Ramprashad v. CIT***, it was provided that where an employer-employee relationship is made out between the managing director and the company, tax can be levied on his income under this section.[15] In ***Lakshmi Narayan Ram Gopal & Son Ltd v Government of Hyderabad***, it was held that various and continuous services provided as managing agents to a company would amount to business and the same will be liable to be taxed as business profits and not as salary even if the services are being rendered to only one company.[16] Further, if the employment is just incidental to the profession, the earnings from such employment will be professional earnings and will not be taxable under Section 15 but would be taxable under Section 28.[17] Further, ***Emil Webber v. CIT***, the Hon'ble Supreme Court has held that the tax paid by Indian companies on the salary of foreign collaborators' employees would be taxed not as "salary" but as "income from other sources".[18] When perquisites and profits are received from persons other than the employer, the same would be taxable not under Section15 but under Section 56. Section 15, along with section 17, makes no distinction between contractual and voluntary payments. In ***Hartland v. Diggines***, it was provided that profits, perquisites or emoluments, even if received

[7] The Income Tax Act, 1961, § 9(1)(ii), No. 43, Acts of Parliament, 1961 (India).
[8] Id.
[9] The Income Tax Act, 1961, § 15, No. 43, Acts of Parliament, 1961 (India).
[10] The Income Tax Act, 1961, § 16, No. 43, Acts of Parliament, 1961 (India).
[11] The Income Tax Act, 1961, § 17, No. 43, Acts of Parliament, 1961 (India)
[12] DR. VINOD K. SINGHANIA, STUDENT'S GUIDE TO INCOME TAX INCLUDING GST (Taxmann 2019).
[13] Id.
[14] Commissioner of Income Tax v. Lady Nawajbai Tata, 1947 15 ITR 8 Bom.
[15] Ramprashad v. CIT, (1972) 86 ITR 122
[16] Lakshmi Narayan Ram Gopal & Son Ltd v Government of Hyderabad, (1955)25 ITR 449
[17] Vinod K. Singhania, Students' Guide to Income Tax Including GST, Taxmann (2019)
[18] Emil Webber v. CIT, (1993) 200 ITR 483.

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as a gift to the employee would still be liable to be taxed.[19] Income chargeable under "Salaries" is exempted from tax through various clauses of Section 10.[20] In addition to this, the pensions received from United Nations Organization is exempt from tax and Section 80R and 80RRA also grant deductions from the remuneration received by an Indian citizen for services which are rendered outside India.[21] Section 16 provides the deductions which are to be made for the computation of income chargeable under the head "Salaries". From 1st April, 2020, the employees would be entitled to a standard deduction of Rs. 50000/- or the amount of salary, whichever is less.[22] This deduction is not available where there is no master-servant relationship.[23] Further, government employees are entitled to a deduction of a sum equal to 1/5th of the salary or Rs. 5000, whichever is less for the purposes of entertainment allowance.[24]

In ***Linde AG. Linde Engineering Division v DDIT***, the Gujarat High Court took the view that the words "earned in India" are to be inferred as "arising or accruing in India" and not "from services rendered in India."[25] By the virtue of this clause in the explanation, it led to the supersession of the view that this clause can be invoked in all the cases where the liability to pay arises in India. It was provided that this explanation is not declaratory in nature and for the determination of where the services have actually been rendered, the relevant test that has to be applied.[26] So, if the services were rendered in India, the salary would count towards income arising in India. The provision of rest period/leave period was added in the Act through the amendment of Finance Act in the year 1999 which was to be applied prospectively with effect from 1st April, 2000.[27] The terms of Double Taxation Avoidance Agreements govern the taxation of Non-residents working in India. In ***CIT v Elitos,*** where the salaries were paid in Italy and not by any permanent establishment in India, they were held to be not taxable by the virtue of Article 16(2)(c) of the DTAA between India and Italy.[28]

SECTION 9(2) serves as an exception to clause (ii). Under sub-section (2), pensions payable pensions payable outside India to certain categories of government officers and judges, who reside permanentlyoutside India, are not deemed to accrue in India.[29] In ***Deoki Nandan Agarwala v. UOI***, the Hon'ble Supreme Court observed that the judges of the supreme court and the high court are constitutional functionaries and what they receive is salary and the same is taxable under Section 15. But as there is no employer-employee relationship between the state and advocate-general of a state, the amount paid by the state government to him is not taxable under the head of "salary."[30] The place of accrual of salaries poses some difficult questions. This clause(ii) tones down some of this difficulty by providing an artificial place of accrual in one case. The clause clarifies the situation of charge on non-residents, including resident but not ordinarily resident, on salaries or pensions earned in India where it is received in abroad or actually accrues abroad. The position of residents is quite clear as their income is deemed to accrue in India and does not make any difference. Article 314 as mentioned in sub-section (2) was repealed by the Constitution (Twenty-eighth Amendment) Act, 1972 with effect from August 29, 1972.[31] This particular clause applies even to salary paid by a foreign government to its employee serving in India, because salary payable by a foreign government which was not taxable under the head 'Salaries' in the 1922 Act has not been made taxable under that head (section-15) in this Act.[32] Section 9(1)(iii) provides that income which is chargeable under the head "Salaries" payable by the government to a citizen of

[19] Hartland v. Diggines, 10 TC 247, 262.
[20] KANG & PALKHIWALA, THE LAW AND PRACTICE OF INCOME TAX (LexisNexis, Vol.1, 2004)
[21] Id.
[22] Id.
[23] Sardar Harpreet v CIT, 187 ITR 679
[24] Id.
[25] Linde AG. Linde Engineering Division v DDIT, 365 ITR 1, 43-44
[26] Supra note 25
[27] Supra note 20
[28] CIT v Elitos, (2005) 196 CTR (All) 638
[29] The Income Tax Act, 1961, § 9(2), No. 43, Acts of Parliament, 1961 (India).
[30] Deoki Nandan Agarwala v. UOI, 237 ITR 872
[31] Supra note 20
[32] CIT v Phra Phraison, 3 ITC 237.

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India for service rendered outside India will also be deemed to arise or accrue in India.[33] Therefore, this clause makes immaterial, the place of actual accrual of the salary. This purpose of adding this clause was to prevent the tax avoidance that happened by the governmentservants posted abroad who became non-residents after some time. Under Section 10(7), the allowances and perquisites in such cases which are paid or allowed by the government are exemptfrom tax.[34]

~SECTION 9(1)(IV): DIVIDEND~

Under section 9(1)(iv) of the Income Tax Act, 1995, dividends which are paid outside India by an Indian company shall be deemed to accrue or arise in India. Under this clause, dividends which are accrued, but not paid are not liable for taxation. A clear distinction is made foreign and Indian companies, wherein, under this clause, dividends paid by foreign companies are not liable for taxation.

It is pertinent to note that with respect to dividends declared and paid until 31.3.2020, the domesticcompany is bestowed with the liability to pay Dividend Distribution tax on dividends which have been distributed to shareholders. Thereafter, under section 10(34), this becomes exempt from taxation inthe hands of foreign shareholders. However, dividends received by Indian residents from foreign companies remain taxable.[35] For this purpose, dividend distribution tax under section 115-O wouldbe payable by the Indian company.[36]

A thorough reading of Explanation 3 of section 4(1) of the 1922 Income Tax Act displays how deemeddividends paid abroad by an Indian company to accrue in India only to the extent to which they were paid out of profits subjected to income-tax in India. It is pertinent to mention, that as per section 2(26), an Indian company must have its registered office in India and the share-register must also be located in India. The situs of shares refers to the place where the share-register is kept.[37] The situs of shares becomes extremely important where attempts may be made to levy taxes like legacy or estate duty upon the corpus of the shares. On the other hand, if attempts are being made to impose tax on the incomeand not on the corpus, and if the place of accrual of the dividend-income becomes contentious, the situs of the shares becomes irrelevant. Therefore, if a dividend is declared which is payable abroad, it would not accrue in India even in the circumstances where the company may be Indian and the situs of the shares may be in India.[38] However, such a dividend would still be deemed to accrue in India on the ground that the source of income is situated in India.[39]

Recently, in the case of ***Morgan Stanley Mauritius Co. Ltd. v. DCIT***,[40] it was laid down by the Bench that the dividend payments made by a foreign company to its domestic depository which were subsequently transferred to IDR holders are not taxable in India under the Indo-Mauritius DTAA. In context of the present case, since the dividend was in consideration of a British based companyit was held that the "deeming fiction" would not be applicable. Since it is a dividend income other than that from an Indian company, the income cannot be taxed under Section 9(1)(iv).

However, in order to have a better understanding of this clause, it is imperative to understand the meaning of dividend. In general, a dividend refers to one of the forms of return on investment. **Section 2(22)** of the Income Tax Act defines the term 'Dividend", by prefixing the word "includes", which means that the definition provided therein is inclusive and not exhaustive.

Under this provision, a dividend can be said to include the following:

(a) The accumulated profits being distributed to the shareholders which will entail the release of the company's assets.

(b) Distribution of deposit certificates or debentures to shareholders from the accumulated profits of the

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[33] Supra note 20

[34] The Income Tax Act, 1961, § 10(7), No. 43, Acts of Parliament, 1961 (India).

[35] *Income deemed to accrue or arise in India – Section 9 of Income Tax Act,* SORTING TAX, https://sortingtax.com/income-deemed- to-accrue-or-arise-in-india-section-9-of-income-tax-act/ (last visited Nov. 17, 2021).

[36] Id.

[37] Id.

[38] Id.

[39] Id.

[40] Morgan Stanley Mauritius Co. Ltd. v. DCIT, ITA No.: 7388/Mum/19, decided on 28.05.2021

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company and bonus shares being issued to preference shareholders from the accumulated profits;
(c) Distribution upon liquidation to shareholders from the accumulated profits;
(d) Distribution to shareholders upon reduction of capital from the accumulated profits; and
(e) Loan or advance made by a closely-held company to its shareholders from the accumulated profits.

Section 2(22)(e) has been held to be constitutionally valid in ***Navnitlal C. Javeri v. K.K.Sen***.[41] Moreover, in ***ACIT v. Bhaumik Colour (P) Ltd.***,[42] the inclusive definition and scope of 'dividend' by virtue of section 2(22)(e) was enlarged to include loans & advances. Another significant provision of the Income Tax Act pertaining to dividends is **Section 8**. As per clause (a) of section 8, any dividendwhich is declared or distributed or paid within the meaning of sub-clauses (a), (b), (c), (d), (e) of sec 2(22) is deemed to be the income of the previous year in which such dividend is declared, distributed or paid as the case may be. This clause section is a reproduction of a portion of section 12(1A) of the 1922 Act.
As per sec 8(b), any interim dividend declared by the company shall be deemed to be the income in the previous year in which it is unconditionally made available to the member who is entitled thereto. This clause was inserted in 1965, making dividends properly taxable in all cases as the income of the year in which it is declared,[43] and not merely the year in which it is declared. The reasoning behind thisis that the shareholder's right to dividend arises only upon declaration.[44]
The year of taxability of dividend may differ from the year in which it is actually paid or is payable.[45] However, a conditional declaration of dividend which does not create an enforceable obligation topay does not amount to a 'declaration'. Thereby, the dividend is not taxable until the fulfilment of the condition.[46]
If certain events occur during the previous year wherein the declaration of the dividend has taken place, the dividend cannot be regarded as taxable for that year. These events include certain eventsdue to which either the Dividend income declaration has been cancelled, or the amount of dividendis to be considered as either a loan or payment of a part of capital, or the declaration of dividend is to be treated as illegal or invalid.[47]
As a result, as held in ***New Shorrock v. CIT*** ,[48] in cases where a company has amalgamated with the recipient company during the previous year, after having declaring the dividend, this dividend which has been declared and received by the recipient amalgamated company will be the company's ownmoney and therefore, not taxable. On the other hand, in ***CIT v. Dishergarh Power***,[49] the court wasof a different opinion. Here, the amount retained after amalgamation was held to be taxable in the hands of the recipient amalgamated company.
As per the law existing prior to 1989, the year of taxability was not required to be within the financial year. In cases where dividend is accounted for on the basis of previous year which differs from thefinancial year, the dividend is taxable during the year in which it is declared.[50] From the assessmentyear 1989–90 onwards, the year of taxability of dividend has been fixed as consisting of only the financial year. If directors merely resolve to pay a certain amount as interim dividend, this does notcreate a debt which is enforceable against a company. The interim dividend is taxable as the income of the year in which the dividend warrant has actually been issued.[51] This principle has now been givenstatutory effect under clause (b) of section 8.
In ***Star Chemicals v. CIT***,[52] it was held that only the loan which has been given during the relevant accounting

[41] Navnitlal C. Javeri v. K.K.Sen, AAC [1965]56 ITR 198 (SC).
[42] ACIT v. Bhaumik Colour (P) Ltd., (2009) 118 ITD 1 (Mum.) (SB).
[43] Purshottamdas v. CIT, 34 ITR 204; Punjab Bank v. CIT, 70 ITR 849
[44] IR v. Blott, 8 TC 101, 125 (HL); Kishinchand v. CIT, 46 ITR 640 (SC).
[45] Rampur Distillery v. CIT, 187 ITR 561 (SC).
[46] Jhimi v. CIT, 80 ITR 273; Patel v. Majumdar, 114 ITR 1.
[47] Mafatlal v. CIT, 193 ITR 188.
[48] New Shorrock v. CIT, 208 ITR 765
[49] CIT v. Dishergarh Power, 207 ITR 850
[50] CIT v. Bikaner Trading, 78 ITR 12 (SC).
[51] Dalmia v. CIT, 53 ITR 83 (SC); CIT v. Godfrey Philips, 161 ITR 684.
[52] Star Chemicals v. CIT, 203 ITR 11.

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year is taxable as 'dividend' under s 2(22)(e). Loans given during prior years are not to be considered.

Other provisions dealing with dividends include the following:

- **Section 10 of the Income Tax Act**, which lays down the dividends which are exempt from tax;
- The **Amendment to the Finance Act, 2020**, which lays down that from 1st April 2020, any dividend that is received is taxable in the hands of shareholder, apart from dividends upon which tax has been paid either under section 115-O or section 115BBDA;
- **Section 115BBDA of the Income Tax Act**, which elaborates upon taxes imposed on certain dividends which have been received from domestic companies; and
- **Section 115-O of the Income Tax Act**, which delineates taxes on distributed profits of domestic companies).

~SECTION 9(1)(V): INTEREST PAYABLE~

Section 9(1)(v) provides for income by the way of interest payable by different categories shall bedeemed to be accrued or arise in India.[53] This clause was inserted through the Finance Act, 1976 'Interest' is defined by s 2(28A) as including all categories of interest and also a service fee or commitment charge. This clause is limited to the payment of interest on debt and does not includepenal interest paid as a part of the deferred sale consideration.[54] It also includes interest on unpaid purchase price payable by letter of credit.[55] Interest is payable by: A) Resident, B) Indian Government,
C) Non-Resident. Now, interest payable to the non-resident can be from the following payers:

- **INTEREST PAYABLE BY THE INDIAN GOVERNMENT**- In this case, such interest shall alwaysbe deemed to accrue or arise in India without any exceptions.
- **INTEREST PAYABLE BY AN INDIAN RESIDENT TO NON-RESIDENT**- In this situation, usually the interest payable is deemed to accrue or arise in India. However, there are two exceptions to the same. First, when the interest is payable for money borrowed and used forthe purposes of a business or profession carried on by person outside India. Second exception is where interest is payable for earning any income from any source outside India.[56] It is pertinent to note that in the above two situations, if the money borrowed is actually used and utilised in a business or profession in India or earning income in India, then the income shall be deemed to accrue or arise in India in the hands of the Non-Resident.[57] Under this clause (v)(b), the interest payable may be wholly or partly entitled to exemption under Section 10(15)(iv).
- **INTEREST PAYABLE BY NON-RESIDENT TO ANOTHER NON-RESIDENT**- in this case, where the interest is payable by one non-resident to another non-resident, there is one condition that needs to be fulfilled. It is that it shall be deemed to accrue or arise in India ifsuch is payable, in respect of any debt incurred or moneys borrowed and used for the purpose of a business or profession carried on by such non-resident in India.[58]

[53] The Income Tax Act, 1961, § 9(1)(v), No. 43, Acts of Parliament, 1961 (India).
[54] Timken India Ltd., In re, 273 ITR 67 (AAR)
[55] Infosys Technologies Ltd., In re, 350 ITR 178.
[56] The Income Tax Act, 1961, § 9(1)(v), No. 43, Acts of Parliament, 1961 (India).
[57] The Income Tax Act, 1961, § 9(1)(v), No. 43, Acts of Parliament, 1961 (India).
[58] Id.

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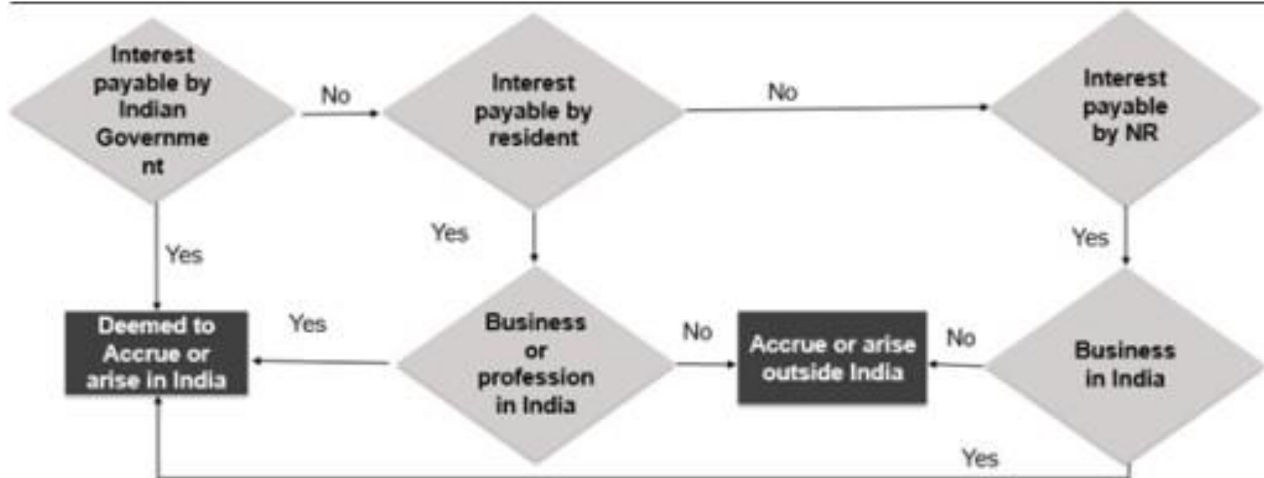

The explanation to this clause was added by the Amendment carried out by the Finance Act, 2015. The scope of this clause was expanded with this amendment. This explanation is specifically applied to only non-resident banking companies. This amendment was added to override the decision takenby a special bench of the tribunal.[59] Herein, the tribunal has held that the interest paid to the headoffice of the bank by its Indian branch, which constitutes its PE in India, is not deductible as expenditure under the domestic law, being payment to itself.[60] Income deemed to accrue or arise inIndia while determining the profit attributable to the PE, which is taxable in India as per Article 7(2) and 7(3) of the India-Japan DTAA.[61] Prior to this amendment, a confusion arose in situations where the foreign bank opened a branch in India for the purpose of doing business in India but did not opena company. Such branches are considered permanent establishment of the foreign bank in India. Now the confusion arose that whether the payment of interest by the branch to the head office would beliable to tax in the hands of the head office or not. Prior to the amendment, the interest payment was considered as a deductible expenditure in the hands of the Indian branch but were considered as non- taxable in the hands of the head office. This was because that these payments constituted as a paymentto the self which were not liable to taxation.[62] With the coming of the amendment, certain changeswere made in the above discussed scenario. The amendment provided that interest payable by Indian permanent establishment of a foreign bank would deem to accrue or arise in India if the recipient ishead office of the bank is located outside India or Permanent establishment of bank is located outside India or any other branch is located outside India. It is pertinent to note that the Indian permanent establishment is obligated to deduct tax at source or any interest payable to either the head office or any other branch or permanent establishment of the non-resident bank outside India.[63] Further, it isalso to be noted that non-deduction would lead to disallowance of interest expenditure and may also attract levy of interest and penalty.[64]

[59] Supra note 20
[60] Id.
[61] XYZ, In re, 348 ITR 31; XYZ, In re, 348 ITR 45; XYZ, In re, 348 ITR 20.
[62] SORTING TAX, https://sortingtax.com/section-91v-of-income-tax-act-deemed-interest-income/ (last visited Nov. 9, 2021).
[63] Supra note 62
[64] Id.

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~SECTION 9(1)(VI): ROYALTY~

Section 9(1)(vi) is a comprehensive clause which provides for different scenarios wherein income by the way of royalty is deemed to accrue or arise in India.[65] To summarize this provision, we can saythat royalty can be payable to the non-residents by the following payers:

- **ROYALTY PAYABLE BY INDIAN GOVERNMENT-** Under such scenario, the royalty payable is always deemed to accrue or arise in India without any exception or condition. The governmentcan be either Central government or the State government.
- **ROYALTY PAYABLE BY RESIDENT TO NON-RESIDENT**- in this scenario, the royalty payable isdeemed to accrue or arise in India as a general rule. But it is subject to two exceptions. First exception is where the royalty payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carriedon by such person outside India. The second exception is where it is payable for the purposes of making or earning any income from any source outside India.
- **ROYALTY PAYABLE BY ONE NON-RESIDENT TO ANOTHER NON-RESIDENT-** In this case, there are three conditions that need to be satisfied for the royalty payable to deem to accrue or arise in India. First condition is the royalty is payable in respect of any right, property or information should be used for the purposes of a business or profession carried on in India, or.Second condition that royalty is payable in respect of services utilized should be for the purposes of a business or profession carried on in India, or. Third condition is that royalty is payable forthe purposes of making or earning any income from any source in India.

[65] The Income Tax Act, 1961, § 9(1)(vi), No. 43, Acts of Parliament, 1961 (India).

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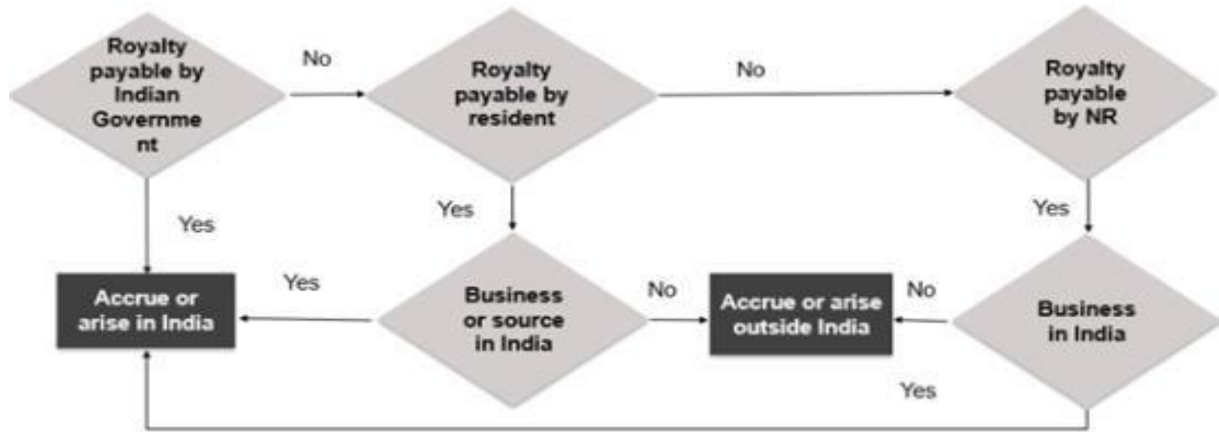

In ***Dell International Services India Pvt. Ltd***[66], Payment for two-way phone and data transfer across telecom bandwidth is not considered "royalty" under Article 12 of the Constitution. DTAAbetween India and the United States, or section 9(1)(vi) of the Act. The equipment in question waspart of a larger project. Ownership of the equipment is within the control of the equipment owner.Dell had only been around for a few years obtaining a uniform service from the owner of the equipment. As a result, the money was not in the form of “royalty”. In addition, because of the "make available" requirement, this payment could be made in accordance with the India-US DTAA. Also, it cannot be classified as "FIS."

Following the Supreme Court's decision in ***Tata Consultancy Services v. State of Andhra Pradesh***,
the question of whether receipts on software transfers are assessable as "royalty" under the Act arose. The Supreme Court ruled, in what I believe was a well-considered conclusion, that software on a CD was "goods" subject to customs duty under the 1962 Customs Act. The Court reached this determination after reviewing a number of international rulings, including those from the United States and England, as well as various treatises on software licencing and intellectual property. 46 Thereasoning for this ruling was that even if the CD or floppy disc in question was a copyrighted articleand carried with it certain intellectual property, the language of the statute was wide enough to includesuch property as 'goods.[67]

The ruling, it is claimed, was based on basic business concepts that clearly distinguished between thetransfer of a right and the transfer of a thing. The issue of royalty can only arise when a 'right' istransferred, not when a good is transferred. Just because something is good doesn't mean it's good. Since the sale of intellectual property is not treated as royalty, it cannot be taxed as such. This is plainly a sale simpliciter, not a transfer of rights. It should be emphasised that such sales agreementsfrequently include exceedingly restrictive covenants, such as to be altered and used. As a result, theclassification of such transactions as sales is appropriate as well as consumables like products.[68]While the adjustments to section 9(l)(i) received the most media and critical attention in the aftermath of the budget, a major amendment to clause (vi) was also made. The Finance Act of 2012 includedthree new Explanations to this clause, bringing the tax net income originating from the transfer ofcomputer software into the tax net income category. The modification rendered all previous judgements in favor of the assesses null and void, with retroactive effect, and replaced them with theKarnataka Historian's opinion.[69]

Explanation 2's wording 'transfer of rights in respect of property' 'always included' the right to 'use computer software,' according to the Explanation. It went on to say that the possession or right inquestion, as well as its location in India, were irrelevant in assessing whether a certain income wasroyalty or not.[70] In effect, the revisions did not attempt to 'clarify the law,' but rather intended to totallyalter the meaning of the

[66] Dell International Services India Pvt. Ltd, [2008] (305 ITR 37) (AAR).
[67] Tata Consultancy Services v. State of Andhra Pradesh, (2004) 271 ITR 401.
[68] Sonata Information Technology v. ACIT, (2006) 103 ITD 324.
[69] CIT v. Samsung Electronics Co. Ltd., [2012] 345 ITR 494 (Kar).
[70] Prateek Andharia, *Section 9 of the Income Tax Act, 1961: Defaced and Defiled?* 25(1) NLSIUR 119 (2013).

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term 'royalty.' How else may a judgement of whether or not an income is royalty revenue be made independent of the ownership or management of such a right?[71]

The changes' proposal is bad law and untenable, according to the author, because it contradicts the fundamental principles of commercial law in general and intellectual property rights law in particular. Nonetheless, the Department appeared to have acted in haste and without thoroughly examining all of the amendment's implications. In the rush to change the legislation, the DTAAs and their definitions of royalty were completely overlooked, severely limiting the amendments' practical utility. All of India's DTAAs have royalty definitions that are comparable to the un-amended clause (vi), and as the assessee can choose between the Act and the DTAA, whichever is more beneficial, the revisionshave been rendered ineffective.

This is exactly what the ***Bombay Tribunal decided in DDIT v. B4U International Holdings Ltd***., awarding the assessee exemption under the DTAA. Article 7 of the DTAA applies to income obtained from a permanent establishment that is in the nature of business profits. As a result, in the absence ofa permanent establishment and income that is not in the nature of royalty payments, the assessees may be able to take advantage of the treaty and avoid paying any taxes. The old adage "haste makes waste" applies more than ever to the Department, which altered Section 9 for no reason.

In ***DIT v. WNS Global Services (UK) Ltd***., it was held that because there is no income made by the assesse, receipt of reimbursement of leased line charges on a cost-to-cost basis from the Indian subsidiary firm does not qualify as royalty or income attributed to a permanent presence in India.[72] In ***Vodafone South Ltd. V. DDIT***[73], it was held that International long distance (ILD) services wereprovided by the company. The Company was responsible for providing connectivity to calls originating or terminating outside India as part of its ILD services business. The corporation used the services of certain non-resident telecom operators (NTOs) to achieve its goal, who supplied carriageor connectivity services across the last leg of the communication line. The company had made a deal with NTOs to provide international carriage and connectivity services. As part of these agreements, the Company was required to pay the NTOs inter connection usage charges (IUC) in exchange forthe services supplied. The said payment to NTOs would be considered a royalty because it is made in exchange for the use of a method, as stated in Explanation 5 to Section 9(1). (vi).[74]

In ***Verizon Communications Singapore Pte Ltd***, it was observed that as revenue involves the use of equipment or a process, the same from the provision of telecommunication services to Indian clients are "royalty" in nature and hence liable to withholding tax. The fact that the High Court hasused Article 3(2) of the treaty to interpret the domestic (2012) revisions in our 'royalty' term in the tax treaty as well, means that the income is taxable in India under both the Income Tax Act and the treaty.[75]

In ***Kerala Vision Limited v. ACIT***, it was held that in light of the addition of explanation 6, paymentsgiven to channel firms for receiving satellite signals in the capacity of a multi-system operator amountto "royalties" as defined in clause I of Explanation 2 to section 9(1).[76]

In ***Bharti Airtel Ltd. v. ITO***[77], a detailed analysis of this clause was done in the following manner:

❖ The term 'process' employed in the definition of 'royalty' under Explanation 2 to section 9(1)(vi) does not imply any 'process' that is publicly known. The terms 'process' used in clauses I (ii), and
(iii) of Explanation 2 to section 9(1)(vi) refer to a 'process' that is an intellectual property item.The term 'royalty' in relation to the use of a 'process' implies that the grantor of the right has anexclusive right to that 'process' and permits the grantee to 'use' it in exchange for a 'royalty.' Guarantee must be able to "use" the "process" on its own and bear the risk of exploitation. The 'process' of running networks is fundamentally the same for all telecom operators, and they donot have any exclusive rights to such a 'process' in order to be able to charge a 'royalty.'

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[71] Finance Act, 2012, § 4(b), Acts of Parliament, 1961 (India).
[72] DIT v. WNS Global Services (UK) Ltd, [2013] 214 Taxman 317 (Bombay High Court).
[73] Vodafone South Ltd. V. DDIT, [2015] (53 taxmann.com 441) (Bangalore ITAT).
[74] Supra note 73
[75] Verizon Communications Singapore Pte Ltd, [2013] 361 ITR 575 (Madras).
[76] Kerala Vision Limited v. ACIT, [2014] (64 SOT 328) (Cochin ITAT).
[77] Bharti Airtel Ltd. v. ITO, [2016] 47 ITR(T) 418 (Delhi ITAT).

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- The necessity of successful exclusivity of the right in respect of such procedure remaining with the person claiming 'royalty' for giving its usage to a third party is not eliminated by Explanation6 to section 9(1)(vi) of the Finance Act, 2012, with retrospective effect from 1-6- 1976. Because none of the Foreign Telecom Operators owns or has exclusive rights to such a procedure, the payment in question cannot be called a royalty.
- Explanation 5 to Section 9(1)(vi) of the Act applies limited to royalties that fall within section 2 of Section 9(1) of the Act (vi). For the purposes of charging 'royalty' under paragraphs I (ii), and (iii) of Explanation 2 to section 9(1), a procedure that is generally available in the public domain and is not solely owned by anybody cannot be considered an item of intellectual property (vi). As a result, the criteria of possession, control, indirect use, and so on, as indicated in Explanation 5, have no bearing in this circumstance.
- The factual judgement of the Jurisdictional High Court in this case is that the Foreign Telecom Operators are providing 'technical services,' but that such 'Technical Service,' as defined under section 9(1)(vii), is not FTS because there is no human participation. It is to be held, based on the binding decision of the Jurisdictional High Court, that the payment cannot be described as covered by Explanation 2 read with section 9(1)(vi) of the Act.
- A review of the various treaties' definitions of 'royalties' reveals that all of them utilise the word "secret formula or method", which is separated by a comma before and after the expression. This means that formula/process belong to the same group, and both are governed by the adjective 'secret.' As a result, under the treaties, a procedure must be 'secret' in order to constitute royalty for its use or the right to use it. However, in the telecom industry, as previously stated, telecommunication services are provided through ordinary facilities, and no 'secret procedure' is involved, therefore consideration was not in the form of royalty.

In ***Asia Satellite Telecommunication Co. Ltd. v/s DIT***, he Delhi High Court overturned the Delhi ITAT's previous decision in the case, ruling that payments for transponder capacity do not qualify as "royalty" under section 9(1)(vi) of the Act. The Delhi High Court based its decision on the AAR finding in the matter of ISRO as well as the OECD Commentary, which states that payments received by clients under transponder leasing agreements are for the use of the transponder transmitting capacity and do not constitute "royalty."[78]

In ***GVK Oil & Gas Ltd. vs. ADIT***, Due to the fact that licensors only provided data relating to geophysical and geological information and were not responsible for the accuracy or usefulness of such data, payments made to said licensors were not in the nature of 'Royalty' as per respective DTAA, since licensors had only made available data acquired by them but did not make available any technology for use of such data, payments made to said licensors were not in the nature of 'Royalty".[79]

~SECTION 9(1)(VII): FEES FOR TECHNICAL SERVICES~

Section 9(1)(vii) is known to create significant controversy in Indian tax jurisprudence regarding extra-territorial operation.[80] This clause can be summarized in the following way:

[78] Asia Satellite Telecommunication Co. Ltd. v/s DIT, [2011] (Delhi HC) (unreported).
[79] GVK Oil & Gas Ltd. vs. ADIT, [2016] 158 ITD 215 (Hyderabad ITAT).
[80] The Income Tax Act, 1961, § 9(1)(vii), No. 43, Acts of Parliament, 1961 (India).

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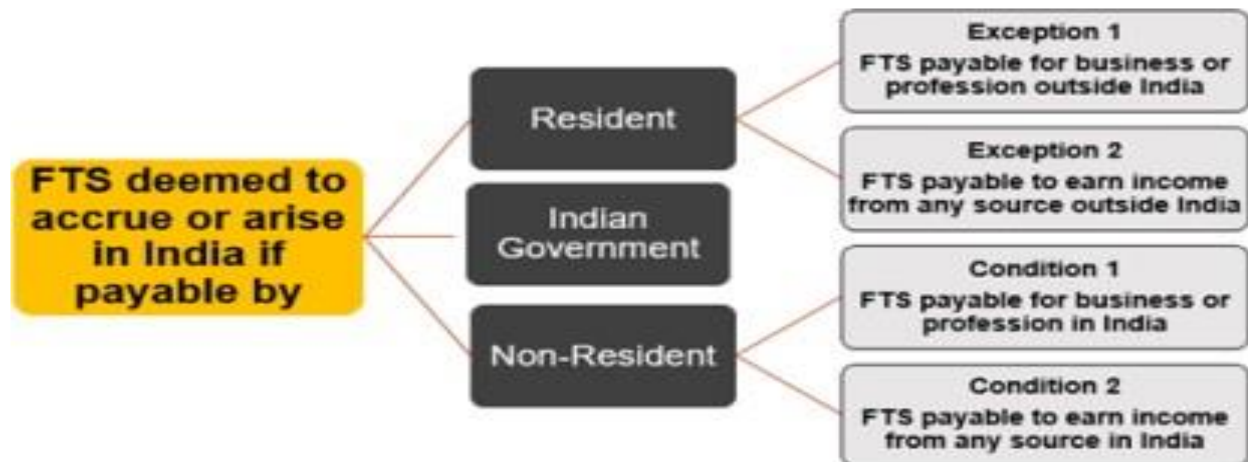

In ***Hughes Systique India (P.) Ltd. v. DCIT***, it was held that The assessee's management fees forrendering 'Payroll and related services' in respect of seconded employees in the United States couldnot be considered 'fees for included services' under article 12(4)(b) of the India-United States DTAA because nothing was made available to the assessee for future use by rendering such services.[81]

In ***ADIT vs. Joint Stock Company Zangas***, it was chalked out that Fees for providing technical supervision and expertise, such as design and engineering for laying pipelines, preparing welding procedures, reviewing work procedures, and delegating expert labour for site review, are fees for technical services.[82]

In ***CIT & others v/s Bharti Cellular Ltd. & others***, the "consultant" term was discussed. It wasobserved that the term "consultant" is derived from the word "consult," which refers to debates, consideration, deliberations conferring with someone, and conferring about or about a subject. "Ask advice from, seek counsel or a professional opinion from; refer to (a source of information); seek authorization or approval for a proposed activity," according to the Shorter Oxford English Dictionary (fifth edition). The service also necessitates human involvement. A consultant (one who provides consulting services) must be a person. In addition, a machine cannot be considered a consultant.[83]

In ***Oil & Natural Gas Corpn. Ltd. v ACIT***[84], it was observed that when the parties to whom payments are made for rendering technical services are not employed in the mining business but are in the business of providing technical services for priming/preparing for mining, such as conducting seismic surveys and rendering related services, the payment is subject to TDS under section 194J rather than 194C.[85]

In ***CIT v. Sundwiger EMFG & Co***[86], it was observed that separate payments for rendering services in India by specialists employees of a non-resident supplier of capital equipment that were part andparcel of the sale consideration of machinery under the original agreement, as well as payments made by residents to said specialists in the form of daily payments, travel and pocket expenses, and so on,were not income deemed to be accruing or arising in India to non-resident in terms of section 9(1)(vii) because there was no business connection.

The provision was termed to be relatively unambiguous until the Apex Court judgement of ***Ishikawajima Harima Heavy Industries Ltd. v. DIT***.[87] In this case, the SC established a new standard for the taxability

[81] Hughes Systique India (P.) Ltd. v. DCIT, [2014] 151 ITD 208 (Delhi ITAT).
[82] ADIT vs. Joint Stock Company Zangas, [2014] 149 ITD 9 (Ahmedabad ITAT).
[83] CIT & others v/s Bharti Cellular Ltd. & others, [2008] (319 ITR 139) (Delhi HC).
[84] Oil & Natural Gas Corpn. Ltd. v ACIT, [2013] 59 SOT 160 (Ahmedabad - ITAT).
[85] Id.
[86] CIT v. Sundwiger EMFG & Co, [2003] (185 CTR 434) (Andhra Pradesh HC)
[87] Ishikawajima Harima Heavy Industries Ltd. v. DIT, 2007(3) SCC 481.

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of fees for non-resident technical services. In his opinion for the bench,Justice Sinha held that in order for such fees to be taxed, the services must be (a) used in India and
(b) rendered in India.

This judgement, which overturned a thirty-year-old legal precedent, caused extreme chaos and doldrums in Indian tax administration.[88]

As a result of the Department's dissatisfaction and discontent with the Court's new interpretation and point of view and its implications for the taxability of lucrative services transactions, a change to the law was enacted within months and inserted into the Finance Act of 2007. This was accomplished by inserting an Explanation below section 9(2), which took effect in 1976. The Explanation basically stated that the earnings indicated in Section 9(1), sub-sections (v), (vi), and (vii), regardless of whether the non-resident had a "residence, place of business, or commercial link in India," would be included in the total income of the non- resident. However, this alteration was found to be insufficient to affect the Supreme Court's interpretation of the legislation. While the amendment clearly did away with the criteria of residence, place of business, and business connection, the Karnataka High Court held in ***Jindal Thermal PowerCo. Ltd. v. DCIT***[89] that the twin criteria of rendering and using services in India laid down by the Supreme Court in Ishikawajima remained unaffected by the edict. In its 2008 judgement in ***Clifford Chance v. DCIT***[90], the Bombay High Court upheld this view. The change was then adjudicated in ***Worley Parsons v. DIT*** before the AAR in 2009, in which some previously overlooked features of the Ishikawajima decision were revealed. For one thing, the Supreme Court's entire decision was based on section 9(l)(vii)(c), which deals with payments for technical services supplied by a non-resident, but the fees in this instance were paid by a resident,Petronet LNG of India. Second, the criterion of 'rendering' was nowhere to be found, even in the inapplicable clause, and was added by the SC as an entirely new and unnecessary addition. The underlying principle of the judgement, namely *applying the test of a territorial nexus* while taxing transactions under section 9, was respected, with the court stating that "we have to respect the observations of the Supreme Court and the spirit behind them, without invoking the doctrine of *per incuriam* as far as possible."[91]

Parliament sought to put an end to the situation with the Finance Act of 2010, which changed the previously inserted Explanation under section 9(2) to eliminate the two-pronged test established in the Ishikawajima judgement in as specific and plain a manner as feasible. For the first time since April 2010, the Income Tax Appellate Tribunal got the opportunity to adjudicate on the situation of law following the change in ***Ashapura Minichem Ltd. v. ADIT***[92], it was decided that the test established in Ishikawajima was no longer legitimate in light of the retrospective amendment, which, coincidentally, went into force in 1976. However, unsolved problems still remains and is looking us int the eye, such as whether the new amendment's grant of extraterritorial taxing power in *section 9 is ultra vires the constitution*, and if so,whether such power can be conferred retrospectively. These issues are not new and have been explored extensively previously[93], but they take on fresh significance in Indian tax law in light of the recent revision.[94]

With respect, it is submitted that the new interpretation of section 9, which has now received legislative recognition through an amendment to the Finance Act, 2010, will be contrary to well-established international taxation norms on a foreigner's income accruing, arising, and received outside the taxing State. It also in contrast to India's many taxation and economic treaties with the rest of the countires including many large economies having an annual GDP of more than $1 trillion dollor, this may effect these economic relations and may render many treaties as fruitless, notwithstanding the fact that a fee imposed by domestic legislation does not and cannot replace international treaties.[95] Such a situation, in which the Parliament empowers the

[88] Id.
[89] Jindal Thermal Power Co. Ltd. v. DCIT, (2006) 286 ITR 182.
[90] Clifford Chance v. DCIT, (2002) 82 ITD 106.
[91] Id.
[92] Ashapura Minichem Ltd. v. ADIT, (2010) 5 TMN 57 (Mum.).
[93] Electronics Corporation of India Ltd. v. CIT, (1990) 183 ITR 43.
[94] Supra note 70.
[95] Citizen Watch Co Ltd v. IAC, [1984] 148 ITR 774.

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Department to cast a wide net of taxation, would be manifestly unreasonable in that foreigner transactions would be taxed regardless of an actual geographical relationship with India. Section 9(l)(vii)(b) of the Act, as amended, seeks to charge a foreigner for income earned outside India solely because an Indian resident pays for the use of services, even if the income is earned under a contract that is made and performed entirely outside India and neither the income nor the contract has any real connection to India. In order to protect the essential principle of territorial connection, the *Supreme Court added the additional requirement of "rendering of services in India*." By removing this criterion in the most recent amendment to section 9, Parliament has demonstrated a complete disregard for the principle of territorial nexus, since now, simply using a service by an Indian resident is supposed to be sufficient territorial nexus for the purposes of imposing tax liability, which is an untenable position.[96] Section 9 is said to be illegal in the absence of any rational or reasonable territorial nexus, as it attempts to tax firms delivering services outside of India based on such extra-territorial operations being devoid of any genuine territorial nexus.[97] If the scope and validity of these clauses were to be challenged in court, Palkhivala believes that the court would have to choose between striking them down as violating the Indian Parliament's *legislative powers or reading them down and limiting their application only to cases where there is a sufficient territorial nexus.*[98]

The most basic argument against such a challenge is that section 9 simply purports to tax any payments made by a resident on account of fees for technical services, and since fees for technical services fall under the heading of income, such payments fall under the legislative jurisdiction of Parliament. Furthermore, granted competence, if the legislature wishes to tax particular transactions, it may do so, and the Constitution extends this right to include extraterritorial legislation[99] through Article 245 of the Constitution (2). However, this reasoning is extremely simplistic and has the problem of ignoring the idea of territorial linkage, which has been reaffirmed multiple times as a key component of any source-based taxing system.[100] Furthermore, a Supreme Court Constitution Bench recently ruled that legislation that has no connection to aspects or causes in India is outside of Parliament's jurisdiction.[101] As a result, the author contends that section 9's extraterritorial application, as defined in the most recent revision, is unconstitutional. Articles 14 and 19 may also be used to dispute the amendment's legality, but a comprehensive treatment of these articles is outside the scope of this article.[102]

~SECTION 9(1)(VIII): INCOME ARISING THROUGH TRANSFER OF GIFTS~

This clause was added in the Act by The Finance (No. 2) Act, 2019 to tax gifts received by non- residents from Indian residents. The purpose of this insertion is widening of the tax base. The amount proposed to be charged to tax is a capital receipt in the hand of person receiving and is taxable in the hands of the transferee. It provides for deemed accrual in India of gift of money by a person resident in India to a non-resident. The provision provides that any sum of money referred to in section 2(24) (xviia) arising outside India [which in turn refers to section 56(2)(x)], paid on or after 5th July, 2019 by a person resident in India to a non-resident, not being a company, or to a foreign company, shall be deemed to accrue or arise in India.[103] The clause uses "income arising outside India" which has to be construed as to come into existence. This means that the income has to come into existence outside India. Further, the word "person" has to be construed as per Section 2(31) and includes individuals, HUFs, companies, firms, LLPs, Association of Persons, etc.[104] The term

[96] Supra note 87.
[97] Supra note 70.
[98] Supra note 20.
[99] Maneka Gandhi v. Union of India, AIR 1978 SC 597
[100] Sijbren Cnossen, TAXING CAPITAL INCOME IN THE EUROPEAN UNION: ISSUES AND OPTIONS FOR REFORM 103 (2000).
[101] GVK Industries Ltd. v. ITO, (2011) 4 SCC 36.
[102] Supra note 70.
[103] Mayur B. Nayak, Tarunkumar G. Singhal, Anil D. Doshi, *Taxation of Gifts Made to Non-Residents*, THE BOMBAY CHARTERED ACCOUNTANTS JOURNAL (last visited Nov. 10, 2021, 9:00 AM), https://bcajonline.org/artcile.aspx?Id=18928&Cid=53.
[104] The Income Tax Act, 1961, § 2(31), No. 43, Acts of Parliament, 1961 (India).

"property" has to be understood and defined as per explanation in Section 56(2)(vii) of the Act. It is a general rule that tax is levied on income. However, gifts were started being taxed with the aim of expanding the tax basein India and the accordingly, the concept of deemed income to tax gifts was introduced by the GiftTax Act, 1958.[105] This statute was abolished with effect from 1st October, 1998 and the gifts wereagain being used to convert money and were also being used for wealth and income distribution amongst family, Hindu Undivided families and friends.[106] This buffer was short lived as the Finance Act, 2004 inserted a provision which introduced a done-based tax wherein any sum of money received by an assessee, being an individual or HUF, exceeding Rs. 25,000 would be deemed to be income under the head 'Income from other sources.'[107] However, certain exceptions were provided to this provision.This limit of Rs. 25000 was enhanced to Rs. 50000 by the amendment of 2007.[108] In 2009, a new clausewas added to the provision which included in it the receipt of immovable property without consideration.[109]Further, with the Finance Act, 2010, yet another clause of (viia) was added for thepurpose to tax a receipt by a by a firm or company (not being a company in which public are substantially interested) of shares of a company (not being a company in which public are substantially interested) without consideration or at less than fair market value. In 2013, (viib) was added in thedeeming provision wherein premium on the issue of shares in excess of the fair market value of such shares was taxed.[110] The final amendment was made via the Finance Act, 2017 wherein all the deemingprovisions were superseded except (viib) and (x) was inserted as a new clause.[111] Therefore, at present,Section 56(2)(viib) and (x) are in force to deem certain issue of shares or receipt of money or propertyas income.

Now with the amendment of 2019, Section 9(1)(viii) creates a fiction wherein income which wasarising outside India is deemed to accrue or arise in India. Prior to this provision, there was no provision which dealt with gifts of sum of money to non-residents by the residents even if it did notaccrue or arise in India and therefore, this created a legal vacuum for the residents to escape tax liability. Under the clause, there are certain conditions that need to be fulfilled for the deeming accrualor arising in India. These are, a) there is a sum of money (not any property) which is paid on or after5th July, 2019, therefore, any payment made before this timeline would not be covered by this clause,

b) by a person resident in India to a non-resident, not being a company or to a foreign company, c) such payment of sum of money is referred to as income in section 2(24)(xviia) [which in turn refers to section 56(2)(x)].[112] It being a deeming provision, no purposive interpretation can be given to this clause and its scope it to be strictly construed. This means that if a gift (by payment) has been givenby a non-resident to another non-resident, this provision will be inapplicable.[113] In ***GVK Industries v. Income Tax Officer***[114], the Apex Court explored the "Source Rule" principle and held that in the context of taxation, Source State Taxation confers primacy and precedence to tax a particular income on the foothold that the source of such receipt / income is located therein and such principle is widely accepted in international tax laws. Further, it also observed that the guiding principle highlighted here is that the where the source of income is situated, that country has the legitimate right to tax such source as inherently wealth is physically or economically generated from the country possessing such an attribute.[115]

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[105] Supra note 103.
[106] Id.
[107] TAXGURU, *Deemed Accrual of gift made to a person outside India by Resident*, https://taxguru.in/income-tax/deemed-accrual- gift-made-person-outside-india-resident.html (last visited Nov. 9, 2021).
[108] Id.
[109] Supra note 103.
[110] RELAKHS.COM, *Latest NRI gift tax rules 2019-29| Gifts to NRIs can be Taxable now!,* https://www.relakhs.com/latest-nri- gift-tax-rules-budget-2019-20/ (last visited Nov. 8, 2021)
[111] Id.
[112] Vikas Bansal, *Taxation of Gifts to Non-Residents: A word of Caution*, MINT (last visited Nov. 5, 2021, 8:00 PM), https://www.livemint.com/money/personal-finance/taxation-of-gifts-to-non-residents-a-word-of-caution-1564662678446.html.
[113] Id.
[114] GVK Industries v. Income Tax Officer, (2011) 332 ITR 130/239.
[115] Tax Management India.com, https://www.taxmanagementindia.com/visitor/detail_article.asp?ArticleID=8597 (last

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The provision exclude property situated in India given as gift. The provision, which finally made it to the Act, reads as *'income arising outside India, being any sum of money referred to in sub-clause (xviia) of clause (24) of section 2, paid...'*. This can be explained by an illustration. If a non-resident receives a gift of awork of art situated outside India from a person resident in India, then such gift is not covered within the ambit of section 9(1)(viii).[116] This refers to only "sum of money" and excludes gift of propertysituated in India is not covered by this clause. This exclusion is due to the fact that such gift of propertyis already taxed in India via Section 5(2).[117] Further, the insertion of Section does not change the position of non-taxability of gifts received from relatives or on the occasion of marriage etc. because this clause refers to the sum of money referred to in Section 2(24)(xviia), which in turn refers to Section 56(2)(x).[118] It is due to this reason that that threshold of Rs. 50000 applies to this clause andpayments made up to Rs, 50000 will not be treated as income under this provision. The budget, however, clarifies that any relief available in the Double Taxation Avoidance Agreements would be available with respect to such income. In general, the benefit under the tax treaty is likely to be available under the article 'Other Income' present in a number of treaties.[119] The provision is, however, stillhovering with loopholes as it restricts its scope to gifts made by residents to non-residents and doesnot include the scenario where a non-resident makes the transfer to a person outside India.[120] Theexpression "person outside India" is an ambiguous one and is prone to a lot of interpretations in absence of a specific definition.[121] Despite certain loopholes in this clause, it is certainly a great initiative to eliminate black money and tax evasion by the residents of our country. If the clause is simplified in a better way while simultaneously addressing the loopholes, the same would become more efficient in application.

~CONCLUSION~

Indian Income Tax Laws include within the ambit of tax liability not only residents, non-residents and residential taxpayers, but also non-ordinary resident taxpayers. Tax liability is also imposed on incomeearned by foreign companies and Non-resident Indians as long as such income arises from withinIndia. Generally speaking, the income of a non-resident person or a foreign company is only taxableto the extent it has arisen in India.

However, a special and unique aspect of taxation law is that under section 9 of the Income Tax Act, provisions have been laid down detailing why certain incomes are deemed to accrue in India even though theymight actually arise outside India. Section 5 is also imperative in providing a better understanding of the scope of Section 9. This is because Section 5 provides for a source rule upon which courts heavily rely in order to determine several questions that often arise under Section 9 of the Income Tax Act,1961.

Section 9 is especially significant because it increases the "territorial nexus" of the Income Tax Act, 1961. Until 1976, there was a lot of confusion and ambiguity surrounding this provision due to contradictory judgments rendered by the court, with different scholars and jurists pushing forward their own distinct opinions. In its original form, the section applied only to business connections, transfer of assets, income from property, dividend and salary. Thereunder, liability was attached tonon-residents only on the basis of territorial nexus. Finally, in 1976, three additional heads of income were added namely, interest, royalty and fees for technical services. These additions substantially modified the character of section 9 by creating liability for a non-resident with respect to his income outside India, even if the contract from which the income arose was performed entirely outside India. Under this provision, the only basis for attracting liability became the fact that the payment was made by an Indian.[122]

This has been heavily criticized by jurists, most notable Nani Palkhivala, who argued that these

visited Nov. 17, 2021).

[116] Supra note 115.

[117] Supra note 103.

[118] Id.

[119] Id.

[120] Id.

[121] Id.

[122] Supra note 70.

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amendments to section 9 are grossly ultra vires since they proceed on an inadequate territorial nexus, operating in an impermissible manner with effects that are extra-territorial in nature. He famouslywrote:

If the Indian Parliament can cast the net wide enough to collect tax in such cases where the foreignersincome has no nexus with India only because the income is derived from a transaction with an Indian, it can equally levy a tax on a hotel in a foreign country where an Indian goes to stay or dine, or on a foreign store where an Indian buys shirts or grocery, or on a foreign physician whose services are sought by an Indian while abroad.[123]

In later years, as well as quite recently, it is these aspects of extra-territorial operation and territorial nexus that tax authorities and the Supreme Court have grappled with, especially pertaining to the context of fees for technical services under clause (vii) of section 9.[124] The principles of "territorial nexus" and "deemed accrual" have formed the foundation of the legal fictions created by section 9and provide an understanding of the controversy behind section 9.

What is even more concerning being that in recent years' numerous amendments have been passed in haste in an attempt to whitewash the legal scenario of adverse and irrational judgments. However, thishas only served to further the ambiguity surrounding this provision, condemning previous follies tobe repeated once again. It is recommended that in cases where adverse judgments have been rendered by the courts, it should be necessary for a high-powered committee or group under the CBDT to be tasked with the review of the decision. Only upon prior recommendation from these committees should amendments be enacted, and even in such cases, such amendments should be made prospective in nature as far as possible.

Such initiatives would imbibe Indian tax law with the consistency it currently lacks. Moreover, thismulti-tier review and recommendation process will go an additional step in preventing the controversies that have arisen under clauses (vi) and (vii) of section 9, wherein the hasty amendments were later held to be insufficient by the courts with respect to overcoming adverse judicial decisions. Taking view of the fact that India is one of the world's fastest growing economies, increasingly becominga major destination for foreign investment, it is important to ensure that consistency and certainty exist in the legal regime. The role played by taxation law with regard to creating a conducive atmosphere for investment must be acknowledged by the legislature and judiciary, and to further this end, reforms to the current regime become the need of the hour.

[123] Supra note 1.
[124] Id.