IN THE INCOME TAX APPELLATE TRIBUNAL, 'I' BENCH MUMBAI

BEFORE: SHRI VIKAS AWASTHY, JUDICIAL MEMBER
&
SHRI M.BALAGANESH, ACCOUNTANT MEMBER

ITA No.975/Mum/2021
(**Assessment Year :2017-18**)

M/s. Gemological Institute of America Inc. C/o. GIA India Laboratory Pvt. Ltd., 10th Floor, Tardeo Centre Bandra Kurla Complex Bandra (E) Mumbai – 400 098	Vs.	The Assistant Commissioner of Income-Tax (International Taxation) Circle-2(3)(2) Mumbai 17th Floor, Air India Building, Nariman Point Mumbai – 400 021
PAN/GIR No. AADCG7962K		
(Appellant)	..	**(Respondent)**

Assessee by	Shri J.D. Mistry, Senior Advocate & Shri Niraj Sheth, Advocate
Revenue by	Shri Milind S. Chavan , Senior AR
Date of Hearing	**10/01/2022**
Date of Pronouncement	**17/01/2022**

आदेश / O R D E R

***PER M. BALAGANESH (A.M)*:**

This appeal in ITA Nos.975/Mum/2021 for A.Y.2017-18 preferred by the order against the final assessment order passed by the Assessing Officer dated 20/04/2021 u/s.143(3) r.w.s. 144C(13) of the Income Tax Act, hereinafter referred to as Act, pursuant to the directions of the ld. Dispute Resolution Panel (DRP in short) u/s.144C(5) of the Act dated 16/03/2021 for the A.Y.2017-18.

2. The ground No.1 raised by the assessee is general in nature and does not require any specific adjudication.

3. The ground No.2 raised by the assessee is with regard to existence of Permanent Establishment (PE) in India. All other grounds raised by the assessee vide ground Nos.3-5 revolves on the existence of PE in India. Hence, we take up the central issue as to whether the assessee has a PE in India.

4. We have heard rival submissions and perused the materials available on record. The assessee is a company incorporated in USA and also a tax resident of USA. It is engaged in the business of diamond grading and preparation of diamond dossiers. The assessee filed its return of income for the A.Y.2017-18 on 30/11/2017 declaring total income of Rs.597,75,36,450/-. Later a revised return was filed on 30/11/2018 declaring total income at Rs.348,35,96,480/-. The assessee is one of the companies of GIA group, a trusted name of gems and diamond grading and gemstone identification industry and is regarded as an authority in Gemology. During the year under consideration, the assessee has rendered diamond grading services to its associated enterprises in India i.e. GIA India Laboratory Pvt. Ltd., and to third parties. The assessee pleaded that it does not have any PE in India in terms of Article 5 of the Double Taxation Avoidance Agreement (DTAA) entered into and subsisting between India and USA. The Indian Company i.e. GIA India Laboratory Pvt. Ltd., which was set up on 26/09/2007, is a subsidiary of the assessee company. This subsidiary company set up a laboratory in India and since then engaged in the activity of gem grading in India.

4.1. Prior to setting up of the subsidiary, the assessee contracted with a third party "consolidator" called "International Diamond Ltd" arrangement, the consolidator coordinated the collection of diamonds from India, and the assessee graded the diamonds and issued grading reports. It was agreed between the parties to the consolidator arrangement that the cost to the consumers would be divided in the ratio of 90:10 (90 for the assessee and 10 for the consolidator). This arrangement continues to exist to date even after formation of GIA India Lab. However, the ratio w.e.f. 12 September 2011 is 88 : 12 (88 for the assessee and 12 for the consolidator). It is important to appreciate that after GIA India Lab was set up, this agreement also requires that the cost to the consumer would remain the same whether diamonds were graded by GIA India Lab or through the consolidator.

4.2. During the year under consideration, GIA India Lab graded diamonds, stones or pearls weighing from 0.15 carats to 3.99 carats. However, due to technical limitations, the diamonds or stones weighing larger than 3.99 carats or colored stones are referred to the assessee for grading which includes testing, analyzing, examining and inscribing and issuing reports. Further, in the case of capacity constraints, normal grading process are also referred to associated enterprises.

4.3 The assessee has entered into 'GIA Gem Grading Services Agreement' and the subsequent Amendment Agreement with GIA India Lab (amongst other entities) for providing gem grading services vis-a-vis diamonds/stones to other group entities.

4.4 In terms of the aforesaid agreement, the entities follow a uniform pricing mechanism of 90:10 ratio for grading services i.e. as per the

arrangement, GIA India Lab shall pay 90% of the service revenue collected from its customer to the assessee for its grading services, and retain 10% of service revenue for its coordinating effort. However, the pricing mechanism w.e.f. 01 April 2012 in terms of the Amendment Agreement is 88:12 ratio i.e. as per the arrangement, GIA India Lab shall pay 88% of the service revenue collected from its customer to the assessee for its grading services, and retain 12% of service revenue for its coordinating effort.

4.5. In the background of the aforesaid agreement, the ld. AO held that assessee has a PE in India viz GIA India Lab through which it carries on its business in India. Accordingly, 50% of gem grading fees received by the assessee from GIA India Lab has been held to be attributable to the Indian PE and a profit percentage of 20.31% was applied thereon to determine the total income of the assessee. The total receipts of the assessee company was determined at Rs.789,00,91,734/- which includes royalty income of Rs.348,35,96,482/-. Hence, the remaining receipts of Rs.440,64,95,252/- represents business receipts of the assessee. The ld. AO applied the profit ratio of 20.31% of 50% of such business receipts (Rs.440,64,95,252/-). Accordingly, the ld. AO determined the profit attributable to PE at Rs.44,74,79,593/- in the final assessment order pursuant to the directions of the ld. DRP. We find that the ld. DRP had given a categorical finding in 5.1 of its order that the contentions raised by the assessee during the year under consideration are identical to those raised by it in earlier assessment years and there is no change of facts involved in the year under consideration vis a vis earlier years. Infact, the ld. DRP while dismissing the contentions of the assessee, had merely placed reliance on the earlier year orders of the ld. DRP. We find that this Tribunal in assessee's own case for A.Y.2010-11 in ITA

No.1138/Mum/2015 dated 21/06/2019 had decided the very same issue in assessee's favour by holding that the assessee does not have any PE in India. The relevant operative portion of the said Tribunal Order is hereby reproduced as under:-

> *9. "We have carefully considered the rival submissions, perused the relevant material, including the orders of the lower authorities as well as the case laws referred at the time of hearing. Notably, the controversy before us primarily revolves around as to whether or not the subsidiary of the assessee company i.e., GIA India Lab can be construed as its PE in India. The income-tax authorities have invoked section 9 of the Act and/or Article 5 of the India-US Treaty in order to say that the assessee company has a PE in India. On the contrary, as per the assessee, the impugned receipts are in the nature of business profits, and in the absence of any PE in India, the same are not taxable in India. Factually speaking, it is evident that the on perusal of the agreements, the transaction of grading services between assessee company and GIA India Lab cannot be considered to be in the nature of a joint venture, since GIA India Lab has its own independent expertise but only due to its technology/capacity constraints, it forwards the stones to the assessee company for grading purposes; it is not an arrangement between two parties where each party contributes its share in order to undertake an economic activity which is subjected to joint control; in fact, the arrangement is akin to an assignment or sub-contracting of grading services to the assessee company, wherever GIA India Lab does not have the requisite expertise or technology or capacity for carrying out the grading services; further, the aforesaid arrangement has also been accepted as a mere rendering of grading services by the Transfer Pricing Officer both in the case of GIA India Lab and the assessee company. In this background, we may now proceed to decide as to whether the Indian Subsidiary GIA India Lab can be construed as a PE under any of the aspects contained in Article 5 of India-USA DTAA.*
>
> *10. Firstly, we may examine whether GIA India Ltd. can be constituted as a fixed place PE of the assessee in terms of Article 5(1) of the India- USA DTAA. As per Article 5(1) of the Indo-USA DTAA, a fixed place PE arises when the foreign entity has a fixed place in India through which its business is wholly or partly carried on. In this context, the learned Counsel pointed out that a similar situation has been considered by the Hon'ble High Court of Delhi in the case of E- Funds IT Solutions (supra), which has been upheld by the Hon'ble Supreme Court. In that case, it has been held that a subsidiary cannot be regarded as a 'fixed place PE' of*

the parent company on the ground of a close association between the Indian subsidiary and the foreign taxpayer. In that case, it was noted that because various services were being provided by E-Fund India (Indian subsidiary) to the taxpayer or that the foreign tax payer was dependent upon Indian subsidiary (e- Fund India) for its earnings or assignment or sub-contract of contracts to e-Fund India or e-Fund India being reimbursed on a certain cost- plus basis or saving / reduction in cost by transferring business or back office operations to the Indian subsidiary or the manner and mode of the payment of royalty transactions or e-Fund India providing support for carrying on core activities being performed by the taxpayer or associated transactions, cannot be the basis to construe the Indian subsidiary as PE of the foreign tax payer. Further, before the Hon'ble Delhi High Court, the Department had contended that the foreign company had a joint venture or partnership with Indian subsidiary as the businesses of the assessee company and the Indian subsidiary were inter-linked and closely connected (which is also contended in the case of the assessee before us) and therefore the Indian subsidiary was regarded as PE of foreign company in India. The aforesaid argument of the Revenue was repelled since the conditions under Article 5 of the DTAA were not met and it has been held that PE cannot be established merely because of transactions between associated enterprises or the principal sub-contracting or assigning the contract to the subsidiary.

11. Factually, in the case of the assessee company, there is no joint venture arrangement between the assessee company and GIA India Lab vis-à-vis gem grading services rendered by the assessee company to GIA India Lab since it is GIA India Lab who enters into agreement with the client and bears all the risks including credit risks, client facing risks, etc. Also, in terms of the agreement, GIA India Lab bears the risk of loss or damage to articles while in transit to and from the assessee company and also during the time when the articles are at or in the assessee company's facilities. Therefore, the economic risks of the gem grading services rendered by the assessee company vis-à-vis stones/diamonds of customers of GIA India Lab shipped to it are borne by GIA India Lab and hence, there is no joint venture arrangement whatsoever between the assessee company and GIA India Lab. In terms of Article 5(6) of the India USA DTAA, it is provided that the mere fact that a company has controlling interest in the other company does not by itself construe the other company to be its PE. Accordingly, the assessee company is not having a 'fixed place' PE in India.

12. In terms of Article 5 (1) of the India - USA DTAA, a service PE arises on the furnishing of services in India by the assessee company through employees or other personnel, but only if: activities of that nature

continue in India for a period or periods aggregating to more than 90 days within any twelve-month period; or the services are performed within India for a related enterprise. Hence, a service PE is triggered if the services (other than included services as defined in Article 12 'Royalties and Fees for Included Services') are rendered by the assessee company through employees or other personnel and activities of that nature continue in India for a period or periods aggregating to more than 90 days within any twelve-month period; or the services are performed within India for a related enterprise. The assessee company renders 'grading services' and 'management services to GIA India Lab'. In fact, 2 graders who were earlier employed with the assessee company are now employed with GIA India Lab and are on the payrolls of GIA India Lab and are working under control and supervisions of GIA India Lab and therefore, no service PE is created in India in terms of India- US DTAA. The Supreme Court has affirmed the decision of the Delhi High Court in E- Funds (supra) wherein it has been held that two employees deputed to e-Fund India fund India did not create a service PE as the entire salary cost was borne by e-fund India and they were working under control and supervision of e-fund India. In the facts of the instant case, since the said services are rendered outside India and none of the employees/ personnel of the assessee company has visited India and therefore, service PE is not triggered in the case of the assessee company.

13. In terms of Article 5(4) of the India – US/DTAA, an agency PE is created where a person-other than an agent of an independent status to whom paragraph 5 applies - is acting in India on behalf of an enterprise of the USA, that enterprise shall be deemed to have a permanent establishment in India, if:

> *(a) he has and habitually exercises in India an authority to conclude on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;*
>
> *(b) he 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 enterprise, and some additional activities conducted in the State on behalf of the enterprise have contributed to the sale of the goods or merchandise ; or*
>
> *(c) he habitually secures orders in India wholly or almost wholly for the enterprise.*

2. The definition excludes from the ambit of a PE 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 acts in the ordinary course of its business. The OECD Commentary deals with the concept of 'Independent Agent' in paragraphs 36 to 39. In terms of paragraph 37 of the OECD Commentary, a person will be regarded as an independent agent (i.e. it will not constitute a PE of the enterprise on whose behalf it acts) only if:

- *He is independent of the enterprise both legally and economically, and*
- *He acts in the ordinary course of his business when acting on behalf of the enterprise.*

In other words, Article 5(5) of the India- USA DTAA stipulates the following conditions which are required to be satisfied in order that an agent may be said to be an independent agent, i.e.,

- *That he should be an agent of independent status; that, he should be acting in the ordinary course of his business; and, that his activities should not be devoted wholly or almost wholly on behalf of the foreign enterprise for whom he is acting as agent.*

15. GIA India Lab is an independent/separate legal entity in India which is engaged in rendering of grading services. Further, considering the functions and the risks assumed by GIA India Lab vis- à-vis its business activities in India (as has been recorded in the transfer pricing study report - which functional and risk analysis has been accepted by the Transfer Pricing Officer both in the case of GIA India Lab and in the case of the assessee company), GIA India Lab is an independent entity which is rendering grading services to its clients in India. GIA India Lab also bears service risk and all client facing risks vis-à-vis the stones sent to the assessee company for grading purposes (as has been recorded in the Transfer Pricing Study Report). Hence, GIA India Lab is not acting in India on behalf of the assessee company. Further, GIA India Lab is not having any authority to conclude contracts and has neither concluded any contracts on behalf of the assessee company nor has it secured any orders for the assessee company in India. Thus, GIA India Lab cannot be regarded as 'agency PE' of the assessee company in India.

16. Before parting, we may also note the reference made by the Ld. Representative to the assessment concluded by the Assessing Officer for assessment year 2009-10. It was explained that during the assessment proceedings for assessment year 2009-10, a similar query i.e. why GIA India Lab should not be construed as PE of the assessee company in

India was raised, but after considering the detailed response furnished by assessee vide reply letter dated 02 November 2012, no addition whatsoever was made, which is evident from the Assessment Order (AY 2009-10) dated 26 March 2013. Thus, in this background it was all the more incumbent upon the Revenue in this year to discharge its onus as to why a different stand is being adopted, especially in the face of the fact that the nature and source of income in question remains the same. Therefore, on this aspect also, we are not inclined to uphold the stand of the assessing authority.

17. Before parting, we may also refer to the reliance placed by the Ld. DR on the judgment in the case of Formula One World Championship Ltd. (supra). In that case, the assessee was a U.K tax resident who obtained licence over all commercial rights in FIA Formula One World Championship. For this purpose, the assessee (foreign tax payer) entered into a contract with J.P. Sports (an Indian concern) by way of which it granted to J.P. Sports the right to host, stage and promote Formula One Grand Prix of India event at Motor racing Circuit owned by J.P. Sports. After examining all the relevant agreements, the case of the Revenue was that the Circuit located in India constituted a PE of assessee (i.e. the foreign tax payer) in India. The Hon'ble High Court concluded that since the assessee (foreign tax payer) had full access to the Circuit and could dictate as to who was authorised to access the Circuit and organising any other event on the Circuit was not permitted, the said Circuit constituted a PE of the foreign tax payer, i.e. Formula One World Championship Ltd., in India. The said decision of the Hon'ble High Court was approved by the Hon'ble Supreme Court. The aforesaid decision, in our view, stands on an entirely different fact-situation. In the present case, there is no material to show that the assessee dictates to the Indian subsidiary as to what activities it is authorised to engage in. We have also noted earlier that the Indian subsidiary is operating in an independent manner and there is nothing to show that factually speaking the Indian subsidiary constitutes a PE of the assessee in India. Thus, on account of difference in fact-situation, the reliance placed by the Ld. DR in the case of Formula One World Championship Ltd. (supra) is misplaced.

18. In view of the aforesaid discussion, in our considered view, the Assessing Officer has erred in invoking section 9 of the Act and/or Article 5 of the India-USA DTAA in order to say that the assessee company has a PE in India. Thus, assessee succeeds on this issue."

4.6. Similar view was expressed by this Tribunal in assessee's own case for A.Yrs. 2011-12 to 2016-17 in ITA Nos.386/Mum/2016, 1836 and 7174/Mum/2017, 53,7739 and 7740/Mum/2019 dated 30/04/2021.

4.7. In view of the fact that there is no change in the facts and circumstances of the case, during the year under consideration vis-à-vis earlier years which has been admitted both by the ld. AO as well as ld. DRP, respectfully following the aforesaid decisions of the Tribunal, we hold that the ld. AO erred in invoking section 9 of the Act and / or Article 5 of the India USA DTAA in order to say that assessee has a PE in India. Accordingly, the ground No.2 raised by the assessee is allowed.

5. With regard to ground Nos.3,4 & 5 raised by the assessee, the same relates to alternative plea of attribution of profits and estimation of gross profit. Since, we have already allowed the ground No.2 of the appeal holding that assessee does not have a PE in India and thus income of the assessee is not allowable to be taxed in India, the aforesaid grounds of appeal are rendered academic.

6. With regard to ground No.6 raised by the assessee in respect of taxability of royalty received during the year under consideration u/s.44DA of the Act, we find that this Tribunal in assessee's own case for A.Yrs. 2011-12 to 2016-17 vide order referred to supra dated 30/04/2021 had indeed examined the same and had come to the conclusion that since there is no PE in India, there will be no occasion to royalty being effectively connected with the PE or taxability of royalty u/s.44DA of the Act. Accordingly this ground also becomes academic and infructuous.

7. The ground No.7 raised by the assessee is only for seeking credit for tax deducted at source of Rs. 65,50,70,081/-. We find that assessee had filed a rectification petition u/s.154 of the Act before the ld. AO on 20/05/2021 which is pending disposal. The ld. AO is hereby directed to dispose of the said rectification petition and grant credit for TDS in accordance with law at the earliest. Accordingly, the ground No.7 is allowed for statistical purposes.

8. The ground No.8 raised by the assessee is with regard to chargeability of interest u/s.234C of the Act. This ground would be consequential in nature as we have directed the ld. AO to re-determine the income in terms of the aforesaid directions. In any event, we hold that interest u/s.234C of the Act shall be charged only on the returned income and not on the assessed income. The law is very well settled in this regard.

9. In the result, appeal of the assessee is allowed for statistical purposes.

Order pronounced on 17/01/2022 by way of proper mentioning in the notice board.

Sd/-	**Sd/-**
(VIKAS AWASTHY)	**(M.BALAGANESH)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai; Dated 17/ 01/2022
KARUNA, *sr.ps*

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai