IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "I", MUMBAI

Before Hon'ble Justice Shri P.P. Bhatt, President
&
Shri G.S. Pannu, Vice-President

ITA No. 1138/Mum/2015
Assessment Year : 2010-11

Gemological Institute of America, Inc C/o. GIA India Laboratory Pvt. Ltd., 10th Floor, Trade Centre, Bandra Kurla Complex, Bandra (E), Mumbai PAN: AADCG7962K	Vs.	The Addl. Commissioner of Income-tax (International Taxation), Range-2(3), Mumbai
(Appellant)		(Respondent)

Applicant by : Shri J.D. Mistry, &
Shri Niraj Sheth,

Respondent by : Shri V. Sreekar, CIT-DR

Date of Hearing : 26.03.2019		Date of Pronouncement : 21.06.2019

O R D E R

PER G.S. PANNU, VICE PRESIDENT:

The captioned appeal by the assessee is directed against the order of Assessing Officer dated 22.01.2015 passed under section 144C(13) r.w.s. 143(3) of the Income Tax Act, 1961 (in short 'the Act'), which is in terms of the directions issued by the Disputes Resolution Panel-III, Mumbai under section144C(5)of the Act dated 22.12.2014.

2. In this appeal, assessee has raised the following Grounds of appeal:

1:0 <u>Re. Holding that the Appellant has a 'Permanent Establishment' ("PE") in India::</u>

1:1 The Assessing Officer/the Dispute Resolution Panel has erred in holding that the Appellant has a 'Permanent Establishment' ("PE") in India.

1:2 The Appellant submits that considering the facts and circumstances of its case and the law prevailing on the subject, it has no PE in India and the stand taken by the Assessing Officer/the Dispute Resolution Panel in this regard is erroneous, misconceived and not in accordance with law.

1:3 The Appellant submits that the Assessing Officer has erred in arriving at various unwarranted and erroneous conclusions unsupported by any relevant material to hold that the Appellant had a PE in India. Further he also failed to consider the contrary material and evidence adduced by the Appellant.

1:4 The Appellant submits that the Assessing Officer's stand that the Appellant has a PE in India be struck down and he be directed to re-compute the Appellant's total income accordingly.

Without prejudice to the foregoing

2:0 <u>Re.: Attribution:</u>

2:1 The Assessing Officer/the Dispute Resolution Panel has erred in holding that 50% of receipts are attributable to the alleged PE of the Appellant in India.

2:2 The Appellant submits that considering the facts and circumstances of its case and the law prevailing on the subject no part whatsoever of its receipts are attributable to India and the stand taken by the Assessing Officer/the Dispute Resolution Panel in this regard is, incorrect, illegal, arbitrary, not in accordance with law and hence ought to be struck down.

2:3 The Appellant submits that the arbitrary action of the Assessing Officer/the Dispute Resolution Panel be struck down and the Assessing be directed to re-compute its total income accordingly.

<u>Without prejudice to the foregoing:</u>

3:0 Re.: Estimation of gross profit:

3:1 The Assessing Officer/the Dispute Resolution Panel has erred in holding that the 20.31% of the receipts attributable to the alleged Indian operations ought to be considered as profits of the PE taxable in India.

3:2 The Appellant submits that considering the facts and circumstances of its case and the law prevailing on the subject, even if it is held that the Appellant has a PE in India no further income can be taxed in India as the alleged PE has been remunerated at an arm's length and hence the stand taken by the Assessing Officer/the Dispute Resolution Panel in respect thereof is incorrect, erroneous, misconceived and illegal and hence ought to be struck down.

3:3 The Appellant submits that the Assessing Officer be directed to recompute its total income accordingly.

4:0 Re. : Levy of interest** u/s **234B of the Income-tax Act, 1961:

4:1 The Assessing Officer has erred in levying interest u/s. 234B of the Income-tax Act, 1961 on the Appellant.

4:2 The Appellant submits that considering the facts and circumstances of its case and the law prevailing on the subject no interest u/s. 234B is leviable and the stand taken by the Assessing Officer in this regard is misconceived, incorrect, erroneous and illegal.

4:3 The Appellant submits that the Assessing Officer be directed to delete the interest u/s. 234B so levied on it and to re-compute its tax liability accordingly.

5:0 Re. : General:

5 : 1 The Appellant craves leave to add, alter, amend and/or substitute all or any of the foregoing grounds of appeal at or before the hearing of the appeal.

3. Although the assessee has raised multiple Grounds of appeal, but the substantive dispute revolves around as to whether the assessee has a Permanent Establishment (in short the 'PE') in India so as to attribute certain income which is taxable in India.

4. Briefly put, the relevant facts are that the appellant assessee is a company incorporated in the USA and is also a tax-resident of USA. It is engaged in the business of diamond grading and preparation of diamond dossiers. Assessee filed its Return of income for Assessment Year 2010-11 declaring a total income at Rs. 3,96,828/- on the plea that it was a tax resident of USA and entitled to be taxed in accordance with the provisions of India-USA Double Taxation Avoidance Agreement ("DTAA") to the extent they are more beneficial. The income so declared was on account of 'Instructor Fee' earned from GIA India Laboratory Private Limited (in short 'GIA India Lab'), which is a company incorporated in India. However, the Assessing Officer was not satisfied as according to him, GIA India Lab, to whom the diamond grading services has been rendered, constituted a permanent establishment (PE) of the assessee in India and to that extent, the assessee's receipts from the diamond grading services would be taxable in India. The Assessing Officer arrived at this conclusion on the ground that the assessee and GIA India Lab together along with the other entities of the group had, in effect, established a joint venture business in which these two operated as partners. The stand of the assessee was that in terms of the relevant DTAA provisions, to draw the conclusion that the assessee had a PE in India, there should exist a place of business in India or a service PE or an agency PE, whereas all the aforesaid features were lacking. This is the precise area of difference between the assessee and the Revenue, which is manifested in Ground of appeal No. 1 enumerated above.

5. In the above background, we may now cull out from the orders of the authorities below and the material on record, the relevant facts

and the basis adopted by the Assessing Officer to hold that assessee has a PE in India. In this context, it is notable that assessee is an organization dedicated to ensure that the public trust in gems and jewellery increases by upholding the highest standards in integrity, science, academics and professionalism. The Assessee continuously researches all aspects of its diamond grading processes, to uncompromisingly maintain its standards for grading diamonds. It has been explained at some length before us that the assessee has not only defined the standards in the field, but has also developed its own unique approach for grading gemstones. It has been pointed out that the name and mark of the assessee is recognized and well-regarded throughout the world. It has created global standards to accurately determine quality of diamonds (4Cs i.e., Cut, Colour, Clarity and Carat Weight), coloured stones and pearls. The grading certificate issued by the Assessee is recognized as the standard of excellence ["gold standard"] and a benchmark in the diamond/gemology industry. Explaining the background, Ld.Representative stated that given the fact that the gem industry, particularly the cutting and polishing of diamonds, after which the cut and polished stones are graded is concentrated in particular parts of the world and specially in India, the assessee set up various entities in proximity to these locations which could independently, provide grading services of the same high quality. The assessee set-up a subsidiary Company in India viz., 'GIA India Lab' on 26 September 2007. This subsidiary Company set-up a laboratory in India and is since then engaged in the activity of gem grading in India.

6. Prior to the setting up of the subsidiary, the assessee contracted with a third party "consolidator" called "International Diamond Ltd." Under the consolidator 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). It was explained that this arrangement continues to exist even after formation of GIA India Lab. It has been emphasised before us and which also emerges from perusal of assessee's stand before the lower authorities that whenever GIA India Lab faces capacity and / or technical constraints, it sends stones for grading to other entities of the GIA Group across the globe, including the assessee before us. This is done in terms of a 'GIA Gem Grading Services Agreement' which has been entered into by the various entities of the Group including the assessee and GIA India Lab. For example, if GIA India Lab receives diamonds for grading of a quantity in excess of what it can handle or beyond the time expected by the customers or beyond the capacity of the machines, computers / staff available, it sends such excess grading work to another GIA Group entity in terms of Gem Grading Services Agreement. At this stage, it has been explained by the Ld.Representative that at the relevant point of time, GIA India Lab only had the technical capacity to grade the diamonds below 2 carats only and hence larger diamonds were being sent to other GIA Group entities for grading. Subsequently, with the increase in technical capacities, GIA India Lab itself started grading diamonds up to 3.99 carats. In terms of the aforesaid agreement, there is a uniform pricing mechanism of 90:10

for grading services i.e. the entity of the Group which is requesting for the grading services retains 10% of the fees it collects from its customer and 90% of the said fees is paid to the entity which provides the grading activity. In the background of such an arrangement, the Assessing Officer held that the assessee has a PE in India viz., GIA India Lab through which it carries on its business in India. Accordingly, 50% of the 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% has been applied thereon to determine the total income of the appellant, which has been held to be taxable in India.

7. Before us, Ld.Counsel for the assessee has explained the key features of the agreement with GIA India Lab, agreement between assessee and International Diamond Ltd (i.e., the consolidator and an unrelated party) and agreement between customers and GIA India Lab. The Ld.Counsel also submitted that the Assessing Officer has misunderstood/misconceived the aforesaid agreements and has made various unsubstantiated allegations and ultimately reached a conclusion that GIA India Lab is a PE of the assessee in India. In support of the contention that the Indian subsidiary cannot be treated as a PE of the assessee either on facts or in law, the Ld.Representative for the assessee has majorly relied on following judgments:

i. DIT vs E-Funds IT Solution (2014) 364 ITR 256 (Delhi) affirmed by Supreme Court in (2017) 399 ITR 34 (SC)

ii. Swiss Re-insurance Co Ltd v. DDIT(IT) (2015) 68 SOT 121

8. On the other hand, the Ld.Departmental Representative for the Revenue has merely reiterated the stand of the lower authorities which is to the effect that the Assessing Officer was correct in arriving at the conclusion that the assessee company had a PE in India and therefore, business income attributable to such PE is liable to be taxed in India. In support, he has relied on the decision of the Hon'ble Supreme Court in the case of Formula One World Championship Ltd (2017) 394 ITR 80 (SC).

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.

14. 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.

19. Ground No.2 and 3 relates to alternative plea of attribution and estimation of gross profit. Since we have allowed Ground No.1 of the appeal holding that the Assessee does not have a PE in India and thus, income of the assessee is not liable to be taxed in India, the aforesaid Grounds of appeal are rendered academic.

20. Insofar as Ground of appeal nos.4 is concerned, it relates to charging of interest u/s 234B of the Act, which is consequential in nature and does not require any specific adjudication.

21. In the result, the appeal of the assessee is allowed, as above.

Order pronounced in the open court on 21st June, 2019

Sd/-	Sd/-
(JUSTICE P.P. BHATT)	**(G.S. PANNU)**
PRESIDENT	**VICE-PRESIDENT**

Mumbai, Date : 21-06-2019

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Copy to :

1) The Appellant
2) The Respondent
3) The CIT(A) concerned
4) The CIT concerned
5) The D.R, Bench, Mumbai
6) Guard file

By Order

Dy./Asstt. Registrar
I.T.A.T, Mumbai