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Newsflash: GIA US gem grading services through GIA India will not constitute PE in India

Gemological Institute of America, Inc C/o. GIA India Laboratory Pvt. Ltd. v. The Addl. Commissioner of Income-tax

IN THE INCOME TAX APPELLATE TRIBUNAL

"I" Bench, Mumbai

ITA No. 1138/Mum/2015

(Assessment Year: 2010-11)

Date of Judgement: 21 June 2019

1.0 Summary

GIA US gem grading services to Indian customers through GIA India will not constitute the 'Permanent Establishment' of GIA US in India and accordingly, shall not be taxable as business profits.

2.0 Facts of the Case

- Gemological Institute of America Inc. ('GIA US' or '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.
- GIA US filed its income tax return for the assessment year ('AY') 2010-11 declaring a total income of INR 3,96,828 based on the beneficial provisions of Double Taxation Avoidance Agreement ('DTAA') entered between India and USA.
- The income so declared during AY 2010-11 was account of 'Instructor Fee' earned from GIA India Laboratory Private Limited ('GIA India'), which is a company incorporated in India and subsidiary of GIA US.
- The Assessing Officer ('AO') was not satisfied with the income declared by GIA US and concluded that GIA India constituted the Permanent Establishment ('PE') of GIA US in India and to that extent, the receipt of GIA US from the diamond grading services would be taxable in India.
- The AO arrived at this conclusion on the ground that GIA US and GIA India, together along with other entities of the group had in effect, established a joint venture business in which these two operated as partners.
- The AO therefore held that GIA US has a PE in India. Accordingly 50% of the gem grading fees received by GIA US from GIA India has been held to be attributable to Indian PE and a profit percentage of 20.31% has been applied thereon to determine the total income of GIA US, which has been held to be taxable in India.

3.0 Contentions of the Assessee

- The assessee stated that the gem industry, particularly the cutting and polishing of diamonds, is concentrated in particular parts of the world especially in India and hence the assessee set up various entities in proximity to these locations which could independently provide grading services of the same high quality.
- As per the assessee, the transaction of grading services between GIA US and GIA India cannot be considered to be in the nature of a joint venture, since GIA India has its own independent expertise but only due to its technology / capacity constraints, it forwards the stones to GIA US for grading purposes.

- There is no such arrangement between GIA US and GIA India where each party contributes its share in order to undertake economic activity which is subjected to joint control. In fact, the arrangement is akin to assignment or sub-contracting of grading services to GIA US. Thus, 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.
- Further, the aforesaid arrangement has also been accepted as a mere rendering of grading services by the Transfer Pricing Officer ('TPO') both in the case of GIA India and GIA US.
- In support of the contention that GIA India cannot be treated as a PE of GIA US, the assessee has relied on the decision of ADIT v. E-Funds IT Solution Inc. [2017] 399 ITR 34 (SC) and Swiss Re-insurance Co. Ltd. v. DDIT (IT) [2015] 68 SOT 121 (Mum-Trib).

4.0 Contentions of the Tax Authorities

- Prior to the setting up of GIA India, the assessee contracted with a third party "consolidator" named 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 has been emphasized before us that whenever GIA India faces capacity and / or technical constraints, it sends stones for grading to other entities of GIA Group across the globe, including GIA US. This is done in terms of a 'GIA Gem Grading Services Agreement'.
- In terms of the aforesaid agreement, there is a uniform pricing mechanism of 90:10 for grading services i.e. 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 AO held that the assessee has a PE in India viz., GIA India, through which it carries on its business in India.
- In support of his contention, the AO has relied on the decision of Hon'ble Supreme Court in case of Formula One World Championship Ltd v. CIT [2017] 394 ITR 80 (SC).

5.0 Ruling and observation of the Tribunal

Whether GIA US has the Fixed Place PE in India?

- As per Article 5(1) of India-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.
- Hon'ble Tribunal refer to the decision of E-Funds IT Solution Inc. (supra) wherein it has been held as under:
 - The 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.

- It was noted that because various services were being provided by e-fund India to the taxpayer or that the foreign tax payer was dependent upon Indian subsidiary (e-Fund India), cannot be the basis to construe the Indian subsidiary as PE of the foreign tax payer.
- The contention of the department 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 has been repelled.
- Since the conditions under Article 5 of the DTAA were not met and hence the PE cannot be established merely because of transactions between associated enterprises or principal sub-contracting or assigning the contract to the subsidiary.
- The Tribunal held that there is no joint venture arrangement between GIA US and GIA India on gem grading services rendered by the assessee, since it is GIA India who enters into agreement with the Client and bears all the risks including credit risks, client facing risks, etc.
- Also, in terms of agreement, GIA India bears the risk of loss or damage to articles while in transit to and from GIA US and also during the time when the articles are at or in the GIA US facilities.
- Therefore, economic risks of gem grading services are borne by GIA India and hence, there is no joint venture arrangement whatsoever between GIA US and GIA India.
- In terms of Article 5(6) of 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, it was held that GIA US does not have fixed place PE in India.

Whether GIA US has the Service PE in India?

- As per Article 5(1) of India-USA DTAA, a service PE arises on furnishing of services (other than included services as defined in Article 12) in India by the foreign entity through employees or other personnel for a period exceeding 90 days or if the services are provided for a related enterprise.
- GIA US render 'grading services' and 'management services' to GIA India.
- In fact, 2 graders who were earlier employed with GIA US are now employed with GIA India and are on the payroll of GIA India and are working under control and supervisions of GIA India.
- Hon'ble Tribunal relied on the decision of E-Funds IT Solution Inc. (supra), wherein it has been held that two employees deputed to e-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.
- Further, in case of the assessee, since the said services are rendered outside India and none of the employees/personnel of GIA US has visited India, service PE is not triggered.
- Accordingly, no service PE of GIA US is created in India in terms of India-US DTAA.

Whether GIA US has the Agency PE in India?

- As per Article 5(4) of India-USA DTAA, an agency PE arises when a person, other than an agent of an independent status, is acting in India on behalf of a foreign entity and fulfills the following conditions:
 - 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;
 - 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 are conducted; or
 - he habitually secures orders in India wholly or almost wholly for the enterprise.
- The definition of Agency PE excludes from its ambit any business activity carried out through a broker, general commission agent or any other agent having an independent status, acting in his ordinary course of its business and his activities should not be devoted wholly or almost wholly on behalf of the foreign entity.
- GIA India is an independent/separate legal entity in India which is engaged in the rendering of grading services to its Client in India.
- Further, considering the functions and the risks assumed by GIA India vis-à-vis its business activities in India, GIA India is an independent entity which is rendering grading services to its Clients
- GIA India also bears service risk and all Clients facing risks vis-à-vis the stones sent to GIA US for grading purposes. Hence, GIA India is not acting on behalf of GIA US.
- Further, GIA India is not having any authority to conclude contracts and has neither concluded any contracts on behalf of GIA US nor it has secured any orders for GIA US in India.
- Thus, GIA India cannot be regarded as 'Agency PE' of the GIA US in India.

Case law of Formula One World Championship Ltd (supra)

- Hon'ble Tribunal also referred to the judgment of Formula One World Championship Ltd (supra) on which the reliance was placed by the department and stated that the said decision stands on an entirely different fact situation.
- In the instant case, there is no material to show that GIA US dictates to the GIA India as to what activities it is authorized to engage in.
- Hon'ble Tribunal has also noted that GIA India is operating in an independent manner and there is nothing to show that factually speaking the GIA India constitutes a PE of GIA US in India.
- Thus, on account of difference in fact-situation, the reliance placed by the department in case of Formula One World Championship Ltd. (supra) is misplaced.

5.0 Conclusion

In view of the aforesaid, Hon'ble Tribunal has held that the AO has erred in invoking section 9 of the Act and / or Article 5 of the India-USA DTAA and thereby GIA US does not have PE in India. In the result appeal of the assessee is allowed.

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