IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.945 OF 2022

Commissioner of Income-tax,
(IT)-2 .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL NO.2306 OF 2022

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL NO.73 OF 2023

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL NO.779 OF 2023

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL (L) NO.21874 OF 2022

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL NO.72 OF 2023

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL NO.2331 OF 2022

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

WITH

INCOME TAX APPEAL NO.553 OF 2023

Commissioner of Income-tax,
(International Taxation)-2, Mumbai .. Appellant

Versus

Gemological Institute of America Inc. .. Respondent

***Senior Advocate N. Venkatraman, ASG**, a/w Mr. Subir Kumar, Mr. Akhileshwar Sharma, Ms. Ashita Aggarwal, Ms. Diksha Pandey, for the Appellants.*

***Mr. J.D. Mistri, Senior Advocate**, a/w Mr. Niraj Sheth, Mr. Gunjan Kakkad, i/b Mr. Atul K. Jasani, for the Respondents.*

CORAM: B. P. COLABAWALLA &
FIRDOSH P. POONIWALLA, JJ.

RESERVED ON : 24th April, 2026
PRONOUNCED ON : 16th June, 2026

JUDGMENT:- [PER B. P. COLABAWALLA J.]

INTRODUCTION:

1. All the above Appeals are filed by the Revenue challenging the orders of the Income Tax Appellate Tribunal (for short the **"ITAT"**) dated 21st June 2019, 30th April 2021 and 17th January 2022, respectively. The order dated 21st June 2019 is with reference to the A.Y. 2010-2011. The order dated 30th April 2021 is with reference to A.Y. 2011-2012 to A.Y. 2016-2017, and the order dated 17th January 2022 is with reference to A.Y. 2017-2018.

2. The two basic issues raised in all these Appeals are:

(i) What is the quantum of royalty that can be brought to tax in India, which was paid by the *GIA India Laboratory Private*

Limited (for short "***GIA India***") to the Respondent – *Gemological Institute of America Inc.* (for short "***GIA US***"). It is undisputed that *GIA US* (the Respondent – Assessee) is an Associated Enterprise (for short "**AE**") of *GIA India*. For the sake of convenience, this issue is referred to as the ***royalty issue***.

(ii) Whether *GIA India* is a Permanent Establishment (for short "**PE**") of the Respondent - *GIA US* in India in terms of Article 5 of the India-US Double Taxation Avoidance Agreement (for short the "**India-US DTAA**"). For the sake of convenience, this issue is referred to as the ***PE issue***.

3. Both the aforesaid issues arise in A.Y. 2011-2012 to A.Y. 2016-2017. However, for A.Y. 2010-2011 and A.Y. 2017-2018, only the *PE issue* arises for our consideration. It is in this light that the parties have referred to and addressed us on the basis of the facts for the A.Y. 2011-2012 (ITXA No. 2306 of 2022). The parties have also stated that the questions that arise in the Appeal for the A.Y. 2011-2012 (ITXA No. 2306 of 2022) be considered as the questions of law. The parties further agreed that though questions in the other Appeals may be differently worded, the questions of law in A.Y. 2011-

2012 be treated as the questions to be decided in all the above-mentioned Appeals. We have, therefore, proceeded on that basis.

4. The questions raised by the Revenue – Appellant in A.Y. 2011-2012 (arising from the order of ITAT dated 30th April 2021) are as follows:-

> *(a) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in allowing reduction of returned income of royalty in the hands of the assessee based on the APA entered into in an earlier year by the Indian entity GIA India laboratory Ltd. even while the assessee was not a party to the APA?*
>
> *(b) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in allowing the claim of the assessee to revise its income without appreciating that allowing such claim of the assessee is beyond the purview of Section 253 of the Act?*
>
> *(c) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in allowing adjustment of income of the assessee as a consequence of the APA with the Indian entity GIA India laboratory Ltd., thereby allowing a secondary adjustment, without appreciating that the first proviso to Section 92CE(1) specifically prohibits Secondary adjustment u/s 92CE?*
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> *(d) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in ignoring the expression of word "through" which has been used in section 9(1)(i) of the Income-tax Act, 1961 in defining income deemed to accrue or arise in India which has been further clarified in Explanation- 4 to Section 9(1)(i) of the Income-tax Act, 1961?*
>
> *(e) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in ignoring the fact that the assessee is doing its business through its AE in India through GIA India Laboratory Private Limited by restricting the AE to grade only low value diamonds and also laying down fees to be charged for grading high value diamonds, obtaining such diamonds from AE, thereby doing its business through its AE in India and erred in ignoring*

the expression of word "through" which has been used while defining the concept of "permanent establishment" and "business profit" in article 5 and 7 of the India-USA DTAA?

(f) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in not considering that the assessee company was supervising and having close control over the general as well as day to day activities of GIA India Lab through its deputed personnel in its employment or control which leads to the conclusion that GIA India Lab is a PE of the assessee company?

(g) Whether on the facts of the case and in law, the Hon'ble ITAT is justified in not considering that entire risk with respect to diamonds received for grading is borne by the GIA India, cost of shipping and delivery are also borne by the GIA India Lab and therefore GIA India is a PE of the assessee?

5. We must mention that for A.Y. 2017-2018, an additional issue was raised, namely, *"Whether in the facts of the case and in law, the ITAT is justified in deleting the addition made on attribution of profit and royalty being effectively connected with PE under Section 44AD of the Income Tax Act, 1961 stating that there is no PE in India.*"

6. As can be seen from the above questions, questions (a) to (c) deal with the *royalty issue*, whereas questions (d) to (g) [along with the additional question for A.Y. 2017-2018] deal with the *PE issue*.

FACTS:

7. Before we deal with these questions, it would be necessary to set out some brief facts in relation to the A.Y. 2011-2012, and on the basis of which parties have also proceeded before us.

8. The Respondent (*GIA US*) is a US-based company and a world leader engaged in the business of gem grading/certification, which is a critical function associated with cutting, polishing and sale of diamonds. A large part of the world's diamond cutting industry is located in India and needs to avail the grading services. The GIA Group, therefore, incorporated a wholly owned subsidiary in India, namely *GIA India*, on 26th September 2007, to grade diamonds. For this purpose, *GIA US* also provided it with the required equipment, technical know-how, expertise, etc. Similar to the set up in India, *GIA US* has also set up subsidiaries in Thailand and Botswana for the same reason.

9. For the technical know-how and expertise, etc., royalty was charged by *GIA US* (the Respondent) to *GIA India* for A.Y. 2011-2012. In the earlier years, post commencement of business, due to technical and physical constraints, diamonds of more than 1.99 carats, or those in excess of *GIA India's* grading capacity, were accepted for grading by *GIA India* and

thereafter sent to *GIA US* or other subsidiaries of the group for grading. This inter group grading services were charged/paid for by the group companies at an agreed rate as per the *GIA Gem Grading Services Agreement*, which is accepted by the Indian Tax Authorities to be at an Arm's Length in case of both *GIA India* as well as *GIA US*. It transpires that subsequently *GIA India* progressively started grading diamonds of higher carats, and currently it can grade diamonds of upto 3.99 carats.

10. For A.Y. 2011-2012, *GIA US* filed its Return of Income on 10th November 2011, declaring a total income of Rs.68,53,46,239/-, which was the royalty received from *GIA India,* and offered to tax. A revised Return of Income was also filed on 6th September 2012, which also included the said royalty income. The case of *GIA US* was selected for scrutiny, and the transaction being an international transaction, initially, on 18th February 2014, a reference was made by the Assistant Commissioner of Income Tax (International Taxation), Circle-2(3)(2) [the Assessing Officer of GIA US] to the Transfer Pricing Officer (**"TPO"**) for computation of the Arm's Length Price (**"ALP"**). On 29th January 2015, the TPO passed his order under section 92CA(3) proposing a NIL adjustment. Thereafter, the Assistant Commissioner of Income Tax (International Taxation), Circle-2(3)(2), passed a draft Assessment Order dated 23rd March 2015 under Section 144C(1) read

with Section 143(3) of the Income Tax Act, 1961 (for short "**IT Act**"). Aggrieved by the said draft Assessment Order, *GIA US* raised its objections before the Dispute Resolution Panel (for short the "**DRP**"), which issued its directions on 27th October 2015. Thereafter, the said Assistant Commissioner of Income Tax passed a final Assessment Order dated 16th December 2015 and assessed *GIA US*' total income at Rs.72,88,67,984/-. This was on the basis that *GIA US* has a Permanent Establishment (PE) in India and therefore, as per Article 7 of the India-US DTAA, assessed the entire income of *GIA US*, including the aforementioned royalty income, at 42.23%.

11. Aggrieved by the final Assessment Order dated 16th December 2015, *GIA US* filed an Appeal before the ITAT on 25th January 2016, which was lodged with the ITAT as Income Tax Appeal No. 386/Mum/2016. It is undisputed that much before any reference was made to the Transfer Pricing Officer either in the case of *GIA US* or *GIA India* (date of making reference to the TPO in the case of *GIA India* was 16th December 2013), *GIA India* filed an application dated 22nd March 2013 for entering into an Advance Pricing Agreement (for short the "**APA**") with the Central Board of Direct Taxes (for short the "**CBDT**") under Section 92CC of the IT Act for A.Ys. 2014-2015 to 2017-2019. This application was for the determination of the ALP of the royalty paid by *GIA India* to *GIA US*. For the roll-back period of A.Y. 2010-

2011 to 2013-2014, *GIA India* filed an application on 30th March 2015 under Section 92CC(9A) of the IT Act. It appears that after a prolonged negotiation, the CBDT entered into an APA dated 7th May 2018 with *GIA India, inter alia*, determining the ALP (Arm's Length Price) of royalty and also requiring the excess royalty received by *GIA US* to be repaid to *GIA India*. As mentioned earlier, for A.Y. 2011-2012, royalty paid by the *GIA India* to *GIA US* was Rs.68,53,46,239/-. However, the ALP of royalty, as determined by the APA, was Rs.49,08,99,461/-. Accordingly, as per the APA, *GIA US* was liable to refund to *GIA India* the excess amount of Rs.19,44,46,788/- within a stipulated period. The aforesaid exercise (with different figures) also applied to A.Y. 2012-2013 to A.Y. 2017-2018.

12. To ensure that the excess amount of royalty paid by *GIA India* to *GIA US* was refunded, the APA dated 7th May 2018, *inter alia*, required *GIA India* to raise an invoice in respect of the excess royalty paid, and for income tax purposes, to reduce the claim of royalty deduction made by it originally in its Return of Income by filing a modified Return of Income for the Assessment Year under consideration. Accordingly, the aforementioned excess sums were invoiced by *GIA India* to *GIA US*, and *GIA India* filed its modified Return of Income, reducing the deduction claimed on account of payment of royalty. For the excess amount paid for A.Y. 2011-2012

(Rs.19,44,46,788/-) an invoice dated 30th June 2018 was raised by the *GIA India* on *GIA US*, and in terms of the said invoice, *GIA US* paid the aforesaid amount to *GIA India* on 18th July 2018. Payments for the other Assessment Years were also made within the time stipulated as per the APA.

13. Since the ALP was now determined as per the APA entered into between the CBDT and *GIA India*, and the excess royalty amount paid was also refunded by *GIA US* to *GIA India*, *GIA US* in its Appeal pending before the ITAT (ITXA No. 386/Mum/2016), sought to raise an additional ground by its letter dated 6th November 2018, claiming that the amount of Rs.19,44,46,788/-, which was refunded back to *GIA India* as per APA dated 7th May 2018, could not be regarded as its income and *GIA US* should not be assessed on the same. In the Appeals filed in relation to A.Y. 2012-2013 to 2013-2014, similar additional grounds were raised by *GIA US* before the ITAT. For A.Y. 2014-2015 to 2016-2017, this issue was raised before the DRP, and for A.Y. 2017-2018, the said claim was made by way of a revised Return of Income filed on 30th November 2018. It is pertinent to note that the revised Return of Income of *GIA US* for A.Y. 2017-2018 was accepted by the Assistant Commissioner of Income Tax (International Taxation), Circle-2(3)(2).

14. The appeals for A.Y. 2011-2012 to A.Y. 2016-2017 were consolidated and were decided by the ITAT by a common order dated 30th April 2021. The additional grounds raised by *GIA US* in respect of the reduction from its total income of the excess royalty paid back to *GIA India* were allowed, and the amounts repaid by *GIA US* to *GIA India* were directed to be reduced from the total income of *GIA US*, subject to verification of *GIA US* having paid the amounts back to *GIA India*. The ITAT also held that *GIA US* did not have a PE (Permanent Establishment) in India, and therefore, royalty income was taxable at 10% in terms of Section 9 read with Section 115A of the IT Act, as opposed to the rate of 42.23% applied by the Assistant Commissioner of Income Tax (International Taxation). Thus, by virtue of the ITAT order dated 30th April 2021 passed for A.Y. 2011-2012 to 2016-2017, as well as the Assessment Order dated 20th April 2021 passed by the Assistant Commissioner of Income Tax (International Taxation) for A.Y. 2017-2018, the position was that *GIA India* got a lesser deduction of royalty and correspondingly, the *GIA US*' income was reduced by the same amount. It is aggrieved by this order of the ITAT that ITXA No. 2306 of 2022 (for A.Y. 2011-2012) has been filed.

SUBMISSIONS OF THE APPELLANT:

15. Considering the aforesaid factual backdrop, Mr. Venkatraman, the learned ASG appearing on behalf of the Revenue, submitted that the ITAT completely misdirected itself by allowing the Appeal of *GIA US* and reducing their income by Rs.19,44,46,788/-. He submitted that Chapter X of the IT Act is a special anti-avoidance regime. Its object is to ensure that the income arising from international transactions between Associated Enterprises is computed having regard to the ALP (Arm's Length Price), so as to prevent erosion of the Indian tax base through profit shifting. According to Mr. Venkatraman, the statutory scheme makes it clear that the determination of the ALP under Chapter X is undertaken with reference to the international transaction as a whole and not from the perspective of either party in isolation. Section 92C, in referring to "the arm's length price" in the singular and to "such persons" in the plural, reflects a transaction-centric and inherently bilateral framework. The ALP is thus an objective standard emerging from the transaction itself and not a party-specific construct. The statute does not contemplate multiple or divergent prices for the same transaction depending on the perspective of the taxpayer or the Transfer Pricing Officer examining either side.

16. Mr. Venkatraman submitted that in this statutory setting, Section 92 assumes central importance. It provides that income arising from an international transaction shall be computed having regard to the ALP, thereby constituting the statutory bridge between the machinery contained in Chapter X and the general framework of charge and computation. Sections 92C and 92CA furnish the machinery for the determination of the ALP by the Transfer Pricing Officer. Sections 92CC and 92CD, which deal with Advance Pricing Agreements and their implementation, operate within the same framework and are likewise confined to the determination and implementation of the ALP. Section 92CC(1) expressly contemplates an agreement only for determining the ALP in relation to an international transaction.

17. Mr. Venkatraman submitted that there are specific statutory prohibitions in the IT Act against a downward adjustment in the hands of a non-APA Associated Enterprise (AE). In this regard, Mr. Venkatraman submitted that Section 92(3) imposes an express limitation by providing that the provisions of Section 92 shall not apply where computation having regard to the ALP results in a reduction of income or increase of loss. This is a substantive restriction consistent with the anti-avoidance character of Chapter X, and ensures that transfer pricing provisions, including those

relating to Advance Pricing Agreements, cannot be invoked to the detriment of the Indian tax base. The only limited relaxation provided under the Advance Pricing Agreement regime is contained in Section 92CC(3), which permits departure from the methods otherwise referred to in Sections 92C and 92CA. That relaxation is confined to the methodology of determining the ALP. There is no corresponding relaxation or override in respect of Section 92, and in particular, no departure from Section 92(3).

18. Accordingly, the determination of the ALP cannot vary in law depending on the perspective of the authority examining one side of the transaction or the other. While the ALP remains uniform, its application in computation operates asymmetrically by reason of Section 92(3). The asymmetry reflected in the two orders dated 29th January 2015, passed by the same Transfer Pricing Officer on the same date in the cases of *GIA India* and *GIA US*, therefore, represents a consequence of a statutory compulsion in view of Section 92(3) inherent in the anti-avoidance framework, and not any divergence in the determination of the ALP itself. Further, the APA mechanism cannot be used as a vehicle to achieve indirectly what the statute prohibits directly. A non-resident AE could never, in law [in view of Section 92(3)] have entered into an APA for the purpose of seeking a downward revision of its income. The absence of such a possibility flows from the design

of the anti-avoidance framework itself. In the present case, however, the impugned order effectively extends to *GIA US* the benefit of an APA entered into by *GIA India,* and thereby permits a reduction of income which could not have been achieved directly under the statute. It does so by giving effect to a subsequent repayment beyond mere adjustment of books, and travels back in time to undo a completed tax levy. Such an approach is legally impermissible.

19. To buttress this argument, Mr. Venkatraman submitted that there is no statutory mechanism for non-APA parties to seek any adjustment. In this regard, Mr. Venkatraman relied upon Section 92CD and submitted that the statutory framework provides a limited deeming fiction for giving effect to an APA and that fiction is confined to the applicant alone (in the present case, *GIA India*). Under Section 92CD, the Assessee entering into an APA is permitted to furnish a modified Return which is deemed to be a Return filed under Section 139(1). It is by virtue of this statutory fiction that the ALP determined under the APA can be given retrospective effect in the case of the signatory to the APA (in the present case, *GIA India*). Crucially, there is no provision enabling the non-resident AE to revise its income or reopen a completed tax position on account of an Advance Pricing Agreement entered into by its Indian affiliate, and any subsequent legislative

developments operate prospectively and cannot be invoked to retrospectively undo a completed tax levy. This position stands further reinforced by the subsequent legislative development introduced by the Finance Act, 2026, which substitutes Section 169(1) of the Income-tax Act, 2025. By this amendment, the statute, for the first time, extends the effect of the deeming fiction associated with an Advance Pricing Agreement beyond the applicant to "any other person being an associated enterprise", by enabling such person to furnish a return or a modified return where income is modified pursuant to the agreement, within the prescribed time frame from the month in which the Advance Pricing Agreement is entered into. The Explanatory Memorandum to the Finance Bill, 2026 candidly acknowledges that under the law as it previously stood, there was no provision enabling a non-signatory Associated Enterprise to modify its return, claim a refund, or seek consequential adjustment of taxes paid or withheld, on account of an Advance Pricing Agreement entered into by another person. The memorandum further clarifies that the amendment is to apply only to Advance Pricing Agreements entered into on or after 1st April 2026 and to Assessment Years commencing from that date, with the provision itself taking effect from 1st April 2026. In these circumstances, the subsequent amendment cannot be invoked to retrospectively confer a right or mechanism upon a non-signatory Associated Enterprise for the relevant Assessment

Years. The statutory scheme, as it stood, lacked any enabling provision for the reduction of income in the hands of such an entity. The repayment made by *GIA US* pursuant to the APA does not alter this position. Such repayment is a consequential adjustment flowing from the implementation of the APA in the hands of *GIA India* and does not operate in law to retrospectively re-characterise or reduce income that had already accrued and been received by *GIA US* in the relevant assessment years. The Act contains no provision by which such repayment can travel back in time to undo a completed tax levy.

20. Mr. Venkatraman then submitted that Section 92CE(3) further reinforces the one-directional asymmetric framework. A "primary adjustment" as defined, contemplates an adjustment to the total income of the Assessee on account of transfer pricing provisions which results in an increase in income or reduction in loss. It does not contemplate a decrease in income. Correspondingly, the provisions relating to "secondary adjustment" are confined to adjustments in the books of accounts of the Assessee, aimed at aligning the cash position with the primary adjustment. These provisions do not operate to recompute or reduce taxable income and are confined to the Assessee who has undergone the primary adjustment. Thus, the statute consistently proceeds on the basis of upward adjustment in the hands of the

Indian Assessee, without any mirrored downward adjustment in the hands of the counter-party.

21. Lastly, on the *royalty issue*, Mr. Venkatraman submitted that Section 92C(4) read with its proviso forms a complete code governing the consequences of the determination of the ALP. The structure of the provision itself makes a clear and deliberate distinction between (i) limiting the relief available to the Assessee undergoing the transfer pricing adjustment and (ii) the express statutory bar against any corresponding adjustment in the hands of the counter-party. In this regard, Mr. Venkatraman placed heavy reliance on the second proviso to Section 92C(4). Mr. Venkatraman submitted that this proviso expressly prohibited any re-computation of income in the hands of the Associated Enterprise corresponding to the adjustment made in the case of the Assessee. He submitted that legislative intent was unambiguous, namely, once an upward adjustment was made in the hands of the tested party (*GIA India*), there was an express prohibition against granting a mirror downward adjustment to the counter-party (*GIA US*). Thus, far from supporting the *GIA US*' plea, the statutory text itself forecloses the very argument of corresponding relief.

22. To put it in a nutshell, Mr. Venkatraman submitted that when one looks at the statutory framework as set out in Chapter X of the IT Act, it was clear that once *GIA US* was paid the royalty by *GIA India* in the relevant Assessment Year, it became taxable, and merely because *GIA US* had refunded the excess royalty paid to it as per the terms of the APA, *GIA US* could not claim a reduction of its income, and which was granted by ITAT in the impugned order. Mr. Venkatraman submitted that this is more so in the present case when one takes into consideration that the Advance Pricing Agreement (APA) operates only in relation to the person who enters into the agreement and the international transaction covered thereby. In terms of Section 92CC(5), the binding effect of an APA is expressly confined to "the person in whose case and in respect of the transaction in relation to which the agreement has been entered into". In other words, the rights and obligations under the APA are limited to its signatory, and no benefit can be claimed by or extended to a non-signatory Associated Enterprise (in the present case *GIA US*).

23. Mr. Venkatraman then submitted that the argument canvassed by *GIA US,* and which was accepted by the Tribunal, namely that only the "real income" could be taxed and not by the statutory framework of transfer pricing or the APA regime, is wholly misplaced and misconceived. Mr.

Venkatraman submitted that the underlying premise is that the repayment is made in the subsequent year out of commercial expediency, and can travel back in time to undo a completed tax levy in earlier Assessment Years. According to Mr. Venkatraman, even proceeding on this basis, and without prejudice to the statutory position discussed earlier, the scheme is untenable on first principles. The jurisprudence on accrual and "real income" operates across three distinct and mutually exclusive categories, each addressing a different stage in the emergence of income. They are: (a) completed accrual and receipt, and subsequent reversal is wholly irrelevant and ineffective; (b) Non-crystallization of accrual, namely adjustment at the stage of determination; and (c) Extinguishment by operation of law or impossibility within the same year. As far as categories (b) and (c) are concerned, they operate at the stage of accrual itself, addressing situations where the income either never comes into existence or stands extinguished before the close of the previous year. They do not contemplate cases where income has fully accrued, has been received and accepted as income, and is thereafter sought to be altered by a subsequent voluntary act. A case like that would squarely fall in category (a).

24. Once the case of *GIA US* falls within category (a), then it is squarely covered by a decision of the Bombay High Court in the case of

Kishinchand Chellaram and Others Vs. The Commissioner of Income-Tax Central Bombay [1955 SCC OnLine Bom 134] and which was confirmed by the Hon'ble Supreme Court in its decision in the case of ***Kishinchand Chellaram Vs. Commissioner of Income-tax [(1962) 46 ITR 640 (SC)]***.

25. Mr. Venkatraman submitted that in the facts of the present case *GIA US* filed its original Return for A.Y. 2011-2012 on 10th November 2011, and APA was executed only on 7th May 2018, and the refund was paid only pursuant to the invoice raised by *GIA India* on 30th June 2018, a gap of 7 years. In these facts, the right to receive income fully crystalized, the income was quantified, billed and received in terms of the contract between *GIA India* and *GIA US*. *GIA US* accepted and returned it as its income, and there was no dispute, contingency or legal infirmity affecting accrual within the relevant previous year. The repayment occurred years after the close of the previous year and after the Return was filed. This is therefore not a case of non-accrual or extinguishment within the year falling within categories (b) and (c) referred to above but one of voluntary repayment of income already accrued and received, and hence, squarely falls within category (a) and is covered by the decision of this Court as well as the Hon'ble Supreme Court in *Kishinchand Chellaram (supra)*.

26. For all the aforesaid reasons, Mr. Venkatraman submitted that the ITAT completely misdirected itself in allowing *GIA US* to reduce its income by Rs.19,44,46,788/- for A.Y. 2011-2012 and also correspondingly for A.Y. 2013-2014 to 2016-2017. He, accordingly, submitted that questions (a) to (c) be answered in the negative and in favour of the Revenue and against the Assessee.

27. As far as questions (d) to (g) are concerned, and which relate to the *PE issue*, Mr. Venkatraman, the learned ASG appearing for the Revenue, took us through the findings of the ITAT in the impugned order dated 30th April 2021. Since this order of the ITAT only relies upon the order passed by it in the case of *GIA US* for Assessment Year 2010-2011, Mr. Venkatraman also took us through the order passed by the ITAT for A.Y. 2010-2011 dated 21st June 2019. After pointing out the relevant paragraphs [of the ITAT order] on the *PE issue*, Mr. Venkatraman submitted that the ITAT completely went wrong in holding that *GIA India* is not a PE of *GIA US*. He submitted that the documents and facts would clearly establish that: (a) with expanding business, the GIA group has set up many labs across the globe, including India, and it is apparent that all units/labs are working under the control, guidance and supervision of *GIA US,* including using the brand, logo,

technology, process and expertise and utilising services of personnel deputed by *GIA US*. Mr. Venkatraman submitted that *GIA India* is now operating in India with the help of the lab directly set up by *GIA US*; (b) the technology, expertise, design etc of the grading services is being provided to *GIA India* by *GIA US*. According to Mr. Venkatraman, the client will approach the lab situated in a specific country and may ask for grading services from *GIA US* either through that office or through GIA's direct office. In some cases, a particular office will grade the diamonds, if it is capable of the same, or it will utilise services of the lab of *GIA US,* Thailand or other affiliate entities. The billing will be centralised by the particular office at the global rate fixed by *GIA US*. The management expenses, advertisement, legal and similar expenses would be incurred by *GIA US,* for which *GIA India* would reimburse it. This operation of *GIA US* and *GIA India* is so overlapping, and the demarcation between them is very blurred. There is no real difference in the treatment accorded to clients either of *GIA US* or Thailand or India. From the client's perspective, he will be dealing with the GIA conglomerate which basic structure has been formalised as a joint venture business spread across multiple jurisdictions.

28. Mr. Venkatraman submitted that the Hon'ble Supreme Court in the case of ***Hyatt International Southwest Asia Ltd. Vs. Additional***

Director of Income Tax [2025] 176 taxmann.com 783 (SC) ruled in the context of a PE and what would constitute a "place of business". Mr. Venkatraman submitted that in paragraph 13, the Hon'ble Supreme Court held that for a PE to exist, two essential conditions must be satisfied: (i) the place must be at the disposal of the enterprise, and (ii) the business of the enterprise must be carried on through that place. The disposal test is pivotal, meaning thereby that the enterprise must have a right to use the premises in such a way that enables it to carry on its business activities. According to Mr. Venkatraman, in the facts of the present case, *GIA India* takes orders from customers to carry out the grading services upto 1.99 carats and for 2 carats and more, uses the services of *GIA US*. Further, *GIA US* exercises strategic, operational and financial control over *GIA India*. Further, there is a continuous business relationship between *GIA US* and *GIA India* to establish the factum of a business connection. All these factors would clearly go to show that *GIA India* is the PE of *GIA US* in India. Therefore, the ITAT completely went wrong in coming to the conclusion that *GIA US* does not have a PE in India. He, therefore, submitted that as far as questions (d) to (g) are concerned, the same also be answered in the negative, and in favour of the Revenue and against the Assessee.

SUBMISSIONS OF THE RESPONDENT *(GIA US)*:

29. On the other hand, Mr. Mistri, the learned Senior Counsel appearing for the Respondent (*GIA US)* submitted that when one looks at the facts of the present case, the issue is whether under the IT Act/India-US DTAA, *GIA US* can be taxed on royalties as finally paid to it of Rs.49,08,99,451/- (real income of the Assessee) or on the amount of Rs.68,53,46,239/- which was the amount initially received by *GIA US* from *GIA India* towards royalty for A.Y. 2011-2012. He submitted that admittedly, out of the initial amount of Rs.68,53,46,239/- [received by the *GIA US* from *GIA India*], a sum of Rs.19,44,46,788/- was undisputably refunded by it to *GIA India* on 18th July 2018. Once this is the case, it is only the real income of *GIA US*, namely the sum of Rs.49,08,99,451/- (Rs. 68,53,46,239 - Rs. 19,44,46,788) can be brought to tax in India. Mr. Mistri submitted that as per the India-US DTAA, and more particularly in terms of Article 12 thereof, what can be brought to tax in India are royalties "paid" to *GIA US* by *GIA India*. He submitted that the word "paid" denotes only that amount which is actually and eventually paid i.e. the amount that remains or is by agreement with *GIA India*, retained by *GIA US*. The clear provisions of the India-US DTAA and the well settled position under the IT Act provide that only the retained amount that *GIA US* is entitled to, can be regarded as its income chargeable to tax. What was received initially but thereafter returned cannot

be regarded as "paid" to *GIA US*. By the plain common meaning of the word and use of this terminology, the DTAA incorporates the doctrine of real income. In support of the proposition that only the real income can be brought to tax, Mr. Mistri placed reliance on the following decisions:-

(a) Godhra Electricity Co. Ltd. Vs. CIT (1997) 225 ITR 746 (SC)

(b) CIT Vs. Bokaro Steel Ltd. (1999) 236 ITR 315 (SC)

(c) CIT Vs. Lok Housing & Construction Ltd. (2015) 58 taxmann.com 179 (Bom)

(d) FGP Ltd. Vs. CIT (2010) 326 ITR 444 (Bom)

(e) CIT Vs. M.P. Audyogik Kendra Vikas Nigam (Raipur) Ltd. (1997) 227 ITR 799 (MP)

(f) H.M. Kashiparekh & Co. Ltd. Vs. CIT (1960) 39 ITR 706 (Bom)

30. Mr. Mistri submitted that the ITAT has, in great detail, dealt with the doctrine of real income in its impugned judgment and order dated 30th April 2021. After a detailed examination of the facts, the ITAT held that there can be no way in which an Assessee can be taxed in respect of that part of the receipt of income which the Assessee has bonafide refunded to the payer. As far as bonafides of the Respondent (*GIA US*) are concerned, the same can hardly be disputed, was the submission. The facts of the present case clearly bear out that even before any transfer pricing reference was made

either in the case of *GIA India* or *GIA US*, in order to ensure that there is certainty and there are no disputes going forward with the Income-tax Department, on 25th March 2013, *GIA India* filed an application under Section 92CC to reach an agreement *inter alia* on the quantum of royalty to be paid by *GIA India* to *GIA US*. Mr. Mistri submitted that it is important to note that the provisions of Sections 92CC to 92CD (Advance Pricing Agreement provisions) were introduced on 1st July 2012 and the application was made by *GIA India* shortly thereafter on 25th March 2013. It is not as if the transfer pricing provisions were already invoked, and with the fear of getting caught, that *GIA India* made the application for entering into an APA. In these circumstances, Mr. Mistri submitted that the finding of the ITAT that the Assessee (*GIA US)* bonafide refunded the excess amount to *GIA India,* in terms of the APA entered into between *GIA India* and the CBDT, cannot be faulted or called into question. Mr. Mistri submitted that it is now a well settled position that in order for income to be taxed in the hands of the Assessee, it must be the real income which the Assessee has actually earned in reality and not merely any hypothetical income which the Assessee could have earned but in fact did not earn.

31. Mr. Mistri submitted that the Revenue has attempted to cloud the issues with extraneous contentions regarding transfer pricing provisions.

He submitted that the Revenue unfortunately, is of the view that (i) transfer pricing provisions need to be considered and (ii) on consideration thereof, *GIA US*' claim be rejected. Mr. Mistri submitted that both these contentions are utterly erroneous and completely misconceived, as more particularly held by the ITAT in the impugned order.

32. Mr. Mistri submitted that the reliance placed by the Revenue on Section 92(3) is wholly misplaced. The *sine qua non* for the application of Section 92(3) is that a computation of income should be made under sub-section (1) in the case of the same person to whom Section 92(3) is sought to be applied. It is only if a person is subject to a computation under Section 92(1) that any question can arise as to whether such computation has the effect of reducing the income chargeable to tax, nevertheless, in the case of the same person. He submitted that the Revenue is completely confused when it seeks to rely upon a Section 92(1) computation in the case of *GIA India* and then applies Section 92(3) to *GIA US.* This is completely unstateable and patently erroneous from a plain reading of Section 92(1). Mr. Mistri submitted that Section 92 only proscribes a downward adjustment in a case where a reduction in income is claimed without repayment of the excess. Section 92(3) could have no application in the present case where the differential royalty of Rs.19,44,46,788/- has been repaid by *GIA US*, and its

claim is based solely on that factor. Mr. Mistri submitted that in the present case, by the APA entered into with *GIA India* [which is approved/signed by the Government of India], the royalty price now paid/received by and between *GIA US* and *GIA India* is at a price which, by operation of law, cannot be considered/questioned as being different from the Arm's Length Price (ALP). Accordingly, all transfer pricing provisions cannot be applied once an APA has been entered into with the CBDT.

33. Mr. Mistri submitted that the reliance placed on the second proviso to Section 92C(4) is also wholly misplaced. The second proviso to Section 92C(4) applies only in case of a transfer pricing adjustment and not where a variation/adjustment of any other type (such as pursuant to an APA) is made. He submitted that this issue is no longer *res integra* and has been clearly decided by the Hon'ble Karnataka High Court in the case of ***PCIT Vs. EYGBS (India) (P) Ltd. [(2025) 180 taxmann.com 681]***. Mr. Mistri fairly pointed out that though this decision was dealing with the first proviso to Section 92C(4), the ratio laid down therein would equally apply even to the second proviso to Section 92C(4), and which was pressed into service by the Revenue. Mr. Mistri submitted that the rationale for providing for an APA is to remove any uncertainty as to the determination of income of an Assessee engaged in international transactions with Associated Enterprises. Where the

Assessee declares his income based on the ALP determined on the basis of an APA, there is a statutory bar on the AO/TPO to enhance the income under the transfer pricing provisions because the transaction price as per the APA conforms to the ALP. In these circumstances, there can be no question of Section 92C(4) or any of its provisos being made applicable.

34. Mr. Mistri submitted that where the ALP is determined by an APA, no adjustment can be made contrary thereto, either for future years or the roll back period. In other words, for all the Assessment Years that are covered by the APA, the ALP would have to be determined on the basis of the APA. In the present case, for all the Assessment Years in question, and since in the present case we are referring to the A.Y. 2011-2012, the ALP determined for the royalty to be paid by the *GIA India* to *GIA US* for this Assessment Year, was Rs.49,08,99,451/-. Hence, what can be brought to tax in India is only Rs.49,08,99,451/-, and not the amount initially received by *GIA US* from *GIA India* of Rs.68,53,46,239/-, especially when the excess amount of Rs.19,44,46,788/- was refunded back to *GIA India.*

35. As far as the decision relied upon by the Revenue in the case of *Kishinchand Chellaram (supra)* is concerned, Mr. Mistri submitted that the same is clearly distinguishable on the facts. He submitted that in this case,

even though the shareholder was compelled to return the dividend, the fact of payment of the dividend was not (and in view of Section 16 could not be) obliterated, but there was a separate event of its repayment. It is in this light the Hon'ble Supreme Court held that in view of the deeming provisions that the dividend became income of the year in which it was declared/paid. He submitted that the factual situation in the present case is completely different and hence, the aforesaid decision can have no application. In any event, Mr. Mistri submitted that much water has flown since the decision rendered in *Kishinchand Chellaram (supra),* and now it is well settled that (i) only real income can be taxed and (ii) claims can be made before the ITAT by raising additional grounds, if proceedings are pending. This is clearly laid down by the Hon'ble Supreme Court in the case of ***National Thermal Power Co. Ltd. Vs. Commissioner of Income-tax [1998] 229 ITR 383 (SC)***.

36. Mr. Mistri lastly submitted that the argument regarding "secondary adjustment" is wholly misplaced, as the question of making a secondary adjustment can only arise in the case of *GIA India* and never in the case of *GIA US*, as is sought to be argued. This is clear from the explicit language of Section 92CE(1). The question of secondary adjustment would only arise if the excess monies representing the primary adjustment are not repatriated to India within the prescribed time. In the present case,

admittedly, excess monies have been repatriated within the prescribed time limit. In any event, the definition of the word "secondary adjustment" is merely a description of what the secondary adjustment is, and the said provision does not impose any obligation on *GIA US* to make any adjustment in its books. However, since the amount of Rs.19,44,46,788/- was actually paid by *GIA US,* an entry in its books maintained in the USA would certainly have been made. Mr. Mistri submitted that the requirement of secondary adjustment can only apply to a foreign enterprise which maintains books of account in India, e.g. an enterprise having a PE or a fixed base in India. It cannot be applicable to an entity like *GIA US* which does not have a PE in India and is otherwise not required to maintain books of account in India. Mr. Mistri pointed out that in fact on the issue of secondary adjustment, the Tribunal has given its discussion and findings in paragraphs 18 to 20 thereof and which Mr. Mistri once again reiterates before us. For all these reasons, Mr. Mistri submitted that questions (a) to (c) to be answered in the affirmative and in favour of the Assessee and against the Revenue.

37. As far as the *PE issue* [questions (d) to (g) and the additional question for A.Y. 2017-2018] is concerned, Mr. Mistri submitted that the same does not give rise to any substantial question of law. In this regard, Mr. Mistri took us through the factual findings rendered by the ITAT in its order

dated 21st June 2019 (for A.Y. 2010-2011) and submitted that the factual findings rendered are in conformity with the facts placed before the ITAT. He submitted that it is not even the case of the Revenue that these factual findings are in any way perverse or contrary to the facts on record. In these circumstances, he submitted that as far as the *PE issue* is concerned, the same does not give rise to any substantial question of law and hence are not required to be entertained at all.

FINDINGS:-

38. We have heard the learned counsel for the parties at length. We have also perused the papers and proceedings in the above Appeals including the written submissions tendered by the parties.

39. As mentioned earlier, in the present Appeals, there are two issues that need to be decided. The first issue is regarding the quantum of royalty that can be brought to tax in India in the hands of *GIA US [questions (a) to (c) reproduced earlier]*. The second issue is whether *GIA India* is a PE of *GIA US* in India in terms of Article 5 of the India-US DTAA *[questions (d) to (g) reproduced earlier as well as the additional question raised in A.Y.2017-18 and reproduced earlier]*. We will deal with these issues independently.

REASONING AND CONCLUSIONS ON THE PE ISSUE:

40. Since these are the two issues that need to be decided, we will first focus our attention on the issue whether the *GIA India* is a PE of *GIA US* in India, in terms of Article 5 of the India-US DTAA. For the Assessment Year 2011-2012 (and the other Assessment Years which we are considering), the ITAT, on the PE issue, only followed its earlier order passed for A.Y. 2010-2011. It would, therefore, be necessary to see the findings of the ITAT for A.Y. 2010-2011. The ITAT, in its order dated 21st June 2019 (for A.Y. 2010-2011), carefully considered the submissions of the Department as well as those of the Assessee (*GIA US*) in relation to whether *GIA India* was a PE of *GIA US,* in India. The discussion of the ITAT on this aspect can be found in paragraphs 9 to 18. To put it in a nutshell, the ITAT factually found that the transaction of grading services between *GIA US* and *GIA India* could not be considered to be in the nature of a joint venture since *GIA India* had its own independent expertise. It was only due to its technology/capacity constraints that *GIA India* forwarded stones to *GIA US* for grading purposes. The ITAT, after examining the facts, came to the conclusion that the arrangement between *GIA India* and *GIA US* was not one where each party contributes its share in order to undertake the economic activity which is subject to joint control. In fact, the arrangement was akin to an assignment or sub-

contracting of grading services by *GIA India* to *GIA US*, whenever *GIA India* did not have the requisite expertise, technology or capacity for carrying out grading services. The ITAT further noted that the aforesaid arrangement was also accepted as a mere rendering of grading services by the Transfer Pricing Officer, both in the case of *GIA India* as well as *GIA US*.

41. With this background in mind, the ITAT first examined whether *GIA India* can be termed as a "fixed place" PE of *GIA US* in terms of Article 5(1) of the India-US DTAA. As per Article 5(1), a fixed place PE arose when the foreign entity had a fixed place through which its business was wholly or partly carried on. The ITAT, being the last fact-finding authority, after examining the facts, came to the conclusion that, in the present case, there was no joint venture arrangement between *GIA US* and *GIA India* vis-à-vis gem grading services rendered by *GIA US* to *GIA India*. To come to this conclusion, ITAT found that *GIA India*, which enters into an agreement with its client, bears all the risk, including credit risks, client-facing risks, etc., and also *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 facilities of *GIA US*. Looking at these facts, the ITAT found that the economic risks of gem grading services rendered by *GIA US* vis-à-vis stones/diamonds of the customers of *GIA India* were borne by *GIA India*, and hence there was

no joint venture arrangement between *GIA US* and *GIA India*. The ITAT also took into consideration the provisions of Article 5(6) of India-US DTAA, which provided that the mere fact that a company has a controlling interest in the other company did not, by itself, without anything more, construe the other company to be its PE. The ITAT therefore found that *GIA US* does not have a "fixed place" PE in India. To come to this finding, the ITAT also took support of a decision of the Delhi High Court in the case of ***DIT Vs. E-Funds IT Solution [(2014) 364 ITR 256 (Delhi)]***, and which was affirmed by the Hon'ble Supreme Court in ***(2017) 399 ITR 34 (SC),*** where the facts were very similar to the facts in the case before the ITAT.

42. Thereafter, the ITAT also went on to examine whether under Article 5(1) of the India-US DTAA, *GIA India* can be termed as a "service PE" of *GIA US*. The ITAT found that a service PE arises only on the furnishing of services in India by *GIA US* through employees or other personnel, but only if the activities of that nature continue in India for periods aggregating to more than 90 days within any twelve-month period or the services are performed within India for a related enterprise. The ITAT, on examining the facts, came to the conclusion that *GIA US* renders grading services and management services to *GIA India*. In fact, two 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 the control and supervision of *GIA India*. After examining the facts, the ITAT found that no "service PE" is created in India in terms of Article 5 of the India-US DTAA. In fact, the ITAT once again relied upon the decision of the Delhi High Court in *E-Funds IT Solution (supra)* where it was held that the 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 the control and supervision of e-Fund India. In the instant case, since the grading services were rendered outside India and none of the employees/personnel of *GIA US* had visited India, the service PE provisions were not triggered in the present case, was the finding of the ITAT.

43. Thereafter, the ITAT also went on to examine whether an "agency PE" was created in terms of Article 5(4) of the India-US DTAA. The ITAT, after examining such provisions, came to the conclusion that 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 US, then 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 goods or merchandise; or (c) he habitually secures those orders in India wholly or almost wholly for the enterprise. The Tribunal also noted the provisions of Article 5(5), which stipulates that an agency PE excludes 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 independent status acts in the ordinary course of business. Having examined the provisions of Articles 5(4) and 5(5), the ITAT thereafter applied those provisions to the facts of the present case. The ITAT came to the conclusion that *GIA India* is an independent and separate legal entity in India, which is engaged in rendering grading services. Further, considering the functions and the risks assumed by *GIA India* vis-à-vis its business activities in India, the ITAT found that *GIA India* is an independent entity which is rendering grading services to its clients in India and bears all the service risks, as well as the client-facing risks vis-à-vis the stones sent to *GIA US* for grading purposes. In these facts, the ITAT found that *GIA India* is not acting in India on behalf of *GIA US*. Further, *GIA India* does not have any

authority to conclude contracts on behalf of the *GIA US*, and neither has it done so. Further, it has not secured any orders for *GIA US* in India. Looking at these facts, and also taking into consideration the transfer pricing study report and the fact that the Transfer Pricing Officer has also accepted the functional and risk analysis in the case of *GIA India* and *GIA US*, the ITAT came to the conclusion that *GIA India* cannot be regarded as an "agency PE" of *GIA US* in India.

44. Before concluding on this issue, the ITAT also noted that a similar query, i.e. why *GIA India* should not be construed as a PE of *GIA US*, was raised for A.Y. 2009-2010. However, after considering the detailed response furnished by *GIA US* (vide its reply dated 2nd November 2012), no addition whatsoever was made, and which fact is evident from the Assessment Order for A.Y. 2009-2010 dated 26th March 2013. The ITAT therefore held that it was all the more incumbent upon the Revenue in A.Y. 2010-2011 to discharge its onus as to why a different stand was being adopted, especially in the face of the facts that the nature and source of the income in question remained the same. On this ground also, the ITAT was not satisfied with the argument of the Revenue that *GIA India* is a PE of *GIA US* in India.

45. Having gone through this order in great detail, we find that the ITAT [for A.Y. 2010-2011] has very carefully examined the facts and thereafter come to the conclusion that *GIA India* is not a PE of *GIA US* in India. When one looks at the factual finding rendered by the ITAT (which is the last fact-finding authority), we are clearly of the view that in the facts of the present case, *GIA India* could not be termed as a PE of *GIA US* in India, as it clearly (a) did not have a fixed place of business in India; (b) was not a service PE as contemplated under Article 5(1); and (c) was not an agency PE as contemplated under Article 5(4) of the India-US DTAA. From the facts narrated, it is clear that *GIA India* was an independent, separate legal entity rendering grading services to its clients upto a particular capacity (at the relevant time upto 1.99 carats). If the stones to be graded were of a higher capacity (more than 1.99 carats), it is only in those circumstances that *GIA India* would forward those stones for grading purposes to *GIA US* or to other enterprises of the GIA Group, depending upon the service requirement. These were independent and individual transactions and can never be termed as one which could take the colour of a joint venture arrangement, a service PE or an agency PE as contemplated under Article 5 of the India-US DTAA. This is more so when one takes into consideration that the entire risk in relation to the stones forwarded by *GIA India* to *GIA US* on behalf of its own

customers was borne entirely by *GIA India*, and no risk was attached whatsoever to *GIA US*.

46. Once these are the facts, and it has not even been contended before us, and correctly so, that these factual findings are either perverse or contrary to the record, we are clearly of the view that the questions raised by the Revenue on the *PE issue*, namely questions (d) to (g), as well as the additional question raised in A.Y. 2017-2018, do not give rise to any substantial question of law requiring an answer by this Court. Hence, questions (d) to (g) reproduced earlier, as well as the additional question raised in A.Y. 2017-2018, also reproduced earlier, are not entertained.

REASONING AND CONCLUSIONS ON THE ROYALTY ISSUE:-

47. As mentioned earlier, the *royalty issue* is basically regarding the quantum of royalty that can be brought to tax in India, which was paid by *GIA India* to *GIA US*. On this issue, questions (a) to (c) have been framed by the Revenue. We hereby admit the appeals for A.Y. 2011-12, A.Y. 2012-13, A.Y. 2013-14, A.Y. 2014-15, A.Y. 2015-16, and A.Y. 2016-17 on questions (a) to (c), and with the consent of the parties, the aforesaid appeals are heard finally at the admission stage itself.

48. It is the undisputed position before us that *GIA US* is an Associated Enterprise of *GIA India*. To put it in a nutshell, it is the argument of the Revenue that for A.Y. 2011-2012, *GIA US* filed its Return of Income declaring a total income of Rs.68,53,46,239/-, which was the royalty received from *GIA India* and which was offered to tax. Since the case of *GIA US* was selected for scrutiny, and the transaction being an international transaction, a reference was made by the Assessing Officer of *GIA US* to the Transfer Pricing Officer for the computation of the Arm's Length Price (ALP). Thereafter, the Transfer Pricing Officer passed his order proposing a NIL adjustment. Accordingly, the Assessing Officer of *GIA US* passed a draft Assessment Order under Section 144C(1) read with Section 143(3), which was initially objected to by *GIA US* before the DRP. Despite the objections, the Dispute Resolution Panel (DRP) issued its directions on 27th October 2015. Thereafter, in line with the directions issued by the DRP, the Assessing Officer passed a final Assessment Order and assessed *GIA US*' total income at Rs.72,88,67,984/-. This was on the basis that *GIA US* has a Permanent Establishment in India, and therefore, its entire income, including the royalty received, was liable to be taxed in India at 42.23%. Aggrieved by this final Assessment Order, *GIA US* filed an Appeal before the ITAT on 25th January 2016. Long before all this, *GIA India* had filed an application (dated 22nd March 2013) for entering into an Advance Pricing Agreement (APA) with the

Central Board of Direct Taxes (CBDT) under Section 92CC of the IT Act for A.Y. 2014-2015 to 2018-2019. Thereafter, on 30th March 2015, *GIA India* filed another application for the rollback period, namely for A.Y. 2010-2011 to 2013-2014. As mentioned earlier, after a prolonged negotiation, an APA was entered into on 7th May 2018 between *GIA India* and the CBDT *inter alia* determining the ALP of the royalty payable by *GIA India* to *GIA US*, and also requiring the excess royalty received by *GIA US* to be repaid back to *GIA India*. It is on this basis that *GIA US* refunded to *GIA India* the excess amount of royalty in the amount of Rs.19,44,46,788/-. Since the excess amount was refunded, it was *GIA US*' case that now what could be taxed in India under Article 12 of the India-US DTAA (Article relating to royalty and fees for technical services) was Rs.49,08,99,451/- [i.e. Rs.68,53,46,239 minus Rs.19,44,46,788]. It therefore raised an additional ground in the Appeal filed before the ITAT, which was pending. This was allowed by the ITAT in the order dated 30th April 2021. According to the Revenue, this could not be done for two reasons: (i) as elaborated earlier, the transfer pricing provisions did not permit any downward adjustment in the income; and (ii) such a ground could not be raised and relief sought in an Appeal that was filed prior to the APA being entered into between *GIA India* and the CBDT.

49. On the other hand, it was the argument of *GIA US* that under the India-US DTAA, and more particularly in terms of Article 12 thereof, what could be brought to tax in India are royalties "paid" to *GIA US* by *GIA India*. This would effectively mean that only the amount that *GIA US* ultimately retained, can be regarded as its income chargeable to tax. What was initially received by *GIA US* but thereafter returned (partly), cannot be regarded as "paid" to *GIA US*. Since, admittedly, the amount retained by *GIA US* is the amount of Rs.49,08,99,451/-, it is only that figure that is "paid" and can be brought to tax in India, and not the amount initially received by it of Rs.68,53,46,239/-.

50. To understand these rival contentions, we will first examine whether the reliance placed on the transfer pricing provisions by the Revenue is of any assistance to them to contend that the amount that has to be brought to tax in India is Rs.68,53,46,239/- and not Rs.49,08,99,451/-. The Revenue placed heavy reliance on Sections 92, 92C, 92CC, 92CD and 92CE of the IT Act to contend that what is to be brought to tax is the amount of Rs.68,53,46,239/- and not Rs.49,08,99,451/-.

51. All the Sections referred to above fall under Chapter X of the IT Act, which relates to *"Special Provisions Relating to Avoidance of Tax"*.

Section 92 deals with the computation of income from international transactions having regard to the ALP and reads as under:-

> *"92. (1) Any income arising from an international transaction shall be computed having regard to the arm's length price.*
>
> *Explanation.-For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.*
>
> *(2) Where in an international transaction or specified domestic transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.*
>
> *(2A) Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price.*
>
> *(3) The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or sub-section (2A) or the determination of the allowance for any expense or interest under sub-section (1) or sub-section (2A), or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub-section (2A), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into."*
>
> *(emphasis supplied)*

52. Section 92(1) stipulates that any income arising from an international transaction shall be computed having regard to the ALP. The determination of the ALP is to be done by the Transfer Pricing Officer under Section 92CA on a reference being made to him by the Assessing Officer. Sub-section (3) of Section 92 provides that the provisions of Section 92 shall not apply in a case where the computation of income under sub-section (1) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of accounts in respect of the previous year in which the international transaction was entered into. Heavy reliance was placed on sub-section (3) to contend that it is because of this provision that *GIA US* could not now contend that the income chargeable to tax was Rs.49,08,99,451/-, where it had initially offered to tax the amount of Rs.68,53,46,239/-.

53. At the outset, we fail to understand how these provisions can be of any assistance to the argument of the Revenue. On reading of the aforesaid Section, we are clearly of the view that for Section 92(3) to apply, computation of income should be made under sub-section (1) in the case of the same person to whom Section 92(3) is sought to be applied. It is only if a person is subject to the computation under Section 92(1) that any question can arise as to whether such computation has the effect of reducing the

income chargeable to tax, nevertheless, in the case of the same person. Section 92(1) cannot be relied upon for computation in the case of one person and then apply Section 92(3) to another person. This, according to us, is patently erroneous from a plain reading of Section 92. Further, we find force in the argument canvassed by Mr. Mistri that Section 92 only prohibits a downward adjustment in a case where a reduction in income is claimed without repayment of excess. Section 92(3) could have no application in the present case, where the differential royalty of Rs.19,44,46,788/- has been repaid by *GIA US* to *GIA India*, and its claim is based solely on that factor.

54. The next provision that was relied upon by the Revenue was Section 92C, and more particularly, Section 92C(4). Section 92C deals with the computation of the ALP. Sub-section (4) of Section 92C stipulates that where the ALP (Arm's Length Price) is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the Assessee having regard to the ALP so determined. For the sake of convenience, Section 92C(3) and (4) are reproduced hereunder:-

> *"(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that-*
>
> > *(a) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or*

(b) any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or

(c) the information or data used in computation of the arm's length price is not reliable or correct; or

(d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

***Provided** that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.*

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

***Provided** that no deduction under section 10A or section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:*

***Provided further** that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIB, the income of the other associated enterprise shall not be*

recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise."

(emphasis supplied)

55. As can be seen from the aforesaid provisions, sub-section (3) stipulates that where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that (a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2) of Section 92C; or (b) any information and document relating to any international transaction have not been kept or maintained by the Assessee in accordance with the provisions contained in sub-section (1) of Section 92D or the rules made in that behalf; or (c) the information or data used in the computation of the Arm's Length Price is not reliable or correct; or (d) the Assessee has failed to furnish, within the specified time, any information or document which he was required to be furnished by a notice issued under Section 92D(3); the Assessing Officer may proceed to determine the ALP in relation to the said international transaction on the basis of such material or information or document available with him.

56. Sub-section (4) stipulates that where the ALP is determined by the Assessing Officer [under sub-section (3)], he may compute the total

income of the Assessee having regard to the ALP. What is important for our purposes, and on which much stress was laid by the Revenue, was the second proviso to Section 92C(4). The second proviso to Section 92C(4) stipulates that where the total income of an Associated Enterprise (*GIA India*) is computed under this sub-section on determination of Arm's Length Price paid to another Associated Enterprise (*GIA US*) from which tax has been deducted or was deductible under the provisions of Chapter XVIIB, the income of the other Associated Enterprise (*GIA US*) shall not be recomputed by reason of such determination of Arm's Length Price in the case of the first-mentioned Enterprise (*GIA India*).

57. On a plain reading of the second proviso of Section 92C(4), at first blush, the argument canvassed by the Revenue appears to carry much weight. However, we find that in the facts of the present case, Section 92C(4) would not apply to *GIA US*. This is for the simple reason that in the present case, there is already an Advance Pricing Agreement (APA) that has been entered into between *GIA India* and CBDT. That APA now governs the determination of the ALP (Arm's Length Price) for all the years that form the subject matter of the APA. Once an APA has been entered into, the ALP has to be determined solely on the basis of the APA. The second proviso to Section 92C(4) applies only in a case where a transfer pricing adjustment is

made by the Assessing Officer, namely where the ALP is determined by the Assessing Officer under Section 92C(3), and not where a variation or adjustment is made pursuant to an APA.

58. In this regard, the reliance placed by Mr. Mistri on the decision of the Karnataka High Court in the case of ***Principal Commissioner of Income-tax Vs. EYGBS (India) (P.) Ltd. [2025] 180 taxmann.com 681 (Karnataka)*** is well founded. The question that was being considered by the Karnataka High Court was whether the Tribunal's order could be said to be perverse in confirming the order of the first appellate authority holding that the voluntary adjustment made to the Arm's Length Price pursuant to the APA is eligible for deduction under Section 10AA of the Act without appreciating that the Assessee had declared TP adjustments pursuant to the APA in its computation of income only in anticipation of TP adjustments by the Transfer Pricing Officer and to avoid the rigors of Section 92C(4) of the Act, and consequently, the enhanced benefits under Section 10AA of the Act. From this question, it is clear that what the Karnataka High Court was considering was the first proviso to Section 92C(4) and not the second proviso to Section 92C(4). Whilst examining this aspect, the Karnataka High Court held that the TP adjustments are made pursuant to the APA entered into by the Assessee with the CBDT. Section 92CC of the Act empowers the

CBDT to enter into an APA with any person for determining the Arm's Length Price or specify the manner in which the Arm's Length Price is to be determined, in relation to an international transaction to be entered into by that person. After considering the provisions of Section 92CD, the Karnataka High Court held that the scheme of providing for an APA is to remove any uncertainty as to the determination of income of an Assessee engaged in international transactions with its Associated Enterprises. The Assessee was required to declare his income in accordance with the APA. Except in certain cases, where there was a change in law and facts, or the agreement is occasioned by fraud or misrepresentation, the APA would be binding. Thereafter, the Karnataka High Court examined the provisions of Section 92C(1) as well as provisions of Section 92C(4) along with its two provisos and came to the conclusion that it was apparent from a plain reading of sub-section (4) of Section 92C that the same would be inapplicable. It held that the said sub-section requires the Assessing Officer to compute the total income, having regard to the ALP determined by the Assessing Officer under sub-section (3) of Section 92C. In turn, Section 92C(3) provided that the Assessing Officer can proceed to determine the Arm's Length Price only in cases where he is of the opinion that (a) the price charged or paid in an international transaction, has not been determined in accordance with sub-sections (1) and (2) of Section 92C; or (b) that information and

documentation relating to the international transaction has not been maintained as mandatorily required; or (c) that the information or data for computing the ALP is unreliable; or there is failure on the part of the Assessee to furnish any information or document required to be furnished along with the notice. The Karnataka High Court held that in a case where the Assessee voluntarily computes the Arm's Length Price pursuant to an APA entered into with CBDT, none of the conditions as set out in sub-section (3) of Section 92C are attracted, and consequently, sub-section (4) of Section 92C is also not attracted. The relevant portion of the Karnataka High Court's decision reads thus:-

> "*14. The questions of law in the present appeals as projected by the Revenue, are similarly worded. We consider it apposite to set out the questions of law as projected in ITA No.106/2025. The same are reproduced below:*
>
> > *"(1) "Whether on facts and circumstances of the case, the Tribunal's order can be said as perverse in nature in confirming the order of first appellate authority holding that voluntary adjustment made to ALP pursuant to APA is eligible for deduction under section 10AA of the Act without appreciating that the assessee has declared TP adjustments pursuant to APA in its computation of income only in anticipation of TP adjustments by the Transfer Pricing Officer and to avoid rigors of Section 92C(4) of the Act and consequently enhanced benefits under section 10AA of the Act"?*
>
> **********
>
> *17. It is material to note that the TP adjustments are made pursuant to the APA entered into by the Assessee with CBDT. Section 92CC of the Act empowers the CBDT (Central Board of Direct Taxes) to enter into an APA (Advance Pricing Agreement)*

with any person for determining an ALP or specify the manner in which the ALP is to be determined, in relation to an international transaction to be entered into by that person and income referred to in Section 9(1)(i) of the Act or the manner in which said income is to be determined as is reasonably attributable to the operations carried out in India.

18. It is relevant to refer to Sub-sections (1) and (2) of Section 92CD of the Act. The same reads as under:

> *"92CD. (1) Notwithstanding anything to the contrary contained in Section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of Section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement.*
>
> *(2) Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished under Section 139."*

19. The provisions of Sections 92CD(1) of the Act are unambiguous and even if a return has been filed prior to an Assessee entering into an APA, he is entitled to furnish a modified return declaring his income in accordance with the terms of the APA. Subject to certain exceptions, the APA is binding both on the Assessee and the Revenue.

20. It is clear that the scheme of providing for an APA is to remove any uncertainty as to the determination of an income of an Assessee engaged in international transactions with associated enterprises. The Assessee is required to declare his income in accordance with the APA. Except in certain cases, where there is a change in law and facts or the agreement is occasioned by fraud or misrepresentation, the APA would be binding. Subsections (5), (6) and (7) of Section 92CC of the Act provide for the same in unambiguous terms. The said Sub-sections are reproduced below:

> *"(5) The advance pricing agreement entered into shall be binding—*

(a) on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

(b) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(6) The agreement referred to in sub-section (1) shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

(7) The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts."

21. We also consider it apposite to set out Section 92C of the Act, in its entirety.

"92C. (1) The arm's length price in relation to an international transaction [or specified domestic transaction] shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:-

(a) comparable uncontrolled price method;

(b) resale price method;

(c) cost plus method;

(4) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in subsection (1) shall be applied for determination of arm's length price, in the manner as may be prescribed:

Provided *that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:*

Provided further *that if the variation between the arm's length price so determined and price at which the international transaction [or specified domestic transaction] has actually been undertaken does not exceed such percentage not exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price:]*

Provided also *that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the first and second proviso shall not apply.*

Explanation-For the removal of doubts, it is hereby clarified that the provisions of the second proviso shall also be applicable to all assessment or reassessment proceedings pending before an Assessing Officer as on the 1st day of October, 2009.

(2A) Where the first proviso to sub-section (2) as it stood before its amendment by the Finance (No. 2) Act, 2009 (33 of 2009), is applicable in respect of an international transaction for an assessment year and the variation between the arithmetical mean referred to in the said proviso and the price at which such transaction has actually been undertaken exceeds five percent of the arithmetical mean, then, the assessee shall not be entitled to exercise the option as referred to in the said proviso.

(2B) Nothing contained in sub-section (2A) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154 for any

assessment year the proceedings of which have been completed before the 1st day of October, 2009.

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that-

(a) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or

(b) any information and document relating to an international transaction specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or

(c) the information or data used in computation of the arm's length price is not reliable or correct; or

(d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with subsections (1) and (2), on the basis of such material or information or document available with him:

Provided *that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.*

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

> ***Provided*** *that no deduction under section 10A "or section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:*
>
> ***Provided further*** *that where the total income of an associated enterprise is computed under this subsection in determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.*

22. It is apparent from a plain reading of sub-section (4) of Section 92C of the Act that the same is inapplicable. The said subsection requires the AO to compute the total income, having regard to the ALP determined by the AO under sub-section (3) of Section 92-C of the Act.

23. Sub-section (3) of Section 92C provides that the AO can proceed to determine the ALP only in cases he is of the opinion on the basis of material that (a) the price charged or paid in international transaction, has not been determined in accordance with sub-sections (1) and (2) of Section 92-C; or (b) that information and documentation relating to the international transaction has not been maintained as mandatorily required; or (c) that the information or data for computing the ALP is unreliable; or there is failure on the part of the assessee to furnish any information or document required to be furnished along with the notice.

24. It is apparent that in a case where the assessee voluntarily computes the ALP pursuant to an APA entered into with CBDT, none of the conditions as set out in sub-section (3) of Section 92C are attracted. It follows that sub-section (4) of Section 92C is not attracted.

25. More importantly, the proviso to sub-section (4) of Section 92C also clearly states that no deduction under Section 10A or 10AA or 10B or under Chapter VI-A of the Act would be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation under the said section. Thus in a case where the assessee voluntarily declares his income

based on the ALP determined on the basis of an APA, there would be no occasion for the AO to enhance the income of the assessee.

26. Absent any enhancement of income, the proviso to subsection (4) of Section 92C is clearly inapplicable."

59. Though we are mindful of the fact that the Karnataka High Court was considering the provisions of the first proviso to Section 92C(4), we find that the ratio of this decision would equally apply even to the second proviso. The second proviso applies only where the total income of an Associated Enterprise (*GIA India*) is computed under Section 92C(4) after determination of the Arm's Length Price [under Section 92C(3)] paid to another Associated Enterprise (*GIA US*) from which tax has been deducted or deductible under Chapter XVIIB. Then, the total income of the other Associated Enterprise (*GIA US*) cannot be recomputed by reason of such determination of the Arm's Length Price in the case of the first-mentioned Enterprise (*GIA India*). Hence, the second proviso would apply only where the ALP is first determined under sub-section (3) of Section 92C and thereafter the total income is computed under sub-section (4) of Section 92C, and not otherwise. It is only when Section 92C(3) comes into play that Section 92C(4) is attracted and consequently its provisos. If the Arm's Length Price is determined on the basis of an APA, Section 92C(3) has no application, and consequently neither does Section 92C(4) or its 2 provisos. We therefore find that though the Karnataka High Court was examining the

first proviso to Section 92C(4), the ratio laid down therein would equally apply to the second proviso to Section 92C(4) as well. Hence, the reliance placed on the second proviso to Section 92C(4) cannot and does not assist the Revenue in contending that *GIA US* ought to be taxed on the amount of Rs.68,53,46,239/- that was initially received by it and offered to tax, and not the amount of Rs. Rs.49,08,99,451/- which is the amount that was ultimately retained by *GIA US* after it refunded the amount of Rs.19,44,46,788/- to *GIA India*.

60. The next provision on which reliance was placed by the Revenue was Section 92CE(3) regarding primary and secondary adjustments to contend that these provisions do not operate to recompute or reduce the taxable income and are confined to the Assessee who has undergone a primary adjustment. To put it in a nutshell, it was the argument that the statute consistently proceeds on the basis of the upward adjustments i.e. adjustments in the hands of the Indian Assessee, without any mirrored downward adjustment in the hands of the counterparty. Section 92CE talks about secondary adjustment in certain cases. Section 92CE(1) stipulates that where a primary adjustment to the transfer price (i) has been made *suo motu* by the Assessee in his Return of Income; (ii) made by the Assessing Officer has been accepted by the Assessee; (iii) is determined by an Advance Pricing

Agreement entered into by the Assessee under Section 92CC on or after 1st April 2017; (iv) is made as per the safe harbour rules framed under Section 92CB; or (v) is arising as a result of resolution of an assessment by way of a mutual agreement procedure under an agreement entered into under Section 90 or Section 90A for avoidance of double taxation, the Assessee shall make a secondary adjustment. Section 92CE reads as under:-

> "*92CE. (1) Where a primary adjustment to transfer price, -*
>
> > *(i) has been made suo motu by the assessee in his return of income;*
> >
> > *(ii) made by the Assessing Officer has been accepted by the assessee;*
> >
> > *(iii) is determined by an advance pricing agreement entered into by the assessee under section 92CC, on or after the 1st day of April, 2017;*
> >
> > *(iv) is made as per the safe harbour rules framed under section 92CB; or*
> >
> > *(v) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or section 90A for avoidance of double taxation,*
>
> *the assessee shall make a secondary adjustment:*
>
> ***Provided*** *that nothing contained in this section shall apply, if,—*
>
> > *(i) the amount of primary adjustment made in any previous year does not exceed one crore rupees; or*
> >
> > *(ii) the primary adjustment is made in respect of an assessment year commencing on or before the 1st day of April, 2016:*

Provided further *that no refund of taxes paid, if any, by virtue of provisions of this sub-section as they stood immediately before their amendment by the Finance (No. 2) Act, 2019 shall be claimed and allowed.*

(2)Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money or part thereof, as the case may be, which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed.

Explanation.—For the removal of doubts, it is hereby clarified that the excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not a resident in India.

(2A) Without prejudice to the provisions of sub-section (2), where the excess money or part thereof has not been repatriated within the prescribed time, the assessee may, at his option, pay additional income-tax at the rate of eighteen per cent on such excess money or part thereof, as the case may be.

(2B) The tax on the excess money or part thereof so paid by the assessee under sub-section (2A) shall be treated as the final payment of tax in respect of the excess money or part thereof not repatriated and no further credit therefor shall be claimed by the assessee or by any other person in respect of the amount of tax so paid.

(2C) No deduction under any other provision of this Act shall be allowed to the assessee in respect of the amount on which tax has been paid in accordance with the provisions of sub-section (2A).

(2D) Where the additional income-tax referred to in sub-section (2A) is paid by the assessee, he shall not be required to make secondary adjustment under sub-section (1) and compute interest under sub-section (2) from the date of payment of such tax.

(3) For the purposes of this section,-

> *(i) "associated enterprise" shall have the meaning assigned to it in sub-section (1) and sub-section (2) of section 92A;*
>
> *(ii) "arm's length price" shall have the meaning assigned to it in clause (ii) of section 92F;*
>
> *(iii) "excess money" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken;*
>
> *(iv) "primary adjustment" to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee;*
>
> *(v) "secondary adjustment" means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.*"

61. We fail to understand how this Section can be of any assistance to the Revenue. All that this Section stipulates is that where a primary adjustment to the transfer price has been made, the Assessee shall make a secondary adjustment. This, in the present case, would apply squarely to *GIA India* and would have no application to *GIA US*. "Secondary adjustment" has been defined in sub-section (3) of Section 92CE to mean an adjustment in the books of account of the Assessee (*GIA India*) and its associated enterprise (*GIA US*) to reflect that the actual allocation of profits between the Assessee

and its Associated Enterprise is consistent with the transfer price determined as a result of the primary adjustment, thereby removing the imbalance between the cash accounts and the actual profit of the Assessee. This provision in no way assists the Revenue in contending that the Revenue can bring to tax the amount of Rs.68,53,46,239/- initially received by *GIA US* from *GIA India* and not the amount of Rs.49,08,99,451/-, which was the amount ultimately retained by *GIA US* towards payment of its royalty because of the APA entered into by *GIA India* with the CBDT. In fact, on this issue, we find that the discussion of ITAT at paragraphs 19 and 20 is the correct understanding regarding primary and secondary adjustments as contemplated in Section 92CE. For the sake of convenience, the same are reproduced as under:-

> "*19. Section 92 CE, as introduced by the Finance Act 2017 w.e.f. 1st April 2018, provides where a primary adjustment to transfer price has been made suo motu by the assessee in his return of income, made by the Assessing Officer has been accepted by the assessee, is determined by an advance pricing agreement entered into by the assessee under section 92CC, on or after the 1st day of April, 2017, is made as per the safe harbour rules framed under section 92CB; or is arising as a result of the resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or section 90A for the avoidance of double taxation, the assessee "shall" make a secondary adjustment. This provision, however, does not apply where primary adjustment does not exceed Rs 1,00,00,000 or where primary adjustment is made in respect of an assessment year prior to the assessment year 2016-17. The way in which secondary adjustment works is like this. Where as a result of a primary adjustment to the transfer price, there is an increase in income or reduction in loss, the excess payment (i.e., amount actually paid minus the arm's length price) will have to be*

repatriated by the foreign AE, or any other AE, within the time prescribed, and, if no such repatriation takes place, (a) the excess amount not so repatriated will be treated as an advance to the AE bearing such interest as may be prescribed; or (b) the assessee, at his option, pay additional income-tax @ 18% on such excess payment or part thereof. Once the assessee so pays the additional income tax @18%, the assessee is not required to make any secondary adjustment under section 92CE(1), and, in that sense, 18% additional income tax is in lieu of inward remittance on account of secondary adjustment. This option of paying 18% as additional income tax was introduced by subsequent amendment in Section 92CE by the Finance Act 2019. While dealing with the introduction of Section 92CE, the Central Board of Direct Taxes, vide circular no. 2/2018, had observed, inter alia, as follows:

> *45.3 In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, a new section 92CE has been inserted in the Income-tax act so as to provide* ***that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price****, has been made suo motu by the assessee in his return of income; or made by the Assessing Officer has been accepted by the assessee; or is determined by an advance pricing agreement entered into by the assessee under section 92CC of the Income-tax Act; or is made as per the safe harbour rules framed under section 92CB of the Income-tax Act; or is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A of the Income-tax Act.*
>
> *45.4 It is also provided that where as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee,* ***the excess money which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed as the income of the assessee; in the manner as may be prescribed.***
>
> *45.5 It is also further provided that such secondary adjustment shall not be carried out if, the amount of*

primary adjustment made in the case of an assessee in any previous year does not exceed one crore rupees or the primary adjustment is made in respect of an assessment year commencing on or before 1st April, 2016.

45.6 Applicability: This amendment takes effect from 1st April, 2018 and will, accordingly, apply from assessment year 2018-19 and subsequent years.

[Emphasis, by underlining, supplied by us]

20. Quite clearly, Section 92CE is in the nature of an additional obligation on the assessee to either repatriate back to India the excess payment made (i.e. actual payment minus the arm's length price) or to pay additional income tax @ 18% thereon. The secondary adjustment under section 92CE is thus not in a vacuum but in the light of the corresponding obligation to either repatriate back that amount to India or pay additional income tax thereon. While proviso to Section 92CE(1) does clarify that the above provisions do not apply where primary adjustments are less than Rs 1 crore or where primary adjustments are made in respect of an assessment year prior to 2016-17, that exception refers to the scheme of this section as a whole because a secondary adjustment under section 92CE(1) is an obligation on the assessee with certain mandatory consequences under section 92CE(2) as also 92CE(2A to 2D), rather than a secondary adjustment simplicitor. Learned CIT(DR) proceeds on the basis that Section 92CE gives certain concession or relief when he treats Section 92CE as "permitting" the secondary adjustments, whereas as a matter of fact, Section 92CE "requires" that the assessee "shall" make the secondary adjustment which being coupled with certain further requirements under section 92CE(2) and 92CE(2A to D), operate in favour of the revenue. Given the scheme of Section 92CE, secondary adjustments are not concessions to an assessee but obligations on the assessee. The proviso to Section 92CE(1) cannot, therefore, be interpreted as a bar on any secondary adjustment by the assessee, even dehors the requirements under section 92CE(1). In any case, Section 92CE has nothing to do with the taxability of correct income in the hands of the foreign AE to which payment for the international transaction has been made, inasmuch as, this provision cannot be seen as a bar on repatriating back the excess payment made (i.e. actual payment minus the arm's length price) even if there was no statutory obligation to do so. In our humble understanding, there was no bar, even in respect of the period prior to insertion of

Section 92CE, on any secondary adjustments being made by parties to a transaction. It is also important to note that so far as the APs are concerned, under rule 10M(1)(vi) of the Income Tax Rules 1962, ***an APA may, amongst other things, include "the conditions, if any, other than provided in the Act or these rules"*** *and, therefore, as long as an APA refers to secondary adjustments, whether specifically permissible under the law or not, these secondary adjustments are to be carried out. It is also important to bear in mind the fact that no secondary adjustment can anyway be unilateral in nature. When an assessee is to raise an invoice on its AE abroad, that invoice is to be accounted for by the entity issuing the invoice as also by the entity receiving the invoice. These two facets of the transactions are two sides of the same coin Section 92CE(3)(v) aptly defines, consistent with the first principles as well, 'secondary adjustment' means* ***an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of the primary adjustment, thereby removing the imbalance between a cash account and actual profit of the assessee."*** *It is, therefore, not correct to say that when an APA requires an assessee to raise debit notes or invoices on its AE abroad, it is open to the AE abroad to ignore those invoices or debit notes and continue with computation of its income dehors these invoices or debit notes, because the said AE is not a party to the APA. The AE may not be party to the APA, yet the impact of the terms of the APA has to be taken note of when these terms affect the AE. That's a reality and cannot be wished away. We, therefore, reject this objection raised by the learned CIT(DR) as well. As for learned CIT(DR)'s observation that* ***"the second proviso to section 92CE(1) stipulates that no refund of taxes paid could be claimed or allowed"****, which suggests that no refund of taxes paid could be claimed or allowed as a result of the secondary adjustment, this observation is wholly misconceived inasmuch as while the second proviso states that* ***"Provided further that no refund of taxes paid, if any, by virtue of provisions of this sub-section as they stood immediately before their amendment by the Finance (No. 2) Act, 2019 shall be claimed and allowed"****, this proviso was quite clearly in specific context of insertion of words "on or after the 1st day of April, 2017" in Section 92CE(1)(iii) by the same Finance Act 2019 which had resulted in the exclusion of rigours of Section 92CE in respect of the cases in which the additional obligations were incurred by the assessee in respect of the APAs concluded even prior to 1st April 2017. All that this proviso meant was that even though the*

assessee may have paid the additional tax, on account of consequences envisaged in Section 92CE(2), with respect to APAs concluded before 1st April 2017, these taxes will not be refunded. In still other words, in our considered view, the practical connotations of the second proviso to Section 92CE(1) was that relief granted by insertion of words "on or after the 1st day of April 2017" in Section 92CE(1)(iii) was with prospective effect. Learned CIT(DR) has been a bit too naive in ignoring the import of words ***"if any, by virtue of provisions of this sub-section as they stood immediately before their amendment by the Finance (No. 2) Act, 2019 shall be claimed and allowed"*** *in the proviso, and, therefore, ended up reading a bit too much into this rather innocuous and unidimensional provision. It is thus not correct to say that, in principle, in terms of the provisions of section 92CE, no refund of taxes could be claimed or allowed on account of secondary adjustments- even if, for example, as in this case, such secondary adjustments end up reducing the income of the foreign AE assesses as a result of partial repatriation of income. A lot of emphasis is then placed by the learned CIT(DR) on the claim that the action of the assessee, in partially refunding the royalty amount to the GIA India, i.e., Indian AE, was voluntary inasmuch as the assessee was not a party to the APA. Nothing, however, turns on this plea. Whether the refund was voluntary or under a legal obligation, it does not really make any difference as long as the refund is bonafide and particularly when its commercial expediency is not, and rightly so, even called into question. None of the objections taken by the DRP or raised by the learned CIT(DR), for the detailed reasons, set out above, really impresses us.*"

62. In light of the aforesaid discussion, we find that the reliance placed on Section 92CE also does not assist the Revenue in their cause. To put it in a nutshell, the transfer pricing provisions discussed earlier do not come to the aid of the Revenue to contend that the amount of Rs.68,53,46,239/- initially received by *GIA US* from *GIA India* is the amount that has to be brought to tax in India and not the amount of

Rs.49,08,99,451/- [which was ultimately retained by *GIA US* after refunding Rs.19,44,46,788] as contended by *GIA US* [the Assessee].

63. This now leaves us to deal with the issue of "real income", which was the main argument of *GIA US* not only before the ITAT but also before us. In the facts of the present case, it is an undisputed position that initially for A.Y. 2011-2012, *GIA US* received from *GIA India* a sum of Rs.68,53,46,239/- as and by way of royalty. It is also undisputed that this amount was offered to tax by *GIA US* by filing its Return of Income on 10th November 2011. It is also undisputed that after prolonged negotiations, on 7th May 2018, an APA was entered into between *GIA India* and the CBDT, which determined the ALP (Arm's Length Price) to be paid by *GIA India* to *GIA US* for all the Assessment Years which formed the subject matter of the APA. One of the critical conditions of this APA was that *GIA India* raises an invoice on *GIA US* to refund to *GIA India* the excess royalty paid by *GIA India* to *GIA US*. It is undisputed that these invoices for all the relevant Assessment Years were raised, and pursuant to the said invoices, the excess amounts have been repaid by *GIA US* to *GIA India*. As far as A.Y. 2011-2012 is concerned, as mentioned earlier, initially the amount of royalty paid by *GIA India* to *GIA US* was Rs.68,53,46,239/-. After the execution of the APA [between *GIA India* and the CBDT], *GIA US* refunded to *GIA India* the excess

amount of royalty paid, namely, Rs.19,44,46,788/-. It is on this basis that *GIA US* contends that what can be brought to tax in India in the hands of *GIA US* is only the sum of Rs.49,08,99,451/- (i.e. Rs.68,53,46,239 minus Rs.19,44,46,788). This, according to *GIA US*, is its real income, and it is only this amount that could be brought to tax in India.

64. What is "real income" and how it is to be taxed has been the subject matter of several decisions not only of this Court but also that of the Hon'ble Supreme Court. This Court in ***H. M. Kashiparekh & Co. Ltd. Vs. Commissioner of Income-tax [1960] 39 ITR 706 (Bombay)*** was considering a question relating to the income of payment of managing agency commission. This Court, being mindful of the fact that under the IT Act each year is a self-contained period, also took note of the basic principle of tax law, which requires the Court (cases of deemed income apart) to see that ultimately it is the real income of the Assessee which alone is brought to tax and not any artificial or notional income that may be said to have accrued to him. The facts of the case were that the Assessee company was the managing agent of Gujarat Paper Mills Ltd. The A.Y. was 1950-1951, and during the accounting year, a commission of Rs.1,17,644/- was earned by the Assessee. At the instance of the managed company, namely Gujarat Paper Mills Ltd., the Assessee company surrendered Rs.97,000/-. The Income-tax Officer

accepted this position, but the Commissioner of Income-tax disapproved the same and served a notice on the Assessee company under Section 33B(1) of the Income Tax Act, 1922. He passed an order directing the Income-tax Officer to include the amount of Rs.97,000/- in the Assessee company's total income for the A.Y. 1950-1951. The matter was carried to the Tribunal, and one of the contentions urged on behalf of the Assessee company was that clause 5 of the managing agency agreement authorised the managed company to cut down a portion of the commission earned by the managing company and that therefore, surrender of Rs.97,000/- was justified. After examining clauses 5 and 6, the Tribunal took the view that the Assessee company was bound to forgo only ⅓ of Rs.1,17,644/-, namely the amount of Rs.39,214/-. The Tribunal accordingly decided in favour of the Assessee company only to this extent and rejected the contention of the Assessee company as to the balance amount of surrender, namely Rs.57,785/-. This made the matter come before this Court in a reference. One of the questions in the reference was whether the sum of Rs.57,785/- (Rs.97,000 - Rs.39,214) could legally be included in the Assessee company's total income. This Court accordingly held as under:-

> "*Succinctly stated, the contention on behalf of the Revenue is that the income accrued to the assessee company in the accounting year, whereas the surrender on ground of commercial expediency of the amount of Rs. 57,000 odd out of the same took place eight months after the expiry of the accounting year and, therefore, it*

could not be treated as an expenditure incurred in the accounting year.

The contention urged on behalf of the assessee company is twofold. It has been urged firstly that in any event and in any view of the case, it is the real income of the assessee company for the accounting year that is liable to tax and that real income cannot be arrived at without taking into account the amount which was forgone by the assessee company. The second contention urged by Mr. Palkhivala is that the amount of Rs. 57,000 odd had been given up by the assessee company on the ground of commercial expediency when the quantum of the entire amount of commission was determined and, therefore, it must necessarily be treated as an expenditure of the year of which the determined amount is taken as the income. It will not be necessary for us to decide the second contention of Mr. Palkhivala and we have not heard counsel for the Revenue on the same. In our opinion, the first contention of Mr. Palkhivala is substantial and must prevail.

Counsel for the Revenue does not question the importance of what he describes as the doctrine of real income. His contention strongly urged before us, however, is that a party who follows the mercantile system of account-there is no dispute that the assessee company follows the mercantile system of account-cannot avail of the benefit of the doctrine where, for instance as in the case before us, the income of managing agency commission is credited in the books in one year and has been surrendered by him in the next year. In such a case, his income accrues in the year in which it is entered in the books and if the surrender is not made and entered in the same year, no question of real income can arise. It is said that the surrender can, if at all, be taken into consideration only in the year in which it is made, i.e., in the next accounting year, and according to learned counsel for the Revenue, in that next year also, he would not be able to avail of the same as an item of expenditure because it could have no bearing on the managing agency commission that may accrue to him in that year. Therefore, so the argument for the Revenue had to run, unless the surrender was made in the very year in respect of which the commission became due, the amount of the commission, even if it was wholly surrendered, would yet remain liable to tax. In support of his argument, Mr. Joshi relied on the following observations of their Lordships of the Privy Council in CIT v. Chitnavis [1932] 2 Comp. Cas. 464:

> *"For the purpose of computing yearly profits and gains, each year is a separate self contained period of time in regard to which profits earned or losses sustained before its commencement are irrelevant."*

Of course, if this principle that you have to measure the income of the year of assessment bearing in mind that for the purpose of computation each year is a separate self-contained period is so absolute that it has no relation with the principle of real income, the court must arrive at the result suggested by Mr. Joshi.

The two rules that income-tax is annual in its structure meaning thereby that for computation each year is a distinct self-contained unit and the other that the income to be taxed is the real income of the assessee do not seem to us to be incompatible or irreconcilable. Mr. Joshi also is not prepared to go so far as that and has fairly stated that there is no antithesis between the two rules. The facts of a case may present some difficulty in applying the rules but the conflict would, in our opinion, be rather apparent than real. The facts of a given case may create the impression of a discrepant situation but the apparent discrepancy can be resolved in a manner not inconsistent with the basic concepts underlying the two rules. In our judgment, they permit of harmonious application, though the application to a degree must depend on the circumstances of each case. Some propositions could be formulated but whether a general formula applicable to all circumstances could be hit on we rather doubt.

Though it may not be possible to prescribe a general formula which may successfully compose every conflicting situation, the position in law seems clear to us that in applying the two rules to particular transactions regard must be had to the true legal rights and the true situation. A fair interpretation of the transaction and the situation would lead to a preferable and, if we may say so, a correct solution than sheer adherence to one rule and discounting of the other. If this be the true approach, and we feel little doubt that it is, the result cannot be said to flow from any non-conformity with the rule that income-tax is annual in its structure and organisation. One merit of this approach would be the avoidance on the one hand of any a prior construction of a legal situation for the purpose of attracting tax to it and on the other allowing escape from liability. After all, each case must depend and its decision turn on its own facts and circumstances and that is how we prefer to deal with this case.

The leading facts to our mind are these. The assessee company had surrendered a part of its managing agency commission for a series of years. A chart showing such surrender is on the record and forms part of the case. The managing agency agreement, the material and relevant part of which we have already set out, in terms contains a provision affecting the quantum of the commission payable by the managed company to the managing company. The proviso must be read as part and parcel of clause 5 and so read, the clause makes it abundantly clear that the quantum of the remuneration that the managing company would ultimately receive would depend on the sufficiency of profits to pay a dividend in the manner there stated. If the profits are not sufficient, the managing company is under a legal obligation to forgo a part of its commission. The amount of commission to be forgone for the purpose of making up such deficit however is not to exceed 1/3rd of the entire commission which the managing company would otherwise become entitled to receive in a particular year.

Then come the balance-sheet of the company and the two resolutions which we have already set out. The system adopted by the assessee company was the mercantile system. A good deal of argument has been advanced before us by Mr. Joshi, who has drawn our attention to a number of decisions explaining the meaning of the expression "mercantile system". The connotation of that expression is well understood and it is not necessary to burden this judgment with citations from those decisions. In the course of his argument, learned counsel for the Revenue stated that there must have been entries in the books of the managed company and the managing company in consonance with clause 5 of the managing agency agreement. Only the balance-sheet of the company seems to have been brought on the record and the entries in those books do not form part of the statement of the case. Even so, we shall proceed on the footing that, the assessee company having followed the mercantile system of account, there must have been entries made in its books in the accounting year in respect of the amount of the commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed the mercantile system of account. That would not have any particular bearing in applying the principle of real income to the facts of this case. Incidentally, we may observe that we ourselves pointed out in the case of CIT v. Shoorji Vallabhdas & Co. [1959| 36 ITR 25, that the question whether the income accrued or not is not a mere matter of cogency of the entries made in the account books of the

assessee but is essentially one of substance and of the real nature of what happened; a mere book entry is not conclusive of the question whether the assessee had become entitled to the sums or not. It may also be mentioned that in that case we were dealing with an assessee who followed the mercantile system of account. The crucial question before us, therefore, is whether the two facts, one the amount of Rs. 1,17,644-4-0, which would have become payable to the managing company but for the surrender and the factum of surrender, are to be isolated or treated as of cogency in determining the actual accrual of income, by which we mean the real income of the assessee company. If the fact of forgoing or surrendering the amount of Rs. 57,000 odd is to be regarded as of cogency in the context of the present point of real income and if it be remembered that the surrender was made at the time of ascertaining the quantum of the commission payable to the assessee company and further if it be remembered, as now found by the Tribunal, that the surrender was made bona fide and on grounds solely of commercial expediency, it seems very difficult to us to see how the Revenue is justified in contending that the real income of the assessee was something different than the amount of Rs. 20,000, which was shown by it at the time of assessment as its income from managing agency commission. To accede to that suggestion would lead to a result highly unfair, though that is not a consideration which can be permitted to influence us in deciding any matter when we have to give effect to the provisions of a fiscal enactment. At the same time, we would not be justified in being unmindful of the consequences of any opinion which we may give on a reference. The enquiry must depend mainly on the broad aspects and the facts and circumstances of the particular case and not on any wire-drawn technicality.

Now the argument of Mr. Palkhivala before us is that having regard to the facts and circumstances of the case before us it cannot be said that any income—any real income—accrued to the assessee company till the accounts were made for the purpose of satisfying the requirements of clause (5) of the managing agency agreement and particularly the proviso to the same. There is, in our opinion, force in this argument. Another facet of the same argument for the assessee company has been presented in this manner. If the year in which income was earned is chosen as the year of taxability, the subsequent settlement of the liability must relate back to the year in which the income was earned. Then, it is said that the right of the assessee company to receive the commission arose only after the accounting year and only when accounts were made up in December, 1950. The crux of the whole

argument is that it is the real income of the assessee company that must be ascertained and that alone should be taxed.

In the present case surrender of commission has been made bona fide and as a matter of commercial expediency and at an early point of time when accounts were made up. We need not recapitulate what we have already stated. The accrual of the commission, the making of the accounts, the legal obligation to give up a part of the commission and the forgoing of the commission at the time of the making of the accounts are not disjointed facts. There is a dovetailing about them which cannot be ignored.

We do not think it to be in accord either with the authorities cited that the principle of real income is to be so subordinated as to amount virtually to negation of it when a surrender or concession or rebate in respect of managing agency commission is made agreed to or given on grounds of commercial expediency simply because it takes place some time after the close of an accounting year. In examining any transaction and situation of this nature the court would have more regard to the reality and speciality of the situation rather than the purely theoretical or doctrinaire aspect of it. It will lay greater emphasis on the business aspect of the matter viewed as a whole when that can be done without disregarding statutory language.

For all these reasons, we are of the opinion that the real income of the assessee company was Rs. 20,000 odd and the amount of Rs. 57,839-12-7 cannot be included in the real income of the accounting year. The opinion we give is in no respect out of harmony with any statutory provision, the decisions on the question of accrual of income or the principle that income-tax is annual in its structure."

(emphasis supplied)

65. The next decision, which discussed the concept of real income, is the decision of the Hon'ble Supreme Court in ***Godhra Electricity Co. Ltd. Vs. Commissioner of Income-tax [1997] 91 Taxman 351 (SC)***. The facts of this case were that the Assessee company, a licensee to generate

supply of electricity to its consumers, enhanced the charges for electricity and motive power in 1963. Suits filed by the consumers challenging the enhancement were allowed by the lower Courts except the Division Bench of the High Court. The Hon'ble Supreme Court in 1969 ultimately decided the case in favour of the Assessee. Shortly thereafter, the Under Secretary of the Government of Gujarat wrote a letter advising the Assessee company to maintain the *status quo* for the rates to the consumers for at least 6 months. During this period, the consumers also filed another representative Suit wherein an interim injunction was granted and finally decreed in favour of the consumers by the lower Court. During the pendency of the subsequent Suit, the management of the undertaking of the Assessee company was taken over by the Government of Gujarat under the Defence of India Rules, 1971. During the pendency of these litigations, the Assessee company was not able to realise the enhanced charges from the consumers from A.Y. 1969-1970 to 1972-1973. The Assessing Officer, while making the assessment, included the disputed amount in the hands of the Assessee company on the ground that it was following the mercantile system of accounting and it had the legal right to recover the said amount. The first appellate authority, however, deleted the additions, and that was affirmed by the Tribunal. However, on a reference, the High Court upheld the view taken by the Assessing Officer. This is how the matter ultimately reached the Hon'ble Supreme Court. The

Hon'ble Supreme Court, in its decision, held that under the Act, income chargeable to tax is the income that is received or is deemed to be received in the previous year relevant to the year for which assessment is made or on the income that accrues or is deemed to accrue during such year. The Hon'ble Supreme Court ultimately held that the question whether there was real accrual of income to the Assessee company in respect of the enhanced charges for the supply of electricity had to be considered by taking the probability or improbability of realisation in a realistic manner. The Hon'ble Supreme Court held that if the matter was considered in this light, it was not possible to hold that there was a real accrual of income to the Assessee company in respect of the enhanced charges for supply of electricity which were added by the Assessing Officer while passing the assessment orders in respect of the Assessment Years under consideration. The Hon'ble Supreme Court therefore opined that the Tribunal had rightly held that the claim at the increased rates as made by the Assessee company on the basis of which necessary entries were made, represented only hypothetical income, and the impugned amounts as brought to tax by the Assessing Officer did not represent the income which had really accrued to the Assessee company during the previous years. The relevant portion of this decision reads thus:-

> "*9. Shri S. Ganesh, the learned counsel appearing for the assessee-company, has submitted that in the facts and circumstances of this case it must be held that no real income had accrued to the assessee-company on account of enhanced charges*

for electricity since the assessee-company was not able to recover the said enhanced charges from the consumers in view of the protected litigation during the period from 1963 to 1969 and thereafter on account of the letter from the Under Secretary to the Government of Gujarat dated 19-3-1969 asking the assessee-company not to charge the enhanced rates for at least six months and the subsequent suit (Suit No. 118 of 1969) filed by the consumers in 1969 and the taking over of the management of the assessee-company by the Collector, Godhra in pursuance of the order passed under rule 115(2). It has been urged that though the assessee-company was following the mercantile system of accounting but in the mercantile system also tax can be imposed only if there is real income and income-tax cannot be imposed on hypothetical income. The learned counsel has placed reliance on the decisions of this Court in CIT v. Shoorji Vallabhdas & Co. [1962] 46 ITR 144, CIT v. Birla Gwalior (P.) Ltd. [1973] 89 ITR 266, Poona Electric Supply Co. Ltd. v. CIT (1965) 57 ITR 521, R.B. Jodha Mal Kuthiala v. CIT [1971] 82 ITR 570 and State Bank of Travancore v. CIT [1986] 158 ITR 102/ 24 Taxman 337.

10. Under the Act income charged to tax is the income that is received or is deemed to be received in India in the previous year relevant to the year for which assessment is made or on the income that accrues or arises or is deemed to accrue or arise in India during such year. The computation of such income is to be made in accordance with the method of accounting regularly employed by the assessee. It may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements or it may be the mercantile system where entries are made on accrual basis, i.e., accrual of the right to receive payment and the accrual of the liability to disburse or pay. In Shoorji Vallabhdas & Co.'s case (supra), it has been laid down:

> *... Income-tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise...." (p. 148)*

This principle is applicable whether the accounts are maintained on cash system or under the mercantile system. If the accounts are

maintained under the mercantile system what has to be seen is whether income can be said to have really accrued to the assessee-company. In H.M. Kashiparekh & Co. Ltd. v. CIT [1960] 39 ITR 706, the Bombay High Court had said:

> *"... Even so, [the failure to produce account losses] we shall proceed on the footing that, the assessee-company having followed the mercantile systme of account, there must have been entries made in its books in the accounting year in respect of the the amount of the commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed the mercantile system of account. That would not have any particular bearing in applying the principle of real income to the facts of this case....." (p. 720)*

The said view was approved by this Court in Birla Gwalior (P.) Ltd.'s case (supra) where the assessee maintained its accounts on the mercantile system. In that case this Court, after referring to the decision in Morvi Industries Ltd. v. CIT [1971] 82 ITR 835, which was also a case where the accounts were maintained on mercantile system, has said:

> *"Hence it is clear that this court in Morvi Industries case did emphasise the fact that the real question for decision was whether the income had really accrued or not. It is not a hypothetical accrual of income that has got to be taken into consideration but the real accrual of the income." (p. 273)*

In Poona Electric Supply Co. Ltd.'s case (supra) this Court has said:

> *.. Income-tax is a tax on the real income, i.e., the profits arrived at on commercial principles subject to the provisions of the Income-tax Act...." (p. 530)*

In that case the Court has approved the following principle laid down by the Bombay High Court in KM. Kashiparekh & Co. Ltd.'s case (supra):

> *The principle of real income is not to be so subordinated as to amount virtually to a negation of it when a surrender or concession or rebate in respect of managing agency*

commission is made, agreed to or given on grounds of commercial expediency, simply because it takes place some time after the close of an accounting year. In examining any transaction and situation of this nature the Court would have more regard to the reality and speciality of the situation rather than the purely theoretical or doctrinaire aspect of it. It will lay greater emphasis on the business aspect of the matter viewed as a whole when that can be done without disregarding statutory language." (p. 707)]

11. If the matter is examined in the light of the aforementioned principles laid down by this Court, it must be held that even though the assessee-company was following the mercantile system of accounting and had made entries in the books regarding enhanced charges for the supply made to the consumers, no real income had accrued to the assessee-company in respect of those enhanced charges in view of the fact that soon after the assessee-company decided to enhance the rates in 1963 representative suits (Civil Suit Nos. 152 of 1963 and 50 of 1964) were filed by the consumers which were decreed by the trial court and which decree was affirmed by the appellate court and the learned single Judge of the High Court and it is only on 3-12-1968 that the letters patent appeals filed by the assessee-company were allowed by the Division Bench of the High Court and the said suits were dismissed. But appeals were filed against the said judgment by the consumers in this Court and the same were dismissed by the judgment of this Court dated 26-2-1969. Shortly thereafter, on 19-3-1969, the Under Secretary to the Government of Gujarat wrote a letter advising the assessee-company to maintain the status quo for the rates to the consumers for at least six months and the Chief Electrical Inspector was directed to go through the accounts of the assessee-company from year to year and to report to the Government about the actual position about the reasonable returns earned by the assessee-company. On 16-5-1969 another representive suit (Suit No. 118 of 1969) was filed by the consumers wherein interim injunction was granted by the Court and which was finally decreed in favour of the consumers on 23-6-1974. It would thus appear that after the decision was taken by the assessee-company to enhance the charges it was not able to realise the enhanced charges on account of pendency of the earlier representative suits of the consumers followed by the letter of the Under Secretary to the Government of Gujarat and the subsequent suit of the consumers and during the pendency of the subsequent suit the manage- ment of the undertaking of the assessee-company was taken over by the Government of Gujarat

> *under the Defence of India Rules, and the undertaking was subsequently transferred to the Gujarat State Electricity Board.*
>
> *14. The question whether there was real accrual of income to the assessee-company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic manner. If the matter is considered in this light, it is not possible to hold that there was real accrual of income to the assessee-company in respect of the enhanced charges for supply of electricity which were added by the ITO while passing the assessment orders in respect of the assessment years under consideration. The AAC was right in deleting the said addition made by the ITO and the Tribunal had rightly held that the claim at the increased rates as made by the assessee- company on the basis of which necessary entries were made represented only hypothetical income and the impugned amounts as brought to tax by the ITO did not represent the income which had really accrued to the assessee-company during the relevant previous years. The High Court, in our opinion, was in error in upsetting the said view of the Tribunal.*"

66. The Hon'ble Supreme Court, thereafter in the case of ***Commissioner of Income-tax Vs. Bokaro Steel Ltd. [1999] 102 taxman 94 (SC)*** followed its decision in *Godhra Electricity Co. Ltd. (supra)*. In the case of *Bokaro Steel Ltd. (supra)*, the Assessee had during the Assessment Year 1971-1972 shown in its accounts as income from interest, a certain sum said to have been accrued to the Assessee from Hindustan Steel Ltd. for eight locomotives supplied by the Assessee company to it. The Assessee company, however, reversed this entry next year because Hindustan Steel Ltd. has replaced the eight locomotives lent by the Assessee company to it with new ones, and no interest income actually accrued to the Assessee company. In these facts, the Hon'ble Supreme Court held as under:-

"*9. In the assessment year 1971-72, the assessee had shown in its books of account a sum of Rs.7,39,232 as income from interest received from Hindustan Steel Ltd. for the eight locomotives supplied by the assessee-company to them. The entry in this regard was reversed in the next year since Hindustan Steel Ltd. had replaced the eight locomotives lent by the assessee-company to it by new ones. The entire nature of the transaction was changed between the parties. There was a resolution of the assessee-company in this regard and the income from interest did not result at all as the original agreement ceased to be operative ab initio. The entry in the books which was made was about a hypothetical income which did not materialise and the entry was reversed in the next year. Both the Tribunal as well as the High Court have held that since this entry reflected only hypothetical income, it could not be brought to tax as income. Only real income can be brought to tax.*

10. In support of this finding, the assessee had drawn our attention to a decision of this Court in Godhra Electricity Co. Ltd. v. CIT [1997] 225 ITR 746/91 Taxman 286, where the Court, inter alia, examined the cash system and the mercantile system of accounting in the context of hypothetical income. The computation of income is made in accordance with the method of accounting regularly employed by the assessee. It may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements; or it may be the mercantile system where entries are made on accrual basis, that is to say, accrual of the right to receive payment and the accrual of the liability to disburse or pay. However, in both cases unless there is real income, there cannot be any income-tax. Considering the facts before it, the Court said that although the assessee-company was following the mercantile system of accounting and had made entries in the books regarding enhanced charges for the supply of electricity made to its consumers, no real income had accrued to the assessee-company in respect of those enhanced charges in view of the fact that soon after the assessee-company decided to enhance the rate, representative suits were filed by the consumers which were decreed by the Court and utlimately, after various proceedings which took place, the assessee-company was not able to realise the enhanced charges. The Court held that no real income had accrued to the assessee-company and, hence, the entries in respect of enhanced charges did not reflect the real income of the assessee and could not be brought to tax by the ITO.

> *11. In the present case also, the entry which was initially made as interest was reversed the next year because in fact the nature of the transaction was changed and the assessee did not receive any real income. The High Court has, therefore, rightly held this entry as not reflecting the real income of the assessee and, hence, not exigible to income-tax.*"

67. The next decision is the decision of this Court in ***Commissioner of Income-tax-8, Mumbai Vs. Lok Housing & Constructions Ltd. [2015] 58 taxmann.com 179 (Bombay)***. The facts of this case reveal that a survey action was carried out on the Assessee's business premises on 11th September 2008. Subsequent to the survey, a notice under Section 142(1) of the IT Act was issued to the Assessee calling for its Return of Income for A.Y. 2007-2008. That was not filed by the Assessee. In response to this notice, the Assessee filed a Return of Income on 23rd September 2008 declaring a total income of Rs.1,35,47,15,708/-. In this Return of Income, the Assessee company *inter alia* declared income on account of sales on land/FSI to 5 parties, which were its associates/sister concerns. Subsequently, on 1st January 2009, the Assessee filed another Return of Income declaring NIL income. It claimed that the income declared in the original Return in respect of the 5 transactions of sales of land/FSI to 5 parties stands withdrawn due to the cancellation of 5 sale agreements. It was argued that the Assessee discovered an omission of cancellation of sale agreements which was not disclosed in the original Return, and hence revised

the same by filing the revised Return of Income. The Assessing Officer passed an order under Section 143(3) and taxed the income from the sale of land/FSI. The Assessee was aggrieved by this order and filed an Appeal before the Commissioner of Income-tax (Appeals), which was also dismissed. The Assessee, therefore, approached the Tribunal by way of an Appeal, which was partly allowed. Being aggrieved by the Tribunal's order, the Revenue approached this Court. In the facts narrated above, this Court held as under:-

> "*10. In relation to the third question, what we have noticed is that the Revenue is seeking re-appreciation and re-appraisal of the factual material on record. That is a course permissible, provided the factual findings can be termed as perverse or vitiated by any error of law apparent on the face of the record. In the present case, the argument was, that this income which was declared could not have been thereafter termed as such. It not being realised as the Sale Agreements have been cancelled.*
>
> *11. In that regard, we find that the Tribunal was informed by the Revenue that there is a doubt about the cancellation of the relevant Agreements. That cancellation is not genuine and bona fide. The other argument was that these are Agreements with sister concerns and therefore in the first place, there was some deliberate exercise and with a view to avoid paying the legitimate taxes. In any event, the Agreements being subsequently cancelled supports the Revenue's version as above.*
>
> *12. On both counts, the Tribunal has in a detailed discussion of more than 40 paragraphs found that there is no substance in the objections of the Revenue. If the Revenue is trying to show that the relevant transactions were sham and not real, then it has to bring in satisfactory material. The Tribunal found in paras 37 to 40 of the impugned order that the income which was earlier disclosed was not as such because the Agreements were terminable or could have been cancelled. Once they were cancelled, the properties have reverted back to the assessee. They are duly reflected in the balance sheet and as assets of the assessee. There were revised accounts and which were also scrutinized. They were found to be in order and meeting the*

> *accounting practice adopted. Therefore, the accounting policy also could not have been faulted. In para 42 of the impugned order, the Tribunal held that income could not have really accrued because of the fact that these Agreements were cancelled. Then the issue of their cancellation has been gone into, and in extensive details. The correct legal principles were applied and a finding of fact is arrived at in para 48, that no income could be said to have really accrued to the assessee as a result of the five transactions in the immovable properties and which income was chargeable to tax in the year under consideration. Once income had not accrued to the assessee in the real sense, then the original return represents wrong statement which was corrected by the assessee by filing a revised return. Therefore, no hypothetical income of the assessee could have been brought to tax.*"

68. We must mention that a Civil Appeal from this decision of the Bombay High Court was dismissed by the Hon'ble Supreme Court vide its judgment and order dated 24th April 2025 in ***Commissioner of Income-tax Vs. Lok Housing and Construction Ltd. (2025) 175 Taxmann.com 848 (SC)***. The order of the Hon'ble Supreme Court reads thus:-

> "*1. Having heard Mr. Arijit Prasad, the learned Senior counsel appearing for the appellant – Revenue and having gone through the materials on record, we find no good reason to interfere with the impugned order dated 13-04-2015 passed by the High Court of Judicature at Bombay.*
>
> *2. The Civil Appeal is, accordingly, dismissed.*"

69. From all the aforesaid decisions, one salutary principle that emerges is that in order that income is taxed in the hands of the Assessee, it must be the real income (cases of deemed income apart), which the Assessee

has actually earned and not a mere hypothetical income which the Assessee could have earned but in fact did not earn.

70. Having said this, we will now proceed to determine as to what was the quantum of royalty paid by *GIA India* to *GIA US* that could be taxed in the hands of *GIA US*. Was it the figure of Rs.68,53,46,239/-, which was initially paid, or is the amount of Rs.49,08,99,451/-, which is the amount that is finally retained by *GIA US* after refunding the amount of Rs.19,44,46,788/- as mandated by the APA entered into by *GIA India* and CBDT.

71. By virtue of the India-US DTAA, royalty paid by *GIA India* to *GIA US* is to be taxed as per Article 12, which reads thus:-

> "*ARTICLE 12 - Royalties and fees for included services - 1. Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*
>
> *2. However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed:*
>
> *(a) in the case of royalties referred to in sub-paragraph (a) of paragraph 3 and fees for included services as defined in this Article [other than services described in sub-paragraph (b) of this paragraph] :*
>
> *(i) during the first five taxable years for which this Convention has effect,*

(a) 15 percent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political sub-division or a public sector company; and

(b) 20 per cent of the gross amount of the royalties or fees for included services in all other cases; and

(ii) during the subsequent years, 15 per cent of the gross amount of royalties or fees for included services; and

(b) in the case of royalties referred to in sub-paragraph (b) of paragraph 3 and fees for included services as defined in this Article that are ancillary and subsidiary to the enjoyment of the property for which payment is received under paragraph 3(b) of this Article, 10 percent of the gross amount of the royalties or fees for included services.

3. The term "royalties" as used in this Article means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright or a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of Article 8.

4. For purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

(b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

5. Notwithstanding paragraph 4, "fees for included services" does not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than a sale described in paragraph 3(a) ;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the personal use of the individual or individuals making the payments; or

(e) to an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in Article 15 (Independent Personal Services).

6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties or fees for included services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties or fees for included services are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be shall apply.

7. (a) Royalties and fees for included services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, or a resident of that State.

Where, however, the person paying the royalties or fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for included services was incurred, and such royalties or fees for included services are borne by such permanent establishment or fixed base, then such royalties or fees for included services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

(b) Where under sub-paragraph (a) royalties or fees for included services do not arise in one of the Contracting States, and the royalties relate to the use of, or the right to use, the right or property, or the fees for included services relate to services performed, in one of the Contracting States, the royalties or fees for included services shall be deemed to arise in that Contracting State.

8. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for included services paid exceeds the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of the Convention."

(emphasis supplied)

72. What is clear from Article 12 of the US – India DTAA is that only the royalties that are paid by *GIA India* to *GIA US* can be taxed in India. To our mind, and especially considering the facts of the present case, the word "paid" appearing in Article 12 would denote that amount which is actually and eventually paid i.e. the amount that remains or is retained by *GIA US* by virtue of the APA entered into between *GIA India* and the CBDT. We say this because we find that one of the critical assumptions in the APA between *GIA*

India [the Associated Enterprise of the *GIA US* (the Assessee)], and the CBDT, was that if payment of royalty by *GIA India* to *GIA US* exceeds the ALP (Arm's Length Price) as determined in the APA, *GIA India* shall raise the appropriate invoice on *GIA US* to recover the aforesaid excess payment made and show the respective excess amounts as additional income in the modified Return. Under Rule 10F(f), a critical assumption means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement if any of the factors or assumptions are changed. It is thus clear that one of the fundamental assumptions of the APA entered into between *GIA India* and the CBDT was partial recovery of royalty from *GIA US*, namely, excess payment of royalty by *GIA India* to *GIA US*. When one takes into consideration the facts of the present case, we are clearly of the view that the royalty refunds by, or the royalty recoveries from *GIA US* are not standalone events which can be seen in isolation with the receipts of related royalties in the corresponding previous year. These refunds and recoveries of royalties are required to be seen in conjunction with the associated receipts of the royalties from *GIA India*. One can hardly dispute that the refund of excess royalty by *GIA US* to *GIA India* was one which was *bonafide* and to adhere to one of the critical assumptions in the APA entered into between *GIA India* and the CBDT. Any part of the royalty received, which had to be *bonafide*

refunded to the payer of royalty (namely *GIA India*), could not be taxed in the hands of *GIA US* as this money did not eventually belong to *GIA US*. It is for this very reason that the excess amount was refunded by *GIA US* to *GIA India*. Just as an example, for A.Y. 2011-2012, *GIA US* had initially received an amount of Rs.68,53,46,239/- as royalty from *GIA India*. However, once an APA was entered into between *GIA India* and the CBDT, the ALP of the royalty to be paid for A.Y. 2011-2012 was Rs.49,08,99,451/-. Hence, under the APA, *GIA India* was under an obligation to call upon *GIA US* to refund the excess royalty paid of Rs.19,44,46,788/-. This, in fact, was done, and there is no dispute on this count.

73. Once this is the factual scenario before us, we are clearly of the view that the royalty "paid" as contemplated under Article 12 was the amount of Rs.49,08,99,451/-, which was ultimately retained by *GIA US* and not the figure of Rs.68,53,46,239/-, which was initially received by *GIA US* from *GIA India* on account of royalty.

74. There is yet another factor why we have taken this view. It is very important to note that the refund received by *GIA India* from *GIA US* has been shown as income of *GIA India* and offered to tax as such. This is by way of a modified Return filed by *GIA India* pursuant to the APA entered into

with the CBDT. Hence, we fail to understand how the Department can tax the same amount twice, once in the hands of *GIA India* and then again in the hands of *GIA US*. Further, the excess royalty payment, which is sought to be taxed in the hands of *GIA US,* has already been declined as a deduction in the hands of *GIA India*, and, correspondingly, higher income has been brought to tax in the hands of *GIA India*. This treatment would clearly be incongruous inasmuch as what has been treated as income in the hands of the recipient of royalty (*GIA US*) has not been treated as expenditure in the hands of the person paying the royalty in question (*GIA India*). What is thus admittedly not treated as paid by the payer of royalty is being sought to be treated as what is received by the recipient of the royalty. This, to our mind, and as correctly held by the ITAT in its impugned judgment dated 30th April 2021, is wholly incongruous. We are therefore clearly of the view that when one takes all these factors into consideration, coupled with the fact that under the IT Act, only real income in the hands of the Assessee can be taxed, the quantum of royalty that could be brought to tax for A.Y. 2011-2012 was the amount of Rs.49,08,99,451/- and not the amount of Rs.68,53,46,239/-.

75. This now leaves us to deal with the decision that was relied upon by the Department rendered by the Hon'ble Supreme Court in the case of ***Kishinchand Chellaram Etc. Vs. Commissioner of Income Tax,***

(Central) Bombay (In all the Appeals) (1962) 46 ITR 640. We find that this judgment is clearly distinguishable on the facts. In *Kishinchand Chellaram (supra),* Mr. Kishinchand was a shareholder and director of a company called Chellsons Ltd. At the general meeting of the shareholders of the company held on 10th July 1943, it was resolved to declare a dividend at "60% on the shares" of the company, and for the purpose of that declaration, the profits of the year 1941-1942 were included in the profit of the year 1942-1943. Pursuant to this resolution, Rs.46,000/- was credited in the books of the company to the account of Kishinchand Chellaram on 31st March 1944, and Rs.23,000/- was credited to each of the other 3 shareholders. Another meeting of the shareholders was held on 15th July 1944, and it was resolved to declare dividend at "60% on the shares" out of the profits of the company for 1943-1944. Pursuant to this resolution, on 29th September 1944, Rs.30,000/- was credited in the company's books of account to Kishinchand and Rs.15,000/- was credited to the accounts of each of the other 3 shareholders. In the Return for A.Y. 1945-1946, Kishinchand included the amounts credited to him in the company's books of account as dividends for 3 years, 1941-1942 to 1943-1944. Thereafter, on 4th December 1947, at an extraordinary general meeting, another resolution purporting to reverse the earlier resolutions dated 10th July 1943 and 15th July 1944 was passed by the company. By virtue of the resolution dated 4th December 1947, the company

resolved that the dividend paid by the company to its shareholders was without taking into consideration the company's liability for taxation, including excess profit tax and because of this, such a dividend inadvertently paid by the company to the shareholders would be considered as a loan to such individual shareholders and be paid back to the company forthwith. It is by virtue of this resolution that Kishinchand then contended that he had not received any dividend at all and could not be taxed as such.

76. It was this contention of Kishinchand that was negated not only by this Court but also by the Hon'ble Supreme Court. In fact, the Hon'ble Supreme Court in paragraph 7 (of ITR report) held that by virtue of Section 16(2), the liability to pay tax attached as soon as dividend was paid, credited or distributed or deemed to have been paid or distributed to the shareholders and IT Act contained no provision for altering the incidence of liability to pay tax on the dividend, merely because it was found that in declaring dividend and paying it, the company violated the prohibition relating to payment of dividend in the Indian Companies Act. In fact, the Hon'ble Supreme Court went on to hold that even if the shareholders agree to refund the amounts received by them as dividend, the original character of the receipt as dividend was not thereby altered. In ascertaining whether liability to pay Income Tax on dividends arose, a resolution of the company whereby payments made to

the shareholders as dividend were to be treated as loans could not retrospectively alter the character of the payment and thereby exempt it from liability which had already attached thereto, was the finding of the Hon'ble Supreme Court. The Hon'ble Supreme Court, in fact, also went on to hold that a payment made as dividend by the company to its shareholders does not lose that character merely because it is paid out of the capital. Under the IT Act, the liability to pay tax attaches as soon as the dividend is paid, credited or distributed or is so declared. The Act does not contemplate an inquiry whether the dividend is properly paid, credited or distributed before the liability to pay tax attaches thereto.

77. The facts of the present case are completely different. What we are considering is what is the amount "paid" as contemplated under Article 12 of the India-US DTAA. In fact, in ***Pfizer Corporation Vs. Commissioner of Income-Tax (2003) 259 ITR 391*** the word "paid" was considered by this Court. The facts in *Pfizer Corporation (supra)* were that the Assessee Pfizer Corporation was a non-resident company. Pfizer Corporation was a shareholder of its Indian subsidiary, Pfizer Limited, a company registered under the Indian Companies Act and assessed to tax. For the A.Y. 1976-1977, Pfizer Limited (Indian entity) declared a final dividend on 31st July 1975. According to the Department, income accrued to Pfizer

Corporation (the non-resident company) during the A.Y. 1976-1977, whereas according to the Pfizer Corporation (the non-resident company), the income accrued to them during A.Y. 1977-1978 as the remittance was permitted by RBI only on 3rd September 1976 i.e. during the A.Y. 1977-1978. This Court after considering the provisions of the IT Act, and more particularly Section 5(2)(b) and Section 9(1)(iv), came to the conclusion that the income could be taxed only in the A.Y. 1977-1978 because Section 9(1)(iv) contemplated that dividend "paid" by an Indian company outside India would constitute income deemed to accrue in India. This was in contra distinction to Section 8, which refers to dividend declared, distributed or paid by the company. The words "declared or distributed" occurring in Section 8 do not find place in Section 9(1)(iv). It is in these circumstances that this Court took the view that dividend income paid to a non-resident is deemed to accrue in India only on payment and not on declaration.

78. For all the aforesaid reasons, we find that the reliance placed by the Department on the judgment in *Kishinchand Chellaram (supra)* is wholly misplaced and does not carry their case any further.

79. In view of the aforesaid discussion, we answer questions (a) to (c) in the affirmative and in favour of the Assessee and against the Revenue.

As mentioned earlier, questions (d) to (g), and the additional question raised in A.Y. 2017-18, are not entertained as they do not give rise to any substantial question of law.

80. All the Appeals are disposed of in the aforesaid terms. However, there shall be no order as to costs.

81. This order will be digitally signed by the Private Secretary/ Personal Assistant of this Court. All concerned will act on production by fax or email of a digitally signed copy of this order.

[FIRDOSH P. POONIWALLA, J.] **[B. P. COLABAWALLA, J.]**