

**IN THE INCOME TAX APPELLATE TRIBUNAL
(DELHI BENCH: 'D': NEW DELHI)**

**BEFORE SHRI GS PANNU, VICE PRESIDENT
AND
SHRI ANUBHAV SHARMA, JUDICIAL MEMBER**

**ITA No:- 760/Del/2021
Assessment Year: 2017-18**

ITOCHU Corporation, 5-1 KITA-Aoyama,2- Chome, Minato-Ku, Tokyo 107-8077, Japan.	Vs.	ACIT, (International Taxation), Circle 2(1)(1), Civic Centre, New Delhi-110002.
PAN No: AABCI5567L		
APPELLANT		RESPONDENT

Assessee by : Shri Ajay Vohra, Sr. Adv
Revenue by : Shri Vizay B. Vasanta, CIT(DR)

Date of Hearing : 25.04.2024
Date of Pronouncement : .07.2024

ORDER

PER ANUBHAV SHARMA, JM

This appeal is preferred by the assessee against the final assessment order dated 16.04.2021 passed by the Assessing Officer, Circle International Taxation 2(1)(1) (hereinafter referred to as the Ld. AO) u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act').

2. On hearing both the sides the relevant set of facts and submissions are that “Itochu Japan’ is a company incorporated under the Laws of Japan in 1858 and is a tax resident of Japan. Globally, Itochu Japan is involved in domestic and overseas trading of various products such as textile, machinery, metals, minerals, energy, chemicals, food, information and communication technology, realty, general products, insurance, logistics services, construction, and finance, as well as business investment in various entities in Japan and overseas. Assessee, Itochu India Private Limited ('Itochu India') is a wholly owned subsidiary of Itochu Japan in India and undertakes the activities of general trading, procurement and supply of chemicals, textiles, machinery and equipment. Further, it also provides business support services to its associated enterprises and third parties.

2.1 In this case, the return of income was filed on 30.11.2017 declaring an income of 3,77,25,763/- and a draft order u/s 143(2) read with section 144C was served on the assessee on 27.12.2019, proposing certain variations in the, income returned. AO in passing the draft assessment order has placed reliance on the draft assessment order for AY 2013-14 and AY 2015-16.

2.2 The assessee has made sale of Apps. INR 1790,12,21,208 and AO observed that assessee could not produce even a single document/ contract to substantiate its position of no PE no tax in India pertaining to its so called business activities.

3. Now from the submission made before us by Ld. Sr. Counsel and as made before the tax authorities below it comes up that as far as non-existence of a permanent establishment is concerned the AO had alleged existence of dependent agent PE in India in terms of Article 5 of the India-Japan Double Taxation Avoidance Agreement ('DTAA') and thereby assessing the income attributable to the alleged PE amounting to Rs.89,50,61,139. Ld. Sr. Counsel submitted that AO has arrived at this conclusions without appreciating the fact that none of the following pre-requisite conditions to constitute a dependent agent PE were fulfilled by Itochu India and so Itochu India was not a dependent agent PE:

- Itochu India does not habitually exercise the authority to conclude the contracts in India for and on behalf of the assessee; and
- Itochu India does not habitually maintains stock of goods in India for delivery to customers for and on behalf of the assessee; and
- Itochu India does not secure orders in India for and on behalf of the assessee; and
- Itochu India is not legally or economically dependent on the assessee.

3.1 Ld. Sr. Counsel has submitted that Itochu India is not legally and economically dependent on the assessee and that AO ignored to

appreciate the fact that Itochu India is an independent entity, primarily engaged in trading activities with major source of income being revenue from such trading activities only. In this context it was submitted that Itochu India secures orders in India on behalf of the assessee and AO has failed to appreciate that:

- the services in relation to the purchase of goods are different from sale of goods;
- the purchase and sale functions performed by Itochu India are separately mentioned in the agency agreement;
- no negotiation activity was undertaken by Itochu India for sale purposes; and
- Itochu India had no authority whatsoever to conclude contracts on behalf of the assessee.

3.2 Ld. Sr. Counsel has submitted that the assessee has provided all the documentary evidences including party wise sale details, copy of contracts/ bill of lading/ invoices/ purchase orders and copy of agency agreement entered between the assessee and Itochu India as and when was requested by the Ld. AO

3.3 Ld. Sr. Counsel submitted the evidences filed by the assessee show that Itochu India has not secured orders in India and is not involved in negotiating terms and conditions of the contract and finalization of prices of contracts with the Indian customers. Itochu India is not being compensated of all costs incurred and Itochu India bears all the cost arising from the performance of its duties.

Further that the Itochu India is not habitually exercising authority in India to bind the assessee under any contracts with the Indian customers. It was also pointed out that the Transfer Pricing Report of Itochu India specifically mentions that the role of Itochu India is limited to act as a communication channel between the associated enterprises and the customers.

4. Now all these aspects when put up before the DRP, the same were not found sustainable and we consider it appropriate to reproduce the relevant part of DRP order here in below;

Decision and Directions of the DRP

“3. The Panel has very carefully considered the grounds of objections and written and oral arguments made on behalf of the assessee. The grounds raised by the assessee are descriptive and detailed. For the sake of convenience, they may be reduced to two core issues before the Panel for consideration:

(a) Issue of permanent establishment:

(b) Issue of attribution of income liable to tax in India

3.1 Existence of Permanent Establishment in India

3.1.1 The Assessing Officer has contended that the assessee made sales of JPY 31,43,32,27,020 and could not produce even a single document/contract to substantiate its position of no PE no tax in India pertaining to its so called business activities. He accordingly held that the assessee was consciously and deliberately hiding some relevant documents required to decide

on the taxability of the assessee company. He also noted that the assessee has admitted in its reply that sales were also made through agents in India, however none of the details were produced for verification, not even the name of the agents were provided. In view of the above and also the fact that the AR of the assessee failed to provide any information or agreements in relation to nature of relationship and dealings with these agents in India, the Assessing Officer held that the assessee has made sale in India to Indian customers wherein Itochu India Pvt Ltd. provides support in execution of sale.

From the perusal of the agreement between Itochu Japan and Itochu India Pvt Ltd. following clauses may be observed:-

From the service agreement, the AO also noted that a few clauses from the scope of services mentioned in the service agreement where Itochu India Private Limited would undertake certain activities for the assessee as follows:

- 1. Promoting sales of products and services of the assessee within the territory. Submitting reports on all sales and purchases, market conditions and other useful information which are necessary for the export and import of the goods sold by the assessee.*
- 2. Submitting proposals on behalf of the assessee and forwarding such proposal to customers within the territory. If Itochu India Pvt. Ltd, in its reasonable opinion, believes that a proposal needs to be amended or redrafted prior to being sent to*

a customer within the Territory then Itochu India Pvt. Ltd. must provide or send to the assessee any suggestions by e- mail for final approval by the assessee and the sole decision power of sending a completed proposal lies with the assessee.

3. Act any other things and matters necessary and concomitant to perform the duties of the agency granted.

4. Further the Itochu India Pvt. Ltd shall perform following additional activities in connection with the Principal's purchase of the goods being imported to Japan.

- To negotiate the goods on behalf of the assessee and to render any other services.*
- To negotiate with suppliers on behalf of the assessee for amicable settlement of claims or complaints.*
- Any other services which may be authorized or instructed by the assessee in connection with conclusion or execution of the Purchase Contract.*

3.1.2 He also noted that Itochu India Pvt. Ltd. was being compensated on all the cost incurred including the cost incurred for the contracts with the third parties. He, accordingly, held that Itochu India Pvt. Ltd. (Itochu India) secured orders in India for the assessee (which is controlling Itochu India) and Itochu India also negotiated and finalized the prices with the customers of assessee in India, though such authority was not vested in them through any agreement, but in practice they were deciding the prices and such prices were later on being

confirmed by the assessee through documents. Such prices decided by Itochu India have the binding effect on the assessee, as the otherwise has not been proved. The AR of the assessee did not even submit any instance wherein Itochu India have proposed a price which were rejected by the assessee. Accordingly, it was held that approval of price negotiation by the assessee was mere paper formality. He accordingly returned a finding that Itochu India was a dependent agent of the assessee in India and the business of the assessee was carried on wholly or partly being carried on. He relied, in this regard on Para 32.1 of the Commentary on OECD Model Tax Convention, Article 5 of the India-Japan tax treaty and the decision of ITAT Delhi in Galileo International Inc. Deputy Commissioner of Income-tax, [2009] 116 ITD 1 (Delhi).

3.1.3 The assessee contended, on the other hand, that it is a company incorporated in Japan and is one of the leading sogo shosha (trading company) in the country. It is engaged in domestic trading, import/export, and overseas trading of various products. Itochu Japan supplies to various Indian customers, several products including oil, chemical products, textile etc. The trading is done either directly or with the support of Itochu India or other third-party independent agents. Itochu Japan receives majority of its revenue from India by making direct sales to Indian customers such as Reliance Industries Limited, Essar Oil Limited etc. The remaining revenue is earned through sales that are completed with the help of Itochu India

(however, contracts are directly concluded by the assessee). The assessee is said to adequately remunerate Itochu India for its services. The AO has attributed 50% of the income from sales made to Indian customers (including direct sales) to the alleged PE in India and applying an arbitrary profit rate of 10% as per the provisions of Section 44BB of the Act, determined the total taxable income of the assessee in India at Rs. 93,27,86,902 as against the returned income of Rs. 3,77,25,763. The AO while attributing profits to the alleged PE failed to appreciate the fact that the sales amounting to JPY 5,18,66,20,164 was directly made by the assessee to the Indian customers without any involvement of Itochu India. In relation to sales made with support of ITOCHU India, the assessee stated that it had entered into a Memorandum of Agency agreement with ITOCHU India. As per the terms of this agreement, ITOCHU India assisted the assessee in both purchase and sales function which are clearly described in para 3 of the Agreement. The purchase and sales functions mentioned in the agreement are different from each other and cannot be intermixed and that the AO erroneously relied upon the activities undertaken by Itochu India in relation its obligations for purchase transactions to hold that Itochu India secures orders in India for Itochu Japan. The services in relation to the purchase of goods from Indian suppliers are said to be different and distinctly mentioned in the said agreement and were different from those relating to sale of goods. This fact was clearly highlighted to the AO during the

course of assessment proceedings. It is further submitted that negotiation of prices with Indian Customers, as alleged by the AO did not relate to the activity of sales at all. Itochu India had no authority whatsoever to conclude contracts on behalf of the Itochu Japan with regard to sale of goods as available to it in relation to purchase of goods. Clause 2 "Power of the Agent" specifically provides that all contracts, orders, proposal and offer for sale or purchase of the goods shall be subject to final and formal approval and acceptance by the assessee and Itochu India will have no power, right or authority to approve or accept the same on behalf of the assessee. It is also submitted that Itochu India and third-party independent agents only acted as a communication channel between the Indian customers and the assessee considering the language and cultural barriers. The negotiation activities performed by Itochu India were in relation to purchase functions and not sale functions. It is further submitted that purchase activity is incapable of creating a business connection in India, much less a PE in India. Reliance in this regard was placed on Explanation 1(b) of section 9(1)(i) of the Income Tax Act, 1961 which states as under:"in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export. It is further submitted that the activity performed by Itochu India is not the core revenue earning activity, which is a sine quo non for creation of PE. Reliance is

placed on Morgan Stanley 292 ITR 416 and E-funds Solutions (399 ITR 34).

3.1.4 The Panel has considered the submission. It is noticed that the issue of permanent establishment in India in the form of assessee's 100% subsidiary Itochu India Pvt Ltd has been examined at great length by the this Panel in assessee's case for AY 2013-14 and AY 2015-16 and it was held that the assessee indeed had a PE. After applying various tests and examining the agreement with Itochu India, and the legal pronouncements on the subject the Panel concluded that Itochu India constituted dependent agent PE of the assessee. For the sake of brevity, we are not reproducing the Panel's decision, which has also been reproduced by the AO in the draft assessment order. Following its order/direction for AY 2013-14 and 2015-16, the Panel holds that the assessee has permanent establishment in India. The objection is accordingly rejected on this count.”

5. The assessee is now in appeal before us and has raised following grounds;

“1. On the facts and in the circumstances of the case & in law, the final assessment order passed by the Ld. AO is bad in law and void ab initio.

2. On the facts and in the circumstances of the case & in law, the Ld. AO/ Ld. Dispute Resolution Panel (DRP) erred in making an addition of Rs.79.48.43,605/-and holding that Itochu India Private Limited (Itochu India'), and other agents constitute a dependent agent Permanent Establishment (PE') of the appellant in India in terms of Article & of the India-Japan Double Taxation Avoidance Agreement (DTAA').

3 On the facts and in the circumstances of the case & in law, the Ll. AO has failed to appreciate that the Itochu India has not fulfilled either of the pre-requisite conditions to constitute a dependent agent PE of the Appellant in India.

4. On the facts and in the circumstances of the case and in law, the addition of Rs. 79.48.43.605 made in the final assessment order is bad in law and needs to be deleted/quashed as it is a mere replica of the assessment order passed for AY 2013-14 and AY 2015-16 and based on account of incorrect appreciation of facts.

4.1 On the facts and in the circumstances of the case & in law, the Ld. AO erred in holding that the Appellant has not produced evidence to substantiate its position that it does not have a PE in India and has failed to appreciate that the company has provided all the documentary evidences including party wise sale details, copy of contracts/ bill of

ladings/invoices/ purchase orders and copy of agency agreement to substantiate the fact that the appellant made sales in India without any involvement of Itochu India or with a limited role of Itochu India where it is only acting as a communication channel.

4.2 That the Ld. AO/Ld. DRP has further erred in holding that the Appellant has failed to provide any information or agreements in relation to nature of relationship and dealings with these agents in India and has failed to appreciate various evidences including financial statements of Itochu India and email correspondences filed by the appellant to substantiate that the role of Itochu India was limited to being a communication channel and that Itochu India is not legally or economically dependent on the appellant.

4-3 That the Ld. AO/Ld. DRP has erred in holding that Itochu India secures orders in India on behalf of the appellant and has failed to appreciate that:

- the services in relation to the purchase of goods are different from sale of goods;*
- the purchase and sale functions performed by Itochu India are separately mentioned in the agency agreement;*

- *no negotiation activity was undertaken by Itochu India for sale purposes; and*
- *Itochu India had no authority whatsoever to conclude contracts on behalf of the appellant.*

5 That the Ld. AO/Ld. DRP has erred in holding that the appellant had a dependent agent PE in India.

5.1 That the Ld. AO/Ld. DRP has failed to appreciate that the Indian subsidiary has not secured any orders for appellant in India and is not involved in negotiating terms and conditions or the finalization of the prices of contract with Indian customers.

5.2 That the Ld. AO/ Ld. DRP has failed to appreciate that the Transfer Pricing Report of Itochu India specifically mentions that the role of Itochu India is limited to act as a communication channel between the associated enterprises and the customers and therefore the reliance placed by the Ld. AO/Ld. DRP is not justified

5.3 The Ld. AO/ Ld. DRP also erred on the facts, in the circumstances of the case and in law in holding that Itochu India is legally and economically dependent on the appellant and ignored to appreciate the fact that Itochu India is an independent entity, primarily engaged in trading activities

with major source of income being revenue from such trading activities only.

5.4 The Ll. AO/ Ld. DRP also erred in disregarding the appellant's submission that the conditions mentioned in Article 5(7) of India-Japan DTAA to constitute a dependent agent PE are not satisfied in the present case and thus, Itochu India should not be considered as a PE of the appellant.

6. On the facts and in the circumstances of the case and in law, the Id. AO/ Ld. DRP have not discharged their primary onus to prove that the appellant has a PE in India as per Article 5 of India-Japan DTAA.

6.1 That the Ld. AO/ Ld. DRP has made unsubstantiated allegation on the appellant that the appellant has a PE in India and have not even controverted to the voluminous details filed by the appellant before the Ld. AO and the Ld. DRP.

7. Without prejudice to the above grounds, the Ld. AO/ Id. DRP has erred on facts and circumstances of the case and in law in attributing 50% of the total sales made by the appellant and assuming a profit margin of 10% to the alleged PE, thereby assessing the income attributable to the alleged

PE amounting to Rs. 79.48.43.605, which is not only arbitrary but highly unreasonable and excessive.

7.1 That the Ld. AO/ Ld. DRP has erred in attributing 50% of the total sales value in India to the alleged PE without any justification and reasonable basis and without controverting to the various judicial precedents which have accepted a lower rate of income attribution

7.2 That the Ld. AO/ Ld. DRP has failed to appreciate that as per the audited non- consolidated accounts for the subject year, the global profit margin earned by the appellant is 0.36%, which ought to have been considered by the Ld. AO/Ld. DRP while determining the profit margin.

7.3 The Ld. AO/Ld. DRP has erred in considering the profit margin as 10% of the sales as per the provisions of Rule 10 of the Income-tax Rules, 1962 read with section 44BB of the Act without appreciating the fact that the provisions of Section 44BB of the Act are not applicable in the present case since the appellant is a trading company and is not involved in the business of extraction/ production/ prospecting of mineral oils or supplying machinery on hire or any related services thereof in India.

7.4 That the Ld. AO while attributing the income to the alleged PE has exceeded his jurisdictional powers and authority as the Ld. AO is specifically restricted from determining the arm's length price as per CBDT instruction No 3/2016 dated 10 March, 2016 read with section 92CA of the Act.

8. Without prejudice to the above grounds, the Ld. AO has failed to appreciate the fact that where the international transactions between Itochu India and the appellant have been found to be at arm's length price in the preceding year(s) and in the absence of any reference to the transfer pricing officer for the subject year, even if it is presumed for argument sake only that Itochu India constituted PE of the appellant in India, no further profits could be attributed and brought to tax in terms of Article 7 of the India-Japan DTAA.

8.1 That the Ld. AO/ Ld. DRP has failed to appreciate the fact that receipt of service fees by Itochu India from the Appellant was also examined by the Transfer Pricing Officer ('Ld. TPO') and was found to be meeting the arm's length criteria and subsequently order has been passed by TPO in preceding previous year.

9. That on the facts and circumstances of the case and in law, the Ld. AO has erred in initiating the penalty proceedings under Section 270A of the Act.

The above grounds are independent and without prejudice to each other.

The Appellant craves leave to alter, amend or withdraw all or any of the grounds herein or add any further grounds as may be considered necessary either before or during the hearing.

6. The submissions of Ld. Sr. Counsel have been rebutted by Ld. DR, submitting that this is second round of litigation and that AO has examined the fact about the presence of key personnel on secondment. Ld. DR has heavily relied the findings of the Coordinate bench in assessee's case for AY AY 2013-14 and AY 2015-16, and submitted that in this year too the issue may be restored to the files of AO for further verification of facts and assertions of assessee.

6.1 The Ld. Sr. Counsel however, contended that engagement of personnel on secondment is not the case of AO. It was submitted that these personnel were employees of *ITOCHU India*.

7. Giving thoughtful consideration to the material on record we find that following is the summary of International transactions entered into by the Itochu Japan with its AE, relevant FY;

International transactions	Name of the AE	Value (in INR)
Commission income	Itochu India	2,06,04,537
	Total	2,06,04,537
Provision of consultancy services	Itochu India	50,62,947
	Total	50,62,947
Receipt of IT support charges	Itochu India	1,01,61,633
	Total	1,01,61,633
Reimbursement of expenses received	Itochu India	12,33,533
	Total	12,33,533

8. If we examine the relevant clauses of the Memorandum of Agency Agreement, the copy of which is available at page no. 27-32 of the PB we find that clause 2 defines the power of agent as follows;

“2. POWER OF AGENT

(a) Unless otherwise authorized by the Principal, all contracts, orders, proposals, and offers for sale or purchase of the Goods are subject to final and formal approval and acceptance by the Principal at its discretion and the Agent has no power, right, or authority to approve or accept same on the Principal's behalf or to bind the Principal in any way.

(b) Notwithstanding the preceding (a), the Agent may at any time subject to the Principal's approval, deal or transact with the Principal on account and risk of the Agent for the import and export of all Goods to and from the Territory and Japan.”

8.1 Then as with regard to the individual transactions in the agency agreement it was agreed that;

“4. INDIVIDUAL TRANSACTIONS

(a) Quotation: Unless otherwise agreed to by Principal, price of the goods shall be quoted in US dollar as follows :

1)

C.I.F. or C. & F. main port located within the Territory in case of the export of the Goods from Japan.

2)

.O.B. main port located within the Territory in case of the import into Japan of the Goods.

(b) Overage: In case the Principal finalizes the business at a price higher than the Base Price, then upon finalizing the business the Principal shall credit the difference between Final Price and Base Price to the Agent's account and remit the same in due course.

(c) Duration of Offer : Unless otherwise agreed all offers or counteroffers by cable or telex shall be valid and irrevocable for forty-eight (48) hours from the time of dispatch, and offers or counteroffers by mail shall be subject to subsequent change or modification..

Payment : Unless otherwise agreed to by the Principal terms of payment for each transaction shall be arranged as follows :

1)

*I
n case of the export of the Goods from Japan irrevocable letter of credit to cover payment shall be opened by or for a customer in the Territory by cable or airmail immediately after a sales contract is finalized.*

2)

*I
n case of the import of Goods into Japan irrevocable letter of credit shall be opened by the Principal i by cable or airmail immediately after a purchase contract is finalized.*

(e) The Agent shall try to minimize the increased costs such as minimum freight charges, government imposition and others that the Principal may encounter in the course of carrying out a contract with buyer or seller in the Territory.”

8.2 Then as to commission in clause 5 of the agency agreement it is agreed as follows;

“5. COMMISSION

The Principal shall pay commission to the Agent at the rate described in the Schedule (A) hereto for all transactions with sellers or buyers of the Goods in the Territory made by the Principal with the assistance of the Agent as paragraph 3 including the transactions made as a result of dealings under paragraph 2 (b) hereof.

The rate of commission herein provided is subject to increase or decrease for a particular transaction if both parties hereto may from time to time so agree, and confirmed by the supplement of Agency Agreement.

Payment of the commission shall be effected basically within a month after the completion of each transaction.”

9. Thus from the relevant clauses in memorandum of agency agreement entered into between the assessee with Indian subsidiary, we find that as per Article 1, the appointment of the Indian subsidiary as agent was for the purpose of performing the functions as selling and purchasing agent for the export from Japan and the import into Japan of all kinds of goods. Article 1 itself mentions that the assessee company as a principal reserved the right to quote price, place orders of the goods and otherwise deal directly with buyers and/or sellers located in the territory or

visiting Japan from the territory, if all the actions of the assessee as principal, circumstances make it necessary advisable to do so.

10. Learned DR has submitted that these recitals in Article 1 establish a principal and agent relationship and apart from that no other evidence would be actually required. However, we are of the considered view that merely be referring to the parties as principal or agent, the provisions of Article 5(6) cannot be invoked. What is essential is to establish that specific condition laid down in Article 5(7) of India-Japan DTAA are fulfilled. Establishing that the said agent habitually exercises authority to conclude contracts in India or habitually maintains stocks of goods in India for delivery to customers or habitually secures orders in India. It is necessary to establish that the business activities of the agent are without any control or supervision of the principal. It is further necessary to establish that the agent has authority to take decisions in relation to its day to day business operations and providing services to the customers on the basis of the agreement with the principal on its own and without any instructions or directions of the principal. It should be established that requisite skills, resources, employees and expertise are available with the agent to perform the services and the agent bears all sorts in relation to the services as an agent. Most importantly the burden is on AO to establish the same.

11. The functional analysis of the two entities as per the TP study, available in PB at page no.77-129 reveals that as far Negotiation with suppliers is concerned Itochu Japan negotiates

prices and other terms with the suppliers. Itochu India does not negotiate price, etc. with suppliers. The role of Itochu India in identification of suppliers, and in negotiation processes with suppliers is very limited. Services rendered by Itochu India to Itochu Japan are recommendatory in nature and decision as to the sale / purchase is taken by Itochu Japan directly. Also, the final decision of approving/ rejecting the supplier (along with prices) lies with Itochu Japan, and Itochu India only facilitates the negotiation process.

11.1 In contract with suppliers Itochu Japan is the party to contract with suppliers and therefore bear any consequential liability. Itochu India does not enter into contracts with suppliers. In trading transactions, Itochu India enters into contracts with Itochu Japan from whom it takes title to the goods.

11.2 In regard to the Identification of customers. The majority of India customers are either existing customers of Itochu Japan i.e. companies having headquarters in Japan and prior business dealings with the Itochu Group or are generally well-known companies. Itochu Japan already possess substantial amount of information on the India customer base or such information is readily available in the public domain. As such, Itochu India does not generally identify the customers.

11.3 Coming to the Negotiation with customers. Itochu Japan is principally responsible for negotiations with customers. Normally, before finalizing a deal, Itochu Japan evaluates, among other factors: credit worthiness of the customer; past experience with the customer or its group; pricing; terms of payment; specifications of product or service required; and delivery terms and conditions: Itochu India does not take active part in price negotiations with prospective customers. Itochu India only acts as a facilitator in Itochu Japan's negotiations with customers. Itochu Japan is responsible for concluding customer negotiations and making all final decisions on pricing and terms. In relation to trading transactions!; Itochu India takes title and holds inventory. However the inventory held by Itochu India is backed by confirmed orders. In majority of cases, Itochu India holds flash title to the goods.

11.4 The role of Itochu India in identification of customers, and in the negotiation process is very limited. Services rendered by Itochu India to Itochu Japan are recommendatory in nature and decision as to the sale / purchase is taken by Itochu Japan directly. Also, the final decision of approving/ rejecting the customer (along with pricing) lies with Itochu Japan, and Itochu India only facilitates the negotiation process.

11.5 The credit evaluation of the customers is made by Itochu Japan. Itochu India gathers relevant information on potential customers and Itochu Japan makes all final decisions on the

credit-worthiness of the customers. In trading transactions where Itochu India takes title, Itochu India gathers relevant information and takes final decision on the credit-worthiness of the customers.

11.6 As with regard to the contractual arrangement with the customers. Itochu Japan enters into all contracts with customers for the sale of products and therefore bears the resulting liability. In the indent transactions, Itochu India does not enter into contracts with customers. In trading transactions, Itochu India enters into contracts with the customers and bears the consequential contractual liability. However, such liability is passed on to the supplier since all orders are confirmed orders and are entered into on back-to-back basis.

11.7 In marketing, since the Itochu Group does not sell products directly to consumers, marketing is not an extensive activity for any Group member. Nonetheless, having a strong reputation across a diverse range of companies and industries is an important business driver for the Group. Itochu Japan decides the brand image for the Itochu Group globally. Itochu India is responsible for coordination, keeping contacts and providing current economic information to Itochu Japan on a regular basis to enable Itochu Japan to consider these factors in formulating its strategy for India.

11.8 In regard to the ordering and order processing, Itochu Japan receives, negotiate, and process all sales orders for third party

customers in India. For trading transactions, Itochu India is responsible for receiving and processing sales orders for Indian customers.

11.9 As far the pricing is concerned, Itochu Japan is solely responsible for developing the pricing for products and services. Itochu India does not independently develop pricing recommendations. However, Itochu India communicates pricing expectations of the customers to Itochu Japan to enable them to negotiate with the customers. In respect of trading transactions, where Itochu India takes title from its AE and re-sells to customers in India, price negotiation is conducted between the customer and Itochu India.

11.10 In regard to the financing, invoicing, and collection. Itochu Japan, based on the terms negotiated with customers, may extend credit to customers. Financing, invoicing, and collection are carried out directly by Itochu Japan vis-a-vis the customers. Itochu India does not assist Itochu Japan in collection of dues from customers. However, upon specific request of Itochu Japan, Itochu India may assist in collection in rare circumstances. In trading transactions Itochu India is responsible for customer invoicing and collections activities.

11.11 The Logistics required is with Itochu Japan who is responsible, directly or indirectly, for developing and maintaining these systems. Itochu Japan develops the overall logistic policies and bear the costs and associated liabilities of logistics depending

on the contractual arrangement with the supplier and customer. Itochu Japan is responsible for arranging, managing and monitoring shipments. Itochu India is only responsible for keeping a track of the movement of goods sold by Itochu Japan and informs the same to the customers upon request. In case of trading transactions with Itochu Japan, generally Itochu India does not hold inventory and only takes flash title to the goods. In this case, Itochu India is involved in entering into a contract with the customer, following-up with the customers and providing information about delivery of goods. In case Itochu India holds inventory, Itochu India is responsible for arranging inland transportation, delivery maintenance and custom clearance.

11.12 The supervision and quality control is ensured by Itochu Japan. It ensures that the products exported / imported meet the quality standards and other specifications as desired by the supplier / customer. Itochu India does not play any role in ensuring the quality, but it provides information to the respective party in case the quality of the product is not in line with the standards agreed.

11.13 We find that Itochu India is merely responsible for staying abreast of market, regulatory, and political conditions in India and updating Itochu Japan on a regular basis to enable them to consider these factors in formulating its strategy for India. Itochu India undertakes industry analysis and identifies industry trends and business opportunities on a continuous basis in India with

the objective of understanding the prevalent demands/ market price, competitive environment and trends in the industry. This is based on specific requests from Itochu Japan. Itochu India provides the results of its research to Itochu Japan in order to enable them to undertake decisions. Itochu India collates such information through various sources such as published reports, journals, newspapers, magazines and attending seminars organized by industry trade bodies.

11.14 However, Itochu Japan and Itochu India are responsible for their respective administrative, financial and legal matters, “they may coordinate certain activities, and may rely on certain central systems (e.g., information technology System).

11.15 Coming to facilitation support by Itochu Japan (resultant commission income for Itochu Japan) we find in certain cases, Itochu Japan provides facilitation support to Itochu India in relation to the trading transactions (back-to-back) entered into by Itochu India with third party customer. The services provided by Itochu Japan includes:

- Support, advise and inform Itochu India of product specification, technical issues etc.;
- Assist in negotiation with third party;
- Assisting Itochu India in purchase scheduling; and
- Assisting Itochu India in achieving appropriate quality of the products.

11.16 As from the above services, Itochu Japan earns a commission, which is based on the sales value and same happened to be one of the international transaction under consideration at time of TP Study.

12. Then we find that as far as the provision of services/ cost allocation to Itochu India is concerned, Itochu India also receives IT support services from Itochu Japan which are in the nature of recharge in relation to the SAP cost [usage of ITOCHU Overseas standard System' ('G-SAP') and IP-VPN, Cisco router.

G-SAP includes the following functionalities:

- Business function;
- Accounting and finance function;
- Consolidation function;
- Business intelligence function; and
- Interface function between G-SAP, and other systems.

12.1 The above transaction is entered into on the basis of reasonable allocation keys without any element of mark-up.

12.2 As with regard to provision of consultancy services, Itochu India receives certain consultancy services from Itochu Japan. As per the arrangement, Itochu Japan is responsible for provision of support services in the nature of human resource strategy for

recruiting, training and development of foreign staff, tax services, etc. in respect of the following divisions of Itochu India:

- Research and business development;
- Human resources and general affairs;
- Legal;
- Finance;
- General accounting control;
- Metals and minerals;
- Energy and chemicals; and
- Food.

12.3 The above transaction is entered into on the basis of reasonable allocation keys without any element of mark-up.

12.4 Thus specifically with respect to the international transactions under consideration, it can be construed that Itochu Japan is a service provider to Itochu India.

15. Now Article 5(7) of the India-Japan DTAA provides that to constitute a Dependent Agent PE, it is necessary that the following conditions are satisfied:

“7. Notwithstanding the provisions of paragraphs 1 and 2, where a person other than an agent of an independent status to whom paragraph 8 applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State, if

(a) he has and habitually exercises in that Contracting State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 6 which, if exercised through a fixed place of

business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph;”

15.1 In this regard, based on the agency agreement we find that ITOCHU India does not have any authority to conclude any contract on behalf of ITOCHU Japan in India in relation to the sale activities. ITOCHU India does not have the power to negotiate any term of the contract with the Indian customer. Thus, the first condition is not satisfied in the present case.

15.2 The second condition for application Article 5(7) of the India-Japan DTAA is;

“(b) he has no such authority, but habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise;”

15.3 What we find is that ITOCHU India does not maintain any stock of goods or merchandise. The goods are supplied offshore and are imported by the Indian customer directly. The same is evident from the copies of various import documents filed in PB Volume II. Thus, this condition is also not satisfied.

15.4 The third condition for application Article 5(7) of the India-Japan DTAA is;

“(c) he habitually secures orders in the first-mentioned Contracting State, wholly or almost wholly for the enterprise

itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control as that enterprise.”

15.5 In this regard, we find that securing an order means complete involvement from the starting to the end including active involvement in negotiating the terms of the contract and convincing the customer to place orders. However, there is no such fact present in this case. We have reproduced all the relevant aspects of the process of entering into contract by assessee, directly with customers or through Itochu India. We find that the role of ITOCHU India is limited to act as a communication channel. We have examined the email correspondences and there is nothing to show ITOCHU India is acting in its individual capacity to conclude the contract or even a part thereof. It is merely bridging the communication gap between ITOCHU Japan and the Indian customer.

16. Then we find that ITOCHU India has been paid a service fee/ commission by the Assessee for the services provided by it which has been tested and found to be meeting the arm's length criteria. In this regard, we have made reference to the transfer pricing documentation maintained by ITOCHU India as well as the transfer pricing certificate obtained by ITOCHU India in Form 3CEB for the captioned year wherein the payment received by ITOCHU India for the services provided to the Assessee have been found to be at arm's length. Accordingly, once it is established that the alleged PE has been compensated at an arm's length

price, no further profits can be attributed to such PE in accordance with the provisions of the DTAA. In this regard, the case of assessee is also that for the preceding years, the transaction of receipt of service fees by ITOCHU India from the Assessee was also examined by the Transfer Pricing Officer and was found to be meeting the arm's length criteria.

17. Then the Revenue cannot dispute the fact that the major sources of Itochu India is from independent trading activities undertaken by it. The audited financial statements of Itochu India for the year ending 31st March, 2017 is available at pages 33 to 62 of the paper book and we find that sales of traded goods mentioned at page 53 of the paper book under 'Revenue from operations' is Rs.628,15,19,264/- and the details of traded goods is provided along with purchase of stock in trade of the traded goods which are similar to the details of sales of traded goods. Further, going through the copy of non-consolidated financial statement of Itochu Japan for the year ending 31st March, 2017 available at pages 63 to 76 of the paper book, we find that the total trading transactions for the year ending 31st March, 2017 was Rs.44,70,329/- million yen. On perusal of the commission income of the Itochu India from Itochu Japan, we find that it forms a very small portion of the total revenue of Itochu India.

18. There is nothing in the form of evidence which show that Itochu India habitually exercises the authority to conclude contracts in India or maintains stocks in India for delivery to customers or

secures orders in India. The AO has rejected all the arguments of the assessee on the basis that the assessee has failed to produce India specific accounts for the trading operations and the profit earned thereon and, accordingly, held that as the profits earned by the assessee from Indian operations are not available guidance is drawn from Rule 10 r.w.s. 44BB of the Act wherein the deemed profits is estimated @ 10% of the revenue of price/consideration. We are of the considered view that when the financials of Itochu India and the assessee were there along with the agency agreement, then making such observations without an independent inquiry on its own is not justified. The AO has laid burden on the assessee to establish the nature of agency. However, no attempt was made to examine the agreement. Only because the nature of business of trading is a continuous flow of the business process that cannot be a foundation to conclude a principal-agent relationship for the purpose of Article 5 of the DTAA. The ld. DRP at the same time discredited the case of the assessee only on the basis of assumptions and surmises, as to how, to his mind, the two entities 'may' have been 'actually' transacting their business.

19. We are of the considered view that before us for the present AY the factual aspects are crystal clear that there is no PE of assessee in the form of Itochu India. Thus there is no justification to follow the AY 2013-14 and 2015-16 orders of Co-ordinate bench to set aside the assessment to the files of AO for further verification of the facts about nature of contractual relationship between the assessee and Itochu India.

20. As a sequel to aforesaid discussion we are inclined to sustain the grounds. Consequently the appeal is allowed.

Order pronounced in the Open Court on 26.07.2024

Sd/-

**(GS PANNU)
VICE PRESIDENT**

Sd/-

**(ANUBHAV SHARMA)
JUDICIAL MEMBER**

Dated: 26/07/2024.

Pooja/-

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI