आयकर अपीलीय अधिकरण "B" न्यायपीठ मुंबई में।

IN THE INCOME TAX APPELLATE TRIBUNAL "B" BENCH, MUMBAI

श्री महावीर सिंह, न्यायिक सदस्य एवं श्री एन. के. प्रधान लेखा सदस्य के समक्ष ।

BEFORE SRI MAHAVIR SINGH, JM AND SRI NK PRADHAN, AM

आयकर अपील सं./ **ITA No. 6553/Mum/2017**

(निर्धारण वर्ष / Assessment Year 2012-13)

The Dy. Commissioner of Income-tax 5(1)(1), Room No. 568, 5th Floor, Aayakar Bhavan, M.K. Road, Mumbai-4000 020	Vs.	Blue Star Diamonds Pvt. Ltd, CE-9010, 8013, 8014, 8016, 9th Floor, tower-C, Bharat Diamond Bourse, BKC, Bandra(E), Mumbai-400 051
(अपीलार्थी / Appellant)	..	**(प्रत्यर्थी / Respondent)**
स्थायी लेखा सं./**PAN No. AADCB6475E**		

अपीलार्थी की ओर से / **Appellant by**	:	Shri G.L.V. Prasad, DR
प्रत्यर्थी की ओर से **/ Respondent by**	:	Shri Subash Shetty, AR

सुनवाई की तारीख **/ Date of hearing:**	13-06-2019
घोषणा की तारीख **/ Date of pronouncement :**	13-06-2019

आदेश / O R D E R

महावीर सिंह, न्यायिक सदस्य/
PER MAHAVIR SINGH, JM:

This appeal by the Revenue is arising out of the order of the Commissioner of Income Tax (Appeals)]-55, in short CIT(A), in appeal No. CIT(A)-55/IT-191/2016-17 dated 28.06.2017. The

penalty was levied by DCIT-1(3)(1), Mumbai, under section 271G of the Act vide order dated 29.07.2016.

2. The only issue in this appeal of Revenue is against the order of CIT(A) deleting the penalty under section 271G of the Act. For this Revenue has raised the following two grounds:

> *"1. Whether in the facts and circumstances of the case and in law, the Ld. CIT(A) was right in deleting the penalty under section 271G in the assessee case even when the assessee had clearly failed in maintaining he documentation as required under section 92D(3) of the act.*
>
> *2. Whether in the facts and circumstances of the case and in law, the CIT(A) was right in arriving at the conclusion that the TPO could have tried to work out the gross profits and net profits by averaging the purchase prices and the expenses in proportion of export sales of each one of the segments to arrive at average profitability of each segment and then to compare the same with the average profitability of other public companies whose details were available in public domain, when it was not*

possible to do so in the absence of proper documentation."

3. Brief facts are that the AO levied the penalty under section 271(1)(c) of the Act amounting to Rs. 5,90,73,838/- being calculated at the rate of 2% of the international transaction. The assessee has contended that the ratio of related party transaction is less than25% of the total transaction and thus segregation of transaction between AE and non AE shall not have significant impact on the operating margin. The assessee has relied on the decision of the ITAT in the case of Actis Advisors P. Ltd in ITA No. 5277/DeI/2011, wherein it is concluded that an entity can be taken as uncontrolled, if it is party transaction (RPT) do not exceed 25% of the total revenue. The contention of the assessee is rejected as entity level profit in such cases does not represent the correct AE profit for the purpose of benchmarking the international transactions of the assessee and therefore comparison at entity level with other comparable is not justified because of which the assessee was asked to furnish segmental profitability of the AE and Non AE separately. The assessee contended that there is no failure to maintain documents and records as per the provision of section 92CA of the Act. The assessee has also objected and stated that it had maintained all the documents and information necessary to substantiate that the transactions entered into with the AE were at arm's length price. The said submissions further stated that documentation as requested under Rule 10D of the Income Tax Rules 1962 as well as providing segmental accounts dividing the segments between AE

sales and non-AE sales and basis of said allocation was also provided. This objection was rejected by the TPO as the assessee has failed to furnish the true and correct segmental results related to transactions with the Associate Enterprises, as the segmental analysis filed by the assessee is based partly on actual figures and partly on ratios applied based on Sales/ Purchase or COGS (cost of goods sold), which has prevented the TPO from determining the ALP in the assessee's case.

4. But, the assessee contended that nature of diamond industry and the difficulties faced in maintaining the segmental results in respect of AE & Non AE can be analyzed. The assessee filed a note and in the said note the assessee has explained various technical aspects in respect of rough diamonds and polished diamonds, manufacturing process and aspects related to assortment of diamonds before and after manufacturing are discussed. The assessee has further stated that due to mixing and remixing of diamonds for the purpose of sales it is not possible to identify the source of diamond sold and exact cost of the product sold which prevents the assessee to bifurcate the transactions with third parties AE and also to prepare separate segmental accounts. It was contended, in the light of this note, the segment reporting as per AS 17 which are available in the Annual Report based on geographical segment. The segmental report based on geographical segment has no relevance in determining ALP of the international transactions as such report does not have any data related to the AE on standalone basis. The assessee also claimed that external

TNMM is the most appropriate method to benchmarking international transactions considering the nature of business of the assessee and such method being consistently followed by the company and the Tax Authorities. In this connection it is stated that the contention of the assessee is rejected as entity level profit in such cases does not represent the correct AE profit for the purpose of benchmarking the international transactions of the assessee and therefore comparison at entity level with other comparable is not justified because of which the assessee was asked to furnish segmental profitability of the AE and Non AE separately.

5. We noted that the CIT(A) has recorded the facts regarding the International transactions as under: -

S.No.	Nature of International Trasactions	Amount in (₹)
1.	Purchase/ sale of Rough diamonds	222,13,90,771/-
2.	Purchase/ Sale of Polish Diamonds	72,23,01,139/-
3.	Investment in shares	33,64,922/-
4.	Loan given	54,87,169/-

TPO issued notices under the TP provisions and asked the assessee to submit details and documents mentioned as per rule 10D(1) and 10D(3) of the Rules along with other specific details. After examining these details and documents, the TPO asked the assessee to submit the segmental profitability for AE transactions and non-AE transactions. Assessee expressed its inability to furnish details in this manner since it did not maintain separate books of accounts for AE and non-AE segments. Therefore, the TPO held that he was prevented from benchmarking various transactions and issued a show cause notice under section 271G of I.T. Act, 1961 as

to why the penalty under section 271G of l.T. Act, 1961 be not levied.

6. But the TPO levied the penalty on the international transaction. However, the CIT(A) deleted the penalty by following the decision of Hon'ble Delhi High court in the case of CIT Vs. Leroy Somer & Controls (India) Pvt. Ltd. [2014] 360 ITR 532 (Delhi).

7. Now the learned Counsel for the assessee before us filed copy of the Tribunal's order in the case of ACIT vs. Dilipkumar V. Lakhi, in ITA No.2142/Mum/2017 order dated 02.08.2018. We noted that this issue has been deliberated by Hon'ble in the case of Dilipkumar V. Lakhi (supra) vide Para 8 as under:

> *"8. Having perused the material on record and after hearing both the parties vis-à-vis the decision of the co-ordinate Bench of the Tribunal in the case of ACIT vs. D Navinchandra Exports Pvt. Ltd. (supra), we observe the identical issue has been decided by the Bench in favour of the assessee. The operative part of the decision is as under:*
>
> > *18. We find that the CIT(A) after deliberating at length on the nature of the business of manufacturing and trading of diamonds, therein concluded that in the backdrop of the intricacies*

involved in the said business it was practically difficult for the assessee to furnish the information in the manner the same was called for by the TPO. We find that the CIT(A) in the backdrop of an indepth study of the nature of activities involved in the business of manufacturing and trading of diamonds, had in a very well reasoned manner culled out the peculiar nature of the trade of the assessee. We are of the considered view that a careful perusal of the very nature of the business of manufacturing and trading of diamonds therein glaringly reveals that certain information which was called for by the TPO could not be furnished by the assessee. We find that the CIT(A) had observed that as the assessee had purchased a mix of imported rough and polished diamonds from AEs and non-AEs, and had also sold/exported rough and polished diamonds to AEs as well as the non-AEs, therefore, the Profit & loss a/c of the assessee reflected a mixture of purchases and sales both from the

AEs and the non-AEs. We are persuaded to be in agreement with the view of the CIT(A) that now when the rough/polished diamonds were traded on lot wise basis, therefore, it was difficult to identify and say whether a polished diamond came out of a particular lot of rough diamonds or the other and/or out of the polished diamonds purchased locally by the assessee. We find that the export bills of the cut and polished diamonds exported to the AEs and the non-AEs revealed that the diamonds of varying size, quality, colour and carat weight were exported as was evident from the price per carat charged in each bill, and similar would have been the position in respect of cut and polished diamonds purchased and sold locally and/or purchased from abroad but sold locally. We are of the considered view that in the backdrop of the aforesaid peculiar nature of the trade of the assessee, it could safely or rather inescapably be concluded that it was extremely difficult to identify which

rough diamond got converted into which polished diamond, unless the single piece rough diamond happened to be of exceptionally high carat value, therein making the tracing out and identification of the polished diamond physically possible and convenient. We find that the aforesaid practical difficulties in providing the details being faced by the industry can be well gathered from the letter of the GJEPC to the CIT-Transfer Pricing, Mumbai, wherein the aforesaid aspects involved in the diamond manufacturing business were explained.

19. We find that the assessee had in the backdrop of the very nature of its business, viz. manufacturing of diamonds, had though explained to the TPO the practical difficulty in furnishing segment wise Profit &loss account of the AE segment and the non-AE segment, however, the TPO insisted for the same and invoked Rule 10D of the Income-tax Rules, 1962, and instead of determining the arms length

price in respect of the international transactions of the assessee with its AEs, rather went ahead and levied penalty under Sec. 271G in the hands of the assessee. We are not impressed with the manner in which the assessee had proceeded with the matter and imposed penalty under Sec. 271G in the hands of the assessee. We are of the considered view that in light of the aforesaid practical difficulties which were being faced by the diamond industry, the TPO should have exercised the viable option of determining the arms length price of the international transactions of the assessee, either by making some comparison of realisation of prices in respect of export sales to AEs and non-AEs by comparing prices of diamonds of similar size, quality and weight to the best extent possible, or in the alternative could have asked for the copies of the Profit & loss accounts and the Balance sheets of the AEs in order to make an overall comparison with the gross profitability levels of the

assessee with its AEs, which would had clearly revealed diversion of profits, if any, by the assessee to its AEs. We are further unable to comprehend that as to on what basis the TPO expected the assessee to have carried out the benchmarking by following CUP method. We are of the considered view that as the comparison by internal CUP method could only be made if two lots of diamonds were similar in size, colour, shape and clarity, which we are afraid, as observed by us at length hereinabove, in light of the peculiar nature of the trade of the assessee would not be possible. We find ourselves to be in agreement with the CIT(A) that if one lot had diamonds of variety of size, colour, shape and clarity, the prices would vary from diamond to diamond and lot to lot, and further, now when the entire lot of diamonds had a common price tag per carat for the whole lot, therefore, it was not possible to evaluate the price of each diamond. We also cannot be

oblivious of the fact that even otherwise in the diamond trade line, unless a diamond would weigh half carat or more or one carat or more, the same would not be priced separately in the bill because it was not practical to price diamonds of weights of lower than half carat or one carat separately weight wise per diamond in the lot. We have deliberated on the aforesaid peculiar facts involved in the business of diamond trading and are of the considered view that the insistence of the TPO that the assessee should have followed CUP method was misconceived and impractical. We are in agreement with the CIT(A) that if the TPO would had carried out a comparison of the Profit & loss account and Balance Sheets of the AEs, the same would had revealed the gross profit margins and levels of profitability earned by the AEs in their businesses, and as such any abnormal variation in their gross profitability would had revealed the aberrations in the international transactions.

20. We further find that as stands gathered from the records, the nature and level of business of the assessee during the year under consideration had increased almost two fold. We find that while for the gross profits of the assessee had also increased from 7.42% for A.Y. 2010-11 to 8.71% for the year under consideration, viz. A.Y. 2011-12, the Net profit had also witnessed a growth from 3.9% in the immediate preceding year to 4.9% during the year under consideration. We further find that as observed by the CIT(A) that in the preceding year, i.e A.Y. 2010-11 the TPO did not propose any adjustment in the ALP. We are not inspired by the fault finding approach adopted by the TPO without understanding the intricacies of the diamond manufacture and trading business, and are of the considered view that he instead of determining the arms length price by asking for the Profit & loss a/c and Balance Sheets of the AEs and comparing the financial ratios in general, had rather hushed

through the matter and imposed penalty under Sec. 271G of Rs. 2,15,98,527/- on the assessee. We also find that the assessee to the extent possible in the backdrop of the nature of its trade had furnished several details on several occasions from time to time with the TPO. We thus are of the considered view that the assessee had substantially complied with the directions of the TPO and placed on his record the requisite information, to the extent the same was practically Possible in light of the very nature of its trade. We though are not oblivious of the fact that the assessee may not have effected absolute compliance to the directions of the TPO and furnished all the requisite details as were called for by him on account of practical difficulties as had been deliberated by us at length hereinabove, but however, in the backdrop of our aforesaid observations, we are of the considered view that the failure to the said extent on the part of the assessee to comply

with the direct ions of the TPO can safely be held to be backed by a reasonable cause, which thus would bring the case of the assessee with the sweep of Sec. 273B of the 'Act'. We thus in the backdrop of our aforesaid observations find ourselves to be in agreement with the view taken by the CIT(A,) and finding no reason to dislodge his well-reasoned order, therefore, uphold the same. We thus uphold the order of the CIT(A) and the resultant deletion of the penalty of Rs. 2,15,98,527/- imposed by the TPO.

21.The appeal of the revenue is dismissed.

9. Since the facts of the assessee's case are materially same with the decision as discussed hereinabove. We, therefore, respectfully following the said decision of the co-ordinate Bench, which has been rendered under identical facts and circumstances, we are inclined to uphold the decision of the learned CIT(A) deleting the penalty."

8. Since, the facts and circumstances are exactly identical and Tribunal is consistently taking a view on these facts. Hence, we confirm the order of CIT(A) deleting the penalty. The appeal of Revenue is dismissed.

9. **In the result, the appeal of Revenue is dismissed.**

Order pronounced in the open court on 13.06.2019.

Sd/-	Sd/-
(एन. के. प्रधान/ NK PRADHAN)	(महावीर सिंह /MAHAVIR SINGH)
(लेखा सदस्य / ACCOUNTANT MEMBER)	(न्यायिक सदस्य/ JUDICIAL MEMBER)

मुंबई, दिनांक/ Mumbai, Dated: 13.06.2019.

सुदीप सरकार, व.निजी सचिव / *Sudip Sarkar, Sr.PS*

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to</u> :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**