

THE INCOME TAX APPELLATE TRIBUNAL  
"H" Bench, Mumbai  
Shri Shamim Yahya (AM) & Shri Ramlal Negi (JM)

I.T.A. No. 3104/Mum/2019 (Assessment Year 2013-14)

ACIT-32(2) Room No. 720 Kautilya Bhavan C-41-43, G Block BKC, Bandra East Mumbai-400 051.	Vs.	M/s. Kapu Gems E-Tower Centre EC-3021, 3 <sup>rd</sup> Floor Bharat Diamond Bourse, BKC Bandra East Mumbai-400 051.  PAN : AADFK3266D
(Appellant)		(Respondent)

Assessee by	Shri K Vaidya Lingam
Department by	Shri Gurbinder Singh
Date of Hearing	11.11.2020
Date of Pronouncement	01.02.2021

ORDER

Per Shamim Yahya (AM) :-

This is an appeal by the Revenue against the order of learned Commissioner of Income Tax (Appeals) [in short learned CIT(A)] dated 7.3.2019 and pertains to A.Y. 2013-14..

2. The grounds of appeal read as under :

- (i) "Whether the Ld. CIT(A) was correct in deleting the penalty levied u/s. 271G of the Act, by holding that the assessee had made substantial compliance, failing to note that under TNMM adopted by the assessee, the profit of the international transaction has to be furnished, whereas the assessee has only furnished the entity level margins which consists of overall profits on AE and significant non non-AE transactions.
- (ii) Whether the decision of the Ld. CIT(A) is not vitiated for the reason that the Ld. CIT(A) has not given any finding on how the assessee has complied with clause (d), (g), (h) and (m) of Rule 10D(1), that have been specifically invoked by the TPO.
- (iii) The Ld. CIT(A) erred in holding that there was reasonable cause for non-compliance of Section 92D read with Rule 10D(1) without

specifying the cause of such non-compliance or demonstrating how the same was reasonable.

- (iv) Whether the Ld. CIT(A) was correct in ignoring the ratio laid down in the decision of the Hon'ble High Court in the case of M/s. Shatrunjay Diamonds (261 ITR 258) holding that the initial burden was cast upon the assessee?
- (v) The Ld. CIT(A) erred in deleting the penalty for the reason that no adjustment was made to the ALP, failing to note that by not producing the material documents necessary to determine the ALP under any of the prescribed methods u/s 92C(1) of the Act, the assessee effectively prevented the TPO to make any determination as recorded by the TPO in the order u/s. 92CA (3) of the Act.
- (vi) The appellant prays that the order of the Ld. CIT(A) on the above grounds be set aside and that of the AO be restored.”

3. Brief facts of the case are that :-

The assessee is engaged in the business of import of rough diamonds, manufacturing the same into polished diamonds, and finally export the said polished diamonds. During the FY 2012-13 relevant to AY 2013-14 the assessee has had the following international transactions with its AEs :-

Sr.No.	Nature of international transaction		Amount (Rs.)	Method
1	Export of cut and polished diamonds	Kapu Gems Ltd.	351,32,76,616	TNMM
2	Import of cut and polished diamonds	Kapu Gems Ltd.	58,58,340	TNMM
			331,91,34,956	

The Assessing Officer noted that it is seen from the following are the total purchases and sales effected by the assessee with AE during A.Y. 2013-14 :-

Total Sale of Cut & Polished Diamonds	= Rs. 718,74 crores
Sale of Cut & Polished Diamonds (AE)	= Rs. 331.33 crores
Purchase of Cut & Polished Diamonds	= Rs. 690.71 crores
Purchase of Cut & Polished Diamonds(AE)	= Rs. 0.58 crores

That the sale of assessee to AE is about 46% of turnover and purchase of assessee from AE is about 0.08% of total purchase. The assessee in its transfer pricing study report has followed TNMM method for the purpose of

benchmarking. Operating profit/Total Cost has been used as Profit Level Indicator (PM). For the purpose of comparison the assessee has compared its entity level margins (4.86%) with that of comparable companies margin (3.69%) and claimed that the transactions are at arm's length. That the entity level margins of assessee included its combined profit in transactions with Associate Enterprises (AE) and non Associate Enterprises (non-AEs).

4. The Assessing Officer referred to provisions of concerned section as under :

“Section 92C(1) of income Tax Act, 1961 prescribes the methods of benchmarking the international transactions as under:

92C(1) The arm's length price in relation to an international transaction [or specific 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;
- (d) 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 sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:

7. Rule 10B describes the five methods for determination of arm's length price for international transaction as per section 92C of income Tax Act, 1961. In the instant case, the assessee has himself selected TNMM as most appropriate method for the purpose of benchmarking its international transaction. TNMM method is prescribed under Rule 10B(1)(e) as under:

- (e) transactional net margin method, by which, -
  - (i) the net profit margin realised by the enterprise from an international transaction 55c [or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) The net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction 55c[or the specified domestic transaction] and the comparative uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market; (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii); (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction 55c[or the specified domestic Transaction];

5. The Assessing Officer was of the opinion that as per above rule, the net profit margin realized by the assessee from international transactions has to be ascertained in relation to cost incurred or sale or any other relevant base. That this net profit margin can be compared with the net profit margin realized by the assessee itself in its transaction with unrelated parties or with the transactions entered into by the unrelated parties in comparable uncontrolled transactions. That so the first step is that, the assessee's net profit margin needs to be calculated with respect to international transactions entered into by it.

6. The Assessing Officer held that the order to find out whether the transactions entered in to by the assessee with its AE are at arms length with that entered in to by the third party in comparable situation with independent parties, the separate segmental results in assessee's transactions with AE and non-AE are a must. Because in combined entity level margins the loss in transactions with AE segment can be easily set off with the profits with non-AE segment. That in such a situation the benchmarking will not be correct. That there is no way by which correct benchmarking can be done unless and until the assessee submits the correct margins in respect of transactions with AE and non-AE. And non availability of data in this regard can make the whole exercise of benchmarking the transactions futile.

7. Thereafter the Assessing Officer discussed certain case laws in this connection. That in the case of UCB India vs. ACIT 317 ITR 292 (AT)/121 no 131(Mum). It has been held that when AE sale is only small part of total segment, entity level benchmarking is not acceptable. Hon'ble ITAT has relied on the ratio of Azetec Software & Technology Services Ltd. [2007] 107 ITD 141(Bang)(SB) and OECD TP guidelines and has held that the international transaction have to be evaluated, on standalone basis and then compared with similar analysis undertaken on independent transactions. Comparison of the operating profit of the taxpayer as a whole, with the overall operating profits of certain other companies, without any adjustments would not satisfy the requirements of evaluating an international transaction The ITAT therefore concluded that the taxpayer was in error in comparing the operational margin ac entity level and such an approach was rejected. That the decision in the case of UCB India vs. ACIT 317 ITR 292 (AT)/121 ND 131(Mum) has been followed by the Hon'ble Bangalore bench of ITAT in the case of Toyota Kirloskar Auto Parts P. Ltd. reported in 52Taxmann 171 (Bangalore Trib) (2014) on the issue of royalty.

8. Hence the Assessing Officer opined that accordingly even if the TPO made adjustments by using the entity level margins the same will not stand the test of Rule 10B(1)(e) of IT Rules.

10. That with this background in mind, the TPO vide questionnaire issued along with notice u/s 92CA(2)dated 01.02.2016 had at query no.2 called for details of transfer pricing study documentation as prescribed under rule 10D(1). Also notice u/s 92D(3) was issued on U.06.2016 requesting assessee to file the relevant details regarding Transfer pricing as called for vide notice u/s. 92CA(2) Of the I.T. Act. But, the assessee had failed to furnish the same not only in its Transfer Pricing study report but also failed to provide details of such comparable transactions even during subsequent Hearings. Therefore, during the course of TP proceedings the TPO had required the assessee's authorised representative to furnish per carat purchase price and sale price

separately for AE and non-AE segments alongwith complete tabulation of purchases and sales made with AEs and non-AEs with carats and volume and also invoice copies for purchases and sales made with non-AEs. Besides, the assessee was also required to provide separate segmental profit for AE and non-AE segments. In response, the authorized representative of the assessee furnished a written submission giving separate AE and non-AE segmental profits which was filed on 30.06.2016, and also furnished only the average per carat purchase and sale price for AE and non-AE transactions. The Assessing Officer found that the segmental accounts of AE, filed are on the basis of sales ratio applied to allocated expenses. He referred to Hon'ble Delhi high court decision that such allocation is not proper in the case of Pr.CIT v/s Saxo India P. Ltd. in ITA No. 682/2016 date 28-9-2016. He further noted that the assessee had further stated that it was not practical to identify and bifurcate the stock cost and revenue between the AE and non-AE segment and hence not practical to identify the profitability between the AE and non-AE segment.

9. The Assessing Officer opined that the proper segmental profitability details called for by the TPO were not filed by the assessee till the date of passing of order u/s 92CA(3) by the TPO till 31-10-2016 and in the absence of details, TPO was prevented from properly benchmarking the transaction.

10. The Assessing Officer further observed that the segmental accounts are required to find out whether the transactions entered into by the assessee with its AE are at arm's length with that entered into with independent third parties in comparable situation. That therefore, the separate segmental results in assessee's transactions with AE and non-AE are a must. That because in combined entity level margins the loss in transactions with AE segment can be easily set off with the profits with non-AE segment, in such a situation the benchmarking will not be correct. That there is no way by which correct benchmarking can be done unless and until the assessee submits the correct margins in respect of transactions with AE and non-AE. That non-furnishing

of data in this regard can make the whole exercise of benchmarking the transactions futile.

11. The Assessing Officer found that during the course of transfer pricing proceedings, it was found by the TPO that the assessee had not maintained proper documentation to apply the TNM method, CUP method or any other prescribed methods. It was also seen that the assessee had both AE and non-AE transactions during the year, but no separate profitability or AE transaction and non-AE transaction had been maintained. Similarly, the qualitative details of AE and non-AE transactions have not been maintained so that CUP method could be applied. Hence, the TPO was constrained from benchmarking the transactions properly and has to admit the transactions of assessee to be at arm's length in its order. Hence, it was found that the assessee had failed to maintain the documentation as required under clause (g) and clause (hi) of Rule 10D(1) of the Income Tax Rules, 1962. Taking the above into consideration, penalty proceedings u/s 271G of the Income Tax Act, 1961 were initiated by the TPO vide notice dated 31-10-2016 and the same was mentioned at para 6 of the transfer pricing order passed u/s 92CA(3) dated 31-10-2016.

12. Thereafter Assessing Officer referred to section 92D & 92(3) and Rule 10D. Section 92D of Income Tax Act, 1961 deals with maintenance, keeping of information and document by persons entering into an international transaction. Section 92D(1) of Income Tax Act, 1961 prescribes that:

“Even person who has entered into an international transaction [or specified domestic transaction] shall keep and maintain such information and document in respect thereof, as may be prescribed.

13. The details of documents in this regard are prescribed in rule 10D of income Tax rules. Section 92C(3) deals with powers of officer to call for details in respect of international transaction and other relevant details. Rule 10D of the Income Tax Rules reads as under :-

"10D.(1) Every person who has entered into an international transaction for a specified domestic transaction] shall keep and maintain the following information and documents, namely:

(a.).....

(b).....

(c) .....

(d) the nature and terms (including prices) of international transactions or specified domestic transactions] entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

(e).....

(f).....

(g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions 56"[or the specified domestic transactions] entered into, including file record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions (or specified domestic transactions, as the case may be],

(h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction 56(or specified domestic transaction] ;

(i)

(j)

(k)

(l)

(m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price

10D(2).....

(3) The information specified in [sub-rules (1) and (2A)] shall be supported by authentic documents, which may include the following :

a) official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

b) reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

c) price publications including stock exchange and commodity market quotations;

d) published accounts and financial statements relating to the business affairs of the associated enterprises;

e) agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions [*or the specified domestic transactions, as the case may be*];

f) letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

g) documents normally issued in connection with various transactions under the accounting practices followed.

14. Hence the Assessing Officer opined that the assessee is required to maintain as per sub rule 1(d), the details of property transferred or services provided and the quantum and value of each such transaction or class of transaction and as per Sub-Rule 1(d), it is required to maintain data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price. That accordingly, the TPO had with notice u/s 92CA(2) dated 24-12-2015, required the assessee to submit the following information/documents:

2(i) "Under Rule 10D(1) of the I.T. Rules, you are required to (maintain the information /documents listed as items (a) to (m) in Rule 10D(1). Please furnish copy of information/documents maintained by you for each of these items (a) to (m). If for any item, no information/documents have been maintained, this may be so indicated along with reasons for non-maintenance.

2(ii) Under Rule 10D(3) of the I T. Rules, required to Support the information maintained under Rule 10D(1) by authentic documents listed as items (a) to (g) in Rule 10D(3). Please furnish copy of all such authentic documents relating under each of these items (a) to (g). If there is no such authentic documents for any of these items (a) to (g), the same may be so indicated."

15. The Assessing Officer noted that in this context, under clause (g) of Rule 10D(1), the assessee is required to maintain a record of uncontrolled transactions taken into account for analyzing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transactions with third parties which may be of relevance to the pricing of the international transactions. But he found that the assessee failed to comply with the above said provision in clause (g) of Rule 10D(1). That this is evident from the assessee's submission dated 22-02-2016, wherein at page 4 of the Report on Transfer Price Study and Related Documentation the assessee had submitted as follows:

a. In the diamond business world over, there are estimated to be 5000 to 10000 different qualities of diamonds. The price of a diamond depends on various factors such as shine, luster, Size, color, clarity, purity, cluster; cartage, etc. In fact, no two diamonds can have same price as valuation also depends upon the perception of individual businessman.

16. The Assessing Officer observed that the above purports that normally there are no comparable; pieces and price of diamonds. Also at each stage in diamond business i.e. from mine owners to distributors to manufacturer/exporter and ultimately to customer or distributor of polished diamonds, the goods are assorted-re-assorted, mixed- remixed quite number of times and hence each piece of diamond loses its identity as to the source"

17. The Assessing Officer held that by giving the above reasoning, the assessee ha a failed to comply with the clause (9) of Rule 10D(1) that mandatorily requires maintenance of comparable third party transactions that may be of relevance to determining the arms length price of international transactions.

18. The Assessing Officer reiterated that under clause (h) of Rule 10D(1), the assessee is required to maintain a record of the analysis performed to evaluate comparability of uncontrolled transaction with the relevant international transaction. But the assessee had failed to comply with the said provision. To support this the Assessing Officer observed that in submission dated 22-06-2016, wherein at page 4 of the Report on Transfer Price Study and Related Documentation the assessee had submitted as follows:-

“b) Diamonds are sold by their generic name and not by any brand. This product lacks homogeneity. Thus

- (i) Prima facie no transaction of purchase of sale or diamonds can be compared with another Transaction.
- (ii) It is not possible and practicable to find out the exact cost of transaction and hence resultant markup or net profit margin of particular transaction. '

c) Also diamond business world over is being done in the form of partnership firm, proprietary concern or private limited companies There are way few public listed companies in India and abroad so it is not difficult but rather impossible to have reliable, comparable and publically available database."

19. That by giving the above reasoning, the assessee had failed to comply with the clause (h) of Rule 100(1) that mandatorily requires assessee to maintain a record of the analysis performed to evaluate comparability of uncontrolled transaction with the relevant international transaction.

20. Hence the Assessing Officer held that in this case the assessee has failed to maintain the full record in respect of transactions entered in to with the Associated enterprises (AEs) i.e. controlled transactions and those entered into with non-Associated Enterprises (non-AEs) i.e. uncontrolled transaction. That eventually it has failed to submit segmental results of profit in respect of transactions with Associated Enterprises and non-Associated Enterprises, which is an essential requirement as per the provisions of rule 10D(1) of IT Rules.

21. The Assessing Officer noted the assessee's contention as under :-

“Considering, the nature of the business and the product involved and the need to assort and re-assort rough and polished diamonds at each stage it was explained that it is not possible nor feasible not only for the company but for the entire trade and industry to give separate transaction wise profit with AE and non-AEs. On the subject, representations were also made by the apex body i.e. Gem & Jewellery Export Promotion Council to DIT-1. Copy of the letter dated 21.7.2015 on the subject is enclosed and the same is self explanatory vis-a-vis the business, product, records, profitability, consistency and the difficulties etc.

In our case, AE, non-AE segmental accounts on rational and recognized basis were duly filed and it seems that same are overlooked while initiating penalty proceedings. We have to re-request you to consider the following submission already duly made during JP assessment before levying any penalty.”

22. Thereafter the Assessing Officer proceeded to reject the assessee's contention and passed a very elaborate order inter alia relying upon Hon'ble Bombay High Court decision in The Commissioner of Income Tax vs. Shatrunjay Diamonds  
261 ITR 258.

23. The Assessing Officer concluded that the TPO has called for specific details pertaining to segmental profitability between AE and non-AE segments within the meaning of section 92D(3) of the income tax Act, 1961. The details were called for during transfer pricing proceedings and assessee was given opportunity to submit the same but the same was not furnished

within 30 days or even till passing of transfer pricing order or at any time subsequently. The details were essential for benchmarking the transaction of the assessee with AE. The assessee could also not provide any alternate method of benchmarking the transaction based on material available on record. In the absence of material the TPO was forced accept the transactions to be at arm's length after initiating penalty proceedings under section 271G of the Income Tax Act, 1961. Accordingly the Assessing Officer levied the penalty of Rs. 6,63,87,700/- under section 271G.

24. Against the above order, assessee appealed before learned CIT(A). Learned CIT(A) referred the provisions of section 271G and 273B of the Act. Thereafter without discussing the fact of the case, the Assessing Officer's finding, leave alone dealing with then, he laconically deleted the penalty by holding as under:-

“The appellant also cited orders of Hon. IT AT and to make a case against the imposition of penalty. They include (a) AQT-5(1)(2), Mumbai vs. M/s. D Navinchandra Exports Pvt. Ltd. (ITA No. 6303 and 6304/Mum/2016) dated 25.10.2017, DC1T-5(2)(1) vs. Inter Jewel Pvt. Ltd. (ITA No. 5628/Mum/2016) dated 01.11.2018 and DCIT-5(2)( 2) vs. Laxmi Diamond Ltd. (ITA No. 2643/Mum/2017) dated 27.12.2018.

Following the above, as facts and circumstances are identical, I cancel the penalty imposed under section 271G of Income Tax Act 1961.”

25. Against the above order assessee is in appeal before us.

26. We have heard both the counsel and perused the records. Learned Counsel of the assessee made elaborate submission. He relied upon ITAT decisions wherein such penalty has been deleted. He also submitted the Hon'ble Bombay High Court decision in the case of Shatrunjay Diamonds (supra) is not applicable.

27. Per contra, learned Departmental Representative submitted that learned CIT(A) has passed a totally non-speaking order and laconic order which is not at all sustainable.

28. Upon careful consideration, we find that learned CIT(A) has failed to discharge the duty cast upon him. He is passing a quasi judicial order. It was incumbent upon him to pass a proper speaking order while deleting a huge penalty of Rs. 6.63 crores levied by the Assessing Officer which is a detailed order and also relies upon Hon'ble Bombay High Court decision. It is settled law that rules of natural justice are applicable to even administrative order and they are applicable to both the parties in a dispute. On this plank itself the order of learned CIT(A) is not sustainable. Moreover the issue of case laws will arise after learned CIT(A) duly deals with facts and issues, which he has failed to do.

29. In this connection we refer to the decision of Hon'ble Supreme Court in the case of Kapurchand Shrimal (131 ITR 451), where Hon'ble Supreme Court held that it is the duty of the appellate authority to correct the error in the order of the authorities below and remit the matter with or without direction unless probable by law. Hence in the interest of justice, we vacate the order of learned CIT(A) and set aside the issue to the learned CIT(A). The learned CIT(A) shall pass a proper and speaking order after giving the assessee proper opportunity of being heard. Assessee is at liberty to canvas the issue at it deems fit.

30. In the result, appeal by the Revenue stand allowed for statistical purpose.

Order pronounced under Rule 34(4) of the ITAT Rules by placing the result on notice board on 1.2.2021.

Sd/-  
(RAMLAL NEGI)  
JUDICIAL MEMBER

Sd/-  
(SHAMIM YAHYA)  
ACCOUNTANT MEMBER

Mumbai; Dated : 01/02/2021

Copy of the Order forwarded to :

1. The Appellant

2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard File.

//True Copy//

*PS*

BY ORDER,

(Assistant Registrar)  
ITAT, Mumbai