IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K" MUMBAI

BEFORE SHRI S.RIFAUR RAHMAN (ACCOUNTANT MEMBER) AND
SHRI RAVISH SOOD (JUDICIAL MEMBER)

ITA No.2010 /MUM/2019
(Assessment Year: 2013-14)

Deputy Commissioner of Income Tax 10(1)(2), 6th Floor, Room No. 623, Aayakar Bhavan, M.K.Road, Churchgate, Mumbai – 400 020	Vs.	M/s Kama Schachter Jewellwery Pvt. Ltd., 601-604, Multi Storied Building, Seepz SEZ MIDC, Andheri (East), Mumbai – 4000 96

PAN No. AAACK2261J

(Revenue) **(Assessee)**

Assessee by : Shri Nitesh Joshi, A.R
Revenue by : Shri Sushil Kumar Mishra, D.R

Date of Hearing : 04/02/2021
Date of pronouncement : 08/02/2021

ORDER

PER RAVISH SOOD, J.M:

The captioned appeal filed by the revenue is directed against the order passed by the CIT(A)-56, Mumbai, dated 09.01.2019, which in turn arises from the penalty order passed by the A.O under Sec. 271G of the Income tax Act, 1961 (for short 'Act') for A.Y. 2013-14 dated 20.04.2017. The revenue has assailed the impugned order on the following grounds of appeal before us:

"1. On the facts and circumstances of the case and in law, the Ld. CIT (A) erred in deleting the penalty u/s.271G of the Income Tax Act, 1961 ignoring the facts that the assessee failed to furnish documents as required under the Rule 10D(1) and subsection (3) of the section 92D of the I.T. Act, 1961 in respect of the international transactions entered into by it?

2. On the facts and circumstances of the case and in law, the Ld. CIT (A) erred in deleting the penalty u/s.271G without appreciating the fact that the benchmarking of the entity level profit by the assessee cannot substitute the requirements of benchmarking of the international transactions to determine the arm's length price.

3. On the facts and circumstances of the case and in law, the Ld.CIT(A) erred in deleting the penalty on the grounds of difficulty, ignoring the facts that it renders the provisions of Rule 10D redundant in cases like that of the assessee which can never be the intention of the legislature.

4. On the facts and circumstances of the case and in law, Ld.CIT(A) erred in holding that the segmental accounts were never called for, when it is seen that TPO had called for documents to be maintained as per Rule 10D(1) and Rule 10D(3) vide notice dated 04.02.2016.

5. The appellant prays that the order of the CIT(A) on the above grounds be set aside and that of the AO be restored.

6. The appellant craves leave to amend or alter any grounds or add a new ground which may be necessary.

The appellant prays that the order of the CIT(A) on the above grounds be set aside and that of the Assessing Officer be restored."

2. Briefly stated the assessee is a private limited company which is engaged in the business of manufacturing of high end diamond jewellery and a diverse variety of jewellery, rings, ear rings, pendants, bracelets, bangles, necklace etc. The case of the assessee was selected for scrutiny assessment under Sec. 143(2) of the Act.

3. The A.O while framing the assessment made a reference under Sec. 92CA(1) to the Transfer Pricing Officer (for short 'TPO') for benchmarking of the specified domestic transactions as mentioned in "Form 3CEB". In the course of the proceedings, it was observed by the TPO that the assessee had carried out the following specified domestic transactions with its AEs:

Sr. No.	Nature of transaction	Amount (Rs.)
1.	Interest on loan	3,70,851
2.	Purchase of cut and polished diamonds	33,59,65,523
3.	Purchase of packing material	10,993
4.	Director remuneration	1,50,69,095
5.	Remuneration	4,93,611
6.	Inter unit Transfer	122,94,52,678
	Total	158,13,72,751

After considering the submissions of the assessee and the facts of the case, the TPO vide his order passed under Sec. 92CA(3), dated 31.10.2016 held the specified domestic transactions of the assessee as being at arm's length and did not make any adjustment. At the same time, the TPO observing that the assessee had failed to submit the segmental accounts regarding its AE

and non-AE transactions, for the reason, that it had not maintained the documents as required under Sec. 92D(3) r.w. Rule 10D(3) of the Income Tax Rules, 1962, initiated penalty proceedings under Sec. 271G of the Act.

4. After the culmination of the assessment proceedings, the TPO holding a strong conviction that the deliberate withholding of information/documents by the assessee had thwarted the determination of the "Arms Length Price" (for short "ALP") in a fair manner as envisaged in Sec. 92AC of the Act, therein called upon the assessee to explain as to why penalty under Sec. 271G may not be imposed on it. In reply, the assessee tried to impress upon the TPO that no penalty under Sec. 271G was liable to be imposed. However, not finding favour with the aforesaid claim of the assessee the TPO imposed a penalty of Rs. 67,19,310/- under Sec. 271G in the backdrop of observations summed up by him in his order, as under :

> "a) The TPO has called for specific details pertaining to profitability between AE and non-AE segments within the meaning of section 92D(3) of Income Tax Act, 1961.
>
> b) The details were called for during transfer pricing proceedings and assessee was given opportunity to submit the same on 16.08.2016 but the same was not furnished within 30 days or even till passing of transfer pricing order u/s 92CA(3) on 31.10.2016 or at any time subsequently.
>
> c) The details were essential for benchmarking the transaction of assessee with AE.
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> d) The assessee could also not provide any alternate method of benchmarking the transaction based on material available on record.
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> e) In the absence of material the TPO was forced to accept the transactions to be at arm's length after initiating penalty proceedings under section 271G of income Tax Act, 1961."

5. Aggrieved, the assessee assailed the penalty imposed by the TPO under Sec. 271G in appeal before the CIT(A). In the course of the appellate proceedings, it was submitted by the assessee that as the TPO had never called upon the assessee to furnish the segmental information, thus, no penalty could have been imposed on the assessee for the failure to furnish such details which were never called for. Alternatively, it was also submitted by the assessee before the CIT(A) that the preparation of the segmental

details in the case of diamond industry was extremely difficult. In order to support his aforesaid contention the assessee relied on a host of judicial pronouncements. After deliberating on the contentions advanced by the assessee, the CIT(A) was of the view that as no default on the part of the assessee could be established beyond doubt, the penalty under Sec. 271G so imposed could not be sustained. Also, the CIT(A) concurred with the assessee as regards the difficulties that were involved in preparation of segmental details in diamond industry. In the backdrop of his aforesaid deliberations the CIT(A) vacated the penalty of Rs. 67,19,310/- that was imposed by the TPO u/s 271G of the Act.

6. The revenue being aggrieved with the order of the CIT(A) has carried the matter in appeal before us. The ld. Departmental Representative (for short 'D.R') relied upon the penalty order passed by the TPO under Sec.271G of the Act. It was averred by the ld. D.R that the fact that the specified domestic transactions of the assessee were accepted by the TPO as being at arm's length could not exonerate it from the penal provisions that were contemplated in the statute for non-maintenance of the information and documents under Sec. 92D r.w. Rule 10D(1) of the Income Tax Rules, 1962. It was submitted by the ld. D.R that as per Rule 10D(1)(g), an assessee who had entered into a specified domestic transaction remained under a statutory obligation to keep and maintain a record of uncontrolled transactions taken into account for analysing their comparability with the specified domestic 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 such specified domestic transactions. It was further submitted by the ld. D.R, that though the TPO had accepted the domestic transactions of the assessee as being at arm's length, however, a perusal of his order passed under Sec. 92CA(3), dated 31.10.2016 clearly revealed that the same came with a specific observation by him that as the assessee had failed to maintain the documents required under Sec. 92D(3) r.w. Rule 10D(3) of the Income Tax Rules, 1962, the segmental accounts regarding AE and non-AE

transactions were not filed by it. In the backdrop of his aforesaid contentions, it was the claim of the ld. D.R that as the failure on the part of the assessee to comply with the statutory obligation of maintaining the requisite information and documents clearly invited penalty under Sec. 271G of the Act, the CIT(A), thus, was in error in vacating the same.

7. Per contra, the ld. Authorized Representative (for short 'A.R') for the assessee at the very outset submitted that the TPO had held the specified domestic transactions of the assessee as being at arm's length. It was submitted by the ld. A.R, that though the TPO had imposed penalty under Sec. 271G for non-furnishing of the segmental details by the assessee, however, the fact as it so remained was that no such information was ever called for by him in the course of the transfer pricing proceedings. In order to buttress his aforesaid claim the ld. A.R took us through the relevant pages of the assessee's paper book (for short 'APB'), and drew our attention to the notices which were issued by the TPO under Sec. 92CA(2) r.w. 92D(3) seeking information for the purpose of benchmarking the international transactions of the assessee. It was the claim of the ld. A.R that in neither of the aforesaid notices the TPO had ever called upon the assessee for furnish the segmental details. On the basis of his aforesaid contention, it was the claim of the ld. A.R that now when the TPO had at no stage called for the segmental details, the assessee, thus, could not have been held to be at fault in non-furnishing the said information/details. Apart from that, it was submitted by the ld. A.R that in a host of judicial pronouncements the various benches of the Tribunal had observed that considering the practical difficulties involved in furnishing of the segment details of the AE and non-AE transactions in the diamond industry, no penalty could justifiably be imposed under Sec. 271G of the Act. In support of his aforesaid contention the ld. A.R relied on the order of the **ITAT, Mumbai, Bench 'K'** in the case of **ACIT, Mumbai, Vs. D. Navinchandra Exports Pvt. Ltd. (2017) 87 taxman.com 306 (Mum)**. It was submitted by the ld. A.R that the aforesaid order of the Tribunal had thereafter been upheld by the **Hon'ble High Court of Gujarat** in **PCIT, (Central) Surat**

Vs. D. Naveen Chandra Exports P. Ltd. (ITA No. 788 of 2018, dated 09.07.2018). (copy placed on record). Further, it was submitted by the ld. A.R that now when no adjustment was made to the ALP of the specified domestic transactions entered into by the assessee with its AEs, no penalty under Sec. 271G could have justifiably been imposed. In support of his aforesaid contention reliance was placed by the ld. A.R on the order of the **ITAT 'K' bench, Mumbai** in **CIT-5(2)(2) VS. Laxmi Diamond Pvt. Ltd. (ITA No. 2643/Mum/2017), dated 27.12.2018** AND **DCIT-14(2)(1), Mumbai Vs. Leo Schachter Diamonds India P. Ltd. (2020) 116 taxman.com 994 (Mum)**. It was further submitted by the ld. A.R that no penalty under Sec. 271G could be imposed for failure to furnish information under Sec. 92D unless the notice was issued by the AO/TPO specifying the information to be produced with respect to the international transactions. In support of his aforesaid contention reliance was placed by the ld. A.R on the order of the **ITAT, Mumbai bench 'B'** in the case of **ITO 8(2)(3) Vs. Netsoft India Ltd. (2014) 150 ITD 454 (Mum)**. On the basis of his aforesaid contentions, it was averred by the ld. A.R that the CIT(A) had rightly vacated the penalty imposed on the assessee under Sec. 271G of the Act.

8. We have heard the authorized representatives for both the parties, perused the orders of the lower authorities and the material available on record, as well as considered the judicial pronouncements that have been pressed into service by them to drive home their respective contentions. Insofar the claim of the ld. A.R that the assessee was never called upon by the TPO to furnish the segmental details of the AE and non-AE transactions is concerned, we find substantial force in the same. On a perusal of the notices dated 04.02.2016, 14.06.2016, 11.08.2016 and 26.09.2016 that were issued by the TPO during the course of the transfer pricing proceedings, we find, that at no stage he had called upon the assessee to furnish the segmental details of the AE and non-AE transactions for benchmarking the international transactions. As observed by the CIT(A), the details closest to the segmental

information, if at all, that was sought for by the TPO was that as per his notice dated 26.09.2016, Item (xxii), as under:

> "(xxii) Details of diamond purchases, sales with AE and non-AE of diamonds of 1 carat and above. Giving specific items wise details. And also detail regarding its colour, clarity, cut and carat."

However, as noticed by the CIT(A), as there was no discussion of the aforesaid details in the order passed by the TPO imposing penalty u/s 271G, thus, the default on the part of the assessee could not be properly identified. We have given a thoughtful consideration to the aforesaid observations of the CIT(A) and finding ourselves in agreement with the view taken by him, uphold the same.

9. We shall now deal with the view taken by the CIT(A) that in the case of the diamond industry, due to the very nature of the trade therein involved it was difficult to prepare the segmental details as regards the AE and non-AE transactions. As observed by us at length hereinabove, the aforesaid issue had came up before the Tribunal in the case of **ACIT Vs. D. Navinchandra Exports Pvt. Ltd. (2017) 87 taxman.com 306 (Mum)**, wherein the Tribunal after exhaustive deliberations had inter alia observed that considering the practical difficulties in furnishing the segment wise details of AE segment and non-AE segment transactions in diamond industry, no penalty under Sec. 271G could justifiably be imposed for failure to furnish the said information. On a perusal of the order of the Tribunal, we find, that the Tribunal while dismissing the appeal of the revenue had observed as under:

> "16. We have heard the ld. D.R and perused the orders of the lower authorities. We have given a thoughtful consideration to the facts involved in the case before us and are of the considered view that it remains as a matter of fact borne from the records that the TPO had imposed penalty under Sec. 271G for the reason that the assessee had failed to furnish the information as was called for by him. We find that the TPO held a conviction that the assessee had not only inappropriately applied the TNMM which patently suffered from serious irregularities, as the assessee had merely allocated the expenses on the basis of sales, in the backdrop of which the working of the margins involved in the transactions of the assessee with its AEs and non-AEs did hardly witness any variance. We have deliberated on the orders of the lower authorities and find that the TPO in the course of the penalty proceedings was driven by the fact that the assessee by not providing the requisite details, had thus not only failed to substantiate the basis for comparing the transactions of the AE with another

AE and/or non-AE, but had also failed to provide any other basis for benchmarking its international transactions with the AEs. We find that the TPO had in his penalty order observed that due to the failure of the assessee to provide requisite data/information as was called for by him in the course of the proceedings to facilitate correct benchmarking of the international transactions of the assessee with its AEs, he could not examine and determine the arms length price and had to accept it as reflected by the assessee in its TPSR. We find that the TPO in order to benchmark the international transactions of the assessee, had as a matter of fact required the assessee to furnish separate profit level indicator (PLI), either by furnishing the AE and non-AE segment wise Profit & loss account, and/or some other evidence to show that the international transactions aggregating to Rs. 107,99,26,354/- of the assessee with its AEs, viz. (i). Purchase of rough diamonds; (ii). Export of rough diamonds; (iii). Export of polished diamonds; and (v). Purchase of polished diamonds, were at arms length price.

17. We find that the TPO pursuant to the notice u/s 92CA(2) along with a questionnaire issued to the assessee had in order to verify as to whether the transactions entered into by the assessee with its AEs were at arms length with that entered into by the third party in comparable situation with independent parties, had therein called upon the assessee to submit documents mentioned as per Rule 10D(1) and 10D(3) of the Income tax Rules, 1962 along with other specific details, and further directed it to furnish the documents specified under Sec. 92D and Sec. 92E of the 'Act'. We find that the TPO after examining the details and documents available on record, had therein called upon the assessee to submit the segmental profitability for AE transactions and non-AE transactions. However, as the assessee had not maintained separate books of accounts for AE and non-AE segments, therefore, it expressed its inability to furnish the details in the manner the same were called for by the TPO. We find that the TPO in the absence of the segmental breakup of the AE and non-AE transactions, therein concluded that it was prevented from benchmarking various transactions, and for the said failure of the assessee to furnish the requisite details had initiated penalty proceedings under Sec. 271G in the hands of the assessee. We find that the TPO not finding favour with the explanation of the assessee that no penalty under Sec. 271G was liable to be imposed, therein proceeded with and imposed a penalty of Rs. 2,15,98,527/- i.e @2% of the aggregate value of the international transactions of Rs. 107,99,26,354/- in the hands of the assessee.

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 directions 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."

We find, that the aforesaid order of the Tribunal had thereafter been upheld by the **Hon'ble High Court of Gujarat** in **PCIT (Central), Surat Vs. D. Navinchandra Exports Pvt. Ltd. (ITA No. 788 of 2018, dated 09.07.2018)**. In the backdrop of the aforesaid facts, we herein respectfully follow the view taken by the Tribunal in the case of Navinchandra Exports Pvt. Ltd. (supra), wherein it was observed that considering the practical difficulties involved in furnishing the segmental details of AE transactions and non-AE transactions in the diamond industry, penalty under Sec. 271G could not be justifiably imposed. Before parting, we may herein observe, that the Tribunal in its aforesaid order had observed that considering the reasonable cause for non-furnishing of the segmental details of the AE transactions and non-AE transactions because of the peculiar nature of the trade in diamond industry,

penalty u/s 271G even otherwise could not have been imposed as per the mandate of Sec. 273B of the Act. Concurring with the view taken by the Tribunal in its aforesaid order which as observed by us hereinabove had been approved by the Hon'ble High Court, we respectfully follow the same.

10. In the backdrop of our aforesaid deliberations, we are of the considered view that as no infirmity emerges from the order of the CIT(A) who had rightly vacated the penalty imposed by the TPO under Sec.271G of the Act, the same, thus, merits to be upheld.

11. The appeal filed by the revenue is dismissed.

Order pronounced in the open court 08.02.2021

Sd/-	Sd/-
S. Rifaur Rahman	Ravish Sood
(ACCOUNTANT MEMBER)	(JUDICIAL MEMBER)

Mumbai, Date: 08.02.2021
*PS: Rohit

Copy of the Order forwarded to :
1. Assessee
2. Respondent
3. The concerned CIT(A)
4. The concerned CIT
5. DR "K" Bench, ITAT, Mumbai
6. Guard File

BY ORDER,

Dy./Asst. Registrar
ITAT, Mumbai