

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

**BEFORE SHRI OM PRAKASH KANT (ACCOUNTANT MEMBER) AND
SHRI RAHUL CHAUDHARY (JUDICIAL MEMBER)**

**ITA No. 4232/MUM/2019
Assessment Year: 2013-14**

Dy. Commissioner of Income-
tax, Circle 5(1)(2),
R.No. 568, Aayakar Bhavan,
M.K. Road,
Mumbai-400020.

Vs.

M/s Dharmanandan
Diamonds Pvt. Ltd.,
FC-7081-82,
Bharat Diamond Bourse,
BKC, Bandra (East),
Mumbai-400051.

PAN No. AACCD 6676 J

Appellant

Respondent

Revenue by : Dr. Yogesh Kamat, CIT-DR
Assessee by : Rashmikant C. Modi/
Ketki Rajeshirke, ARs

Date of Hearing : 23/03/2022
Date of pronouncement : 19/05/2022

ORDER

PER OM PRAKASH KANT, AM

This appeal by the Revenue is directed against order dated 27th of March, 2019 passed by the Ld. Commissioner of Income-Tax (Appeals)-55, Mumbai [in short 'the Ld. CIT(A)'] in relation to penalty for non-maintenance of the documents for determination of

arm's-length price of international transactions for assessment year 2013-14. The grounds raised by the Revenue in its appeal are reproduced as under:

- i. *Whether the 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-AE transactions.*
 - ii. *Whether the decision of the CIT(A) is not vitiated for the reason that the CIT(A) has not given any finding on how the assessee has complied with clause (d), (g), (h) and (m) of Rule 10 D (1), that have been specifically invoked by the TPO.*
 - iii. *Whether the CIT(A) was not incorrect in stating that the TPO should have asked for copies of profit and loss accounts and balance sheets of AE's to make an overall comparison with the gross profitability levels of the assessee with AE's to ascertain diversion of profits, if any ignoring the findings of the ITAT in the case of Aztec Software Technology Services Ltd. vs ACIT(ITA No. 584/Bang/2006), in which it has been held that there is no legal requirement for the AO to prima facie demonstrate tax avoidance before invoking the provisions of section 92 and 92CA of the Act.*
- (iv)(a) The Id. CIT(A) erred in holding that there was reasonable cause for non-compliance of sec.92D read with*

Rule 10D(1) without specifying the cause of such non-compliance or demonstrating how the same was reasonable.

(iv) (b) the Id. CIT(A) was correct in ignoring the ratio laid down in the decision of Hon'ble Bombay High Court in the case of M/s. Shatrunjay Diamonds (261 ITR 258) holding that the initial burden was cast upon the assessee.

2. Briefly stated facts of the case are that the assessee is in the business of manufacturing of cutting and polished diamond and during the year under consideration carried out international transactions of purchase of cut/polished and rough diamonds and also sale of cut/polished diamonds and rough diamonds to its Associated Enterprises (AEs) situated overseas. For determination of the arm's-length price of those transactions, the assessee applied Transactional Net Margin Method (TNMM) as the most appropriate method. The assessee submitted two different working of segmental result for AE and non-AE transactions. In one working, the assessee has allocated expenses in the ratio of the sales except manufacturing expenses, which has been allocated in the ratio of 'Carat' sold to AE and non-AE. According to the Ld. TPO this has resulted into lower

amount of expenses to AE transactions, which according to him was an absurd situation. In the second working the assessee has identified the margins based on the grouping of finished products into sub-categories, based on quantity of diamonds, which has been rejected by the Ld. TPO on the ground that being inconsistent with the approach for allocation of other expenses and hence cannot be considered for the purpose of benchmarking. The Ld. TPO asked the assessee to submit the segment profitability separately for the AE and non-AE segment on the basis of the actual direct cost. In view of the failure on the part of the assessee to provide segmental profit result of AE and non-AE transactions, the Ld. TPO initiated penalty proceeding under section 271G of the Income Tax Act, 1961 (in short 'the Act') on the ground that assessee had failed to furnish the details called for *vide* notice under section 92D(3) of the Act dated 28/07/2016. The Ld. TPO rejected the submission of the assessee of difficulty in maintaining the segmental profit of AE and non-AE looking to the peculiar nature of diamond trade. The Ld. TPO *vide*

order dated 26th April, 2017 levied penalty of ₹43,32,56,335/-. On further appeal, the Ld. CIT(A) deleted the penalty observing as under:

“3.3 I have considered the facts of the case and submissions of the assessee. The AO/TO levied penalty u/s. 271G on the ground that the assessee failed to furnish information called for. The TO mentioned that the assessee inappropriately applied the TNMM Method, non maintenance of records has frustrated the department and despite the major irregularities in the entity level TNMM, the assessee adopted this method. Finally, the TO rejected all the objections and held that assessee did not provide any basis for comparing the transactions of AE with another AE and /or non-AE and assessee failed to provide any alternative method for benchmarking the international transactions and the failure of the assessee resulted in and forced the TPO to accept the arms-length price as it is and thus preventing the TPO from examining and determining the arms-length price of various international transactions and hence levied penalty under section 271G of IT. Act, 1961 of Rs.43,32,56,335/- @ 2% of international transactions. On the other hand, the appellant submitted that it maintained necessary books and furnished various information and documents as required by Rule 10D and submitted segment-wise PLI during the penalty proceedings. The appellant further submitted that CUP method could not be applied as each invoice of sale to AE and Non-AEs include different types of goods sold for different price and due to peculiar character of the goods sold, the appellant did not consider the CUP method as the most appropriate method. It is also mentioned that the department

accepted TNMM Method as the most appropriate method and no adjustments were made in the preceding years. The AO/TPO should have considered the peculiar nature of diamond trade and should have appreciated the difficulties in adopting CUP method, the assessee furnished all the particulars on the basis of which the AO could come to the conclusion regarding the ALP in the case of international transaction and there were no adjustments made. In these circumstances, the penalty us.271G should not be levied.

(A) Before deciding the issue of levy of penalty whether justified or not, it is essential to know and understand the nature of diamond manufacture and trading business to appreciate the basis issues. Assessee and its auditors in their submissions have described nature of diamond trade, its peculiarities and assessee's business as follows:

(B) "(c)The Nature of Diamond Business world over:

Diamond business involves following major stages:

(a) Extracting of rough diamonds by diamond mine owners. In the world, majority of diamond mines are located in Africa, Russia, Australia, etc. These mines are mainly owned by a handful of companies who enjoy near monopoly over supply of rough diamonds. DTC (i.e. Diamond trading Co., a distributing arm of De Beers, a major mine owner in Africa) is a major supplier of rough diamonds in the world. The supply cycle, the terms of supply, quantity and quality of supply etc. are controlled and decided by it. Other major suppliers are Argyle, BHP Diamonds, Rio Tinto Diamonds, etc. They also are in a position to dictate major terms of supply of rough diamonds. As in any other extraction activity, diamond extraction involves a lot of risks and requires deployment of huge manpower, sophisticated

machineries and huge capital. Possibility of entire extraction activity resulting into a failure is also very high.

(b) Extracted rough diamonds are then sold to major distributors in Antwerp, Israel, etc. who are sight holders. These distributors then in turn resell these rough diamonds to small distributors.

(c) These small distributors then sell the goods to actual cutters/manufacturers. India is a major centre of cutting and polishing. These distributors perform very little function in the entire process of diamond business and undertake no value addition activity. They also undertake very little risks and the time involved in their business cycle is comparatively very less.

(d) These rough diamonds are then cut and polished into finished polished diamonds by employing man power and deploying sophisticated machineries, either directly or through job workers. The entire cutting and polishing activity involves various functions such as assorting, cleaving, kerfing, boiling, bruising, shaping, grading etc. The whole cycle from the purchase of rough diamonds till the final output of polished diamonds takes minimum of one month to maximum of two to two and half months. The cutting and polishing activity gives value addition. Also the person involved undertakes risks as ultimate yield of polished diamonds and the quality of the same depends on various factors like purity, size, shape of rough diamonds, skill of the workers, etc.

(e) The polished diamonds so manufactured are then sold either directly or through distributors spread across the globe to various customers who are mainly jewellery manufacturers.

D. Peculiarities of Products and Business:

(a) In the diamond business world over, there are estimated to be 8000 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. Also no two diamond businessmen may value the same piece of diamond at the same price as valuation also depends upon the perception of individual businessman.

In view of this, one can say that normally there are no comparable pieces and prices 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 a number of times and hence each piece of diamond loses its identity as to the source.

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 or sale of diamonds can be compared with any other transaction.

(ii) It is not possible and practicable to find out exact cost of transaction and hence resultant mark up or net profit margin of particular transaction.

c) Also diamond business world over is being done mainly in the form of partnership company, partnership concern or private limited companies. There are very few publicly listed companies in India and abroad. So it is not just difficult but rather impossible to have very wide reliable, comparable, detailed and publicly available database.

E. The nature of Assessee's Business:

The assessee company is engaged in the business of import of rough and polished diamonds, processing the rough diamonds to cut and polish diamonds and sale of rough and polished diamonds both in local and international markets. The appellant's business is to export majority of diamonds from its manufacturing and locally procured stocks of diamonds.

(C) In addition to the foregoing descriptions it is essential to know as to what happens in the manufacture and trading of the diamond business. Rough diamonds are mined from various places all over the world and they vary from a size of 0.3 carat to 10 carat usually and the price of rough diamonds vary on the composition of each lot of diamond consisting of various sizes, shapes and colours and weight and each lot is likely to have rough diamonds varying in size, shape, colour and weight. It also remains a fact that no two rough diamonds in the lot are likely to be of the same size, shape, colour and weight which leads to anomalous situations when these are cut and polished. The process of cutting consists of pruning the edges, flattening the top and shaping the sides as to give the rough stone a final shape and then polish it. The entire process of cutting and polishing results in diamonds of different shapes and sizes depending upon the structure of the rough diamonds and the skills of the cutters and polishers of diamonds. Thus a lot of 100 carat of rough diamonds may usually yield 27% to 29% cut and polished diamonds of varying sizes and shapes and colours and weights (carats). Diamonds are weighed in carats and one gram is equal to 5 carats. Thus diamonds get cut and polished lot wise and even if each lot of rough diamonds is pre- sorted before giving it for cutting and polishing, the polished diamonds are likely to vary in size, shape, size, colour and weight. Normally diamonds are exported and sold locally in lots and/or by weight of

similar size and colour because these diamonds are then used by diamond jewellery manufacturers in the manufacture of diamond jewellery which requires diamonds of similar size, shape and colour while designing and making jewellery except for one unique piece which may be required for the ring or for centre of the necklace. Hence a diamond manufacturer is continuously required to sort out rough diamonds before giving for cutting and polishing which is done in stages and also sort out polished diamonds when the lots of cut and polished diamonds are received from the cutters and polishers to make lots of similar sizes, colours, shapes and weight before selling /exporting polished diamonds. It is also worth mentioning here that normally polished diamonds of higher carat weight command higher prices if other factors like size, colour and shape are same and/or similar and if there is variation, prices will again vary. Moreover, there is no standard price for a diamond in the world, because price varies with each diamantaire who values the diamond and a broad price range can be fixed for diamonds of particular size, shape, colour and weight at a particular point of time. Moreover, diamonds are sold in lots of carats unless one diamond is of one carat or two carts in weight with unique features and shape and size. Thus determining the price of a diamond and /or diamonds is a difficult issue and even if the diamonds are physically evaluated, prices will vary with valuer to valuer.

(D) This aspect of diamond trade is also explained by the GJEPC India in its letter dated 21/7/2015 addressed to the CIT-Transfer Pricing, Mumbai.

The TPO basically wanted the assessee to furnish separate profit level indicator (PLI), that is, AE and non-AE segment wise either the P & L

Accounts and/or some other evidence to show that the international transactions were at arm's-length price. Assessee had entered into following international transactions:

<i>S. No.</i>	<i>Nature of International Transactions</i>	<i>Amount in (Rs.)</i>
<i>1.</i>	<i>Sale of cut, polished diamonds & rough diamonds</i>	<i>14,93,52,36,682/-</i>
<i>2.</i>	<i>Purchase of Cut, Polished & Rough Diamonds</i>	<i>6,72,75,80,074/-</i>
	<i>Total</i>	<i>21,66,28,16,756/-</i>

Total value of transactions of diamonds entered by the assessee with AEs and non-AEs were as follows:

A perusal of the correlation of the imported rough diamonds and polished diamonds and total purchases reveals that the assessee's total turnover during the year was R.2166 Crores, whereas sale to AE was Rs.1494 Crores. The assessee's total purchase during the year was Rs.2947 Crores, whereas purchase from AE was Rs.672 Crores. Thus assessee had a mix of imported rough from AEs and non AEs and also sold/exported polished diamonds to AEs as well as non-AEs. Thus the P&L Account reflects a mixture of purchases and sales both from AEs as well as non AEs. In this connection, categorization details of rough diamonds and polished diamonds were also perused and analysed to understand and verify the facts and following observations can be made:

Correlation of Rough and Polished Diamonds

Firstly every import or purchase of rough diamond at Surat factory passes through assortment. Upon assortment, the quantity of rough diamonds under each import is fragmented into different lots

depending upon the size, shape, quality, purity and parity and each assorted lot is assigned cost attributable to it out of respective individual import of which such lot is a part of. Upon completion of production process, quantity of polished diamonds manufactured out of the particular lot under production, the manufacturing costs attributable to that particular lot is apportioned and added to the assigned cost (as stated above) of each lot of rough diamonds consumed. After the completion of the production process, the goods are subjected to stringent quality control process and upon the passing and approval from Quality Control department, the said finished goods are sent to Polished diamonds Assortment Department where the said goods are sub-divided into "Class A-1 to Class A-5" and "Class B-1 to Class B-4" sub-categories or more of such categories as is considered expedient and desirable looking strictly in to the production line. Finished goods having passed through the stated assortment process as above are transferred to Mumbai Sales office.

Upon receipt of finished goods in Mumbai sales office, the said goods are incorporated in respective inventory record and opening balance of the finished goods of the respective Class is automatically revised with the incorporation of the new inward receipt. Quantity and value of each Sale of goods is subtracted from the respective Class of goods by allocating opening per carat weighted daily average cost under that Class of goods.

Further, consistently weighted average cost for valuation of the inventory of stock of rough diamonds as well as polished diamonds over the years was adopted as the weighted average cost is the most balance and reliable method for the entity. Here, it is pertinent and sensible to note that though each of the sub-class has a defined

opening and closing stock value which is based on the daily weighted average cost valuation method at all times which gets adjusted upon every inward receipt of goods from production and against every outward issue of goods on sale, the closing value of inventory is adjusted at the opening per carat cost of production under respective sub-category. Although while presenting the cost of each and every export to AE or non-AE, there may be certain transactions showing loss but in factual position, there is no loss in any transaction for the simple reason that while effecting the sale, the goods have to be assorted in more than 20 sieves by the buyers during the goods selection process and only such ardently selected goods are negotiated for sale and the deal gets finalized on mutually terms including price and payment timeline. Hence, if the high value selection gets sold out from the a particular sub-category, it may show handsome margin and like-wise if the case is otherwise, such particular transaction may figure loss howsoever, at the end of the day, there will be a situation of symmetrical and consistent profit as per pricing system followed from time to time. The above stated explanation has been verified, perused and analysed from the stock records detailing category-wise import/consumption of rough diamonds and category-wise categorization of polished diamonds showing the costs of the goods sold for a particular invoice at its daily weighted average cost for the month of April, 2011.

Crux of the matter is that it is extremely difficult for even the diamond trader and manufacturer to identify which rough diamond got converted into which polished diamond specifically unless the single piece rough diamond happened to be of exceptionally high carat value making the tracing out and identification of the polished diamond physically possible and convenient. Only indication about

the size may come from the market price realised per carat unless each diamond is subjected to pre checking as done by the trader and manufacturer before selling and exporting to realise a better price per carat of the lot. In nutshell, it is extremely difficult for the trader to identify each rough diamond piecewise unless the rough diamond is exceptionally of high carat value by weight and similarly, it is also difficult to identify each cut and polished diamond vis-à-vis the original rough diamond from which it was cut and polished.

The TPO asked for details of PLI- Profit Level Indicator, that is, segment wise Profit & Loss Account of the A segment and non-AE segment in respect of export of goods as well as local sales to arrive at arms-length price in respect of international transactions. The assessee submitted segment wise result of AE & Non AE at GP level. Assessee explained the difficulties to the TP in various communication described earlier, however, the TPO insisted for the same and then invoked rule 10Dof IT. Rules 1962 and did not determine the arms length price in respect of the international transactions, but went ahead with the levy of penalty under section 271G of IT. Act, 1961. In this regard, the TPO had another option of either 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 and/or asked for the copies of P& L Accounts and the Balance Sheets of the AEs to make an overall comparison with the gross profitability levels of the assessee with AEs to ascertain diversion of profits if any in broad manner. However, this was not done by the TO and the TPO went ahead with the levy of penalty under section 271G of IT. Act, 1961 of Rs. 43,32,56,335/- at the rate of 2% of international transactions of Rs.21,66,28,16,756/-.

Another issue on which the TPO has laid stress is that the assessee could have followed the internal CUP method to work out the arm's length price in respect of its exports. However, the basic issue remains, that is, an apple has to be compared with an apple and not with an orange. As discussed earlier, a comparison by internal CUP method can be made only if two lots of diamonds are similar in size, colour, shape and clarity and unless they are similar, prices will vary from one diamond to another diamond and if one lot has variety of

diamonds varying in size, colour, shape and clarity, prices will vary from diamond to diamond and lot to lot. And then the question again arises how do you evaluate price of each diamond when the invoice is one and has a common price tag of XYZ dollars per carat for the whole lot. And by industry practice, unless a diamond is weighing half carat or more or one carat or more, these are not priced separately in the bill because it is not practical to price diamonds of weights lower than half carat or one carat separately weight-wise per diamond in the lot. Hence unless lots of diamonds exported to an AE and a Non-AE are of similar size, colour, shape and clarity, it will be difficult to compare the prices generally under CUP method except a rough estimate can be made in general. Hence insistence of the TPO to follow internal CUP method was also not a practical suggestion keeping in view the nature of the trade and the lots of diamonds exported by the assessee to AEs and Non-AEs during the assessment year. In nutshell, TPO's insistence and directions to follow internal CUP method were not fair and reasonable and practicable.

The TPO has invoked specifically rule 10D(1)(d), (g), (h) (l) and G of IT Rules, 1962 to substantiate the levy of penalty, however, the TPO has not made use of the details and documents to determine the

arm's length price when the lot wise details of exported cut and polished diamonds were available with him. Moreover when the type of details and documents are not available in public domain, the TP should have utilised the details and documents made available by the assessee to arrive at a fair and reasonable opinion regarding the determination of arm's length price in respect of international transaction vis-à-vis the other transactions of import of rough diamonds and locally purchased rough diamonds and export of polished diamonds to non AEs abroad. Moreover, a comparison of the P & L Accounts and the Balance Sheets of the AEs would have revealed the overall gross profit margins vis-à-vis the gross profit margins earned by the AEs in their businesses to reveal levels of profitability.

The assessee has also submitted that when the assessee had furnished all the particulars on the basis of which the AO could have come to the conclusion regarding ALP in the case of International Transaction and further submitted that the TPO had not asked for only one specific detail but several details on several occasions from time to time. Even the explanation for the specific details of segmental AE, Non-AE transactions were also filed and submitted. Thus, it appears that the assessee had made substantial compliance with the requirements of filing all major information called for by the TO for determination of the ALP and accordingly, the ALP was accepted by the TPO. Further, the assessee relied on the Hon'ble High Court of Delhi in the case of CIT vs. M/s. Leroy Somer & Controls (India) Pvt. Ltd. which observed as under:

"The decision and observation of the Hon'ble High Court of Delhi in Income Tax Appeal No. 410/2012 (decided on 30.08.2013 in the case

of CIT-2 vs. M/S. Leroy Somer & Controls (India) Pvt. Ltd.), which confirmed the ITAT decision and dismissed the revenue appeal on the subject of penalty u/s. 271G supports this stand fully. Inter alia, the Hon'ble High Court after discussing the provisions of 92D, 271G & Rule 10D states as under:

"The tribunal has rightly concluded that with such a broad rule, which requires documentation and information voluminous and virtually unlimited, Section 271G has be interpreted reasonably and in rational manner.....When there is general and substantive compliance of the provisions of Rule 10D, it is sufficient.....The documentation or information should be one specified in Rule 10D, which has been formulated in terms of section 92D(1) of the Act. Looking from any quarter and angle, the appeal of the Revenue is misconceived, totally lacking in merits and is, therefore, dismissed".

The assessee also cited the below mentioned decision of Hon'ble ITAT which is as under:

"The following observations of Hon'ble ITAT Bench "B", Chennai in the case of DCIT vs. Magick Woods Exports (2012) 32 CCH 0422 Chen Trib, which had concluded that penalty us. 271G cannot be imposed where assessee proves that there was reasonable cause for particular failure is also necessary to be considered.

"Moreover, in spite of all these things, the TPO has not suggested any adjustment in the ALP reported by the assessee. When that is the case, the default if at all any in the hands of the assessee, turns out to be a technical default.

The levy of penalty under section 271G is to be considered in the above circumstances. The penalty prescribed under section 271G is very severe. The quantum of penalty is 2 percent of the value of the international transaction for each failure on the part of the assessee. If there are more failures on the part of the assessee, the penalty may end up almost in a capital punishment. When the penalty provision is very severe, it should be applied with great caution and only if circumstances sufficiently justify invoking the penal provision".

I have gone through the above and found that the facts of the above case laws are similar to the facts of the assessee's case.

In view of the above, I am of the opinion that levy of penalty u/s.271G of the IT. Act, 1961 is neither fair nor reasonable and therefore it is not justified in facts of the case, viz., the nature of diamond trade, substantial compliance made by the assessee and the reasonable cause showed by the assessee and above all, when there is no adjustment made in the ALP. In nutshell, the levy of penalty of Rs. 43,32,56,335/- under section 271G of IT. Act, 1961 is hereby deleted. In view of the fact that levy of penalty under section 271G of IT. Act, 1961 is itself deleted, other objections raised by the assessee before the TO and in appeal are not considered relevant and are not discussed. In nutshell, levy of penalty under section 271G of I.T. Act, 1961 is hereby deleted."

3. Aggrieved, the Revenue is in appeal before the Tribunal raising the grounds as reproduced above.

4. Before us the assessee has filed a paperbook containing pages 1 to 193.

5. The Ld. departmental representative relied on the order of the Ld. TPO and submitted that in view of non-maintenance of the documents required under the Income Tax Rules, 1962 (in short 'the Rules') the Ld. TPO could not benchmark the international transactions of the assessee and therefore he is justified in levying the penalty.

6. On the contrary, the Ld. counsel of the assessee submitted that identical issue of levy of penalty under section 271G of the Act in the case of the assessee for assessment year 2012-13 has been allowed in favour of the assessee by the Tribunal in ITA No. 649/Mum/2018.

7. We have heard rival submission of the parties on the issue in dispute and perused the relevant material on record. We find that in assessment year 2012-13 also the penalty was levied due to failure on the part of the assessee to provide documents maintained by the

assessee in support of AE and non-AE segment of its business, but the Tribunal (supra) has deleted the penalty observing as under:

“6. After due consideration of factual matrix, it could be gathered that the assessee has maintained primary books of account / documents in respect of its business activity. The international transactions carried out by the assessee with its AEs has also been well documented which is supported by benchmarking done by the assessee under TNMM method. Further, the assessee has made substantial compliances before Ld. Transfer Pricing officer and furnished all possible information, data and documents. The only lapse is that the assessee failed to furnish the segmental profitability of the AE and non-AE transactions which would be explained by the fact that it was practically difficult to maintain these details considering the nature of assessee’s business. It could also be seen that finally the transactions have been accepted to be at arm’s length. If the Transfer Pricing Officer was not satisfied with the benchmarking of the assessee under TNMM, nothing prevented him from rejecting assessee’ benchmarking and proceed to determine the ALP independently by applying any one of the prescribed methods. The blame for failure on the part of the Transfer Pricing Officer to determine the arm’s length price cannot be fastened with the assessee.

7. We find that similar issue of penalty u/s 271G for diamond industry has been adjudicated in assessee’s favor in various decisions of this Tribunal. The coordinate bench of Mumbai Tribunal in the case of D. Navinchandra Exports (P.) Ltd. (87 Taxmann.com 306) held 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. The relevant observations were 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 nonAEs, 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 GJEP 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 have 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."

This decision has been followed subsequently in various other decision of the tribunal rendered on similar factual matrix. Few of the recent decisions are DCIT V/s Decent Dia Jewels Private Ltd. (117 Taxmann.com 358; 13/03/2020) and DCIT V/s Kama Schachter Jewellery P.Ltd. (127 Taxmann.com 677; 08/02/2021). We find that fact in the appeal before us are quite identical to facts in all these decisions. Therefore, respectfully following these decisions, we confirm the impugned order deleting the penalty u/s 271G."

8. In view of the issue in dispute being identical to the issue in dispute in the order of the Tribunal (supra), respectfully following the finding of the Tribunal (supra), the penalty levied under section 271G of the Act in the year under consideration is deleted.

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

Order pronounced in the open Court on 19/05/2022.

Sd/-

**(RAHUL CHAUDHARY)
JUDICIAL MEMBER**

Sd/-

**(OM PRAKASH KANT)
ACCOUNTANT MEMBER**

Mumbai;

Dated: 19/05/2022

Dragon Legal/Rahul Sharma, Sr. P.S.

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//

BY ORDER,

(Sr. Private Secretary)
ITAT, Mumbai