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

BEFORE SHRI ABY T. VARKEY (JUDICIAL MEMBER) AND
SHRI OM PRAKASH KANT (ACCOUNTANT MEMBER)

ITA No. 6713/MUM/2019
Assessment Year: 2015-16

Asst. Comm. of Income Tax 32(2), 720, 7th floor, Kautilya Bhavan, C-41 to C-43, G Block BKC, Bandra East, Mumbai-400051.	**Vs.**	M/s Kapu Gems, E Tower, EC-3021, Bharat Diamond Bourse, Bandra Kurla Complex, Bandra East, Mumbai-400051. **PAN No. AADFK 3266 D**
Appellant		**Respondent**

Revenue by	:	Mr. Ashish Deharia, DR
Assessee by	:	Mr. K.A. Vaidyalingan, CA
Date of Hearing	:	07/06/2022
Date of pronouncement	:	14/06/2022

ORDER

PER OM PRAKASH KANT, AM

This appeal has been filed by the Revenue challenging the finding of the Ld. Commissioner of Income-tax (Appeals)-56, Mumbai [in short 'the Ld. CIT(A)'] in order dated 20/08/2019 for assessment year 2015-16, wherein, he is has deleted the penalty levied by the Assessing Officer for non-maintenance of details in

terms of section 92D(3) of the Income Tax Act, 1961 (in short 'the Act') r.w. Rule 10D of Income Tax Rules, 1962 (in short 'the Rules').

2. Brief facts, qua issue in dispute that the assessee is engaged in the business of importing rough diamonds, cutting & polishing and thereafter selling/exporting finished diamonds to overseas markets to various customers including Associated Enterprises (AEs) of the assessee. During transfer pricing proceedings the Ld. Transfer Pricing Officer asked the assessee to furnish documents maintained in respect of segment profitability between the AEs and non-AEs, but the assessee expressed difficulty in view of the trade practices. It was submitted by the assessee that it was not practically possible to track each and every diamond during the process of cutting and polishing and the diamond imported from the AEs and non-AEs get mixed. The assessee submitted that there was reasonable cause for not complying for not maintaining the segmental details of AEs and

non-AEs transactions. The Ld. Assessing Officer accordingly, levied the penalty under section 271G of the Act concluding as under:

> *"8. In view of the above facts, it can be concluded that the TPO had called for specific details pertaining to segmental profitability between AE and non-AE segments within the meaning of section 92D(3) of the I.T. Act, 1961. The details were essential for benchmarking the transaction of 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 to accept the transactions to be at arm's length after initiating penalty proceedings u/s 271G of the I.T. Act, 1961."*

3. The Ld. CIT(A), however deleted the penalty in view of the decision of the coordinate bench in various cases. The relevant part of the order of the Ld. CIT(A) is reproduced as under:

> *"6. Penalty under section 271G is imposed after establishing a specific default which is non-production of documents and information prescribed under Rule 10D when called for by Transfer Pricing Officer under section 92D(3) of I.T. Act. If a default is established then escape route is section 273B as per which reasonable cause for default is to be established.*

> *7. The appellant also cited orders of Hon. ITAT and to make a case against the imposition of penalty. They include (a) ACIT-5(1)(2), Mumbai vs. M/s. D Navinchandra Exports Pvt. Ltd. (ITA No. 6303 and 6304/Mum/2016) dated 25.10.2017, DCIT-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."*

4. Before us the Ld. Departmental Representative relied on the order of the Ld. Assessing Officer and submitted that due to failure on the part of the assessee, the Ld. TPO could not examine the arm's length price of the transaction and accordingly no adjustment was made. He accordingly submitted that the assessee has failed to substantiate reasonable cause for not maintaining the required details.

5. The Ld. counsel of the assessee on the other hand relied on the order of the Ld. CIT(A). He also relied on the decision of the Hon'ble Gujarat High Court in the case of **CIT vs. Navindhandra Exports P. Ltd.**, wherein the order of the Tribunal, Mumbai Bench, deleting the

penalty u/s 271G in case of diamond trader/manufacturer, has been upheld.

6. We have heard rival submission of the parties on the issue in dispute and perused the relevant material on record. We find that the issue in dispute in the case of the assessee is whether in case of the diamond manufacturer, can any penalty be levied under section 271G of the Act for non-maintenance of segment profitability between AEs and non-AEs transactions. We find that coordinate Bench of the Tribunal in the case of **Navin Chandra exports Private Limited in ITA No. 6304/Mum/2016** and other appeals has after a detailed discussion, held that there was reasonable cause for non-maintaining the said details. The relevant finding of the Tribunal (supra) is reproduced 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."

6.1 Against the order of the Tribunal (supra), the Revenue preferred appeal before the Hon'ble Gujarat High Court. The Hon'ble

High Court in Tax Appeal No. 788 of 2018 has dismissed the appeal of the Revenue observing as under:

> *"(5.1) Considering the material on record, when the learned Tribunal was satisfied that there is substantial compliance of Section 92CA(3) of the Income Tax Act and when the Gross Profit of the assessee had increased from 7.42% for Assessment Year 2010-11 to 8.71% for the year under consideration, the Net Profit had also witnessed growth from 3.9% to 4.9% and looking to the business of the assessee in diamond, both the learned CIT(A) as well as the learned Tribunal have rightly observed and held that the PO was not justified in levying the penalty under Section 271G of the Income Tax Act. We are in complete agreement with the view taken by the learned Tribunal. The findings of the fact recorded by the learned Tribunal are on appreciation of material on record. No substantial question of law arises."*

6.2 Since identical issue of non-maintenance of segment profitability for AEs and non-AEs transactions and consequent levy of penalty under section 271G of the Act is involved in the instant case before us, respectfully following the finding of the coordinate Bench of the Tribunal and Hon'ble Gujarat High Court, we hold that in the instant case there was reasonable cause for non-maintaining

the details, which were required in terms of Rule 10D of the Rules and accordingly we do not find any error in the order of Ld. CIT(A) and uphold the order of the Ld. CIT(A) on the issue-in-dispute. The grounds raised by the Revenue are accordingly dismissed.

7. In the result, the appeal filed by the Revenue is dismissed.

Order pronounced in the open Court on 14/06/2022.

Sd/-	Sd/-
(ABY T. VARKEY)	**(OM PRAKASH KANT)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai;
Dated: 14/06/2022
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.

BY ORDER,

//True Copy//

(Sr. Private Secretary)
ITAT, Mumbai