

IN THE INCOME TAX APPELLATE TRIBUNAL “J” BENCH, MUMBAI

BEFORE SHRI PRASHANT MAHARISHI, AM
AND
SHRI PAVAN KUMAR GADALE, JM

ITA No.5710/Mum/2016
(Assessment Year 2010-11)

M/s S. Vinodkumar Diamonds
Pvt. Ltd.
Office No. BW-3010
Bharat Diamond Bourse,
Bandra (East), Mumbai-400 051
(Appellant)

Vs.

Dy. Commissioner of Income
Tax,
Circle 5(3),
Mumbai
(Respondent)

PAN No. AAICS5514N

Assessee by : Shri Fenil Bhatt &
Shri Sankit Chordia, ARs'
Revenue by : Shri Samuel Pitta, DR

Date of hearing: 13.12.2022
Date of pronouncement : 14.12.2022

ORDER

PER PRASHANT MAHARISHI, AM:

01. This appeal is filed by the assessee for A.Y. 2010-11 against Appellate order of the learned Commissioner of Income-tax (Appeals)-58, Mumbai [the learned CIT (A)] dated 16th June, 2016 for A.Y. 2010-11 raising following grounds of appeal:-

“A. Grounds related to transfer pricing adjustment

1. The learned Commissioner of Income Tax (Appeals) [Ld. CIT(A)] grossly erred, in facts and in law, in upholding the order of learned Transfer Pricing Officer (Ld. TPO) u/s 92CA(3) of the Income Tax Act, 1961 (Act') and consequential assessment order of learned Assessing Officer (Ld. AO) which is bad in law and void ab initio, because it is not in compliance with the mandatory provisions of law

as the Ld. TPO did not issue any written show cause notice as required in terms of proviso to section 92C(3) of the Act for his proposal to make transfer pricing adjustment in respect of notional interest on export receivables by the appellant from its Associated Enterprises (AEs).

2. *The Ld. CIT(A) grossly erred, in facts and in law, in upholding the transfer pricing adjustment of Rs. 24,27,405/- u/s. 92 of the Act made by the Ld. TPO/AO towards notional interest on delay in export receivables by the appellant from its AES. 2:1 The Ld. CIT (A) grossly erred, in facts and in law:*

2.1.1 in holding delayed outstanding receivables as an international transaction within the meaning of international transaction as per section 92B of the Act for AY 2010-11. The Ld. CIT(A) failed to appreciate that amendment in s. 92B of the Act by Finance Act, 2012 whereby an explanation has been added to s. 92B, shall be considered prospective in operation and cannot have retrospective effect.

2.1.2 in not holding that receivables arising out of sale of cut and polished diamonds in the ordinary course of appellant's business are not in the nature of capital financing and hence not covered in clause (c) of explanation to s. 92B of the Act even if it is assumed (though not admitted) that explanation to s. 92B of the Act has retrospective effect.

2.1.3 in not considering that Ld. TPO/AO has made impugned transfer pricing adjustment without selecting any of the method prescribed in s. 92C(1) of the Act and thereby impugned transfer pricing

adjustment, not being in accordance with law, is bad in law and deserves to be deleted.

2.1.4 in not holding that receivables being closely linked with cut and polished diamonds sales transactions, there is no requirement to conduct separate and independent benchmarking for such receivables independent of determination of ALP for cut and polished diamonds sale transactions which have been benchmarked applying the Transactional Net Margin Method (TNMM)

2.1.5 in not appreciating that the appellant does not charge interest to non-associated enterprise customers also for delayed receivables, and hence, the practice of not charging interest to AES for delayed receivables is an arm's length practice applying the comparable uncontrolled price method, not warranting any such adjustment for notional interest when the terms of sale do not stipulate charge of interest for payment beyond credit period.

2.1.6 in not appreciating that working capital adjustment takes into account the impact of outstanding receivables on the profitability and that OP/OC margin of the appellant are substantially higher than arithmetic mean of working capital adjusted OP/OC margin of comparable companies and hence, any further transfer pricing adjustment on the pretext of outstanding receivable is unwarranted and wholly unjustified.

2.1.7 in not granting set off for notional interest on pre-mature payments made by AEs and for the period of delays in import payment by the appellant to its

AES 2.1.8 by failing to appreciate that the appellant has also delayed in its imports payments to its AEs upon which the AEs have not charged interest to the appellant and hence this policy is on reciprocal basis.

2.1.9 in not appreciating that impugned transfer pricing adjustment is within +/-5% arm's length range of value of the international transaction of cut and polished diamond sale wherefrom such outstanding receivables arise.

2.1.10 in upholding the impugned transfer pricing adjustment on hypothetical and notional basis without any material on record to demonstrate that there has been under charging of real income.

2.1.11 in not considering that ALP interest rate on receivables shall be 3.51% p.a. being average of interest rates paid by the appellant on USS working capital loan for debtor financing, as against impugned ALP interest rate of 5.69% p.a. applied by the Ld. TPO

2.2 The Ld. CIT(A) grossly erred, in facts and in law, in not following binding judicial precedents and this action of the Ld. CIT(A) is against the principle of judicial discipline and propriety. B. Other Grounds

B. Other Grounds

1.1 The Learned Commissioner of Income Tax (Appeals) erred in confirming disallowance of proportionate interest expenditure of Rs. 5,79,000/- by applying proviso to section 36(1)(i) of the Income Tax Act, 1961.

1.2 He erred in holding that interest bearing funds were utilized for purchasing the office premises at Bharat Diamond Bourse (BDB) without appreciating that the appellant had utilized its own funds to acquire the property and the borrowings were used only for business purpose.

1.3 He erred in interpreting that purchase of fixed assets as per the cash flow statement were financed from borrowings without appreciating that the advance paid towards purchase of property at BDB is actually included in "Trade and other receivables and financed from the operating profits of the year.

1.4. without prejudice to above,

He erred in confirming calculation of proportionate disallowance of interest of Rs.5,79,000/- considering the entire investment in the property of Rs. 3,16,96,826/-as on 31.3.2010 instead of investment made during the year of Rs. 38,30,523/-. The appellant craves leave to add, alter, amend or delete all or any of the grounds of appeal before or during the course of hearing.”

02. The brief fact of the case shows that assessee is a Private Limited Company engaged into the business of manufacturing and marketing of cut and polished diamonds. It filed its return of income on 29th September, 2010 at ₹ 20,97,29,090/-. It was found that assessee has entered into an international transaction therefore the matter was referred to the learned Transfer Pricing Officer for determination of Arms' Length Price.

03. During the course of assessment proceedings, it was found that for A.Y. 2009-10 adjustment of ₹1.51 crores was made on account of delayed realization of export proceeds beyond invoice credit period from its Associated Enterprises. Therefore, show cause notice was issued to the assessee on the issue. The assessee submitted that there is industry practices of not charging interest on delayed payments, outstanding receivable is also not a separate international transaction and further the fact of trade credit is already included in the sale price. Further no interest was charged on account of global financial crisis.
04. The learned Transfer Pricing Officer rejected the contentions. He found that credit period given to Associated Enterprises and non Associated Enterprises is 150 days, further 30 days credit is granted on account of industry practice and therefore, total credit period of 180 days is claimed by the assessee. Same is not supported by any evidence. The learned Transfer Pricing Officer held that other arguments of the assessee are vague and unsubstantiated. Accordingly, he computed the interest on delayed realization of export proceeds considering the interest at the rate of 5.69% and proposed the adjustment of ₹24,27,405/- to the international transaction. Thus, Order under Section 92CA (3) of the Act was passed on 30th September, 2013.
05. The learned Assessing Officer further noted that assessee has given advance against capital expenditure of ₹3,16,96,827/-, however, assessee did not capitalized any expenditure to the cost of capital asset. Assessee was issued show cause notice on 27th February, 2014, which was replied on 28th February, 2014. The argument of the assessee was that investment was made out of company's interest free fund and not from borrowed funds and

therefore, no disallowance or addition to the cost of capital is required. The learned Assessing Officer referred to the proviso to Section 36(iii) of the Act and computed the interest cost of ₹5,79,000/- on the advances. Disallowance under Section 14A of the Act of ₹13,93,798/- was also made. Accordingly, the assessment order under Section 143(3) read with section 144C(3) of the Act was passed on 3rd April, 2014 determining the total income of the assessee at ₹21,41,29,290/-.

06. The assessee preferred the appeal before the learned CIT (A). The learned CIT (A) on the issue of outstanding receivable holding that it is a separate international transaction. The learned CIT (A) held that the learned Assessing Officer is correct in charging interest on outstanding receivable from Associated Enterprises. He further held that for A.Y. 2009-10, the learned CIT (A) has confirmed identical addition. On the issue of disallowance of interest of ₹5,79,000/-, he further rejected the contention of the assessee raised before the learned Assessing Officer of interest free funds availability and confirmed the disallowance. Therefore, the assessee is aggrieved and is in appeal before us.
07. The learned Authorized Representative submitted that the learned CIT (A) has relied upon the decision of the learned CIT (A) in A.Y. 2009-10. The order of the learned CIT (A) was challenged by the assessee before the Tribunal in ITA No.79/Mum/2015 which was decided on 3rd August, 2020, wherein the identical addition was deleted vide paragraph no. 14 and 15 of that order. His argument was that non-charging of interest is trade practice, and no interest is charged on outstanding of independent third party and therefore, same was deleted in A.Y. 2009-10. He

submitted that the decision of the co-ordinate Bench requires to be followed.

08. Even independently, he submitted that there is internal CUP available as the credit period of non-Associated Enterprises and Associated Enterprises is also similar. He referred to paper book page no. 347 to 368 and submitted that the credit period to the Associated Enterprises and non-Associated Enterprises is same. Therefore, outstanding receivable, despite being an international transaction, no interest is required to be charged. As according to CUP method there is no difference between the Associated Enterprises transaction credit days and non Associated Enterprises credit period.
09. Ground no. 2 of interest disallowance, he submitted that assessee has non-interest bearing funds available in the hands of the assessee to the tune of ₹141 crores. He stated that the advance given is only ₹316,96,827/-. Therefore, the presumption is available to the assessee that investment/ advances are out of interest free funds available. He relied upon the decision of Hon'ble Supreme Court in CIT vs. Reliance Industries Ltd. 410 ITR 466.
010. The learned Departmental Representative vehemently supported the orders of the lower authorities. On the issue of outstanding receivable he submitted that if assessee would like to take benefit of CUP method then assessee has to show the similar credit period allowed to the non Associated Enterprises on the similar time period. He further stated that in certain cases the credit period allowed to the non Associated Enterprises is only 10 days where the credit period allowed to the Associated Enterprises is 180 days. Therefore, the internal CUP available on

the face of the records clearly suggests that adjustment is proper. He submitted that assessee has failed to prove that evidence about the industry practices of non-charging interest. On the issue of interest disallowance, he supported the order of the learned Assessing Officer and learned CIT (A).

011. We have carefully considered the rival contentions and perused the orders of the lower authorities. The fact suggests that the learned Assessing Officer/ Transfer Pricing Officer has considered the export receivable from its associated enterprises as international transaction separate from export. We do not find fault with above approach of the learned Assessing Officer confirmed by the learned CIT (A). Moment export proceeds remain outstanding beyond agreed credit period; it becomes a transaction of loan or financing to the Associated Enterprises. This is different from the transaction of export. Thus there is an international transaction of overdue outstanding of export receivable from AE which is separate from international transaction of export of goods.
012. As it is a separate transaction it needs to be benchmarked on the facts of the case, we find that the export dues are outstanding for similar period from non Associated independently. If the assessee has kept the export proceedings outstanding for similar period from a non associated enterprises and did not charge interest thereon, and has also not charged interest on similar period overdue period on overdue outstanding of AEs, then there is a comparable instances available to state that Arms' length price of international transaction of overdue export proceeds of AE is at Arm's length. In the present case on the bills/ invoices itself assessee has mentioned the credit period on

export receivable of AE and Non AE. In case of independent third parties on similar transaction with similar credit period of similar goods no interest is charged. This fact is proved by the assessee for this year by producing the bills of AE as well as Non AEs. Therefore, We find that non-charging of interest on advances being overdue export proceeds from Associated Enterprises as a comparable internal CUP as for similar time on similar conditions, for almost similar period no interest is charged from Non Associated Enterprises. In view of this, we find that Arms Length Price of overdue Export proceeds and receivable from Associated Enterprises is ₹ Nil.

013. We also hasten to add that assessee has failed to show any evidence that there exists a trade practice of not charging interest on overdue advances of export proceeds. Even common sense defies such an argument. Assessee has also failed to show any evidence that due to recession the interest was not charged. Evidence were not laid down that , there was recession in the business of the assessee in this year or when there was boom , assessee was charging interest on such advances.
014. In view of this, we reverse the orders of the lower authorities; direct the learned Transfer Pricing Officer/ Assessing Officer to delete the above adjustment. Accordingly, ground no.1 of the appeal is allowed.
015. With respect to ground no.2, we find that the assessee has given advances of ₹3.17 crores. Against this, the assessee has the share capital of ₹ 9.80 crores and reserves and surplus of ₹117 crores which is much more than the amount advanced for fixed assets. It is the claim of the assessee that it has not incurred any interest expenditure which is covered by the Provision of Section 36(1)



(iii) of the Act. We find that assessee has interest free funds available which were more than the amount of advance for capital asset. Therefore, the issue is squarely covered by the decision of the Hon'ble Supreme Court in case of CIT VS. Reliance Industries Ltd. 410 ITR 466. In view of this, we direct the learned Assessing Officer to delete the disallowance and accordingly, we reverse the orders of the lower authorities. Ground no. 1.1 of the appeal is allowed.

016. No other grounds were argued, hence, same were dismissed.

017. In the result, appeal filed by the assessee is partly allowed.

Order pronounced in the open court on 14.12.2022.

Sd/-
(PAVAN KUMAR GADALE)
(JUDICIAL MEMBER)

Sd/-
(PRASHANT MAHARISHI)
(ACCOUNTANT MEMBER)

Mumbai, Dated:14.12.2022

Sudip Sarkar, Sr.PS

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/ Asst. Registrar
Income Tax Appellate Tribunal, Mumbai