

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

**BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND
SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER**

ITA NO. 7193/MUM/2010 : (A.Y : 2006-07)

Aurostar Jewellery India Pvt. Ltd., Vs. DCIT Circle-3(1), Mumbai
310-312, Prasad Chambers, (Respondent)
3rd floor, Opera House,
Mumbai 400 004.
PAN : AAACA7307D (Appellant)

**Assessee by : Shri Yogesh Thar
Revenue by : Shri N.K. Chand (CIT-DR)**

**Date of Hearing : 19/07/2016
Date of Pronouncement : 17/08/2016**

ORDER

PER SAKTIJIT DEY, JM :

The instant appeal of the assessee is directed against the assessment order dated 20.9.2010 passed u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (in short 'the Act') for the Assessment Year 2006-07 in pursuance to the directions of the Dispute Resolution Panel (DRP). The assessee has raised the following grounds in appeal:-

- "1. Dy. Commissioner of Income Tax ("DCIT") erred in making an upward adjustment, as determined by Transfer Pricing Officer u/s 92 of the Income Tax Act 1961, in value of sales to associated enterprise by ignoring facts and evidence and in particular ignoring additions to the value of closing stock and thereby adding a sum of Rs. 12 lacs to the returned income.*

2. *The Appellant prays that the said addition be deleted.*
- II. 1. *Dy. Commissioner of Income Tax ("DCIT") has further erred in changing the method of valuation of stock from actual cost of purchase to average cost, in respect of raw materials (rough diamonds), by ignoring facts and evidence and in particular applying irrelevant basis of arriving at raw material stock and its value and thereby making an addition of Rs.50,22,587 to the returned income.*
 2. *The Appellant prays that the said addition be deleted."*

2. Ground no. 1 pertains to the issue relating to Transfer Pricing (TP) adjustment. Briefly, the facts are that the assessee is an Indian company engaged in the business of import of rough diamonds and export of cut and polished diamonds. During the relevant previous year assessee imported rough diamonds from M/s. Arjav Diamonds N.V., Belgium and exported cut and polished diamonds to various customers including M/s. Arjav Diamonds N.V, Belgium and M/s. Arjav Diamonds (Middle East). Though, in the Transfer Pricing (TP) study report, the assessee had claimed the overseas entities, M/s. Arjav Diamonds N.V, Belgium and M/s. Arjav Diamonds (Middle East) as not related parties, however, the assessee itself conducted a benchmarking of the international transactions entered with these two overseas entities by applying Transactional Net Margin Method (TNMM) as most appropriate method. The Transfer Pricing Officer (TPO), however, did not accept assessee's contention regarding M/s. Arjav Diamonds N.V, Belgium and M/s. Arjav Diamonds (Middle East) as unrelated parties. In fact, in the present appeal we are not called upon to decide the issue whether M/s. Arjav Diamonds N.V, Belgium and M/s. Arjav Diamonds

(Middle East) are related parties/associated enterprises of the assessee or not. Hence, there is no need to deliberate any further on this issue. Be that as it may, the TPO after verifying the TP study report of the assessee was of the view that the benchmarking done by the assessee was inappropriate. He, however, applying TNMM as the most appropriate method proposed certain comparables in the diamond industry and called for the objections/submissions on the proposed comparables. After considering the submissions of the assessee, the Assessing Officer rejected most of the objections of the assessee except the objection in respect of a comparable, viz. M/s. Bapalal Keshavlal, which he excluded on account of abnormal margins. Thus, the final comparables selected by the TPO were 9 and the average OP/TC of the comparables selected worked out to 4.32% as against the margin shown by the assessee of 2.31%. Applying the aforesaid margin, the TPO determined the A.E sales at Rs.2.20 crores as against Rs.2.03 crores. The resultant shortfall of Rs. 17 lacs was treated as TP adjustment. In terms of the order of TPO, the Assessing Officer framed a draft assessment order adding back an amount of Rs. 17 lacs to the income of the assessee. Being aggrieved of the addition made, assessee placed objections before the DRP. The DRP after considering the objections of the assessee excluded one more comparable, viz., Hope (India) Polishing Works as a result of which the average OP/TC of the comparable companies was further reduced to 3.72% as against 4.32% worked out by the TPO. In terms of the directions of DRP, the Assessing Officer, applying the revised margin of 3.72% to the total sales of Rs.8.83 crores, determined the Arms Length Price (ALP) of sales to A.E at Rs. 2.15 crores. The resultant shortfall of Rs. 12 lacs having

exceeded the $\pm 5\%$ range was treated as TP adjustment and added back to the income of the assessee. Being aggrieved of such an addition, assessee is before us.

3. The Ld. AR referring to the computation of ALP by the Assessing Officer in para 4.1 of the assessment order submitted that the Assessing Officer has considered the sales at entity level by aggregating both A.E and non-A.E sales and applied margin of 3.72% to the total sales effected by the assessee instead of applying it to only A.E sales. The Ld. AR submitted, if the average margin of comparables worked out at 3.72% is applied to A.E sales only, then, the variation will be 1.37% and, hence, will be within the tolerance range of $\pm 5\%$. In this context, he submitted a working of the TP adjustment as made by the Assessing Officer at entity level as well as adjustment relating to A.E transactions only. The Ld. AR referring to the TP provisions submitted that the very purpose of determination of ALP is to find out whether international transactions between related parties are at arms length. Therefore, the transactions which form the basis for determination of ALP are international transactions with the A.E. In support of such proposition, he relied upon the following decisions :-

- i) CIT v. Ratilal Becharlal & Sons, [2016] 65 taxmann.com 155 (Bombay);
- ii) CIT v. Thyssen Krupp Industries India (P.) Ltd., [2016] 70 taxmann.com 329 (Bombay);
- iii) CIT v. Firestone International (P.) Ltd., [2015] 60 taxmann.com 235 (Bombay); and

iv) Smt. Dina Sudhir Shah v. ACIT, [2015] 53 taxmann.com 496
(Mum-Trib)

4. The Ld. DR, on the other hand, submitted that it is the duty and responsibility of the assessee to provide data of profitability of A.E and non-A.E segments as they are in the special knowledge of the assessee. He submitted that the assessee has not discharged its onus by providing data of A.E and non-A.E segments. The Ld. DR submitted that the assessee has failed to provide reliable data of the two segments and cannot take benefit of such failure. If the assessee's contention that entity level data can be segregated is accepted, it will result in availability of internal TNMM, in which event, there was no necessity to follow external TNMM. Contesting the margin computed by the assessee in the working submitted by the Ld. AR, the Ld. DR submitted that the assessee's contention to restrict the adjustment to A.E transactions only is not acceptable as it is based on an erroneous presumption that A.E and non-A.E transactions have actually earned same percentage of profit. He submitted that allocation of cost in proportion to A.E and non-A.E transactions is meaningless as it will result in identical PLI for these two segments. He submitted that in absence of correct and contemporaneous segmental accounts, and presuming that non-A.E transactions are at arms length, the method adopted by the TPO to arrive at PLI of A.E transactions is a reasonable method to determine if such transactions are at ALP. The Ld. DR accepting that adjustment, if any, should be limited to A.E transactions, however, in the same breath he submitted that where A.E and non-A.E

accounts are not bifurcated, on actual comparison with adjustment at entity level, the method adopted by TPO was correct.

5. We have considered the submissions of the parties and perused the material on record in the light of the decisions relied upon. On a perusal of the table containing working of ALP in para 4.1 of the assessment order, there is no doubt that the Assessing Officer has computed the ALP by applying the margin (OP/TC) of comparables to the total turnover of the assessee at entity level by including both A.E and non-A.E sales. Therefore, the issue arising for consideration is whether the adjustment of margin is to be restricted only to the turnover relating to international transactions or the turnover at the entity level. On going through the transfer pricing provisions contained under Chapter X of the Act, we are of the view that the arms length price has to be determined only with reference to the international transactions by comparing the price charged for such international transactions between two or more associated enterprises with similar one or more transactions between unrelated parties. Therefore, if any adjustment has to be made, it has to be made to the turnover relating to international transactions with A.E instead of the entire turnover of the assessee at entity level. The Hon'ble Bombay High Court in the case of CIT v. Ratilal Becharlal & Sons (*supra*) while examining an identical issue held as under :-

“(d) Chapter X of the Act inter alia deals with computation of income from international transactions having regard to the ALP. Section 92 thereof specifically brings to charge income arising from International Transactions with an Associated Enterprise

to tax on computation of income having regard to the ALP of the transactions entered into between the Associated Enterprises, as the heading of Chapter X itself indicates that these are special provisions relating to avoidance of tax and the mandate is to ensure adjustment in respect of the International Transactions with Associated Enterprise or specified domestic transaction on the determination of ALP. It does not allow adjustment of the income on the basis of determining of ALP in respect of all the Assessee's transactions. If the contention of the Revenue is to be accepted, it would result in taxing non-existing income/profits of transactions entered into between the Respondent Assessee and independent third parties. This in the present fact, even in the absence of an allegation that the transactions with parties other than Associated Enterprise is not at ALP. The transactions with parties other than the International Transactions with Associated Enterprise or in respect of specified domestic transactions are not within the ambit of Chapter X of the Act. In fact, a similar question arose for our consideration in Tara Jewels Exports Pvt. Ltd. (supra) and an identical contention was negated. So also the Delhi High Court in Keihin Panalfa Ltd. (supra) has negated a similar contention.”

The other decisions relied upon by Ld. AR also express similar view. That being the case, respectfully following the ratio laid down therein, we hold that the adjustment, if any, has to be made to the turnover relating to international transactions with A.E and not at entity level. Therefore, the non-A.E sales cannot be taken into consideration while computing/determining the ALP. In this context, we may refer to the working of TP adjustment by restricting to A.E sales which is as under :-

Particulars	Amount
Sales (i)	202,59,290
Operating Profit % on sales (Refer pg no. 327 of the Factual Paper Book {'FPB'}) (ii)	2.25%
Operating Cost (iii)=(i-ii)	198,03,456
Arm's Length Margin as per the DPR's directions	3.72%
Arm's Length sales (iv)={iii*ii}+ii}	205,40,145
Difference between the Arm's Length Price and Actual Sale (v)=(iv)-(i)	2,80,855
% of variation from the Arm's Length price (v)/(iv)*100	1.37%
95% of the Arm's Length price of the transactions with the AE's	195,13,137
105% of the Arm's Length price of the transaction with the AE's	215,67,152

It is the contention of the Ld. AR that if the arms length margin of 3.72% is applied to the A.E transactions only, then, the difference/variation would come down to 1.37% and the ALP will be within the \pm 5% range requiring no further adjustment. We direct the Assessing Officer to examine the working of the assessee while determining the ALP afresh by restricting the adjustment to only A.E transactions. The ground raised is allowed.

6. In ground no. 2, assessee has challenged the addition of Rs.50,22,587/- on account of stock valuation. Briefly, the facts are that during the assessment proceedings the Assessing Officer, while verifying the accounts of the assessee, noticed that assessee has shown value of rough diamonds at Rs.28,64,12,171/- as on 31.3.2006 which also includes rejected rough diamonds amounting to Rs.1,13,500/- received from *karigars*. He further noticed that as per assessee's accounting policy, rough diamonds are valued at cost of purchase whereas finished goods are valued at cost or net realizable value, whichever is lower. Having noted that the assessee has imported rough diamonds, he called upon the assessee to furnish certain details like bill-

wise break-up of purchase of diamonds with copy of the bills, method of valuation of closing stock of rough diamonds, copy of stock register showing purchase and issue of rough diamonds, etc. He also called upon the assessee to furnish copy of stock register of polished diamonds alongwith work-in-progress and method of valuation. After examining the details submitted by the assessee, the Assessing Officer noted that assessee has maintained eight separate lots of rough diamonds, however, only one lot is having opening stock. He also noted that each lot is having different purchase price/carat which implies that the quality of rough diamonds is varying in each lot. After examining the relevant details submitted by the assessee, the Assessing Officer was of the view that the method of maintaining account of cut and polished diamonds is against the norms of the trade. He observed that though the rough diamonds of different grades are maintained in different lots, however, polished diamonds which are having significantly higher value were not maintained in lots. The Assessing Officer observed that the assessee could not properly explain such discrepancy. Therefore, the Assessing Officer held that the contention of the assessee that valuation of rough diamonds has been carried out on the basis of actual closing stock lying as on 31.3.2006 is incorrect as the quantity of rough diamonds lying in closing stock of various lots as on 31.3.2006 cannot be considered as correct. He, therefore, opined that the best suitable method for valuing the rough diamonds is on the basis of average price method. Having held so, the Assessing Officer proceeded to value the closing stock of rough diamonds on the basis of average purchase price as computed in page 9 and 10 of the assessment order and on the basis of such computation/valuation,

difference of Rs.50,22,587/- was found between the value of closing stock of rough diamonds shown by the assessee and the total value of closing stock of rough diamonds determined by the Assessing Officer at Rs.29,14,34,759/-. The shortfall was added back to the income of assessee. The addition made was challenged before DRP. The DRP, however, sustained the addition made by the Assessing Officer by observing that the assessee could not satisfactorily explain the method of valuation of closing stock.

7. The Ld. AR submitted before us that the issue is covered by the decision of ITAT in assessee's own case for Assessment Year 2005-06 as well as 2007-08. The Ld. AR submitted that the Tribunal after considering the submissions of the assessee held that the average cost of purchase applied by the Assessing Officer is not correct and the valuation of stock by the assessee as per actual cost of purchase should be accepted. In this context, he submitted before us the orders of the Tribunal. The Ld. AR referring to the copies of purchase register of rough diamonds submitted that each of the purchase of rough diamonds made during the previous year was recorded in the purchase register and supported by purchase bills. Referring to the lot-wise stock register maintained by the assessee, copies of which were submitted in the Paper Book, the Ld. AR submitted that each bill-wise purchase of rough diamonds, as mentioned in the purchase register, can be tallied with the lot-wise stock register and the stock lying as per lot-wise stock register can be co-related to the actual purchase bills. Therefore, the actual valuation of stock as per the actual purchase price, as followed by the assessee, has to be applied. The Ld. AR further submitted that

the assessee has been consistently following the aforesaid method of valuing stock on actual purchase price consistently over the years which has also been certified by the Auditor in the Audit report. In this context, he referred to the note under Schedule XIV of the Audit report wherein the raw materials have been noted to have been valued at cost of purchase.

8. The Ld. DR, on the other hand, relied upon the observations of the Assessing Officer and the DRP.

9. We have considered the submissions of the parties and perused the material on record. Undisputedly, the Assessing Officer has rejected the valuation of closing stock of rough diamonds shown by the assessee and has proceeded to value the stock by applying the average rate of purchase. However, as could be seen from the materials placed before us, assessee has maintained not only day-to-day purchase register on the basis of actual purchase bills, but such purchases entered in the purchase register can be co-related to the lot-wise stock register maintained by the assessee in respect of rough diamonds. We have further noted that the actual purchase price of rough diamonds in a particular lot in the stock register can be identified with reasonable certainty, therefore, the method of valuation of stock of rough diamonds as per actual purchase price as adopted by the assessee, in our view, cannot be disturbed. It is also a matter of fact that the assessee has been consistently following the actual purchase price method for valuation of stock of rough diamonds. We have further noted that similar addition made by applying the average purchase

price method by the Assessing Officer was disapproved by the ITAT in assessee's own case for Assessment Year 2005-06 in ITA No. 3972/Mum/2009 dated 3.12.2010 by holding that the cost of purchase method of valuation of stock of raw materials by the assessee is correct. The same view was again reiterated by the ITAT in assessee's own case for Assessment Year 2007-08 in ITA No. 4007/Mum/2012 dated 10.7.2013. In fact, while upholding the orders of CIT(A) in deleting the addition made on the basis of valuation of closing stock by applying average per carat rate, the Tribunal has noted the fact that the method of valuation of closing stock of rough diamonds was regularly employed by the assessee. In view of the aforesaid, we hold that the addition made on account of difference in valuation of closing stock of rough diamonds is not sustainable. Accordingly, the same is deleted. We may further note that though the assessee had objected the addition made before the DRP, but the DRP has disposed of the objections of assessee in a most perfunctory and mechanical manner without properly appreciating either the submissions of the assessee or the facts and materials brought on record. Ground no. 2 is allowed.

10. In the result, assessee's appeal is allowed to the extent indicated above.

Order pronounced in the open court on 17th August, 2016.

Sd/-

(RAMIT KOCHAR)
ACCOUNTANT MEMBER

Mumbai, Date : 17th August, 2016

SSL

Sd/-

(SAKTIJIT DEY)
JUDICIAL MEMBER

Copy to :

- 1) The Appellant
- 2) The Respondent
- 3) The CIT(A) concerned
- 4) The CIT concerned
- 5) The D.R, "K" Bench, Mumbai
- 6) Guard file

By Order

Dy./Asstt. Registrar
I.T.A.T, Mumbai