आयकर अपीलीय अधिकरण "के" न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL
"K" BENCH, MUMBAI

माननीय श्री महावीर सिंह, उपाध्यक्ष **एवं**
माननीय श्री मनोज कुमार अग्रवाल ,लेखा सदस्य के समक्ष।
BEFORE HON'BLE SHRI MAHAVIR SINGH, VP AND
HON'BLE SHRI MANOJ KUMAR AGGARWAL, AM
(Hearing Through Video Conferencing Mode)

आयकरअपील सं./ I.T.A. No.649/Mum/2018
(**निर्धारण वर्ष /** Assessment Year: 2012-13)

ACIT–Circle-5(1)(2) Room No.568, 5th Floor Aaykar Bhavan, M.K. Road Mumbai-400 020	Vs.	**M/s. Dharmanandan Diamonds (P) Ltd.** FC-7081-7082, Bharat Diamond Bourse G-Block, Bandra Kurla Bomplex Bandra (E), Mumbai-400 051
स्थायीलेखासं ./जीआइआरसं ./PAN/GIR No. **AACCD-6676-J**		
(अपीलार्थी**/Appellant**)	:	(प्रत्यर्थी / **Respondent**)

Assessee by	:	Shri Rashmikant Modi – Ld. AR
Revenue by	:	Shri Sunil Deshpande – Ld. CIT-DR

सुनवाई की तारीख**/ Date of Hearing**	:	22/07/2021
घोषणा की तारीख / **Date of Pronouncement**	:	01/10/2021

आदेश / O R D E R

Manoj Kumar Aggarwal (Accountant Member)

1. Aforesaid appeal by Revenue for Assessment Year (AY) 2012-13 arises out of the order of Ld. Commissioner of Income Tax (Appeals)-55 Mumbai [CIT(A)] dated 15/11/2017 which has deleted penalty of Rs.2818.16 Lacs as levied by learned Assessing Officer (AO) u/s. 271G vide order dated 29/07/2016.

2. The Ld. CIT-DR, drawing attention to the factual matrix, justified the penalty levied by Ld. AO whereas the Ld. AR submitted that keeping in view the nature of business, the details as sought by lower authorities

could not be furnished and therefore, the penalty has rightly been deleted in the impugned order. The Ld. AR relied on various favorable decision of Tribunal rendered on similar facts and circumstances, the copies of which have been placed on record.

3. We have carefully heard the rival submissions and deliberated upon the case laws placed before us. Our adjudication to the subject matter of appeal would be as given in succeeding paragraphs.

4. Facts leading to imposition of penalty are that assessee being resident corporate assessee is stated to be engaged in manufacturing and marketing of cut and polished diamonds. Since the assessee carried out certain international transactions with its Associated Enterprises (AE) during the year, the same were referred to Ld. Transfer Pricing Officer-1(2), Mumbai (TPO) for determination of Arm's Length Price (ALP). During these proceedings, various details were called from the assessee and the assessee submitted the details of cost of sales of different categories / class of cut and polished diamonds sold to AE and non-AE against each sale on the basis of cost ascertained from cost records maintained by the assessee for each category /class of goods. However, after examination, Ld. TPO asked the assessee to furnish segmental profitability for AE and non-AE transactions. The assessee furnished two different segmental workings and benchmarked the transactions using TNMM method. Regarding benchmarking under CUP method, it was submitted by the assessee that it is prevented by reasonable cause from maintaining and furnishing the information owing to the heterogeneous nature of goods i.e. rough and polished diamonds. The same led Ld. TPO to form an opinion that the assessee did not provide any basis for comparing the transactions and it failed to provide any alternative

method to benchmark the transactions which had prevented determination of ALP of these transactions. Therefore, the assessee would be liable for penalty u/s 271G as computed @2% of value of international transactions. Accordingly, the assessee was saddled with impugned penalty u/s 271G vide order dated 29/07/2016.

5. During appellate proceedings, the assessee assailed the penalty by way of elaborate written submissions and relied upon various favorable decisions of the Tribunal rendered for diamond industry.

The Ld. CIT(A), after due consideration of factual matrix concurred with assessee's submissions and noted that continuous sorting of diamond would be required before cutting and polishing. Even after cutting and polishing, the diamonds would have to be segregated in lots of small sizes, colors, shapes and weight before sale. Normally polished diamonds of higher carat command higher prices if other factors like size, color and shape are same and if there is variation, the prices will again vary. Moreover, there is no standard price for diamond because prices would vary with each diamantaire who value the diamond and a broad price range can be fixed for diamonds of particular size, shape, color 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 carat in weight with unique features, shape and size. Thus, determining the price of a diamond would be difficult issue and even if the diamonds are physically evaluated, price will vary with valuer to valuer. Therefore, it was difficult to benchmark the transactions under internal CUP method as sought by Ld. TPO. Finally, the impugned penalty was deleted by observing as under: -

9. 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-a-vis the original rough diamond from which it was cut and polished.

10. The TPO asked for details of PLI- Profit Level Indicator, that is, segment wise Profit & Loss Account of the AE 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 TPO in various communication described earlier, however, the TPO insisted for the same and then invoked rule 10D of I.T.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 I.T.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 TPO and the TPO went ahead with the levy of penalty under section 271G of I.T.Act, 1961 of Rs.28,18,16,216/- at the rate of 2% of international transactions of Rs.14,09,08,10,798/-.

11. 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 doyou 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.

12. The TPO has invoked specifically rule 10D(1)(d), (g), (h) (i) and (j) 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 TPO 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-a-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-a-vis the gross profit margins earned by the AEs in their businesses to reveal levels of profitability.

13. 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 TPO 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 to be interpreted reasonably and in a 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 ChenTrib, which had concluded that penalty u/s. 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".*

14. 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 I.T.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.28,18,16,216/- under section 271G of I.T.Act, 1961 is hereby deleted.

Aggrieved as aforesaid, the revenue is in further appeal before us.

Our findings and Adjudication

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 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."

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. The appeal stand dismissed.

Order pronounced on 1st October, 2021.

Sd/-	**Sd/-**
(Mahavir Singh)	**(Manoj Kumar Aggarwal)**
उपाध्यक्ष **/ Vice President**	लेखा सदस्य **/ Accountant Member**

मुंबई Mumbai; दिनांक Dated :01/10/2021
Sr.PS, Dhananjay

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकरआयुक्त(अपील) / The CIT(A)
4. आयकरआयुक्त/ CIT– concerned
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, मुंबई/ DR, ITAT, Mumbai
6. गार्डफाईल / Guard File

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उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकरअपीलीयअधिकरण, मुंबई **/ ITAT, Mumbai.**