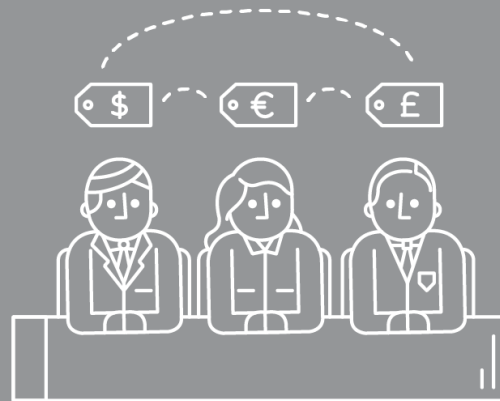


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Newsflash: ITAT Deletes Sec. 271G Transfer Pricing Penalty for diamond merchants

Decision of Mumbai ITAT in the case of ACIT V/s M/S D. Navinchandra Exports Pvt Ltd (ITA No. 6304/Mum/2016) dated 25th October 2017

In this case the present appeals filed by the revenue were directed against the deletion of penalty by CIT(A)- 55 which was imposed by the Transfer Pricing Officer (TPO) in the backdrop of certain common facts under Sec. 271G.

1.0 Facts of the Case

The assessee company was mainly engaged in the business of importing and locally purchasing rough diamonds, getting them cut and polished, and exporting or locally selling the same. It also procured polished diamonds and exported the same without carrying out any material function.

The TPO was of the view that entity level benchmarking using Transactional Net Margin Method (TNMM) did not lead to correct results as the loss in transactions with AE segment could easily be set off with the profits of the non-AE segment. Accordingly the TPO had called upon the assessee to submit the segmental profitability for AE transactions and non-AE transactions even though the assessee had expressed its inability to furnish details in the manner for the reason that it had not maintained separate books of accounts for AE and non-AE segments.

The TPO accordingly proposed to levy penalty under Sec. 271G on the assessee for its failure to furnish the said requisite details.

The assessee submitted that it was not possible to maintain the accounts of AE and non-AE separately considering the nature of trade. It was the claim of the assessee that it was not possible to bifurcate the purchase cost, the overhead expenses and the stocks between the transactions with AE and non-AE. The contention of the assessee that the requirement of maintaining details as per Rule 10D(g) and Rule 10D(h) and segmental reporting of the AE and non-AE transactions was required only if the transactions would have been benchmarked by the assessee adopting Comparable Uncontrolled Price (CUP) basis, and there was no such requirement now when the assessee had benchmarked the transactions on TNMM basis also did not find favour with the TPO.

The TPO concluded that as the assessee had failed to comply with the statutory obligation cast upon it and furnish the requisite details as were called for by him for correctly benchmarking the international transactions of the assessee with its AEs, therefore, imposed a penalty under Sec. 271G @ 2% of the aggregate value of the international transactions in the hands of the assessee

2.0 Order of CIT (A)

The CIT (A) after deliberating on the contentions of the assessee in the backdrop of the facts of the case, gave a thoughtful consideration to the nature of the diamond business. The CIT (A) further observed that the rough diamonds are mined from various places all over the world and they vary from size of 0.3 carat to 10 carat usually and the price of rough diamonds varied 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. The CIT(A) further observed that no two rough diamonds in the lot are likely to be of the same size, shape, colour and weight which thus leads to anomalous situations when these are cut and polished. The CIT(A) also took cognizance of the letter by the GJEPC to the CIT-Transfer Pricing, Mumbai, wherein the various aspects involved in the diamond manufacturing business were explained. Thus, in the backdrop of his aforesaid observations as regards the nature of the diamond manufacturing business, the CIT(A) concluded that determining the price of a diamond and/or diamonds is a difficult issue and even if the diamonds are physically evaluated, the prices would vary from valuer to valuer.

The CIT(A) observed that a comparison by internal CUP method could only be made if two lots of diamonds were similar in size, colour, shape and clarity, failing which the prices were bound to vary from one diamond to another diamond. The CIT(A) observed 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.

Thus, in the backdrop of the aforesaid facts it was observed by the CIT(A) that the insistence of the TPO that the assessee should have followed CUP method was misconceived and impractical. The CIT(A) also observed that in the preceding year, i.e A.Y. 2010-11 the TPO did not propose any adjustment in the ALP.

The CIT(A) in the backdrop of the aforesaid facts, viz. the nature of diamond trade; substantial compliance made by the assessee; and the reasonable cause shown by the assessee for not furnishing certain details, read with the fact that the TPO had not made any adjustment to the ALP, therefore, concluded that the penalty under Sec. 271G imposed on the assessee was liable to be deleted.

3.0 Observation by Honorable Mumbai ITAT

The Honorable Mumbai Income Tax Appellate Tribunal (ITAT) opined that “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.”

ITAT taking cognizance of the letter of GJEPC upheld CIT(A)'s view 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). Additionally, ITAT also upheld the CIT (A)'s rejection of using CUP method for the purpose of benchmarking. The ITAT remarked that the TPO should have exercised the viable option of determining the arm's 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.

4.0 Conclusion

Thus, ITAT stated that though 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, failure to the said extent can safely be held to be backed by a reasonable cause, which would bring the case of the assessee within the sweep of Sec. 273B;

Thus, in backdrop of aforesaid observations ITAT dismissed Revenue's appeal and upheld CIT(A)'s deletion of penalty u/s 271G.

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