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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **INCOME TAX APPEAL No. 825/2018**

Date of decision: 3rd August, 2018.

PR.COMMISSIONER OF INCOME TAX-2, ... Appellant

Through: Mr. Ashok K. Manchanda, Sr. Standing Counsel for Income Tax Department.

versus

SINOSTEEL INDIA PVT. LTD. ..... Respondent

Through: None.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE CHANDER SHEKHAR

SANJIV KHANNA, J. (ORAL)

Present appeal by the Revenue under Section 260A of the Income Tax Act, 1961(the Act, for short) in the case of M/s Sinosteel India Limited (respondent-assessee, for short) impugns the order dated 29th January, 2018 passed by the Income Tax Appellate Tribunal (Tribunal) deleting penalty for concealment of income under Section 271(1)(c) of the Act. The appeal relates to Assessment Year 2006-07.

2. Penalty for concealment was imposed for failure to correctly compute arm's length price of international transactions between the respondent-assessee and its holding company M/s Sino Steel Corporation, China and associated enterprises by excluding internal

comparable while applying the Comparable Uncontrolled Price (CUP) method.

3. Respondent-assessee was providing support and assistance to its holding company and associated enterprises in procuring and supplying metallurgical materials and related activities, for which the respondent-assessee was paid commission in related international transactions @ US$ 0.15 per DMT and US$ 0.33 per WMT.

4. During the year in question, the respondent-assessee had entered into a third party independent or unrelated international transaction in which commission @ US$ 0.50 per DMT was paid.

5. The respondent-assessee had received commission of Rs. 1,58,12,470/- and after setting off expenses and permissible deductions, the respondent-assessee had declared a total income of Rs. 42,30,567/- in its return.

6. Details with regard to unrelated third-party transaction were duly disclosed and informed to the Assessing Officer and Transfer Pricing Officer.

7. Respondent-assessee had justified exclusion of internal unrelated comparable in view of the small volume of transaction. It was an isolated transaction, substantially lower in value in comparison to the volume of the transactions with the associated enterprises, which were enduring and to continue over a period of time. It was normal in business to charge lower commission on larger volumes from parties with long-term business relationship.

8. Transfer Pricing Officer, vide order dated 28th August, 2009, however, did not agree with the respondent-assessee. Arm's length price was computed by taking the independent unrelated party comparable into consideration. Dispute Resolution Panel vide order dated 25th November, 2011 also rejected the respondent-assessee's challenge to include the internal comparable. By assessment order dated 9th September, 2010 income was assessed at Rs. 3,30,02,880/-. Penalty proceedings under Section 271(1)(c) of the Act were directed to be initiated.

9. In the present appeal, we are not concerned with the question whether the independent transaction should or should not be considered as a comparable. This would be decided in the quantum appeal pending before the High Court. Obviously, if the respondent-assessee succeeds, the penalty would be quashed for there is no addition, which has been sustained. However, the scope of the present appeal, as stated above, relates to the question of *bona fides* of the explanation of the respondent-assessee and whether exclusion of the internal comparable was after due diligence.

10. The Assessing Officer had imposed penalty referring to Explanation 7 to Section 271(1)(c) of the Act, and without any discussion on the question of explanation given by the assessee, it was observed and held:-

> "In view of Explanation 7 of Section 271(1)(c) of the I.T. Act 1961, this amount of Rs.2,87,72,311/- shall also be deemed to represent the income in respect of which particulars have been concealed/inaccurate

> particulars have been furnished. The assessee has failed to establish that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C of the IT Act 1961 and lathe manner prescribed under that section in good faith and with due diligence.
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> In view of the above, I am of the considered opinion that the assessee has concealed particulars of its income and is liable to penalty u/s 271(1)(c) of the I.T. Act 1961."

The Assessing Officer, in our view, had failed to appreciate that imposition of penalty was not automatic in the sense that it was mandatory as addition had been made in the quantum proceedings.

11. The Commissioner of Income Tax (Appeals) vide order dated 6th October, 2015 upheld the penalty order observing that the respondent-assessee merely stated that the lower rate of commission was on account of higher volume. The transfer pricing report had not mentioned that the lower rate of commission was at arm's length when compared to internal comparable. Further, the respondent-assessee had not acted with due diligence. In view of Explanation 7 to Section 271 (1)(c) of the Act, penalty was rightly imposed on the deemed concealed income or income in respect of which inaccurate particulars were furnished. The Commissioner of Income Tax (Appeals), however, did observe that the respondent-assessee had filed fresh evidence in the penalty proceedings explaining and justifying lower rate for higher volume of transactions. This submission was rejected observing that fresh evidence was not part of the Transfer Pricing Report. It was stated that two opinions were not possible.

12. The Tribunal in the impugned order has held as under:-

> "3. We have perused the submissions advanced by both the sides in the light of the records placed before us.
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> 3.1. On perusal of assessment order, we observe that assessee as well as Ld.TPO agreed upon CUP to be the most appropriate method for computing the arm's length price. Further in our view, under CUP, selection of comparables is within strict parameters and has to be accurately made on functional similarities. Admittedly there was lack of comparables internal/external for the type of services rendered by assessee to its AE. It is observed that the transfer pricing adjustment is because of the difference in the computation of ALP due to lack of comparables.
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> 3.2. Ld. A.R. forcefully contended that the addition based on the difference in arm's length price is a debatable issue and, therefore, the claim of assessee, though not accepted, that by itself would not attract the penalty u/s 271(1)(c) as held by the Hon'ble Supreme Court, in the case of *Reliance Petroproducts (P) Ltd.* reported in 322 ITR 158. To substantiate this contention that the issue of addition is debatable in nature, Ld. A.R. referred and relied upon the substantial question of law framed by the Hon'ble High Court in the appeal preferred by the assessee against the order of this Tribunal in quantum. The decision of Hon'ble Delhi High Court dated 05.10.2010 in the case of Liquid Investment & Trading *Coo (supra)* has been relied upon on this point, where Hon'ble Court has observed as under:
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> > *"Both the CIT(A) as well as the ITAT have set aside the penalty imposed by the Assessing Officer under section 271(1)(c) of the Income Tax Act, 1961 on the ground that the issue of deduction under section 14A of the Act was a debatable issue. We may also note that*

against the quantum assessment where under deduction under section 14A of the Act was prescribed to the assessee, the assessee has preferred an appeal in this Court under Section 260A of the Act which has also been admitted and substantial question of law framed. This itself shows that the issue is debatable. For these reasons, we are of the opinion that no question of law arises in the present case."

3.3. Thus, it is the nature of addition/disallowance, which is material to determine whether the issue involved in the addition is a debatable issue and, therefore, the claim of the assessee is a bona fide claim, though not acceptable. Even otherwise legislature has made it clear by inserting Explanation 7 to section 271(1)(c) that any addition in the computation of the total income is made as per the provisions of section 92C. The amounts so added or disallowed shall for the purpose of Clause(c) of section 271(1) would be deemed to represent the income, in respect of which the particulars have been concealed or inaccurate particulars have been furnished unless, the assessee proves to the satisfaction of the taxing authority that the price or charges are paid in international transactions was computed in accordance with the provisions of section 92C and in the manner prescribed under that section in good faith and with the due diligence. For ready reference, we quote Explanation 7 as under:

"Where in the case of an assessee who has entered into an international transaction [or specified domestic transaction] defined in section 92B, any amount is added or disallowed in computing the total income under sub-section(4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause(c) of this subsection, be deemed to represent the income in respect of

which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) for the Commissioner] that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good, faith and with due diligence."

3.4. The cases of addition/disallowance in computing the total income as per the provisions of section 92C does not fall under the general rule of *bona fide* explanation as per Explanation 1 to section 271(1)(c). The Explanation 7, itself has prescribed exceptions in the case whether the price has been computed in accordance with the provisions of section 92C and in the manner prescribed there under in good faith and with due diligence. Therefore, if the assessee proves to the satisfaction of the taxing authority that the price charged or paid has been computed as per the provision and manner prescribed under section 92C, in good faith and with due diligence then the addition made under section 94C(4) would not attract the penalty. Once the exclusion from attracting the provisions u/s 271(1)(c) has been provided in the Explanation-7 itself then the first requirement for escaping from the levy of penalty u/ s 271(1)(c), against the addition made as per the provisions of section 92C is that the decision of the assessee in computation of the price in respect of international transactions is as per the provisions and manner prescribed under section 92C and further the said decision is taken in good faith and with due diligence.

3.5. No doubt that in the case of international transactions regarding purchase of raw material, the most appropriate method for determining the ALP would be Comparable Uncontrolled Transactions (CUP). However, the selection of the method is further

> subjected to various factors and one of the factors is the availability, coverage and reliability of data necessary for application of the method. In the facts of the present case entire adjustment has been made due to the lack of reliable data. We find that the decision of the Hon'ble Delhi High Court in Liquid Investments & Trading Co. *(supra)* clinches the issue in favour of the assessee. In this case it was held by the Hon'ble High Court that where the assessee has preferred an appeal u/s 260A of the Act which has also been admitted a substantial question of law framed; this itself shows that the issue is debatable. In our considered view no penalty u/s 271(1)(c) of the Act could be imposed on a debatable issue. In this view of the order we hold that the case of the assessee is not a fit case for levy of penalty u/s 271(1)(c) of the Act and accordingly the grounds of the appeal by the assessee stand allowed."

13. Quantum appeal on the question of internal comparable has been admitted by the High Court. This is an admitted position.

14. The reasoning given by the Assessing Officer to impose penalty for concealment has been quoted in entirety. It shows complete non-application of mind by the said officer on the relevant considerations. The Commissioner of Income Tax (Appeals), however, did go deeper and had rejected the stand of the respondent-assessee on *bona fides* and due diligence. In spite of evidence placed by the respondent-assessee on the question of difference in quantum or volume of transactions, etc., it was observed that this evidence was not part of the Transfer Pricing Study.

15. Per contra, the Tribunal after referring to the material, had taken an opposite view after examining the factual matrix of the present case.

16. Explanation 7 to Section 271(1)(c) of the Act reads:-

> *"Explanation 7.*—Where in the case of an assessee who has entered into an international transaction or specified domestic transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (*c*) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence."

Thus, addition or disallowance made while computing the income under Section 92C of the Act, is deemed to be concealed income or income of which inaccurate particulars have been furnished. Explanation 7 however states that penalty is not to be imposed where the assessee establishes that the price charged or paid was computed as per provisions of Section 92C and the assessee had acted in good faith and with due diligence. Conduct of the assessee is the distinguishing and relevant factor to be adjudicated in the penalty proceedings. Onus to establish bona fides and exercise of due diligence is on the assessee. Explanation of the assessee on the computation of arms length price may be the same, but appreciation

and consideration is from a different point of view, i.e. bona fides and due diligence.

17. Respondent-assessee had applied CUP method to compute the arms length price of the international transactions with the associated enterprises. Revenue has not disputed that the CUP method was the preferred or appropriate method to be applied. Revenue no doubt states that there was lack of reliable data for application of the CUP method, but the method adopted and applied by the respondent-assessee was not rejected.

18. As noticed above, the respondent-assessee had justified and explained why the independent transaction was disregarded as an internal comparable, for two reasons. Firstly, the transaction was of low value in comparison with transactions with associated entities. Secondly, it was a single transaction, whereas transactions with associated enterprises were continuous and based upon long-term business relationship. This factual position and distinction is undisputed. In view of the factual matrix, the explanation of the respondent/assessee was accepted as bona fide and that the assessee had exercised due diligence in selection of the method and comparables. It is in this context, we find that the Tribunal has taken a reasonable and considered view of the matter. The said findings on the question of explanation, *bona fides* and due diligence is a finding of fact.

19. There was divergence of view whether the internal isolated/sole unrelated third party transaction should be taken as a comparable. In the quantum proceedings the stand of the respondent-assessee that the

internal transaction should be excluded has been rejected. This has resulted in transfer pricing addition. However, as recorded above, the issue and question before the Tribunal in penalty proceeding was different; whether the respondent-assessee while excluding the internal transaction had acted in good faith and with due diligence. The Tribunal has duly applied its mind to the relevant aspect of good faith and due diligence. The Tribunal has held that the respondent-assessee had been able to discharge the onus placed upon them in terms of Explanation 7 to Section 271(1)(c) of the Act and show that their stand and stance in not taking into consideration the internal transaction was in good faith and they had acted with due diligence. These findings of the Tribunal in the present case are factual and clearly plausible and reasonable.

20. Recording the aforesaid, we do not find any reason to interfere in the impugned order. The appeal is accordingly dismissed. No costs.

SANJIV KHANNA, J.

CHANDER SHEKHAR, J.

AUGUST 03, 2018
MR/VKR