

## Kgk Enterprises(Now Known As Kgk ... vs Dcit, Jaipur on 28 November, 2017

vk;dj vihyh; vf/kdj.k] t;iqj U;k;ihB] t;iqj  
IN THE INCOME TAX APPELLATE TRIBUNAL, JAIPUR BENCHES, JAIPUR

Jh dqy Hkkjr] U;kf;d lnL; ,oa Jh foøe flag ;kno] ys[kk lnL; ds le{k  
BEFORE: SHRI KUL BHARAT, JM & SHRI VIKRAM SINGH YADAV, AM

vk;dj vihy la-@ITA No. 567/JP/2016  
fu/kZkj.k o"kZ@Assessment Year :2007-08

M/s KGK Enterprises (now known as KGK Diamonds (I) Pvt. Ltd.) DE-4011-16, Tower D, 4th Floor, Bharat Diamond Bourse, Bandra Kurla Complex, Bandra (East), Mumbai-400051, Maharashtra LFkk;h ys[kk la-@thvkbZvkj la-@PAN/GIR No.: vihykFkhZ@Appellant	cuke Vs.	The Asstt. Commissioner of Income-tax Central Circle-2, Jaipur  AADFK7821L izR;FkhZ@Respondent
--	-------------	---

vk;dj vihy la-@ITA No. 610/JP/2016  
fu/kZkj.k o"kZ@Assessment Year :2007-08

The Dy. Commissioner Income-tax Central Circle-2, Jaipur	of Vs.	cuke M/s KGK Enterprises (now known as KGK Diamonds (I) Pvt. Ltd.) 647-A, Pancharatna, Opera House, Mumbai AADFK7821L izR;FkhZ@Respondent
--	-----------	--

vk;dj vihy la-@ITA No. 568/JP/2016  
fu/kZkj.k o"kZ@Assessment Year :2008-09

M/s KGK Enterprises (now known as KGK Diamonds (I) Pvt. Ltd.) DE-4011-16, Tower D, 4th Floor, Bharat Diamond Bourse, Bandra	cuke Vs.	ACIT, Central Circle-2 Jaipur
---	-------------	-------------------------------------

2 ITA No. ITA No. 567, 610, 568, 611, 569 & 612  
M/s KGK Enterprises vs. The ACI

Kurla Complex, Bandra (East), Mumbai-400051, Maharashtra LFkk;h ys[kk la-@thvkbZvkj la-@PAN/GIR No.: vihykFkhZ@Appellant	AADFK7821L izR;FkhZ@Respondent
---	-----------------------------------

vk;dj vihy la-@ITA No. 611/JP/2016  
fu/kZkj.k o"kZ@Assessment Year :2008-09

The Dy. Commissioner of Income-tax Central Circle-2, Jaipur vs. M/s KGK Enterprises (now known as KGK Diamonds (I) Pvt. Ltd.) 647-A, Pancharatna, Opera House, Mumbai  
LFkk;h ys[kk la-@thvkbZvkj la-@PAN/GIR No.: AADFK7821L  
vihykFkhZ@Appellant izR;FkhZ@Respondent

vk;dj vihy la-@ITA No. 569/JP/2016  
fu/kZkj.k o"kZ@Assessment Year :2009-10

M/s KGK Enterprises (now known as KGK Diamonds (I) Pvt. Ltd.) DE-4011-16, Tower D, 4th Floor, Bharat Diamond Bourse, Bandra Kurla Complex, Bandra (East), Mumbai-400051, Maharashtra vs. ACIT, Central Circle-2 Jaipur  
LFkk;h ys[kk la-@thvkbZvkj la-@PAN/GIR No.: AADFK7821L  
vihykFkhZ@Appellant izR;FkhZ@Respondent

vk;dj vihy la-@ITA No. 612/JP/2016  
fu/kZkj.k o"kZ@Assessment Year :2009-10

The Dy. Commissioner of Income-tax Central Circle-2, Jaipur vs. M/s KGK Enterprises (now known as KGK Diamonds (I) Pvt. Ltd.) 647-A, Pancharatna, Opera House, Mumbai  
3 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/  
M/s KGK Enterprises vs. The ACIT

LFkk;h ys[kk la-@thvkbZvkj la-@PAN/GIR No.: AADFK7821L  
vihykFkhZ@Appellant izR;FkhZ@Respondent

fu/kZkfjrh dh vksj l@s Assessee by : Shri S.R.Sharma (CA) & Shri Rajnikant Bhatra (C.A.)  
jktLo dh vksj ls@ Revenue by: Shri Varindra Mehta (CIT)

lquokbZ dh rkjh[k@ Date of Hearing : 28/09/2017  
mn?kks"k.kk dh rkjh[k@Date of Pronouncement: 28/11/2017

vkns'k@ ORDER

PER: SHRI VIKRAM SINGH YADAV, A.M. These are cross appeals filed by the assessee and the Revenue directed against the orders passed by ld. CIT(A)-4, Jaipur dated 18.03.2016 for A.Y.

2007-08, 2008-09 and 2009-10 respectively. Given the similarity of facts and common grounds of appeal involved in all these cases, all these appeals were heard together and are being disposed off by this consolidated order.

2. With the consent of both the parties, the matter relating to A.Y 2007-08 was taken as a lead case for the purpose of present discussion and adjudication of the issues that have been raised before us. In this case, the respective grounds of appeal taken by the assessee and the Revenue are as under:-

Assessee's grounds of appeal (ITA No. 567/JP/16) "1. The learned Commissioner of Income-tax (Appeals) has erred in law and on facts and in the circumstances of the case in confirming disallowance under section 14A r.w.r. 8D to the extent of Rs. 6,47,319/-.

4 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

2. The learned Commissioner of Income-tax (Appeals) has erred in confirming the interest expenses as per rule 8D without appreciating the fact that the learned AO has not recorded his satisfaction having regards to accounts of the appellant.

3. The learned Commissioner of Income-tax (Appeals) has erred in law and on facts and in the circumstances of the case in confirming disallowances Rs. 64,060/- being 10% of business promotion expenses on estimation basis without appreciating the fact that these expenses were incurred wholly and exclusively for the purpose of business."

Revenue's grounds of appeal (ITA No. 610/JP/16) "1. Whether on the facts and the circumstances of the case Id CIT(A) was right in deleting the addition of Rs. 1,87,41,073/- made on account of interest on the outstanding receivables from the AE's as determined by Addl DIT, TPO-1, Jaipur in its order u/s 92CA without appreciating the fact that addition was made by applying the most appropriate method for calculating the ALP on outstanding receivables from AE's."

2. Whether on the facts and the circumstances of the case Id CIT(A) was right in restricting the disallowance of Rs. 4,76,314/- to Rs.

64,060/- made on account of unverifiable expenses without appreciating the fact that AO specifically pointed out the deficiencies that details like name of person who had incurred the said expenses or details in respect of its nature and purpose business or otherwise, were not mentioned."

3. Firstly, in respect of grounds no. 1 & 2 of assessee's appeal relating to disallowance under section 14A, briefly the facts of the case are that there were investments of Rs 7,85,050 which have been made in the earlier years and carried forward to this year and further, the assessee company has made a fresh investment of Rs. 1,99,52,000 (Rs 2,07,37,050/- less Rs. 7,85,050/-) during the year

under consideration. In this regard, the submission of the assessee before the AO was that such investments have been made from internal accruals and not from 5 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur any borrowed funds and no expenditure has been incurred by the assessee company. The AO didn't accept the contentions of the assessee and disallowed an amount of Rs. 653,513/- which has been sustained by the ld. CIT(A) to the extent of Rs. 6,47,319/-. Now, the assessee is in appeal before us.

4. At the outset, it was submitted by the ld AR that for A.Y 2010-11, similar disallowance under identical set of facts was made by the AO by invoking section 14A r.w.r. 8D and the said disallowance was deleted by the Tribunal in ITA no. 797/JP/15 dated 11.08.2016. It was accordingly submitted that the same may kindly be followed and necessary relief may be provided to the assessee.

5. It was further submitted by the ld AR that no disallowance can be made when interest free funds available with the assessee company are much higher than investments made to earn exempt income. In support, reliance was placed on decision of Hon'ble Bombay High Court in case of Reliance Utilities & Power Ltd. 313 ITR 340, Hon'ble Gujarat High Court in case of CIT vs. Gujarat Narmada Valley Fertilizers Co. Ltd. 221 Taxman 479, and Hon'ble Bombay High Court in case of CIT vs. HDFC Bank Ltd. 366 ITR 505. It was further submitted that the said investments were made for acquiring controlling stake and were part of strategic investments and they were not made with an intention of earning tax free income. Accordingly section 14A does not apply to such investment, in support, reliance was placed on decision of Hon'ble Delhi High Court in case of Cheminvest Ltd. v. CIT 378 ITR 33. It was further submitted that disallowance of interest expenditure would not be 6 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur tenable where AO failed to establish a nexus between interest bearing funds and investment made. In support, reliance was placed on the decision of Hon'ble Karnataka High Court in case of Karnataka State Industrial & Infrastructure Development Corporation Ltd. 65 taxmann.com 295. It was further submitted that no defect has been pointed out by the ld. AO in the claim of the assessee that no expenses were incurred for the purpose of making investment. It was further submitted that the application of section 14A and rule 8D is not automatic and the AO has to record his objective satisfaction having regard to the accounts of the assessee and in support, the ld AR placed reliance on the decision of Hon'ble Supreme Court in case of Godrej & Boyce Manufacturing Company Ltd. v. DCIT 81 taxman.com 111. It was further submitted that during the year, assessee claimed NIL income as exempt from tax and in view of that, there cannot be any disallowance u/s 14A as the same can't exceed the exempt income and in this regard, reliance was placed on decision of Punjab & Haryana High Court in case of Empire Package Pvt ltd (ITA No. 415 of 2015 dated 12.01.2016).

6. The ld. DR is heard who has vehemently argued the matter, took us through the findings of the AO and the ld CIT(A) and relied on the order of the said authorities.

7. We have heard the rival contentions and perused the material available on record. The assessee company has made fresh investment of Rs. 1,99,52,000/- during the year and it is contended that the same is made out of internal accruals and in support, the assessee has 7 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur submitted that the

partner's capital account stood as on 31.3.2007 at Rs 1,30,33,76,061 which demonstrate sufficient interest free funds available with the assessee to make the subject investments of Rs 1,99,52,000/-. Further, we don't see any finding of the AO establishing the nexus between the borrowed funds and the subject investments. A presumption would therefore arise in favour of the assessee that the investments have been made out of interest free funds. However, the Assessing Officer went ahead and disallowed an amount of Rs. 653,513 invoking provisions of section 14A and Rule 8D. On appeal, the disallowance was reduced to Rs. 647,319/- by the Id. CIT(A) whereby he allowed setting off of interest income from gross interest expenses while working out disallowance u/s 14A. Under identical set of facts in assessee's own case for AY 2010-11 (in ITA No. 797/JP/15 dated 11.08.2016), the AO had made a disallowance following the same reasoning and after examining the matter in detail, we have taken a view that disallowance under the provisions of Section 14A is not warranted and the relevant findings are contained at para 2.4 of the said order which is reproduced as under:-

"2.4 We have heard the rival contentions and perused the material available on record. It is noted that the investment worth Rs. 3.37 crores have been made by the assessee in the earlier years and not in the year under consideration. Even if one were to consider the availability of interest free funds during the year, it is noted that partner's capital account is worth Rs. 115.70 crores. Further, the secured loans availed by the assessee in form of packing Credit Limit (PCL) and Post Shipment Export Finance (PSEF) from various bank are exclusively for the purpose of purchase of raw material, payment of labour charges and other direct expenses and which thus have a end-use restriction and 8 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur monitoring by the banks towards the manufacturing and export activity of the appellant. In light of above, we agree with the contention of the assessee that giving the availability of interest free funds over and above the secured loans and also the fact that the secured loans had a specific end-use restriction, the investments have been made from its internal accruals in the earlier years and given that no expenditure has been incurred, no disallowance u/s 14A is warranted. Further, the decision of Hon'ble Bombay High Court in case of HDFC Bank Ltd. (Supra) and Hon'ble Gujarat High Court in case of Gujarat Narmada Valley Fertilizers (supra) also supports the case of the assessee. In light of above, ground no. 1 of the assessee is allowed."

8. In light of above, following our decision in assessee's own case for AY 2010-11, the disallowance under section 14A is hereby deleted. Further, given that there is no income that has been earned during the year which has been claimed as exempt from tax, there cannot be any disallowance which exceeds such exempt income as has been held by Hon'ble Punjab and Haryana High Court in decision referred supra. Further, the Special Bench of the Tribunal in case of Assistant Commissioner of Income-tax, Circle 17 (1), New Delhi Vs Vireet Investment (P.) Ltd [2017] 82 taxmann.com 415 (Delhi - Trib.) (SB), following the decision of the Hon'ble Delhi High Court in case of CIT v. Holcem India (P.) Ltd. [2015] 57 taxmann.com 28 (Delhi), has held that only those investments are to be considered for computing average value of investment which yielded exempt income during the year. Following the same, the disallowance made under section 14A is deleted and grounds no. 1 and 2 of assessee's appeal are thus allowed.

9 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

9. Now coming to revenue's appeal. In ground No. 1, the revenue has challenged the action of ld CIT(A) in deleting the addition of Rs. 1,87,41,073/- made on account of interest on outstanding receivables from associated enterprises as determined by the TPO in his order u/s 92CA(3) of the Act.

10. The facts of the case are that the assessee is mainly engaged in the business of manufacturing cut and polished diamonds. However, during the year under consideration, it has also undertaken certain trading activities in relation to cut and polished diamonds. The assessee has selected TNMM as the most appropriate method to benchmark its transactions relating to purchases and sales. The operating profit on sales has been selected as PLI and has reported its operating margin of 6.15% as against the comparable updated margin of 6.00%.

11. During the course of assessment proceedings, a reference was made by the AO to the TPO to determine the arm's length price so determined by the assessee in respect of its reported international transactions during the financial year 2006-07 relevant to impugned assessment year. The TPO examined the international transactions and arm's price so determined by the assessee and has not proposed any transfer pricing adjustment in respect of the said transactions. The assessee's TNMM method of determination of arm's length price in respect of its sale and purchase transactions with its AEs and operating margin of 6.15% has thus been accepted by the TPO. At the same 10 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur time, the TPO, on perusal of the financial statements of the assessee, observed that the assessee has substantial amount of outstanding receivables from the AEs which remained outstanding for a long period of time and no interest had been charged on such amount. The TPO decided to examine the said transactions by invoking his powers under section 92CA(2A) and 92CA(2B) of the Act and issued a detailed show cause notice to the assessee which reads as under:-

"Perusal of the financials of the assessee company shows that you have substantial amount of outstanding receivables from the AEs, which have remained outstanding for a prolonged period and no interest had been charged on such amount. A perusal of the copies of invoices raised to AEs during the year reveal that the terms of payment have not been honoured and there is a considerable delay in payment as per the period stipulated in invoices or payments have not been received.

2. The main question here is whether the tax payer could have extended such facility to any unrelated party similar to that of the AE without charging adequate compensation. Because, when independent enterprises deal with each other, the conditions of their financial relations ordinarily are determined by market forces. But for the relationship between the tax payer and its AE, income would have accrued to the tax payer. No seller would allow a debtor to enjoy the interest free amount endlessly and in normal business practice is expected to make efforts for recovery of the receivables amount after a time gap.

11 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur Considering the above, it is proposed that the arm's length price of the interest on the outstanding receivables from the AE be determined by considering it to be similar to a loan in nature. This transaction has not been analyzed in the TP study. It is proposed that Comparable Uncontrolled Price (CUP) method should be applied for determination of the ALP, as CUP method is most appropriate for determination of the ALP of interest. In an uncontrolled situation, the assessee would have expected a suitable return (interest) on the amount advanced (or due from the other party). The rate of interest expected in a similar situation would give arm's length interest. So far as the interest rate is concerned it is to be appreciated that the interest rate is to be benchmarked by considering the assessee as a lender and not as a borrower. The rate at which independent lender in India would have advanced money to an unrelated borrower in India is relevant. Here the assessee is the lender, hence the rate of interest expected on money advanced to an unknown party in India could be considered as the arm's length price of the interest on the advance.

It is very pertinent to mention here that it is a trade practice that these kind of delays attract penal rate of interest somewhere from 24% to 36% p.a. depending on case to case. However, to be reasonable and fair to the assessee, instead of charging the penal interest, which would have made the case for charging of interest in the range of 24% to 36% it was considered not to be out of proportion to treat these delayed payments as unsecured loans advanced to the AEs as has been proposed above. It is proposed to charge a normal rate of interest @ 14.05% 12 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur 2.2 Determination of Fair and reasonable rate of Interest:-

In the case at hand, payments have been extended to the AE by an Indian company. It is also a fact that the risk perception of a bank is very different from that of a commercial entity like yours that does not allow such a long period for realization in the normal course of business. In your case, the risk faced is higher. Therefore, it is considered prudent that interest equal to the prime lending rate of the State Bank of India be applied on this account. The PLR of SBI was 11.05% for the FY 2006-07 and 300 basis points to be added for risk including lack of security, forex, processing fee, credit rating and loan tenure is considered appropriate. Therefore, a total of 14.05% markup is considered to be appropriate."

3. \* \* \* \* \*

#### 4. Determination of Arm's Length Interest due from AEs:-

Subject to the above remarks, the interest is calculated in the Annexure-1 to 4 of this notice. The ledger accounts were taken as furnished by the assessee. The interest calculated in the annexure is tabulated below. The credit period as per 'Payment Term' in the Invoices raised has been allowed. The assessee has been allowed the benefit of payables from the AEs and accordingly, the benefit of interest on payables has been allowed.

13 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur Particulars Interest on Interest on Total outstanding export/impo Interest from/to AEs rt from AEs as on 31.3.2006 Total Interest Rs. Rs. Rs.

receivables 1,99,02,722/- 68,82,140/- as 2,67,84,862/-

	as	per per	annexure	
	annexure '1'	'2'		
Total Interest Rs.		Rs.		Rs.
payable	16,47,710/-	as 45,51,473/-	as 61,99,183/-	
	per annexure '3'	per	annexure	
		'4'		
Net interest chargeable				Rs.
				2,05,85,679/-

Based on the calculation above, the arm's length interest is determined as Rs. 2,05,85,679/- and accordingly, the same is the proposed adjustment u/s 92CA."

12. In response to the show-cause, the assessee filed detailed submissions which were considered but not found acceptable by the TPO. The TPO referred to the explanation (1)(c) to section 92B which has been inserted with retrospective effect from 01.04.2002 and held that any type of advance, payments or differed payment or receivable or any other debt arising during the course of business advancement is covered under the definition of international transaction. Referring to 14 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur the provisions of section 92F(v) and rule 10B(2)(c), the TPO held that the transfer pricing regulation are to be applied keeping in mind the overall scheme of the tax payer's business arrangements. The TPO held that the assessee has provided benefit to its AEs by way of advancement of interest fee loan in the garb of delay receipt of receivables. It was held that these funds could have been otherwise deployed for at least earning interest income. The assessee has therefore incurred cost in connection with a benefit and services provided to the AE by way of delay receipt of receivable, accordingly, the delay in receipt of receivables was held to be an international transactions u/s 92B(1) read with clause (v) of section 92F.

13. It was further held by the TPO that the amendment to section 92B is clarificatory in nature and it has only clarified the stand of the department by making the provision explicitly clear and the receivables were always covered under the definition of international transaction even prior to amendment.

14. It was further held by the TPO that explanation (i)(a) and (c) of section 92B recognizes sales and receivables arising during the course of business as separate transaction. Requiring determination of ALP of the interest chargeable on excess period of credit allowed to an associated enterprise, it has to be computed having regard to the arm's length principle and it is independent of other transactions entered into by the assessee with the AEs.



15 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

15. Regarding assessee's contention that over dues receivable from AEs cannot be compared to the loan whether secured or unsecured, the TPO held that the transaction has been considered to be similar to the loan transaction and since the assessee has not charged any interest from its AEs, it is required to be examined and charge arm's length interest by considering the rates prevailing in independent transaction.

16. It was further held by the TPO that real income theory is not applicable in the context of chapter X. Further, it was held that the business expediency does not have any role to play. While applying arm's length principle, one has to determine what independent parties in comparable transaction would do.

17. Regarding assessee's contention that it does not charge interest on debit balance with independent parties and under CUP method, no adjustment can be made as controlled transactions is comparable with uncontrolled transactions, it was appreciated by the TPO that main question therefore is whether the taxpayer could have extended such credit facilities to any unrelated party similar to that of its AE without charging arm's length rate of interest. Because, when independent enterprises deal with each other, the conditions of their financial relations ordinarily are determined by market forces. It was however held by the TPO that but for the relationship between the tax payer and its AEs, arm's length interest income would have accrued to the tax payer as in independent unrelated transactions, the party advancing credit expects financial compensation in the form of interest as prevalent under such circumstances.

16 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

18. Regarding assessee's contention that average period of realization from non AEs is more (18 days) than the average period of realization from AEs (5 days), the TPO, acknowledging the fact that assessee has not charged any interest from both AEs and non AEs, held that the average realization period becomes irrelevant.

19. Further, the assessee's contention regarding non-application of rate of interest at 14.05% was also rejected by the TPO. The assessee had contended that it has borrowed foreign currency for packing credit facilities and post shipment facilities from various banks and average cost of borrowings made by the assessee has been worked at 7.80% which is based on LIBOR and it was submitted that to benchmark the interest rate, actual cost of borrowing attributable to financing of such experts shipments to AEs should be taken into consideration.

20. Based on the above, the ALP of the interest on the outstanding receivable was determined by the TPO at Rs. 1,87,41,073/- applying CUP method as against Nil shown by the assessee's companies. Based on the TPO order u/s 92CA (3), the AO made an addition of Rs. 1,87,41,073/- was made to the total income of the assessee company.

21. On close perusal of the order of the TPO as we have noted above, what we find is that one issue which the TPO has emphasized time and again in his order, right from the show-cause notice to her final analysis, is whether the tax payer could have extended such facility to any unrelated party similar to that of the AE without charging 17 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur adequate compensation. In response, the assessee submitted that it has extended similar credit facility to non-AEs without charging any interest. The TPO though acknowledged the said fact but refused to accept the same. Under the CUP method which has been invoked by the TPO (which we will discuss later whether the same is warranted in the instant case or not), the TPO is required to evaluate the arm's-length character of a controlled transaction by comparing the price and conditions to the price and conditions of similar transactions between the taxpayer and an unrelated party ("internal CUP"), or between two unrelated parties ("external CUP"). The immediate question that comes to our mind is that where internal CUP is available, would there be a necessity to examine the external CUP and can the latter be held to present a more reliable outcome in the facts of the present case. We find that the same was appreciated by the Id CIT(A) who on appeal by the assessee, has granted relief to the assessee company by deleting the notional interest charged for delay in realization of export selling invoices.

22. The relevant findings of the Id. CIT(A) is as under:-

"3.1.2 I have duly considered assessee's submission and carefully gone through assessment order passed by the AO. I have also taken a note of the factual matrix of the case as well as judicial pronouncements relied upon.

It is a matter of fact that as a matter of trade practice in the Gem and Jewellery industry, interest on overdue receipts is not charged. Further, it is submitted that as a matter of policy, no interest was charged on 18 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur delayed realization of sale proceeds from AE and Non AE customers. Therefore, the Appellant submits that non charging of interest to Non- AEs could be regarded as an internal CUP and on the same basis, there can be no case for the appellant to charge interest to its AEs. Appellant has also submitted the calculation of average of the realization days beyond the credit period in respect of sales made during FY 2006-07 taken by AE's and taken by Non AE's. The AEs have taken on an average of additional 5 days from the due date, whereas Non AEs have taken on an average of additional 18 days from the due date to make the payments in respect of sales made to them during FY 2006-07. It is quite evident that both AE's and Non AE's have taken additional days over and above the credit period granted to them and interest have not been charged from any of them irrespective of period of delay. Relying the decision of following cases, appellant further submits that in respect of the excess credit period granted to the AE's, no adjustment is required to be made:

- Tech Mahindra Limited (Formerly known as Mahindra British Telecom Ltd.

• Tecnimont ICB House • M/s Indo American Jewellery Ltd • M/s Agilisys IT Service Pvt. Ltd.

• M/s Living Stones V • Baush & Lomb Eyecare (I) P. Ltd • VIP Industries Ltd.

• Tata Autocomp Systems Limited Further, appellant without prejudice to above, even if proposed adjustment has to be made, has requested that the calculation of interest should be based on the LIBOR based rate as per the RBI 19 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur guidelines in respect of the external commercial borrowings and trade credits.

The fact is that the assessee had adopted uniform policy of not charging interest on delayed realization on sale proceeds from both the AEs and Non AE customers. This being so, the judgments of Hon'ble ITAT Jaipur in case of Vaibhav Gems Ltd & VVF Ltd Hon'ble Bombay High Court in case of Indo American Jewellery Ltd Hon'ble ITAT Mumbai in case of Tech Mahindra and ITAT Delhi Bench in the case of Bausch & Lomb Eyecare (India) (P) Ltd. cited (supra) are squarely applicable in assessee's case.

Thus, in view of facts and circumstances of the case as discussed above, thereof, the adjustment in respect of notional interest on delayed realization of sale proceeds is hereby deleted. Assessee gets a benefit of Rs. 1,87,41,073/- on account of notional interest charged for delay in realization of export sales invoices from associated enterprises."

23. During the course of hearing, the Id. AR submitted that assessee firm also made sales to non AEs, during the year under consideration, where it had unpaid receivable at the year end. It was submitted that the assessee firm provided uniform credit, both to AEs and non- AEs/third parties, of 145 days and did not charge any interest, on such unpaid receivables, from both type of the customers. Additional days, taken beyond due date, for making payment by Non-AEs were 18 days 20 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur whereas those taken by AEs were 5 days. There was no agreement between the assessee firm and the AE to charge interest on delayed payments. It was submitted that the above facts remains undisputed by the lower authorities.

24. It was further submitted that since no interest has been charged from the non AEs, i.e. in case of independent transactions, as well, there cannot be any occasion to make an Arms Length Price adjustment, for notional interest, on delay in realization of trade debts from the AEs. The very purpose of the arm's length price adjustments is to neutralize the impact of intra AE relationship on commercial transaction, but, given the uncontroverted facts, there is no impact of intra AE relationship in the above case. Thus there was no basis for imposing "notional interest" on export proceeds that were received late from the AEs.

25. Our reference was drawn to the decision of the Hon'ble Bombay High Court in the case of Indo American Jewellery Ltd. [2014] 44 taxmann.com 310 (Bombay), wherein, under identical set of facts, it was held as under:

"..in the facts of the present case, the specific finding of the ITAT is that there is complete uniformity in the act of the assessee in not charging interest from both the Associated Enterprises and Non Associated Enterprises debtors and the delay in realisation of the export proceeds in both the cases is same. In these circumstances the decision of the Tribunal in deleting the notional interest on outstanding amount of export proceeds realised belatedly cannot be faulted...."

21 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

26. Our reference was also drawn to the decision of the ITAT, Delhi Bench in the case of Bausch & Lomb Eyecare (India) (P.) Ltd. (60 taxmann.com 141), which had relied on the ratio laid down by the Hon'ble Bombay High Court in the case of Indo American Jewellery Ltd. (Supra) and held as under:

"....18.1 We find that ld. DR has claimed that inordinate delay in receiving the outstanding amounts to passing a benefit to AE and it constitutes real income. Apropos assessee has been able to demonstrate that assessee as a policy does not charge any interest on any delayed payment irrespective of the party being AE or non AE, as it was a consistent business policy. Reliance is placed by assessee on OECD guidelines at para 1.9 prescribing that no interest could be charged on delayed payment on commercial consideration for ensuring a long and healthy relationship as persuasive value.

18.2 In the case of Indo American Jewellery Ltd. (supra ), Hon'ble Bombay High Court while affirming the ITAT decision has held that there being uniformity in assessee's act in not charging interest both from AE and non AE and delay in realization in both the cases is same, notional interest cannot be considered with ALP on delayed realization. This has been further followed by the ITAT in the case of Lintas India P. Ltd. (supra ) & Mastek Ltd. (supra ).

18.2 In view of above facts, respectfully following these judicial precedents we are of the view that the adjustment in relation to notional interest on outstanding receivables cannot be made in the case of the assessee. This ground of the assessee is allowed...."

22 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

27. Our reference was also drawn to the decision of ITAT Jaipur Bench in the case of Vaibhav Gems Ltd. (ITA No. 01/JP/2014), wherein the Jaipur Bench, following the ratio laid down in the above mentioned judgments of Indo American Jewellery Ltd. (Supra) and Bausch & Lomb Eyecare (India) (P.) Ltd. (Supra), had deleted the adjustment made by the TPO, with respect to notional interest on delayed realization of sale proceeds and held as under:

"We have heard the rival contentions and perused the materials available on record. The fact is that the assessee had adopted uniform policy of not charging interest on delayed realization on sale proceeds from both the AEs and non -AEs customers. This being so, the judgement of Hon'ble Bombay High Court CIT vs. Indo American Jewellery Ltd. and the judgement of ITAT Delhi Bench in the case of Bausch & Lomb Eyecare (India) (P) Ltd. cited (supra) are squarely applicable in assessee's case. Thus, in view thereof, we delete the adjustment in respect of notional interest on delayed realization of sale proceeds. Thus ground no. 1 of the assessee is allowed..."

28. Further, our reference was also drawn to the decision of ITAT Mumbai Bench in the case of Tech Mahindra Limited ITA No. 1176/Mum/2010, wherein it was held as under:

"As a matter of fact, in case the Transfer Pricing officer indeed wanted to adopt internal CUP in this case, it would prima facie appear that the correct comparable was the interest that the assessee was charging from independent enterprises - which was admittedly NIL in the present case. It is only elementary that an ALP adjustment can only be made to nullify the impact of interrelationships between the associate 23 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur enterprises, i.e. for variations in assessee's dealings vis-à-vis dealings with independent enterprises, and, therefore, when assessee is not charging the interest on delayed payments from independent enterprises, a view is perhaps possible that the assessee cannot be subjected to the ALP adjustment in respect of delayed payments from associated enterprises either. In other words, the TPO need not consider what must happen in ideal circumstances but need to restrict himself to locating the differences in assessee's dealings with AEs vis-à-vis assessee's dealings with non AEs, and neutralize the impact of such differences..."

29. Further reliance was placed by the ld AR on the following judicial pronouncements:

29.1 Det Norske Veritas A/S vs. ADIT [2016] 67 taxmann.com 16 (Mumbai - Trib.)  
"...When deciding the arm's length price of an international transaction with the associated enterprises, the real issue for consideration is as to what would have been the situation in an arm's length situation i.e. in respect of delay in realization of similar debt from an independent enterprises in this case. Once the assessee has contended that the interest is not being charged from anyone, including, of course, the non AEs, and that contention is not disputed to be factually incorrect, it cannot be open to the TPO to make adjustment in the case of delays in realization from the AEs. The treatment being accorded to the AEs and non AEs is the same, and, in such a situation, ALP adjustment cannot be made for delay in realization of monies from the AE. The consideration as to how the assessee would have received interest if 24 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur money was given to an outsider is irrelevant because it is not a case of extending loan or placing deposit, rather it is a case of amount becoming due as a result of commercial transaction.

29.2 Excellence Data Research Private Limited vs. ACIT (2016) 48 CCH 51 Hyd Trib  
"...Since in the case before us, the facts and circumstances are similar and more particularly the TPO has not taken into consideration that the fact that the assessee has also not charged the interest not receivable from the non AE, we comply the assessee's plea on this ground.

Accordingly Ground No. 14 to 17 are allowed...."

29.3 ACIT vs. Gitanjali Exports Corporation Limited (2016) 178 TTJ 0529 (Mumbai) "...We find that this is uncontroverted stand of the assessee that he has not charged interest on delay in realization of debts in non AE situations as well. Once it is not in dispute, as is the case before us, that no interest is charged from the non AEs, i.e. independent transactions, as well, there cannot be any occasion to make an ALP adjustment, for notional interest, on delay in realization of trade debts from the AEs. The very purpose of the arm's length price adjustments is to neutralize the impact of intra AE relationship on commercial transaction, but, given the above facts, there is no impact of intra AE relationship in the above case..."

30. It was further submitted by the Id AR that the Ld. TPO in her order has misplaced her reliance on various judicial pronouncements. The cases are distinguishable as submitted below:

25 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur 30.1 Tecnimont ICB Ltd. v. Deputy Commissioner of Income-tax [2013] 32 taxmann.com 357 (Mumbai - Trib.) This is the case pertaining to reimbursements received from AEs where there was no instances where in similar transactions were not entered with non-AEs whereas in present case there is explicit finding that the receivables are due from both AEs and non-AEs and none of the case interest was not charged by the assessee.

30.2 Logix Micro Systems Ltd. v. Assistant Commissioner of Income-

tax [2010] 42 SOT 525 (Bangalore) In this case there are no findings that the assessee company was making sales to AEs and that whether interest was charged from AE or not.

30.3 Cox & King (India) (P.) Ltd. v. Income-tax Officer [2010] 42 SOT 15 (MUM.) (URO) In this case there was an express finding of TPO that the assessee had shown more favor in giving credit period to AE than non-AE. Whereas in the case at hand, additional days, taken beyond due date, for making payment by Non-AEs were 18 days whereas those taken by AEs were 5 days.

30.4 VVF Ltd. V. Dy. CIT (ITA No. 673/Mum/06):

In this case, the assessee company had extended interest free loans to its AEs. Whereas the present case pertains to notional interest calculated on outstanding receivables on the sales made by the assessee firm to its AEs.

26 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs.  
The ACIT, Jaipur

31. It was further submitted by the Id AR that exports made to the AE is benchmarked on the basis of the Transactional Net Margin Method (TNMM) and the TPO has accepted the same. However with respect to delayed realization of debts, the TPO re-characterized the said transaction as an unsecured loan. The Hon'ble Delhi High Court in the case of EKL Appliances Limited [(2012) 345 ITR 241 (Del)], held that recharacterization of a transaction is possible in only two situations - i.e. (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner. None of these conditions is satisfied in the present case. The form and substance of the transactions are the same. The TPO has not brought on record any material to demonstrate and establish that the form and substance of transactions are different. It is not the case of the Transfer Pricing Officer that the export transaction was a sham transaction to finance the AE. Whatever are the terms of realization of the exports proceeds with the non-AEs, the same are the terms of realization of exports from the non AEs.

32. It was further submitted that realization of export proceeds is inextricably linked with the sale transaction. It was submitted that transaction of allowing credit period to AE on realization of sale proceeds is not an independent international transaction but it is a closely linked or continuous transaction along with sale transaction to the AE. The credit period allowed to the party depends upon various 27 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur factors which also includes the price charged by the assessee from purchaser. Therefore, the credit period extended by the assessee to the AE cannot be examined independently but has to be considered along with the main international transaction being sale to the AE. As a result, once the sale is found to be at an Arm's Length Price, no further adjustment can be made in respect of delay in realization of export proceeds.

33. Reliance was placed on the following judicial pronouncements:

33.1 Det Norske Veritas A/S vs. ADIT [2016] 67 taxmann.com 16 (Mumbai - Trib.) "...In any event, when international transactions have been benchmarked on the basis of TNMM, and interest on delay in realization of amounts is only incidental to such transactions rather than a standalone transaction, such an adjustment cannot be made independently. For this proposition, we find support from a coordinate bench decision in the case of Micro Ink Ltd. v. Addl. CIT [2015] 63 taxmann.com 353 (Ahd.). In the light of the above discussions, and bearing in mind entirety of the case, we deem it fit and proper to delete the impugned ALP adjustment of Rs 7,20,110. The assessee gets the relief accordingly...."

33.2 Kusum Healthcare Pvt Ltd Vs ACIT (2015) 62 taxmann.79 (Del) "...From the above analysis, it is clear that assessee had earned significantly higher margin than the comparable companies (which have been accepted by the TPO) which more than

compensates for the credit period extended to the AEs. Thus, the approach by the assessee of 28 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur aggregating the international transactions pertaining to sale of goods to AE and receivables arising from such transactions which is undoubtedly inextricably connected is in accordance with established TP principles as well as ratio laid down by the Hon'ble jurisdictional High Court in the case of Sony Ericsson Mobile Communication India (P.) Ltd. (supra).."

33.3 Micro Ink Ltd Vs ACIT (2014) 63 taxmann.353 (Ahd):

"...The whole exercise of ALP adjustments is to neutralize the impact of inter se relationships between the AEs and it is, therefore, not the delay simpliciter in payment but delay in payment vis-a-vis similar situations with non-AEs (i.e. independent enterprises) which is of crucial consideration, such a comparison cannot be based on the hypothesis as to what would have, in the wisdom of the TPO, happened if assessee was to have similar transactions with non-AEs. The comparison has to be based on real transactions of similar nature, if at all such transactions have taken place. When no such transactions have taken place, as in instant case, there is obviously no occasion of any comparison. The stand taken by the revenue, therefore, is not only quite detached from commercial reality but also wholly untenable in law. In any case, what can be examined on the touchstone of arm's length principles is the commercial transaction itself, as a result of which the debt balance has come into existence, and the terms and conditions, including terms of payment, on which the said commercial transaction has been entered into...."

"...The international transaction is exports of goods which been benchmarked on TNMM basis and which is duly accepted by the TPO. In view of these discussions, and respectfully following the decision of the 29 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur coordinate bench in assessee's own case for the earlier years, the grievance of the assessee is upheld and the Assessing Officer is directed to delete, the impugned ALP adjustment...."

34. It was further submitted that extension of credit to AEs beyond stipulated credit period cannot be construed as an 'International Transaction'. It was submitted that a continuing debit balance, in the account of the AE, does not amount to an International Transaction under section 92B in respect of which ALP adjustments can be made. Factum of payment has to be considered vis-a-vis terms of payment set out in the transaction arrangement, and not in isolation with the commercial terms on which transaction in respect of which payment is to be made.

35. Our reference was drawn to the decision of the ITAT Mumbai Bench in the case of Nimbus Communications Ltd Vs ACIT (2011) 139 TTJ 214 (Mumbai), held that "...A continuing debit balance, in our humble understanding, is not an international transaction per se, but is a result of the international transaction...."



"...The payment terms are an integral part of any commercial transaction, and the transaction value takes into account the terms of payment, such as permissible credit period, as well. The residuary clause in the definition of 'international transaction', i.e. any other transaction having a bearing on the profits, incomes, losses or assets of such enterprises, does not apply to a continuing debit balance, on the given facts of the case, for the elementary reason that there is nothing on record to show that as a result of not realizing the debts from 30 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur associated enterprises, there has been any impact on profits, incomes, losses or assets of the assessee..."

36. It was submitted that laying down a similar ratio, Hon'ble ITAT Pune Bench in the case of Patni Computer Systems Ltd. V. Dy. CIT (2011) 141 TTJ (Pune) 190 has held that extension of credit to AEs beyond stipulated credit period cannot be construed as an 'international transaction' so as to require adjustment for ascertaining ALP.

37. It was further submitted that amendment in Section 92B is to be treated as prospective in effect. The Finance Act 2012 widened the scope of International Transaction by inserting Explanation in Section 92B with retrospective effect from 01.04.2002. As per this explanation, capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payment or deferred payment or receivable or any other debt arising during the course of business is now deemed as international transaction.

38. It was submitted that such amendment to section 92B is an amendment to substantive law since it resulted in enhancement of the scope of international transactions as envisaged under erstwhile section 92B of the Act.

The subject amendment though stated to be clarificatory should be treated as effective from Assessment Year 2013-14 onwards. Reliance was placed on the decision of the Hon'ble Delhi High Court in the case of New Skies Satellite BV [TS-64-HC -DEL (2016)] held that amendments though originally notified as clarificatory may turn out to 31 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur be substantive in fact and such a substantive amendment is incapable of being given retrospective effect. Relevant extracts of the said order is reproduced hereunder:-

"...Undoubtedly, the legislature is competent to amend a provision that operates retrospectively or prospectively. Nonetheless, when disputes as to their applicability arise in court, it is the actual substance of the amendment that determines its ultimate operation and not the bare language in which such amendment is couched. A clarificatory amendment presumes the existence of a provision the language of which is obscure, ambiguous, may havemade an obvious omission, or is capable of more than one meaning. In such case, a subsequent provision dealing with the same subject may throw light upon it. Yet, it is not every time that the legislature characterizes an amendment as retrospective that the Court will give such effect to it. This is not in derogation of the express words of the law in question, (which as a

matter of course must be the first to be given effect to), but because the law which was intended to be given retrospective effect to as a clarificatory amendment, is in its true nature one that expands the scope of the section it seeks to clarify, and resultantly introduces new principles, upon which liabilities might arise. Such amendments though framed as clarificatory, are in fact transformative substantive amendments, and incapable of being given retrospective effect. An important question, which arises in this context, is whether a "clarificatory" amendment remains true to its nature when it purports to annul, or has the undeniable effect of annulling, an interpretation given by the courts to the term sought to be clarified. In other words, does

32 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur the rule against clarificatory amendments laying down new principles of law extend to situations where law had been judicially interpreted and the legislature seeks to overcome it by declaring that the law in question was never meant to have the import given to it by the Court? The general position of the courts in this regard is where the purpose of a special interpretive statute is to correct a judicial interpretation of a prior law, which the legislature considers inaccurate, the effect is prospective. Any other result would make the legislature a court of last resort. *United States v. Gilmore* 8 Wall [(75US ) 33019LEd396 ( 1869 )] *Peony Park v. O'Malley* [ 223F2d668 ( 8th Cir 1955)] It does not mean that the legislature does not have the power to override judicial decisions which in its opinion it deems as incorrect, however to respect the separation of legal powers and to avoid making a legislature a court of last resort, the amendments can be made prospective only[ *Ref County of Sacramento v State* (134 Cal App 3d 428) and *In re Marriage of Davies* (105 III App 3d 66)] (Emphasis, by underlining, supplied by us)..."

39. It was submitted that the ITAT Mumbai Bench, relying on the ratio laid down by the Hon'ble Delhi High Court in the above mentioned case, in its order dated 31.03.2016, in the case of *Rusabh Diamonds* (2016) 158 ITD 0564 (Mumbai), has held that since explanation to Section 92B has increased the scope of International Transaction, such amendment though stated to be clarificatory and stated to be effective from 1st April 2002, has to be necessarily treated as effective from, at best, Assessment Year 2013-14. Relevant extracts of the said order is as under:-

33 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur "...if the 2012 amendment does increase the scope of international transaction under section 92B, as is our considered view, there is no way it could be implemented for the period prior to this law coming on the statute i.e. 28th May 2012. The law is well settled. It does not expect anyone to perform an impossibility. Reiterating this settled legal position, Hon'ble Supreme Court has, in the case of *Krishnaswamy S PdVs Union of India* [(2006) 281 ITR 305 (SC)].."

40. It was further submitted that similar ratio was laid down by the Hon'ble ITAT Mumbai Benches in the below mentioned cases:-

• Hiraco Jewellery (India) Pvt. Ltd., I.T.A. No.7297/Mum/2014 (Mumbai) • Gitanjali Exports Corporation Limited (2016) 178 TTJ 529 (Mumbai) • Siro Clinpharm Private Limited (2016) 177 TTJ 609 (Mumbai)

41. It was finally submitted that without prejudice to the above submissions, interest rate to be charged for excess credit period, should be based on LIBOR rate rather than the interest rate charged by the Domestic Banks. Hon'ble ITAT Delhi Bench in the case of Avenue Asia Advisors (P.) Ltd [2016] 178 TTJ 295 (Delhi - Trib.) held that "Head Notes - Section 92C of the Income-tax Act, 1961 - Transfer pricing -

Computation of arm's length price (Comparables and adjustments/Adjustments - Interest) - Assessment year 2009-10 - Whether since in case of assessee, invoices were reised by assessee in foreign currency and AE enjoyed benefit of interest in terms of LIBOR rate of interest, while computing adjustment for interest on receivables, 34 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur said LIBOR rate of interest had to be considered rather than prime lending rate of interest of SBI - Held, yes..."

42. The ld DR is heard who has vehemently argued the matter and took us through the findings of the TPO which we have already noted above. He submitted that in view of the amendment brought in by the Finance Act 2012, there is no ambiguity that delay in realization of export proceeds beyond stipulated credit period and continuing debit balance in the account of the associated enterprises constitute an international transactions u/s 92B of the Act. It was further submitted that the said transaction was accordingly benchmarked applying the CUP method which is the most appropriate method and adjustment has been proposed by the TPO towards calculation of interest on such receivables beyond the prescribed credit limit.

43. We have heard the rival contentions and perused the material available on record including the order of the Transfer Pricing Officer, the ld. CIT(A) as well as the decisions of the Hon'ble High Courts and the Co-ordinate Benches.

44. In our view the first and the foremost issue which arise for consideration is whether delay in realization of export proceeds beyond stipulated credit period and continuing debit balance in the account of the associated enterprises amounts to an international transaction u/s 92B of the Act in light of explanation to section 92B inserted by the Finance Act 2012 which has been specifically invoked by Transfer Pricing Officer. The said explanation to section 92B reads as under:-

35 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur "Explanation.--For the removal of doubts, it is hereby clarified that--

(i) the expression "international transaction" shall include--

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or

any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, 36 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur losses or assets of such enterprises at the time of the transaction or at any future date."

45. The Co-ordinate Bench in case of Ameriprise India (P.) Ltd. [2015] 62 taxmann.com 237 (Del) had an occasion to examine the said explanation in the context of the expression "any other debt arising during the course of business" and has held as under:-

"21. After considering the rival submissions and perusing the relevant material on record, it is noticed as highlighted above, that the assessee argued before the TPO that interest on receivables is not an international transaction. At this stage, it would be apposite to note that the Finance Act, 2012 has inserted Explanation to section 92B with retrospective effect from 1.4.2002. Clause (i) of this Explanation, which is otherwise also for removal of doubts, gives meaning to the expression 'international transaction' in an inclusive manner. Sub-clause (c) of clause (i) of this Explanation, which is relevant for our purpose, provides as under:

'Explanation.--For the removal of doubts, it is hereby clarified that--

(i) the expression "international transaction" shall include--

(a) to (b)\*\*

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of

advance, payments or deferred payment or receivable or any other debt arising during the course of business;....' 37 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

22. On going through the relevant part of the Explanation inserted with retrospective effect from 1.4.2002, thereby also covering the assessment year under consideration, there remains no doubt that apart from any long-term or short-term lending or borrowing, etc., or any type of advance payments or deferred payments, 'any other debt arising during the course of business' has also been expressly recognized as an international transaction. That being so, the payment/non-payment of interest or receipt/non-receipt of interest on the loans accepted or allowed in the circumstances as mentioned in this clause of the Explanation, also become international transactions, requiring the determination of their ALP. If the payment of interest is excessive or there is no or low receipt of interest, then such interest expense/income need to be brought to its ALP. The expression 'debt arising during the course of business' in common parlance encompasses, inter alia, any trading debt arising from the sale of goods or services rendered in the course of carrying on the business. Once any debt arising during the course of business has been ordained by the legislature as an international transaction, it is, but, natural that if there is any delay in the realization of such debt arising during the course of business, it is liable to be visited with the TP adjustment on account of interest income short charged or uncharged. Under such circumstances, the contention taken by the assessee before the TPO that it is not an international transaction, turns out to be bereft of any force."

46. Further, we refer to the decision of the Hon'ble Delhi High Court in case of Kusum Health Care Pvt. Ltd. (ITA No. 765/2016 dated 38 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur 25.04.2017) wherein the Hon'ble High Court was pleased to held as under:-

"10. The Court is unable to agree with the above submissions. The inclusion in the Explanation to Section 92B of the Act of the expression "receivables does not mean that de hors the context every item of "receivables appearing in the accounts of an entity, which may have dealings with foreign AEs would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which will have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the Assessee will have to be studied. In other words, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way.

11. The Court finds that the entire focus of the AO was on just one AY and the figure of receivables in relation to that AY can hardly reflect a pattern that would justify a

TPO concluding that the figure of receivables beyond 180 days constitutes an international transaction by itself. With the Assessee having already factored in the impact of the receivables on the working capital and thereby on its pricing/profitability vis-à-vis that of its comparables, any further adjustment only on the basis of the outstanding receivables would have distorted the picture and re-characterised the transaction. This was clearly impermissible in 39 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur law as explained by this Court in CIT v. EKL Appliances Ltd. (2012) 345 ITR 241 (Delhi).

12. Consequently, the Court is unable to find any error in the impugned order of the ITAT giving rise to any substantial question of law for determination. The appeal is, accordingly, dismissed."

47. In light of above, in the instance case, what has to be examined is whether outstanding receivables in relation to sale transactions with the AEs reflects a pattern over a period of time or is just restricted to the impugned assessment year that would justify a TPO concluding that the figure of receivables beyond 145 days constitutes an international transaction by itself. From perusal of records pertaining to AY 2007-08, 2008-09 and 2009-10, it is observed that the assessee has outstanding receivables beyond 145 days in respect of its export sale transactions with its AEs though the quantum of receivables, period of delayed realization may vary in each of these years. In each of these years, the TPO has also categorized these outstanding receivables as an independent transaction and has proposed a transfer price adjustment towards interest on such outstanding receivables beyond 145 days. However, at the same time, there is not enough material on record which throw light on the exact reasons for such delay in receivables and hence, in view of the same, it cannot be stated with certainty that there seems to be some pattern in delayed realization of export proceeds beyond stipulated credit period and continuing debit balance in the account of the associated enterprises which intends to benefit the associated enterprises and amounts to an international transaction in terms of explanation to section 92B of the Act.

40 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

48. Here, it would be equally relevant to examine another contention raised by the Id. AR that such amendment by way of an explanation to section 92B is an amendment to a substantive law as it has resulted in enhancement of the scope of international transactions as envisaged u/s 92B of the Act and such amendment, though stated to be clarificatory, should thus be treated as effective from AY 2013-14 onwards and is not applicable for the impugned assessment year i.e, AY 2007-08 and even to two subsequent assessment years ie, AY 2008-09 and AY 2009-10 which are under consideration before us.

49. In this regard, Id. AR has placed reliance on the decision of Hon'ble Delhi High Court in case of New Skies Satellite BV (supra) and the decision of Co-ordinate Bench in the case of Rusabh Diamonds (supra) wherein, in the latter case, it was held that 2012 amendment does increase the

scope of international transactions u/s 92B and there is no way that it could be implemented prior to the law coming on the statute i.e. 28th May, 2012 and accordingly such amendment though stated to be clarificatory and effective from 1st April, 2002 has to be necessarily treated as effective from AY 2013-14 onwards. The relevant extracts of the decision of the Co-ordinate Bench reads as under:-

"20. In order to explain this line of reasoning, a few material factual developments and the legal analysis will have to be taken note of. We have noted that everything hinges on application of Explanation to Section 92B, vide Finance Act 2012, though with retrospective effect from 1st April 2002. This Explanation provides as follows:

Explanation\*: - For the removal of doubts, it is hereby clarified that

--

41 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur (\*inserted by the Finance Act 2012, though with retrospective effect from 1st April 2002)

(i) the expression "international transaction" shall include --

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of business restructuring or reorganisation, entered into 42 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

(ii) the expression "intangible property" shall include --

- (a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;
- (b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;
- (c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;
- (d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;
- (e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schematics, blueprints, proprietary documentation;
- (f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;
- (g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete 43 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur agreements;
- (h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;
- (i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;
- (j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;
- (k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
- (l) any other similar item that derives its value from its intellectual content rather than its physical attributes.'

21. Shortly before the 2012 amendments were brought, a coordinate bench of this Tribunal, in the case of Nimbus Communications Ltd. (supra) and speaking through one of us, had observed as follows:

"4. It is only elementary, in terms of the provisions of Section 92, any income arising from an international transaction has to be computed having regard to the arm's length price (ALP), and that this exercise includes the allowance for any expense or interest arising from an international transaction as well. That is the only provisions



under which ALP adjustments can be made. In other words, therefore, arm's length price adjustments can only be made 44 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur in respect of an 'international transactions'. The expression 'international transaction', on the other hand, is defined under section 92B as a transaction between two or more associated enterprises, either or both of them are non-residents, "in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing of money, or any other transaction having a bearing on the profits, incomes, losses or assets of such enterprises" as also transaction in the nature of cost or expense sharing arrangement. The question that we must address ourselves to is whether a continuing debit balance constitutes a 'transaction' in terms of the provisions of Section 92B.

5. A continuing debit balance, in our humble understanding, is not an international transaction per se, but is a result of the international transaction. In plain words, a continuing debit balance only reflects that the payment, even though due, has not been made by the debtor. It is not, however, necessary that a payment is to be made as soon as it becomes due. Many factors, including terms of payment and normal business practices, influence the fact of payment in respect of a commercial transaction. Unlike a loan or borrowing, it is not an independent transaction which can be viewed on standalone basis. What can be examined on the touchstone of arm's length principles is the commercial transaction itself, as a result of which the debit balance has come into existence, and the terms and conditions, including terms of payment, on which the said commercial transaction has been entered into. The payment terms are an integral part of any commercial transaction, and the 45 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur transaction value takes into account the terms of payment, such as permissible credit period, as well. The residuary clause in the definition of 'international transaction', i.e. any other transaction having a bearing on the profits, incomes, losses or assets of such enterprises, does not apply to a continuing debit balance, on the given facts of the case, for the elementary reason that there is nothing on record to show that as a result of not realizing the debts from associated enterprises, there has been any impact on profits, incomes, losses or assets of the assessee. In view of these discussions, in our considered view, a continuing debit balance per se, in the account of the associated enterprises, does not amount to an international transaction under section 92B in respect of which ALP adjustments can be made. The factum of payment has to be considered vis-a-vis terms of payment set out in the transaction arrangement, and not in isolation with the commercial terms on which transaction in respect of which payment is, according to the revenue authorities, delayed."

22. We have noted the learned Departmental Representatives contention that the above decision is no longer good in law since a coordinate bench of this Tribunal, in the case of i-Gate Computer Systems Ltd. (supra) has, inter alia, stated that "the Hon'ble Bombay High Court, in assessee's own

case relating to the assessment year 2002-03 in Income Tax Appeal No. 1148/2012, vide judgment dated 28.2.2013, has held that in view of the amendment by the Finance Act 2012 with retrospective effect from 1st April 2002, the said transaction of charging of interest from the 46 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur AEs is covered under the amended provision of Section 92B(1) of the Act".

23. However, when we perused Hon'ble Bombay High Court's judgment referred to in this coordinate bench's order, we found the factual slightly, but very materially, different.

24. The relevant question before Their Lordships, in the said case and as set out at page 2 of this judgment, was "(c) whether, on the facts and circumstances of the case and in law, the Tribunal did not err in holding that the loss suffered by the assessee by allowing excess period of credit to the associated enterprises without charging any interest during such period would not amount to international transaction whereas Section 92B(1) of the Income Tax Act, 1961, refers to 'any other transaction having a bearing on the profits, income, losses or assets of such enterprise'". Rather than answering this question on merits, and with the consent of both the parties, Their Lordships sent the matter back for fresh consideration of the Tribunal. While doing so, at page 3-4 of the judgment, Their Lordships observed as follows:

"2. So far as question (c) is concerned, counsel for the parties state that in view of the amendment to Section 92B(1) of the Income Tax Act, 1961 ('Act' for short) by Finance Act, 2012 with retrospective effect from 1st April 2002, the question as framed may be restored to the file of the Tribunal for fresh decision in light on the amendment. Accordingly, this issue is remitted to the file of the Tribunal for fresh decision on merits"

47 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

25. The observations so made by Hon'ble jurisdictional High Court, in our limited understanding, cannot be construed as holding that "in view of the amendment by the Finance Act 2012 with retrospective effect from 1st April 2002, the said transaction of charging of interest from the AEs is covered under the amended provision of Section 92B(1) of the Act". As it appears from the plain words of the statute- as extracted earlier, the issue is left open for adjudication by this Tribunal.

26. In any event, to this extent, this judgment does not involve an adjudication on a legal issue as it is a result of consensus of the parties. When both the parties before Their Lordships agreed, and so 'stated' before Their Lordships, to let the matter be restored to the file of the Tribunal, there could not have been, and there was no, adjudication on any legal issue.

27. It is for this reason that the said decision of the Pune bench of the Tribunal, relied upon by the learned Departmental Representative, is per incurium and does not bind the coordinate benches.

28. The question then is as to what is the impact of amendment in section 92B, by the virtue of Finance Act 2012, on the definition of international transaction so far as the interest on delayed realization of debt is concerned.

29. The amendment so made by the Finance Act 2012, stated to be with retrospective effect 1st April 2002, inserts an Explanation to Section 92B which, inter alia, that "For the removal of doubts, it 48 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur is hereby clarified that (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business". In plain words, this amendment inter alia implies that capital financing of any type, including by way of "deferred payment or receivable or any other debt arising during the course of business" will constitute an international transaction under section 92B. Going by this definition "any debts arising during the course of business" will constitute an international transaction. A trade debt is, accordingly, covered by this definition. However, since the assessment year that we are dealing with is prior to the assessment year 2012-13, the next important question is whether this amendment could be held to be applicable in the assessment year before us as well. Undoubtedly, the amendment is said to be retrospective but then the question really is whether just stating the law to be retrospective will make it retrospective in effect.

30. The fact that judicial precedents, prior to the insertion of Explanation to Section 92B, held that a continuing debit balance, on a standalone basis, does not constitute an international transaction required to be benchmarked assumes considerable significance in the light of a new judicial development that we will deal with in a short while now. In the present case, we are dealing with a situation in which the amendment was made with retrospective effect and it covered certain issues which were already subjected to a judicial interpretation in a particular manner. The judicial 49 ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur interpretation so given was certainly not the end of the road. The matter could have been carried in appeal before higher judicial forums. If the decision of a judicial body does not satisfy the tax administration, nothing prevents them from going to the higher judicial forum or from so amending the law, with prospective effect, that there is no ambiguity about the intent of legislature and it is conveyed in unambiguous words.

31. Nullifying a judicial interpretation though legislative amendment, much as many of us may abhor it, is not too uncommon an occurrence. Of course, when legislature has to take an extreme measure to nullifying the impact of a judicial ruling in taxation, it is the time for, at least on a theoretical note, introspection for the draftsman as to what went so wrong that fundamental intent of law could not be conveyed by the words of the statute, or, perhaps for the judicial forums, as to what went so wrong that the interpretation was so off the mark vis-à-vis fundamental principles of taxation or the sound policy considerations. However, amendment so made are generally prospective, and there is a sound conceptual foundation, as has been highlighted in the binding judicial precedents that we will deal with in a short while, for that approach. There is no dearth of examples on this aspect of the matter. Take for example, the amendment to Section 263 by the Finance Act, 1961. In many judicial precedents, [such as in the case of CIT v. Sunbeam Auto Ltd.

[2011] 332 ITR 167/[2010] 189 Taxman 436 (Delhi) wherein it was held that "Learned counsel for the assessee is right in his 50 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur submission that one has to keep in mind the distinction between "lack of inquiry" and "inadequate inquiry". If there was any inquiry, even inadequate that would not by itself give occasion to the CIT to pass orders under s. 263 of the Act, merely because he has different opinion in the matter. It is only in cases of "lack of inquiry"

that such a course of action would be open"], it was reiterated that it was only the lack, not the adequacy, of inquiry which could confer jurisdiction under section 263 on the Commissioner. By inserting Explanation 2 to Section 263(1), which inter alia provided that powers under section 263 could also be invoked in the cases where "the order is passed without making inquiries or verification which should have been made", all ratio of all these decisions was nullified. That, however, is done with prospective effect, i.e. with effect from 1st June 2015. As a matter of fact, it is a laudable policy of the present tax administration to stay away from making the retrospective amendments, and thus contribute to greater certainty and congenial business climate. Nothing evidences it better than this subtle, but easily discernible, paradigm shift in the approach to the amendments made in Section 263 in the very first full budget of the present Government.

32. What has, however, been done in the case before us is to amend the law with retrospective effect. Of course, it happened much before the current awareness about the evils of retrospective taxation having been translated into action.

51 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

33. Dealing with such a situation, Hon'ble Delhi High Court has, in the case of DIT v. New Skies Satellite BV [2016] 382 ITR 114/68 taxmann.com 8, observed as follows:

'30. Undoubtedly, the legislature is competent to amend a provision that operates retrospectively or prospectively. Nonetheless, when disputes as to their applicability arise in court, it is the actual substance of the amendment that determines its ultimate operation and not the bare language in which such amendment is couched.....

36. A clarificatory amendment presumes the existence of a provision the language of which is obscure, ambiguous, may have made an obvious omission, or is capable of more than one meaning.

In such case, a subsequent provision dealing with the same subject may throw light upon it. Yet, it is not every time that the legislature characterizes an amendment as retrospective that the Court will give such effect to it. This is not in derogation of the express words of the law in question, (which as a matter of course must be the first to be given effect to), but because the law which was intended to

be given retrospective effect to as a clarificatory amendment, is in its true nature one that expands the scope of the section it seeks to clarify, and resultantly introduces new principles, upon which liabilities might arise. Such amendments though framed as clarificatory, are in fact transformative substantive amendments, and incapable of being given retrospective effect. ....

37. An important question, which arises in this context, is whether a "clarificatory" amendment remains true to its nature 52 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur when it purports to annul, or has the undeniable effect of annulling, an interpretation given by the courts to the term sought to be clarified. In other words, does the rule against clarificatory amendments laying down new principles of law extend to situations where law had been judicially interpreted and the legislature seeks to overcome it by declaring that the law in question was never meant to have the import given to it by the Court? The general position of the courts in this regard is where the purpose of a special interpretive statute is to correct a judicial interpretation of a prior law, which the legislature considers inaccurate, the effect is prospective. Any other result would make the legislature a court of last resort. *United States v. Gilmore* 8 Wall [(75 US) 330, 19L Ed 396 (1869)] *Peony Park v. O'Malley* [223 F2d 668 (8th Cir 1955)]. It does not mean that the legislature does not have the power to override judicial decisions which in its opinion it deems as incorrect, however to respect the separation of legal powers and to avoid making a legislature a court of last resort, the amendments can be made prospective only [Ref *County of Sacramento v. State* (134 Cal App 3d 428) and *In re Marriage of Davies* (105 III App 3d 66)]' (Emphasis supplied)

34. Quite clearly, in view of the law so laid down by Their Lordships, just because a provision is stated to be clarificatory, it does not become entitled to be treated as 'clarificatory' by the judicial forums as well.

35. Legislature may describe an amendment as clarificatory in nature, but a call will have to be taken by the judiciary whether it is 53 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur indeed clarificatory or not. This determination, i.e. whether the amendment is indeed clarificatory or is the amendment to overcome a judicial precedent, assumes great significance because when it is found that the purpose of such interpretive statute, or clarificatory amendment, is "correct a judicial interpretation of prior law, which the legislature considers inaccurate, the effect is prospective".

36. It is very important to bear in mind the fact that right now we are dealing with amendment of a transfer pricing related provision which is in the nature of a SAAR (specific anti abuse rule), and that every anti abuse legislation, whether SAAR (specific anti abuse rule) or GAAR (general anti abuse rule), is a legislation seeking the taxpayers to organize their affairs in a manner compliant with the norms set out in such anti abuse legislation. An anti-abuse legislation does not trigger the levy of taxes; it only tells you what behaviour is acceptable or what is not acceptable. What triggers levy of taxes is non-compliance with the manner in which the anti-abuse regulations require the taxpayers to conduct their affairs. In that sense, all anti abuse legislations seek a certain degree of compliance with the norms set out therein. It is, therefore, only elementary that amendments in the anti-abuse legislations can only be prospective. It does not make sense that someone tells you today

as to how you should have behaved yesterday, and then goes on to levy a tax because you did not behave in that manner yesterday.

54 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

37. When this is put to the learned Departmental Representative, his stock reply is that the amendment only clarifies the law, it does not expand the law.

38. Well, if the 2012 amendment does not add anything or expand the scope of international transaction defined under section 92B, assuming that it indeed does not- as learned Departmental Representative contends, this provision has already been judicially interpreted, and the matter rests there unless it is reversed by a higher judicial forum. However, if the 2012 amendment does increase the scope of international transaction under section 92B, as is our considered view, there is no way it could be implemented for the period prior to this law coming on the statute i.e. 28th May 2012. The law is well settled. It does not expect anyone to perform an impossibility. Reiterating this settled legal position, Hon'ble Supreme Court has, in the case of Krishnaswamy S. Pd. v. Union of India [2006] 281 ITR 305/151 Taxman 286, observed as follows:

"The other relevant maxim is, *lex non cogit ad impossibilia*--the law does not compel a man to do what he cannot possibly perform. The law itself and its administration is understood to disclaim as it does in its general aphorisms, all intention of compelling impossibilities, and the administration of law must adopt that general exception in the consideration of particular cases. [See : U.P.S.R.T.C. v. Imtiaz Hussain 2006 (1) SCC 380, Shaikh Salim Haji Abdul Khayumsab v. Kumar & Ors. 2006 (1) SCC 46, Mohammad Gazi v. State of M.P. & Ors. 2000 (4) SCC 342 and Gursharan Singh v. New Delhi Municipal Committee 1996 (2) SCC 459]."

55 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur

39. It is for this reason that the Explanation to Section 92B, though stated to be clarificatory and stated to be effective from 1st April 2002, has to be necessarily treated as effective from at best the assessment year 2013-14. In addition to this reason, in the light of Hon'ble Delhi High Court's guidance in the case of New Skies Satellite BV (supra) also, the amendment in the definition of international transaction under Section 92B, to the extent it pertains to the issuance of corporate guarantee being outside the scope of 'international transaction', cannot be said to be retrospective in effect. The fact that it is stated to be retrospective, in the light of the aforesaid guidance of Hon'ble Delhi High Court, would not alter the situation, and it can only be treated as prospective in effect i.e. with effect from 1st April 2012 onwards."

50. We find that the Coordinate Bench in Rishabh Diamonds (supra) has examined at length the effect of the amendment brought in by the Finance Act 2012, considered the decision of the Hon'ble Delhi High Court in case of New Skies Satellite BV and has held that explanation to Section 92B

which increases the scope of international transaction, has to be necessarily treated as effective prospectively from the assessment year 2013-14 though stated to be clarificatory and stated to be effective from 1st April 2002. We have also gone through other Coordinate Bench decisions in case of Gitanjali Exports Corporation (supra) and Siro Clinpharm Private limited (supra) where similar view has been taken. The decision of Hon'ble Bombay High Court in case of Patni Computer Systems Ltd. has been rightly analysed by the Coordinate Bench in Rishabh Diamonds (supra) and it was held that "rather than answering 56 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur this question on merits, and with the consent of both the parties, Their Lordships sent the matter back for fresh consideration of the Tribunal"

and to this extent, the decision of the Coordinate Bench in case of Ameriprise India Pvt Ltd which has equally relied on the said decision of the Bombay High Court is distinguishable. In light of the same, following the decision of the Coordinate Bench in Rishabh Diamonds and in absence of any contrary higher authority on the subject, we agree with the contention raised by the ld. AR that such amendment by way of an explanation to section 92B is an amendment to a substantive law as it has resulted in enhancement of the scope of international transactions as envisaged u/s 92B of the Act. Accordingly, the subject transaction if at all, it has to be considered as an international transaction in light of decision in case of Kusum Healthcare (supra), which it is not, in the facts of the present case, as we have held above, it has to be considered as an international transaction from AY 2013-14 onwards and for the years under consideration being AY 2007-08, 2008-09 and 2009-10, the same will thus not qualify as an international transaction.

51. Now, in the pre-amended legislative scenario i.e, prior to insertion of the explanation to section 92B, which will be applicable in the instant case, the transfer pricing provisions have been judicially interpreted and the matter is no more res integra. In this regard, we refer to the decision of the Hon'ble Bombay High Court in case of Indo American Jewellery Ltd (supra) wherein the question for consideration before the Hon'ble High Court was as under:

57 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur "Whether on the facts and in the circumstances of the case and in law the ITAT was justified in deleting the addition of Rs.87,66,641/- being interest receivable on outstanding amount due to the Assessee Company from the Associated Enterprises?"

52. While answering the above question, the Hon'ble High Court was pleased to held as under:

"3. As regards the second question is concerned, the Transfer Pricing Officer while determining the Arms Length Price of the international transactions, noticed that the outstanding balance from Associated Enterprises was amounting to Rs.8.76 crores. As that amount was outstanding for more than year, taking the rate of interest at 10%, the Transfer Pricing Officer determined the interest receivable at Rs 87.66 lacs

and added the same to the international transaction cost.

4. On appeal, the CIT(A) held that the total outstanding amount was Rs.8.73 Crores and out of which the amount outstanding from the Associated Enterprises was to the extent of Rs.5.11 Crores and the balance amount of Rs 3.62 Crores was outstanding from non Associated Enterprises. Relying on the Board Circular no. 12 of 2001, the CIT(A) further held that in the present case, the profit of one Associated Enterprise is negligible and the other Associated Enterprise has incurred losses and therefore it cannot be said that the assessee had transferred any profit to the Associated Enterprises outside India by not charging interest on the outstanding payment which has been realised after the

58 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur due date and accordingly deleted the interest charged on late realisation of the export proceeds.

5. On appeal filed by the Revenue, the ITAT upheld the order of CIT(A). While, upholding the order of CIT(A), the ITAT held that interest income is associated only with the lending or borrowing of money and not in case of sale. We express no opinion on the above reasoning of the ITAT and keep that reasoning open for debate in an appropriate case. However, in the facts of the present case, the specific finding of the ITAT is that there is complete uniformity in the act of the assessee in not charging interest from both the Associated Enterprises and Non Associated Enterprises debtors and the delay in realisation of the export proceeds in both the cases is same. In these circumstances the decision of the Tribunal in deleting the notional interest on outstanding amount of export proceeds realised belatedly cannot be faulted."

53. Following the above decision of Bombay High Court in case of Indo American Jewellery, similar position has been adopted by the various Co-ordinate Benches of the Tribunal including the Jaipur Benches in case of Vaibhav Gems Ltd (supra) and Gillette India (ITA No. 1/JP/13 & 2/JP/13 dated 12.8.2016 (speaking through one of us). During the course of hearing, the ld AR has stated that revenue has filed an appeal against the decision of the Tribunal in case of Vaibhav Gems Ltd, the same has been admitted and heard by the Hon'ble Rajasthan High Court and we find that the Hon'ble Rajasthan High Court has since pronounced its decision in that case vide its order dated 13.10.2017 in ITA No. 14/2015 & others in favour of the assessee and 59 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur against the revenue, thus affirming with the position taken by the Bombay High Court in case of Indo American Jewellery. No contrary authority has been brought or has come to our notice in this regard. Rather, we find that subsequently, the Bombay High Court in the case of Livingstones (ITA No. 887/2014) in its order dated 28 November 2016 has taken a similar view following the above decision in case of Indo American Jewellery.

54. In case of Livingstones case (supra), the Hon'ble Bombay High Court was pleased to held as under:



"3. The grievance of the revenue is that the respondent- assessee granted longer period of credit to its Associated Enterprises on sale of goods as compared to the period of credit granted to Non Associated Enterprises. Consequently the notional interest on delayed collection of consideration on sale of goods to Associated Enterprises needs to be added to the declared consideration to arrive at an arms length price.

4. The Tribunal by the impugned order rendered a finding of fact that the respondent-assessee has not charged any interest from third parties i.e. Non Associated Enterprises on delayed payments exceeding more than 300 to 400 days from the sale of goods. Consequently, it holds that once such delayed payment in respect of sale of goods made to third parties carries no interest, then adding of notional interest to delayed payments made by the Associated Enterprises is not called for.

5. Further, the impugned order places reliance upon the order of this Court in Income Tax Appeal (L) No. 1053 of 2012 60 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur (Commissioner of Income Tax-9 vs. M/s Indo Amercian Jewellery Ltd.) rendered on 8th January, 2013. In the above case a similar question was not entertained by this Court on the ground that there is complete uniformity in the act of the assessee therein in not charging interest from Associated Enterprises and Non Associated Enterprises for delay in recovery of its sale proceeds.

6. In the present case also the Tribunal has rendered a finding of fact that the interest is not being charged in case of sales made to Non-Associated Enterprises for delayed payment just as in the case of Associated Enterprises. These finding of fact rendered by the Tribunal is not shown to be perverse in any manner.

7. Consequently, the question of law as proposed does not give rise to any substantial question of law. Thus not entertained."

55. Applying the above legal proposition in the instant case, we find that there are sales made to associated enterprises amounting to Rs 3,53,56,20,066 and sales to non-associated enterprises amounting to Rs 1,98,60,46,262. The sales to associated enterprises constitute 64% of total sales made by the assessee and at the same time, there are sales to non-associated enterprises which equally constitute a big percentage at 36% of the total sales. The ld. AR has contended that in accordance with the company's policy and also in accordance with practice in the Gems and Jewellery Industry, no interest was charged on delayed realization of sale proceeds from both associated enterprises and non- associated enterprises and uniform credit period of 145 days has been 61 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur granted to both associated enterprises and non-associated enterprises. It was further contended that average period of realization from non- associated enterprises is slightly more than the average period of realization from the associated enterprises and in that sense, no benefit could

be said to have been provided to associated enterprises over and above the non-associated enterprises. In this regard, the Id CIT(A) has returned a finding that the assessee had adopted uniform policy of not charging interest on delayed realization on sale proceeds from both the AEs and Non AE customers. Regarding average period of realization beyond the credit period in respect of sales made during FY 2006-07 taken by AE's and taken by Non AE's, the Id CIT(A) has returned a finding that the AEs have taken on an average of additional 5 days from the due date, whereas Non AEs have taken on an average of additional 18 days from the due date to make the payments in respect of sales made to them during FY 2006-07 and it is quite evident that both AE's and Non AE's have taken additional days over and above the credit period granted to them and interest have not been charged from any of them irrespective of period of delay. There is nothing which has been brought on record by the Revenue to contest the said findings of the Id CIT(A) and the abovesaid facts and finding of the Id CIT(A) remain uncontroverted before us.

56. In the instant case, we therefore find that there is complete uniformity in the act of the assessee in not charging interest from both the associated enterprises and non-associated enterprises and the average period of realization of the export proceeds is titled more in 62 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur favor of non-associated enterprises and thus cannot be said to benefit the associated enterprises vis-à-vis non-associated enterprises.

57. Further, as we have noted initially that the TPO had emphasized time and again in his order, right from the show-cause notice to her final analysis, as to whether the tax payer could have extended such facility to any unrelated party similar to that of the AE without charging adequate compensation. Interestingly, in this regard, the TPO acknowledged the fact the assessee has extended similar credit facility to non-AEs without charging any interest but he refused to accept the same and went ahead and computed ALP adjustment by way of notional interest applying CUP method. It is this fallacy in stand of the Revenue that we find is not in consonance with the transfer pricing regulations. The whole exercise of ALP adjustment is to neutralize the impact of inter-se relationship between the associated enterprises and what is therefore relevant is not just to examine whether there is delay in realization of export proceeds from the associated enterprises but delay in realization of export proceeds vis-à-vis similar situation with non-associated enterprises. And on the same footing, what is therefore equally relevant is not just to examine whether the assessee is charging any interest for delay in realization of export proceeds from the associated enterprises but charging interest for the delay in realization of export proceeds vis-à-vis similar situation with non-associated enterprises. We find that the same was rightly appreciated by the Id CIT(A) who has granted relief to the assessee company by deleting the notional interest for delay in realization of export proceeds. The said action of the Id CIT(A) is therefore in consonance with the legal 63 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur proposition laid down by the Hon'ble Bombay High Court in case of Indo- American Jewellery (supra) and consistent view taken by various Coordinate Benches including Jaipur Benches as we have noted above.

58. Now, let's look at the matter from the transfer pricing methodology perspective as well. We find that the TPO has applied CUP method for determining the ALP adjustment towards the notional

interest on delay in realisation of export proceeds. Under the CUP method, the TPO is required to evaluate the arm's-length character of a controlled transaction by comparing the price and conditions to the price and conditions of similar transactions between the taxpayer and an non-associated enterprise ("internal CUP"), or between two non-associated enterprises ("external CUP"). In the instant case, where there are real transactions of similar nature undertaken by the assessee with non-associated enterprise, in our view, the same will reflect a better and more reliable comparison as compared to hypothetical transactions between two non-associated enterprises. In other words, in the instant case, internal CUP would provide a more reliable comparison than an external CUP which has been applied by the TPO. Given the undisputed fact in the instant case that there is complete uniformity in non-charging of interest on delay in realization of export proceeds and the average period of realization of the export proceeds is tilted more in favor of non-associated enterprises, there cannot be any ALP adjustment even applying the CUP method as done by the TPO.

59. Finally, even under the TNMM method which has been applied by the assessee to benchmark its international transaction of export of goods, extending credit period for realization of sale proceeds beyond 64 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur the prescribed period to the associated enterprise, where the same is considered as an international transaction, is a closely linked transaction with the transaction of export of goods and therefore, the same cannot be treated as an individual and separate transaction which will require an independent benchmarking. The same is in consonance with Rule 10A(d) as well as the concept of aggregation of closely linked transaction supported by the OECD transfer pricing guidelines. It is not the case of the Revenue before us that where such a transaction is aggregated with transaction of extending credit period for realization of sale proceeds beyond the prescribed period to the associated enterprise, it will require any further ALP adjustment than what has been determined by the assessee and accepted by the TPO. In the instant case, the international transaction of export of goods has been duly benchmarked on TNMM basis and the assessee has reported its operating margin of 6.15% as against the comparable updated margin of 6.00% which has been accepted by the TPO and thus not in dispute and thus doesn't require any further ALP adjustment.

60. In light of above discussions and in the entirety of facts and circumstances of the case, we confirm the order of the Id CIT(A) in setting aside the order of the TPO and the AO in relation to ALP adjustment in relation to interest on outstanding receivables from the associated enterprises. In the result, ground no. 1 of the Revenue's appeal is dismissed.

61. Now coming to ground no. 3 of the assessee's appeal and ground no. 2 of the revenue's appeal, the AO made disallowance of Rs. 476,314/- being 10% of the total expenses of Rs. 47,63,146/- incurred 65 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur on various expenses. The Id. CIT(A) confirmed 10% disallowances of business promotion expenses amounting to Rs. 64,060/- and the balance disallowance was deleted. Now the assessee in appeal against the said disallowance of Rs. 64,060/- and the revenue is in appeal against the relief granted by the Id CIT(A). The Id. AR submitted that the said disallowance has been confirmed on estimated basis without pin-pointing any specific defects in the books of account or vouchers maintained by the assessee company and hence, the same may be deleted. On perusal of

orders of the lower authorities, we find that the disallowance has been made on a purely adhoc basis and such adhoc disallowance cannot be sustained in the eyes of law. In the result, disallowance of Rs. 64,060/- is hereby deleted. The ground no. 3 of the assessee's appeal is allowed and ground no. 2 of revenue is dismissed.

62. In the result, the appeal of the assessee is thus allowed and the appeal of the Revenue is dismissed.

63. Now, coming to cross appeals for AY 2008-09 in ITA No. 568/JP/16 and 611/JP/16 and cross appeals for AY 2009-10 in ITA No. 569/JP/16 and 612/JP/16, both parties agreed and submitted that facts and circumstances of the case are pari materia and respective contentions raised in the context of ITA No. 610/JP/16 and 567/JP/16 may be considered. Therefore, following our detailed reasoning as given in ITA No. 610/JP/16 and 567/JP/16, our findings and directions contained therein shall apply mutatis mutandis to these cross appeals as well.

66 ITA No. ITA No. 567, 610, 568, 611, 569 & 612/JP/2016 M/s KGK Enterprises vs. The ACIT, Jaipur With the above directions, the respective appeals filed by the assessee and the Revenue for the impugned assessment years are disposed off.

Order pronounced in the open Court on 28/11/2017.

Sd/-  
¼dqy Hkkjr ½  
(Kul Bharat)  
U;kf;d lnL;@Judicial Member

Tk;iqj@Jaipur  
fnukad@Dated:- 28/11/2017  
\*Ganesh Kr.

Sd/-  
¼foøe flag ;kno½  
(Vikram Singh Yadav)  
ys[kk lnL;@Accountant Member

vkns'k dh izfrfyfi vxzfs 'kr@Copy of the order forwarded to:

1. vihykFkhZ@The Appellant- M/s KGK Enterprises, Maharashtra
2. izR;FkhZ@ The Respondent- The ACIT Central Circle-2,Jaipur, The DCIT, Central Circle-2, Jaipur
3. vk;dj vk;qDr@ CIT
4. vk;dj vk;qDr@ CIT(A)
5. foHkkxh; izfrfuf/k] vk;dj vihyh; vf/kdj.k] t;iqj@DR, ITAT, Jaipur.
6. xkMZ QkbZy@ Guard File {ITA No. 567, 610, 568, 611, 569 & 612/JP/2016}  
vkns'kkuqlkj@ By order, lgk;d iathdkj@Asst. Registrar