IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI A BENCH, MUMBAI

Before Shri Pramod Kumar (Accountant Member)
and Shri Vijay Pal Rao (Judicial Member)

ITA No. 2570/Mum/2010
Assessment year: 2004-05

Dy. Commissioner of Income Tax
Circle 4(1), Mumbai ***……Appellant***

Vs.

RBS Equities India Ltd ***……Respondent***
(formerly known as ABN Amro Asia Equities India Ltd.)
83/84, Sakhar Bhawan, Behind Oberoi Towers
Nariman Point, Mumbai 400021
PAN : AAACH1596D

Appearances:
P K B Menon, *for the appellant*
Jay Mankad, *for the respondent*

Date of hearing : August 11, 2011
Date of pronouncement : August 26 , 2011

O R D E R

Per Pramod Kumar:

1. The short issue that we are required to adjudicate in this appeal is whether or not the CIT(A) was justified in deleting the impugned penalty of Rs. 39,56,921 imposed on the assessee under section 271(1)(c) of the Income Tax Act, 1961, for the assessment year 2004-05, in respect of arm's length price (ALP) adjustments made to the value of international transactions entered into by the assessee.

2. The assessee before us is a corporate member of the Bombay Stock Exchange as also National Stock Exchange, and also holds a merchant banker licence from Securities and Exchange Board of India. During the relevant previous year, the assessee has carried out stock broking activities for foreign institutional investors, mutual funds, domestic financial institutions and banks. In the course of business so carried out, the assessee has also provided stock broking services to certain associated enterprises, namely, ABN Amro Asia (Mauritius) Limited, Mauritius, ABN Amro Assets Management (Asia) Limited, Hong Kong; ABM Amro Asia Equities (UK) Limited, UK, and ABN Amro Bank NV, the Netherlands. While computing arm's length price, the assessee's transfer pricing study had adopted the transactional net margin method. The CUP method was rejected for the reason that to compare similarity of transactions, one would need to establish the closeness of all material factors affecting the pricing of transactions, but there are various factors that affect the brokerage rates viz volumes traded, types of trade and nature of services included therein, client relationship, client type, market forces at the point of time when transactions were entered into, brokerage offered by the competition, business referrals by the clients and other related factors, and the differences on account of these factors may not be quantifiable at all. The assessee took the stand that Indian transfer pricing regulations prescribe application of CUP method, in determining arm's length price, only in cases wherein reliable adjustments can be made for differing factors, which would affect the price, and since, in the instant case, no reliable adjustments could be made to neutralize all the varying factors, it was not possible to apply internal CUPs for ascertaining the arm's length price. In the course of the assessment proceedings, the Assessing Officer referred the ascertainment of arm's length price to the Transfer Pricing Officer, and, in the course of the proceedings before the TPO, it was once again contended by the assessee that prices charged for stock broking services to the AEs cannot be compared with prices charged for stock broking services to the non AEs for the reason that no marketing effort are required, or credit risks involved, in doing business with

AE, and as no research inputs are furnished to the AEs. It was submitted that while AEs are given services in the nature of 'Execution only', non AEs are being rendered 'Full Broking Services'. The TPO rejected these contentions and observed that "there is no agreement between the assessee and its AE and no documentary evidences in this regard has been produced except a confirmation letter from Mr Anil Shah, Head of Equities of the assessee company- which is only a self serving letter". The TPO also observed that "..the contention of the assesse that no marketing and sales efforts are required in the case of the AEs is not acceptable in totality" and that "It is no possible that marketing and sales department would not have made any efforts in sourcing business from AEs". With these observations, the TPO rejected the TNMM method and proceeded to adopt CUP. It was mainly in this backdrop that the TPO made an adjustment of Rs 1,10,29,746 to the arm's length price of broking service charges invoiced by the assessee to its AEs. This determination of the ALP was adopted by the Assessing Officer. The assessee did not pursue the matter in appeal, and this ALP adjustment of Rs 1,10,29,746 thus attained finality.

3. The matter, however, did not rest there.

4. In the penalty proceedings, the Assessing Officer further observed that "the TPO has calculated the arm's length price in a very systematic method and his calculation is based on a solid footing" and "thus the assessee has filed inaccurate particulars of his income to evade tax in respect of his true income to evade tax in respect of the same". He also noted that the provisions of Explanation 1 to Section 271(1)(c) clearly apply to the facts of this case. The Assessing Officer also observed that "in a recent judgment, Hon'bl Supreme Court, in the case of Union of India vs Dharmedra Textile Processors(2008) 14 DTR 114, have held that element of *mens rea* is not an essential ingredient for levy of penalty" and thus penalty is to be levied in all cases of concealment of income or filing of inaccurate particulars. On the basis of this reasoning, the Assessing Officer imposed a penalty equivalent to 100% tax sought to be thus

evaded, which worked out to Rs 39,56,921. Aggrieved, assessee carried the matter in appeal before the CIT(A).

5. It was submitted before the CIT(A) that based on FAR (functions, assets and risk) analysis undertaken by the assessee, and taking into consideration the provisions of Section 92 C of the Income Tax Act read with rule 10 B and 10 C of the Income Tax Rules, the assessee had considered TNMM as the most appropriate method with Net Profit Margin (NPM) as the profit level indicator to benchmark its stock broking transactions with its AEs. It was also submitted that the transfer pricing study, which examined all the factors in detail, had come to the conclusion that CUP cannot reasonably apply to this fact situation. The submissions before the TPO and the AO were reiterated, and it was submitted that it was not the case that the assessee did not furnish adequate or improper information, and that the ALP adjustment made by the TPO was on account of different approach adopted by TPO – which itself is highly debatable. Reliance was placed on decision of a coordinate bench of this Tribunal in the case of DCIT vs Vertex Customer Services India Pvt Ltd (126 TTJ 184). Learned CIT(A) upheld the contentions of the assessee and observed that merely because an addition has been made to the income of the assessee, which has been accepted by the assessee, does not mean that the assessee has concealed income. Recognizing the position that consideration for penalty are different than the consideration while making the addition, learned CIT(A) further observed that "this aspect of the law assumes greater importance when we are dealing with levy of penalty……which deals with special provisions relating to the transfer pricing regulations". He was of the view that "transfer pricing is not an exact science and the arm's length price is an estimate only, and it is inherent in transfer pricing that reasonable people can end up drawing different conclusions on the same facts". Learned CIT(A) concluded that "the explanation offered by the appellant is *bonafide* and there is neither any concealment of income nor furnishing of inaccurate particulars". The penalty was, accordingly, deleted. However, the Assessing Officer is not

satisfied by the stand so taken by the CIT(A) and is in appeal before us.

6. We have heard the rival contentions, perused the material on record, and duly considered factual matrix of the case as also the applicable legal position.

7. The relevant portion of section 271(1)(c) and Explanations 1 and 7 thereto, which are relevant for the present purposes, are as follows:

> 271. Failure to furnish returns, comply with notices, concealment of income, etc.
>
> (1) If the assessing officer or the Commissioner (Appeals) or the CIT in the course of any proceedings under this Act, is satisfied that any person
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> (a) and (b) ********
>
> (c) has concealed the particulars of his income or furnished inaccurate particulars of such income,
>
> he may direct that such person shall pay by way of penalty,
>
> (i) , (ii) and (iii) ********
>
> Explanation 1.: Where in respect of any facts material to the computation of the total income of any person under this Act,
>
> (A) Such person fails to offer an explanation or offers an explanation which is found by the assessing officer or the Commissioner (Appeals) or the CIT to be false, or
>
> (B) such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him, then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of Clause (c) of this subsection, be deemed to represent the income in respect of which particulars have been concealed.
>
> *Explanations 2 to 6 **********
>
> Explanation 7 : Where in the case of an assessee who has entered into an international transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section

> 92C then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence.
>
> *(********** not relevant for present purposes)*

8. A plain reading of these statutory provisions makes it clear that so far as the scheme of penalty for concealment of income is concerned, it is like this. It is *sine qua non* for imposition of penalty that during that the Assessing Officer or the CIT(A), during the course of any proceedings before the him, should be satisfied that the assessee has (i) concealed his income , or (ii) furnished inaccurate particulars of income. It is not even Assessing Officer's case that the penalty could have been imposed on the assessee under the main provisions of Section 271(1)(c), and rightly so, because a penalty under the main section, as a plain reading of this section unambiguously indicates, can only be levied when there is something on record to lead to positive finding that the assessee has concealed income or furnished inaccurate particulars. 'Concealment' as also 'furnishing of inaccurate particulars' cannot be passive in nature, and, therefore, unless there is material on record demonstrate active conduct of the assessee towards concealment of income or towards furnishing of inaccurate particulars, penalty under the main section can not be imposed. That is not the situation before us. However, in addition to the situation so envisaged, i.e. in the case of concealment of income or in the case of inaccurate particulars having been furnished, there are situations in which the assessee deemed to have concealed the income or furnished the inaccurate particulars. Thessse are the situation in which, even without there being anything to indicate concealment of income or furnishing of inaccurate particulars, statutory deeming fiction for 'concealment of income' and 'furnishing of inaccurate particulars' comes into play. In addition

to normal connotations of 'concealment' and 'furnishing of inaccurate particulars' thus, a deeming fiction is also implicit in the scheme of penalty provisions. One deeming fiction, by way of Explanation 1 to Section 271(1)(c) envisages two situations – (a) first, where in respect of any facts material to the computation of total income under the provisions of the Act, the assessee fails to offers an explanation or the explanation offered by the assessee is found to be false by the Assessing Officer or the CIT(A); and, (b) second, where in respect of any facts material to the computation of total income under the provisions of this Act, the assessee is not able to substantiate the explanation and the assessee fails to prove that such explanation is *bonafide* and that the assessee had disclosed all the facts relating to the same and material to the computation of total income. There is, however, another deeming fiction, which is a special provision with regard to the arm's length price adjustments made by the Assessing Officer under section 92C(4).This deeming fiction provides that where any ALP adjustments are made under section 92 C(4), the amount so disallowed or added back is deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee can demonstrate " that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence". In other words, therefore, the deeming fiction cannot apply when assessee is able to show that price charged or paid in respect of related international transaction was computed in accordance with the scheme of Section 92 C, and in the manner prescribed therein, in good faith and due diligence. While Explanation 1 is a general provision in the sense it deals with explanation on "any facts relating to computation of total income', Explanation 7 is a specific provision which is confined to "any amount is added or disallowed in computing the total income under sub-section (4) of section 92C". The question as to which Explanation is to be applied, on the facts of this case which is specifically dealing with a n ALP adjustment under section

92C(4), is not difficult to answer. It is fairly well settled in law that general provisions do not override specific provisions, as aptly described by the maxim '*generalia specialibus non derogant*'. A special provision normally excludes the operation of a general provision and we are of the view that such a principle governs the instant case also. In the case of South India Corporation (P) Ltd. vs. Secretary, Board of Revenue AIR 1964 SC 207, at p. 215, Hon'ble Supreme Court had an occasion to consider whether Art. 277 or Art. 372 of the Constitution of India should govern the particular situation involved therein. Their Lordships then pointed out that "a special provision should be given effect to the extent of its scope, leaving the general provision to control cases where specific provisions do not apply." Therefore, in a situation in which Explanation 7 comes into play, the provisions of Explanation 1 cannot be applied. It is thus clear that so far as the present case is concerned, the same is to be examined on the touchstone of legal position under Explanation 7 to Section 271(1)(c). In this view of the matter, the Assessing Officer's reference to Explanation 1 to Section 271(1)(c), and reliance upon judicial precedents on the scope of the said Explanation, is wholly misconceived. The question then arises whether, on the facts of the present case, penalty could have been imposed in the light of legal position under Explanation 7 to Section 271(1)(c).

9. The scheme of Explanation 7 to Section 271(1)(c) makes it clear that the onus on the assessee is only to show that the ALP was computed by the assessee in accordance with the scheme of Section 92 C in good faith and with due diligence. It is not even in dispute in the present case that the ALP was computed in accordance with the scheme of Section 92 C inasmuch as transactional net margin method (TNMM), which is followed by the assessee, is one of the prescribed method under section 92 C(1) and the Assessing Officer has not found any faults in computation of ALP in accordance with transaction net margin method. In fact, he has rejected the TNMM on the ground that CUP method could be applied to the facts of this case. Whatever

be the legal merits of this approach and the judicial precedents by the coordinate benches on this issue, it is certainly a highly contentious issue whether a priority in the methods of determining ALPs can be said to exist, even implicitly, giving an edge to CUP over other methods. In a situation, therefore, when the TNMM is rejected by the revenue authorities, without finding any specific reasons for inapplicability of the TNMM and simply on the ground that a direct method is more appropriate to the particular fact situation, it cannot at all be a fit case for imposition of penalty inasmuch as it cannot be said that in a such situation, and despite the findings – contested or uncontested – to the effect that a direct method is preferable, the ALP has not been computed by the assessee under the scheme of Section 92 C of the Act. As to the scope of connotations of expression 'in good faith' appearing in Explanation 7, we find guidance from Section 3(22) of General Clauses Act which states that " a thing shall be deemed to be done in 'good faith' where it is in fact done honesty, whether it is done negligently or not". A thing done in good faith is a thing done honestly, and, therefore, it is not even necessary whether in doing that thing the assessee has been negligent or not. There is no way that an assessee can prove his honesty, because honesty, in practical terms, only implies lack of dishonesty, and proving not being dishonest is essentially proving a negative, which, as Hon'ble Supreme Court has observed in the case of KP Verghese Vs ITO (131 ITR 597), is almost impossible. However, as the expression 'good faith' is used alongwith 'due diligence', which refers to 'proper care, it is also essential that not only the action of the assessee should be in good faith, i.e. honestly, but also with proper care. An act done with due diligence, in our humble understanding, would mean an act done with as much as care as a prudent person would take in such circumstances. In view of these discussions, in our considered view, as long as no dishonesty is found in the conduct of the assessee and as long as he has done what a reasonable man would have done in his circumstances, to ensure that the ALP was determined in accordance with the scheme of Section 92 C, deeming fiction under Explanation 7 cannot be invoked.

10. Coming to the facts of the case before us, we find that the assessee has determined the ALP in good faith inasmuch as he has proceeded on the basis that TNMM is most appropriate method on the facts of this case, and he has also set out the reasons as to why CUP must not be applied in this case. While the TPO has not even questioned the former, he has rejected latter only on the grounds that (a) it is incorrect to proceed on the basis that no marketing efforts are required in the case of the AEs, and (b) the onus was on the assessee to demonstrate that no research inputs were given by the AEs. Both of these reasons, to say the least, are highly questionable . The very foundation of transfer pricing exercise is that whereas when independent enterprise deal with each other, their financial and commercial terms are dictated by the dynamics of market forces, it is not exactly the case vis-à-vis dealings with intra associated enterprises transactions and that associated enterprises are able to influence commercial decisions of each other. The plea that when intra associated enterprises transactions are inherently treated as not really based on the dynamics of market forces, it is unrealistic to expect that marketing efforts are also required for securing intra AE business, cannot be dismissed as worthy of outright rejection. It is also well settled in law that nobody can be expected to prove the impossible of proving a negative. Therefore, to expect the assessee to establish that the assessee did not give research inputs to the AEs may perhaps indeed be an impossible burden to discharge. The grounds on which the ALP determination by the assessee has been rejected are thus reasonably debatable. Lack of good faith and due diligence cannot be inferred when the grounds on which ALP determined by the assessee has been rejected are reasonably debatable, even if correct. The assessee has obtained a transfer pricing study from an outside expert, and this transfer pricing study, objectivity of which is neither called into question or seems to be, upon perusal of this TP study, questionable to us anyway, approves TNMM for determination of ALP – a proposition which has not been specifically rejected by the revenue authorities. On these facts, lack of 'due diligence' in determining the ALP is neither indicated nor can be

inferred. In such a situation, it cannot be said that the assessee has not determined the ALP in accordance with the scheme of Section 92 C in good faith and with due diligence. In our considered view, therefore, the conditions precedent for invoking Explanation 7 to Section 271(1)(c) did not exist on the facts of this case. Neither the case of the assessee is covered by the main section 271(1)(c), nor Explanation 7 thereto can be invoked on the facts of this case. Explanation 1 to Section 271(1)(c), as we have seen earlier in our discussions, has no application in respect of additions or disallowances in respect of ALP adjustments anyway, nor any other deeming fictions come into play here. Accordingly, the facts of the present case did not warrant or justify the imposition of penalty under section 271(1)(c). We, therefore, approve the conclusions arrived at by the learned CIT(A) and decline to interfere in the matter.

11. In the result, the appeal is dismissed. Pronounced in the open court today on 26th day of August, 2011.

Sd/xx ***Sd/xx***
(Vijay Pal Rao) **(Pramod Kumar)**
Judicial Member Accountant Member
*Mumbai; **26th** _day of **August, 2011**.*

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Income Tax Appellate Tribunal
Mumbai benches, Mumbai