IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "H", MUMBAI

BEFORE SHRI C.N. PRASAD, HON'BLE JUDICIAL MEMBER AND SHRI N.K. PRADHAN, HON'BLE ACCOUNTANT MEMBER

ITA NO.2455/MUM/2017 (A.Y: 2011-12)

A.C.I.T Circle – 19(2) Room No. 207, Mathru Mandir, Mumbai – 400 007	*v.*	M/s. K.P. Sanghvi & Sons LLP {formerly known as M/s. K.P. Sanghvi & Sons} GW-7011/7012, Bharat Diamond Bourse, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051 **PAN: AAAFK 8390 F**
(Appellant)		**(Respondent)**

CO NO.237/MUM/2018 (A.Y: 2011-12)
[ARISING OUT OF ITA NO.2455/MUM/2017]

M/s. K.P. Sanghvi & Sons LLP {formerly known as M/s. K.P. Sanghvi & Sons} GW-7011/7012, Bharat Diamond Bourse, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051 **PAN: AAAFK 8390 F**	*v.*	A.C.I.T Circle – 19(2) Room No. 207, 2nd Floor Mathru Mandir, Tardeo Road, Mumbai – 400 007
(Appellant)		**(Respondent)**

Assessee by : Shri Aditya R. Ajgaonkar

Department by : Shri Manoj Kumar Singh

Date of Hearing : 09.08.2018

Date of Pronouncement : 28.09.2018

O R D E R

PER C.N. PRASAD (JM)

1. The appeal by the Revenue and Cross Objection by assessee are filed against the order of the Learned Commissioner of Income-tax (Appeals)-30, Mumbai dated 31.01.2017 for the Assessment Year 2011-12.

2. The First ground of appeal in the appeal of the Revenue is in respect of estimating the profit rate @5% on the purchases disallowed by the Assessing Officer. The Assessing Officer while completing the assessment disallowed entire purchases of ₹.2.47 Crores made from certain parties as the assessee failed to furnish the confirmations and produce the parties who supplied the materials. The Assessing Officer rejected the Books of Accounts and brought to tax the entire purchases from M/s. Daksh Diamonds, M/s. Kailash Enterprises and M/s. Aadi Impex. On appeal the Ld.CIT(A) restricted the addition to 5% of the purchases, in view of the various judicial pronouncements and also since the assessee has maintained quantitative details, sales were not doubted. Against this order the Revenue is in appeal before us.

3. Ld. DR vehemently supported the order of the Assessing Officer and the Ld. Counsel for the assessee relied on the order of the Ld. CIT(A). The Counsel for the assessee further submitted that in the subsequent

years the Assessing Officer himself restricted the disallowance to 5% of the purchases.

4. We have heard the rival submissions, perused the orders of the Authorities below. This aspect of the matter has been considered by the Ld.CIT(A) with reference to the submissions and averments made by the Assessing Officer in the Assessment Order. It is the finding of the Ld.CIT(A) that the assessee is maintaining quantitative details and the Assessing Officer not doubted the genuineness of the sales and sales have been accepted. The Ld.CIT(A) followed various judicial pronouncements and estimated the profit element @5% from the purchases observing as under: -

> *"7.10 In this case, I find that quantitative details were maintained, Ld. AO not doubted the genuineness of sales, but added the entire amount of purchases made from the concerns of Shri Bhanwarlal Jain & Rajendra Jain, Shri Sanjay Choudhary and Shri Dharmi Chand Jain by recording a finding that the appellant made the purchases from grey market. Thus, the issue would boil down to find out whether the AO is right in adding the entire amount of bogus purchases which the appellant made from such unknown entities. In this regard, it is apt to refer certain decisions dealing the similar issue of bogus purchases. The decision of Gujarat High Court in the case of* ***Bholanath Poly Fab Pvt. Ltd. 355 ITR 290 (Guj)*** *where the Hon'ble Court was battling with the finding of Hon'ble ITAT that purchases were made from bogus parties since notice issued by the A.O. to these parties were allegedly received "returned/unserved' and the assessee was unable to produce any confirmation from these parties. The Tribunal had held that though purchases were made from bogus parties, nevertheless, the purchases themselves were not bogus as the entire quantity of opening stock, purchases and sales were tallying and hence, only the profit margin embedded in such amount would be subjected to tax. The Hon'ble Gujarat High Court taking cognizance of the fact held that whether purchases themselves were bogus or whether parties from whom such purchases were made were bogus, is essentially a question of fact and the Tribunal having examined the evidence on record and concluded that the assessee did produce cloth and sell finished goods, the entire amount covered under such purchase would not be subjected to tax and only the profit element embedded therein was to be*

taxed. While coming to the above conclusion, the Hon'ble High Court also relied on the ***decision in the case of Sanjay Oil Cake Ind. 316 ITR 274 (Guj).***

7.11 In ***Sanjay Oilcake Industries v. Commissioner of Income-tax [2009]*** *316 ITR 274 (Guj), it was held as under: -*

> *"12. Thus, it is apparent that both the Commissioner (Appeals) and the Tribunal have concurrently accepted the finding of the Assessing Officer that the apparent sellers who had issued sale bills were not traceable. That goods were received from the parties other than the persons who had issued bills for such goods. Though the purchases are shown to have been made by making payment thereof by account payee cheques, the cheques have been deposited in bank accounts ostensibly in the name of the apparent sellers, thereafter the entire amounts have been withdrawn by bearer cheques and there is no trace or identity of the person withdrawing the amount from the bank accounts. In the light of the aforesaid nature of evidence it is not possible to record a different conclusion, different from the one recorded by the Commissioner (Appeals) and the Tribunal concurrently holding that the apparent sellers were not genuine, or were acting as conduit between the assessee-firm and the actual sellers of the raw materials.* ***Both the Commissioner (Appeals) and the Tribunal have, therefore, come to the conclusion that in such circumstances, the likelihood of the purchase price being inflated cannot be ruled out*** *and there is no material to dislodge such finding. The issue is not whether the purchase price reflected in the books of account matches the purchase price stated to have been paid to other persons. The issue is whether the purchase price paid by the assessee is reflected as receipts by the recipients.* ***The assessee has, by set of evidence available on record, made it possible for the recipients not being traceable for the purpose of inquiry as to whether the payments made by the assessee have been actually received by the apparent sellers.*** *Hence, the estimate made by the two appellate authorities does not warrant interference. Even otherwise, whether the estimate should be at a particular sum or at a different sum, can never be an issue of law."*

7.12. Similarly, in yet another decision of Hon'ble Gujarat High Court in the case of ***CIT vs. Simit Sheth (2013) 38 Taxmann.com 385 (Guj),*** *Hon'ble Court was seized with a similar issue where the A.O. had found that some of the alleged suppliers of steel to the assessee had not supplied any goods but had only provided sale bills and hence, purchases from the said parties were held to be bogus. The A.O. in that case added the entire amount of purchases to gross profit of the assessee. Ld. CIT(A) having found that the assessee had indeed purchased though not from named parties but other parties from grey market, partially ^'sustained the addition as probable profit of the assessee. The Tribunal however, sustained the addition to the extent of 12.5%. Taking into account the above facts, the Hon'ble Gujarat High Court held that since the purchases were not bogus, but were made from parties other than those mentioned in books of accounts, only the profit element embedded in such purchases could be added to the assessee's income and as such no question of law arose in such estimation. The tribunal for arriving the profit embedded in the transactions @ 12.5% held as under:*

"Having heard the submissions of both sides, we have been informed that the malpractice of bogus purchase is mainly to save 10% sales tax etc.,. It has also been informed that in this industry about 2.5% is the profit margin. Therefore, respectfully following the decisions of the co-ordinate bench pronounced on identical circumstances, we hereby direct that the disallowance is required to be sustained at 12.5% of the purchase from those parties. With these directions, we hereby decide the grounds of the rival parties which are partly allowed."

7.13 Taking into consideration, the issue arrives at, is to what would be the margin, one can expect while buying the material from grey market instead of normal course of business. Two aspects need to be taken into consideration in such circumstances. First, these diamonds in the grey market are always cheaper than the diamonds sourced from the genuine dealer. This is because, the genuine dealer would charge his incidental cost including the whole administrative cost while selling the goods in the market, whereas the petty dealers in the grey market do not carry such incidental charges on such sales, wherein they are only looking for a quick profit. Secondly, there is always an element of discount in the case of instant cash purchase.

7.14 Hence, the task is to ascertain the additional GP, which the appellant must have earned by purchasing the said goods from the grey market, than from the regular dealer. During the present proceedings, the AR brought to my notice that the appellant has shown the G.P. margin of 8.49% which is at par with the industry standards in which appellant operates. During the present proceedings, the AR also brought to my notice and also furnished, copies of the assessment orders passed for the assessment years 2009-10, 2012-13, 2013-14 & 2014-15, wherein the AO considered the same issue of bogus purchases and estimated the addition @5% on the total non-genuine purchases. The reasons given by the AO for adopting different percentages, in the order is as under:

"In such a scenario, wherein there are circumstantial evidences of obtaining of bills from Bhanwarlal Jain and Rajendra Jain Group concerns, the benefit obtained by the assessee would not be more than 5% of the purchase cost debited against Bhanwarlal Jain and Rajendra Jain Group concerns. This should take care of the margin earned by the assessee to indulge into such transactions. The reason why this margin looks practical is that most of the traders in the market actually operate at this level of margin in the open market. In fact, this fact was also identified in the Report of the Task Group constituted by Department of Commerce in 2013, in which the margin in diamond industry was accepted to be in the range between 1 to 4.5%. Hence, the margin for the assessee in the grey market would be not more than 5% which is the same margin that is now being adopted for purchases made from dealers in the grey market by assessee and for which the bills are procured from Bhanwarlal Jain and Rajendra Jain Group concerns. Accordingly, the profit margin embedded in these transactions is taken at 5% of the value of the purchases made from the above mentioned parties and ….."

7.15. As seen from the above, in the assessments completed for the A.Ys. 2009-10, 2012-13, 2013-14 & 2014-15, AO made the addition @ 5% as the estimated profit margin embedded on such bogus purchases. Taking into consideration all

these facts and circumstances, the material available on record for this assessment year, and there is no change in the facts of the case, where the same parties are available in the assessments completed for the A.Ys. 2009-10, 2012-13, 2013-14 & 2014-15, and also the AOs themselves adopted 5% as the profit margin on the total purchases in the subsequent scrutiny assessments passed for the above assessment years, AO is directed to restrict the addition @5% of the purchase amount of ₹.2,47,45,023/-, made from the three parties, as the profit element embedded on such purchases in this year also for the reasons stated therein. Accordingly; the issue raised in the Ground No.2 of the appeal is treated as ***'Partly Allowed'****.*

5. On a careful reading of the order of the Ld.CIT(A), we do not find any valid reason to interfere with the findings. Thus, we sustain the Ld.CIT(A) order on this issue.

6. The second ground of appeal in the Revenue's appeal is in deleting the disallowance made towards additional depreciation.

7. At the outset, Ld. Counsel for the assessee submitted that the issue of additional depreciation has been decided by the Tribunal in assessee's own case by the Coordinate Bench for the Assessment Year 2008-09 in ITA Nos. 3756 & 3109/Mum/2013 dated 03.01.2017 which is placed at Page No. 279 of the Paper book.

8. We have perused the order of the Coordinate Bench of the Tribunal and find that the issue is squarely covered in favour of the assessee. The Coordinate Bench while dismissing the appeal of the Revenue for the Assessment Year 2008-09 accepted the contention of the assessee that it is eligible for additional depreciation observing as under: -

"6. The second issue in the appeal of the Revenue is against the order of CIT(A) deleting the disallowance of additional claim of depreciation. For this, the Revenue has taken following grounds of appeal:

> *"3. Whether on the facts and circumstances and in law, the Ld.CIT(A) has erred in allowing the additional depreciation claimed of ₹.23,21,714/-.*
>
> *4. Whether on facts and circumstances of the case, the Ld.CIT(A) erred in not appreciating the fact that Hon'ble Supreme Court in the case of CIT Vs. Gem India Manufacturing Co. (2001) 249 ITR 307 (Supreme Court) & Hon'ble High Court of Bombay in the case of London star Diamond Co (L) Ltd., 213 ITR 517 (BOM) had held that the diamond cutting & polishing amounts to processing of goods and not manufacturing of goods and decision relied upon in the case of M/s. Sheetal manufactures has not been accepted on merits."*

7. We have heard the rival contentions of the parties and perused the material placed before us. We find that the claim of the assessee is that the business of cutting and polishing of diamonds is manufacturing and production of an article or thing as required for claiming additional depreciation u/s. 32(1) (iia) of the Act. The AO disallowed the claim by observing that the assessee is not engaged in manufacturing or production of any article or thing. The CIT(A) relying on the decision of the Hon'ble Supreme Court in the case of Arihant tiles & Marble Pvt. Ltd., 320 ITR 79 (SC) allowed the claim of the assessee vide Para 7.2 as under: -

> *7.2. I have carefully considered the appellant's submissions on this issue. The AO held that the appellant's activity of cutting and polishing of diamonds does not amount to manufacturing or production of goods in the light of the Hon'ble Supreme Court in the case of CIT Vs. Gen India Mfg. CO. (2001) 249 ITR 307. In this regard, I note that the aforesaid issue whether cutting and polishing of diamond would constitute manufacturing activity or not was considered in detail by the Hon'ble ITAT, Mumbai Bench in their order in the case of Sheetal Diamonds Pvt. Ltd. Vs. ITO in ITA.Nos. 6687 to 6689/Mum/2003 dated 23.03.2011 for the purpose of deduction once again u/s. 80IA of the Act. In the aforesaid order the Hon'ble Tribunal has referred to the technical details of cutting and polishing the rough diamonds in order to obtain the final polished diamonds, provisions of section 2(29BA) and explanation 1 to section 10A of the Act, the decision of the Hon'ble Supreme Court in the case of Gem India Mfg. Co. (2001) and the subsequent decision of the Supreme Court in the cases of ITO Vs. Arihant tiles and Marbles Pvt Ltd., 320 ITR 779, Vijay Ship Breaking Corpn. Vs. CIT 311 ITR 309, CIT vs. Empee poly yarn Pvt. Ltd., 320 ITR 665 etc and finally held that the assessee was engaged in the business in the manufacture of cutting and polishing rough diamonds and accordingly eligible for deduction u/s. 80IA of the Act. Thus, the decision of the Hon'ble ITAT, Mumbai bench which is later to the date of the Hon'ble Supreme Court decision in the case of Gem India Mfg Pvt Ltd and which also refers to the decision of the Gem India Mfg Pvt . Ltd clearly holds that the activity of cutting and polishing of rough diamonds constitute manufacturing activity. In view of the above, I am of the considered opinion that the given*

facts and circumstances being similar to that of the Sheetal diamonds Pvt. Ltd., case cited above, the appellant is engaged in manufacturing activity and therefore entitled to claim additional depreciation u/s. 32(1)(iia) of the Act. Accordingly, I direct the AO to allow the additional depreciation of ₹.23,21,714/-. Appellant succeeds on this ground."

8. We also find that the Tribunal in the case of Flawless Diamond India Ltd., Vs. Addl. CIT (2014) 45 Taxmann.com 67 (Mum) after considering the recent decision of the Hon'ble Supreme Court held that cutting and polishing of diamonds amounts to manufacturing or production of article or thing by observing in para 16 as under: -

"16. Thus, from the aforesaid decision, it can be safely inferred that, what is required is the process undertaken for conversion of raw / rough diamonds into superior or polished diamond. In this case, as stated above, the assessee has duly placed on record the entire process and the stages through which the rough diamond undergoes for becoming the polished diamond, which is a separate and distinct product and has different usage. Such a process has neither been rebutted by the Revenue nor any other counter opinion have been sought to contradict the assessee's version of the process. Thus, in our opinion, once the entire process of cutting and polishing of diamond have not been rebutted and also the fact that the rough and polished diamond are two distinct commodity having different usage, not only in the common parlance but also in real sense, then it has to be understood that the cutting and polishing of diamond amounts to manufacturing or production of article or thing as envisaged for the purpose of claiming deduction under section 80-IC. Thus, the contention raised by the learned counsel before us is accepted that simply relying on the decision of Gem India Mfg. Co (supra) by the Revenue to deny the claim of deduction is uncalled for in the present case, especially in the wake of later decision of the Hon'ble Supreme Court in Heavens Diamond (supra) which has clarified this point. Accordingly, the decision and the conclusion drawn by the learned Commissioner (appeals) for the year under appeal i.e. Assessment Year 2008-09 are set aside and assessee's claim for deduction under section 80-IC is allowed.

Respectfully following the Coordinate Bench decision in the case of Flawless Diamond India Ltd. (supra), we hold that cutting and polishing of diamonds manufacturing or production of article or thing as envisaged for the purpose of claiming additional depreciation u/s. 32(1)(iia) of the Act. The Tribunal has also taken similar view in assessee's own case for the Assessment Year 2009-10 in ITA.No. 4588/Mum/2014 vide orders dated 29.09.2016. Hence, we confirm the order of the CIT(A) on this issue and dismiss the Revenue's appeal."

9. Respectfully following the said decision, we reject the ground raised by the Revenue on this issue.

10. Coming to the Cross Objection filed by the assessee, since we have upheld the order of the Ld. CIT(A) on the both the issues the cross objection is dismissed.

11. In the result, both appeal of the Revenue and Cross Objection of the assessee are dismissed.

Order pronounced in the open court on the 28th September, 2018

Sd/-	Sd/-
(N.K. PRADHAN)	**(C.N. PRASAD)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai / Dated 28/09/2018
Giridhar, Sr.PS

Copy of the Order forwarded to:

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER

(Asstt. Registrar)
ITAT, Mum