

**IN THE INCOME TAX APPELLATE TRIBUNAL, SURAT BENCH, SURAT
BEFORE SHRI PAWAN SINGH, JUDICIAL MEMBER AND
DR. ARJUN LAL SAINI, ACCOUNTANT MEMBER
ITA No. 1662/Ahd/2015 (AY: 2006-07)**

M/s Darrk Diamonds, 308, Navratna Chambers, Sardar Chowk, Varachha Road, Surat-395006. PAN No. AACFD 5315 M	Vs.	I.T.O., Ward-(9)(1), Surat.
Appellant/ assessee		Respondent/ revenue

Appellant represented by	Shri Hiren Vepari, CA
Respondent represented by	Shri Sita Ram Meena, Sr.DR
Date of hearing	17/02/2022
Date of pronouncement	04/05/2022

Order under section 254(1) of Income Tax Act

PER PAWAN SINGH, JUDICIAL MEMBER:

1. This appeal by the assessee is directed against the order of Id. Commissioner of Income Tax (Appeals)-3, Surat (in short, the Id. CIT(A) dated 02/03/2015 for the Assessment year 2006-07. The assessee has raised following grounds of appeal:

"(I) Validity of the order:

The learned Commissioner of Income Tax (Appeals) erred in wrongly holding that the Assessing Officer had followed the directions laid down by the Income Tax Appellate Tribunal of examining the evidence as per para 5 of the order of the Income-tax Appellate Tribunal and on that ground the order is required to be cancelled.

(II) Rejection of book result:

- (1) On the facts and circumstances of the case and as per law, the learned Commissioner of Income Tax (Appeals) erred in rejecting book result when the assessee had maintained complete quantitative accounts of the diamonds.*

(2) *The appellant submits that the learned Commissioner of Income Tax (Appeals) erred in not considering the submission and evidence in the above matter.*

(3) *The appellant further submits that the learned Commissioner of Income Tax (Appeals) erred in relying on the judgment of D. Subhashchandra & Co. which dealt with polished diamonds whereas the appellant dealt with rough diamonds.*

(4) *The appellant further submits that the learned Commissioner of Income Tax (Appeals) further erred in not differentiating between the rough makeable diamonds and rough rejected diamonds.*

(III) Changing base of addition:

(1) *On the facts and circumstances of the case and as per law, the learned Commissioner of Income Tax (Appeals) was not justified in changing the base of addition from valuation of stock (Rs. 52,32,680/-) to estimating alleged unaccounted profit of (Rs. 41,00,000) to alleged unaccounted profit.*

(2) *The appellant further submits that there was no basis to retain and make addition of Rs. 41,00,000/-.*

(IV) Miscellaneous:

(1) *The learned Commissioner of Income Tax (Appeals) erred in not dealing with ground No. IV.*

(2) *The appellant craves leave to add, alter or vary any of the grounds of appeal."*

2. At the outset of hearing the learned authorised representative (AR) of the assessee submits that he is not pressing ground No.1, thus, the ground No.1 of the appeal is dismissed as not pressed. Now adverting to the facts leading to the additions assailed in other grounds of appeals.

3. Brief facts of the case are that the assessee is a partnership firm, engaged in the manufacturing and trading of rough and polished diamonds. Initially the assessment for assessment year (AY) 2006-07 was completed under section 143(3) on 31.12.2008. The assessing officer made addition of Rs. 52,32,680/- on

account of under valuation of stock of rough diamonds. The assessing officer made addition by taking view that the average purchase rate was much higher than the average rate of opening stock and that still the closing stock was valued at 12% than the average rate of opening stock. It was also held that no lot wise details were provided though such records are maintained by the manufacturer. On appeal before Id CIT(A), the additions were upheld. The Id CIT(A) also held that lot wise details were not furnished and that average valuation of opening stock of rough diamonds was higher than the valuation of closing stock. On further appeal before Tribunal the matter was restored the file of assessing officer vide order dated 25.01.2012 in ITA No. 168/Ahd/2010. The reasons to restore the appeal to the assessing officer was that before Id CIT(A), the assessee filed additional details which was not accepted by him. The Tribunal also noted that the assessing officer raised the issue of valuation of stock on 24.12.2008 by issuing show cause notice to the assessee and assessment order was passed on 31.12.2008. Thus, the assessee was prevented to file requisite details. The details filed before Id CIT(A) was not appreciated and that such details require verification at the end of assessing officer.

4. In restoration proceedings the assessing officer again repeated the similar addition in order passed under section 143(3) read with section (rws) 254 dated 28.03.2013. Before passing the assessment order the assessing officer issued show cause notice to the assessee to furnish required details as submitted before Id CIT(A). The assessing officer recorded that the assessee submitted that rough

diamonds are obtained and issued to the contractors for manufacturing of polished diamonds but these rough diamonds from which also include and remained in stock and are referred to as rejected rough diamonds having negligible value. It was also contended that when the rough diamonds and rejected rough diamonds are shown together rough diamonds having very low value, the overall valuation of all rough diamonds goes down considerably. And that rough diamonds of 20,294.02 carat, there was rejection of 17,041.34 carat. The reply of the assessee was not accepted by the assessing officer. The assessing officer held that the assessee has not furnished the quality wise details of diamonds. Diamonds are very precious item and the assessee is require to maintain stock movement register, lot to lot details, issue and dispatch register and has to prepare detail inventory of opening and closing stock. From verification of purchase bills, sales bills and from purchase and sale register, genuineness of rejected diamonds is not verifiable. Hence, the details filed before Id CIT(A) regarding valuation of closing stock in not credible. The assessee failed to produce documentary evidences to substantiate the valuation of closing stock during the original assessment as well as in restoration proceedings. The contention of the assessee that closing stock of rough diamonds of 20,294.03 carat contained rejected diamonds of 17,041 carat is not reliable and is afterthought exercise. The valuation of closing stock is not genuine and is not supported by documentary evidences and was rejected. The assessing officer worked out the addition in the following manner;

Opening	Issued	Remaining	Rate Rs.000	Value of stock
19908.19	2605.56	17302.63	551.03	9534268.21
2091.49	1494.48	597.01	740.15	441876.95
2010.22		2010.22	2307.61	4638803.77
2021.78	1388.42	633.36	926.86	587036.05
26031.68	5488.46	20543.22	740.00	15201984.98

5. The assessee has shown the value of closing stock at Rs. 99,69,305/-, therefore, the difference of Rs. 52,32,680/- (1,52,01,984 – 99,69,305) was added back to the total income of the assessee. Further aggrieved, the assessee filed appeal before Id CIT(A). Before Id CIT(A) the assessee filed detailed note narrating the mistake committed by assessing officer. The Id CIT(A) called the remand report of the assessing officer and the comment of assessee on the remand report furnished by the assessing officer. The contents of the remand report and the comment of the assessee are reproduced by Id CIT(A) at page number 12 to 16 of his order. The Id CIT(A) after considering the contents of remand report and the comments of the assessee upheld the rejection of valuation of closing stock of assessee. The Id CIT(A) while affirming the rejection of valuation of closing stock held that maintenance of quality wise and quantitative details are necessary as held by Tribunal in D Subashchandra & Co Vs ACIT (123 ITD 635 Ahd). However, on merits of addition the Id CIT(A) examined the case and find various discrepancies that no finance charges are claimed, sales and administrative expenses are only Rs. 3.44 Lacks only, labour charges were Rs. 18.30 lakhs. On the basis of the above discrepancies and figures of turnover, the

Id CIT(A) opined that the monthly net profit shown by the assessee is only Rs. 27,544/- which is equal to the normal salary of semi-skilled diamond labour. It was noted by Id CIT(A) that the addition of Rs, 52,32,680/ was questioned by assessee being absurd, which is about 45.63% of the turnover. The Id CIT(A) made additions of Rs. 41.00 lakhs by applying 20% rate to the total inward of diamonds (opening stock plus purchases) in the following manner;

Particulars	Carats	Rate/ carat Rs.	Amount Rs.
Opening stock values by the assessee- rough (Marketable + rejected)	19,630.27	558.84	1,09,70,181
Opening stock values by assessee –Polished	244.5	6070.55	14,84,251
Purchases during the year	6123.49	1303.33	79,80,949
Total inward	25,998.26	786.03	2,04,35,381
Addition @ 20%			40,87,076
Rounded			41,00,000

6. Further aggrieved the assessee has filed present appeal before this Tribunal.
7. We have heard the submissions of the Id. AR for the assessee and the learned departmental representative (DR) for the revenue and have gone through the orders of the lower authorities. Ground No. 2 relates to the rejection of books of accounts and the ground No.3 relates to the addition of Rs. 41,00,00/- on account of valuation of stock. The Id AR for the assessee submits that assessee is a partnership firm engaged in the business of manufacturing of rough and polished diamond. In the first round of assessment, the assessee was not given sufficient time to furnish details to support valuation of closing stock. This fact

was acknowledged by Tribunal while restoring the appeal to the file of assessing officer for fresh adjudication in its order dated 25 January 2012. In the restoration proceedings the assessing officer repeated the addition on account of valuation of closing stock of rough diamonds of ₹ 52,32,680/-, without considering the evidences furnished by assessee. The assessee preferred appeal before learned CIT(A). The CIT(A) deleted the additions, however, he further substituted the addition by changing the base by making addition on account of unaccounted profit estimated at 20% of opening the stock and purchase. During the course of assessment proceedings, the assessee furnished evidences to demonstrate movements of rough diamonds. These were the very details filed by assessee during the course of first round of appeal proceedings. The assessee follows weighted average basis of valuation for valuation of stock as recognized in para-16 of Accounting Standard -2, dealing with the valuation of inventories issued by Institute of Chartered Accountants of India. Date wise, quantity -wise polished diamond, stock register, date wise polished diamond, quantitative details regarding the rejection of diamonds, date wise quantity and value floor of the polished diamond register along with the valuation of closing stock was given. Monthly wise register and copy of tax Audit Report under section 44AB was also filed. The assessing officer instead of verifying the details concluded that assessee did not maintain quality wise details of the diamonds. It was not possible for him to verify the lot wise diamonds, genuineness of rejected diamonds is not verifiable and the assessee has failed to produce documentary

evidence to substantiate the valuation of closing inventories. The learned AR of the assessee submits that quality wise details of diamonds can be maintained only after the rough diamonds is polished. The assessing officer made addition in respect of closing stock valuation of rough diamonds. In various case laws the Tribunal consistently held that books of account cannot be rejected for want of quantitative details of polished diamonds. Lot -wise details were prepared when it comes to the lot wise manufacturing. It was because lot wise polished diamonds manufactured cannot be traced back to the cost of rough diamonds for the purpose of polished diamonds valuation. This is a case of valuation of rough diamonds, where the assessee follow weighted average basis of valuation which is scientific and acceptable. For rough diamonds valuation, what needs to be seen suppliers invoices. The valuation done by assessee is purely at cost. The Id AR for the assessee submits that next objection of the assessing officer was the genuineness of the rough diamonds rejection is not verifiable. The logic of assessing officer is that there would not be rejection of rough diamonds. This is absolutely absurd and is a statement without any knowledge of industry. While making assortment of rough diamonds, many rough diamonds are of extremely low quality are not fit for manufacturing. These diamonds are extracted by undertaking assortment of rough diamonds and get in a separate low value assigned at its market value, which is generally very low. Unfortunately, both the assessing officer and the Id. CIT(A) has disregarded the submissions of the assessee. There was no reason for rejection of books of account, if the rejection

diamonds are removed at the lower value, the corresponding value of normal diamonds would go up to that extent. The average of rough diamonds prior to removal had an average of ₹ 1 289.88 per carat, rejection diamonds are extracted from the above at ₹ 9 4.50 per carat. The resultant balance of diamonds after removing has ₹ 1 632.82 per carat. With the rough diamonds issue to the manufacturing at the weighted average price as per the working given, the average value of rough diamonds works out Rs. 1488 per carat. The next objection of the assessing officer was that the assessee could not produce valuation of inventories. The learned AR of the assessee submits that complete details were furnished to the assessing officer, thus neither the assessing officer were justified in rejection of valuation of inventories nor Id CIT(A) were justified in confirming it.

8. Ground No. 3 relates to changing of basis of addition by the Id CIT(A) from closing inventory based valuation to estimation at 20% valuation of total inward diamonds. The Id AR for the assessee submits that the Id CIT(A) made addition by holding that the assessee earned unaccounted profit. There is no whisper or any allegation of unaccounted sales in the assessment order or by Id CIT(A) which can possibly result in addition on this ground. No show cause notice was issued by the Id CIT(A). The substituted addition is made without any basis and is liable to be quashed. In other alternative submissions the Id AR for the assessee submits that if the addition is substituted it will amount to 36% net profit rate of the turnover which is unrealistic. The Gross profit result would be

42% which is also unrealistic. The Central Board of Direct Taxes (CBDT) in its circular No. 2/2008 dated 22.02.2008 issued direction that 6% profit in the trade of diamonds is acceptable.

9. In without prejudice submissions, the Id AR for the assessee submits that even if the addition is based on the Gross Profit (GP) as applied by Id CIT(A), it can apply on the turnover and not on the total of reopening stock plus purchases. It was submitted that even if every thing is against the assessee, the additions needs to be restricted to Rs. 16,19,548/-, after reducing the GP declared by the assessee. The Id AR of the assessee furnished working of such figure in his written submissions. To buttress his submissions, the Id AR of the assessee relied on the following case laws;

- ❖ ITO Vs B Sureshkumar & Co (ITA No. 2632/Ahd/2003,
- ❖ ACIT Vs Gami Export (ITA 3146/Ahd/2007),
- ❖ Dhami Brothers Vs ACIT (ITA No. 2309/Ahd/2008),
- ❖ Pankaj Diamond Vs ACIT (ITA No. 555/Ahd/2008) and
- ❖ Arvind Kumar Kuberbhai Patel Vs DCIT [2017] 82 taxmann.com 214 (Gujarat).

10. On the other hand the Id DR for the revenue supported the orders of the Id CIT(A) on both the grounds of appeals. The Id DR for the revenue further submits that during the assessment the assessee failed to furnish complete details of valuation of closing stock despite granting opportunity. The assessee made part compliance of the show cause notices issued by the assessing officer. On verification of purchase bills, sales bills and from purchase and sale register, genuineness of rejected diamonds was not verifiable. The details filed before Id

CIT(A) regarding valuation of closing stock is not credible and was rejected by the assessing officer. The Id DR for the revenue prayed to reject the ground No. 2 of the assessee.

11. On the validity of the additions on estimation basis, the Id DR for the revenue submits that the Id CIT(A) after affirming the rejection of valuation of closing stock, the Id CIT(A) examined the case independently and find that there was various discrepancies in the books of the assessee as recorded in para 13 of his order. The Id CIT(A) recorded that that no finance charges are claimed, sales and administrative expenses are only Rs. 3.44 Lacks only, labour charges were Rs. 18.30 lakhs. On the basis of the above discrepancies the Id CIT(A) opined that the monthly net profit shown by the assessee is only Rs. 27,544/- which is equal to the normal salary of semi-skilled diamond labour. And estimated the addition @20% of total inward of diamond which is quite reasonable. The Id DR for the revenue prayed for dismissal of ground No. 3 as well.
12. We have considered the rival submissions of the parties and perused the record carefully. We have also gone through the orders of the lower authorities and the material placed before us. We have also deliberated on various case laws relied by the lower authorities as well as by Id AR of the assessee. The assessing officer rejected the working of closing stock by taking view that complete details were not furnished by the assessee. It was also held that the assessee has not furnished the quality wise details of diamonds. And that diamonds are very precious items and the assessee is require to maintain stock movement register,

lot to lot details, issue and dispatch register and has to prepare detail inventory of opening and closing stock. From verification of purchase bills, sales bills and from purchase and sale register, genuineness of rejected diamonds is not verifiable. The Id CIT(A) confirmed the action of assessing officer by similar view.

13. Before us, the Id AR for the assessee submits that during the course of assessment proceedings, the assessee furnished evidences to demonstrate movements of rough diamonds. These were the very details filed by assessee during the course of first round of appeal proceedings. The assessee follows weighted average basis of valuation for valuation of stock as recognized in para-16 of Accounting Standard -2, dealing with the valuation of inventories issued by Institute of Chartered Accountants of India. Date wise, quantity -wise polished Diamond, stock register, date wise polished diamond, quantitative details regarding the rejection of diamonds, date wise quantity and value floor of the polished diamond register along with the valuation of closing stock were furnished. We find that the submissions of Id AR of the assessee are contrary to the submissions recorded by the assessing officer. It is not the case of assessee that the finding of the assessing officer is perverse. We are conscious of the fact that that this is second round of litigation and instead of sending matter back, we are proceeds to adjudicate the issues. We find that there is objection of the assessing officer that the complete details were not provided by the assessee on the other hand, now we noted that the assessee has now taken stand that assessee follows weighted average basis of valuation for valuation of stock as

recognized in para-16 of Accounting Standard -2, dealing with the valuation of inventories issued by Institute of Chartered Accountants of India. No such explanation or stand was asserted by the assessee before assessing officer. The assessee has taken new plea, which is not acceptable to us. Thus, we affirm the order of assessing officer in rejecting the valuation of closing stock.

14. In view of the aforesaid discussions, the ground No. 2 of the appeal is dismissed.

15. Now turning to the ground No.3, relates to the addition of account of valuation of stock. The assessing officer reinstated the addition of Rs. 52,32,680/- by taking view that no details were furnished by the assessee despite providing opportunity to the assessee. Before Id CIT(A) the assessee retreated that the addition of Rs, 52,32,680/ is absurd, which is about 45.63% of the turnover. We find that the Id CIT(A) made additions of Rs. 41.00 lakhs by applying 20% rate to the total inward of diamonds (opening stock plus purchases). We further find that before making working of addition the Id CIT(A) recorded certain discrepancies in the books of the assessee viz; no finance charges are claimed, sales and administrative expenses are only Rs. 3.44 Lacks only, labour charges were Rs. 18.30 lakhs and that the monthly net profit shown by the assessee is only Rs. 27,544/- which is equal to the normal salary of semi-skilled diamond labour. We further find that the Id CIT(A) estimated the unaccounted profit at the rate of 20% on the total inward of diamonds consisting of opening stock plus purchases. The Id CIT(A) worked out the addition of Rs. 40,87,076/-, which was rounded off to Rs. 41,00,000/- (forty one lakhs).

16. We find that on making addition the unaccounted profit on estimation, went upto 36% of the turnover, if it is added the gross profit of the assessee it would be 42 %, which is quite unrealistic in the in the trade of diamonds. The assessee has already declared GP at 5.88%. We further noted that Central Board. of Direct Taxes (CBDT) in its Circular No 2/2008 dated 22nd February 2008 had came with instruction that profit to the extent of 6% in the trading and manufacturing of diamonds is acceptable as results. We find that total sale of the assessee is not disputed by the assessing officer. Considering the facts that we have upheld the rejection of books of account, and further held that estimation adopted by Id CIT(A) is not realistic that is higher side, therefore, we direct the assessing officer to consider the consider the unaccounted profit of assessee at 10% of the sales during the year under consideration, which in our view will be sufficient to avoid the possibility of revenue leakage. As the assessee has already declared 5.88% GP, the assessee be granted set off of the GP already declared by it. In the result, the Ground No. 3 raised by the assessee is partly allowed.
17. Considering the facts that we have granted substantial relief to the assessee on primary submissions of Id AR for the assessee, therefore, consideration and adjudication on his other alternative submission and all other general grounds of appeal have become academic.
18. In the result, the appeal of the assessee is partly allowed.

Order pronounced on 04/05/2022, in open court and result was also placed on notice board.

Sd/-
(Dr. ARJUN LAL SAINI)
ACCOUNTANT MEMBER

Sd/-
(PAWAN SINGH)
JUDICIAL MEMBER

Surat, Dated: 04/05/2022

**Ranjan /(dragon)*

Copy to:

1. Assessee –
2. Revenue -
3. CIT(A)
4. CIT
5. DR
6. Guard File

By order

Sr.Private Secretary, ITAT, Surat