

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

BEFORE SHRI NARENDRA KUMAR BILLAIYA, ACCOUNT MEMBER AND  
SHRI ANIKESH BANERJEE, JUDICIAL MEMBER

ITA No.1375/Mum/2024  
(Assessment Year: 2018-19)

<b>DCIT, Circle 5(1)(1), Mumbai</b> Room No.568, Aayakar Bhavan, M.K. Road, Mumbai- 400 020	vs	<b>Blue Star Diamonds Pvt Ltd</b> CE-9010,9013, 9 <sup>th</sup> Floor, Tower-C, Bharat Diamond Bourse, BKC, Bandra (East), Mumbai-400 051 <b>PAN: AADCB6475E</b>
<b>APPELLANT</b>		<b>RESPONDENT</b>

Assessee by : Shri Nitesh Joshi & Ashwin Kashinath  
Respondent by : Shri Satyaprakash R. Singh, CIT DR.

Date of hearing : 22/07/2025  
Date of pronouncement : 04/08/2025

**ORDER**

**Per Anikesh Banerjee (JM):**

Instant appeal of the revenue was filed against the order of the National Faceless Appeal Centre (NFAC), Delhi [in short, 'Ld.CIT(A)] passed under section 250 of the Income-tax Act, 1961 (in short, 'the Act'), for Assessment Year 2018-19, date of order 25/01/2024. The impugned order was emanated from the order of the National Faceless Assessment Centre, Delhi [in short, the "Ld. AO"], passed under section 143(3) read with section 144B of the Act, date of order 28/09/2021.

2. The revenue has taken the following grounds: -

*"1. Whether in the facts and circumstances of the case, the Ld. CIT(A) has erred in dismissing the action of the AD rejecting the book results u/s. 145(3) rws 1448 of the Income tax Act, 1961, ignoring that the Assessee had not only failed to Justify the omission in disclosure of inventory in the Tax Audit Report as required under the ICDS-II but also failed to corroborate the valuation of closing stock in the course of assessment proceedings?*

*2. Whether in the facts and circumstances of the case the Ld. CITTA) has erred in dismissing the action of the AD rejecting the book route us. 145(3) rws 144B of the Income-tax Act, 1961, Ignoring the ratio laid down by the Hon'ble Supreme Court in the case of Kachwala Gems Vs JCIT, Jaipur 288 ITR 10 (BC) where it was held that there was no arbitrariness of the Income Tax authority in rejection of the books u/s 145(3) where the assessee failed to submit evidence/documents to verify the basis of valuation of closing stock valuation shown by it and the assessee has himself to blame for not submitting the same and once the books of account of assessee are rejected, then, profit has to be estimated?*

*3. Whether in the facts and circumstances of the case, the Ld. CIT(A) has erred in directing the Assessing Officer to adopt the valuation of closing stock on the basis of weighted average method, as declared by the Assessee in the audited financial statement for the AY 2018-19, ignoring that the assessee had failed to furnish item-wise stock register along with purchase invoices to corroborate the authenticity of valuation of such weighted average method especially in view of the omission noted with regard to the mandatory disclosure of inventory details in the Form 3CD of the Tax Audit Report?*

*4. Whether in the facts and circumstances of the case, the Ld. CIT(A) has erred in restricting the disallowance made u/s 14A to exempt income ignoring that in view of Explanation to Section 144, inserted by Finance Act, 2022, which clarifies that the provisions of this section shall apply and shall be deemed to have always applied in a case where the income, not forming part of the total income under this Act, has not accrued or arises or has not been received during the previous year relevant to an assessment year and the expenditure has been incurred during the said previous year in relation to such income not forming part of the total income?*

5. *Whether in the facts and circumstances of the case, the Ld. CIT(A) has erred in deleting the addition after explanatory amendment was inserted by Finance Act, 2022 which again strengthened the preposition that such disallowance can be made when explanatory memorandum is interpreted as per the rules of interpretation of statute thereby making its applicability retrospective in nature. It is also to state that in 'Principles of Statutory Interpretation' by Justice G.P. Singh, it was noted that a declaratory act may be defined as an act to remove doubts existing as to the common law, or meaning or effect of any statute. Such acts are usually held to be retrospective in nature. If a new act is to explain' an earlier act, it would be without object unless construed to be retrospective?*

6. *Whether in the facts and circumstances of the case and in Law, the Ld.CITA) has justified in restricting the disallowance u/s 14A of the Income Tax Act, 1961 thereby overlooking the computational procedure laid down in Rule BD of the IT Rules, 1962 which has to be necessarily followed whenever a disallowance u/s 144 was to be made?*

7. *Whether in the facts and circumstances of the case, the Ld.CIT(A) has erred in not appreciating the CBDT Circular No. 5/2014 dated 11.02.2014 which is binding on the assessing officer wherein it has been clarified that the disallowance u/s 14A is to be made even if no exempted income had been earned by the assessee during the year?*

8. *The appellant prays that the order of the C17(A) on the grounds be set aside and confirm the order of the AO.*

9. *The appellant craves leave to add, amend or alter all or any of the grounds of appeal."*

3. The brief facts of the case are that the assessee is a diamond trader and carries out the manufacturing activities like cutting, polishing and assorting the diamonds. The assessee exports the goods to various countries worldwide and also the same in the local market. During the impugned assessment year, the assessee filed return of income of Rs.34,36,95,120/- and claimed a refund of Rs.24,13,680/-

. The case was selected for scrutiny under CASS and the notices under section 143(2) was issued by identifying that claim of any other amount allowable as deduction in Schedule BB. ICDs and adjustment and capital gains / income on sale of property. Thereafter, the assessment was completed; but Ld.AO found that the assessee is maintaining low profit during the impugned assessment year. So, the Ld.AO, being dissatisfied on the valuation of closing stock rejected the books of account under section 145(3) of the Act and made his own valuation of closing stock under the weighted average method. Whereas the assessee was maintaining books of account as per section 44AA and 44AB of the Act. The assessee is maintaining the stock under "Cost or Net Realisable Value (NRV)", whichever is lower. Further, the Ld.AO made disallowance under section 14A read with rule 8D(2)(iii) of the I.T. Rules, 1962 (in short, the "Rule"). Accordingly, the Ld.AO completed the assessment by addition in closing stock amount to Rs.92,80,87,527/- and disallowance under section 14A of Rs.39,97,753/-. Aggrieved assessee filed an appeal before the Ld. CIT(A). The Ld. CIT(A) deleted the addition related to addition of closing stock and related to disallowance under section 14A of the Act, he has set aside the issue related 14A to the file of Ld.AO for further verification. Being aggrieved, the revenue filed an appeal before us.

4. The Ld. DR argued that the assessee has huge lower valuation of the closing stock which was noticed in the assessment proceeding. The valuation of the diamonds depending on 4 Cs (cut, colour, carat and clarity). On verification of invoice, the Ld.AO found that whether the assessee has taken the closing stock of Rs.10,577 per carat based on the weighted average method. However, on careful scrutiny of purchase data for the months of February and March 2018, it was found

that the assessee has purchase rough diamond and polish diamond with average rate of Rs. 31,270/- per carat for rough diamond and Rs. 1,36,330/- per carat for polish diamond. The Ld. DR argued that rough diamond (last two months) was purchased at lowest rates amount to Rs.14,441 per carat. This raises a serious question as to how weighted average cost could drop to Rs.10,577/- per carat and which is significantly lower than the lower purchase price.

The relevant part of the synopsis filed by the Ld. DR, filed on dated 19/12/2024 is reproduced below: -

**"Ground 2: Valuation of Closing Stock**

*Assessee's Submission:*

*The assessee argues that the valuation of closing stock was carried out in compliance with ICDS II and Ind AS-2. It contends that the weighted average method was adopted for determining the value of inventories, a method that is recognized under both accounting standards. The assessee claims that diamonds are unique commodities, and their valuation is subject to the 4Cs principle (Cut, Colour, Carat, and Clarity), which makes any invoice-to-invoice or purchase-to-sale comparison infeasible. To substantiate its valuation, the assessee has relied on the reports of a government-approved valuer who has provided the net realizable value (NRV) of rough and polished diamonds. The assessee further contends that the methodology adopted by the AO-computing average cost using simple arithmetic-ignores the peculiarities of the diamond trade and is, therefore, incorrect.*

*Revenue's Rebuttal:*

*The Revenue strongly refutes the assessee's submissions and asserts that the valuation of closing stock as determined by the assessee is arbitrary, inconsistent, and violates fundamental accounting principles under ICDS II. The addition made by the AO is justified and fully supported by facts, and sound logic. The detailed counter-arguments are as follows:*

2.1) The primary dispute arises from the valuation of rough diamonds in the closing stock. The assessee has valued rough diamonds at ₹10,577 per carat using the weighted average method. However, during the assessment proceedings, it was revealed that the rough diamonds purchased in February and March 2018 were procured at rates ranging between 14,441 to 269,026 per carat. The lowest purchase price recorded during this period was 214,441 per carat. This fact alone demonstrates that the assessee's valuation of ₹10,577 per carat is significantly below the actual cost of acquisition.

2.2) Under ICDS II and Ind A5-2, inventories must be valued at cost or net realizable value (NRV), whichever is lower. The cost, in this case, clearly exceeds the value reported by the assessee. By undervaluing the closing stock, the assessee has suppressed its taxable income.

2.3) The AO recalculated the weighted average cost of rough diamonds to be ₹15.318 per carat, based on the opening stock value and purchases during the year

a. Opening Stock Value: ₹108.39 crore.

b. Purchases: ₹1,005.05 crore.

c. Total Quantity: 7,26,863 carats.

d. Revised Weighted Average Cost- ₹15,318 per carat.

This recalculation is based on concrete figures available in the assessee's financial records and represents a fair and reasonable value for the closing stock of rough diamonds.

2.4) The valuation of polished diamonds in the closing stock further highlights inconsistencies in the assessee's approach. The assessee has reported the closing stock value of polished diamonds at ₹58,999 per carat. However, a careful examination of the assessee's purchase data for the year shows that the weighted average cost of polished diamonds was much higher, at 170,827 per carat.

- By valuing polished diamonds at ₹58,999 per carat, the assessee has again violated the principle of cost or NRV, whichever is lower, as prescribed under ICDS II.
- The AO recalculated the weighted average cost of polished diamonds as ₹70,625 per carat, derived from:
  - Opening Stock Value: ₹319.93 crore.
  - Purchases: ₹306.22 crore.

- Total Quantity: 88,759 carats.
- Revised Weighted Average Cost ₹70,625 per carat

*It is observed by the AO that the assessor had valued opening stock with weighted average value at rate of Rs. 70,433 per carat and purchase with weighted average rate of Rs. 70,827 per carat, but the closing stock was valued with weighted avg rate of Rs. 58,999 per carat. In the valuation report furnished by the assessee to AO in assessment proceedings the details in respect of items and specification are not mentioned along with rationale and justification for valuation has not been mentioned. This recalculation is based on the correct methodology and accurately reflects the cost incurred for acquiring polished diamonds during the year.*

*2.5) The assessee has submitted valuation reports prepared by a government-approved valuer to substantiate the net realizable value (NRV) of rough and polished diamonds. However, the Revenue submits that these reports are not reliable for the following reasons:*

- *The valuation reports lack itemized details and do not provide the specific characteristics (4Cs) of the diamonds used to determine their NRV. Without such details, the valuation remains unverifiable and subjective.*
- *The valuer's reports also fail to explain the rationale and justification behind the values assigned to various lots of rough and polished diamonds. Such vague reports cannot override the AO's recalculations based on actual data.*
- *Further, the assessee's claim that diamonds cannot be valued invoice-wise does not excuse it from providing proper documentation to justify the valuation adopted. Valuation must be based on actual costs incurred, not arbitrary estimations.*

*2.6) The assessee's valuation methodology is fundamentally flawed and inconsistent with the principles laid down in ICDS II and Ind AS-2. Both standards clearly mandate that inventory must be valued at cost or NRV, whichever is lower. While the assessee claims compliance with ICDS II and Ind AS-2, its actions contradict the principles laid down in these standards. The assessee selectively applies NRV for polished diamonds but undervalues rough diamonds using an unsupported weighted average cost. This inconsistency in valuation*

*methodology clearly indicates manipulation of figures to suppress profits and reduce taxable income. (Refer to written submission of assessee point 4(c)(iv)*

- *For rough diamonds, the cost (₹15,318 per carat as per AO's calculation) exceeds the reported valuation (₹10,577 per carat), indicating a deliberate undervaluation.*
- *For polished diamonds, the weighted average cost (₹70,827 per carat) has been arbitrarily reduced to ₹58,999 per carat, which is inconsistent with both accounting standards.*

*The Revenue submits that the assessee has selectively applied NRV for polished diamonds while undervaluing rough diamonds under a manipulated weighted average method. Such inconsistencies clearly demonstrate an attempt to suppress income. It is submitted by the assessee vide letter dated 25.11.2024 at pg no 4 (i) that "Assuming without admitting that the AO is justified in revaluing the cost element of the closing stock, no addition could be made in respect of cost of Cut and polished diamond and such addition in respect of rough diamond cannot exceed Rs.47.97 lacs. Thus it can be seen that the assessee itself had admitted that there is element of error in valuation of closing stock". The AO has rightly stated that in Para 35(a) in Form No 3CD for inventory of traded goods and mixed values to create complexities and after manipulating with data it reduce the value of closing stock for rough diamond and polished diamond approx. Rs. 41.60cr in respect of rough diamond and Rs. 51.20 cr in respect of polished diamond. (Refer to written submission of assessee point 4(c)(i))."*

5. The Ld.AR argued and filed a paper book which is kept on record. The Ld.AR stated that the assessee is maintaining the stock register on day to-day basis. The stock register was duly submitted before the Ld.AO. The details of stock was inserted in the tax audit report and the assessee is maintaining the valuation of closing stock under "cost or net realizable value, whichever is lower". The assessee filed a valuation report, duly valued by the government approved valuer. But the Ld.AO rejected the same and finally, the books of accounts were rejected, and

addition was made by revaluating the closing stock. The Ld.AR relied on the impugned appellate order. The relevant paragraphs page 37 to 42 of impugned appellate order is extracted below: -

*“4.1.3 The issues have been examined and it is seen that the AO had rejected the books of account u/s 145(3) of the Act and enhanced the taxable income of the appellant by adopting enhanced valuation of closing stock. This shows that the AO was not satisfied with the valuation of the closing stock and adopted the simple average method for valuation of stock of rough as well as polished diamonds. Further, the AO did not find any incorrectness in claim of expenses and disclosure in receipts shown in the profit & loss account. This shows that the AO had accepted the quantities as well as value of opening stock, purchases and sales of rough diamonds as well as polished diamonds and didn't accept the value of closing stock. In this case, the appellant is engaged in manufacturing business of diamond where each piece of diamond is different on a/c of cut, colour, carat & clarity whereas the AO has adopted average cost valuation method, which is applicable for valuing an identical standard goods and not in items/goods, where each item has unique character/quality. Further, I find that the AO had asked the details of purchases and sales for the month of February and March, 2018 only along with copy of purchase bills which form part of the closing stock, which were provided by the appellant (refer point no 5 of Notice u/s 142(1) dated 09.04.2021 and para 4 of Assessment Order) In this regard, the appellant submitted month-wise sales and purchases along with random invoices stating that due to peculiar nature of the industry, invoice-wise comparison is not possible (refer para 4.5 of Assessment Order). However, it is seen that the AD had not gone through the sample invoices and corresponding entries in the stock register to know the correctness of the methodology adopted by the appellant for valuation of stock. Perusal of the evidences reveals that the appellant has maintained the stock register for its manufacturing business and correctly recorded the quantities and value/cost of the purchases, sale or consumption of the polished stock and necessary evidences including sample copy of invoices, complete stock & purchase register of polished diamond and two months stock & purchase register of rough diamonds were furnished during the assessment proceedings vide reply dated 23.09.2021 in response to the final show cause notice. On examination of these evidences shows that the appellant had incorporated the purchases in stock register at cost and some of the illustrations are as under, which is prepared with the help of documents furnished by the appellant during the assessment proceedings: -*

<i>Dt of invoice</i>	<i>Lot</i>	<i>Carat</i>	<i>Amount</i>	<i>PB pg No. of Invoice</i>	<i>PB pg No of Purchase Register</i>	<i>PB No. of Stock Register</i>
21.04.17	D	106.37	40001200	286	258	241

27.05.17	B & C	8.10	809673	287	259	226 & 234
09.06.17	B, C&D	116.99	5412427	288	259	226,234 & 242
22.06.17	A & B	883.30	55228085	289	260	328 & 226
17.07.17	C	0.80	85865	290	261	235
17.08.71	B	0.71	67050	291	263	227
06.09.17	X	6.04	6448334	292	264	252
26.10.17	C & D	2.51	515456	293	266	237 & 245
04.11.17	B & C	5.88	603031	294	267	229 & 237
25.12.17	B	6.19	319036	295	270	230
25.12.17	B	24.15	1143904	296	270	230
06.01.18	B	14.03	542330	297	271	230
02.02.18	B, C & D	12.26	3137406	298	273	231,239&247
02.02.18	B & D	1.73	274335	299	273	231 & 247
28.03.18	B & C	1.94	244194	300	278	232 & 240

*Perusal of the above details shows that the appellant has correctly incorporated the purchases in its lot-wise stock register but the AO didn't consider these evidences after issuing the final show cause notice and before passing the final scrutiny assessment order. In fact, it is observed that the AO has passed the same assessment order, which was issued as draft assessment order with the final show cause notice and didn't make any specific comment/finding on the final submission of the appellant.*

*4.1.3.1 So far as the issue of non-accounting of consumed diamond of 90,746 caret is concerned, it is seen from clause 35bA of tax audit report that the appellant has shown manufacturing of 72116 caret of polished diamond on consumption of 162862 caret and the remaining rough diamond of 90746 caret is nothing but a manufacturing loss. Further, it is seen that the appellant has shown yield 44.28%, which is higher than the standard yield of diamond manufacturing industry. The information available in the public domain also support this contention of the appellant. Also, the AO didn't make any comparison of this manufacturing process loss for the present financial year with the earlier years' loss to arrive at a conclusion that the appellant didn't account all the consumed diamond. I have gone through the earlier years' tax audit report and finds that the yield in FY 2015-16 & 2016-17 is 46.68% & 46.24% respectively and therefore, the difference of yield from earlier years is 2% only. Since the each & every lot of diamonds has different weight & quality, the reduction in yield by 2% in comparison to earlier years is not found to be excessive.*

4.1.3.2 It is observed that CBDT has notified the Indian Computation and Disclosure Standard (ICDS) II relating to valuation of inventories vide Notification No. SO 3079(E) [No. 87/2016 (F.No. 133/23/2015-TPL)] dated 29.09.2016 for computation of income chargeable under the head "Profits and Gains of Business or Profession" or "Income from Other Sources" and one of the reasons for selection of the present case was to examine the ICDS Compliance and adjustment and the AO didn't point out any non-compliance of ICDS in the assessment order but didn't accept the valuation of stock made as per notified ICDS-II even though AO was intimated by the appellant that it had adopted the method of valuation of closing stock as per the ICDS-II and Ind AS-2.

4.1.3.3 From the assessment order, it is seen that the AO has rejected the book result and made a valuation of closing stock on average method of valuation for closing stock only and didn't adjust the value of the opening stock by adopting same average method of valuation. This shows that the AO had accepted the appellant's method for opening stock but didn't accept the same method of valuation of closing stock.

4.1.3.4 It is further seen that the method of valuation of stock has been accepted by the AO in scrutiny assessment proceedings for immediately preceding four years and in subsequent year for AY 2020-21, wherein one of the reasons for selection of the case was "Stock Valuation". The relevant extract of the assessment order is reproduced below.

"3.2 During the course of assessment proceedings, the assessee was asked to furnish the explanations/details of opening and closing stock during the year and justification for difference in the closing stock shown in Balance sheet and P&L at of current year as per Return of income along with supporting documents in this regard, the assessee has submitted reconciliation and the assessee has submitted that the assessee company has followed the Ind-AS 2 and ICDS for the valuation of inventories which are lower of cost price or Net Realizable value. After verification of the same and also cross checking from the ITR of AY. 2019-20 the opening and closing stock are found to be in line with reconciliation provided by the assessee. Accordingly, no adverse interference is drawn."

This shows that the AO didn't consider the earlier assessment orders in the present case. Further, the AO had accepted the method of valuation in subsequent assessment year, wherein no discrepancies were found w.r.t. valuation of closing stock.

4.1.3.5 It is also seen that the AO had rejected the valuation report of the Government approved independent valuer without pointing out any specific defects and only on the basis of general observation that the valuer has not valued each & every piece of diamonds and not furnished any corroborative evidences by the appellant. As discussed in earlier paragraphs that the appellant

*had submitted purchase & sales invoice for the month of February and March along with stock register but the AO failed to cross check valuation done by the Valuer with purchase Invoices & entries in stock register. Further, the statutory auditor has not pointed out any inconsistency or discrepancies in the report. Thus, the AO's general observation on this count is contrary to the facts of the issue.*

*4.1.3.6 in the assessment order, the AO has repeatedly highlighted that the appellant didn't furnish purchase bills and stock register to support the valuation of closing stock but nowhere the AO has specifically pointed out the notice dated in which such requisition was made during the assessment proceedings. In fact, I have seen that the AO had asked to furnish details of purchase for the month of February and March 2018 and sales for these two months vide point no. 5 of notice u/s 142(1) dated 09.04.2021 and the appellant submitted the same vide point no. 5 of submission letter dated 12.04.2021. This shows that the AO had made the observation without going into the details already on record.*

*4.1.3.7 I have also gone through the case laws cited by the appellant and find that there are several decisions of court that where the appellant adopted same method of valuation regularly & consistently, the same can't be generally disturbed. In this regard, the Hon'ble Supreme Court in the case of Radhasoami Satsang v. CIT [193 ITR 321] held that where facts and law in a subsequent assessment year are the same, no authority whether quasi-judicial or judicial, can generally be permitted to take a different view. Also, the Hon'ble Supreme Court in the case of United Commercial Bank v. CIT [240 ITR 355] it was held that the method of accounting adopted by the taxpayer consistently and regularly cannot be discarded by the departmental authorities on the view that he should have adopted a different method of keeping accounts or of valuation. Further, the Hon'ble Allahabad High Court in the case of CIT v. Ema India Ltd [296 ITR 510] wherein it was held that where a consistent method of valuation of stock was adopted by the assessee, the same should not be disturbed because the closing stock of this year is the opening stock of subsequent year and hence, a consistent method adopted for valuation by the assessee should not be disturbed.*

*In view of the above discussion, I find that the valuation of closing stock declared by the appellant doesn't suffer from any discrepancies and the AO had wrongly rejected the book result u/s 145(3) of the Act. Further, I find that the method of valuation of closing stock has been accepted by the AO in earlier as well as subsequent years without any modification. Hence, the action of the AO rejecting the book result u/s 145(3) of the Act on the basis of incorrect valuation of closing stock is dismissed and AO is directed to adopt the valuation of closing stock declared by the appellant in the audited financial statement for the present financial year. Thus, both the grounds of appeal of the appellant are allowed.”*

6. Related to disallowance under section 14A, the Ld.AR respectfully relied on the order of Ld.CIT(A) and the relevant paragraph No.4.2.2 on page 42 is extracted below:-

*“4.2.2 The issue has been examined and it is seen that the appellant itself has made disallowance of Rs. 60,000/- and not justified the quantification of such disallowance. Further, suo-moto disallowance shows that the appellant was in agreement that disallowance of expenditure u/s 14A of the Act r.w.s. Rule 8D is applicable. Further, the AO has decided the issue solely based on the CBDT's Circular No. 05/2014 dated 11.02.2014 but thereafter, the Hon'ble Supreme Court in the case of CIT, (Central) 1 Vs. Chettinad Logistics (P.) Ltd. [2018] 95 taxmann.com 250 (SC) and PCIT Vs Delhi International Airport (P.) Ltd. [2022] 143 taxmann.com 209 (SC) had held that section 14A cannot be invoked where no exempt income was earned in the relevant assessment year. Further, the Special Bench in the case of Vireet Investments Private Ltd [2017] 82 taxmann.com 415 (Delhi - Trib.) (SB) held that only those investments which yielded exempt income during the year are to be considered for computing the average value of investment. This order has also been followed by the Mumbai Tribunal in the case of Piramal Enterprises Ltd. Vs ACIT 197 taxmann.com 352], DCIT Vs Macritech Developers Ltd [ITA No. 2382/Mum/2022] and Shivnarayan Nemani Shares & Stock Brokers (P.) Ltd. Vs DCIT [2021] 132 taxmann.com 242 (Mumbai Trib.). Further, the ITAT Mumbai bench in the case of Mahindra & Mahindra Ltd. Vs DCIT [2020] 117 taxmann.com 518 (Mumbai Trib.) has held that while working out disallowance under third limb of rule 8D(2), only those investments which had actually yielded exempt income during current year, was to be considered. Being similarity of the facts, hereby direct the AO to grant relief in disallowance following the decision of the SB in Vireet Investment. Further, if the disallowance on those investments which had actually yielded exempt income during current year is computed at lower than the suo-motto disallowance, the suo-motto disallowance should be adopted. Nonetheless to say that the appellant shall furnished the evidences of exempt income earned during the year because the AO had stated at para 5.1 of the assessment order that the appellant didn't earn any exempt income whereas the appellant has submitted that it had earned exempt income of Rs. 37,28,266/- Thus, this ground of appeal is allowed for statistical purpose.”*

7. We have carefully considered the rival submissions, perused the orders of the revenue authorities and examined the material available on record. Primarily, the Ld. AO rejected of Books of Account and made addition on account of closing stock valuation. The principal issue raised by the revenue pertains to the rejection of the books of account under section 145(3) of the Act and the consequential revaluation of closing stock of rough and polished diamonds. The Ld. AO, relying solely on average purchase prices of the last two months of the year, recomputed the closing stock, thereby enhancing the total income substantially. However, it is evident from the record that the assessee has consistently followed the method of valuation prescribed under ICDS-II and Ind AS-2, i.e., “cost or net realisable value, whichever is lower”, and the same has been accepted by the department in preceding as well as subsequent assessment years. The assessee has maintained day-to-day stock register and has also produced government-approved valuation reports during the assessment proceedings. The Ld. AO has not pointed out any specific defect in either the stock register or the valuation report and has failed to correlate the valuation of stock with the method consistently employed by the assessee. Further, no adjustment was made to the opening stock, despite the changed basis of closing stock valuation, which renders the entire approach of the Ld. AO incomplete and contrary to settled accounting principles.

Moreover, the action of the Ld. AO stands contrary to various judicial precedents, including **Radhasoami Satsang v. CIT** (supra) and **United Commercial Bank v. CIT** (supra), which uphold the principle that a consistently followed method of accounting or stock valuation should not be disturbed in the absence of cogent reasons. As noted by the Ld. CIT(A), even in scrutiny assessment proceedings for

the immediately preceding four years and the subsequent year, the valuation method adopted by the assessee has been accepted without modification.

In light of the above, we see no infirmity in the well-reasoned findings of the Ld. CIT(A) in deleting the addition made by the Ld. AO on account of revaluation of closing stock. The action of the Ld. AO in rejecting the books of account under section 145(3) lacks legal and factual justification.

8. With respect to the disallowance under section 14A read with Rule 8D, we note that the Ld. CIT(A) has neither deleted nor upheld the disallowance entirely but has directed the Ld. AO to verify the actual exempt income earned by the assessee during the year and compute the disallowance accordingly. The direction is in consonance with the binding precedents of the Hon'ble Supreme Court in **Chettinad Logistics (P.) Ltd.** (supra) and **Delhi International Airport (P.) Ltd.** (supra), wherein it has been held that no disallowance under section 14A of the Act can be made in the absence of exempt income.

Further, the direction of the Ld. CIT(A) to adopt the disallowance on the basis of actual exempt income earned, and to apply Rule 8D(2)(iii) only to those investments which have actually yielded exempt income, is in line with the decision of the Special Bench in **Vireet Investment Pvt. Ltd.** (supra). The said direction is well-reasoned and does not call for interference.

9. In view of the foregoing analysis, we find that the order passed by the Ld. CIT(A) does not suffer from any legal or factual infirmity. All grounds raised by the revenue are devoid of merit and accordingly, the appeal of the revenue is dismissed.

10. In the result, the appeal of the revenue bearing **ITA No.1375/Mum/2024** is dismissed.

Order pronounced in the open court on 04<sup>th</sup> day of August 2025.

Sd/-

sd/-

(NARENDRA KUMAR BILLAIYA)  
ACCOUNTANT MEMBER

(ANIKESH BANERJEE)  
JUDICIAL MEMBER

Mumbai, दिनांक/Dated: 04/08/2025

Pavanan

**Copy of the Order forwarded to:**

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त CIT
4. विभागीय प्रतिनिधि, आय.अपी.अधि., मुंबई/DR, ITAT,  
Mumbai
5. गार्ड फाइल/Guard file.

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