आयकर अपीलीय अधिकरण "A" न्यायपीठ मुंबई में।

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

BEFORE SHRI MAHAVIR SINGH, JUDICIAL MEMBER
AND SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER

आयकर अपील सं./I.T.A. No. 1207/Mum/2012
(**निर्धारण वर्ष /** Assessment Year : 2008-09)

M/s Kumudchandra D. Mehta, 14, Hanvant Bhuvan, 80E, Nepean Sea Road, Mumbai – 400 006.	**बनाम/** v.	ACIT – Range 16(2), Mumbai.
स्थायी लेखा सं./PAN : AAAFK6824G		
(अपीलार्थी /**Appellant**)	..	(प्रत्यर्थी / **Respondent**)

Assessee by	Ms. Mrugakshi Joshi
Revenue by :	Shri Aarsi Prasad

सुनवाई की तारीख /**Date of Hearing : 09-6-2016**
घोषणा की तारीख /**Date of Pronouncement : 07-09-2016**

आदेश / O R D E R

PER RAMIT KOCHAR, Accountant Member

This appeal, filed by the assessee firm , being ITA No. 1207/Mum/2012, is directed against the appellate order dated 16th December, 2011 passed by learned Commissioner of Income Tax (Appeals)-27, Mumbai (hereinafter called "the CIT(A)"), for the assessment year 2008-09, the appellate proceedings before the learned CIT(A) arising from the assessment order dated 23rd December, 2010 passed by learned the Assessing Officer (hereinafter called "the AO") u/s 143(3) of the Income Tax Act,1961 (Hereinafter called "the Act").

2. The grounds of appeal raised by the assessee firm in the memo of appeal filed with the Income Tax Appellate Tribunal, Mumbai (hereinafter called "the Tribunal") read as under:-

> "On the facts and circumstances of the case and in law,
>
> 1. The learned CIT (A) has erred in confirming the addition of Rs. 5,37,250/- on account of estimating the gross profit @ 7% instead of accepting the gross profit @ 6.93% as returned by the appellant."

3. The brief facts of the case are that the assessee firms deals in diamonds. The A.O. observed that during the relevant previous year, total sales of the assessee firmwas Rs.81,60,68,947/- which included export of cut/polished diamonds of Rs.47,35,18,419/- and local sale of polished diamonds of Rs. 33,45,86,347/- and export sale of rough diamonds of Rs. 79,64,181/-. The assessee firm has shown an income of Rs. 91,01,299/- from the exchange rate difference which is a part of the gross profit. The gross profit of Rs.5,65,87,574/- was worked out and the GP rate was arrived at 6.93%. The GP ratio arrived in the last assessment year was 7.79%. The assessee firm was asked to explain the reason for the fall in gross profit ratio.

The assessee firm explained that the assessee firm maintains the stock of rough diamonds at cost. The assessee values the closing stock of polished diamonds at 'cost plus labour'. The assessee submitted that during the year under consideration the value of the closing stock of polished diamond was Rs.46,92,889/- which comprised of 228.95 carats. The assessee submitted the details of inventory of polished diamonds and its subsequent realization in the assessment year 2009-10 along with copy of sale invoices duly marked there in the items exported are also filed before the AO. On perusal of the same, it was submitted that the valuation of polished diamonds is proper.

The comparative analysis of gross profit, GP % and sales of last three assessment years was culled out as follows:-

A.Y.	Sales (In Rs.)	Gross Profit (in Rs.)	G.P.%
2008-09	81,60,68,947	5,65,87,574	6.93
2007-08	65,91,11,112	5,13,28,051	7.79
2006-07	38,31,22,862	3,09,81,525	8.09

From the above table it can be seen that the turnover of the firm has gone up by about 25% during the year as compared to preceding year and hence there was slight fall in gross profit margin ratio. The assessee submitted that during the year under assessment the diamond trade industry has faced tremendous recession and hence the realization was slightly less as compared to earlier years. The gross profit of the assessee is much higher as compared to other firms. The assessee also submitted that the assessee maintains day to day stock register in respect of rough diamonds and polished diamonds. The assessee submitted that the Mumbai Tribunal has deleted the entire addition made by A.O. in assessee's own case in the assessment year 2003-04 and hence the book results may be accepted.

The A.O. had gone through the reply of the assessee and observed as under:-

(a) The assessee maintains stock register of rough diamonds. It consist of date, mention of whether it is purchase or sent for manufacturing, weight of purchased rough diamond in carats, weight of rough diamonds in carats sent for manufacturing and value of only rough diamonds purchases. Value of rough diamonds, against each lot is not stated. It does not state as to which purchase of rough diamonds has been sent for manufacturing. Purchase cost of each purchase of rough diamonds is different. For instance the opening stock of rough diamond is valued @ Rs.25,526.54 per carat. The first purchase is @ Rs.33,222.91 per carat. The second purchase is @ Rs.36,309.60 per carat. The 3rd purchase is @ Rs.23,927.87 per carat. The last purchase is @ Rs.24,048/- per carat. The last but one purchase is @ Rs.22,094.78 per carat. Purchases, as low as @ Rs.3,770/- per carat has also been made.

(b) The average yield has also come down from 43.32% to 41.60%, in comparison to last year. No record of yield of each lot sent for manufacturing has been maintained.

(c) The export sale of 1266.81 carats of rough diamond has been made @ Rs.6,286.79 per carat.

(d) In nowhere in this stock register it is stated as to which lot is being sent to karigars or to its own factory for manufacturing of the polished diamonds. In the absence of which it is no possible to work out the exact cost of rough diamonds sent for manufacturing of the polished diamonds and consequently no proper value of the polished diamonds can be made.

(e) The 1st receipt of the manufactured polished diamonds weighing 900.25 carats has been shown on 30.4.2007. This work was carried out in its own factory by the assessee. When the rough diamonds were sent to the factory and which part of the purchases of rough diamonds were sent to the factory, is not evident from the stock register filed, it is not possible to value correctly the polished diamonds received out of rough diamonds sent for manufacturing.

(f) Stock register of polished diamond is also filed. It consist of date, opening stock of polished diamonds in carats, weight of polished diamonds received on manufacturing in carats and total value of polished diamonds. It does not consist of number of pieces of diamonds received, their size or weight, its cut, its quality, its clarity. These are the parameter which decides the value of the polished diamonds.

(g) 1st sale or export of polished diamonds was made on 11.05.2007. It was 60.49 carats. It was @ Rs.92,860.29 per carat. The second sale was @ Rs.27,129.35 per carat. The third sale was @ Rs. 50,726.98 per carat. The 4th sale was @ Rs. 31,312.17 per carat; The average value of the opening stock of polished diamonds was @ Rs.35,841.92 per carat. The lowest rate of sale of polished diamonds Rs.9,000/- per carat. The highest rate of sale of polished diamonds was Rs.2,22,582/- per carat. But in nowhere in the stock register the size or number of pieces or quality or clarity or colour of the diamond has been mentioned.

(h) In the opening stock of the polished diamonds and in the closing stock of the polished diamonds, no where the size or number of pieces, or colour or clarity has been stated. In the absence of which no reliability can be placed upon their valuation.

(i) The assessee has filed copy of the sale bills of the items, which were appearing in the closing stock as on 31.3.2008. In the bill type of diamond as "1 D CUT BLACK DIAMOND", their number of pieces and their weight in carat has been stated. When these details can be stated in the sale bill why cannot same be stated in the stock register.

From the above discussion the AO observed that it is clear that assessee is maintaining its production records in such a manner that the :

(i) What part of rough diamonds has been sent for manufacturing is not evident.

(ii) The number of pieces of diamonds received, weight of each piece, its size or cut, colour of each piece and its clarity etc., of the received manufactured polished diamonds are not evident.

(iii) These are the parameters, to decides the value of a particular piece of diamond.

Under the circumstances the AO observed that the valuation of opening stock, the valuation of manufactured stock and the valuation of closing stock is not open to the verification. The manufacturing results, valuation of stock and finally, the book results of the assessee cannot be accepted. So the reasons given in the fall of gross profit are also not acceptable.

The AO observed that it is an accepted fact that the assessee maintains stock of rough diamonds at cost and it is not disputed.

The AO observed that the assessee's submission that he values its closing stock of polished diamonds at "Cost + labour" and inventory of closing stock of polished diamonds has been filed and on the basis of it the valuation of closing stock is proper, is not acceptable. The inventory of closing stock of polished diamonds consist of weight in carats and its value. What is the number of pieces, what is the colour of pieces, what is the weight of each piece, what is the- size of each piece, what piece is made out of which purchase of rough diamond is not available. As valuation of each piece of diamond depends upon the above parameters, the submission of the assessee was not accepted by the AO as none of the details has been filed. When this details can be furnished in the sale bill why can't it be maintained in the stock register.

The AO observed that If the turnover has gone up, then it does not mean that the gross profit has to come down. Even there is fall in yield, despite the utilization of sophisticated machinery for cutting and polishing. The AO observed that the figures of gross profit rates furnished by the assessee in other cases show that in the case of M/s Riken & Co., the G.P. rate is 8.08%.

The AO observed that the assessee maintains day to day stock registers of rough diamonds and polished diamonds which is accepted, but when it lacks basic details as stated above, the same cannot justify the correctness of the book results.

It was observed by the AO that the 'A' Bench of ITAT, Mumbai's decision in the assessee's own case for the assessment year 2003-04 was on the different footings. The facts were different in that case. The above stated defects were never brought on the records. The said decision is not applicable in the instant case was the observations of the AO.

Thus, the A.O. came to the conclusion that the method adopted by the assessee to maintain the records of rough diamonds, sending for manufacturing, its receipt back as polished diamonds and its valuation was not satisfactory. The A.O. observed that it does not give correct profit of the business, hence, this is the reason for fall in the gross profit shown by the assessee. The A.O. also rejected the book results u/s 145 of the Act. The A.O. accordingly worked out the fresh figure of sales at Rs. 83,35,13,362/- by applying GP ratio of 7.79% as it was in the last year. Similarly , the extra profit was worked out at Rs. 83,43,116/- which was added to the income of the assessee by the AO vide assessment order dated 23.12.2010 passed by the AO u/s 143(3) of the Act.

4. Aggrieved by the assessment order dated 23.12.2010 passed by the A.O. u/s 143(3) of the Act, the assessee filed its first appeal before the ld. CIT(A).

5. Before the ld. CIT(A) , the assessee contended that the assessee is a manufacturer and exporter of cut and polished diamonds. The assessee imports rough diamonds and gets it manufactured in its own factory as well as gets it polished through outside labour parties. The assessee also purchases polished diamonds from the local market and exports polished diamonds as well as sell the same in the local market. The assessee buys various qualities of rough diamonds depending upon the demand in the international market. The assessee maintains day to day stock register in respect of rough diamonds as well as polished diamonds. The assessee submitted that all purchases and sales pertaining to import and export were subject to strict surveillance of Customs. Quality-wise polished diamond stock was not maintained in view of the different quality of polished diamonds due to factors like weight, cut, clarity, colour, shape and number of pieces. It was submitted that due to peculiarity of diamond trade and the high price of the commodity the sale of diamond activity is a complex affair. When the

diamonds are shown to the customers in packets, it is not necessary that the entire packet will be bought by them. The buyer himself assorts the diamond or through his staff and offers the price with a condition that he will buy only 70% to 80% of the goods shown to him depending upon the orders he has in his hand. When such unsold goods are received back from the prospective buyers, these diamonds are again mixed with other packet containing polished diamonds. This cycle of trade is a perpetual one. Hence it is not only cumbersome but a herculean task to maintain the stock of polished diamonds according to quality. There are more than 2500 exporters in the diamond trade and none of them maintains the stock register of polished diamonds quality wise was the contention of the assessee before the learned CIT(A). It was submitted that for the assessment year 2007-08 no such additions have been made by the Revenue vide assessment orders farmed u/s 143(3) of the Act, although the same practice of maintaining the stock registers was followed. The addition has been made mainly in the instant assessment year due to fall in the gross profit and that the valuation of opening stock, valuation of manufactured stock and valuation of closing stock was not open to verification and hence the book results of the assessee was rejected and the reasons given for fall in GP were also not acceptable to the A.O. . The assessee submitted that the Tribunal considered the submissions of the assessee on these issues and the appeal filed by the department was dismissed for the assessment year 2003-04. The A.O. alleged that the average yield has come down from 43.32% to 41.6%. It was submitted by the assessee that the assessee deals in different variety of rough diamonds each year. There are about 350 qualities of rough diamonds and it is not necessary that the assessee manufactures the same quality of rough diamonds as done in the previous year, hence, the comparison of yield is irrelevant. It was submitted that in the assessment year 2007-08 the turnover comprised of the entire exports , while in the assessment year 2008-09 out of Rs. 81.60 crore turnover the assessee had exported polished diamonds worth Rs 47.35 crores and had made local sales of Rs 33.46 crores. It was submitted by the assessee that there was recession in the international market like USA, Japan, Europe etc. due to bankruptcies of leading bank and mutual fund in USA and it is a common knowledge that the margin of profit is always better in the export market than in the local market. This was also prime reason for fall in G.P. ratio. The assessee submitted that the A.O. in his order mentioned that in the case of M/s. Riken & Co., the GP rate was 8.08% which is higher than shown by the assessee. The A.O. has ignored the turnover of this company which is Rs. 10 crores and hence the said case is not comparable. It was submitted that the assessee had done manufacturing activity for the first time at its factory at Dahisar and had paid wages to its own workers of Rs.36,66,550/-. Xerox copy of the wage register of the entire previous year in this regard was also filed. It was submitted that the partners of the assessee firm had no experience of running the factory and the workers were taking them for a ride. There were go slow practice on the part of the workers which hampered the production as well. The workers were continuously demanding higher wages, bonus, leave pay, etc. which the assessee firm was not willing to give and ultimately at the end of the year, it was difficult to continuing the manufacturing activity with the help of their own labour and hence they discontinued the production in their factory and from the assessment year 2009-10 onwards , the assessee got the manufacturing done through outside job work parties. With respect to the increase in the percentage of labour as compared to last year, the assessee submitted that there were 350 qualities of rough diamonds of different rates and in the preceding assessment year 2007-08 the assessee had bought rough diamonds of high value and high quality of average price Rs.25,537/- per carat whereas in the assessment year 2008-09, the assessee bought rough diamonds, the average price was Rs.17,165/- per carat. The average sale price in the assessment year 2007-08 was Rs.68,241/- per carat whereas the average sale price in the assessment year 2008-09 was Rs.47,415/- per carat and hence the yield of finished product due to inferior quality of rough diamond manufacturing has gone down from 43.32% to 41.60%. The labour charges in the assessment year 2008-09 was very high as the rough diamonds which they had purchased were involved in multi-cleaving process due to inferior quality of rough diamonds. The assessee had engaged more labour for cleaving of rough diamonds due to which the labour charges were high. It was also submitted that due to multi- cleaving process, the yield of the rough diamond had also gone down. The assessee had made each and every payment of labour charges and wages by account payee cheques only.

The ld. CIT(A) considered the submissions of the assessee and observed that there was a slight fall in GP ratio in the assessment years 2006-07 to 2008-09 which is evident from the following table:-

A.Y.	Sales (In Rs.)	Gross Profit(in Rs)	G.P. %
2008-09	81,60,68,947/-	5,65,87,574/-	6.93
2007-08	65,91,11,112/-	5,13,28,051/-	7.79
2006-07	38,31,22,862/-	3,09,81,525/-	8.09

It was observed that the turnover of the assessee firm had gone up about 25% during the year and hence there was slight fall in gross profit margin ratio. The ld. CIT(A) observed that due to the peculiarity of diamond trade, the stocks are always assorted and re-assorted depending upon the requirement from time to time, therefore, it was not possible to maintain the stock registers with respect to quality of stocks and it is a trade practice followed in this industry. The ld. CIT(A) observed that what is to be looked into is whether the assessee has been following a consistent method of valuation of stocks and whether such method is scientific and it is possible to verify the results by examining the details in the light of the method followed by the assessee. It was observed that the rough diamonds purchased during the year have been put to manufacture and the closing stock is nil. As regards the polished diamonds manufactured during the year, the assessee submitted that the value is arrived by considering the ‘cost + labour’ involved therein and the closing stock thereof is valued at cost or realizable value whichever is lower. The AO has not pointed out any defect in respect of cost incurred by the assessee in this regard. With regard to the realizable value, the assessee has explained the reasonableness of the same having regard to the value of exports made in the subsequent year out of the closing stock held by him as on 31st March, 2008. Thus, the contention of the A.O. that the valuation of opening stock, manufactured stock and closing stock is not open to verification does not appear to be correct was the observation of learned CIT(A). It was also observed by the learned CIT(A) that the assessee entered into local market for the first time unlike the earlier years in which he was exclusively engaged in exports. Due to recession in the export markets, the assessee has to change his strategy that he has not only entered into local market, but also into the low value products. Thus, the assessee involved in achieving higher turnover with a lower margin of profit and this resulted in a slight fall in the GP compared to the earlier years but an increase in the net profit rate due to saving on the administrative costs etc. . The assessee duly explained the inferior quality/low value rough diamonds used in the manufacturing but the A.O. has not considered the aforesaid information arriving at correctness or otherwise of the reasons for fall in GP during the year. The A.O. has not pointed out any defect in respect of the purchases and sales of diamonds nor brought any instance on record to show that the assessee has indulged in sales outside the books of account. Though the books of accounts are rejected, the A.O. has no reason to estimate the sales at a figure higher than the reported sales which were audited. Thus, the ld. CIT(A) rejected the A.O.’s action in estimating higher sales vide appellate orders dated 16.12.2011.

With regard to the fall in G.P. rate, the ld. CIT(A) observed that the labour cost incurred by the assessee in manufacturing of polished diamonds have tremendously increased during the year. The assessee was involved in purchase and sale of polished diamonds during the assessment years 2008-09 to 2011-12 unlike in the earlier years where the entire sales were out of polished diamonds manufactured by the assessee. The local purchases and the corresponding local sales do not involve any labour cost in respect of manufacturing, hence, the assessee's explanation as to labour charges ratio to turnover is misleading and not reliable. Again it was observed that the assessee's submission that the inferior quality rough diamonds involve multi cleaving process resulting in higher labour cost is entirely not correct. It was also observed that from the invoices for labour charges for job work placed on record, the same were charged per carat of rough diamonds worked upon uniformly @ Rs.500/- per carat irrespective of the quality of the rough diamonds involved. As compared to the labour charges paid at Rs.108/- per carat for production through job work during the earlier year, the charges were at Rs.500/-- per carat during the year under consideration. As against this, the wages paid in the assessee's own factory during the year works out to Rs.172/- per carat of rough diamonds i.e. Rs. 36,66,550/- / 21310 carats of rough diamonds consumed. The ld. CIT(A) observed that there was no uniformity in respect of labour charges incurred for the own production vis-a-vis job work. Similarly there was also no proper explanation for abnormal increase in per carat rate of job work charges paid during the year compared to the earlier year. The assessee's contention that he has worked upon inferior quality of rough diamonds may explain part of the increase in the labour charges incurred during the year but it may not be a complete explanation by itself. Thus, it was observed that there is no verifiable information as to the quality of the rough diamonds that was worked upon through job workers and hence, the fall in the gross profit rate is not fully explained. The ld. CIT(A) accordingly estimated the GP at 7% instead of 6.93%

reported by the assessee on the turnover shown in the books and addition of Rs. 5,37,250/- was upheld vide appellate order dated 16/12/2011 passed by learned CIT(A).

6. Aggrieved by the appellate order dated 16/12/2011 passed by the ld. CIT(A), the assessee is in appeal before the Tribunal.

7. The ld. Counsel for the assessee submitted that the assessee had a GP ratio of 6.93% during the assessment year 2008-09 as against 7.79% in the preceding year. The ld. Counsel submitted that books of account were rejected by the A.O. on the ground that closing stock is not verifiable due to details of received manufactured polished diamonds are not evident and the closing stock is not verifiable as to color, size etc.. The ld. CIT(A) estimated the GP ratio at 7% instead of 6.93% declared by the assessee and upheld the same which led to the addition of Rs. 5,37,250/- as against the addition of Rs. 83,43,116/- made by the A.O. by applying the GP ratio at 7.79%. It was submitted that learned CIT(A) arrived at finding that it is not possible to arrange closing stock as per color , size etc due to trade practice. The ld. Counsel submitted that the labour expenses are very high as compared to the last year due to own labour deployed whereby lot of added benefits such as PF/ESIC etc are to be given. The assessee has set up factory where there was a labour problem also which led to higher wages. The ld. Counsel drew our attention to the order of the ld. CIT(A) and submitted that the ld. CIT(A) came to the conclusion that the labour charges paid at a higher rate i.e. Rs. 500/- per carat during the year under consideration whereas the assessee had paid Rs. 108/- per carat in the earlier years. The ld. Counsel submitted that the labour bills are placed at paper book page 28 to 56 and these payments are made to job workers and due TDS is deducted and prayed that the additions sustained by learned CIT(A) be deleted.

8. The ld. D.R. submitted that the ld. CIT(A) has also upheld the rejection of books of account and GP ratio estimated at the rate of 7% against which the Revenue is not in appeal with respect to the relief granted to the assessee.

9. We have considered the rival contentions and also perused the material placed on record. We have observed that the assessee is engaged in the business of diamonds whereby the assessee is purchasing rough diamonds which is being cut and polished. The assessee was earlier engaged in the business of diamonds export whereby the entire cut and polished diamonds were exported. In the impugned assessment year, the assessee has also entered into manufacturing by setting up his own factory whereby the assessee is also engaged in dealing by selling in local market. Due to the setting up of its own factory, higher wages including labour welfare costs such as PF/ESI etc is stated to have been paid to the workers and ultimately it is stated that assessee closed the factory in the subsequent year as the assessee is not able to run the factory due to labour problem. It is also observed that the assessee has paid substantially higher rate of job work charges i.e. @ Rs. 500/- peer carat as against the rate of Rs. 108/- per carat in the preceding year. The invoices are placed in paper book filed with the Tribunal at page 28-56. We have observed that the assessee is not able to justify the substantial rise in the payment of job work charges to the workers i.e. @ Rs. 500/- per carat as against Rs. 108/- per carat in preceding year. The labour charges have substantially gone up as compared to the preceding year which is almost 400% without any justification . It was observed that TDS has been deducted but the assessee has to explain the abnormal rise in the job work charges per carat with cogent reasons. No cogent explanation has been brought on record by the assessee to substantiate this substantial rise in the job work charges. It is stated before us by the ld DR. that the Revenue is not in appeal against the order of the ld. CIT(A) which order of ld. CIT(A) has been accepted by the Revenue. In our considered view, the ld.

CIT(A) has taken the GP ratio @ 7% as against 6.93% which in our considered view is quite justified and fair keeping in view factual matrix of the case. We do not find any infirmity in the order of the ld. CIT(A). The A.O. adopted the GP rate @ 7.79% whereas the assessee has declared GP rate @ 6.93%. The ld. CIT(A) estimated the GP rate @ 7% keeping in view the peculiar facts and circumstances of the assessee's case. In our considered view, the view taken by the ld. CIT(A) is quite reasonable and fair considering the peculiar facts and circumstances of the case. We, thus uphold / sustain the order of the ld. CIT(A) in which we do not find any infirmity. We order accordingly.

10. In the result, appeal filed by the assessee firm in ITA No. 1207/Mum/2012 for the assessment year 2008-09 is dismissed.

Order pronounced in the open court on 7th September, 2016.
आदेश की घोषणा खुले न्यायालय में दिनांकः 07-09-2016 को की गई ।

Sd/-	sd/-
(MAHAVIR SINGH)	(RAMIT KOCHAR)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated 07-09-2016

व.नि.स./ *R.K.*, Ex. Sr. PS

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to</u> :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)- concerned, Mumbai
4. आयकर आयुक्त / CIT- Concerned, Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai "A" Bench
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai