

Cit Vs. Shatrunjay Diamonds

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Court : Mumbai

Decided On : Jan-29-2003

Reported in : [2003]128TAXMAN759(Bom)

Appeal No. : IT Appeal No. 142 of 2001 29 January 2003

Appellant : Cit

Respondent : Shatrunjay Diamonds

Advocate for Pet/Ap. : R.V. Desai, P.S. Jetley, K.R. Chaudhari and K.B. Rao, *for the Revenue* S.J. Mehta and Ms. A. Vissanjee, *for the Assessee*

Judgement :

J.P. Devadhar, J.

The revenue has filed this tax appeal under section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') against the order passed by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') dated 28-9-2000 stating therein that the following substantial question of law arises out of the order of the Tribunal :

'Whether on the facts and in the circumstances of the case, the Honble Income Tax Appellate Tribunal was justified in law in deleting the addition of Rs. 12,50,000 made by the assessing officer under section 40(A)(2)(b) of the Act, 1961 ?'

2. The assessment relevant for the purpose herein is assessment year 1988-89.
3. The assessee is engaged in the diamond business and for that purpose it imports rough diamonds and after cutting and polishing exports the same.
4. In the assessment year in question, the assessee had imported rough diamonds from M/s. Paras Gems, New York, which is a substantially interested concern within the meaning of section 40A(2)(b) of the Income Tax Act. The assessing officer compared the price of the rough diamond imported by the assessee with the price of rough diamond imported by the assessee from other concerns and came to the conclusion that the assessee had paid excess price to the extent of Rs. 12,50,000 to M/s. Paras Gems. The assessing officer held that there is no correlation between the purchase price of rough diamonds with that of the sale price of cut and polished diamonds and in the absence of any further enquiry possible the assessing officer made disallowance to the extent of Rs. 12,50,000 under section 40A(2)(b) of the Act.
5. On appeal the Commissioner (Appeals) following decision in the case of the assessee for the assessment year 1987-88 allowed the appeal and deleted the disallowance. The revenue filed appeal against said order of Commissioner (Appeals) before the Tribunal and the Tribunal following its decision in the case of the assessee for the assessment year 1987-88 confirmed the order passed by the Commissioner (Appeals). Hence this appeal at the instance of the revenue.
6. Mr. R.V. Desai, learned senior counsel appearing on behalf of the revenue submitted that once the parties were falling within the categories specified in section 40A(2)(b) of the Act then the assessing officer was justified in making disallowance to the extent the price paid found to be excessive or unreasonable. Mr. Desai submitted that against the decision of the Tribunal in the case of the assessee for assessment year 1987-88 the revenue has filed tax appeal under section 260A of the Act and the same is pending.
7. Mr. Mehta, learned counsel appearing on behalf of the assessee on the other hand, submitted that all the necessary documents pertaining to the purchase of rough diamonds from M/s. Paras Gems were placed before the assessing officer.

He submitted that there are 7,000 different varieties of diamonds and there can be no generalisation or averaging of rate with respect to the different varieties of diamonds. Mr. Mehta brought to our notice the order of the Tribunal in the case of the assessee for the assessment year 1987-88. Referring to the order of Commissioner (Appeals), quoted in the said order of the Tribunal, Mr. Mehta submitted that all imports and exports were subject to checking at both the ends and no cargo is cleared, unless the value shown in the invoices is in conformity with the international price. For the assessment year 1987-88, the Commissioner (Appeals) had deleted the disallowance on the ground that department does not have any superior expertise for valuation of the precious stones, and, therefore, the assessing officer should accept the price and cleared across the border. In its order for assessment year 1987-88, the Tribunal referred to its decision in the case of Sameer Diamonds and held that in view of there being thousands of varieties of diamonds, it cannot be assumed that what the assessee imported on a given date was the same quality as the imports of a sister concern or a relative and, therefore, difference in the rate cannot be treated as over-invoicing of the imports.

8. Mr. Mehta further submitted that the imported diamonds are ordinarily not available at the time of assessment because immediately on importation, the rough diamonds are cut and polished and thereafter exported. Therefore, all the documents pertaining to the imports whichever were available with the assessee have been furnished by the assessee and even certificate from the approved valuer have been furnished to establish that there is no over-invoicing. Accordingly, Mr. Mehta submitted that the additions of Rs. 12,50,000 under section 40A(2)(b) was unjustified and the Tribunal has rightly deleted the disallowance.

9. The undisputed facts are that the assessee and M/s. Paras Gems from whom the assessee has imported rough diamonds, fall within the category specified under section 40A(2)(b). Therefore, if the expenses incurred on purchase of rough diamonds from M/s. Paras Gems is found by the assessing officer to be excessive or unreasonable, then the burden is on the assessee to establish that the price is not excessive and that there is no over-invoicing. In the present case, the

assessee had furnished a summary chart of purchases in respect of rough diamonds showing the price at which such diamonds have been purchased from different parties : The assessee had also furnished group-wise summary of the cut and polished diamonds exported by the assessee. It appears that the assessee had furnished certificates of several parties, but no evidence was led in the matter to prove the veracity of those certificates. Since correlation between imported rough diamonds and exported polished diamonds could not be established and no further enquiry was possible on account of the assessee not maintaining lot-wise chart showing the quantity; quality and cost either in respect of purchases or sales of the finished products, the assessing officer brought the differential amount to tax. The Commissioner (Appeals) as well as the Tribunal deleted the disallowance merely following their earlier decisions without going into the question as to whether the assessee had discharged its burden to establish that the price paid by it was not excessive.

10. It is admitted fact that the assessee has not filed before the assessing officer any affidavit making statement on oath to establish that the price paid by it to M/s. Paras Gems was fair market value and that there is no over-invoicing. It is also an admitted fact that no evidence was led by the assessee to establish that the price paid by it to M/s. Paras Gems were as per the prevailing international market price. Even Commissioner (Appeals) as well as Tribunal have not gone into this aspect and by merely relying upon their decisions in the case of the assessee in the earlier years have deleted the disallowance. In our opinion, once the imports are made by the assessee from the persons falling under the category under section 40A(2)(b), then the burden is upon the assessee to establish that the price paid by it is not excessive or unreasonable.

11. It is important to bear in mind that certain trade practices prevalent in the Diamond Industry are within the knowledge of the assessee. The purpose behind the legislature enacting section 40A(2)(b) was to provide for shifting of burden on the assessee in cases where the transactions are not at arms length. In this case, M/s. Paras Gems is a sister concern of the assessee, which is not in dispute. It is located in Belgium. The purchases are made by the assessee from its sister concern. In such cases, the intricacies of the transactions are required to be

explained by the assessee. The decision of the Tribunal in this case and the decision of the Tribunal in the case of the very assessee in the last year prior to the assessment year in question are all on the department. It is for this reason that an important question of law arises in this case which is mentioned hereinbelow. In our opinion, the burden of proof shifts on to the assessee in cases falling under section 40A(2)(b) and in such cases it is the duty of the assessee to prove and discharge its burden by leading proper evidencing subject to cross-examination by the department. Now, in this case, the average cost of purchase of rough diamonds by the assessee from M/s. Paras Gems is Rs. 1,223.98 whereas, the average cost of purchase of rough diamonds from M/s. Aarohi Diamonds is Rs. 1,123.90. This difference has got to be explained by the assessee by appropriate evidence subject to cross-examination by the department. This is particularly important because the transaction is not at arms length. In the circumstances, we have reframed the question as follows :

'Whether in the facts and circumstances of the case, the assessee who had imported the rough diamonds from a concern falling under section 40A(2)(b) of the Income Tax Act, had discharged its burden by adducing cogent evidence and establish that the price of rough diamonds paid by it to M/s. Paras Gems was not excessive or unreasonable ?'

12. Since all authorities below have not gone into this aspect of the matter, we think it necessary, in the interest of justice, to set aside all the orders passed by the authorities below and remit the matter back to the assessing officer, to decide afresh the question of disallowance under section 40A(2)(b) of the Act.

13. In this view of the matter, we direct :

(i) the assessee to file before assessing officer, within six weeks from today, an affidavit making statement on oath and annexing additional documents/statements to established that the price paid by it to M/s. Paras Gems is not excessive or unreasonable.

(ii) if the assessing officer is not satisfied by such affidavit and documents/statements adduced by the assessee, the assessing officer will call

upon the assessee to lead oral evidence of these witnesses to establish its case. It will be open to the assessing officer to cross examine such witnesses, if he deems fit.

(iii) Similarly, if the assessing officer wants to rely on any documents, he shall furnish copies thereof to the assessee and permit the assessee to cross examine the author of that document, if the assessee so desires.

(iv) On conclusion of recording the evidence, the assessing officer shall furnish copies of the evidence to the assessee and thereafter hear the matter on merits in accordance with the principles of natural justice and pass appropriate assessment order on merits, in so far as it pertains to making disallowance under section 40A(2)(b) of the Income Tax Act.

14. We, accordingly, set aside the order of the Tribunal as well as the order passed by the Commissioner (Appeals) and the original assessment order and restore the matter to the file of the assessing officer with direction to pass appropriate assessment order pertaining to disallowance under section 40A(2)(b) of the Act, in accordance with law by following the guidelines set out hereinabove.

15. Appeal is disposed of in above terms, with no order as to costs.