

Are Jewellers paying income tax by selling gold jewellery already kept in their shops?

Executive Summary: -

As we all know that gold prices are increasing very fast. Talking about the rate of 24 carat gold in August 2023, it is Rs 6050 per gram. Whereas in August 2024, the rate of 24 carat gold is Rs 7050. Due to increase in gold prices, jewellers have to pay income tax by selling the jewellery already kept in their shops. This has become a cause of concern for jewellers these days. The situation is discussed in this article in detailed.

Let's consider one example to understand the situation faced by jewellers: -

A person opens a new jewellery shop in the month of **August, 2023** and buys 20kg of gold at the rate of Rs. 6050 per gram. This was the initial investment that the jeweller made in the business.

Suppose, In the month of **August 2024**, the jewellers sold 8 kg of gold at the rate of Rs. 7050 (prevailing rate in the market) + Rs. 700 adding their profit margin per gram. With this transaction the quantity of gold reduces from 20 kg to 12 kg. Because every jeweller wants to keep maximum quantity of gold in the shop, so that customers can get jewellery designs as per their choice. And that is why jeweller buy 8 kg jewellery from the market at the rate of Rs 7050 per gram (the prevailing rate in the market at that time).

Apart from the above, let us assume that the jewelers incurred expenses of running the business-like employee salaries, electricity bill, advertisements etc amount to Rs. 50 lakhs.

Now, if we check the fund available from the jewelers after the above transaction then the figures of funds available are as follows -

PARTICULARS	AMOUNT
Realized from Sales (8000 gms @ 7750 per gram)	6,20,00,000
(-) Paid at the time of new jewellery purchase, i.e. (8000 gms @ 7050 per gram)	-5,64,00,000
(-) Expenses Incurred	-50,00,000
Fund Available	6,00,000

Now, we calculate the income tax liability of the jeweler from the above transactions and assume the tax percentage is 30%: -

As all accounting or tax professionals know, to calculate income tax we first need to find the jeweller's net profit. To calculate net profit, we will need the following data, namely -

- (a) Sales
- (b) Closing Stock
- (c) Opening Stock
- (d) Purchases
- (e) Direct and Indirect Expenses

Accordingly, if we have all the figures mentioned above, the Net Profit of the jewelers will be as follows: -

$$= \text{Sales (+) Closing Stock (-) Opening Stock (-) Purchases (-) Direct and Indirect Expenses}$$

In the given example, we have all the data readily available except the closing stock data. The closing stock figure is calculated as per the valuation methods provided by the accounting system of India. As all accounting or tax professionals know, there are three methods of stock valuation available. Which are as follows: -

1. First-In, First-Out (FIFO)

The First-In, First-Out (FIFO) method is an inventory management technique that assumes the oldest inventory items are sold or used first.

2. Last-In, First-Out (LIFO)

Last-In, First-Out (LIFO) is an accounting method that assumes the most recently acquired or produced items are sold first.

3. Weighted Average Cost (or Avg Cost)

Weighted average cost (WAC) is an accounting method that assigns a cost to inventory items by dividing the total cost of goods by the total number of items. It's also known as the average cost method.

The **Last-In, First-Out (LIFO) valuation method** is not compatible with the guidelines of International Financial Reporting Standards. **Therefore, it is not an accepted method under the taxation rules of many countries worldwide, including India.** And accordingly, jewelers are bound to use the FIFO method or weighted average method for the purpose of final stock valuation.

I. Now, we are going to calculate the tax liability first by applying the FIFO method of stock valuation: -

(a) Sales = 8 kg sold at 7750/- per gram = 6,20,00,000/-

(b) Closing Stock (As per FIFO Method):

Out of 20 kg stock available; first 12 kg of stock assumes available from oldest purchase and the remaining 8 kg was from the fresh purchase made in August, 2024 month. And accordingly –

= 12 kg (*) 6050 (+) 8 kg (*) 7050

= 7,26,00,000 (+) 5,64,00,000

= 12,90,00,000/-

(c) Opening Stock = 20 kg buys at 6050/- per gram = 12,10,00,000/-

(d) Purchase = 8 kg buys at 7050/- in August, 2024 = 5,64,00,000/-

(e) Direct and Indirect Expenses = 50,00,000/-

Net Profit equals: -

= Sales (+) Closing Stock (-) Opening Stock (-) Purchases (-) Direct and Indirect Expenses

= 6,20,00,000 (+) 12,90,00,000 (-) 12,10,00,000 (-) 5,64,00,000 (-) 50,00,000

= 86,00,000/-

Income Tax payable @ 30% of Net profit are as follows: -

= 86,00,000 * 30%

= 25,80,000/-

Now, if we summarize the entire situation above, what we get is this: -

1. Jewelers are keeping the same weight of gold in their inventory i.e. 20 Kg as they had at the time of opening the store, there has been no increase in the weight of gold for jewelers.
2. Funds Available with the jewelers is Rs. 6 lacs.
3. On adopting FIFO method of stock valuation, Jewelers will have to pay Rs. 25.80 lakh of income tax.

From the above, it is very clear that the jeweler cannot pay the tax figures from the available funds. To pay the tax, the only option left for jewelers is to pay the tax by selling their gold stock. If they do so, it will adversely affect the growth of the business.

II. Let us know what the tax figures would be if jewelers apply the weighted average cost method for valuing closing stock.

(a) Sales = 8 kg sold at 7750/- per gram = 6,20,00,000/-

(b) Closing Stock (As per Weighted Average Cost Method):

Weighted average buying rate per gram: -

= Total purchase value in rupees / Total Purchase Weight

= (20 kg purchase at Rs. 6050 per gram) + (8 kg purchase at Rs. 7050 per gram)

divided by 28 kg

= (12,10,00,000 + 5,64,00,000) / 28000 gms

= 17,74,00,000 / 28000 gms

= 6335.71 per gram

Accordingly, closing stock value as per weighted average cost will be as under: -

= 20,000 gms (say 20kg) * 6335.71

= 12,67,14,200/-

(c) Opening Stock = 20 kg buys at 6050/- per gram = 12,10,00,000/-

(d) Purchase = 8 kg buys at 7050/- in August, 2024 = 5,64,00,000/-

(e) Direct and Indirect Expenses = 50,00,000/-

Net Profit equals: -

= Sales (+) Closing Stock (-) Opening Stock (-) Purchases (-) Direct and Indirect Expenses

= 6,20,00,000 (+) 12,67,14,200 (-) 12,10,00,000 (-) 5,64,00,000 (-) 50,00,000

= 63,14,200/-

Income Tax payable @ 30% of Net profit are as follows: -

= 63,14,200 * 30%

= 18,94,260/-

If the weighted average method is applied then this method also becomes a cause of concern for the jeweler as the tax liability for the jeweler again exceeds the funds available with the Jeweler. Here too, jewelers had to sell their own weight of gold to pay the tax liability.

III. Let us know what the tax figures would be if jewelers apply the Last-In, First-Out (LIFO) method for valuing closing stock.

(a) Sales = 8 kg sold at 7750/- per gram = 6,20,00,000/-

(b) Closing Stock (As per LIFO Method):

All 20 kg stock available assumes available from oldest purchase. And accordingly –
= 20 kg (*) 6050 per gram
= 7,26,00,000 (+) 5,64,00,000
= 12,10,00,000/-

(c) Opening Stock = 20 kg buys at 6050/- per gram = 12,10,00,000/-

(d) Purchase = 8 kg buys at 7050/- in August, 2024 = 5,64,00,000/-

(e) Direct and Indirect Expenses = 50,00,000/-

Net Profit equals: -

= Sales (+) Closing Stock (-) Opening Stock (-) Purchases (-) Direct and Indirect Expenses
= 6,20,00,000 (+) 12,10,00,000 (-) 12,10,00,000 (-) 5,64,00,000 (-) 50,00,000
= 6,00,000/-

Income Tax payable @ 30% of Net profit are as follows: -

= 6,00,000 * 30%
= 1,80,000/-

From the above, it is concluded that LIFO method is absolutely suitable for jewelers and it brings stability to the jeweler's business in paying their income tax liability.

It is quite natural that jewellery being a fashion industry, the old stocks would most of the times remain with the jewelers and one cannot expect the old stocks will be sold out first, although it will remain in the wish list of the Jewellers. **One case law dealt with by the Hon'ble Income Tax Appellate Tribunal (ITAT) in this regard are given below: -**

ITAT Kolkata Bench in case of M/s Roopshree Jewellers (P) Ltd Vs ITO (ITAT Kolkata) I.T.A No. 442/Kol/2015

We find that the assessee had duly reflected in the audited financial statements under Significant Accounting Policies with regard to inventory valuation as under: -

- Gold: At cost including making charges under LIFO method
- Diamond: At cost or net realizable value whichever is lower under LIFO method
- Pearl & Emerald: At cost under LIFO method

We find that the said accounting policy is part and parcel of the audited financial statements which has been approved by the shareholders in the general body meeting. It is not in dispute that the assessee had been following LIFO method **regularly for valuation of closing stock since its inception**. It is not in dispute that the LIFO method adopted by the assessee had been accepted by the revenue in the past. It is not in dispute that the LIFO method is also one of the recognized methods for valuation of closing stock.

The Id AO (Assessing Officer) had observed that as per AS-2 issued by ICAI, the assessee is not permitted to adopt LIFO method for valuation of closing stock. However, Id CIT(A) had deleted the addition on the ground that the assessee company had been regularly employing LIFO method for the purpose of valuation of its stocks since its inception and there is no deviation of the same during the year and the said method had been accepted by the revenue in the earlier years

The Id AR (Assessee representative) pleaded before us that the LIFO method is also recognized in AS-2 and in this regard, he placed reliance on the decision of Pune Tribunal in the case of **“Sandvik Asia vs DCIT”** reported in 69 ITD 59.

ITAT Kolkata Bench in this case held that, It is quite natural that jewellery being a fashion industry, the old stocks would most of the times remain with the assessee and the revenue cannot expect the old stocks to be sold out first though it would remain in the wish list of the jeweler. We find that the aforesaid valuation (LIFO Method) exactly fits into the accepted method of valuation for a jeweler as approved in the case of Cochin Tribunal supra. In any event, we hold that no addition could be made towards value of stock because the closing stock cannot be construed as a source of profit for the assessee. We place reliance on the decision of the **Hon'ble Supreme Court** in the case of Chainrup Sampat Ram vs CIT reported in 24 ITR 481 (SC) in support of this proposition.

Similar decision was rendered by this tribunal in the very same case for the Asst Year 2011-12 in **ITA No. 202/Kol/2015 dated 4.10.2016**. The facts of that case and decision rendered thereon are squarely applicable to the facts of the instant case. Hence respectfully following the said decision of this tribunal, we hold that the ld CIT(A) had rightly deleted the addition made by the AO and hence no interference is warranted in the same.

Conclusion: -

If there is an increase in the rate of gold from last year to this year and in this situation FIFO method or weighted average method if adopted for stock valuation then the jeweler will have to pay tax by selling his inventory kept in the shop. And if he changes the method from FIFO or weighted average to LIFO method, the judiciary system may be against it.

If one has been regularly using LIFO method for the purpose of valuation of its stocks since its inception and there has been no deviation in it during the year, then the above-mentioned case law completely covers the situation and the taxpayer is in favor.
