

OFFICE OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

NEW DELHI

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**PERFORMANCE AUDIT ON ASSESSMENT OF ASSESSEES OF GEMS AND JEWELLERY SECTOR
TABLED**

The Comptroller & Auditor General of India (C&AG) carried out a Performance Audit (PA) on 'Assessment of Assesseees of Gems and Jewellery Sector' Audit Report No. 06 of 2022 on Direct Taxes. The PA was carried out from June 2020 to October 2020. Additional cases relating to audit sample were also examined during April 2021 to October 2021, wherever it was necessary to do so, and findings were discussed with the Central Board of Direct Taxes (CBDT) in January 2022. The Report was laid on the floor of the Parliament here today.

Introduction

The Gems and Jewellery sector is one of the fastest growing sectors and it is extremely export oriented and labour intensive. Today, India is the largest consumer of gold as well as the largest player in diamond cutting and polishing. The industry has a primary position in economic activities and has tremendous potential for growth. Given the high value of the transactions and foreign exchange involvement due to large amount of diamond and gold imports, the Gems and Jewellery sector is susceptible to misuse and money laundering. The Customs Receipt Audit unit of the Comptroller and Auditor General of India (Indirect Taxes- Customs C&AG Audit Report No.6 of 2016) as well as the Directorate of Revenue Intelligence had pointed out irregularities including large scale round tripping of gold Jewellery and exports of machine made crude to artificially increase the turnover to take status certificate and to enhance credit limits/financing from banks. In view of the issues flagged in the Audit Report as mentioned above and the various irregularities reported from time to time in respect of Gems and Jewellery sector, this Performance Audit (PA) on the 'Assessment of assesseees in Gems and Jewellery Sector' was taken up for examination from the perspective of the assessment of direct taxes.

The objectives for this Performance Audit were to examine the adequacy of rules, regulations, notifications, circulars, etc. issued from time to time in relation to assesseees of Gems and Jewellery sector and to check loopholes/ ambiguity in the existing law and procedure, to assess the efficiency and effectiveness of the Assessing Officers (AOs) in ensuring compliance with the provisions of the Income Tax Act/Rules in relation to Gems and Jewellery sector and to ascertain whether the systems, internal controls, processes and monitoring and

coordination mechanism within the Department and with external Departments are sufficient and robust to ensure effective assessment of assessee of Gems and Jewellery sector.

The Performance Audit covered the assessments completed during the financial years 2015-16 to 2018-19.

Summary of audit findings is given below:

- Audit noticed irregular trends in growth of quantity and value of imports and exports of rough diamonds during 2010 to 2020 that require examination at the detailed granular level of imports and exports.

[para 2.2.2]

- Analysis of import and export figures of pearls revealed that though there was not much variation in export of pearl during FY 2012-13 to FY 2017-18 [except FYs 2012-13 and 2013-14], there was an abrupt rise in import of pearls during the said period followed by a sudden fall in import from FY 2018-19.
- Audit observed that India's import of pearls during 2013-14 to 2017-18 was 3 to 10 times more than the average annual value of global pearl production. Further, there was manifold increase in the rate at which pearls were imported in the country. The value of imports of pearls in India being much higher than the value of global production of pearls is indicative of trade mis-invoicing and round-tripping of funds which have been flagged as critical concerns in respect of Gems and Jewellery sector.
- The imports of pearls primarily being made from UAE, Hong Kong and Thailand, whose contribution in global pearl production was negligible.

[para 2.2.4]

- Audit observed in seven out of 84 scrutiny cases that ITD allowed aggregate deductions of ₹115.45 crore under section 10AA against total export turnover of ₹ 5,654.39 crore even though a major part of export proceeds (ranging from 40 *per cent* to 100 *per cent* of the total export turnover) amounting to ₹ 3,878.95 crore was outstanding for more than six months. The potential revenue loss in these cases worked out to be ₹ 28.57 crore. Further, Audit observed that there is no time-limit prescribed in the Income-Tax Act 1961 for timely remittance of export proceeds by SEZ Units for claiming deduction under section 10AA. In the absence of provisions in the Income Tax Act, deductions were being allowed by ITD even in cases where major part of export proceeds was pending realisation.

[para 3.1]

- Audit observed from sampled cases checked in audit that the assessments were completed based on disclosures in the Tax Audit Reports and submission made by the assessee. In the absence of proof of detailed examination of valuation details in the assessment records, audit could not ascertain as to how the Department satisfied itself

about the correctness of the valuation of inventory disclosed by assesseees in Income Tax Returns and Tax Audit Reports. Also, no Standard Operating Procedure (SOP) or instructions/ guidelines has been prescribed by the CBDT for completion of assessment of assesseees specific to Gems and Jewellery sector.

[para 3.3]

- Audit noted that the existing forms of ITR and TAR do not capture details of exports and imports undertaken during the respective FY by any entity engaged in Gems and Jewellery business. Further, the existing business codes do not enable ITD to identify commodities being traded in Gems and Jewellery sector. Thus, identification of suspicious transactions on account of imports and exports made to the same related parties and linking it to the commodities traded in Gems and Jewellery business would not be possible from the data captured through existing reports and returns

[para 4.1.2.1]

- While examining cases in respect of seven assesseees under 360-degree analysis, Audit observed various irregularities like non-examination of suspicious business activities; unexplained excess output, short accounting of stocks, and non-verification of differences in claims made by assessee as per records of the assessee vis-a-vis the records of the related party in 33 significant issues involving tax effect of ₹ 37,909.38 crore. Such irregularities had the underlying risk of tax evasion that require further probing and detailed examination.

[para 4.2]

- Audit noticed 40 cases in nine States relating to incorrect allowance of business expenditure involving tax effect of ₹188.40 crore.

[para 4.4]

- Audit noticed in 34 cases in 10 States where the AO failed to consider the income under various provisions of the Income Tax Act. Such income includes cessation of liability, computation of income under section 115JB, under reporting of stocks/sales, etc. by the assessee, etc. Total tax effect involved in all these cases worked out to ₹58.86 crore.

[para 4.6.2]

- Audit observed instances where AOs made mistake in computation of tax, surcharge, interest, penalty and refund leading to short levy of tax of ₹112.31 crore in 58 assessment cases in 10 States.
- The errors are indicative of the fact that the ITD systems were deficient or did not possess the required functionality.

[para 4.7]

- Audit observed from the sample cases checked in audit that correctness of business codes filled in by the assesseees in ITRs was not verified during assessment proceedings. Consequently, it is not possible to generate accurate sector specific information.

[para 5.1]

- Audit found 33 assessment cases with sales turnover of ₹ 30,560.46 crore pertaining to 19 assesseees [unique PAN] where ITRs had not been filed in all four AYs. Audit noted that the System was not effectively monitored as timely sharing of information within the Department was also not being ensured for initiating the remedial action against the non-filers by the concerned Assessing Officers.

[para 5.2.1]

- Audit noticed instances of mismatch between data maintained centrally by the DGIT (Systems) vis-à-vis the data as per assessment records in the assessment units. The instances of data mismatch were indicative of systemic issues, deficient handling of data at entry level, and non-updation of assessment data by the field formations of the ITD.

[para 5.3]

- Audit observed that in 346 instances the assesseees had not disclosed the quantitative details of inventory in ITRs and/ or in Tax Audit Reports; in 362 instances, there was mismatch in quantitative details as per the ITR vis-à-vis the disclosures through Tax Audit Report and in 330 cases there were discrepancies in Tax Audit Reports such as, incorrect carry forward of closing stock, mistakes in various disclosures required under the Income Tax Act. The discrepancies were indicative of the fact that the ITD systems was deficient in detecting discrepancies and gaps at ITR processing stage through CPC Bengaluru in such cases. Further, Audit observed from the available records that the Department did not examine these discrepancies. The non-verification of such discrepancies further entailed a risk of income escaping assessment.

[para 5.4]

- Audit observed in 81 scrutiny assessment cases that although there was shortage/excess in stocks as per quantitative details disclosed in ITR/Tax Audit Report, nothing was available in the assessment records to show that the Department made any examination/verification in respect of such discrepancies.

[para 5.6]

- Sharing of information within the Income Tax Department (ITD) was not effectively utilized by the assessment as well as non-assessment units due to lack of co-ordination within the Department, thereby impacting the quality of scrutiny assessments, and possibility of revenue leakage cannot be ruled out.

[para 6.1]

- Audit observed that there was no uniformity or consistency across assessments in additions made towards bogus entries and purchases despite there being similar grounds of additions. Audit noted that there is no guidelines/SOP for disallowances of accommodation entries/ bogus purchases. The additions were made in an arbitrary or discretionary manner and without recording proper justification in the assessment order with an inherent risk of non-sustainability of additions at the appellate stage.

[para 6.1.2.2]

- Audit could not ascertain the extent of co-ordination existing between ITD and other Departments due to non-furnishing of information sought during audit. Audit could not verify whether information was shared with outside agencies to detect discrepancies or irregularities related to transactions relating to entities engaged in Gems and Jewellery business.

[para 6.2]

- Audit noticed issues indicative of weak monitoring mechanism in the ITD with respect to the Gems and Jewellery sector. The areas included unusual trend in exports and imports of commodities of Gems and Jewellery sector, non-verification of correctness of business codes filled in by the assesseees in the ITRs at the filing stage or during assessment proceedings, absence of time limit for bringing export proceeds in India for claiming deduction under section 10AA, non-verification of quantitative disclosures of inventory in ITR and TAR during scrutiny assessment and lack of SOP or instructions/ Guidelines for assessment of assesseees specific to the Gems and Jewellery sector. These areas require stricter monitoring as the Gems and Jewellery sector involves significant risk of money laundering, round tripping, mis-invoicing, and risk of routing of black money in the garb of transactions and claims. Audit noted that these issues escape examination by the ITD in the absence of guidelines/ SoPs and instructions specific to this sector for addressing the risks, also highlighted by the various Government Committees and FATF from time to time.

[para 6.4]

Summary of Recommendations

Audit recommends that:

- *The CBDT may consider specifying a time limit for bringing consideration against export proceeds into India for claiming of deduction under Section 10AA of the Act.*

[para 3.1, 3.5(a)]

- *A Standard Operating Procedure (SOP) and standard guidelines entailing checks to be exercised during scrutiny assessment of Gems and Jewellery cases is imperative for making additions which is sustainable in the Court of law and to also curb the unscrupulous trade practices resorted by diamond traders/ manufacturers.*

[para 3.3, 3.5(d)]

- *The CBDT may consider revising format of Tax Audit Report for incorporating grade-wise details necessary for valuation of diamonds in line with the requirements of diamond industry only in very high value cases with sufficiently high threshold e.g. gross turnover above ₹ 500 crore or ₹ 1000 crore or such other limit to be specified by the CBDT.*

[para 3.3.1, 3.5(e)]

- *The CBDT may examine the adequacy of the current provisions with respect to bogus purchase, inflated invoices etc. as undisclosed income from these do not get covered under the existing provisions.*

[para 3.3.1, 3.5(f)]

- *The CBDT may consider devising detailed Standard Operating Procedure for assessment of entities engaged in Gems and Jewellery business encompassing instructions for risk areas specific to this sector in order to ensure error free assessments. The CBDT may consider applying a combination of risk parameters for identification of cases for limited as well as complete scrutiny under Computer Aided Scrutiny Selection (CASS) in respect of assessees engaged in Gems and Jewellery business on the following lines: Sales turnover exceeding a threshold value of ₹500 crore or ₹ 1000 crore or any other high value deemed fit by the Board, Returned Income less than 0.5 per cent of Sales turnover, non-realisation of foreign exchange proceeds in lieu of exports of items of Gems and Jewellery for more than a year, non-filing of Form 3CEB etc.*

[para 4.1, 4.10(a)]

- *The CBDT may consider capturing of details of exports and imports transactions undertaken with related parties, beyond a certain threshold limit to be specified by the CBDT, by any entity engaged in Gems and Jewellery business for identification of transactions of suspicious nature and prevention of possibility of tax evasion though detailed examination of such cases under scrutiny.*

[para 4.1.2.1, 4.10(b)]

- *The CBDT may ensure mandatory disclosure of PAN details of related parties for transactions beyond a certain threshold limit to be specified by the CBDT through Form 3CD and may also consider validation of PAN of related parties.*

[para 4.2, 4.10(c)]

- *The ITD may consider examining reasons for non-verification of differences in disclosure of stocks as per Profit and Loss Account and TAR specifically in entities with large sales turnover and non-verification of unexplained excess output to prevent possibility of evasion through suppression of sales and introduction of unaccounted raw material.*

[para 4.2, 4.10(d)]

- *ITD systems may accord priority to selection of cases involving differences in disclosures in quantitative details of stocks made through different sources by the same assessee in a particular assessment year for detailed examination under scrutiny assessment.*

[para 4.2, 4.10(e)]

- *Considering the specialized nature of business activity of the assessees of Gems and Jewellery sector and multiplicity of transactions involved in such business, the CBDT may consider undertaking special audit under Section 142(2A) of the assessees and their*

related parties for examining the issues related to improper disclosure of quantitative details of stocks, abnormal yield/wastage, claims as per records of the main assessee vis-à-vis the disclosure in the records of related parties etc.

[para 4.2.8, 4.10(f)]

- *The CBDT may ascertain whether the errors/ irregularities are errors of commission and take necessary action as per law in such cases. ITD may take remedial measures to prevent recurrence of errors and irregularities.*

[para 4.3 to 4.8, 4.10(i)]

- *The CBDT may accord priority to selection of cases involving non-filing of Form 3CEB in respect of international transactions or specified domestic transactions in combination with other risk factors as there may be a possibility of foregoing of filing of Form 3CEB by assessees lead to lower probability of selection of such cases under CASS parameters.*

[para 4.8.2, 4.10(j)]

- *The CBDT may like to issue instructions to all AOs to ensure correctness of the business codes filled in by the assessees of Gems and Jewellery sector. Further, CBDT may also consider the business codes prescribed for Gems and Jewellery sector to be more elaborative to ensure better monitoring, improved vigilance, identification of assessees for detailed scrutiny and timely sharing of relevant information to other stakeholders.*

[para 5.1, 5.11(a)]

- *The ITD should put in place a system to reject incomplete ITRs, wherever the assessee is liable to audit under Section 44AB and does not fill in the quantitative details of stock/purchase /consumption/ sales etc. The system should not accept the ITR and it should prompt the assessee to fill in the details in the prescribed clauses of the ITR. Besides, liability should be fixed on the assessee for quoting incorrect/nil data like business code, closing stock etc. to prevent casual approach adopted by the assessee in disclosure of details at filing stage.*

[para 5.4.4 to 5.4.6, 5.11(c)]

- *The CBDT may consider mandating AOs through SOP to examine the reasons for non-disclosure of stocks and mismatch in stocks in ITR and TAR. Further, where the value of stocks have been shown in ITR and Annual accounts but the quantitative details have not been disclosed, and vice versa, the reasons for the same and their impact on profitability should be ascertained in the assessment to minimise risk of routing of unaccounted stocks by entities of Gems and Jewellery sector and to prevent possibility of tax evasion.*

[para 5.4, 5.11(e)]

- *To restrict round-tripping, the DGFT's Foreign Trade Policy vide Handbook of Procedures prescribes the value-addition and wastage norms for import and exports of certain items of Gems and Jewellery sector. The CBDT may consider selecting cases with significantly high imports and exports with negligible value addition as one of the criteria for detailed*

scrutiny. Similarly, where the yield or wastage is exceptionally low or high vis-à-vis the industry average, the AO should invariably call for the reasons for the same to ensure that the assessee has not been suppressing the profits.

[para 5.7, 5.11(f)]

- *The ITD should evolve a system for timely sharing of information among different units within the ITD to facilitate verification of the purchases, sales, debtors, creditors, unsecured loans and other inputs on related party transactions etc. in the Gems and Jewellery sector in view of risk of tax evasion due to non-sharing/ non-utilisation of information on fake invoices, bogus purchases and accommodation entries.*

[para 6.1.1, 6.6(a)]

- *The CBDT may strengthen the existing mechanism for inter-jurisdictional sharing of inputs including sharing the list of accommodation entry providers in the Gems and Jewellery sector with the Assessing Officers of the counter parties for utilisation during examination of the issue related to accommodation entry, if any, taken by the assessee(s). Further, to ensure consistency and uniformity in basis adopted for additions that are sustainable in the court of law, Board may prescribe guidelines for procedure to be followed for making addition in respect of cases of accommodation entry.*

[para 6.1.2, 6.6(b)]

- *DoR may ensure stricter monitoring mechanism for inter Departmental sharing of information so that the major importers, exporters and domestic sellers could be identified and verified from the taxation point of view to prevent possibility of leakages of tax revenues.*

[para 6.2, 6.6(d)]

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