

Report of the Comptroller and Auditor General of India



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Performance Audit on Assessment of Assessee of Gems and Jewellery Sector

Union Government
Department of Revenue - Direct Taxes
Report No. 6 of 2022

**Report of the
Comptroller and Auditor General of India**

for the year ended March 2021

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Assessment of Assessees of Gems and
Jewellery Sector**

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Preface

This Report for the year ended March 2021 has been prepared for submission to the President under Article 151 of the Constitution of India.

The Report contains significant results of the performance audit of Assessment of Assesseees of Gems and Jewellery Sector completed by the Income Tax Department, Department of Revenue of the Union Government during the financial years 2015-16 to 2018-19.

The instances mentioned in this Report are those, which came to notice in the course of audit conducted 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.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Executive Summary

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. India manufactures over 65 *per cent* of the world's polished diamonds in terms of value, 85 *per cent* in terms of volume and 92 *per cent* in terms of number of pieces. 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.
- 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 assesseees of Gems and Jewellery sector.

The Performance Audit covered the assessments completed during the financial years 2015-16 to 2018-19. The DGIT (Systems) provided aggregate and assessee-wise data on assessments of assesseees engaged in Gems and Jewellery business completed during financial years 2015-16 to 2018-19. The data received from DGIT (Systems) was analysed and extractions made based on audit parameters were segregated area-wise to arrive at a sample. DGIT

(Systems) had provided aggregate data of 1,52,927 cases out of which 3,171 cases were selected for the Performance Audit. Further, 61 additional cases were also selected from the Demand and Collection Registers (D&CR) and the total sample for this audit was 3,232. The audit sample included 74 cases selected on pan-India basis for 360-degree analysis. The sample of 3,232 cases was reduced to 2,593 cases due to constraints and travel restrictions faced by field audit offices across the country in undertaking out-station audits during Covid pandemic [July 2020 to October 2020].

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]

- Country-wise analysis of imports and exports of rough diamonds during the period 2009-10 to 2019-20 revealed that 76 *per cent* of total imports and 80 *per cent* of total exports of rough diamonds were to three countries viz. United Arab Emirates, Belgium and Hong Kong whose contribution in global diamond mining were negligible.

[para 2.2.3]

- 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.
- Enforcement Directorate in its investigation report in respect of the N Group of cases (May 2018) found that 20 entities based in the UAE and Hong Kong controlled by the Group were created in order to facilitate layers and laundering of funds from Punjab National Bank (PNB) to camouflage the real intention and identity of beneficiaries of the funds siphoned off from PNB. The transactions during FY 2012-13 to FY 2017-18

may involve potential over-invoicing on import of pearls with underlying risk of significant amounts of income escaping assessment.

[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]

- Although the Government brought amendment in Section 56(2) by inserting clause (viib) to curb the practice of bringing unaccounted money of promoters / Directors by issuing shares at very high premium, the gate was left open for foreign investors particularly money coming from tax haven countries and where investee company did not have much net worth or business plan to justify the receipt of huge share premium.

[para 3.2.1]

- There is no provision in the Income Tax Act to deal with the share application money pending allotment for long period. The non-verification of share application money pending for allotment for a long period is indicative of risk of routing of black money or illegal money.

[para 3.2.2]

- 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 assessee 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 assessee specific to Gems and Jewellery sector.

[para 3.3]

- Audit noted that the valuation of the diamond depends on four Cs i.e. Cut, Clarity, Colour and Caratage. The Tax Audit Report, however, contains only carat- wise quantitative details of diamonds (rough, rejected & polished),

and does not give grade- wise (Cut, Clarity, Colour & Caratage) details. In absence of grade wise details of diamonds, it was not clear how the Department was satisfying itself that the value of diamonds declared by assessee was correct. The gradations of diamonds or precious gems based on difference in cut, clarity, color and carat makes it extremely difficult to have standard valuation methodology.

[para 3.3.1]

- Valuation of inventory or stock is a relatively less probable parameter for selection of assessment cases of Gems and Jewellery sector under CASS for detailed verification or examination during scrutiny assessment.

[para 3.3.2]

- 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 assessees 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.

- Of 74 cases, in twelve cases records were not furnished due to which the examination of cases selected for 360-degree analysis got constrained.

- Of 173 cases, audit could examine records of 114 related parties only as records pertaining to 59 related parties were not furnished.

- 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]

- Audit could not ascertain the existing mechanism in place within the Department for verification of veracity and genuineness of claims allowed on account of unsecured loans at different stages of examination and finalisation of assessment cases viz. summary processing through CPC and scrutiny assessment through ITD systems in the sample test checked.

[para 5.7]

- 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 examined 178 case records in five states wherein beneficiaries had obtained bogus invoices aggregating to ₹ 2,477.73 crore. Audit observed that, while completing the assessments, the AOs made partial disallowances on account of entries of bogus purchases either based on their own estimation or on the basis of discretion post receipt of information to that effect from the Investigation units. As such, there was no uniformity or consistency across assessments in additions made towards bogus entries and purchases despite there being similar grounds of additions and in some cases, even the assessment charges were also same. The percentage of disallowance varied from 3 to 100 *per cent*. 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. Further, the absence of a focused approach to address the risks specific to this sector gets compounded due to deficiencies in the verification and monitoring mechanism at the field level.

[para 6.4]

Summary of Recommendations

Audit recommends that:

- *The Department of Revenue (DoR) may consider investigating trends in imports and exports of rough diamonds and pearls to assess the impact of overvaluation/ undervaluation from income tax assessment perspective through utilisation of special powers notified under the Black Money Act and the Double Taxation Avoidance Agreements for obtaining information on foreign transactions related to Gems and Jewellery sector not reported or disclosed through ITRs of the entities engaged in the business of Gems and Jewellery.*

[para 2.2.2 to 2.2.4, 2.4(a)]

- *The DoR may consider examining the country-wise trends of exports and imports of rough diamonds to verify the reasons for high value imports of rough diamonds from countries with negligible contribution in global production keeping in view the nominal customs duty levied on import of rough diamond and potential for misuse of this commodity being used by unscrupulous traders as a conduit to launder money.*

[para 2.2.3, 2.4(b)]

- *The DoR may consider examining the genuineness of import of pearls in India in co-ordination with other Government Departments/ Agencies as the abnormal trends during 2013-14 to 2017-18, indicated the possibility of round-tripping and mis-invoicing.*

[para 2.2.4, 2.4(c)]

- *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)]

- *The CBDT may consider to bring the foreign investors within the ambit of Section 56(2)(viib) to eliminate the possibility of tax evasion in form of share application money/ share premium.*

[para 3.2.1, 3.5(b)]

- *The CBDT may like to strengthen the system to address the issue of pending share application money after it is due for refund as per the Companies Act to prevent its misuse and possibility of routing of black money in the form of share application money.*

[para 3.2.2, 3.5(c)]

- 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 discrepancies in disclosures of inventory or stock of items may be accorded priority for selection as well as detailed examination under scrutiny assessments.

[para 3.3.2, 3.5(g)]

- 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 assessee 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 through 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 assesseees 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 assesseees 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 revisit the assessments involving errors and irregularities in computation of income, tax, interest etc. to ascertain the reasons for such errors and put in place a robust system and internal control mechanism to eliminate possibility of such avoidable errors and to ensure compliance to provisions and conditions laid down under the Income Tax Act by the Assessing Officers.*

[para 4.7, 4.10(g)]

- *The reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite clear provisions in the Act may be reviewed by CBDT. The ITD may identify items of expenses and deductions with higher propensity to irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance.*

[para 4.3, 4.4, 4.10(h)]

- *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 business codes prescribed for Gems and Jewellery sector may be more elaborative to include details of entities engaged in major commodities viz. (i) diamond, (ii) gold, (iii) silver, (iv) pearls, (v) a combination of these and (vi) other items of Gems and Jewellery 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(b)]

- *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)]

- *ITD systems may have in built mechanism to match closing stock of preceding year with opening stock of next year for systemic identification of such discrepancies.*

[para 5.4.4 to 5.4.6, 5.11(d)]

- *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)]

- *The ITD should design an online system where an AO who wants to share or seek necessary information can be pushed to the Jurisdictional AO of the persons (with PAN) for verification.*

[para 6.1.3, 6.6(c)]

- *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)]

Chapter-1: Introduction

1.1 Overview

The Gems and Jewellery sector is one of the fastest growing sectors and it is extremely export oriented and labour intensive. The sector employs over 2.5 million workers and contributes about six *per cent* to seven *per cent* of the Gross Domestic Product (GDP) of the country. Today, India is the largest consumer of gold as well as the largest player in diamond cutting and polishing. India manufactures over 65 *per cent* of the world's polished diamonds in terms of value, 85 *per cent* in terms of volume and 92 *per cent* in terms of number of pieces. India is the largest exporter of Gems and Jewellery and the industry plays a vital role in terms of foreign exchange earnings and Government's 'Make in India' initiative.

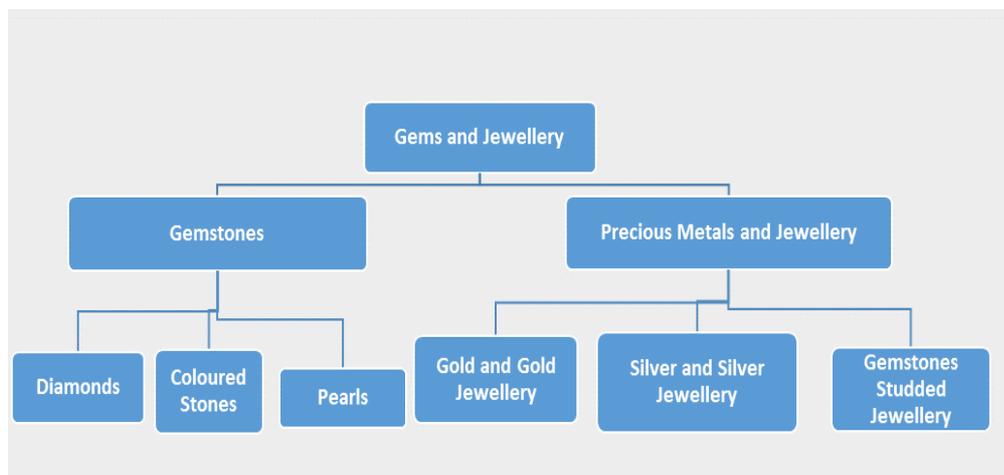
Most of the manufacturing activity is centred in the western coast of India in Gujarat, especially Surat. The Bharat Diamond Bourse in Mumbai, the modern and new trading complex that began operations in 2010, is the largest bourse in the world and accounts for nearly 90 *per cent* of India's total diamond imports and exports.

India also has a long tradition in the manufacturing of jewellery and coloured gemstones. Jaipur, which is the hub of the coloured gemstone trade, is the world's largest manufacturer of many different gemstones including *tanzanite* and *emeralds*, amongst others.

The Gems and Jewellery market comprises of the following segments:

- Cutting & polishing of rough diamonds
- Diamond studded jewellery
- Gold jewellery
- Silver jewellery and
- Precious and semi-precious gemstones and its jewellery.

Figure 1.1: Segments of Gems and Jewellery Sector

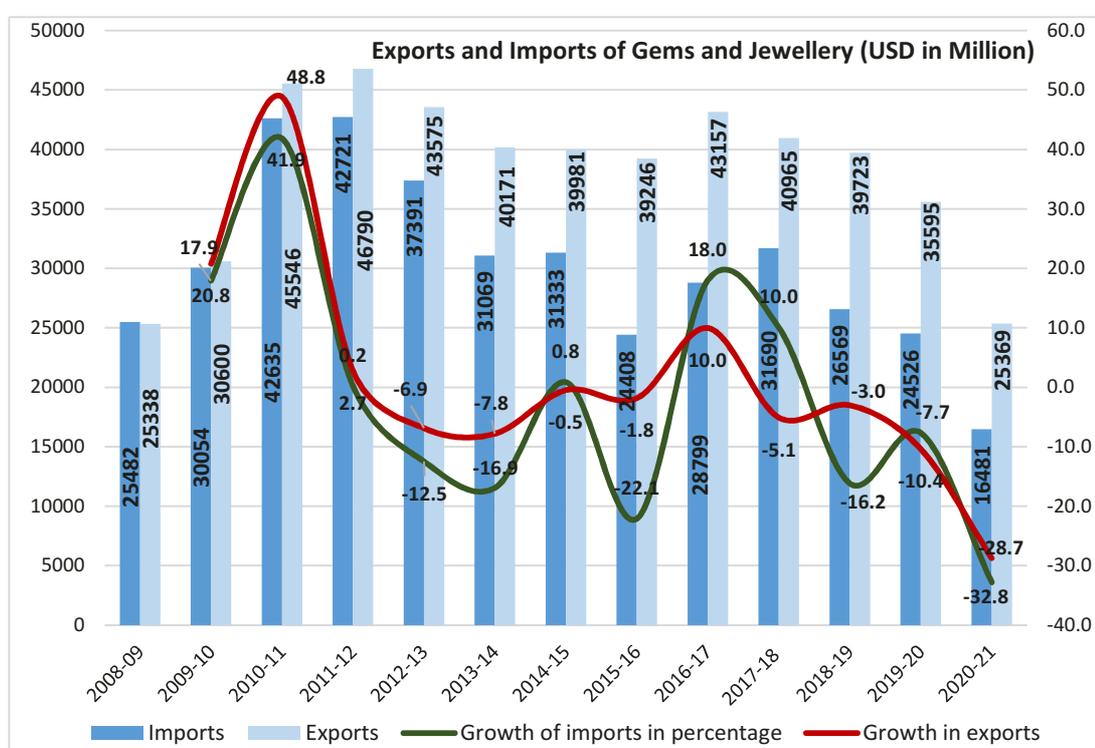


The different activities connected with jewellery include mining and extraction of precious stones and metals viz. diamond mining, coloured gemstone mining, gold mining and platinum mining; cutting and polishing covering gemstone processing (cutting & polishing), fabrication covering jewellery design and fabrication and retailing covers jewellery retailing.

1.2 Trends of Import and Export of Gems and Jewellery

Based on the potential for growth, the Gems and Jewellery industry has been declared as a focus area for export promotion. Government of India has also set up the Gem & Jewellery Export Promotion Council to facilitate this sector. The trend in growth of exports and imports of the Gems and Jewellery sector during 2008-09 to 2020-21 is indicated in Chart 1.2 given below:

Chart 1.2: Exports and Imports of Gems and Jewellery



[Source: Gems and Jewellery Industry in India | Commodity Wise Export - GJEPC India]

As can be seen from the data relating to Exports of Gems and Jewellery Sector for the period between FYs 2015-16 to 2019-20, the growth in value of total exports decreased on a year-on-year basis from (-) 5.1 per cent to (-) 10.4 per cent except positive growth (10 per cent) in FY 2016-17. The growth in export value further decreased to 28.7 per cent on year-on-year basis in the FY 2020-21.

1.3 Commodity-wise Exports and Imports

Export of Cut and Polished Diamonds is the major constituent of the total exports basket of Gems and Jewellery. In FY 2008-09, export of Cut and Polished Diamonds comprised almost 60 per cent of the total exports from the Gems and Jewellery

sector. In FY 2012-13, this proportion gradually declined to 50 per cent due to increase in export of gold jewellery (42 per cent), the other significant constituent of the exports basket of Gems and Jewellery. During FY 2013-14 to FY 2020-21, the proportion of export of Cut and Polished Diamonds in the total exports basket of this sector fluctuated between 52 per cent and 61 per cent. The share of Gold jewellery, gold medallions and coins in the total exports basket of Gems and Jewellery fluctuated between 20 per cent and 42 per cent during FYs 2008-09 to 2020-21. The total share of export of Cut and Polished Diamonds and Gold jewellery, gold medallions and coins in the exports basket of Gems and Jewellery ranged between 84 per cent to 95 per cent during FY 2008-09 to FY 2020-21. The item-wise gross exports and imports of Gems and Jewellery sector during FYs 2008-09 to 2020-21 is indicated in Table 1.1 given below.

Table 1.1 : Item-wise Gross Exports and Imports of Gems and Jewellery Sector (FY 2008-09 to 2020-21)														
(US \$ in million)														
FY→ Item↓	Export/ Import	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Cut & Polished Diamonds	Export	15143 (60%)	19356 (63%)	30574 (67%)	26672 (57%)	21607 (50%)	24498 (61%)	23160 (58%)	20668 (53%)	22784 (53%)	23723 (58%)	23817 (60%)	18665 (52%)	16288 (54%)
Cut & Polished Diamonds	Import	8807 (35%)	11610 (39%)	20808 (49%)	14472 (34%)	5559 (15%)	6541 (21%)	6640 (21%)	2771 (11%)	2634 (9%)	2235 (7%)	1328 (5%)	1713 (7%)	2183 (13%)
Gold Jewellery, Gold medallion & Coins	Export	8812 (35%)	9726 (32%)	12276 (27%)	16612 (36%)	18421 (42%)	11404 (28%)	12726 (32%)	13797 (35%)	13675 (32%)	11286 (28%)	12796 (32%)	12872 (36%)	5178 (20%)
Gold Bars	Import	5033 (20%)	8709 (29%)	8850 (21%)	10963 (26%)	11192 (30%)	5663 (18%)	5458 (17%)	4283 (18%)	4292 (15%)	5856 (18%)	8025 (30%)	7962 (32%)	1533 (9%)
Silver Jewellery	Export	238 (1%)	375 (1%)	569 (1%)	742 (2%)	931 (2%)	1474 (4%)	2050 (5%)	2957 (8%)	3948 (9%)	3382 (8%)	837 (2%)	1687 (5%)	2331 (9%)
Silver Bars	Import	30 (0%)	32 (0%)	68 (0%)	100 (0%)	52 (0%)	37 (0%)	35 (0%)	42 (0%)	51 (0%)	56 (0%)	42 (0%)	41 (0%)	38 (0%)
Rough Diamonds	Export	776 (3%)	744 (2%)	1137 (2%)	1774 (4%)	1579 (4%)	1585 (4%)	1419 (4%)	1170 (3%)	1500 (3%)	1430 (3%)	1354 (3%)	1109 (3%)	503 (2%)
Rough Diamonds	Import	7957 (31%)	9050 (30%)	11994 (28%)	15163 (35%)	14927 (40%)	16716 (54%)	16757 (53%)	14048 (58%)	17085 (59%)	18889 (60%)	15724 (59%)	13026 (53%)	10903 (66%)
Colored Gemstones worked	Export	281 (1%)	306 (1%)	349 (1%)	420 (1%)	729 (2%)	648 (2%)	453 (1%)	433 (1%)	420 (1%)	433 (1%)	398 (1%)	321 (1%)	189 (1%)
Rough Coloured Gemstones	Import	111 (0%)	117 (0%)	150 (0%)	146 (0%)	208 (1%)	238 (1%)	282 (1%)	370 (2%)	572 (2%)	906 (3%)	351 (1%)	250 (1%)	177 (1%)
Pearls (Worked & Unworked)	Export	4 (0%)	4 (0%)	6 (0%)	5 (0%)	90 (0%)	326 (1%)	3 (0%)	2 (0%)	6 (0%)	3 (0%)	2 (0%)	2 (0%)	1 (0%)
Raw Pearls	Import	5 (0%)	5 (0%)	7 (0%)	8 (0%)	170 (0%)	79 (0%)	3 (0%)	306 (1%)	602 (2%)	1039 (3%)	8 (0%)	11 (0%)	1 (0%)
Other Items of Export	Export	84 (0%)	89 (0%)	635 (1%)	565 (1%)	218 (1%)	236 (1%)	170 (0%)	219 (1%)	824 (2%)	708 (2%)	519 (1%)	939 (3%)	879 (3%)
Other Items of Import	Import	3539 (14%)	531 (2%)	758 (2%)	1869 (4%)	5283 (14%)	1795 (6%)	2158 (7%)	2588 (11%)	3563 (12%)	2709 (9%)	1091 (4%)	1523 (6%)	1646 (10%)
Total Gross Exports of Gems and Jewellery		25338	30600	45546	46790	43575	40171	39981	39246	43157	40965	39723	35595	25369
Total Imports of Gems and Jewellery		25482	30054	42635	42721	37391	31069	31333	24408	28799	31690	26569	24526	16481

Source: Gems And Jewellery Industry In India | Commodity Wise Export - GJEPC India

[Figures in brackets against Exports and Imports indicate commodity-wise per cent share in Exports basket and per cent share in Imports basket of Gems and Jewellery respectively.]

Similarly, from the data relating to commodity-wise imports of Gems and Jewellery sector for the period between FYs 2008-09 to 2020-21, it can be seen that Rough Diamonds, Gold bars and Cut and Polished Diamonds comprised the significant constituents of the total imports basket of Gems and Jewellery. During the said period, the imports of Rough Diamonds ranged between 28 per cent to 66 per cent whereas the imports of Gold bars ranged between 9 per cent to 32 per cent of the total imports of Gems and Jewellery. The significant increase of proportion of imports of rough diamonds from 31 per cent in FY 2008-09 to 66 per cent in FY 2020-21 requires further examination in view of the concerns raised regarding overvaluation of imports as brought out in para 2.2.1 of this Report. The imports of Cut and Polished Diamonds ranged between 5 per cent to 49 per cent of the total imports of Gems and Jewellery. The total share of import of Rough Diamonds, Gold bars and Cut and Polished Diamonds in the imports basket of Gems and Jewellery ranged between 83 per cent to 98 per cent during FY 2008-09 to FY 2020-21.

1.4 Legal Provisions

There are no specific legal provisions specified for Income Tax assessee engaged in Gems and Jewellery business. The general provisions of the Income Tax Act relevant to the assessee of Gems and Jewellery sector is at **Annexure A1**.

A summary of the relevant latest judicial decisions relating to the taxation of assessee falling under Gems and Jewellery Sector are given in **Annexure A2**.

1.5 Audit Approach

1.5.1 Why we chose the topic

- The industry has an important position in economic activities and has tremendous potential for growth. Moreover, the Government has taken many initiatives to promote it, such as concessions, exemptions, and reduction of duties and has consequently foregone large quanta of duty.
- 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. As per the Financial Action Taskforce (FATF) report of October 2013, India has reported instances where diamond prices were overvalued for purposes of laundering and suspected financing. The red flag indicators due to fraudulent diamond imports brought out in this FATF report *inter alia* included gross overvaluation of diamonds, lack of valid certification, circular trading of diamonds, proprietors and managers of foreign counterparts both being nationals and average price per carat not corresponding to trade practices. The report further stated that lack of known and stable prices for diamonds allows for the manipulation of price. Further,

there were no set standards of diamond pricing in the country, resulting in the agents overvaluing the costly and prized gemstones.

- The Customs Receipt Audit unit of the Comptroller and Auditor General of India (Indirect Taxes-Customs C&AG Audit Report No.6 of 2016¹) as well as the Directorate of Revenue Intelligence² had pointed out large scale round tripping of gold Jewellery and exports of machine-made plain gold jewellery to artificially increase the turnover to take status certificate and to enhance credit limits/financing from banks. Audit had also pointed out variations in import and export data as per the database maintained by the Directorate General of the Valuation³ vis-à-vis actual data available at Commissionerates of the Department of Customs and absence of a mechanism or protocol for sharing data with other Government agencies. It was therefore recommended that CBEC should maintain a robust and updated valuation data for all the tariff lines so that these could be utilised and shared with other concerned Departments. Other issues flagged through this audit included insufficient SEZ rules to curb smuggling activities of goods prone to evasion of duties which include gold, silver, diamond and other precious and semi-precious metals/ stones and non-accounting of imported gold/ silver by SEZ units. The implications of observations related to valuation and evasion through mis-invoicing would impact the assessments of the direct taxes and revenues reported by the entities engaged in Gems and Jewellery business and assessed by the Income Tax Department as well.
- 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.

1.5.2 Audit Objectives

The audit 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.

¹ Audit Report No. 06 of 2016 on Performance Audit on Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof, imitation jewellery, coins (Chapter 71 of CTH) tabled in the Parliament on 29 April 2016.

² The Directorate of Revenue Intelligence (DRI) is the premier intelligence and enforcement agency of the Government of India on anti-smuggling matters.

³ The Directorate of Valuation (DOV) was established in the year 1997 as an attached office of the Central Board of Excise and Customs (CBEC) under the Department of Revenue, Ministry of Finance, Government of India. Its functions and duties *inter alia* include assisting and advising the CBEC in policy matters concerning Customs and Central excise valuation and developing valuation tools for effective and uniform application of uniform laws.

- 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.
- 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.

1.5.3 Scope of audit and sample size

The Performance Audit covered the assessments completed during the financial years 2015-16 to 2018-19. The DGIT (Systems) provided aggregate and assessee-wise data on assessments of assessee engaged in Gems and Jewellery business completed during financial years 2015-16 to 2018-19. The data received from DGIT (Systems) were analysed and extractions made based on audit parameters were segregated area-wise to arrive at a sample.

The DGIT (Systems) had provided aggregate data of 1,52,927 cases out of which 3,171 cases were selected for the Performance Audit. Further, 61 additional cases were also selected from the Demand and Collection Registers (D&CR) and the total sample for this audit was 3,232. The audit sample included 74 cases⁴ selected on pan-India basis for 360-degree analysis. The sample of 3,232 cases was reduced to 2,593 cases due to constraints and travel restrictions faced by field audit offices across the country in undertaking out-station audits during the Covid pandemic [July 2020 to October 2020]. Further, additional information/ records in respect of cases included in the audit sample were also examined during April 2021 to October 2021 wherever it was found necessary to do so.

1.5.4 Audit methodology and approach

An Entry Conference was held on 28th January 2020 with the CBDT, wherein the audit scope, objectives and methodology were explained. The audit methodology included scrutiny of assessment records, collection of information through audit requisitions, analysis of data with reference to audit criteria and issue of audit observations. Apart from the cases covered in the performance audit, 83 audit observations noticed during the compliance audit have also been considered for this report.

Besides, Audit issued letters to ITD and other Departments seeking statistical information. Audit also issued a questionnaire to ITD seeking their views regarding valuation and assessment of assessee of the Gems and Jewellery sector.

The draft performance audit report was first issued to the Ministry/ CBDT on 11 November 2021 for their comments. Post receipt of the CBDT's response in

⁴ Out of 74 cases, 20 cases were processed under section 143(1) of the Act and 48 cases were processed under section 143(3) of the Act. Further, 45 cases were pertaining to corporate assessee whereas 29 cases were pertaining to non-corporate assessee.

January 2022, an Exit Conference was held with the CBDT on 28 January 2022 to discuss audit findings and audit recommendations vis-à-vis their comments. The results of the discussion, the CBDT's comments and audit comments have been duly incorporated in the performance audit report.

1.5.5 Non production of records and information by the CBDT

Out of the total 3,232 cases selected and requisitioned for the performance audit; 2,261 cases were produced by ITD, while 292 cases were not produced to audit despite repeated requests, reminders and discussions at different levels. Though ITD furnished detailed data pertaining to 1,52,927 assessment cases, records pertaining to 292 cases were not furnished during field audit without citing any reasons. The assessment particulars of the cases examined in audit and records not produced are indicated in **Annexures B and C** respectively.

Audit found that 40 cases furnished in the granular data furnished by the DGIT(systems) were not relating to the Gems and Jewellery sector. Further, in the cases examined, Audit noted that all records were not available viz. Income Tax Returns, Tax Audit Reports and ITNS [Income Tax Computation Sheet]. The complete examination of records was therefore constrained due to partial furnishing of records. The assessment units could not furnish the orders processed under section 143(1) and section 154 of the Act, citing that the same was available with the CPC Bengaluru. The details of such cases were sent to the CIT(CPC) Bengaluru in October 2020 with a request to share electronic copies of the cases. The documents as requested were not shared centrally with Audit.

Besides non-furnishing of records in cases selected for audit, the decrypted PAN details of entire assessee-wise detailed data was also not furnished to audit despite repeated requests at the planning stage [January 2020, February 2020, March 2020] and through subsequent reminders in November 2020, July 2021 and September 2021. The decrypted PAN details of cases selected in the audit sample alone were furnished in June 2020 after 11 months of furnishing of detailed granular data (August 2019). Audit could not verify whether all entities engaged in the business of Gems and Jewellery were in the tax net across all jurisdictions. The requisite information and documents are yet to be furnished (January 2022).

For assessing co-ordination within the Income Tax Department audit requested [between February 2020 and October 2020] information on searches conducted against assesseees of Gems and Jewellery sector, fake invoices, bogus purchases, irregular benefits received from beneficiaries and other related details for the period from FY 2015-16 to 2018-19 from Investigation wing and Principal Commissionerates (Central) of the ITD. However, the information as sought during audit is yet to be received (January 2022).

For verifying the co-ordination mechanism of the ITD with the Customs Department, audit requested information on importers/ exporters involved in over-invoicing/

under-invoicing during the period 2012-13 to 2018-19 [sought through letters issued between February 2020 and October 2020]. However, the details are yet to be received (January 2022) from the Department of Customs.

1.5.6 Other Constraints

The following constraints were faced by audit while conducting the performance audit:

- i. Performance Audit has been conducted during the prevailing COVID-19 pandemic. Due to staff restrictions and working of the staff of Income Tax Department on roster basis, the Assessing Officers were not able to provide the records/data in time.
- ii. The complete jurisdictional restructuring in August 2020 post introduction of the faceless assessment, involving re-allocation of charges and lack of clarity in jurisdictional control over assessments and underlying records and documents, severely constrained the furnishing of records during field audit.
- iii. As indicated in para 1.5.3 of this Chapter, the original sample of 3,232 cases was reduced to 2593 cases by excluding outstation cases due to constraints and several restrictions including outstation travel etc. faced by field audit parties during pandemic [July 2020 to October 2020]. Further, 40 cases furnished in the granular data furnished by the DGIT(systems) were not relating to the Gems and Jewellery sector.
- iv. Limited documents were available in the assessment folders as most of the cases were selected under limited scrutiny by the Income Tax Department.
- v. The information on importers/ exporters of Gems and Jewellery sector in respect of whom irregularities were detected by the Directorate of Revenue Intelligence (DRI) was not furnished in Mumbai and Ahmedabad. The impact of irregularities detected by DRI on the Direct taxes side could not be examined in audit. Information on bogus purchases availed by the beneficiaries or fake GST invoices sought from Central GST/ State GST Department [sought through letters issued between February 2020 and October 2020] was not furnished.

1.5.7 Acknowledgment

Audit acknowledges the co-operation of the ITD for providing the assessment records and facilitating the conduct of this performance audit. The ITD extended their co-operation in providing the requisitioned records even under the testing circumstances due to COVID-19 pandemic. Without their facilitation, it could not be possible to finalise the audit work.

Chapter-2: Analysis of Sample and select commodities of Gems and Jewellery Sector

The DGIT (Systems) provided aggregate and assessee-wise data of 1,52,927 records of assessments of assessee engaged in Gems and Jewellery business completed during financial years 2015-16 to 2018-19. Data of 1,52,927 records were analysed on the basis of audit parameters and were segregated area-wise to arrive at a centrally derived audit sample of 3,171 cases. In this Chapter, the profile of audit sample based on several parameters viz. PAN registration category of assessee, assessment year of the assessments examined in audit, type of ITR form filed by the assessee, regional jurisdiction-wise profile of returned income, assessed income, demand raised and gross turnover has been discussed. ITD is the premier Government Department primarily responsible for combating the menace of black money in the country. The tools available with the Department include scrutiny assessment and information based investigation. As Gems and Jewellery sector involves high value foreign exchange transactions through exports and imports of valuable commodities such as diamond, gold, pearls etc. and is susceptible to misuse and money laundering, Audit attempted to analyse the commodity-wise and country-wise trend of imports and exports of select commodities viz. rough diamonds and pearls in India vis-à-vis- overall world imports and exports. Audit noted unusual trends in imports and exports of rough diamonds and pearls, as discussed in this Chapter, that require further examination at detailed level by the ITD.

2.1 Profile of Audit Sample of assessments of Gems and Jewellery Sector

Out of the selected 3,171 cases, the number of cases assessed in Scrutiny manner, Summary manner and other sections of the Income Tax Act (appeal, rectification, etc.) were 907, 1,437, and 827 respectively. Similarly, out of the 61 additional selected cases, 59 cases were assessed under scrutiny manner and 2 cases were assessed under summary manner. Out of the total 3,232 cases selected and requisitioned for the performance audit; 2,261 cases⁵ were produced by the ITD and 292 cases were not produced to audit. The details are tabulated in Table 2.1 below:

⁵ Out of 2,261 cases, number of cases processed under section 143(1) of the Act were 1,147, no. of cases assessed under section 143(3) of the Act were 572; no. of cases assessed under other sections of the Act, viz; 147, 144, 154, 250 etc. were 542.

Table 2.1: Type of assessment-wise details of sample selected and examined during audit

Type of Assessment (Scrutiny or otherwise)	No. of cases in the data furnished by DGIT (Systems)	Sample selected			Status of case records			
		From Database	Additional cases	Total Sample	Produced	Not produced	Not related to Gems and Jewellery	Total
Scrutiny	2,894	907	59	965	572	123	13	708
Summary	1,46,911	1,437	2	1,440	1,147	108	20	1,275
Other ⁶	3,122	827	0	827	542	61	7	610
Total	1,52,927	3,171	61	3,232	2,261	292	40	2,593⁷

Of these 2,261 cases, 50.73 per cent were processed summarily under section 143(1) of the Act whereas 25.30 per cent were assessed under scrutiny through detailed examination of incomes disclosed and claims made by the assessee through Income Tax Returns.

2.1.1 Category-wise sample selected

Out of the total number of 1,52,927 assesseees in the Gems and Jewellery sector provided by the ITD, 1,50,138 assesseees (98.18 per cent) were Non-corporate and only 2,789 (1.82 per cent) were Corporate assesseees. Out of the audit sample selected of the 3,171 cases, the number of corporate and non-corporate assesseees was 750 and 2,421 respectively. Similarly, out of the 61 additional cases, 28 were corporate assesseees and 33 cases were non corporate assesseees. The details are mentioned in Table 2.2 below:

Table 2.2: Category-wise details of sample selected and examined during audit

Category of Assessee	No. of cases in the data furnished by DGIT (Systems)	Sample selected			Status of case records			
		From Database	Additional case	Total Sample	Produced	Not produced	Not related to Gems and Jewellery	Total
Corporate	2,789	750	28	778	613	62	30	675
Non corporate	1,50,138	2,421	33	2,454	1,648	230	10	1,878
Total	1,52,927	3,171	61	3,232	2,261	292	40	2,593

The sample of 3,232 assesseees selected by Audit also had 24.07 per cent and 75.93 per cent of Corporate and Non-corporate assesseees respectively.

2.1.2 PAN Registration-wise Profile of Audit Sample

The selected assessments examined in Audit included assesseees with PAN registration status of Company, Firms, Individuals, HUF, AOP and AOP [Trust]. Table 2.3 below contains PAN registration category-wise distribution of sample selection.

⁶ These include cases assessed under sections 144, 147, 154, 92CA(4), 250, 254, 263 etc. of the Income Tax Act.

⁷ The difference in total sample selected from the data furnished by the DGIT(Systems) and that examined in audit was due to exclusion of outstation cases by the field audit offices due to travel restrictions during pandemic for which audit could not be undertaken

Table 2.3: PAN Registration-wise Profile of Audit Sample

PAN Registration Category	No of records
Association of Persons	25
Company	613
Firms	690
HUF	37
Individuals	889
Association of Persons[Trust]	7
Grand Total	2,261

The audit sample comprised 39 *per cent*, 31 *per cent*, and 27 *per cent* of cases of assesseees registered as Individuals, Companies and Firms respectively. The remaining three *per cent* of total selections in the sample comprised two *per cent* and one *per cent* of cases of assesseees registered as Hindu Undivided Family [HUF] and AOP respectively.

2.1.3 Assessment Year-wise Audit Sample

The sample of 2,261 comprised cases assessed during AY 2007-08 and AY 2018-19. Of 2,261 assessment cases⁸ examined in audit, 26 *per cent* cases were relating to AY 2018-19 followed by 19 *per cent*, 14 *per cent*, 13 *per cent* and 11 *per cent* were relating to AYs 2015-16, 2016-17, 2014-15 and 2017-18. The AY-wise distribution of audit sample is given in Table 2.4 below:

Table 2.4: AY-wise Audit Sample Distribution

(₹ in crore)

AY	No. of cases	Sales Turnover/ Gross Receipts	Returned Income	Assessed Income	Demand Raised
2007-08	8	2,639.31	83.95	87.56	0.99
2008-09	27	10,017.02	273.68	386.02	82.91
2009-10	28	10,976.06	103.69	210.43	90.14
2010-11	31	9,336.12	192.84	268.68	96.25
2011-12	42	21,833.51	419.86	471.13	44.27
2012-13	56	36,566.88	818.94	1,081.04	161.45
2013-14	185	77,061.12	1,282.05	1,954.96	631.45
2014-15	296	1,01,658.86	2,330.53	2,625.39	267.94
2015-16	419	1,23,140.34	2,519.96	2,952.79	429.80
2016-17	326	1,10,606.37	1,982.28	4,380.86	231.41
2017-18	259	1,16,312.34	2,503.09	1,628.98	181.77
2018-19	583	12,449.14	125.90	79.88	1.70
Grand Total	2,260*	6,32,597.05	12,636.76	16,127.72	2,220.10

2.1.4 ITR Form type-wise Audit Sample

Of 2,261 assessment cases in the audit sample, in 33.5 *per cent* of cases, ITR-6 Form applicable for the Company was used for filing return. In the remaining sample, ITR-5, ITR-3 and ITR-4 and ITR-4S Form types were used for filing returns in 30.6 *per cent*, 17.5 *per cent*, 11.4 *per cent* and 4.6 *per cent* of total selections respectively. The ITR Form type-wise distribution of the audit sample is given in Table 2.5 below.

⁸ Details of AY were not available in one case

Table 2.5: ITR Form Type-wise Audit Sample Distribution

ITR Form Type	Applicability	No. of records
ITR-6	Companies not claiming exemption under section 11	607
ITR-5	Partnership Firm, AOP	720
ITR-3	Individual, HUF, Partner in a Firm with Business income	482
ITR-4	Individual, HUF, Firm with Presumptive Business income	300
ITR-4S	Individual, HUF, Firm with Presumptive Business income	133
ITR-7	Trusts	5
ITR-1	Resident Indian Individual	1
Details Not Available		13
Grand Total		2,261

The details of ITR Form type used by assesseees were not available in 2.1 per cent of sample.

2.1.5 Region-wise distribution of Audit Sample

The assessments selected in the audit sample comprised cases pertaining to all the regions/states from Income Tax Department jurisdictions across the country. The sample of 2261 cases⁹ comprised 48.2 per cent cases of Maharashtra, 16.5 per cent cases of Gujarat, 5.5 per cent cases of Delhi and 5.1 per cent cases of Rajasthan as depicted in **Annexure B**. Of these 2,261 cases, 50.73 per cent were processed summarily under section 143(1) of the Act whereas 25.30 per cent were assessed under scrutiny through detailed examination of incomes disclosed and claims made by the assessee through Income Tax Returns.

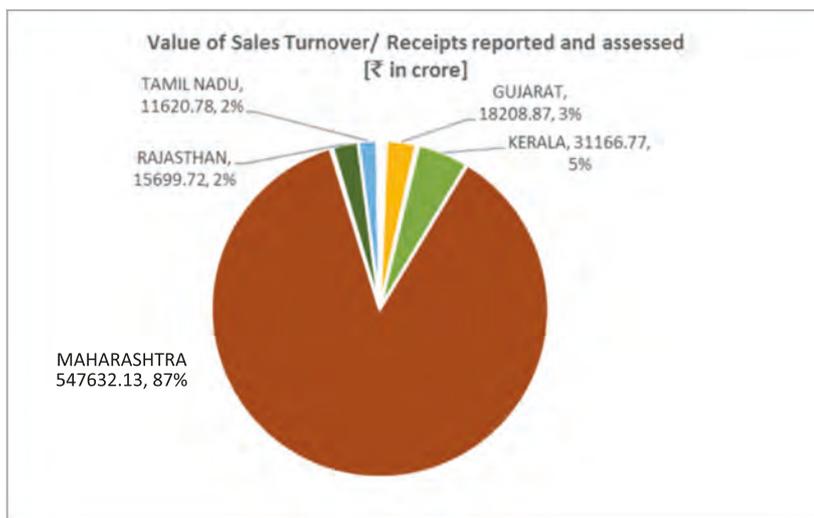
The Sales Turnover or Gross Receipts reported and assessed in 2,261 assessments examined in audit was ₹ 6,32,597.05 crore while the returned income, assessed income and demand raised was amounting to ₹ 12,636.76 crore, ₹ 16,127.72 crore and ₹ 2,220.10 crore respectively. Thus, additions amounting to ₹ 3,490.96 crore approximating to 27.6 per cent of the returned income were made by the Assessing Officers in these cases based on detailed examination of assessments.

The amount of Sales Turnover or Gross Receipts of Maharashtra region reported ₹ 5,47,632.13 crore through Income Tax Returns and as per the assessment records comprised 86.6 per cent of aggregate Sales value of ₹ 6,32,597.05 crore of total sample cases. The Sales Turnover or Gross Receipts reported and assessed in sample selections of Kerala at ₹ 31,166.77 crore comprised 4.9 per cent of aggregate Sales Turnover or Gross Receipts value, whereas selection selections of Gujarat, Rajasthan and Tamil Nadu at ₹ 18,208.87 crore, ₹ 15,699.72 crore and ₹ 11,620.78 crore comprised 2.9 per cent, 2.5 per cent and 1.8 per cent respectively of aggregate Sales

⁹ Out of the total 2,261 cases audited, No. of cases processed under section 143(1) of the Act were 1,147, No. of cases assessed under section 143(3) of the Act were 572; No. of cases assessed under other sections of the Act, viz; 147, 144, 154,250 etc. were 542.

Turnover or Gross Receipts of audit sample. The amount of Sales Turnover or Gross Receipts of cases of the remaining regions/states was negligible [almost 0 to 0.4 per cent of aggregate Sales value of total sample cases]. The region-wise distribution of Sales Turnover or Gross Receipts of total sample cases as a proportion of aggregate value of Sales Turnover or Gross Receipts of audit sample is depicted in Chart 2.1.

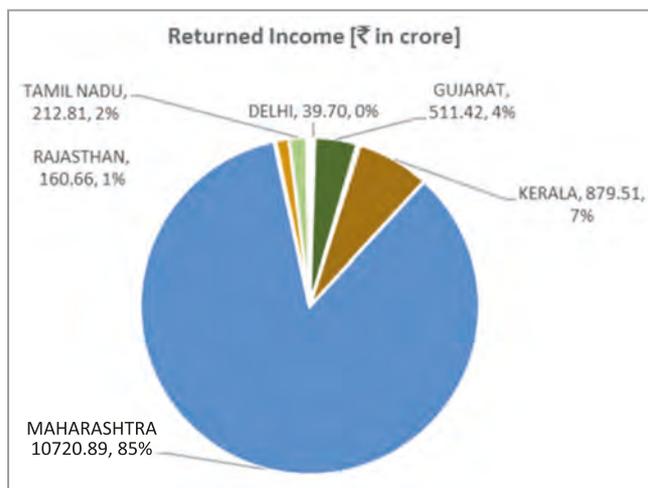
Chart 2.1: Region-wise Sales Turnover/ Receipts of Audit Sample



Source: Assessment Records of ITD

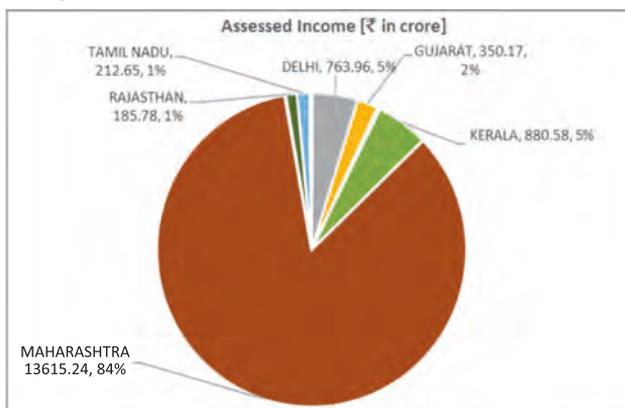
The region-wise distribution of Returned Income of sample cases as a proportion of aggregate value of Returned Income of audit sample at ₹ 12,636.76 crore is depicted in Chart 2.2. The sample cases of Maharashtra region contributed Returned Income of ₹ 10,720.89 crore comprising 84.8 per cent share whereas the cases of Kerala and Gujarat comprised 7.0 per cent and 4.0 per cent share with Returned Income of ₹ 879.51 crore and ₹ 511.42 crore respectively. Tamil Nadu and Rajasthan with Returned Income of ₹ 212.81 crore and ₹ 160.66 crore comprised 1.7 per cent and 1.3 per cent share of aggregate value of Returned Income of audit sample. The remaining regions reported 0 to 0.3 per cent of aggregate value of Returned Income of total sample cases.

Chart 2.2: Region-wise Returned Income of Audit Sample



The region-wise distribution of Assessed Income of sample cases as a proportion of aggregate value of Assessed Income of audit sample is depicted in Chart 2.3. Maharashtra region contributed 84.4 per cent share of Assessed Income at ₹ 13,615.24 crore whereas the cases of Kerala and Delhi with Assessed Income at ₹ 880.58

Chart 2.3: Region-wise Assessed Income of Audit Sample



crore and ₹ 763.96 crore comprised 5.5 per cent and 4.7 per cent respectively of aggregate value of Assessed Income of audit sample. Other regions/ states reported insignificant or nil proportion of aggregate value of Assessed Income of audit sample.

2.1.6 Analysis of Assessments of the sample cases and demands raised

The region/ state-wise profile of returned Income, Assessed Income and Demand Raised is depicted in Table 2.6 given below.

Region	[₹ in crore]		
	Returned Income	Assessed Income	Demand Raised as per the latest order
MAHARASHTRA	10,720.89	13,615.24	1,692.87
DELHI	39.7	763.96	425.11
TAMIL NADU	212.81	212.65	70.07
RAJASTHAN	160.66	185.78	18.35
KARNATAKA AND GOA	37.09	46.88	4.39
GUJARAT	511.42	350.17	3.88
ODISHA	6.74	12.46	2.67
MADHYA PRADESH AND CHATTISGARH	2.34	4.71	1.57
KERALA	879.51	880.58	0.58
WEST BENGAL AND SIKKIM	27.29	24.01	0.58
BIHAR AND JHARKHAND	0.97	1	0.01
NORTH WEST REGION	9.04	8.6	0.01
ANDHRA PRADESH AND TELENGANA	18.58	13.74	0
NORTH EAST REGION	1.69	0	0
UTTAR PRADESH (EAST)	7.08	7.08	0
UTTAR PRADESH (WEST)	0.95	0.86	0
Grand Total	12,636.76	16,127.72	2,220.10

Source: Data sets furnished by ITD and assessment records of Assessing charges.

The sample cases of Maharashtra with Returned Income, Assessed Income and Demand raised of ₹ 10,720.89 crore, ₹ 13,615.24 crore and ₹ 1,692.87 crore comprised the predominant share at 86.6 *per cent*, 84.8 *per cent* and 84.4 *per cent* of aggregate value of Returned Income, Assessed Income and Demand respectively.

Although sample cases of Delhi with Returned Income of ₹ 39.70 crore and Assessed Income of ₹ 763.96 crore comprised only 0.3 *per cent* and 4.7 *per cent* share of aggregate value of Returned Income and Assessed Income respectively, it reported Demand of ₹ 425.11 crore comprising 19.1 *per cent* of share of aggregate value of Demand raised, indicating relatively higher risk of under reporting of incomes or excess claims made.

The sample cases of Kerala with Returned Income of ₹ 879.51 crore and Assessed Income of ₹ 880.58 crore comprised 7.0 *per cent* and 5.5 *per cent* share of aggregate value of Returned Income and Assessed Income respectively, whereas it reported Demand of ₹ 0.58 crore with Nil *per cent* of share of aggregate value of Demand raised.

Likewise, the sample cases of Gujarat with Returned Income of ₹ 511.42 crore and Assessed Income of ₹ 350.17 crore comprised 4.0 *per cent* and 2.2 *per cent* share of aggregate value of Returned Income and Assessed Income respectively, whereas it reported Demand of ₹ 3.88 crore comprising 0.2 *per cent* of share of aggregate value of Demand raised.

2.2 Role of Income Tax Department in assessment of Black Money

The white paper on Black Money¹⁰ defines black money “as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession”. As per the report, bullion and jewellery is one such sector which is prone to both generation and consumption of black money. Income Tax Department (ITD) is the premier Government Department primarily responsible for combating the menace of black money in the country. For this purpose, it uses the tools of scrutiny assessment as well as information based investigations for detecting tax evasion and penalizing those found guilty of tax evasion as per the provisions of the Income Tax Act, 1961 (Act).

To bring back undisclosed (black) money stashed abroad, the Government came out with a New Act named ‘The Black Money (Undisclosed Foreign Income and Assets) And Imposition of Tax Act, 2015’ (hereinafter referred to in short as ‘Black Money Act’), which was notified in May 2015 and was made applicable from 1st April 2016. ‘The Black Money Act, 2015’ contains provisions to deal with the problem of black money that is undisclosed foreign income and assets, the procedure for dealing with such income and assets and to provide for imposition of tax on any undisclosed foreign income and assets held outside India and for matters connected therewith or

¹⁰ White paper on Black Money issued by Ministry of Finance, Department of Revenue, CBDT dated 16 May 2012.

incidental thereto. Section 3 of the Black Money and Imposition of Tax Act 2015 provides the basis of charge on tax on total undisclosed foreign income and asset at the rates of 30 *per cent* of such undisclosed income and assets. The value of undisclosed asset means fair market value of an asset [including financial interest in any entity]. Section 4 of this Act specifies that the value of total undisclosed income from sources and assets located outside India which are not disclosed in the return of income fall within the scope of this Act. Income included under the undisclosed foreign income and asset under this Act shall not form part of total income under the Income Tax Act. Section 6 is the empowering section for tax authorities for the purpose of this Act. The prescribed tax authorities are vested with the powers regarding discovery and production of evidence and for compelling production of the books of accounts and other documents.

Under the Black Money and Imposition of Tax Act, the Assessing Officer (AO), on receipt of information from the Income Tax Authority or any other authority under any law for the time being in force is authorised to serve notice on any person for production of documents, accounts or evidence or can make enquiry necessary for obtaining full information in respect of undisclosed foreign income and assets of a person in the relevant AY. The AO has the powers to assess [or re-assess] the undisclosed foreign income and assets and determine the sum payable by the assessee. This Act *inter alia* provides for recovery of tax dues in pursuance of agreements with foreign countries [viz. Double Taxation Avoidance Agreements (DTAAs)] or specified territories.

2.2.1 Analysis of commodity-wise trend of imports and exports of rough diamonds and pearls

Audit sought to analyse the commodity-wise trend of imports and exports of rough diamonds and pearls in India vis-à-vis- overall world imports and exports.

2.2.2 Analysis of production, imports and exports of rough diamonds

Analysis of domestic production, imports and exports data of rough diamonds for the years 2010 to 2020¹¹ shows that India's share in global production of diamonds is negligible. The domestic production of rough diamond in proportion to global production ranged between 0.01 *per cent* to 0.03 *per cent* in terms of quantity of production and between 0.02 *per cent* to 0.06 *per cent* in terms of value of rough diamonds produced. Further, the quantity of rough diamonds imported in India in all these years was higher than the quantity of rough diamonds mined globally (Table 2.7).

¹¹ https://kimberleyprocessstatistics.org/public_statistics

Table 2.7 : Trend of domestic production, imports and exports of rough diamonds								
Year	Domestic production of rough diamonds		Import of rough diamonds		Export of rough diamonds		Global production of rough diamonds	
	Quantity, (in thousands cts)	Value, (In US \$ Million)	Quantity, (in thousands cts)	Value, (In US \$ Million)	Quantity, (in thousands cts)	Value, (In US \$ Million)	Quantity, (in thousands cts)	Value, (In US \$ Million)
2010	18.08	3.35	1,65,219.03	11,234.79	32,993.16	967.81	1,28,317.46	11,392.95
2011	12.32 [(-)31.86%]	2.20 [(-)34.33%]	1,35,066.98 [(-)18.25%]	14,731.05 [31.12%]	37,070.73 [12.36%]	1,799.86 [85.97%]	1,22,828.81 [(-)4.28%]	14,065.25 [23.46%]
2012	26.99 [119.07%]	4.81 [118.67%]	1,48,896.75 [10.24%]	14,737.02 [0.04%]	34,439.40 [(-)7.10%]	1,803.56 [0.21%]	1,27,965.78 [4.18%]	12,645.63 [(-)10.09%]
2013	36.60 [35.61%]	6.46 [34.30%]	1,59,429.13 [7.07%]	15,975.71 [8.41%]	48,891.56 [41.96%]	1,846.81 [2.40%]	1,29,840.91 [1.47%]	13,581.61 [7.40%]
2014	37.02 [1.15%]	6.70 [3.72%]	1,53,616.41 [(-)3.65%]	17,154.56 [7.38%]	36,483.89 [(-)25.38%]	1,716.45 [(-)7.06%]	1,25,420.51 [(-)3.40%]	15,626.31 [15.05%]
2015	33.50 [(-)9.51%]	6.97 [4.03%]	1,30,100.34 [(-)15.31%]	13,364.97 [(-)22.09%]	34,255.56 [(-)6.11%]	1,540.44 [(-)10.25%]	1,28,294.75 [2.29%]	14,241.02 [(-)8.87%]
2016	33.00 [(-)1.49%]	7.39 [6.03%]	1,49,319.26 [14.77%]	16,665.72 [24.70%]	38,485.10 [12.35%]	1,787.49 [16.04%]	1,26,380.58 [(-)1.49%]	12,268.65 [(-)13.85%]
2017	41.70 [26.36%]	7.35 [(-)0.54%]	1,95,003.87 [30.60%]	18,976.94 [13.87%]	45,609.09 [18.51%]	2,087.70 [16.80%]	1,50,936.36 [19.43%]	14,124.51 [15.13%]
2018	39.45 [(-)5.40%]	8.49 [15.51%]	1,70,008.08 [(-)12.82%]	17,218.32 [(-)9.27%]	39,394.95 [(-)13.62%]	1,812.32 [(-)13.19%]	1,48,434.77 [(-)1.66%]	14,465.92 [2.42%]
2019	36.38 [(-)7.78%]	6.05 [(-)28.74%]	1,58,626.84 [(-)6.69%]	14,084.51 [(-)18.20%]	28,933.50 [(-)26.56%]	1,678.86 [(-)7.36%]	1,38,139.37 [(-)6.94%]	13,570.54 [(-)6.19%]
2020	22.04 [(-)39.42%]	3.06 [(-)49.42%]	1,16,414.89 [(-)26.61%]	9,725.75 [(-)30.95%]	18,927.83 [(-)34.58%]	801.58 [(-)52.25%]	1,07,076.74 [(-)22.49%]	9,235.32 [(-)31.95%]
Total	337.08	62.83	16,81,701.58	1,63,869.34	3,95,484.77	17,842.88	14,33,636.04	1,45,217.71

Source: https://kimberleyprocessstatistics.org/public_statistics

i) Figures in brackets against imports and exports of rough diamond indicate year-over-year percentage growth in imports and exports of rough diamond.

ii) Figures in brackets against quantity/ value of domestic production and global production of rough diamond indicate year-over-year percentage growth in quantity/ value of domestic production and global production of rough diamond respectively.

iii) Data of domestic production, exports and imports of rough diamond in India, global production of rough diamond is in respect of Calendar Year]

Further, more than 23 per cent of quantity of rough diamonds imported in the country has been exported during 2010 to 2020.

The growth in quantity of imports of rough diamond fluctuated between a slump of (-)26.61 per cent and a growth of 30.60 per cent during 2010 to 2020 whereas the growth in value of rough diamond imports fluctuated between a slump of (-)30.95 per cent and a growth of 31.12 per cent during the said period. During 2011, the quantity of imports of rough diamond showed year-over-year (y-o-y) slump of (-)18.25 per cent whereas the value of imports of rough diamond showed significant increase of 31.12 per cent (y-o-y). During 2012, the quantity of imports of rough diamond showed y-o-y increase of 10.24 per cent whereas the value of imports of rough diamond showed minimal increase of 0.04 per cent (y-o-y) only.

The growth in quantity of exports of rough diamond fluctuated between a slump of (-)34.58 per cent and a growth of 41.96 per cent during 2010 to 2020 whereas the growth in value of rough diamond exports fluctuated between a slump of (-)52.25 per cent and a growth of 85.97 per cent during the said period. During 2011, the the quantity of exports of rough diamond showed year-over-year (y-o-y) growth of 12.36 per cent whereas the value of exports of rough diamond showed significant growth of 85.97 per cent (y-o-y). During 2013, the quantity of exports of rough diamond showed y-o-y increase of 41.96 per cent whereas the value of exports of rough diamond showed increase of 2.40 per cent (y-o-y) only. The reasons for

irregular trends in growth of quantity and value of imports and exports of rough diamonds require examination at the detailed granular level of imports and exports by the ITD.

2.2.3 Country-wise analysis of Imports and Exports of Rough Diamonds

Country-wise analysis of imports and exports of rough diamonds¹² (Table 2.8) for the period between 2009-10 to 2019-20 shows that 76 per cent of total imports and 80 per cent of total exports of rough diamonds were to three countries viz. United Arab Emirates, Belgium and Hong Kong whose contribution in global diamond mining were negligible. Major countries where rough diamonds are mined¹³ are Russia, South Africa, Botswana, Namibia, Angola, Tanzania, Australia and Canada.

S. No.	Country	Country	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total	% share
1	United Arab Emirates	Export	252.94	455.56	647.99	797.34	676.02	640.55	480.95	463.37	476.44	321.84	177.93	5390.93	36.42
		Import	986.99	1703.04	2671.83	2827.42	3055.09	3421.93	3411.42	4854.75	5572.95	5157.17	4054.87	37717.46	23.09
		% of export to import	25.63	26.75	24.25	28.20	22.13	18.72	14.10	9.54	8.55	6.24	4.39	14.29	
2	Belgium	Export	308.94	357.93	674.91	451.3	534.03	499.47	462.88	566.73	352	267.17	587.69	5063.05	34.21
		Import	5445.19	7004.1	8310.41	8122.02	8869.49	8865.87	6917.37	7031.29	7179.96	5794.05	3866.21	77405.96	47.38
		% of export to import	5.67	5.11	8.12	5.56	6.02	5.63	6.69	8.06	4.90	4.61	15.20	6.54	
3	Hongkong	Export	119.08	158.09	204.30	222.34	192.56	154.66	85.85	67.20	76.99	100.24	45.80	1427.11	9.64
		Import	379.19	493.08	637.89	679.41	1268.44	727.75	672.14	1089.59	2449.62	648.33	341.50	9386.94	5.75
		% of export to import	31.40	32.06	32.03	32.73	15.18	21.25	12.77	6.17	3.14	15.46	13.41	15.20	
4	Singapore	Export	0.39	0	2.54	1.52	2.21	0.98	92.64	203.28	188.41	175.66	131.06	798.69	5.40
		Import	8.44	1.48	3.26	21.15	95.52	159.66	71.14	220.51	231.0028	266.1	171.95	1250.213	0.77
		% of export to import	4.62	0.00	77.91	7.19	2.31	0.61	130.22	92.19	81.56	66.01	76.22	63.88	
5	United Kingdom	Export	2.56	37.66	39.64	3.11	2.15	4.05	1.67	42.62	172.74	285.83	1.18	593.21	4.01
		Import	1066.37	1119.6	1491.74	1202.54	661.89	10.18	4.97	59.61	396.15	249	48.29	6310.34	3.86
		% of export to import	0.24	3.36	2.66	0.26	0.32	39.78	33.60	71.50	43.60	114.79	2.44	9.40	
6	Netherland	Export	19.72	66.86	53.1	41.97	46	34.58	6.43	78.05	52.74	47.65	66.21	513.31	3.47
		Import	0.00	0.00	0.00	0.00	0.00	1.83	18.16	0.00	0.00	0.00	0.00	19.99	0.01
		% of export to import	Very high	1889.62	35.41	Very high	Very high	Very high	Very high	2567.83					
7	Israel	Export	27.58	35.85	73.96	36.29	52.72	39.3	19.58	23.07	85.99	37.56	62.2	494.10	3.34
		Import	697.61	1046.88	990.85	1005.01	1073.62	933.30	930.53	1015.53	847.80	707.56	404.73	9653.42	5.91
		% of export to import	3.95	3.42	7.46	3.61	4.91	4.21	2.10	2.27	10.14	5.31	15.37	5.12	
8	United States Of America	Export	1.72	4.63	19.64	15.82	28.47	30.85	7.72	9.99	2.87	99	2.43	223.14	1.51
		Import	57.95	99.87	51.61	45.13	90.02	193.67	199.65	176.2	159.8	156.77	19.32	1249.99	0.77
		% of export to import	2.97	4.64	38.05	35.05	31.63	15.93	3.87	5.67	1.80	63.15	12.58	17.85	
9	South Africa	Export	3.13	3.74	13.83	2.32	11.94	3.02	2.33	27.11	17.35	12.52	16.38	113.67	0.77
		Import	23.52	24.39	39.002	36.23	248.68	1491.03	1044.71	1655.77	823.99	981.06	964.3	7332.68	4.49
		% of export to import	13.31	15.33	35.46	6.40	4.80	0.20	0.22	1.64	2.11	1.28	1.70	1.55	
10	Russia	Export	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.55	0.00	0.00	0.55	0.00
		Import	233.96	370.18	687.85	685.42	797.37	648.89	603.5	727.31	716.33	809.91	1275.95	7556.67	4.63
		% of export to import	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.08	0.00	0.00	0.01
11	Others	Export	8.41	16.86	43.95	7.33	38.69	11.13	9.92	18.88	3.64	6.87	18.01	183.69	1.24
		Import	150.52	131.37	278.90	302.62	556.11	303.25	174.23	254.15	511.05	954.28	1878.79	5495.24	3.36
		% of export to import	5.59	12.83	15.76	2.42	6.96	3.67	5.69	7.43	0.71	0.72	0.96	3.34	
Total	Total	Export	744.47	1137.18	1773.86	1579.34	1584.79	1418.59	1169.97	1500.30	1429.72	1354.34	1108.89	14801.45	100.00
		Import	9049.74	11993.99	15163.34	14926.95	16716.23	16757.36	14047.82	17084.71	18888.65	15724.23	13025.91	163378.9	100.00
		% of export to import	8.23	9.48	11.70	10.58	9.48	8.47	8.33	8.78	7.57	8.61	8.51	9.06	

Source: GJEPC

¹² Gem Jewellery Import & Export Statistics - GJEPC India

¹³ The Kimberley Process (KP) | KimberleyProcess

Further, analysis of the exports data vis-à-vis the imports data of respective countries¹⁴ revealed that exports of rough diamonds compared to imports were quite high in respect of countries like UAE and Hong Kong which was at 14.29 *per cent* and 15.20 *per cent* respectively. The exports to Belgium stood at 6.54 *per cent* only even though the majority of imports of rough diamonds (47 *per cent*) were made from Belgium. Similarly, exports to Singapore, Netherland and USA was very high.

The irregular trends in imports and exports to countries such as UAE and Hong Kong have a probable risk of suspicious business transactions and tax evasion that need to be examined in co-ordination with regulating Departments. As diamond imports and exports are subject to clearances by the Department of Customs and fall within their investigative purview, the declarations made by entities of Gems and Jewellery sector that obtain clearances through Department of Customs are required to be verified and examined by the Income Tax Department using a risk based approach. Further, documentation in support of examination are also required to be kept in the assessment records to justify the claims allowed to an assessee and to further reduce the possibility of outgo of precious forex, being siphoned off through illegal channels.

2.2.4 Suspected round tripping of funds and over- invoicing of imports of pearls

Pearls are one of the important commodities in the Gems and Jewellery Sector. During the Performance Audit, Audit compiled and analysed the import and export data of pearls¹⁵ from the website of Ministry of Commerce for the period 2009-10 to 2019-20.

Analysis of import and export figures of pearls revealed that there was not much variation in export of pearl during FY 2012-13 to FY 2017-18 [except FYs 2012-13 and 2013-14], but 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. There was a 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 possible trade mis-invoicing and round-tripping of funds which have been flagged as critical concerns in respect of Gems and Jewellery sector.

¹⁴ 'Others' in respect of export of rough diamond comprise Canada, Thailand, Sri Lanka, Switzerland, China P. Republic, Botswana, Australia, Tanzania, Namibia, Germany, Korea, Japan, Ireland, Taiwan, Armenia, France, Peru, Italy, Philippines, Mauritius, Kiribati Republic, Turkey, Bangladesh, Estonia, Yemen Republic, Brazil, Cambodia, Finland, Lebanon and Zimbabwe.

'Others' in respect of import of rough diamond comprise Ireland, Canada, Switzerland, Botswana, Angola, Sierra Leone, Congo D Republic, Namibia, Australia, Zimbabwe, Thailand, Lesotho, Namibia, China P Republic, Congo P. Republic, Sri Lanka, Netherland, Germany, Ghana, Italy, Slovakia, Japan, Tanzania, Brazil, Armenia, Ukraine, Guines, Korea, Malaysia, Belarus, Guyana, Algeria, Colombia, Cambodia, France, Maldives and Taiwan.

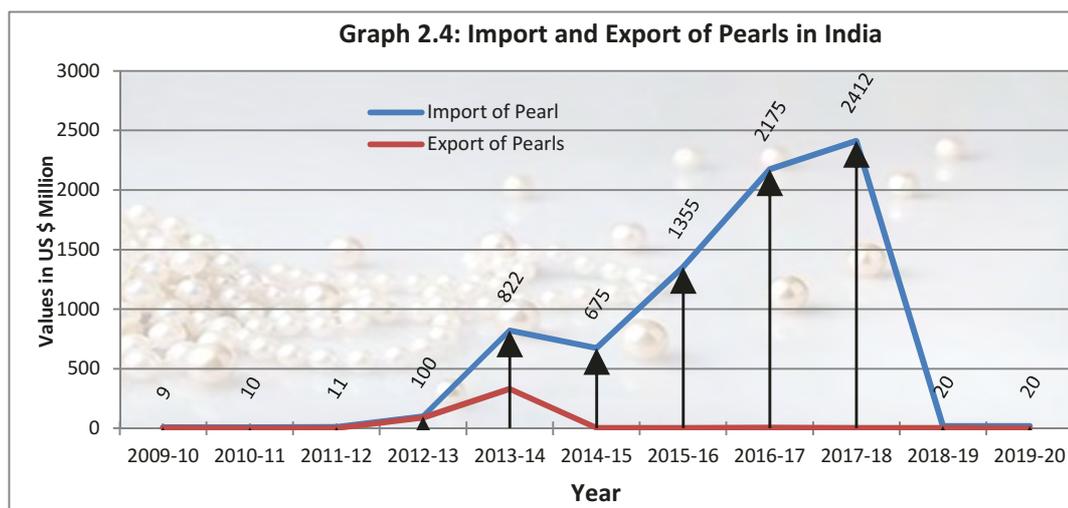
¹⁵ (ITC HS Code 7101)

Another area of examination could be the imports of pearls primarily being made from UAE, Hong Kong and Thailand, whose contribution to global pearl production was negligible. As per the Food and Agricultural Organisation’s (FAO)¹⁶ Report, Japan, China and French Polynesia are the major pearl producing countries/ regions. The details of Imports and Exports of Pearls, Articles of Pearls and Jewellery of Gold set with Pearls are depicted in Table 2.9 and Graph 2.4.

Financial Year	Exports (In US \$ Million)			Imports (In US \$ Million)	
	Pearls	Articles of Natural/ cultured pearls	Jewellery of gold set with pearls	Pearls	Total Imports of G&J Sector
2009-10	3.58	0.36	86.54	8.63	46,321.87
2010-11	1.04	0.05	97.56	9.91	77,054.45
2011-12	2.12	0.08	82.72	11.04	91,074.99
2012-13	90.98	0.14	38.06	100.01	83,896.46
2013-14	329.58	0.02	491.17	821.61	58,464.77
2014-15	3.47	0.00	95.62	674.82	62,379.93
2015-16	3.99	0.03	50.55	1,354.60	56,536.97
2016-17	5.31	0.13	21.50	2,174.76	53,767.41
2017-18	3.98	0.19	27.04	2,412.34	74,710.43
2018-19	2.65	0.58	22.42	19.81	64,720.24
2019-20	1.77	0.29	9.23	20.03	54,493.81
Total	448.47	1.87	1,022.41	7,607.56	7,23,421.33

[Source: Government of India, Ministry of Commerce]

Audit further observed that although there was a substantial rise in import of pearls during the period from FY 2012-13 to FY 2017-18, the total import of Gems and Jewellery sector as a whole remained stagnant or declined during the same period.



[Source: Government of India, Ministry of Commerce]

¹⁶ Food and Agricultural Organisation of the United Nations

Further analysis of nation-wise import of pearls (Table 2.10) indicated that imports were primarily made from the countries such as UAE, Hong Kong and Thailand, whose contribution in the global pearl production was negligible.

Sl. No.	Name of country	Year of import										
		2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
1	HONG KONG	1.93	2.48	4.77	6.35	435.09	434.89	634.24	1,451.74	2,070.42	9.79	8.55
2	U ARAB EMIRATES	0.03	0.03	0.05	85.61	379.19	235.18	677.66	704.22	301.63	0.01	1.42
3	THAILAND	0.03	1.15	0.11	0.09	0.11	0.1	5.04	9.69	22.31	0.26	0.37
4	CHINA P REPUBLIC	1.68	1.71	2.33	3.28	2.68	1.74	5.5	5.26	9.89	4.51	4.1
5	JAPAN	3.02	3.31	3.12	3.54	4.08	1.58	2.32	3.22	5.35	3.99	1.47
6	OTHER COUNTRIES	1.93	1.22	0.65	1.13	0.47	1.31	29.85	0.62	2.74	1.26	4.11
	Total Imports	8.62	9.91	11.04	100.01	821.61	674.82	1,354.59	2,174.76	2,412.34	19.81	20.03

(Source: <https://commerce-app.gov.in/eidb>)

Audit further observed that the majority of the imports of pearls were done by a single corporate group viz. N Group which constituted almost 11.46 per cent to 84.3 per cent quantity-wise and 52.52 per cent to 97.97 per cent value-wise of total import of pearls during the period from FY 2013-14 to FY 2017-18. The audit observation based on analysis of import and export of pearls by the N Group of companies is brought out in para 4.1.2.1 of this report. Audit is of view that there is a distinct possibility that imports of pearls during the period 2012-13 to 2017-18 may not be genuine and was fraught with the risk of pearls being used by hawala operators to launder money by over invoicing and round tripping of imports as has also been concluded by the Enforcement Directorate (ED) in its investigation report in respect of the N Group of cases (May 2018) which found that 20 entities based in the UAE and Hong Kong controlled by the Group were created in order to facilitate layers and laundering of funds from Punjab National Bank (PNB) to camouflage the real intention and identity of beneficiaries of the funds siphoned off from PNB. The transactions during FY 2012-13 to FY 2017-18 may involve potential over-invoicing on import of pearls with underlying risk of significant value of income escaping assessment.

Consequently, the imports of pearls during the period 2012-13 to 2017-18, especially made from Hong Kong, UAE and Thailand, require a comprehensive and coordinated investigation by investigating agencies for examining the aspect of any over-invoicing or round tripping as FATF had indicated in its report¹⁷ (October 2013) that most of the hybrid hawala transactions were routed through major international destination such as Dubai (UAE).

¹⁷ In para 3.6.4 of the report

2.3 Conclusion

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. Country-wise analysis of imports and exports of rough diamonds during the period 2009-10 to 2019-20 revealed that 76 per cent of total imports and 80 per cent of total exports of rough diamonds were to three countries viz. United Arab Emirates, Belgium and Hong Kong whose contribution in global diamond mining were negligible.

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. The imports of pearls primarily being made from UAE, Hong Kong and Thailand, whose contribution in global pearl production was negligible. The Enforcement Directorate in its investigation report in respect of the N Group of cases (May 2018) found that 20 entities based in the UAE and Hong Kong controlled by the Group were created in order to facilitate layers and laundering of funds from Punjab National Bank (PNB) to camouflage the real intention and identity of beneficiaries of the funds siphoned off from PNB. The transactions during FY 2012-13 to 2017-18 may involve potential over invoicing on import of pearls with underlying risk of significant value of income escaping assessment.

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. ITD should have taken appropriate action through utilisation of powers under Black Money Act and DTAAs in view of trade mis-invoicing and hawala transactions.

2.4 Summary of Recommendations

a) *The Department of Revenue (DoR) may consider investigating trends in imports and exports of rough diamonds and pearls to assess the impact of overvaluation/ undervaluation from income tax assessment perspective through utilisation of special powers notified under the Black Money Act and the Double Taxation Avoidance Agreements for obtaining information on foreign transactions related to Gems and Jewellery sector not reported or disclosed through ITRs of the entities engaged in the business of Gems and Jewellery.*

[para 2.2.2 to 2.2.4]

b) The DoR may consider examining the country-wise trends of exports and imports of rough diamonds to verify the reasons for high value imports of rough diamonds from countries with negligible contribution in global production keeping in view the nominal customs duty levied on import of rough diamond and potential for misuse of this commodity being used by unscrupulous traders as a conduit to launder money.

[para 2.2.3]

c) The DoR may consider examining the genuineness of import of pearls in India in co-ordination with other Government Departments/ Agencies as the abnormal trends during 2013-14 to 2017-18, indicated the possibility of round-tripping and mis-invoicing.

[para 2.2.4]

Chapter-3: Regulatory law and procedure governing assesseees of Gems and Jewellery sector

During this performance audit, one of the audit objectives was to examine the adequacy of existing rules, regulations, notifications, circulars etc. in respect of assesseees of Gems and Jewellery sector and to check loopholes/ambiguity in the existing law and procedure, if any. Audit sought to ascertain the existing regulatory law and procedure under the Income tax Act specific to the assesseees of Gems and Jewellery sector while examining the 2,261 assessments¹⁸ during this audit. Audit found that there is no Standard Operating Procedure prescribed by the Central Board of Direct Taxes for finalisation of assessments of entities engaged in Gems and Jewellery related business. Audit noticed that assessments are completed while placing reliance on the quantitative disclosures by the Chartered Accountants through Tax Audit Reports [TAR]. Audit noticed several discrepancies in the disclosures related to inventory made through TAR as discussed in para 5.4 of this Report, warranting further verification during scrutiny assessments.

While examining compliance to other governing provisions viz. section 10AA specified under the Income Tax Act, Audit noticed lacunae in provisions of the Act vis-à-vis the legislative intention for which such provisions were brought into effect. Audit observed that there is no time limit prescribed in the Income Tax Act for timely remittance of export proceeds by Special Economic Zone (SEZ) units for claiming deduction under section 10AA of the Act. In the absence of clarity in the Act, deduction was allowed by ITD even in cases where major part of export proceeds were pending realisation. The allowance of deduction on notional basis may involve risk of allowance of fake transactions. Also, there is no provision under the Act to deal with the share application money pending allotment for a long period. Audit findings in respect of lacunae and gaps in law and procedure are discussed in this Chapter.

Issues noticed in Audit and their Tax effect noticed are summarised in Table 3.1 as under:

Table 3.1: Issues noticed in Audit and their Tax effect

Sl. No.	Para no. and brief description	No. of cases	Tax Effect (₹ in crore)
1	3.1 Absence of time limit for bringing Exports proceeds in convertible foreign exchange to India leading to Irregular allowance of deduction under section 10AA	7	28.57
2	3.2.1 Absence of provision for taxing share premium received from non-residents investors in excess of Fair Market Value	1	System Issue
3	3.2.2 Absence of provision to deal with the share application money which is pending for allotment of shares for long period	1	System Issue
4	3.3 Absence of standard operating process/instructions / guidelines for examining the valuation aspects of Gems and Jewellery	-	System Issue
	Total	9	28.57

¹⁸ 2,261 cases comprised 1,147 cases [processed under section 143(1) of the Act], 572 [assessed under section 143(3) of the Act] and 542 cases [assessed under other sections of the Act].

3.1 Absence of time limit for bringing exports proceeds in convertible foreign exchange to India leading to Irregular allowance of deduction under section 10AA

Government has set up various Special Economic Zones (SEZs) with specific incentives to promote exports of goods and services including the Gems and Jewellery sector, for generation of economic activity and development of infrastructure. The Gems and Jewellery sector involves significantly high value foreign exchange transactions and potentially the risk of money laundering. Monitoring of transactions is significant to ensure allowance of deduction and exemption on eligible incomes or profits.

Tax holiday under section 10AA of the Income-Tax Act for 15 years is available to newly established units in SEZ (100 *per cent* of the profits & gains derived from the export for the first five years, 50 *per cent* of such profits & gains for next five years and further deduction of 50 *per cent* for the next five years subject to creation of Special Reserve).

As per Explanation 1 of section 10AA, "export turnover" means the consideration in respect of export received in, or brought into India by the assessee. Further, as per section 10AA (8) read with sub-section 5 of section 10A, deduction shall not be admissible unless the assessee furnishes the Auditor's Report in Form 56F showing the realisation of export proceeds. Thus, deduction under section 10AA is subject to the condition that the consideration against export turnover has to be brought in India; however, there is no specific provision in the Act prescribing a time limit for bringing such export consideration into India.

Although, RBI monitors the timely remittance of export proceeds and issues Circulars from time to time specifying the period of realisation of export proceeds, this circular is meant for regulating foreign exchange as per the Foreign Exchange Management Act 1999 read with Foreign Exchange Management (Export of Goods and Services) Regulations 2000. However, there is no specific provision in the Income-Tax Act 1961 for timely remittance of export proceeds for claiming deduction under section 10AA although there is a clear provision as per Explanation 1 that export consideration has to be brought into India for allowing deduction. In the absence of clarity in the Income Tax Act, deductions are being allowed in full by ITD, instead of allowing it in proportion to the realisation of export proceeds.

Further, once the deduction under section 10AA has been allowed, ITD has no mechanism in place to monitor the subsequent realisation/ non-realisation of export proceeds.

Audit examined 84 scrutiny cases where the assesseees had claimed aggregate deduction of ₹ 3,101.32 crore under section 10AA of the Act. Of these 84 cases, audit noticed seven scrutiny assessment cases in Maharashtra where ITD allowed the

aggregate deductions of ₹ 115.45 crore under section 10AA against total export turnover of ₹ 5,654.39 crore even though a major part of realisation against export proceeds amounting to ₹ 3,878.95 crore was outstanding for more than six months. The pending export realisation in these cases varied from 40 per cent to 100 per cent of the total export turnover. The allowance of deduction on notional basis involves risk of allowance of fake transactions that require to be monitored to prevent misuse of claims. The potential revenue loss in these cases worked out to be ₹ 28.57 crore. Two such cases are illustrated below:

Box 3.1: Allowance of deduction under section 10AA without exports proceeds being brought in India

(a) Charge: Pr.CIT-8, Mumbai

Assessee: M/s R Pvt. Ltd.

Assessment Year: 2016-17

The return of income of the assessee, a company, for the AY 2016-17 was filed in October 2016 at a loss of ₹ 19.15 crore and the assessment was completed in scrutiny manner (December 2018) under Section 144 of the Act determining loss at ₹ 19.09 crore and book profit of ₹ 5.28 lakh. As per the Profit & Loss Account for the financial year 2015-16, total turnover of the assessee company was ₹ 938.80 crore.

Audit observed (May 2019) from the Form 56F submitted by the assessee in support of deduction claimed under section 10AA that it had earned total profit of ₹ 19.19 crore from its Surat SEZ unit and the entire profit was claimed as deduction under section 10AA. As per details furnished in the Form 56F, exports consideration of ₹ one lakh only was received out of the total exports value of ₹ 589.18 crore during the financial year under consideration. Audit further noticed from the Form 56F that the auditor had mentioned in the prescribed column number 16 that full consideration in convertible foreign exchange for exports was not brought into India within a period of six months from the end of the previous year or within such further extended period as allowed by the competent authority. Thus, although a substantial amount of exports proceeds was not received, the AO neither asked for any justification from the assessee nor made any disallowance of deduction under section 10AA. Audit is of the opinion that disallowance of deduction of ₹ 19.19 crore under section 10AA was not made due to the absence of a specific provision in the Income Tax Act to disallow the deduction in cases of non-realisation of export proceeds. The potential revenue impact in this case works out to ₹ 6.64 crore.

The Ministry has not accepted the audit observation [January 2022] stating that there is no specific provision as per the Income Tax Act prescribing a time limit for receipt of export proceeds under section 10AA of the Act. The Ministry's reply is

not tenable as the main purpose of SEZ is to bring export proceeds into India; however, the absence of time limit is defeating this purpose. Though Section 10AA is a sunset clause, a clarification may be inserted for prescribing the time limit to avoid misuse of the clause. Alternatively, for the purpose of allowing deduction, the ITD may adhere to the time limit as prescribed by the competent authority authorised for dealing in foreign exchange for the time being in force i.e. the RBI. Furthermore, deduction under Section 10AA will be available to assessee till March 2035, if a unit is established in March 2020. The Ministry may, therefore, reconsider the para.

(b) Charge: PCIT 5, Mumbai

Assessee: M/s W Ltd.

Assessment Year: 2012-13

The return of income of the assessee, a company, for the AY 2012-13 was filed in November 2012 at income of ₹ 41.62 crore and the scrutiny assessment was completed (April 2016) under section 143(3) read with section 144C(3) of the Act determining the income at ₹ 45.69 crore thereby raising a demand of ₹ 1.53 crore for AY 2012-13. As per the Profit & Loss Account for the financial year 2011-12, total turnover of the assessee company was ₹ 5,527.99 crore which includes export turnover of ₹ 4,500.26 crore.

Audit observed (January 2018) from the assessment records that the assessee had claimed deduction of ₹ 77.89 crore under section 10AA in respect of profits derived from three SEZ units and there was no discussion and disallowance in the assessment order in this respect. However, audit noticed from the Form 56F and balance sheet of the FY 2011-12 that approximately 64 *per cent* of export proceeds amounting to ₹ 2,877.10 crore was still outstanding for more than six months. In this case also, though a substantial part of exports proceeds was not received, the AO neither asked for any justification from the assessee nor made any disallowance of deduction under section 10AA. Audit is of the opinion that disallowance of deduction of ₹ 77.89 crore under section 10AA was not made due to the absence of specific provision in the Income Tax Act to disallow the deduction in cases of non-realisation of export proceeds. The potential revenue impact in this case works out to ₹ 17.31 crore. Reply of the Ministry is awaited [January 2022].

3.2 Introduction of unaccounted money through share premium and share application money

The Committee headed by the Chairman, CBDT in para 3.24 of its report 'Measures to Tackle Black Money in India and Abroad' (March 2012) had pointed out that '*in many cases, it has been observed that unaccounted income of business groups are*

brought back into the regular books in the form of share application, share capital and share premium, through bogus investment companies popularly known as ‘jama-kharchi’ companies’. To curb the above practice, the Committee recommended that ‘it is imperative to bring necessary amendments in the Act, treating such receipt of share capital and share premium at par with cash credits with onus on the assessee of proving the creditworthiness, genuineness and identity of the shareholder. In case of corporate assessee, the identity should be deemed to be not established if the directors are not traceable on the address given. Such legislation will go a long way in curbing ploughing back of black money’.

3.2.1 Absence of provision for taxing share premium received from non-residents investors in excess of Fair Market Value

To ‘prevent generation and circulation of unaccounted money’ through share premium received from resident investors, amendments were made and clause (viib) of sub section (2) of section 56¹⁹ was inserted vide Finance Act, 2013 i.e., applicable w.e.f. AY 2013-14. However, the said section was not made applicable for consideration (share application money/ share premium) received from Non-resident investors. Nevertheless, the Department has to verify the genuineness of the transactions under existing provisions of section 68 of the Act. As per the provisions of section 68 of Income Tax Act 1961, where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source of the same or the explanation offered by him is not satisfactory in the opinion of A.O., the sum so credited may be charged to income tax as the income of the assessee of that previous year.

Audit examined 37 scrutiny cases where the assessees had received share premium aggregating to ₹ 1,475.28 crore and observed in one scrutiny case in Karnataka that though the assessee had received share premium in excess of the fair market value (FMV) from non-resident, the AO did not add the same due to absence of provision in the Act. The case is illustrated below.

Box 3.2: Illustration of Absence of provision for taxing share premium received from non-residents investors in excess of Fair Market Value

(a) Charge: Pr.CIT-4, Bangalore
Assessee: M/s M Private Limited
Assessment Year: 2016-17

The return of income of the assessee, a company, for the AY 2016-17 was filed in August 2016 at income of ₹ 1.20 crore and the assessment was completed in scrutiny manner under Section 143(3) in June 2018 determining the income at

¹⁹ Section 56(2)(viib) - where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head “Income from other sources”.

₹ 6.13 crore thereby raising a demand of ₹ 2.07 crore for AY 2016-17. As per the Profit & Loss Account of financial year 2015-16, total turnover of the assessee company was ₹ 64.89 crore.

Audit observed (October 2020) from the balance sheet for the financial year 2015-16 that the assessee had issued 18,720 shares to M/s H LLP (non-resident investor) at premium of ₹ 490 per share and received share premium of 0.91 crore. Further, the assessee had issued 50,000 shares to M/s D Pvt. Ltd. (resident investor) at premium of ₹ 990 per share and received share premium of ₹ 4.95 crore. Thus, the assessee received aggregate Share Premium of ₹ 5.87 crore by issuing total 68,720 shares. The assessee also submitted the valuation report to justify the charging of share premium, but the AO while rejecting the said valuation report determined the fair market value (FMV) of share at ₹ 12.58 per share under Rule 11UA of Income Tax rules and added the excess share premium of ₹ 4.94 crore as received from the resident investor to the income of the assessee. However, the excess share premium received from the non-resident investor was neither computed nor any addition was made by the AO although the premium was found to be excessive by him during the assessment. Audit observed from the assessment order [Para 5(e)] that as per the submission of the assessee the amount of share premium received from non-resident would not be covered under Section 56(2)(viib). Since, the AO did not compute the excess premium received from the non-resident, it is implied that the assessee's aforesaid contention was accepted by it. Thus, due to the absence of suitable provision in the Act, the AO was not able to make addition against excess share premium received from the non-investors. Based on the FMV of ₹ 12.58 per share as determined by the AO, the excess share premium against the non-resident investor works out to ₹ 0.89 crore with potential revenue impact of ₹ 0.29 crore.

The Department stated in its reply (December 2021) that the share premium received from non-resident entity cannot be brought to tax as per the provisions of Section 56(2)(viib) of the Income Tax Act as the above provision is not applicable to non-residents but applicable to residents.

The reply of the Department is not acceptable as the genuineness of the share premium should be examined to prevent possibility of unaccounted money being brought into the country in the guise of excessive share premium.

3.2.2 Absence of provision to deal with the share application money pending for allotment of shares for long period

As per Section 42 of the Companies Act, 2013, the companies shall allot shares within 60 days from the receipt of the share application money; otherwise share application money shall be refunded within 15 days from the expiry of 60 days. If a company fails to repay the application money within the aforesaid period, it shall be liable to

repay that money with interest at the rate of 12 *per cent* per annum from the expiry of the 60th day. However, no such provision exists in the Income Tax Act where the assessee accepts share application money and does not issue the shares for long period of time for treating such receipts as income.

Audit observed in one scrutiny case that share application money was pending allotment; however, the AO did not examine its source and also did not make any addition due to the absence of provision in the Act. The non-verification of share application money pending for allotment for a long period is indicative of the risk of routing of black money or illegal money. The case is illustrated below:

Box 3.3: Illustration of share application money pending for allotment of shares for long period

Charge: PCIT-6, Delhi

Assessee: M/s Y Private Limited

Assessment Year: 2016-17

The return of income of the assessee, a company, for the AY 2016-17 was filed in October 2016 at income of ₹ 11.82 lakh and the assessment was done in scrutiny manner under Section 143(3) in December 2018 accepting the returned income as such thereby raising a demand of ₹ 243 for AY 2016-17. As per the Profit & Loss Account of financial year 2015-16, total turnover of the assessee company was ₹ 5.78 crore.

The case of the above assessee for AY 2016-17 was selected by the Department (August 2017) for limited scrutiny to examine '*whether the share application money was genuine and from disclosed sources*'. Audit observed (October 2020) that the AO had mentioned in the Office Note attached to the assessment order that the same share application money of ₹ 2.19 crore was pending for allotment in AY 2015-16 as well as in AY 2016-17; hence, there was no increase either in share capital or in share applicant money pending allotment during the assessment year under consideration. Audit further noticed from the balance sheet of the assessee for the earlier years that the share application money of ₹ 2.19 crore was in fact received in FY 2005-06 and the same has been pending for allotment in AY 2016-17 also; however, even after lapse of 10 years the assessee company did not allot any share to the applicants. Audit observed that nothing was available in the assessment records to show that the AO had examined during assessment as to for how long the share application money was actually pending for allotment and reasons for not allotting any shares to the applicants. Hence, audit could not ascertain from the assessment records how the AO satisfied himself about the genuineness of the transaction.

The possibility of routing its own unaccounted money through share application money by the assessee cannot be ruled out in such cases; however, there was

nothing on record to show that the AO has examined the issue keeping in view this whole gamut of circulation of money in the form of share application money. Thus, no addition to income was made of the share application money pending for allotment although it was pending allotment for ten years.

Audit noticed that though the cases were being selected under CASS on the issue of pending share application money, there is no suitable provision in the Act to tax the share application money which was pending for allotment for a considerable period without any valid reason.

Reply of the Ministry is awaited (January 2022).

3.3 Absence of Standard Operating Procedure/ instructions/ guidelines for examining the valuation aspects of Gems and Jewellery

The issue of over-valuation of imports related to Gems and Jewellery sector has been an area of concern for policymakers and stakeholders. Audit noted that an unstarred question number 3917 was raised in Lok Sabha [answered on 10 August 2018]. While bringing out details of ₹ 2,000 crore scam in Diamond imports which was still under investigation [August 2018], the Government in its reply stated that investigation had been undertaken in respect of a few consignments of 'Rough Diamonds'. In some cases, the value was reassessed as ₹ 1.2 crore as against the declared value of ₹ 156 crore. Similarly, in some other cases, consignments were valued at ₹ 2.62 crore, as against declared value of ₹ 62.66 crore.

As per the FICCI's Study Report (2016)²⁰, quantity of gold imports by India during 2011 to 2015 was more than nearly 1,295 tonnes of what was exported by the rest of the world to India, thus indicating that a huge quantity of gold had entered Indian markets in the form of 'negative' technical smuggling of gold through over-invoicing the value of the quantity of gold that is imported. The average technical smuggling during 2011-2015 was estimated at nearly 259 tonnes with a maximum of 781.34 tonnes in 2011. Further, analysis of the mirror statistics of export and import of gold in terms of value per unit [US\$ million per tonne] in the FICCI report indicates undervaluation of gold. The average undervaluation during 2011-2015 mentioned was between 3.7 US\$ and 8.4 US\$ million per tonne.

Audit examined 2,261 cases²¹ of which 257 cases were assessed under section 143(3) of the Act with complete scrutiny to ascertain whether the Valuation Report was called from External Valuer. The sales turnover of these 257 cases amounted to ₹ 2,09,030 crore, while returned income and assessed income amounted to ₹ 3,970.77 crore and ₹ 5,035.51 crore. Audit found that out of 257 cases assessed

²⁰ Invisible Enemy: A Threat to our National Interests, source: ficci.in

²¹ 2,261 cases comprised 1,147 cases [processed under section 143(1) of the Act], 572 [assessed under section 143(3) of the Act] and 542 cases [assessed under other sections of the Act]

under complete scrutiny, only in two cases of Maharashtra region did the Expert Valuer conduct valuation. In these cases, details of sale of rough diamonds were available in the submission made by the assessee and the assessments were completed, accepting the assessee's income returned at ₹ 53.68 crore. In the remaining 255 assessment cases related to Gems and Jewellery business with sales turnover of ₹ 2,07,716.74 crore and with returned income and assessed income at ₹ 3,917.08 crore and ₹ 4,981.82 crore respectively, no evidence was available in the assessment records with respect to valuation done by external expert. Details of sample cases examined in audit are mentioned in Table 3.2 below:

Table 3.2: Details of sample cases under complete scrutiny examined in audit

(₹ in crore)					
Details of sample cases examined in audit	Number	Sales Turnover	Returned Income	Assessed Income	Additions made
Cases assessed under complete scrutiny under section 143(3) of the Act	257	2,09,030.00	3,970.77	5,035.51	1,064.74
Cases where Returned Income was accepted as Assessed Income	99	24,056.60	510.71	510.71	Nil
Cases where additions were made to Returned Income after scrutiny assessment	146	1,79,087.00	3,341.79	4,415.76	1,073.97
Cases where Returned Income was greater than Assessed Income	12	5,886.39	118.28	109.04	(-)9.24

Source: Assessment records of ITD

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 the existence of an adequate mechanism for valuation of quantitative details of inventory disclosures made by assessee through Income Tax Returns, Tax Audit Reports and other related records submitted by assessee.

As also discussed in the subsequent chapters, valuation of stock is not subjected to detailed verification or examination during scrutiny assessment. Audit noted that in several cases, the disclosures made by the assessee through Income Tax Returns were considered or accepted on face value and disclosures certified through Tax Audit Reports were not being verified during the scrutiny assessment.

3.3.1 Issues of valuation of Inventory including diamonds

Valuation of inventory is a major challenge faced by regulators and bodies administering Gems and Jewellery Industry. Accounting Standard-2 (AS-2) issued by the ICAI prescribes that inventory should be valued at lower of cost or net realisable value (NRV). Stock of diamonds generally subsumes rough diamonds (raw materials), cut and polished diamonds (Finished goods) and diamond rejections (rejected raw materials).

During the planning stage of this performance audit, audit ascertained (March 2019) the assessment and valuation mechanism existing in the Income Tax Department, as brought out below, through a questionnaire regarding valuation of diamonds.

- i. There is no specific Standard Operating Procedure (SOP) or instructions/ guidelines issued by the CBDT specific to assessment of assessees of Gems and Jewellery sector. However, guidance is available on the i-taxnet portal of the ITD wherein a write-up is available on techniques of investigation in assessment of jewellery, bullion and precious stones sector to help the AO in conducting the assessment.
- ii. For examination of valuation of diamonds during assessments, no Valuation Reports are called for. There are no specific guidelines for valuation of rough and polished diamonds. Furthermore, no standard norms were in place and no checks exercised during assessment with regard to wide variation in yield of finished products, average operating profit margin, labour expenses etc. which have bearings on profitability of the assessee.
- iii. The Department has a panel of Registered Valuer for valuation of Gems, Jewellery, Bullions, other precious metals and Stones. However, their services are mainly used only in search and survey actions where they physically verify the articles before valuing them, which is not possible in scrutiny cases since the Assessment Year concerned is well in the past.
- iv. The Department had neither conducted any study on bogus purchase/accommodation entries nor issued any Standard Operating Procedure/ guidelines put in place regarding adoption of percentage of addition to be made against bogus purchases.

Audit further noted that the valuation of the diamond is a very subjective matter, and it becomes very difficult and complex due to its dependency on four Cs i.e. Cut, Clarity, Colour and Caratage (**Annexure-D**). The Tax Audit Report, however, contains only carat- wise quantitative details of diamonds (rough, rejected & polished), and does not give grade- wise (Cut, Clarity, Colour & Caratage) details. In absence of grade wise details of diamonds, it was not clear how the Department was satisfying itself that the value of diamonds declared by assessee was correct. The gradations of diamonds or precious gems based on difference in cut, clarity, color and carat makes it extremely difficult to have a standard valuation methodology.

Audit sought details of mechanism in the Customs Department for assessment and valuation of imports and exports of commodities of Gems and Jewellery sector from the CBIC (September 2021). The CBIC in its reply stated that (October 2021) the valuation of goods imported and exported at Precious Cargo Customs Clearance Centre (PCCC) is done by the Customs Officers on the basis of Customs Valuation Rules (for both Import and Export). Valuation of cut and polished diamonds is done

on the basis of Rappaport Diamond report after providing prevalent trade discounts or as per the past import/ export of similar goods. In case of disputes between the Department and the Importer/ Exporter regarding valuation, the matter is referred to the expert valuers from the Panel²². It was further stated that no specific guidelines/SOP for valuation of commodities of Gems and Jewellery sector have been issued.

Audit could not ascertain the same as details sought in respect of over-invoicing and under-invoicing of imports and exports in respect of commodities of Gems and Jewellery sector was not furnished to audit as pointed out in para 1.5.5 of this Report.

3.3.2 Relevance of valuation as CASS parameter

Audit noticed that the discrepancy in stock of inventory or difference in opening stock vis-a-vis closing stock based on disclosures made in profit and loss account and Tax Audit Report is relatively a less probable parameter for selection of an assessment case for detailed scrutiny or examination under Computer Aided Scrutiny Selection [CASS]. Audit observed that in only 0.09 *per cent* of cases in the audit sample, the criteria for scrutiny selection was the difference in stock or verification of correctness of valuation of stock. Thus, Audit could not ascertain whether the valuation mechanism was built-in for detailed examination of quantitative disclosures of inventory during scrutiny assessments, in the absence of proof of details of valuation in the sampled cases checked in audit. In view of the manipulation in valuation reported by Investigation agencies, valuation of stock of assessments of Gems and Jewellery sector calls for detailed scrutiny in close co-ordination with other Departments.

3.4 Conclusion

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 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. The allowance of deduction on notional basis involves the risk of allowance of fake transactions that require to be monitored to prevent misuse of claims.

Although the Government brought amendment in Section 56(2) by inserting clause (viib) to curb the practice of bringing unaccounted money of promoters / Directors by issuing shares at very high premium, the gate was left open for foreign investors, particularly money coming from tax haven countries and where investee company did not have much net worth or business plan to justify the receipt of huge share premium.

²² As per Public Notice no.30/2018 dated 19.12.2018 Customs shall accept the opinion of the Panel of Experts, except in case of any specific intelligence of any collusion between the Panel and the Importer or Exporter or Broker.

There is no provision in the Income Tax Act to deal with the share application money pending allotment for long period as possible addition to income. The non-verification of share application money pending for allotment for a long period is indicative of the risk of routing of black money or illegal money.

No Standard Operating Procedure (SOP) or instructions/ guidelines has been prescribed by the CBDT for completion of assessment of assessee specific to Gems and Jewellery sector.

The Tax Audit Report, in the present form, gives merely carat- wise quantitative details of diamonds and does not give grade- wise details. In absence of grade - wise details viz. Cut, Clarity, Colour and Caratage, Audit could not ascertain as to how the Department was seeking assurance that the value and stock of diamonds declared by assessee was correct.

- a) Valuation of inventory or stock is a relatively less probable parameter for selection of assessment cases of Gems and Jewellery sector under CASS for detailed verification or examination during scrutiny assessment.
- b) Audit could not ascertain whether the valuation mechanism was built-in for detailed examination of quantitative disclosures of inventory during scrutiny assessments in absence of proof of details of valuation in the sampled cases checked in audit.

3.5 Summary of Recommendations

a) *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]

The CBDT stated in its reply (January 2022) that the provisions of this section are specified by the Special Economic Zones (SEZ) Act which does not mandate any time limit. Section 10AA of the Act is a sunset clause as it only applies to units set up before 1 April 2020. Hence it may not be proper to put this additional condition at this stage.

The reply of the CBDT is not tenable as in the extant scenario, ITD has no mechanism in place to monitor the subsequent realisation or non-realisation of export proceeds once the deduction has been allowed under section 10AA of the Income Tax Act, 1961. It could not be ascertained as to how the realisation of export proceeds is being verified and monitored specifically in respect of assessee availing tax benefits for export promotion. As the realisation of export proceeds need close monitoring, the CBDT may, therefore, re-consider specifying time limit for bringing consideration against export proceeds into India for claiming deduction under section 10AA of the Act on similar lines as specified under other sections of the Act viz. section 10A or 10B to prevent instances of allowance of deduction to ineligible incomes or profits or to

prevent risks of money laundering. Further, though Section 10AA is a sunset clause, a clarification in this regard may be brought out in prescribing the time limit, as deduction under this section will be availed by assessee till March 2035.

b) The CBDT may consider to bring the foreign investors within the ambit of Section 56(2)(viib) to eliminate the possibility of tax evasion in form of share application money/ share premium

[para 3.2.1]

The CBDT stated in its reply (January 2022) that this is an anti-avoidance measure intended specifically for residents in which case this abuse was noted. For non-resident investors, RBI and SEBI regulations are in place regarding private equity/ shareholding involving foreign parties. Section 68 of the Act also has laid down provisions for dealing with share application entries.

The reply of the CBDT is not acceptable as the legislative intent behind introduction of section 56(2)(viib) was to bring into tax net the unaccounted moneys received in the garb of share premium. Further, the genuineness of the share premium should be examined both in the case of residents as well as non-residents. The intention of RBI is to bring forex into the country; however, the ITD is primarily responsible to see whether any unaccounted money is brought in the country in the guise of excessive share premium. Audit noted that the additions made during assessments on account of share premium received in excess of Fair Market Value in the case of non-residents could not sustain²³ in the courts of law due to lacunae in the provision under section 56(2)(viib) of the Income Tax Act, 1961. The CBDT may therefore reconsider the audit recommendation.

c) The CBDT may like to strengthen the system to address the issue of pending share application money after it is due for refund as per the Companies Act to prevent its misuse and possibility of routing of black money in the form of share application money.

[para 3.2.2]

The CBDT stated in its reply (January 2022) that SEBI and Ministry of Company Affairs monitor shareholding and related matters. Further, this pertains to capital contribution not income, and therefore should not be regulated through the Income-Tax Act.

The CBDT may reconsider the audit recommendation as the issue was also flagged as a concern in CBDT's report on 'Measures to tackle Black Money in India and Abroad' brought out in March 2012 wherein it was specifically mentioned that 'there is a common modus operandi adopted by many private companies for introduction of black money, i.e. by way of share application money, share capital or unsecured loan.

²³ ITA No. 176/Ind/2020 [Ruchi J. Oil Pvt. Ltd. Vs PCIT Ujjain, ITAT Indore]

The idle share application money is just like unsecured loan but without interest.’ Although the regulation of shareholding and related matters is done by SEBI and Ministry of Corporate Affairs, the CBDT may consider examining the issue of taxability of unaccounted moneys in the garb of share application money pending for allotment for a long period in co-ordination with regulatory bodies, as appropriate, to prevent its misuse. Further, share premium and unsecured loans are also capital in nature, but provisions are there in the Income Tax Act for making additions of these if not found justifiable.

d) 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]

The CBDT stated in its reply (January 2022) that the suggestion of the C&AG regarding framing of guidelines has been noted and is under examination.

e) 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]

The CBDT stated in its reply (January 2022) that role of tax administration is to check if the provisions of the Act are complied with or not. While designing any form a fine balance must be maintained between tax enforcement and ease of compliance. If each classification is incorporated, the form will become bulky and will impose onerous compliance burden on taxpayers. Hence at this stage, this suggestion may not be feasible.

Audit is of the view that the documents related to valuation of closing stock are to be maintained in line with the requirements of Accounting Standard for valuation of inventories. The CBDT may reconsider the recommendation regarding capturing of grade-wise details of stock in case of high value assessee engaged in Gems and Jewellery business with sufficiently high threshold to be specified by the CBDT to ensure the correctness of valuation to the extent feasible which has a direct bearing on profitability. Audit noted that the Assessing Officers rely heavily upon the disclosures made in the Tax Audit Report (TAR), the Income Tax Return (ITR) filed by the assessee and other submissions made by assessee specific to valuation. Also, at the time of ITR scrutiny, the period covered has long elapsed and it is not predictable for external valuer to easily conduct physical assessments of valuation of inventory of

diamonds held in the past. In view of the same, it is imperative for the CBDT to revisit the relevance and reliability of disclosures made through TAR and ITR.

f) 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]

The CBDT stated in its reply (January 2022) that adequate provisions are in place. Under Section 271 AAD of the Act, penalty can be levied if false entry in books, inflated invoices, bogus purchases etc. is found. The penalty payable by such person shall be equal to the aggregate amount of false entries or omitted entries. Under Section 277 of the Act, prosecution provisions are in place for furnishing a false statement in verification. Section 69C of the Act has provisions relating to unexplained expenditure which gets taxed at the rate of 60 per cent.

Audit is of the view that the provisions specified by the CBDT viz. Section 271AAD, Section 277 and Section 69C of the Income Tax Act are relevant to assessment of claims on account of bogus purchases, inflated invoices etc. Section 271AAD deals with penalty but does not address the issue of percentage addition against bogus purchases. Audit noted inconsistencies in additions made on bogus purchases from accommodation entry providers despite there being similar grounds of additions as brought out in para 6.1.2.2 of this Report. In order to ensure uniformity/ consistency in proportion being brought to tax or additions made on account of bogus purchases and inflated invoices; ITD may undertake a study for ensuring uniformity and consistency in taxation of inflated or bogus claims before framing a Standard Operating Procedure/ guidelines.

g) The discrepancies in disclosures of inventory or stock of items may be accorded priority for selection as well as detailed examination under scrutiny assessments.

[para 3.3.2]

The CBDT stated in its reply (January 2022) that similar risk parameters already exist for selection of cases for scrutiny under CASS.

Although risk parameters exist in respect of the discrepancies in disclosures of inventory or stock of items, audit noticed that in the sampled cases examined in audit the probability of selection of cases under this parameter is very low. Although audit noticed instances of discrepancies in disclosures of inventory or stock of items as discussed in Chapters 4 and 5 of this Report, the proof of verification of discrepancies during assessments was either not available in records or the details of verifications were not clearly recorded in the assessment order. Thus there was an underlying risk of non-examination of discrepancies in disclosures of inventory or stock in case of assessees of Gems and Jewellery sector.

Chapter-4: 360-degree analysis and Compliance issues related to assessments of entities of Gems and Jewellery Sector

Audit attempted to ascertain whether existing systems and controls were adequate to ensure compliance with the general provisions of the Act in the assessments relating to the Gems and Jewellery sector. The assessments undertaken under the Income Tax Act at different stages of processing of the Income Tax Return (ITR) filed by the assessee include summary processing²⁴ under section 143(1) of the Act and scrutiny assessment²⁵ made under section 143(3) of the Act. Audit sought to examine issues related to deficiency /uniformity in the application of provisions of the Act, and compliance with relevant rules and judicial pronouncements during assessment of assessee of this sector.

Audit noticed 230 instances²⁶ of non-compliance to the provisions of the Act involving potential tax effect²⁷ of ₹ 38,449.59 crore as per the quantitative details and other related information in the records furnished by the Income Tax Department and the probable revenue implication as computed by Audit. The category-wise mistakes noticed in assessments and the corresponding tax effect involved are given in Table 4.1 below and detailed audit findings are discussed under different categories of mistakes in para 4.2 to 4.8 of this Chapter.

Sl. No.	Para no. and Nature of Mistakes	No. of cases	Tax Effect (₹ in crore)
1	4.2 Audit findings of 360-degree analysis	33	37,909.38
2	4.3 Irregular exemptions/deductions/relief given	8	18.64
3	4.4 Irregular allowance of business expenditure	40	188.43
4	4.5 Irregular set off/carry forward of losses	14	40.14
5	4.6 Income escaping assessment	67	164.28
6	4.7 Mistakes in computation of tax and interest	58	112.31
7	4.8 Arm's Length Price and reference of the cases to the Transfer Pricing Officer	10	16.41
	Total	230	38,449.59

²⁴ The summary processing of ITR is preliminary checking of errors in ITR without calling for any additional information or documents as in the case of scrutiny assessment. Notice under section 143(1) is issued after automated verification of ITR filed specifying the sum determined to be payable, or the amount of refund due to the taxpayer. If no sum is payable or refundable, the acknowledgement of the ITR will be deemed to be the intimation.

²⁵ Assessment under section 143(3) of the Act is a detailed assessment referred as scrutiny assessment. In a scrutiny assessment detailed scrutiny of ITR is carried out to confirm the correctness and genuineness of various claims, deductions etc. made by the taxpayer in the ITR. The objective of scrutiny assessment is to confirm that the taxpayer has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner. Notice under section 143(2) of the Act can be issued to the assessee calling for information, necessary evidence and explanation for finalising the scrutiny assessment.

²⁶ 230 cases include 45 cases processed under section 143(1) and 185 cases processed under sections 143(3), 144, 147, 154, 250 etc. of the Income Tax Act. These 230 instances of non-compliance include 49 Local Audit Report (LAR) paras raised viz. audit objections raised during regular compliance audit involving tax effect of ₹ 228.95 crore.

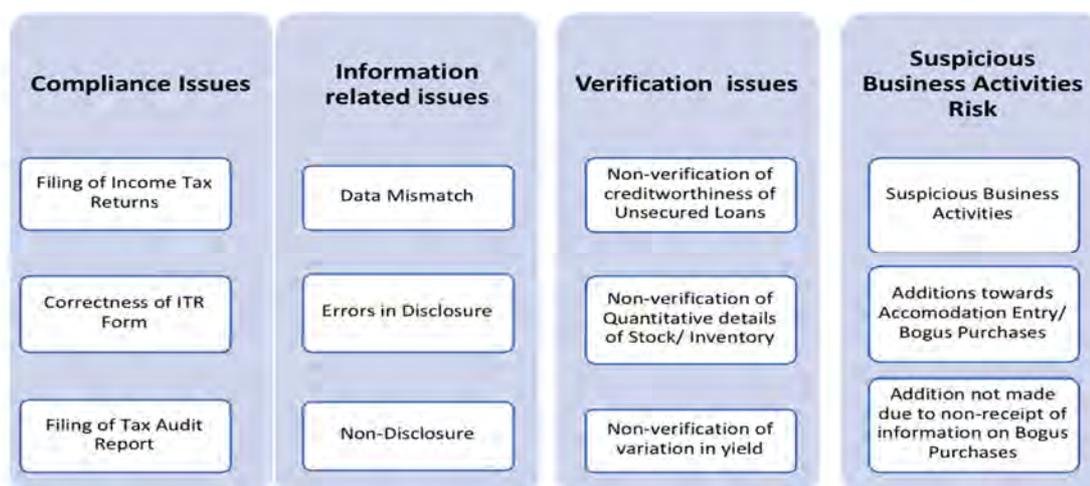
²⁷ The tax implication pertaining to cases examined under 360-degree analysis amounting to ₹ 37,909.38 crore, inter alia, included probable tax implication of ₹ 36,178.44 crore [paras 4.2.4.1 to 4.2.4.5 of this report] in respect of M/s GJ Pvt. Ltd. [PCIT(Central)-1, Chennai] and ₹ 1,719.81 crore [paras 4.2.1.1 to 4.2.1.7 of this report] in respect of M/s DF [PCIT-22, Mumbai]. The tax implication computed by Audit is based on tentative values as per details in assessment records of ITD and may involve overlapping of amounts depending upon the corresponding overlap of quantitative details of different items as per records of ITD which need to be closely examined and verified by the ITD. Further, overlapping cannot be ruled out in the absence of complete details of quantities of stock in the assessment records, furnished to Audit by the ITD.

4.1 Analysis of assessment profile of two group companies of M Group and N group

Audit examined 44 assessments²⁸ of 11 assessees belonging to two groups of companies of the M group and the N group to ascertain the profile of such entities engaged in the business of Gems and Jewellery.

Audit also tried to ascertain different types of risks associated with different stages of assessment viz. Compliance issues relevant to the stage of ITR processing, verification and information related issues relevant to detailed examination or scrutiny assessment stage and issues indicative of suspicious business activities. These issues examined during audit were derived from findings noted through application of related lines of enquiry.

The issues noticed have been grouped mainly under four categories: compliance Issues, information related issues, verification issues and suspicious business activities (Chart below).



The errors or discrepancies noticed in respect of filing of Income Tax Returns, correctness of ITR form and filing of Tax Audit Reports were grouped under Compliance issues; the audit findings related to data mismatch, errors in disclosures made through Income Tax Returns and Tax Audit Reports or non-disclosure of significant details in ITRs and TARs were grouped under Information related risk; findings on non-verification of creditworthiness of Unsecured Loans, quantitative details of Stock/ Inventory and of variation in yield were grouped under Verification issues whereas issues involving suspicious business activities included inconsistencies in additions made on account of bogus purchases or accommodation entries.

²⁸ 44 assessments comprised 17 cases processed under section 143(1), 13 cases assessed under section 143(3) of the Act and 14 cases assessed under other sections [144, 154, 250 etc.] of the Act.

4.1.1 Analysis of assessment profile of M Group

Audit examined 35 cases of entities operating as group companies of M Group with sales turnover of ₹ 64,041.79 crore. The assessee-wise profile of gross receipts or sales turnover, returned income, assessed income and demand raised in respect of these 35 cases are depicted in Table 4.2.

Sl. No.	Assessee	Assessed under section/Date of assessment	Assessment Year	Sales Turnover	Returned Income	[₹ in crore]	
						Assessed Income	Demand as per latest order
1	M/s G1 Ltd.	143(3) 29/12/2016 Complete	2013	472.08	-182.44	8.50	453.72
2		143(3) 29/01/2018 Complete	2014	395.00	-25.24	55.56	77.27
3		144 14/02/2019	2015	8,427.94	0.00	410.22	202.42
4		143(1) Not Available	2017	10,464.77	0.00	0.00	13.85
5	M/s G2 Ltd.	154 29/12/2018	2011	1,341.10	36.92	36.92	2.47
6		143(3) 29/12/2016 Complete	2013	2,283.99	6.05	6.15	0.10
7		143(3) 23/12/2016 Complete	2014	1,494.38	0.00	0.03	0.00
8		143(1) 30/06/2016	2015	1,347.19	0.00	0.00	0.00
9		143(1) 11/12/2016	2016	1,484.07	0.00	0.00	0.00
10	M/s D	154 21/10/2016	2010	291.42	3.95	3.95	0.00
11		250 29/12/2016	2013	332.89	0.00	0.00	0.02
12		143(3) 26/12/2016 Complete	2014	324.74	0.00	0.00	0.00
13		143(1) 20/11/2016	2015	336.09	0.00	0.00	0.00
14		144 26/12/2018	2016	334.43	0.05	7.58	3.19
15	M/s G3 Ltd.	143(3) 22/05/2015 Complete	2012	1,833.56	14.15	49.54	13.07
16		143(3) 29/12/2016 Complete	2013	2,329.58	-30.07	41.65	10.74
17		143(3) 24/12/2016 Complete	2014	2,014.06	0.00	0.00	0.00
18		143(1) 05/11/2016	2015	2,297.59	0.00	0.00	0.00
19	M/s G4 Ltd.	250 02/01/2018	2013	1,377.55	38.39	38.39	0.42
20		143(3)	2014	1,260.02	0.00	0.14	0.00

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		26/12/2016 Complete						
21		143(1) 07/04/2016	2015	1,481.86	0.00	0.00	0.00	
22		144 26/12/2018	2016	1,803.95	0.00	155.47	66.36	
23		143(1) 28/02/2019	2017	2,343.45	0.00	0.00	6.62	
24	M/s N Ltd.	143(1) 17/08/2009	2008	163.64	6.03	6.03	0.03	
25		143(3) 17/04/2016	2012	982.75	21.03	21.06	0.00	
26		250 08/06/2018	2013	1,289.25	11.40	11.49	0.23	
27		143(3) 26/12/2016 Complete	2014	1,240.48	0.00	0.10	0.03	
28		143(1) 23/02/2017	2015	2,605.10	0.00	0.00	0.17	
29		144 28/12/2018	2016	3,042.95	115.11	115.11	36.16	
30		144 01/03/2019	2017	3,802.23	0.00	0.00	18.05	
31		M/s A Ltd.	154 29/12/2018	2011	748.19	9.96	14.17	3.02
32			250 29/12/2016	2013	1,367.82	-22.62	-22.56	0.27
33			143(3) 23/12/2016 Complete	2014	1,142.92	0.00	0.00	0.00
34	143(1) 12/01/2016		2015	1,226.04	0.00	0.00	0.00	
35	M/s G5 Ltd.	154 10/12/2018	2013	358.71	0.87	2.87	1.09	
	Total			64,041.79	3.54	962.37	909.3	

Source: Assessment records of ITD

As evident from the above Table, in 19 cases of seven assessees involving sales turnover of ₹ 37,419.67 crore, nil additions or disallowances were made. Of these 19 cases, in five cases with turnover of ₹ 6,216.67 crore, income of ₹ 2.00 crore was returned as well as assessed whereas in the remaining 15 cases with turnover of ₹ 31,203 crore, nil income was returned as well as assessed.

In the remaining 16 cases with sales turnover of ₹ 26,622.12 crore, additions of ₹ 958.83 crore was made which was around 3.60 *per cent* of the sales turnover. Of these 16 cases, in five cases with turnover of ₹ 14,226.78 crore, income was returned as 'Nil' and assessed as ₹ 565.96 crore with additions made at around 3.98 *per cent* of the turnover. Further, in seven cases with turnover of ₹ 7,830.87 crore where income was returned at ₹ 63.52 crore, additions of ₹ 49.34 crore were made which was around 0.63 *per cent* of the turnover whereas in the remaining four cases with turnover of ₹ 4,564.48 crore where income was returned at loss of ₹ 260.37 crore, additions of ₹ 343.52 crore were made which was around 7.53 *per cent* of the turnover.

The summary of the assessment particulars of entities with nil and a positive addition is given in Table 4.3 below:

Particulars of disallowances made	Details of Returned Income	Number of assessment cases	Sales Turnover	Returned Income	Assessed Income	Additions made	Demand Raised
Cases where nil additions were made	Nil RI	14	31,203.00	0.00	0.00	0.00	38.72
	Positive RI	05	6,216.67	200.40	200.40	0.00	39.08
	Sub-total (A)	19	37,419.67	200.40	200.40	0.00	77.80
Cases where additions were made by AOs	Nil RI	05	14,226.77	0.00	565.96	565.96	268.80
	Positive RI	07	7,830.87	63.52	112.86	49.34	20.69
	Returned Loss	04	4,564.48	-260.37	83.15	343.52	542.01
	Sub-total (B)	16	26,622.12	-196.85	761.98	958.83	831.50
Total	(A)+(B)	35	64,041.79	3.55	962.38	958.83	909.30

Further, Audit attempted to ascertain the risks associated with these cases in terms of compliance requirements, information related risks, verification risk and risk of suspicious business transactions. Audit noticed that out of 35 cases, there were instances of non-verification of significant details such as unsecured loans, yield etc. in 19 cases with turnover of ₹ 39,922.45 crore; discrepancies in disclosure of quantitative details of items traded and manufactured in 16 cases with turnover of ₹ 40,414.59 crore; instances of data mismatch as per ITR vis-à-vis Form 3CD in 10 cases with turnover of ₹ 20,736.24 crore; instances of inconsistent additions on account of bogus transactions in seven cases with turnover of ₹ 18,581.17 crore and instances of delayed/non filing of ITRs in six cases with turnover of ₹ 16,472.57 crore.

Audit noticed that in 30 out of 35 cases of the M Group, there were instances of non-compliance at ITR filing stage, discrepancies in disclosures as per ITRs and TARs, data mismatch as per data maintained by the DGIT(Systems) vis-à-vis assessment data, inconsistent additions made on account of bogus transactions. The company-wise details of audit findings of this group are given in **Annexure E** of this Report. Reply of the Ministry is awaited (January 2022).

Audit further examined in detail the assessment details of a company of the M Group viz. M/s G4 Limited for AYs 2013-14 to 2017-18 to assess the risks associated with the assessee based on disclosures made through returns and reports. Details examined during assessment of the assessee have been discussed below:

Assessee: M/s G4 Limited

AYs: 2013-14, 2014-15, 2015-16, 2016-17, 2017-18

Charge: Pr.CIT(Central)-1 Mumbai

The summary of the assessment particulars of gross receipts or turnover, returned income, assessed income and demand raised in respect of the assessee are shown in Table 4.4 below.

AY, Assessed under section	Date of filing of ITR	Date of assessment	Gross Turnover	Returned Income	Assessed Income	Additions made
2013-14 250	30-11-2013	02-01-2018	1,377.55	38.39	38.39	0.00
2014-15 143(3)	30-11-2014	26-12-2016	1,260.02	0.00	0.14	0.14
2015-16 143(1)	30-11-2015	07-04-2016	1,481.86	0.00	0.00	0.00
2016-17 144	30-11-2016	26-12-2018	1,803.95	0.00	155.47	155.47
2017-18 143(1)	30-11-2017	28-02-2019	2,343.45	0.00	0.00	0.00
2018-19		Non-Filer				
2019-10		Non-Filer				

Source: Assessment records of ITD

Audit noted that the assessment of the assessee for AY 2016-17 was completed under section 144 of the Act (November 2016) at an income of ₹ 155.47 crore after rejecting the books of accounts furnished by the assessee. While completing assessment for AY 2016-17 the AO disallowed amount of ₹ 123.70 crore on account of bogus purchases made by the assessee suggesting risk of suspicious transactions being undertaken by the assessee.

Audit further analysed the quantitative details disclosed made by the Company in the Form 3CD (i.e. Tax Audit Report) in respect of jewellery and noted the following details as tabulated in Table 4.5 below:

AY/ Assessed under Section	Opening Stock	Purchases	Quantity manufactured	Sales	Closing Stock	Shortage as per TAR
2013-14 250	61,746	8,999	7,42,828	7,46,592	66,986	0
2014-15 143(3)	66,986	1,10,153	1,79,960	2,28,868	1,28,231	0
2015-16 143(1)	77,204	0	39,59,843	35,58,693	4,78,353	0
2016-17 144	4,78,353	6,19,375	0	8,39,917	2,57,812	0
2017-18 143(1)	2,57,812	1,59,101	0	1,15,898	3,01,015	0

Source: Assessment records of ITD

Audit observed that as per the disclosures made in the Tax Audit Report, quantity of manufacturing of jewellery during AY 2015-16 increased abnormally high to 39,59,843 nos compared to 1,79,960 nos in AY 2014-15 whereas purchases declined to Nil in AY 2015-16 as against 1,10,153 units in AY 2014-15. Thereafter, during 2016-17 and 2017-18 the quantity manufactured was disclosed as Nil whereas purchases were disclosed as 6,19,375 and 1,59,101 in AYs 2016-17 and 2017-18 respectively. Further, the closing stock of jewellery in AY 2014-15 was disclosed as 1,28,231 whereas the opening stock in AY 2015-16 was disclosed as 77,204 only. Although the closing stock of jewellery for AY 2014-15 did not match with the opening stock of AY 2015-16 the discrepancy was not pointed out by the ITD IT systems as the case for AY 2015-16 was processed under summary assessment through CPC Bengaluru. The discrepancy in stocks disclosed through TARs was required to be examined further specifically as the books of accounts of the assessee were rejected during AY 2016-17 due to bogus purchases made by assessee.

Further, the assessee did not file ITRs during AY 2018-19 and 2019-20.

Thus, audit observed that there was a risk of non-compliance and suspicious transactions in respect of the above assessee. Audit could not ascertain the action taken by the ITD in these cases. Reply of the Ministry is awaited (January 2022).

4.1.2 Analysis of assessment profile of N Group

Audit examined nine cases of entities operating as group companies of N Group with turnover of ₹ 20,953.25 crore, details are mentioned in Table 4.6 below.

Sl. No.	Assessee	Assessed under section/ Date of Assessment	AY	Sales Turnover	Returned Income	Assessed Income	Demand Raised as per latest order
1	M/s FI Pvt. Ltd.	143(3) 28/03/2016	2012	2,522.80	0.00	0.00	0.17
2		143(3) 20/04/2016	2013	3,454.80	0.00	0.00	0.16
3		143(1) Not Available	2017	5,226.14	44.01	44.13	0.00
4	M/s DR	143(1) Not Available	2015	878.93	0.00	0.00	0.00
5		143(1) Not Available	2016	1,485.08	0.73	0.73	0.00
6		143(1) Not Available	2017	2,744.66	5.14	5.14	0.00
7	M/s SD	143(1) 12/11/2018	2015	657.14	0.00	0.00	0.00
8		143(1) 12/11/2018	2016	1,328.80	0.00	0.00	0.00
9		143(1) 12/11/2018	2017	2,654.90	0.00	0.86	0.00
	Total			20,953.25	49.88	50.86	0.33

Audit noticed that in seven cases involving sales turnover of ₹ 13,072.22 crore, nil additions or disallowances were made. Of seven cases where nil additions were made, in two cases income of ₹ 5.87 crore was returned as well as assessed whereas in the remaining five cases, nil income was returned as well as assessed. In two cases with gross turnover of ₹ 7,881.04 crore, additions of ₹ 97.76 lakh were made which was around 0.01 *per cent* of the sales turnover, as detailed in Table 4.7 below.

Particulars of disallowances made	Details of Returned Income	Number of assessment cases	Sales Turnover	Returned Income	Assessed Income	Additions made	Demand Raised as per latest order
Cases where nil additions were made	Nil RI	05	8,842.47	0.00	0.00	0.00	0.34
	Positive RI	02	4,229.75	5.87	5.87	0.00	0.00
	Sub-total (A)	7	13,072.22	5.87	5.87	0	0.33
Cases where additions were made by AOs	Nil RI	01	2,654.90	0.00	0.86	0.86	0.00
	Positive RI	01	5,226.14	44.01	44.13	0.12	0.00
	Sub-total (B)	02	7,881.04	44.01	44.99	0.98	0.00
Total	(A)+(B)	09	20,953.26	49.88	50.86	0.98	0.33

Source: Assessment records of ITD

In nine cases of N Group, audit noticed instances of non-compliance at ITR filing stage, discrepancies in disclosures as per ITRs and TARs and data mismatch as per data maintained by the DGIT (Systems) vis-à-vis assessment data. The assessee-wise details of audit findings of this group are given in **Annexure F** of this Report.

4.1.2.1 Analysis of imports and exports of pearls by entities of N Group

Analysis of the import and export data of pearls obtained from the Ministry of Commerce during the period 2009-10 to 2019-20, as brought out in para 2.2.3 of this report, indicate an abrupt rise in import of pearls during FY 2012-13 to FY 2017-18 followed by a sudden fall in import from FY 2018-19. Further, import of pearls in India during 2013-14 to 2017-18 was 3 to 10 times more than the average annual value of global production of pearls.

Audit had requisitioned the list of top importers of pearls during the period from FY 2012-13 to FY 2017-18 from the ITD (October, 2020). The ITD provided the details of import and export of pearls in respect of five entities²⁹ belonging to the N Group. Analysis of the data revealed that the import of pearls by these five entities constituted almost 11.46 *per cent* to 84.3 *per cent* quantity-wise and 52.52 *per cent* to 97.97 *per cent* value-wise of total import of pearls during the period from FY 2013-14 to FY 2017-18, as detailed in Table 4.8 below.

²⁹ M/s SE, M/s FD Pvt. Ltd., M/s FI Pvt. Ltd, M/s SD and M/s DR.

AY	Import of pearls by five entities of N Group*		Total import of pearls in India**		Percentage import of total import by five entities of N Group	
	Quantity in tonnes	Value (USD Mn)	Quantity in tonnes	Value (USD Mn)	Quantity [per cent]	Value [per cent]
2014-15	15.73	643.49	137.24	821.61	11.46	78.32
2015-16	21.24	661.10	50.61	674.82	41.97	97.97
2016-17	49.65	1,078.07	86.93	1,354.60	57.12	79.59
2017-18	84.43	1,735.66	100.16	2,174.76	84.3	79.81
2018-19	55.14	1,267.00	160.25	2,412.34	34.41	52.52

* Data as provided by ITD.
** Data source: GJEPC

Audit also observed that the majority of the imports of pearls and exports of pearl studded jewellery made by these five entities were from their group companies/related parties set up in Hong Kong and UAE only.

Audit further observed that in the case of M/s DR and M/s SD, all the exports of pearl studded jewellery during the period from F.Y. 2015-16 to 2017-18 were made to the same parties from whom pearls were imported. In the F.Y. 2013-14 and FY 2014-15, apart from export to the same suppliers from whom pearls were imported, a few exports were also made to others related parties in UAE and Hong Kong. Further, in respect of F1 Pvt. Ltd. and F2 Pvt. Ltd. though exports were not to the same party from whom pearls were imported, they were to group companies situated in those countries.

As per the assessment records, the Enforcement Directorate (ED) had conducted investigations in the N Group of cases (May 2018) and found that 20 entities based in the UAE and Hong Kong controlled by N Group from among the companies listed in Table 4.9 below were created in order to facilitate layers and laundering of funds from Punjab National Bank (PNB) to camouflage the real intention and identity of beneficiaries of the funds siphoned off from PNB.

S. No.	Name Of Supplier/ Consignee	Country
1.	S1 Limited	Hong Kong
2.	S2 Limited	Hong Kong
3.	D2	UAE
4.	D3	UAE
5.	E1	UAE
6.	E2 Ltd.	Hong Kong
7.	F1 Ltd.	UAE
8.	F2	UAE
9.	F3 Limited	UAE
10.	H1	UAE
11.	H2	UAE
12.	P	Hong Kong

13.	S3	United States
14.	S4 Limited	Hong Kong
15.	S5 Limited	Hong Kong
16.	T1	UAE
17.	U1	UAE
18.	U2	UAE
19.	U3 (Branch)	UAE
20.	V1 (Branch)	UAE
21.	W1 (Branch)	UAE
<i>Source: ITD</i>		

As the parties with whom exports/ imports were undertaken by five entities of N Group were created for laundering of funds, there was a significantly high risk that the imports and exports of pearls/ pearl-Jewellery were not genuine. Further, audit noted that all the imports and exports of pearls/pearls jewellery were made from a single port viz. S Special Economic Zone, Gujarat.

The ITD may examine the feasibility of identification of entities involved in the import and export of pearls/ pearl studded jewellery during the period from FY 2013-14 to FY 2017-18 for further investigation of genuineness of transactions.

Audit also 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. Reply of the Ministry is awaited (January 2022).

4.1.2.2 Non levy of penalty under section 271BA of the Income Tax Act for non-furnishing of Form 3CEB for three years despite high value international transactions

Audit noticed that all three assessee companies of N group did not file their returns of income for AY 2018-19 and 2019-20 though they had filed their ITRs for AY 2016-17 and 2017-18. Further, one assessee company although had entered into high value international transactions amounting to ₹ 1,254.80 crore, ₹ 2,511.90 crore and ₹ 5,406.92 crore during AY 2015-16, 2016-17 and AY 2017-18 respectively, the assessee did not file form 3CEB as per compliance requirement under the Act. The ITD did not levy penalty under section 271BA of the Act, also discussed in para 4.8.2 of this Report, is illustrated below:

Assessee: M/s SD

Charge: PCIT (Central)-3 Mumbai

AYs: 2015-16, 2016-17, 2017-18

The return of income filed by the assessee for AYs 2015-16, 2016-17 and 2017-18 were processed under section 143(1) of Act in November 2017. In all three years, the assessee reported large turnover but filed return [ITR-5] at nil income, which is indicative of associated risks warranting further verification and examination. All the cases for three years were processed under section 143(1) of the Act, implying that the ITD system did not have an adequate control/ check for flagging non-compliance of filing of Form 3CEB, despite substantial international transactions (Table 4.10), delay in processing ITRs and levy of penalty as per requirement in the Act. This resulted in non-levy of penalty of ₹ 3 lakh under section 271BA of the Act.

Table 4.10: Details of international transactions as per books of accounts of assessee				
Name of Assessee	AY, assessed under section	Date of referral of case to TPO by the Assessing Officer	Reasons for referral of case to TPO by the Assessing Officer	Aggregate value of international transactions as per books of account [₹ in crore]
M/s SD	2015-16 143(1)	12/11/2018	Large international transactions	1,254.80
M/s SD	2016-17 143(1)	12/11/2018	Large international transactions	2,511.90
M/s SD	2017-18 143(1)	12/11/2018	Large international transactions	5,406.92
<i>Source: Assessment records of ITD</i>				

Audit further noted that a search action under Section 132 was carried out in the company in January 2017. As per the details in the assessment records, Directorate of Enforcement, Mumbai conducted investigations of the Group of cases and filed a charge sheet in May 2018. During the investigations, information on imports and exports made by the assessee from its unit at Surat SEZ was called for in respect of these AYs. Subsequently, the assessments of the assessee under section 153A read with section 144 for the AYs 2015-16 and 2017-18 were completed in December 2019 at income of ₹ 59.15 crore and ₹ 347.51 crore respectively.

Audit further noticed that in the Tax Audit Report, complete disclosures of financial particulars were not made. Although turnover of the previous year and preceding previous year had been disclosed, the Stock in trade/ Turnover were not disclosed in TAR for AY 2016-17 and AY 2017-18. The details of disclosures made through Form 3CD are tabulated below.

Table 4.11: Disclosures made in Form 3CD furnished alongwith ITR				
AY, assessed under section	Name of Partner/ [Profit Sharing Ratio]	Total Turnover [Sl. No.40 of Form 3CD] [Previous Year]	Total Turnover [Sl. No.40 of Form 3CD] [Preceding Previous Year]	Stock in trade/ Turnover [Sl. No. 40 of Form 3CD]
2015-16 143(1)	N Family Trust; N Family; 25:75	633.25	1,788.85	0
2016-17 143(1)	N Family Trust; N Family; 25:75	1,292.38	633.25	Not Available
2017-18 143(1)	N Family Trust; N Family; M Trust; MJS 0.5:0.5:49.5:49.5	2,654.90	1,292.38	Not Available
<i>Source: Assessment records of ITD</i>				

Further, the assessee did not file the return of income in AY 2018-19 and 2019-20. Action taken by the ITD in this regard could not be ascertained from the records produced to Audit.

Thus the assessee was non-compliant during AYs 2015-16, 2016-17 and 2017-18 in respect of non-furnishing of Form 3CEB and during AY 2018-19 and 2019-20 in furnishing of ITR indicative of risk of non-compliance on many counts in the instant case. However, delay in taking the remedial action in a timely manner in the instant case resulted in huge revenue loss to the exchequer, as the probability of recovering the outstanding demands seems to be remote.

Reply of the Ministry is awaited (January 2022).

4.2 360-degree analysis of assessments

During the performance audit, 74 cases in respect of 31 major assesseees were selected for 360-degree analysis on pan-India basis to ascertain whether the credibility/genuineness of various transactions such as incomes and expenses, sales/purchases, unsecured loans, loans and advances given to or received from other assesseees, sundry debtors and sundry creditors were examined and whether the details reflected in the records of the assessee were verified vis-à-vis the details as per records of the related parties while completing these assessments.

Further, audit identified 173 cases of related parties in respect of 31 major assesseees with a view to ascertain the genuineness of the claims of various expenses (salary, rent, etc.) made by the main assesseees and veracity of the same vis-à-vis details as per records of related parties.

Out of 74 cases selected, 48 cases were assessed in scrutiny under section 143(3) and the remaining 20 cases were processed in summary manner under section 143(1) of the Income Tax Act. Out of the above 74 cases, 45 corporate assesseees had shown total turnover of ₹ 89,127.80 crore and returned income of ₹ 1,404.66 crore, while ITD assessed the income of these assesseees at ₹ 1,848.16 crore and raised demand

of ₹ 797.34 crore in these cases. The remaining 29 cases pertained to non-corporate assessees, which had shown total turnover of ₹ 16,983.94 crore and returned income of ₹ 63.11 crore, while ITD assessed the income of these assessees at ₹ 87.16 crore and raised demand of ₹ 17.02 crore in these cases. The details are given in Table 4.12 below:

Type of assessee	Type of assessment	Number of assessment cases	Turnover	Returned income	Assessed income	Demand
Company	Scrutiny	30	71,856.67	1,286.05	1,820.47	783.35
	Summary	15	17,271.14	118.61	27.69	13.99
	Company Total	45	89,127.81	1,404.66	1,848.16	797.34
Firm	Scrutiny	13	12,045.98	39.17	68.42	17.01
	Summary	2	4,793.69	21.06	16.31	0.00
	Not known	4				
	Firm Total	19	16,839.67	60.23	84.73	17.02
HUF	Scrutiny	2	81.74	0.09	0.09	0
	Summary	2	59.30	0.46	0.00	0
	HUF Total	4	141.04	0.55	0.09	0
Individual/ proprietor	Scrutiny	3	0.49	2.25	2.25	0.00
	Summary	1	2.75	0.09	0.09	0
	Not known	2				
	Individual Total	6	3.24	2.33	2.34	0.00
Grand Total		74	1,06,111.75	1,467.77	1,935.32	814.36

Source: Assessment records of ITD

Non-production of records

Of the 74 cases selected, records were not furnished in 12 cases due to which the examination of cases selected could not be undertaken. The case-wise details of records not furnished in respect of main assessees examined under 360-degree analysis are given at **Annexure G**.

Of 173 cases of the related parties selected, records pertaining to 59 related parties were not furnished. Audit could examine records of 114 related parties. Details of records not furnished are given in **Annexure H** of this report.

As audit examination was limited to the sample selected for 360-degree analysis and records furnished by ITD, the CBDT may consider reviewing related party transactions of significant value pertaining to other related parties that were not examined in audit.

Audit observed various irregularities like non-examination of suspicious business activities; unexplained excess output, short accounting of stocks, and non-verification of difference in claims made by assessee as per records of the assessee vis-à-vis the records of the related party in these cases. Audit raised a total of 134 audit observations with potential tax effect of ₹ 37,948.16 crore in respect of cases selected for 360 degree analysis and 32 audit observations having tax effect of

₹ 142.85 crore in respect of related parties. Out of these observations, 33 significant issues noticed in respect of seven assessees involving tax effect of ₹ 37,909.38 crore are discussed in para 4.2 below, while the remaining issues have been incorporated under suitable headings of this report. Such irregularities were indicative of the risk of tax evasion due to non-verification and risk of suspicious business activities that require detailed examination and verification by the ITD.

4.2.1 Audit findings in respect of M/s DF (Pr.CIT-22 Mumbai)

Audit examined the assessment records of M/s DF for AY 2013-14 to AY 2018-19 assessed under Pr.CIT-22 Mumbai charge. The income tax return for AY 2015-16 was processed in a summary manner in February 2017 and the return for AY 2018-19 was processed under section 143(1) of the Act³⁰. The assessment particulars viz. turnover, returned income, assessed income and demand raised by ITD in respect of the assessee for AYs 2013-14 to 2018-19 are given in Table 4.13 below:

AY	Turnover	Returned income	Assessment section	Assessed income	Date of order	Demand
2018	2,636.50	4.74	143(1)	Order under Section 143(1) was not furnished by Department		
2017	2,048.56	2.61	143(3)	2.61	19/12/2019	0
2016	2,882.76	5.84	143(3)	5.84	29/12/2018	0.00
2015	2,157.18	16.31	143(1)	16.31	29/02/17	0.0044
2014	1,896.63	0.30	143(3)	9.15	29/12/2016	0.32
2013	4,449.30	0.00	143(3)	0.00	17/07/2015	0.00

Source: Assessment records of ITD

The scrutiny assessments of the assessee for AYs 2013-14, 2014-15, 2016-17 and 2017-18 were completed in July 2015, December 2016, December 2018 and December 2019 determining income at Nil, ₹ 9.15 crore; ₹ 16.31 crore, ₹ 5.84 crore and ₹ 2.61 crore respectively.

Records not furnished in respect of M/s DF [PCIT-22 Mumbai]: The party-wise details of purchases and sales (imports and exports) for AY 2016-17 and party-wise details of purchases (imports) for AY 2014-15 were not furnished to audit. Further in respect of AY 2013-14 assessee's submission folder, Balance Sheet, Profit and Loss Account, Report in Form 56F, Profit and Loss account of SEZ unit and working of 10AA deduction were not furnished to audit. For AY 2018-19, records related to summary processing under section 143(1) of the Act were not furnished to audit. Audit examination of the assessments of this assessee was therefore constrained to that extent.

³⁰ Order under section 143(1) of the Act for AY 2018-19 was not furnished to Audit.

A 360-degree analysis of the assessment records of the assessee firm revealed irregularities such as insignificant expenses vis-à-vis large annual turnover [AY 2013-14 to AY 2016-17], unexplained excess output of gold bars [AY 2016-17, AY 2017-18], irregular allowance of deduction under section 10AA despite there being no manufacturing activity in its Surat SEZ [AY 2013-14], non-verification of discrepancy in opening stock of gold [AY 2016-17] versus closing stock of earlier year [AY 2015-16], discrepancy in disclosures of quantitative details as per Form 3CD and ITR [AY 2015-16 to AY 2018-19], incorrect allowance of forward contract premium [AY 2013-14, AY 2014-15] and irregular allowance of speculation loss [AY 2013-14].

Audit examined the records of two related parties³¹ of M/s DF to verify the rent and interest expenses as claimed by the assessee. These related parties had duly accounted the rent and interest income in their books of accounts. Further, purchases and sales were mainly made through imports and exports from overseas parties which were disclosed by assessee as non-related parties. The details of related parties of this assessee are given at Sl. no. 13 of **Annexure H** of this report.

The details of audit observations in respect of the main assessee firm are brought out in paras 4.2.1.1 to 4.2.1.7 below:

4.2.1.1 Suspicious business activities

Audit examined the records of the assessee and observed that various expenses as shown by it were not justifying the huge sales turnover. The assessee started a unit in Surat SEZ vide the Letter of Approval dated 25.08.2010. In the AY 2013-14 and AY 2014-15, the assessee carried out trading in jewellery, pearls from Surat SEZ. Subsequently it got a licence from Directorate General of Foreign Trade on 07.03.2014 for gold refinery at Rudrapur. The licence for refinery was initially granted for 2 MT only, since 20:80 Scheme of RBI restricted the import of gold/ gold doré bars in the Country during operation of 20:80 scheme. In AY 2015-16 and AY 2016-17, the assessee had shown income mainly from sale of gold bars manufactured from its gold refinery. The activities of the assessee firm for four assessment years are given in Table 4.14 below:

Table 4.14: M/s DF				[₹ in lakh]
Main Business Activity during the year	AY 2013-14	AY 2014-15	AY 2015-16	AY 2016-17
	Trading of Jewellery	Trading in Pearls	Gold Refinery	Gold Refinery
Sale of Goods	4,44,930.90	1,89,663.30	2,15,718.32	2,88,276.87
Labour expenses	0	0	136.22	146.14
Salary & wages	63.84	1.12	119.12	140.94
Electricity expenses	0.99	1.26	4.58	4.67

Source: Assessment records of ITD

³¹ M/s SM Pvt. Ltd. and M/s SH Pvt Ltd.

Analysis of data disclosed that there was a distinct possibility that the assessee was not carrying out genuine business activities in certain areas as discussed below:

- Although the total turnover of the assessee ranged from ₹ 1,896.63 crore to ₹ 4,449.31 crore during these years, electricity expenses of only ₹ 0.98 lakh to ₹ 4.67 lakh were incurred. This does not appear to be realistic as trading activity during AY 2013-14 and AY 2014-15 and manufacturing activity during AY 2015-16 and AY 2016-17 of such a large business requires substantial electricity expenses. From FY 2015-16 onwards, the assessee added one refinery at Rudrapur and had an existing unit at Surat SEZ, and one office in Mumbai. If the assessee was actually involved in such a large business, there must have been substantial electricity expenses for achieving such a huge turnover.

Audit observed that this aspect was, however, not verified by the AO during the assessment. Audit compared the power consumption of assessee firm with other two gold refiners viz (i) M/s SG Refinery Ltd., a company which is in gold refinery business for more than 30 years and listed in NSE and BSE and (ii) M/s MP Ltd. a Joint Venture between M/s M Ltd., a PSU Company and P SA, Switzerland. M/s MP Ltd. is the only gold refinery in India which is accredited by LBMA (London Bullion Market Association). M/s SG refinery Ltd. consumed power of ₹ 1.23 crore to achieve turnover ₹ 3,895.34 crore for the year ended 2016. Similarly, M/s MP Ltd. with turnover ₹ 24,560.70 crore consumed power of ₹ 7.46 crore, as given in Table 4.15 below. Therefore, power consumed by the assessee firm [₹ 4.6 lakh] for running a gold refinery and a SEZ unit and an office in Mumbai was negligible and appeared unrealistic.

	[₹ in Crore]		
AY 2016-17 (FY 2015-16)	M/s MP Ltd. ³²	M/s SG refinery Ltd. ³³	M/s DF
Turnover	24,560.70	3,895.34	2,882.76
Electricity	7.46	1.23	0.046
Labour expenses	27.82	5.4	1.46

- Labour charges and freight/transportation charges were insignificant as compared to turnover and when compared with other refinery This creates doubts about the genuineness of import and export of materials by the assessee on such a large scale by incurring insignificant expenses on account of electricity and labour expenses. No verification was, however, made by the AO in this regard.

³² M/s MP Ltd. is a Joint Venture between M/s M Ltd., a PSU Company and P SA, Switzerland. M/s MP Ltd. is only gold refinery in India which is accredited by LBMA (London Bullion Market Association's)

³³ M/s SG Refinery Ltd., a company which is in gold refinery business for more than 30 years and listed in NSE and BSE.

- In the A.Y. 2014-15, the assessee had furnished the name of the parties to whom pearls were exported, but, no details of parties had been given from whom the traded goods were imported. In the A.Y. 2016-17, parties from whom gold doré bars were purchased/imported and parties to whom exports were made were not available on record. In absence of these details, it could not be ascertained in audit whether imports were from actual gold miners or they were purchased from some related party/ entities formed in UAE or other countries and whether assessee was merely doing round tripping of product. Further, Audit noted that the AO had not called for any documentary evidence such as bills of entry, foreign exchange realisation certificates, etc. which could establish the genuineness of the transactions. No such details were available in Annual Information Return/Individual Transaction Statement of the Department.

Although the aforesaid discrepancies necessitated a detailed investigation of the activity of the assessee. However, this was not done and the assessee's submission was accepted by the Department. This was pointed out to the Department in August 2019. Reply of the Ministry is awaited (January 2022).

In the Customs Performance Audit Report on the Gems and Jewellery sector³⁴, Audit had pointed out that M/s DF was accorded approval by the Directorate General of Foreign Trade (DGFT) (March 2014) to import gold doré bars. The assessee was given approval to import doré bars by the DGFT without issuing notification which contravened the procedure prescribed by RBI in its circular dated 14 February 2014. It is worthwhile to mention here that the assessee was given approval to import gold doré bars at a time when RBI's 20:80 scheme was operational and import of gold bars and gold doré bars were restricted for imports in the country.

On an average, a doré bar contains 50-75 *per cent* pure gold³⁵ and rest is composed of a mixture of silver and/or other base and precious metals. The pictorial depiction of the composition of a doré bar is given below.



³⁴ Audit Report no. 06 of 2016 on Performance Audit on Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof, imitation jewellery, coins (Chapter 71 of CTH)

³⁵ <https://www.bullionbypost.co.uk/index/gold/gold-doré/#>

The exact composition varies widely depending on its source and processing history. However, it was noticed that in case of M/s DF, no by-products of silver bars or other precious metals were produced during the refining process. This further raises doubts on genuineness of activity of the assessee.

Audit further noted that India has only one London Bullion Market Association (LBMA)³⁶-accredited gold refinery³⁷, M/s MP Ltd., and this assessee was not enlisted under the same as per the Good Delivery list of Gold refineries worldwide. Only refiners whose bars have been accredited by LBMA as made by the existing standards for trade in the global OTC market appear in the Good Delivery list. This necessitated further enquiry in respect of credibility and genuineness of the refinery activity undertaken by the assessee during the said FYs.

Reply of the Ministry is awaited (January 2022).

4.2.1.2 Un-explained excess output

The scrutiny assessment of M/s DF for AY 2016-17 was completed in December 2018 under section 143(3) of the Act accepting the assessee's returned income of ₹ 5.84 crore. Audit observed (August 2019) from the Tax Audit Report and Profit & Loss Account that during the year, the assessee had mainly manufactured Gold Bars from the Gold doré bars and sold them. As per details available in the Tax Audit Report, the assessee was able to manufacture 20,106.52 kg of gold bars (99.5 per cent Pure) by consuming 10,910.88 kg of gold doré bars (serial number 35bA & 35bB). Thus, the manufactured quantity almost doubled after processing which is not possible in any manufacturing activity. The excess yield of 9,195.64 kg (20,106.52 kg - 10,910.88 kg), thus, appears to be an unexplained input and the corresponding value of the same was required to be added as unexplained credit to the income of the assessee. If the prevailing rate of ₹ 2,834 per gram as on March 2016 (as per the Income Tax Department's website) is considered, the corresponding value of unexplained credits would be ₹ 2,606.04 crore and the consequent revenue implication would be ₹ 901.90 crore. This was pointed out to the Department in August 2019. Reply of the Ministry is awaited (January 2022).

Similarly, the scrutiny assessment for the A.Y. 2017-18 was completed under Section 143(3) of the Act in December 2019 accepting the assessee's returned income of ₹ 2.61 crore. As per details available in the Tax Audit Report, by consuming 7,534.07 kg of gold doré bars, the assessee was able to manufacture 14,405.15 kg of gold bars. Therefore, the excess yield of 6,871.09 kg should have been treated as unexplained credit. If the prevailing rate of ₹ 2,895 per gram as on March 2017 (as per Income Tax Department's website) is considered, the corresponding value of

³⁶ The London Bullion Market Association (LBMA), established in 1987, is an international trade association representing the global Over the Counter (OTC) bullion market manages the accreditation process for all Good delivery listed refiners. LBMA maintains and publishes the Good delivery lists for gold and silver comprising accredited gold and silver refineries that meet the stringent acceptance criteria.

³⁷ Source: www.lbma.org.uk/good-delivery/gold-current-list

unexplained credits would be ₹ 1,989.18 crore and the consequent revenue implication would be ₹ 688.41 crore.

Audit had asked the Department in August 2019 to examine the issue and verify the reasons for such discrepancies of output of gold bars. Further, the exact revenue implication, if any, was also asked to be examined.

The Department in its reply (March 2021) stated that no transactions were carried out by the assessee in gold in AY 2014-15 and the data of AY 2016-17 was used to point out the observation in AY 2014-15.

The Department's reply is not tenable as the audit observation was raised in respect of AY 2016-17 and not for AY 2014-15. The analysis of four years was done by Audit to indicate the suspicious nature of business activity of the assessee company. In view of this clarification, the Ministry may re-examine the audit observation for AY 2016-17 for taking remedial action.

4.2.1.3 Incorrect allowance of deduction under section 10AA

The assessee M/s DF filed the return of income for AY 2013-14 in September 2013 at ₹ nil and the scrutiny assessment was completed under Section 143(3) in July 2015 accepting returned income as such thereby raising nil demand. As per the Profit & Loss Account of financial year 2012-13, total turnover of the assessee company was ₹ 4,449.30 crore.

The assessee was engaged in export and import of jewellery during the year. It had claimed and was allowed total exemption of ₹ 16.36 crore under section 10AA in respect of profits derived from three SEZ units situated in the Special Economic Zone of Surat, Gujarat.

Audit observed (August 2019) that the assessee was engaged merely in trading activity in Surat, SEZ and had not carried any manufacturing during the year, which was evident from the following.

- i. The nature of business mentioned in Form 3CB was 'Trading'.
- ii. In 3CD Report, materials consumed were shown as nil.
- iii. Power and fuel consumption were ₹ 0.99 lakh only, which is practically not possible with any genuine manufacturing activity with turnover of ₹ 4,449.30 crore.
- iv. Total employee/labour expense was merely ₹ 63.84 lakh which constituted 0.01 *per cent* of turnover. This is insignificant considering the fact that manufacturing of jewellery/ diamond is a labour-intensive work.

Section 10AA of the Act stipulates that the assessee can avail exemption if it begins to manufacture or produce article or things. In the instant case, the assessee was not engaged in the activity of manufacture or production of article or things. Trading

activity may be an allowable activity under the SEZ Act, but for claiming deduction under section 10AA, the assessee must carry out manufacturing activity and produce articles or things.

Thus, the deduction under section 10AA claimed by the assessee and allowed by the AO in assessment was irregular. The incorrect allowance of deduction under section 10AA resulted in underassessment of income by ₹ 16.36 crore with consequent short levy of tax of ₹ 5.06 crore.

Audit further noted that the Department had itself disallowed the assessee's claim of exemption under section 10AA in the AY 2014-15 during scrutiny assessment (December 2016) on the ground that assessee was not doing any manufacturing activity from the Surat SEZ unit and was engaged in only trading activity. Thus, on similar grounds, deduction under section 10AA should have been disallowed in AY 2013-14 as well by reopening the case.

This observation was pointed out to the Department in November 2020. Reply of the Ministry is awaited (January 2022).

4.2.1.4 Mistake in carry forward of stocks

As per the Tax Audit Report, there was no closing balance shown against the item 'Gold' in AY 2015-16, whereas the opening balance for the same was shown at 1,523 gm in AY 2016-17. Thus, there was a mistake in carry forward of closing stock. Due to this the value corresponding to 1,523 gram should have been added either to AY 2015-16 as understatement of profit by reopening the case or to AY 2016-17 as unexplained credit. However, nothing was available on records of AY 2016-17 to show that the AO had made any verification to examine the reasons of the above discrepancy. If the prevailing rate of ₹ 2,895 per gram as on March 2017 (as per Income Tax Department's website) is considered, the corresponding value of unexplained credits would be ₹ 44.09 lakh and the consequent revenue implication would be ₹ 14.99 lakh.

This is also indicative of weaknesses in controls in prevention of suppression of any profit due to irregular carry forward of stocks. Audit had asked (November 2020) the Department to examine the issue and verify the reasons for such discrepancies of output of gold bars. The exact revenue implication, if any, is also required to be examined.

Reply of the Ministry is awaited (January 2022).

4.2.1.5 Discrepancy in disclosure of quantitative details in tax audit report vis-à-vis ITR

In the case of M/s DF, discrepancies were noticed in the quantitative details of stocks (rough diamond, polished diamond, gold, etc.) as disclosed in the Tax Audit Report vis-à-vis ITR for the years from AY 2015-16 to AY 2018-19. It was seen that in

AY 2015-16, the consumption of gold doré bar was shown as 82,32,286 gm in ITR as against 82,89,648 gm in Form 3CD. This also led to difference in disclosure of closing stock of gold doré bar which was 2,470 gm in Form 3CD and 59,832 gm in ITR. Further, in the AYs 2016-17 to 2018-19, the quantitative details were shown as nil in ITR, although there were actual stocks as per the Tax Audit Report. Further, it was also noticed that the closing balances of Gold Jewellery and Gold bar were wrongly mentioned as Nil in the Tax Audit Report in AY 2017-18 instead of actual closing balances of 3,384 units and 64,900 gm respectively.

The scrutiny assessment was done in the case of the assessee for AY 2016-17 and 2017-18; however, the reason for the above mismatch between ITR and Tax Audit Report was not examined by the AO while, the above issue for AY 2015-16 and AY 2018-19 remained unverified as only summary assessment under section 143(1) was done for these two assessment years. Thus, Audit could not ascertain as to how the Department was ensuring the correctness of the stock details as declared by the assesseees in their books of accounts, as these details were not matching with the declaration made in ITR and were not properly disclosed in the duly certified Tax Audit Reports.

This observation was pointed out to the Department in November 2020. Reply of the Ministry is awaited (January 2022).

4.2.1.6 Irregular claim of expenditure towards forward contract premium

The assessee M/s DF filed return of income for AY 2013-14 (September 2013) at ₹ nil and the scrutiny assessment was done under Section 143(3) (July 2015) accepting returned income as such, thereby raising nil demand for AY 2013-14. Further, the assessee filed return of income for AY 2014-15 (November 2014) at ₹ 30.09 lakh and the scrutiny assessment was done under Section 143(3) (December 2016) determining the income at ₹ 9.15 crore, thereby raising demand of ₹ 32.42 lakh for AY 2014-15.

Audit observed (August 2019) that the assessee had claimed expenditure towards forward contract premium of ₹ 187.19 crore during the AY 2014-15 and the same was allowed by the Department without any further verification. Nothing was available on record to indicate that the above claim was a genuine one and was actually incurred by the assessee for the purpose of business. Furthermore, details of turnover and various expenses revealed many discrepancies as discussed in preceding paragraphs raises doubts regarding genuineness of assessee's business activities. Consequently, the claim of forward contract premium was required to be disallowed during the assessment in the absence of appropriate evidence. Omission to do so resulted in underassessment of income ₹ 187.19 crore with consequent short levy of tax of ₹ 63.63 crore.

Similar discrepancies were also noticed for the AY 2013-14 during which forward contract premium of ₹ 166.21 crore was not disallowed, leading to loss of revenue of ₹ 56.50 crore.

This observation was pointed out to the Department in August 2019. Reply of the Ministry is awaited (January 2022).

4.2.1.7 Irregular claim of speculation loss

The assessee M/s DF filed return of income for AY 2013-14 (September 2013) at nil income and the scrutiny assessment was completed under Section 143(3) in July 2015, accepting returned income as such, thereby raising nil demand. Further, the assessee filed return of income for AY 2014-15 in November 2014 at ₹ 30.09 lakh and the scrutiny assessment was completed under Section 143(3) (December 2016), determining the income at ₹ 9.15 crore thereby raising demand of ₹ 32.42 lakh for AY 2014-15.

Audit observed that the assessee had claimed speculation loss on commodity derivatives amounting to ₹ 6.03 crore during AY 2014-15 and the same was also allowed by the AO. However, it was seen from the AIR details that the assessee was not involved in any trading of shares/commodity. Although no documentary evidence was made available by the assessee to prove its claim during the assessment, the AO allowed the above loss. This resulted in underassessment of income with consequent short levy of tax of ₹ 2.05 crore. Similarly, in AY 2013-14, speculation loss of ₹ 6.22 crore was allowed by the AO leading to loss of revenue of ₹ 2.11 crore.

This observation was pointed out to the Department in August 2019.

The Department while not accepting the objection in respect of AY 2014-15 has stated (March 2021) that the speculation loss debited in the Profit & Loss Account was in the nature of 'future & options & derivative loss' which was a business loss. Reply of the Department is not tenable on the ground that various expenses and details shown in the assessee's accounts and Tax Audit Report suggest suspicious business activity which was required to be examined in detail at the time of scrutiny. Further, the assessee's claim of the said speculation loss should have been supported with the relevant documents (transactions details, broker's report, etc.); however, no such document was available in the records furnished to audit. In view of this, the Department may re-examine assessments of the assessee firm in view of the irregularities pointed out in audit.

4.2.2 Audit findings in respect of M/s GG Ltd. [Pr.CIT (Central)-1, Mumbai]

Audit examined the records of M/s GG Ltd. assessed under PCIT(Central)-1, Mumbai for AY 2013-14, AY 2014-15, AY 2015-16 & AY 2017-18. The scrutiny assessment of the assessee was completed for AYs 2013-14, 2014-15 & 2015-16 in December 2016, January 2018 and February 2019 at income of ₹ 8.50 crore, ₹ 55.56 crore and ₹ 410.22 crore respectively. The return for AY 2017-18 was processed in a summary manner. The particulars of the assessee viz. turnover, returned income, assessed income and demand raised by ITD for these AYs are given in Table 4.16 below:

AY	Turnover for the year	Returned income	Assessment section	Assessed income	Date of order	Demand
2017	10,464.77	0	143(1)	0	Not available	13.85
2015	8,427.94	0	143(3) /144	410.22	14/02/2019	202.41
2014	395.00	0	143(3)	55.57	29/01/2018	77.27
2013	472.08	0	143(3)	8.50	29/12/2016	453.71

Source: Assessment records of ITD

Records not furnished in respect of M/s GG Limited [PCIT(Central)-1 Mumbai]: The order passed under section 143(1) of the Act for AY 2017-18 and the scrutiny assessment folder for AY 2013-14 in respect of this assessee were not furnished to audit. Audit examination of the assessments of this assessee was therefore constrained.

A 360-degree analysis of the assessment records of the assessee company revealed difference in quantitative details of sales and purchase of rough diamonds and jewellery, sales and manufacture of polished diamond as per revised ITR and revised Form 3CD [AY 2015-16]. The money value on account of under declaration of sale could not be worked out due to absence of item-wise value details in the assessment records. Further, audit noticed instances of data mismatch in respect of certain claims and incomes as per DGIT(Systems) vis-à-vis the data as per assessment records indicating non-updation of centralised data.

Audit examined the records of six related parties³⁸ of M/s GG Ltd. and raised 12 audit observations related to difference in figures between DGIT (Systems) and actual records; excess allowance of exemption under section 10AA, irregular allowance of depreciation on amalgamation, etc. with tax effect of ₹ 142.78 crore. These observations have been incorporated under suitable headings of the Report. The details of related parties of this assessee are given at Sl. no. 7 of **Annexure H** of this report.

³⁸ M/s G3 Ltd.; M/s A Ltd.; M/s G4 Ltd.; M/s D Pvt. Ltd.; M/s N Ltd.; M/s G2 Ltd.

The details of audit observations in respect of the main assessee company are brought out in paras 4.2.2.1 to 4.2.2.2 below:

4.2.2.1 Under declaration of sale

The assessee filed the return of income in November 2015 for AY 2015-16 at nil income and the AO completed the scrutiny assessment in February 2019 under section 143(3) read with section 144 at income of ₹ 410.22 crore raising demand of ₹ 202.41 crore. Audit observed (October 2020) that the assessee had submitted the revised ITR and Tax Audit Report on merging of Associated Company with it. On comparing the quantitative details as mentioned in ITR with those mentioned in Tax Audit Report, it was observed that there was difference in sales and purchase quantity of raw materials; and sales and manufactured quantity of finished goods as shown in Table 4.17 below:

Particulars	Unit	Nature of transaction	As per Revised ITR 6	As per Revised Form 3CD	Difference
Rough Diamonds	Carat	Purchase	28,49,598	30,95,639	2,46,041
Rough Diamonds	Carat	Sale	22,01,749	24,47,790	2,46,041
Jewellery Raw Material	Grams	Purchase	58,43,607	65,07,215	6,63,608
Jewellery Raw Material	Grams	Sale	8,22,166	14,85,774	6,63,608
Polished Diamond	Carat	Manufacture	1,13,738	1,27,231	13,493
Polished Diamond	Carat	Sale	8,24,124	8,37,608	13,484

Source: Assessment records of ITD

Thus, there was an under declaration in respect of sale of 2,46,041 carats of rough diamonds, 6,63,608 grams of jewellery- raw materials (proper name of the item not mentioned) and 13,484 carats of polished diamond in the revised ITR. Audit could not work out the value of under declaration due to non-availability of item-wise value in the Balance Sheet and Profit and Loss account. Audit noted that during scrutiny assessment details were not verified by the AO and no action was taken to examine the difference in details mentioned as per ITR and Form 3CD.

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

4.2.2.2 Difference in data furnished by DGIT (Systems) and as per the Departmental records

The assessee filed return of income for AY 2015-16 in November 2015) at nil income and the AO completed the scrutiny assessment (February 2019) under section 143(3) read with section 144 at income of ₹ 410.22 crore raising demand of ₹ 202.41 crore. Audit observed (October 2020) that there was difference in the statistical details in respect of deduction claimed/ allowed under section 10AA, gross receipts, profits, etc. as per data provided by DGIT (Systems) vis-à-vis actual records maintained by

AO. Audit observed that the assessee had submitted revised ITR on 30.11.2016; however, the DGIT (Systems) captured and reflected the data only from the original ITR.

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

4.2.3 Audit findings in respect of M/s DD Pvt. Ltd. (Pr.CIT-5, Mumbai)

Audit examined the records of M/s DD Pvt. Ltd. assessed under PCIT-5 Mumbai for AY 2012-13 to AY 2017-18. The scrutiny assessment of the assessee was completed for AYs 2012-13, 2013-14, 2014-15 & 2016-17; and summary assessment was done for AY 2017-18. The turnover, returned income, assessed income and demand raised by ITD for these AYs are given in Table 4.18 below:

[₹ in crore]					
AY	Turnover	Returned income	Assessment section	Assessed income	Demand
2017	5439.21	90.92	143(1)	Order under section 143(1) was not furnished by Department	
2016	4502.45	49.99	143(3)	50.62	0.00
2015	5279.14	86.96	143(3)	88.80	0.01
2014	4150.85	104.69	143(3)	106.50	0.00
2013	3115.20	53.19	143(3)/ 147	53.42	Not available
2012	2328.04	43.74	143(3)	46.47	0.00

Source: Assessment records of ITD

A 360-degree analysis of the assessment records of the assessee company revealed non-verification of difference in closing balance of studded jewellery in AY 2015-16 vis-a-vis opening balance in AY 2016-17, non-verification of loans/ deposits given to specified persons disclosed in the books of specified person and non-verification of payment made to a specified person for purchase of goods. Although the PAN of specified person disclosed in the Form 3CD was not available, the genuineness of transaction was not verified during scrutiny assessment. The details of audit observations in respect of the assessee company are brought out in para 4.2.3.1 below:

4.2.3.1 Mismatch in stocks

The assessee filed return of income for AY 2016-17 (November 2016) at income of ₹ 49.99 crore and the Department completed scrutiny assessment (December 2018) under section 143(3) at income of ₹ 50.62 crore. Audit observed (November 2020) from the Tax Audit Report (serial number 35) that the closing balance of studded jewellery (finished goods) was NIL in AY 2015-16, whereas it was shown as 2,166 grams in the opening balance of AY 2016-17. Also, a shortage of 18 carats of cut and polished diamonds was shown in the Tax Audit Report. However, nothing was available in the assessment records to show that the Department had made any verification in this regard to examine the reasons for these discrepancies and also to

ensure that the assessee was not suppressing any profit due to shortage/ irregular carry forward of stocks.

This observation was pointed out to the Department in November 2020. Reply of the Ministry is awaited (January 2022).

4.2.4 Audit findings in respect of M/s GJ Private Limited [Pr.CIT (Central)-1, Chennai]

The case of M/s GJ Pvt. Ltd. was selected for 360-degree analysis for AY 2014-15 to AY 2017-18. Scrutiny assessment for AY 2014-15, AY 2015-16, AY 2017-18 was completed in March 2016, December 2017 and December 2019 determining income at ₹ 36.07 crore, ₹ 163.73 crore and ₹ 219.25 crore respectively. The summary assessment for the AY 2016-17 was processed under section 143(1) for which the assessee admitted income of ₹ 124.11 crore. The turnover, returned income, assessed income and demand raised by ITD for these AYs are given in Table 4.19 below:

Table 4.19: Assessments particulars of M/s GJ Pvt. Ltd.						[₹ in crore]
AY	Turnover	Returned income	Assessment section	Assessed income	Date of order	Demand
2017	8,119.67	215.30	143(3)	219.25	31/12/2019	
2016	6,715.18	124.11	143(1)			
2015	6,208.31	163.42	143(3)	163.73	31/03/2016	0.14
2014	4,691.99	35.13	143(3)	35.13	28/12/2017	4.00

Source: Assessment records of ITD

During 360-degree analysis of assessment records of the assessee, audit observed deficiencies such as non-referral of the case to the Transfer Pricing Officer (TPO), suppression of sale of gold bullion in the profit and loss account, excess yield of jewellery on consumption of gold bullion, shortage/excess of closing stock of jewellery, as well as under reporting of purchase and sale of jewellery.

Audit examined the records of 10 related parties³⁹ of M/s GJ Private Limited and found no observation. The details of related parties of this assessee are given at Sl. no. 22 of Annexure H of this report.

4.2.4.1 Non-referral of case to the transfer pricing officer

Although the case of the assessee for AY 2014-15 was selected for scrutiny in CASS on the ground of “Large specified domestic transaction”, it was not referred to the TPO by the AO despite significant specified domestic transactions of ₹ 119.20 crore. AO not only failed to follow the prescribed procedure but also failed to utilise assistance of a specialised TPO cell created by the Department to deal with complicated issues arising out of transfer pricing mechanism.

³⁹ M/s GT- Firm, GR; GR(HUF); GA; GA(HUF); GR1 (HUF); M/s GH Pvt. Ltd.; PS; RM and RV.

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

4.2.4.2 Suppression of sale of gold bullion

Audit observed that although the assessee had shown in the Tax Audit Report (TAR), significant quantity of sale of gold bullion during AYs 2014-15, 2015-16, 2016-17 and 2017-18, no corresponding value against sale of such gold bullion was disclosed in the ITR and Profit and Loss accounts during these AYs. This indicated the possibility of suppression of sale of the aforementioned quantities of gold bullion. If the prevailing market value of gold is adopted (as per www.livechennai.com), the value of such suppression and the consequential revenue implications would be as per Table 4.20 below:

AY	Sale of gold bullion as per TAR (Quantity in Grams)	Sale of gold bullion as per ITR and P&L account (₹ in crore)	Market rate of gold per gram (₹)	Corresponding sale value not disclosed in ITR and P&L account (₹ in crore)	Potential revenue implication ⁴⁰ (₹ in crore)
2014-15	8,50,944	0	2,509	213.50	72.57
2015-16	4,08,413	0	2,420	98.84	33.60
2016-17	2,03,000	0	2,344	47.58	16.46
2017-18	96,606	0	2,647	25.57	8.85

Source: Assessment records of ITD

The Department needs to examine the issue and verify the reasons for such discrepancies of sale of gold bullion. Assessment only based on declarations made by the assessee without verification of records and invoices may involve revenue implications as pointed in Audit. The exact revenue implication, if any, is also required to be examined.

These observations were pointed out to the Department in October 2020 and October 2021. Reply of the Ministry is awaited (January 2022).

4.2.4.3 Excess yield of jewellery on consumption of gold bullion

The assessee had shown in the TAR the manufacture of excess gold jewellery during AYs 2014-15, 2016-17 and 2017-18 from consumption of gold bullion (Table 4.21). This indicated that the manufactured quantity was almost five times during AYs 2014-15 and 2016-17 and 1.09 times during 2017-18 of raw materials consumed. This was not possible without introducing unaccounted raw materials. Further, the excess yield during these AYs 2014-15, 2016-17 and 2017-18 appeared to be unexplained input and the corresponding value of the same was required to be added as unexplained credit to the income of the assessee.

⁴⁰ Tax implication computed by Audit is based on tentative values as per the details available in assessment records of ITD and may involve overlapping of amounts depending upon the corresponding overlap of quantitative details of different items as per records of ITD which need to be examined and verified in detail. Overlapping cannot be ruled out in absence of complete details of quantities of stock in the assessment records furnished to the Audit by the ITD.

If the prevailing market value for these AYs is adopted (as per www.livechennai.com), the value of such unexplained excess yield and corresponding revenue implications would be as shown in Table 4.21 below:

AY	Consumption of gold bullion as per TAR (Grams)	Manufacture of gold jewellery as per TAR (Grams)	Excess manufacture (Grams)	Market rate of gold per gram (₹)	Corresponding sale value not disclosed in ITR and P&L account (₹ in crore)	Potential revenue implicatio ⁴¹ (₹ in crore)
2014-15	90,95,156	4,43,66,052	3,52,70,896	2,509	8,849.47	3,007.94
2016-17	1,54,25,705	8,90,91,109	7,36,65,404	2,344	17,267.17	5,975.82
2017-18	1,69,66,138	1,85,82,308	16,16,170	2,647	427.80	148.05

Source: Assessment records of ITD

The Department needs to examine the issue and verify the reasons for such discrepancies of excess yield of gold jewellery. Assessment only based on declarations made by the assessee without verification of records and invoices may involve revenue implications as pointed in Audit. The exact revenue implication, if any, is also required to be examined.

These observations were pointed out to the Department in October 2020 and October 2021. Reply of the Ministry is awaited (January 2022).

4.2.4.4 Shortage/excess of closing stock of jewellery

Audit observed from the details available for jewellery in the TAR that the closing quantity of jewellery was not properly disclosed. There was short disclosure of closing stock in AY 2014-15 and excess disclosure of closing stock in AYs 2015-16 and 2016-17 as shown in Table 4.22 below.

AY	Quantity of opening stock (A)	Quantity of Purchases (B)	Quantity manufactured (C)	Quantity of Sales (D)	Quantity of closing stock to be shown in TAR (E=A+B+C-D)	Actual Quantity of closing stock disclosed in TAR (F)	Difference in disclosure of quantity of closing stocks (G)
2014-15	1,02,42,759	4,69,12,367	4,43,66,052	5,59,06,378	4,56,14,800	1,27,89,074	(-) 3,28,25,726
2015-16	1,27,89,074	7,56,79,925	10,01,436	8,35,56,069	59,14,366	2,09,38,994	(+) 1,50,24,628
2016-17	2,13,86,822	2,17,740	8,90,91,109	10,43,47,039	63,48,632	2,17,05,500	(+) 1,53,56,868
2017-18	2,17,05,500	9,00,15,203	1,85,82,308	10,56,73,905	2,46,29,106	2,46,29,106	NIL

Source: Assessment records of ITD

⁴¹ Tax implication computed by Audit is based on tentative values as per the details available in assessment records of ITD and may involve overlapping of amounts depending upon the corresponding overlap of quantitative details of different items as per records of ITD which need to be examined and verified in detail. Overlapping cannot be ruled out in absence of complete details of quantities of stock in the assessment records furnished to the Audit by the ITD.

This could be indicative of the fact that the assessee had suppressed the closing stock in AY 2014-15 and introduced its unaccounted stocks in AY 2015-16 and AY 2016-17. However, the same (shortage/ excess) was neither disclosed/justified in the TAR nor examined by the Department during assessment.

If the prevailing market value of gold for AYs 2014-15, 2015-16 and 2016-17 is adopted (as per www.livechennai.com), the value corresponding to suppression of closing stock/ introduction of unaccounted stock and revenue implication⁴² for these AYs would be as per Table 4.22(A) below:

AY	Difference in disclosure of quantity of closing stocks (As per Table 4.22, Col. G)	Market rate of gold per gram (₹)	Corresponding sale value not disclosed in ITR and P&L account (₹ in crore)	Potential revenue implication (₹ in crore)
2014-15	(-) 3,28,25,726	2,509	8,235.97	2,799.41
2015-16	(+) 1,50,24,628	2,420	3,635.96	1,235.86
2016-17	(+) 1,53,56,868	2,344	3,599.65	1,245.77

Source: Assessment records of ITD

The Department needs to examine the issue and verify the reasons for such discrepancies of shortage and excess of closing stocks. The exact revenue implication, if any, is also required to be examined.

These observations were pointed out to the Department in October 2020 and October 2021. Reply of the Ministry is awaited (January 2022).

4.2.4.5 Discrepancies in respect of sale and purchase price of jewellery

Audit observed on comparing the sale/ purchases value of finished jewellery (as per ITR and Profit & Loss Account) with the corresponding quantity (as per TAR) that per gram rate adopted for sale/ purchase was significantly low vis-à-vis the prevailing market rate. The details are shown in Table 4.23 below:

AY	Purchases			Sales			Prevailing market value per gram (₹)
	Quantity in Gram as per TAR	Value as per ITR and P&L account (₹ in crore)	Rate per gram (₹)	Quantity in Gram as per TAR	Value as per ITR and P&L account (₹ in crore)	Rate per gram (₹)	
	2014-15	4,69,12,367	1,540.50	328.00	5,59,06,378	4,323.91	
2015-16	7,56,79,925	1,899.88	251.00	8,35,56,069	5,762.04	686.00	2,420
2016-17	2,17,740	1,759.12	80,790.00	10,43,47,039	6,198.72	594.00	2,344
2017-18	9,00,15,203	2,158.47	239.78	10,56,73,905	7,480.35	707.87	2,647

Source: Assessment records of ITD

⁴² Tax implication computed by Audit is based on tentative values as per the details available in assessment records of ITD and may involve overlapping of amounts depending upon the corresponding overlap of quantitative details of different items as per records of ITD which need to be examined and verified in detail. Overlapping cannot be ruled out in absence of complete details of quantities of stock in the assessment records furnished to the Audit by the ITD.

In view of the above, the sales and profit were suppressed due to the sale of gold jewellery at such a low price. If the prevailing market value of gold for AYs 2014-15, 2015-16, 2016-17 and 2017-18 is adopted (as per www.livechennai.com), the corresponding value of under reporting of sales due to low sale price, and the consequential revenue implications⁴³ would be as per details mentioned in Table 4.23(A) below (total ₹ 21,634.11 crore).

AY	Sales			Prevailing market value per gram (₹)	Short adoption of rate per gram for sale (₹)	Corresponding value not disclosed in ITR and P&L account (₹ in crore)	Revenue implication (₹ in crore)
	Quantity in Gram as per TAR	Value as per ITR and P&L account (₹ in crore)	Rate per gram (₹)				
2014-15	5,59,06,378	4,323.91	773.42	2,509	1,735.58	9,703.00	3,298.05
2015-16	8,35,56,069	5,762.04	686.00	2,420	1,734.00	14,488.62	4,924.68
2016-17	10,43,47,039	6,198.72	594.00	2,344	1,750.00	18,260.73	6,319.67
2017-18	10,56,73,905	7,480.35	707.87	2,647	1,939.13	20,491.54	7,091.71

Source: Assessment records of ITD

The Department needs to examine the issue and verify the reasons for such discrepancies in sale price and purchase price of gold jewellery. Assessment only based on declarations made by the assessee without verification of records and invoices may involve revenue implications as pointed in Audit. The exact revenue implication, if any, is also required to be examined.

Similarly, the purchase of jewellery was shown at a very low price in AYs 2014-15, 2015-16 and 2017-18, and at very high price in AY 2016-17 in comparison to market rate, which could indicate that the assessee might have paid the differential amount in cash. This aspect was also not examined by the Department during assessment.

These observations were pointed out to the Department in October 2020 and October 2021. Reply of the Ministry is awaited (January 2022).

4.2.5 Audit findings in respect of M/s AT Private limited (Pr.CIT-1, Bangalore)

Audit examined the records of M/s AT Private limited for AY 2014-15 to AY 2018-19. The scrutiny assessment of the assessee was completed for AY 2014-15; and summary assessment was done for AY 2015-16 to AY 2018-19. The assessment particulars viz. turnover, return income, assessed income and demand raised by ITD for these AYs are given in Table 4.24 below:

⁴³ Tax implication computed by Audit is based on tentative values as per the details available in assessment records of ITD and may involve overlapping of amounts depending upon the corresponding overlap of quantitative details of different items as per records of ITD which need to be examined and verified in detail. Overlapping cannot be ruled out in absence of complete details of quantities of stock in the assessment records, furnished to the Audit by the ITD.

AY	Turnover for the year	Returned income	Assessment section	Assessed income	Date of order	Demand
2014	165.21	6.76	143(3)	11.49	29.12.2016	2.29
2015	165.56	6.86	143(1)	6.86	Order processed under section 143(1) was not furnished to Audit	
2016	145.95	5.60	143(1)	5.60		
2017	133.17	7.72	143(1)	7.72		
2018	145.76	0.00	143(1)	0.00		

Source: Assessment records of ITD

The above assessee company, incorporated in February 2011, acquired (April 2013) the business of M/s AJ as a going concern. The assessee had filed return of income for AY 2014-15 (September 2014) at income of ₹ 6.76 crore and the AO completed the scrutiny assessment (December 2016) under section 143(3) determining the income at ₹ 11.49 crore.

Records not furnished in respect of M/s AT Private Limited [PCIT-1 Bengaluru]: The order passed under section 143(1) of the Act for AYs 2015-16, 2016-17, 2017-18 and 2018-19 in respect of this assessee were not furnished to audit.

A 360-degree analysis of the assessment records for AY 2014-15 of the assessee company revealed short adoption of closing stock in the books of accounts and short accounting of cash and bank balances, post acquisition of M/s AJ. Audit observed various irregularities which remained unnoticed during the Scrutiny assessment for AY 2014-15. The details of audit observations are brought out in paras 4.2.5.1 to 4.2.5.2 below:

4.2.5.1 Underassessment on account of short adoption of closing stock

The assessee, during the acquisition, had incorrectly adopted the closing stock at ₹ 40.75 crore in its books of account instead of the actual amount of ₹ 60.70 crore as held in the books of M/s AJ. However, the AO had not added the differential amount of ₹ 19.95 crore to the income of assessee. This resulted in underassessment of ₹ 19.95 crore with resultant short levy of tax of ₹ 9.02 crore including interest of ₹ 2.24 crore under section 234B.

Reply of the Ministry is awaited (January 2022).

4.2.5.2 Underassessment on account of short accounting of opening cash balance

The cash and bank balances of M/s. AJ were accounted by the assessee at ₹ 2.99 lakh only, as against the actual amount of ₹ 4.45 crore. The AO did not point out this discrepancy, resulting in underassessment of income of ₹ 4.45 crore with consequent short levy of tax of ₹ 2.00 crore including interest of ₹ 49.59 lakh under section 234B.

Reply of the Ministry is awaited (January 2022).

ITD may consider examining reasons for non-verification of short adoption of closing stock and short accounting of cash and bank balances of the assessee. ITD may also examine reasons for non-furnishing of assessment records for audit examination.

4.2.6 Audit findings in respect of M/s KD Pvt. Ltd. [Pr.CIT(Central), Jaipur]

Audit examined the records of two related parties⁴⁴ of M/s KD Pvt. Ltd. and found no observations. Further, the records of another related party [M/s KI (P) Ltd.] for AY 2013-14 were not made available to audit. The details of related parties of this assessee are given at Sl. no. 7 of **Annexure I** of this report.

4.2.6.1 Non-verification of loan/deposit of ₹ 66.50 lakh to specified person

The assessee filed return of income for AY 2013-14 (November 2013) at income of ₹ 27.70 crore and the AO completed the scrutiny assessment (December 2016) under section 143(3) accepting the returned income as such. Audit observed (October 2020) that the assessee had not disclosed loan/deposits of ₹ 66.50 lakh given to a specified person M/s K1 Private Limited in AY 2013-14, although M/s K1 Private Limited disclosed in its books that it had accepted the above loan/deposit from the assessee in AY 2013-14. Although the amount of ₹ 66.50 lakh remained an undisclosed loan/deposit, this was not added to the income of the assessee under section 69 of the Act during scrutiny assessment. This resulted in underassessment of income by ₹ 66.50 lakh involving short levy of tax of ₹ 21.58 lakh.

On being pointed out in audit, the Department replied (October 2020) that the matter would be looked into.

4.2.6.2 Non-verification of payment of purchase of goods to specified person

The assessee filed return of income for AY 2013-14 (November 2013) at income of ₹ 27.70 crore and the AO completed the scrutiny assessment (December 2016) under section 143(3) accepting the returned income as such. Audit observed (October 2020) that in case of specified person SG Inc, incorrect PAN was mentioned in Tax Audit Report. A transaction for purchase of goods of ₹ 10.64 lakh was made with the above party in AY 2013-14. The Department had reported that the said PAN did not exist". Thus, genuineness of transactions with M/s SG Inc. amounting to ₹ 10.64 lakh remained unverified during the assessment, and therefore the amount was required to be added to total income of the assessee under section 69 of the Act. This resulted in underassessment of income by ₹ 10.64 lakh and consequent short levy of tax of ₹ 3.45 lakh.

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

⁴⁴ M/s K1 Pvt. Ltd. and M/s KC Pvt. Ltd.

4.2.7 Audit findings in respect of M/s SL Limited [PCIT-4 Ahmedabad]

Audit examined the records of M/s SL Limited assessed under PCIT-4 Ahmedabad for AY 2015-16 and AY 2016-17. The scrutiny assessment of the assessee was completed for AY 2016-17 and summary assessment was done for AY 2015-16. The turnover, returned income, assessed income and demand raised by ITD for these AYs are given in Table 4.25 below:

AY	Turnover for the year	Returned income	Assessment section	Assessed income	[₹ in crore]
					Demand
2015	153.49	0	143(1)(a)	0	0.14
2016	119.66	0	143(3)	0	0.01

Source: Assessment records of ITD

The assessee company filed its return of income for AY 2016-17 in November 2016 declaring NIL income and the scrutiny assessment for the said AY was completed under section 143(3) in December 2018 accepting the returned income.

Audit examined the records seven related parties⁴⁵ of M/s SL Limited and noticed mismatch in the amount of salary, rent expenses, etc. Further, the records of another related party (MP) for AY 2015-16 and AY 2016-17 were not made available to audit. The details of related parties of this assessee are given at **Sl. no. 2 of Annexure H** of this report.

A 360-degree analysis of the business activity of the assessee company revealed following observations:

- The assessee had claimed aggregate salary expenditure of ₹ 1.06 crore against four related parties (AP, DP, MP and LP) in AY 2016-17; however, these parties offered total salary income of ₹ 1.01 crore in their ITRs. Thus, there was mismatch in respect of salary expense of ₹ 4.56 lakh.
- Further, the assessee had shown reimbursement to another related party SS as ₹ 12.29 lakh in AY 2016-17, however these details were not found in the Tax Audit Report of SS.
- The assessee had shown rent expenses as paid to SS as ₹ 1.78 crore in AY 2016-17; however SS had shown rent income from the assessee as ₹ 1.56 crore leading to difference rent expenses of ₹ 21.73 lakh.

The above differences in salary and rent expenses were also observed in respect of the assessment case for AY 2015-16. Audit observed that the Department did not make any verification in respect of the above discrepancy which may result in underassessment and resultant short demand.

⁴⁵ LP (Individual); AP (Individual); DP(Individual); MT(Individual); AP HUF; MP(Individual); SS (Firm)

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

4.2.8 Special Audit under Section 142(2A) of Income Tax Act

During the Performance Audit, audit examined 1,089 assessment records in Mumbai pertaining to the Gems and Jewellery sector and observed various systemic and compliance issues. Yet, audit did not find any case where the Department has conducted special audit under Section 142(2A)⁴⁶. The information on special audit conducted, if any, during the period from F.Y.2015-16 to F.Y.2018-19 in respect of assessees of Gems and Jewellery Sector has been sought from the Department (October 2021).

Audit noted that despite having all the conditions fulfilled in the case of the assesses covered in the audit sample especially for 74 cases of 31 assessees, namely complex nature of business transactions, complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialised nature of business activity, and the interests of the revenue, the provisions under Section 142(2A) of Income Tax Act do not seemed to have been invoked for assessment of any assessees selected by Audit.

Reply of the Ministry is awaited (January 2022).

4.3 Irregular exemptions/deductions/relief given

The Income Tax Act, 1961 provides that the AO is required to examine the exemptions/ deductions/ various expenses claimed by the assessees so as to make a correct assessment of the total income or loss and determine the correct amount of tax or refund, as the case may be.

Tax Holiday under section 10AA of the Income-tax Act for 15 years is available to newly established units in SEZ. (100 *per cent* for first five years, 50 *per cent* for the next five years and further deduction of 50 *per cent* for the next five years subject to creation of Special Reserve).

Further, as per clarification issued vide Explanation under Section 10AA on 01 April 2018 *the amount of deduction under this section shall be allowed from the total income of the assessee computed according to the provisions of this Act, before giving effect to the provisions of this section and the deduction under this section shall not*

⁴⁶ As per the provisions of Section 142(2A) of Income Tax Act, if, at any stage of the proceedings before him, the Assessing Officer, having regard to the nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialised nature of business activity of the assessee, and the interests of the revenue, is of the opinion that it is necessary so to do, he may, with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, direct the assessee to get the accounts audited by an accountant, as defined in the *Explanation* below sub-section (2) of section 288, nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in this behalf and to furnish a report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed and such other particulars as the Assessing Officer may require.

exceed such total income of the assessee'. Since this is clarification of the existing provision, this is effective from the date of introduction of Section 10AA.

Audit noticed in eight assessment cases in Maharashtra where deduction under Section 10AA was incorrectly allowed, involving money value of ₹ 18.64 crore. Three such cases are illustrated below:

Box 4.1: Illustrations of incorrect claim of deduction under section 10AA

(a) Charge: Pr. CIT 14, Mumbai

Assessee: M/s CM

Assessment Year: 2012-13

The assessee, a company, filed the return of income for AY 2012-13 in November 2012 at income of ₹ 4.72 crore and the scrutiny assessment was completed under Section 143(3) read with section 144C(3) of the Act in May 2016 determining income at ₹ 5.39 crore thereby raising demand of ₹ 0.16 lakh. As per the Profit & Loss Account of the financial year 2011-12, total turnover of the assessee company was ₹ 226.86 crore.

The assessee company claimed exemption of ₹ 13.55 crore under section 10AA of the Act in respect of units stated to be situated in Surat, SEZ. Audit observed that the SEZ unit had no factory building and plant and machinery of insignificant value of ₹ 8.44 lakh only had been shown. Further, there was no rent expense incurred for SEZ unit. Audit noticed that turnover of ₹ 226.86 crore appears to have been achieved without having any factory building and with minuscule plant and machinery. This clearly indicated that there was no manufacturing activity at the stated SEZ unit and the SEZ unit was involved only in trading activity. The exemption allowed under section 10AA was irregular and was required to be disallowed. The omission had resulted in under assessment of income of ₹ 13.55 crore involving short levy of ₹ 4.40 crore.

This observation was pointed out to the Department in February 2017. The Ministry in its reply has accepted the audit objection (January 2022) and stated that remedial action has been taken by passing an order under section 147 read with section 144 on 10 December 2019 .

(b) Charge: PCIT 4, Mumbai

Assessee: M/s AG Pvt. Ltd.

Assessment Year: 2012-13

The assessee, a company, filed the return of income for AY 2012-13 in September 2012 at ₹ 14.65 crore and the scrutiny assessment was completed under Section 143(3) read with section 147 in December 2018 determining the income at ₹ 25.71 crore thereby raising nil demand for AY 2012-13. As per the Profit & Loss

Account of financial year 2011-12, total turnover of the assessee company was ₹ 2,558.74 crore.

The assessee was operating two units located in SEZ, Surat and claimed exemption of ₹ 23.91 crore under section 10AA on the export of plain and studded Gold jewellery. The AO in the assessment order concluded that the assessee was not carrying out any manufacturing activity at SEZ or in its unit and the exemption claimed was to be withdrawn. However, it disallowed only ₹ 11.06 crore as against the entire exemption of ₹ 23.91 crore. This resulted in under assessment of income of ₹ 12.85 crore leading to tax effect of ₹ 4.37 crore.

This observation was pointed out to the Department in September 2019. Reply of the Ministry is awaited (January 2022).

(c) Charge: Pr.CIT-9, Mumbai
Assessee: M/s CJ Pvt. Ltd.
Assessment Year: 2013-14

The assessee, a company, filed the return of income for AY 2013-14 in September 2013 at a loss of ₹ 1.86 crore and the scrutiny assessment was completed under Section 143(3) in March 2016 assessing loss at ₹ 89.82 lakh. As per the Profit & Loss Account of financial year 2012-13, total turnover of the assessee company was ₹ 41.92 crore.

The Board vide circular No. 7 dated 16th July, 2013 clarified that losses of ineligible units should be set off against the profits of the eligible units before allowing deductions of 10A/10AA units of the Income Tax Act.

Audit observed that the assessee had a loss of ₹ 35.30 lakh (before claiming deduction under section 10AA), which increased to ₹ 94.89 lakh after claiming deduction under section 10AA of ₹ 59.59 lakh in respect of Cochin-I-SEZ and Cochin-II-SEZ units. As the loss in respect of ineligible unit was more than the income from eligible units, the assessee should have first adjusted losses derived from ineligible unit before availing deduction under section 10AA as per the circular quoted above. Consequently, the assessee would not be entitled to claim of deduction under section 10AA of ₹ 59.60 lakh, and failure to do so resulted in excess carry forward of losses of ₹ 59.60 lakh involving potential short levy of tax of ₹ 19.36 lakh.

This observation was pointed out to the Department in November 2020. Reply of the Ministry is awaited (January 2022).

4.4 Irregular allowance of business expenditure

Audit noticed 39 cases in nine States relating to incorrect allowance of business expenditure involving tax effect of ₹ 188.40 crore.

4.4.1 Allowance of interest expenses on Bank loan which turned NPA

Under section 43B of the Income Tax Act, 1961, any sum payable by the assessee as interest on any loan borrowed from any public financial institution, bank etc. is allowed as deduction in the previous year only if the amount is actually paid during the previous year. Explanation 3C/3D to the section has clarified that any interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid. This has also clearly been explained in CBDT Circular No. 7/2006 dated 17th July 2006.

Further, Section 133(6) of the Income Tax Act enables the Income Tax Authorities to compel any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, giving information in relation to such points or matters as, in the opinion of the Assessing Officer, will be useful for, or relevant to, any enquiry or proceeding under this Act.

Audit noticed in five assessment cases in Maharashtra that the total interest expenditure of ₹ 90.35 crore on bank loans turning into Non-Performing Assets (NPA) was allowed. The tax effect worked out to be ₹ 27.80 crore. Two such cases are illustrated below:

Box 4.2: Illustrations of Allowance of interest expenses on Bank loan without verification

(a) Charge: PCIT 4, Mumbai

Assessee: M/s AG Pvt. Ltd.

Assessment Years: 2011-12, 2012-13 and 2013-14

In this case, the returns of income for AY 2011-12, AY 2012-13 and 2013-14 were filed at income of ₹ 4.67 crore (September 2011), ₹ 14.65 crore (September 2012) and ₹ 1.26 lakh (November 2013) respectively. The scrutiny assessments in these cases were done under Section 143(3) determining the income at income of ₹ 17.39 crore (December 2018), ₹ 25.71 crore (December 2018) and ₹ 90.20 crore (December 2018) respectively. The demand for AY 2011-12, AY 2012-13 and 2013-14 were raised for ₹ 8.37 crore, ₹ Nil and ₹ 49.04 crore respectively. Total turnover of the assessee company for AY 2011-12, AY 2012-13 and 2013-14 was ₹ 1,771.58 crore, ₹ 2,558.75 crore and ₹ 3,686.12 crore respectively.

As per the assessment orders for the AY 2011-12, AY 2012-13 and AY 2013-14 and Office Notes annexed therewith, the cases of the assessee company were reopened (March 2018) on the basis of information received from the office of the Pr.DIT (Investigation)-1 Mumbai [February 2018], regarding the assessee company and its directors being involved in fabricating import and export documents and had raised bank loans on the basis of such forged documents. Audit noted that in the assessment order it was mentioned that the said bank loan had turned out to

be non-performing assets (NPA), therefore, the interest claimed in the profit and loss account needed to be re-examined and withdrawn under section 41(1) of the Act.

Audit observed (September 2019) that following amounts were shown as loan from banks and interest on bank loan for the FYs 2010-11, 2011-12 and 2012-13.

FY	Total loan outstanding at year end (Term loan + Vehicle loan + cash credit) (₹ in crore)	Interest on loan debited to the profit and loss account (₹ in crore)
2010-11	117.20	10.67
2011-12	163.51	19.38
2012-13	209.63	28.22
	Total	58.27

Although, the cases were re-opened to examine the assessee's claim of interest on Bank loans which had turned to NPA, the AO did not make any disallowance of interest payment on the ground that the bank loan had become NPA subsequently in the FYs 2014-15 and 2015-16. The AO had accepted the assessee's submission that no interest to the scheduled bank was outstanding and that the proper disclosures had been made in the financial statement and Tax Audit Report.

Audit is of view that the declaration of NPA by the banks indicated that the assessee was defaulting in payment of interest much before the date on which loan was declared as NPA. Further, the AO himself had mentioned in the assessment order that imports and exports of the assessee were not genuine and were based on fraudulent representations and that there was possibility of other misrepresentation by the assessee as well. Thus, in view of the information received from the office of the Pr.DIT (Investigation)-1, the AO should not have relied upon the books of account and Tax Audit Report for allowing interest expenses. Instead, assessee's claim of payment of loan and interest should have been cross verified with the details as per banks' records. Omission in this regard resulted in incorrect allowance of total interest expenses of ₹ 58.27 crore during AY 2011-12 to AY 2013-14 on NPA loans involving potential tax effect of ₹ 18.13 crore.

This observation was pointed out to the Department in September 2019. Reply from the Ministry is awaited (January 2022).

(b) Charge: PCIT 4, Mumbai
Assessee: M/s RG Pvt. Ltd
Assessment Year: 2015-16

In this case, the return of income for AY 2015-16 was filed (February 2017) at the loss of ₹ 9.94 crore and the scrutiny assessment was done under Section 143(3) (December 2017) accepting returned income as such thereby raising nil demand

for AY 2015-16. As per Profit & Loss Account of financial year 2014-15, total turnover of the assessee company was ₹ 286.63 crore.

As per the Balance Sheet of FY 2014-15, the assessee had taken secured loan of ₹ 71.26 crore from bank and debited interest of ₹ 12.08 crore thereon in AY 2015-16. As per notes to the financial statements, the bank had considered the account of the company as NPA due to non-payment of principal and interest. Further, the bank had given cash credit of ₹ 68.00 crore to assessee and interest was added in cash credit. However, the interest amount so added in cash credit cannot be considered as the actual payment of interest and should have been treated as not paid and added back to the income under section 43B. Omission to do so resulted in under assessment of income of ₹ 12.08 crore involving potential tax effect of ₹ 3.62 crore.

This observation was pointed out to the Department in June 2018. The Ministry in its reply (January 2022) has accepted the audit objection and stated that remedial action has been initiated by issuing Notice under section 148 of the Act on 30 March 2021.

4.4.2 Irregular allowance of various expenses/deductions

Section 37(1) of the Income Tax Act, 1961 provides that any expenditure not being in the nature of capital expenditure or personal expenses of the assessee, laid or expended wholly and exclusively for the purpose of the business or profession shall be allowed in computing the income chargeable under the head “Profit and Gains of business or profession”.

Audit noticed in 28 cases in nine States⁴⁷ that expenses/ deductions were allowed by ITD without verifying the genuineness of the claim resulting in short levy of tax of ₹ 6.98 crore. Two cases are illustrated below:

Box 4.3: Illustrations of irregular allowance of loss by theft

(a) Charge: Pr.CIT (Central)-3, Mumbai

Assessee: M/s AG Pvt. Ltd.

Assessment Year: 2014-15

In this case, the return of income for AY 2014-15 was filed (November 2014) at ₹ 11.61 crore and the assessment was done in scrutiny under Section 143(3) (December 2017) determining the tax payable at ₹ 75.98 crore thereby raising demand of ₹ 37.80 for AY 2014-15. As per the Profit & Loss Account of financial year 2013-14, total turnover of the assessee company was ₹ 3,672.07 crore.

⁴⁷ Maharashtra (4); Gujarat (4); AP & Telangana (1); Punjab & Haryana (1); Tamilnadu (3); Delhi (1); Kerala (2); West Bengal & Sikkim (10) and Karnataka & Goa (2)

The assessee had debited ₹ 2.26 crore to the profit and loss account related to loss on account of embezzlement of raw materials by an employee of the company. However, nothing was available on the assessment record to prove the genuineness of the aforesaid claim. As this loss was on estimation basis, the same was required to be disallowed during the assessment. Omission to do so has resulted in underassessment of income of ₹ 2.26 crore with consequent short levy of tax of ₹ 76.64 lakh.

This observation was pointed out to the Department in September 2018. Reply of the Ministry is awaited (January 2022).

(b) Charge: Pr.CIT (Central)-2, Kolkata
Assessee: AR HUF, Proprietor of M/s SR
Assessment Year: 2013-14

In this case, the return of income for AY 2013-14 was filed (September 2013) at ₹ 8.75 lakh and the scrutiny assessment was done in under Section 143(3) (March 2016) determining the income at ₹ 8.76 lakh thereby raising nil demand. As per the Profit & Loss Account of financial year 2013-14, total turnover of the assessee company was ₹ 32.24 crore.

Audit observed that the assessee had claimed expenses of ₹ 53.18 lakh on account of 'provision for exchange difference, but the same was not an allowable expenditure under Section 37(1) of the Act and was required to be disallowed by the Department during assessment. Omission to do so resulted in underassessment of income of ₹ 53.18 lakh, with consequent short levy of tax of ₹ 21.48 lakh including interest under section 234B of ₹ 5.18 lakh.

This observation was pointed out to the Department in September 2019. Reply of the Ministry is awaited (January 2022).

4.4.3 Irregular allowance of depreciation

Audit noticed four cases in Maharashtra of irregular allowance of depreciation of ₹ 484.92 crore having tax effect of ₹ 151.12 crore. In three out of the aforesaid four cases, the assessee had artificially created goodwill to inflate the expenses and reduce the tax liability. These are discussed in para 4.4.3.1 below:

4.4.3.1 Irregular allowance of depreciation on artificially created goodwill

Section 32(ii) of the Act prescribes that depreciation is allowable at prescribed rates on know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998. Further, Proviso 5 to Section 32(1) of the Income Tax Act, provides that in the case of amalgamation, the aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licences, franchises or any

other business or commercial rights of similar nature, being intangible assets allowable to amalgamating company and the amalgamated company, shall not exceed in any previous year the deduction calculated at the prescribed rates as if the amalgamation had not taken place.

Though Section 32 of the Act provides for depreciation on tangible and intangible assets, which are acquired and used by the assessee for the purposes of business, 'Goodwill' has neither been defined nor been expressly mentioned as one of the intangible assets in the Act. Common dictionaries describe it as the established reputation of a business regarded as a quantifiable asset. As per Accounting Standard 26, 'Goodwill' which is self-generated over a period of time is not recorded as an asset in the books of accounts of the company/ firm. However, during the course of merger and amalgamation, any premium paid by the buyer to seller over and above the recorded net worth of the business, i.e. value of all other assets minus liabilities, is often recorded as 'Goodwill' in the books of the buyer. Whether such 'Goodwill' can be said to have been acquired or mere accounting treatment; and whether the buyer is entitled for depreciation on such 'Goodwill' has been a subject matter of debate. Though 'Goodwill' was not expressly mentioned as one of the intangible assets in the Income Tax Act, the Supreme Court held⁴⁸ it as an intangible asset. However, ITAT, Bangalore⁴⁹ after discussing the above decision of Supreme Court took a contradictory view and did not allow depreciation on goodwill arising in course of amalgamation by holding that that in view of the fifth proviso to section 32(1) of the Act (now sixth proviso)⁵⁰, the assessee (being an amalgamated company) cannot claim or be allowed depreciation on the assets acquired in the scheme of amalgamation more than the depreciation allowable to the amalgamating company. Since then, the companies were using 'Goodwill' as a depreciating asset and claiming depreciation thereon, while there was no uniformity within the Department on allowing the depreciation on 'Goodwill'. Thus, the claim of depreciation on 'Goodwill' generated during merger & amalgamation has been a debatable issue till the Finance Act 2021. But after the Finance Act 2021⁵¹, "Goodwill" is no longer considered as a depreciating asset and provisions have been added to Section 32 and Section 2(11) in this regard.

⁴⁸ In the case of CIT, Kolkata vs M/s Smifs securities Ltd. (2010)

⁴⁹ In the case of M/s United Breweries Ltd. (I.T.A. No.722, 801 & 1065/Bang/2014 dated 30 September 2016)

⁵⁰ In a case of succession/amalgamation/ demerger during the previous year, depreciation is to be calculated as if the succession or amalgamation or demerger has not taken place during the previous year and is to be apportioned between the predecessor and the successor, or the amalgamating company and the amalgamated company, or the demerged company and the resulting company, as the case may be, in the ratio of the number of days for which the assets were used by them.

⁵¹ The memorandum explaining the provisions to the Finance Bill, 2021, states that '*while Hon'ble Supreme Court has held that the Goodwill of a business or profession is a depreciable asset, the actual calculation of depreciation on goodwill is required to be carried out in accordance with various other provisions of the Act.... Once these provisions are applied, in some situations (like that of business reorganization) there could be no depreciation on account of actual cost being zero and the written down value of that assets in the hand of predecessor/amalgamating company being zero. However, in some other cases (like that of acquisition of goodwill by purchase) there could be valid claim of depreciation on goodwill in accordance with the decision of Hon'ble Supreme Court holding goodwill of a business or profession as a depreciable asset.*'

Two cases of irregular claim of depreciation on internally generated goodwill are illustrated as under:

Box 4.4: Illustrations of Irregular allowance of depreciation on artificially created goodwill

(a) Charge: PCIT 5, Mumbai

Assessee: M/s BG Pvt. Ltd.

Assessment Years: 2015-16 and 2016-17

In this case, the returns of income for AY 2015-16 and 2016-17 were filed at income of ₹ 16.20 crore (November 2015) and ₹ 9.44 crore (November 2016) respectively. The scrutiny assessments in these cases were done under Section 143(3) determining the income at income of ₹ 16.21 crore (December 2017) and ₹ 9.44 crore (November 2018) respectively. The demand for AY 2015-16 and 2016-17 were raised for ₹ 7.99 lakh and ₹ 1.56 lakh respectively. Total turnover of the assessee company for AY 2015-16 and 2016-17 was ₹ 1,001.18 crore and ₹ 588.43 crore respectively.

In this case, the assessee had *inter alia* claimed depreciation on goodwill amounting to ₹ 6.50 crore and ₹ 4.87 crore in AYs 2015-16 and 2016-17 respectively and the same was allowed by the Department. Audit noticed from the Annual accounts of FY 2011-12 that the goodwill was not acquired or purchased from any other entity, and it was a self-generated Goodwill by the erstwhile partnership firm viz M/s BG before its conversion into the assessee company⁵². It is worth noting that during the AYs 2012-13 to 2014-15, the assessee company did not claim any depreciation on this goodwill. It started claiming depreciation on goodwill from AY 2015-16 onwards,

As depreciation on self-generated goodwill is not an allowable deduction as per the extant provisions the AO should have disallowed the depreciation on goodwill and added it to the income of the assessee. Omission to do so resulted in short levy of tax of ₹ 2.20 crore and ₹ 1.68 crore in the AY 2015-16 and 2016-17 respectively. Further, there was also incorrect carry forward of written down value (WDV) of ₹ 14.62 crore in respect of the above self-generated Goodwill with potential short levy of tax of ₹ 5.06 crore. The total tax effect worked out to be ₹ 8.94 crore.

This observation was pointed out to the Department in May 2019 and October 2020.

The Department while not accepting the audit observation for AY 2016-17 in its reply stated (May 2019) that the said asset of 'Goodwill' was already in the Balance Sheet in the erstwhile Firm of the assessee. The assessee company issued shares

⁵² The assessee company was incorporated in March 2012 by conversion of erstwhile partnership firm viz. M/s BG.

for acquiring the business including the above assets. Hence, the depreciation on the same is allowable under Income Tax Act.

Reply of the Department is not acceptable on the ground that the said Goodwill was a self generated/ internally generated goodwill by the erstwhile firm. The depreciation on the same was neither admissible to the firm nor the assessee company after acquiring the business. Further, there was no change in the Partners of the firm who later became the Promoters/ shareholders of the company. Thus, the conversion of firm into company and internal generation of goodwill was a colourable device⁵³ to suppress the profit.

Further reply of the Department is awaited (January 2022).

(b) Charge: Pr.CIT (Central)-1, Mumbai
Assessee: M/s NB Limited
Assessment Year: 2015-16

In this case, the return of income for AY 2015-16 was filed (November 2015) at ₹ nil and the summary assessment was done under Section 143(1) (February 2017) accepting returned income as such, thereby raising nil demand for AY 2015-16. As per the Profit & Loss Account of financial year 2014-15, total turnover of the assessee company was ₹ 2,605.09 crore.

The assessee company merged two companies M/s. AJ Limited and M/s. SJ Limited under the scheme of amalgamation approved by the Hon'ble High Court of Bombay on 22.04.2016. Consequently, the shareholders of the amalgamating companies, M/s. AJ Limited and M/s. SJ Limited were issued 12,45,675 and 64,140 numbers of shares respectively of the assessee company at the rate of ₹ 4,477.88 per share. In lieu of that, the assessee *inter alia* added intangible asset artificially in the form of brand/trademark of ₹ 459.94 crore to the fixed assets, although the amalgamating companies or the resultant company did not have any intangible asset of brand/trademark at any period prior to the merger.

Audit observed that the assessee had claimed 25 *per cent* depreciation of ₹ 114.98 crore in the revised ITR on the intangible assets in AY 2015-16. As the value against issue of shares was merely an accounting entry, the claim of depreciation on such artificially created intangible assets was improper and it denoted the motive of the assessee to evade tax by claiming incorrect depreciation. In view of this, the Department should have disallowed the claim of the depreciation of ₹ 114.98 crore having potential short levy of tax of ₹ 35.53 crore. Further, this also resulted in incorrect carry forward of WDV of

⁵³ Honorable Supreme court in case of McDowell & Co. Ltd. vs. Commercial Tax Officer (154 ITR 148) dated 17-4-1985 wherein Apex Court observed that tax planning within the law is permitted, but colorable devices cannot be part of tax planning. The term 'Colourable device' was used by the Apex Court in this case to distinguish between the tax planning and tax evasion wherein it was held that '*Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods*'.

goodwill of ₹ 344.96 to subsequent years with potential tax implication of ₹ 106.59 crore. Total tax effect worked out to ₹ 142.12 crore.

Audit noted that although enormous depreciation availed on such artificially intangible assets resulted in huge losses, the case was not selected for scrutiny assessment. This indicated that selection criteria required changes to mark such cases as high-risk category.

This observation was pointed out to the Department in October 2020. The Ministry in its reply (January 2022) accepted the audit objection and stated that remedial action had been initiated by issuing Notice under section 148 of the Income Tax Act on 30 March 2021.

4.4.4 Non-invoking of the provisions of section 40A(3) of the Act in respect of purchases made in cash from grey market

Section 40A(3) of the Act prescribes that where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure. Section 40A(3) was introduced by the Finance Act 1968 as a provision designed to curb wasteful and lavish expenditure and to counter evasion of tax through claims for expenditure.

Audit noticed in two cases in two states⁵⁴ where purchases were made in cash involving tax effect of ₹ 2.50 crore. One case is illustrated below.

Box 4.5: Illustration of Non-invoking the provisions of section 40A(3) of the Act in respect of purchases made in cash

(a) Charge: Pr.CIT-23, Mumbai

Assessee: M/s AM

Assessment Year: 2013-14

The assessee, a company, filed the return of income for AY 2013-14 in September 2013 at income of ₹ 1.08 crore and the scrutiny assessment was done under Section 143(3) in January 2016 determining the income at ₹ 1.24 crore thereby raising demand of ₹ 6.94 lakh. The assessee had shown gross turnover at ₹ 17.49 crore for financial year 2012-13.

As per the assessment order, the assessee had made bogus purchases amounting to ₹ 8.06 crore from the concerns controlled and managed by the BJ Group. The AO during the assessment concluded that the assessee procured the material from the grey market by paying cash; and arranged the bills for the same from accommodation entry providers at commission. In view of this, the said purchase

⁵⁴ Maharashtra (1) and West Bengal & Sikkim (1)

of material in cash was required to be disallowed under section 40A(3) of the IT Act. Omission to do so resulted in underassessment of income by ₹ 8.06 crore involving short levy of tax of ₹ 2.49 crore.

This observation was pointed out to the Department in April 2016. The Ministry in its reply has accepted the audit observation (January 2022) and stated that remedial action has been initiated under Section 148 of the Income Tax Act (June 2021).

4.5 Irregular set off/carry forward of losses

Audit noticed in 14 cases in five States⁵⁵ having tax effect of ₹ 40.14 crore where irregular set-off/ carry forward of losses was allowed by ITD. The cases are discussed in succeeding paragraphs:

4.5.1 Losses adjusted against additions made under section 68 and 69 of the Act

Section 115BBE(1) provides that where the total income of an assessee includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, the income-tax payable shall be the aggregate of the amount of income-tax calculated on income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, at the rate of 30 *per cent*. Further sub section (2) provides that notwithstanding anything contained in this Act, no deduction in respect of any expense or allowance or set off of any loss shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a) and clause (b) of sub-section (1).

Audit noticed two cases in Maharashtra where the additions made by AOs were set off against the losses in contravention of the Section 115BBE of the Act. These mistakes resulted in loss of revenue of ₹ 34.00 crore. One such case is illustrated below.

Box 4.6: Illustrative case of Losses adjusted against additions made under section 68 and 69 of the Act

(a) Charge: Pr.CIT-5, Mumbai

Assessee: M/s PS Ltd.

Assessment Year: 2015-16

The assessee, a company, filed the return of income for AY 2015-16 in September 2016 at the loss of ₹ 85.44 crore and the scrutiny assessment was completed under Section 143(3) in December 2017 determining the income at ₹ 74.28 crore thereby raising demand of ₹ 36.06 crore. The assessee had shown total turnover at ₹ 959.15 crore for financial year 2014-15.

⁵⁵ Maharashtra(9), Gujarat(2), Karnataka & Goa (1), Delhi(1) and West Bengal & Sikkim(1)

Audit observed (February 2019) that, while completing the scrutiny assessment, the AO had added ₹ 141.61 crore as unexplained cash credit under section 68 and ₹ 5.55 lakh as unexplained expenditure under section 69C of the Act. However, the same was adjusted against the current year loss of ₹ 85.44 crore in contravention of the provisions of the Act. These mistakes resulted in underassessment of ₹ 85.44 crore and short levy of tax of ₹ 32.98 crore.

This observation was pointed out to the Department in February 2019. The Department accepted (September 2021) the audit objection and stated that remedial action has been taken by passing an order under section 154 of the Act (April 2019).

4.5.2 Irregular set off/ carry forward of losses

As per section 72(1) of the Act where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss to the assessee, not being a loss sustained in a speculation business; and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section, so much of the loss as has not been so set off or, where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and it shall be set off against the profits and gains, if any, of any⁵⁶ business or profession carried on by him and assessable for that assessment year; if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

Further, as per section 157 of the Act when, in the course of the assessment of the total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set off under the provisions of sub-section (1) of section 72, sub-section (2) of section 73, sub-section (1) or sub-section (3) of section 74 or subsection(3) of section 74A, the Assessing Officer shall notify to the assessee by an order in writing the amount of the loss as computed by him for the purposes of sub-section (1) of section 72, sub-section (2) of section 73, sub-section (1) or sub-section (3) of section 74 or sub-section (3) of section 74A.

Audit observed irregular set-off/ carry forward of losses in 12 cases in five States⁵⁷ with short levy of tax of ₹ 6.14 crore. Two such cases are illustrated below:

⁵⁶ As per earlier proviso to section 72(1)(i), the business or profession for which the loss was computed has to be continued in order to avail of carry forward and set off of loss. However, this proviso was omitted by Finance Act, 1999 with effect from 1 April 2000. Thus, w.e.f. 1st April 2000, the loss of any business (except speculative business) can be set off against profit of any business. Loss of speculative business can be set off against profit of speculative business only.

⁵⁷ Maharashtra (7); Gujarat (2); Karnataka & Goa (1); Delhi (1) and West Bengal & Sikkim (1)

Box 4.7: Illustrations of irregular set off/ carry forward of losses

(a) Charge: Pr.CIT (Central)-2, Mumbai

Assessee: M/s SG

Assessment Years: 2011-12

The assessee, a company, filed the return of income for AY 2011-12 in December 2016 at income of ₹ 2.21 crore and the scrutiny assessment was completed under Section 143(3) read with Section 153A in December 2017 determining the income at ₹ 6.45 crore thereby raising a demand of ₹ 2.22 crore for AY 2011-12.

Audit observed (February 2019) that the assessee was allowed set off of loss of ₹ 2.92 crore as against the available loss of ₹ 50.93 lakh. This resulted in under assessment of income of ₹ 2.41 crore with consequent short levy of tax of ₹ 74.44 lakh.

This observation was pointed out to the Department in February 2019. The Ministry in its reply accepted the audit observation (January 2022) and stated that the remedial action had been taken while passing order giving effect to order of Ld. CIT(Appeals) on 14 February 2019.

(b) Charge: Pr.CIT-4, Ahmedabad

Assessee: M/s SL Limited

Assessment Years: 2015-16 and 2016-17

The assessee had set-off their income of ₹ 1.04 crore of AY 2016-17 and ₹ 2.78 crore of AY 2015-16 with brought forward losses of previous years accumulated between AY 2011-12 and AY 2014-15. However, as per the scrutiny assessment records of AY 2014-15, no loss was available for set off. Yet, the Department allowed the set off of losses in both the AYs. This resulted in irregular set off of losses in above two AYs aggregating to ₹ 3.81 crore resulting in total short levy of tax of ₹ 1.24 crore.

This observation was pointed out to the Department in July 2020. The Ministry in its reply (January 2022) has accepted the audit objection and stated that remedial action has been initiated by issuing Notice under section 148 of the Act on 30 March 2021 and 27 March 2021 for AY 2015-16 and AY 2016-17 respectively.

4.6 Income escaping assessment

The Income Tax Act, 1961 provides that the total income of a person for any previous year shall include all incomes from whatever source derived, actually received or accrued or deemed to be received or accrued. Audit observed instances where the AOs did not assess/under assessed income leading to short levy of tax of ₹ 164.28 crore in 67 assessment cases in 11 States.

4.6.1 Non-addition of unexplained investment/expenditure/ cash credit

Section 68 of the Income Tax Act, 1961 provides that where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the AO, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year. The assessee is required to establish the proof of identity of the creditors, capacity of creditors to advance money and genuineness of the transactions.

Audit observed 33 cases of unexplained investment/cash credit involving tax effect of ₹ 105.42 crore in nine States⁵⁸. Seven cases are illustrated below:

Box 4.8: Illustrations of Non-addition of unexplained investment/expenditure/ cash credit

(a) Charge: Pr.CIT 5, Mumbai
Assessee: M/s DE Pvt. Ltd.
Assessment Year: 2014-15

The assessee, a company, filed the return of income for AY 2014-15 in September 2014 at income of ₹ 4.56 lakh and the scrutiny assessment was completed under Section 143(3) in November 2016 accepting returned income as such thereby raising nil demand.

The assessee company, incorporated in March 2013, had shown sales of ₹ 24.03 crore and purchases of ₹ 23.90 crore during AY 2014-15. The aggregate sundry creditors stood at ₹ 53.57 crore despite overall purchases of ₹ 23.90 crore. Audit observed (February 2018) that most of the sales and sundry creditors were shown against such companies which were confirmed as shell companies by the Central Government in the list released in August 2017. Besides, the following irregularities were also observed:

- (i) The Directors of the company viz. Mr. AS and Mr. KS were found as hawala operators who worked in close coordination with another hawala operator Mr. PJ.
- ii) Search and Seizure was undertaken under section 132 of the Act (October 2013) in the premises where the assessee company was registered. During the search, the investigation authorities found that four companies viz. M/s. NG Pvt. Ltd., M/s. DE Pvt. Ltd., M/s. SG Pvt. Ltd. and M/s. VE Pvt. Ltd. were in the business of providing accommodation entries only. The directors of the assessee company were also the Directors in M/s. NG Pvt. Ltd.

⁵⁸ Maharashtra (4); Delhi (16); Bihar (1); Jharkhand (2); Gujarat (2); Punjab & Haryana (4); Tamilnadu (1); Orissa (2) and West Bengal & Sikkim (1)

iii) The assessee had remitted ₹ 24.71 crore to SB, Hong Kong and ₹ 24.87 crore to AI. The antecedents of these companies were not ascertainable, and no information was available in the public domain about these companies.

iv) The assessee had also stated to have imported diamonds from MT Ltd., Hong Kong and CS Ltd., Hong Kong. As per the information available in the public domain⁵⁹, MF Ltd., which was a UAE based entity, was involved in a hawala racket and was granting fake bills for export of diamonds. These allegations were confirmed by the police investigating authorities also.

All the above discrepancies suggested that the assessee was not involved in any genuine business activity and was merely providing accommodation entry or doing hawala transactions. By resorting to such activities, the assessee brought its own or its director's unaccounted money to the extent of ₹ 53.57 crore through various shell companies (shown as sundry creditors) and remitted the same to foreign shell companies in the guise of advance or imports. Consequently, the above amount was required to be added as unexplained credit to the income of the assessee.

Despite these red flags, the AO neither did any verification of the sundry creditors nor took any action against the assessee so as to centralise its case (as done in case of M/s NG Pvt. Ltd.) for thorough examination of its various dubious transactions and to add these to safeguard the revenue. This resulted in underassessment of minimum amount of ₹ 53.57 crore with consequent short levy of tax of ₹ 18.20 crore.

This observation was pointed out to the Department in February 2019. The Department stated in its reply (December 2020) that proposal for taking remedial action had been forwarded to the higher authorities. Further details of action taken could not be verified by Audit. Reply of the Ministry is awaited (January 2022).

(b) Charge: Pr.CIT Ranchi

Assessee: M/s SA

Assessment Year: 2013-14

The assessee, a retailer of jewellery trading, filed the return of income for AY 2013-14 in September 2013 at ₹ 35 lakh and the scrutiny assessment was completed under Section 143(3) (March 2016) determining the income at ₹ 38.19 lakh thereby raising demand of ₹ 1.42 lakh. The assessee had shown total turnover at ₹ 9.10 crore for financial year 2012-13.

Audit observed (September 2020) from the Tax Audit Report that there was excess quantity of stock (2,459.99 grams of 18K Gold and 3,807.72 grams of 22K Gold). However, neither was this disclosed in the Tax Audit Report nor did the Assessing

⁵⁹ Times of India report dated 12th April 2014 that ICICI Bank had found in the case of M/s. R.A. Distributors Ltd.

Officer examine this aspect during assessment. In the absence of any justification, the corresponding value of the excess quantity of stocks should have been added as unexplained credit to the income of assessee. This resulted in underassessment on account of non-addition of unexplained credit of stocks of gold valued at ₹ 1.50 crore with consequent short levy of tax of ₹ 62.83 lakh.

This observation was pointed out to the Department in September 2020. Reply of the Ministry is awaited (January 2022).

(c) Charge: Pr.CIT-I, Bhubaneswar

Assessee: M/s EJ Pvt. Ltd.

Assessment Year: 2015-16

In this case, the return of income for AY 2015-16 was filed in September 2015 at income of ₹ 1.61 crore and the scrutiny assessment was completed under Section 143(3) in December 2017 determining the income at ₹ 1.62 crore thereby raising demand of ₹ 0.25 lakh. The assessee had shown total turnover of ₹ 71.43 crore for financial year 2014-15.

The assessee had shown unsecured loans of ₹ 1.26 crore as taken from one of its directors during AY 2015-16. Audit observed from the ITRs filed by the said Director that loans and advances given to the assessee during the AY 2015-16 were ₹ 75.00 lakh only. In view of this, the overstated unsecured loan amounting of ₹ 51.29 lakh needed to be disallowed under section 68 of the Act. Omission to do so resulted in under assessment of income of ₹ 51.29 lakh with consequent short levy of tax of ₹ 22.31 lakh including interest.

This observation was pointed out to the Department in August 2020. The Ministry in its reply accepted (January 2022) the audit objection and stated that remedial action had been initiated by issuing Notice under section 148 of the Income Tax Act on 20 April 2021.

(d) Charge: Central Circle 1, Chandigarh

Assessee: M/s SH

Assessment Year: 2017- 18

The assessee filed the return of income for AY 2017-18 in October 2017 at income of ₹ 10.86 crore and the scrutiny assessment was completed under Section 143(3) in December 2018 determining the income at ₹ 25.72 crore thereby raising demand at ₹ 13.86 crore. The assessee had shown total turnover of ₹ 85.30 crore for the financial year 2016-17.

The assessee had shown an amount of ₹ 1.65 crore as advance received from customers in the balance sheet. On being asked about the documentary evidence and complete detail of customers in support of the above amount by the AO, the assessee failed to furnish the same. In view of this, the above amount was required

to be added as unexplained credit, however, this was not done. This resulted in under assessment of income of ₹ 1.65 crore with tax effect of ₹ 1.27 crore.

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

(e) Charge: Pr.CIT 2, Ahmedabad

Assessee: HK

Assessment Year: 2013-14

In this case, the return of income for AY 2013-14 was filed in September 2013 at ₹ 6.75 lakh and the scrutiny assessment was completed under Section 143(3) in February 2016 accepting returned income as such thereby raising nil demand for AY 2013-14. The assessee had shown total turnover of ₹ 192.96 crore for financial year 2012-13.

During assessment procedure, the AO asked the assessee to submit details (Name, Permanent Account Number, Contra Account Ledger) in respect of all creditors having closing balance over Rupees one lakh, however, the assessee could not furnish such details in respect of one sundry creditor having a huge closing balance of ₹ 27.57 crore. Thus, though the amount remained unexplained, assessment was completed without addition of this amount under Section 68 of the Act. This resulted in underassessment of income of ₹ 27.57 crore with resultant potential short levy of tax of ₹ 11.50 crore including interest under section 234B of the Act.

This observation was pointed out to the Department in July 2020. Reply of the Ministry is awaited (January 2022).

(f) Charge: Pr.CIT-I, Bhubaneswar

Assessee: M/s LJ Pvt. Ltd

Assessment Year: 2014-15

In this case, the return of income for AY 2014-15 was filed (November 2014) at income ₹ 3.55 crore and the scrutiny assessment was completed under Section 143(3) in December 2016 determining the income at ₹ 3.75 crore thereby raising demand at ₹ 0.11 lakh. The assessee had shown total turnover of ₹ 266.41 crore for financial year 2013-14.

Audit observed that the assessee had shown advance of ₹ 32.96 lakh given to a related party (M/s LB Pvt. Ltd.) during AY 2014-15. However, as per the ITR of the related party M/s LB Pvt. Ltd. for AY 2014-15, short term borrowings were ₹ Nil and hence, the same should have been disallowed and added back to the total income of the assessee under section 69 of the Act. Further, the assessee had shown trade payable of ₹ 1.86 crore against another related party i.e., M/s A Ltd. for the AY 2014-15. However, as per the debtors schedule of M/s A Ltd., the actual amount payable by the related party was ₹ 219.54 lakh. Hence, there was under

statement of trade payables of ₹ 33.76 lakh, which was required to be added to the assessed income of the assessee under section 68 of the Act. Thus, there was total underassessment of income of ₹ 66.72 lakh (₹ 32.96 lakh + ₹ 33.76 lakh) under related parties' transactions involving tax effect of ₹ 24.59 lakh.

This observation was pointed out to the Department in August 2020. The Ministry in its reply accepted (January 2022) the audit objection and stated that remedial action had been initiated by issuing Notice under Section 148 of the Income Tax Act on 31 March 2021.

(g) Charge: Pr.CIT-5, Ahmedabad

Assessee: BM

Assessment Year: 2016-17

In this case, the return of income for AY 2016-17 was filed in December 2016 at income of ₹ 13.46 lakh and the scrutiny assessment was completed under Section 143(3) in September 2018 determining the income at ₹ 13.49 lakh, thereby raising demand at ₹ 0.01 lakh for AY 2016-17. The assessee had shown total turnover of ₹ 6.54 crore for financial year 2015-16.

The case of assessee was selected under "Limited Scrutiny" to verify various aspects of outward remittances. The assessee had submitted during assessment 15CA certificates in support of foreign remittances made against import of Diamonds. Audit observed that the nature of remittances was shown as "Purchase of software" in the 15CA certificates. However, as per the P&L of the assessee, no expenditure was booked for purchase of software. Thus, the foreign remittance of ₹ 6.36 crore made by the assessee was suspicious and required to be added as unexplained expenditure. Omission to do so resulted in underassessment of income of ₹ 6.36 crore involving tax effect of ₹ 2.20 crore.

This observation was pointed out to the Department in September 2020. Reply of the Ministry is awaited (January 2022).

4.6.2 Income not assessed under various provisions of the Act

As per Section 41(1) of Income Tax Act, where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year, and the assessee has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

Section 56(2)(viib) of the Act stipulates that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources". Rule 11UA(2) of the Income Tax Rules provides that the fair market value of unquoted equity shares for the purposes of Section 56(2)(viib) shall be determined as per the prescribed formula.

Section 115JB of the Act specifies the manner of computing the book profits in cases where the tax under normal provision is less than that of MAT provision.

Audit noticed in 34 cases in 10 States⁶⁰ 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. Four cases are illustrated below:

Box 4.9: Illustrations of Income not assessed under various provisions of the Act

(a) Charge: CIT, Thrissur

Assessee: M/s KJ Private Ltd.

Assessment Year: 2015-16

The scrutiny assessment was completed under section 143(3) in December 2016 accepting the income of Rs.79.77 lakh under normal provisions and ₹ 99.79 crore under 115JB as returned by the assessee. During FY 2014-15 in order to hedge the price risk of gold, the Company had entered into commodity forward contracts and simultaneous foreign currency forward contracts to hedge the USD/INR risk. During the year, the assessee had earned market to market (MTM) gain on the gold forward contracts aggregating to ₹ 55.63 crore and recognised the same in the Statement of Profit and Loss. However, the income was excluded from the total income under normal provisions of the Income Tax Act. There is no provision in the Act to exclude the MTM gain recognised in the Statement of Profit and Loss on accrual basis in accordance with accounting principles regularly followed by the company as envisaged under section 145(1) of the Act. Further, the assessee had claimed MTM losses on accrual basis during the previous assessment year. The incorrect allowance had resulted in income escaping assessment of ₹ 55.63 crore under normal provisions with potential tax effect of ₹ 18.91 crore.

This observation was pointed out to the Department in July 2018. The Department accepted the audit observation (September 2021) and took remedial action under Section 143(3) read with Section 263 of the Act in July 2021. However, while

⁶⁰ Maharashtra (8); Gujarat (3); Karnataka & Goa (5); Punjab & Haryana (1); Tamilnadu (1); Kerala (2); Delhi (5); Odisha (1); West Bengal & Sikkim (6) and Bihar (2)

computing the tax, the addition was made under Section 115JB of the Act instead of normal provisions. The same was brought to the notice of the Department and final reply is awaited (January 2022).

(b) Charge: Pr. CIT-32, Mumbai

Assessee: M/s SD

Assessment Year: 2014-15

In this case, the return of income for AY 2014-15 was filed (September 2014) at income of ₹ 78.81 lakh and the scrutiny assessment was done under Section 143(3) (December 2016) accepting returned income as such thereby raising demand at ₹ 3.33 lakh. The assessee had shown total turnover of ₹ 80.81 crore for financial year 2013-14.

The case was selected under CASS to verify Large increase in Sundry Creditors against reduction in business income as compared to preceding year. Audit observed from the balance sheet of the assessee for the year ending 31.03.2014 that the amount of sundry creditors at the year-end was ₹ 45.39 crore against seven parties. However, it was observed from the confirmation statements issued to the creditors that none of statements was signed by the concerned parties. Thus, the above credit balance remained unexplained and the entire amount of Sundry creditors of ₹ 45.39 crore should have been added to the income as cessation of liabilities. Omission to do so resulted in under assessment of income of ₹ 45.39 crore with resultant short levy of tax of ₹ 15.43 crore.

This observation was pointed out to the Department in October 2017. The Ministry in its reply accepted (January 2022) the audit objection and stated that remedial action had been taken by passing order under Section 263 read with Section 143(3) of the Income Tax Act on 17 December 2019.

(c) Charge: Pr.CIT-15

Assessee: M/s KK Pvt. Ltd.

Assessment Year: 2014-15

The assessee, a company, filed the return of income for AY 2014-15 in November 2014 at income of ₹ 1.40 crore and the scrutiny assessment was completed under Section 143(3) in December 2016 determining the income at ₹ 1.59 crore thereby raising demand at ₹ 8.67 lakh.

The assessee had issued 48,000 equity shares to M/s UI at price of ₹ 1,250 per share (including premium of ₹ 1,150 per share). Audit observed (April 2017) that the assessee had received ₹ 6.00 crore in the financial year 2012-13 as share application money which was included in capital and reserves in the Balance Sheet as on 31.03.2013. The above capital and reserves were considered by the assessee for determining the fair market value of shares as on 31.03.2013 under net asset

value (NAV) method. However, this was not correct as the share application money pending allotment cannot be treated as capital or reserves for the purpose of arriving at the net worth of the company. Consequently, the AO should have re-computed the FMV after excluding the share application money from capital and reserve. Omission to do so resulted in arriving at inflated FMV of share at ₹ 1,286/- as against the actual FMV of ₹ 668/-. This led to underassessment of ₹ 2.79 crore involving tax effect of ₹ 90.64 lakh.

This observation was pointed out to the Department in April 2017. Reply of the Ministry is awaited (January 2022).

(d) Charge: Pr.CIT (Central)-2, Mumbai

Assessee: M/s MG

Assessment Year: 2015-16

The assessee, engaged in the business of manufacturing/trading of Gems and Jewellery, filed the return of income for AY 2015-16 in September 2015 at nil income and the scrutiny assessment was completed under Section 143(3) in December 2017 accepting returned income as such thereby raising nil demand.

As per the Balance Sheet, the amount of ₹ 65.99 crore was shown as outstanding for more than a year under Sundry Creditors as on 31.03.2015. Scrutiny of records revealed that creditors were outstanding from AY 2010-11 onwards and also there was nothing on record to suggest whether the amount payable to sundry creditors was under any legal dispute or related to the assessee. As the creditors were pending for a very long period and there was nothing on record to ascertain the genuineness of the liability, the same should have been treated as cessation of liability under Section 41(1) of the Income Tax Act.

This observation was pointed out to the Department in February 2019. The Ministry in its reply accepted the audit objection (January 2022) and stated that remedial action had been initiated by issuing Notice under Section 148 of the Act on 31 March 2021.

4.7 Mistakes in computation of tax and interest

Audit observed instances where AOs made mistake in computation of tax, surcharge, interest, penalty and refund leading to short levy of tax of ₹ 106.89 crore in 49 assessment cases in 10 States.

4.7.1 Arithmetical errors in computation of income and tax

Section 143(3) of the Income Tax Act, 1961, provides that the AOs, shall by an order in writing, make an assessment of the total income or loss of the assessee and determine the sum payable by him or refund of any amount due to him on the basis of such assessment after taking into account such evidence as the assessee may

produce and such other evidence as the AO may require on specified points, and after taking into account all relevant material which he has gathered.

Audit noticed arithmetical errors in computation of income and tax in nine cases in three States⁶¹ involving tax effect of ₹ 10.90 crore. Two cases are illustrated below:

Box 4.10: Illustrations of Arithmetical errors in computation of income and tax

(a) Charge: Pr.CIT-5, Mumbai

Assessee: M/s KG Private Limited

Assessment Year: 2016-17

In this case, the return of income for AY 2016-17 was filed (November 2016) at income of ₹ 37.95 crore and the scrutiny assessment was done under Section 143(3) (December 2018) determining income at ₹ 38.63 crore thereby raising nil demand.

Audit observed that while computing the tax liability, the AO erroneously considered returned income instead of assessed income. This mistake resulted in short demand of tax of ₹ 23.48 lakh.

This observation was pointed out to the Department in October 2019. Ministry in its reply has accepted (March 2022) the audit observation and stated that remedial action has been taken under Section 154 read with Section 143(3) in February 2022.

(b) Charge: CIT (Central) -2, Delhi

Assessee: NK

Assessment Year: 2013-14 to 2016-17

In this case, the return of income for AY 2013-14 to 2016-17 was filed (October 2013, November 2014, September 2015 and October 2016 respectively) at income of ₹ 8.74 lakh, ₹ 8.36 lakh, ₹ 9.37 lakh and ₹ 10.48 lakh respectively and the scrutiny assessment was done under Section 143(3) (December 2018) determining income at ₹ 136.41 crore, ₹ 228.42 crore, ₹ 108.82 crore and ₹ 67.17 crore respectively thereby raising demand at ₹ 70.96 crore, ₹ 121.51 crore, ₹ 53.63 crore and ₹ 30.48 crore respectively. As per the Profit & Loss Account of financial year 2012-13 to 2015-16, total turnover of the assessee company was ₹ 133.79 crore, ₹ 223.86 crore, ₹ 101.03 crore and ₹ 65.79 crore respectively.

Audit observed that in the assessment for AY 2014-15 the AO had erroneously raised demand of ₹ 121.51 crore instead of actual demand of ₹ 124.96 crore. The mistake resulted in short raising of tax demand of ₹ 3.44 crore. Similar mistakes in computation noticed in assessments of the assessee for the AYs 2013-14, 2015-16

⁶¹ Maharashtra (2); Delhi (6) and Bihar (1)

and 2016-17 resulted in tax effect of ₹ 1.92 crore, ₹ 1.43 crore and ₹ 1.31 crore respectively.

This observation was pointed out to the Department in December 2019. The Ministry in its reply accepted (January 2022) the audit objection and stated that remedial action had been taken by passing order under Section 154 of the Income Tax Act on 23 June 2021 for AYs 2013-14, 2014-15 and 2015-16 and on 02 August 2021 for AY 2016-17.

4.7.2 Mistake in levy of tax, surcharge, interest and penalty

Section 4(1) of the Income Tax Act, 1961, provides that income tax is chargeable for every AY in respect of the total income of the previous year of an assessee, according to the rates prescribed under the relevant Finance Act.

The Income Tax Act, 1961 provides for levy of interest for omissions on the part of the assessee at the rates prescribed by the Government from time to time. Section 234A of the Act provides for levy of interest on account of default in furnishing return of income at specified rates and for specified time period. Section 234B of the Act provides for levy of interest on account of default in payment of advance tax at specified rates and for specified time period. Section 234C of the Act provides for levy of interest on account of default in payment of instalments of advance tax at specified rates and for specified time period. Section 244A (1) of the Act provides that where refund of any amount becomes due to the assessee under the Act, he shall, subject to the provisions of this section, be entitled to receive, in addition to the said amount, simple interest thereon calculated in prescribed manner.

Audit noticed issued related to mistake in levy of tax, surcharge, interest, penalty and refund in 41 cases in 10 States⁶² involving tax effect of ₹ 99.16 crore. Two such cases are illustrated below:

Box 4.11: Illustrations of application of incorrect rates of tax and surcharge

(a) Charge: Pr.CIT (Central)-2, Delhi

Assessee: NK

Assessment Year: 2017-18

The assessee filed the return of income for AY 2017-18 in March 2018 at income of ₹ 34.90 lakh and the scrutiny assessment was completed under Section 143(3) in December 2018 determining income at ₹ 115.32 crore, thereby raising demand at ₹ 52.50 crore. As per the Profit & Loss Account of financial year 2016-17, total turnover of the assessee company was ₹ 96.43 crore.

The AO completed the scrutiny assessment of the assessee for AY 2017-18 under Section 143(3) in December 2018 at assessed income of ₹ 115.32 crore and tax

⁶² Maharashtra (21); Gujarat (7); Karnataka & Goa (1); Punjab & Haryana (3); Tamilnadu (1); Delhi (4); Chhattisgarh (1); Orissa (1); Bihar(1) and West Bengal & Sikkim (1)

liability of ₹ 40.80 crore thereon. Audit observed that the above assessed income included ₹ 114.02 crore added on account of undisclosed income and unexplained cash deposits which attracted tax rate of 60 *per cent* and surcharge of 25 *per cent*. However, the AO while computing the final demand of the assessee charged the tax on entire additions at the normal rate of tax. This resulted in short levy of tax of ₹ 61.56 crore.

This observation was pointed out to the Department in December 2019. The Ministry in its reply accepted (January 2022) the audit objection and stated that remedial action had been initiated by issuing Notice under Section 154 of the Income Tax Act on 09 December 2021.

(b) Charge: Pr.CIT-25, Mumbai

Assessee: M/s ZJ LLP

Assessment Year: 2014-15

In this case, the return of income for AY 2014-15 was filed in November 2013 at income of ₹ 51.18 lakh and the scrutiny assessment was completed under Section 143(3) in December 2017 accepting returned income as such, thereby raising nil demand. Tax was calculated on income of ₹ 8.82 crore which was determined under Section 115JB. Audit observed from the tax computation sheet that though the assessed income was more than one crore, the surcharge leviable at the rate of 10 *per cent* was not levied. This resulted in short levy of tax of ₹ 23.87 lakh.

This observation was pointed out to the Department in May 2018. Reply of the Ministry is awaited (January 2022).

4.7.3 Blocking of refund by levy of incorrect interest

Audit observed in five cases in three states⁶³ that the AOs manually modified the interest under section 234B and levied interest of ₹ 29.22 lakh, which was not leviable, so as to avoid issue of refund. Further, in two cases⁶⁴ in Maharashtra involving tax effect of ₹ 1.78 crore, the AOs had not taken any action on issue raised by internal audit despite lapse of two years. In one case⁶⁵ in Bihar, the internal audit failed to point out the mistake in computation of income and interest leading to tax effect of ₹ 18.40 lakh.

4.8 Arm's Length Price and reference of the cases to the Transfer Pricing Officer (TPO)

Section 92CA of the Income Tax Act, 1961 provides that where any person, being the assessee has entered into an international transaction in any previous year and the AO considers it necessary or expedient so to do, he may, with the previous approval

⁶³ Maharashtra (3); Rajasthan (1); and Chandigarh (1)

⁶⁴ M/s NG and M/s KG for AY 2015-16 in Pr.CIT 19, Mumbai

⁶⁵ M/s SJ Pvt. Ltd. for AY 2011-12 in Pr.CIT-1, Patna

of Principal Commissioner refer the computation of the arm's length price in relation to the said international transaction to the Transfer Pricing Officer (TPO).

Audit noticed issues related to incorrect estimation of arm's length price, non-referring the cases to TPO and non-filing of mandatory report in Form No. 3CEB in seven assessment cases, in Maharashtra involving tax effect of ₹ 16.41 crore.

4.8.1 Incorrect estimation of Arm's Length Price

Section 92C(1) of the Act provides that the arm's length price in relation to an international transaction shall be determined by any of the methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe.

Audit noticed incorrect estimation of Arm's Length Price in one case in Maharashtra involving tax effect of ₹ 1.34 crore. The same is illustrated below.

Box 4.12: Illustration of Incorrect estimation of Arm's Length Price

Charge: CIT (TP), Mumbai

Assessee: M/s NW Ltd.

Assessment Year: 2016-17

In this case, the return of income for AY 2016-17 was filed (November 2016) at nil income of and the return was processed under Section 143(1) (December 2016) accepting returned income as such, thereby raising demand of ₹ 0.05 lakh. The assessee had shown total turnover at ₹ 1,484.07 crore for financial year 2015-16.

The case of the assessee (earlier known as M/s G2 Limited), a part of N group of companies, was referred by DCIT Central Circle 1(2), Mumbai to DCIT(TP)-3(1)(2), Mumbai (December 2018) for determining the Arm's Length Price (ALP) in respect of international transactions and specified domestic transactions entered into by it with its Associate Enterprises. The Transfer Pricing Officer (TPO) passed the order (October 2019) under section 92CA(3) of the Act with ALP adjustment of ₹ 52.82 crore.

Audit observed (February 2020) from the transfer pricing order that the TPO determined the arithmetic mean at 7.40 *per cent* of operating cost of ₹ 107.06 crore in respect of six comparables and computed the ALP adjustment under section 92CA of the Act at ₹ 52.82 crore. However, the TPO worked out ALP on the basis of simple arithmetic mean instead of median as stipulated in percentile range concept data set as per sub Rule 4 read with Rule 2 of Income Tax Rule 10CA. The Arm's length median for the given data set would be 8.49 *per cent* as against the simple arithmetic mean of 7.40 *per cent* calculated by the TPO. Thus, incorrect

calculation of median has resulted in short ALP adjustment of ₹ 4.33 crore with potential tax effect of ₹ 1.34 crore.

This observation was pointed out to the Department in February 2020. The Ministry in its reply accepted (January 2022) the audit objection and stated that remedial action had been initiated by passing order on 03 November 2020 under Section 92CA(5) read with Section 154 of the Income Tax Act.

4.8.2 Non-levy of Penalty for failure to furnish Form 3CEB Report

As per Section 92E of the Income Tax Act, every person who has entered into an international transaction or specified domestic transaction (SDT) during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed. If any person fails to furnish a report as required under section 92E, the defaulter is liable to pay the penalty amounting to ₹ one lakh under section 271BA.

Further, Section 271AA provides that if such person (i) fails to keep and maintain any such information and document as required by section 92D; (ii) fails to report such transaction which he is required to do so; or (iii) maintains or furnishes an incorrect information or document, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two *per cent* of the value of each international transaction or specified domestic transaction entered into by such person.

As per the CBDT Instruction No.3 of 2016, all cases selected for scrutiny, either under CASS system or under compulsory manual selection system on the basis of transfer pricing risk parameters in respect of international transactions or specified domestic transactions or both have to be mandatorily referred to the TPO. However, cases selected for scrutiny on non-transfer pricing risk parameters but also having international transactions or specified domestic transactions, shall be referred to TPOs only in the limited circumstances as prescribed in the said Instructions. One of the conditions for mandatorily referring to TPO are cases where the AO comes to know that the taxpayer has entered into international transactions or specified domestic transactions or both but the taxpayer has either not filed the Accountant's report under Section 92E at all or has not disclosed the said transactions in the Accountant's report filed.

Audit noticed six assessment cases of two assesseees in Maharashtra where assesseees had not filed the audit report in Form 3CEB despite substantial international and specified domestic transactions with the related parties. This resulted in non-levy of penalty of ₹ 15.07 crore under sections 271AA and 271BA of the Act. One such case is illustrated below:

Box 4.13: Illustration of Non-levy of Penalty for failure to furnish Form 3CEB Report**Charge: Pr.CIT 5 Mumbai****Assessee: M/s HK Pvt. Ltd.****Assessment Years: 2014-15, 2016-17 and 2017-18**

In this case, the returns of income for AY 2014-15, AY 2016-17 and AY 2017-18 were filed at incomes of ₹ 191.63 crore (November 2014), ₹ 163.83 crore (October 2016) and ₹ 222.78 crore (October 2017) respectively. The scrutiny assessment for AY 2014-15 (December 2016), AY 2016-17 (December 2018) and AY 2017-18 (December 2019) were completed under Section 143(3) determining the income at ₹ 191.66 crore, ₹ 163.83 crore and ₹ 222.78 crore respectively. The demand for AY 2014-15, AY 2016-17 and AY 2017-18 were raised at ₹ 7.51 lakh, ₹ nil and ₹ nil respectively. The assessee had shown total turnover of ₹ 4,309.68 crore for financial year 2013-14, ₹ 4,452.81 crore for financial year 2015-16 and ₹ 6,030.77 crore for financial year 2016-17.

Audit observed (November 2020) that the assessee had entered into specified domestic transactions with related parties to the extent of ₹ 223.83 crore, ₹ 275.96 crore and ₹ 250.79 crore during FYs relevant to AYs 2014-15, 2016-17 and 2017-18 respectively. As per the provisions of Section 92E, the assessee was liable for audit report in Form 3CEB for the said assessment years. However, the assessee had not filed the report in Form 3CEB in respect of AY 2014-15, AY 2016-17 and AY 2017-18. Omission resulted in under reporting of specified domestic transactions for which the Department should have levied penalty under section 271BA and under section 271AA.

The total penalty under section 271AA at the rate of two *per cent* of the amount not reported worked out at ₹ 15.01 crore for the AYs 2014-15, 2016-17 and 2017-18. Besides, the assessee was also liable for penalty of ₹ 1 lakh each under section 271BA for the said assessment years.

This observation was pointed out to the Department in November 2020. Ministry in its reply has accepted the audit observation (March 2022) and stated that remedial action has been initiated by issuing Notice under Section 271BA and under Section 271AA on 18 January 2022 for AY 2014-15, 2016-17 and 2017-18.

Audit noted that the penalty for not filing the Form 3CEB is ₹ one lakh under section 271BA of the Act whereas the penalty for furnishing of incorrect information or failure to report international transaction or specified domestic transaction where assessee is required to do so attracts levy of penalty of 2 *per cent* of the value of each international transaction or specified domestic transaction entered into. As the amount of penalty for not furnishing Form 3CEB is nominal compared to the penalty for incorrect reporting, it may incentivise the assessee engaged in significantly high

value international transaction or specified domestic transaction to forego furnishing of Form 3CEB.

4.9 Conclusion

While examining cases 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. Such irregularities had underlying risk of tax evasion that require further probing and detailed examination.

Audit noticed instances of non-compliance with the provisions laid down in the Act with respect to allowances of deductions/ expenses/ set-off and carry forward of losses, mistakes in computation of tax and interest, non-deduction of TDS, non-levy of penalty etc.

AOs committed errors in assessments ignoring clear provisions in the Income Tax Act. The cases of incorrect assessment involving arithmetical errors in computation of income and tax are not acceptable as the assessment processes in the ITD are automated and the assessment is being completed through ITD systems and applications. The errors are indicative of the fact that the ITD systems were deficient or did not possess the required functionality.

Application of incorrect rates of tax and surcharge, errors in levy of interest for default in furnishing of return and for payment of advance tax etc. point towards weaknesses in assessment procedure and internal controls of ITD which needs to be addressed.

4.10 Summary of Recommendations

Audit recommends that:

a) *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 assessee 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]

The CBDT has stated in its reply (January 2022) that the suggestion of the C&AG regarding framing of guidelines has been noted and is under examination. The CBDT has further stated that CASS risk parameter finalisation is done by a dedicated CASS committee so constituted by the Board for each financial year in this regard and the matter is under consideration of the CASS Committee for CASS 2022.

b) 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]

The CBDT has stated in its reply (January 2022) that risk parameters regarding this are already in existence.

The reply of the CBDT is not tenable as the existing format of Income Tax Return or Tax Audit Report do not have a provision to capture the details of exports and imports transactions undertaken by assesseees. The CBDT may reconsider capturing details of import and export transactions above a certain threshold limit to be decided by the CBDT undertaken with related parties in view of the risk of suspicious nature of transactions entered into by entities engaged in Gems and Jewellery business and risk of tax evasion, as also reported from time to time by several agencies regulating this sector.

c) 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]

The CBDT has stated in its reply (January 2022) that Form 3CD clause 23 provides for reporting details of related party with which transaction is undertaken (including PAN). Extending it to all related parties even when there is no transaction, would make 3CD bulky and may put extra burden on the taxpayer. Validation of PAN of related parties in every transaction shall also impose onerous burden on administration. However, during scrutiny proceedings the same can always be verified by the AO.

Audit is of the view that in clause 23 of Form 3CD, only payments made to the related parties have to be disclosed. However, there is no such clause in Form 3CD for capturing details of receipts in respect of related parties. The CBDT may also consider capturing details of receipts obtained from related parties in Form 3CD above a certain specified threshold limit to be decided by the CBDT and to ensure mandatory disclosure of PAN details of related parties through Form 3CD and may also consider

validation of PAN of related parties. CBDT may consider introducing PAN validation feature in respect of related party transactions above a certain specified threshold defined as per analysis of information available in database of ITD to ensure coverage of high risk cases based on perception of the ITD. Further, ITD may consider optimum utilisation of technology driven tools under faceless assessment regime in order to reduce the burden of manual verification and administrative intervention during the verification/ assessment process.

d) 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]

The CBDT has stated in its reply (January 2022) that as far as the C&AG recommendation with respect to non-verification of disclosure of stock as per P&L account and TAR specifically in entities with large sales turnover, it is mentioned that a similar issue was flagged in the half yearly report in respect of repeated/ common errors for April, 2019 to September, 2019 period by CIT(Audit) Hyderabad. Thereafter, in the Audit Manual 2019 and in the compendium of Audit 2020-21, issued by the Directorate of Audit and Inspections, the Audit Checklist includes two of the following items with respect to computing profits and gains of business or profession:

- Whether turnover/gross receipts/sale including exports, have been disclosed correctly as per the information available in AIR/ITS details/360 degree data.
- Whether remarks made in the Tax Audit Report have been duly considered for disallowance.

Thus, this aspect of C&AG recommendation is adequately covered.

It was further stated that the CAG recommendation with respect to non-verification of unexplained excess output, to prevent possibility of evasion through suppression of sales and introduction of unaccounted raw-material, has been noted for due consideration during preparation of audit checklist for the forthcoming 'Compendium of Audit for 2021-22'.

As the recommendation has been noted for due consideration during preparation of audit checklist for the forthcoming 'Compendium of Audit for 2021-22', details of further action taken in this regard may be intimated to Audit.

e) *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]

The CBDT has stated in its reply (January 2022) that similar risk parameters already exist for selection of cases for scrutiny.

Audit is of the view that although risk parameters similar to differences in disclosures in quantitative details of stocks made through different sources by the same assessee in a particular assessment year exist for selection of cases for scrutiny, Audit noticed instances of discrepancies in disclosures made through ITR and TAR in case of the same assessee that need in-depth scrutiny to ensure correctness of disclosures made by the assessee. The CBDT needs to review the system for taking corrective measures through identification of discrepancies in disclosures made through Tax Audit Report furnished alongwith ITR to the ITD.

f) *Considering the specialized nature of business activity of the assessee 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 assessee 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]

The CBDT has stated in its reply (January 2022) that as per the provisions of Section 142(2A) of the Income-tax Act, 1961, the Assessing Officer may form an opinion whether it is necessary to conduct special audit in a particular case after taking into consideration various factors like nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialised nature of business activity of the assessee and the interests of the revenue. Therefore, whether the special audit has to be conducted or not is to be examined on a case-to-case basis and it may not be possible to issue uniform standardised guidelines on this issue.

Audit noted that although the provisions for special audit exist under the Income Tax Act, the extent of utilisation of the special powers in respect of high risk assessment cases of Gems and Jewellery sector could not be ascertained during audit. Though the Gems and Jewellery sector entails all the requisite criteria for special audit like multiplicity and complexity of transactions/ accounts, specialised nature of business activity etc., no special audit even in the sample cases were undertaken during the period 2015-16 to 2018-19 by the Department. Thus the CBDT may consider

undertaking sectoral risk assessment for identifying cases for special audit as per provisions of the Act.

g) The CBDT may revisit the assessments involving errors and irregularities in computation of income, tax, interest etc. to ascertain the reasons for such errors and put in place a robust system and internal control mechanism to eliminate possibility of such avoidable errors and to ensure compliance to provisions and conditions laid down under the Income Tax Act by the Assessing Officers.

[para 4.7]

The CBDT has stated in its reply (January 2022) that the earlier system of computation of income of the assessee after verifying with old records was prone to errors has been now dispensed with by a new application for assessment functions called 'Income Tax Business Application' ('ITBA'). Correct and uniform computation of income and taxes is being taken care of in ITBA. There is marked difference in the approach of passing assessment orders in ITBA from legacy AST system. In ITBA, the AO is required to follow a more detailed and comprehensive approach while making addition/ disallowance to compute taxable income and as a result of these systemic developments, computation errors can be avoided. Also several cases of Gems and Jewellery sector wherein Internal Audit of Income-tax Department has raised audit objections in the last few years.

As stated by the CBDT, the correct and uniform computation of income and taxes is being taken care of in ITBA. However, in view of irregularities noticed during audit, the computation errors are a cause of concern irrespective of the manual/ systemic mode of computation. Audit may be provided access to the ITBA system for verification of the same.

h) The reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite clear provisions in the Act may be reviewed by CBDT. The ITD may identify items of expenses and deductions with higher propensity to irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance.

[para 4.3, 4.4]

The CBDT has stated in its reply that the suggestion of the C&AG regarding framing of guidelines has been noted and is under examination. Also in 2019, Directorate of Audit & Inspections issued an Audit Manual for the Departmental stakeholders which contains a detailed check-list of issues to be looked into by an auditor, while also seeking to prevent future occurrence of wrong allowability of inadmissible claims by the Assessing Officers in assessments. Further from financial year 2018-19 onwards, Directorate of Audit & Inspections, for the guidance of auditors in Income-Tax Department and field formations, has been issuing an annual compendium of common mistakes detected during Internal Audit & Revenue Audit, which has acted

as a valuable tool to the departmental stakeholders in making error-free assessments and thereby preventing leakage of revenue by curbing revenue deductions/ expenses which are non-allowable or have a higher propensity to irregular claims.

The efforts made by the ITD in respect of bringing out annual compendium of common mistakes detected during Internal Audit and Revenue Audit for ensuring error free assessments is appreciated. The CBDT may, further consider reviewing the reasons for occurrence of irregularities pointed out in audit despite the awareness of issues with higher propensity of irregular allowances or claims amongst departmental stakeholders for taking remedial action to avoid occurrence of such large number of inconsistencies/ irregularities in the future.

i) 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.

The CBDT has stated in its reply (January 2022) that whether a mistake committed during framing of assessment and detected during Internal-Audit is malafide/ bonafide has to be ascertained depending on facts and circumstances of each case by the supervisory authorities. It is submitted that Income-tax Department has a well-established mechanism at the field level to deal with any instance of error of commission which comes to light during Internal-Audit.

Reply of the CBDT is not acceptable as the system/ mechanism was not functioning effectively as was evident from the systemic and compliance irregularities brought out in this Report that were not raised by the Internal Audit wing of the ITD. The CBDT may review the effectiveness of the functioning of the Internal Audit wing of the ITD in view of deficiencies pointed out in C&AG audit.

j) 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 assesseees lead to lower probability of selection of such cases under CASS parameters.

[para 4.8.2]

The CBDT has stated in its reply (January 2022) that it will be considered before the CASS Committee.

As the recommendation has been noted for consideration before the CASS Committee, details of further action taken in this regard may be intimated to Audit.

Chapter-5: Systemic issues related to assessments of assesseees of Gems and Jewellery Sector

The performance audit envisaged ascertaining whether the ITD had proper internal control system and monitoring mechanism to ensure appropriate timely action and quality assessments. Audit examination of assessments of entities engaged in business related to Gems and Jewellery sector revealed instances of wrong business codes filled up by assesseees, non-compliance at the preliminary stage of filing of Income Tax Returns, discrepancies in disclosures of quantitative details of inventory indicative of inadequate verification during processing of returns and finalisation of assessments, non-verification of unsecured loans, non-verification of shortage/ excess of stocks and non verification of disclosures made regarding yield of diamond. These deficiencies entailed risk of escapement of revenue due to non-verification of sector specific issues, risk of generation of incorrect and unreliable information, risk of allowance of unverified claims, risk of suppression of profits or bringing unaccounted income by way of shortage/ excess of stocks, and risk of concealment of revenue due to non-verification of yield. The audit findings related to extant system and procedure within the ITD for verification and monitoring of information pertaining to entities of Gems and Jewellery sector are discussed in paras 5.1 to 5.8 of this Chapter. Audit noticed instances of insignificant expenses as compared to huge turnover, which was indicative of non-genuine business activities of the assesseees warranting further verification by the Department. Instances of suspicious business activities in assessments of entities of Gems and Jewellery sector are discussed in para 5.9 of this Chapter. The nature of audit findings discussed in this Chapter are summarised in Table 5.1 given below.

Sl. No.	Audit Observation	No. of cases	Tax effect (₹ in crore)
1.	5.1 Non-maintenance of sectoral database by the Department	-	Systemic Issue
2	5.2.1 Effectiveness of Non-filer Management System	-	Systemic Issue
3	5.2.2 Non-levy of Penalty under Section 271F/ late fee under Section 234F	349	Systemic Issue
4	5.3 Mismatch in data as furnished by the DGIT (Systems) vis-à-vis actual ITR data	261	Systemic Issue
5	5.4 Mismatch in disclosures made in Income Tax Returns (ITRs) and Tax Audit Reports	1,038	Systemic Issue
6	5.5 Verification of shortage/ excess of stocks	180	Systemic Issue
7	5.6 Non verification of variation in yield /wastage of polished diamond	357	Systemic Issue
8	5.7 Non- verification of creditworthiness of unsecured loans	45	Systemic Issue
9	5.8.1 Suspicious business activities by the assesseees of Gems and Jewellery sector	15	Systemic Issue
10	5.9 Grievances/ complaints filed by assesseees of Gems and Jewellery Sector	--	Systemic Issue
	Total	2,245	Systemic Issue

The results of the audit examination are given in the succeeding paragraphs.

5.1 Non-maintenance of sectoral database by the Department: Non-filling up of sector specific business codes

ITD has allocated specific business codes for income tax return forms to the assessee engaged in Gems and Jewellery Sector. Allocation of specific codes to different businesses is essential for proper monitoring, collection and sharing of relevant information as well as expert handling of sector-specific issues during the course of assessment. Monitoring of assessee of Gems and Jewellery sector is important in view of the various reports⁶⁶ suggesting misuse of the Gems and Jewellery trade for money laundering and suspected financing. Further, there is also a non-tax angle for inappropriate monitoring of diamond sector. Financial Action Task Force (FATF) in its report in October 2013 had alerted India that it had instances where diamond trade was used for purposes of money laundering and terrorist financing. The possibility that some assessee might be deliberately filling wrong business codes to avoid attention of regulators and Investigating agencies cannot be ruled out.

Keeping in view the significance of the sector and risk of money laundering, terror funding and leakage of Government revenues, there is an earnest need for more detailed Codes for Gems and Jewellery sector, so as to enable assessee to select the exact type of business, and for improving the quality of assessments by the AOs in the field as the complete and reliable sectoral database would facilitate handling of sector-specific issues by the departmental officials during the course of assessment.

The business codes were revised from AY 2018-19. The old and new business codes specific to Gems and Jewellery sector are as follows.

Table 5.2: Business codes for assessee engaged in Gems and Jewellery business	
Nature of business	Business code
Business codes up to A.Y. 2017-18	
Manufacturing Industry [Diamond cutting]	104
Business codes from A.Y. 2018-19	
Manufacturing -Manufacture of jewellery	4093
Mining and Quarrying- Mining of gemstones	3009

The DGIT (Systems) provided aggregate and assessee-wise data of assessee engaged in Gems and Jewellery business for assessments completed during financial years 2015-16 to 2018-19. The data provided by the DGIT (Systems) contained 1,52,927 records. For ascertaining the completeness of data provided by the DGIT (Systems),

⁶⁶ Financial Action Task Force Report on Money Laundering and Terrorist Financing through Trade in Diamonds. FATF is a Paris-based global body set to combat money laundering and terrorist financing. India became its member in the year 2010.

a test check was carried out comparing the actual scrutiny assessment of Gems and Jewellery cases completed in the assessment charges with the data provided by the DGIT (Systems).

Audit observed in four states⁶⁷ that 1,089 cases pertaining to Gems and Jewellery sector were not appearing in the data provided by the DGIT (Systems). The discrepancy was attributable to the wrong business codes filled by the assesseees. Up to AY 2017-18, the code for diamond cutting was '0104' but in many cases, the assesseees had mentioned 'manufacturing others-0124' or trading others- 0204'. Further, the revised code (w.e.f. AY 2018-19) for 'manufacturing of jewellery' was '04093'. However, many of the assesseees had filled in code as 'Other Manufacturing-04097'.

Audit noticed in 41 cases in 10 states⁶⁸ that although the assesseees were not related to Gems and Jewellery sector, they mentioned business code as 104 (cutting of diamonds) in the ITR due to which these cases were captured in DGIT (Systems) database for Gems and Jewellery.

Audit also observed that up to AY 2017-18, there was no separate code for manufacturing of jewellery. Further, in the revised code w.e.f AY 2018-19, there was no separate code for cutting and polishing of diamonds, trading in diamonds, gold or precious metals, gold refineries etc. In absence of clearly defined codes for Gems and Jewellery sector, many of the assesseees are putting codes as 'manufacturing others' or 'trading others. Consequently, details of the Gems and Jewellery assessment cases are not getting reflected in the sector specific data.

As an Assessing Officer is to verify the correctness of business codes declared by assessee in the return of income under the Scrutiny assessment, in the absence of specific codes for the sector, the correctness and accuracy of business codes declared by the assesseees in the return of income was not found verified in the cases audited.

Without having a clear mapping and categorisation of key sectors as suggested above, a systematic and consistent approach to selection under CASS and scrutiny assessment will be difficult. Further, audit findings reflected that in the absence of complete, comprehensive and reliable sectoral database, the Department would not be able to properly monitor, collect and timely share the relevant information to other Government agencies and Departments. The possibility of escapement of revenue due to non-verification of any sector-specific issue cannot be ruled out.

Reply of the Ministry is awaited (January 2022).

⁶⁷ Maharashtra (1065); Delhi (19); Madhya Pradesh (1) and Chhattisgarh (4)

⁶⁸ Gujarat (1); Karnataka & Goa (2); Punjab & Haryana (3); Delhi (4); Madhya Pradesh & Chhattisgarh (2); AP & Telangana (5); Rajasthan (6); Bihar (1) and Maharashtra (17).

5.2 Issues requiring monitoring at filing stage and processing stage of Income Tax Returns

The audit findings based on examination of 2,261 assessment cases indicative of risks at different stages of processing and assessment have been categorised on the basis of nature of irregularity depicted in Table 5.1 and are discussed in para 5.2.1 to 5.10 of this Chapter.

5.2.1 Effectiveness of Non-Filers Monitoring System

Non-Filers Monitoring System (NMS) was implemented (September 2013) by the ITD to prioritise action on non-filers with potential tax liabilities. Data analysis was carried out to identify non-filers about whom specific information was available in AIR data and TDS/TCS Returns. As per Standard Operative Procedure issued by the CBDT(Board), AOs are required to issue letters to non-filers, capture the delivery date of letter, capture the details of return in AST (if return is filed by the non-filers), and initiate proceedings under Section 143(2)/148 (if return is not filed) in NMS module. However, despite a proper system in place to identify and address the non-filers/stop filers and gap filers, audit noticed discrepancies in the data of provided by the DGIT (System):

Audit examined Income Tax Return filing pattern of the assesseees to assess mandatory preliminary compliance required from all entities of this sector. Audit observed that although in 243 instances⁶⁹ of 125 assesseees in 16 states⁷⁰, the assesseees had either stopped filing return of income or had not filed return regularly, no action was taken by the ITD. Further, in respect of 26 cases in 10 states⁷¹, although the data of the DGIT (System) indicated them as Stop filers/gap filers, it could not be confirmed whether the assesseees were actually 'stop filers/ gap filers' as related details were not furnished by the ITD. The PAN registration category-wise trends of filers and non-filers during AY 2016-17 to AY 2019-20 is depicted in Table 5.3 given below.

⁶⁹ 243 cases consisted of 149 cases processed under section 143(1), 36 cases assessed under section 143(3) of the Act and 54 cases assessed under other sections of the Act [147, 154, 250 and 254]. In remaining four cases details not available.

⁷⁰ AP & Telangana (7), Maharashtra (82);Madhya Pradesh & Chhattisgarh (18); Gujarat (48); Karnataka & Goa (8); Uttar Pradesh (15); Odisha (7); Rajasthan (5); Punjab & Haryana (5); Tamilnadu (4); Kerala (25); Delhi (7);Bihar & Jharkhand (6) and West Bengal & Sikkim (1).

⁷¹ AP & Telangana (3); Madhya Pradesh & Chhattisgarh (1); Uttar Pradesh (14); Rajasthan (1); Karnataka & Goa (1); Odisha (1); Punjab & Haryana (1) Tamilnadu (2) and West Bengal & Sikkim (2).

Category	AY 2016-17		AY 2017-18		AY 2018-19		AY 2019-20	
	Filers	Non-Filers	Filers	Non-Filers	Filers	Non-Filers	Filers	Non-Filers
Company	237	12	238	13	222	26	217	28
AOP	6	1	6	2	8	0	7	1
Firms	384	12	389	10	384	10	348	19
HUF	29	1	30	1	32	0	30	0
Individuals	746	12	736	22	775	30	699	43
Trusts	2	0	2	0	5	0	1	0
Total	1,404	38	1,401	48	1,423	66	1,302	91

Audit noticed that the instances of non-filers as a proportion of total entities, during AY 2016-17 to AY 2019-20, increased from 2.6 per cent to 6.5 per cent indicating rising trend in non-compliance. The increase of non-filers compared to earlier year ranged between 26 per cent to 38 per cent during AY 2016-17 to AY 2019-20.

The instances of filers as a proportion of total entities decreased from 97.4 per cent to 93.5 per cent indicating reduction in basic compliance in terms of filing of ITRs. The number of filers decreased by 0.2 per cent to 1,401 in AY 2017-18 [year-over-year] followed by increase of 1.6 per cent to 1,423 in AY 2018-19 and decrease of 8.5 per cent to 1,302 in 2019-20.

Audit found 33 assessment cases with sales turnover of ₹ 30,560.46 crore pertaining to 19 assessees [unique PAN] where ITRs had not been filed in all four AYs. The assessee-wise details of non-filers are tabulated in **Annexure I**. Audit could not ascertain action taken by the concerned jurisdictional Assessing Officers in these cases.

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.

Reply of the Ministry is awaited (January 2022).

5.2.2 Non-levy of Penalty under Section 271F/ late fee under Section 234F

Section 139(1) of the Income Tax Act prescribes that a person, other than a company or a firm, is required to file returns of income (ITR) if his total income exceeds the maximum amount, which is not chargeable to income tax. Further, as per Section 271F of the Act up to the AY 2018-19, where the assessee has not filed the return of income, within the last date of Assessment Year concerned, the AO has discretion to levy penalty of ₹ 5000.

With effect from AY 2018-19, under Section 234F, where the assessee has not filed the ITR upto 31st December of the AY concerned, penalty should be paid at ₹ 5000. Where the assessee filed the ITR after 31st December of the concerned AY, the

penalty shall be levied at ₹ 10,000. Further, where the taxable income of the assessee is below ₹ 5.00 lakh, maximum penalty of ₹ 1,000 is leviable.

Audit examined 2,244 assessment cases of 1,637 assessee⁷² in sample to ascertain the extent of compliance with respect to filing of Income Tax Returns within specified due dates by the assessee of Gems and Jewellery sector. Audit examination of assessment records revealed that out of 2,244 cases, in 1,836 cases the ITRs had been filed within the specified due dates whereas in 364 cases the ITRs had been filed after the due dates. The assessment details of filers and non-filers are discussed in paras 5.2.3 and 5.2.4 of this Chapter.

5.2.3 Category-wise assessment details of filing of ITRs within due dates of filing of returns

The PAN registration category-wise details of cases of compliant filers of ITRs is shown in table 5.4 below.

Category	No. of assessment cases	Gross Receipts/ Sales Turnover	Returned Income	Assessed Income	Demand as per latest order
Company	579	4,81,067.89	9,212.58	10,422.51	1,676.10
Firm	617	90,005.83	2,680.26	4,212.80	106.64
Individual	592	8,826.65	334.76	678.94	176.28
HUF	32	312.15	4.37	2.33	0.00
AOP	11	17.21	0.25	0.25	0.00
Trust	5	0	0.01	0.00	0.00
Total	1,836	5,80,229.73	12,232.23	15,316.83	1,959.02

Audit noticed that out of 1,836 cases involving gross receipts of ₹ 5,80,229.73 crore and returned income and assessed income of ₹ 12,232.23 crore and ₹ 15,316.83 crore respectively, the number of cases where ITRs were filed within due dates corresponding to firms, individuals and corporate assessee comprised 33.6 per cent, 32.2 per cent and 31.5 per cent of total number of cases respectively. The remaining 2.7 per cent comprised of assessee registered as HUFs, AOPs and Trusts.

5.2.4 Category-wise assessment details of delayed filing of ITRs

The PAN registration category-wise assessment details of cases of delayed filing of ITRs is shown in table 5.5 below.

⁷² Unique PAN-wise

Category	No. of assessment cases	Gross Receipts	Returned Income	Assessed Income	Demand as per latest order
Individual	269	593.58	10.14	238.37	123.03
Firm	49	6,573.44	140.19	148.49	4.62
Company	26	22,576.87	182.23	223.25	52.76
HUF	4	1.19	0.14	0.09	0.00
AOP	14	0.14	0.03	0.03	0.00
Trust	2	0.00	0.00	0.00	0.00
Total	364	29,745.22	332.73	610.23	180.41

Audit noticed that out of 364 cases involving gross receipts of ₹ 29,745.22 crore and returned income and assessed income of ₹ 332.73 crore and ₹ 610.23 crore respectively, the number of cases where ITRs were filed after due dates corresponding to individuals, firms and corporate assessees comprised 74 per cent, 13 per cent and 7 per cent of total number of cases respectively. The remaining six per cent comprised of assessees registered as AOPs, HUFs and Trusts.

5.2.5 Region-wise distribution of delayed filing of ITRs

Audit observed in 364⁷³ cases that the assessees had filed the ITR after the due date prescribed by the CBDT, ITD had taken necessary action for levy of penalty under section 234F/271F in 15 cases only while, in the remaining 349 cases, nothing was available on the records furnished to audit to show whether ITD had levied penalty or waived it with justification. Further, in 25 cases, the ITRs filed by assessees were found defective/invalid; however, ITD had taken corrective action in 15 cases while no information of action taken was available in respect of remaining 10 cases. It was also observed that there was no provision in the CPC System to impose penalty in summary cases. The region-wise distribution of delayed filing of Income Tax Returns is indicated in Table 5.6 given below.

S. No.	Region/State	AOP	Corporate	Firms	HUF	Individuals	Trust	Total
1	Andhra Pradesh and Telengana			3		8		11
2	Bihar and Jharkhand					16		16
3	Delhi		1	1		9		11
4	Gujarat	9	2	12	3	91		117
5	Karnataka And Goa					7		7
6	Kerala		5	9		18		32

⁷³ 364 cases comprising 273 cases processed under section 143(1), 28 cases assessed under section 143(3), 61 cases assessed under other sections (147, 154, 250 etc.) and no details (2 cases) pertaining to AP & Telangana (11); Bihar & Jharkhand (16); Delhi (11); Gujarat (117); Karnataka & Goa (7); Odisha (16); Punjab & Haryana (10); Tamilnadu (24); Madhya Pradesh & Chhattisgarh (24); Rajasthan (29); Kerala (32); Uttar Pradesh (5); Maharashtra (48) and West Bengal & Sikkim (14).

S. No.	Region/State	AOP	Corporate	Firms	HUF	Individuals	Trust	Total
7	Madhya Pradesh and Chhattisgarh			2	1		21	24
8	Maharashtra	5	11	16		14	2	48
9	North West Region			1		9		10
10	Odisha			2		14		16
11	Rajasthan		3	2		24		29
12	Tamil Nadu		2		1	21		24
13	Uttar Pradesh (East)			1		2		3
14	Uttar Pradesh (West)					2		2
15	West Bengal and Sikkim			1		13		14
	Grand Total	14	26	49	4	269	2	364

The instances of delayed filing of ITRs amongst assesseees of Gems and Jewellery sector were proportionately higher at 31.2 per cent in Gujarat followed by 13.2 per cent in Maharashtra, 8.8 per cent in Kerala, 8.0 per cent in Rajasthan and 6.6 per cent in Tamil Nadu.

5.3 Mismatch in data as furnished by DGIT (Systems) vis-à-vis actual data captured from ITR and assessment records

The DGIT (Systems) maintains centralised granular information on details of incomes, expenses, exemptions and deductions returned by assesseees through data captured from ITRs furnished by them and the assessments carried out by the AOs thereafter. As the systems and processes are designed to capture ITR level data and assessment level data, ideally there should not be any mismatch between data available with DGIT (Systems) and with the assessment units, as they emanate from the same source like ITR and assessment process. However, Audit observed that in 117 cases⁷⁴ of 73 assesseees in five States⁷⁵ out of the total 2,201 cases⁷⁶ examined, the data of returned income, assessed income, demand, international transactions, etc. as provided by the DGIT (System) was not matching with the actual data collected from ITR and assessment records.

Further, out of 117 cases, in 83 cases audit noticed mismatch in a single measure (e.g. only in returned income, assessed income, demand raised etc.) only whereas in the remaining 34 cases audit noticed mismatch in more than one measure. The measure-wise details of data mismatch noticed in audit is given in Table 5.7 below:

⁷⁴ 117 cases consist of 10 cases processed under section 143(1) of the Act, 45 cases assessed under section 143(3) and 62 cases assessed under other sections (144, 147, 154, 250, 254 and 263) of the Act.

⁷⁵ Gujarat (6); Maharashtra (104); Madhya Pradesh & Chhattisgarh (1); Karnataka & Goa (3) and West Bengal & Sikkim (3).

⁷⁶ Unique PAN-AY assessment cases comprising 10 cases processed under section 143(1) while remaining 2191 cases processed under sections 143(3), 147, 144, 154, 250, 254, 263 etc. of the Act.

S. No.	Measure(s) in which data Mismatch noticed in audit	Number of cases with mismatch in one measure only	Number of cases with mismatch in two or more measures	Total number of errors of data mismatch
1.	Returned Income	63	13	86
2.	Assessed Income	5	16	21
3.	Demand raised	6	13	19
4.	International Transaction	3	3	6
5.	Unsecured Loans	2	0	2
6.	Gross Receipts	2	1	3
7.	Deduction claimed under section 10AA	2	3	5
8.	Deduction allowed under section 10AA	0	8	8
9.	Others	0	6	6
	Total	83	63	156

Audit further noticed that out of 117 cases involving errors in data furnished by ITD, 10 cases were processed under section 143(1) while the remaining cases were assessed under sections 143(3), 147, 144, 154, 250, 254, 263 and 92CA(4) of the Income Tax Act.

Audit further observed in 129 cases⁷⁷ in Gujarat that although the aggregate amount of returned income (RI) was ₹ 13.15 crore, the assessed income (AI) was reduced to ₹ 0.90 lakh after rectification under Section 154, resulting in negative addition of AI of ₹ 13.14 crore. In 116 cases out of the above 129 cases, assessed income was mentioned as Nil whereas in the remaining 13 cases assessed income⁷⁸ was ranging between ₹ one and ₹ 40,588 and negative addition in assessed income was ranging between ₹ 2.07 lakh and ₹ 1.72 crore. Reasons for these deficiencies could not be ascertained, as the AOs did not furnish the assessment records.

Similarly, in Rajasthan also in 15 cases, audit observed that as per the information furnished by the DGIT (Systems), aggregate value of assessed income was ₹ 7.23 lakh, whereas aggregate value of assessed income as furnished by the assessment units of the Department was ₹ 2.40 crore. The details of assessed income need to be reviewed and updated from the assessment records to prevent such instances of incorrect reflection of figures in centralised data.

Reply of the Ministry is awaited [January 2022].

The DGIT (Systems) maintains centralised granular information on details of incomes, expenses, exemptions and deductions returned by assesseees through data captured through ITRs furnished by them and the assessments carried out by the

⁷⁷ pertaining to AY 2017-18 and AY 2018-19 assessed under section 143(1) and subsequently rectified under Section 154 during 2018-19

⁷⁸ Except one case, where information is pending from AO, amount of demand (before rounding off) as per last order under section 154 was shown as Assessed Income as per DG System data.

Assessing Officers. The reasons for mismatch may be reviewed as ideally there should not be any mismatch between data available with DGIT(Systems) and with 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. Such instances of data mismatch give rise to possibility of generation of incorrect and unreliable information for which the ITD may initiate action to streamline and strengthen the ITD systems and monitoring and review mechanism in place and reconcile the data on priority.

5.4 Mismatch in disclosures made in Income Tax Returns (ITRs) and Tax Audit Reports:

An assessee is required to make proper and correct disclosures of income and expenditure in an ITR. Part A of the ITR captures general particulars of the assessee including details of the tax auditor certifying the Tax Audit Report under section 44AB of the Act. ITR also captures disclosures made through Balance Sheet (viz. details of Assets, Liabilities, Loans and Borrowings). ITR captures details of Manufacturing Account, Trading Account, Profit and Loss Account for the respective financial year. ITR further captures Other Information (OI) and Quantitative Details (QD) which are mandatory for disclosures if the assessee is liable for audit under section 44AB of the Act.

5.4.1 Quantitative Details part of ITR

The QD part of Income Tax return captures the following details:

- opening stock, purchases and sales made during the previous year, closing stock and shortage/ excess, if any in the case of trading concern,
- Details of raw materials viz. opening stock, purchases, consumption and sales during the previous year, closing stock, yield of finished products, percentage of yield and shortage/ excess, if any, of a manufacturing concern.
- Details of finished products in the case of a manufacturing concern, viz. opening stock, purchases, quantity manufactured and sales during the previous year, closing stock, and shortage/ excess, if any, of a manufacturing concern.

As Gems and Jewellery sector deals with trading and manufacturing of commodities such as gold, silver, other precious metals, diamond, pearls, precious stones, jewellery etc. the quantitative disclosures made through ITR and TAR are significant from the verification and assessment point of view as they directly impact the revenues and expenses from business operations of entities engaged in this sector. All the required clauses provided for in the ITR should be filled in properly so as to give a true and fair picture of the business.

5.4.2 Disclosures made in Tax Audit Report

The CBDT made e-filing of the Tax Audit Report mandatory under this Section with effect from AY 2014-15 onwards. Section 44AB of the Income-tax Act, 1961 contains provisions for the tax audit⁷⁹ of an entity. As per the provisions of the Act, tax audit shall be conducted by a Chartered Accountant who ensures that the taxpayers whose income under business⁸⁰ has maintained proper books of account and complied with the provisions of the Income-tax Act. Tax Audit conducted by a Chartered Accountant is reported to the Income-tax Department in Form no. 3CA/3CB and Form no. 3CD⁸¹ along with the income tax return.

Form 3CD captures general particulars of the assessee that include, inter alia, nature of business or profession, books of accounts maintained and method of valuation of closing stock employed in the previous year. It further includes following details:

- Clause 35(a) of the Form 3CD captures quantitative details of principal items of goods traded viz. opening stock, purchases and sales during the previous year, closing stock, shortage/ excess, if any.
- Clause 35(b) of the Form 3CD captures quantitative details of principal items of raw materials, finished products/ by-products viz. opening stock, purchases, consumption/ quantity manufactured, sales, closing stock, yield of finished products, percentage of yield, shortage/ excess, if any.
- It further captures financial particulars viz. total turnover, ratios such as Gross profit/ turnover, Net profit/turnover, Stock-in-trade/turnover and Materials consumed/ finished goods produced for previous year and preceding previous year.

Further, Section 271J⁸² of the Act prescribes that if the AO or the Commissioner (Appeal), in the course of any proceedings under this Act, finds that an accountant or a merchant banker or a registered valuer has furnished incorrect information in any report or certificate furnished under any provision of this Act or the rules made thereunder, the AO or the Commissioner (Appeals) may direct that such accountant or merchant banker or registered valuer, as the case may be, shall pay, by way of penalty, a sum of ten thousand rupees for each such report or certificate.

5.4.3 Category-wise assessment particulars of relevant audit sample

Audit examined 1,335 cases where the quantitative disclosures made in Income Tax Returns were verified to examine consistency with disclosures made in Tax Audit

⁷⁹ Tax Audit is an audit, made compulsory by the Income Tax Act, if the annual gross turnover/receipts of the assessee exceed the specified limit. Tax audit is conducted in Sec 44AB of the Income Tax Act, 1961 by a Chartered Accountant.

⁸⁰ Assessee other than company having business turnover less than ₹ one crore and professional income less than ₹ 50 lakh are exempted.

⁸¹ Form 3CD is a Statement of particulars required to be furnished under section 44AB of the Income Tax Act.

⁸² Inserted by Finance Act of 2017 (w.e.f. 1-4-2017).

Reports. The PAN registration category-wise distribution of cases examined in audit is given in Table 5.8 below:

Table 5.8: Category-wise assessment particulars of sample examined for consistency in disclosure in ITR and Tax Audit Report [₹ in crore]

Category of assessee	No of cases [143(1)]	No of cases [143(3)]	No of cases [Other sections: 144, 147, 154, 250 etc.]	Total no of cases	Gross Receipts/ Sales Turnover	Returned Income	Assessed Income	Additions made
Col.1	Col.2	Col.3	Col.4	Col.5=Col.(2+3+4)	Col.6	Col.7	Col.8	Col.9=Col.8-Col.7
Company	160	214	127	501	4,74,446.91	9,291.19	9,931.28	640.09
Firm	246	258	55	559	88,587.43	2,640.06	4,205.06	1,565.00
Individual	162	26	67	255	8172.94	107.38	123.70	16.32
HUF	8	4	1	13	304.81	2.84	1.76	-1.08
AOP	5	0	2	7	13.89	0.16	0.17	0.00
Total	581	502	252	1,335	5,71,525.98	12,041.63	14,261.97	2,220.34

Audit sought to examine whether the quantitative details of items traded/ manufactured [raw materials (Opening Stock, Purchases, Consumption, Sales, Closing Stock, Yield, Percentage of yield, shortage/ excess, if any), finished products (Opening Stock, Purchases, quantity manufactured, Sales, Closing Stock, shortage/ excess, if any)] as per Form 3CD was consistent with the details disclosed in books of accounts of the assessee. Audit sought to ascertain whether disclosures to be certified through Tax Audit Report were adequately complied with. The deficiencies noticed in the disclosures made in ITRs and TARs are discussed in paras 5.4.4 to 5.4.6.

5.4.4 Non-disclosure of Quantitative details of inventory

As per the ITRs, an assessee who is liable to audit under Section 44AB is required to furnish quantitative details of stock/purchase, sales and others in the prescribed clauses of the ITR compulsorily.

Audit observed in 346 cases in 13 States⁸³ that the assessee had not disclosed the quantitative details of inventory either in Part Quantitative Details (QD) of the ITRs (209 cases⁸⁴) or in Tax Audit Reports (13 cases⁸⁵) or in both (124 cases⁸⁶) ITRs as well

⁸³ Andhra Pradesh & Telangana (8); Bihar & Jharkhand (1); Delhi (31); Gujarat (54); Karnataka & Goa (4); Kerala (12); MP & Chhattisgarh (11); Maharashtra (145); Punjab & Haryana (22); Odisha (4); Rajasthan (10); Tamilnadu (29); Uttar Pradesh (6) and West Bengal & Sikkim (9).

⁸⁴ 209 cases included 98 cases processed under section 143(1) of the Act, 36 cases assessed under section 143(3) of the Act, 46 cases assessed under other sections of the Act (sections 147, 154, 250 etc. of the Act) while in 29 cases details were not available.

⁸⁵ 13 cases included 9 cases processed under section 143(1) of the Act, 2 cases assessed under section 143(3) of the Act, 2 cases assessed under other sections of the Act (sections 143(3) and 154 of the Act).

⁸⁶ 124 cases included 63 cases processed under section 143(1) of the Act, 24 cases assessed under section 143(3) of the Act and 1 case assessed under section 148 of the Act.

as in TARs. Further, in 87 cases⁸⁷, either TARs (73 cases⁸⁸) or ITRs (13 cases⁸⁹) or both (1 case⁹⁰) were not available. Consequently, the quantities of stock/purchases as mentioned in the ITRs could not be verified with the quantities disclosed in TARs. Moreover, the correctness of the value of stocks and purchases claimed in ITR/accounts could not be ascertained in these cases. In one case in Kolkata⁹¹, Audit observed discrepancies in respect of disclosure of opening and closing balances in terms of quantity vis-a-vis value in ITR, while in another case in Delhi⁹², despite the availability of closing quantity, the corresponding value was not declared in the Profit and Loss Account. These discrepancies could not be identified by the Department. Similarly, in two cases in two States⁹³, the mistake in carry forward of closing balances to subsequent year was not examined by the Department.

The casual approach in disclosure of quantitative details and non-verification of the same in respect of entities of Gems and Jewellery sector may involve risk of under-reporting of income. Audit noted that discrepancies in disclosure(s) went unnoticed despite the processing of cases through ITD systems. Ideally, ITD systems should, to the extent feasible, identify such discrepancies in ITR and TAR at the summary processing stage. In cases which are examined subsequently under scrutiny, Audit noted that the details of verification and examination of correctness of disclosure of stocks are not being recorded or documented in the assessment records by the AOs in several cases. Two cases are illustrated below:

Box 5.1: Illustrations of Non-disclosure of Quantitative details of inventory and other mistakes in ITR

(a) Charge: CIT (Central)-1, Delhi

Assessee: M/s JM

Assessment Year: 2018-19

In this case, the return of income for AY 2018-19 was filed in August 2018 at ₹ 25.27 lakh and the income tax return was processed in summary manner under Section 143(1) in February 2019 accepting returned income as such, thereby raising nil demand for AY 2018-19. As per the Profit & Loss Account for the financial year 2017-18, total turnover of the assessee company was ₹ 81.69 crore. As per the disclosures made through the ITR and TAR, the assessee had shown quantitative details of closing stock of raw materials (gold bars) as 2,17,109 grams in Form 3CD

⁸⁷ 87 cases included 26 cases processed under section 143(1) of the Act, 24 cases assessed under section 143(3) of the Act and 18 cases assessed under sections of the Act (sections 147, 154 of the Act) while in remaining cases details were not available.

⁸⁸ 73 cases included 22 cases processed under section 143(1) of the Act, 16 cases assessed under section 143(3) of the Act and 16 cases assessed under sections of the Act (sections 147, 154, 250 etc. of the Act) while in 19 cases details were not available.

⁸⁹ 13 cases included 4 cases processed under section 143(1) of the Act, 8 cases assessed under section 143(3) of the Act, 1 case assessed under other sections of the Act (section 147 of the Act).

⁹⁰ One case processed under section 147 of the Act.

⁹¹ M/s RG, under ITO Ward 43(3) in PCIT-15, Kolkata for AY 2018-19

⁹² M/s JM for AY 2018-19

⁹³ Jharkhand [UV (Individual) in PCIT Dhanbad for AY 2018-19] and Chandigarh (Pr. CIT Hisar)

and ITR, whereas the value of closing stock in the Profit and Loss Account in ITR was shown as NIL. Thus, there was a suppression of closing stock equivalent to the value of 2,17,109 grams of gold bars due to incorrect disclosures in the ITR. As the case was processed under section 143(1) of the Act, the discrepancy in disclosure could not be detected by the ITD systems and this resulted in under reporting of profit of ₹ 66.61 crore (at the rate of ₹ 3,068 per gram as per the website of Income Tax Department involving tax effect of ₹ 23.05 crore. Reply of the Ministry is awaited (January 2022).

(b) Charge: PCIT -19, Mumbai

Assessee: M/s AD

Assessment Year: 2013-14

In this case, the return of income for AY 2013-14 was filed (November 2013) at income of ₹ 1.77 crore and the scrutiny assessment was done under Section 143(3) (November 2016) accepting the returned income as such, thereby raising nil demand for AY 2013-14. As per the Profit & Loss Account of financial year 2017-18, total turnover of the assessee company was ₹ 174.89 crore.

Audit observed (November 2020) that the assessee had not disclosed the quantitative details of stock (trading, raw materials and manufacturing items) in the ITR and TAR, however, the value of export sales and purchase of diamonds was duly disclosed in the Profit and Loss Account. Further, the assessee had also disclosed the quantitative details along with corresponding value of the import of rough diamond in Form 3CEB Report. Thus, there was non-disclosure of quantitative details in the ITR and TAR by the assessee; however, this issue was not examined by the AO during the scrutiny assessment.

Ideally such discrepancies in the ITR and TAR should be identified by the ITD Systems at the filing stage. However, verification and examination of the correctness of disclosures of quantitative details of stock during scrutiny assessment should also be recorded and documented in the assessment records.

The CBDT has not accepted the audit objection in view of the following reasons:- The Diamond Industry is a very peculiar industry in a sense, in which diamonds are manufactured from rough diamonds and it needs to be polished after various stages of manufacturing processes. Nowadays the assessee is manufacturing as well as doing trading business in this industry also; it is practically difficult to bifurcate between trading stock of polished diamonds and manufactured stock of polished diamonds. These two types of diamonds usually are mixed assorted and re-assorted for the business purposes, so they lose their original identity; hence, bifurcating diamonds between two categories is not easy. However, in the case of the present assessee, which is a trader in rough diamonds, in the relevant year under consideration, there was no opening and closing stock of diamonds,

whatever purchases are made everything is sold during the year under consideration and all the sales and purchases are properly accounted and audited under Income Tax Act and Transfer Pricing Provisions. During the scrutiny assessment, books of accounts were produced and verified by erstwhile assessing officer. As the audit observation relates to quantity not duly punched in ITR and TAR; however, audit has also observed the said quantities duly reported in P&L account and in Form 3CEB. As the quantitative details were duly accounted in P&L and other financials hence, it will not at all affect or have any impact on profitability or escapement of income, as all the sales and purchases are rightly shown in audited financials and duly verified by the erstwhile assessing officer and transfer pricing officer. Thus, the audit party had only made an observation that the assessee had not disclosed the quantitative details of stock (trading, raw material and manufacturing items) in the ITR and TAR, however the audit party itself stated that the value of export sales and purchase of diamonds was duly disclosed in the profit and loss account, which was duly verified by the erstwhile AO and TPO and the said authorities accordingly did not make any addition/ disallowance/ adjustments. Hence, as discussed above there is no income escapement as such in this case of the assessee for the concerned period. However, this audit observation is noted for future reference for compliance in other cases too.

The CBDT's reply is not justifiable on the following grounds: Audit has clearly mentioned that the assessee had not disclosed the quantitative details in the ITR and TAR although these details were duly disclosed in Form 3CEB. This shows that the assessee was having the quantitative details of inventory; yet it left the relevant columns of the ITR and TAR blank. Further, CBDT has mentioned in the reply that the assessee was a trader in rough diamonds; hence, the question of bifurcation of inventory between trading and manufacturing does not arise. The assessee could have easily disclosed the quantitative details in the returns. Further, if the CBDT's view is accepted that 'it is practically difficult to bifurcate between trading stock of rough diamonds and manufacturing stock of polished diamond', it would have issued suitable instructions/Circulars exempting the Diamond industry from disclosing the quantitative details in the ITR and TAR; however, there is no such Circular/instructions issued till date. This clearly indicates that the ITD requires the assessee to disclose all the relevant details in the prescribed format and the quantitative details can be left blank only if the assessee is not having any inventory. Non-disclosures of relevant details of inventory in the ITR and TAR by the Assessee and and issue of non-verification by the AO during the assessment are required to be addressed by the ITD as systemic issue for ensuring quality assessment, even if they may not have any revenue implication. The CBDT may therefore reconsider the para.

As the quantitative details are not filled in despite there being a separate provision for such entries, Audit could not ascertain as to how ITRs /TARs were accepted by the system in cases without disclosures. Besides, it could not be ascertained how the ITD ensured the correctness of the valuation of stock and claims of purchases made by the assessee. Thus, the purpose for which the quantitative details are being obtained through ITR/ TAR filed by the assessee is not being served. The non-verification of such discrepancies further entailed a risk of income escaping assessment.

5.4.5 Mismatch of quantitative details of Inventory between ITR and Tax Audit Report

The quantitative details given in ITR should match with the details given in Form 3CD as certified by the tax auditor. Any difference pointed out in Form 3CD has to be added back to the taxable income of the assessee.

Audit observed in 362 cases⁹⁴ in 13 States⁹⁵, involving mismatch in quantitative details as per the ITR vis-a-vis the disclosures through Tax Audit Report; discrepancies in disclosures and instances of incomplete disclosure of quantitative details etc. One such case where the Department has not examined the mismatch in quantitative details is illustrated below:

Box 5.2: Illustrations of mismatch in quantitative details as per ITR and TAR

(a) Charge: PCIT (Central)-3, Mumbai
Assessee: M/s FI Private Limited
Assessment Year: 2013-14

In this case, the return of income for AY 2013-14 was filed (November 2013) at nil income and the scrutiny assessment was done under section 143(3) read with section 144(13) determining the income at ₹ nil (January 2017) thereby raising demand of ₹ 16.83 lakh. The assessee had shown total turnover of ₹ 3,454.80 crore in the Profit & Loss Account of financial year 2012-13 relevant to AY 2013-14.

Audit observed (October 2020) from the quantitative details of various items as disclosed in ITR *vis-à-vis* Tax Audit Report (TAR) that there was mismatch in quantity of rough diamonds, polished diamonds, rings, etc. The quantitative details of trading goods as per ITR and TAR are tabulated below:

⁹⁴ 362 cases included 141 cases processed under section 143(1) of the Act, 137 cases assessed under section 143(3), 60 cases assessed under other sections (sections 144, 147, 154, 250 etc. of the Act) whereas details were not available in 24 cases.

⁹⁵ Delhi (21); Gujarat (52); Karnataka & Goa (3); Kerala (2); AP & Telangana (9); Madhya Pradesh & Chhattisgarh (1), Maharashtra (232); Punjab & Haryana (7); Rajasthan (7); Tamilnadu (13); Uttar Pradesh (1) and West Bengal & Sikkim (14).

(A) Trading Goods									
Item Name	Unit	Opening Stock		Purchases during the previous year		Sales Quantity		Closing Stock	
		As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR
Diamonds	112	35862	35861	32962	32962	57568	57567	11256	11256
Rough Rejection	112	100000	100000	0		0	100000	100000	0

The quantitative details of raw materials of manufacturing concern as per ITR and TAR are tabulated below:

(B) Manufacturing Concern (Raw Materials)											
Item Name	Unit	Opening Stock		Purchases during the previous year		Consumption		Sales Quantity		Closing Stock	
		As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR
Rough Diamonds	112	26738	26738	35938	35938	6654	6794	37779	37779	18103	18103
Rough Rejection	112	1693	Not shown	0				141		1834	Not shown
Polished Diamonds	112	7788	7788	59294	59293	40338	39383	0	954	26744	26744
Colour Stone	112	926	Not shown	574		1209	Not shown	0		291	Not shown

The quantitative details of finished goods of manufacturing concern as per ITR and TAR are tabulated below:

(C) Manufacturing concern (Finished Goods)									
Item Name	Unit	Opening Stock		Finished Goods manufactured		Sales Quantity		Closing Stock	
		As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR	As per ITR	As per TAR
Polished Diamonds	112	24393	24393	2242	1812	15949	15519	10686	10686
Rings	107	2558	2558	14147	12228	15134	13215	1571	1571
Pendants	107	220	220	17203	16980	17421	17198	2	2
Earrings	107	326	326	695	403	959	667	62	62
Necklace	107	18	18	318	315	317	314	19	19
Bracelets	107	76	76	69		129	60	16	16

Audit noted that although the assessment was completed under scrutiny, it could not be ascertained from the records whether the Department had examined the issue.

This observation was pointed out to the Department in October 2020. Reply of the Ministry is awaited (January 2022).

The discrepancies in disclosures are indicative of the fact that the existing system is not being utilised for identification of cases involving such irregularities during the summary processing of the ITRs. Further, such discrepancies are also not being examined during the scrutiny assessment stage. It is further indicative of casual handling of data, resulting in discrepancies. Audit further noted that out of 1.53 lakh assessments of Gems and Jewellery sector, only 1.89 *per cent* cases were examined under the scrutiny assessment whereas a significant proportion of 96.07 *per cent* were processed under summary assessment, thereby making it all the more imperative to strengthen the verification mechanism at the summary stage.

5.4.6 Discrepancies in Tax Audit Report

Audit observed discrepancies in tax audit reports in 330 cases⁹⁶ in 13 States⁹⁷. The discrepancies included incorrect carry forward of closing stock, mistakes in disclosing details related to turnover, gross profit, etc. (Serial number 40 of the Tax Audit Reports), mistakes in various disclosures required under the Income Tax Act and others. In all these cases, nothing was available on record to show that the Department had taken corrective action to address the issue. Two cases are illustrated below:

Box 5.3: Illustrations of Discrepancies in Tax Audit Report

(a) Charge: Pr.CIT-5, Mumbai
Assessee: M/s DB Pvt. Ltd
Assessment Year: 2014-15

The assessee, a company, filed the return of income for the AY 2014-15 in November 2014 at ₹ 13.47 crore and the scrutiny assessment was completed under Section 143(3) in December 2016 accepting returned income as such thereby raising nil demand for AY 2014-15. As per the Profit & Loss Account of financial year 2013-14, total turnover of the assessee company was ₹ 482.31 crore. Audit observed from the Tax Audit Report that the closing balance of finished goods was 2,58,635 units in AY 2013-14, while it was shown as Nil in the opening balance of AY 2014-15. Although the case was assessed in scrutiny manner under section 143(3), the discrepancy was not pointed out by the Department. Reply of the Ministry is awaited (January 2022).

⁹⁶ 330 cases included 190 cases processed under section 143(1) of the Act, 57 cases assessed under section 143(3), 61 cases assessed under other sections (sections 144, 147, 154, 250 etc. of the Act) whereas details were not available in 22 cases.

⁹⁷ Gujarat (143); Karnataka & Goa(7); Odisha (5); Punjab & Haryana (20); Tamilnadu (7); Delhi (14); Madhya Pradesh & Chhattisgarh (10); AP & Telangana (8); Rajasthan (16); Kerala (11); West Bengal & Sikkim (8); Uttar Pradesh (2) and Maharashtra (79).

(b) Charge: Pr.CIT-1, Bhubaneswar**Assessee: M/s EJ****Assessment Year: 2015-16**

The assessee, a company filed the return of income for the AY 2015-16 in September 2015 at ₹ 1.61 crore and the scrutiny assessment was completed under Section 143(3) in December 2017 determining income at ₹ 1.62 crore thereby raising demand at ₹ 0.24 lakh for AY 2015-16. Total turnover of the assessee company was ₹ 71.43 crore as per profit and loss account for financial year 2014-15. Audit observed that the quantitative details of principal items traded at Sl. No. 35(a) of Tax Audit Report was mentioned as Nil, but they were duly disclosed in the ITR. However, the discrepancy remained unverified during the assessment. Reply of the Ministry is awaited (January 2022).

The discrepancies noticed in TAR are indicative of the fact that ITD systems are deficient in identifying such discrepancies at the summary stage. Further, Audit noted that there was lack of adequate documentation in support of examination undertaken at the scrutiny assessment stage. Non-verification of discrepancies noticed in a TAR is indicative of weaknesses in the monitoring system, for which the Department is required to take corrective measures to ensure avoidance of the risk of escapement of revenue and avoid re-occurrence of such mistakes in future.

5.5 Verification of shortage/ excess of stocks

The Directorate General of Foreign Trade (DGFT) prescribes Standard Input-Output Norms (SION) for certain items for export. But no norms have been prescribed for items of Gems and Jewellery. However, the DGFT has prescribed wastage norms in respect of certain items of Gems and Jewellery for availment of export incentives. As per the Foreign Trade Policy for 2015 to 2020 read with Handbook of Procedures [2015-2020] issued by the Department of Commerce, the maximum wastage or manufacturing loss on Gold/ Silver/ Platinum jewellery and articles thereof is specified⁹⁸ with reference to Gold/Platinum/Silver content in export item. Such norms are not prescribed for export of diamond. The Income Tax Department has not specified any such norms for items of Gems and Jewellery. However, the shortage/ excess in stocks are required to be disclosed under Quantitative Details in the Tax Audit Report.

The quantity manufactured in Gems and Jewellery sector has considerable impact on the overall profitability in view of the very high per unit rates involved. Excess output would entail a risk that some unaccounted raw materials have been introduced into the business, whereas short output would entail a risk that some unaccounted sales have been made resulting in creation of unaccounted income. Audit observed that in

⁹⁸ For Gold and platinum the wastage norms ranges between 0.9 per cent to 2.5 per cent whereas for silver the wastage norms range between 0.9 per cent to 5 per cent.

180 cases⁹⁹ out of 2,261 cases examined in 11 states¹⁰⁰, 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. It is pertinent to mention here that 81 cases out of aforesaid 180 cases were completed under scrutiny assessment and 56 cases out of these 81 scrutiny cases were selected for complete scrutiny. This reflected that the Department did not have an adequate mechanism to ascertain that the assessee were not suppressing any profit or bringing unaccounted income by way of shortage/ excess of stocks. One case is illustrated below:

Box 5.4: Illustration of verification of shortage/ excess of stocks

(a) Charge: PCIT 5, Mumbai

Assessee: M/s GD Pvt. Ltd.

Assessment Year: 2016-17

The assessee, a company engaged in manufacturing and trading of rough diamond/ cut and polished diamond, filed the return of income for AY 2016-17 in October 2016 at income of ₹ 60.54 lakh and the scrutiny assessment was completed under Section 143(3) of the Act in December 2018 accepting returned income. As per the Profit & Loss Account for the Financial Year 2015-16, total turnover of the assessee company was ₹ 41.16 crore. Audit observed (May 2019) from the quantitative details given in the Tax Audit Report that there was shortage of rough diamond of 589 carats due to which the profit attributable to the cost of the same was suppressed for the year under consideration. In view of this, the Department should have examined reasons for such shortage and added the cost attributable to shortage of rough diamond to the income of the assessee. However, nothing was available in assessment records to show that the Department had made any verification in this regard. Reply of the Ministry is awaited (January 2022).

5.6 Non verification of variation in yield /wastage of polished diamond

The Tax Audit Report [Form 3CA/3CD], required to be certified by Chartered Accountants for cases over the specified gross turnover or gross receipts limits, captures quantitative details of principal items of goods traded in case of a trading concern and quantitative details of principal items of raw materials, finished products and by-products in case of a manufacturing concern alongwith details of opening stock, closing stock, yield of finished products, percentage of yield, shortage/ excess,

⁹⁹ 180 cases consisted of 64 cases processed under section 143(1) of the Act, 81 cases assessed under section 143(3) of the Act, 29 cases assessed under other sections (144, 147, 154, 250) and 6 cases where details were not available.

¹⁰⁰ Andhra Pradesh & Telangana (7), Delhi (3); Gujarat (9); Karnataka & Goa (2), Kerala (1), Madhya Pradesh & Chhattisgarh (1), Punjab & Haryana (1), Rajasthan (5); Maharashtra (142); Tamilnadu (4); and West Bengal & Sikkim (5).

if any etc. As it is not administratively feasible for the Assessing Officers to verify the quantitative details of stock/ inventory in cases of trading and manufacturing concerns, they rely on the third party certification done by Chartered Accountants and finalise their assessments based on disclosures made through certified books of accounts and tax audit reports.

In the Gems and Jewellery sector, understatement of yield is a possible method of suppression of production. The yield depends upon the quality and size of the rough diamonds. An understatement of yield by even two to three *per cent* can make a significant difference. Further, it was seen that no standard norms exist for the industry in respect of percentage of yield of finished products.

Audit observed that the Department did not examine the issues related to yield in 357 cases¹⁰¹ in five States¹⁰². The percentage yield in these cases varied from 22 *per cent* to 94 *per cent*. Further, the assessee had not disclosed the details of yield (quantity and/or percentage) in the tax audit report in 116 cases¹⁰³ out of the aforesaid 357 cases. Also there was nothing on the records produced to audit to show whether the Department had conducted any verification or called for any justification in respect of the lower / non-disclosure of yield. Audit analysed the gross turnover-wise distribution of cases with turnover exceeding ₹ 100 crore wherein issues related to yield were not verified during assessment. Audit noticed that in 98 out of 357 cases where the issue related to yield was not verified, the gross turnover of the assessee was more than ₹ 500 crore, indicating significant volume of sales or high money value transactions. The details of high value cases involving non verification of yield is given in Table 5.9 below.

S. No.	Value of Gross Turnover/ Receipts	Number of cases where yield was not verified	Total Amount of Turnover
1.	>= ₹ 100 crore & < ₹ 500 crore	79	18,267.87
2.	>= ₹ 500 crore & < ₹ 1000 crore	23	15,082.63
3.	>= ₹ 1000 crore & < ₹ 1500 crore	19	23,869.00
4.	>= ₹ 1500 crore & < ₹ 2000 crore	16	28,016.34
5.	>= ₹ 2000 crore & < ₹ 2500 crore	9	19,578.77
6.	>= ₹ 2500 crore & < ₹ 3000 crore	9	24,150.72
7.	>= ₹ 3000 crore & < ₹ 4000 crore	6	19,788.02
8.	>= ₹ 4000 crore & < ₹ 5000 crore	6	26,692.00
9.	>= ₹ 5000 crore	10	70,581.35
	Grand Total	177	2,46,026.70

Source: Assessment records of ITD

¹⁰¹ 357 cases consisted of 4 cases processed under section 143(1), 274 cases assessed under section 143(3) and 79 cases assessed under other sections of the Act (144, 147, 153C, 154 and 250).

¹⁰² Maharashtra (339); Tamilnadu (3); Delhi (7); Odisha (1) and Rajasthan (7)

¹⁰³ 116 cases consisted of 4 cases processed under section 143(1), 62 cases assessed under section 143(3) and 49 cases assessed under other sections of the Act (144, 147, 153C, 154 and 250) and one case where details were not available.

Out of 357 cases where there was no proof for verification of yield, 28.4 *per cent* cases reported gross turnover ranging between ₹ 100 crore and ₹ 1000 crore; 18.1 *per cent* cases reported gross turnover ranging between ₹ 1000 crore and ₹ 5000 crore and 2.8 *per cent* cases reported gross turnover above ₹ 5000 crore as indicated in the above table.

This indicated that the Department did not have an adequate mechanism to derive assurance on correctness of yield of diamond as shown by the assesseees in their books of account. Although yield and percentage of yield is directly related to the generation of revenue/concealment of revenue, this aspect was not verified by the ITD during the assessments/processing of ITRs with the underlying risk of revenue leakages.

5.7 Non- verification of creditworthiness of unsecured loans

Audit sought to examine 366 assessment cases¹⁰⁴, where assesseees had disclosed amount of unsecured loans of ₹ 5,389.96 crore in the books of accounts, to ascertain whether the AOs had verified the genuineness of transactions of unsecured loans and creditworthiness and financial capacity of the lenders giving such unsecured loans. Audit examined the selected assessment records so as to verify the extent of assurance derived by ITD on parameters like identity, creditworthiness and genuineness of the lenders.

Audit observed in 45 cases¹⁰⁵ in five States¹⁰⁶ that although the assesseees had taken unsecured loans from various parties, documentary evidence such as annual accounts, return of income, bank statements and confirmation of the lender was not available on record as evidentiary proof of verification of identity, creditworthiness and genuineness of the lenders.

Further, no efforts had been made by the Department to share the information with the respective AOs of the lenders to examine the financial capacity of the lenders. In absence of these details, Audit could not ascertain how the credibility and creditworthiness of the lenders providing unsecured loans was ensured by the ITD. One case is illustrated as under:

¹⁰⁴ Of 366 cases, 52 cases were processed under section 143(1) of the Act, 218 cases assessed under section 143(3) of the Act and 95 cases were assessed under other sections of the Act viz. sections 144, 147, 154, 250 and 254 of the Income Tax Act. 366 cases were pertaining to Delhi (6), Gujarat (8), Karnataka & Goa (1), Kerala (16), Madhya Pradesh & Chhattisgarh (1), Maharashtra (271), Rajasthan (40), Tamilnadu (4), Bihar & Jharkhand (5), Odisha (3), Uttar Pradesh (5) and West Bengal & Sikkim (6).

¹⁰⁵ Of 45 cases, 35 cases were processed under section 143(1) of the Act and 10 cases were assessed under other sections of the Act viz. sections 147, and 154 of the Income Tax Act.

¹⁰⁶ Maharashtra (32); Delhi (3); West Bengal & Sikkim (5); Bihar & Jharkhand (4) and Karnataka & Goa (1).

Box 5.5: Illustration of Non- verification of creditworthiness of unsecured loans**(a) Charge: Pr.CIT-2, Bangalore****Assessee: M/s CI Pvt. Ltd.****Assessment Year: 2013-14**

In this case, the return of income for AY 2013-14 was filed (September 2013) at ₹ 63.19 lakh and the assessment was done in scrutiny under Section 143(3) (January 2016) determining income at ₹ 64.49 lakh thereby raising nil demand for AY 2013-14. As per the Profit & Loss Account of financial year 2012-13, total turnover of the assessee company was ₹ 38.04 crore.

Audit observed that the assessee had obtained unsecured loans of ₹ 2.34 crore from five related parties, but the Department had neither verified the credit worthiness and genuineness of the transaction nor examined the financial capacity of the lenders. Hence, the possibility of the unsecured loan of ₹ 2.34 crore being just an adjustment entry remained unverified.

The Department (January 2021) while not accepting the audit observation has stated that details of unsecured loans/deposits obtained during the year exceeding ₹ 0.1 crore was called for from the assessee. However, since no loan from related party was received during the year, no information was furnished for verification during scrutiny. The loan that was outstanding has been obtained during the previous years.

As per the reply of the Department, the outstanding loans and advances have not been verified by the Assessing Officer. The issue of non-examination of loans and advances received from related party has been pointed out in the audit observation. Since less than one *per cent* of the returns filed are being selected for scrutiny, the Department should have a mechanism to verify the outstanding related party loans and advances, above a specified threshold amount to be specified by the CBDT, in the year of scrutiny. Thus, the para may be reconsidered.

The verification of veracity and genuineness of claims allowed on account of unsecured loans at different stages of examination and finalisation of assessment cases viz. summary processing through CPC and scrutiny assessment through ITD systems could not be ascertained from the assessment records test checked during audit. Reply of the Ministry is awaited. (January 2022)

5.8 Suspicious business activities by the assessee

A genuine business activity of cutting and polishing of diamonds and manufacturing of jewellery should entail certain minimum expenditures in terms of labour and employee expenses, consumption of power and fuel, depreciation, transportation, insurance, rent commission etc.

Out of the total sample of 3,232 cases¹⁰⁷, there were 124 cases¹⁰⁸ (unique PAN-AY) pertained to 39 assessees¹⁰⁹ having annual turnover of more than ₹ 1,500 crore. In 15 cases of 12 assessees in two states¹¹⁰, Audit observed irregularities indicative of possible suspicious business activities viz. very low expenses *vis-à-vis* annual turnover and excess manufacturing of finished goods *vis-à-vis* consumption of raw materials, which warranted detailed examination. The discrepancies noticed in these cases have been discussed in the succeeding paragraphs:

5.8.1 Low expenses *vis-à-vis* annual turnover

Audit observed in five cases in Maharashtra that the assessees had shown abnormally low expenses on account of manufacturing, power and fuel, depreciation, advertisement & commission and employees/labour expenses as compared to the total turnover. Similar irregularities were also observed in 10 other cases having annual turnover of less than ₹ 500 crore in Delhi. The case-wise details of expenses *vis-à-vis* turnover is tabulated in **Annexure J** of this report. Such insignificant expenses as compared to huge turnover were indicative of possible non-genuine business activities of the assessees and should have been investigated upon by the ITD. The possibility of assessee being involved only in accommodation entry or hawala operations cannot be ruled out in such cases.

Audit noticed that in the case of an assessee, M/s DF, in Maharashtra, as brought out in para 4.2.1 of this report, detailed investigation of activity of the assessee was not undertaken during assessment despite the expenses being negligible and non-justifiable as compared to sales turnover reported during AYs 2013-14 to 2016-17. Also, in the case of the same assessee the manufactured quantity of Gold Doré bars almost doubled after processing with excess yield of 9,195.64 kg in AY 2016-17 and 6,871.09 kg in AY 2017-18 which required further examination to ascertain whether it was unexplained excess output.

Audit could not ascertain the details of examination undertaken by the Assessing Officer in issues indicative of suspicious transactions due to non-recording of such details in the assessment order.

Reply of the Ministry is awaited (January 2022).

5.9 Other issues noticed

5.9.1 Grievances/ complaints filed by Gems and Jewellery Sector.

The Income Tax Department (ITD) introduced a Grievance Redressal Mechanism in 2003 to ensure prompt redressal of grievances of assessees. Manual of Office

¹⁰⁷ 3,232 cases consisted of 1,440 cases processed under section 143(1), 965 cases assessed under section 143(3) and 827 cases assessed under other sections of the Act [144, 147, 154, 250, 254, 263 etc.].

¹⁰⁸ 124 cases consisted of 36 cases processed under section 143(1), 51 cases assessed under section 143(3) and 38 cases assessed under other sections of the Act [144, 147, 154, 250 and 263].

¹⁰⁹ 32 corporate assessees (111 cases) and 7 Non-corporate assessees (13 cases)

¹¹⁰ Maharashtra (5) and Delhi (10)

Procedures (MOP) also stipulates constitution of Regional Grievance Cells in the Office of the Chief Commissioners of Income Tax laying down procedures for handling the grievance petitions received from public. The Grievance Cell is headed by the Public Relations Officer who works directly under the Principal Chief Commissionerate of Income Tax of the region. Further, the Citizen's charter 2014 provides for redressal of grievances within a time-frame of two months.

Audit sought the details of grievances/complaints filed by the assesseees in 2,252 cases in 17 States¹¹¹. The Department furnished information in respect of 804 cases, out of which in 796 cases no grievance/ complaint was filed, while eight cases of grievances/ complaints were disposed of properly. Further, no information was furnished in respect of 1,448 cases, despite repeated requisitions. In the absence of such details, the effectiveness of the grievance redressal mechanism of the Department could not be ascertained in respect of sample cases examined in audit.

5.10 Conclusion

The data base maintained centrally by the Pr.DGIT (Systems) was not properly updated and reconciled with the assessment charges finalising the assessments related to Gems and Jewellery sector. Audit could not ascertain whether ITD systems could detect incorrect business codes furnished through ITRs at the summary processing stage of ITRs. Consequently, it is not possible to generate accurate sector specific information. Hence, elaborative codes need to be prescribed for the Gems and Jewellery sector so as to enable the assessee to select the correct type of business code.

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.

Audit noted instances of mismatch in quantitative disclosures made through TARs/ITRs or non-disclosure of quantitative details of traded and manufactured items that are compulsorily required to be disclosed in cases under section 44AB of the Income Tax Act indicative of the fact that the ITD systems had deficiencies in detecting discrepancies and gaps at ITR processing at summary stage.

Audit observed that the Assessing Officers are relying either on submission made by the assessee or quantitative disclosures made in ITR and TARs while examining valuation of inventory of assesseees of Gems and Jewellery sector at the time of assessment. As the assessment records did not have details of examination

¹¹¹ Karnataka (46); Odisha (23); Punjab & Haryana (71); AP & Telangana (61); Tamilnadu (94); Delhi (124); Maharashtra (1088); North East Region (4); Madhya Pradesh (48); Gujarat (374); Kerala (61); Kolkata (82); Uttar Pradesh (22); Bihar (12); Jharkhand (16) Chhattisgarh (10) and Rajasthan (116)

made/ verification of quantitative details of inventory as per disclosures in ITRs and TARs; the possibility of suppression of income resulting in revenue loss cannot be ruled out. ITD may review the existing mechanism of verification of inventory in assessments relating to Gems and Jewellery sector as per the disclosures made in the ITR and Tax Audit Report in co-ordination with other Departments and agencies monitoring the transactions and consignments of Gems and Jewellery business.

Audit could not ascertain the existing mechanism in place within the Department for verification of veracity and genuineness of claims allowed on account of unsecured loans at different stages of examination and finalisation of assessment cases viz. summary processing through CPC and scrutiny assessment through ITD systems in the sample test checked.

5.11 Summary of Recommendations

a) *The CBDT may like to issue instructions to all AOs to ensure correctness of the business codes filled in by the assesses 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 assesseees for detailed scrutiny and timely sharing of relevant information to other stakeholders.*

b) *The business codes prescribed for Gems and Jewellery sector may be more elaborative to include details of entities engaged in major commodities viz. (i) diamond, (ii) gold, (iii) silver, (iv) pearl, (v) a combination of these and (vi) other items of Gems and Jewellery to ensure better monitoring, improved vigilance, identification of assesseees for detailed scrutiny and timely sharing of relevant information to other stakeholders.*

[para 5.1]

The CBDT stated in its reply (January 2022) that the Business codes are filled by the assesseees while filing the return of income e-online. It would not be possible for the AOs to ensure the correctness of the business codes being filled in by the assesseees at the time of filing of tax returns.

The CBDT may consider having elaborative business codes prescribed for the Gems and Jewellery sector for ensure better monitoring, improved vigilance, identification of assesseees for detailed scrutiny and timely sharing of relevant information to other stakeholders. Although the Business Codes are filled up by the assesseees the same is also required to be certified by the Chartered Accountant through tax Audit Report. The errors in codes filled up by assessee may be updated during assessments, specially based on available information to ensure correct activity/ business-wise categorisation of assesseees and ensure reliable MIS generated from the data base maintained centrally within the ITD. The CBDT may consider issuing necessary

instructions in this regard including the option of issuing notice to the assessee for incorrect reporting of business codes at the time of scrutiny assessment.

c) 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]

The CBDT stated in its reply (January 2022) that income tax return is filed after submission of the Form 3CD which also contains quantitative details. This information is captured in applicable cases. Incomplete information in the return is subject to provisions of section 139(9) wherein the AO can declare the return of income submitted as defective. Hence there are mechanisms in place.

Reply of the CBDT is not acceptable as audit noticed several instances where vital information on stocks was either not disclosed uniformly in the TAR and ITR or not disclosed. Further, audit noticed instances where the assessment order also did not contain details of verification of quantitative disclosure of stocks, if any, done by the AOs. Audit further noticed that though there were discrepancies in disclosures, the system did not reject such ITRs or mark those cases as defective. Audit could not ascertain the extent of utilisation of the mechanism existing for verification of disclosures to ensure correctness of valuation of stock offered by the assessee of Gems and Jewellery sector. The CBDT may review the effectiveness of the mechanism in place and consider initiating penalty proceedings for incorrect reporting or certification by the third party in the forms filed alongwith with the ITR that may include incorrect disclosures as well as non-disclosures.

d) ITD systems may have in built mechanism to match closing stock of preceding year with opening stock of next year for systemic identification of such discrepancies.

[para 5.4.4 to 5.4.6]

The CBDT stated in its reply (January 2022) that this is already part of the risk management strategy. Hence system is in place to verify mismatches.

Reply of the CBDT is not acceptable as Audit could not verify effectiveness of the systems in place to detect and flag such mismatch as Audit noted discrepancies in quantitative disclosures in a large number of cases indicating that the system was either not utilised to point out such discrepancies at the summary stage or the same was not examined and recorded during the scrutiny assessment. The CBDT may review the effectiveness of the mechanism in place and consider initiating penalty proceedings for incorrect reporting or certification by the third party in the forms filed

alongwith with the ITR that may include incorrect disclosures as well as non-disclosures. Further, suitable Guidelines/ SOP/instructions may be issued to the Assessing Officers in this regard.

e) 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]

The CBDT stated in its reply (January 2022) that the suggestion of the C&AG regarding framing of guidelines has been noted and is under examination. Data in audit report is being compared with the available data in the return of income from the perspective of making adjustments under section 143(1). More analysis can be taken up depending on the provisions of law and rules, based on changes made, if any.

Audit could not ascertain effectiveness of the verification mechanism in place at the summary processing stage. In view of the same, the CBDT may review and strengthen the existing mechanism for verification of disclosures of quantitative details of stocks at the summary stage as well as subsequent stages of assessment to minimise risk of routing of unaccounted stocks by entities of Gems and Jewellery sector and to prevent possibility of tax evasion.

f) 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]

The CBDT has stated in its reply that this will be considered before the CASS Committee.

As the recommendation is proposed to be considered before the CASS Committee, details of further action taken in this regard may be intimated to Audit.

Chapter-6: Coordination and monitoring mechanism in the Income Tax Department

The performance audit envisaged ascertaining whether the ITD had proper internal control system, monitoring and coordination mechanism within the Department and with external Departments to ensure appropriate timely action and quality assessments. Coordination and timely sharing of vital information is very important for the purpose of cross verification of information of the related assessee to prevent the possible leakages of revenue.

Audit sought details pertaining to assessments of entities of Gems and Jewellery sector from the investigation unit and the Central Circle Commissionerates of ITD in order to ascertain the extent of co-ordination existing within the Department. However, the details still remain to be furnished. Audit noticed instances of ineffective sharing and non-sharing of information between different units of the ITD in the sample cases checked during audit as discussed in para 6.1 of this Chapter. Audit further sought details of irregularities noticed in respect of entities engaged in Gems and Jewellery business such as bogus purchases, fake invoices and importers/exporters involved in over-invoicing/ under-invoicing from authorities of other Departments viz. Department of Customs, Central Goods and Services Tax (GST), State GST and Directorate of Revenue Intelligence in order to ascertain the extent of co-ordination between ITD and other Departments. Information as sought during audit is yet to be received. Due to non-furnishing of information by authorities overseeing assessments of revenues related to the Gems and Jewellery sector, Audit could not ascertain the extent of co-ordination existing within the ITD and with other Departments. Instances of lack of co-ordination between ITD and other Government Departments are discussed in para 6.2 of this Chapter. The nature of audit findings discussed in this Chapter are summarised in Table 6.1 given below:

Sl. No.	Audit Observation	No. of cases	Tax effect (₹ in crore)
1	6.1.1 Co-ordination within the Department	6	Systemic Issue
2	6.1.2.1 Issues related to accommodation entry	6	12.37
3	6.1.2.2 Inconsistencies in addition made on bogus purchases	178	Systemic Issue
4	6.1.3 Sharing of information related to Unsecured loans among AOs	--	Systemic Issue
5	6.2 Co-ordination between ITD and other Government agencies	2	0.93
	Total	192	13.30

6.1 Co-ordination Mechanism

6.1.1 Co-ordination within the Income Tax Department

The assessing units in ITD are structured in such a way so as to administer the different provisions of the Act pertaining to levy and collection of direct taxes. Further, for the purpose of efficient correlation between assessee related records and for effective cross-verification of information pertaining to assessments, coordination amongst various wings of the ITD and timely sharing of information is crucial in preventing the possible leakage of revenue.

Audit attempted to verify the existence of co-ordination between the assessment and non-assessment units within the Department, for which information was sought (through letters issued between February 2020 and October 2020) regarding investigation/surveys conducted in respect of the assessees of Gems and Jewellery Sector during 2015-16 to 2018-19 and also assessees involved in fake invoice or bogus purchase in this sector from the administering wings viz. Investigation Wing of the Department and the Principal Commissionerates of Income Tax (Central). However, the information as sought during audit is still to be received (October 2021).

Audit noticed six instances of ineffective sharing of information between different units of ITD in five States¹¹² indicative of lack of co-ordination within the Income Tax Department. Audit observed instances of non-addition on account of purchases made from accommodation entry providers in six assessment cases in Maharashtra owing to non-dissemination of information by Investigation wing of ITD, as discussed in Para 6.1.2 of this report. In Andhra Pradesh & Telangana, Pr. CIT (Central Circle), Hyderabad furnished details of four cases against whom searches were conducted. On verification of these files, Audit found that the information was not shared between the Assessing Officers in respect of related party transactions. The Department replied (October 2020) that the information was not exchanged and the same is now being passed to the jurisdictional AO for verification of transactions. Other four instances of non-sharing of information in respect of creditors, related parties, and share application money providers, as noticed during audit, are illustrated below.

As per Section 147 of the Income Tax Act, 1961, if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of Sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recomputed the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year

¹¹² Maharashtra (1); AP & Tenalgana (1); W. Bengal & Sikkim (1); Delhi (2) and Bihar & Jharkhand (1)

concerned (hereafter, in this section, and in Sections 148 to 153, referred to as the relevant assessment year).

Box 6.1: Illustrations of Co-ordination between different units within the ITD

Charge: Pr.CIT (Central)-2, Kolkata

Assessee: AR

Assessment Year: 2010-11

The assessment of the assessee, an individual, for the AY 2010-11 was completed under section 147 of the Act in December 2017 without any additions. The case was reopened under section 147, on the grounds of income of ₹ 53 crore escaping assessment, on the basis of information received from DDIT (Investigation wing) Unit 8(2), Mumbai in March 2017. The DDIT(Investigation wing) Unit 8(2), Mumbai, had shared information specific to the assessee regarding regular circular transactions with other 9 accounts, as also huge values outward remittances made from this account for import payments. It was further observed that purchases, sales and total credit of Profit and Loss account of the assessee, for the FY 2009-10, were ₹ 49.45 crore, ₹ 49.49 crore and ₹ 51.33 crore respectively. The net profit of the assessee during the said F.Y was ₹ 5.40 lakh which was 0.1 *per cent* of the total credits of the Profit and Loss account (₹ 51.33 crore).

During scrutiny, DCIT-4(3) Kolkata sought (October 2017) complete details regarding the assessee's involvement in circular transactions with other 9 accounts from the DDIT (Investigation wing) Unit 8(2), Mumbai. The DDIT (Investigation wing) Unit 8(2), Mumbai, stated in its reply (December 2017) that the said details were not available, although the initial information was transmitted from Mumbai DDIT (Investigation wing) Unit 8(2). In the absence of information regarding circular transactions with other 9 accounts, the assessment was completed under section 147, on 26 December 2017, without any additions and adverse remarks. The matter was initially brought to the notice of the Department in September 2020. The ITD stated during the Exit Conference of West Bengal jurisdiction (February 2022) that in the absence of requisite information from DG (Investigations), Mumbai, it was difficult for the Assessing Officer to probe the matter during the assessment procedure.

b) In Delhi Region, the Director General of Income Tax (Investigation), New Delhi had shared the information (October 2020) with Audit in respect of beneficiaries of "fake invoice or bogus purchase" pertaining to Gems and Jewellery sector. It was observed from the list that 46 beneficiaries had received fake GST invoices, bogus purchases etc. amounting to ₹ 136.33 crore. Although the Director General of Income Tax (Investigation), New Delhi had also forwarded appraisal reports to the concerned Assessing Officers (as mentioned in the information), PAN of nine

beneficiaries involving an amount of ₹ 85.52 crore was not known to the ITD. In the absence of the PAN details, it could not be ascertained as to how the respective Assessing Officers would identify the jurisdiction of the beneficiaries to initiate action required as per the Act against these beneficiaries. Reply of the Ministry is awaited (January 2022).

Charge: Pr.CIT-8, Delhi

Assessee: BS

Assessment Year: 2017-18

The scrutiny assessment of the assessee, an individual, was completed in December 2018. As per the Balance Sheet for the financial year 2016-17, the assessee booked ₹ 2.17 crore as trade payables under liabilities. Audit observed that genuineness of these creditors was not established as there was no documentary evidence available in the assessment records. Further, there was no documentary evidence of sharing of information with the jurisdictional AOs to confirm the credit transactions reported by the assessee. In absence of any documentary proof of examination and sharing of information within the ITD, audit could not ascertain the extent of verification undertaken by the Assessing Officer, if any, during assessment. Reply of the Ministry is awaited (January 2022).

Charge: Pr.CIT-1, Patna

Assessee: M/s SJ Pvt. Ltd.

Assessment Year: 2011-12

The assessee, a company, filed the return of income for AY 2011-12 at income of ₹ 8.68 lakh. Subsequently, the case was reopened after survey (November 2016) to verify the Share Application Money. The reassessment of the assessee was completed after scrutiny under section 147 in December 2018 determining income of ₹ 37.13 lakh after adding ₹ 22.25 lakh as SK (Director of the company) had accepted that the amount was his own undisclosed money and genuineness of transactions and creditworthiness of share application money had not been established. The amount of ₹ 22.25 lakh was shown to be received as share application money from eight persons detailed (viz. Name of person, PAN and amount of transaction) in the survey report. Audit noticed that the AO did not share the above information with the concerned AOs of the share application money providers though the PAN numbers were available in the survey report. Reply of the Ministry is awaited (January 2022).

Sharing of information within the Income Tax Department (ITD) was not effectively utilized by the assessment as well as non-assessment units as pointed out in the illustrated cases above, thereby impacting the quality of scrutiny assessments, depicting lack of co-ordination within the Department. The ITD may strengthen the

existing mechanism for sharing and cross verification of information within the Department, to ensure quality assessments.

6.1.2 Issues related to accommodation entry

The white paper on Black Money defines black money “as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession”. Significant amount of black money is generated through legally permissible economic activities, which are neither accounted for nor disclosed to the public authorities as per the law or regulations, in order to evade payment of taxes by artificially reducing profits.

One of the common ways to reduce profits is by inflating the purchase costs and various expenses. In such cases, bogus bills are obtained from the accommodation entry providers by paying nominal fees/charges. This again gives rise to black money in the market. Accommodation entries are generally given to beneficiaries for bogus purchases, imports made on behalf of real importers, loans & advances and for investment in unquoted shares. The modus-operandi¹¹³ adopted by typical hawala operators for a bogus purchase/ sale is explained briefly by the help of diagrams as shown in **Annexure K**. Audit observed instances of non-addition of bogus purchases due to non-sharing of information with jurisdictional assessment units and inconsistencies in disallowances made relating to accommodation entries for bogus purchases during the test check of assessment records of selected charges as discussed in sub-para below.

6.1.2.1 Non-receipt of information from Investigation wing of ITD resulting in non-addition of bogus purchase

Audit observed instances of non-addition of bogus purchases due to non-sharing of information with jurisdictional assessment units during the test check of assessment records of selected charges as discussed in sub-paras below.

The Investigation Wing of the ITD collects information from various sources, carries out investigations and conveys its findings to the AOs for them to examine these findings and take necessary remedial actions.

Audit observed in respect of six cases¹¹⁴ in PCIT 19, Mumbai Charge that although the assessee had claimed total expenses of ₹ 36.38 crore on account of purchases made from 17 accommodation entry providers, the jurisdictional AOs of the final beneficiaries were not intimated about the fictitious purchases made by the assessee for bringing them to the tax net appropriately. Thus, the AOs neither received information from the Investigation Wing nor did they disallow such bogus expenses on their own. Had addition at the rate of 100 *per cent* been made in these

¹¹³ Source: Appraisal report for search & seizure and records of Benami concerns of of Shri BH group, PR group, SA group, DH group, DB group, RA group, M/s GG Ltd and M/s SG.

¹¹⁴ All six cases assessed under section 143(3).

cases, there could have been potential demand of tax of ₹ 12.37 crore. The case-wise details are given in Table 6.2 below.

Name of assessee	of AY	Returned Income	Assessed Income	No of accommodation entry providers	Amount of Bogus Purchases	Tax Effect
M/s PS	2014-15	1.02	1.03	3	22.09	7.51
M/s LK	2014-15	0.92	0.96	2	1.35	0.46
M/s VD	2014-15	2.45	2.45	3	6.47	2.20
M/s RE	2009-10	7.59	7.61	5	0.62	0.21
M/s SS	2014-15	0.73	1.41	1	1.01	0.34
SR	2014-15	3.58	3.58	3	4.84	1.65
TOTAL		16.29	17.04		36.38	12.37

One such case where AO did not disallow purchases made from accommodation entry providers is illustrated below:

Box 6.2: Illustration of non-receipt of information from Investigation wing of ITD resulting in non-addition of bogus purchase

(a) Charge: PCIT 19, Mumbai

Assessee: M/s PS

Assessment Year: 2014-15

The assessee M/s PS, a partnership firm engaged in the business of cutting and polishing of diamonds, filed its return of income for AY 2014-15 in November 2014 declaring total income at ₹ 1.02 crore. Subsequently, the scrutiny assessment was completed in November 2016, determining assessed income at ₹ 1.03 crore. As per the Profit & Loss Account of the financial year 2013-14 relevant to AY 2014-15 the total sale of diamonds was ₹ 91.16 crore and purchase of rough and polished diamond stood at ₹ 88.84 crore. Out of total purchase of rough and polished diamond of ₹ 88.84 crore, ₹ 43.38 crore was purchased domestically and the balance ₹ 45.46 crore was imported. Audit scrutiny revealed that the assessee had made purchases amounting to ₹ 22.09 crore in FY 2013-14 from the parties whose names were identified as accommodation entry providers by the DGIT (Investigation), Mumbai during the search and survey conducted in respect of Shri BJ group companies¹¹⁵. The name and amount of purchase made by M/s PS from such accommodation entry providers is given below.

¹¹⁵ A search and survey action was conducted by DGIT (Inv.), Mumbai in respect of Shri BJ group companies on 31st October, 2013. Post search, information was disseminated by DGIT (Inv), Mumbai to the respective Jurisdictional Assessing Officers of the assesses who had taken accommodation entries of purchase from the Shri BJ group.

Sl. No.	Name of the accommodation entry provider	Amount of purchase (₹ in crore)
1	M/s MA	7.73
2	M/s MO	7.29
3	M/s PR	7.07
Total		22.09

Audit noticed that information of the above mentioned parties being accommodation entry providers was not received in respect of M/s PS. However, information of the above mentioned parties being the accommodation entry providers were received from DGIT (Investigation), Mumbai in respect of other assessee¹¹⁶ assessed in the same Pr.CIT charge. Audit further noted that the Department reopened these cases and made addition on the amount of bogus purchases. However, similar addition was not made in respect of M/s PS which had also purchased from the same accommodation entry providers. This shows that mechanism of dissemination of information by DGIT (Investigation), Mumbai was not adequate and effective.

Had the Department utilised the information of accommodation entry providers available with them and examined the legitimacy of purchase of diamonds amounting to ₹ 22.09 crore made by M/s PS from accommodation entry providers, there would have been potential demand of tax of ₹ 7.51 crore. If disallowances at the rate of 100 *per cent* had been made in these cases.

The Ministry in its reply has accepted the audit observation (January 2022) and stated that remedial action has been initiated under section 148 of the Income Tax Act (May 2021).

6.1.2.2 Inconsistencies in addition made on bogus purchase from accommodation entry providers

Section 69C of the Act provides that where an assessee incurs any expenditure but offers no explanation about the source of such expenditure or explanation offered by him is not satisfactory in the opinion of the AO, the amount of such expenditure may be deemed to be the income of the assessee. Thus, once it is established that the expenditure was unexplained/bogus, the entire amount of bogus expenditure should be added. There is no scope for partial disallowance in section 69C. Further, as per provisions of section 37(1), expenditure incurred only for the purposes of the business shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

¹¹⁶ SR, AY 2013-14, Pr.CIT 19, Mumbai.

Audit examined 178 case records¹¹⁷ in five states¹¹⁸ wherein beneficiaries had obtained bogus invoices aggregating to ₹ 2,477.73 crore. Audit observed that, while completing the assessments, the AOs made partial disallowances on account of entries of bogus purchases either based on their own estimation or on the basis of discretion post receipt of information to that effect from the Investigation units. As such, there was no uniformity or consistency across assessments in additions made towards bogus entries and purchases despite there being similar grounds of additions and in some cases, even the assessment charges were also same. The percentage of disallowance varied from 3 to 100 *per cent*. The method of disallowance involved ad-hoc percentage, addition to gross profit margin, rejection of books of accounts under section 145(3) and based on views taken in judicial rulings by various courts. In many cases, the AOs did not record the section of the Income Tax Act [Section 37, 68, 69 or 145(3)] in support of the disallowance made. The non-recording of specific provision of the Income Tax Act under which disallowance is made in the assessment order while adding back bogus purchases is indicative of inadequate, subjective and arbitrary basis adopted by the AOs for disallowance with an inherent risk of non-sustainability of additions at the appellate stage. Five such cases where inconsistencies in addition made in respect of bogus purchase made from accommodation entry providers noticed are illustrated below:

Box 6.3: Illustration of inconsistencies in addition made on bogus purchase from accommodation entry providers

(a) Charge: PCIT - 5, Mumbai

Assessee: M/s SI Pvt. Ltd.

Assessment Years: 2009-10, 2010-11, 2012-13, 2013-14 & 2014-15

In the case of assessee M/s SI Pvt. Ltd., the cases for AYs 2009-10 to 2014-15 were selected for scrutiny by the Department to examine the issue related to accommodation entry taken by the assessee. The details of returned income, assessed income and order dates are tabulated below:

AY	Returned income (₹ in crore)	Assessed income (₹ in crore)	Date of order	Order section
2009-10	(-)0.53	38.21	30/11/2018	143(3)/ 263
2010-11	15.52	104.47	30/11/2018	143(3)/ 263
2012-13	20.84	248.26	30/11/2018	143(3)/ 263
2013-14	16.72	24.03	28/12/2016	143(3)
2014-15	16.90	17.33	28/12/2016	143(3)

¹¹⁷ 178 cases consisted of 4 cases processed under section 143(1), 22 cases assessed under section 143(3) of the Act and 121 cases assessed under other sections (144, 147, 154, 250, 254 and 263) of the Act, details not available in remaining cases.

¹¹⁸ Maharashtra (172); Odisha (1); West Bengal (2); Tamilnadu (1) and Bihar (2)

Audit noted from the assessment records that the AO made addition in these cases against the accommodation entry taken by the assessee as detailed below:

AY	Total accommodation entry taken by assessee (₹ in crore)	Amount added by the AO (₹ in crore)	Percentage adopted for addition	Basis for addition
2009-10	37.62	37.62	100	Unexplained expenditure under section 69C
2010-11	86.36	86.36	100	Unexplained expenditure under section 69C
2012-13	220.80	220.80	100	Unexplained expenditure under section 69C
2013-14	134.59	7.31	5.43	Gross profit
2014-15	6.23	0.44	6.98	Gross profit

Audit observed from the assessment records that the scrutiny assessments for AYs 2009-10, 2010-11 and 2012-13 were completed by the Department under section 143(3) read with section 147 in March 2016 and additions against accommodation entry were made on the basis of gross profit margin declared by the assessee. Consequently, these orders were reviewed by the CIT-5, Mumbai and he held that orders passed by the AO for these AYs were erroneous and prejudicial to the interest of the revenue. Further, CIT-5, Mumbai directed the AO vide orders passed under section 263 (March 2018) to make fresh enquiries and then make fresh assessment accordingly. Pursuant to these directions, the AO made fresh enquiries and concluded in the assessment orders that the parties from whom the purchases were made were merely entry providers and the purchases made by the assessee from these entry providers were not genuine. Consequently, the AO added the 100 *per cent* amount of the purchases shown by the entry providers under section 69C and raised demand accordingly.

However, the AO did not reopen the case for AYs 2013-14 and 2014-15 although these involved identical issue of accommodation entry. Audit further observed from the list of entry providers that all the parties were belonging to BJ group from whom the assessee was found to have taken accommodation entries in all the AYs 2009-10, 2010-11, 2012-13, 2013-14 & 2014-15. Although the scrutiny assessments of the assessee for these AYs were completed in the same assessment charge (Circle 5(3)(1), Mumbai), there was inconsistency in making additions against the amount of accommodation entry taken by the assessee. In three AYs (2009-10, 2010-11 and 2012-13), 100 *per cent* amount of accommodation entry was added as unexplained expenditure by reopening the case; while, in two AYs (2013-14 & 2014-15) only a marginal (5.43, 6.98) *per cent* of amount was added. This resulted in inconsistent stand being taken by the Department while making

additions in respect of cases involving accommodation entries even within the same assessment charge and in respect of same assessee.

Audit observed that there is no guideline prescribed for adoption of specific percentage by AOs while making addition against accommodation entry/ bogus purchases. Due to this, there is no uniformity or consistency in addition made by the AO in respect of accommodation entry.

This observation was pointed out to the Department in November 2020. Reply of the Ministry is awaited (January 2022).

During the planning stage, Audit had issued a questionnaire (March 2019 and February 2020) to the Department to ascertain whether any study regarding bogus purchases had been undertaken and whether standard guidelines were issued based on such study for adoption of certain percentage by AOs while adding back bogus purchases. The Department replied (May 2019) that neither had any study been conducted nor standard guidelines issued in this regard.

Audit had highlighted the issue related to “Fictitious sales/ purchase by shell companies/ Hawala operators” in C&AG’s Audit Report no. 2 of 2017. Although the Ministry has taken remedial action in respect of the illustrative cases, it is yet to evolve a suitable mechanism to prevent recurrence of such lapses in future. However, no standard guidelines/ instructions have been issued in this regard for ensuring uniformity and consistency in assessments and to avoid instances of inconsistencies while disallowing and adding back income in a subjective and arbitrary basis by AOs.

A standard operating guideline for assessment of cases involving bogus entries is necessary in view of detection of increasingly large number of cases of accommodation entry providers and inconsistent stand being taken AOs while making addition on such cases.

Further, the persons who provide accommodation entries as a business or profession alongwith the offenders should be prosecuted as per the provisions under the Income Tax Act to ensure deterrence against perpetration of such illegal activities and wilful evasion of taxes.

6.1.3 Sharing of information related to Unsecured Loans among AOs

Timely sharing of vital information between assessment charges is important to ensure appropriate timely remedial action and quality assessments. AOs may share the information relating to the third party noticed during scrutiny assessment and considered vital for assessment of that person, with another jurisdictional AO(JAO) and vice-versa.

During examination of identified assessment cases, Audit noticed that the ITD usually verify identity, genuineness and creditworthiness of unsecured loans taken during the year by calling for loan confirmation, bank statements, ITRs, balance sheets and profit and loss accounts in some cases. If these documents are not submitted by the assessee, necessary facts are collected by AOs *inter-alia* by exercising the powers under section 133(6) of the Act to call for the information from lenders or banks.

During this performance audit, Audit did not come across any case where the AOs had shared the information about the entities providing unsecured loans with Jurisdictional Assessing Officers for verification of sources of funds. Further, there are several judicial decisions which pronounced that AO cannot verify the source of source of lenders i.e. sources from where the creditors have accumulated the amount, which they have advanced, in form of the loans, to the assessee.

Audit ascertained through discussion with the officers of the ITD that the CCIT/CIT/DCIT/AO of one jurisdiction are having restricted access to data pertaining to their jurisdiction only with no access to the data of any other jurisdiction. However, they can request information from jurisdictional AO of lenders. It was informed that they normally don't refer to the jurisdictional AO of lenders for verification as the current provisions of the Act doesn't allow JAO to seek information by issuing notice to assessee or reopen the case based on their letters.

6.2 Co-ordination between ITD and other Government agencies

According to section 131(1) of the Income Tax Act, 1961 (Act), AOs shall, for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, 1908, including, *inter alia*, "compelling the production of books of account and other documents". Further, the ITD Manual of Office Procedure prescribed by CBDT entrusts ITD with the responsibility to liaise with other Government Departments and agencies like Enforcement Directorate, Customs and Central Excise Department, Central Economic Intelligence Bureau, Sales tax and Trade tax Departments, State Excise Departments, District Administration, Government agencies dealing with economic offences and police authorities to enable income-tax authorities to get hold of vital information on assessees, both existing as well as potential. Audit found that the information of the assessee available with other Departments was not effectively utilized by AOs while completing assessment, thereby leaving the scope for leakages of revenue.

Audit attempted to verify the co-ordination mechanism of the ITD with external Departments for which information was sought (between February 2020 to July 2020, October 2020) regarding fake GST, bogus purchases availed by the beneficiaries and detected by the Department and details of importers/exporters involved in over-invoicing/under-invoicing during the period 2012-13 to 2018-19 from the respective authorities viz. Customs Commissionerates, Office of the

Additional Director General, Directorate of Revenue Intelligence, Office of the Principal Chief Commissioner, Central GST and the Commissioner of State Tax (State GST). However, the information sought by Audit is yet to be received from these offices (October 2021). Audit could not examine the impact of over-invoicing of imports and under-invoicing of exports from income tax perspective due to non-furnishing of details. However, issues related to non-coordination noticed during audit examination of sample cases are discussed below.

Audit noticed instances of lack of coordination between ITD and other Government agencies in two cases in Maharashtra. The cases are illustrated below:

Box 6.4: Illustrations of Non-coordination between ITD and other Government agencies

(a) Charge: Pr.CIT-4, Mumbai

Assessee: M/s RU Pvt. Ltd

Assessment Year: 2015-2016

The assessee, a company, filed the return of income for AY 2015-16 in February 2017 at the loss of ₹ 9.94 crore and the scrutiny assessment was completed under Section 143(3) in December 2017 accepting returned income as such and raising nil demand for AY 2015-16. As per the Profit & Loss Account of the Financial Year 2014-15, total turnover of the assessee company was ₹ 286.63 crore. The assessee was engaged in the business of manufacture and trading of gold ornaments and other similar articles. The case was selected for limited scrutiny due to significant differences in the opening stock of the current year and closing stock of the previous year and current liabilities as compared to total assets in the balance sheet.

Audit noticed from the notes to the financial statement that a search by VAT authorities was conducted in the office premises of the assessee in January 2016. During search proceedings, VAT authorities had observed the difference in stock as per books and physical stock amounting to ₹ 65.64 crore. Further, the assessee had shown total sales of ₹ 286.63 crore and closing stock of ₹ 39.25 crore in the FY 2014-15 relevant to A.Y. 2015-16. The difference of stock found by VAT authorities might also be related to FY 2014-15. However, neither the VAT Authorities themselves passed on the relevant data to ITD, nor ITD called for the information from the VAT Authorities. Reply of the Ministry is awaited (January 2022).

(b) Charge: Pr.CIT-6, Mumbai

Assessee: M/s SA Pvt. Ltd. (Formerly M/s AV Pvt. Ltd.)

Assessment Year: 2015-2016

The assessee, a company, filed the return of income for AY 2015-16 in September 2015 at Nil income and the scrutiny assessment was completed in December 2017 accepting returned income as such. As per the Profit & Loss Account for the financial year 2014-15, total turnover of the assessee company was ₹ 8.77 crore. This case was selected for complete scrutiny in CASS to examine the low profit before interest and tax and mismatch in amount paid to related persons under section 40A(2)(b) reported in audit report and ITR.

Audit observed that although the assessee had recorded a sales turnover of ₹ 10.81 crore for the FY 2014-15 as per sales tax returns, only an amount of ₹ 8.60 crore had been shown in the profit and loss statement as income from gross sales operation. It was further noticed that the net sale value of the services provided by the assessee was ₹ 70.57 lakh as per the ST-3 Returns for FY 2014-15, whereas the sale of services as per profit and loss account was shown as ₹ 17.25 lakh. Therefore, sales had apparently been understated in profit and loss account by ₹ 2.74 crore resulting in under assessment of income by similar amount and consequent short levy of tax of ₹ 93.30 lakh. Audit is of the view that the Department should have sought for reconciliation from the assessee or should have cross checked the same with the Sales Tax/ Service Tax department [now Goods and Services Tax Department]. The Ministry in its reply (January 2022) has accepted the audit objection and stated that remedial action has been initiated by issuing Notice under section 148 of the Act on 21 June 2021.

Audit in these instances noticed from the records available with the Assessing officers lack of coordination and sharing of information between ITD and other Departments.

Audit sought the details of the existing methodology and system in place for exchange of information pertaining to assesseees of the Gems and Jewellery sector between Enforcement Directorate and the Department of Revenue (September 2021). The Enforcement Directorate (ED) stated in its reply (October 2021) that ED, a premier financial investigation agency mandated with enforcement of provisions under the legislations such as the Foreign Exchange Regulation Act, 1973; the Foreign Exchange Management Act, 1999; the Prevention of Money Laundering Act, 2002 etc., has devised a mechanism for exchange of information with other Law Enforcement Agencies (LEAs) to identify potential cases of Money Laundering (ML) for investigation following a risk-based approach. It further stated that on request of ED, the CBDT has nominated the Commissioner

(Investigation), CBDT as the Nodal Officer for exchange of information between the ITD and the ED. Similarly, the Special Director of Enforcement (HO) has been nominated as the Nodal Officer for exchange of information between the ED and the ITD.

Audit could not ascertain the effectiveness and timely sharing of inputs received from other Government agencies at the central level with the local Jurisdictional Assessing officer at the field level.

6.4 Issues requiring adequate monitoring by the Income Tax Department

During the Performance Audit, audit noticed following issues which indicate the weak monitoring mechanism in the ITD with respect to the Gems and Jewellery Sector:

i) Trend analysis of commodities of Gems and Jewellery Sector: Trend analysis of domestic production, imports and exports of rough diamonds shows that the quantity of rough diamond imported in India in last 10 years was higher than the quantity of rough diamond mined globally. Further, the majority of imports and exports of rough diamonds were made to three countries viz. United Arab Emirates, Belgium and Hong Kong whose contribution in the global diamond mining were negligible. Audit also analysed the import and export of pearls and observed the unusual trend in import of pearls into India and its consumptions within the country vis-à-vis the overall global production of pearls. Thus, the above discrepancies warranted further examination by the ITD. The unusual trend in commodities of Gems and Jewellery Sector have been elaborated in paras 2.2.1, 2.2.2 and 2.2.3 of this report.

ii) Filling of incorrect business codes: Audit findings reflected that correctness of business codes filled in by the assesseees in ITRs is not verified either at the filing stage or during assessment proceedings. Non- verification in this regard might result in assesseees deliberately filling wrong business codes to avoid monitoring by regulators and investigating agencies. Audit findings in respect of non-verification of codes being filled in by the assesseees of the Gems and Jewellery sector have been discussed in detail in para 5.1 of this report.

iii) Absence of time limit for bringing exports proceeds in India: Audit observed that no time limit has been prescribed for bringing the export proceeds in the country for claiming deduction under section 10AA. Further, once deduction under section 10AA has been allowed, ITD has no mechanism in place to monitor the subsequent realisation/ non-realisation of export proceeds. Consequently, it may not be possible for the ITD to make a reliable estimate of the magnitude of the total tax concessions claimed by the assesseees without actually bringing the foreign currency in the country. Audit findings in this regard are discussed in para 3.1 of this report.

iv) Issue related to valuation of stocks: Audit observed that valuation of stock was not subjected to detailed verification or examination during scrutiny assessment. Thus, Audit could not ascertain whether the valuation mechanism was built-in for detailed examination of quantitative disclosures of inventory during scrutiny assessments. The issue has been brought out in chapters 3, 4 and 5 of this report.

v) Issues related to disclosures and suspicious business activities: During the Performance Audit, Audit observed issues related to non-disclosure/ wrong disclosure of quantitative details in ITR and TAR, mistakes in carry forward of closing stocks, shortages of stocks, etc. Audit also observed instances where the assessee had claimed very nominal business expenditure (rent, power and fuel, etc.) against huge turnover. Further, in some cases the assessee had declared excess output and shown sales/ purchases of goods at much below the market rate. However, these issues were not examined during the scrutiny assessment. Audit findings in this regard have been duly discussed in paras 4.2, 5.4, 5.6, 5.9.1 of this report.

vi) Lack of guidelines/ SOP/instructions: Audit observed that CBDT has not issued any Standard Operating Procedure (SOP) or instructions/ guidelines for completion of assessment of assessee specific to Gems and Jewellery sector. Further, the investigation wing of the ITD had pointed out numerous issues of bogus purchase/ accommodation entries prevalent in the sector; however, no SOP/ guidelines have been issued for maintaining consistency in respect of additions made against bogus purchases/accommodation entries.

vii) Special audit: Audit observed that the ITD has not been utilising the power vested on them to conduct special audit under section 142(2A) of the Act even in those cases where suspicious business activities and huge volume of transactions were noticed.

All the issues mentioned above indicate that due importance to this sector is required to be given; and the ITD needs to streamline the systems and strengthen its monitoring mechanism in respect of assessment of Gems and Jewellery Sector given the high risks of money laundering, round tripping, mis-invoicing, potential to generate and consume black money, also highlighted by various committees of the Government of India and FATF.

6.5 Conclusion

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 coordination within the Department, thereby impacting the quality of scrutiny assessments, and possibility of revenue leakage cannot be ruled out.

Audit noted that the Department lacked consistencies in making disallowances in similarly placed cases involving bogus entries/ purchases in the absence of any 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.

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.

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. Further, the absence of a focused approach to address the risks specific to this sector gets compounded due to deficient verification and monitoring mechanism at the field level.

6.6 Summary of Recommendations

a) *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]

The CBDT stated in its reply (January 2022) that existing practices/ mechanisms provide for sharing of information within the Department as well as with other Government agencies. Information available related to the identified CASS scenario of a particular case is made available to the field users through Profile views of the Insight Portal.

The reply of the CBDT is not acceptable as audit noted that the sharing of inputs is not being done at the field level. The CBDT may review and strengthen the mechanism to ensure effective sharing of information, timely referral of inputs to the jurisdictional AOs and stricter monitoring of utilisation of inputs at ground level to improve the quality of assessments at field level to mitigate the risk of tax evasion due to non-sharing/ non-utilisation of information on fake invoices, bogus purchases and accommodation entries.

b) 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, the Board may prescribe guidelines for procedure to be followed for making addition in respect of cases of accommodation entry.

[para 6.1.2]

The CBDT stated in its reply (January 2022) that the Income Tax Department does not contemplate widespread sharing of any information across the assessing officers or jurisdictions. The Department has consistently followed the policy of granting limited access of sensitive information to only those, who may require the same or have to actually use it. It needs to be appreciated that the Department holds any information in fiduciary capacity and it may not behave it to disseminate such sensitive information among the assessing officers/ officials across India, particularly when the relevance of the same is limited to few assessing officers in a particular region(s) or area(s) etc. Be that as it may, it is relevant to clarify that with effect from 01.04.2021, the Legislature has made amendments to the manner of initiating reassessment proceedings and also the time limit for reopening the proceedings. While the time limit has been reduced to only three previous assessment years, the procedure for selection of a case for reassessment for any reasons whatsoever (including the cases of beneficiaries of the accommodation entry providers) is now subjected to a risk management strategy. Thus, the selection of a case now is dependent upon the risk profiling strategy formulated at an appropriate point in time.

The CBDT has further stated in its reply that the suggestion of the C&AG regarding framing of the guidelines has been noted and is under examination.

Audit noted instances of non-addition of bogus claims due to non-sharing of inputs with the Jurisdictional AOs within ITD and inconsistencies in additions made on bogus purchases from accommodation entry providers despite there being similar grounds of additions as brought out in para 6.1.2 of this Report. Audit is of the view that such inputs may be shared with the relevant Assessing Officers in a timely manner for improving the quality of assessment and to prevent tax evasion. The CBDT may consider issuing Guidelines on priority to ensure consistency and uniformity in

assessments and to eliminate the risk of allowance of fake transactions and tax evasion and non-initiation of penalty proceedings.

c) The ITD should design an online system where an AO who wants to share or seek necessary information can be pushed to the Jurisdictional AO of the persons (with PAN) for verification. [para 6.1.3]

The CBDT stated in its reply (January 2022) that under the Faceless Assessment scheme, verifications, if required by the Assessment Unit, are to be carried out by the Verification Unit and not the Jurisdictional AO. There already exists a functionality in the Income Tax Business Application (ITBA), over which assessment proceedings are being carried out in a faceless manner, for the AO to send requests for carrying out verifications, to the Verification Unit. For assessment cases outside the faceless Assessment Scheme (like the assessments carried out by the Central and International Taxation charges), the assessment proceedings are carried out by the jurisdictional AO itself and the recommendation would not be applicable in that case. ITD users have online system available various functionalities under ITBA/Insight portal along with webmail facility to flag/ share information wherever deemed fit.

The reply of the CBDT regarding there being a functionality in the ITBA for carrying out verification is noted. However, it may be noted that although the powers of verification existed with the Assessing Officers in the pre-faceless assessment regime, it could not be ascertained in Audit whether the same was being done due to lack of evidential proof/ non-recording of details of verification in the assessment order. Further, even in the case of assessments not falling within the purview of Faceless Assessment regime, the facility of inter-jurisdictional sharing of details may be accorded to ensure effective utilisation of information through timely sharing of inputs within the ITD. Audit may be provided access to the ITBA system for verification of the same.

d) 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]

The CBDT stated in its reply (January 2022) that sharing of information by CBDT is governed by the Section 138 of the Income Tax Act, 1961. Income Tax Department (ITD) shares actionable inputs/ intelligence/ inference of laws to the concerned agencies, duly notified under section 138 of the Income Tax Act. Further, there is already an existing mechanism in the form of REICs (Regional Economic Intelligence Committee) meetings wherein relevant information gathered during the course of income tax proceedings is duly discussed and shared with other agencies by the Income Tax Department. Moreover, request based sharing of information takes place through the Commissioner (Inv.), CBDT as the nodal officer. This mechanism is applicable to sharing of information with the ED, CBI, SFIO, RBI, SEBI, CBIC/DRI, FIU-India and the Delhi Police. There also exists an MOU between CBDT and CBIC for

sharing of data and Export-Import data, GST data, ITR Data is being exchanged between two. Thus, existing practices/ mechanisms provide for sharing of information within the Department as well as with other Government agencies.

The reply of the CBDT is not acceptable as the details of exchange of information between ITD and other Departments in respect of Gems and Jewellery sector was not furnished to Audit. Audit could not ascertain the extent of sharing of data/information undertaken between the ITD and other Departments viz. Department of Customs, Directorate of Revenue Intelligence, Department of Central Goods and Services Tax and Department of State Goods and Services Tax due to non-furnishing of details by these Departments as sought by the Audit.

DoR may ensure stricter monitoring of sharing and utilisation of critical data/information relating to entities of Gems and Jewellery sector as it involves significant risk of money laundering, round tripping, mis-invoicing, 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. Further, the absence of a focused approach to address the risks specific to this sector gets compounded due to deficient verification and monitoring mechanism at the field level.

New Delhi
Dated: 27 April 2022


(Monika Verma)
Director General (Direct Taxes-I)

Countersigned

New Delhi
Dated: 27 April 2022


(Girish Chandra Murmu)
Comptroller and Auditor General of India

Annexures

Annexure A1

(Refer Para No.1.4)
Relevant Legal Provisions

The relevant general legal provisions in respect of all sectors including assesses of the Gems and Jewellery Sector are as under:

Section of Income Tax Act, 1961	Description of provisions as per the Income Tax Act, 1961
Section 44AB	Section 44AB of the Income Tax Act contains the provisions for the tax audit of an entity if the annual gross turnover/receipts of the assessee exceed the specified limit. As per these provisions, a tax audit shall be conducted by a Chartered Accountant who ensures that the taxpayers have maintained proper books of account and complied with the provisions of the Income-tax Act. Tax Audit conducted by a Chartered Accountant is reported to the Income-tax department in Form no. 3CA/3CB and Form no. 3CD along with the income tax return.
Section 92CA	As per Section 92CA(1) of the Income Tax Act, where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Principal Commissioner or Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under Section 92C to the Transfer Pricing Officer.
Section 92E	As per Section 92E of the Income Tax Act, the person who entered into an international transaction shall obtain a report from an accountant in prescribed Form 3CEB showing all details relevant to international transactions.
Section 139	Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income.
Section 142A	Section 142(2A) deals with special audit. As per Section 142(2A), if the conditions justifying special audit as given in Section 142(2A) are satisfied, then the Assessing Officer will direct the taxpayer to get his accounts audited from a chartered accountant nominated by the Principal chief commissioner or Chief Commissioner or Principal Commissioner or Commissioner and to furnish a report of such audit in the prescribed form.
Section 143(1)	Section 143(1) of the Act provides for summary assessment without calling the assessee. It involves preliminary checking of return. At this stage detailed scrutiny of the return of income is not carried out and the total income or loss is computed after making the following adjustments. Assessment under Section 143(1) can be made within a period of 9 months from the end of the financial year in which the return of income is filed.
Section 143(3)	Section 143(3) of the Act provides for detailed assessment and is referred to as scrutiny assessment. At this stage a detailed scrutiny of the return of income will be carried out is to confirm the correctness and genuineness

Section of Income Tax Act, 1961	Description of provisions as per the Income Tax Act, 1961
	of various claims, deductions, etc., made by the taxpayer in the return of income. The objective of scrutiny assessment is to confirm that the taxpayer has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner.
Section 144	Assessment under Section 144 of the Act is an assessment carried out as per the best judgment of the Assessing Officer on the basis of all relevant material he has gathered. This assessment is carried out in cases where the taxpayer fails to comply with the requirements specified in Section 144.
Section 145	As per Section 145(1) of the Act Income under head Business or Profession and Income under head Other Sources is to be calculated on basis of Cash or Mercantile basis of accounting regularly employed by the assessee. Further, Section 145(2) of the Act provides that the Central Government may notify in Official Gazette from time to time income computation and disclosure standards to be followed by any class of assesseees or in respect of any class of income. Section 145(3) of the Act provides that where the AO is not satisfied about the correctness or completeness of the accounts of assessee, or where the method of accounting have not been regularly followed by the assessee or income has not been computed in accordance with the standards notified the AO may make an assessment under Section 144.

Annexure A2

(Refer Para No.1.4)

Relevant Judicial Pronouncements

The case laws/ judicial decisions in respect of assesseees of Gems and Jewellery Sector are as under:

Sr. No	Case laws no.	Authority	Gist
1	N.K. Proteins Ltd. vs DCIT [2017] 250 Taxman 0022	The Hon'ble Supreme Court.	The Hon'ble Apex Court held that addition on the basis of undisclosed income could not be restricted to certain percentage when the entire transaction was found as bogus.
2	Sri Ganesh Rice Mills vs CIT [2007] 294	The Hon'ble Allahabad High Court.	The Hon'ble Allahabad High Court upheld the action of AO to disallow the entire purchases made from non-existent concerns.
3	M/s Kanchwala Gems vs. JCIT ITA No.134/JP/2002 dated 10.12.2003	The Hon'ble Supreme Court.	The Hon'ble Supreme Court affirmed the decision of The Hon'ble ITAT, Jaipur wherein it has been held that even payment by account payee cheque is not sufficient to establish the genuineness of purchase.
4	CIT vs Bholanath Polyfab Pvt. Ltd. (2013) 355 ITR 290(Gujrat)	The Hon'ble Gujarat High Court.	The Hon'ble Gujarat High Court held that when the assessee made purchases and sold the finished goods as a natural corollary not the entire amount covered under bogus purchases would be subject to tax but only the profit element embedded therein. Similar view has been taken by the Hon'ble Gujarat High Court in the case of CIT v. Simit P. Seth [38 taxman.com 385].
5	DIT vs. Bharat Diamond Bourse [2003] 126 Taxman 365 (SC)	The Hon'ble Supreme Court.	The Hon'ble Supreme Court has held that where primary or dominant purpose of 'institution' is charitable and other objects which, by themselves, may not be charitable, but are merely ancillary or incidental to primary or dominant object, same would not prevent 'institution' from validly being recognized as a charity.
6	CIT vs. Gem India Mfg. Co, [2001] 117 taxman 368 (SC)	The Hon'ble Supreme Court.	The Hon'ble Supreme Court has held that cutting and polishing of diamonds does not amount to manufacture or production of goods for purpose of Section 80-I when there was no material on the record upon which such a conclusion could be reached.
7	D. Subhashchandra & Co. vs. ACIT, [2010] 123 ITD 635 (AHD.)	The Hon'ble ITAT Ahmedabad Bench	The Hon'ble ITAT Ahmedabad Bench, has held that assessee's method of valuation of closing stock of polished diamonds on the basis of net realizable value is not correct. Even though net realizable value method is duly recognised by AS-2, yet onus is on assessee to prove that net realizable value, whatever has been shown by him, is correct value and is less than cost.

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Sr. No	Case laws no.	Authority	Gist
8	Kachwala Gems vs. JCIT [2007] 158 Taxman 71 (SC),	The Hon'ble Supreme Court.	The Hon'ble Supreme Court has held that no doubt, authorities concerned should try to make an honest and fair estimate of income even in a best judgment assessment, and should not act totally arbitrarily but there is necessarily some amount of guess work involved in a best judgment assessment, and it is assessee himself who is to blame as he did not submit proper accounts. The AO rejected assessee's books of account and resorted to best judgment assessment under Section 144. Since cogent reasons had been given by AO for doing so, there was no reason to take a different view.
9	DCIT vs. Samir Diamonds Export, [1999] 71 ITD 75 (Mum.),	The ITAT Mumbai Bench	The ITAT Mumbai Bench upheld the order of AO in estimating the profits of the assessee based on facts. Assessee admitted before AO that it did not maintain details of polished diamonds on basis of weight, cut, clarity, shape and number of pieces. Assessee also did not furnish details regarding issuing of lots of rough diamond to labour parties for cutting, polishing, etc., and actual yield therefrom as they were said to have been destroyed after goods were received back. He, therefore, concluded that in absence of vital details and in view of incompleteness of books of account, book results could not be accepted and on the basis of assessee's own record and results disclosed by sister concerns, made flat addition at five <i>per cent</i> of disclosed sales. The ITAT held that assessee cannot claim that since his books of account were found to be correct and complete in preceding years, it is a conclusive proof of fact that they are correct and complete for subsequent year also.
10	M/s Surgems vs Jt. CIT Range 16(3) (ITA no. 376/mum/08) in ITAT Mumbai "E" Bench	ITAT Mumbai "E" Bench	The ITAT upheld the order of A.O. in rejection of books of accounts and estimated the profits in the absence of reliability of accounts.
11	CIT vs . P. P. Jewellers [2009] 180 Taxman 50 (Delhi)	The Hon'ble Delhi High Court	The Department had adopted bulk weighing method for weighing, jewellery and thereafter, compared same with stock register. Tribunal found that said method suffered from various imperfections inasmuch as, it meant that weighment was not done item-wise and, consequently, was not as per stock registers maintained by assessee, weighment was not fool proof and was also not free from doubt and, accordingly, deleted addition made by AO, the Hon'ble Delhi High Court held that the Tribunal was justified in deleting the additions.

Sr. No	Case laws no.	Authority	Gist
12	CIT vs. Shatrunjay Diamonds [2003] 128 Taxman 759 (Bom.)	The Hon'ble Bombay High Court	The Hon'ble Bombay High Court has upheld that the AO's addition u/s 40A(2)(b) against assessee who had imported diamonds from a sister concern in New York and on comparison of the prices of diamond imported, the AO found that the diamonds are excessively priced.
13	Dialust vs. DCIT [2003] 133 Taxman 810 (Bom.)	The Hon'ble Bombay High Court	The Hon'ble High Court has upheld the findings of the revenue and held that seized diamonds represented unaccounted income of assessee and additions made were in accordance with law. The conduct as well as evidence of parties failed to prove genuineness of source and confession thereof failed to inspire confidence in authorities below.

Annexure B

(Refer Para No. 1.5.5, 2.1.5)

Regional jurisdiction-wise distribution of sample cases examined in audit

(*₹ in crore*)

Region	No of cases [unique PAN-AY]				Sales Turnover/ Gross Receipts	Returned Income	Assessed Income	Demand Raised as per latest order
	Summary	Scrutiny	Others	Total				
ANDHRA PRADESH AND TELENGANA	58	0	3	61	1,460.02	18.58	13.74	0.00
BIHAR AND JHARKHAND	23	1	1	25	11.55	0.97	1.00	0.01
DELHI	88	17	19	124	2,308.44	39.70	763.96	425.11
GUJARAT	200	8	166	374	18,208.87	511.42	350.17	3.88
KARNATAKA AND GOA	38	6	3	47	1397.30	37.09	46.88	4.39
KERALA	55	15	1	71	31,166.77	879.51	880.58	0.58
MADHYA PRADESH AND CHATTISGARH	51	3	4	58	265.12	2.34	4.71	1.57
MUMBAI	295	496	298	1,089	5,47,632.13	10,720.89	13,615.24	1,692.87
NORTH EAST REGION	3	0	1	4	213.03	1.69	0.00	0.00
NORTH WEST REGION	58	0	13	71	796.50	9.04	8.60	0.01
ODISHA	19	3	1	23	389.60	6.74	12.46	2.67
RAJASTHAN	92	7	17	116	15,699.72	160.66	185.78	18.35
TAMIL NADU	78	9	7	94	11,620.78	212.81	212.65	70.07
UTTAR PRADESH (EAST)	9	0	0	9	96.27	7.08	7.08	0.00
UTTAR PRADESH (WEST)	12	0	1	13	30.23	0.95	0.86	0.00
WEST BENGAL AND SIKKIM	68	7	7	82	1,300.73	27.29	24.01	0.58
Grand Total	1,147	572	542	2,261	6,32,597.05	12,636.76	16,127.72	2,220.10

Annexure C

(Refer Para No.1.5.5)

Regional jurisdiction-wise distribution of records not produced during audit

(*₹ in crore*)

Name of Region	Number of cases not produced				Returned Income	Assessed Income	Demand Raised as per latest order
	Summary	Scrutiny	Others	Total			
ANDHRA PRADESH AND TELENGANA	3	0	1	4	0.25	0.17	0.00
BIHAR AND JHARKHAND	1	0	0	1	0.10	0.10	0.00
DELHI	1	0	0	1	0.01	0.02	0.01
GUJARAT	1	1	1	3	5.23	5.23	0.00
KARNATAKA AND GOA	1	0	1	2	0.10	0.01	0.00
MADHYA PRADESH AND CHATTISGARH	1	0	0	1	0.03	0.03	0.00
MUMBAI	27	116	50	193	899.52	919.85	127.64
NORTH WEST REGION	2	0	0	2	0.00	0.01	0.00
RAJASTHAN	5	5	4	14	46.59	46.49	0.29
TAMIL NADU	3	1	0	4	0.14	0.14	0.00
UTTAR PRADESH (EAST)	20	0	0	20	0.79	0.79	0.00
UTTAR PRADESH (WEST)	34	0	4	38	6.59	6.01	0.00
WEST BENGAL AND SIKKIM	9	0	0	9	0.89	0.89	0.00
Grand Total	108	123	61	292	960.24	979.74	127.94

Annexure D

(Refer Para No.3.3.1)

Valuation of diamonds

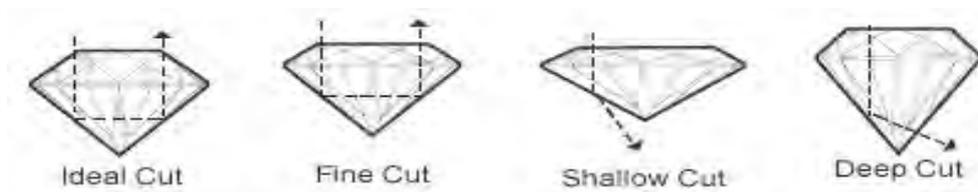
Valuation of diamonds is a crucial aspect for assessment purposes. Valuation of diamonds depends upon the 4Cs i.e Carat, Cut, Colour and Clarities. The details of these 4Cs are shown as under:

i) Carat- carat is actually a standard unit of measure that defines the weight of a diamond. One carat is equivalent to 200 milligrams. Carat sizes are also expressed as "points", with a one carat diamond equalling 100 points, a one-half carat diamond being 50 points, a three-quarter carat diamond being 75 points, and so on.

ii) Colour- The Gemmological Institute of America (G.I.A.) grades colour alphabetically from D (totally colourless) to Z (yellow) as follows:



iii) Cut-A good cut gives a diamond its brilliance, which is that brightness that seems to come from the very heart of a diamond. The angles and finish of any diamond are what determine its ability to handle light, which leads to brilliance.



iv) Clarity- Diamonds are graded for clarity under 10x loupe magnification. Clarity grades range from Internally Flawless, diamonds which are completely free of blemishes and inclusions even under 10 x magnifications, to Imperfect 3, diamonds which possess large, heavy blemishes and inclusions that are visible to the naked eye.

GIA	FL - IF	VVS1	VVS2	VS1	VS2	SI1	SI2	I1	I2	I3
clarity grading scale	Internally Flawless	Very Very Slight inclusions	Very Slight inclusions	Slight inclusions	Imperfect					

Annexure E

(Refer Para No.4.1.1)

Audit observations in respect of Group Companies of M Group

Sl. No.	Particulars of assessee	Sales Turnover (₹ in crore)	Compliance Issues	Information related Issues	Verification related Issues	Suspicious Business Activity
1	M/s G1 Ltd. AY 2013 Order u/s 143(3) dated 29/12/2016	472.08	Non-filing of ITR in AYs 2018-19 and 2019-20	--	Non-verification of variation in yield	--
2	M/s G1 Ltd. AY 2014 Order u/s 143(3) dated 29/01/2018	395.00	Non-filing of ITR in AYs 2018-19 and 2019-20	Mismatch in Quantitative Details as per ITR and Form 3CD	Non-verification of shortage/excess of stocks	Addition made towards Bogus Purchases
3	M/s G1 Ltd. AY 2015 Order u/s 143(3) dated 14/02/2019	8,427.94	Non-filing of ITR in AYs 2018-19 and 2019-20	Difference in figures as per DGIT (Systems) vis-a-vis actual data. Mismatch in Quantitative Details as per ITR and Form 3CD	Non-verification of variation in yield	Addition made towards Bogus Purchases
4	M/s G1 Ltd. AY 2017 Order u/s 143(1) Date of order not available	10,464.77	Non-filing of ITR in AYs 2018-19 and 2019-20	Mismatch in Quantitative Details as per ITR and Form 3CD	Non-verification of shortage/excess of stocks	
5	M/s G2 Ltd. AY 2011 Order u/s 154 dated 29/12/2018	1,341.10	--	--	--	--
6	M/s G2 Ltd. AY 2013 Order u/s 143(3) dated 29/12/2016	2,283.99	--	--	--	--
7	M/s G2 Ltd. AY 2014 Order u/s 143(3) dated 23/12/2016	1,494.38	--	Data Mismatch in amount of deduction claimed and allowed under section 10AA as per DGIT (Systems) vis-a-vis actual data. Discrepancy in Tax Audit Report	--	--
8	M/s G2 Ltd. AY 2015 Order u/s 143(1) dated 30/06/2016	1,347.19	--	Discrepancy in Tax Audit Report	--	--
9	M/s G2 Ltd. AY 2016 Order u/s 143(1) dated 11/12/2016	1,484.07	--	--	--	--

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Sl. No.	Particulars of assessee	Sales Turnover (₹ in crore)	Compliance Issues	Information related Issues	Verification related Issues	Suspicious Business Activity
10	M/s D Ltd. AY 2010 Order u/s 154 dated 21/10/2016	291.42	Non-filing of ITR in AYs 2018-19 and 2019-20	--	--	--
11	M/s D Ltd. AY 2013 Order u/s 250 dated 29/12/2016	332.89	Non-filing of ITR in AYs 2018-19 and 2019-20	Mismatch in Quantitative Details as per ITR and Form 3CD	--	--
12	M/s D Ltd. AY 2014 Order u/s 143(3) dated 26/12/2016	324.74	Non-filing of ITR in AYs 2018-19 and 2019-20	Data Mismatch in amount of deduction allowed under section 10AA as per DGIT (Systems) vis-a-vis actual data.	--	--
13	M/s D Ltd. AY 2015 Order u/s 143(1) dated 20/11/2016	336.09	Non-filing of ITR in AYs 2018-19 and 2019-20	Mismatch in Quantitative Details as per ITR and Form 3CD	--	--
14	M/s D Ltd. AY 2016 Order u/s 144 dated 26/12/2018	334.43	Non-filing of ITR in AYs 2018-19 and 2019-20	Data Mismatch in amount of Returned Income and Demand raised as per DGIT (Systems) vis-a-vis actual data.	--	--
15	M/s G3 Ltd. AY 2012 Order u/s 143(3) dated 22/05/2015	1,833.56	--	Data Mismatch in amount of Returned Income as per DGIT (Systems) vis-a-vis actual data. Mismatch in Quantitative Details as per ITR and Form 3CD	Non-verification of shortage/excess of stocks, variation in yield	Addition made towards Bogus Purchases
16	M/s G3 Ltd. AY 2013 Order u/s 143(3) dated 29/12/2016	2,329.58	--	Mismatch in Quantitative Details as per ITR and Form 3CD	Non-verification of shortage/excess of stocks	Addition made towards Bogus Purchases
17	M/s G3 Ltd. AY 2014 Order u/s 143(3) dated 24/12/2016	2,014.06	--	Mismatch in Quantitative Details as per ITR and Form 3CD	--	--
18	M/s G3 Ltd. AY 2015 Order u/s 143(1) dated 05/11/2016	2,297.59	--	Mismatch in Quantitative Details as per ITR and Form 3CD	--	--
19	M/s G4 Ltd. AY 2013 Order u/s 250 dated 02/01/2018	1,377.55	--	--	Non-verification of variation in yield	--
20	M/s G4 Ltd. AY 2014 Order u/s 143(3) dated 26/12/2016	1,260.02	Non-filing of ITR in AYs 2018-19 and 2019-20	Data Mismatch in amount of Returned Income and deduction	Non-verification of variation in yield	--

Sl. No.	Particulars of assessee	Sales Turnover (₹ in crore)	Compliance Issues	Information related Issues	Verification related Issues	Suspicious Business Activity
				allowed under section 10AA as per DGIT (Systems) vis-a-vis actual data.		
21	M/s G4 Ltd. AY 2015 Order u/s 143(1) dated 07/04/2016	1,481.86	Non-filing of ITR in AYs 2018-19 and 2019-20	--	--	--
22	M/s G4 Ltd. AY 2016 Order u/s 144 dated 26/12/2018	1,803.95	Non-filing of ITR in AYs 2018-19 and 2019-20	--	--	Addition made towards Bogus Purchases
23	M/s G4 Ltd. AY 2017 Order u/s 143(1) dated 28/02/2019	2,343.45	Non-filing of ITR in AYs 2018-19 and 2019-20	--	--	--
24	M/s N Ltd. AY 2008 Order u/s 143(1) dated 17/08/2009	163.64	--	--	--	--
25	M/s N Ltd. AY 2012 Order u/s 143(3) dated 17/04/2016	982.75	--	--	Non-verification of variation in yield	--
26	M/s N Ltd. AY 2013 Order u/s 250 dated 08/06/2018	1,289.25	--	--	Non-verification of variation in yield	--
27	M/s N Ltd. AY 2014 Order u/s 143(3) dated 26/12/2016	1,240.48	--	--	Non-verification of variation in yield Tax Audit Report not available	--
28	M/s N Ltd. AY 2015 Order u/s 143(1) dated 23/02/2017	2,605.10	--	Discrepancy in Tax Audit Report	--	--
29	M/s N Ltd. AY 2016 Order u/s 144 dated 28/12/2018	3,042.95	--	Mismatch in Quantitative Details as per ITR and Form 3CD	Non-verification of shortage/excess of stocks, variation in yield	Addition made towards Bogus Purchases
30	M/s N Ltd. AY 2017 Order u/s 144 dated 01/03/2019	3,802.23	--	Data Mismatch in amount of deduction allowed under section 10AA as per DGIT (Systems) vis-a-vis actual data.	--	--

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Sl. No.	Particulars of assessee	Sales Turnover (₹ in crore)	Compliance Issues	Information related Issues	Verification related Issues	Suspicious Business Activity
31	M/s A Ltd. AY 2011 Order u/s 154 dated 29/12/2018	748.19	Non-filing of ITR in AYs 2016-17, 2017-18, 2018-19 and 2019-10	Data Mismatch in amount of Returned Income as per DGIT (Systems) vis-a-vis actual data.	--	Addition made towards Bogus Purchases
32	M/s A Ltd. AY 2013 Order u/s 250 dated 08/12/2017	1,367.82	Non-filing of ITR in AYs 2016-17, 2017-18, 2018-19 and 2019-10	Data Mismatch in amount of deduction claimed and allowed under section 10AA as per DGIT (Systems) vis-a-vis actual data. Mismatch in Quantitative Details as per ITR and Form 3CD	--	--
33	M/s A Ltd. AY 2014 Order u/s 143(3) dated 23/12/2016	1,142.92	Non-filing of ITR in AYs 2016-17, 2017-18, 2018-19 and 2019-10	Data Mismatch in amount of deduction claimed and allowed under section 10AA as per DGIT (Systems) vis-a-vis actual data. Discrepancy in Tax Audit Report	--	--
34	M/s A Ltd. AY 2015 Order u/s 143(1) dated 12/01/2016	1,226.04	Non-filing of ITR in AYs 2016-17, 2017-18, 2018-19 and 2019-10	Non-disclosure of Quantitative Details in ITR	--	--
35	M/s G5 Ltd. AY 2013 Order u/s 154 dated 10/12/2018	358.71	Non-filing of ITR in AYs 2018-19 and 2019-20	--	--	--

Annexure F

(Refer Para No.4.1.2)

Audit observations in respect of Group Companies of N Group

Sl. No.	Particulars of Assessee	Sales Turnover (₹ in crore)	Compliance Issues	Information related Issues	Verification related Issues	Suspicious Business Activity
1	M/s FI Pvt. Ltd. AY 2012 Order u/s 143(3) dated 23/03/2016	2,522.80	Non-filing of ITR in AYs 2018-19 and 2019-20	Data Mismatch in amount of deduction allowed under section 10AA Mismatch in Quantitative Details as per ITR and Form 3CD	Non- verification of Unsecured loans, shortage/ excess of stocks, yield	--
2	M/s FI Pvt. Ltd. AY 2013 Order u/s 143(3) dated 20/04/2016	3,454.80	Non-filing of ITR in AYs 2018-19 and 2019-20	Data Mismatch in amount of deduction allowed under section 10AA Mismatch in Quantitative Details as per ITR and Form 3CD	Non- verification of Unsecured loans, shortage/ excess of stocks, yield	--
3	M/s FI Pvt. Ltd. AY 2017 Order u/s 143(1) Date of order not available	5,226.14	Non-filing of ITR in AYs 2018-19 and 2019-20	Non-disclosure of Quantitative Details in ITR	Non- verification of variation in yield	--
4	M/s DR AY 2015 Order u/s 143(1) Date of order not available	878.93	Non-filing of ITR in AYs 2018-19 and 2019-20	Mismatch in Quantitative Details as per ITR and Form 3CD	Non- verification of shortage/ excess of stocks	--
5	M/s DR AY 2016 Order u/s 143(1) Date of order not available	1,485.08	Non-filing of ITR in AYs 2018-19 and 2019-20	Discrepancy in Tax Audit Report	--	--
6	M/s DR AY 2017 Order u/s 143(1) Date of order not available	2,744.66	Non-filing of ITR in AYs 2018-19 and 2019-20	Discrepancy in Tax Audit Report	--	--
7	M/s SD AY 2015 Order u/s 143(1) dated 12/11/2018	657.14	Non-filing of ITR in AYs 2018-19 and 2019-20 Non-furnishing of Form 3CEB	--	--	--
8	M/s SD AY 2016 Order u/s 143(1) dated 12/11/2018	1,328.80	Non-filing of ITR in AYs 2018-19 and 2019-20 Non-furnishing of Form 3CEB	--	--	--

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Sl. No.	Particulars of Assessee	Sales Turnover (₹ in crore)	Compliance Issues	Information related Issues	Verification related Issues	Suspicious Business Activity
9	M/s SD AY 2017 Order u/s 143(1) dated 12/11/2018	2,654.90	Non-filing of ITR in AYs 2018-19 and 2019-20 Non-furnishing of Form 3CEB	Discrepancy in Tax Audit Report	--	--

Annexure G

(Refer Para No.4.2)

Table: Records not furnished in respect of Main assessees examined under 360-degree analysis

Sl. No.	PCIT Charge	Details of Assessee	List of records/ documents not furnished in respect of Main assessee
1	CIT Central-1 Delhi	M/s DL AY 2017-18 Order u/s 143(3)/153C dated 29/12/2019	1. Assessment records of the related parties were not provided. 2. Details of assessment charges of all creditors and unsecured loans providers. 3. Confirmation of accounts, ITR and documentary evidences of the parties from whom , the unsecured loans were taken. 4. No confirmation of accounts in respect of the sundry creditors was provided.
2	PCIT-5 Ahmedabad	AS Bigger HUF AY 2018-19 Order u/s 143(1)(a) dated 20/02/2019	ITNS 150
3	Pr.CIT (C) 1, Mumbai	M/s GG Ltd. AY 2013-14 Order u/s 143(3) dated 29/12/2016	Assessment Folder
4	Pr.CIT (C) 1, Mumbai	M/s GG Ltd. AY 2017-18 Order u/s 143(1) Date Not Available	Order under section 143(1)
5	PCIT-22 Mumbai	M/s DF AY 2013-14 Order u/s 143(3) dated 17/07/2015	Submission folder; Balance sheet; Profit and Loss Account; Report in Report in Form 56F; Profit and loss account of SEZ unit; Working of 10AA deduction
6	PCIT-22 Mumbai	M/s DF AY 2014-15 Order u/s 143(3) dated 29/12/2016	Partywise details of purchases (Imports)
7	PCIT-22 Mumbai	M/s DF AY 2016-17 Order u/s 143(3) dated 29/12/2018	Partywise details of purchases and sales(Imports and Exports)
8	PCIT-1 Bangalore	M/s AT Private Ltd. AY 2015-16 Order u/s 143(1) dated 29/09/2015	Order under section 143(1)
9	PCIT-1 Bangalore	M/s AT Private Ltd. AY 2016-17 Order u/s 143(1) dated 13/10/2016	Order under section 143(1)

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Sl. No.	PCIT Charge	Details of Assessee	List of records/ documents not furnished in respect of Main assessee
10	PCIT-1 Bangalore	M/s AT Private Ltd. AY 2017-18 Order u/s 143(1) dated 15/10/2017	Order under section 143(1)
11	PCIT-1 Bangalore	M/s AT Private Ltd. AY 2018-19 Order u/s 143(1) dated 14/10/2018	Order under section 143(1)
12	PCIT-2 Raipur	M/s AR Pvt. Ltd. AY 2011-12 Order u/s 147 dated 26/12/2018	Information/document on unsecured loans

Annexure H

(Refer Para No.4.2)

Table: Records not furnished in respect of Related Parties of main assessee examined under 360-degree analysis

Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
1	AS Bigger HUF AY 2018-19 Order u/s 143(1)(a) dated 20/02/2019 PCIT-5 Ahmedabad	(1) M/s CP; (2) RA; (3) DS; (4) YS; (5) SS; (6) SS HUF; (7) BS HUF; (8) KT; (9) LS; (10) PS; (11) RS; (12) YS; (13) SS1; (14) BS1; (15) DS1 HUF; (16) YS HUF; (17) M/s SJ1; (18) NS1; (19) MS1;	No records furnished for following four parties: (1) BS HUF; (2) NS1; (3) DS; (4) RA;	Audit noticed three observations with no money value: (1) YS: Difference of ₹ 4.79 lakh in Salary payment as per Form 3CD of assessee vis-a-vis ITR of Related party; (2) MS: Difference of ₹ 0.16 lakh in Interest payment as per Form 3CD of assessee vis-a-vis ITR of Related party; (3) M/s CP - Difference in Unsecured loan of ₹ 1,890.53 lakh taken by assessee as per its Form 3CD vis-à-vis schedule of balance sheet of Related party.	Out of 19 related parties processed under summary, audit examined records of 15 related parties whereas records of remaining four parties were not furnished.
2	M/s SL Limited AYs 2015-16 & 2016-17 PCIT 4 Ahmedabad	(1) LP; (2) AP; (3) DP; (4) MP; (5) M/s MT; (6) AP HUF; (7) MP1; (8) M/s SS1	(1) Complete record not furnished for MP; for AYs 2015-16 & 2016-17. (2) Assessment processing details screenshot not furnished for:	Audit noticed 12 observations with no money value: (1) LP; (AY 2015): Difference of ₹ 2.70 lakh in salary payment as per 3CD of assessee vis-a-	Out of 16 cases, eight cases were processed under summary whereas the assessment details of the eight related parties are not available.

Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
			(i) AP HUF; (AYs 2015 & 2016). (ii) MP1; (AYs 2015 & 2016). (iii) M/s SS1; (AYs 2015 & 2016).	vis ITR of Related party. (2) AP; (AY 2015) -(i) Difference of ₹ 2.70 lakh in Salary payment as per 3CD of assessee vis-a-vis ITR of Related party. (ii) Difference of ₹ 1.80 lakh in Rent payment as per Form 3CD of main assessee vis-à-vis rent as per ITR of Related party. (3) DP; (AY 2015) Difference of ₹ 0.27 lakh in Salary payment as per 3CD of assessee vis-a-vis ITR of Related party. (4) MP1; (AY 2015) Difference of ₹ 0.12 lakh in Salary payment as per 3CD of assessee vis-a-vis ITR of Related party. (5) M/s SS1; (AY 2015) Difference of ₹ 15.41 lakh in Rent payment as per Form 3CD of main assessee vis-à-vis rent as per P&L of Related party. (6) LP; (AY 2016) Difference of ₹ 0.52 lakh in	

Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
				<p>Salary payment as per 3CD of assessee <i>vis-a-vis</i> ITR of Related party. (7) AP; (AY 2016) Difference of ₹ 1.77 lakh in Salary payment as per 3CD of assessee <i>vis-a-vis</i> ITR of Related party. (8) DP; (AY 2016) Difference of ₹ 1.77 lakh in Salary payment as per 3CD of assessee <i>vis-a-vis</i> ITR of Related party. (9) MP1; Difference of ₹ 0.52 lakh in Salary payment as per 3CD of assessee <i>vis-a-vis</i> ITR of Related party. (10) M/s SS1 ;(2016) (i) Difference of ₹ 12.29 lakh in reimbursement of expenses as per Form 3CD of main assessee <i>vis-à-vis</i> Form 3CD of Related party. (ii) Difference of ₹ 21.73 lakh in Rent as per Form 3CD of assessee <i>vis-à-vis</i> P&L account of Related party.</p>	

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Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
3	M/s CJ Private Limited AYs 2013-14; 2015-16; 2016-17; 2017-18; 2018-19 PCIT- 2(1)(1), Bangalore	M/s CI Pvt Ltd. AY 2013-14; U/s 143(3) dated January 2016	Nil	Non verification of unsecured loan taken by M/s CI Pvt. Ltd. from five parties.	Nil
4	M/s DL AY 2017-18 Order u/s 143(3)/153C dated 29/12/2019 CIT Central-1 Delhi	1. AR 2. AC1 3. AC2 4. GT 5. GS 6. KM 7. KK 8. MS 9. NC 10. RK 11. SC 12. HC 13. RC	Assessment records of all the 13 related parties were not provided.	Nil	
5	M/s MS AY 2016-17 Order u/s 143(1)	1. AG 2. KG 3. JG	ITRs of AG and JG were not furnished.	Nil	
6	M/s SB AY 2015-16 Order u/s 143(1)	1. OP 2. NK 3. KB 4. RG	ITR of RG was not furnished.	Nil	
7	M/s GG Ltd. AY 2013-14 Order u/s 143(3) dated 29/12/2016; AY 2015-16; AY 2016-17; AY 2017-18 Order u/s 143(1) Date Not Available Pr.CIT (C) 1, Mumbai	(1) M/s G3 Ltd.; (2) M/s A Ltd.; (3) M/s G4 Ltd.; (4) M/s D Pvt. Ltd.; (5) M/s N Ltd.; (6) M/s G2 Ltd.	Nil	(1) M/s A Limited (AY 2013) Difference in figures as per DGIT (Systems) vis-a-vis actual data. (2) M/s A Limited (AY 2014) Difference in figures as per DGIT (Systems) vis-a-vis actual data. (3) M/s D Pvt. Ltd. (AY 2013) Excess allowance of	Out of 26 assessment records, nine were processed under summary and 17 were assessed under scrutiny. Audit raised 12 observations in assessments of related parties involving tax

Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
				deduction u/s 10AA. (4) M/s D Pvt. Ltd. (AY 2014) Difference in figures as per DGIT (Systems) vis-a-vis actual data. (5) M/s D Pvt. Ltd (M/s BI Pvt. Ltd.) (AY 2016): Difference in figures as per DGIT (Systems) vis-a-vis actual data. (6) M/s G4 Limited (AY 2014):(i) Irregular allowance of deduction u/s 10AA; (ii) Difference in figures as per DGIT (Systems) vis-a-vis actual data. (7) M/s G2 Limited (AY 2014): Difference in figures as per DGIT (Systems) vis-a-vis actual data. (8) M/s G3 Ltd (AY 2012): Difference in figures as per DGIT (Systems) vis-a-vis actual data. (9) M/s N Limited (AY 2013): Difference in figures as per DGIT (Systems) vis-a-vis actual data.	effect of ₹ 142.78 crore.

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Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
				(10) M/s N Limited (AY 2015) Irregular availment of depreciation on amalgamation. (11) M/s N Limited (AY 2017) Difference in figures as per DGIT (Systems) vis-a-vis actual data.	
8	M/s AJ Pvt. Ltd. AY 2011 Pr.CIT- 2, RAIPUR	1- Shri SJ1 2- Ku. AJ 3- Ku. NJ 4- Ku. PJ1 5- Ku. PJ2. 6- Ku. PJ3 7- Ku. SJ2 8- Mst. BJ 9- Mst.RJ 10- Mst. SJ3 11- Mst. SJ4 12- RJ 13- BT 14- BJ 15- SJ1 (HUF) 16- Smt. DJ1 17- Smt. SJ5 18- Smt. UJ.		Nil	Due to non-availability of PAN, the jurisdictional assessment charge of the related parties could not be identified and records could not be requisitioned.
9	AS (Prop. VS) AY 2018-19 Order u/s 143(3) dated 17/07/2015 PCIT 1 Jabalpur	(1) M/s VP (2)M/s NT	Records not furnished in respect of 2 related parties: (1) ITR, sale details of the Firm M/s VP, (2) ITR and confirmation of NT	Nil	Nil
10	M/s KJ Pvt Ltd AYs 2013-14 2014-15 2015-16 2016-17 Pr.CIT, Thrissur	(i) M/s KG AY 2013-14, Order u/s 143(3) dated 28/01/2016; AY 2014-15, Order u/s 143(3) dated 23/12/2016 &	Nil	Income not assessed involving tax effect of ₹ 7.77 lakh.	Nil

Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
		AY 2015-16, Order u/s 143(3) dated 25/12/2018. (ii) Shri TS AY 2015-16, Order u/s 143(3) dated 20/12/2017 & AY 2016-17, Order u/s 143(3) dated 12/12/2018 (iii) Shri TK1 AY 2015-16, Order u/s 143(3) dated 27/12/2017 & AY 2016-17, Order u/s 143(3) dated 27/12/2018 (iv) Smt TK2 AY 2015-16, Order u/s 143(3) dated 29/12/2017 & AY 2016-17, Order u/s 143(3) dated 27/12/2018 (v) M/s SA1 AY 2014-15, Order u/s 143(3) dated 28/09/2017			
11	M/s MI AY 2013-14 PCIT 11, Kolkata	(1) KD1 (2) KD2 (3) RD2 (4) AD1 (5) DD (6) AD2 (7) MD (8) M/s MS Pvt. Ltd (9) M/s MJ (10) M/s IR Pvt. Ltd.	Nil	Mismatch in repayment of unsecured loan to Modern Solaurum Pvt. Ltd.	The details of assessment (order section and date) of 10 related parties were not available.
12	M/s NC AY 2013-14 PCIT 2, Kolkata	LB	Nil	Mismatch in payment of Director's remuneration	The details of assessment (order section and date) of one related party were not available.
13	M/s DF AYs 2013-14, 2014-15, 2015-16, 2016-17,	1. M/s SM Pvt Ltd., AY 2015-16, Order u/s 143(3), dated 06/10/2017 &	Nil	Nil	Only interest and rent charges were paid to these related

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Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
	2017-18 & 2018-19 PCIT-22 Mumbai	AY 2014-15, Order u/s 143(3), dated 30/11.2016. 2.M/s SP Pvt. Ltd.			parties and records of M/s SM Pvt. Ltd. were examined to cross verify the rent expenses. Further, purchases and sales were mainly made through imports and exports from overseas parties which were disclosed by assessee as non related parties.
14	M/s AT Private Ltd. AY 2015-16 Order u/s 143(1) dated 29/09/2015 PCIT-1 Bangalore	Nil	Nil	Nil	Nil
15	AR AY 2015-16, PCIT 9, Kolkata	(1) AR (HUF), (2) LR, (3) PR, (4) SR	Nil	Nil	The assessment details (order section and date) of related parties were not available.
16	M/s LJ AY 2015-16 Pr.CIT-1, Bhubaneswar	1. M/s LB Ltd. 2. M/s UH Ltd. 3. SJ1 4. AH1 5. SH 6. AH2 7. M/s AJ Ltd. 8. M/s CN Pvt. Ltd. 9. M/s IJ Pvt. Ltd. 10. M/s SJ Ltd. 11. M/s UD Pvt. Ltd. 12. M/s OG	Nil	Nil	The assessment details (order section and date) of related parties were not available.

Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
		13. M/s SG Ltd. 14. M/s DJ 15. SU			
17	M/s DJ AY 2016-17 Pr.CIT-1, Bhubaneswar	1. M/s MJ 2. M/s RS	Nil	Nil	The assessment details (order section and date) of related parties were not available.
18	M/s EJ Pvt. Ltd. AY 2015-16 Pr.CIT-1, Bhubaneswar	1. NN 2. ER 3. EK 4. M/s DF Ltd.		Nil	The assessment details (order section and date) of related parties were not available.
19	M/s MA1 AY 2013-14	1. RG1 2. UD 3. AG 4. SG 5. RG2 6. NG 7. MG (Order u/s 143(1), AY 2013-14)	Nil	Nil	
20	M/s MA1 AY 2014-15	1. VG 2. SG 3. UD 4. RG3 (Order u/s 143(1), AY 2014-15)	Nil	Nil	
21	M/s SD Pvt. Ltd., AYs 2012-13, 2015-16 and 2016-17 Order u/s 143(1) PCIT/CIT 6, Chennai	(1) MD (2) ND (3) M/s SH Pvt Ltd (4) M/s SN Pvt Ltd. (5) PC	Nil	Nil	
22	M/s GJ Private Limited AY 2014-2015, 2015-16 and 2016-17 PCIT / CIT (Central) 1, Chennai	(1) M/s GR1 - Firm, (2) GR2 (3) GR2 (HUF) (4) GR3 (5) GR3 (HUF) (6) GR4 (HUF) (7) M/s GR5 Pvt Ltd. (8) PS (9) RM (10) RV	Nil	Nil	

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Sl. No.	Details of Main Assessee	Details of Related Parties	List of records/ documents not furnished in respect of Related Parties	Nature of Audit Observation	Remarks
23	M/s VJ AYs 2015-16; 2016-17 & 2017-18 Ward Parwanoo	1. NV 2. SV 3. PV 4. NV, HUF 5. AV	Nil	Nil	
24	M/s SJ Central Circle-1 Chandigarh	1.AK 2.CS 3. SR 4 GK 5 KK 6.HS 7.DS 8. GK2 9. GD	Nil	Nil	
25	M/s KD Private Limited DCIT Central Circle 2, Jaipur	(1) M/s KD1 Pvt. Ltd. (2) SG1 (3) M/s PI Pvt. Ltd. (4) M/s NG Pvt. Ltd. (5) M/s KD2 Pvt. Ltd. (6) MK (7) M/s KG1 Pvt. Ltd. (8) NK HUF (9) M/s UD Pvt. Ltd. (10) M/s KH Pvt. Ltd. (11) M/s AI Pvt. Ltd. (12) NK2 (13) SK2 (14) M/s KG2 Pvt. Ltd. (15) M/s KD2 Ltd.	No records furnished in respect of KI (P) Ltd.	Loan taken from main assessee as shown in 3CD of related party viz M/s KD Pvt. Ltd. in AY 2013-14, but the same was not found in the books of account of the main assessee.	Cases of following 12 related parties were transferred to Ward 12(3)(1), Mumbai: (1) M/s KD Pvt. Ltd. (2) M/s SG1 (3) M/s PI Pvt. Ltd. (4) M/s NG Pvt. Ltd. (5) M/s KD2 Pvt. Ltd. (6) MK (7) NK HUF (8) M/s UD Pvt. Ltd. (9) M/s KH Pvt. Ltd. (10) M/s AI Pvt. Ltd. (11) NK2 (12) SK2

Annexure I

(Refer Para No. 5.2.1)

List of Non-filers during AY 2016-17 to AY 2019-20

List of assesseees those who did not file ITRs during all four AYs			
Sl. No.	Name of assessee	AY	PCIT Charge
1	M/s BB Private Limited	2008, 2009, 2013	PCIT-5 Mumbai
2	M/s CD Limited	2009, 2012, 2013, 2014	PCIT-5 Mumbai
3	M/s G2 Ltd.	2013, 2014, 2015	PCIT (Central)-1 Mumbai
4	M/s SD Pvt. Ltd.	2015	PCIT-5 Mumbai
5	M/s SG2	2011, 2012, 2013, 2014	PCIT (Central)-1 Mumbai
6	M/s A Limited	2011, 2013, 2014, 2015	PCIT (Central)-1 Mumbai
7	M/s GS Pvt. Ltd.	2013	PCIT -12 Mumbai
8	M/s TL Pvt. Ltd.	2013	PCIT -11 Mumbai
9	M/s SJ2 Ltd.	2013, 2014	PCIT (Central)-1 Mumbai
10	M/s SK Private Limited	2015	PCIT-4 Ahmedabad
11	SJ1	2018	PCIT, Ghaziabad
12	M/s SI2	2014	PCIT-3 Surat
13	M/s RB	2015	PCIT-2 Raipur
14	M/s SJ3 Private Limited	2015	PCIT-5 Mumbai
15	JG	2014	PCIT-7 Bangalore
16	RG	2014	PCIT-6 Ahmedabad
17	BK	2015	PCIT Thrissur
18	AS	2014	PCIT Allahabad
19	DS	2014	PCIT-2 Surat

Annexure J

(Refer Para No.5.8.1)

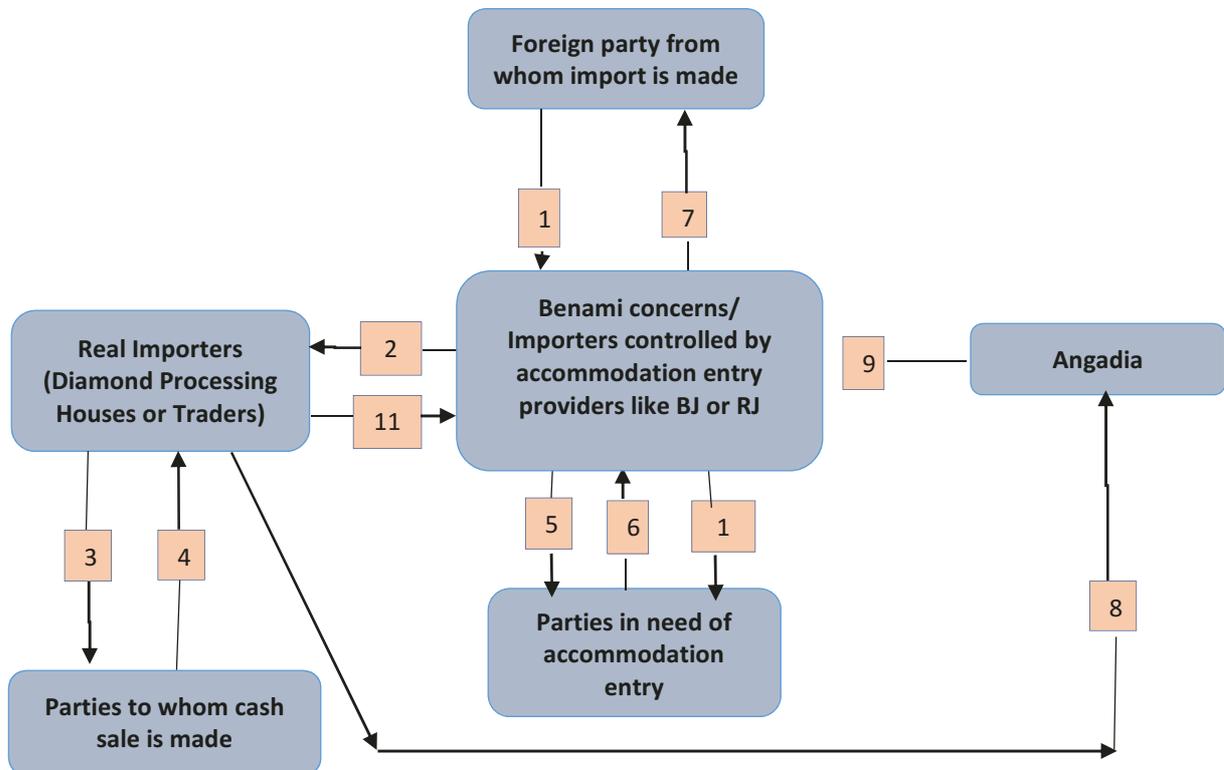
Table: Low Expenses vis-à-vis Annual Turnover

(₹ in lakh)

Sl. No.	Name of Assessee	AY	PCIT Charge	Gross Turnover	Power and fuel (electricity)	Rent	Employee/labour	Other expenses
1	M/s NM	2018	PCIT 16, DELHI	578.36	0.23	0.00	6.58	3.80
2	M/s GT	2018	PCIT 10, DELHI	2,207.40	0.24	0.62	2.36	3.10
3	M/s KJ	2018	PCIT 17, DELHI	2,910.52	0.07	0.58	5.54	0.78
4	GD	2018	PCIT 17, DELHI	4,140.13	0.17	0.00	14.58	123.01
5	BY	2018	PCIT 16, DELHI	13,097.55	0.00	0.60	2.35	1.55
6	M/s ST	2018	PCIT 17, DELHI	1,334.04	0.24	0.99	2.16	3.31
7	MJ	2018	PCIT 16, DELHI	49,678.90	0.85	9.00	5.20	22.47
8	M/s KJ LLP	2017	PCIT 16, DELHI	2,318.14	1.29	0.00	14.71	2.47
9	M/s RG Pvt. Ltd.	2015	PCIT 7, DELHI	2,173.51	0.00	0.00	5.60	1.14
10	M/s JE	2018	CIT CENTRAL 1, DELHI	8,169.74	0.69	10.10	17.59	2.49
11	M/s DF	2013	PCIT 22, Mumbai	4,44,930.90	0.99	0.96	63.84	17,442.80
12	M/s DF	2014	PCIT 22, Mumbai	1,89,663.30	1.26	10.12	1.12	19,760.18
13	M/s DF	2015	PCIT 22, Mumbai	2,15,718.32	4.58	4.58	255.34	3110.15
14	M/s DF	2016	PCIT 22, Mumbai	2,88,276.87	4.67	4.67	287.08	711.91
15	M/s AG Pvt. Ltd.	2013	Pr.CIT-4, MUMBAI	3,68,601.78	15.87	0.00	21.54	2.34
	Total			15,93,799.46	31.15	42.22	705.59	41,191.5

Annexure K

(Refer Para No. 6.1.2)

Modus operandi of Accommodation Entry providers

1. Diamond import by benami importers (name lending concerns) on behalf of real importer.
2. Diamonds handed over to real importer by the Benami importer after clearance by the Customs, without recording sales in the Books of Account.
3. Sale of imported diamonds by real importer in cash to various parties.
4. Payment of cash to real importers.
5. Issue of bogus bills/ accommodation entries to various parties to show purchase against their cash sale.
6. Issue of cheque/ RTGS by the parties getting accommodation entries.
7. RTGS/ cheque payment made to foreign party.
8. Cash generated by real importer on sale of imported diamonds given to Angadia to make payment to accommodation entry provider.
9. Angadia make payment to accommodation entry provider.
10. Accommodation entry provider returns cash to the parties who took accommodation entries.
11. Real importer pays commission of 0.10 to 0.20 per cent of the import turnover to accommodation entry provider.

Glossary

ACIT	Assistant Commissioner of Income Tax
Act	Income Tax Act, 1961
Addl. CIT	Additional Commissioner of Income Tax
AE	Associated Enterprises
AIRs	Annual Information Returns
ALP	Arm's Length Price
AO	Assessing Officer
AST	Assessment Information System
AY	Assessment Year
CASS	Computer Assisted Scrutiny Selection
CBDT	Central Board of Direct Tax
CBEC	Central Board of Excise and Customs
CCIT	Chief Commissioner of Income Tax
CIT	Commissioner of Income Tax
CIT (A)	Commissioner of Income Tax (Appeal)
CPC	Central Processing Centre, Bengaluru
DC (CC)	Deputy Commissioner (Central Circle)
DCIT	Deputy Commissioner of Income Tax
D&CR	Demand and Collection Register
DIT	Directorate of Income Tax
DGIT (Systems)	Director General of Income Tax (Systems)
DOR	Department of Revenue
FMV	Fair Market Value
FY	Financial Year
GDP	Gross Domestic Product
ICAI	Institute of Chartered Accounts of India
ITAT	Income Tax Appellate Tribunal
ITBA	Income Tax Business Application
ITD	Income Tax Department
ITO	Income Tax Officer
ITRs	Income Tax Returns
MAT	Minimum Alternate Tax
NMS	Non-filers Monitoring System

PA	Performance Audit
PAN	Permanent Account Number
PCCIT	Principal Chief Commissioner of Income Tax
Pr. CIT	Principal Commissioner of Income Tax
RBI	Reserve Bank of India
Rules	Income Tax Rules, 1962
SOP	Standard Operating Procedures–Defining operation Procedures
TAR	Tax Audit Report
TDS	Tax Deducted at Source
TP	Transfer Pricing
TPO	Transfer Pricing Officer
WDV	Written Down Value

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