

Chapter 1

Introduction

Any income which has not been taken into consideration for the purpose of calculation of Income-tax is known as undisclosed income. It is known as black money - the money for which tax has not been paid; the money which the owner wants to hide.

For example, Mr. "A" earns from his business Rs. 25,00,000 in real terms and he pays tax for an amount of Rs. 15,00,000 and to that extent, he files his income-tax returns and in this case, the undisclosed income is Rs. 10,00,000.

"Unaccounted Income is the income from those economic activities that circumvent or otherwise avoid government regulation and taxation."

Sectors Vulnerable to Unaccounted Income

There are some sectors in the economy that are more vulnerable to unaccounted income as a large proportion of it is generated and invested in these sectors. The sectors where unaccounted income is found to be highest included real estate, mining, pan masala, gutkha and tobacco industry, bullion and commodity markets, film industry, educational institutes and professionals. The other sectors, namely securities market and manufacturing also showed high incidence of unaccounted income.

(1) Unaccounted Money in the Urban Real Estate Sector

The real estate market in India, at present is widely known and acknowledged as extremely inefficient and opaque. There is easy absorption and generation of black money in this sector.

Land allotment/purchase of land in auction from the government is the initial activity in the sector that gives rise to confusion and corruption. Conversion of land use is another issue where discretion is exercised. After acquisition of land, the builder has to decide the nature of construction and also to seek various permissions and licenses from government agencies. The generation of unaccounted money in the building construction can also be attributed to flexible interpretation of Floor Space Index (FSI), sharp accountancy practices using percentage of completion method for revenue recognition, inflation of expenses and extracting wrong tax concessions.

The search and survey action on brokers and builders conducted by the Income Tax Department gave an idea about the market prices of the property. It was observed in many cases that the value adopted by the

stamp valuation authority in form of circle rates is much lesser than the fair market value of the properties on the date of transfer. Large disparities and variations have been noted in different parts of the country.

A group of Pune engaged in business of executing civil contracts was searched by Income Tax Authorities. During the search operation, it was found that the group was inflating expenses under the head "Site Expenses" by preparing non-genuine cash vouchers. It was also found that the group was investing the unaccounted income generated through this *modus operandi* in purchasing assets such as land, TDR (Transfer of development rights) etc. The undisclosed additional income of Rs. 2 crores were admitted during search for the Financial years 2006-07 & 2007-08.

During the search on a Mumbai based group engaged in the business of real estate development, it was found that the assessee was maintaining its financial accounts in two accounting softwares, namely ERP (SAP) and "TALLY". The ERP software contained the genuine purchases of materials made by the assessee-company. The "TALLY" software contained the combined records of genuine purchases as well as the bogus purchases. It was found that the assessee had debited non-genuine purchases of Rs. 361 Cr. in its books. Further evidences showing unaccounted cash receipts from the sale of flats amounting to Rs. 39.62 Cr. and undisclosed sale of scrap materials of Rs. 7.69 Cr. were found and seized. The company declared an undisclosed income of Rs. 350 Cr. and paid tax of Rs. 40 Cr. so far on the undisclosed income admitted.

(2) Unaccounted income in the Manufacturing sector

The major evasion prone industries are Iron & Steel, Gulkha/Pan Masala, Khaini, Bidi, Copper and articles thereof, Cement and pharmaceuticals. Further, the manufacturing units availing area based exemption notifications were also found to be prone to evasion.

The Indian Manufacturing industry is broadly divided into: Capital Goods & Engineering, Chemicals, Petroleum, Chemicals & Fertilizers, Packaging, Consumer Non-durables, Electronics, IT Hardware & peripherals, Leather & Leather Products, Steel & Non-Ferrous Metals, Textiles & Apparels and Tobacco.

Over claiming business expenses (failure to report accurately) may be the non-compliant behaviour that is observed and that needs to be addressed.

Non-filing of tax returns; not declaring income/under-reporting income; and the over-claiming of expenses by businesses and corporations, trade mispricing false claiming of tax exemptions and deductions were rated high on the gravity scale by the respondents, wrong claim of exemption u/s 10A of the Income Tax Act, 1961. Misuse of SSI Exemption, Large

scale manipulation in prices, to evade the customs duties was also observed as a method for generation of unaccounted money.

(3) Unaccounted Income in the Indian Securities Markets

The findings and observations gathered during the search and survey pointed apparently to an array of methods for converting unaccounted income into accounted income in the securities market with the different techniques customized to varied situations and needs of the individual/corporates/firm etc. Arranging for hawala loans, buying book entries and admission of share premium is the most common method utilized for conversion of black money into white money.

As per the search and survey results, Benami transactions, getting gifts from abroad and bogus long-term capital gains are also utilized invariably for conversion of unaccounted income. As long-term capital gains of shares sold through recognized Stock Exchange on payment of Securities Transaction Tax (STT) are not subjected to tax, many a times business income is disguised as capital gains to take advantage of the wide gap in tax rate between the long-term capital gains and business profit. Another active method of tax avoidance is through Mauritius Route. Foreign portfolio investors and other categories of investors have to pay a short-term capital gains tax of 10% in India if they sell shares within an year of purchase. They are, however, exempt from paying long-term capital gains tax as local investors if they sell the shares after one year of purchase. But by routing their investments from Mauritius, foreign portfolio investors do not have to pay even the short-term capital gains tax by virtue of Indo-Mauritius tax treaty.

(4) Unaccounted income in the Indian Diamond Industry

Common methods of generation of unaccounted income:

Experience of tax officials as found through survey reveals that the most common methods of suppression of profits and generation of unaccounted income in this trade include:

(i) SUPPRESSION OF THE VALUE OF STOCK AND STOCK MANIPULATION

Rough diamonds of lower quality are purchased in the local market abroad and imported into India. When these diamonds reach India, these are shown to be against the invoices from the Diamond Trading Company (DTC), but actual stock may not be of the quality shown in these invoices. Sometimes actual exporters also manipulate the valuation of stock of diamonds by taking bills from bill providers in view of the fact that stock of diamonds cannot be maintained quality-wise.

It was held that assessee's method of valuation of closing stock of polished diamonds on the basis of net realizable value is not correct. Assessing Officer took a view that valuation so made was without any basis and, thus, rejected assessee's books of account and thereafter, Assessing Officer valued closing stock at average cost and made certain addition to assessee's income. Hon'ble ITAT while confirming the addition made by the Assessing Officer held that even though net realizable value method is duly recognized by AS-2, yet onus shown by him is correct value and is less than cost.—[*Dr. Subhashchandra & Co. v. ACIT (2010) 123 ITD 635 (ITAT Ahmedabad)*]

(ii) UNDERSTATEMENT OF YIELD

This is another common method of suppression of production. Yield depends upon the quality and size of the rough diamonds. The average yield generally ranges between 25% and 40%. An understatement of yield by even 2% to 3% can make a big difference in suppression of income.

(iii) INFLATION OF LABOUR EXPENSES

The manufacturing of the diamond is done at the factory site and the labourers are generally paid in cash. Such payments in cash to labourers or job work contractors are sometimes not shown in the regular books of accounts and are shown only when payments are received through banking channels which have to be recorded in books of accounts. The head office sends bank drafts. The bank drafts are deposited in the bank account, and simultaneously cheques are prepared in the names of job work contractors which are deposited in the bank account of the job contractors and cash is withdrawn from their bank account. Cash so withdrawn, is again sent to the head office, through the 'angadias' or otherwise.

(iv) OVER-STATEMENT OF REJECTION OR WASTAGE

Only the trader has the knowledge of wastage in polishing and so he decides how much rejection is to be shown in the regular books of accounts. The tax authorities do not have any basis to determine or estimate it. It can range from 2-3% to 50% of the total rough diamonds imported. The so-called rejection is sold in the local market at higher rate in view of the fact that these are not rejection but actual rough diamonds. In these transactions, the entire sale consideration is trader's profit earned outside the books of accounts, as he has already debited purchase value of such stock. Rejection is claimed to be of no commercial use or value, it is shown as re-export, and the documents relating to re-export are obtained in support of the claim.

(v) **BOGUS PURCHASES THROUGH ACCOMMODATION BILLS**

The Indian sight holders procure rough diamonds from their companies sometimes based in Belgium. These sight holders sometimes sell in local market either in Belgium or in India and get premium on rough diamond. These are then exported to India via the hawala route through bill providers. The bill providers mainly operating from Kolkata comply with all the formalities i.e. RBI and claim that they are genuine importers. The person who takes the goods from bill providers sells it in local market unofficially and settlement of payment takes place through Angadia (parallel banking system). Rough diamonds circulating in the market get converted into polished diamonds and on conversion are again sold in local market unofficially and thus result in generation of unaccounted income and wealth. Actual exporters also buy polished diamonds from such people unofficially, however bills for such purchases are taken from bill providers who have imported the rough diamonds at first instance. The bill providers, convert rough diamonds imported in books as polished diamonds through dubious means by fudging their accounts. The bill providers charge commission (around 0.10% to 0.20% of turnover) for facilitating such transaction for diamond exporters/importers.

(vi) **UNACCOUNTED TRADING**

The diamonds sold by the DTC through sight system are of better quality and there is always a huge demand in the open market for such diamonds. The sight holder sells entire or part of the diamonds purchased from sight in the open market, and earns profit on such transactions which are not recorded in regular books of accounts. Such profit is brought into India with the help of sister concerns having offices outside India.

On the basis of information received, two passengers carrying jewellery worth Rs. 1.27 Cr. from Ahmedabad to Mumbai were intercepted by the AIU, Mumbai on 10.10.2009. In their statements, they could not offer any satisfactory explanation regarding source of the said jewellery. Accordingly, a survey was conducted on the business premises of the Jewellery Company which led to detection of certain incriminating documents in the form of Jangads for unaccounted diamonds worth Rs. 8.81 Cr. The jewellery was also not recorded in the books of the Jewellers and it had claimed to have purchased the said jewellery from a jeweller in Bhavnagar. Accordingly, the AIU, Ahmedabad was requested to verify the facts. The Bhavnagar jeweller however denied the delivery of such

jewellery. When this fact was confronted to the Director of the jewellery company, he could not offer any satisfactory explanation and admitted undisclosed income of Rs. 10.08 Cr for Financial year 2009-10.

AIU, Mumbai intercepted a passenger who was carrying Diamond Jewellery worth INR 85 lacs. When questioned, he could not produce the transfer vouchers and also failed to explain satisfactorily the source of the same. Accordingly, a survey action was carried out on the business premises of the company engaged in the business of manufacturing and sales of diamond studded gold jewellery which led to detection of unaccounted stock of Rs. 8.56 Cr.

(vii) FAMILY CONTROLLED

The diamond trading business is generally controlled by a very close group of blood relations. Almost 90% trade is in the hands of a group of businessmen reportedly from Palitana and the balance 10% is in the hands of Kathiawadis and some other trading. This facilitates close group operations and transaction in the manner the trader's desire. Money is retained in India or abroad at their sweet will, by way of under or over-invoicing of imports and exports which is managed through imports of rough diamonds or export of finished diamonds.

In the case of *CIT v. Shatrunjay Diamonds (2003) 128 Taxman 759 (Bom)*, the assessee had imported diamonds from a sister concern in New York and on comparison of prices of diamonds imported, the Assessing Officer found that the diamonds are excessively priced, the Assessing Officer made disallowances under section 40A(2)(b) of the Act. On appeal, in view of the entities not being at arm's length, the High Court upheld the order of the Assessing Officer.

(viii) DABBA SYSTEM

It has been observed that most of the transactions in this sector go unreported which make the sector all the more vulnerable. More law enforcement measures are required to be devoted to curb abuses in the diamond trade. Coordination between Income Tax and the Customs Department may also facilitate better monitoring of in case of evasion by unaccounted trading and accommodation bills. Where high value rough diamonds are purchased and still a higher rejection is being claimed, verification of physical stock of rejection with reference to what is shown in books is also suggested.

The two major segments of the gems and jewellery business in India are jewellery fabrication and diamond processing in form of

cut and polished diamonds (CPDs). A predominant portion of rough, uncut diamonds processed in India are exported either in the form of polished diamonds or in the form of finished diamond jewellery. Gold jewellery fabrication comprises 29.86% of the total gem and jewellery export basket while Cut & Polished Diamonds (CPDs) have a bigger share of around 65.49%.

The diamond industry has registered a remarkable growth over the last four decades. India has the distinction of being one of the first countries to introduce diamonds to the world and also one of the first countries to mine, cut & polish, and trade in diamonds. India is the leading diamond cutting nation in the world.

Some of the major vulnerabilities of diamond industry noticed are as under:

- ❖ Valuation of a diamond is an art and not a science. It cannot be valued based on average or weighted average of past purchases since qualities of all purchases are different unlike other metal or commodity where particular type of quality is only manufactured or dealt within. Typically value of any particular diamond is based on the following 4Cs (Caratage, Colour, Clarity and Cut), by changing any of the characteristics, value is affected disproportionately, other factors being equal.
- ❖ Maintenance of stock details/register of diamonds based on quality or number of pieces is impracticable since there are large variations in quality. The practice in the industry has been to maintain stock on caratage basis. This leads to lot of subjectivity in stock valuation and there is a scope for huge manipulation.
- ❖ Diamonds have a high intrinsic value and have a compact size. This makes it as an attractive vehicle for money laundering world-wide. The ease with which the diamonds can be hidden and transported and its high value makes it further vulnerable for money laundering.

Modus operandi

Some brief description of the *modus operandi* in the various methods is as under:

(i) Arranging of Hawala Loans

Hawala is a method used to round trip the unaccounted money to India. The money transferred outside may come back to India through various methods such as investments in Indian stock markets through participatory notes, raising of capital through foreign direct investment (FDI) especially from beneficial tax jurisdictions and by Indian companies raising capital through Global Depository Receipts (GDRs).

(ii) Participatory Note (P-notes)

Investment in the Indian Stock Market through PNs is another way in which the black money generated by Indians is re-invested in India. These instruments are traded overseas outside the direct purview of SEBI surveillance thereby raising many apprehensions about the beneficial ownership and the nature of funds invested in these instruments. Participatory Notes also aid in reducing the tax liability of the FIIs. The FII is subject to capital gains tax in India if he sells the shares and makes a profit from the sale of such shares. However, when the FII issues a PN to a hedge fund or other institutional buyers, the P-Note holder is not subjected to Indian tax because the situs (issuance) of the P Note is not in India.

Participatory Note is a derivative instrument issued in foreign jurisdictions, by a Foreign Institutional Investor (FII) or its sub-accounts against underlying Indian securities. PNs are popular among foreign investors since they allow these investors to earn returns on investment in the Indian market without undergoing the significant cost and time implications of directly investing in India.

(iii) Admission of share application, share capital and share premium

This practice is very commonly employed in case of unquoted shares to convert black money into white money. The private limited companies either issue shares at a very high premium or book share application money. The idle share application or share premium money is just like an unsecured loan but without interest.

Investigation case

On the basis of information received from FIU, search was conducted by the Mumbai directorate in four related cases. After discreet enquiries large networking of entry providers was unearthed. It was found that persons of one group were running more than 36 companies which were being used for providing bogus entries relating to share capital, Long Term capital gain, Short Term capital gain, gifts, sale and purchase bills etc. The transaction appeared to be genuinely conducted on stock exchanges. However, during enquiries it was accepted by the persons involved that none of the transactions had taken place on Stock Exchange. More than 24 agents all over India were using more than 300 bank accounts for the purpose. The estimated concealment of income on account of these transactions was likely to be around Rs. 1000 crores.

(iv) Benami Transactions

Benami transaction is one where an asset is transferred or purchased in the name of one person but another person has paid consideration of transfer. Such transactions help to a large extent safe investment of black money.

(v) Bogus long-term capital gains

As long-term capital gains of shares sold through recognized Stock Exchange on payment of Securities Transaction Tax (STT) are not subjected to tax, many a times business income is disguised as capital gains to take advantage of the wide gap in tax rate between the long-term capital gains and business profit. As per the experience of the tax experts the rate for giving bogus LTCG in the grey market is approximately 5%.

The “White Paper on Black Money” presented in the Parliament on 16.05.2012 was, *inter alia*, concerned with the laundering of unaccounted money by taking advantage of basic exemption limit. The above stated position of taxing income of the nature referred to in the specified sections at the normal rate/applicable rate of income-tax applicable on total income of the assessee has been changed w.e.f. 01.04.2013 by the Finance Act, 2012 as a result of introduction of section 115BBE dealing with a special rate of tax applicable to income of the nature referred to in sections 68, 69, 69A, 69B, 69C and 69D.

Speech of FM and Explanatory Memorandum for introduction of section 115BBE

The Finance Minister, in his speech, while introducing the Finance Bill, 2012 on 16.03.2012, said: “I propose a series of measures to deter the generation and use of unaccounted money. To this end, I proposeTaxation of unexplained money, credits, investments, expenditures, etc., at the highest rate of 30 per cent irrespective of the slab of income”.

If the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc., the source for which is not satisfactorily explained by the assessee to him, there are various provisions in the Income Tax Act which empower the assessing officer to charge tax on such amount.

Comparison between section 68, section 69, section 69A, section 69B and section 69C:—

Particulars	Section 68	Section 69	Section 69A	Section 69B	Section 69C
Plain reading	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	Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of	Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion,	Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing	Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation,

	source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.	account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year	jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.	Officer finds that the Amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.	if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year: Provided that, notwithstanding anything contained in any other provision of this Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.
Maintenance of Books of Accounts	Compulsory	Not Compulsory as the word "if any" is used	Not Compulsory as the word "if any" is used.	Compulsory	Not Compulsory
Explanation to Assessing Officer	Assessing Officer can ask for explanation only when the sum is credited in the Books of Accounts.	Assessing Officer can ask for explanation only if investment is not recorded in the Books of Accounts.	Assessing Officer can ask for explanation only if money, bullion, jewellery or any other valuable article	Assessing Officer can ask for explanation only if the investment, money, bullion, jewellery or any other valuable article is	Assessing Officer can ask for the source of "incurred expenditure".

			is not recorded in the Books of Accounts.	recorded in the Books of Accounts and the value recorded is less than the amount spent in acquiring.	
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Overview of Sections 68, 69, 69A, 69B, 69C and 69D

<i>Sr. No.</i>	<i>Section</i>	<i>Nature of addition</i>	<i>What can be taxed</i>	<i>Year in which taxable</i>
1.	68	Unexplained Cash credits	(a) Unexplained loans (b) Unexplained Gifts, received (from residents as well as from non-residents) (c) Share Capital including share application money, share premium, etc.	Previous year in which amount credited in books of account
2.	69	Unexplained investments	Unexplained investments not recorded in books of account maintained	Previous year in which amount invested
3.	69A	Unexplained money, etc.	Unexplained money, bullion, jewellery or valuable article	Previous year in which assessee is found in possession of money, bullion, jewellery or valuable article
4.	69B	Amount of investments, etc. not fully disclosed in books of account	Investments, money, bullion, jewellery or other article not fully disclosed in books maintained	Previous year in which investment made or bullion, jewellery or other article is found in possession
5.	69C	Unexplained expenditure	Expenditure incurred out of unknown sources	The year in which expenditure is incurred
6.	69D	Amount borrowed or repaid on hundi	Amount borrowed or repaid otherwise than by an account payee cheque	Amount borrowed or repaid otherwise than by an account payee cheque. If addition is made of amount borrowed, same amount cannot be added when repaid (Refer CBDT's Circular No. 204, dated 24.07.1976)