

Smugness over pace & direction of Fiscal Reforms not good for growth

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SMUGNESS

has become the hallmark of fiscal governance. At the risk of sounding cynical, we can draw this conclusion after reading reports from Comptroller and Auditor General (CAG), Parliament Standing Committees and other similar entities.

Take the case of CAG's 'Performance Audit on Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof, imitation jewellery and coin' released on 29th April 2016.

The report shows the smugness with which the Government continues to deal with tax revenue leakages, foreign exchange wastage, under and over invoicing, round-tripping of imports & exports and money laundering in the diamond & jewellery business.

What has pained CAG is the Government has not implemented its recommendations made several years. Undeterred by such non-compliance, CAG has proposed a new set of initiatives to put regulation of Gem & Jewellery (G&J) on a sound footing.

Before taking up CAG's suggestions, we should recall its few observations to drive home the urgency for Government to shed inertia.

According to CAG,

"G&J sector was last audited in 2008 however most of the improvements recommended by audit were not achieved. Lack of an impact assessment of the scheme prior to its implementation and an outcome assessment after implementation, or on exit, rendered the policies ineffective due to insufficient coordination, control and monitoring; cases of operational malfunction, non compliance; inadequate ICT infrastructure for tax administrations, border control, facilities and certification."

The Report has identified revenue implication of Rs 1,003.37 crore. This is in addition to **"systemic issues"** worth Rs 19,522.67 crore.

The Report has cited several specific instances of laxities in enforcement of policy norms and oversight of scheme violations in G&J, which has enjoyed numerous incentives over a long period. No credible justification has been provided by Government for inaction.

Analyzing the working of Advance Authorization Scheme (AAS), CAG concluded that when Net Foreign Exchange (NFE) realized is less than the duty forgone, it has a direct impact on the fiscal management. It added:

"Very low value addition did not help in generating economic activity in the sector and induced inflated trade data, opening up the window for round tripping."

Comparing duty foregone on import of gold bar/silver bar in five cases with respect to NFE earned by exporters under AAS, CAG observed that to support earning of each USD 1, government sacrificed customs duty in range of Rs 56.67 to Rs 221.75. This value was higher than the exchange rate of USD in the open market during the period.

The Report notes that

"gaps in the valuation database management and Customs electronic data application allowed gradual increase in trade mis-invoicing over the period leading to foreign exchange/capital outflow."

The analysis of G&J trade flows between India, UAE and three other countries indicates repeated transactions between each of the four products (gold, diamond, cut and polished diamond and jewellery); cases of related party transactions, inverted duty structure and re-export.

CAG says:

"Evidently, trade with UAE involving re-export did not create major economic activity while inflating the total value of the trade. It necessitated a detailed examination to distinguish imports and exports tied to the real economy through value addition and creation of economic growth, rather than from the re-exports simply passing through the trade accounting and bank financing channels."

Referring to 'Global illicit Financial Flows Report: 2015', CAG observes:

"The difference between the transaction wise valuation of trade between India and its exporting/importing partners indicated that India ranked 4th in volume of illicit financial outflows in the world. This was almost USD 83 billion USD in 2013 and growing, akin to the last ten years trend. It is around 4.5 per cent of India's GDP (against global average of 4 per cent) and totally comprises of outflows due to trade mis-invoicing."

CAG has pertinently raised alarm at the risks posed by clubbing natural and synthetic diamonds under a single tariff classification category in January 2012. Clubbing has led to illicit and undisclosed mixing of manmade diamonds with natural diamonds.

CAG says:

"This also leaves scope for duping consumers and possible money laundering. Further, this threatens the consumer and trade confidence in Indian diamond industry. Hence a clear categorization specific to man - made diamonds is needed to enable specific tracking of synthetic diamonds."

The report says that DOC had made a similar proposal to Finance Ministry in its proposals for 2014-15 budget. In December 2015, CBEC stated that the issue is being examined. CAG has responded to the delay on this issue as:

"There is no revenue angle. The decision may be taken as soon as possible."

We hope the Government would also promptly act on CAG's other major recommendations. It has, for instance, proposed that DOC should undertake an outcome analysis of the important schemes implemented to boost G&J sector from an economic, trading and revenue perspective.

CAG has rightly pitched for careful review of all inverted duty structures, transaction costs, related-party transactions, re-export transactions, facilitation measures before designing an effective promotional scheme for G&J.

Another recommendation calls upon Central Board of Excise and Customs (CBEC) to maintain a robust and updated valuation data for all the tariff lines so that these could be shared with other concerned departments.

We whole-heartedly endorse CAG's call for effective coordination among DoR, CBEC, DoC and DGFT to facilitate

"a growth-led licit Gems and Jewellery trade" and to "avoid inflated export figures through mere trade accounting."

The Government should also factor in suggestions from Financial Action Task Force (FATF) and Egmont Group of Financial Intelligence Units.

In a joint report released in January 2014, these agencies had advised countries to subject diamond business to appropriate anti-money laundering (AML) and countering the financing of terrorism (CFT) safeguards and thus prevent tax evasion.

Reverting to subject of smugness, Parliamentary Standing Committee (PSC) on Finance has touched upon this issue in its report on Demand for Grants for 2016-17 for Department of Revenue (DOR).

PSC has expressed its disappointment over the fact that DOR has failed to act on its earlier recommendation to unveil a comprehensive road map for reviewing revenue forego.

Similarly, PSC has voiced its dismay over Finance Ministry's ***"casual approach"***

in stating that there is no merit in proceeding ahead with proposed Direct Taxes Code, 2010.

It has thus reiterated its earlier suggestion for DTC's adoption in its entirety to simplify and rationalize cumbersome tax regime.

Smugness in tax reforms would persist as long as the Executive would not give up its 'play safe' attitude and its love for 'slow and steady' approach.