

**REPORT OF THE
TASK GROUP FOR DIAMOND SECTOR
TO MAKE INDIA AN
“INTERNATIONAL TRADING HUB FOR ROUGH
DIAMONDS”**

**GOVERNMENT OF INDIA
MINISTRY OF COMMERCE AND INDUSTRY
DEPARTMENT OF COMMERCE
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FOREWORD

The diamond industry is currently facing a severe slump. The total export of cut and polished diamonds during the years 2011-12 and 2012-13 (April-December) witnessed a decline of 17% and 36% respectively. Our share in USA, which has traditionally been a major market for diamonds, has started declining. There have been reports that China is emerging as a major threat to Indian diamond industry through acquisition of mines in African countries which would be a major challenge to us. Dubai is also emerging as a global diamond trading centre. Sharing this concern and with a view to protect the genuine interest of diamond industry, the Department of Commerce constituted a Task Group for the Diamond Sector to suggest measures to increase the diamond trade and to make India an "International Trading Hub" for rough diamonds.

The Task Group held meetings on 16th and 30th January, 2013 and considered issues relating to trade facilitation, taxation and fiscal measures and promotional matters. The Task Group has made a number of recommendations for the growth of diamond sector which can be considered for implementation by the Government.

The Task Group is optimistic that these recommendations will help to achieve the ambitious targets set for the sector in the Strategy Paper prepared by the Department of Commerce to double the merchandise exports by 2013-14. The Task Group is convinced that creation of a conducive environment for the sector would enable it to achieve greater heights through exploitation of the available opportunities.

Enthusiastic participation of the members of the Task Force in the two meetings and their productive contribution is gratefully acknowledged. It is our fond hope that implementing these recommendations would facilitate India becoming a trading hub for rough diamond.



(Anup K. Pujari)

Director General of Foreign Trade and Chairman of Task Group

EXECUTIVE SUMMARY

The Indian Diamond Industry is currently going through a downturn phase. The total exports of cut and polished diamonds during FY 2011-12 and 2012-13 (Apr-Dec) witnessed decline of 17% and 36% respectively. USA is the major market for diamonds as exports to USA are pegged at US\$ 6.1 billion higher than that from Belgium and Israel. Though the diamond sales have bottomed out, the industry is expected to witness positive growth in festive months during October-December 2013. Our share in USA has started declining; the industry strongly believes that USA will continue to be a strong global trading partner.

Of lately, there have been reports that China, through governmental interactions and aids, is pushing through direct deals with the African governments for the supply of rough diamonds which would put it in a strong position to merge as a major diamond manufacturer in the world. Dubai has started strongly emerging as global diamond trading centre.

Sharing these concerns and to protect the genuine interest of the diamond industry, the Hon'ble Minister directed the Department of Commerce to constitute a Task Group for Diamond Sector to suggest measures to increase the diamond trade and to make India an International Trading Hub for Rough Diamonds

SYNOPSIS OF SUGGESTIONS

Legislation Related

- 1) While the industry would like a Presumptive Taxation regime in the long run, it would request the finance ministry to start by reducing the net profit rate for computation of Income Tax under the Benign Assessment Procedure (BAP) introduced in 2007-08, from 6.0% to 2.5% so that exporters are encouraged to opt for the same which is not the case now as the BAP has remained a scheme on paper only. Observing the interest of taxpayers, size of tax collection and compliance a Block Benign Taxation Regime may be introduced in future. This measure will be tax accretive with a realistic threshold rate.
- 2) Allow for duty free re-import quota for cut and polished diamonds to the tune of 15% of the previous 3 year's average exports
- 3) Establishment of Special Notified Zones (SNZ) for import and trading of rough diamonds, where net income is fixed and taxes are paid only on invoices raised to Indian companies
- 4) For the Diamond Sector, the system of Honorary Valuation Panels at ports of Surat and Mumbai for any valuation disputes, a mechanism which was operational well prior to Notification no 94/2007 and 95/2007 may be continued

with and accordingly added in such notifications for the Special Valuation Branch in case of valuation for diamonds.

- 5) Looking at the fact that India does not produce rough diamonds and almost 90-94% of the end product of cut and polished diamonds that are manufactured in India gets exported any indirect taxation on the sector will only result to export of taxes, the industry should be declared as zero-rated indirect tax regime and all duties collected in way of Service Tax, VAT or GST should be refunded by way of drawback at the rates computed by way of survey of actual exports.

Policy Related

- 6) Establish a special fund by RBI to the tune of USD 3-5 billion for the refinance of borrowing given to non-petroleum export industries, which have a high import content of more than 70% of their exports. In case of inability of the Govt. to provide such facility, such sectors should be allowed to arrange for ECB in foreign currency for their working capital requirements for purchase of raw material.
- 7) 2% interest subvention scheme should be extended for the entire gem & jewellery exporters as it was done in 2008-09.

Procedure Related

- 8) Reduce documentation requirements at Customs for exports from 23 to 12 documents as suggested and agreed during the previous task group formed for the industry in the year 2006.
- 9) Some other suggestions for streamlining the export procedural issues faced by the industry

Additional Measures

- 10) Policy for Beneficiation of Indian diamantaires for Diamonds Mined in India
- 11) Pursuing Free Trade Agreements with countries which are consumers of diamonds and diamond studded jewellery, but have prohibitive import duties on diamonds like Brazil and Russia
- 12) Govt. may establish a fund partnering with the industry for a) Generic promotion of diamonds and b) Promotion of Indian-made jewellery, in major consuming markets

- 13) Create a Rs 200 Crore Technological Upgradation Fund Scheme (TUFS) to enable small manufacturers of diamonds and diamond studded jewellery to gain access and equip themselves with latest manufacturing technologies.
- 14) Developing skills in the diamond sector in terms of:
 - a. Introduction of Diamond Appreciation and diamond cut-designing as a vocational course in CBSE and other schools from the 9th Standard. Gujarat will be a pilot state for this programme.
 - b. Launch a programme to upgrade the small diamond processing job-working units.
 - c. Undertake the task of preparing training manuals for all job functions at the entry level in the Diamond Processing Sub-sector.
- 15) For import, preforms of gemstones should be treated as rough gemstones

REPORT

Chapter One: Introduction

Background

Diamond comes from the Greek adamao, transliterated as “adamao”, “I tame”, “I subdue”. The adjective “adamas” was used to describe the hardest substance known, and eventually became synonymous with diamond. Knowledge of diamond and the origin of its many connotations start in India, where it was first mined. The word most generally used for diamond in Sanskrit is transliterated as “vajra”.

The earliest known reference to diamond is a Sanskrit manuscript, the Arthashastra by Kautilya. The “Ratnapariksha” for Buddha Bhatta is a 6th century treatise on gems. The manuscript summarizes India’s knowledge about diamond.

For 1,000 years, starting in roughly the 4th century BC, India was the only source of diamonds. World famous diamonds such as Koh-i-Noor, the Orlov, The Great Mogul, Sancy Hope, Florentine, Nassak, Regent, Pitti, Nizam etc were the products of India. In 1725, important sources were discovered in Brazil, and in the 1870s major finds in South Africa marked a dramatic increase in the diamond supply. Additional major producers now include Russia, Canada, Botswana, Australia, DR Congo, Ghana etc. Today diamonds are mined in more than 25 countries.

Geological processes create two basic types of diamond deposits, referred to as primary and secondary sources. Primary sources are the Kimberlites and lamproite pipes that raise diamonds from Earth’s mantle, where they originate. Secondary sources, created by erosion, include such deposits as surface scatterings around a pipe, concentrations in river channels and fluxes from rivers moved by wave action along ocean coasts, past and present.

The use of diamonds as gemstones of decorative value is the most familiar use to most people today. Since around 1900, experts in the field of gemology have developed methods of characterizing diamonds and other gemstones based on the characteristics most important to their value as gem.

Chapter Two: The Indian Scenario:

2.1 - Indian Gem & Jewellery Industry

India's gem and jewellery industry is a bright star of the economy, and one of the important foundations of the country's export-led growth. The Industry valued at US\$ 43 billion in the financial year 2011-12, is one of the leading growth sectors of India's export led economy and leading foreign exchange earner accounting for 14% of the total Indian exports during the last financial year.

2.2 - Indian Diamond Industry

Diamonds account for 54% of the total gem and jewellery export basket of the industry and India is world's leading exporter of Cut and Polished Diamonds. A major contributor to the creditable performance of the industry is the massive diamond manufacturing sector, which employs nearly one million people across the country. The industry has grown from its small origins in the 50s and has established itself as the world's largest manufacturing centre of cut and polished diamonds for the last many years, contributing 60% of the world's supply in terms of value, 85% in terms of volume and 92% in terms of pieces. Surat along with Navsari, Bhavnagar, Amreli are known as the diamond manufacturing/processing hub whereas Mumbai is the diamond trading hub.

India is the world leader in diamonds both in quantity and value terms. This pre-eminent position has been achieved through progressive liberalization of Government policies, entrepreneurships and skilled labour. India has achieved global leadership position, in the business of cutting and polishing diamonds also due to its price competitiveness and willingness to work for low margins.

14 out of every 15 diamonds set in jewellery worldwide are processed in India. India has already established itself as "International Diamond Manufacturing Hub". Indian diamantaires have gone on to create a marketing network worldwide. Added to this is the strong financial base of the industry and support of financial institutions of the country.

Today, after creating a niche for itself in the diamond world with small diamonds, India is developing skills for cutting and polishing larger stones and fancy cuts. Indian diamond polishing factories are on par with the world's best employing cutting edge of technology using laser machine, computerized yield planning machines, advanced bruiting lathe, diamond impregnated scaives etc.

Other successful Global Diamond Trading Centres like Belgium, Israel, China and Dubai realizing this offer low and predictable taxation regimes for diamond business. This has meant that despite India's current dominance in manufacturing, it has failed to become a hub for rough diamonds, thus increasing the transaction cost of our exporters in way of travel costs, cost of brokerage and etc. Also small manufacturers suffer more as they do not have the reach and capability to deal with suppliers of roughs in Hong Kong, Belgium, Dubai and etc, thus totally dependent on secondary suppliers.

2.3 - Statistical Background

Export of Rough and Cut & Polished Diamonds (Value: US\$ in Million)

Year	Rough Diamonds	Cut and Polished Diamonds
2011-12	1772	23356
2010-11	1137	28221
2009-10	744	18224
2008-09	776	14804
2007-08	567	14205
2006-07	565	10910

Import of Rough and Cut & Polished Diamonds (Value: US\$ in Million)

Year	Rough Diamonds	Cut and Polished Diamonds
2011-12	15163	14472
2010-11	11994	20808
2009-10	9048	11610
2008-09	7960	8982
2007-08	9797	5461
2006-07	8767	2027

(The Global statistics has been included in Appendix 6)

The major markets for cut and polished diamonds are Hong Kong, UAE, USA, Belgium, Israel etc. the overall potential for growth in the cutting and polishing industry is limited, mainly due to the restricted supply of raw materials i.e. rough diamonds in the country. However, the diamond trading business, which is centered in Antwerp, Israel, can be attracted to the India, given the large cutting and polishing activity that happens in India and the sizeable domestic market.

Chapter 3 - DETAILED SUGGESTIONS AND THEIR EXPLANATION

Legislation Related

1. While the industry would like a Presumptive Taxation regime in the long run, it would request the finance ministry to start by reducing the tax rate for the Benign Assessment Procedure (BAP) to 2.5% to gain industry acceptance, assess the rate of collection of tax, gauge the interest of the industry to opt for such scheme.

Issues faced by the Industry

In the year 2006, gauging the need to implement competitive tax reforms in India, the Gems and Jewellery Export Promotion Council ('GJEPC'), represented before the Ministry of Finance ('MoF') and Ministry of Commerce ('MoC') seeking to introduce a simplified income tax computation mechanism for the Industry.

The said representation highlighted the concerns faced by the members of the Industry, at the time of explaining various factors of business ie 4Cs (cut, clarity, carat and colour), to the Income tax officers and its impact on computing taxable profits.

GJEPC categorically highlighted that the Industry requires the Government to only introduce a simplified tax computing mechanism, in order to avoid any litigation and does not require any tax concession or exemption for its members.

Impact of the Representations filed by the Industry

The issues raised by the Industry were highly appreciated and duly acknowledged by the MoF and MoC and the need to analyse and study the said issues faced by the GJI, together with the practices prevalent in globally competing nations was stressed. The Finance Minister in the Budget Speech for 2006-07 had stated as follows:

*'We believe that there is considerable scope for developing India as a hub for the gems and jewellery industry. I, therefore, propose to constitute an expert body that will look into the potential of this sector and **the prevalent taxation practices in India and abroad, and make its recommendations in this behalf**'*

Consequent to this, the MoF set up the Expert Committee headed by Mr. Sivaraman ('Sivaraman Committee') in 2006 to study the tax issues including international precedents and make recommendations which will provide impetus to the growth of this sector and enable India to develop as an International trading hub. The Committee, in its report, inter-alia recommended the implementation of a presumptive method for

the gems and jewellery sector. The scheme was to be introduced as variants of such systems prevailing in competing jurisdictions like Belgium, Israel and Thailand.

As per the Sivaraman Committee's recommendations, the introduction of a Presumptive Tax system would:

- Encourage more investment in the sector;
- Retain trade, skilled labour and capital within the country;
- Enable voluntary compliance leading to increased revenue;
- Enhance global competitiveness of the Indian industry; and
- Foster increased employment opportunities.

The MoC in its report submitted in April, 2007 agreed with the recommendations of the Sivaraman Committee on the need for adoption of a presumptive system of taxation for the GJI.

Despite the Expert Committee recommendation for a Presumptive tax scheme for the GJI, a **Benign Assessment Procedure** ('BAP') was introduced in the Budget for 2007-08 by the MoF. As per the BAP, the books of accounts of assessee shall not be subject to detail scrutiny if the said assessee declares net profit of 8% or more of the turnover from the activity of diamond manufacturing and trading. The said deemed threshold was subsequently revised to 6% as per a CBDT issued Instruction Order No. 2/2008 dated 22.02.2008.

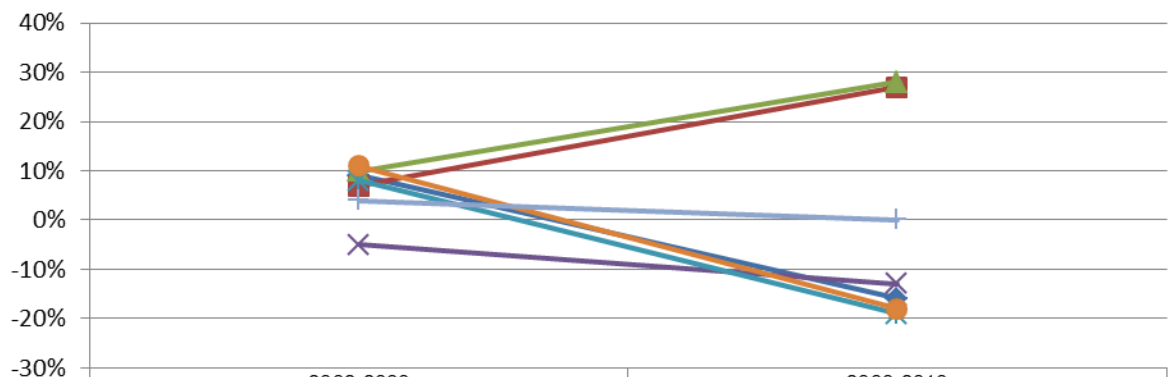
The BAP in its present form is available only to those Assessee whose profits and gains from the activity of manufacturing and/ or trading of diamonds is equal to or higher than the threshold of 6%. However, the said rate of 6% so prescribed is nowhere reflective of the reality in the diamond manufacturing and trading industry, which operates on profit margins in the range of 1% to 3% only. It should be appreciated by the MoF that if industry were to demand profit of 6%, it would have never earned the amount of market share which it has gained by operating on low margins.

Issues faced under BAP

- Given the above, the BAP is more a scheme on paper, as it does not have the capability of being adopted by the majority of the industry participants. The reasons for this are:
- The threshold of 6% for the current BAP set is such that only 2% of the current industry may be able to meet the threshold.
- Actual net profit in diamond manufacturing is in the range of 1.5-4.5% and in diamond trading in the range of 1-3%. The margins in 2012-2013 will possibly be even lower as rough producers kept their prices high (*See Appendix 1*)

- The value addition for the industry in India is to the range of 20-25%, as we deal with smaller size and lower quality goods, which requires a higher labour content. Hence net income is about 8-15% of such value addition of 20-25%, of the turnover, after considering interest costs which are paid on the entire value of diamonds.
- Diamonds are traded 2-3 times before they reach marketable lots. Considering one manufacturing and one trading cycle of the goods in India, the margins would be
 - 1.25-3.75% on turnover (average of manufacturing and trading ranges)
 - 12.5-30% of the value addition
- This not only resulted in ineffectiveness of applicability of BAP by the industry members, but has in fact resulted in irrational deemed additional which have been subject matter of various litigations.

Also, due to the presence of an unfavourable tax regime in India, the Country is losing its market leadership position to other low cost economies. This can be established from the fact that India, in last decade, has witnessed negative growth in GJI sector, however, our competitors e. g China, Thailand, Dubai etc, during the same period, have experienced substantial increase in its market share.



	2002-2008	2008-2010
India	9%	-16%
China, Thailand and Others	7%	27%
South Africa	10%	28%
Israel	-5%	-13%
Russia	8%	-19%
United States of America	11%	-18%
Belgium	4%	0%

It can be established from the fact that countries with higher labour cost have witnessed negative growth¹. Indian despite being low cost economy has suffered negative growth mainly due to complex tax regime.

Recommendation:

Based on past interactions, the industry realizes that there is lack of confidence between the tax authorities and the industry on issues of books of accounts, yields, valuation of opening and closing stock and etc. Based on this it is understood that almost 100% of the income tax files of the diamond sector goes for scrutiny in income tax. Such scrutiny Hence as a **first step, the industry would like to see the profit rates for computation of income tax under BAP to be reduced to 2.5% to enable such trust to develop**. This rate would encourage the majority of the industry to become opt for the BAP and become compliant. It is also above the median of the taxable income for the entities surveyed by the GJEPC. (See Appendix 2 on Taxation Challenges in the Diamond Industry for profitability spread)

In the past the industry has requested for Presumptive Tax for net profit calculated @ 2% of trading activity and 3% of manufacturing activity. We understand that it might be difficult to segregate between manufacturing and trading business from the books of account during assessment. If that is the case a suggested rate of net profit of 2.5% across the board would encourage compliance of both manufacturers and traders, and ensure that the BAP introduced by the Govt. achieves success.

The industry also requests the Department of Revenue of the Finance Ministry to include the following for those companies who will be BAP compliant:

- Audited books should be accepted by the relevant authorities
- The industry should be exempt from transfer pricing compliance on sale of rough and polished diamonds. The BAP implies that the books are acceptable, and hence raising transfer pricing queries become irrelevant and defeats the very purpose of the BAP (See Appendix 2)
- Foreign Exchange forward and option contracts to the tune of exports and imports with authorized banks by such exporters, should be considered part of the business operations and profits/losses should be given same status as in case of commodity markets. Forex transactions are an integral and inseparable part of the business, given that diamonds are priced in USD.

¹ Report by Indian Institute of Management, Banaglore – Overview of India' Export Performance: Trends and Drivers

- All rough and polished diamond sales should be considered for the benign taxation scheme, with no rough rejection diamond sales classified as scrap
- Based on the information collected by the GJEPC at the time of the annual registration of members, the total export turnover in diamonds was to the tune of INR 99,835.12 cores in the financial year 2011-12 . If all companies adopt the 2.5% benign assessment procedure, then the potential tax revenue for the government would be approximately to the tune of INR 750 crores.

If a realistic threshold rate is set, this measure is expected to be Tax Accretive with an estimated 6-15% increase in tax collection (see Appendix 7)

2. Allow for duty free re-import quota for cut and polished diamonds to the tune of 15% of the previous year's exports in value terms

In January 2012, the government introduced a 2% import duty on cut and polished diamonds. The industry, through the GJEPC, had requested such a measure to prevent the round tripping of diamonds, which leads to an inflated import and export for the country.

While this measure has had its desired effects, it has also meant that

- Genuine cases of omissions or errors in cases of goods returned by customers and return of consignments, can go into disputes for small problems
- In above cases, though genuine returns, exporters are asked to pay the 2% import duty
- Indian companies, who used to import rough diamonds polished at their factories outside India, to get the quota of roughs from those countries like Botswana are also disadvantaged.

Allowing companies a duty free re-import quota up to 15% of the previous year's export turnover, will enable companies to avoid such disputes and also enable companies with factories abroad to import polish into India. The relatively small percentage will discourage any abuse of this quota in terms of round tripping.

3. Establishment of a Special Notified Zone (SNZ) for import of rough diamonds, where net income is fixed and taxes are paid only on invoices raised to Indian companies and not on re-exports

Large diamond producers are aware that the majority of their rough diamonds get polished in India. The large market of such rough diamonds in India also means that they can make a couple of percent added by value by selling directly in India instead of

the traditional trading centres of Belgium, Israel or UAE. However the complicated procedures and potential taxation disputes which can arise, make the large producers hesitant to set up operations in India, given the fact that the advantage of setting shop in India currently means an additional revenue of only a couple of percentage points.

Creating a notified zone for import and trading of rough diamonds in India will help companies bring their rough supplies directly for trading in India.

- Initially it will be opened to large, established and reputed mining companies, who are currently already notified by RBI for advance remittance (RBI A.P. (DIR Series) Circular No. 21 dated December 29, 2009), their respective offices can be demarcated as the notified zone under Customs bond.
- For others, an area managed by BDB and operated by GJEPC can be used as a common notified zone under Customs bond

Within this notified zone

- Only rough diamond sales and rough assortment activities would be allowed
- All transactions would be checked and verified by Customs by carats and not by value
- There would be free import and export from these zones under Customs Bond
- On all sales to domestic companies (either in Rupees or through the DDA mechanism)
 - Notional income for any sales at the zone to DTA would be considered @ 2%
 - Income Tax would be payable as per the applicable rates and rules based on such notional income
 - There would be no notional income charged on any goods which are re-exported

The respective books of accounts of these rough sales companies would not be scrutinized and would not require compliance to transfer pricing rules

- **The notional income scheme levies tax on any additional price the companies gain by selling the goods in India, as against any other international location where it's currently being carried out**
- As the notional profits are taxed, transfer pricing is not relevant

4. For the Diamond Sector, the system of Honorary Valuation Panels at ports of Surat and Mumbai for any valuation disputes, a mechanism which was operational well prior to Notification no 94/2007 and 95/2007 may be continued with and accordingly added in such notifications for the Special Valuation Branch in case of valuation for diamonds.

Honorary valuer for valuation of diamonds, jewellery, coloured gemstones and pearls exist at Mumbai. Similar honorary valuer panels exist at Surat and Jaipur also. This is being followed for long and much before the promulgation of Notification no 94/2007 for imports and notification no 95/2007 for exports. However in recent times the gem and jewellery exports and imports especially colored gemstones & diamonds are more and more being referred for Special Valuation by Customs at Mumbai, Jaipur and Surat citing Notification no 94/2007 for imports and notification no 95/2007 for exports in case of export/import to related parties. These notifications might be less relevant to the diamond industry as,

Diamond parcels are checked by specially appointed and trained customs appraisers

- 100% of all parcels are checked for weight
 - 25% of all parcels are checked for quality and value
- Additionally, Mumbai, Surat & Jaipur have honorary valuation panels which are referred to in case of doubts or disputes by the Customs authorities.

Due to the high value of the goods and the industry by nature, have independent companies run by siblings or relatives based in different countries, based on the nature of operations like manufacturing or marketing. In fact it is a great advantage to have such a huge network of Indian diamantaires abroad which has seen this industry to grow exponentially in these last four decades. However this fact is now leading to many parcels being referred to the SVB by Customs. Unfortunately the appraising by such special valuation branch (SVB) for transactions between related companies is not a time-bound process

- The SVB also lack the expertise required in valuing diamonds, which the customs possess due to their familiarity and regularly experience in dealing.

Where it is understood that monitoring process essential, given the existing monitoring of transactions by the customs, any valuation disputes can be referred to the existing honorary valuation panels instead of Special Valuation Branch. This arrangement was efficiently run through all these years.

Hence referrals for valuation by Customs for this sector should continue to be done through honorary panel of valuers and the same procedure for this sector should be incorporated in the Notification No.94/2007-Customs (N.T.) and Notification No. 95/2007 (N.T.) for imports and exports respectively for dealing with suspicious valuation in the appraisal level for individual shipments. (See Appendix 1)

5. Looking at the fact that India does not produce rough diamonds and almost 90-94% of the end product of cut and polished diamonds that are manufactured in India gets exported any indirect taxation on the sector will only result to export of taxes, the industry should be declared as zero-rated indirect tax regime and all duties collected in way of Service Tax, VAT or GST should be refunded by way of drawback at the rates computed by way of survey of actual exports.

Diamond exports are highly import sensitive as it is totally dependent on rough diamond supply imported from abroad. While the diamond industry produces 14 out of 15 diamonds, it consumes only about 7.3% of the diamonds, as reported in the recent Bain report, which was commissioned by the Antwerp World Diamond Council (AWDC). Hence this industry is primarily an export intensive industry ideal for zero rated tax regimes as it is the policy of the government of not exporting the taxes while doing the exports.

As per Notification No. 12/2012-Service Tax, the job work on way of manufacturing of diamond is already exempted from the Service tax net. Also as per Notification No.41/2012-Service tax dated 29th June 2012 a duty drawback of 0.06% has already been announced for exports of gem and jewellery against Service Tax already paid on way of exports.

Government should review the drawback for service tax as provided to the sector and should declare the diamond sector as zero rated tax sector under GST regime which is being formulated for introduction very soon.

POLICY RELATED

6. Establish a special fund by RBI to the tune of USD 3-5 billion for the refinance of borrowing given to non-petroleum export industries, which have a high import content of more than 70% of their exports. In case of inability of the Govt. to provide such

facility, such sectors should be allowed to arrange for ECB in foreign currency for their working capital requirements for purchase of raw material.

A Special Dollar Fund should be set up for such sectors which

- Have a high import content of over 70% of the export value excluding petroleum and petrochemicals, where projects are large enough to access dollar financing

For this fund, which would be available to the diamond industry, the

- banks can refinance up to 50% of their USD lending to the sector and banks can avail of these funds at near LIBOR Rates as prevalent in the international market
- To access these funds, banks should ensure
 - USD finance is always available to the Industry when required
 - Banks strictly adhere to RBI guidelines on spreads

Refinance from this fund would be on a recourse basis, with the credit risk lying with the respective banks and not the fund

Such a measure will help the industry as

Financing of working capital remains a primary driver for the industry

- The industry, in the past has been driven by availability of finance
- India's growth post global economic turmoil in 2008 can be partially attributed to continued availability of dollar finance to the trade by Indian financial institutions
- That enabled Indian companies to buy rough and increase their assets
- Given that the underlying working capital asset is priced in US dollars, competitors in other countries get dollar based finance

In the last 1-2 years the industry (borrowing of USD 6 billion) in India

- Faced tough period during unavailability of dollar finance especially with Indian Banks
- The spreads charged to the Industry were well above RBI guideline of 3.5% spread (country risk factor affecting USD borrowing costs)

- Alternate method was to avail of INR finance, which meant that additional cost has to be incurred to hedge the currency exposure

The RBI, in its circular dated 14th January 2013, has recently introduced a swap facility for export credit. However this swap facility is to support incremental Pre-shipment Export Credit in Foreign Currency (PCFC). It does not meet the industry's requirement of getting adequate dollar finance on the existing credit.

Alternatively the Govt. may allow the exporters to arrange and avail of ECB in foreign currency for their working capital requirements.

7. 2% interest subvention scheme should be extended for the entire gem & jewellery exporters as it was done in the year 2008-09

The 2% interest subvention scheme on rupee export credit is currently applicable for only SME's in gem and jewellery Industry. The high turnovers in the industry exclude most companies outside the SME definition. However many small diamond companies are forced to borrow in rupees at high interest rates making them uncompetitive in the international market.

For all polished diamond sales the 2% interest subvention scheme should be re-introduced. It can be directed to benefit the manufacturers. The need for this borrowing will reduce if the Special Dollar Fund, as mentioned in point 7, if it is introduced for this sector of the industry.

The RBI, in its circular dated 14th January 2013, has recently included the 134 tariff liens in engineering goods under the 2% interest subvention scheme. However, it does not mention the diamond industry, though it covers the SME sector. Given the high value of the machinery and underlying in diamonds, most exporters do not meet the guidelines set for SME's and hence are unable to avail of this interest subvention.

PROCEDURE RELATED

8. Reduce documentation requirements for exports from 23 to 12 copies as suggested and agreed during the previous task group formed for the industry in the year 2006.

The current export procedure requires about 23 copies of the various documents to be submitted to different agencies of Government of India. Managing this documentation is a time consuming effort. Non-submission of any of these documents can delay the export process. These procedures are unlike any of the other major international diamond exporting centres.

These document copies can be reduced to 12. A previous Committee which was set up under the Chairmanship of the then Joint Secretary of Commerce to recommend the policy initiatives required to make India an International Diamond Trading Centre in 2006 recommended on similar lines based on a study on the same. The recommendations of the study which indicate specific copies which can be excluded, is shown in Appendix 4.

9. Other procedural related suggestions for streamlining the procedural issues faced by the industry

Other recommendations for streamlining the procedures are as follows

1. Separate Customs Appraisal for & processing for import & export parcels, as the objectives of these processes are different
 - a) Imports need to be valued correctly with 100% appraisal as it is from a revenue perspective
 - b) Exports are checked as follows
 - (i) 100% of exports checked for carats, rate per carat and value only
 - (ii) 25% of exports are considered for detailed valuation
 - (iii) Current documentation procedure to be brought in line with international centres, where only point 1.b.i is checked. Checking of detailed diamond characteristics to be discontinued
2. Increase in number of appraisers & officers for Gem and Jewellery at the Customs Outposts
3. Increase in the operating hours of Customs involved in clearance of consignments of Gem and Jewellery items , along with keeping it open on Saturdays and to enable seamless exports to avoid delays
4. Implementation of EDI system at Customs and also the implementation on online payment gateway system
5. As per Notification no.1009RE-20100/2009-14, goods which are 0.25 carats and above only are authorized for export and reimport for certification and grading purposes. Advances in grading technologies and greater customer interest in buying certified stones has meant that stones which are even 0.10 - 0.15 carats in size are now being certified increasingly. Therefore this limit of minimum stone size for certification and grading should be reduced from 0.25 to 0.10 carats.
6. Consider allowing rough diamond consignment export for certification purposes
 - a) Some rough diamonds difficult to differentiate from treated goods after polishing (potential price impact of up to 30-40%)

- b) Labs accept and test rough diamonds before polishing and certify on that basis
 - c) It will encourage the polishing of larger diamonds in India
7. Separate out the ITC HS codes for synthetic rough and polished diamonds which will help in monitoring and tracking this growing area.

ADDITIONAL MEASURES

10. Policy for Beneficiation of Indian diamantaires for Diamonds Mined in India

Over the last 20-30 years, there has been no significant mining or discovery of mines of rough diamonds in India. However with Rio Tinto's Bunder mine under development, and other diamond firms prospecting in India very aggressively it is expected that India would start producing about 2-3m carats of rough diamonds annually (one of the largest new mine) very soon. Most African countries, Canada and Russia currently have some form of beneficiation process in place to ensure that a part of the value and jobs in processing are retained in their respective countries

India should consider ensuring

- All rough assortment of diamonds, mined in India, should be done in India only
- Indian companies should have the first right of refusal to buy any rough which is produced from the mine
- Rough can be exported, only if there are no Indian buyers for that rough at the export value

11. Pursuing Free Trade Agreements with countries which are consumers of diamonds and jewellery, but have prohibitive import duties on diamonds like Brazil and Russia

Certain developing and high-growth countries are high-growth diamond and jewellery markets. However the direct sale into this market is hampered by the high duties on diamonds, which make exports prohibitive.

These markets include countries like Brazil and Russia.

These markets need to be considered for Free Trade Agreements, and inclusion into any bilateral agreements.

12. Establish separate funds for a) generic promotion of diamonds and b) promotion of Indian-made jewellery, in key markets

Diamonds, being a luxury product, need constant promotion to ensure its share of wallet of the consumer. Promotion by individual brands or jewellers is either

inadequate or has not been effective in promoting diamonds as a category in recent times.

For over 50 years, De Beers used to promote diamonds with marketing spends touching over USD 200 million annually. However they have stopped these promotions as their market share of mining of diamonds has dipped from 85% to 35% over the last 10 years. India, which employs over 90% of the people in the trade, happened to be the chief beneficiary of this promotion. Based on such promotions iconic diamond jewellery brands like Nakshatra, Asmi and etc were developed.

In 2009, the GJEPC in association with 27 manufacturers and 85 retailers launched the “Anant” promotion in India to promote diamonds and diamond jewellery as a category. However it was shelved after 1 year due to dearth of funds.

In 2012, the GJEPC has committed to spend USD 10 million over 3 years for promoting diamonds in 2-3 key markets, including India and China. The GJEPC hopes to become the catalyst for other players in the diamond pipeline like rough producers and traders to contribute and make this fund larger, thereby ensuring sustained diamond promotion. Hence the government should earmark funds for matching trade’s contributions into this fund.

In 2011, the Council commissioned the Swiss based branding-Institute CMR AG to conduct a consumer perception survey in Baselworld 2011 to gauge the perception of the “Made in India” Brand. Mr Marco Casanova, head of the institute, made a presentation titled “Perception of Indian Jewellery in European Market” before the Dr. Rahul Khullar, the then Commerce Secretary on 13th July 2011 in New Delhi. The primary findings of the research were

There is no other country apart from India, that is able to position itself as the country for the jewellery

- The biggest threat for the Indian jewellers is not moving up the value chain, as they will lose the entire business to the Chinese
- If the Indian jewellery industry continues to consider itself as jewellery suppliers, they will lose the pricing war against the Chinese
- India needs to position itself on the world stage as jewellers driven by
 - Heritage
 - Tradition

- Craftsmanship

The GJEPC requests the government to contribute USD 10 million to a fund to promote Indian-made Diamond jewellery. This fund will

- Target 2-3 markets with high potential
- Highlight the traditional skills in a modern context
- Run the promotion for 3-5 years on a sustained basis
- The program can be designed with jewellery exporters who can add their own contributions to make the fund larger and more results oriented

13. Create an Rs 200 Crore Technological Up-gradation Fund Scheme (TUFS) to enable small manufacturers of diamonds and jewellery access latest manufacturing technologies.

The world is undergoing a huge technological change, and so is the industry. Most large manufacturers have the capabilities to import and deploy the latest technology available globally. However, the strength of India is in its small manufacturers, who lack both exposure and understanding of these technologies. (See Appendix 5 for details)

A Technological Up-gradation Fund Scheme needs to be set up to train and enable smaller manufacturers to access the latest technologies. To begin with, a fund of Rs. 200 crores may be ear marked for the same and the process for operation for disbursement of such fund may be devised as similar to what is there for Apparel and Leather sectors.

In this regard, based on submissions of GJEPC the Government has sanctioned Rs 50 crores under XII 5 year plan for TUFS. Based on that GJEPC has submitted a pilot proposal for creation of Common Facility centers for the diamond industry. The current plan covers 13 clusters in Gujarat, where small manufacturers are prevalent. In these Common Facility centers

- Equipment purchase would be financed from the TUFS
- Equipments would be purchased as per the needs of the respective cluster community
- The responsibility for operating and maintaining the machinery would lie with the respective local association, thereby increasing engagement of the smaller manufacturers

The GJEPC will help with the setup and an ongoing monitoring to ensure optimal use of the machinery supplied

Based on the success and interest, the scheme can be extended to other clusters and also to jewellery. This will go a long way in upgrading the technology used in jewellery manufacturing.

14. Skill Development

The Gems and Jewellery industry has traditionally been a skill based industry, with the craft being passed down from generations. However technological advances have left Indian handmade jewellery becoming less appealing to global consumers. The industry requires that workers be re-skilled in tune with global developments.

The Gem and Jewellery Skill Council of India (GJSCI) was set up in January 2011 to enhance and upgrade the skill requirements in Gem and Jewellery Industry.

(See Appendix 5 for details)

Future Course of Action:

- Introduction of Diamond Appreciation and diamond cut-designing as a vocational course in CBSE and other schools from the 9th Standard. Gujarat will be a pilot state for this program
- Launch a program to upgrade the small diamond processing job-working units. It also aims to train the workers at these units to upgrade their skills to improve productivity and efficiency. The training will be provided through manuals as well as seminars (both on-site and off-site).
- Undertake the task of preparing training manuals for all job functions at the entry level in the Diamond Processing Sub-sector. These manuals will be in local languages and will be developed with the help of machinery and tool manufacturers.

15. For import, preforms of gemstones should be treated as rough gemstones

At present, many countries who are producing rough gemstones are now insisting on processing of gemstones in their country itself like the Republic of Tanzania has put the ban on export of rough tanzanite gemstones weighing one gram or more so that some value addition is achieved on it in Tanzania. Hence the Indian exporters are left with no choice but to import the preforms of such stones.

Preforms are being imported by the exporters for manufacturing of coloured gemstones. It is mainly the rough coloured gemstones which are also used as raw

materials for manufacturing of the finished goods. The Field Formations of Customs in India are neither treating these performs of precious and semi-precious stones as rough of these gemstones which are duty free nor as cut and polished precious and semiprecious which attract 2%import duty since January, 2012. Customs classify these performs as "Others" and are imposing 10% import duty on the same.

"Preform "is just a 3rd step out of 8 steps involved in manufacturing of coloured gemstones. From the rough gemstones, the steps involved in manufacturing of cut and polished precious and semiprecious are Marking & Trimming, Sawing, Marking Preform, Calibrating, Sandling/Lapping, Doping, Faceting & Polishing. The definition of preforming as published in "Dictionary of Gems & Gemmology" by Mohsen Manutchehr-Danai is "preliminary shaping of gem substance for lapidary faceting".

Since the gemstones are treated as precious cargo by the airlines and their airfreight is quite high, the import of preform saves the cost of airfreight as the undesired portion of the rough like inclusions and other minerals attached to it are removed in steps involved in trimming and Sawing. This makes our exports much competitive in the international market. Thus treating preforms as cut and polished coloured gemstones and imposing duty shall render the exports uncompetitive.

APPENDICES

APPENDIX ONE

F.No. 12/1028/2012-EP(G&J)
Government of India
Ministry of Commerce & Industry
Department of Commerce

Udyog Bhawan, New Delhi
Dated: 7th January, 2013

ORDER

Subject: Constitution of a Task Group for Diamond Sector to suggest measures to increase the diamond trade and to make India an International Trading Hub for rough diamonds.

On the directions of Hon'ble Commerce, Industry and Textiles Minister, a Task Group has been constituted for Diamond Sector to suggest measures to increase the diamond trade and to make India an International Trading Hub for rough diamonds. The Composition of the Task Group is as under:-

1. Director General of Foreign Trade	Chairman
2. CMD, Hindustan Diamond Company Private Limited	Member
3. Chairman, Gems & Jewellery Export Promotion Council	Member
4. President, Bharat Diamond Bourse	Member
5. Chairman, Indian Diamond Institute	Member
6. Joint Secretary, EP(G&J), DOC	Convenor

2. The Terms of Reference of the Task Group is to make recommendations:

- (i) to make India an "International Trading Hub for Rough Diamonds".
- (ii) for rationalization of Taxation Regime in sync with international diamond centres.
- (iii) for availability of bank finance to the industry
- (iv) for beneficiation of Indian mined diamonds
- (v) for the brand promotion of Indian polished diamonds.
- (vi) for any other measure necessary to increase diamond export.

3. The Task Group will have the powers to co-opt members or to invite any one to make suggestion before the Group.

4. The Task Group will submit its Report to Hon'ble Commerce, Industry and Textiles Minister in 30 days.

(Siddharth)
Joint Secretary to the Government of India
Tel.: 2306 1837

To,
All members of the Task Group

Copy to: PS to CITM / PPS to CS / PS to JS (AS)

APPENDIX TWO: INDUSTRY BACKGROUND

The diamond industry in general has been facing severe headwinds in the last 5 years, since the onset of the financial crisis, which has changed the nature of doing business

1. **Diamond price volatility has become a new challenge** which all diamond companies now have to face. In the past, prices of both rough and polished were stable, with a steady annual increase of 1-4%. Post global economic turmoil in 2008, the scenario has changed. The industry experiences periods of volatility, where prices can change much in a short time. Price falls are typically more severe than the increases. The reasons for this volatility is
 - a. Changing demand patterns of emerging countries like China
 - b. Fragmentation of rough supplies, with De Beers now accounting for 35-38% of rough supplies as compared to previous 85% of supplies, and hence rough producers now preferring to sell what is produced, rather than holding goods to maintain prices
 - c. Increased speculation in rough and polished trading by few entities
2. The volatility in prices makes it extremely **difficult for manufacturers to be able to predict their profitability**. Manufacturers will have a rough purchase to polished sales cycle of 3-6 months. In addition to this the fluctuations in the value of the Indian Rupee has further increased volatility as diamonds are essentially priced in USD in the international market.
3. Fragmentation of rough supplies has meant that the attitude of rough producers is that they **want to maximize the revenues for their rough at the cost of their customers**. Large producer like Alrosa and De Beers, who have long term supply contracts, are quick to raise prices, while they maintain high rough prices when polished prices fall. Long term contract customers continue to pay the high prices and bear losses to ensure that their supply contract continues.
4. The **value addition of the diamond polishing sector has reduced to 15-20% from the 20-25%** which it commanded over a decade ago. Over the last decade, the cost of value addition from polishing has remained nearly static, while the rough and polished prices have moved up. This is true even in India, which polishes lower quality goods, i.e where the value addition is higher.

5. The pricing volatility makes it more difficult in diamonds, where typical mid-size manufacturer would **have over several thousand qualities of polished in stock**. The prices of each of these qualities can move independently, depending on the demand and supply for each quality.

Additionally there have been certain factors which are also affecting the dominance of India in polishing

1. Emergence of China is an imminent threat for the industry, with polishing of better quality small diamonds, increasingly picking up.
 - a. Import data from the US shows that polished diamond imports from China have gone up by 160% in 2011, much higher than any other centre
 - b. China has also been aggressive in acquiring rough, with the government taking active interest negotiating with African governments to buy rough diamonds and ship it directly to China. Rough purchases are typically as part of a larger package of mineral rights acquired, in lieu of infrastructure facilities provided to that country.
2. Rough supplies and rough trading is an area of the business which is still not in India, despite India polishing over 93% of all stones and over 60% in value
 - a. Companies like Alrosa supply rough directly to a few Indian companies, however they do not have an office in India, unlike say Hong Kong, Israel and Antwerp
 - b. Ambiguity of the tax regime remains the biggest hurdle for the large organized rough producing companies to set up base in India
 - i. Run of mine production, typically gives assortments from a few \$/ct to a few thousands of \$/ct. Using conventional accounting logic to this would naturally lead to disputes on valuation and pricing
 - ii. They currently can set up in other centers which have a low and predictable tax structure with low scrutiny
 - iii. Overseas Rough producing countries/companies understand the importance of India and know that they can possibly get better

prices here, however, they would like to be taxed on the incremental income which they would receive in India

- iv. Additionally transactional delays are also critical for the industry as the value implies a high holding cost
 - c. For smaller African countries, Chinese presence and activity is increasingly capturing a larger portion of the rough diamonds
3. Transaction costs for the industry continue to become larger, while other centers, like Antwerp, Israel and Dubai, focus on reducing transaction costs, despite employee costs being much higher in those countries. The areas where transaction costs continue to be inefficient for the industry include
- a. Larger documentation efforts for exports, with over 21 copies of the documents required to be submitted for export
 - b. Export valuation disputes, especially for exports to related parties
 - i. The high value of the exports and their sale without surety has meant that the industry prefers to export with whom there is some relation, more as a risk management process. However this leaves such shipment open to scrutiny, and referral to the Special Valuation cell
 - ii. Special valuation cell can take upto 7-15 days, which ties up significant capital, given the value of the goods
 - iii. The SVB might not be applicable to the industry as customs check
 - 1. 100% of exports are checked for weight
 - 2. 25% of exports are randomly selected for checking their value, through approved and trained customs valuers
 - iv. The SVB does not have the requisite knowledge to value the diamonds
 - v. Customs have an Honorary Panel of members for any valuation disputes, and that mechanism can be used instead of the SVB process

APPENDIX THREE: TAXATION CHALLENGES IN THE DIAMOND INDUSTRY

There are certain unique characteristics of the diamond trade which make it difficult for auditors and investigators to accurately determine the profitability of an entity. The main issues which the industry faces on the valuation front are as follows

- There are wide variations in yields and in the Gross Margins as
 - o There are wide variations in the processes and the yield due to the variation in the rough procured
 - o This creates complications in determination of yield as well as gross profits
 - o In certain goods, companies have an option to sacrifice yield for better realization (either through better quality or even different shapes). This option will make physical (carat) yields less important. This will make comparisons still more difficult
 - o Companies have different skills and the level of goods which are not polishable by a particular company might also determine the yield
- Inventory tracking and valuation is complicated
 - o Unique nature of the industry leads to issues of cost allocation for stock – in-trade and market valuation thereof
 - o There are multiple transactions in each parcel where parcels are assorted and remixed as required by different customers and sources of diamonds. This repeated mixing and assortment (where prices are assigned), makes it difficult to accurately put the cost to the inventory
- Multiple valuations depending on the characteristics of the diamond
 - o Typical manufacturers would have about 4,000 different qualities, most of which would need to be priced separately
 - o In many cases, parcels contain a mix of qualities, so that they become more marketable lots (smaller quantities fetch lower prices, as these would be purchased by traders)
 - o This makes valuation in assortment and mixing more complicated, and hence most diamond buyers physically check and assort each parcel before they negotiate the price

- In the Indian context this leads to non-acceptance of the inventory valuation methodology followed by industry players for
 - o Their mere inability to maintain quality/ grade wise stock reports cannot be the ground of making adjustment to the stock;
 - o A corresponding contra effect in subsequent year is often not provided
- Industry comparisons of profitability might also be quite different and can also be affected by operating situation of the company. Given the small average manufacturing margins, the impact can be quite substantial on overall profitability
 - o The type of goods the company deals with
 - o The type of supply, whether primary or secondary market (For much of 2012, primary rough supply prices were higher than those in the secondary market)
 - o The levels of leverage of a particular company, and hence their interest burden
- Foreign exchange forward and option transactions, including those with banks, are an integral part of the business operations as
 - o Diamonds, are always priced and dealt in USD
 - o Foreign exchange forward and option transactions are necessary to hedge Forex risks for import/export payment/receipt actual as well as projected and bank borrowing repayments
 - In a truly hedged scenario, when all receivables are hedged, it is possible that in a strengthening rupee scenario, the profits are shown in the forward contracts, while in reality the forex risk has been hedged
 - o Most export bills are discounted with banks, and typically hedging transactions have been carried out with banks
 - However, Forex transactions with banks are classified as speculation

- While transactions with exchanges are considered as business operations
- Losses on account of foreign exchange forward and option contracts are part and parcel of the business as these are
 - Not a notional/ contingent loss
 - Entered with banks authorized by RBI and within RBI guidelines
 - Losses accrued based on accounting principles - AS - 11;

These problems also mean that the industry becomes more susceptible to transfer pricing compliance issues and disputes

- For the Gems and Jewellery Industry, dealing with associated enterprises outside the country is a method of risk management method, as the dealings are based on trust and involved high value underlying assets
- However, such dealings are subject to transfer pricing under the Income-tax Act. 1961.
- Transfer pricing compliance is difficult to prove in the industry as the relevant methods for Transfer Pricing are not applicable to the industry
 - Comparable Uncontrolled Price (CUP) method
 - Too much variation in the diamond lots sold (rough and polished) and hence cannot be applied
 - Each diamond is unique
 - Resale Price Method (RPM)
 - Practically difficult to determine gross margin separately for each grade of diamonds
 - Gross margins of comparables not available in the public domain (in view of amendment of Schedule VI to the Companies Act, 1956 which no longer requires disclosure of quantitative details of stocks)

- Preparing internal segments (gross margins of transactions with group compared with non-group) is difficult due to co-mingling of inventory
- Cost Plus Method (CPM) – issues same as RPM.
- Profit Split Method (PSM)
 - Non-availability of data on manner in which independent third parties would split their profits
 - Financial statement disclosure practice widely varies globally
 - Difficulty in identification / valuation of value-drivers in the business.
- Transactional Net Margin Method (TNMM) - Difficult to obtain segment wise data viz., like manufacturing / trading of rough/polished diamonds from the public domain.
- Lack of adequate data of comparable companies in the public domain, as most industry players tend to be partnership firms or private companies
- The wide definition of Associated Enterprises (AEs) under the Indian TP law could at times make third parties as AEs
- Due to co-mingling of inventory, difficulty to bifurcate transactions with third parties / Associate Entities and also prepare separate segmental accounts
- In the event a Transfer Pricing adjustment is made by the Revenue, the entire turnover of the Company should not be subjected to adjustment

Other global centres have faced similar issues with taxation with the diamond industry and have ultimately implemented some sort of presumptive tax regime. The current rates in force are as follows

Country	Methodology	Polished Exports 2012 (\$ bn)	Net Income (% of Turnover)	Effective Tax % (% of Turnover)
Belgium	Presumptive Tax for diamond industry	14.6	0.175 – 0.25%	0.06 – 0.09%
Israel	Presumptive Tax for diamond industry	7.2	Mfg : 1.16 – 1.33% Trader : 0.63%	0.29 – 0.33% 0.16%
Dubai	Zero tax regime	~15.5	NA	NA
China	Complete tax exemption in certain provinces		NA	0%

India remains the only large global trading centre which does not still have a benign taxation regime. All other centres have a presumptive taxation regime in some form or another.

On the other hand, the actual taxes paid by the industry for a sample of 71 companies totaling over Rupees 42,500 cr revenues in 2011-12 are as follows

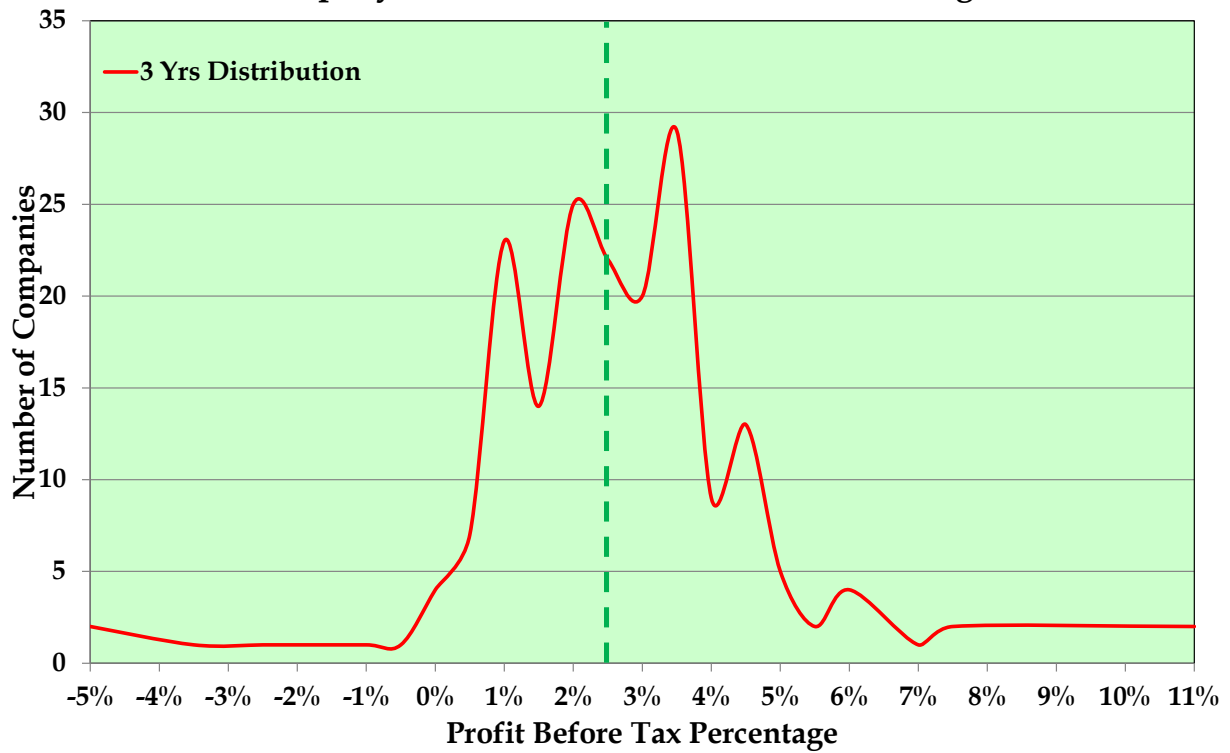
Financial Year	07-08	08-09	09-10	10-11	11-12
Average Profit Before Tax %	2.2%	0.3%	2.0%	2.3%	2.3%

Additionally GJEPC collected information from banks, as to their customers and the profitability as reported. The results were as follows

No	Entity	Average Net Profit %
1	State Bank of India	2.56%
2	Indusind Bank	1.5 - 2.5%
3	Yes Bank	2.2%
4	Saraswat Co-op Bank: >100 cr Turnover <100 cr Turnover	1.5 - 3.0% 0.5 – 1.5%
5	State Bank of Travancore	2.45%
6	Antwerp Diamond Bank	2.39%
7	Royal Bank of Scotland	3.39%

Over the last 3 financial years, the distribution of the actual net profit before tax reported by these companies is as follows

Company Distribution Based on PBT Percentage



The median value, over the 3 years of data points, is about 2.27%. It has to be kept in mind that 2010 and 2011 were relatively better years for the industry, and the actions by producers has reduced industry profitability in the current scenario.

APPENDIX FOUR: EVOLUTION OF DIAMOND INDUSTRY TAXATION IN INDIA

Based on Prime Minister's vision to develop India as a Global gem and Jewellery Hub, Shri P. Chidamabaram, the then Hon'ble Finance Minister, while presenting the Union Budget for 2006-07 announced the constitution of an Expert Body to look into the potential of the gems and jewellery sector and the prevalent taxation practices in this sector in India and abroad and make suitable recommendations got making India the global hub for this industry.

Accordingly, an Expert Body was constituted under the Chairmanship of Shri M.R. Sivaraman, former Revenue Secretary

The terms of reference of the Committee were as follows:

- a) To undertake a comparative analysis of the legislative provision, rules and regulations governing taxation (direct as well as indirect) in the gems and jewellery industry in the countries which have substantial turnover in this sector
- b) To make recommendations for a taxation system based on best international practices, for the gems and jewellery industry in India, which will:
 - a. Provide impetus to the growth of this enable India to develop a hub for this industry
 - b. Facilitate exports
 - c. Widen tax base and secure adequate revenue for the Government
 - d. Minimize the scope of evasion
 - e. Facilitate voluntary compliance

One of the major recommendations of the Committee was the introduction of presumptive taxation for the whole gems and jewellery exports sector. Thereafter in the Union Budget 2007-08, a Benign Assessment Procedure was announced for assesseees declaring a net profit of 8% or more from the activities of diamond manufacturing and trading. This was followed by long period of interactions between the Gem and Jewellery industry and the Ministry of Finance on the concerns arising therefrom. Subsequently, vide an Instruction Order No. 2/ 2008 dated February 22, 2008, the threshold net profit rate for the eligibility to the "Benign Assessment Procedure" was reduced to 6% or more.

Since then the industry till date, has made multiple representations and presentations to the Government of India to introduce the Presumptive Taxation System for the Industry.

APPENDIX FIVE: DOCUMENTATION REQUIRED IN EXPORTS

At present, for export of cut and polished diamonds, an exporter has to make 21 invoices, 2 GR forms, 3 Green Delivery Challans and 4 Shipping Bills per shipment. Total number of documents being filed is 30. We recommend that this may be reduced to 7 invoices; 2 GR forms; NIL green delivery challans and 3 shipping bills. Hence the total numbers of documents proposed are 12.

Invoices:

(a) 21 invoices may be reduced to 7 as follows:

Department	Present No. of Copies	Proposed No. of Copies
Custom	5	3 (1 to be retained by Customs and 2 to be returned to the exporter after attestation.
CHA	5	2
Bank / Exporter	11	2
Total	21	7

(b) GR Form: 2; may not be insisted for shipment up to US\$3, 00,000

Department	Present No. of Copies	Proposed No. of Copies
Custom/RBI	Presently 2 copies of GR Form are required for Custom/RBI purpose. Filing of GR form is not necessary for the goods upto US\$ 25000.	It is recommended that 2 copies of GR Form should be filled in for Customs/RBI purpose. Further, it is recommended that the limit of clearing the goods without filling the GR Form should be extended upto US\$ 10,000 for general firms and US\$ 3, 00,000 for status holders.

(c) Green Delivery Challan (Exporters Declaration): 3; May be eliminated

Department	Present No. of Copies	Proposed No. of Copies
	3	NIL (The declaration may be incorporated in the invoices and / or GR form)

Shipping Bill : 4; May be reduced to 3

Department	Present No. of Copies	Proposed No. of Copies
	4	3
CHA	1	1
Custom Stats Dept	1	1
Custom Record Dept	1	
EP Copy	1	1
Total	4	3

APPENDIX SIX: INDUSTRY TECHNOLOGY AND SKILLS REQUIREMENTS

TECHNOLOGY REQUIREMENTS

The Indian Gem & Jewellery Industry is a leading foreign exchange earner and one of the fastest growing sectors accounting for 14% of India's total merchandise exports during the year 2011-12. The Industry has registered a remarkable growth over the last four decades with exports grown from US\$ 29.35 million in 1966-67 to US\$ 43 billion in the year 2011-12.

Industry as per studies done by ICRA is spread across 13 clusters in India. The diamond clusters are based mainly in the western coast of India in the state of Gujarat and the colour gemstone cluster at Jaipur and parts of Rajasthan. Other than that all the clusters generally are of jewellery manufacturing.

This Industry is a highly skill based industry. Right from identification and assortment of rough diamonds to manufacturing of final jewellery, definite skill is required. However, the dependence on skill has resulted in the concentration and captivation of definite skills within small geographic regions whereby with the advent of modernization, those jewellers had lost their demand over a space of time resulting the workers losing their job and livelihood. This Industry deals in the traditional handmade jewellery where every state has its own cultural background and its own set of artisans to cater to the local taste. This traditional handmade jewellery was and is manufactured in every nook and corner of the country. Industry in this 21st century is still in the traditional age.

Most of our exports of jewellery was happening from those traditional jewellery manufacturing sectors and was catering to the South Asians, NRIs and Arabian population giving us a strong head way in the Middle East markets. However, with the recent advent of technology Italy, Turkey, Malaysia, Hong Kong, China and Singapore are eating away our traditional market of the Middle East with superior technology, quality and manufacturing techniques. In the late 1990s with the advent of SEEPZ at Mumbai, the diamond industry forward integrated successfully to mechanized studded precious jewellery manufacturing and made successful inroads in the western type jewellery markets of US and Europe. SEEPZ had shown how market can be captured successfully with technological up gradation, better manufacturing techniques, better skills and working environment for the workers. It is envisaged that in the current context the traditional jewellery manufacturing industry of India requires same kind of make over to capture the hand crafted markets of the high end jewellery manufactured by brands like Bucheron, Cartier etc of France and Clusters of Verona, Valenza etc. in Italy. This requires a wholesale push from the government and the industry vide which the small scale manufacturing units of artisans with their machineries and processes may be upgraded to be in sync with the requirement of modern day market and

compete with upcoming players like Malaysia, Singapore, Indonesia, Turkey etc. It is also pertinent as the artisan class is ageing and very few new workers are coming to industry due to low returns. The returns can only match the current trends and standards of India which is growing at an average annual rate of 7-8%, if such manufacturing is done with new techniques which ensure efficiency and quality output. Working in factories with better machineries and proper working conditions will give their off –springs ego satisfaction to stay in the industry and continue with the tradition of manufacture of jewellery.

SKILL REQUIREMENTS

The Gem & Jewellery Export Promotion Council (GJEPC) in association with the Gem & Jewellery Federation (GJF), SEEPZ Gems and Jewellery Manufacturers' Association (SGJMA) and Jewellers Association of Jaipur (JJA) and under the aegis of National Skill Development Corporation had formed the Gem and Jewellery Skill Council of India (GJSCI) in January 2011 to enhance and upgrade the skill requirements in Gem and Jewellery Industry.

GJSCI is one of many Sector Skill Councils that NSDC is setting up in association with industry. NSDC's objective is to create 500 million skilled workers in India by 2022. GJSCI will have on its governing council, 11 directors from industry and 2 from the government. Of the 11 industry directors, 5 will be nominated by GJEPC, 4 by GJF, and one each by SGJMA and JJA. Currently the Gem & Jewellery sector employs a workforce of around 3.4 million. GJSCI aims to train, skill and enhance 4.07 million people by 2022.

Current Training Scenario

- Most key skills are transferred on a one-on-one basis and passed on from person to person, based on the trainer's tacit knowledge. The effort is centered in a few clusters and not spread country wide. New workforce entrants are drawn from these regions as well. The training is neither standardized nor systematic with emphasis practice but not on holistic professional development. The present approach is not scalable and may not be able to meet the increased manpower demands being made.
- Skill development in this industry is fragmented. Being labour intensive, there is an urgent need to train skilled artisans and workers across the industry in a consistent manner. An efficient mechanism to create and deliver training would greatly facilitate this development. An adequately trained workforce is essential for continued growth and will offer high return on training investment since a skilled workforce will further enable the industry's rapid growth. Cost effective

skill training that attracts an appropriate workforce is therefore of utmost importance.

Functions of Gem & Jewellery Skill Council of India

- Study methods to club the ancient industry with evolving technologies
- Showcasing careers rather to make the industry more appealing for job seekers
- Increase art life spans by systematic capture and imparting of native skills
- Improved ways of performing traditional activities
- Focus on work hygiene to enhance productivity, resulting in a satisfied workforce
- Reduce in wastage, losses and time taken and more efficient product creation
- Incorporate emerging technologies leading to mass manufacture to favorably compete with centres across the world and better satisfy international markets
- Elevate skill training to a formal education discipline and attract people to work in this industry

APPENDIX SEVEN: IMPORT / EXPORT STATISTICS

Table: 1

Total Exports of Rough Diamonds by Major Countries

	2006		2007		2008		2009		2010		2011	
	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions
China & HK	18.01	964.41	15.89	896.98	23.15	1821.16	14.05	763.41	12.57	972.11	15.60	1440.79
israel	22.78	3450.45	23.58	4135.21	17.92	4197.59	16.87	2328.53	24.45	3739.30	18.57	4418.94
India	40.08	546.44	30.55	601.05	37.60	829.59	22.43	713.18	32.99	967.81	37.07	1799.86
UAE	42.22	2367.70	40.20	2825.25	35.58	3085.23	29.68	2088.25	46.60	3542.90	47.21	5871.78

Table: 2

Total Imports of Rough Diamonds by Major Countries

	2006		2007		2008		2009		2010		2011	
	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions	CTS IN Millions	us \$ In Millions
China & HK	24.59	2114.10	26.63	2230.13	26.66	2331.18	19.57	1674.66	18.03	2023.13	21.70	3156.80
Israel	27.15	5492.55	23.90	5858.19	20.73	5357.61	18.83	2938.17	26.75	4429.40	22.61	5324.70
India	172.26	8555.62	173.77	9664.34	147.79	9591.57	119.73	6954.95	165.22	11234.79	132.10	14279.72
UAE	42.38	1561.47	42.63	1954.03	38.78	2155.66	29.19	1386.32	43.42	2061.93	52.12	3700.80

Table: 3**Imports to India from Major Trading Hub****US \$ in value & carats**

Country	2011		2010		2009	
Belgium	75.18	7,997.91	96.01	6574.52	70.13	4184.987
Israel	4.61	1,096.74	5.185	923.5	3.1	475.72
United Arab Emirates	23.15	2,311.25	28.26	1492.52	17.77	786.628
Hongkong	6.86	545.34	7.76	483.19	8.12	329.819
Others	22.24	2,358.85	27.57	1,730.81	19.94	1,133.90
Total	132.04	14,310.09	164.8	11204.5	119.1	6911.049

Israel's import of rough diamonds in 2011

Participant	Volume Cts in Million	Value in US\$ Million
European Community	10.01	2849.26
Switzerland	3.18	908.02
Russian federation	3.47	384.68
Angola	1.1	243.03
United States of America	0.34	212.6
South Africa	0.37	174.91
People's Republic of China	0.35	149.69
Thailand	0.31	126.13
India	1.52	79.12
Canada	0.03	65.58
Democratic Republic of Congo	1.35	37.53
Botswana	0.04	26.33
Zimbabwe	0.31	15.78
Guinea	0.05	11.79
Sierra Leone	0.01	7.26
Namibia	0.01	4.95
Belarus	0.01	4.54
Liberia	0.01	3.77
Ghana	0.06	3.62
Sri Lanka	0	2.48
Guyana	0	0.86
Tanzania	0	0.58
Armenia	0.07	0.28
Brazil	0	0.23
Central African Republic	0	0.13
Others	0.01	11.54

European Community Import of Rough Diamonds in 2011

Participant	Volume Cts in Million	Value in US\$ Million
Botswana	21.9	3887.65
United Arab Emirates	20.21	2538.3
Russian Federation	19.41	2519.61
Canada	8.86	2404.02
Israel	9.78	1939.64
South Africa	5.69	964.99
Namibia	1.11	677.29
Lesotho	0.12	355.05
Australia	7.9	219.56
Democratic Republic of Congo	8.73	189.8
Lebanon	0.45	86.52
Sierra Leone	0.23	80.95
Sri Lanka	0.28	61.88
Central African Republic	0.27	50.94
Zimbabwe	0.33	43.31
Armenia	0.18	40.21
Angola	0.09	40.02
Belarus	0.03	15.59
Guinea	0.17	13.75
Liberia	0.02	8.69
Tanzania	0.03	8.18
Guyana	0.04	7.97
Ghana	0.1	5.31
Brazil	0.01	2.47
Others	27.44	2347.55
Total	133.38	18509.28

People's Republic of China's imports of rough diamonds in 2011

Participant	Volume Cts in Million	Value in US\$ Million
European Community	10.2	1482.27
Switzerland	2.68	654.69
Israel	1.38	390.03
United Arab Emirates	0.88	205.11
India	5.07	205.05
Angola	1.01	110.42
Russian Federation	0.1	46.33
South Africa	0.04	9.03
Botswana	0.01	5.3
Central African Republic	0.01	3.28
Liberia	0.01	2.95
Zimbabwe	0.06	2.82
Canada	0	2.19
Sierra Leone	0	2.15
Australia	0.01	1.57
Guinea	0	0.92
Sri Lanka	0	0.39
Brazil	0	0.25
Democratic Republic of Congo	0	0.18
Others	0.21	31.86
Total	21.7	3156.8

Import of Rough Diamonds by United Arab Emirates

Participant	Volume Cts in Million	Value in US\$ Million
European Community	13.25	1402.58
India	10.61	573.93
Angola	4.03	537.48
Zimbabwe	8.25	418.36
People's Republic of China	2.5	159.24
South Africa	1.1	152.14
Switzerland	0.68	129.95
Russian federation	2.71	122.71
Democratic Republic of Congo	8.05	76.6
Sri Lanka	0.01	7.1
Central African Republic	0.04	6.5
Botswana	0.02	4.76
Sierra Leone	0.02	4.04
Ghana	0.05	3
Guinea	0.01	2.15
Tanzania	0	1.63
Guyana	0.01	1.15
Democratic Republic of Congo	0.04	0.84
Brazil	0.01	0.45
Liberia	0	0.12
Armenia	0	0.12
Others	0.74	95.96
Total	52.12	3700.8

APPENDIX EIGHT: TAX ACCRETIVE IMPACT OF BENIGN/PRESUMPTIVE TAXATION

A sample of 71 members of the council was surveyed, covering a spectrum of diamond exporting members. The spread of profitability as reported by these members is as follows

Number of Entities			
Profit Before Tax Percentage	Financial Year		
	2009-2010	2010-2011	2011-2012
< -5.0%	2		
-4.0% to -3.5%		1	
-3.0% to -2.5%	1		
-2.5% to -2.0%			1
-1.5% to -1.0%	1		
-1.0% to -0.5%		1	
-0.5% to 0.0%		2	2
0.0% to 0.5%	1	3	3
0.5% to 1.0%	5	9	9
1.0% to 1.5%	7	4	3
1.5% to 2.0%	9	8	9
2.0% to 2.5%	11	6	5
2.5% to 3.0%	6	6	8
3.0% to 3.5%	7	12	10
3.5% to 4.0%	1	6	2
4.0% to 4.5%	6	3	4
4.5% to 5.0%	2	3	
5.0% to 5.5%	1	1	
5.5% to 6.0%	2	1	1
6.5% to 7.0%		1	
7.0% to 7.5%		1	1
> 10.0%	1		
Grand Total	63	68	58

Note that data from some financial years was not reported all the members who were part of the survey.

The total incomes reported by these members were as follows

<i>Profit Before Tax Percentage</i>	<i>Financial Year</i>		
	<i>2009-2010</i>	<i>2010-2011</i>	<i>2011-2012</i>
< -5.0%	180,278		
-4.0% to -3.5%		275,701	
-3.0% to -2.5%	16,099		
-2.5% to -2.0%			15,499
-1.5% to -1.0%	4,660		
-1.0% to -0.5%		188,491	
-0.5% to 0.0%		64,448	42,442
0.0% to 0.5%	79,253	186,959	117,444
0.5% to 1.0%	182,984	222,434	640,827
1.0% to 1.5%	331,997	173,296	54,622
1.5% to 2.0%	401,104	243,436	1,153,499
2.0% to 2.5%	974,692	636,405	414,993
2.5% to 3.0%	163,537	381,582	857,589
3.0% to 3.5%	419,277	741,718	502,825
3.5% to 4.0%	60,153	480,193	211,574
4.0% to 4.5%	263,333	254,579	122,350
4.5% to 5.0%	25,480	60,675	
5.0% to 5.5%	16,055	52,609	
5.5% to 6.0%	140,179	85,508	116,469
6.5% to 7.0%		147,684	
7.0% to 7.5%		16,219	17,211
> 10.0%	10,943		
<i>Grand Total</i>	<i>3,270,025</i>	<i>4,211,938</i>	<i>4,267,343</i>

The profitability, as reported by the members, was as follows

Profit Before Tax (Rs lakhs)			
Profit Before Tax Percentage	Financial Year		
	2009-2010	2010-2011	2011-2012
< -5.0%	-11,716		
-4.0% to -3.5%		-10,176	
-3.0% to -2.5%	-451		
-2.5% to -2.0%			-387
-1.5% to -1.0%	-58		
-1.0% to -0.5%		-965	
-0.5% to 0.0%		-92	-119
0.0% to 0.5%	299	431	234
0.5% to 1.0%	1,596	1,758	4,898
1.0% to 1.5%	4,241	2,311	641
1.5% to 2.0%	6,529	4,173	21,249
2.0% to 2.5%	21,866	14,021	9,231
2.5% to 3.0%	4,657	10,063	24,148
3.0% to 3.5%	13,772	23,372	16,025
3.5% to 4.0%	2,297	17,636	7,895
4.0% to 4.5%	11,000	11,326	5,336
4.5% to 5.0%	1,213	2,886	
5.0% to 5.5%	836	2,654	
5.5% to 6.0%	8,049	4,844	6,879
6.5% to 7.0%		10,036	
7.0% to 7.5%		1,209	1,284
> 10.0%	1,179		
Grand Total	65,308	95,487	97,314

On the basis of this information, the analysis was conducted to determine the percentage additional profitability and the percentage additional tax revenues which the government could get by extending the Benign Tax Regime.

For the purposes of the simulation, it is assumed that

- The benign/presumptive taxation threshold is set at 2.5% as
 - o It reflects a realistic profit threshold earned by the industry, after considering the multiple times diamonds are sold and over a longer term period
 - o Companies would not object to paying a slightly higher tax rate for avoiding long drawn disputes

- All companies who reported profitability >1%, will be inclined to choose to go into a benign/presumptive taxation structure

Based on the above, the possible additional net incomes and hence tax collections would be as follows

Profit Before Tax (Rs lakhs) @ 2.5% Benign/Presumptive Tax			
Profit Before Tax Percentage	Financial Year		
	2009-2010	2010-2011	2011-2012
< -5.0%	-11,716		
-4.0% to -3.5%		-10,176	
-3.0% to -2.5%	-451		
-2.5% to -2.0%			-387
-1.5% to -1.0%	-58		
-1.0% to -0.5%		-965	
-0.5% to 0.0%		-92	-119
0.0% to 0.5%		431	234
0.5% to 1.0%	1,596	1,758	4,898
1.0% to 1.5%	8,300	4,332	1,366
1.5% to 2.0%	10,028	6,086	28,837
2.0% to 2.5%	24,367	15,910	10,375
2.5% to 3.0%	4,657	10,063	24,148
3.0% to 3.5%	13,772	23,372	16,025
3.5% to 4.0%	2,297	17,636	7,895
4.0% to 4.5%	11,000	11,326	5,336
4.5% to 5.0%	1,213	2,886	
5.0% to 5.5%	836	2,654	
5.5% to 6.0%	8,049	4,844	6,879
6.5% to 7.0%		10,036	
7.0% to 7.5%		1,209	1,284
> 10.0%	1,179		
Grand Total	75,068	101,310	106,770
Increase over Base	15%	6%	10%

The potential increase in tax revenues would be to the tune of 6-15% for the government.

Financial year 2012-13 has been tough for the industry as diamond prices declined, the rupee strengthened and rough diamond producers maintained their high prices. Financial year 2013-14 is expected to be slightly better, with flat prices, but producers would continue to keep prices high. In such a scenario, it is expected that the possible

additional revenue, over what would have been normally collected, would be in the 10-15% range.

Based on the information collected by the GJEPC at the time of the annual registration of members, the total export turnover in diamonds was to the tune of INR 99,835.12 cores in the financial year 2011-12. If all companies migrate to the 2.5% benign or a presumptive taxation regime, then the potential tax revenue for the government would be a MINIMUM of INR 750 crores.

Export of Rough and Cut & Polished Diamonds (Value: US\$ in Million)

Year	Rough Diamonds	Cut and Polished Diamonds
2011-12	1,772	23,356
2010-11	1,137	28,221
2009-10	744	18,224
2008-09	776	14,804
2007-08	567	14,205
2006-07	565	10,910
2005-06	566	11,831
2004-05	357	11,163
2003-04	533	8,603
2002-03	241	7,105
2001-02	142	5,982

Import of Rough and Cut & Polished Diamonds (Value: US\$ in Million)

Year	Rough Diamonds	Cut and Polished Diamonds
2011-12	15,163	14,472
2010-11	11,994	20,808
2009-10	9,048	11,610
2008-09	7,960	8,982
2007-08	9,797	5,461
2006-07	8,767	2,027
2005-06	8,698	2,992
2004-05	7,648	2,839
2003-04	7,137	1,183
2002-03	6,273	631
2001-02	4,207	466

Looking at the export numbers, the estimated additional revenue for the department could be estimated as follows

- Total polished + rough diamond exports for 2011-12 = USD 25 billion
- Estimated exports for 2012-13 = USD 17-18 billion (however this is in a depressed market)
- Taking annual exports to be about USD 18 – 20 billion in the base case
 - o At an average INR/USD of Rs 54 / USD = INR 97 – 108,000 crores of exports
 - o Average profit in 2011-12 for the sample of 71 companies was 2.3%
 - o Estimated profit on entire exports @ 2.3% = 2,230 – 2,485 crores
 - o Estimated tax paid @ 30.9% = 690 – 770 crores
 - o If additional profit declared is 15% = 103 – 115 crores in additional revenues

These estimates are purely on the basis of existing turnover.

Benign/Presumptive taxation system would also attract companies and business which is currently being deterred by the tax practices in India. *This incremental increase in revenues and hence taxes has not been factored into these calculations.*