

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

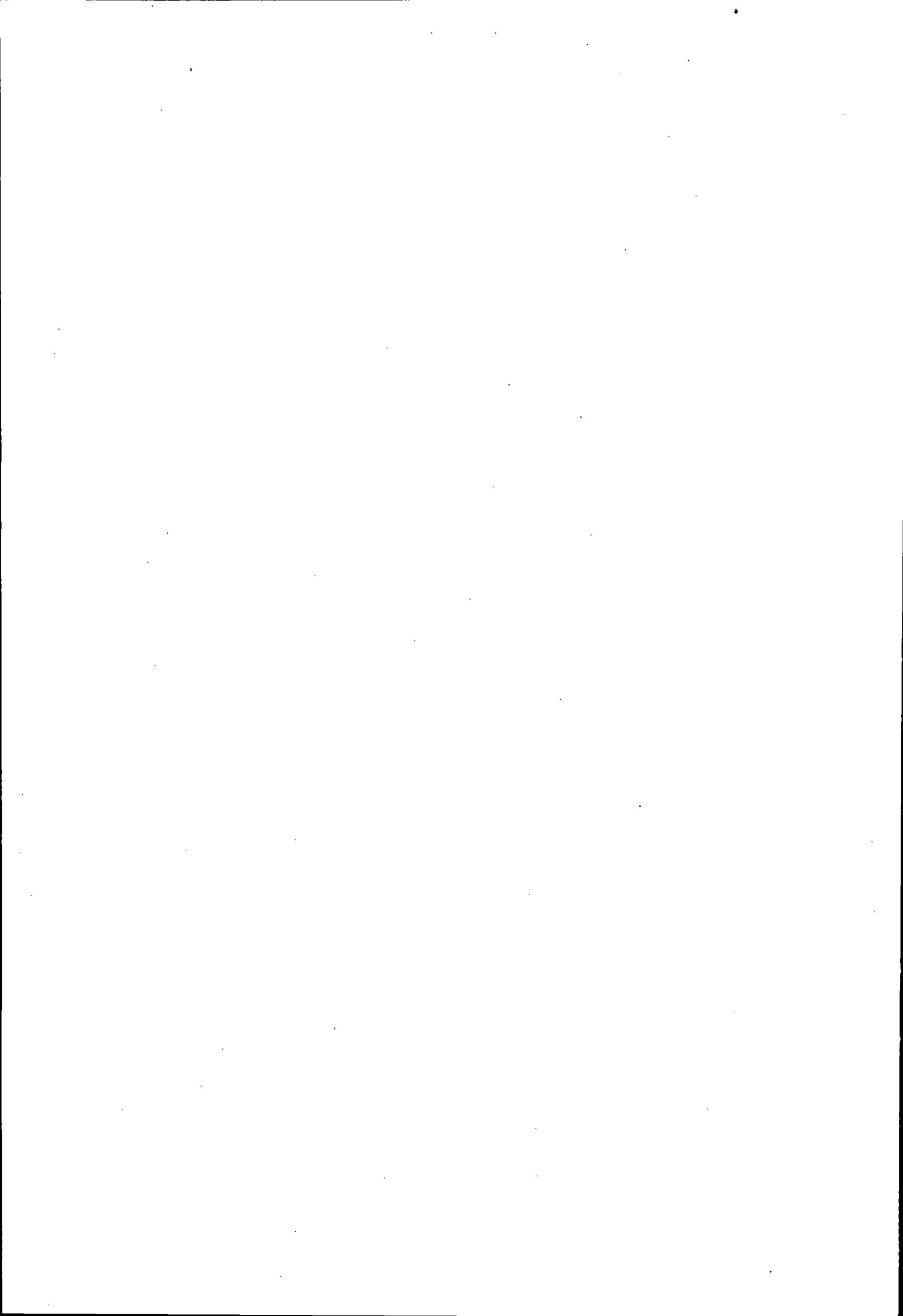
for the year ended March 2010

**Union Government
(Indirect Taxes – Customs)
(Compliance Audit)
No.24 of 2010-11**

Laid on the table of Lok Sabha and Rajya Sabha on 25 MAR 2011

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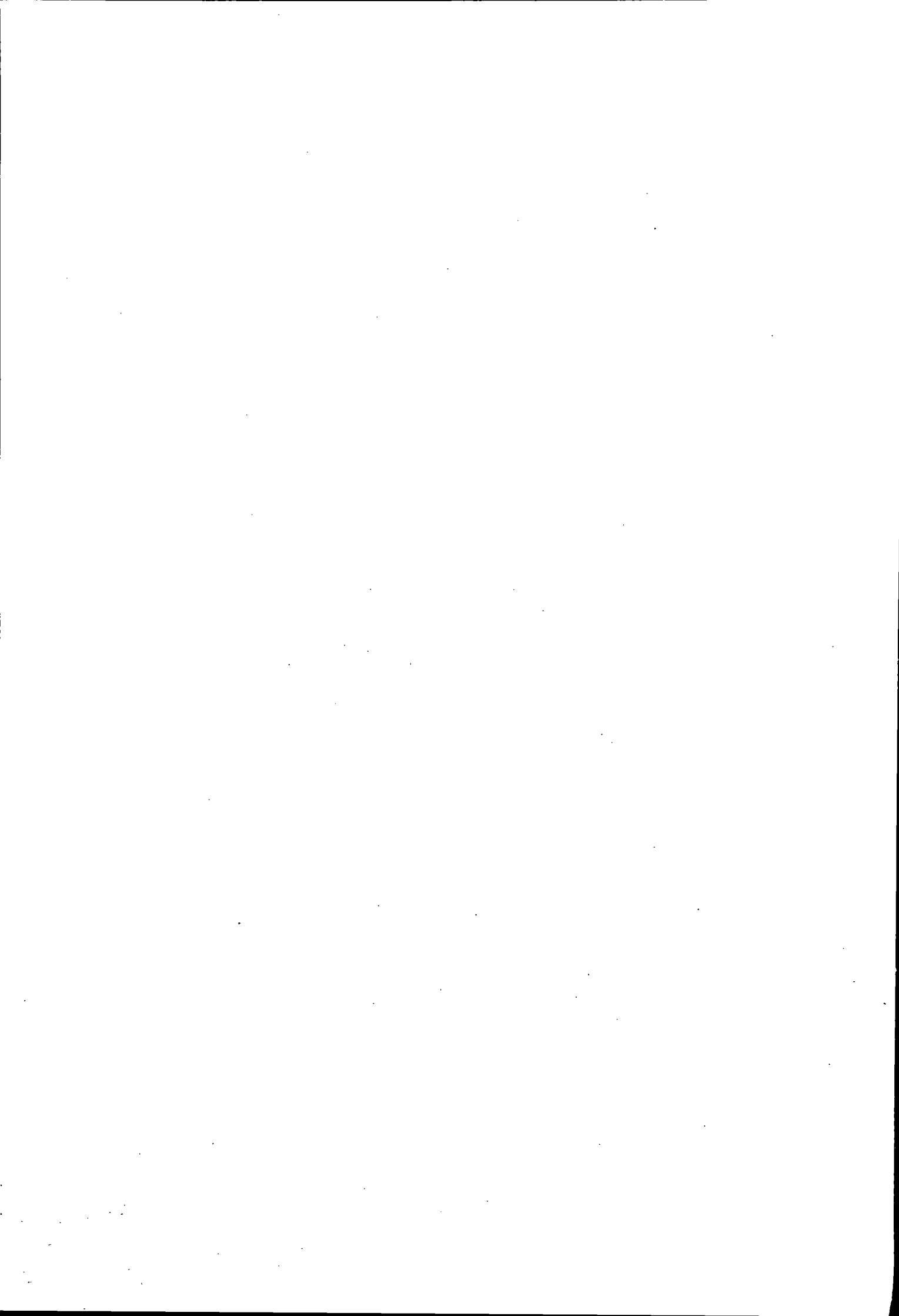
PREFACE

This Report for the year ended March 2010 has been prepared for submission to the President of India under the Article 151 (1) of the Constitution of India.

Audit of Revenue Receipts – Indirect Taxes of the Union Government is conducted under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971.

This Report presents the results of audit of receipts of customs duties.

The observations included in this Report have been selected from the findings of the test check conducted during 2009-10, as well as those which came to notice in earlier years but were not included in the previous Reports.



EXECUTIVE SUMMARY

The Report has a total revenue implication of ₹ 46.91 crore covering 22 paragraphs. We had issued another 102 paragraphs involving money value of ₹ 32.71 crore on which rectificatory action was taken by the department/Ministry in the form of issuing show cause notices, adjudicating of show cause notices and recovery of ₹ 18.01 crore. A few significant findings included in this Report are mentioned in the following paragraphs.

Chapter I: Customs receipts

- Duty foregone under various export promotion schemes during the year 2009-10 was ₹ 52,606 crore which was approximately 63 per cent of the total receipts of customs duty.

{Paragraph 1.5}

- In the last five audit reports (including current year's report), we had included 711 audit paragraphs involving ₹ 417.53 crore. Of these, the Government had accepted audit observations in 608 audit paragraphs involving ₹ 261.11 crore and had recovered ₹ 78.64 crore.

{Paragraph 1.8}

Chapter II: Incorrect assessment of customs duties

- We detected incorrect assessment of customs duty totalling ₹ 37.94 crore. These arose mainly due to delay in presentation of Bills of Entry, interest paid on Terminal excise duty refunds, incorrect adoption of rate of duty, incorrect assessment of high sea sale and non-levy of safeguard duty etc.

{Paragraphs 2.1 to 2.5}

Chapter III: General exemption notifications

- Duty of ₹ 4.06 crore was short levied due to incorrect application of exemption notifications.

{Paragraphs 3.1 to 3.4}

Chapter IV: Duty exemption/Remission schemes

- Revenue of ₹ 3.32 crore was due from exporters/importers who had availed of the benefits of the duty exemption schemes but had not fulfilled the prescribed obligations/conditions.

{Paragraphs 4.1 to 4.3}

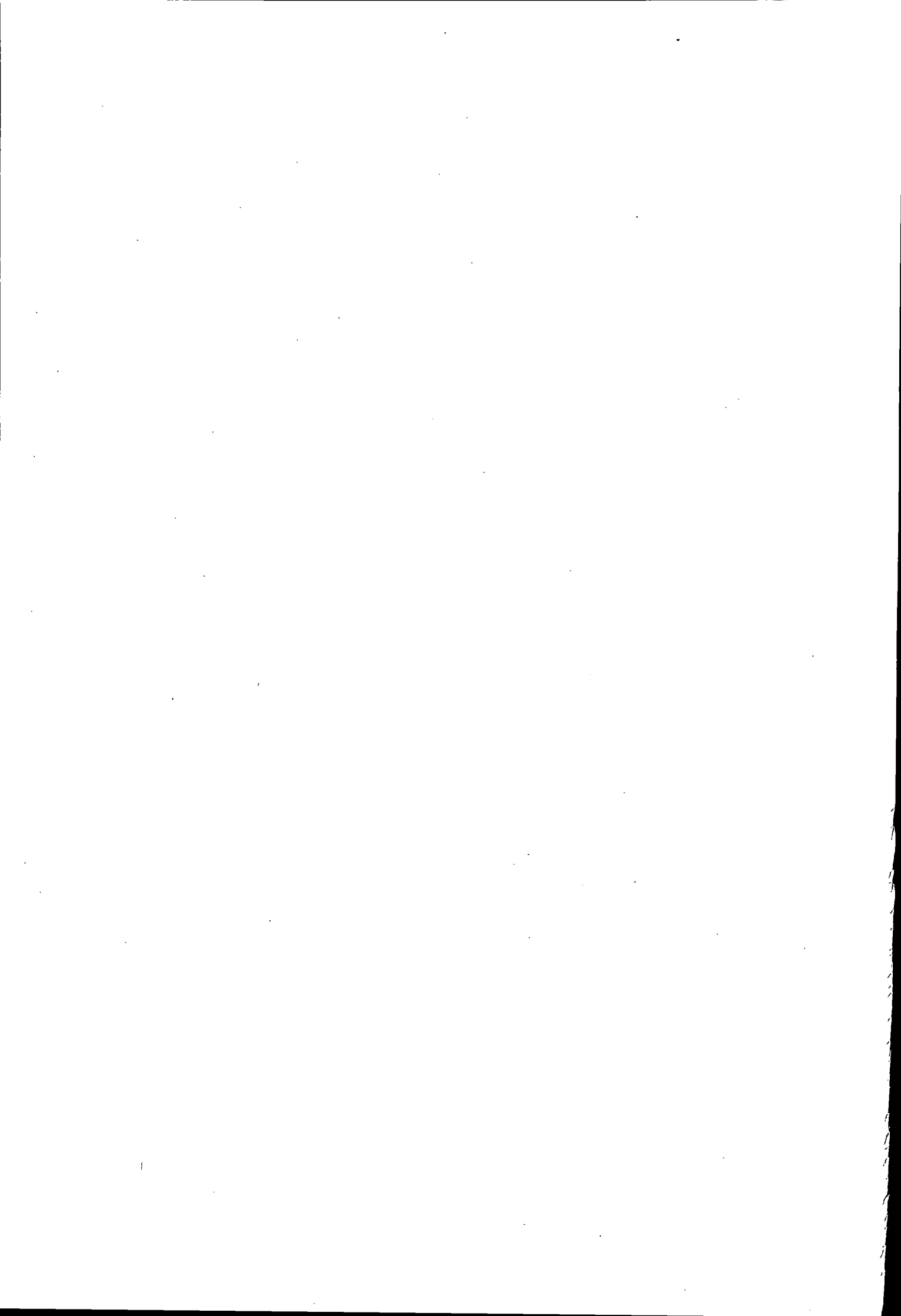
Chapter V: Classification

- Duty of ₹ 1.59 crore was short levied due to misclassification of goods.

{Paragraphs 5.1 to 5.6}

Glossar of terms and abbreviations

Expanded form	Abbreviated form
Advance release order	ARO
Basic customs duty	BCD
Bill of entry	BE
Customs tariff heading	CTH
Central Board of Excise and Customs	CBEC
Central Excise Tariff Act	CEAT
Central Excise tariff heading	CETH
Central Sales Tax	CST
Cost Insurance Freight	CIF
Commissionerate of customs	Commissionerate
Countervailing duty	CVD
Crude palm oil	CPO
Crude degummed soyabean oil	CDSO
Director General of Foreign Trade	DGFT
Duty Entitlement Pass Book	DEPB
Domestic tariff area	DTA
Duty Free Credit Entitlement Certificate	DFCEC
Duty Free Replenishment Certificate	DFRC
Export obligation	EO
Export Oriented Unit	EOU
Export Performance	EP
Export Promotion Capital Goods	EPCG
Export Processing Zone	EPZ
Free on Board	FOB
Foreign Trade Policy	FTP
Hand Book of Procedures	HBP
High speed diesel	HSD
Harmonised system of nomenclature	HSN
High sea sale	HSS
Inland Container Depot	ICD
Joint Director General of Foreign Trade	JDGFT
Letter of permission	LOP
Marine gas oil	MGO
Regional licensing authority	RLA
Rupees	₹
Show cause notice	SCN
Terminal excise duty	TED
The Ministry of Finance	the Ministry
Vishesh Krishi upaj yojana	VKUY



CHAPTER I CUSTOMS RECEIPTS

1.1 Results of audit

This Report contains 22 audit paragraphs, featured individually or grouped together, with revenue implication of ₹ 46.91 crore.

We had issued another 102 paragraphs for the audit conducted up to March 2010. The department/Ministry had already taken rectificatory action involving money value of ₹ 32.71 crore in these 102 paragraphs in the form of issuing of show cause notices, adjudicating of show cause notices and reported recovery of ₹ 18.01 crore. We have also recommended in paragraphs 2.1 and 3.1 that the Government should examine the two issues for requisite clarifications/amendments in view of ambiguity in provision and risk of revenue loss.

1.2 Budget estimates, revised budget estimates and actual receipts

The budget estimates, revised budget estimates and actual receipts of customs duties, during the years 2005-06 to 2009-10, are exhibited in the following table and graph:-

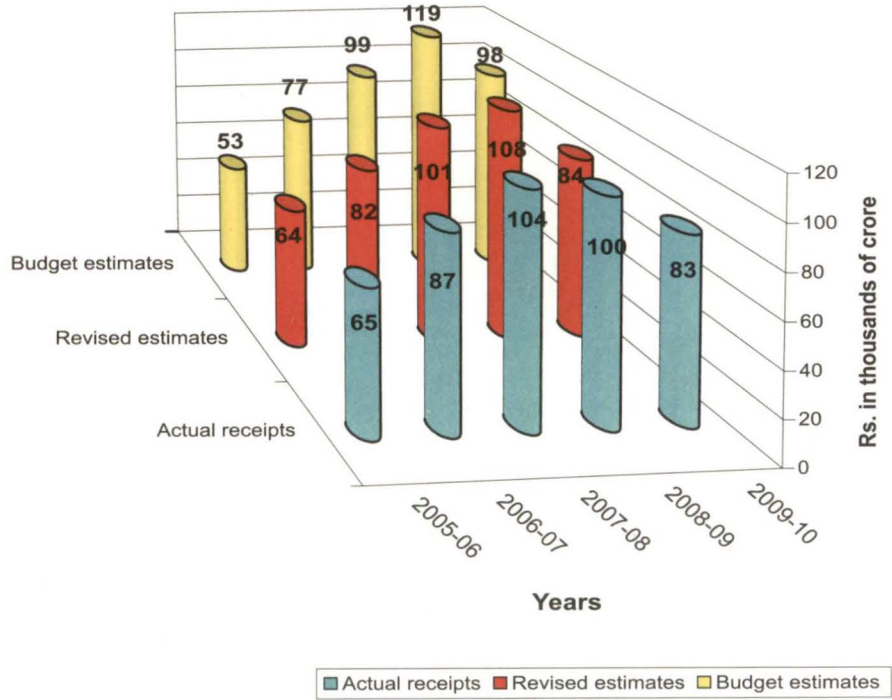
Table no. 1

(Amounts in crore of rupees)

Year	Budget estimates	Revised budget estimates	Actual receipts*	Difference between actual receipts and budget estimates	Percentage variation
2005-06	53,182	64,215	65,067	11,885	22.35
2006-07	77,066	81,800	86,327	9,261	12.02
2007-08	98,770	1,00,766	1,04,119	5,349	5.42
2008-09	1,18,930	1,08,000	99,879	(-)19,051	(-)16.02
2009-10	98,000	84,477	83,324	(-)14,676	(-)14.98

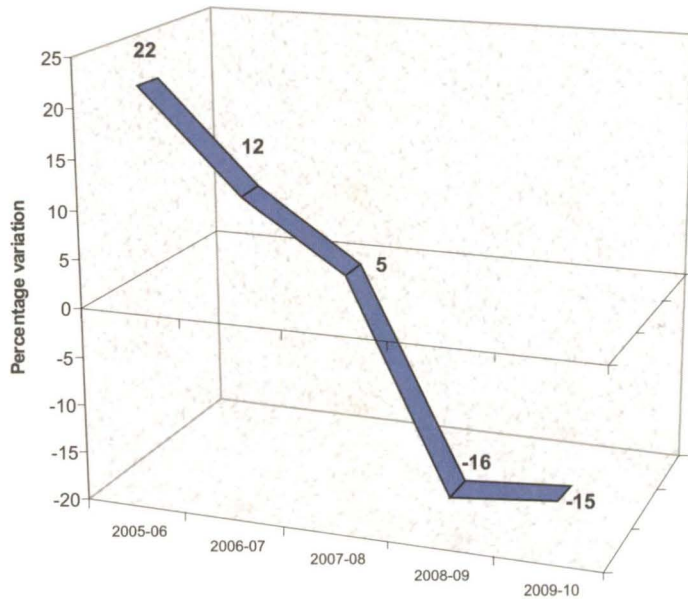
*Figures as per Finance Accounts

Graph 1: Customs Receipts – Budget, Revised and Actual



The actual receipts were more than both the budget and revised estimates during 2005-06 to 2007-08. However, the actual collection fell short of both the budget and revised estimates in 2008-09 and 2009-10. In these years, there were reductions in the duty rates for major items such as Petroleum and Electrical machinery. The percentage variation of actual receipts over the budget estimates during the years 2005-06 to 2009-10 are depicted in the following graph:-

Graph 2: Percentage variation of actual receipts over budget estimates



1.3 Trend of receipts

A comparison of total year-wise imports with the corresponding net import duties collected during 2005-06 to 2009-10 has been shown in the following table:-

Table no. 2

(Amounts in crore of rupees)

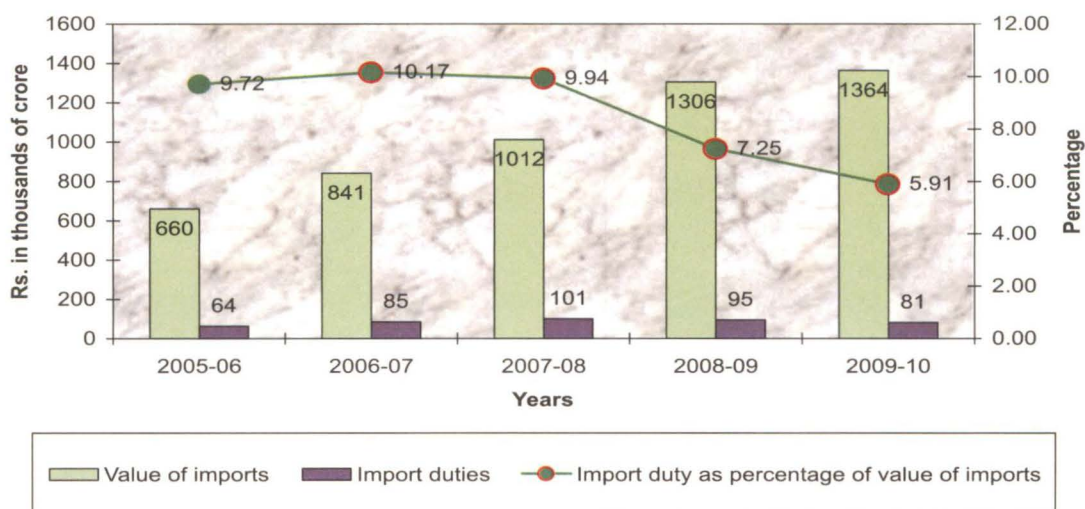
Year	Value of Imports [#]	Import duties [*]	Import duty as percentage of value of imports
2005-06	6,60,409	64,201	9.72
2006-07	8,40,506	85,440	10.17
2007-08	10,12,312	1,00,635	9.94
2008-09	13,05,503	94,583	7.25
2009-10	13,63,736	80,544	5.91

Source - *Directorate of Data Management, New Delhi

Export Import Data Bank, Ministry of Commerce, New Delhi.

While the value of imports has recorded a growth of 107 per cent over the last five years, the corresponding import duties had increased by 25 per cent.

Graph 3: Import duty as percentage of value of imports



1.4 Commodities yielding major import duties

Commodities which yielded major import duties during the year 2009-10 alongwith corresponding figures for the year 2008-09 are mentioned in the following table:-

Table no. 3

(Amounts in crore of rupees)

Sl. No.	Budget Head No.	Commodities	Import duties realised		Percentage variation in 2009-10 over 2008-09	Percentage share in total import duties collected	
			2008-09	2009-10		2008-09	2009-10
1.	44	Electrical machinery	15162	12777	(-16)	16	16
2.	41	Machinery excluding machine tools and their parts and accessories, ball or roller bearing	14593	12245	(-16)	15	15
3.	52A	All other articles not covered under commodities group at Budget head Sl.No. 1 to 52	8636	7872	(-9)	9	10
4.	18	Plastic and articles thereof	3753	4430	18	4	6
5.	11	Organic chemicals	4813	4153	(-14)	5	5
6.	46	Motor vehicles and parts thereof	4853	4108	(-15)	5	5
7.	8	Petroleum oils and oils obtained from bituminous minerals other than crude	5829	3378	(-42)	6	4
8.	50	Project imports	2380	2835	19	2	4
9.	9	Other mineral fuel, oils, waxes and bituminous substances	2577	2625	2	3	3
10.	48	Optical, photographic, cinematographic, Measuring Medical and Surgical instruments	2550	2475	(-3)	3	3
11.	29	Iron & Non-alloy steel	2534	1981	(-22)	3	2

Source- Directorate of Data Management, New Delhi

The above table indicates that by and large there was overall decline in the collection of import duties on major commodities. Commodities 'Petroleum oils and oils obtained from bituminous minerals other than crude' had shown a major decline (42 per cent) of revenue (compared to previous year), while the customs revenue from Iron & non-alloy steel had dipped by 22 per cent during the year 2009-10.

1.5 Duty foregone

Export promotion schemes

The break-up of customs duty foregone on various export promotion schemes viz., advance licence, DEPB, EPCG, EPZ, EOUs and refund of duty under drawback and other schemes, for the period from 2006-07 to 2009-10, is shown in the following table:-

Table no. 4

(Amounts in crore of rupees)

Year	Customs duty collected	Advance licence & others*	EOU/STP	Duty drawback	EPCG	DEPB	SEZ	Total (of col. 3 to 8)	Duty foregone as a percentage of customs receipts (Col.9 over percentage of Col.2)
1	2	3	4	5	6	7	8	9	10
2006-07	86,327	23,596	10,948	6,057	9,069	4,789	1,654	56,133	65
2007-08	1,04,119	20,481	18,759	9,015	8,933	4,986	1,848	64,022	62
2008-09	99,879	18,403	13,401	12,116	7,833	7,092	2,329	61,174	61
2009-10	83,324	16,264	8,076	9,219	7,020	8,008	4,019	52,606	63

*Includes DFRC/DFECC/TPS/VKUY/SFIS/DFIA/FMS/Focus product schemes

Source – Directorate of Data Management, New Delhi

1.6 Cost of collection of customs duties

The expenditure incurred on the collection of customs duty during the year 2009-10 as a percentage of customs receipt was higher than that incurred in the previous year as mentioned in the following table:-

Table no. 5

	(Amounts in crore of rupees)	
	2008-09*	2009-10*
Expenditure on revenue cum import/export and trade control functions	234.56	304.38
Expenditure on preventive and other functions	989.28	1217.85
Transfer to Reserve Fund, Deposit Account and other expenditure	11.65	9.83
Total	1235.49	1532.06
Customs receipt	99,879	83324
Cost of collection as percentage of customs receipts	1.24	1.84

* Figures as per Finance Accounts

1.7 Arrears of customs duties

The amount of customs duty assessed up to 31 March 2010 which was still to be realised as on 31 December 2010, was ₹ 4,384.19 crore.

The Central Board of Excise & Customs (CBEC) was unable to provide the breakup of disputed and undisputed arrears and period wise breakup i.e. upto five years, more than five years, more than ten years etc.

1.8 Impact/follow-up of Audit Reports

Revenue impact

In the last five audit reports (including current year's report), we had included 711 audit paragraphs involving ₹ 417.53 crore. Of these, the Government had accepted audit observations in 608 audit paragraphs involving ₹ 261.11 crore and had recovered ₹ 78.64 crore. The details are shown in the following table:

Table no. 6

Year of Audit Report	Paragraphs included		Paragraphs accepted						Recoveries effected					
			Pre printing		Post printing		Total		Pre printing		Post printing		Total	
	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt
2005-06	139	63.22	74	25.92	39	6.99	113	32.91	49	11.69	37	6.12	86	17.81
2006-07	133	121.99	94	105.18	22	7.59	116	112.77	57	7.32	25	2.31	82	9.63
2007-08	182	96.50	137	37.83	22	3.37	159	41.12	80	9.85	19	3.89	99	13.74
2008-09	133	56.20	101	33.75	17	7.85	118	41.60	68	16.54	15	2.91	83	19.45
2009-10	124	79.62	102	32.71	Not applicable		102	32.71	63	18.01	Not applicable		63	18.01
Total	711	417.53	508	235.39	100	25.80	608	261.11	317	63.41	96	15.23	413	78.64

1.9 Status of action taken notes

Public Accounts Committee in their ninth report (eleventh Lok Sabha) had desired that remedial/corrective action taken notes (ATNs) on all the paragraphs in the reports of the Comptroller and Auditor General, duly vetted by audit, be furnished to them within a period of four months from the date of laying of the audit report in Parliament.

The action taken notes on 14 paragraphs included in the Audit Report pertaining to the year 2008-09 had not been received for over eight months.

CHAPTER II

INCORRECT ASSESSMENT OF CUSTOMS DUTIES

We found a few cases of incorrect assessment of customs duties during test check, having an implication of ₹ 37.94 crore. They are described in the following paragraphs. These observations were communicated to the Ministry through five draft audit paragraphs.

2.1 Financial gain by delaying the presentation of Bills of Entry

As per section 46 read with section 48 of the Customs Act, 1962, an importer is required to present a bill of entry (BE) in respect of imported goods and take clearance within 30 days from the date of unloading or within such extended time as the department may allow. Goods not cleared, could be sold by the person having the custody after notice to the importer and with the permission of the proper officer. As per section 15 (1) of the Customs Act, 1962 the rate of duty and tariff valuation applicable to imported goods should be the rate and valuation in force on the date of presentation of BE.

The duty on Crude palm oil (CPO) was reduced from 45 per cent to 20 per cent vide notification no.37/2008-cus dated 20 March 2008 and the same was again reduced to 'nil' as per notification no.42/2008 dated 1 April 2008. Duty on Crude degummed soyabean oil (edible grade) (CDSO) was also reduced from 40 per cent to 'nil' as per notification 42/2008 dated 1 April 2008.

We found 92 consignments of 'CPO & CDSO' that were imported between December 2007 and February 2008 by M/s Adani Willmer & 22 others through Custom House, Kandla, Commissionerate. They were neither cleared within 30 days from the date of unloading nor were any extensions sought by the importers. After delays ranging from 35 days to 161 days, 92 BEs were filed between 24 March and 30 June 2008 claiming duty concessions under aforesaid notifications. The department allowed clearance of goods after imposing penalty (The penalty is token, with maximum of ₹ 1 lakh) under section 117 of the Customs Act, 1962 and duty was levied at concessional rates. Thus, the importers managed to pay lower rates by delaying the presentation of BEs. This resulted in a notional loss of revenue of ₹ 36.67 crore.

When we pointed this out (August/November 2008), the department stated (August 2009, February 2010) that:-

- i) The duties were assessed and paid at the rate prevalent on the date of presentation of BE as provided in section 15.
- ii) Custom department/customs officers were not the custodian of the goods and could not suo moto insist that the importer clear the goods within 30 days.

The reply of the department underlined the lacunae in the current set of provisions which enabled the importers to delay the clearance of imported goods beyond the prescribed period of 30 days, resulting in loss of revenue.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

Recommendation

It is recommended that the Government may examine amendments/notifications that should provide that in case of clearances after 30 days attributable to the importer, any loss of revenue suffered due to reduction in duty rates would have to be made good by the importer.

2.2 Interest paid on Terminal excise duty (TED) refunds

As per paragraph 8.3 (c) of the Foreign Trade Policy (FTP) 2004-09, deemed exports shall be eligible for refund of Terminal excise duty (TED) in respect of manufacture and supply of goods qualifying as deemed exports subject to the terms and conditions prescribed in the Handbook of procedure Vol.-I. Further, as per paragraph 8.5.1 simple interest at the rate of 6 per cent per annum will be payable on delay in refund of TED.

Test check of TED payment records in the office of the Joint DGFT, Ludhiana, revealed that in 379 cases the claims for refunds were not settled within the prescribed time limit resulting in payment of interest amounting to ₹ 75.31 lakh.

When we pointed this out (September 2009), the Regional DGFT authority stated that payment of interest was made as per the policy and claims could not be settled because of delay in allocation of funds from the DGFT, New Delhi. The reply confirmed that the delays and the resultant payment of interest of ₹ 75.31 lakh could have been avoided with the timely allocation of funds.

We reported (September 2010) the matter to the Ministry; its response had not been received (December 2010).

2.3 Incorrect adoption of rate of duty

In terms of section 3 of Customs Tariff Act, 1975 read with Central Excise notification no.2/2008 dated 1 March 2008; additional duty of customs (CVD) at the specified rate was leviable on imported goods listed in the table annexed to the notification. The rate of CVD was reduced to 10 per cent on all the goods vide Central excise notification 58/2008 dated 7 December 2008 except goods specified at serial nos. 14,16 & 18 of the notification 2/2008-CE.

M/s Delphi automotive systems Pvt. Ltd. and twenty other importers imported (December 2008 to March 2009) 42 consignments of various goods namely Grease (CTH 27101980, serial no.16), semi refined paraffin wax (CTH 27122090, serial no.18), automatic transmission fluid (CTH 27101980, serial no.16) through Chennai Sea Commissionerate for a total value of ₹ 5.37 crore and these were incorrectly assessed to CVD at the rate of 10 per cent under notification 58/2008-CE, even though they were specifically excluded from

the concession. The incorrect application of rate of duty resulted in short levy of duty of ₹ 30.96 lakh which was recoverable.

When we pointed this out (May 2009), the department reported recovery (June/October 2009) of duty of ₹ 24.37 lakh along with interest of ₹ 0.88 lakh in respect of 30 consignments. Reply for the remaining consignments had not been received (December 2010).

We reported (August 2010) the matter to the Ministry; its response had not been received (December 2010).

2.4 Incorrect assessment of high sea sale

As per Rule 3 (1) of Customs Valuation Rules 2007, the value of imported goods shall be the transaction value. The Central Board of Excise and Customs in its public notice no. 145/2002 dated 3 December 2002 clarified that in case the actual high sea sale contract price is more than 'c.i.f. value plus 2 per cent', then the actual sale contract price paid has to be considered for the purpose of duty assessment. The assessable value would also include commission charges or other expenses incurred by the importer besides landing charges of one per cent.

M/s Patanjali Ayurved Ltd. purchased capital goods e.g. "Steam Pressure Peeling machine", "Belt Press with accessories" (June/July 2009) on high sea sale basis from M/s Alfa Leval (India) Ltd against EPCG licence dated 25 March 2009. Audit scrutiny revealed that the BEs were filed on "the c.i.f. value plus two per cent of high sea sale charges" and duties were paid accordingly. Even though the "agreement values" were more than the invoice values. Thus, non adoption of agreement value for the purpose of assessment resulted in short levy of duty of ₹ 13.38 lakh.

This was pointed out to the department in February 2010, their reply has not been received (December 2010).

We reported (August 2010) the matter to the Ministry; its response had not been received (December 2010).

2.5 Non-levy of safeguard duty

As per notification no.75/09-cus dated 30 June 2009, safeguard duty is leviable on 'Phthalic anhydride' classifiable under the Customs tariff heading (CTH) 29173500, when imported from countries other than notified 'developing countries'. Such duty was to be levied on ad valorem basis at the rate of 25 per cent from 29 January 2009 to June 2009 and at the rate of 15 per cent from July 2009 to December 2009.

M/s Asian PPG Industries Ltd. and M/s Atul Ltd. imported (May/October 2009) three consignments of 'Phthalic anhydric' from Taiwan through Jawaharlal Nehru Custom House (JNCH), Mumbai. The department cleared these consignments without levy of safeguard duty. This resulted in non levy of duty of ₹ 7.59 lakh.

When we pointed this out (December 2009), the department stated that as the safeguard duty notification was rescinded, the duty was not leviable on goods.

The reply of the department was not acceptable because notification no.9/2009-cus dated 29 January 2009 imposing provisional safeguard duty was rescinded on 30 June 2009 and another notification no.75/2009-cus was issued on the same day levying safeguard duty on phthalic anhydride on a final basis.

We reported (August 2010) the matter to the Ministry; its response had not been received (December 2010).

CHAPTER III GENERAL EXEMPTION NOTIFICATIONS

The Government under section 25 (1) of the Customs Act, 1962 is empowered to exempt either absolutely or subject to such conditions as may be specified in the notification, goods of any specified description from the whole or any part of duty of customs leviable thereon. Some illustrative cases of non-levy/short levy of duties aggregating ₹ 4.06 crore due to incorrect grant of exemptions are discussed in the following paragraphs. These observations were communicated to the Ministry through four draft audit paragraphs.

3.1 Jute bags

In terms of central excise notification no. 30/2004-CE dated 9 July 2004, textiles and textile articles (Chapter 50 to 63) are exempt from central excise duty provided Cenvat credit is not taken for duty paid on inputs. Circular no. 37/2001-cus date 18 June 2001 provided that imported goods will not be eligible for benefits of exemption of part of countervailing duty (equivalent to excise duty) as they are not produced from duty paid inputs.

M/s RDB Textiles Ltd. and 17 others had imported 176 consignments of 'Jute bags' through Petrapole Land customs station under the Commissionerate of customs (Preventive), West Bengal between December 2008 and August 2009. The department extended the benefit of aforesaid notification and allowed clearance of the goods without levy of countervailing duty. Incorrect grant of exemption resulted in non-levy of duty of ₹ 3.01 crore.

When we pointed this out (October 2009), the department stated (March 2010) that CVD exemption was granted as per Board's clarification dated 20 January 2006 (F. No. 552/16/2005-LC) after ascertaining the practice being followed in West Bengal (Preventive) and Patna Commissionerates where CVD on Jute products was exempt since Indian manufacturers did not pay central excise duty on similar goods in terms of notification no. 30/2004-CE.

In our opinion, an incorrect practice was being followed by allowing exemption to imported goods which did not fulfill the condition of being manufactured from duty paid inputs as required in central excise notification no. 30/2004-CE.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

Recommendation

It is recommended that the Government may examine the issue and clarify the exact position on admissibility of exemption of countervailing duty in view of the requirement "provided Cenvat credit is not taken for duty paid inputs".

3.2 Necktie and other miscellaneous items

As per notification no.19/06-cus dated 1 March 2006, an additional duty of customs was imposed at the rate of 4 per cent ad valorem under section 3 (5) of the Customs Tariff Act, 1975 on all goods imported into India other than specified under notification no.20/06-cus dated 1 March 2006.

M/s Krish International Pvt. Ltd. and 27 other importers imported (between October 2006 to July 2008) 'Necktie' and other miscellaneous items through ICD, Tughlakabad, Delhi at total assessable value of ₹ 12.70 crore. We found that the department cleared these consignments without levy of additional duty of 4 per cent by extending the benefit available to goods specified in the first schedule to the additional duty of excise (Goods of Special importance) Act, 1957 under serial no.50 of notification 20/06. However, these goods were not covered under the aforesaid Act of 1957. This resulted in non levy of additional duty of ₹ 63.92 lakh.

When we reported (October 2010) the matter to the Ministry, it intimated recovery of ₹ 17.05 lakh including interest. Recovery particulars of the remaining amount were awaited (December 2010).

3.3 Silk yarn and woven fabrics of silk

Silk yarn (other than yarn spun from silk waste) and woven fabrics of silk or of silk waste are classifiable under Customs tariff heading (CTH) 5004 and 5007 respectively.

M/s Enterprise International Ltd. imported (July to December 2009) 13 consignments of 'Silk fabrics' and 'Thrown silk yarn' through Chennai (Sea), Commissionerate. The goods were classified under CTH 50072090 and 50040090 respectively and exempted from levy of CVD under notifications no.4/2006-CE dated 1 March 2006 (serial no.3) and 6/2006-CE dated 1 March 2006 (serial no.1 & 8). It was found in audit that the imported goods were not covered under any of these Central excise notifications. The incorrect grant of exemption resulted in short levy of ₹ 28.16 lakh.

This was reported (November 2009, January 2010 and February 2010) to the department, its reply had not been received (December 2010).

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

3.4 Disposable spinal needles

As per Customs notification no.21/2002-cus (serial no.370) dated 1 March 2002, read with notification no. 6/2006-CE dated 1 March 2006, import of specified goods including 'spinal instruments' (serial no.68) intended for use as 'assistive devices, rehabilitation aids and other goods for disabled' are exempt from duty.

M/s Healthcare Associates Pvt. Ltd. imported (July 2006/January 2007), two consignments of 'Spinocan Disposable Spinal Needle' through the Kolkata (Port) Commissionerate. The department allowed clearance of the goods at

'nil' rate of duty by extending the benefit under the aforesaid notifications. We observed that the goods were in the nature of general surgical instruments for enabling smooth penetration for spinal anesthesia and cerebrospinal fluid collection. They were not spinal instruments meant exclusively for use as 'assistive devices/rehabilitation aids' by the disabled/handicapped. Hence the exemption was irregular. Thus, incorrect grant of exemption resulted in non-levy of duty of ₹ 13.28 lakh.

When we pointed this out (December 2007), the department justified (February 2008) the grant of duty exemption on the basis that the importers of similar goods in earlier cases had submitted certificates from renowned hospitals to the effect that the imported needles were 'spinal instruments' used for operation procedure.

The contention was not acceptable. While the needles in question were certified as 'spinal instruments used for operations,' they were not certified as intended for the assistance of the disabled, as required for getting benefit of the notification.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

CHAPTER IV

DUTY EXEMPTION/REMISSION SCHEMES

The Government may exempt wholly or part of customs duties for import of inputs and capital goods under an export promotion scheme through a notification. Importers of such exempted goods undertake to fulfil certain export obligations (EO) as well as comply with specified conditions, failing which the full rate of duty becomes leviable. A few illustrative cases where duty exemptions were availed of without fulfilling EOs/conditions are discussed in the following paragraphs. The total revenue implication in these cases is ₹ 3.32 crore. These observations were communicated to the Ministry through seven draft audit paragraphs.

4.1 Advance licence scheme

Import of inputs after invalidation for indigenous procurement

In terms of paragraph 4.14 of HBP Vol.-I (2004-09), Advance licence holders may apply to Regional Licensing Authority (RLA) for the grant of Advance release order (ARO) to procure inputs from indigenous sources/State Trading Enterprises. Advance release orders are issued after invalidating the licence for imports.

M/s TVS Srichakra Ltd., Madurai was issued (August/October 2005, June 2006) three advance authorisation licences through RLA, Madurai to import inputs required for the export of automobile tyres. On the request of the licensee the RLA invalidated these licences for the entire quantity of 8,18,496 kgs of carbon black (input) allowed for direct import. We found that the licensee incorrectly imported 7,62,600 Kgs of carbon black under these three licences in addition to indigenous sourcing of the same. The customs duty foregone amounting to ₹ 1.03 crore was recoverable alongwith interest from the licensee as this item had been invalidated for import.

When we pointed this out (August 2009/April 2010), the RLA reported (June 2010) recovery of ₹ 13.68 lakh and interest of ₹ 6.00 lakh in respect of one licence. Reply in respect of remaining two licences had not been received (December 2010).

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

4.2 Export oriented units (EOUs)/Export processing zone (EPZ) scheme

4.2.1 Adoption of incorrect assessable value

Rule 47 (4) of the Special Economic Zone (SEZ) Rules, 2006 provides that valuation and assessment of the goods cleared into Domestic Tariff Area (DTA) shall be made in accordance with Customs Act and Rules made there under.

According to Rule 10 (2) of the Customs Valuation (Determination of value of imported goods) Rules, 2007, the value of the imported goods for the purpose of sub-section (1) of the Section 14 of the Customs Act, 1962 and Customs Valuation Rules, 2007 shall be the value of such goods, and shall include additional costs and services, namely, (a) freight, (b) insurance, and (c) loading, unloading and handling charges.

In respect of 3019 consignments of goods cleared into DTA by M/s Coastal Energy Ltd. and other 49 SEZ units under the jurisdiction of the Development Commissioner (DC), Falta SEZ and the commissionerate of Customs (Airport) Kolkata between April 2008 and October 2009, the invoice/transaction value of goods was taken as assessable value for payment of duty on such clearances. Scrutiny revealed that such invoice/transaction value did not include cost of insurance and landing charges for clearance to DTA. After adding these components, the assessable value worked out to ₹ 292.61 crore (excluding cost on account of freight since clearance was made at the SEZ gate). The incorrect computation of assessable value resulted in short levy of ₹ 90.46 lakh.

When we pointed this out (November 2009), the DC stated (March 2010) that the objection was not acceptable because the imported goods were brought to SEZ units after adding freight, insurance, landing and handling charges etc. with the transaction value which formed the assessable value of the goods. It was further stated that since these charges were already included in the assessable value at the time of import to SEZ, further inclusion of these expenses for assessing DTA bills of entry was not justified.

The reply of the department was not acceptable. When SEZ units clear goods in DTA it acts as an exporter and the domestic buyer treats it as import into the country and accordingly the value shall be transaction value which should include the cost of freight, handling charges and insurance charges in terms of customs valuation (Determination of value of imported goods) Rules 2007. Insurance and handling charges are again incurred during transfer of goods out of SEZ, which are unrelated to those added with transaction value of the goods at the time of their entry into SEZ and are therefore to be included in the assessable value.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

4.2.2 *Incorrect DTA sale of waste generated during manufacturing process*

In terms of first proviso to paragraph 3 of notification no.52/2003-cus dated 31 March 2003, as amended, where non excisable finished goods (including waste) or goods leviable to nil rate of BCD/CVD are produced by an EOU and allowed to be sold in the DTA, no exemption shall be available in respect of inputs utilised for manufacture of such finished goods including waste.

M/s Abhishek Mills Ltd. and M/s Eurotex Industries & Exports Ltd., two EOUs under Pune II Commissionerate, manufacturing cotton yarn from duty free imported raw cotton, cleared 'cotton waste' (arising out of the production process) in DTA during the period 2005 to 2009 at 'nil' rate of Central Excise duty under the notification no.23/2003-CE dated 31 March 2003. Since

effective basic customs duty and CVD under the notification were 'nil' for DTA sale, the cotton waste was non excisable in terms of paragraph 6.8 (j) of the FTP 2004-2009. Therefore, duty of ₹ 75.86 lakh was payable on that portion of inputs which was generating the cotton waste.

When we pointed this out (December 2009), the department stated (March 2010) that cotton waste classifiable under Central Excise Tariff Act (CETA), 1985 heading 5202 was excisable and attracted 'nil' rate of duty. It was also stated that cotton waste could not be considered as non excisable merely because it was not liable for duty as per first schedule of CETA or under some exemption notification. The department's reply is not acceptable. This was a case of DTA sale of goods manufactured by EOU, where BCD and CVD was 'nil' rendering such goods ('cotton waste' in this case) as non excisable for payment of duty in terms of aforesaid paragraph 6.8 (j) of the FTP. This was communicated to the department in August 2010, its response had not been received (December 2010).

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

4.2.3 Incorrect reimbursement of Central sales tax

As per paragraph 6.11 (c) of the FTP 2004-09, EOUs are entitled to full reimbursement of 'Central Sales Tax (CST)' on purchases made from DTA for production of goods. In terms of clause 2 (a) of Appendix 14-I-I of the Hand Book of Procedures (HBP) Volume-1, admissibility of the reimbursement is subject to the condition that the supplies from DTA must be utilised by the EOU for production of goods meant for export and/or utilised for export products. However, provision of Appendix 14-I-1 was amended in the FTP 2009-14, w.e.f August 2009, removing the compulsion of goods for export and allowing reimbursement of CST to EOUs on supplies from DTA provided these were utilised by the EOUs for production of goods/services.

M/s Granules India Ltd. a 100 per cent EOU functioning under the jurisdiction of the DC, Visakhapatnam Special Economic Zone (VSEZ), Hyderabad was granted reimbursement of CST amounting to ₹ 1.63 crore on raw materials/consumables procured and utilised by the assessee in production of granulated products between 2006-07 and 2008-09. However, this amount also included reimbursement of ₹ 32.64 lakh on raw materials which were used to make finished products that were sold back in DTA before August 2009, (i.e date of effect of amendment in the FTP). This resulted in excess reimbursement of CST amounting to ₹ 32.34 lakh.

When we pointed this out (July 2008), the DC, VSEZ stated (June 2010) that there was no such restriction that CST is to be restricted in proportion to the value of inputs used in export production. The department further added that CST is to be reimbursed to the EOUs for any inputs used in production.

The reply of the department was not acceptable. The position cited by the department had become applicable only from August 2009 i.e. after the amendment in FTP 2009-14. Prior to that, CST reimbursement was available only for exported goods.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

4.2.4 Irregular DTA sale

In terms of paragraph 6.8 (a) of FTP 2004-09, an EOU may sell goods upto 50 per cent of FOB value of exports in Domestic Tariff Area (DTA) at concessional rate of duties subject to fulfillment of positive NFE. Within the entitlement of DTA sale the unit may sell in DTA its products similar to the goods which are exported or expected to be exported from the units.

M/s Jabs International Pvt. Ltd. was issued Letter of Permission (LOP) in December 1998 which was further revised in August 2004 for manufacture and export of processed spices and oil seeds. The unit had cleared the goods 'Mace' and 'Pippali' during 2005-06 to 2006-07 in DTA at a concessional rate of duty under notification no. 23/2003-CE dated 31 March 2003. Audit scrutiny of sales invoices revealed that these items were never exported by the unit during the period between 2005-06 and 2007-08. As per aforesaid paragraph, clearance in DTA at concessional rate of duty is applicable only if the similar goods are exported or expected to be exported. Since the unit had not exported similar goods, grant of concessional rate of duty was irregular. This resulted in short levy of duty of ₹ 16.29 lakh.

When we pointed this out (August 2009), the department admitted the objection in respect of "Pippali" and informed (July 2010) that a show cause notice has been issued to the unit for DTA sales during 2005-06 and 2006-07. However, in case of 'Mace', the department stated that the imported item was utilised for manufacture of curry powder, which was subsequently exported. Hence, clearance of 'Mace' in DTA at concessional rate of duty was valid and as per law. The department's reply was not acceptable because as per paragraph 6.8 (a) of FTP, an EOU may sell products in DTA similar to goods exported or expected to be exported. The unit had used 'Mace' to manufacture and export 'Curry powder'. Therefore, it was entitled to clear 'Curry powder' to DTA but was not entitled to clear mace.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

4.3 Vishesh krishi upaj yojana (VKUY) scheme

Excess grant of duty credit

As per paragraph 3.8.2 of FTP 2004-2009, exporters of agriculture products are entitled to duty credit under Vishesh Krishi Upaj Yojana (VKUY) scheme equivalent to 5 per cent of FOB value of exports. However, where the exporter has availed benefit under chapter 4 (duty exemptions scheme) of the FTP, such duty credit shall be graded only at a reduced rate of 3.5 per cent of the FOB.

M/s Priti Oil Ltd. and two other exporters under the jurisdiction of the JDGFT, Cuttack were issued (March 2007 and May 2009), five VKUY scrips for duty credit of ₹ 45.81 lakh at 5 per cent of the FOB value for export of agricultural products (Neutralised bleached Sal Fat, Reprocessed cleaned and graded India

Niger seed etc.). We found that the exporters had also availed of the benefit of duty exemption under Duty entitlement pass book (DEPB) scheme of the FTP. The duty credit under VKUY scheme was therefore admissible for ₹ 31.93 lakh. This resulted in excess grant of duty credit for ₹ 13.88 lakh.

When we pointed this out (July 2009), the JDGT, Cuttack citing DGFT policy circular no. 3 (RE 2008)/2004-2009 dated 24 April 2008 (Paragraph 3) stated (July 2009) that since the exporters had claimed DEPB benefit for packing materials under serial no. 22D of product code 90 of DEPB schedule, grant of VKUY benefit at higher rate of 5 per cent was justified. The JDGFT reiterated its stand subsequently (December 2009) based on clarification from the DGFT, New Delhi issued in this regard on 29 September 2009 (letter F. No. 01/91/180/764/AM 10/PC-3/348).

The reply of the JDGFT was not acceptable. The DEPB rates under the aforesaid entry at serial no. 22D was not meant exclusively for packing material, rather it provides DEPB rates for export product for which no specific DEPB rates have been notified, packed in any packing material. Further, paragraph 4 of the circular dated 24 April 2008 allowed VKUY credit at higher rate of 5 per cent where exporters availed drawback up to 1 per cent only. It was noticed that in these cases the exporters had availed DEPB drawback at a rate exceeding 1 per cent. Accordingly, they were eligible for VKUY credit at the lower rate of 3.5 per cent. The DGFT clarification of 29 September 2009 was not applicable to these exports made prior to 27 August 2009 under the then provision in paragraph 3.8.2 of FTP (2004-2009).

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

CHAPTER V CLASSIFICATION

A few cases of incorrect classification of goods resulting in short-levy/non-levy of customs duties of ₹ 1.59 crore noticed in test check are discussed in the following paragraphs. These observations were communicated to the Ministry through six draft audit paragraphs.

5.1 Insecticides, rodenticides, fungicides and herbicides

'Insecticides, rodenticides, fungicides and herbicides' are classified under Customs tariff heading (CTH) 3808 and leviable to basic customs duty (BCD) at the rate of 10 per cent.

M/s J.U. Pesticides and Chemicals Pvt. Ltd. and M/s Tropical Agro System (India) Ltd. imported (January to July 2009) 44 consignments of 'Imidacloprid 95 per cent technical', 'Pretilachlor 95 per cent technical' and other chemicals used as insecticides, herbicides and fungicides for a value of ₹ 30.10 crore through Chennai (Sea), Commissionerate. The imported goods were classified under CTH 29420090/29201100 as 'other organic compound' / 'esters of other inorganic acids' and assessed to concessional BCD at the rate of 7.5 per cent under notification no.21/2002-cus dated 1 March 2002 (serial no.553) instead of applicable rate of 10 per cent.

As these goods were 'technical grade chemicals meant for pesticides/insecticides' they merit classification under the CTH 3808 in terms of the Board's circular no.727/43/2003-CX dated 29 July 2003 and 34/2007-cus dated 17 September 2007. The misclassification had resulted in short levy of duty of ₹ 87.47 lakh.

When we pointed this out (July/October 2009), the department stated (September 2009/July 2010) that demand notices have been issued to the importers. One importer had contested the audit observation while the other had given an interim reply. The department further stated that adjudication proceedings are being initiated. Further progress was awaited (December 2010).

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

5.2 Food Flavouring material

As per Section 5(b) of notes under Chapter 21 of the Customs Tariff Act (CTA), preparations for use, either directly or after processing (such as cooking, dissolving or boiling in water, milk or other liquids) for human consumption are classifiable under Customs tariff heading (CTH) 2106. 'Food Flavouring material' is classifiable under CTH 21069060 and leviable to BCD at the rate of 30 per cent under notification no 21/2002- cus dated 1 March 2002 (serial no.47).

M/s International Flavours and Fragrances India Ltd. and M/s Symrise Private Ltd. imported (May to December 2009) 20 consignments of 'Tomato Flavour

Powder' through Chennai (Sea), Commissionerate. The department classified these goods under CTH 33021010 and levied BCD at the rate of 10 per cent under notification 21/2002 (serial no.119). The imported goods being food flavouring material merit classification under CTH 21069060 and leviable to BCD at 30 per cent under notification 21/2002 (serial no.47). The misclassification of these goods had resulted in short levy of duty of ₹ 23.87 lakh.

When we pointed this out (October 2009, January and February 2010), the department stated (January 2010) that the imported goods were comprising of synthetic aromatic chemicals and essential oils and hence classifiable under CTH 330210. The reply of the department was not acceptable, as it had been ascertained from the ingredient details that the imported goods were produced from Tomato/Tomato pulp. Accordingly these merit classification under CTH 2106.

We reported (September 2010) the matter to the Ministry; its response had not been received (December 2010).

5.3 Vegetable waxes

'Vegetable waxes' are classified under Customs tariff heading (CTH) 15211019 and attracts basic customs duty (BCD) at the rate of 30 per cent.

M/s Perfetti Van Mella India Pvt. Ltd., Gurgaon imported three consignments of 'Tren wax oil'. The department classified the imported goods under CTH 34049090 as 'Artificial waxes and prepared waxes' and levied BCD at the rate of 10 per cent. We found that the ingredients of 'Tren wax oil' were vegetable oils, wax esters, vegetable fat and soya lecithins. These products are used as anhydrous mould release agent for pastries and confectionery. Moreover, the importer was a manufacturer of confectionary items. Accordingly, 'Tren wax oil' should have been classified under CTH 15211019 as 'Vegetables waxes' and BCD at the rate of 30 per cent should have been levied instead of 10 per cent. This misclassification resulted in short levy of duty of ₹ 14.78 lakh.

This was reported (November/December 2009, February 2010) to the department, their reply had not been received (December 2010).

The reply of the Ministry had not been received (December 2010).

5.4 Marine diesel oil (Light diesel oil (LDO))

Marine gas oil {High speed oil (HSD)} is classifiable under Customs tariff heading (CTH) 27101930 and attracts BCD at the rate of 7.5 per cent and additional duty at ₹ 1.25/litre. But Marine diesel oil {Light diesel oil (LDO)} is classifiable under CTH 27101940 and attracts BCD at the rate of 10 per cent and additional duty at ₹ 2.50/ litre.

On conversion (April/October 2007) of two foreign run vessels to coastal run ones, oil remaining in bunkers was classified as HSD under CTH 27101930 instead of the correct classification of LDO under CTH 27101940 and levied duty at lower rates. This resulted in short levy of ₹ 12.88 lakh.

When we pointed this out (February 2007/December 2009), the department confirmed (December 2009) a demand of ₹ 10.70 lakh in respect of one consignment. However, in respect of another, although it issued a demand letter, it also stated that the objection was not legally sustainable as it was raised after the statutory time limit of six months.

The reply of the department was not accurate because the objection was initially raised in July 2007, well within the statutory time limit. The statement of facts, which is a subsequent stage in the audit reporting process, was issued thereafter in December 2009.

We reported (October 2010) the matter to the Ministry; its response had not been received (December 2010).

5.5 Shaft assembly drives

'Shaft assembly drives' are to be classified under Customs tariff heading (CTH) 8708 as 'parts and accessories' of Motor Vehicles, in terms of notes under CTH heading 8708 in the Harmonized system of nomenclature (HSN), wherein it was specifically mentioned that gear boxes of all types, shafts (Other than internal parts of engine) and other transmission parts and components (for example, propeller shafts, half shafts etc) are to be included under this heading as parts and accessories.

M/s Toyota Kirloskar Motor Pvt Ltd. imported (June 2009 to February 2010) 60 consignments of 'Shaft assembly FR Drives' through Chennai (Sea), Commissionerate. The department classified the imported goods under CTH 84831099 and levied BCD at the rate of 7.5 per cent instead of at the rate of 10 per cent. We found that the imported goods were actually 'automotive parts used in the manufacture of Car' and not parts of any machinery and merited classification under CTH 87085000. The incorrect classification resulted in short levy of duty of ₹ 12.43 lakh.

When we pointed this out (January/March 2010), the department replied (March 2010) that the shaft assembly drive was a connecting shaft between an engine (source of power) and the wheels, and the imported component acted as the transmission shaft. Moreover, since the goods were specifically covered under CTH 84831099, the assessment was in order.

The reply of the department was not acceptable. The importer is a manufacturer of motor vehicles falling under Chapter 87 and the goods were to be used solely/principally for the manufacture of motor vehicles. Besides, the imported goods have not been excluded from classification under CTH 8708 by the provisions of the notes to Section XVII of the Customs tariff. Moreover, the Technical write-up revealed that "Shaft assembly drive was nothing but a drive shaft, which was a transmission medium used to transfer the power from gear box to road wheels". Further, as per note 3 of section XVII of the Customs tariff, a part or accessory which answers to a description in two or more of the headings of those chapters is to be classified under that heading which corresponds to the principal use of that part of accessory. Moreover, the CBEC in their circular dated 9 July 1990, specified classification of Gear boxes under CTH 8708 when they have been specifically designed for use with vehicle of section XVII of central Excise

tariff Act 1985. Accordingly, the imported goods merit classification under heading 8708, since they were used solely as parts of motor vehicles.

The response of the Ministry had not been received (December 2010).

5.6 Micro-crystalline wax

'Micro-crystalline wax' is classifiable under Customs tariff heading (CTH) 27129010 and attracts basic custom duty (BCD) and countervailing duty (CVD) at the rate of five per cent and 14 per cent respectively.

M/s Perfetti Van Mella India Pvt. Ltd., Haryana imported (June 2009 to January 2010), 23 consignments of 'Micro-crystalline wax' valued at ₹ 6.43 crore. The department incorrectly classified the imported goods under CTH 340490 as 'Artificial prepared waxes' and levied BCD at the rate of 10 per cent and CVD at the rate of 8 per cent. This misclassification resulted in short levy of duty of ₹ 7.44 lakh.

When we reported the matter (August 2010), the Ministry admitted the observation and stated (December 2010) that proceedings had been initiated to recover duty short levied. Further progress was awaited (December 2010).

New Delhi

Dated :

15 मार्च
MAR 2011



(SUBIR MALLICK)

Principal Director (Indirect Taxes)

Countersigned

New Delhi

Dated :

15 मार्च
MAR 2011



(VINOD RAI)

Comptroller and Auditor General of India