



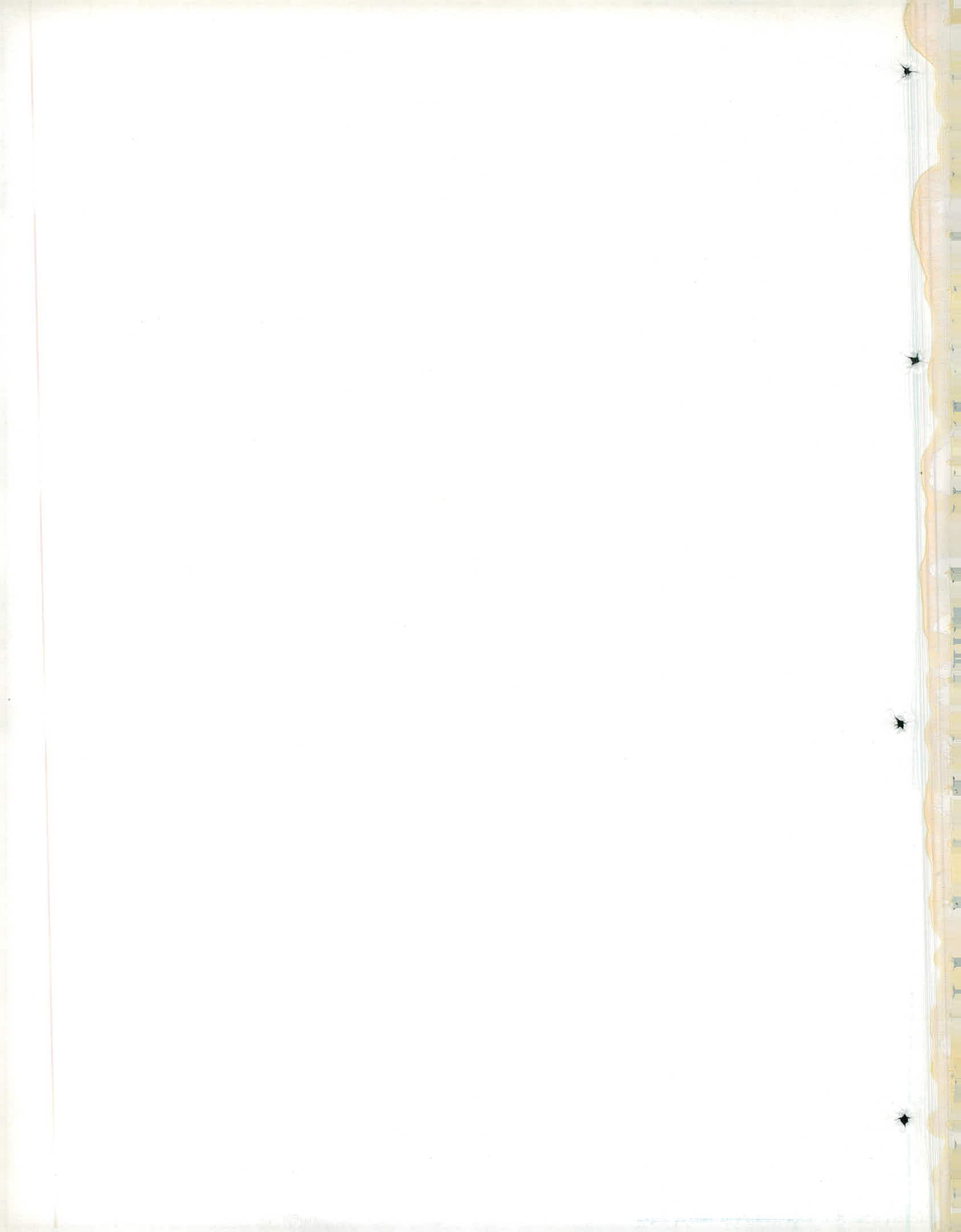
सत्यमेव जयते

Report of the  
Comptroller and Auditor General  
of India

for the year ended March 1997

10 JUN 1998

Union Government  
(Indirect Taxes- Customs)  
No. 10 of 1998





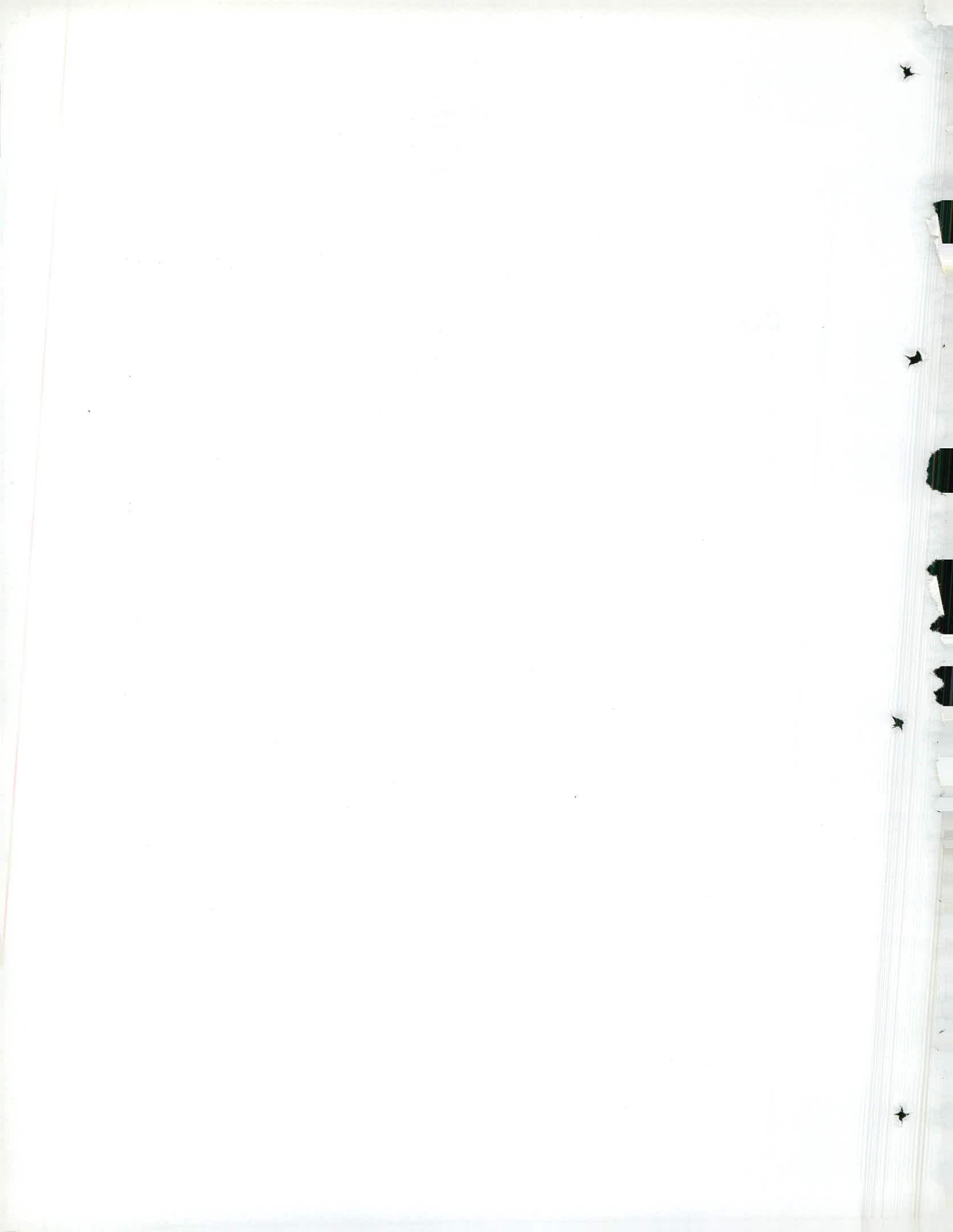
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**REPORT OF THE  
COMPTROLLER AND AUDITOR GENERAL  
OF INDIA**

**FOR THE YEAR ENDED 31 MARCH 1997**

**NO. 10 OF 1998**

UNION GOVERNMENT  
REVENUE RECEIPTS - INDIRECT TAXES  
(CUSTOMS)



# *Contents*

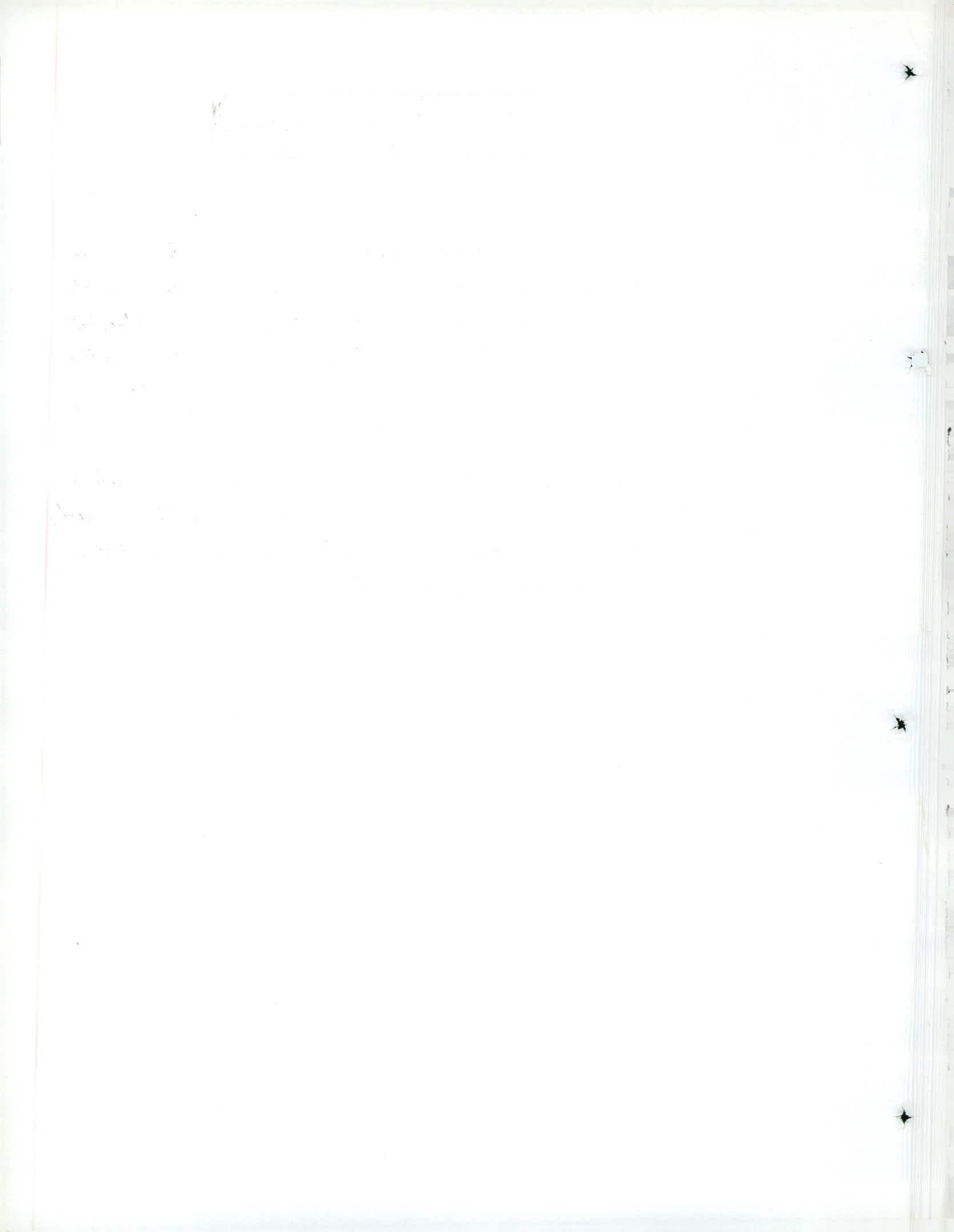
<b>Chapter</b>	<b>Paragraph</b>	<b>Page</b>
Prefatory remarks		(iii)
Overview		(v)
Statistical Information	1	1
Review on 'Export Processing Zones'	2	15
Short levy due to undervaluation	3	45
Short levy of duty due to incorrect classification	4	49
Short levy due to incorrect grant of exemption	5	55
Non levy/short levy of additional duty	6	66
Irregularities in Duty Exemption Scheme	7	71
Other topics of interest	8	82



## *Prefatory remarks*

*This Report for the year ended 31 March 1997 has been prepared for submission to the President under Article 151 of the Constitution based on the audit of Customs Receipts of the Union of India in terms of Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.*

*The cases mentioned in the Report are among those which came to notice in the course of audit during 1996-97 and early part of 1997-98 as well as those which came to notice in earlier years but could not be reported earlier.*





# Overview

This report contains one review and 184 paragraphs involving non levy/short levy of customs duty of Rs.4108.32 crore. Some of the important audit findings included in the Report are highlighted below:

## I. GENERAL

The net receipts from customs duties during the year 1996-97 amounted to Rs.42,851 crore against the Revised Estimates of Rs.44,135 crore.

[Paragraph 1.1]

An analysis of 10 commodities, which accounted for 62.24 per cent of the total customs revenue during 1996-97 showed that there was an increase in the value of imports and the duty collected thereon for all the commodities except in respect of 'Machinery and electrical machinery' as compared to the previous year. The average rate of duty also went up for all the commodities except 'Animal or vegetable fats'.

[Paragraph 1.4]

Customs duty of Rs.9189.09 crore was forgone on imports made under 4 major export related schemes during 1996-97.

[Paragraph 1.5]

## II. REVIEW ON 'EXPORT PROCESSING ZONES'

The basic objective of the EPZ Scheme was to develop export oriented industries with a view to augment foreign exchange earnings. The Development Commissioners appointed by the Ministry of Commerce monitor and coordinate the functioning of each Zone while the Customs department (Ministry of Finance) acts in close liaison with them in providing the bond facilities.

a) An appraisal of the seven EPZs was undertaken during August 1996 to July 1997. Out of 2333 units granted letters of Approval, 513 units were

functional as on 31 March 1997. The Ministry of Commerce stated that 1351 projects/LOAs had been cancelled or lapsed on account of non-implementation indicating 58 per cent mortality in the units approved.

During the five year period ending 1996-97 the foreign exchange outgo on imports made by the units and the customs duty forgone amounted to Rs.16461.58 crore against which exports of only Rs.13563.87 crore were reported. This would indicate that the EPZ scheme is not viable even against these two parameters though they enjoy a number of concessions. Ministry of Commerce has also not carried out any cost benefit analysis of the scheme.

b) Despite PAC recommendations that the purpose of the Customs exemption notification on EPZ should be clearly spelt so that no private party is in a position to take advantage of the notification without fulfilling the objectives of the scheme and that the notifications be modified to clearly bring out the provisions to avoid loss of revenue, **the customs notification issued in June 1994 (133/94) rescinding the notifications issued earlier did not indicate that the exemptions granted were subject to fulfilment of the prescribed V.A./E.O.**

c) In the Exim Policy for 1997-2002, the methodology for calculating value addition was substantially diluted making the value addition formula less stringent as compared to that of 1992-97.

d) The appraisal highlights the following points:

**Out of 513 functional units and 160 closed units, records relating to 167 functional and 139 closed units were test checked, revealing short collection of duty of Rs.1897.25 crore. An interest of Rs.1045.32 crore was also recoverable from them.**

-- 66 units which had completed five years of commercial production did not achieve the export obligation/value addition prescribed, the duty recoverable from them was Rs.1766.73 crore including interest of Rs.694.44 crore. Out of these, 14 units recorded negative value addition on which duty recoverable with interest was Rs.951.39 crore.

Further in 15 units the short fall exceeded 50 per cent on which duty recoverable along with interest amounted to Rs.461.86 crore.

[Paragraph 2.4]

- 85 units which were closed did not achieve export obligation/value addition. The duty recoverable from them was Rs.462.15 crore including interest of Rs.180.99 crore.

[Paragraph 2.5]

- Foreign exchange amounting to Rs.106.48 crore remained unrealised from 101 units.

[Paragraph 2.6]

- Failure to achieve the currency balancing resulted in short levy of duty amounting to Rs.110.77 crore in 9 units.

[Paragraph 2.7]

- Non-levy/short levy of customs and excise duties amounted to Rs.217.95 crore on irregular DTA sales was noticed in 46 units.

[Paragraph 2.10]

- Other irregularities like shortage of stocks, goods not utilised in manufacture of export products, irregular sale of scrap/rejects etc., involved non-levy of duty of Rs.183.16 crore in case of 26 units.

[Paragraph 2.11]

### **III. IRREGULARITIES IN ASSESSMENTS**

Test audit of the records of the Custom Houses/ Commissionerates of Customs revealed unassessments and loss of revenue of Rs.1164.25 crore. The Ministry of Finance have accepted loss of revenue of Rs.14.93 crore.

-- Undervaluation of goods liable for customs duty resulted in short collection of Rs.57 lakh in 11 cases.

[Paragraph 3]

-- In 33 cases imported goods were incorrectly classified leading to short levy of Rs.2.68 crore.

[Paragraph 4]

-- Irregular grant of exemptions on medical equipments imported by private hospitals and on imports made by charitable institutions; incorrect application of exemption notifications etc; lead to short recovery of duty of Rs.46.86 crore.

[Paragraph 5]

-- Additional duty leviable under Section 3 of the Tariff Act amounting to Rs.1.43 crore was not levied/short levied in 38 cases.

[Paragraph 6]

-- Inadequate monitoring by Custom Houses/licensing offices on 54 Advance licences issued resulted in loss of revenue of Rs.1070.35 crore.

[Paragraph 7]

-- Other irregularities like, non recovery of brand rates of drawback granted without verification of the inputs data; non collection/short collection of Inland air travel tax, foreign travel tax, delay in disposal of warehoused goods, delay in realisation of revenue etc., lead to loss of Rs.42.35 crore.

[Paragraph 8]

## 1.1 CUSTOMS RECEIPTS

The customs revenues have witnessed a buoyancy in the recent past. This is attributable mainly to the rising trend in the imports following the liberalisation of the Indian economy. On the basis of the information furnished by Principal Chief Controller of Accounts, CBEC, the net receipts from customs duties during the year 1995-96 and 1996-97 (alongwith the budget estimates and the revised estimates for 1996-97) are shown in the table below.

(Rupees in crore)

Net Customs Receipts from	Actual Receipts 1995-96	Budget estimates 1996-97	Revised estimates 1996-97	Actual Receipts 1996-97
Imports	34717	42128	42265	
Special customs duty	—	1600	1400	42110
Exports	39	01	03	23
Cess on exports	116	122	140	142
Sale proceeds of confiscated goods	442	150	50	235
Other receipts	414	434	277	341
<b>Net receipts</b>	<b>35728</b>	<b>44435</b>	<b>44135</b>	<b>42851</b>

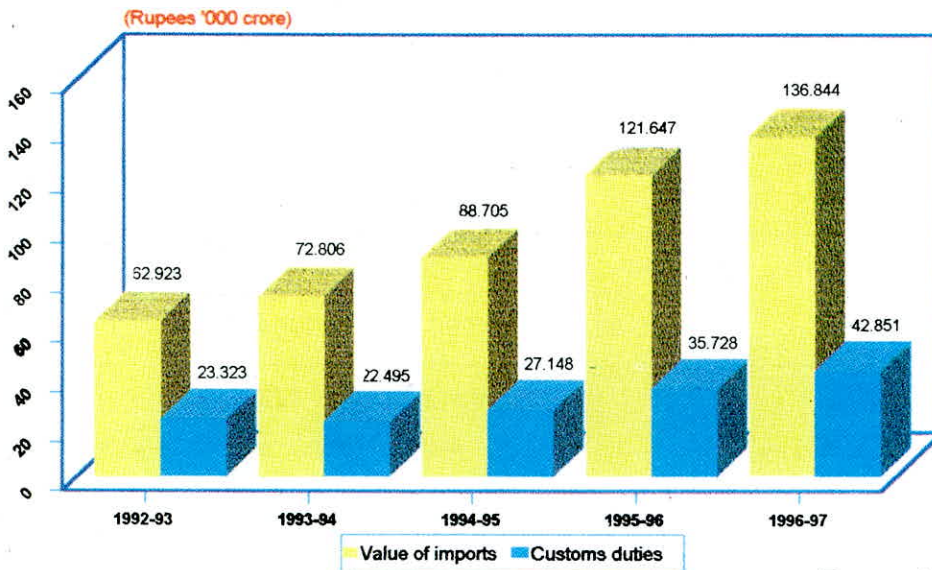
(N.B. The figures shown have been arrived at after deducting refunds and drawback paid)

Though the actual receipts in 1996-97 has registered a growth of 19.94 per cent over the receipts of 1995-96, yet the receipts in 1996-97 fell short by 2.91 per cent with reference to the revised estimates. The increase in collection over the previous year could be attributed mainly to the levy of special customs duty in 1996-97. Higher revenue realisations over the previous year was also noticed in respect of imports from Petroleum (crude) and Petroleum products, inorganic chemicals, plastics, aluminium, aircrafts and vessels, clocks and watches etc.

## 1.2 TREND OF RECEIPTS

A comparison of total year-wise imports with the corresponding net customs duties collected during 1992-93 to 1996-97 has been shown in the bar chart and the table below.

**VALUE OF IMPORTS AND CUSTOMS DUTY COLLECTED  
1992-93 TO 1996-97 (YEAR-WISE)**



Year	Value of imports	Customs duties	Growth percentage of value w.r.t. previous year	Growth percentage of import duty w.r.t. previous year
(1)	(2)	(3)	(4)	(5)
1992-93	62923	23323	31.80	6.90
1993-94	72806	22495	15.71	(-) 3.55
1994-95	88705	27148	21.84	20.68
1995-96	121647	35728	37.14	31.60
1996-97	136844	42851	12.49	19.94

There has been a steady growth in the value of imports from the year 1992-93 onwards. The revenue collection when compared to value of imports was proportionally higher in 1996-97. In 1993-94, the collections were much lower due to the drastic reduction in the rates of customs duty and doing away with the levy of auxiliary duty.

### 1.3 COMMODITY WISE DETAILS OF CUSTOMS RECEIPTS

Major commodity wise value of imports and exports and the gross duty therefrom during the financial year 1996-97 and the previous year 1995-96 are given below in the table:

#### a) IMPORTS

(Rupees in crore)

Sl. No.	Commodities	Value of imports		Import duties*	
		1995-96	1996-97	1995-96	1996-97
1.	Petroleum crude and products	25211	35737	8453	12418
2.	Machinery excluding machine tools and their parts and accessories	13242	13171	3475	3867
3.	Electrical machinery	7113	6158	2910	3184
4.	Organic chemicals	5747	6344	2514	2891
5.	Project imports	7528	6516	2028	2038
6.	Motor vehicles and parts thereof	3619	3628	1123	1463
7.	Plastics and articles thereof	2726	2829	1755	2050
8.	Others	56461	62461	13875	15602
Total		121647	136844	36133	43513

\* Source - Directorate of Statistics and Intelligence, New Delhi.

#### b) EXPORTS

(Rupees in crore)

Sl. No.	Commodities	Value of Exports		Export duty and cess	
		1995-96	1996-97	1995-96	1996-97
1.	Food items	17969	19716	6	15
2.	Beverages and Tobacco	366	738	8	8
3.	Crude materials inedible except fuels (including mica)	5445	6936	17	22
4.	Mineral, fuels, lubricant and related materials	1518	1710	—	—
5.	Chemicals and related products	12621	14451	—	—
6.	Manufactured goods classified according to materials except pearls, precious, semi precious stones and carpets, hand made leather and leather manufactures including readymade garments and clothing accessories	25406	28844	—	—
7.	Engineering goods	12106	13992	—	—
8.	Miscellaneous manufactured articles including handicrafts, gems and jewellery	26494	25861	—	—
9.	Others	4540	5277	81	92
Total of exports and re-exports		106465	117525	112	137

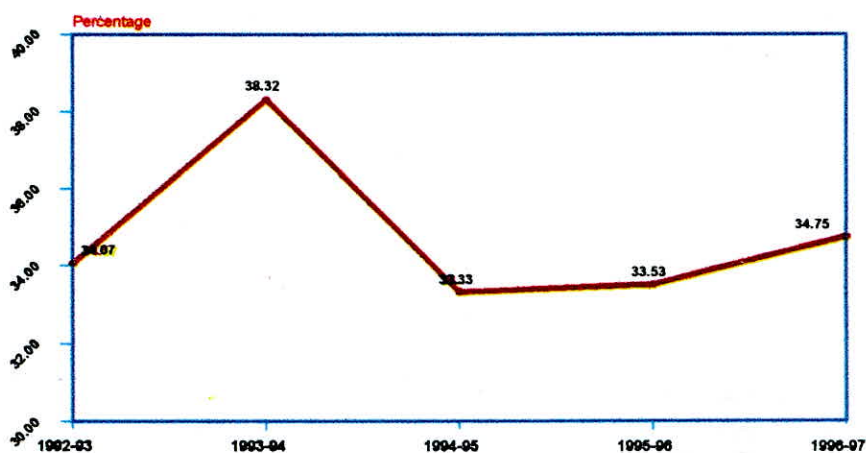
It would be seen that the value of total imports was more than the value of total exports in both the years. While the imports registered an increase of 12.49 per cent in 1996-97 over the previous year, the exports increased by 10.38 per cent in respect of the same period.

#### 1.4 COMMODITY WISE CHANGE IN TARIFF LEVELS

The following charts/tables show the changes in the average Tariff levels for the years 1992-93 to 1996-97 in respect of different product groups (arrived at by dividing the total import duty collected by the total cif value of imports) in respect of ten major commodities. It may be mentioned that these commodities accounted for 62.24 per cent of the total customs revenue during 1996-97. The commodity wise analysis of 10 commodities viz. Petroleum (crude) and Petroleum Products, Organic Chemicals, Motor Vehicles and parts thereof, Plastic and articles thereof, Machinery (excluding machine tools) and their parts and accessories, Electrical Machinery, Pulp, paper, paper board and articles thereof, Animal or vegetable fats and oils, Misc. chemicals products, Rubber and articles thereof and Dyes, colours, paints and varnishes is as follows:

#### COMMODITY WISE ANALYSIS OF TARIFF LEVELS

##### TREND IN AVERAGE RATE OF DUTY FOR PETROLEUM (CRUDE) & PRODUCTS

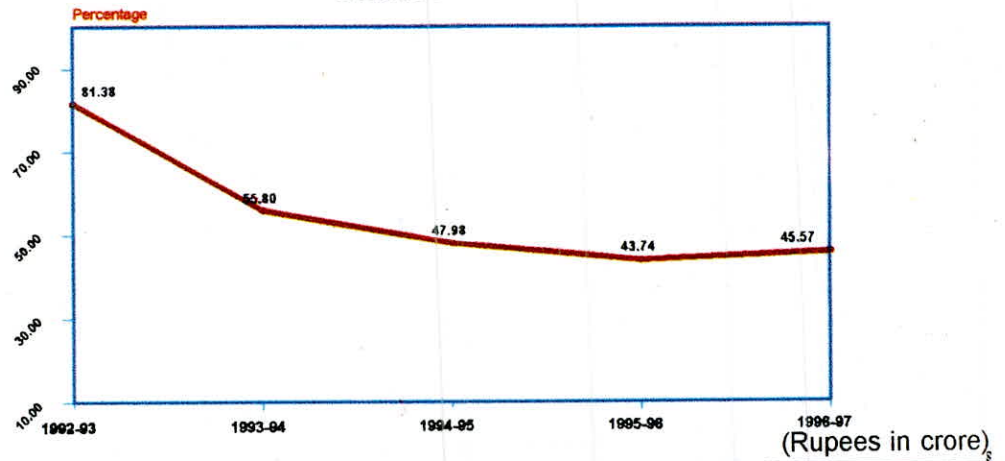


(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	17153	5844	34.07
1993-94	18045	6914	38.32
1994-95	18629	6209	33.33
1995-96	25211	8453	33.53
1996-97	35737	12418	34.75

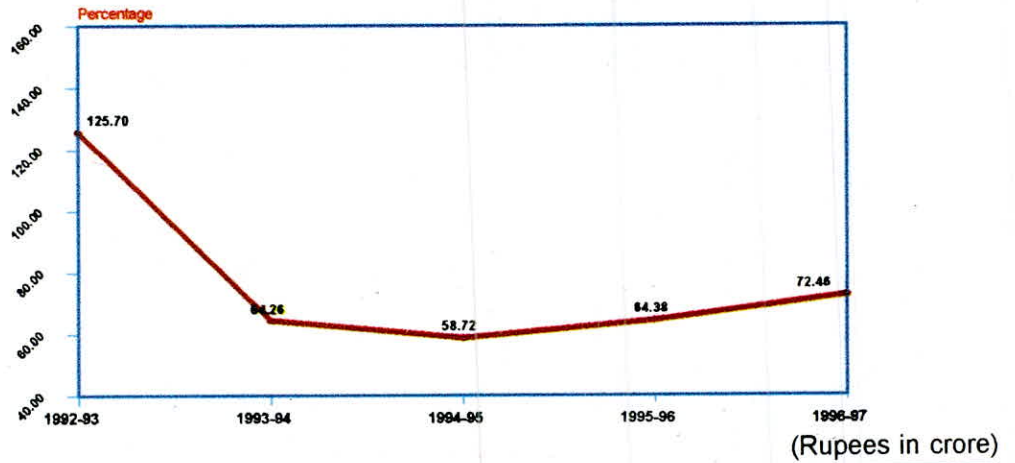


### ORGANIC CHEMICALS



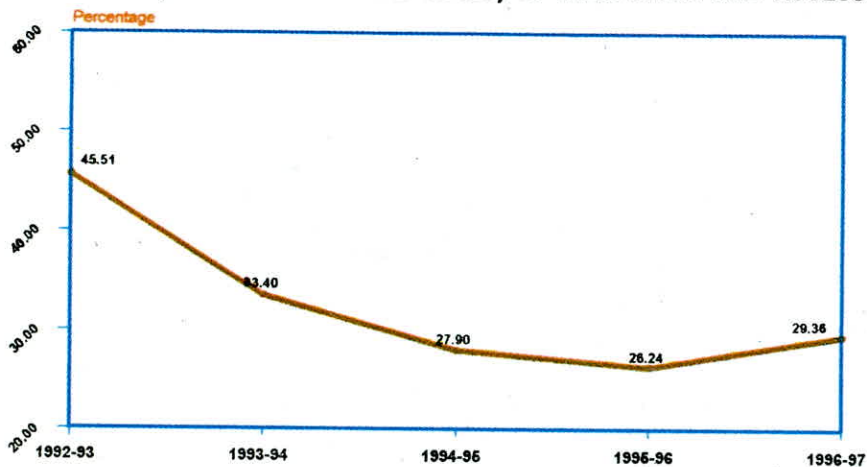
Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	1977	1609	81.38
1993-94	2783	1553	55.80
1994-95	4449	2135	47.98
1995-96	5747	2514	43.74
1996-97	6344	2891	45.57

### PLASTIC & ARTICLES THEREOF



Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	1206	1516	125.70
1993-94	1363	876	64.26
1994-95	1938	1138	58.72
1995-96	2726	1755	64.38
1996-97	2829	2050	72.46

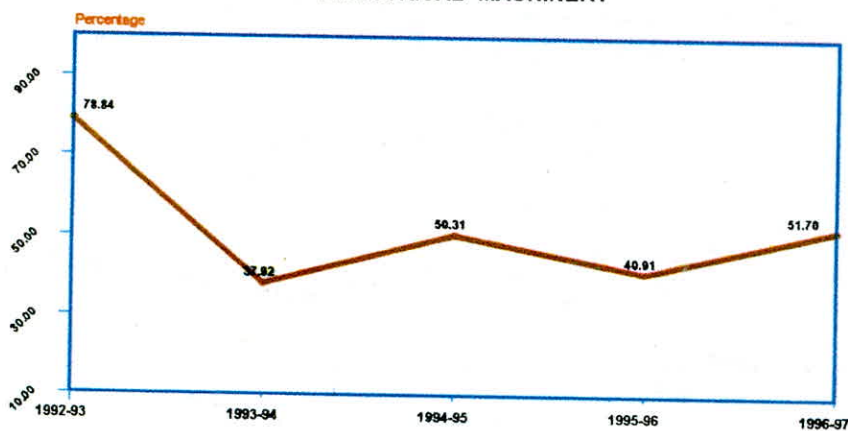
## MACHINERY (EXCLUDING MACHINE TOOLS) & THEIR PARTS AND ACCESSORIES



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	4865	2214	45.51
1993-94	5902	1971	33.40
1994-95	8549	2385	27.90
1995-96	13242	3475	26.24
1996-97	13171	3867	29.36

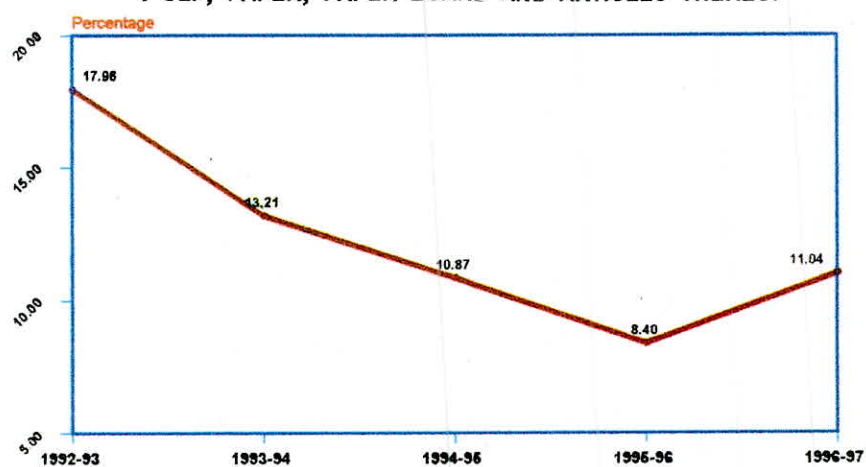
## ELECTRICAL MACHINERY



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	2358	1859	78.84
1993-94	3502	1328	37.92
1994-95	4206	2116	50.31
1995-96	7113	2910	40.91
1996-97	6158	3184	51.70

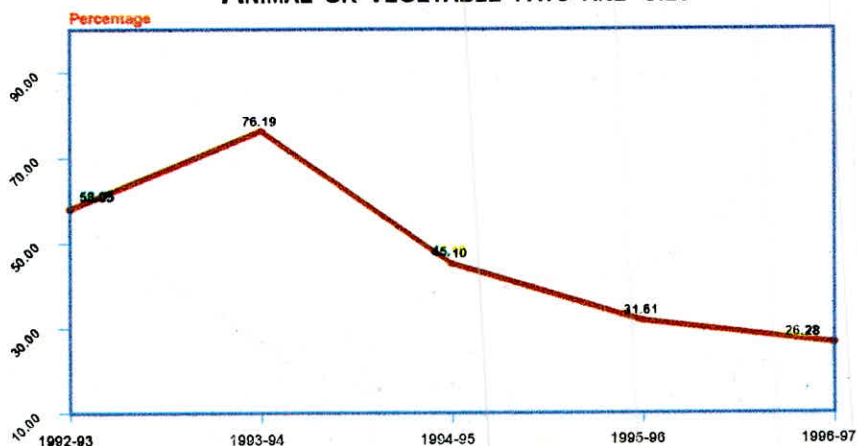
### PULP, PAPER, PAPER BOARD AND ARTICLES THEREOF



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	1091	196	17.96
1993-94	1408	186	13.21
1994-95	1601	174	10.87
1995-96	2785	234	8.40
1996-97	2898	320	11.04

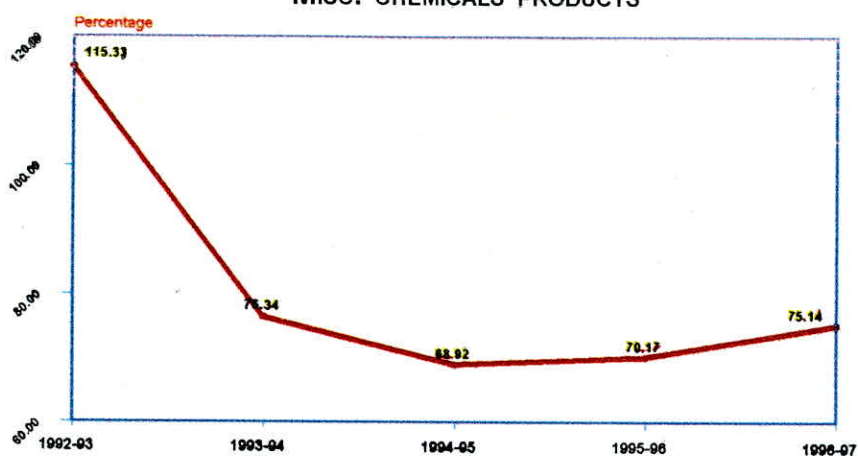
### ANIMAL OR VEGETABLE FATS AND OILS



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	174	101	58.05
1993-94	168	128	76.19
1994-95	612	276	45.10
1995-96	2186	691	31.61
1996-97	2938	772	26.28

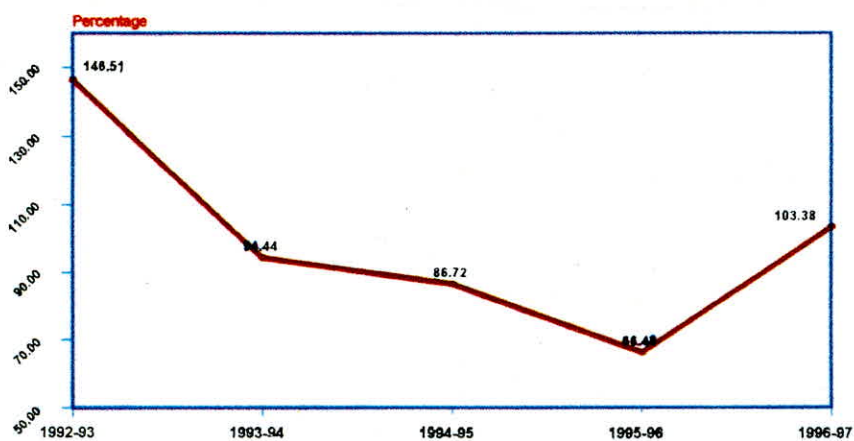
### MISC. CHEMICALS PRODUCTS



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	450	519	115.33
1993-94	524	400	76.34
1994-95	592	408	68.92
1995-96	808	567	70.17
1996-97	881	662	75.14

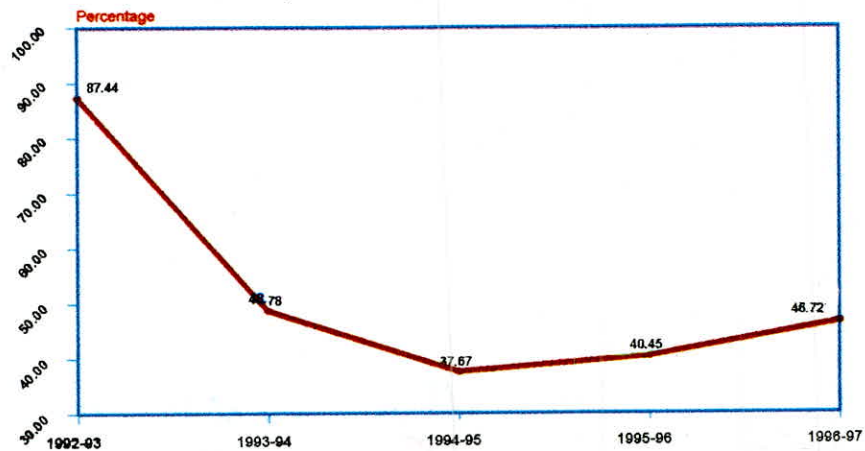
### RUBBER AND ARTICLES THEREOF



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	258	378	146.51
1993-94	342	323	94.44
1994-95	369	320	86.72
1995-96	716	476	66.48
1996-97	622	643	103.38

## DYES, COLOURS, PAINTS AND VARNISHES



(Rupees in crore)

Year	Value of imports	Import duty	Average rate of duty (Percentage)
1992-93	199	174	87.44
1993-94	287	140	48.78
1994-95	438	165	37.67
1995-96	581	235	40.45
1996-97	595	278	46.72

The following trends emerge from the study of the 10 commodities shown above.

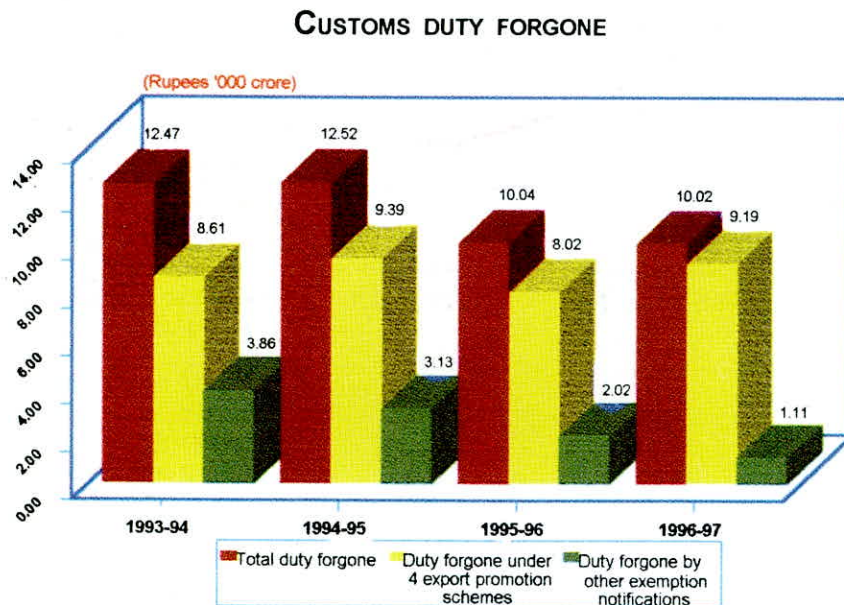
i) The value of imports and import duty collections have registered a growth in 1996-97 over the previous year in respect of all the commodities except value of import in respect of Machinery and Electrical machinery. The growth in value of imports was more than 20 per cent in Petroleum (crude) and products (41.75 per cent) and Animal or vegetable fats (34.40 per cent).

ii) It was noticed that though from 1992-93 to 1995-96 the average rate of duty was coming down for most of the commodities. However, in 1996-97, the average rate of duty went up for all the commodities except Animal or vegetable fats.

The increase in the rates of duty was marginal in respect of Petroleum products, Organic chemicals, Machinery parts and accessories and Paper and paper board. The increase in the rates of duty was particularly pronounced in respect of Rubber products from 66 to 103 per cent, Motor vehicles and parts from 31 to 40 per cent and Electrical machinery from 40 to 51 per cent.

## 1.5 DUTY FORGONE

a) Total duty forgone under various exemption notifications vis-a-vis the amount forgone in respect of four export promotion schemes viz., Advance Licence, EPCG, EPZ and EOU for the period 1993-94 to 1996-97 are shown in the bar chart and the table below.



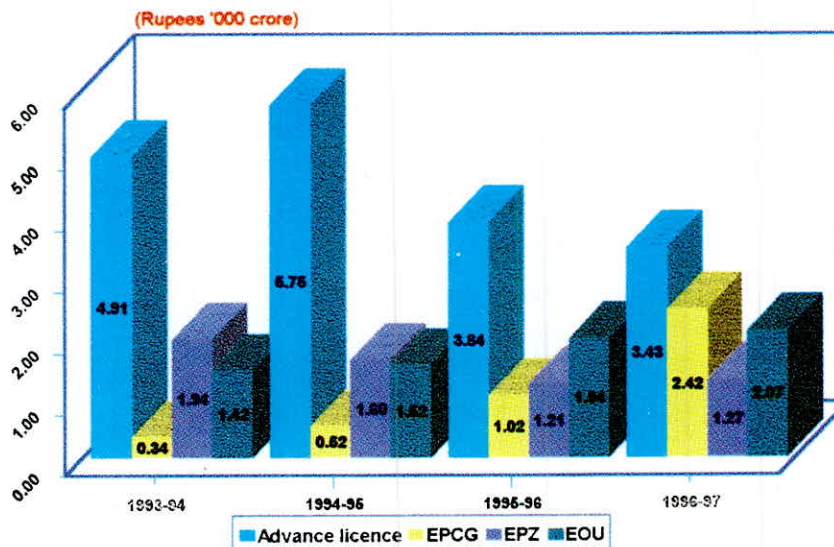
(Rupees in crore)

Year	Total duty forgone	Duty forgone under 4 export promotion schemes	Duty forgone by other exemption notifications
1993-94	12468.56	8605.12	3863.42
1994-95	12521.77	9390.50	3131.27
1995-96	10042.06	8022.68	2019.38
1996-97	10302.49	9189.09	1113.40

It will be seen that during 1993-94 to 1996-97, the duty forgone under these four export related schemes was substantially higher than the total customs duty forgone under all other exemption notifications. 89 per cent of the exemptions granted during 1996-97 pertained to Export Promotion Schemes. These schemes were reviewed and short comings including revenue loss commented in the Audit Reports for earlier years viz. EPCG (1993-94), Advance Licensing (1994-95) and 100% Export Oriented Units (1995-96). In this Report, an appraisal on Export Processing Zones is included in Chapter 2.

b) The break-up of the duty forgone in respect of the four export promotion schemes viz., Advance Licence, EPCG, EPZ and EOUs for the period from 1993-94 to 1996-97 are shown in the bar chart and table below.

#### CUSTOMS DUTY FORGONE UNDER 4 MAJOR EXPORT RELATED SCHEMES



(Rupees in crore)

Year	Advance Licence	EPCG	EPZ	EOU	Total
1993-94	4908.83	338.43	1937.30	1420.56	8605.12
1994-95	5748.25	520.98	1602.12	1519.15	9390.50
1995-96	*3842.73	1022.71	1213.65	1943.59	8022.68
1996-97	3429.82	2420.97	1268.94	2069.36	9189.09

\* Figures revised by Ministry of Finance.

c) Duty forgone under section 25(1) and (2) of the Customs Act, 1962 {other than in respect of four export promotion schemes vide para 1.5(b)} during 1993-94 to 1996-97 are shown in the table below.

(Rupees in crore)

Year	No. of exemption issued under 25(1)	No. of total exemption issued under 25(2)	No. of exemption notifications issued	Duty forgone under 25(1)	Duty forgone under 25(2)*	Duty forgone
1993-94	183	260	443	3676.77	186.65	3863.42
1994-95	172	285	457	2797.90	333.37	3131.27
1995-96	55	258	313	1467.17	552.21	2019.38
1996-97	63	159	222	934.50	(A)178.90	1113.40

\* Figures revised by Ministry of Finance.

(A) This does not include the reports of three Commissionerates viz., CCE Kanpur, Trivandrum and Jaigaon (W.B.)

## 1.6 COST OF COLLECTION OF CUSTOMS RECEIPTS

The expenditure incurred on collection of customs duty during the year 1996-97 alongwith the figures for the previous year are given below:

(Rupees in crore)

Head of Account	Cost of collection	1995-96	1996-97
2037-101	Revenue cum import export and trade control functions	52.91	72.85
2037-102	Preventive and other functions	227.27	263.19
	Total	280.18	336.04
	Cost of collection as percentage of Customs receipts	0.76	0.76

## 1.7 SEARCHES, SEIZURES AND CONFISCATIONS

The details of searches conducted and seizures effected by the Customs officers as given by Ministry are indicated below:

### SEARCHES AND SEIZURES

Sl.No.	Description	1995-96	1996-97
1.	Number of searches	636	713
2.	Value of goods seized (Rupees in crore)	09	24.53
3.	Number of seizure cases adjudicated	1888	1792

## 1.8 ARREARS OF CUSTOMS DUTY FOR RECOVERY

The amount of customs duty assessed upto 31 March 1997 which was still to be realised as on 30 June 1997 was Rs.231.56 crore in 39 Custom Houses and Commissionerates. In the previous year the amount was Rs.101.48 crore in 36 Custom Houses and Commissionerates.

## 1.9 DEMANDS OF DUTY BARRED BY LIMITATION

Demands raised by the department up to 31 March 1997 which were pending realisation as on 30 June 1997 and where recovery was barred by limitation amounted to Rs.39 lakh in 39 Custom Houses and Commissionerates. In the previous year the amount was Rs.50 lakh in 36 Custom Houses and Commissionerates.



## 1.10 DUTY WRITTEN OFF

Customs duties written off, penalties waived and exgratia payments made during the year 1996-97 and the preceding two years are given below:

(Rupees in lakh)

Year	Amount
1996-97	*Awaited
1995-96	20.67
1994-95	70.98

\* Awaited from Ministry of Finance

## 1.11 NUMBER OF PENDING AUDIT OBJECTIONS

The number of audit objections raised in audit upto 31 March 1997 and the number pending settlement as on 30 September 1997 in the various Custom Houses and combined Commissionerates of Customs are given overleaf :

### OUTSTANDING OBJECTIONS AND AMOUNT INVOLVED

(Rupees in crore)

Sl. No.	Name of Custom House or Commissionerates	Raised upto 1995-96		Raised in 1996-97		Total	
		Number	Amount	Number	Amount	Number	Amount
1.	Hyderabad	133	8.27	47	2.40	180	10.67
2.	Ahmedabad,	38	11.84	--	--	38	11.84
3.	Ahmedabad (Prev.)	60	14.94	4	0.94	64	15.88
4.	Kandla	51	30.96	6	7.49	57	38.45
5.	Madras	991	40.67	717	7.28	1708	47.95
6.	Tiruchirapalli	61	13.79	47	0.35	108	14.14
7.	Cochin Custom House	45	6.38	28	4.04	73	10.42
8.	Bombay (Sea)	176	25.65	34	40.74	210	66.39
9.	Bombay (Air)	142	12.10	2	0.07	144	12.17
10.	Karnataka	571	14.14	281	7.77	852	21.91
11.	Calcutta	770	92.18	171	61.34	941	153.52
12.	West Bengal (Prev.)	118	20.04	53	3.50	171	23.54
13.	Bhubuneshwar	25	1.22	3	37.76	28	38.98
14.	Others	615	40.84	283	5.69	898	46.53
Total		3796	333.02	1676	179.37	5472	512.39

## 1.12 Categories of outstanding audit objections

(Rupees in crore)

Sl. No.	Categories of objections	No. of objections	Amount
1.	Short levy due to misclassification	1103	42.45
2.	Short levy due to incorrect grant of exemption	964	51.06
3.	Non levy of import duties	556	13.86
4.	Short levy due to undervaluation	196	15.34
5.	Irregularities in grant of drawback	499	2.04
6.	Irregularities in grant of refunds	50	23.60
7.	Irregularities in levy and collection of export duty	83	7.40
8.	Other irregularities	1985	353.07
9.	Overassessment	36	3.57
	Total	5472	512.39

## 1.13 CONTENTS OF THE REPORT

The Report includes 184 paragraphs and review on EPZ, having a total revenue effect of Rs.4108.32 crore. As of December 1997, the Ministry/Department have replied to 70 paras, out of 203 cases referred to them.

Apart from these cases 402 other objections involving duty of Rs.1.50 crore were also pointed out to the Custom Houses/Commissionerates. The department has accepted all the objections and reported recovery of an amount of Rs.1.12 crore.

## Chapter 2 Review on 'Export Processing Zones'

### 2.1 INTRODUCTION

The Export Processing Zones (EPZ) set up as enclaves separated from domestic tariff area by fiscal barriers were intended to provide an internationally competitive duty free environment for export production. The basic objectives of EPZs were to enhance foreign exchange earnings, develop export oriented industries and to generate employment opportunities. The first Free Trade Zone was established in Kandla (Gujarat) in 1965 followed by an EPZ at Santacruz in Bombay in 1972. Four more zones were set up at Noida (U.P.), Falta (W.B.), Cochin (Kerala), Madras (Tamil Nadu) in 1984. The seventh zone was set up at Visakhapatnam (Andhra Pradesh) in 1989.

The Development Commissioners appointed by the Ministry of Commerce monitor and coordinate the functioning of each zone. The Customs department (Ministry of Finance) acts in close liaison with the Development Commissioner of the respective Zone in providing bond facilities and for ensuring that goods imported duty free, are utilised in the production of goods for export. Specific notifications allowing duty free imports of the required capital goods, raw materials, components and other specified materials were issued by the Ministry of Finance for each zone from time to time. A consolidated notification covering all the EP zones/ Free Trade zones was issued in June 1994.

Out of 2333 units granted letters of Approval in the 7 zones, only 513 were functional as on 31 March 1997. The zone wise position showing the number of units approved and functional is as below:

#### Zone wise position of the units in EPZs/FTZs

Sl.No.	Name of the zone	No. of units approved	No. of units functional
1.	Cochin EPZ	136	40
2.	Falta EPZ	178	34
3.	Kandla FTZ	891	97
4.	Madras EPZ	311	74
5.	Noida EPZ	417	111
6.	Santacruz electronic EPZ	376	157
7.	Vizag EPZ	24	-
	Total	2333	513

Ministry of Commerce in their reply of November 1997 stated that in case of 1351 projects, LOAs had been cancelled or lapsed on account of non implementation. This works out to 58 per cent of the letters of approval granted. Although no reasons have been cited by the Ministry of Commerce for the high mortality rates of the units approved, it would appear that due to (i) liberalisation of economy (ii) other schemes - Advance licence and EPCG with similar advantages without locational disadvantages, and (iii) general reduction in customs and excise duties, the EPZ scheme has lost its raison-de-etre.

The details of imports, exports, customs duty forgone on the imports etc., for the five year period ending 1996-97 for the different zones as furnished by the Ministry of Commerce/Finance are given below :

(Amount in crore)

Year	No. of operational units	cif value of imports	Customs duty forgone on imports	Total Col. 3&4	CE duty forgone	F.O.B. value of exports
1	2	3	4	5	6	7
1992-93	A	942.64	1555.42	2498.06	B	1376.31
1993-94	A	1346.27	1937.30	3283.57	B	1959.91
1994-95	A	1812.64	1602.12	3414.76	B	2653.11
1995-96	511	2268.56	1213.65	3482.21	B	3235.62
1996-97	513	2514.04	1268.94	3782.98	B	4338.92
Total		8884.15	7577.43	16461.58		13563.87

A: Awaited from Ministry of Commerce

B: Awaited from Ministry of Finance

The EPZ units have been given a wide range of concessions such as exemption from customs and central excise duties, income tax and sales tax exemptions, concessional rent for lease of industrial plots and factory shades etc. These costs should be matched by enhanced levels of exports by the units and augmentation of the foreign exchange earnings. No cost benefit analysis in respect of the scheme appears to have been carried out by the Ministry of Commerce. If the fob value of exports is compared against two of these parameters viz., cif value of imports and customs duty forgone on imports, it would be clear that the fob value of exports from 1992-93 to

1995-96, was much less than the customs duty forgone and cif value of imports taken together. Only in 1996-97, the fob value of exports had overtaken the combined figures of cif value of imports and customs duty forgone. It would however be necessary to keep in view the fact that fob value of exports does not represent the actual foreign exchange earned as this aspect is not being monitored by the Ministry of Commerce.

## **2.2 SCOPE OF AUDIT**

The performance of the EPZ's was reviewed to see whether the basic objective of augmenting the exports and enhancing the foreign exchange earning was achieved and also to examine whether EPZ's were functioning within the ambit of the Exim Policy for 1992-97 and the Customs notifications governing the scheme.

An appraisal of the seven EPZs was undertaken during August 1996 to July 1997. Out of 513 functional and 160 closed units, records relating to 167 functional and 139 closed units in the seven zones and those in the offices of the Development Commissioners and the concerned Commissioners of Customs were test checked.

## **2.3 HIGHLIGHTS**

**i) 66 units which had completed five years of commercial production did not achieve the export obligation/value addition prescribed. The duty recoverable from them was Rs.1766.73 crore including interest of Rs.694.44 crore. Out of these, an amount of 951.39 crore was recoverable from 14 units which recorded negative value addition. Further in 15 units the shortfall in value addition exceeded 50 per cent and the duty recoverable from them along with interest amounted to Rs.461.86 crore.**

**(Para 2.4)**

**ii) 85 units which were closed did not achieve the export obligation/value addition. The duty pending recovery in these cases amounts to Rs.462.15 crore including interest of Rs.180.99 crore.**

**(Para 2.5)**

iii) Foreign exchange amounting to Rs.106.48 crore remained unrealised on the exports made by 101 units.

(Para 2.6)

iv) Nine units failed to achieve the currency balancing and as a result, duty amounting to Rs.110.77 crore was recoverable from them.

(Para 2.7)

v) Irregular availment of exemption from duty on goods not permitted for import by 15 units amounted to Rs.60.24 crore.

(Para 2.9)

vi) Irregular DTA sales by 46 units led to non levy/short levy of customs and excise duties amounting to Rs.217.95 crore.

(Para 2.10)

vii) Other irregularities like shortage of stocks, goods not utilised in manufacture of export products, irregular sale of scrap/rejects etc., involved non levy of duty of Rs.183.16 crore in case of 26 units.

(Para 2.11)

#### **2.4 FAILURE IN ACHIEVEMENT OF EXPORT OBLIGATION AND VALUE ADDITION**

a) Ministry of Finance under specific notifications issued from time to time (227/79, 77/80, 262/85, 263/85 339/85, 340/86, 170/93) exempted specified goods from the whole of the duties of customs when imported into India by approved units in the different Export Processing Zones (EPZs) subject to the condition that the unit should achieve a minimum value addition of 20 per cent or the value addition as specified in the Letter of Permission. The licence/LOA also prescribed that the unit had to achieve the export obligation as stipulated therein within a period of five years.

b) Test check of the records maintained in the six EPZs at Cochin, Falta, Kandla, Madras, Noida and Santacruz disclosed that out of 167 units,

66 units which had completed five years since the commencement of their commercial production had failed to achieve the required value addition or the prescribed export obligation. **Accordingly on imports valued Rs.1236.36 crore made by these units, the duty recoverable as per Para 4 of the LUT worked out to Rs.1072.29 crore. The interest recoverable in terms of Para 7 of the LUT was Rs.694.44 crore.**

In the case of 14 units, there was negative value addition and the customs duty recoverable in these cases was Rs.951.39 crore including interest of Rs.332.56 crore. In 27 units where the shortfall in value addition exceeded 20 per cent, the prorata duty recoverable amounted to Rs.589.75 crore including interest of Rs.272.87 crore. Out of these, in 15 cases shortfall in value addition exceeded 50 per cent on which duty recoverable along with interest amounted to Rs.461.86 crore. In 25 units though the prescribed value addition was achieved there was shortfall in export obligation and duty of Rs.225.59 crore was recoverable including interest of Rs.89.01 crore. In none of these cases action was taken either by the Development Commissioner or the Customs authorities. A test check of the records relating to 14 units which had not completed the prescribed period of 5 years also disclosed shortfall in performance and the prorata customs duty recoverable in these cases was Rs.35.09 crore.

A few of these cases are highlighted below:

- i) A unit in Madras EPZ (MEPZ) which commenced commercial production to manufacture microprocessors based on computers and peripherals on 1 January 1991 and which as per letter of approval had to fulfil an export obligation of Rs.95.74 crore within five years could export only goods valued at Rs.16.70 crore as on 31 December 1995. The value addition achieved by the unit was also negative. The customs duty exempted on the imports made amounting to Rs.20.45 crore and the excise duty on Rs.48 lakh stood recoverable. The interest recoverable at the rate of 18 per cent as per provisions in the LUT was Rs.17.81 crore.
- ii) Another unit in MEPZ which commenced production of computer peripherals in August 1988 and required to fulfil an export obligation of Rs.93.18 crore by July 1993, was able to achieve only Rs.18 crore resulting

in a shortfall of Rs.75.18 crore in export obligation. The value addition achieved was 2.64 per cent as against 26.30 per cent prescribed. The customs duty and excise duty exempted and recoverable was Rs.33.67 crore while interest recoverable was Rs.39.72 crore.

iii) A unit in Noida EPZ which commenced production of PCB assemblies in January 1990 and had imported duty free capital goods, computers, raw materials valued at Rs.137.64 crore, achieved negative value addition. The export obligation prescribed was Rs.555.85 crore and the export obligation achieved was Rs.130.53 crore. Therefore, the entire customs duty of Rs.102.17 crore exempted was recoverable along with interest of Rs.47.92 crore.

iv) Another unit in NEPZ producing 'Compact lamps and halogen lamps' registered negative value addition. As against the export obligation of Rs.247.60 crore the unit which commenced production in March 1992 was able to achieve an export obligation of only Rs.121.31 crore by March 1997. The duty forgone amounting to Rs.102.02 crore and interest of Rs.49.09 crore was recoverable.

v) A unit in Kandla EPZ approved for manufacture of 'Medical X-ray processing system' which commenced production in October 1989 closed down in April 1993. The value addition prescribed for the unit was 56 per cent, while the value addition achieved was only 28.95 per cent. The export obligation prescribed was Rs.48.10 crore but the exports made were only for Rs.6.99 crore. The customs duty forgone on the imports of Rs.4.83 crore was Rs.6.36 crore. The prorata customs duty recoverable in this case was Rs.3.07 crore along with interest of Rs.2.64 crore.

vi) A unit in Santacruz EPZ manufacturing computer components of sub assemblies achieved negative value addition of 87.18 per cent against the 43 per cent prescribed. The prorata duty recoverable on the total imports of Rs.167.21 crore was Rs.167.21 crore. The interest recoverable from the date of import was Rs.30.10 crore.

vii) Another unit in SEEPZ manufacturing computer systems which commenced production in 1991-92 had to achieve a value addition of 15.05



to 43 per cent from time to time. However, after a period of five years, the unit had achieved a negative value addition 10.51 per cent. Duty amounting to Rs.74.28 crore was therefore, recoverable on the total imports of Rs.63.38 crore and the interest recoverable was Rs.49.72 crore.

viii) A unit in Cochin EPZ, engaged in the manufacture of 'readymade garments' commenced production in April 1991 and was required to achieve a value addition of 40.02 per cent with an export obligation of Rs.52.80 crore. The unit which imported goods worth Rs.19.45 crore could achieve exports of only Rs.27.34 crore and a value addition of 28.88 per cent. The prorata customs duty recoverable was Rs.12 crore along with interest of Rs.8.71 crore.

## 2.5 PREMATURE CLOSURE OF UNITS WITHOUT ACHIEVING VA/EO

In terms of para 116 and 117 of the Exim Policy, the bonding period for units under the scheme is 10 years which can be reduced to 5 years by the Board of Approvals. EPZ units can also be debonded prematurely on their inability to achieve export obligation, value addition or other requirements and such debonding/closure of the unit will attract penalty and payment of duties of customs and excise applicable at the time of debonding.

A test check of 139 closed units in 7 EP zones showed that in 49 cases the units had been closed without achieving the stipulated VA/EO and in 36 cases the units could not fulfil the prescribed export obligation as detailed below :

(Rupees in crore)

Sl. No.	EPZ	Number of units which failed to achieve stipulated VA/EO	Number of units which failed to achieve prescribed EO	Duty recoverable on units in Col.3	Duty recoverable on units in Col.4	Interest recoverable on duty amount in Col.5	Interest recoverable on duty amount in Col.6	Total 5+6+7+8
1	2	3	4	5	6	7	8	9
1.	Falra	01	--	0.24	--	0.07	--	0.31
2.	KFTZ	08	04	155.61	0.93	75.43	0.64	232.61
3.	MEPZ	--	20	--	24.20	--	26.62	50.82
4.	NEPZ	27	08	53.44	6.85	43.42	6.04	109.75
5.	SEEPZ	13	04	31.29	8.60	21.16	7.61	68.66
Total		49	36	240.58	40.58	140.08	40.91	462.15

Though a sum of Rs.462.15 crore including interest of Rs.180.99 crore upto March 1997 was recoverable besides penalty etc., leviable under the above provisions, no action was taken by the department except in four cases in Cochin where the Customs department had issued show cause notices and initiated penal action.

Department (DC/MEPZ) has intimated part recovery of Rs.8.35 lakh in five cases (October 1997). Recovery particulars of the balance amount is awaited (December 1997).

The Ministry of Commerce in their reply of November 1997 contended as follows:

*"The export processing zone scheme is one of the many options offered to investors for developing and promoting export oriented industries in an internationally competitive exporter friendly environment by allowing duty free access to raw materials, equipment and other inputs at world market prices, as this is a key factor in making export industries competitive. Other duty free options for export oriented industries are prior exemption or duty free licences for dutiable imports and duty drawback, claimed on post-export basis.*

*Unlike other units exporting their products from the Domestic Tariff Area, and claiming duty drawback who are not under obligation to achieve any prescribed value addition norm or specified minimum quantity of exports, EPZ units are under obligation to ensure value addition/net foreign exchange earning as a percentage of exports and export obligation not below the minimum norms as stipulated for different sectors in the Export Policy and Procedures.*

*When the EPZ unit approaches the Development Commissioner/Board of Approvals for permission to operate under the EPZ scheme, the projections of value addition and export obligation made by them in their application are reflected in their letter of approval and their performance is monitored against these projections. However, these projections are, more often than not, optimistic estimates. Recognising that the value addition as reflected in the LOA may not be achievable in all cases in a dynamic and competitive market situation, minimum value addition norms have been prescribed reflecting the anticipated industry average at a given point of time. EPZ projects are approved by Development Commissioner/Board of Approval, keeping in mind the minimum value addition/export obligation prescribed for different sectors of the industry as per Policy and Procedures."*

Regarding the liability of imported goods to customs duty in the event of non-fulfillment of export obligation, the Ministry contended as follows :

- i) *Duty is not payable when the goods imported have been actually used in the manufacture of products for export as per provisions of the scheme.*
- ii) *When any goods, finished products, scrap/waste or surplus raw material etc. are disposed in the Domestic Tariff Area, the same is subject to payment of applicable duty.*
- iii) *Even in the case of capital goods, the duty is not forgone but only deferred as the units have to pay duty when they debond even after achieving VA/EO.*

**Ministry's stand is not tenable for the following reasons.**

- i) In terms of Para 97 of the Exim Policy for 1992-97 (during which period the EPZ review was conducted) EPZ units are to achieve a minimum value addition of 20 per cent. In case of items specified in Appendix II of the Exim Policy, the value addition shall be as per norms indicated in the said Appendix. The Board of Approval determines the value addition for each unit keeping in view the minimum value addition as prescribed in the Policy. The unit also executes a bond/legal undertaking with the Development Commissioner, undertaking to abide by the value addition prescribed. It cannot therefore be stated that such value addition is an "optimistic estimate". In terms of the said bond/legal undertaking the unit is liable to penalty as well as recovery of customs and central excise duty in the event of its failure to fulfil the export obligation. **In other words, once the value addition has been fixed for a particular unit, the same has to be adhered to by the unit.**

The legal undertaking executed by the unit with the Development Commissioner in the form as given in Appendix XXXI of the Hand Book of Procedures of the Exim Policy 1992-97 clearly spells out the liability of the unit in the event of failure to fulfil the export obligation. **Para 4 of the LUT stipulates that if the unit is not able to fulfil the export obligation undertaken, it shall, on the instructions of the Development**

**Commissioner, pay to the Government, the amount of customs duty that would be leviable at the relevant time on the items of plant and machinery, equipments, raw materials, components and consumables allowed for import by the unit in terms of the licence granted to it and also the amount of excise duty leviable on the indigenous goods purchased by the unit during the period.** The unit shall also be liable for payment of **liquidated damages** as decided by the Development Commissioner.

**Para 7 of the said undertaking also provides that in addition to the customs duties and excise duties, interest thereon at the rate of 18 per cent shall also be recoverable from the unit.** In addition, as per Section 11(2) of the Foreign Trade (Development and Regulation) Act, 1992 penalty not exceeding one thousand rupees or five times the value of the goods imported, whichever is higher, is to be imposed in case contravention of any provision of the Exim Policy is made or attempted to be made.

Therefore, in the event of non-fulfillment of export obligation the Development Commissioner has to enforce the terms of the bond executed with him by the concerned unit, not only for imposition of penalty, but also for recovery of customs and central excise duty as well as interest thereon. The unit cannot be absolved from its contractual obligations.

ii) In terms of para 3 of the Customs notification of 1994, the unit has to execute a bond with the Customs department and is required under this bond to fulfil the export obligation including the value addition and conditions stipulated in the said Notification. Violation of these conditions as prescribed in the bond would entail recovery of customs duty in cases where either the export obligation or the value addition as stipulated under Para 97 of the EXIM Policy has not been fulfilled.

iii) The letter of approval issued to the units by the Development Commissioner (condition 13) clearly states that if the undertaking fails to fulfil its export and other obligations under the scheme, it will be liable to pay besides penalties the customs and central excise duties and such other amounts as may be decided by the Government.

iv) The **basic objective of the EPZ scheme was to boost exports** by allowing duty free imports of capital goods and inputs on condition that 100 per cent output would be exported except for sale of specified allowable quantities in DTA. Under EPZ the scheme duty exemption on imports, encompasses not only capital goods and raw material/components but also the following items:

- a) Material handling equipments
- b) Consumables
- c) Office equipments
- d) Captive power plants
- e) Tools, jigs fixtures, moulds dies etc.
- f) Samples/prototypes
- g) Drawings/blue prints/technical maps/charts
- h) Packaging material
- i) Spares of capital goods material handling equipment etc.

**Thus the ambit of the customs notification relating to EOU/EPZ scheme is much wider than those issued under the duty exemption scheme** (covering duty free import of **inputs** for manufacture of export products) **and EPCG scheme** (which provides for exemption/duty concession on **capital goods** to be used for export production). **Under the DEEC and EPCG schemes, the exemption from customs duty is subject to the condition that the specified levels of exports should be achieved within specified periods of time and each of these schemes envisage recovery of duty, in addition to other penal measures, in the event of such export obligation not being fulfilled.**

Accordingly, in the case of EOU/EPZ scheme which covers not only inputs and capital goods but also a wide range of other products, there is no basis for claiming that custom duty is not recoverable where the export obligation has not been fulfilled. In the event, the EPZ unit is unable to achieve the given level of export performance, **the distinction between the said unit and the domestic unit** (which is not entitled to duty free import of capital goods, material handling equipments, office equipment, captive power plants etc.) **gets erased and the former cannot be accorded any preferential treatment in the form of non recovery of customs duty.** Again there is no comparison between the

Drawback scheme and the EPZ scheme because under the drawback regime only the input stage duty gets reimbursed (even such compensation in many cases is inadequate) while EOU/EPZ scheme envisages exemption on a much larger scale extending to capital goods, office equipments, material handling equipments and even captive power plants.

v) Ministry pointed out that sale of finished goods, scrap and waste in the Domestic Tariff Area are subject to duties. As regards sales in the Domestic Tariff Area, an EPZ unit can be permitted by the Development Commissioner or the Board of Approvals to clear any of the imported goods (including inputs, capital goods, material handling equipment and captive power plants) in the Domestic Tariff Area subject to the condition that such goods are permitted for import under the Exim Policy in force. In such cases the rate of duty applicable is the rate prevailing on the date of payment of such duty. In the case of capital goods etc. depreciation in value for the purpose of the charging duty is also allowed. However, a unit violating any of the conditions of the Exim Policy or of the Customs Notification including the condition relating to fulfilment of the export obligation/value addition stands on a different footing. Here it is a case of default, to be dealt with, inter alia, by enforcing the terms of the LUT/bond executed by the unit. Since there is a violation of the conditions of the Exim Policy (i.e. relating to the minimum value addition to be achieved) the duty foregone at the time of import is recoverable.

vi) Ministry pointed out that in the case of capital goods the duty is not forgone but only deferred as the units have to pay duty when they debond even after achieving VA/EO. The Ministry's reply is not acceptable due to the following reasons :

Debonding is the action taken when a unit wishes to opt out of the EPZ scheme and entails payment of duty on duty free imports viz. inputs, capital goods etc. lying with the unit at the time of debonding. The duties levied at the time of debonding are in the nature of deferred duties and are not linked to fulfilment of export obligation. While it is correct that Para 117 of the Policy regarding levy of penalty and duty of customs and excise would be applicable at the stage of debonding, **the contention of audit is that**

**such duty liability, arises not only at the stage of debonding of the unit but also when there is a violation of any of the conditions of the scheme.**

Ministry also stated that as action is initiated under FT (D&R) Act, 1992, raising demand of duty on duty free materials used in exported product for failure to fulfil VAVEO would tantamount to inflicting double penalty.

This is not correct as **recovery of custom duty is not a penalty.** In terms of section 11(2) of the FT (D&R) Act, 1992, "where any person makes or abets or attempts to make any export or import in contravention of any provision of this Act or any rules or orders made thereunder or the export and import policy, he shall be liable to a penalty not exceeding one thousand rupees or five times the value of the goods in respect of which any contravention is made or attempted to be made, whichever is more." **Penalty as envisaged under the aforesaid provisions is thus distinct from customs duty recoverable.** The exemptions granted under the customs notifications are often conditional and the non-fulfillment of these post importation conditions entail recovery of customs duty. Therefore, recovery of such duty would not amount to penal action. Even in case of duty exemption scheme or the EPCG Scheme where the licence holders have not been able to achieve the prescribed levels of exports, penal action is initiated by the concerned authorities under Foreign Trade (Development and Regulation) Act, 1992 in addition to recovery of customs duty.

vii) PAC on the basis of the discussion held in the report relating to EPZ in 1991-92 recommended that the purpose of the relevant notification should be clearly spelt so that no private party is in a position to take advantage of the notification without fulfilling the objective of the scheme. It was also suggested that the notifications be modified to clearly bring out the provisions to avoid loss of revenue. However, it was noticed that while the Customs notifications in force prior to June 1994 relating to the specific export promotion zones clearly stipulated that the exemption was subject to execution of a bond by the importer as prescribed by the Development Commissioner to fulfil the export obligations and also the other conditions of the Customs notification and the Exim Policy, **the Customs notification**

**issued in June 1994 (133/94) rescinding the notifications issued earlier did not clearly indicate that the exemptions granted were subject to fulfilment of the prescribed value addition or export obligation. Consequently, Government revenues are not adequately safeguarded.**

The mechanism to effect recovery of duty for the non fulfilment of the conditions of duty free import as well as the specific authority who should effect such recoveries has also not been spelt out either in the Customs notification or in the EXIM Policy.

## **2.6 NON REALISATION OF FOREIGN EXCHANGE**

According to para 119 of the Exim Policy 1992-97, the value addition was to be calculated on the basis of fob value of exports realised but it was noticed in audit that the Development Commissioners were relying on the value declared in shipping bills for discharge of export obligation and value addition which was not correct.

A test check of the records of units operating in the EPZs of Calcutta, Kandla, Madras, Noida, Santacruz and Vizag disclosed non realisation of foreign exchange of Rs.106.48 crore by 101 units as per records of the Reserve Bank of India. One unit in VEPZ which exported goods worth Rs.89 lakh during December 1994 to February 1996 realised only Rs.1.7 lakh. In MEPZ, in 14 units fob value of exports amounting to Rs.19.20 crore was still pending realisation as on 30 June 1996. In KFTZ, in 12 units though exports between July 1978 to September 1996 was Rs.18.89 crore export proceeds was still pending realisation as confirmed by RBI. In Bombay the export sale proceeds yet to be realised in the case of 53 units was Rs.46.84 crore. In Noida the amount in respect of 18 units was Rs.20.08 crore. In Calcutta an amount of Rs.60 lakh was yet to be realised in the case of three units.

On this being pointed out in audit one Commissionerate (Vizag) confirmed the facts.

Ministry of Commerce in their reply of November 1997 stated as follows :



"Appreciating that net foreign exchange earnings ought to be the relevant consideration and not foreign exchange earnings per unit of manufacture, the EPZ scheme as it appears in the Exim Policy (1997-2002) reflects this shift in emphasis, in the provisions of para 9.29 of the Policy. It has been further decided with effect from 1 April 1997 to monitor the annual performance of EPZ units with reference to minimum net foreign exchange earnings as percentage of exports (NFEP) prescribed as per industry norm for purpose of imposing penalties under Foreign Trade (Development and Regulation) Act, instead of monitoring performance of the units against projected VA norms as reflected in their LOA. This has been done in recognition of the dynamic conditions of demand and supply affecting prices of raw materials, components, intermediates CG and finished products at any given point of time, which may vary vastly over a period of 4 to 5 years covering the time when the unit gets the project approved under the EPZ scheme, when certain VA/EO projections were made, and the time of setting up of the unit and coming into commercial production."

**Ministry's reply is not tenable for the following reasons :**

In the current Policy, the expression "value addition" has been replaced by the term "NFEP" (Net Foreign Exchange Earning as a percentage of exports) which is to be calculated as per the following **revised formula**:

$$\text{NFEP} = \frac{\text{A}-\text{B}}{\text{B}}, \text{ where}$$

**NFEP** is Net Foreign Exchange Earning as a percentage of export.

**A** is the fob value of exports by the EOU/EPZ/EHTP unit; and

**B** is the sum total of the cif value of all imported inputs, the cif value of all imported capital goods, and the value of all payments made in foreign exchange by way of commission, royalty, fees, dividends interest on external borrowings during the first five years period or any other charges. "Inputs" mean raw materials, intermediates, components, consumables, parts and packing materials.

The base for working out the percentage has been changed to 'total cif value of imports' from 'the fob value of exports' envisaged in the earlier formula. The earlier formula based on export value has been relaxed and so the exporter is benefited as shown in Annexure 1 at page 44.

Another major departure in the Exim Policy 1997-2002 relates to realisation of foreign exchange. **In the Exim Policy 1992-97 value addition was to be calculated with reference to the foreign exchange realised whereas the present Policy only mentions "fob value exports" and the word 'realised' has been dropped.** As a result there is no linkage now between the exports and the foreign exchange actually realised, enabling **the exporter to claim realisation of value addition on the basis of export documents without linking it with the foreign exchange actually earned.**

Audit test checks of the units operating in EPZ have revealed significant shortfalls/delays in realisation of foreign exchange on the basis of limited data made available by the Reserve Bank of India. Finance Secretary in his deposition before PAC during oral evidence on advance licensing scheme had also confirmed that Reserve Bank of India did not maintain any scheme-wise data of foreign exchange realised. Thus the key objectives viz., realisation of foreign exchange through exports is neither being monitored by the Ministry of Commerce nor by the Reserve Bank of India. **Monitoring the achievement of exports based on the trading records without linking to the actual foreign exchange earnings is therefore, contrary to the basic objective of the scheme.**

## **2.7 CURRENCY BALANCING**

As per para 126 of Exim Policy 1992-97, all export contracts and invoices shall be denominated in freely convertible currency. In order to prevent excess outflow of foreign exchange, Ministry of Commerce, in their circular letter dated 14 October 1993 reiterated the need for currency balancing and directed that the units envisaging exports to Rupee Payment Area were to ensure that outgo of free foreign exchange on account of imports of capital goods, raw materials and other outflows were atleast balanced by making additional exports to General Currency Area. Further, the Ministry of Commerce in July 1995, instructed that currency balancing was to be achieved over a period of one year from the date of export, failing which the unit would be liable to pay applicable duties on the imported inputs used in the manufacture of goods exported.

a) During the period 1988-1996 six units in Noida EPZ exported goods valued Rs.70.54 crore to RPA, against import of Rs.34.66 crore from GCA. Since the units failed to effect additional exports to GCA equal to the value of imports the duty recoverable on the imported inputs worked out to Rs.44.18 crore in these cases.

b) A unit in SEEPZ was required to achieve currency balancing in respect of exports made to Russian Federation on an annual basis. The shortfall in currency balancing during 1994-95 was Rs.6.69 crore involving a customs duty of Rs.6.56 crore on components used in manufacture of the export goods. Though the department issued a show cause notice to the unit in September 1995, no recovery of duty has been reported so far (July 1997).

c) Two units in Falta EPZ, which imported goods valued Rs.29.97 crore from GCA, exported goods valued Rs.9.5 crore only to GCA. The duty recoverable on the shortfall of Rs.20.47 crore was Rs.60.03 crore.

The Ministry of Commerce in their reply of November 1997 argued as follows:

*"Regarding short levy of duty for non achievement of currency balancing, it may be mentioned that Ministry of Commerce had issued instructions only in July 1995 to the effect that the currency balancing is to be achieved over a period of one year from the date of export, failing which the unit would be liable to pay applicable duties on the imported inputs used in the manufacture of goods exported to Russian Federation against repayment of State Credit. Such a stipulation was not prescribed prior to 1995. However, the audit has included RPA exports of the zones pertaining to the period prior to July 1995, even dating back to 1988 in which the question of duty recovery does not arise."*

The reply of the Ministry of Commerce is not acceptable for the following reasons :

Statutory provisions of para 234(1) of Exim Policy 1990-93 stressed on the achievement of currency balancing. Accordingly fob value of exports was not to be less than the cif value of imports. Subsequently the Ministry of Commerce in their Circular dated 14 October 1993 reiterated the stand that hard currency outgo on imports should atleast be made up by equivalent

exports to the General Currency Area. The circular issued on 25 July 1995 only specified the provisions for recovery of duty on imported inputs used in manufacture of export goods in the event of failure to achieve currency balancing within a period of one year and as such was in line with the provisions of the earlier Policy.

## **2.8 NON EXECUTION OF LEGAL UNDERTAKING**

In terms of para 98 of Exim Policy 1992-97 read with Appendix XXXI of Hand Book of Procedure (1992-97) Vol I, EPZ units are required to execute a bond or legal undertaking with the Development Commissioner concerned to fulfil the export obligation, value addition and other conditions prescribed by the Board of Approval. The LUT is an important instrument to safeguard the revenue due to the Government and to ensure compliance with the conditions prescribed under the scheme and no legal action can be initiated against the unit in the absence of this undertaking.

A test check of the records of 25 functional units in MEPZ revealed that only three units had executed LUT in time. Eight units had executed the LUTs belatedly after completion of five years and 14 units had not executed them till the lacuna was pointed out by Audit (April 1997). Similarly in Falta EPZ, 10 units did not execute LUTs while importing the goods. In KFTZ, 22 units did not execute the requisite bonds/LUTs with the Development Commissioner and in CEPZ, five units which are under operation and one unit which is in the process of debonding had not executed LUT. A unit in SEEPZ, engaged in the manufacture and export of 'Agriculture sprayer information and control system' failed to execute a bond/LUT with the Development Commissioner even after a period of 10 years of its operation.

## **2.9 IRREGULAR IMPORTS-NON LEVY OF DUTY**

Duty free imports of capital goods and other materials by an EPZ/FTZ unit is allowed subject to the specified conditions in the relevant Customs notifications.

15 units in 6 EPZs/FTZs were allowed duty free imports in violation of one or more of the conditions prescribed in the notifications prevailing

on the date of import. This resulted in irregular exemption of duty amounting to Rs.60.24 crore including interest. Details of a few cases are given below.

**a) IMPORT OF GOODS OTHER THAN PERMITTED IN LOA**

Capital goods and raw materials to be imported duty free are to be specifically indicated in the list duly approved and attested by the Development Commissioner.

i) Duty free import of capital goods, other than those items approved by the Development Commissioner for import by four units in SEEPZ, valued at Rs.4.45 crore, resulted in loss of revenue of Rs.5.59 crore (including interest) and were pointed out by audit in July 1997. Reply of the department is still awaited.

ii) A unit in Falta EPZ (since debonded) was to manufacture and export 'Printers and floppy drives' as per the LOA issued. However, in 1987, they were allowed to import 2000 pieces of components duty free for 'Hard disk drives' valued Rs.31.57 lakh which were not required for the export products. Non levy of duty amounting to Rs.97.25 lakh and consequential loss of interest of Rs.1.69 crore (upto December 1996) was pointed out by audit in March 1997. Department's response is still awaited.

iii) Accessories viz., 'Cleaning disks, diskettes etc.', were included for import in the LOA in March 1989 in case of a unit in Falta EPZ (since debonded) engaged in the manufacture and export of 'Printers and floppy drives'. The import of these items not specified in the LOA was Rs.19.78 lakh during December 1986 to February 1987 resulting in non levy of duty of Rs.55.11 lakh. Loss of interest (upto December 1996) on the unauthorised imports amounted to Rs.97.06 lakh.

iv) 'Printed circuit boards' were specifically prohibited for duty free import in the LOA issued to two EPZ units at Falta and Madras in October 1989/ June 1990, though the imports were permitted subsequently on 11 January 1990/8 September 1992. The import of these goods during the period when they were prohibited resulted in short levy of duty amounting to Rs.1.01 crore including interest of Rs.8.27 lakh in respect of one unit.

The reply of the department has not been received in any of these cases.

**b) IMPORT OF GOODS NOT REQUIRED FOR EXPORTS**

Para 94 of the Exim Policy and Para 163 and 165 of the Handbook of Procedures provides for duty free import of goods required for the manufacture of the exported products.

i) A unit in SEEPZ was permitted to manufacture and export 'Computer systems' which consisted of CPU, Key board, Monitor and In-built peripherals. 'Add-on peripherals' were excluded. However, the unit was allowed free import of 'Printers' valued at Rs.4.44 crore during the period 1992-93 to 1994-95 resulting in non levy of duty of Rs.8.11 crore including interest of Rs.2.15 crore. No reply to the audit comments issued in May 1997 was received.

ii) Another unit in SEEPZ which was permitted to export 'Computer software' imported 'Software' valued Rs.30.60 lakh duty free during 1989-90 to 1993-94. 'Software' being finished goods and not 'raw materials and components' was not admissible for duty free import. The duty not levied was Rs.46.67 lakh. Interest of Rs.36.69 lakh was also recoverable.

iii) Two units in the EPZs of Cochin and Kandla were allowed duty free import of goods viz., 'Flame detector heads', 'Electrical goods' not required for use in relation to the manufacture of articles for export and this resulted in short levy of Rs.30.41 lakh including interest of Rs.5.67 lakh in respect of one unit.

**c) IMPORT OF GOODS IN EXCESS OF THE PRESCRIBED LIMIT**

As per notification No.339/85 (relating to Noida EPZ) the exemption from levy of customs duties is available only to goods for which necessary licence has been issued by the Ministry of Commerce.

i) A unit in NEPZ was permitted import of capital goods worth Rs.36.36 crore as per the project approved. However, they imported (during 1992-93 to 1994-95) goods worth Rs.65.46 crore resulting in excess import of goods valued Rs.29.10 crore without due approval. The duty recoverable on the excess imports was Rs.32 crore including interest of Rs.16 crore upto March 1997.

ii) Another unit engaged in the manufacture of electronic goods imported capital goods worth Rs.3.95 crore (during 1992-93 to 1994-95) against the permissible limit of Rs.30 lakh per annum. The duty on the excess imports and interest was Rs.4.44 crore and Rs.3.55 crore respectively.

## **2.10 DTA SALES**

In terms of para 102 of the Exim Policy 1992-97, entire production of an EPZ unit shall be exported. However 25 to 35 per cent of the production in value terms are permitted to be sold in DTA as a post export entitlement subject to attainment of the requisite value addition. All DTA clearances are subject to payment of duties at concessional rates as notified by the Ministry of Finance from time to time.

### **a) CLEARANCE OF PROHIBITED ITEMS INTO DTA**

Para 186 of the Hand book of Procedures stipulates that prohibitions or restrictions applicable on imports of any goods shall be applicable on such goods when cleared into DTA from a unit in the EPZ. 'Computer system including personal computer' upto a cif value of Rs.1.50 lakh and Key boards or Monitors, each with a cif value not exceeding Rs.7500 were items appearing in the Negative List of Imports of the Exim Policy 1992-97 and accordingly required necessary licences for import during the years 1992 to 1997.

Six units in SEEPZ were allowed to clear these goods into DTA in violation of the provisions of the Exim Policy during the relevant period. The total duty concession amounting to Rs.107.77 crore during the period 1991-92 to 1995-96 extended to these clearances with an interest of Rs.60.18 crore was recoverable in these cases. Penalty was also leviable for violation of the policy provisions under the Foreign Trade (Development and Regulations) Act, 1992.

### **b) DTA SALES WITHOUT ACHIEVEMENT OF VALUE ADDITION**

The DTA sales are permissible only if the value addition achieved is not less than the minimum prescribed in the Letter of Approval/Permission. Where the minimum value addition is not endorsed in the LOA, minimum value addition of 20 per cent as stipulated in the Exim Policy would apply. The Development Commissioners of the EPZs were empowered to revise the value addition so fixed upto the minimum level of VA percentage as mentioned in the Exim Policy. However, such changes could be prospective only.

After applying the specified formula for calculation of value addition as given in para 119 of the Exim Policy, it was noticed that in the EP Zones

at Cochin, Kandla, Madras, Noida and Santacruz, 14 units did not achieve the specified level of value addition and were not entitled for any DTA sales. Incorrect calculation of VA and resultant clearances in DTA resulted in loss of duty of Rs.26.64 crore including interest of Rs.6.36 crore. A few cases are detailed below:

i) A unit in Noida EPZ was granted an LOA for manufacture and export of 'Tungsten halogen lamps and their parts'. The unit commenced production in June 1992. The Development Commissioner of the Zone specified that the unit had to achieve a minimum value addition of 31.86 per cent upto July 1994 and at the rate of 20.37 per cent from 15 July 1994 onwards. As the unit achieved negative value addition during the years 1992-93 to 1994-95 and 1996-97 and a VA of only 6 per cent during 1995-96, the unit was not entitled to any DTA sales. The unit made DTA sales valued at Rs.37.04 crore during these years at concessional rate of duty resulting in short levy of Rs.15.72 crore as customs duty. The interest leviable on this was Rs.3.90 crore upto March 1997.

ii) Another unit in Noida was granted LOA for manufacture and export of 'Compact discs' with a stipulated VA of 15.21 per cent. The unit though recording a negative value addition of (-) 42.39 per cent, was allowed to make DTA sales of Rs.2.30 crore during the period 1 April 1994 to 30 April 1996. The unauthorised DTA sales resulted in short levy of Rs.86 lakh as customs duty. The interest leviable was Rs.19 lakh.

iii) A unit in SEEPZ was allowed permission for DTA sale for Rs.83.66 lakh in October 1994, based on the exports made during 1993-94. However the unit achieved negative VA as against the prescribed VA of 24.89 per cent. The duty concession of Rs.50.57 lakh including interest of Rs.13.39 lakh on the DTA clearances was recoverable.

iv) A unit in Cochin EPZ approved in 1987 had made exports of only Rs.3.75 lakh and achieved negative value addition against the prescribed 30.46 per cent as on 31 March 1996. However the unit was allowed DTA sales valued Rs.22.15 lakh resulting in short levy of Rs.8.29 lakh.

v) The minimum stipulated VA to be achieved by Electronic hardware units was 15 per cent. A unit in Madras EPZ which had not achieved the



minimum value addition during 1993-94 to 1994-95 was permitted to sell its products valued at Rs.3.86 crore in DTA during the year 1993-94 to 1995-96. The duty recoverable on the irregular DTA sales worked out to Rs.2.58 crore including interest of Rs.96 lakh.

**c) UNDERVALUATION OF GOODS CLEARED INTO DTA**

Section 3 of the Central Excise Act, 1944 provides for the levy and collection of duties of excise on goods cleared from a unit in a EPZ/FTZ to DTA at an amount equal to duties of customs leviable under section 12 of the Customs Act, 1962. The value of such excisable goods are to be determined in accordance with the provisions of the Customs Act, 1962 and the Customs Tariff Act, 1975 (51 of 1975) read with Customs Valuation Rules 1988. The valuation of the goods and assessments in such cases, are to be done in the manner prescribed by the Board/ Ministry of Finance.

Three units in SEEPZ engaged in the manufacture of 'Paper copier and computer systems' understated the value of the goods cleared into DTA to their sister concerns/ related units by omitting certain pre manufacturing charges like octroi, margin of profit etc. The customs duties/excise duties short levied due to the undervaluation in these cases worked out to Rs.8.19 crore including interest of Rs.2.80 crore.

**d) DTA SALES OF GOODS OTHER THAN APPROVED FOR MANUFACTURE**

As per appendix XXXIII of the Handbook of Procedures, the DTA entitlement will be applicable only to goods that are approved for manufacture and export in the Letter of Permission. A unit in SEEPZ cleared in DTA 324 'ESBX systems' and 43 'Cable fault locaters' valued at Rs.46.37 lakh which were not items listed in the Letter of Permission for manufacture. The short levy of duty worked out to Rs.49.02 lakh including interest of Rs.7.48 lakh. 2 other units also effected DTA sales of the goods other than that approved for manufacture and export in LOA. These units were liable to pay duty amounting to Rs.15.63 lakh including interest amounting to Rs.4.70 lakh.

**e) ADVANCE DTA SALES**

Advance DTA sale is permissible only in case of trial production and shall not exceed the entitlement accruable on the exports envisaged in the

first year. Such sale shall be adjusted against the subsequent entitlements. Irregular advance clearances by six units in SEEPZ resulted in loss of duty of Rs.6.59 crore including interest. A few cases are detailed below :

i) A unit in SEEPZ was granted permission for advance DTA sales in respect of trial production amounting to Rs.90.46 lakh in August 1994. The business of assembly of Photocopier from components in CKD/SKD conditions did not require any trial production. Moreover as the unit had been established in 1985 it did not require any trial production. As the unit did not earn any subsequent entitlements, the advance clearances could also not be adjusted leading to short levy of duty amounting to Rs.1.64 crore including interest of Rs.43 lakh.

ii) Another unit in SEEPZ was allowed provisional DTA sale of Rs.70.60 lakh in June 1992. Further the unit was allowed regular DTA sale permission for Rs.1.69 crore without adjusting the provisional permission granted. The duty recoverable on the excess clearances worked out to Rs.1.30 crore. Interest leviable on the duty short levied amounted to Rs.93.78 lakh.

**f) DTA SALES AFTER PRESCRIBED TIME LIMIT**

As per the guidelines governing the DTA sales in the Exim Policy, the DTA sale entitlement should be availed within one year of its accrual. The Development Commissioner may, if he deems fit, extend this period by another six months.

Eight units in SEEPZ, Cochin, and Kandla cleared goods in DTA after expiry of validity period of 18 months without obtaining Board's permission for extension beyond 18 months. The short levy of duty in these cases was Rs.3.22 crore including interest of Rs.1.00 crore in respect of two units.

**g) UNAUTHORISED DTA SALE**

i) A unit in SEEPZ was granted an adhoc permission for manufacture and export of 'Micro processor based computer system' subject to the condition that no DTA sale shall be permitted. However the unit was allowed to sell goods worth Rs.2.14 crore in DTA in July 1992. The duty recoverable was Rs.2.47 crore. The interest recoverable amounted to Rs.1.50 crore.

ii) Another unit manufacturing 'Loud speakers' in SEEPZ was specifically forbidden in the LOA to sell the products in DTA. However, sales worth Rs.48.20 lakh were made during 1993-97 leading to irregular grant of exemption of Rs.51.38 lakh along with interest of Rs.10.63 lakh.

**h) DTA SALE WITHOUT PAYMENT OF DUTY**

Four units in Falta, Kandla, Madras and Santacruz EPZ cleared goods into DTA without payment of the appropriate rate of duty. The non levy/short levy of duty in these cases amounted to Rs.11.52 lakh including interest of Rs.2.56 lakh in respect of 3 units.

The Ministry of Commerce in their reply of November 1997 contended as follows:

*"Regarding audit observation on DTA sales without achievement of VA, it is clarified that revision of value addition is done by the competent authority as per provisions of the Policy and VA is not reduced below the minimum prescribed in the Exim Policy. Wherever there is shortfall in VA, DTA sale is allowed on proportionate basis as per Exim Policy and Procedures. However, no DTA sale is allowed if VA achieved is below industry norms. Advance DTA sale against trial production which is permitted in anticipation of exports is not subject to fulfilment of VA at the time of sanction but is subject to adjustment from the unit's entitlement against exports as per specified VA norms."*

Ministry has relied on para J(ii) of Appendix XXXIII of Handbook of Procedures Vol.I which permits proportionate sale of goods in DTA by EPZ units even where value addition achieved is lower than the prescribed percentage. The cases illustrated in para 2.10(b) relate to sale of goods in DTA by EPZ units which had negative value addition. Therefore para J(ii) relating to proportionate sales would not be applicable to the cases mentioned in para 2.10(b). Further, the benefit of para J(ii) is available to only those units which achieve a minimum value addition of 20 per cent.

**2.11 OTHER TOPICS**

Irregularities like shortage of stock, non levy of duty, and grant of inadmissible benefits that came to notice as a result of test check are

detailed below. The loss of revenue was Rs.183.16 crore in 26 of these cases. Some of these cases are narrated below:

**a) GOODS IMPORTED LYING IDLE/UNUTILISED**

In terms of the Customs notifications which were in force prior to June 1994 the goods imported duty free by the EPZ units were required to be used/installed within one year of import failing which duty exempted was recoverable.

Ten units in Kandla, Madras, Noida and Santacruz failed to use/install within one year, the capital goods and raw materials imported by them under the aforesaid notifications. The duty recoverable in these cases amounted to Rs.151.64 crore including interest of Rs.61.48 crore. The replies of the department are awaited.

**b) INTER UNIT TRANSFERS**

i) In terms of para 110 of the Exim Policy 1992-97, goods imported by an EOU & EPZ unit may be transferred or given on loan to another EPZ unit with the permission of the Development Commissioner concerned.

A unit in Santacruz EPZ permitted to manufacture and export 'Monitors and Power Supplies' had made inter unit transfer during 1995-96 of imported raw materials worth Rs.2.26 crore to two other EPZ units for job work without obtaining the permission from the concerned Development Commissioner. The unauthorised transfer of raw materials resulted in non levy of customs duty amounting to Rs.1.93 crore including interest of Rs.29 lakh. Besides penalty was also leviable for violation of the provisions in the Policy.

ii) As per the norms laid down by Ministry of Finance in its Circular dated 31 January 1994, it should be ensured that the substantial activity of manufacturing is carried out within the bonded premises of EPZ unit and there is no attempt to parcel out the manufacturing operations outside the bonded premises. This required that the finished goods/products received after job work were capable of being identified with raw materials/components sent out to the EPZ units.

During test check it was noticed that in three cases of Noida EPZ, the entire manufacturing activity was carried on outside the zone on job work basis and it was not possible to identify the finished goods with reference to the raw materials sent out for the job work. The value of goods transferred to DTA was Rs.8.44 crore and the amount of duty and interest worked out to Rs. 8.51 crore (Rs.6.16 crore and Rs.2.35 crore).

**c) DISPOSAL OF SCRAP/WASTE/REMNANTS**

Para 114 of the Exim Policy (1992-97) provides that scrap, waste, remnants arising out of the production process can be permitted to be sold in the DTA, on payment of appropriate duties and taxes within the percentage as fixed by the Board of Approval and notified by the DGFT.

Two units in Kandla EPZ cleared 'Caster oil cakes' during 1991-92 to 1996-97 as remnants produced from 'Caster oil' without payment of duty under notification No.116/87-CE issued under Rule 8(1) of the Central Excise Rules, 1944. As the said rule was deleted with effect from 1 July 1988, the notification issued thereunder also became void from the said date. Duty was leviable on the goods cleared in DTA in terms of Central Excise notification No.2/95 and its earlier version. Loss of revenue to the Government worked out to Rs.6.17 crore including interest of Rs.1.95 crore.

Four units in Cochin and Kandla EPZ cleared waste (cut pieces of fabric) and scrap generated in the course of manufacture of 'Readymade garments', 'Stainless steel utensils' and 'Hardware items' respectively into DTA either in excess of the limits prescribed or without any norms of wastage being fixed and notified by the proper authority. The duty recoverable on the excess clearances amounted to Rs.4.11 crore including interest of Rs.7.43 lakh in respect of one unit of Kandla.

**d) NON LEVY OF DUTY ON GOODS DESTROYED IN FIRE**

In terms of para 3(v) and para 4(ii) of Ministry of Finance circular No.99/95 dated 20 September 1995 goods deposited in the warehouses are to be fully insured against theft, pilferage, fire accidents, riot risks and other natural calamities etc. at least for a value equal to the customs duty

by a comprehensive insurance policy drawn in favour of the Commissioner of Customs by the warehouse keeper.

i) Goods deposited in an EPZ unit in Falta valued at Rs.9.56 crore were destroyed in a fire. Though the unit claimed insurance for Rs.12.55 crore, it did not pay any duty on the goods amounting to Rs.3.39 crore. When this was pointed out (February 1997), the department replied that the unit had applied for abatement under section 22 and 23 of Custom Act 1962. As the unit had received insurance claim of Rs.12.55 crore, it was not entitled for any abatement and was liable to pay the full duty.

ii) The duty recoverable on goods lost by theft/fire etc., in 3 units of Santacruz EPZ worked out to Rs.1.83 crore including interest of Rs.56 lakh.

**e) EXPORT THROUGH OTHER EXPORTERS**

According to para 104 of Exim Policy 1992-97, goods manufactured by a unit in an EPZ can be permitted to be exported through an Export House/Trading House, with a view to facilitate marketing of the goods by Export/Trading Houses etc. However, the value addition as well as any other export obligation relating to the imports and exports shall continue to be discharged by the EPZ unit.

A unit in CEPZ processing seafoods commenced exports jointly with merchant exporters outside the EPZ. Though the exports made by the unit were claimed towards discharge of export obligation by the unit in the progress reports being submitted, the unit issued disclaimer certificates in favour of the merchant exporters in respect of same exports valued at Rs.52.88 crore between 1993-94 and 1995-96 to enable them to claim certain export related benefits. As avilment of double benefits was in violation of the provisions of Para 104, the duty foregone on the imports and indigenous goods amounting to Rs.1.24 crore was recoverable.

The Ministry of Commerce (November 1997) argued that all export benefits, including Special Import Licence and recognition as Export House/Trading House etc. would accrue to the exporter in whose name foreign exchange earnings are realised.

Ministry's reply is not acceptable as the EPZ unit had already given disclaimer certificates for the entire exports and such exports made cannot be considered as fulfilment of export obligation in the hands of EPZ unit. Consequently the duty forgone on imports and indigenous goods was recoverable.

**f) SHORTAGES OF STOCK**

According to the conditions of notification No.262/85-Cus, the importer shall pay duty on all imported goods that have not been used in the manufacture of goods for export.

In one unit (since debonded) of Falta EPZ, out of the 28906 sets of Printers imported duty free during December 1988 to June 1990, 1590 sets having an assessable value of Rs.41.28 lakh could not be accounted for. Duty amounting to Rs.1.29 crore was recoverable along with interest of Rs.1.52 crore upto December 1996. Besides these items, 340 pieces of Cleaning Disks and 1960 pieces of Floppy Disk Drives also could not be accounted for by the unit involving duty of Rs.59.79 lakh and interest of Rs.92.27 lakh.

**ANNEXURE - 1**

**COMPARISON OF VALUE ADDITION FORMULA AND NET FOREIGN  
EXCHANGE EARNING AS A PERCENTAGE OF EXPORTS (NFEP)  
IN EXIM POLICY 1992-97 AND 1997-2002**

Example	Imports (CIF)	Exports (FOB)	Foreign exchange realised (FOB realised)	Exim Policy 1992-97	Exim Policy 1997-2002 (For DEEC Scheme)	Exim Policy 1997-2002 (For EOU/EPZ Scheme)
				$VA = \frac{FOB\ realised - CIF}{FOB\ realised} \times 100$	$VA = \frac{FOB - CIF}{CIF} \times 100$	$NFEP = \frac{FOB - CIF}{CIF} \times 100$
1. Where the FOB and FOB realised are equal						
	\$ 1000	\$ 1500	\$ 1500	$\frac{1500-1000}{1500} \times 100 = 33.34\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$
2. Where FOB realised is less than the FOB						
	\$ 1000	\$ 1500	\$ 1200	$\frac{1200-1000}{1200} \times 100 = 16.67\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$
3. Where FOB realised is less than FOB but equal to CIF						
	\$ 1000	\$ 1500	\$ 1000	$\frac{1000-1000}{1000} \times 100 = 0\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$
4. Where FOB realised is less than FOB as well as CIF						
	\$ 1000	\$ 1500	\$ 500	$\frac{500-1000}{500} \times 100 = (-)100\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$	$\frac{1500-1000}{1000} \times 100 = 50\%$

Note: The factor 'Net Foreign Exchange Earning as a percentage of exports (NFEP)' has been introduced in the Exim Policy 1997-2002.



### *Chapter 3. Short levy due to undervaluation*

#### **3.1 INCORRECT COMPUTATION OF ASSESSABLE VALUE**

a) In terms of section 14 of Customs Act 1962 read with rule 9(i)(b) of Valuation rules 1988, transaction value, for the purpose of assessment of duty shall include the value of goods and services supplied directly or indirectly by the buyer free of charge or at reduced cost.

The assessable value of two consignments of 'PECOL catalyst' imported by a private importer (March and May 1994) through a major Custom House was computed excluding the value of the sponge platinum supplied free of cost by the importer resulting in the undervaluation and short levy of duty of Rs.29.51 lakh.

On being pointed out (September/November 1994) the department justified the exclusion, stating (October 1994/February 1995) that in a cyclic process, the platinum was getting used many times in the manufacture of the catalyst and the value stood included in the first shipment itself. The department further stated that the sponge platinum, was analogous to tools, dies etc., referred to in Rule 9(1)(b)(ii) of the Valuation Rules.

The contention of the department was not tenable as,

- i) in view of the specific description in the invoice and write-up, the spent PECOL catalyst could not be regarded as tool, die or mould to be covered under Rule 9(1)(b)(ii) but to be regarded only as material in terms of Rule 9(1)(b)(i);
- ii) the specific notification which gave exemption to catalyst containing platinum, palladium or silver produced out of the said metal recovered from spent catalyst was withdrawn with effect from 1 March 1994 and as such the duty was leviable on the full value from that date.

Ministry's reply has not been received (November 1997).

b) According to Rule 9 (2) of the Valuation Rules, 1988, the value of imported goods for assessment shall be the value inclusive of the cost of

transportation to the place of importation. It also provides that where the cost of transport is not ascertainable, such cost shall be 20 per cent of free on board (fob) value of such goods.

While arriving at the assessable value of the goods imported through a major Custom House in February 1995, the element of freight charges was ignored, resulting in short levy of duty of Rs.2.01 lakh.

On being pointed out (July 1995), the department realised the short levied amount in December 1996.

c) While computing the assessable value of a consignment of 48 tonne of 'C.S. Plates' imported by a private limited company, the cif value of the goods was erroneously taken as US\$ 19372 instead of US\$ 27028. This resulted in duty being short collected by Rs.1.49 lakh.

On being pointed out (October 1995), the Ministry admitted the objection and reported recovery of the duty short levied (July 1997).

d) Transaction value for the assessment of Phosphoric acid shall be based on the quantity of Phosphoric acid actually contained in the bulk solution imported.

The transaction value of a consignment of phosphoric acid imported through a major Custom House (October 1991) was arrived at based on the quantity of acid content as 53.14 per cent shown in the invoice as against the 54.56 per cent reported in the test report of the Custom House. The incorrect valuation resulted in short levy of duty amounting to Rs.1.51 lakh.

On being pointed out (May 1995) the department replied (June 1996) that percentage of Phosphoric acid content as per test report was not applied for determining the assessable value as it did not show any considerable difference.

The reply of the department is not tenable as the difference of 1.42 per cent cannot be treated as nominal. Moreover, the import of Phosphoric acid being regular and in bulk could result in huge loss of revenue.

### **3.2 NON IMPLEMENTATION OF BOARD'S DECISION IN TIME**

Sale price of confiscated goods was revised by enhancing it by 10 per cent over the prevailing sale-price vide Central Board of Excise and Customs circular dated 28 July 1992.

In six disposal units under two Commissionerates of Customs, 283 cases of various confiscated goods were sold during July 1992 to March by adopting the prices as fixed prior to 28 July 1992 instead of the enhanced prices resulting in loss of revenue of Rs.5.92 lakh.

On being pointed out (June 1995 and August 1996), the department stated (July 1995 and November 1996), that the new price list was not received in time.

The fact remains that due to delay in communication of the Board's decision and implementation thereof by the department, the goods were sold at lower prices resulting in loss of revenue.

### **3.3 SALE ON HIGH SEAS BASIS**

According to rule 3(i) of the Valuation Rules, 1988, the value of imported goods shall be the transaction value. In case of the sale of goods at high seas such transaction value shall include the commission charges or other expenses incurred by the importer.

Five consignments of different dutiable goods imported through two major ports between May 1992 and April 1994, sold on high seas basis to other private importers, were assessed without taking into account the actual transaction value or the service charges, stevedoring charges, etc. The short collection of duty in these cases amounted to Rs.4.75 lakh.

On this being pointed out (October 1992, June 1993 and October 1994), the department admitted the undervaluation in all the cases.

Ministry have confirmed the facts and reported recovery in respect of one consignment (September 1997).

### **3.4 UNDER VALUATION OF GOODS DUE TO NON ADOPTION OF COMPARABLE RATES**

In a major Custom House, 20 lakh pieces of 'Organ' brand 'Industrial sewing machine needles' (Type DBXI) of Chinese origin imported in March 1995 were assessed to duty on the basis of invoice value which was 10 times lesser than that of a contemporary import of the needles of the same brand and same type from Japan. The adoption of lower value resulted in duty being levied short by Rs.12.25 lakh.

On being pointed out (September 1995), the department, instead of ascertaining the international price of the goods, justified the assessment stating (November 1995) that the goods of Chinese origin could not be compared with those of Japanese origin as goods manufactured in Japan were more expensive than those manufactured in China.

The department's reply is not tenable as, in the case of M/s. Ankita Traders and Investments Limited, Madras {1995 (76) ELT 465}, the Collector (Appeals) had concluded that the value of similar/identical goods of other countries could also be adopted for fixing the value of similar/identical goods.

## *Chapter 4. Short levy due to incorrect classification*

Some illustrative cases of short levy of customs duty arising from incorrect classification of goods are briefly narrated below:

### **4.1 TOBACCO AND MANUFACTURED SUBSTITUTES**

'Reconstituted tobacco' when imported is classifiable under sub heading 2403.91/2404.19 of the Customs and Central Excise Tariffs respectively.

A consignment of 'Reconstituted tobacco' (CPCL Tobacco) imported during June 1994 was classified under sub heading 2401.10/2401.00 of the Customs/Central Excise Tariffs respectively. The misclassification resulted in short collection of duty amounting to Rs.58.63 lakh.

On this being pointed out (March 1997), the department stated (July 1997) that the goods though classifiable under sub heading 2403.91 of Customs Tariff, were assessable under sub heading 2404.90 of Central Excise Tariff for levy of additional duty.

The reply of the department is not tenable as the goods imported were for use in the manufacture of smoking mixture for use in pipes and cigarettes which are specifically covered under sub heading 2404.19 of the Central Excise Tariff.

### **4.2 CHEMICAL PRODUCTS**

'Antioxidising preparations for rubber' are classifiable under sub heading 3812.30 of Customs Tariff.

Two consignments of Santoflex 13, imported through a major Custom House and cleared from the warehouse of an importer (August 1996) were assessed under sub heading 3812.10. As the test reports indicated that the goods were 'Antioxidising preparations for rubber', audit pointed out (December 1996/January 1997) the correct classification of the goods under sub heading 3812.30 and the short levy of duty of Rs.4.25 lakh.

The Ministry admitted the misclassification and reported recovery of the short levied amount (November 1997).

### **4.3 ARTICLES OF BASE METAL**

#### **a) COPPER AND ARTICLES THEREOF**

As per Note (1)(g) to Section XVI, 'Parts of general use of base metal' as defined in Note 2 to Section XV are excluded from the purview of Section XVI and are classifiable according to the description of the article. Accordingly 'Tubes of copper alloys' are classifiable under Customs Tariff heading 74.11.

Two consignments of 'Seamless nickel-copper alloy heat exchanger tubes' imported (May/June 1994) were assessed under sub heading 8419.90 as 'Parts of heat exchanger units' extending the benefits of Customs notification No.62/94 dated 1 March 1994.

When the misclassification resulting in short levy of duty of Rs.6.88 lakh, was pointed out by Audit in November 1994, the department admitted the objection (August 1996). Recovery particulars are awaited (November 1997).

#### **b) IRON OR STEEL AND ARTICLES THEREOF**

'Pipes and pipe fittings' of iron and steel are classifiable under Customs and Central Excise Tariff sub heading 7307.19.

A consignment of 'Pipe fittings' imported during June 1996 was assessed under CTH 7304 as 'Seamless pipes' with the benefit of notification No.26/95-cus dated 16 March 1995.

The misclassification and incorrect application of exemption notification resulted in short levy of duty of Rs.6.50 lakh.

On this being pointed out in audit (January 1997) the department admitted the objection and recovered the amount of duty short levied (April 1997).

### **4.4 MACHINERIES AND PARTS**

#### **a) DESIGN JET/COLOURJET/INKJET PLOTTERS**

'Plotters' being 'Output units of data processing machines - transforming the data of computer aided designing/drawing into written/visual

form' are classifiable under Customs Tariff heading 84.71. Nineteen consignments of 'Design jet/Colourjet/Inkjet plotters' imported through a major Custom House during February-July 1996 were assessed under Customs Tariff heading 90.17 as 'Automatic drafting machines'. The misclassification resulting in short levy of Rs.37.73 lakh, was pointed out in audit (June to November 1996). The department upheld the classification of the goods under heading '90.17' (November 1996) quoting an 'Order in Appeal' passed by Commissioner of Customs Bangalore in October 1996.

The department's reply is not tenable in view of the following:

- i) as per HSN (Page 1299) 'Plotters' are peripheral units of analogue machines classifiable under heading 84.71;
- ii) the ITC classification list published by Ministry of Commerce (based on HSN) specifically mentions 'Plotters' as an output unit of computer systems under heading 84.71;

**b) REFRIGERATORS**

A consignment of household 'Refrigerators - 330 litre capacity' classifiable under heading 8418.29 of the Customs/ Central Excise Tariffs imported during September 1995 was classified under 8418.10 of the said Tariffs with the benefit of notification No.49/95-cus. The misclassification and the incorrect application of the exemption notification for goods under sub heading 8418.10 resulted in short levy of Rs.5.07 lakh.

On this being pointed out in audit (March 1996), the department admitted the objection and recovered the amount (January 1997).

Ministry have confirmed the facts (July 1997).

**4.5 ELECTRICAL/ELECTRONIC MACHINERY AND EQUIPMENT**

**a) UNINTERRUPTIBLE POWER SUPPLY SYSTEM**

In terms of a CEGAT decision [1995 (80)ELT 208(T)], Uninterruptible Power Supply Systems (UPSS) are classifiable under heading 85.43 of the Customs Tariff.

13 consignments of UPSS imported through two major Custom Houses during January to November 1996 were classified under sub heading 8501.10/8504.40 of the Customs Tariff. The misclassification resulted in short levy of duty of Rs.66.01 lakh.

On this being pointed out (June 1996 to March 1997), the department admitted the objections and recovered Rs.48.06 lakh in respect of five consignments.

Ministry have confirmed the facts (September 1997).

**b) TRANSMISSION/RECEPTION EQUIPMENT USED IN RADIO TELEPHONY**

i) Transmission/Reception equipment used in Radio telephony/Radio telegraphy when imported are classifiable under Customs Tariff sub heading 8525.20.

A consignment of 'Air link modems' imported during June 1996 was classified under Customs Tariff sub heading 8529.90 as parts of equipments falling under sub heading 8525.20 and extended the benefit of notification No.61/95-cus not applicable to them. The misclassification resulted in short levy of duty of Rs.19.89 lakh.

On this being pointed out (December 1996), the department admitted the objection and recovered the duty short levied (January 1997).

The Ministry confirmed the facts (July 1997).

ii) Transmission apparatus for Radio-telephony/Radio-broadcasting are classifiable under heading 85.25, while parts thereof are classifiable under heading 85.29 of the Customs and Central Excise Tariff. Cable in running length is, however, classifiable under heading 85.44 of both the Tariffs.

One consignment containing 'Cable in running length' and 'Parts of telecommunication equipments', and another containing 'Sub-assemblies/modules', imported in June 1994 were classified under heading 85.25 as complete apparatus. The misclassification resulted in short levy of duty of Rs.5.83 lakh.



On this being pointed out (December 1994 and April 1997), the department reported recovery of Rs.3.23 lakh. Recovery of the balance amount is awaited (November 1997).

**c) PARTS**

In terms of Note 2(a) to Section XVI of Customs Tariff Schedule, 'parts which are goods included in any of the headings of chapter 84 or 85 are, in all cases, to be classified in their respective headings'.

A consignment of 'Parts of engines/motors used in motor cycles', classifiable under sub headings 8511.90 and 8512.90, was imported in July 1995 through a major Custom House and classified under heading 8503 as parts of motors. The misclassification resulted in duty being levied short by Rs.19.23 lakh.

On this being pointed out (January 1996), the department accepted the objection and recovered the amount short levied (March 1996).

The Ministry have confirmed the facts (July 1997).

**d) GASKETS OF REFRIGERATORS**

Six consignments of 'Gaskets' for Domestic refrigerators imported (December 1993 and July 1994) through a major Custom House were assessed under sub headings 8418.95 of the Customs and Central Excise Tariff. 'Gaskets' being 'plastic extruded profile' used for sealing the door was classifiable under sub heading 3926.90 of both the Tariffs. The misclassification resulted in short levy of Rs.6.80 lakh.

On this being pointed out in audit (July 1995) the Ministry accepted the objection and reported recovery thereof (September 1997).

**4.6 OTHER CASES**

In 17 other cases of incorrect classification reported to the Ministry short levy of customs duty amounting to Rs.30.88 lakh was involved, of

which 15 cases involving Rs.27.67 lakh were accepted by the department as per details below:

(Rupees in lakh)

Sl. No.	Details of product	Heading where classifiable	Heading where classified	Amount short levied	Amount accepted	Amount recovered
1.	Clutches and shaft couplings	8483.60	8406.90	2.89	2.89	—
2.	Motor vehicle parts	8714.19	8483.19	2.65	2.65	2.65
3.	Evaporators	8419.99	7616.90	2.61	2.61	2.61
4.	Components of capacitors	8532.90	7606.91	2.56	2.56	2.56
5.	Buckles	8308.00	9113.90	2.40	2.40	1.40
6.	Ceramic counter facing	6419.90 6909.90	8408.99	2.05	2.05	2.05
7.	Turbo chargers	8409.99	8414.80	1.76	1.76	1.76
8.	Batteries for digital electronic watches	8506.19	9114.90	1.69	1.69	—
9.	Additives	3823.00	3815.00	1.69	—	—
10.	Clutch plates for power shaft transmission	8708.93	8483.60	1.66	1.66	1.66
11.	Parts of automatic data processing machine	8423.90	8473.30	1.59	1.59	1.59
12.	Fascimile/fax machine	8517.21	8525.20	1.52	—	—
13.	Electronic instruments	8471.00	9030.39	1.42	1.42	1.42
14.	Portable band saw with self contained motor	8505.00	8461.00	1.33	1.33	1.33
15.	Xylene OMP	2707.30	2902.44	1.08	1.08	1.08
16.	Chemically defined organic compound	3823.90	2902.44	1.06	1.06	1.06
17.	Nickel silver rod	7407.22	7403.23	0.92	0.92	0.92
Total				30.88	27.67	22.09

## *Chapter 5. Short levy due to incorrect grant of exemption*

Some illustrative cases of short levy of duty on account of incorrect grant of exemption are narrated below:-

### **5.1 IRREGULAR IMPORTS OF MEDICAL EQUIPMENTS BY PRIVATE HOSPITALS**

In terms of notification No.64/88-cus dated 1 March 1988 all equipment apparatus and appliance, including spare parts and accessories there of (referred to as 'hospital equipment') imported for use in any hospital of the type specified in table annexed to the notification were exempted from whole of the basic and additional duties of customs subject to fulfilment of conditions prescribed therein. The essentiality of the import of the equipments was to be verified either by the Ministry of Health and Family Welfare or by the Directorate General of Health Services but it was the Ministry of Health and Family Welfare who had to specifically certify that the hospital which availed the benefit of notification was a charitable hospital or was treating certain percentage of the patients free of cost or was an institution run on non profit basis etc., under one of the four categories specified in the table.

A review of the imports of these equipments through different Custom Houses and the assessments thereof revealed the following irregularities.

a) In Chennai Custom House 494 consignments of Medical equipments involving duty of Rs.32.94 crore were assessed provisionally for want of the requisite certificates between 1989 and 1994 under the notification. Out of these 291 cases with customs duty of Rs.11.52 crore pertained only to 3 hospitals.

It was noticed (May 1997) that in 411 cases involving duty of Rs.21.27 crore, the assessments were still pending for finalisation and 24 of these cases were pending for more than 5 years. Although the assessments were finalised in 83 cases, an amount of Rs.7.81 crore were still pending for recovery in these cases. In 155 cases with a duty implication of Rs.19.86 crore, no bank guarantees to protect the revenue were obtained by the

department. In 225 cases bank guarantees taken for an amount of Rs.9.26 crore had expired thereby reducing the chances for recovery. In 6 cases, the duties recoverable were worked out incorrectly and Rs.82.07 lakh was short demanded.

These points were brought to the notice of the Ministry in August 1997. Reply is awaited as of October 1997.

**b)** In Delhi Custom House, equipments valued Rs.5.73 crore imported by seven hospitals during September 1992 to February 1994 were assessed provisionally for want of the requisite certificates under the notification. Though on production of the certificates from DGHS, two cases were finalised, the essentiality certificate from the Ministry of Health as prescribed in the notification were not available in any of these cases. Therefore, the benefit of the notification was not available to the importers and customs duty amounting to Rs.2.55 crore was recoverable.

Further it was also observed that (i) in three of these cases, goods valued at Rs.2.71 crore imported during January to April 1993 were undervalued to the extent of Rs.1.79 crore resulting in loss of duty of Rs.71.59 lakh. (ii) The value of bank guarantees obtained from the importers for provisionally assessing the cases were short by Rs.1.06 crore. (iii) the demands raised on finalisation of the assessment against two of the bank guarantees for Rs.11.15 lakh were not honoured by the issuing bank and (iv) demands for Rs.30.42 lakh raised in March 1997 could not be enforced as the bank guarantees had expired in December 1996.

The Matter was reported to the Custom House (July 1997) and the Ministry (November 1997); their reply is awaited.

**c)** Two importers in Hyderabad Commissionerate imported duty free, equipment and accessories valued Rs.98.20 lakh during February to June 1993 based on the certificates issued by DGHS (January 1993) instead of from the Ministry of Health and Family Welfare as prescribed under the notification. The incorrect grant of exemption resulted in revenue loss of Rs.1.39 crore.

On this being pointed out by audit (February 1994 and March 1995), the department stated that the transitory certificate issued by DGHS was final and duty free imports were in order. The department's reply is not tenable as the certificate that the hospital was one of the type specified in the table annexed to the notification could be given only by the Ministry.

**d)** In Calcutta Custom House, the benefit of the aforesaid notification was granted provisionally to an importer in respect of two consignments of hospital equipment and spares in the absence of the required certificate (June 1992). As the importer could not produce the requisite certificates within the specified period, the department issued a show cause cum demand notice for Rs.3.36 crore in December 1994. However, the same was neither confirmed nor was any recovery effected till May 1997.

On this being pointed out by audit (May 1997), the Ministry confirmed the facts and stated (November 1997) that the SCN issued was adjudicated confirming the demand.

**e)** Extending the benefit of the aforesaid notification, no duty was levied on two consignments of hospital equipments imported by two private hospitals through Delhi Commissionerate in July and November 1992. During the audit of these hospitals, it was noticed (November 1996) that one of the hospitals had not maintained any record on the basis of which it could be established that the requisite number of outdoor or indoor patients as envisaged in the notification were being treated free, while in the other hospital the indoor-patient facility was started only after a lapse of two years from the date of import of equipment. Moreover, the income of the patients treated at the hospital was not recorded from which it could be verified that the patients having income of less than Rs.500 were being treated free. The hospital not being of the type mentioned in the notification, grant of exemption from payment of customs duty to the tune of Rs.89.34 lakh was incorrect.

On this being brought to the notice of the department, (November 1996) a show cause notice for Rs.79.11 lakh was issued in May 1997. Further progress is awaited (November 1997).

f) A private medical college imported two consignments of 'dental equipments' in November 1992 through an Inland Container Depot under Bangalore Commissionerate. The Department assessed the goods extending the benefit of the aforesaid notification and a total duty amounting to Rs.26.41 lakh was shown as forgone.

It was pointed out (February 1995) in audit that since the import was made by an institution not certified as eligible for duty free imports by the Ministry of Health and Family Welfare, the grant of exemption from duty was irregular (June 1997).

The Ministry stated (October 1997) that the goods were assessed provisionally at the time of import and the entire duty was recovered on finalisation of the assessment.

## **5.2 IRREGULAR IMPORTS OF MEDICAL EQUIPMENTS BY GOVERNMENT HOSPITALS**

In terms of notification No.63/88-cus dated 1 March 1988 hospital equipments imported by Government Hospitals and Government controlled hospitals were exempt from payment of basic and additional duties of customs subject to the production of a certificate from Director General of Health Services.

Three consignments of medical equipments imported by a private hospital through Chennai Commissionerate during October 1992 to March 1993 were assessed with the benefit of exemption under the above notification based on a duty exemption certificate issued in the name of a Government hospital. However, the institution's status as a State Government hospital had changed to a private trust hospital at the time of assessment. On the incorrect grant of exemption and consequential loss of revenue to the extent by Rs.56.53 lakh being pointed out by audit (August 1993), the department stated (February 1996) that due to the changed status of the institution exemption was available in terms of another customs notification No.64/88 dated 1 March 1988.

The reply of the department is not tenable as at the time of assessment of goods, the exemption certificate produced under notification

No.63/88-cus was not valid. Further certificate as prescribed under notification No.64/88-cus was also not produced by the importer till date.

### **5.3 IRREGULAR IMPORTS MADE BY CHARITABLE INSTITUTION**

In terms of notification No.148/94-cus dated 13 July 1994 goods such as food stuff, medicines, medical stores of perishable nature, clothing and blankets, etc., imported by Charitable Institutions as free gifts from abroad to be distributed free to the poor and the needy are exempt from payment of import duties subject to certain conditions prescribed therein.

As per conditions to the notification, a certificate was required to be produced from the State Government concerned or from persons or institutions specified by the Central Board of Excise and Customs certifying that the importer is a bonafide organisation engaged in relief work and in the distribution of relief to the poor and the needy without any distinction of caste, creed or race at the time of import. The importer had also to give an undertaking to the Assistant Commissioner of Customs to the effect that a certificate relating to the free distribution of the imported goods to the poor and needy free of cost without any discrimination of caste, creed and race would be produced within six months from the date of importation or such period as extended by the Assistant Commissioner of Customs.

In 57 consignments of duty free imports valued Rs.8.53 crore made by different charitable institutions for the period April 1994 to March 1996 through a major Custom House, the certificates as prescribed were not produced by the importers even after the specified periods. It was also noted that the CBEC had not specified any person or institute as certifying agencies as required in the notification. In a few cases the certificates issued by the District Magistrates/Collectors were incorrectly accepted by the department as certificates from the State Government at the time of importation. However, the certificate of distribution as specified were not produced by any of the importers.

On the duty recoverable in these cases amounting to Rs.6.51 crore being pointed out by audit (June 1996), the department stated (February 1997) that demand notices were issued to the defaulting importers.

#### **5.4 NON VERIFICATION OF END USE**

**a)** Notification No.83/90-cus dated 20 March 1990 as amended, prescribes concessional rate of customs duty on import of melting scrap of Iron and Steel required for use in 'Electric arc furnace or induction furnace or melting in hot blast cupola' or for supply to a unit for use in 'Electric arc furnace' or 'Induction furnace' or melting in 'hot blast cupola'.

The end use certificates as required in the notifications were not produced by 8 importers and audit pointed out (April 1994) that the customs duty exempted amounting to Rs.1.87 crore was recoverable in these cases. Department on verification of the cases reported (December 1995) that in respect of 5 cases the required certificates were available and in two cases besides encashing bank guarantees for Rs.6.16 lakh, demands for differential duty for Rs. 26.01 lakh and Rs.17.70 lakh were raised and confirmed. Reply in respect of one case was awaited (May 1997). Non realisation of the demands also resulted in loss of interest of Rs.13.55 lakh upto May 1997.

**b)** Under notification No.72/93-cus dated 28 February 1993, a concessional rate of duty was applicable to specified components and parts required for the manufacture of Motor Vehicles by a manufacturing factory. Further, the importer was required to produce an extract of accounts evidencing utilisation of the imported goods in the manufacture of motor vehicles duly certified by the jurisdictional Central Excise Officer within three months or such extended period. A manufacturer of axles assembly, who had imported several consignments of 'Roller bearings' between May 1994 to February 1995 did not produce any evidence of the end use. The short collection of duty and interest of Rs.29.59 lakh was pointed out by audit (November 1994 to July 1995).

The department contended (June 1995) that the importer being a manufacturer of original equipments of motor vehicles, extension of the aforesaid concession to the subject goods was in order.

The contention of the department is not tenable as the importer being only a manufacturer of axle assembly, the end use of imported goods in the



manufacture of motor vehicles could not be established. This view was also upheld by the Collector's Conference held in November 1996.

## **5.5 RE-IMPORT OF GOODS FOR REPAIR**

a) Under notification No.98/95-cus issued in May 1995, goods manufactured in India when re-imported for repairs, were fully exempted from customs duties. This notification was superseded by another notification 158/95-cus issued on 14 November 1995 under which the exemption was made applicable to all goods re-imported for repairs, reprocessing, refining or remaking.

A consignment of different types of pencillin drugs re-imported through a major Custom House for 're-processing' in October 1995 were cleared without payment of duty under aforesaid notifications.

Audit pointed out the incorrect grant of exemptions resulting in short levy of duty of Rs.30.59 lakh in October 1996 as notification No.98/95-cus was not applicable to goods re-imported for re-processing and notification No.158/95-cus issued in November 1995 was not extendable to goods imported prior to its issue.

The department justified the assessment stating that the term 'repairs' used in notification No.98/95-cus included 'reprocessing'.

The reply is not tenable. If the term 'repairs' included 'reprocessing', then there was no need to issue a fresh notification in supersession of notification 98/95-cus to incorporate re-imports for reprocessing, refining, or re-making alongwith the re-imports for repairs.

b) As per section 20 of the Customs Act, 1962; the goods imported into India after export shall be liable to duty, unless shown to the satisfaction of the Assistant Commissioner of Customs that they are the same which were exported earlier.

Four consignments of 66,990 numbers of 'Indexable tungsten carbide ISO turning milling inserts' exported during October 1994 to January 1995 were re-imported during December 1994 to March 1995 and assessed under section 20 of the Customs Act without levying any basic customs duty.

It was pointed out in audit (July to October 1995), that the goods were re-imported after coating aluminium oxide, titanium carbide, titanium nitride of different grades on chargeable basis and therefore, the nature of the goods did undergo a change and they were not the same goods as exported earlier. They were thus chargeable to customs duty under section 20(1) of the Customs Act read with notification No.204-cus dated 2 August 1976 as amended by notification No.93/94. Short levied duty amounted to Rs.16.83 lakh.

The Ministry to whom the case was referred (July 1996) stated (July 1997) that the benefits of section 20 was extended to the consignments as the goods were re-imported into India within 3 years of export and the Assistant Commissioner was satisfied that the goods were the same which were exported.

The reply of the Ministry is not tenable as:

- i) the re-imported inserts were not the same as exported. They were specially exported for coating with different types of chemicals and the goods re-imported were 'coated inserts';
- ii) the cost of the exported materials and the re-imported materials differed substantially denoting considerable change in the nature of the goods;
- iii) the process of coating undertaken on the goods abroad was very much covered by the term 'repairs' specified in the notifications referred to above for re-imported goods and duty was chargeable accordingly.

## **5.6 IMPORT BY RESEARCH INSTITUTIONS**

In terms of notification No.70/81-cus dated 26 March 1981, scientific and technical instruments, apparatus and equipment including spare parts, imported by a research institution are exempt from payment of all import duties subject to production of a certificate from the concerned Administrative Ministry that the imported goods are essential for and used for research and shall be used only for such purposes and that the said institution is not

engaged in any commercial activity. In the Collector's conference held in February 1986 it was decided that the term 'Research institution' would not apply to R&D units attached to commercial organisations.

A consignment of 'Sucrolyser system with accessories' imported in March 1992 by a sugar manufacturer through an agricultural university for rapid analysis of quality of cane and sugar recovery was allowed benefit of notification ibid and exempted from levy of customs duty of Rs.10.51 lakh. The essentiality certificate from Ministry was also procured in the name of the university. However, as the Sucrolyser system was not imported for any research work by the University, exemption from levy of customs duty was not in order.

The incorrect availment of exemption was communicated to the department in April 1997. No reply has been received (November 1997).

#### **5.7 INCORRECT APPLICATION OF NOTIFICATION**

a) Under notification No.66/94-cus dated 1 March 1994, 'machinery, instruments, apparatus and appliances as well as components or raw materials required for renovation and modernisation of fertilizer plant' are exempted from the whole duty of customs leviable thereon.

A consignment of 'Sulphuric acid catalysts of ring type' assessable under heading 38.15 imported by a private importer in March 1994 was allowed exemption of customs duty under the said notification, though the goods were not covered by the notification. On the short levy of duty amounting to Rs.10.15 lakh resulting from the incorrect grant of exemption being pointed out by audit (September 1994), the department justified the assessment on the grounds that Catalysts were covered by the terms 'components' in the notification and the exemption was granted based on certificate issued by the DGTD and Ministry of Chemicals and Fertilizers.

Reply of the department is not tenable as, (i) the Tribunal, has held that catalysts do not fall under the definition of 'raw material' or component part vide 1987 (31) ELT 218 (Tribunal), 1988 (38) ELT 523 (Tribunal) and 1988 (35) ELT 479, (ii) the certificate issued by DGTD and Ministry of Fertilizer given

under notification No.276/92-cus covered goods falling under chapter 84, 85 and 90 only, whereas the goods imported fell under chapter 38.

**b)** A concessional rate of customs duty was provided in terms of notification No.84/94-cus dated 1 March 1994 to components of wrist watches other than bezel, movement holder, crown, gasket and spring bars.

One consignment of these items imported by a private limited company (June 1996) through a major Custom House was assessed under the notification resulting in short levy of Rs.6.57 lakh.

On this being pointed out (November 1996) the department admitted the objection and recovered the short levied amount (March 1997).

Ministry have confirmed the facts (July 1997).

**c)** Notification No.20/88-cus dated 1 March 1988 exempted 'Insulations', when imported, from the whole of additional duty. The exemption from additional duty was withdrawn with effect from 21 July 1993 by notification No.151/93-cus.

A consignment of insulations imported in November 1993 was assessed without levy of additional duty resulting in short collection of duty of Rs.5.44 lakh. The incorrect grant of exemption was pointed out by audit in May 1994. Reply has not been received (September 1997).

**d)** In terms of notification No.17/93-cus dated 28 February 1993, prawn feeds when imported are fully exempted from basic customs duty.

Three consignments of 'prawn feed supplements' imported through a major Custom House, during February 1996 were assessed under sub heading 2309.90 as prawn feed and were cleared free of duty under the aforesaid notification. On the non levy of duty of Rs.4.54 lakh being pointed out by audit in July 1996, the department admitted the objection (September 1996) and recovered Rs.2.22 lakh in respect of one consignment. Recovery particulars in respect of the other two cases are awaited (November 1997).

Ministry of Finance have confirmed the facts (August 1997).

e) Goods exported under DEEC and then reimported are not eligible for any exemption under notification No.97/95.

A consignment of 'Folley balloon catheters' exported under DEEC during January/February 1996 were re-imported during August 1996 and the goods were assessed to 'Nil' customs duty under notification No.97/95-cus. The incorrect application of exemption notification, resulting in short levy of Rs.5.26 lakh was pointed out in audit in March 1997. No reply has been received (November 1997).

### 5.8 OTHER CASES

In 20 other cases the objections issued to the Ministry involved short levy of Rs.41.50 lakh of which Rs.20.46 lakh had been recovered as per details given below:

(Rupees in lakh)

Sl. No.	Products on which exemption granted incorrectly	Amount of short levy	Amount recovered
1.	Copper wire	3.78	3.78
2.	Medical equipments	3.69	—
3.	Dane's salt	3.14	2.00
4.	Spares of medical equipments	2.95	1.01
5.	Copper scrap	2.64	—
6.	Ladies cardigans	2.39	—
7.	Spare parts for precision surface grinding machine	2.61	2.61
8.	Testing machine	2.04	—
9.	H.R. coils	1.93	1.93
10.	Red raisins	1.73	—
11.	CCTV systems	1.68	1.68
12.	Ice cream freezer	1.65	1.65
13.	Walkie talkie	1.48	1.48
14.	Unit soles	1.32	1.32
15.	Spare parts for gear shaping machine	1.23	1.23
16.	Gasketing materials in running length	1.22	—
17.	Toner cartridges	1.11	1.11
18.	Zircon sand	0.88	—
19.	Electrical equipments	0.66	0.66
20.	Modelling Software Master	3.37	—
Total		41.50	20.46

## ***Chapter 6. Non levy/short levy of additional duty***

As per Section 3 of the Customs Tariff Act, 1975, any article which is imported into India shall be liable to 'Additional duty' equal to the Central Excise duty for the time being leviable on a like article produced in India, in addition to the duty levied under Section 2.

Some illustrative cases of non levy/short levy of additional duty noticed in course of test audit are narrated below:

### **6.1 SHORT LEVY OF ADDITIONAL DUTY DUE TO MISCLASSIFICATION**

#### **a) RUBBER AND ARTICLES THEREOF**

i) 'Pneumatic tyres of rubber of a kind used on other motor vehicles such as buses, lorries, and station wagons' are classifiable under CET heading 4011.50 and leviable to additional duty at Rs.4000 per tyre (except those covered by notification No.21/95-CE).

A consignment of 'Pneumatic tyres' for light commercial vehicles imported during March 1996 were assessed under CET 4011.99 and levied additional duty at 35 per cent advalorem. The misclassification resulted in short levy of additional duty of Rs.23.33 lakh.

On this being pointed out (August 1996), the department stated in November 1996 that though a less charge demand notice had been issued to the importers, they have claimed that additional duty was leviable on the goods at Rs.945 per tyre only, as levied on similar indigenous goods.

The importers contention is not tenable as additional duty at Rs.945 per tyre is leviable only on tyres of specification '215/80.D 14', whereas the specification of the imported tyres was '215.R14. COBI'. Final reply of the department has not been received (November 1997).

ii) 'Conveyor belts' of vulcanised rubber are classifiable under the heading 4010 of Central Excise Tariff.

A consignment of 'ERMA Conveyor belts' imported during September 1996 was classified under Central Excise Tariff 8709.10 as parts of Work Trucks. The misclassification resulted in short levy of additional duty of Rs.9.18 lakh. On this being pointed out in audit (February 1997), the department defended the classification on the ground that the goods were mounted on truck chassis used at the airports for loading and off loading of bulk cargo and were therefore parts of vehicles for transportation.

The reply of the department is not acceptable because as per Note 2(a) to Section XVII of the Customs Tariff Act, 1975 the terms 'parts' and 'parts and accessories' do not apply to articles of vulcanised rubber. Moreover, conveyor belts of vulcanised rubber are specifically covered under heading 4010.

iii) Tyres for transfer cranes for loading and unloading of heavy loads within the port area being vehicles not meant for use on regular roads, are assessable to additional duty of customs under Central Excise Tariff sub heading 4011.91.

Two consignments of 'Tubeless tyres for transfer cranes', imported by a Government Department (September 1994 and February 1995) through a major Custom House were assessed to additional duty of customs under Central Excise Tariff sub heading 4011.99. The misclassification resulted in short collection of additional duty of Rs.6.11 lakh.

On this being pointed out (March 1995 and July 1995), the department stated (March 1996) that as the Transfer cranes were being used on 'roads' laid within the port area they were not to be treated as vehicles or equipments designed for use off the road.

The department's reply is not acceptable as

- a) it has been held by Karnataka High Court in 1978 ELT (J) 15 that the word 'road' would mean a 'public road' or 'highway';
- b) similar audit objection was accepted by the Ministry of Finance (Para 2.38 Sr. No.2, 8 and 15 of Audit Report 1993-94).

iv) Tyres for use on aeroplanes, whether new or retreaded, when imported are assessable under Central Excise Tariff sub heading 4011.91 as 'Tyres of a kind used on vehicles or equipments designed for use off the road'.

Four consignments of 'Retreaded aeroplane tyres' imported during March 1996 through a major Custom House were levied additional duty under Central Excise Tariff sub heading 4012.90. The misclassification resulted in short levy of duty of Rs.4.33 lakh.

On this being pointed out in audit (July 1996) the Ministry admitted the objection and reported the recovery (July and August 1997).

**b) MISCELLANEOUS ARTICLES OF BASE METAL**

In terms of Interpretative Rules 3(a) of Central Excise Tariff, the heading which provides the most specific description shall be preferred to headings providing a more general description.

Various consignments of 'E and I Laminations and Strips (pressed components)' imported during 1995-96 were classified under the heading 8504 CET, as parts of Transformer. However, the goods were specifically classifiable under heading 8312 CET. The misclassification resulted in short levy of additional duty amounting to Rs.23.12 lakh.

On this being pointed out in audit (April 1995 to July 1996), the Ministry admitted (August 1997) the objection and reported recovery of Rs.1.47 lakh. Recovery of the balance amount is awaited (November 1997).

**c) ELECTRICAL/ELECTRONIC MACHINERY AND EQUIPMENTS**

'Tape deck mechanisms' are classifiable under the Customs/Central Excise Tariff heading 8548 in accordance with Board's decision dated 20 October 1993.

11 consignments of 'Tape deck mechanisms' imported through a major Custom House during 1994-95 were classified under heading 8522 of the Central Excise Tariff resulting in short levy of additional duty of Rs.7.27 lakh.

On this being pointed out, the Ministry accepted the objection (September 1997), and reported recovery of Rs.4.68 lakh. Recovery of the balance amount is awaited (November 1997).



## **6.2 NON LEVY/SHORT LEVY OF ADDITIONAL DUTY OF EXCISE**

In addition to the basic excise duty, an additional excise duty as specified under 'Additional duty of Excise (Goods of Special Importance Act) 1957' are leviable on goods assessable under CTH/CET heading 5902.10/5907 and chapters 52, 54, 55 and 60.

The additional duty of excise leviable on 23 consignments of various goods assessable under chapters 52, 54, 55, 59 and 60 imported through three major Custom Houses during November 1995 to October 1996 was computed incorrectly resulting in short levy of Rs.22.50 lakh.

On this being pointed out in audit (April 1996 to March 1997), the department reported recovery of Rs.4.02 lakh in three cases (July to October 1997).

The Ministry also confirmed the facts in one case (July 1997).

## **6.3 NON LEVY OF ADDITIONAL DUTY IN CASE OF VABAL**

As per notifications issued on 31 March 1995, goods imported into India against 'Value based advance licences' issued on or after 1 April 1995 are leviable to additional duty of customs at appropriate rates.

In case of six consignments of various dutiable goods imported through four Commissionerates during August 1995 to May 1996, additional duty amounting to Rs.11 lakh was not levied.

On this being pointed out in audit (March to December 1996), the department accepted all the objections (June to February 1997) and reported recovery of Rs.8.91 lakh in 5 cases.

The Ministry have confirmed the facts in four cases (July and October 1997).

## **6.4 SHORT LEVY OF ADDITIONAL DUTY DUE TO APPLICATION OF INCORRECT RATES**

Consignments of 'Parts and accessories for oxygen compressor' and 'Parts of welding machines' imported through two major Custom House during

March 1995/August 1996 were assessed to additional duty under sub heading 8414.90/8468 of the Central Excise Tariff at rates lower than those applicable.

On the short levy of additional duty amounting to Rs.9.15 lakh being pointed out by audit (October 1995/January 1997), the department admitted the objections and recovered the short levied duty in one case (March 1997). Recovery particulars of the other case are awaited (November 1997).

## 6.5 OTHER CASES

In 15 other cases, incorrect classification, wrong application of rates of duty etc., resulted in short levy of additional duty of Rs.27.17 lakh. 14 cases involving Rs.24.59 lakh had been accepted by the department as per details below:

(Rupees in lakh)

Sl. No.	Item on which duty short levied	Irregularity	Amount short levied	Amount accepted	Amount recovered
1.	Tacho generators	Misclassification	3.33	3.33	0.18
2.	Man-made filament yarn	-do-	3.22	3.22	3.22
3.	Microwave passive item	-do-	1.79	1.79	1.79
4.	Wiring harness	-do-	1.63	1.63	1.63
5.	Contractors - 1000 V.	-do-	1.60	1.60	1.60
6.	Parts of general use made of base metals	-do-	1.46	1.46	--
7.	Electrical lighting equipments	-do-	1.26	1.26	1.26
8.	Tools for bending machine	-do-	1.19	1.19	1.19
9.	Parts of gear pump	-do-	1.17	1.17	1.17
10.	Acrylic soft waste	Incorrect rates	2.58	—	—
11.	Coaxial cables	-do-	2.09	2.09	2.09
12.	Accumulator tubes	-do-	1.81	1.81	1.81
13.	Polyester monofilament yarn	-do-	1.74	1.74	1.74
14.	Parts of circuit breakers	-do-	1.20	1.20	1.20
15.	Organic surface active agent	-do-	1.10	1.10	1.10
Total			27.17	24.59	19.98

## *Chapter 7. Irregularities in Duty Exemption Scheme*

### **7.1 NON-FULFILMENT OF EXPORT OBLIGATION**

Para 63 of Exim Policy 1992-97 read with para 125 of Hand Book of Procedures provides that the export obligation imposed under duty free licences shall be fulfilled within a period of 12 months from the date of issue of the licence. The regional licensing authority can consider the request on merits and grant one or more revalidations but not exceeding a period of one year from the date of expiry of the original licence. In exceptional cases, the requests for further revalidation of licence can be considered by Advance Licensing Committee (ALC). However, these requests for revalidation of licence should have been made within 2 months of the expiry of licence.

Para 125 A of the said Handbook of Procedures, further states that the licensing authority with whom the LUT is executed by the licence holder shall monitor the export obligation and that the licensee within 2 months from the date of expiry of the export obligation period, shall submit relevant evidence in discharge of the export obligation. The para clearly provides that in case of failure on the part of the exporter to complete the export obligation or to submit the relevant informations/documents the licensing authority shall take action to enforce the BG/LUT and also to initiate penal action as per law.

In terms of para 128 of the Hand Book of Procedures 1992-97 Vol.I, if the export obligation is not fulfilled both in terms of quantity and value, the licence holder shall, for regularisation, pay:-

- i) to the customs authority, customs duty on the unutilised imported material along with interest at the rate of 24 per cent per annum thereon;
- ii) to the licensing authority, a sum in rupees which is equivalent to the cif value of the unutilised imported materials; and
- iii) to the licensing authority, a sum in rupees which is equivalent to the shortfall in export obligation expressed in free foreign exchange,

Alternately the licensee has to surrender Special Import Licences of value equivalent to twice the amount of the shortfall.

In addition if the holder of a duty free licence under the scheme violates any conditions of the licence, penalty in terms of section 11(2) of F.T.(D&R) Act, 1992 was also leviable.

a) Seven quantity based advance licences were issued by DGFT between February 1993 to October 1995 for duty free import of goods valued Rs.297.27 crore. An export obligation of Rs.506.24 crore was prescribed in these licences. Though the licensees actually imported raw materials valued at Rs.267.23 crore, an export of only Rs.13.27 crore was made by them within the initial validity period of 12 months resulting in short fall of export obligation. In three cases, the extension in the export obligation period granted by the licensing authority had lapsed. In the remaining cases, the licensees did not seek any extension. Though the department issued show cause notices in three cases (February 1997), the cases were yet to be adjudicated (October 1997).

The customs duty recoverable on the unutilised value of imported materials in these cases in terms of para 128A (iii) amounted to Rs.191.69 crore and interest at the rate of 24 per cent per annum recoverable thereon worked out to Rs.143.44 crore.

The sum in rupees payable to the licensing authority equivalent to the unutilised imports amounted to Rs.263.51 crore. Further a sum of Rs.432.47 crore equivalent to the shortfall in export obligation was also payable.

The irregularities were pointed out to the DGFT/Custom Houses in October 1997, their replies are awaited (November 1997).

b) A quantity based advance licence issued by Jt.DGFT, New Delhi in November 1992 permitted import of duty free goods for a cif value of Rs.2.47 crore and the licensee was required to fulfil the export obligation of Rs.3.29 crore. The licensee could not fulfil the export obligation within the stipulated period and there was a shortfall in export obligation both in terms of quantity

and value. Therefore, the licensee was liable to pay customs duty of Rs.1.83 crore on the unutilised material with interest at the rate of 24 per cent amounting to Rs.0.95 crore. The liability of the licensee towards the licensing authority for shortfall in export obligation and cif value of the unutilised material imported worked out to Rs.2.02 crore and Rs.1.65 crore respectively.

This was brought to the notice of the Jt. DGFT and the Custom House in August 1996. Their replies are awaited as of November 1997.

c)(i) A value based advance licence was issued in June 1992 by Jt.DGFT, Mumbai to an importer towards the export of 'Partially oriented yarn' of specified denier with fob value of Rs.2.39 crore. The licensee could export yarn of the specified denier for Rs.1.90 crore only within the validity period of the licence. As per I.O norms, against the exports made by the assessee, imports of 180.82 MT of Mono Ethylene Glycol (MEG) and 4.96 MT of 'Finish oil' only were permissible for duty free import. However, the party imported a total quantity of 1050 MT of MEG and 45 MT of 'Finish oil'. The customs duty recoverable on the excess imports amounted to Rs.1.95 crore. Besides interest at the rate of 24 per cent ad valorem was also recoverable.

This was brought to the notice of the Commissionerate and the Dy.DGFT in August 1996. Their replies have not been received. (November 1997).

ii) In the case of another value based advance licence issued to the same licensee in June 1992 for export of polyester staple fibre for Rs.5.45 crore, the licensee could export fibre valued Rs.2.12 crore only within the validity period of the licence. Though the licensee applied for regularisation of the licence in February 1996, no action for recovery of the dues was taken by the department/licensing authority. The customs duty recoverable on the unutilised imported raw material amounted to Rs.1.77 crore and the interest at the rate of 24 per cent recoverable on the same amounted to Rs.1.28 crore. The sum equivalent to the short fall in export obligation payable to the licensing authority amounted to Rs.3.33 crore.

Replies to the audit comments issued in July 1996 have not been received (November 1997).

**d)** Four advance licences were issued to two importers by Jt.DGFT, New Delhi between May 1992 and September 1994 for import of duty free goods. The cif value of import was Rs.5.31 crore and licencees were required to fulfil the export obligation of Rs.7.18 crore. The licencees could not fulfil the export obligation fully and there was a shortfall in export obligation both in terms of quantity and value. Therefore, the licencees were liable to pay customs duty of Rs.1.71 crore alongwith interest of Rs.20.35 lakh on the unutilised imported material. For the shortfall in export obligation the licencees were also liable to pay to the licensing authority a sum of Rs.1.95 crore equivalent to the cif value of unutilised imported material and a sum of Rs.2.99 crore equivalent to the shortfall in export obligation.

The matter was brought to the notice of the Customs and the licensing departments (July and August 1996). Their replies are awaited as of November 1997.

**e)** A steel and allied industrial company was issued by Dy.DGFT, Coimbatore an advance intermediate licence in September 1993 with cif value of Rs.4.56 crore for import of 8700 MT of Melting Scrap. The export obligation was fixed at 7717 MT of M.S. Billets with a value of Rs.6.17 crore.

Though the licencee imported 8613 MT of melting scrap valued Rs.4.48 crore invoicing duty of Rs.1.43 crore, they could export only 2439 MT of M.S. Billets. As such the corresponding duty free entitlement to import was only 2750 MT of melting scrap. The excess import of 5863 MT involved customs duty of Rs.97.65 lakh, which was recoverable. Interest at the rate of 24 per cent recoverable upto May 1997 was Rs.87.88 lakh. Further, for shortfall in terms of quantity, the licensee was to pay a sum of Rs.3.05 crore being the cif value of unutilised material imported or had to surrender special import licence for a sum of Rs.6.10 crore. Though the licencee was declared a defaulter by the licensing authority (March 1996), no action to recover the duty has been taken.

Replies to the audit comments issued (April 1997) have not been received (November 1997).

**f)** Four 'Quantity based advance licences' were issued by Jt.DGFT, New Delhi between January and May 1993 for import of duty free goods to an

importer. The cif value of import permitted was 1.56 crore against an export obligation of Rs.2.08 crore. As the licensee could not fulfil the export obligation fully and as there was a shortfall in export obligation both in terms of quantity and value, the licensee was liable to pay to the Customs authority, customs duty of Rs.67.74 lakh on the unutilised imported material alongwith interest of Rs.12.90 lakh. The licensee was also liable to pay to the licensing authority a sum equivalent to the cif value of excess material imported amounting to Rs.60.90 lakh and a sum of Rs.94.18 lakh equivalent to the shortfall in export obligation.

The matter was brought to the notice of department of Customs/Jt. DGFT by audit in August 1996. Their replies are awaited as of November 1997.

**g)** A quantity based advance licence was granted to a licensee by Jt. DGFT, Kanpur in January 1993 with cif value of Rs.83.85 lakh against an export obligation of Rs.1.92 crore.

Though raw materials involving duty of Rs.35.37 lakh was imported upto March 1994, requisite proof of exports was not submitted by the licensee. The incorrect availment of customs duty exemption resulted in loss of revenue of Rs.65.55 lakh. (Rs.35.37 lakh customs duty plus Rs.30.18 lakh interest) Though the department had declared the licensee as defaulter on 6 June 1996, no recovery of the dues was effected by them. Replies to the audit comments issued in October 1996 have not been received (November 1997).

**h)** A manufacturer-exporter of 'steel bars and rods' was issued a Value based advance licence in May 1993 by Jt.DGFT, Chennai with cif value of Rs.1.37 crore for import of steel melting scrap against an export obligation of Rs.1.98 crore Though the licensee imported scrap having cif value of Rs.72.19 lakh, he could export steel rods with fob value of Rs.8.19 lakh only within the validity period of the licence i.e. upto May 1994.

It was pointed out in audit (January 1997) that for failure to fulfil the export obligation, in terms of both quantity and value, the duty foregone on the unutilised imported material amounting to Rs.22.46 lakh along with the interest at 24 per cent amounting to Rs.22.01 lakh was recoverable from

the licensee. Further, a sum of Rs.67.49 lakh being the value of the excess imported raw materials and a sum equivalent to the shortfall in export obligation amounting to Rs.96.16 lakh were also payable to the licensing authority.

The replies are awaited from the custom House and the licensing authority as of November 1997.

i) A Quantity based advance licence was issued in November 1992 by Jt.DGFT, Mumbai with an export obligation of 100 MT of Rigid PVC pipes having an fob value of Rs.26.95 lakh against import of material having cif value of Rs.18.62 lakh. As the party could export only 45.81 MT of pipes valued Rs.17.47 lakh, customs duty of Rs.13.07 lakh with interest thereon at 24 per cent amounting to Rs.12.55 lakh (upto March 1997) was recoverable on the unutilized raw materials imported. The amount payable to the licensing authority towards shortfall in export obligation worked out to Rs.9.48 lakh.

This was pointed out to the Department (June 1996); no reply has been received as of November 1997.

j) In cases of two Quantity based advance licences, issued by Jt.DGFT, Calcutta to a manufacturer of 'Silk fabrics' and a manufacturer of 'Knitted fabrics' in August 1992 and October 1992 respectively, the licensees failed to fulfil export obligation both in terms of quantity and value even after 3 years of expiry of the licence. Customs duty and interest upto 31 March 1997 payable in these cases to the Customs authority worked out to Rs.9.29 lakh and Rs.9.85 lakh respectively. A sum of Rs.17.18 lakh for short-fall in export obligation was also payable to the Licensing authority. Other than issuing a show-cause notice in one case, no action was taken for recovery of the aforesaid amounts from the licence holders.

On this being pointed out, the Licensing authority (August 1996) admitted the facts in November 1997. Reply from the Customs department and the action taken for the recovery of dues are awaited (November 1997).

k) In respect of a Quantity based advance licence issued in May 1994 by Dy.DGFT, Bhopal. The export obligation was fixed at US \$ 2,00,000



against imports of US \$ 1,50,375 cif (Rs.47.37 lakh). Though the licensee imported items having a total cif value of Rs.11.72 lakh, no exports were made till the expiry of the licence in May 1995. As such customs duty of Rs.11.61 lakh on the unutilised imported material and interest thereon amounting to Rs.5.57 lakh was recoverable from the exporter.

On The matter being pointed out to the department in July 1996, the Dy. DGFT stated (May 1997) that orders for enforcing the LUT had been issued in September 1996. Report on the recovery is awaited as of October 1997.

I) A manufacturer of 'Plastic pipes and solvent cement' was issued a 'Quantity based advance licence' in December 1992 by Jt.DGFT, Chennai for export of 85 MT of Solvent cement with fob value of Rs.29.64 lakh against duty free import of raw materials with cif value of Rs.21.23 lakh. This was subsequently enhanced (September 1993) to Rs.69.21 lakh and Rs.49.39 lakh respectively. Though the licensee imported raw material with cif value of Rs.3.37 lakh, no exports were made by the licensee till July 1996.

On the non fulfilment of export obligation and the resultant loss of duty being pointed out by audit (July 1996), the Customs department reported recovery of an amount of Rs.5.32 lakh representing the duty and interest leviable on the raw materials. The Deputy DGFT also confirmed the facts and stated (July 1996) that the licensee was directed to surrender the special import licence.

Ministry of Finance have confirmed the facts.

## **7.2 EXCESS IMPORTS**

### **a) GREASY WOOL**

Against three advance licences issued by Jt.DGFT, Ludhiana for import of 83,822 Kg.of Raw/greasy wool, 1,22,525 Kg.of Raw wool was allowed to be imported by the Customs authorities by entering the weight of clean wool in the DEEC book. This entitled the assessee to import excess quantity of Raw/greasy wool valued Rs.34.94 lakh. The customs duty not levied on the excess imports worked out to Rs.13.98 lakh. Interest was also recoverable on the duty not collected.

On this being pointed out in audit (May 1996) the department admitted the facts (December 1996) and intimated that the matter was under examination of DGFT, New Delhi. Further report is awaited (November 1997).

**b) PACKING MATERIAL**

As per the input-output norms in the Handbook of Procedures Vol.II of the Export Import Policy 1992-97 (amended upto March 1994), the import of LDPE granules was restricted to 1.10kg. for each 1kg. of finished product viz. bag sheet used for packing 'frozen marine products' for export. Further, the cif value of LDPE granules permitted to be imported was to be restricted to 2.5 per cent of the fob value of exports. However, as per the Customs notifications, packing materials actually required or used for packing the export product alone was eligible for duty exemption.

i) A Public Notice No.54/PN/92-97 dated 25 September 1992 issued by Ministry of Commerce restricted cif value of LDPE to be used as packaging material for export of Frozen Marine Products, to two and a half per cent of the fob value of exports.

In respect of two licences issued (28/29 September 1992) by Jt.DGFT, Calcutta to an exporter of frozen Marine Products cif value of LDPE allowed was more than 9 per cent of the fob value of export. The non levy of duty on the excess imports amounted to Rs.63.51 lakh. The amount of interest recoverable on the duty worked out to Rs.67.26 lakh till March 1997.

This was brought to the notice of Customs authority and the Licensing authority in March 1997. Their replies are awaited as of November 1997.

ii) Two exporters were issued 11 value based advance licences for import of packing materials (1993-94 to 1994-95) by Jt.DGFT, Hyderabad on post export basis for cif value of Rs.72.53 lakh adopting 5 per cent of the fob value of the export products as claimed by the exporters in their applications. It was, however, noticed in audit (June 1996) that the actual quantity of packing material used in the exports worked out to 52 MT only as against the 286 MT allowed for import. Non enforcement of the limit in respect of packing material with reference to actual quantity exported resulted in excess

import of duty free packing materials valued at Rs.59.04 lakh. The customs duty on the excess import amounted to Rs.39.31 lakh and was recoverable with interest.

On this being pointed out (June 1996), the department replied that the matter was under examination. Final reply is awaited (November 1997).

iii) Five value based Advance Licences were issued in January 1993 by Jt.DGFT, Cochin to a unit for export of frozen marine products. In all the five cases, export obligations prescribed were fulfilled before making imports and as such the licences were endorsed as freely transferable on 30 March 1994.

In all these cases, the licensing authority did not consider the actual quantity of LDPE bags required for packing the export product which was only 3.387MT against 12.50 MT permitted to be imported. Customs duty on the excess imports amounting to Rs.22.60 lakh was thus recoverable.

On the irregularity being pointed out in audit (May 1996), the licensing authority justified the issue of licences stating that at the time of issue of the licence there was no quantity restriction. The reply is not acceptable as (i) LDPE granules was a sensitive item at the time when the licences were endorsed for transferability i.e. on 30 March 1994. (ii) The exemption under Customs notification dated 30 March 1990 was admissible only to goods actually used in the products exported.

**c) ANTI OXIDANTS**

According to the input-output norms import of 1Kg. only of antioxidants was permitted for every 2 kgs of rubber chemicals imported.

On this basis in an advance licence issued in September 1995 by Jt.DGFT, New Delhi import of 45 MT of antioxidants was permissible. But 50 MT of antioxidants was allowed to be imported through a major custom house (November 1995 to September 1996). On the excess imports and the non levy of duty amounting to Rs.5.20 lakh being pointed out in audit (May 1996), the department reported recovery thereof in November 1996.

**d) EXCESS IMPORTS OF SENSITIVE ITEMS**

According to para 49 of the Export Import Policy 1992-97, an item specified as sensitive in a value based advance licence (VABAL) can be imported only to the extent of the quantity or value as stipulated in the licence.

In respect of two value based advance licences issued by Jt.DGFT, Madras during June and July 1993, the licensing authority specifically restricted the cif value of 'Polypropylene' to be imported to Rs.4.22 lakh. However, the actual imports allowed was for a cif value of Rs.44.10 lakh. Failure to restrict the import as per the licence resulted in excess import of Polypropylene valued Rs.39.88 lakh and non levy of duty of Rs.60.56 lakh.

On this being pointed out in audit (April 1996) both the Customs department and the licensing authority justified the imports stating (August 1996 and September 1996) that the said goods were declared as sensitive only from 14 September 1993. The replies are not tenable in view of the restrictions specifically imposed in the licences which had to be adhered to at the time of import. Non adherence to the restrictions imposed in the licences resulted in a loss of revenue of Rs.1.02 crore (including interest of Rs.46.94 lakh).

**7.3 IMPORT OF INADMISSIBLE GOODS**

As per para 236(1) of EXIM Policy 1990-93, only items of raw materials, as are relevant and actually required for the manufacture of the resultant product to be exported are allowed duty free for import against licences issued under Duty Exemption Scheme.

Five advance licences were issued by Jt.DGFT, Mumbai in March 1991 for export of 'Polyester staple fibre' (PSF) to a licensee and 13 items of inputs including 'Paraxylene, acetic acid, catalyst TBP, cobalt acetate, manganese acetate and hydrobromic acid' were allowed to be imported duty free. As per the input-output norms, these items were not directly used for the manufacture of PSF. The inadmissible imports made during March 1991 to April 1992 resulted in short levy of custom duty of Rs.3.99 crore. Interest recoverable on the short levied amount upto March 1997 worked out to Rs.5.32 crore.

The irregularities were pointed out to Dy.DGFT, and the Custom department in October 1996.

The 'Licensing department' replied (June 1997) that these items were allowed to the licensee in July 1987 for manufacture of 'PTA' and 'PTA' being one of the raw material for PSF, the licence was issued with backward 'integration'. The reply is not tenable as no documentary evidence for such integrated issue of licence was available.

#### 7.4 IRREGULAR DEEMED EXPORTS

As per Para 197 of Hand book of Procedures, the indigenous producer of any item can supply that item to a person holding a valid licence issued under the Duty exemption Scheme if the said item is permitted for import under the said licence. Such supplies termed as 'Deemed Exports' are permitted to be counted towards fulfilment of export obligation.

A company was granted a 'Quantity based advance licence' by Jt.DGFT, Mumbai for the export of plastic extruded products made out of LDPE. A supply of 99 MT of 'LDPE tubular films' made by them to a hundred per cent EOU for the manufacture of HDPE laminates was counted towards the fulfilment of Export obligation. The goods supplied, i.e. 'LDPE films' not being a raw material to be used by the EOU for manufacture of 'HDPE laminates' the supply did not qualify for treatment as 'Deemed exports' and the duty exempted on the corresponding import of 101.475 MT of LDPE amounting to Rs.24.07 lakh was liable for recovery. Interest recoverable on this duty worked out to Rs.14.44 lakh upto March 1997.

This was pointed out by audit to Dy.DGFT and the Commissioner of Customs in June 1996. Their replies have not been received (November 1997).

On this being pointed out in audit (July 1995), the Directorate stated (May 1996) that 17 out of the 44 cases pointed out by audit were closed based on the reports from the respective Commissioners and the remaining cases were still pending finalisation. Of the 27 cases pending, the details of 25 cases involving an amount of Rs.11.37 crore were available and were as follows:

**8.1 FIXATION OF BRAND RATES OF DRAWBACK WITHOUT PRE-VERIFICATION (SIMPLIFIED PROCEDURES)**

In cases where no 'All Industry rate of drawback' have been fixed or when such rate works out to be less than 80 per cent of the drawback due, 'Brand Rate' (BR) of drawback under the provisions of Rule 6 or 7 of the Customs/Central Excise is admissible to the exporters. For fixation of 'Brand rates of drawback', consumption of inputs and duty suffered thereon are required to be pre-verified by the Customs/Central Excise Commissionerates.

With a view to expedite the fixation of brand rates of drawback, the pre-verification of data was dispensed with effect from October 1988, in cases of certain types of 'manufacturer-exporters'. From January 1993, the scheme was further extended to 'manufacturer-exporters' of all sectors with the stipulation that the applicant would have to arrange post-verification of data relating to inputs and duty suffered, from the concerned Customs/Central Excise Commissionerates within 3 months of the date of filing their application and fixation of drawback. In cases where post-verification reports were not received, the BR letters were to be revoked and the drawback paid in excess of the All Industry Rates was to be recovered.

A review of the records maintained by the Directorate of Drawback by audit revealed that no proper records relating to the BR letters issued by them were being maintained. In 44 cases, the department had not taken any action against the exporters where the post-verification reports had not been received from the Commissionerates even after 2 to 7 years of the drawback payments.

On this being pointed out in audit (July 1995), the Directorate stated (May 1996) that 17 out of the 44 cases pointed out by audit were closed based on the reports from the respective Commissionerates and the remaining cases were still pending finalisation. Of the 27 cases pending, the details of 25 cases involving an amount of Rs.11.37 crore were available and were as follows:

a) In 17 cases involving Rs.9.65 crore, even though the B.R. letters had been revoked by the Directorate during October 1993 to October 1995, the recoveries had not been effected by the respective Commissionerates. Of these, 10 cases involving Rs.6.67 crore and 3 cases involving Rs.2.57 crore related to two manufacturers of electronic goods.

b) In four cases where the drawback rates were reduced (May 1993 to April 1996), Rs.12.61 lakh were yet to be recovered.

c) In four cases involving a drawback payment of Rs.1.60 crore the verification reports received were still pending with the Directorate.

The above facts were brought to the notice of the Ministry in August 1997. Their reply is awaited as of November 1997.

## **8.2 EXCESS PAYMENT OF DRAWBACK**

On export of goods, refunds of duties of excise and customs paid on components and raw materials can be claimed as drawback as per provisions in the relevant Acts and Rules thereunder. In 6 cases, excess payment of drawback amounting to Rs.10.24 lakh pointed out by Audit, were accepted by the Ministry/department and recovery of Rs.8.33 lakh was reported in 5 cases.

## **8.3 OUTSTANDING DUES ON INLAND AIR TRAVEL TAX**

As per notification No.2/94 (IATT) issued under Section 48 of the Finance Act 1989, each carrier/airline authorised to collect Inland Air Travel Tax (IATT) was required to pay into the treasury such tax collected in any month before the expiry of thirty days from the end of that month. If the carrier/airline/person authorised to collect IATT failed to pay the said amount to the Government within thirty days, interest at the rate of 20 per cent per annum was also payable by them. In addition the defaulter was also liable to pay penalty.

Scrutiny of the records relating to the collection of IATT for the year 1995-96 in Delhi Commissionerate, revealed that a sum of Rs.4.49 crore collected by the airlines as IATT were not credited to Government Account.

Apart from the tax, these airlines had to pay Rs.4.74 crore as interest for the delay in payments. An amount of Rs.6.84 crore levied as penalty against them was also pending realisation as on 30 November 1996.

The short collection of IATT, interest and penalty aggregating Rs.16.07 crore was brought to the notice of the department (January 1997); their reply is awaited as of November 1997.

#### **8.4 NON COLLECTION OF FOREIGN TRAVEL TAX**

Under Rule 9 of the Foreign Travel Tax Rules 1979, every carrier of passengers is required to file a monthly return in the prescribed form detailing the number of flights operated, the number of passengers travelled and the amount of tax collected and remitted. A perusal of this return filed by a major Airline for the month of June 1995 revealed (June 1996) discrepancy in the number of passengers resulting in short collection of FTT.

On this being pointed out in audit (June 1996), the department reviewed the actual number of passengers travelled and admitted short collection of tax in respect of 3178 passengers and reported recovery amounting to Rs.9.53 lakh (March 1997).

#### **8.5 RE-EXPORT OF LIFE SAVING EQUIPMENTS**

Notification 208/81 exempts specified 'Life saving medical equipments' from the entire duty of customs leviable thereon when imported into India in public interest.

47 'Haemodialysers' along with six 'Water treatment plants', one 'Water softening unit' and one 'Reverse osmosis unit' valued at Rs.2.46 crore were imported duty free in November 1987 by a private company through an Air cargo complex under the aforesaid notification. It was noticed in Audit that the entire consignment had been exported to USSR through another major Custom House in December 1987. Audit pointed out (August 1992) that exemption from duty for 'Life saving equipments' given in public interest under notification No.208/81-cus was for making available the equipments to the public in general and that the goods if exported out of India were liable for confiscation and penal action.



Non-confiscation of the goods at the time of export and non levy of duty/penalty on the goods even at the time of party's declaration of their export, resulted in loss of revenue to the Government amounting to Rs.2.46 crore (duty) and Rs.1.23 crore (Penalty).

The department to whom the case was referred (June 1993) stated (January 1996) that the case was under investigation by the CBI.

### **8.6 SHORT COLLECTION OF CUSTOMS DUTY LEVIED BY POSTAL APPRAISING DEPARTMENT**

According to the revised procedure effective from 1 April 1988 the customs duty on inward foreign letters, mail articles and parcels collected by the Department of Posts was to be credited to the customs head of account. The monthly statement of customs duty credited by the department of posts was to be checked by the customs unit of the office of Exchange.

During the audit of Postal appraising Department of a major Custom House, it was noticed that there was a difference of Rs.1.11 crore in the customs duty levied by the postal appraising department and the amount of duty collected and credited to Government account by post offices during 1988-89 to 1995-96.

Even though the difference in customs duty as levied by postal appraising department and that of the duty collected by post offices from 1988-89 onwards was brought to the notice of the department, no effective remedial action was taken by the department. On this being pointed out by audit in July 1996, the department stated (July 1997) that substantial portion of the amount pending for collection related to the year 1988-89 for which collection statement was not received from the Postal Department.

The matter was brought to the notice of the Ministry in November 1997. Their reply is awaited.

### **8.7 LOSS OF REVENUE DUE TO DELAY IN DISPOSAL OF CONFISCATED GOODS**

As per Para I(A) of Section 110 of the Customs Act 1962, the Central Government is empowered to dispose off the seized goods, having regard

to the perishable or hazardous nature of the goods in such manner as prescribed. Accordingly, 'chemicals, electronic goods and their parts and other items which are likely to depreciate or lose market value by passage of time, are to be disposed off immediately.

Perusal of the stock taking reports of a warehouse under a major Custom House by audit (September 1996) revealed that some packages containing these goods were lying undisposed from 1980 onwards. As on 31 March 1996, 2611 packages valued at Rs.1.86 crore were outstanding for disposal. Most of these items had lost their identity in the market or had become obsolete and non saleable.

The non disposal of the goods resulting in loss of revenue was pointed out in audit (September 1996). The department stated (January 1997) that goods valued at Rs.12.37 lakh were disposed and efforts to dispose off the remaining items valued Rs.1.74 crore were being taken.

#### **8.8 LOSS OF REVENUE DUE TO DELAY IN DISPOSAL OF UNCLEARED WAREHOUSED GOODS**

In terms of Section 72(1)(b) of the Customs Act, 1962, where any warehoused goods have not been removed from a warehouse at the expiry of the period for which permitted to be warehoused under section 61, the full amount of duty chargeable on such goods together with all penalties, rent, interest and other charges becomes payable. If the owner fails to pay the amount so demanded, the warehoused goods can be detained and sold by the proper officer.

Two consignments of 'Carbon Steel Pipes' and 'acrylic plastic scrap' warehoused in April 1983 and June 1986 respectively, remained uncleared in a warehouse and were finally sold in December 1994/March 1995. However, weighment of the goods before delivery revealed shortage of 87 MT of steel pipes and 13 MT of acrylic scrap resulting in loss of revenue of Rs.15.16 lakh.

In the first case, the shortage was noticed after 11 years subsequent to the date of warehousing and in the second case after eight and a half years, disclosing deficiency in the stock taking checks prescribed in the Custom

Preventive Manual. These points were brought to the notice of the department in December 1996. Their reply has not been received (November 1997).

### **8.9 LOSS OF REVENUE ON THE GOODS CLEARED FROM WAREHOUSE**

In terms of Section 61(1)(b) of the Customs Act 1962, failure to remove warehoused goods of the specified categories by owners after the prescribed period of warehousing attract penalty under Section 72, besides full duty, rent, interest and other charges. It has been judicially held by the Supreme Court {1996 (86) ELT 464 (SC)} that in cases, where the goods have been allowed to be cleared after expiry of the warehousing period the removal of goods should be treated as 'Improper removal' and the rate of customs duty payable should be at the rate applicable on the date on which the permitted warehousing period had come to an end.

a) Seven consignments of various goods imported through a major Custom House and warehoused under Section 61(1)(b) of the Customs Act 1962 between October 1992 and January 1994 remained in the warehouse beyond the maximum permissible period and were allowed to be cleared between July 1993 and November 1994 on payment of duties at the rates in force on the dates of clearances resulting in loss of revenue of Rs.80.99 lakh. Audit pointed out the incorrect assessment in February 1994/May 1995.

b) In another major Custom House, in thirteen cases goods were allowed to be cleared from warehouse after expiry of the permitted warehousing periods. The clearances were allowed on payment of duties at the rates in force on the date(s) of clearances which were lower than the rates prevailing on the respective dates of expiry of the warehousing periods. The clearances at lower rates resulted in loss of revenue amounting to Rs.8.55 lakh which was pointed out by audit during May 1992-October 1994.

The Ministry did not initially accept the loss of revenue pointed out by audit and stated that the rate of duty had to be determined under the provisions of Section 15(1)(c) of the Act. However, in view of the Supreme Court's judgement quoted above, the Ministry finally accepted the audit view and issued revised instructions upholding the said decision in August 1997.

#### **8.10 NON RECOVERY OF INTEREST ON BELATED PAYMENT OF DUTY**

In terms of Board's letter No.473/28/84-cus/VII dated 18 May, 1985, the importer who failed to pay duty on due date and went in litigation but did not succeed in the litigation was liable to pay interest under section 47(2) of the Customs Act, 1962 on the ground that had the importer not gone to court, duty would have been paid in time.

a) On a consignment of Resin imported through a major Custom House in November 1984, customs duty of Rs.1.48 crore was payable. The importer disputed the demand and paid an amount of Rs.1.08 crore under protest. However, the appeal filed by him in the High Court was finally dismissed in October 1994 and the department realised the remaining duty by encashing the bank guarantee in January 1995. But the interest to the extent of Rs.23.77 lakh on belated payment of duty was not demanded from the importer.

On this being pointed out in audit (August 1995), the department admitted the omission and issued show cause cum demand notice in October 1995. Report of the recovery is awaited as of November 1997.

b) In another case, two importers paid differential duty of Rs.63.77 lakh and Rs.71.98 lakh in October, 1995 and February 1995 on dismissal of the appeals filed by them in the High Court in 1981. It was noticed in audit that the interest for the delayed payment of duty from the date of vacation of stay order to the date of payment which worked out to Rs.28.06 lakh and Rs.34.79 lakh was not demanded from the respective importers. The omission was brought to notice of department in October/November 1996. Their reply has not been received (November 1997).

#### **8.11 LOSS OF INTEREST DUE TO NON RECOVERY OF CONFIRMED DEMANDS**

In terms of Ministry of Finance, Department of Revenue, Notification No.33/95-cus (NT) dated 26 May 1995 interest at the rate of 20 per cent per annum has become leviable on delayed recovery of confirmed demands.

a) During the course of audit of records of a major Custom House it was noticed in audit (July 1995) that demands of Rs.46.42 lakh confirmed in respect of seven importers during the period from September 1989 to

September 1994 were pending realisation. When the delay in recovery of the confirmed demands was pointed out (July 1995), the department stated (July 1995) that in most of the cases action for recovery of demand was taken by issue of detention notices.

The payments are still outstanding for recovery. Failure of the department to follow up the cases not only resulted in abeyance of revenue of Rs.46.42 lakh, but also in loss of interest of Rs.18.57 lakh.

The Ministry confirmed the facts (October 1997).

**b)** A vessel reverted on 11 January 1991 from foreign run to coastal run but duty payable on ship stores due on such reversion was not paid till November 1991. The delay in filing of bill of entry, assessment and recovery of the duty on the ships' stores was pointed out by audit in November 1991. Though assessments were finally made on 4 May 1993 and a total duty of Rs.10.62 lakh was realised (December 1995 and April 1996), interest amounting to Rs.5.98 lakh chargeable for delay in payment of duty was not recovered.

Reply to the audit comments relating to the non recovery of interest issued in March 1996 has not been received (November 1997).

#### **8.12 LOSS OF REVENUE DUE TO FAILURE TO RAISE DEMAND IN TIME**

Pending completion of an enquiry regarding the value, a consignment of 'transistors' was allowed to be cleared by a major Custom House (March 1993) on furnishing a Bond for Rs.4.56 lakh equivalent to the duty for the disputed value. The validity of the Bond expired on 9 March 1994. The higher value was finally approved in September 1994, but no demand was raised.

Failure to raise demand in time resulting in loss of revenue of Rs.4.56 lakh was reported to the department by audit in October 1996 and to the Ministry in May 1997. The Ministry stated (September 1997) that the case is under adjudication.

### **8.13 NON LEVY OF PENALTY UNDER SECTION 116 OF CUSTOMS ACT 1962**

In terms of Section 116 of the Customs Act, 1962 read with Section 148 *ibid*, if any goods loaded in a conveyance for import into India are not unloaded at the destination or the quantity unloaded is short and if the failure to unload or the deficiency is not duly accounted for, the steamer agent is liable for penal action.

In respect of two cases of short landings in two major Custom Houses, no action to levy the penalty as provided in the Section 116 was taken. On the short collection of penalty amounting to Rs.18.76 lakh being pointed out by audit (July/August 1996), Ministry confirmed the facts in both the cases (October/November 1997).

### **8.14 LOSS OF REVENUE DUE TO ABSENCE OF PROVISIONS OF CHARGING INTEREST ON NON PAYMENT/DELAYED PAYMENT OF PENALTY**

As per the provisions of section 28AA of the Customs Act, 1962 introduced in Finance Bill, 1995 (No.33/95-cus (N.T.) dated 26 May 1995), interest at the rate of 20 per cent per annum was leviable on delayed payment of confirmed demand of duty not levied, short levied or erroneously refunded. It was noticed that no provision had been made in the Customs Act, 1962 for charging interest on delayed payment of penalty and penalty levied but not paid.

Absence of a provision to recover interest on delayed payment of penalty/penalty levied but not paid resulted in loss of revenue of Rs.43.29 lakh as detailed below:

a) In a major Custom House three short landing cases were finalised between June-July 1994 and a penalty of Rs.6.77 lakh was imposed under section 116 of the Customs Act, 1962. The amount was payable within thirty days from the date of demand notice. Though notices were issued in June-July 1994 the demand of penalty of Rs.6.77 lakh was realised by the department only in October/November 1995. The loss of interest was estimated at Rs.1.54 lakh.

b) In another case of short landing, a penalty of Rs.29.15 lakh was imposed in January 1990. Non-enforcement of demand led to unintended financial accommodation to the importer for over a period of six years. The omission of non-enforcement of demand of Rs.29.15 lakh was brought to notice of the department in November 1996. The loss of interest in this case worked out to Rs.38.41 lakh (April 1997).

c) In another case, as per adjudication order (September 1993) of a confiscated vessel (December 1991) duty of Rs.1.50 lakh was to be realised along with Rs.5 lakh as penalty from the party concerned. On the non realisation of the revenue being pointed out by audit in July 1994, the department reported that (November 1996) an amount of Rs.0.35 lakh was realised from the bank guarantee executed by them and certificate action under Section 142 was initiated for recovery of the remaining amount.

Absence of a provision in the Customs Act to recover interest on the penalty not paid also resulted in loss of revenue of Rs.3.34 lakh.

#### **8.15 DELAY IN REALISATION OF FINES AND PENALTIES**

Section 112 and 125 of the Customs Act, 1962 provide for levy of penalties for improper importation of goods and other specified offences and imposition of fines in lieu of confiscation of goods the importation or exportation of which is prohibited. If the fines and penalties are not paid, different measures for their realisation including certificate action are prescribed under section 142 of the Customs Act, 1962.

During the audit of a Customs Division, it was pointed out that (August 1995), fines and penalties to the extent of Rs.4.79 crore levied in 1098 cases pertaining to period from 1974-75 onwards were pending realisation as of 31 August 1995.

The department reported in March 1997 recovery of Rs.0.40 lakh and stated that though the district authorities were informed to recover the dues, no significant action was taken by them. This further highlights the necessity in providing for levy of interest in cases of delayed payments of penalty as discussed in para 8.14 above.

## **8.16 NON LEVY OF DUTY**

Eight cases of non levy of customs duty/short levy due to application of incorrect rates of basic customs duty, incorrect computation of duty, etc., resulting in short levy of Rs.13.78 lakh were reported to the concerned Custom Houses during December 1995 to February 1997. The department admitted the mistakes and reported recovery of Rs.11.01 lakh in five cases.

## **8.17 SHORT COLLECTION OF LIGHT DUES DUE TO INCORRECT CLASSIFICATION OF VESSELS**

As per an order dated 7 January 1993, issued by the Ministry of Surface Transport, charges for light dues were payable at all ports in India at the rate of Rs.8 per ton in respect of foreign going vessels. It was also clarified (September 1993) that vessels of over 3000 GRT were to be considered as foreign going vessels, irrespective of the voyages they undertook.

In a major Custom House light house dues were collected between February and July 1993 in respect of vessels above 3000 GRT at Rs.6 per ton treating them as 'home trade' vessels instead of foreign going vessels. The incorrect classification resulted in short collection of Rs.8.89 lakh which was pointed out by audit (February 1995).

The department's reply that 'in view of the clarification issued on 13 September 1993, the higher charges were leviable only from that date', is not tenable as the same was only clarificatory in nature and the distinction based on GRT was already in existence under the provisions of the Merchant Shipping Act.

## **8.18 SHORT LEVY OF DUTY DUE TO VIOLATION OF PROVISION OF SECTION 19 OF THE CUSTOMS ACT, 1962**

As per Section 19(b) of the Customs Act, 1962, goods consisting of a set of articles liable to duty with reference to value shall, if they are liable to duty at different rates, be chargeable to duty at the highest of such rates.

In a major Custom House two consignments having different sets of articles were classified (January 1995) under heading 37.05 and assessed to duty under lower rates, though they contained 'floppy disks' and 'printed matter' attracting higher rates of duty.



The short levy of duty amounting to Rs.7.31 lakh in these cases was pointed out by audit (July 1995), the department admitted the mistakes and reported recovery of the short levied amount in August 1996.

Ministry have confirmed the facts (June 1997).

#### **8.19 SHORT COLLECTION DUE TO NON LEVY OF 'ANTI DUMPING DUTY'**

In terms of a Customs notification dated 14 November 1995, 'Acrylo nitrile butadiene rubber' (NBR) when exported from Japan, into India, would attract levy of Anti-dumping duty as prescribed therein.

In respect of two consignments of NBR, imported from Japan through a major Custom House (March 1996), the duty amounting to Rs.2.05 lakh was not levied.

On this being pointed out in audit (August 1996), Ministry admitted the facts (September 1997) and reported recovery of Rs.1.43 lakh from one of the importers.

#### **8.20 NON LEVY OF CESS**

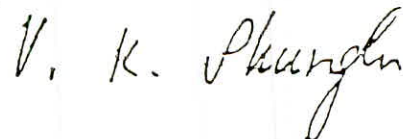
Two cases of non levy of 'export cess' on Agricultural products and one case of non levy of cess on import of coking coal were pointed out by audit (September 1995 to November 1996), to the department/Ministry, who admitted the short collection of Rs.4.41 lakh in these cases and recovered the amount.

New Delhi  
The 08 MAY 1998



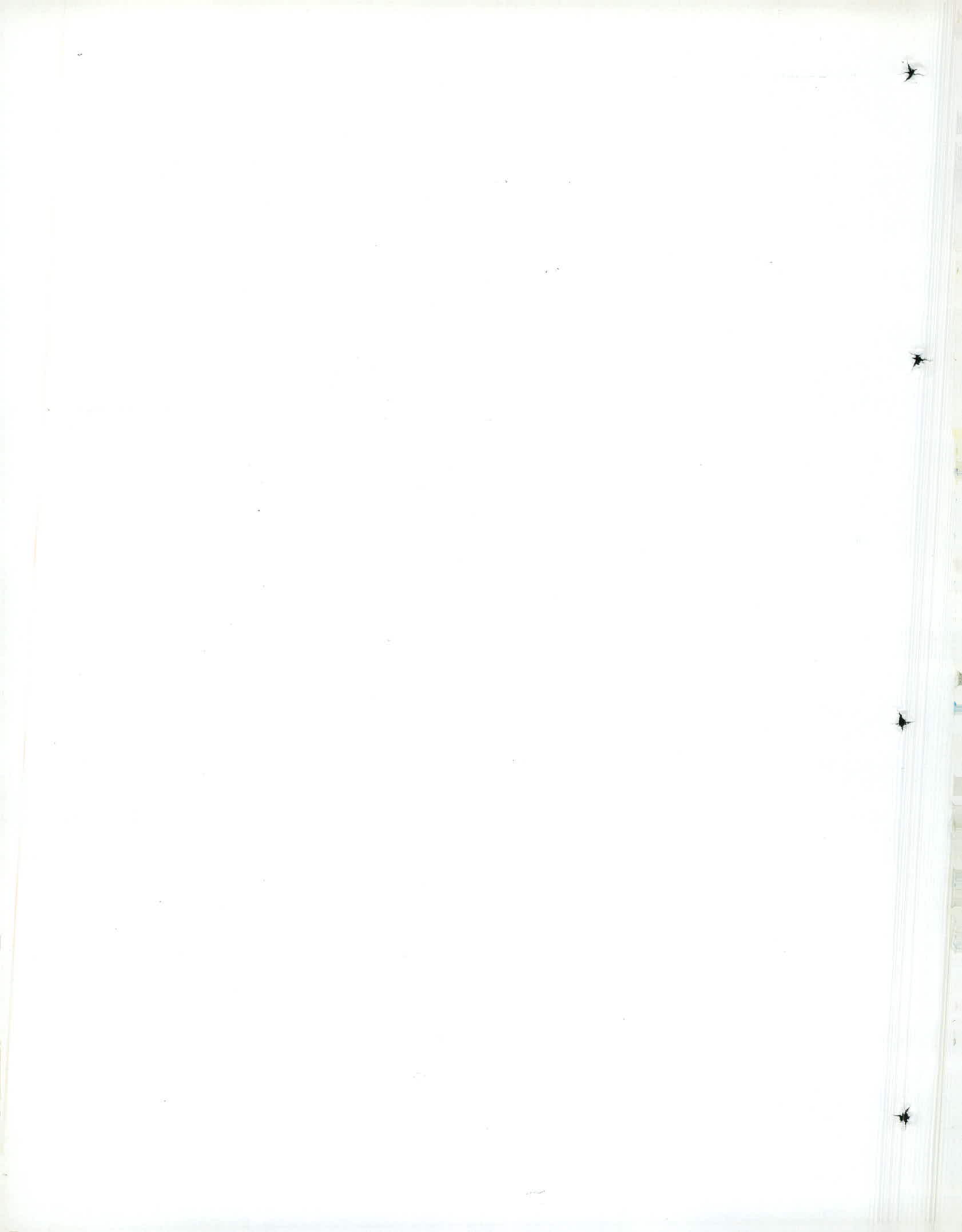
**(VIKRAM CHANDRA)**  
**Principal Director Of Receipt Audit**  
**(Indirect Taxes)**

Countersigned



New Delhi  
The 08 MAY 1998

**(V.K. SHUNGLU)**  
**Comptroller and Auditor General**  
**of India**



## ERRATA

Page No.	Para No.	Line No.	For	Read
vii	Overview	2 from bottom	unassessments	under assessments
viii	Overview	9 from top	lead	led
4	1.4	12 from top	Motor vehicles and parts thereof,	--
9	1.4	10 from bottom	though	--
9	1.4	3 from bottom	, Motor vehicles and parts from 31 to 40 percent	--
13	1.11	14 from top	Overleaf :	below :
20	2.4(b)(iii)	10 from top	core	crore
47	3.2	6 from top	to March	to March 1996
65	5.7(e)	2 from top	No.97/95	No.97/95-Cus.
84	8.5	19 from top	208/81	No.208/81-Cus
86	8.7	3 from top	lose	loose

MEMORANDUM

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FROM : [Faint text]

SUBJECT : [Faint text]

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