

Chapter 1: Introduction

1.1 Background

The Export Oriented Unit Scheme (EOU) was launched in December 1980, eighteen years after the first export processing zone (EPZ) was formed in Kandla and twenty years before SEZs came into being. Over the years the scheme has undergone various changes and its scope also expanded substantially. The scheme provides for duty free import/procurement of indigenous capital goods, raw materials etc. These units have to operate under custom bond and to achieve the level of value addition as specified in the Letter of Permission (LoP). The administrative control of the scheme is under the DoC. The benefits of the scheme are admissible under chapter 6 of FTP, and are administered by DC functioning under DoC. Director General of Foreign Trade (DGFT) is overall responsible for administering FTP.

1.2 Objectives of the scheme

The scheme was introduced with the objective of boosting exports by generating additional production capacity¹. It allows the establishment of business units anywhere in the country (outside the SEZ) with the obligation to achieve a specified Export Obligation.

It was primarily designed for the promotion and growth of manufacture and export of value added products. In order to make these units cost efficient, facilitate their free access to foreign technology and encourage them to venture into foreign markets on a large scale, wide range of incentives have been introduced for the units operating under the scheme.

The key objective of the Government was to arrest the declining exports and reverse the trend and achieve export target of US\$450 Billion in 2013-14 and then to \$750 Billion².

1.3 Administrative Set up

The functioning of EOUs is governed by three tier administrative set up. The Board of Approval (BoA) is the apex body and is headed by the Secretary, Department of Commerce. The Unit Approval Committee (UAC) at the Zonal; level deals with the approval of the units within the jurisdiction of Development Commissioner (DC), who is ex officio chairperson of the UAC.

The provisions of the Custom and Central Excise law in respect of the EOUs are administered by the Commissioner of Custom and Central Excise under

¹ Circular No. F. No. 8(15)/78-EP dated 31.12.1980

² Strategic Plan, Department of Commerce.

the control of Central Board of Excise and Custom (CBEC), Ministry of Finance (MoF).

1.4 Audit Objectives

Government of India had forgone significant custom and central excise revenue amounting to ₹ 32,932 crore³ during 2009-10 to 2013-14 on EOU/EHTP/STP scheme. A Performance Audit on the working of the EOU, corresponding to the FTP (2009-14), was conducted with a view to seek an assurance that:

- a. there exists adequate statutory provision/rules regulation, instructions/notification with regards to approval, creation, functioning and monitoring of EOUs.
- b. the EOUs fulfilled the import conditions as laid down in the relevant notifications and FTP and applicable provisions of HBP.
- c. the EOUs were able to fulfill the intended objectives as stated in the Foreign Trade Policy.
- d. the internal controls system and monitoring mechanism are effective.

1.5 Audit scope, sample and criteria

Records of 365 EOUs were audited during the period June 2014 to September 2014, out of total 2095 functional EOU as on 31 March 2014. Audit covered the period from 2009-10 to 2013-14 for the purpose of this report.

The criteria for selection of sample were as follows:

- a. Units completing five years having import or DTA clearance of ₹ 1 crore or above in the last four years.
- b. Others EOUs
- c. De-bonded units.
- d. Units closed during last four years

We bench marked our findings against the following Audit criteria:

- I. Customs Act, 1962
- II. Customs Tariff Act, 1975
- III. Central Excise Act, 1944
- IV. Central Excise Tariff Act, 1985
- V. Export of Services Rules, 2004
- VI. Service Tax Act, 1994
- VII. Foreign Trade Policy (2009-14) along with Handbook of Procedures with Appendices
- VIII. Audit Report No. 7 of 2007 (Indirect Taxes)

³ Source: Directorate of Data Management, CBEC

1.6 Provisions governing the Scheme

Chapter 6 of FTP 2009-14 and HBP 2009-14 govern the scheme. In addition, relevant provisions of Central Excise Act 1944, the Customs Act, 1961 and rules made there under and the notifications issued under provisions of Finance Act 1994 relating to the applicability of Service Tax and provision of Foreign Exchange Management Act, 1999 etc. are also applicable.

Monitoring achievement of Net Foreign Exchange (NFE) and in cases of default, levy of penalty under section 11(2) of Foreign Trade (Development and Regulation) Act, 1992 (FTD&R Act) are within the jurisdiction of the DC functioning under the Department of Commerce (DoC). With the approval of DC/BoA, EOUs can be de-bonded on their inability to achieve NFE or other exigencies, subject to payment of duty applicable at the time of de-bonding.

1.7 Salient Features of the Scheme

The long-term vision of the DoC is to make India a major player in the world trade by 2020. Its goal in the medium-term as outlined in the Foreign Trade Policy (FTP 2009-14) is to double India's exports of goods and services by 2014 with a long term objective of doubling India's share in global trade by the end of 2020 through appropriate policy support. *The aspiration of the Department is to achieve an average annual growth of exports of 25 per cent over the next six years.* Working on this aspiration, the Department aims to double its merchandise exports from US \$225 billion in 2010-11 (expected level) to US \$450 Billion in 2013-14 and then to US \$750 Billion.

EOUs enjoys various incentives such as duty free imports or domestic procurement of capital goods, raw materials, consumables, spares, packing materials etc, exempted from levy of anti-dumping duties in case of inputs used for physical exports sub-contracting part of the production and production process in the domestic area and also eligible for DTA sale (within specific limit) on concessional duty.

An entrepreneur desirous to establish EOU need to make an application along with the project report to DC. DC on approval, issues LoP with an initial validity period of three years. The Minimum investment should be ₹ 1 crore in plants and machinery (except agriculture, floriculture, aquaculture, IT etc.).

Result framework document of the Department for the year 2013-14 indicates its objective, as to provide policy support to increase India's annual export growth and diversification of India's export efforts through exploitation of new and emerging markets as well as promoting employment intensive products of high export potential with no special mention of the EOUs. Outcome Budget of DoC does not have any specific targets to boost exports through EOUs. Outcome study of the scheme has not been conducted

during 2009-10 to 2013-14 by the department. DoC stated that issues pertaining to EOUs have not been included in the pre-budget proposal of DoC for the year 2015-16.

1.8 EOU/DTA unit vis-à-vis SEZ unit

EOU/DTA units can be established anywhere in India whereas SEZs could be set up in specifically notified zones. Both SEZ units and EOU had to achieve positive NFE over five year period. SEZ unit, EOU and DTA units are entitled for DTA sale after payment of applicable duties. EOU and SEZ units are exempted from routine examination of import/export cargo, DTA units had to go for cargo examination by Customs. Restricted and canalised items can be imported without licence by EOU and SEZ units. EOUs had to bear apportioned infrastructure cost and cost recovery charge for Custom official posted at EOUs and warehousing charges.

On the taxation matter, EOU and SEZ units are exempted from payment of any duty on imports and exports whereas DTA units had to pay applicable duties on imports, however, DTA units are entitled to claim duty drawback for the exported goods and are also entitled for Chapter 3 (Promotional Measures) benefits under FTP. Service tax is refundable on export of services by EOUs and DTA units and in case of SEZ units, input services are exempted. VAT was leviable to service units amongst EOUs, in SEZ VAT was exempted/refunded as per State VAT laws, however, for DTA units, credit was allowed against VAT. EOU and SEZ units are exempted from excise duty on inputs, whereas, DTA units avail specific exemption of excise duty. Any tax impact in SEZ starts getting calculated as and when DTA clearances were made but for EOUs similar benefits as in cases of SEZ units accrue but at the exit stage of product as in case of DTA units.

Comparison of benefits, duty comparison and duty structure are given in Appendix 1. The same is referred in other audit paras also.

The EOU is constantly working under supervision of Central Excise and Custom department, it has to obtain permissions for giving the goods for job work, DTA sales etc.

The process of de-bonding is cumbersome. Firstly the unit has to get in principle approval for de-bonding from the Development Commissioner to the proposal. Then the unit has to intimate its desire to de-bond to Central Excise department to obtain a no objection certificate. The levy of duty on finished goods and work in progress in stock at the time of de-bonding is not clearly interpreted in the extant law. The last step in the de-bonding process will be to obtain final de-bonding letter from Development commissioner's

office. During the process of obtaining de-bonding till the final certification the unit continues to operate as an EOU.

The declining number of EOUs and its exports indicate that with the advent of SEZs, the export oriented units could not retain interest of the entrepreneurs in spite of having locational advantage.

DoC in their reply (February 2015) stated that the department have not conducted any comparative study of benefits under EOU scheme vis a vis SEZ units and export sale by DTA.

1.9 Earlier Audit Report on 100 Per cent Export Oriented Scheme

A review of the scheme was conducted in 2007. The audit findings were included in Audit Report No. 7 of 2007 (Indirect Taxes). Some of the important findings highlighted in the report were inconsistent, incomplete and unreliable macro data on EOUs, non fulfilment of export obligation (EO)/NFE, excess DTA sales, irregular payment of Central Sales Tax (CST)/drawback on DTA sales and mismatch of export performance recorded by DoR and DoC.

Out of the nine recommendations made in the report, DoC accepted two recommendations on verification of macro data of functional/closed and de-bonded units in co-ordination with revenue department and strengthening of internal control mechanism to ensure that DTA sales effected are after achievement of export obligation by the units. Specific replies to other recommendations were not furnished. The two accepted recommendation of the earlier report still remains an area of concern as observed in the performance audit.

1.10 Non availability of the data in EOU's dedicated website

Neither DGFT nor DCs have put up year wise details in their websites, viz. number of EOUs functioning, number of new entrants, number of units opting out of the scheme, their exports/imports etc. Consequently this data is not available in the website of Ministry of commerce/DGFT.

Audit observed that in the dedicated web site of EOU (eouindia.gov.in) some data is available only up to the financial year 2007-08. DCs do not have a data base relating to EOU similar to that of SEZs units, falling under its jurisdiction.

DoC in their reply (January 2015) stated that Zonal DCs are being directed to ensure regular updation of data relating to EOUs in their respective web-sites of the Zones. DoC in the exit conference stated that (January 2015) website 'eouindia.gov.in' become non-functional and the data is now being captured in www.epces.in maintained by Export Promotion Council for EOUs and SEZs.

Audit observed that only export performance of EOUs upto December 2013 is available in the website. There are no other details regarding EOUs in the aforementioned website.