Chapter 4: Cases of non compliance and Policy mis representation

4.1 DTA sales

In 48 cases irregular/incorrect DTA sales were noticed by EOUs under DCs Mumbai, Cochin, Noida, Kandla, Falta and Cochin involving short/non levy of duty of ₹ 62.52 crore as illustrated below.

4.1.1 Clearance of products into DTA in excess of permitted limits

As per Paragraph 6.8(a) of FTP (2009-14), units, other than gems and jewellery units, may sell goods up to 50 per cent of FOB value of exports, subject to fulfilment of positive NFE, on payment of concessional duties. Within entitlement of DTA sale, unit may sell in DTA, its products similar to goods which are exported or expected to be exported from units. Units which are manufacturing and exporting more than one product can sell any of these products into DTA, up to 90 per cent of FOB value of export of the specific products, subject to the condition that total DTA sale does not exceed overall entitlement.

Audit observed that in case of nine EOUs under SEEPZ and CSEZ, the units cleared individual product in excess of 90 per cent of FOB value into DTA at concessional rate of duty resulting in short levy of duty amounting to ₹ 35.03 crore. Similarly, another unit under SPEEZ made DTA clearances in excess of 50 per cent of FOB value of exports resulting in short levy of duty amounting to ₹ 33.90 lakh. Some of the cases are highlighted below.

DoC in their reply (January 2015) stated that the cases has been forwarded to jurisdictional Central Excise Authorities to examine and submit the factual report.

Box 2 Illustrative case of excess clearance to DTA

M/s Axiom Cordages Ltd, an 100 per cent EOU, Boisar, Maharashtra was issued LoP in January 2002 for manufacture of HDPE/PP Ropes and HDPE/LDPE/PP Yarn (Twisted). While the Ropes were mostly exported, the yarn was cleared in to DTA on payment of concessional rate of duty. Audit observed that the FOB Value of exports during the last four years in respect of yarn was only ₹ 50.01 lakh, whereas yarn valuing ₹ 394.72 crore was cleared in DTA. The other product exported by unit was HDPE/LDPE/PP Ropes cannot be said to be similar to twisted yarn as they are having different classification headings and have different commercial use compared to the twisted yarn. Thus, the product cleared into DTA was not similar to the goods exported, unit was not entitled to pay concessional rate of duty for clearance of HDPE/LDPE/PP yarn (Twisted). The differential duty payable on DTA clearance of yarn during the period from 2009-10 to 2012-13 worked out to ₹ 11.20 crore.

The department reported that demand notice had been issued on 6 May 2014 for ₹ 13.40 crore.

In another case, M/s VVF Limited (100per cent EOU), Taloja, was issued LoP in January 2003 for manufacture and export of lauryl Alcohol, Myristyl Alcohol, Fatty Acids, Toilet soaps, Sodium salt of Monocarboxylic acids etc. One of its product Viz. Soap Noodles (also known as Sodium salt Monocarboxylic acid) was cleared in DTA also. During years 2008-09 to 2010-11, unit cleared finished goods amounting to ₹ 60.77 crore in DTA. However, the clearance was more than DTA entitlement as per paragraph 6.8 (a) of FTP.

Thus there was excess clearance of goods amounting to ₹ 42.20 crore during the year 2008-09 to 2010-11. The department while accepting the observations, reported (April 2014) that a SCN was being issued.

Similarly, M/s Cipla Ltd. (unit II), an EOU under DC, SEEPZ, Mumbai, manufactured 'Active Pharmaceutical ingredients and Formulation' with specific names and cleared some of the bulk drug (2 Amino 5 Mehyl Thazole – Processed, 7 Chlro 6 Flur Carboxylic, Mycophenolate Mofetil, Pantoprazole Sodium Sesquihydrate, SMK (N) and Zidovudine in DTA in 2009-10 at concessional rate of duty. Audit observed that the unit had not exported these goods. Hence, clearance of entire quantity of manufactured goods in DTA at concessional ratye was irregular. This resulted in short levy of duty of ₹ 18.87 lakh.

DC, SEEPZ reported (April 2013) that Central Excise department intimated the payment of differential duty of ₹ 36.65 lakh by the unit for the period 2009-10 and 2010-11 under protest.

Final outcome may be intimated to audit.

4.1.2 Irregular availing of concessions on clearance of finished goods into DTA

(a) As per S.No.3 of Notification 23/2003-CE dated 31 March 2003, in case of EOU where the goods are produced or manufactured wholly from the raw materials produced or manufactured in India and the goods are cleared into DTA, then only applicable Central Excise duty is payable otherwise applicable custom duty is payable, in other words to avail central excise duty, separate account has to be maintained by the unit for indigenous as well as imported inputs.

Audit observed in 13 EOU units, separate accounts for indigenous and imported inputs have not been maintained and goods were cleared to DTA on payment of central excise duty instead of applicable customs duty. This resulted in short levy of customs duty amounting to ₹ 1.88 crore. In four cases, the department reported recovery of ₹ 0.50 crore.

(b) Section 3 of the Central Excise Act, 1944 provides for the levy of duty of excise on excisable goods produced or manufactured by an EOU and cleared into DTA. Section 3 also provides that for the purpose of levy of duty of excise, the value shall be determined as per the provisions of the Customs Act, 1962 and the Customs Tariff Act, 1975.

M/s Gala Precision Technology Pvt. Ltd, an EOU under DC, SEEPZ SEZ was clearing a portion of their product to their DTA unit (sister concern) on payment of concessional duty on a value determined on the basis of cost plus ten per cent. Audit observed that the DTA unit sold similar product at higher rate by 27 to 42 per cent as compared to the unit price applied for clearance from EOU to DTA unit. Thus it appears that some value addition is done at DTA to products cleared from EOU, in which case the goods cleared from EOU to DTA were not similar to the goods exported by the EOU unit. Hence the unit was not entitled to clear such goods at concessional rate of duty.

Considering that the DTA unit cleared similar goods to the one exported by the EOU. Then, for the purpose of calculation of concessional duty at the time of DTA sale, the valuation of such goods sold by EOU to DTA units should be at par with the unit price applied by the DTA unit. Thus, undervaluation of the goods at the time of DTA sale could not be ruled out.

On being pointed out the department issued a Show Cause cum Demand Notice to the unit in May 2014 for ₹ 15.40 lakh.

DoC in their reply (January 2015) stated that the cases has been forwarded to jurisdictional Central Excise Authorities to examine and submit the factual report.

4.1.3 Clearance/sale of marble in DTA in violation of provisions of FTP

Sale of imported marble by EOUs in DTA is prohibited under paragraphs 6.8 (a) and (h) of FTP 2009-14.

Audit observed that that M/s Jain Grani Marmo Pvt Ltd under jurisdiction of Development Commissioner NSEZ, Noida cleared marble slabs and dressed marble of ₹ 36.70 crore in DTA during April 2011 May 2012 in violation of the provisions of FTP/LoP.

The department failed to initiate any action against the EOU for violation of the provisions of FTP/LoP.

DoC in their reply (January and February 2015) stated that as per APR submitted for the relevant period, no DTA clearance under paragraph 6.8(a) and (h) is reflected. The only DTA clearance effected by the unit was under paragraph 6.9(b) of FTP. Therefore, this clearance is being verified from the unit as well as from Jurisdictional Central Excise, as source of information regarding this clearance is not evident from the audit observations. Further, the unit was allowed by the Hon'ble High Court of Rajasthan, Jodhpur under paragraph 6.9 from 11.12.2009 till the conclusion of writ petition (November 2013), DTA sale against foreign exchange remittance on the condition that if, however, ultimately the petitioner is found liable to any other consequences, he will give an undertaking to suffer those consequences.

A copy of the Hon'ble High Court of Rajasthan judgement cited above, current status of the case and details of foreign exchange remittance against which DTA sale was not made available to audit.

4.1.4 Short payment of duty on sale of scrap in DTA

As per paragraph 6.8(e) of FTP (2009-14), an EOU may clear Scrap/waste/remnants arising out of production process or in connection therewith may be sold in DTA, on payment of concessional duties as applicable, within overall ceiling of 50 per cent of FOB value of exports.

Audit observed that in three units[6] under SEEPZ, Mumbai cleared scrap into DTA at concessional rate of duty in terms of Sr. No. 2 of notification No. 23/2003 dated 31 March 2003. While clearing the goods the units claimed full exemption of BCD under Sr. No. 200 of notification No. 83/2004 and 21/2002 applicable to melting scraps. However, the scrap (turning) produced in these units was not cleared for melting; thus the units were not entitled for full exemption of BCD. The incorrect application of rate resulted in short levy of duty amounting to ₹ 13.19 lakh.

The department reported recovery of ₹ 10.89 lakh in two cases (July 2014).

DoC in their reply (January and February 2015) stated that since duty is levied in EoU by the jurisdictional Central Excise Authority, observation of audit has been referred to them and appropriate action will be taken after receipt of the comments.

Final outcome may be intimated to audit.

4.1.5 Non-payment of SAD on clearance made to DTA

As per S.No.1 of notification No.23/2003-CE dated 31 March 2003, Special Additional Duty of customs (SAD) leviable in case of DTA clearance by an EOU provided the goods being cleared into DTA are not exempted by the State Government from payment of sales tax.

In respect 16 EOUs under DCs Mumbai, Kandla, Falta and Chennai, neither SAD was levied nor was sales tax/VAT collected on clearances made to DTA by the concerned Central Excise/Customs Department. The SAD payable worked out to ₹ 22.69.crore. Recovery of ₹ 83.83 lakh in seven cases was reported by DCs, SEEPZ and FALTA.

DoC in their reply (January and February 2015) stated that remedial action has been initiated in the cases highlighted by audit.

No documentary evidence was however produced by DoC.

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[6]M/s Magnum Forge & Machines Works Pvt Ltd , M/s Worldwide Oilfields Machines Pvt Ltd and M/s Suttatti Entreprises Ltd under DC SEEPZ SEZ. , Mumbai

4.1.6 Non-payment of proportionate Anti-Dumping Duty (ADD) on DTA clearance

As per paragraph 6.8(a) of FTP, an EOU shall pay proportionate ADD leviable, under section 9A of the Custom Tariff Act, 1975, on inputs used in the manufacture of goods cleared into DTA.

Audit observed that in two EOU units under CSEZ, Cochin and SEEPZ, Mumbai[7] cleared goods into DTA without paying the ADD of ₹ 10.45 lakh.

DoC in their reply (January and February 2015) stated that the unit under SEEPZ SEZ has paid the ADD and in respect of unit under CSEZ stated that the goods were destroyed in the presence and under the supervision of jurisdictional Central Excise and not sold in DTA hence duty is not applicable.

No documentary evidence was however produced by DoC.

4.1.7 Irregular DTA sale by 100 per cent EOU units despite negative NFE

As per paragraph 6.8(h) of the FTP (2009-14), 100 per cent EOUs may sell finished products, which are freely importable under FTP in DTA against payment of full duties, under intimation to DC, provided they have achieved positive NFE.

M/s MIC Electronics Ltd., Kushaiguda, under jurisdiction of DC VSEZ, Hyderabad made DTA sales of ₹ 5.65 crore during 2008-09, 2009-10 and 2012-13 at concessional rate of duty despite having negative NFE in the respective years. As the unit could not achieve the positive NFE to sell the goods in DTA at concessional rate of duty, the unit required to pay full duty, accordingly, proportionate duty of ₹ 39.79 lakh may be recovered from the unit under intimation to audit.

DoC while accepting the observation reported (January and February 2015) that a SCN was issued on 11.9.2013 for violation of provision of FTP. As for recovery of duties as pointed out in audit, jurisdictional Central Excise Authorities have already been informed by the DC, VSEZ.

No documentary evidence was however produced by DoC.

Recommendation No. 4: *Department may strengthen the internal control in case of DTA clearances by EOUs, by way of improving the prescribed mechanism of joint monitoring by Development Commissioners and Central Excise authorities as well as by fixing accountability for any serious non compliance as per the FTDR/Customs/Central Excise/Service Tax Act.*

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[7] M/s DC Mills Pvt Ltd, under DC CSEZ Cochin and M/s MDB Chemicals(I) Pvt. Ltd. under DC SEEPZ SEZ, Mumbai

DoC in their reply (January and February 2015) stated that the Appendix 14-I-G of FTP provides joint monitoring of EoUs by the Unit Approval committee on six monthly basis. The jurisdictional Commissioner of Central Excise and Customs or his nominee is the member of the Committee. Apart from the Joint monitoring review, meeting with the jurisdictional Central Excise are also conducted wherein non-compliance or any violation by the EoUs is discussed and action is taken accordingly.

No documentary evidence was however produced by DoC.

4.1.8 Non reversal of Cenvat credit on clearance of goods without payment of duty

In terms of Rule 6 of Cenvat Credit Rules, 2004, Cenvat Credit shall not be allowed on such quantity of inputs or input services, which are used in the manufacture of exempted goods. As per sub-rule 3(b) of Rule 6, the manufacturer of exempted as well as dutiable goods, opting not to maintain separate account for receipt, consumption and inventory of input and input services meant for use in the manufacture, shall pay duty equal to six per cent of the total price charged by the manufacture for sale of such goods. The provisions of this sub-rule are applicable in all cases of clearance without payment of duty except those mentioned in sub-rule 3(b) of Rule 6. Clearance made under notification dated 26 June 2001 against CT-2 certificates is not covered under these exceptions.

Audit observed that M/s Sun Pharma Ltd and M/s Fairfield Atlas Pvt. Ltd under DC SEEPZ SEZ Mumbai cleared goods amounting to ₹ 14.65 crore and ₹ 17.87 crore during April 2011 to March 2014 and April 2009 to March 2014 respectively under notification dated 26 June 2001. As clearance under notification dated 21 June 2001 to be treated as clearance in DTA without payment of duty, the Cenvat credit availed on the inputs used manufacture of cleared goods was not admissible as the units did not maintain separate accounts separate account for receipt, consumption and inventory of input and input services meant for use in the manufacture, accordingly, the units required to pay six percent duty on the value of goods cleared in DTA.

Non levy of duty at the rate of six per cent resulted in short levy of duty amounting to ₹ 1.95 crore.

DoC in their reply (January and February 2015) stated that the cases has been forwarded to jurisdictional Central Excise Authorities to examine and submit the factual report.

Final outcome may be intimated to audit.

4.2 Short levy of duty at the time of exit from EOU Scheme

Paragraph 6.18 of FTP laid down the procedure and condition for EOU to exit from the EOU scheme. The procedure *inter alia* lay down that with approval of DC, an EOU may opt out of scheme subject to payment of Excise and Customs duty. An EOU may be permitted to exit from the scheme at any time on payment of duty on capital goods under the prevailing EPCG scheme for DTA units subject to fulfilling of positive NFE under EOU scheme.

Scrutiny of records of DC, SEEPZ, NSEZ, Falta and CSEZ revealed that ten EOU units were allowed to exit from the scheme by allowing incorrect rate of duty on finished goods, stock of finished goods, unfinished goods and incorrect depreciation allowed on capital goods etc. This resulted in short levy of duty amounting to ₹ 1.93 crore.

DoC in their reply (January and February 2015) stated that the cases has been forwarded to jurisdictional Central Excise Authorities to examine and submit the factual report.

Final outcome may be intimated to audit.

4.3 Incorrect availing of Cenvat credit.

(a) Central Excise Circular dated 29 April 2011 stipulates that Cenvat credit is admissible on the services of sale of dutiable goods on commission basis. Hon'ble High Court of Gujarat[8], however, disallowed the credit considering the said service was not an input service and this judgement was further upheld[9] in the High Court of Gujarat wherein it was also stated that order of jurisdictional High Court is binding on the department. Audit observed that the circular dated 29 April 2011 was still in force, the Central Excise Authorities have not amended the circular in lines of High Court judgement.

Scrutiny of records of DC, KSEZ revealed that six EOUs availed Cenvat credit amounting to ₹ 1.88 crore on payments towards sales commissions as detailed below:

Table 6: Incorrect availing of Cenvat credit (sales commission)

Name of the unit	Jurisdictional authorities	Cenvat credit availed (₹ in lakh)
M/s Cadila Health Care Ltd.	Range I Padra Division II Vadodara I.	15.97
M/s Kemrock Industries and Export Ltd.	Range II Division Wagodia Vadodara II	68.83
M/s Sun Pharmaceutical Industries Ltd.	Range II Division Ankleshwar III Surat II	33.62

[8] in case of Commissioner of Central Excise, Ahmedabad-II Versus Cadila Health Care Ltd 2013 (30) STR 3 (Guj) (2013-TIOL-12-HC-AHM-ST)

[9] in case of Astik Dyestuf Pvt. Ltd.Vs . Commissioner of C. Excise and Custom (Tax Appeal No. 1078 of 2013)

M/s GEA Pharma Ltd.	AR-I, Div-City Division Vadodara-II	3.89
M/s KLJ Organic Ltd.	Range IV, Division II, Surat II	2.09
M/s Sun Pharmaceutical Industries Ltd.	Range III Division Wagodia Vadodara II	63.45

DoC in their reply (January and February 2015) stated that the Central Excise authority informed that SCN has been issued to M/s. Cadila Healthcare on 17 September 2014.

Remedial action taken in the remaining cases may be intimated.

(b) As per Rule 2(l) of Cenvat Credit Rules, 2004, input service exclude service portion in the execution of a works contract and construction services including service listed under clause (b) of section 66E of the Finance Act in so far as they are used for construction or execution of works contract of a building or a civil structure or a part thereof; and service provided by way of renting of motor vehicle. Audit observed that in three cases, service tax credit of ₹ 28.47 lakh was availed in contravention to Rule 2(l) of Cenvat Credit Rule, 2004 as detailed below.

Table 7: Incorrect availing of Cenvat credit (work contract)

Name of the unit	Jurisdictional authorities	Excess duty credit (₹ in lakh)
Cadila Healthcare Ltd	AR I, Division II, Vadodara I,	14.90
Asahi Songwon Colours Ltd.	AR II Division II Vadodara I,	4.68
Sun Pharmaceutical Industries Ltd	AR II Division III Surat II,	8.89

DoC in their reply (January and February 2015) stated that M/s Asahi Songwon, Vadodara reversed ₹ 4.68 lakh in June 2014 and SCN to M/s Cadila Healthcare SCN being issued. Reply from the jurisdictional Central Excise Authority in respect of Ms. Sun Pharmaceutical Industries is awaited.

(c) Similarly under Rule 4 of Cenvat Credit Rules, 2004 credit of input can be taken on receipt of input in the factory of manufacturer or in the premise of the provider of the output service. M/s International Packaging Products Pvt. Ltd., Plot No. 380/2, Village Dapoda, Silvassa under Central Excise Jurisdictional authorities of AR-IV, Div-III, Silvassa Commissionerate, Vapi availed service tax credit of ₹ 19.58 lakh in respect of manpower supply received at 389/1, Village- Sayali, Silvassa. To avail the credit, it is essential to receive the services in the factory of manufacturer or in the premises of the provider of the output service. In this case, inputs were used at a different location. Thus, the credit allowed was irregular and recoverable from the unit.

4.4 Non levy of Service Tax

(a) Online information and database access or retrieval services are brought under the service tax net vide notification No. 4/2001-ST dated 9 July 2001.

Further, Rule 9 of Place of Provision of Service Rules, 2012 envisages that the place of provision of service or the services provided through online information and database access or retrieval will be the place of service provider.

Scrutiny of records of M/s. Mylan Laboratories Limited, (Unit-III) (100 per cent EOU), under DC VSEZ revealed that the unit received convertible foreign exchange equivalent to ₹ 737.14 crore during the period from July 2012 to March 2014 towards Dossier[10] Sales.

As "Dossier" is being supplied by the unit to the overseas customers (recipient) in electronic form through a computer network and delivered over the internet or an electronic network accordingly, the activity falls under "Online information and database access or retrieval service".

The services are provided from the taxable territory (Hyderabad, India) and the receiver is located overseas and the charges are received by the unit in foreign currency hence and therefore do not fall under the category of exports of services. The service tax thus will be payable by the unit being the service provider as per Rule 9 ibid.

Service Tax on sale of Dossier for the period July 2012 to March 2014 worked out to ₹ 91.11 crore, which is recoverable from the unit.

Similarly, another EOU, M/s Aurobindo Pharma Limited, Hyderabad, under DC VSEZ rendered similar services valued ₹ 36.66 crore with service tax liability of ₹ 4.53 crore to foreign buyers during July 2012 to March 2014.

On this being pointed out (August 2014), the department stated (August 2014) that the matter would be examined and reply submitted. No further reply has been received.

(b) Commission paid to foreign agents under Section 66A of Finance Act, 1994, income received on account of service provided by way of finding prospective customers in India for overseas client, rent received and processing charges attracts service tax.

[10]The "Dossier" is a document which gives the technical data of the tests conducted out of the manufacture of Active Pharmaceutical Ingredients and Pharmaceutical formulations. The dossiers are in the form of tangible as well as intangible goods which are stored in the form of CD as well as documentation and the same was exported to the overseas customers.

Audit scrutiny of records of DC, Kandla revealed that one EoU received income on account of service provided by way of finding prospective customers in India for overseas client and in CSEZ, Cochin two units paid commission to foreign agents under Section 66A and in another unit received rent and processing charges, however, no service tax was levied in these cases as detailed below.

Table 8: Non levy of Service tax

DC	Unit	Amount of Service tax not levied (₹ in crore)	
KASEZ, Gandhidham	M/s GEA Pharma Ltd.- Ahemdabad	0.18	Income received on account of service provided by way of finding prospective customer in India for overseas client.
CSEZ, Kochi	M/s AVT McCormick Ingredients Pvt Ltd, Vazhakulam	1.31	Commission paid to foreign agents under Sec 66A of Finance Act 1994.
CSEZ, Kochi	M/s Synthite Indutries Ltd	0.07	Commission paid to foreign agents under Sec 66A of Finance Act 1994.
CSEZ, Kochi	M/s Alleppey Company Ltd, Puthenangadi,	0.16	Processing charges and rent received
Total		**1.72**	

DoC in their reply (January and February 2015) stated that these cases relate to Service Tax and DoR is to furnish comments.

Final outcome may be intimated to audit.

4.5 Irregular reimbursement of Central Sales Tax (CST)

(a) As per Appendix 14-I-I read with paragraph 6.11 (C) of the FTP (2004-09), EOUs are entitled to full reimbursement of CST on purchases made from DTA for production of goods

Audit observed from the records at the office of DC, FSEZ, that M/s Mittal Technopack Pvt. Ltd, an EOU was reimbursed CST claim on goods which included PP Granules/Homopolymer procured from M/s Reliance Industries Ltd., an SEZ unit and not from DTA unit. This was in contravention to the provisions discussed above resulting in excess reimbursement of CST amounting to ₹ 12.11 lakh

(b) As per Para 3(iii) of Appendix-14-I-I to HBP (2009-14) regarding procedure to be followed for reimbursement of CST on supplies made to EOUs, the reimbursement of CST shall be admissible only to those units who get themselves registered with the Sales Tax authorities in terms of Section 7 of the CST Act, 1956 read with Registration and Turnover Rules, 1957 and furnish a Photostat copy of the Registration Certificate issued by the Sales Tax authorities. We noticed in the case of M/s Rohit Ferro-Tech Ltd, under the jurisdiction of FSEZ, Kolkatta was sanctioned reimbursement of CST during 2012-13. It was revealed that the CST Registration (effective from

1.4.2003 submitted with the claims) was for its Kolkata office/unit located at 35, Chittaranjan Avenue, and not for its 100 per cent EOU unit located at Purba Medinipur. The mandatory requirement of CST registration was not fulfilled by unit that resulted in irregular reimbursement of ₹ 58.98 lakh.

DoC in their reply (January and February 2015) stated that recovery in one case has been made and in the other case recovery is under process.

4.6 Non receipt of re warehousing certificates

As per the provisions of Section 67 of the Customs Act, 1962, read with Warehoused Goods (Removal) Regulations, 1963, goods can be removed from one warehouse to another warehouse by executing a bond for an amount equivalent to duty leviable on such goods. Paragraph 12.1 under Chapter 25 of Customs Manual and Regulation 4 of Warehoused Goods (Removal) Regulations, 1963, provides that the warehouse owner shall produce re-warehousing certificate within a period of ninety days from the date of issue of procurement certificate failing which he shall be liable to pay import duty leviable on such goods.

Audit observed that delay in submission of 3177 re-warehousing certificates ranging from 1 month to 73 months. The value of imports involved was ₹ 762.34 crore with duty forgone of ₹ 204.16 crore

DoC in their reply (January and February 2015) stated that these cases relate to Service Tax and DoR is to furnish comments.

Final outcome may be intimated to audit.

4.7 Insufficient/non execution of Bond

(a) As per section 59 of Customs Act 1962, (1) the importer of any goods specified in sub-section (1) of section 61, which have been entered for warehousing and assessed to duty under section 17 or section 18 shall execute a single all-purpose bond before jurisdictional DC/AC of Customs and Central Excise binding himself in a sum equal to twice the amount of the duty assessed on such goods covering liability of duty in the event of failure to achieve positive NFE.

Audit scrutiny of Bond files and records of DC, NSEZ, VSEZ, SEEPZ and CSEZ revealed that five EOU units executed bonds in the form of B-17 bond far below the required amount ranging from 30 per cent to 193 per cent. In another two units bond register was not maintained. Execution of insufficient bond and non maintenance of bond register carries a risk of safeguarding of government revenue to the extent of ₹ 62.27 crore in these as detailed in Appendix 4.

(b) Similarly, audit observed that bond register in respect of M/s Allied Instruments Pvt. Ltd and Code Work Solutions Pvt. Ltd under DCs NSEZ and CSEZ respectively were not maintained in contravention to the provisions laid down in section 59 of the Customs Act.

DoC in their reply (January and February 2015) stated that these cases relate to Service Tax and DoR is to furnish comments.

Final outcome may be intimated to audit.

4.8 Removal of goods for job work without obtaining permission from jurisdictional authorities

As per para 6.14 (a) (i) of FTP read with circular no. 65/2002- Cus dated 7 Oct 2002 EOUs are required to obtain permission for job-work from jurisdictional AC/DC of Customs /Central Excise under whose jurisdiction the unit operates. The permission so granted, shall be valid for a period of one year. In case of four units[11] it was found that permission for job work from jurisdictional Asst/Deputy Commissioner of Customs and Central Excise were not obtained.

DoC in their reply (January and February 2015) stated that these cases relate to Service Tax and DoR is to furnish comments.

Final outcome may be intimated to audit.

4.9 Non availability of data of cases received for fixation of ad hoc norms and finalization thereof

In terms of paragraph 6.8 (e) of FTP 2009-14 scrap/waste/remnants (SWR) arising out of production process or in connection therewith may be sold in DTA, as per SION notified under Duty Exemption Scheme, on payment of concessional duties as applicable, within overall ceiling of 50 per cent of FOB value of exports. In respect of items not covered by norms, DC may fix ad-hoc norms for a period of six months and within this period, norm should be fixed by Norms Committee. Ad-hoc norms will continue till such time norms are fixed by Norms Committee. Sale of SWR by units not entitled to DTA sale, or sales beyond DTA sale entitlement, shall be on payment of full duties. SWR may also be exported. The issue of ad hoc norms has also been dealt under proviso annexed to condition number (4) of clause (a) sub clause (ii) of notification dated the 31 March 2003, G.S.R. 265 (E), dated the 31 March 2003 amended vide CE notification dated 6 July 2007, wherein it has been clarified that if additional items other than those given in the SION are required as inputs or where the user industry considers the existing SION as

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[11] M/s Keerthi Industries Limited (Electronic Division) (100per cent EOU) Balanagar-I Range and M/s DVB Design & Engineering under VSEZ, Visakhapatnam
M/s Santec Exim Pvt Ltd Delhi and M/s Welspring Universal,New Delhi under NSEZ, NOIDA

inadequate or where generation of WSR is beyond 2 per cent of the inputs procured, use of such goods shall be allowed on the basis of self-declared norms till such norms are fixed on *ad hoc* basis by the jurisdictional Development Commissioner within a period of three months from the date of self declared norms and the unit undertakes to adjust the self-declared/*ad hoc* norms in accordance with norms as finally fixed by the Board of Approval within six months of fixation of *ad hoc* norms.

Audit scrutiny of the records of DC, KASEZ Gandhidham revealed that the office did not had data regarding number of cases received for fixation of ad hoc norms, number of cases finalized and number of cases pending for finalization. This shows that the monitoring mechanism in respect of cases pertaining to ad hoc norms was poor.

M/s Bissaza India Pvt.Ltd. an EOU under DC, KASEZ that the unit was given permission to manufacture Glass Mosaic. From APR and the Chartered Engineer Certificate filed by the unit it was observed that the quantum of SWR generated and sold *vis a vis* finished goods (i.e Glass Mosaic) produced during the period 2009-10 to 2013-14 was substantial i.e. nearly 65 per cent of the finished product as detailed below.

Table 9: Non fixation of ad hoc norms

					Qty.of finished goods (glass mosaic)				
Year	Qty of SWR generated (kgs).	Qty of SWR sold (kgs)	Value (₹ in lakh)	Unit cost (₹)	Kg	Sq.Mtrs.	Meter	Piece	Module
2009-10	723664	902867	6.64	0.73	1441094	74435.37	15	33	NA
2010-11	1437879 Kg +51.75 sq. mt	1352830	3.21	0.23	2593829	116960	44	NA	26
2011-12	1476158	1510084	4.43	0.29	2453601	110256	32	NA	30
2012-13	2330426	2165980	5.89	0.27	2701798	97759	191	NA	76
2013-14	2346068	2394674	3.38	0.14	3553548	93736.61	92.85	NA	20
Total	8314195 Kg +51.75 sq. mt	8326435	23.58	NA	12743870	493146.98	374.85	33	152

Though the unit applied for the fixation of SION to DC, KASEZ on dated: 21 August 2006 wherein the claimed wastage of 50 percent. Same was allowed by DC on ad hoc basis on 6 November 2008 and the same ad hoc permission continued, without finalization, till the date of audit (June 2014). Non finalisation of ad hoc norms within time reflects the poor monitoring cases of fixation of norms fixation by the DC. The undue delay in finalizing of ad hoc norms reflects that tracking of such case at the office of the Development Commissioner KASEZ, Gandhidham, is poor. Further it reflects poor monitoring on the part of Central Excise authority too.

DoC in their reply (January and February 2015) stated that paragraph 6.6(e) of HBP, Vol. I, stipulates that, where additional items other than those given in SION are required as inputs or where generation of waste, scrap and remnants is beyond 2 per cent of input quantity, use of such inputs shall be allowed by the jurisdictional DC within a period of three months. In other words, the competent authority to fix the norms of consumption of input and ratio of generation of scrap is the Norms Committee and not the DC. Further, Para 6.8(e) of FTP, clearly states that in respect of items not covered by norms, DC may fix Ad-hoc norms for a period of six months and within this period, norms should be fixed by Norms Committee. Ad-hoc norms will continue till such time norms are fixed by Norms Committee. Hence, it is clear that till finalization of Ad-hoc norms, the norm on self declaration fixed by the DC will be applicable.

As regards, generation of more waste, scrap and remnants by M/s. Bissazza India Pvt. Ltd., the unit vide letter dated 13.10.2014 through Central Excise Authority, submitted that calculation done by Audit is incomplete as they have calculated the scrap ratio based on production of finished goods only on Kg. basis. They further submitted that actual wastage percentage is only 33% which is much below than the approved ad-hoc norms. They further submitted that their product is used for decorative purpose and due to this, scrap is generated during manufacturing process and not useable and liable to clear them as scrap but the same is within the approved limit. In case DGFT fixes the wastage norms lower than that of ad-hoc norms fixed by the DC, the unit is liable to pay the difference from the date of fixation of ad-hoc norms.

Reply of DoC is not relevant. Issue raised by audit was non finalisation of ad hoc norms by Norm Committee within six months from the date of fixation of ad hoc norms by the DC. Further, DC KSEZ does not have any data base to keep track of the cases for finalisation of ad hoc norms.

4.10 Non-levy of duty on consumption of imported inputs/raw materials /consumables etc. other than those allowed under SION

As per Sl. No.-A 1049 of Standard Input Output Norms (SION), FTP (2009-14)(Vol.2), for manufacture and export of 'Opthalmic lenses', input allowed is 'Rough blanks'.

Audit scrutiny of records relating to M/s GKB Rx LENS PVT. Ltd.,(100 per cent EOU) located in Kolkata & Gurgaon (additional unit) under jurisdiction of DC, FSEZ & Kolkata-V/Delhi-III Central Excise Commissionerate revealed that LoP was issued in February, 1995 and June, 2009 respectively for manufacture of 'Opthalmic lenses'. However, the units imported and consumed 'Spectacle Lens' and 'consumables' during 2009-14, which were not eligible items of import for manufacture of 'Opthalmic lenses'. As per the raw material

procurement data furnished by the EOU the unit imported 'Spectacle Lens' and 'consumables' worth ₹ 363.13 crore involving duty of ₹ 77.83 crore during the period of 2009-14 which was inadmissible.

On this being pointed out (September 2014), DC, Falta stated (November 2014) that during 2009-10 to 2013-14 the EOU unit at Gurgaon did not use 'Rough blanks made up of glass'-CTH-70151010 (which was permissible item of import for export of Ophthalmic lenses as per SION entry No. A-1049 for manufacture of Ophthalmic lenses') and used only 'Spectacle lenses made up of plastic'- CTH-90015000 and as per importer's claim, in view of paragraph 6.6(e) of HBP (v-1) and notification no. 52/2003-Cus, there was no need of fixing the SION from DGFT or any other authority because their waste/scrap/remnants are less than 2 per cent of input quantity.

The reply is not acceptable because as per paragraph 6.6(e) of HBP (v-1) and condition 3(d)(I)(ii) of notification no. 52/2003-Cus the imported goods has to be used in accordance with SION for export of finished goods out of India and as per proviso(a) under the aforesaid notification in case where no SION have been notified, the generation of waste, scrap and remnants upto 2 per cent of input quantity shall be allowed. In the instant case, SION (A-1049) already exists for item of manufacture- 'Ophthalmic lenses'.

4.11 Non-recovery of duty forgone on excess consumed imported inputs/raw materials

In SION, FTP (2009-14)(Vol.2), no norms have been fixed for 'Instant tea'. Therefore, in absence of any SION for 'Instant tea', generation of waste should have been allowed up to maximum 2 per cent of input quantity in terms of proviso(a) under condition 3(d)(I)(ii) of the notification dated 31.3.2003.

Scrutiny of records of M/s Goodricke Group Ltd., (Instant Tea Plant), Jalpaiguri (100 per cent EOU) (LoP dated 28.10.94) under jurisdiction of DC, Falta SEZ and Siliguri Central Excise Commissionerate revealed that the unit was granted permission by the Ministry of Industry in October 1994 for manufacture of 'Instant Tea' for which the unit was regularly importing 'Oolong tea' by availing duty exemption under Notification No. 52/2003-Cus dated. 31.3.2003. However, the unit allowed to generate waste upto 79 per cent of input quantity during the period 2009-10 to 2012-13 in contravention to proviso(a) under condition3(d)(I) of the notification dated 31.03.2003..

From the import and finished goods data made available by the unit for the period 2009-13, Audit observed that the unit consumed 7,20,326.4 Kgs of excess 'Oolong tea' for manufacture of 2,10,800 Kgs 'Instant tea' (after allowing the permissible wastage) on which customs duty amounting to

₹ 7.09 crore along with interest of ₹ 3.40 crore was recoverable. However, no action was initiated either by the Central Excise Department or the DC, Falta SEZ authority to recover the duty and interest.

DoC in their reply (January and February 2015) stated that reply is awaited from DoR.

Final outcome may be intimated to audit**.**

4.12 Violation of conditions of in LoP

Units undertaking to export goods and services produced by them under the EOU Scheme make an application along with project report. On approval, a Letter of Permission (LoP) shall be issued by DC/designated officer to EOU. LoP has an initial validity of 3 years, by that time the unit should commence production. Its validity may be extended further up to 3 years by competent authority. However, proposals for extension beyond six years shall be considered in exceptional circumstances, on a case-to-case basis by Board of Approval (BOA). Once unit commences production, LoP issued shall be valid for a period of five years for its activities. This period may be extended further by DC for a period of five years at a time

LoP issued to EOU units by concerned authority, would be construed as an Authorisation for all purposes. After receiving LoP, the unit has to execute a Legal undertaking (LUT) in prescribed form to abide by the terms and conditions of LoP with DC concerned. Failure to ensure positive NFE or not abiding any of the terms and conditions of LoP render the unit liable for penal action under provisions of the FT (D&R) Act.

i) Audit scrutiny revealed that in seven EOUs under NOIDA SEZ, actual production was in excess to the projected production as per the LoP ranging from 15.96 per cent to 1813.54 per cent. The units violated the condition of the LoP in these cases and thus were liable for penal action under the FT (D&R) Act. Even reason for such variations has not been reported in the APRs submitted by the units.

DoC in their reply (January 2015) stated that production in excess of permitted installed capacity is a procedural violation. EOU should have taken DC's permission in terms of paragraph 6.32(4) of FTP. However, since the excess production was exported, there appears to be no revenue loss to the Government. Actions against the unit concerned for contravening provisions of FTP / HBP are being taken.

Final outcome may be intimated to audit.

ii) In case of four units (two each in NOIDA SEZ and CSEZ), the procurement of capital goods and raw materials was in excess of approved

limit of LoP. The variation of actual procurement and quantity approved as per LoP ranging from 96.80 per cent to 556.18 per cent.

DoC in their reply (January 2015) in respect of CSEZ stated that in one case the procurement of goods in excess of the approved limit of ₹ 9.98 crore were regularised in December 2014 considering the performance of the unit and the positive NFE achieved by the unit and in the other case a notice has been issued to the unit and reply from the unit is awaited.

Final outcome may be intimated to audit.

iii) In another case of another four units under SEEPZ, the actual exports fell short of projected exports as per LoP. In these cases, the actual exports fell short of the exports projected in LoP ranging from 61.13 per cent to 97.83 per cent.

DoC in their reply (January and February 2015) stated that the actual export performance against projected figures are monitored/reviewed including non performance, at the time of grant of renewal permission to the unit.

Reply of the department is not acceptable because LoP issued to EoU units by concerned authority, would be construed as an Authorisation for all purposes. After receiving LoP, the unit executes a Legal undertaking (LUT) to abide by the terms and conditions of LoP. Failure to ensure positive NFE or not abiding any of the terms and conditions of LoP render the unit liable for penal action under the FT (D&R) Act. Department may consider clarifying the applicability of FT (D&R) Act for violations of terms and conditions of LoP.

iv) In one case under FSEZ, the unit started its commercial production (March 2005) after eleven years of the issue of LoP (December 1993) as against validity of three years stipulated in the LoP. It was also observed that the DC, FALTA had extended (March 2005) the LoP but extension being beyond six years requires approval of BOA, which was not furnished/available in records. Although the unit remained non- operational, neither any penalty was imposed nor the LoP was cancelled.

In all the above cases, audit observed that there is no provision in FTP to link actual production with the projected production mentioned in the application for setting up of EOU nor there is any provision to monitor difference in production. The cases reported above indicate that the structures of the APRs are not mapped adequately to the process to be followed by EOUs specific to its negotiated targets.

DoC in their reply (January and February 2015) stated that the figures indicated by the unit in Project Report at the time of setting up of EOU or at the time of renewal of LoP are projections depending upon the prevailing

market conditions for their product. This cannot be the sole basis for monitoring the export performance. EOU is under obligation only to achieve positive NFE cumulatively over a period of five years.

There is already a mechanism for monitoring as set out in Appendix 14-I-G according to which the Unit is monitored and if there is a shortfall in achieving the NFE as per norms in EOU scheme at the end of 1st and 2nd year, the unit is kept under watch category. For failure to achieve positive NFE, after completion of one year from the date of commencement of production, a cautionary letter is issued; at the end of 3rd or subsequent year, SCN is issued. If positive NFE is not achieved after completion of block period as per paragraph 6.5 of FTP, DC initiate penal action under the FT (D&R) Act, 1992.

Reply of DoC is not acceptable because audit observed that DCs are not monitoring the performance of EoUs.

Recommendation No. 5: *The department may modify the relevant provision of FT (D&R) Act to regulate the process/procedures in EOU linked to the objectives envisaged.*

DoC may furnish specific reply to the recommendation.

4.13 Foreign exchange not realised

Paragraph 6.11 of the HBP 2009-14 stipulates that performance of EOU shall be monitored by UAC. EOUs have to realise their export proceeds within 12 months of exports in terms of paragraph 6.12 (c) of FTP.

Audit observed that in case of four EOUs under CSEZ, Bangalore, NSEZ, Noida and VSEZ, Visakhapatnam, foreign exchange amounting to ₹ 22.30 crore remained unrealised though the units completed the five year block from the date of commencement of production. Concerned DC/UAC failed to monitor the realisation of FE in these cases. Corresponding duty forgone on the unrealised may be recovered from the concerned EOUs in terms of paragraphs 6.9 and 6.11 of HBP. Further audit observed that as on 31.03.2014, in another 29 EOUs under DCs SPEEZS, Mumbai, NSEZ, NOIDA, CSEZ, Kochi, MEPZ, Chennai and VSEZ, Visakhapatnam, foreign exchange amounting to ₹ 64.40 crore remained unrealised beyond the period allowed, no record has been found to show that action has been taken by the concerned DCs for monitoring of realisation of FE[12].

These are a few cases of inadequate monitoring of foreign exchange realization by the DCs.

DoC in their reply (January and February 2015) stated that in respect of units in NSEZ letters for ascertaining present status of foreign exchange

[12] in terms of Appendix 14-I-G of the HBP

remittances have already been issued to the concerned units on the basis of APRs and in respect of a unit in CSEZ, the unit has requested for waiver as the company from which FE to be realised was bankrupt. Pending FE from another company was realised. Similarly in other units concerned DC sought for report from the concerned EOUs.

Reply of DoC clearly indicates that there was inadequate monitoring of foreign exchange realization by the DCs.

4.14 Applicability of central excise exemption notifications issued under section 5A of the Central Excise Act, 1944 to EOU.

Section 3 of the Central Excise Act, 1944 provides that goods produced or manufactured in a hundred percent EOU shall pay duty equivalent to duty leviable on imported goods on clearances into DTA.

Section 5A of the Central Excise Act, 1944 empowers the government to issue exemption notification which exempts certain goods from payment of whole or part of excise duty subject to conditions specified therein. However, as per proviso to section 5A, exemption provided therein shall not apply to excisable goods which are produced or manufactured in a hundred percent EOU.

Thus while DTA clearances from EOU attract duties at par with imports as per Section 3 of Central Excise Act, 1944, exemption benefits available to imports under section 5A of the Act are not applicable to DTA clearances from EOU.

Audit observed that in eight EOUs, seven under jurisdiction of DC, Falta and one under DC, SEEPZ, Mumbai availed duty exemption benefit of ₹ 17.67 crore under central excise notification issued under section 5 of the Central Excise Act in contravention to the proviso there under as detailed below:

Table 10: Applicability of Central Excise notification

(₹ in crore)

S.No	Development Commissioner	Name of the unit (M/s)	Period/date of de bonding	Value of clearance into DTA	Duty short paid/not paid
1	Falta SEZ	Sova Power Ltd.	2009-14	62.63	8.19
2	Falta SEZ	Manaksia Ltd., Hooghly	2009-14	4.45	0.60
3	Falta SEZ	Synergy Electric Pvt. Ltd.	2007-13	16.06	2.35
4	Falta SEZ	Gradient Wire Product Pvt. Ltd.	2012-14 (upto 20.3.14)	4.52	0.27
5	Falta SEZ	Goodricke Group Ltd.	2009-13 (up to 28.5.12)	9.20	1.42
6	Falta SEZ	AI Champdany Industries Ltd	25.5.2012	NA	3.81
7	Falta SEZ	Naffar Chandra Jute Mills Ltd.	6.5.2013	NA	0.27
8	SEEPZ SEZ	Shreya Life Science Pvt. Ltd	2008-09 to 2010-11	8.58	0.76

Central Excise Department in respect of one unit under SEEPZ SEZ issued SCN for ₹ 0.76 lakh.

DoC in their reply (January and February 2015) stated that the cases has been forwarded to jurisdictional Central Excise Authorities to examine and submit the factual report.

Final outcome may be intimated to audit.

Recommendation No. 6: *Department may consider suitable amendment to remove the ambiguity created due to contradictory provisions of Section 5A and Section 3 of the Central Excise Act, 1944 relating to duty leviable on domestic clearances made by EOUs.*

DoC in their reply (January and February 2015) stated that DoR will be requested to examine and consider the recommendation to remove ambiguity. DoC will also write to the DoR for examination of these items, giving its comments and take further necessary action.

Final outcome may be intimated to audit.

4.15 Ambiguity in the FTP and CE notification

Serial number 1(d) to the Appendix 14-I-H to the HBP provides that an EOU can avail DTA sales entitlement within three years of the accrual of entitlement. Hence, EOUs are entitled to carry forward their DTA sale entitlement to next years. However, in terms of condition number 2(b) of the table annexed to the CE notification dated 31 March 2003 stipulates that if the goods are cleared into DTA in accordance with sub-paragraphs (a), (b), (d) and (h) of paragraph 6.8 of FTP the total value of such goods being cleared from the unit does not exceed 50 per cent of the FOB value of exports made during the year (starting from 1st April of the year and ending with 31st March of next year) by the said unit, thus restricting the DTA sale entitlement to the current year's exports. Thus there was an ambiguity in the provision of FTP and CE notification on DTA sales entitlement of EOU, which need to be rectified.

Recommendation No. 7: *DoC may consider amendments to the applicable provisions in order to avoid the ambiguity between FTP and the Central Excise notification regarding DTA sales entitlement of EOUs.*

DoC while accepting the recommendation replied (January and February 2015) that DoR is being requested to consider amendment to its various notifications as suggested by audit so as to make it in conformity with the provisions of FTP/HBP in order to avoid ambiguity.

Final outcome may be intimated to audit.

5. Conclusion

Medium-term goal as outlined in the Foreign Trade Policy (FTP 2009-14) was 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.

As per Strategic Plan of Department of Commerce, the aspiration of the Department was to achieve an average annual growth of exports of 25 per cent. Working on this aspiration, the Department aimed 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 (2016-17).

Owing to their flexibility and unique position, EOU scheme flourished in 1980's, 1990's and upto mid 2000 decade which had contributed to the process of structural change in the domestic industry via technological and skill spillover, economic linkages and disaggregation of the units for a positive development.

There has been a gradual reduction in EOUs after the SEZ Act came into force in 2006-07. The FTP did not have any special provision to utilise the unique advantages of the 100 per cent EOU Scheme.

Further, audit observed that the share of EOUs in overall exports has been declining during last five years barring a marginal improvement in 2010-11.

DoC may take steps to ensure that APRs are submitted in time and these reports which meant for monitoring the performance of EOUs may contain all relevant data not only of exports but also about duty foregone, DTA sale for Government to use them as useful feedback on the performance of the scheme.

DoC may institutionalise a system of regular internal audit of the EOU scheme and may take steps to collect, clean, collate and communicate updated data on the dedicated website.

DoC may consider amendments to the applicable provisions in order to avoid the ambiguity between FTP and Central Excise notification regarding DTA sales entitlement of EOUs.

Apart from the systemic issues highlighted in the report, specific cases of operational malfunction led to short/non levy of duty of ₹ 317.06 crore. Cases of non compliance and policy misinterpretation including DTA sales, short levy of duty at the time of exit from EOU scheme, applicability of central excise exemption notification, incorrect availing of Cenvat credit, non levy of Service tax etc. were also observed in audit.

DoC in their reply (February 2015) stated that most of the issues raised are of factual nature. The department has already initiated steps to implement the suggestions made by audit, such as timely submission of APRs, updation of Zonal websites, strengthening of internal audit system. As regard,

amendments to the applicable provisions to avoid the ambiguity between FTP and Central Excise notification regarding DTA sale entitlement of EOUs, Department of Revenue will be requested to amend its notifications wherever, as and when new FTP comes into force.

New Delhi **(Dr. Nilotpal Goswami)**
Dated: 17 March 2015 **Principal Director (Customs)**

Countersigned

New Delhi **(Shashi Kant Sharma)**
Dated: 18 March 2015 **Comptroller and Auditor General of India**