CHAPTER V
DUTY EXEMPTION/REMISSION SCHEMES

The Government may exempt wholly or part of customs duties for import of inputs and capital goods under an export promotion scheme through a notification. Importers of such exempted goods undertake to fulfill prescribed export obligations (EO) as well as comply with specified conditions, failing which the full rate of duty becomes leviable. During test check (October 2013 to October 2015) of records, a few illustrative cases noticed where duty exemptions were availed of without fulfilling EOs/conditions are discussed in the following paragraphs. The total revenue implication in these cases is ₹ 168.94 crore.

Non recovery of drawback where export proceeds are not realised

5.1 In terms of the provisions of Section 75(1) of the Customs Act, 1962 read with the sub-rule 16A (1) of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, where an amount of drawback has been paid to an exporter but the sale proceeds in respect of such export goods have not been realised within the time allowed under the Foreign Exchange Management Act (FEMA), 1999, such drawback amount is to be recovered. Sub-rule 16A (2) also stipulates that if the exporter fails to produce evidence in respect of realisation of export proceeds within the period allowed under the FEMA, 1999 or as extended by the Reserve Bank of India (RBI), the Assistant/Deputy Commissioner of Customs shall issue a notice to the exporter for production of evidence of realisation of export proceeds, failing which, an order shall be passed to recover the amount of drawback paid to the claimant.

To monitor the export proceeds of value upto $25,000 only, the Central Board of Excise and Custom (Board) vide Circular No.5/2009 dated 2 February 2009 introduced an in-house monitoring mechanism for export proceeds realization and prescribed the procedure to be followed by the exporters.

The circular emphasized for creation of a special cell for management of declarations by the exporters and monitoring of exports proceeds realization. In cases where export proceeds have not been realized notices are to be issued by Customs to recover drawback paid.

Comparing RBI XOS with Export data (up to 31^{s}March 2013) in four Customs Commissionerates (Chennai Sea, Chennai Air, Tuticorin and Coimbatore) revealed that the export proceeds were not realised in respect of 619 shipping bills for which drawback payments of ₹ 9.12 crore had been made. The non-realisation of export proceeds has also been confirmed with the DGFT database. All these shipping bills were dated on or before 31 March 2013, due to which the available time limit for export proceeds realisation is already

over. Hence, in these cases, the drawback paid is recoverable with interest as per the aforesaid Drawback provisions.

On this being pointed out (October 2015), the department stated (November 2015) that notices have been issued to concerned exporters under Chennai (Sea) and Tuticorin Commissionerates.

Ministry response is awaited (January 2016).

Excess DEPB credit due to application of incorrect DEPB credit rate

5.2 The DEPB credit rates, as intimated by Public notice from time to time, are stored and updated.

Audit scrutiny of data of DEPB entitlements revealed that though the applicable credit rate was fetched from the DEPB rate directory the rate awarded was higher than the applicable rate in 32 records, which led to excess duty credit amounting to ₹ 23.78 lakh. Out of the above incorrect duty credits amounting to ₹ 12.41 lakh were observed in 10 records related to RLA Ahmedabad alone.

This was pointed to the Department/ Ministry in September/October 2015 their reply is awaited (January 2016).

Incorrect discharge of advance authorization

5.3 As per paragraph 4.1.3 of the FTP- 2009-14, an Advance Authorization (AA) is issued to allow duty free import of inputs for (i) Physical Exports (including exports to SEZ), (ii) Intermediate supplies,(iii) Supply of goods to the categories mentioned in paragraph 8.2(b), (c), (d), (e), (f), (g), (i), and (j) of FTP, treated as Deemed Export and (iv) Supply of 'stores' on board of foreign going vessel.

The imported goods against the aforementioned Advance Authorization were exempted from all imported duties, including safeguard duty and anti-dumping duty leviable thereon under sections 8B and 9A of the said Customs Tariff Act, 1975, under notification no.96/2009-cus dated 11 September 2009 and 112/2009-cus dated 29 September 2009. The Export Obligation (EO) of the Authorization issued under notification no.96/2009-cus was to be fulfilled, in terms of condition 1(viii), by physically exporting their manufactured goods as per paragraph 4.1.3 (i) of FTP or by supplying their resultant products to exporters in terms of paragraph 4.1.3 (ii) of FTP. In case of failure to fulfil the conditions of Notifications, the Authorization holder was liable to pay the duty along with applicable interest in terms of condition (1) (iv) of the notification.

The notification no.112/2009-cus dated 29 September 2009, while allowing aforementioned duty exemption on imported goods against AA issued under

paragraph 4.1.3 (iii) of FTP, has limited the duty benefits by specifying, at paragraph 2, that the exemption from Safeguard Duty and Antidumping Duty shall not be available in respect of materials required for supplies of final goods covered under Sub-Clause (a), (b), (c), (i) and (j) of clause (iii) of the explanation appended to the notification, which includes supply of goods to Export Oriented Units under Sub-Clause (iii)(b).

M/s Kalpana Plastics Ltd., Kolkata and two other importers were granted (January 2010 to August 2012) five Advance Authorizations by the office of the Zonal DGFT, Kolkata with endorsement of customs notification no.96/2009-Customs dated 11 September 2009 on it against which they imported goods through Kolkata Port Commissionerate by availing duty exemption of ₹ 2.63 crore under notification no.96/2009-cus. However, scrutiny of related Export Obligation Discharge Certificates (EODC) issued by the ZDGFT, Kolkata and Statements of Supply/Export furnished by the Authorization holders to ZDGFT, Kolkata and Customs revealed that the EO of the aforesaid five Authorizations were discharged against their supply of goods to an EOU unit (viz., M/s Tara Holdings Pvt. Ltd.), which in terms of paragraph 8.2 (b) of the FTP is considered as Deemed Export. However, as the EO under notification no.96/2009-cus could only be discharged by physical exports or intermediate supplies made by the importer, the discharge of EO in the objected cases against the deemed export supplies was incorrect for which the importers were liable to pay total duty of ₹ 2.63 crore along with the applicable interest of ₹ 86.99 lakh in terms of condition (iv) of Notification ibid. The irregularity was also not noticed by the customs department who, in turn, cancelled (August 2012) the Bonds and the respective Bank Guarantees without recovering any duty from the importers.

The issue was initially taken up with Customs in October 2013 and subsequently reported to DGFT, Kolkata in May 2014. The DGFT, Kolkata in their reply (September 2014) contended that the objected Authorizations were redeemed on the basis of the Deemed export supplies as the firm had actually applied for Advance Authorization for Deemed export categories but the customs notification no.96/2009 was automatically endorsed on the copy of Authorization generated through DGFT server. The department was informed (March 2015) that their reply is not sustainable because neither the endorsement of notification no.96/2009-cus on all the objected Authorizations were amended till the date of audit/issue of EODC nor recovery of antidumping duty of ₹ 18.41 lakh applicable on the imported materials under notification no.11/2008-cus dated 23 January 2008 (as amended) was ensured at the time of deemed export supply to the EOU in compliance to the notification no.112/2009-cus justifying their argument.

The Custom Department while intimating (March and May 2015) the issue of demand notices to all the importers contended that the notification no.96/2009-cus also covers deemed export as it only specifies that the EO has to be discharged by exporting goods, which does not mean that the finished goods have to be physically exported.

The Customs Department was informed (June 2015) that their reply is not tenable because the export, as defined under Section 2(18) of Customs Act, 1962 means "taking out of India to a place outside India" which definitely means physical export but does not include the deemed Export supplies as specified under paragraph 4.1.3 (iii) of FTP covering the supplies to EOU located within India. Moreover, audit contention was also obvious from the fact that a separate notification no.112/2009-cus dated 29 September 2009 was already issued for allowing duty benefit on imports against Advance authorization issued for deemed Export under paragraph 4.1.3 (iii) of FTP.

Ministry of Commerce in respect of M/s Kalpana Plastics Ltd stated (August 2015) that supplies were made to EOU as deemed as such exempted from payment of all duties including antidumping duties.

The reply is not acceptable because supplies to EOUs are not exempted from antidumping and safeguard duties under notification No. 112/2009-cus (sub para 2 refers).

Ministry of Finance (Drawback Division) replied (January 2016) that:

i) Para 3 of notification No. 112/2009-cus specifically provides for exemption to materials required for manufacture of final goods supplied to EOUs from the ADD.

ii) The FTP provides for different allowable means for fulfilling the EO under the self contained AA scheme. No provision in FTP bars combining of exports/ supplies by different allowable means. Even the DGFT's application form ANF 4 J and redemption form ANF 4F both refer to products or items as "exported/supplied".

iii) Notifications issued by Revenue including notification Nos 96/2009-cus and 112/2009-cus are required to be applied in the context of the scheme.

iv) Exemption was in accordance with the FTP hence duty is not recoverable.

The reply of Ministry of Finance is not acceptable to Audit because:

i) Para 3 of notification 112/2009-cus is for supply of imported goods "as such" to EOU and not for the supply of manufactured goods of AA holder to EOU. In the instant case the imported goods were not supplied "as such",

rather final goods were supplied to EOU. Therefore, para 2 of notification 11/2009-cus read with explanation (b) annexed to the notification was applicable which specifically disallows exemption from safeguard and ADD in respect of materials supplied to EOUs/STP/EHTP which are required for final goods. Accordingly, ADD was recoverable if final goods as in the instant case are supplied by AA holder to EOU.

ii) The FTP only lays down different category of exports for which AA could be issued. However, the AA has to be issued Custom notification wise/ export category wise as evident from paras 4.20, 4.20.2 of HBP, Vol. I.

The redemption form ANF 4F of AA refers to product or items as "exported/supplied" because the same form is used for redemption of all categories of AA. However, the guidelines annexed require separate set of procedures/documents for redemption of AA for Physical exports and deemed exports.

iii) Separate Customs notifications were issued (96/2009-cus and 112/2009-cus) to regulate exemption to AA for physical exports and deemed exports respectively which are binding on respective AA holders.

iv) Accordingly, duty exemption is regulated by compliance to conditions of notifications under which AA were issued. Failure to fulfill such conditions necessitates recovery of duty.

Reply in respect of remaining units is awaited (January 2016).

Undue benefit to ineligible firm under SHIS scheme

5.4 Paragraph 3.10.3 of Handbook of Procedure (HBP), Vol-I, 2009-14 envisaged that if an applicant has availed Zero Duty EPCG Authorization during the year 2012-13, he shall not be eligible for Status Holders Incentive Scrip (SHIS) for exports made during that year.

Audit scrutiny revealed that M/s Raj Overseas, Panipat under Joint Director General of Foreign Trade, Panipat had taken the benefit of Zero duty EPCG scheme (Duty saved ₹ 0.59 crore) during 2012-13. However, the firm was also allowed benefit under SHIS scheme amounting to ₹ 1.41 crore for the exports made during the year 2012-13 (SHIS Licence No.3310027774 dated 30 September 2013) in contravention to aforesaid provision. This resulted into incorrect grant under SHIS scheme amounting to ₹ 1.41 crore which is recoverable from the licencee.

On this being pointed out (November 2013), the department stated (June 2014) that assessee had been directed to surrender the said amount. Further progress is awaited (January 2016).

Grant of SHIS duty credit for services rendered beyond the application period

5.5 In terms of paragraph 3.16.1 (b) of the Foreign Trade Policy (FTP) 2009-14, Status Holders of sectors specified in paragraph 3.16.4 shall be entitled to a Duty Credit Scrip at the rate of 1 per cent on Free on Board (FOB) value of exports made during the period from 2009-10 to 2012-13. As per paragraph 3.10.3 (a) of Handbook of Procedure (HBP) Vol-I, 2009-14, the last date for filing Status Holders Incentive Scrip (SHIS) application for exports made during 2009-10 to 2012-13 shall be 31 March of 2011/ 2012/2013/2014 respectively.

Audit scrutiny of the SHIS licences issued by the Regional Licensing Authority (RLA), Coimbatore revealed that in respect of 18 applications filed by 17 exporters during the year 2011-12/2013-14, the duty credit scrips were granted on exports made beyond the financial year for which the applications were made, resulting in excess grant of SHIS credit to the tune of ₹ 43.58 lakh, which is recoverable with interest.

On this being pointed out (January 2015), the department reported (March 2015) recovery of excess duty credit of ₹ 28.46 lakh from 14 exporters. Reply in respect of remaining three cases is awaited (January 2016).

Grant of SHIS duty credit scrip to companies already issued Zero duty EPCG and vice-versa

5.6. Status Holders Incentive Scrip (SHIS) can be applied for in the year subsequent to year of export. As per Para 3.10.3 (b) of the HBP, in case an applicant has availed Zero Duty EPCG authorisation during the year 2014-15, they shall not be entitled to SHIS for that year (i.e. for export made during the respective previous year. Such SHIS applications will be rejected and Para 9.3 (late cut for delay in filing application) shall also not be applicable.

Scrutiny of cases revealed that 74 SHIS scrips for duty credit of ₹ 61.57 crore were irregularly issued in cases where Zero duty EPCG authorisation had already been issued to the same firm in the same year.

Audit noticed that licenses/scrip had been incorrectly issued in nine cases under seven[37] RLAs. However, in some cases the process was not mapped in the application and licenses/scrip were cancelled before issue indicating that the database of the Central Server was not updated at the time of cancellation of the licenses/scrip.

RLA, Ahmedabad stated (September 2015) that the firm has been directed to submit SHIS licence for further necessary action.

Reply from RLA, Surat, Gandhidham, Bangalore, Varanasi, Kochi and Ludhiana is awaited (January 2016).

[37] Bengaluru, Ahmedabad, Surat, Gandhidham,Varanasi, Kochi and Ludhiana

Irregularities in grant of duty credit under VFFM schemes

5.7 Chapter-3 schemes viz. Vishesh Krishi Upaj Yojana (VKUY), Focus Market Scheme (FMS), Focus Product Scheme (FPS) and Market Linked Focus Product Scheme (MLFPS) are jointly known as the VFFM schemes.

Excess grant of duty credit under VFFM schemes due to grant of entitlements on FOB values in excess of custom supplied values

5.7(a) Under the FTP most of the benefits to exporters are based on Shipping Bill information. After the online filing and clearance of Shipping Bills the information is communicated by Customs to DGFT.

Test check of License files in RLA, Amritsar, Panipat, Ludhiana, Chandigarh, Vadodara, Ahmedabad, Surat, Rajkot, Hyderabad and Kolkata revealed that all the items of each SB of similar description and falling under the same CTH, admissible to the same rate of VFFM credit, had been clubbed under one serial number against each SB. This had resulted in mis-match of FOB value of SBs at item level, as claimed in the VFFM applications, in comparison to the Customs values at item level. In the case of 122,106 Shipping bill records (22,453 License files), duty credit of ₹ 720.46 crore were clubbed under one serial number which could not be verified with the customs certified FOB values of the SB items at item level.

Similarly, Audit noticed that in two cases (RLA, Ahmedabad), the same Shipping Bills were used in different applications on which duty credit scrip under different schemes of Chapter 3 of the FTP were granted, resulting in incorrect duty credit. Reply from RLA, Ahmedabad is awaited.

This was pointed to the Ministry in October 2015, their reply is awaited (January 2016).

5.7(b) Different FOB values of same SB item for VFFM Schemes and DEPB Scheme

Same shipping bills could be used for duty credit entitlement under DEPB Scheme of chapter 4 of the FTP and simultaneously for VFFM scheme under Chapter-3.

A comparison of the FOB values of such SBs which had been used for availing two different scheme benefits, viz. DEPB and VFFM, during the period 2014-15, revealed that in 44 cases (RLA, Kolkata, Mumbai, Chennai, New Delhi, Ahmedabad, Cochin and Pune) where same item were used in the both the schemes, the FOB values were different, even the Bank Realisation Certificate (BRC) number, date of the SB also matched, indicating that the claims under both schemes were made post-realisation claims.

Duty credit calculated on the lower of the two FOB values, allowed excess duty credit of ₹ 5.20 crore in the above 44 cases.

Audit observed that the FOB values were modified after considering values as per Shipping Bill or the bank realization information available in the relevant tables, indicating the need to improve input control to avoid grant of excess duty credit.

Cross checking of eight License files in RLA, Kolkata revealed that there was a mismatch of item level FOB value of SB items as claimed in the VFFM applications, when compared with DEPB item level values, because of clubbing of all items of each SB of similar description falling under the same CTH with same rate of VFFM credit under one serial number against VFFM claims.

Thus, there was inadequate compliance to ensure submission and recording of crucial data like FOB value of SB at item level for grant of duty credit benefits.

This was pointed to the Department/Ministry in August/October 2015, their reply is awaited (January 2016).

5.7(c) Grant of duty credit under VFFM schemes where Export date is incorrect

Shipping bills (SBs) information relating to VFFM duty entitlement claims revealed that export date was before the Let export order (LEO) date for 160018 SBs. Duty credit under VFFM schemes amounting to Rs.959.37 crore was allowed against 160018 such SBs during the period 2014-15.

Test check revealed that in 2342 SBs of VFFM under RLA Panipat, Chandigarh, and Visakhapatnam duty credit of ₹ 5.62 crore was allowed wherein Export date was before the LEO/ shipping bill date given as export date instead of LEO date.

Reply from RLA, Panipat, and Visakhapatnam is awaited (January 2016).

Domestic Tariff Area (DTA) clearances

5.8 As per serial no.3 of the table annexed to notification no.23/2003-CE dated 31 March 2003 read with condition 3 (i), if the goods cleared by a 100 per cent EOU in DTA are manufactured wholly from the raw materials manufactured in India, it will be liable to pay duty equal to excise duty leviable under section 3 of the Central Excise Act, 1944 and in case the unit uses the imported raw materials, excise duty equal to aggregate of duties of customs is payable as provided at serial no.2 of the aforesaid notification. Section 53 of the Special Economic Zones (SEZ) Act, 2005 specifically state that a SEZ shall be deemed to be a territory outside the customs territory of India for the purpose of undertaking the authorized operations.

Paragraph 9.21 of the FTP defines DTA as area within India which is outside SEZ and EOU/EHTP/STP/BTP. Further, section 30 the SEZ Act, 2005 stipulates that any goods removed from a SEZ to the DTA shall be chargeable to duties of customs including anti dumping, countervailing and safeguard duties under the Customs Tariff Act, 1975, where applicable as leviable on such goods when imported. Thus, procurement of goods from SEZ is mandated to be treated as import and such procurement could not be treated as 'indigenous procurement' for the purpose of paying excise duty under serial no.3 of aforesaid notification.

Audit noticed that M/s Shri Ambica Polymer Pvt. Ltd., (EOU), under the jurisdiction of Central Excise Commissionerate, Ahmedabad III, during 2010-14, cleared its finished goods (HDPE/PP Woven fabric/waste generated) in DTA on payment of Central Excise duty under serial no.3 of aforesaid notification. However, the principal raw materials (Polypropylene and Masterbatch) of finished goods were procured from M/s Reliance Industries Ltd., Jamnagar, a SEZ unit. The audited entity incorrectly treated the supplies received from SEZ unit as raw materials procured from India and discharged its duty liability on finished goods accordingly under serial no.3 of notification above instead of serial no.2 which resulted in short payment of duty to the tune of ₹ 54.14 lakh.

On this being pointed out (May 2014), the superintendent (CE) Central Excise & Customs forwarding (September 2014) response of the unit contested the audit observation on following grounds:-

a) Section 30 of the SEZ Act, 2005 has no applicability to the clearances made by an EOU for which provisions of Central Excise Act and Rules should be adhered to.

b) Honorable High Court of Gujarat in case of Essar Steel Ltd. Vs. UOI {2010 (249) ELT 3 (GUJ)} specifically mentioned (paragraph 20) that SEZ is located within India.

c) Honorable High Court of Gujarat in case of Varsha Exports Vs. UOI [2000 (71) ECC 834} has also pronounced that Kandla free trade zone is a part of India.

Reply of the department is not tenable in view of the following facts:-

(i) Since the EOU procured its raw material from the SEZ unit, the transaction has to be seen in context of section 30 of the SEZ Act which has a direct impact on the duty structure for DTA clearance of the EOU. Hence, it is inappropriate to say that SEZ Act has no applicability on DTA clearance of the EOU.

(ii) The issue decided by the High Court in case of M/s Essar Steel Ltd., was entirely different as it dealt with issue of levy of export duty on supplies to SEZ units and the wordings of the case should be read in that context only. Also, section 30 of the SEZ Act clearly stipulates that levy of duties of customs on DTA clearance of goods by SEZ units which clearly show that those supplies are treated as imports. For these transactions, bills of entry were also filed which is an import document.

The High Court pronouncement, in case of M/s Varsha Exports is not relevant to the above audit observation since it pertains to the period before enactment of SEZ Act 2005 (Even Kandla SEZ was known as 'Kandla free trade zone (KFTZ)' during the period of the judgment.

5.9 As per paragraph 6.8 (a) of Foreign Trade Policy (FTP) 2009-14, units, other than gems and jewellery units, may sell goods upto 50 per cent of FOB value of exports, subject to fulfillment 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.

M/s Godavari Bio Refineries Ltd., a 100 per cent EOU was issued LOP in April 2011 (as amended) for manufacture and export of chemicals viz 'Crotonaldehyde, Paraldehyde, Ethyl Acetate', etc. The unit cleared into DTA during 2013-14 to 2014-15 products viz "Paraldehyde" classifiable under CTH 29122990 and "Acetaldehyde" classified under CTH 29121200 valued at ₹ 2.04 crore and ₹ 3.98 crore respectively. Even though no exports were made of the products cleared in DTA during this period. As products 'Paraldehyde' and 'Ethyl Acetate' were not exported during 2013-15, DTA clearance made on concessional rate of duties is irregular. Accordingly, the differential duty of ₹ 52.06 lakh on DTA clearance is recoverable.

On this being pointed out (March/July 2015), the Ministry replied (January 2016) that the licensee fulfilled the condition regarding achievement of positive NFE during the relevant period and the products cleared in DTA are similar goods as stipulated in Para 6.8(a) of FTP 2009-14. Therefore the licensee could sell these products into DTA subject to the condition that total DTA sale does not exceed overall entitlement.

The reply is not acceptable Audit is not objecting to DTA clearances of these products either because of non-achievement of NFE or exceeding the overall entitlement. Because DTA clearances of the "specific" product are allowed

within prescribed percentages of its FOB value only when the product is actually exported. Here reliance on the word "specific" in paragraph 6.8(a) of FTP is of prime consideration to decide eligibility of its clearance in DTA apart from fulfillment of other conditions. In the instant case the products in question were not exported during the relevant period but were cleared in DTA.

Issue of Licenses to firms in the Denied Entity List (DEL)

5.10 A Denied Entity List (DEL) is maintained as per provisions of Enforcement Division of DGFT Circular vide F.No. 18/24//HQ/99-2000/ECA II dated December 31, 2003, read with Rule 7 of Foreign Trade (Regulation) Rules 1993. An IEC holder is refused any further License if put under DEL for any violation of the FTP or FTDR Act.

Audit scrutiny revealed that in 349 cases test checked from records at 17 RLAs[38] the Department issued License with duty credit / cif value of ₹ 80.78 crore without checking the DEL status at the time of issue of license.

In response to the audit queries RLA Moradabad, Panipat and Ludhiana stated that licenses/scrip were issued after removal from DEL which is incorrect because the firms were issued licenses without withdrawing them from DEL (Central Server).

Further, issuance of licenses to entities in DEL, keeping DEL order in abeyance was not in order, since as per Circular of December 2003 and provision of Foreign Trade (Regulation) Rules 1993, an IEC holder could not be issued a license, once black listed under DEL.

Moreover, it was noticed from the RLA replies that insertion into and removal from DEL was not being updated into the central DEL database promptly, which has resulted in creation of an unreliable DEL list.

The DGFT EDI system did not have proper mapping of the business rules for barring entities in DEL from submitting e-COM applications or for issuance of authorisation/duty credit scrip to such entities. DEL status is being checked manually on a case-to-case basis, leading to lapses and irregular issuance of licenses.

Reply from RLA Chennai, Coimbatore, Cochin, Madurai, Hyderabad, Kolkata, Mumbai, Surat, Ahmedabad, Vadodara, Kanpur, Delhi and Jaipur is awaited (January 2016).

[38]17 RLA: Kolkata, Chennai, Coimbatore, Cochin, Kochi, Madurai, Vadodara, Ahmedabad, Rajkot, Jaipur, Hyderabad, Mumbai Delhi, Kanpur, Moradabad, Panipat, Ludhiana.,