CHAPTER IV
DUTY EXEMPTION/REMISSION SCHEMES

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

4.1 Advance licence scheme

Import of inputs after invalidation for indigenous procurement

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

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

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

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

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

4.2.1 *Adoption of incorrect assessable value*

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

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

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

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

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

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

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

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

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

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

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

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

4.2.3 *Incorrect reimbursement of Central sales tax*

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

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

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

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

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

4.2.4 *Irregular DTA sale*

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

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

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

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

4.3 Vishesh krishi upaj yojana (VKUY) scheme

Excess grant of duty credit

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

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

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

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

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

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