



CHAPTER II FINDINGS ON RULES, REGULATIONS AND SYSTEMS

2.1 In this chapter we have included audit findings and recommendations on system issues viz. inadequacies in the Acts/rules/notifications issued by the Government for export/import of products as well as the internal control mechanism, which adversely affect the collection of revenue. To highlight the issues, certain illustrative cases have been included.

2.2 Database of imported and exported goods

The Directorate General of Valuation (DGOV), Mumbai was established in the year 1997 to assist the Board in policy matters concerning valuation. To carry out this task, the DGOV had to develop a comprehensive real time electronic database of imported and exported goods which would fulfil the following objectives:-

- The assessing officers would have instant access to the data to check for cases of undervaluation/overvaluation;
- Check abuse of export incentive schemes and valuation frauds;
- Monitor sensitive commodities which were prone to undervaluation;
- Maintain a central registry of special valuation (SVB) cases;
- Provide assistance to the Board for fixation of tariff value and transfer pricing;
- Monitoring of valuation risk component of risk management system (RMS) under Indian Customs Data Interchange System (ICES);
- Generating valuation alerts, publishing valuation bulletins and resolving valuation disputes.

The Expert Committee on Gems and Jewellery had expressed concern over the absence of reliable turnover statistics in this sector and had opined that the domestic trade was grossly under-estimated to avoid both sales tax and income tax and had recommended sharing of the trading data with other tax authorities to detect instances of tax evasion.

Given the multiple uses of the database, completeness of data was a prerequisite for doing any reliable analysis. We found that the import/export data was incomplete and could not be used as the base data for any realistic analysis. The value of imports and exports for the total transactions captured in the DGOV database for the customs tariff heading 71 was way below the actual trade figures reported by the Ministry of Commerce and Industries on the DGFT website. The figures are given in the table overleaf:-

Table no 2.1
Comparison of import/export figures

Year	DGOV data		DGFT data	
	Value of imports	Value of exports	Value of imports	Value of exports
2005-06	42,462	391	91,604	70,209
2006-07	53,689	189	1,02,250	72,784
2007-08	52,768	70	1,06,451	79,763

To examine the issue further, we took the data available on the DGOV database in respect of the commissionerates of Ahmedabad, Kandla and Bangalore; Air Cargo Complex, Jaipur; New Customs House (NCH), Delhi; Inland Container Depots (ICDs), Tughlakabad (TKD) and Patpadganj (PPG) and compared it with the data maintained by the respective commissionerates. There were substantial variations, as depicted below: -

Table no 2.2
Comparison of figures of DGOV and commissionerates

Year	Commissionerate and other offices	As per DGOV data		As per commissionerate data	
		No. of BEs	No. of SBs	No. of BEs	No. of SBs
2005-06	Bangalore	833	52	1,101	656
	NCH, Delhi	1,209	10	350	22,490
	ICD , TKD	32	1	108	22
	ICD, PPG	41	5	52	299
	Ahmedabad & Kandla	699	Nil	4,754	1,280
2006-07	ACC, Jaipur	3,481	Nil	4,695	19,130
	Bangalore	1,063	30	1,123	746
	NCH, Delhi	800	70	350	17,766
	ICD , TKD	61	2	794	27
	ICD, PPG	30	1	133	566
	Ahmedabad & Kandla	594	Nil	5,301	1,294
2007-08	ACC, Jaipur	2,477	Nil	5,472	21,288
	Bangalore	991	10	1,164	837
	NCH, Delhi	560	37	367	19,469
	ICD , TKD	133	Nil	834	31
	ICD, PPG	46	10	40	547
	Ahmedabad & Kandla	561	1	11,420	1,496
	Total	13,611	229	38,058	1,07,944

We observed that only 35 per cent of BEs and less than one per cent of SBs had been entered in the DGOV database. While the import data was incomplete, in the case of exports, virtually no data had been captured in the database.

The Diamond Plaza Customs Clearance Centre (DPCC) under the Commissioner of Customs, Sahar Airport, Mumbai had imported and exported goods worth Rs. 1,18,162 crore and Rs. 1,71,937 crore respectively in three years which were 36 per cent to 43 per cent of the imports and 74 per cent to 80 per cent of the exports of the entire country under chapter 71. However, the import and export data pertaining to the DPCC was not being entered in the database of DGOV.

We concluded that it was not possible to use the DGOV data for any meaningful analysis as only a small portion of the total data was being captured. Therefore, none of the objectives for setting up the DGOV database were achieved.

Recommendation No. 1

- *We recommend that the database of international trade should be kept updated, especially with the DPCC data, so that it can be utilised for the various purposes for which it has been created. This can also enable sharing of data with other tax authorities for detection of cases of duty evasion.*

2.3 Implementation of ICES in DPCC

The DPCC was set up in 1985 to facilitate expeditious clearance of consignments for import and export of diamonds, gems and jewellery. The bulk of imports and exports of the country are handled by the DPCC.

Indian Customs Electronic Data Interchange System (ICES) captures details of imports and exports in all commissionerates. It was introduced to speed up

assessments, improve transparency and to act as a repository of data. We noticed that although the DPCC had a dedicated server, the entire data relating to customs clearance of exports and imports was being kept manually. Therefore, the information relating to the bulk of the total trade for these articles was not captured in the ICES.

Consequently, the transactions at DPCC are escaping the scrutiny of the Risk Management System and Post Compliance Audit introduced by the department for examination of the high risk cargo. In our opinion, this omission of DPCC data has increased the risk of tax evasion and other unlawful activities which were sought to be reduced by the introduction of ICES. Thus, the data in two major IT systems, ICES and DGOV database is largely incomplete primarily because DPCC has not implemented these systems.

On the matter being pointed out (July 2009), the department stated (August 2009) that the ICES could not be implemented in DPCC as it was being shifted to a new location and some changes were required in the existing software. In addition, the traders were opposed to the implementation as they felt that it would result in delays in clearance of goods, leakage of information about their imports and they would have to pay fees for the data entry at service centres.

The reply is not tenable. Due to the non-implementation of ICES at DPCC, bulk of the imports and exports of the entire country have been excluded from the ICES which defeats the very objective of the system. Issues like additional cost, confidentiality etc. have been adequately addressed in the ICES for safeguarding the interest of the importers. Moreover, the traders' data is being captured in other commissionerates and there is no justification for giving special status to the traders at DPCC and keeping their information out of the ICES.

Recommendation No. 2

- *We recommend that the department must implement the ICES in DPCC to mitigate the risk of undervaluation and overvaluation of these sensitive commodities.*

2.4 Physical examination of consignments

According to circular no. 9/2006-07 dated 1 July 2006, issued by the Reserve Bank of India (RBI), customs authorities are required to examine and certify the value of the goods exported in the guaranteed remittance (GR) form to be submitted by the exporters to their respective banks.

The Board has not fixed any norms for physical examination of goods during import or export by a SEZ unit, to adhere to the RBI requirement. We found that 10,010 consignments of total

FOB value of Rs. 198.30 crore were cleared for export from SEZ Surat, during the period 2005-06 to 2007-08, without any physical examination.

On the matter being pointed (November 2008 and April 2009), Deputy Commissioner of Customs, SEZ, Surat replied (March 2009) that as per SEZ Rules 2006, export of SEZ unit need not be examined and export is on the basis of self certification.

Similarly, four SEZ units, engaged in trading activity under MSEZ, Chennai imported diamonds valued at Rs. 985.65 crore during the period 2005-06 to 2008-09. These were assessed on the basis of supplier's invoice alone.

In our opinion, the absence of any form of physical examination implies that there is no check on the risk of undervaluation/overvaluation of goods in imports/exports. The requirements of RBI are also not being fulfilled.

Recommendation No. 3

- *We recommend prescription of norms for physical examination of goods cleared by the SEZ units adhering to the RBI requirements and to prevent any loss of revenue.*

2.5 Duty rates for 'Gold coins' and 'Gold in any form'

Notification no. 62/2004-cus dated 12 May 2004 provides that the expression 'gold in any form' or 'silver in any form' shall include medallions and coins, but shall not include foreign currency coins. The notification also provides that customs duty is leviable on 'gold coins' at the rate of Rs. 100 per 10 gm (Sl. no. 1) and on 'gold in any form' at the rate of Rs. 250 per 10 gm (Sl. no. 2).

The notification is ambiguous because it gives a lower rate of duty for gold coins in comparison to 'gold in any form' whereas it also provides that gold coins are included in the term 'gold in any form'.

We found that 16,904.85 kg of gold coins with assessable value of Rs. 888.80 crore were imported through customs commissionerates at ACC, Chennai, ACC, Coimbatore, NCH Delhi, ACC, Bangalore and ACC, Mumbai, in 270 consignments, between April 2005 and November 2008 and were assessed at the rate of Rs. 100 per 10 gm. Had the duty been collected at the higher rate of Rs. 250 per 10 gm, Rs. 36.14 crore of additional revenue would have been generated.

On the matter being pointed out (July 2006, January and February 2009), customs commissionerate at Coimbatore issued (October 2006 to September 2008) SCNs for an amount of Rs. 1.67 crore but stated (November 2006 and April 2009) that duty concession was allowed correctly in terms of Sl. no. 1 of the notification read with Board's circular no. 40/2004 dated 4 June 2004,. The Supreme Court had held that when a notification contained two different rates for specific commodity, only beneficial rate would be extended and as per principles of classification, specific entry would be preferred to residuary entry for the purpose of levy of duty.

The reply underlines the ambiguity in the notification. If it had clarity, the interpretation would be self evident and it would not be necessary to resort to Supreme Court decisions and principles of classification to decide on the rate of duty.

Recommendation No. 4

- *We recommend that the ambiguity in the notification may be clarified so that 'gold coins' can be classified as a unique item subjected to a specified rate of duty.*

2.6 Procurement from domestic tariff area on payment of foreign exchange

According to Rule 53 of the SEZ Rules 2006, the units in SEZ have to achieve a positive net foreign exchange (NFE) over a period of five years from the commencement of production. The NFE is calculated by subtracting the total CIF value of imports from the total FOB value of exports by the units. The rule also specifies that one of the components of the export earnings is the value of goods sold to DTA against payment in foreign exchange.

In our opinion, if goods sold to DTA are included under exports, then the goods procured from DTA by paying foreign exchange should also be included under imports to give a realistic picture of NFE. We found that there is no such provision in the rules and, therefore, the NFE gets grossly

overstated. There is also a probability that a positive NFE could actually turn to negative if DTA purchases are included in imports.

Our contention is further supported by the provision that the sale of goods by DTA units to SEZ units are treated as 'deemed exports'² for the former, who become eligible for matching duty free imports under the exemption remission schemes of FTP. By the same analogy, procurement from DTA by EOU/SEZ unit should also be considered as 'deemed imports' for the SEZ unit.

Two cases of overstated NFE in Mumbai SEZ are illustrated below:

M/s Jewalex International Pvt. Ltd. had total export and import of Rs. 228.44 crore and Rs.166.84 crore respectively during 2006-08 and achieved a positive

² According to chapter 8 of FTP 2004-2009, 'deemed exports' refers to the transaction in which goods supplied do not leave the country and payment for such supplies is received either in Indian rupees or in free foreign exchange

NFE of Rs. 61.60 crore. However, if the DTA procurement of Rs. 51.01 crore is considered as imports, the NFE works out to only Rs. 10.59 crore.

Similarly, M/s Goldiam Jewels Ltd. had a positive NFE of Rs. 6.08 crore which reduces to only rupees one crore if DTA procurement of raw material amounting to Rs. 5.08 crore is considered as imports.

Recommendation No. 5

- *We recommend that the Government should introduce a provision in the SEZ rules to consider sales by DTA units to SEZ units, on foreign exchange payments, as ‘imports’ by SEZ units for the purpose of calculating NFE.*

2.7 Minimum value addition prescribed for EOUs but not for SEZ units

According to paragraph 4A.2.1 of HBP, Volume-I (2004-09), an exporter of gold/platinum/silver jewellery has to achieve prescribed minimum value addition to get benefit of various schemes for exemption/remission scheme of duty. An EOU also has to achieve similar value addition.

We observed that a similar provision has not been included in SEZ Rules 2006 and FTP. Consequently, SEZ units have an undue advantage over EOU and DTA units. We found that nine SEZ units out of the 47 EOU/SEZ units audited by us under SEZ, Chennai, Cochin and Mumbai had exported without

minimum value addition. They had availed of duty exemption of Rs. 89.58 lakh on imports. Had these exports been made by EOUs, they would have had to pay duty of Rs. 89.58 lakh for not achieving the prescribed value addition.

It is evident that while the units under SEZ scheme and EOUs are both involved in export oriented activity and enjoy similar benefits of duty free inputs, the absence of value addition norms for SEZ units gives them an unfair advantage over EOUs.

Recommendation No. 6

- *We recommend that the Government may consider introducing a suitable provision in the SEZ rules to prescribe a minimum value addition by the SEZ units to bring them at par with the EOUs, thereby providing a level playing field.*

2.8 Annual performance reports of exporters

According to rule 22 of SEZ Rules 2006, every unit in a SEZ has to maintain proper accounts and furnish Annual Performance Report (APR) in the prescribed format to the Development Commissioner (DC) of the SEZ duly certified by a chartered accountant (CA). There is a similar provision for EOUs in HBP, Volume I (2004-09).

The EOU/SEZ schemes rely mainly on self-certification and the rules do not require the APRs to be supported by other statutory documents like annual accounts, customs records, income tax (IT)

returns, bank realisation certificates (BRC) etc. We correlated the data furnished by the units in their certified APRs, with data available in the stock register, sale register and customs records, etc. and found discrepancies in ten units (two EOUs and eight SEZ units) under Noida SEZ and Cochin SEZ. Two EOUs under Noida and Cochin SEZ had reported inflated FOB value of exports, one SEZ unit in Noida had under reported CIF value of imports and inflated the exports and seven SEZ units under Noida had delayed submission of APRs ranging between 21 days and two years.

The APR data forms the basis for verifying whether the units have indeed achieved the required positive NFE and also as a monitoring mechanism to ensure that the units are functioning within the ambit of the applicable rules. Thus, the discrepancies in the data can distort the NFE and delays in submission of APR weakens the monitoring mechanism.

Some illustrative cases are given below:

(i) M/s Agra Products Pvt. Ltd, an SEZ unit in Noida SEZ had shown import of capital goods during the year 2007-08 as Rs. 81.22 lakh and cumulative import of capital goods as Rs. 2.61 crore in its certified APR. We found from the stock registers that the unit had actually imported capital goods of Rs. 1.21 crore in the year 2007-08 and cumulative import was Rs. 5.44 crore. Further, as against the value of exports amounting to Rs. 25.70 crore shown in APR for the year 2006-07, the actual export as per sales ledger was Rs. 25.19 crore. This has resulted in inflation of cumulative NFE by Rs. 3.34 crore.

(ii) M/s Vaibhav Gems, an EOU under Noida SEZ, had shown export of value of Rs. 236.72 crore in the APR submitted for the year 2006-07. We found from the accounts of the unit that actual export was Rs. 236.15 crore. Thus, the unit overstated the value of exports by Rs. 57.66 lakh in their APR submitted to the DC, Noida SEZ. This has resulted in inflation of NFE by Rs. 57.66 lakh.

Recommendation No. 7

➤ *We recommend that the department should institute a suitable control mechanism to get assurance on the reliability of the data furnished in APRs and ensure their timely submission.*