Chapter 1
Introduction

1.1 EPCG Scheme: The background

The Export Promotion Capital Goods (EPCG) Scheme is one of the earliest export promotion schemes presently in operation. It was introduced on 1st April 1992. The scheme grants licences to exporters to import capital goods at a concessional rate of customs duty. The licencees have to fulfil an export obligation (EO). This means that they have to export a prescribed quantity of goods related to the capital goods being imported under the scheme, within a prescribed number of years from the date of issue of licence.

As the general duty rates on imports fell over time, the concessional rates were also revised downwards. The export obligation on new licencees was reduced substantially in 2004 and the basis for calculation of EO was changed from the CIF value of imports to quantum of duty saved.

The Ministry of Finance statistics showed that the total revenue forgone on this scheme from 2005-06 to 2009-10 was ₹ 38,188 crore. The DGFT intimated that 89,000 licences had been issued between the year 2000 and 2008 of which 63 per cent were issued from Mumbai, Delhi, Coimbatore, Chennai and Bengaluru.

1.2 Process of EPCG Authorisation

The scheme is administered by the Regional Licensing Authorities (RLAs) under the Director General of Foreign Trade (DGFT), Ministry of Commerce. The provisions governing the EPCG Scheme are contained in Foreign Trade Policy (FTP). Detailed procedural aspects are available in the Handbook of Procedures (HBP) notified by Director General of Foreign Trade under Ministry of Commerce and Industries. For being eligible for grant of an authorisation, an applicant must possess, inter alia, a valid IEC[1] code, a nexus certificate showing the production relationship between the machinery to be imported and the items to be exported towards fulfilment of export obligation. The application for licence is to be submitted to the RLA as specified under the Handbook of Procedures of the Foreign Trade Policy. The RLA verifies the information on the application and is required to issue the authorisation, known as EPCG licence, within three days. The applicant is thereafter referred to as authorisation holder or licencee.

[1] Importer Exporter code

As the scheme involves forego of substantial customs revenue, certain responsibilities relating to the monitoring of fulfilment of export obligations (EO) are vested with the Customs Department. The licence issued by the RLA should be submitted thereafter by the licencee to Customs for registration followed by execution of bond and Bank Guarantee. The jurisdictional Commissioner of Customs has to do random verification of some of the authorisations registered at his port to check the correctness of addresses mentioned in the authorisation. On discharge of export obligation, the licencee makes an application of redemption to the Regional Licensing Authority concerned. The RLA issues an Export Obligation Discharge Certificate (EODC) to the Authorisation holder and sends a copy of the same to the Customs Authority with whom the Bond and Bank guarantee had been executed.

In case, the licencee fails to fulfil the prescribed export obligation, he has to pay the customs duty foregone plus interest. The RLA may initiate penal proceedings against the authorisation holder for failure to fulfil the conditions prescribed.

1.3 Audit Objectives

The review was conducted to assess whether:

A. the Regional Licensing Authority conducts due verification of documents and declarations mandatorily submitted by the IEC holder with the applications.
B. the export obligation is fixed correctly taking into account the duty saved and the previous three years' exports.
C. the licensing authorities ensure that licences are not issued to defaulters and ineligible applicants
D. the RLA/ Customs Department ensure that the capital goods have been imported within the prescribed time limit, have been installed and the licencee submits reports on the progress in fulfillment of export obligation.
E. the EPCG authorisation is redeemed timely and after verifying the discharge of export obligation.

1.4 Scope and methodology of Audit

As the period allowed for fulfillment of export obligation is eight years, we checked two sets of licences – those that have been issued after April 2007 and another set issued prior to March 2003 for which redemption would be due by March 2011. We conducted the audit in 12 JDGFT Offices[2] (RLAs) which had issued the highest number of licences. They

[2] Regional Licencing Authorities at Ahmedabad, Bengaluru , Chennai, Coimbatore, Delhi, Ernakulum, Hyderabad, Kolkata, Ludhiana, Madurai, Mumbai and Pune.

were located in nine states[3]. These RLAs have issued a total of 52,114 licences. We selected a sample of 1814 current licences i.e. issued after April 2007, which was the basis for scrutiny of the first four audit objectives. In some cases we used the entire sample and in other cases, subset of the entire sample, as per requirements of the audit procedures. For the last audit objective on redemption of licences, we selected 461 licences in which redemption was due as the period of EO was over and another 421 licences which had already been redeemed.

We also covered 22 Customs Commisionerates[4] linked to the selected RLAs. We carried out physical verification of the installation of machinery imported under the scheme at the premises of 224 licencees. The audit was conducted from December 2010 to March 2011.

1.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and Ministry of Commerce and Industries and their field formations in providing necessary information and records during the conduct of this audit. The objectives, scope and audit methodology for the review was discussed in entry conference held on 8 December 2010 with both the Ministries. The draft report was issued to both the Ministries in July 2011. The audit findings and recommendations were discussed in an exit conference held on 7 September 2011 with both the Ministries. The written responses, from the Ministries wherever received, have been appropriately incorporated in this report.

[3] Andhra Pradesh, Tamil Nadu, Delhi, Gujarat, Karnataka, Kerala, West Bengal , Maharashtra and Punjab,

[4] Kandla, ICD Ahmedabad, Mundra, Ahmedabad Air Cargo, Cochin, Air Cargo Hyderabad, ICD Hyderabad, Kolkata (Sea) Port, Kolkata (Air), ICD Bengaluru, Bengaluru Air, ICD Patparganj, ICD Tuglakabad, NCH, New Delhi, NCH- Mumbai, Mumbai (Air), JNCH, Tuticorin (sea) , Tuticorin (St Johns'), Chennai (Sea), Chennai (Air) and Ludhiana.