

## Duty Entitlement Pass Book (DEPB) Scheme

### Chapter I: Introduction

#### 1.1 Background

With a view to continuously increase India's global trade and to use trade expansion as an instrument of economic growth, several fiscal incentive schemes have been launched by the Government of India. Duty Entitlement Pass Book (DEPB), as an incentive scheme was notified vide circular no. 10/1997 dated 17 April 1997. DEPB scheme substituted the Value Based Advance Licencing (VABAL) scheme and the Pass Book scheme of the earlier Exim policy. DEPB scheme initially consisted of two sub-schemes, viz 'Pre-export DEPB' and 'Post-export DEPB'. The pre-export DEPB scheme was abolished with effect from 1 April 2000. After several extensions through the years, the post-export scheme was phased out on 30 September 2011 vide public notice no. 54/2010 dated 17 June 2011 and thereafter DEPB items were incorporated into the Duty Drawback Schedule with effect from 1 October 2011 vide Ministry of Finance, Department of Revenue, Central Board of Excise and Custom (CBEC) Circular no. 42/2011-Cus dated 22 September 2011, bringing the curtains down on this popular export incentive scheme after eight and a half years of sporadic extensions.

Performance of the scheme was audited by C&AG in the year 2000 with the objective to verify whether the (a) benefits of duty credit allowed under the scheme were commensurate with the actual incidence of duties of customs suffered by exporters, (b) scheme was implemented as per the relevant notification, rules and procedures, (c) monitoring and interdepartmental co-ordination mechanisms was efficacious, and (d) DEPB scheme plugged the loopholes of the erstwhile VABAL scheme.

Audit *inter alia* commented upon (i) the duty credit allowed which were unrelated to actual incidence of duty (ii) not-debiting the SAD in Pass Book (iii) unjustified exemption from SAD (iv) unintended benefits of DEPB credit due to late fixation/non revision of value caps (v) absence of provisions to prevent negative value addition (vi) incorrect fixation of DEPB credit rates (vii) non-revision/delay in revision of credit rates (viii) incorrect set off of duty on import of negative list inputs against credit rates (ix) imports in excess of the limit prescribed in DEPB (x) non-application of rates on the date of Let Export Order (xi) excess/irregular grant of DEPB credit (xii) overvaluation of goods (xiii) non realisation of foreign exchange etc.

Various facets of the scheme were once again audited in 2004-05 reiterating that (a) duty credit was not related to actual incidence of duty (b) there were

unintended benefits of DEPB credit (c) certain export proceeds were not realised (d) certain DEPB rates were incorrectly fixed (e) items not specified in DEPB schedule were granted credit (f) incorrect DEPB credits were granted (h) DEPB clearance restrictions were not imposed. Further, twelve audit observations on various aspect of DEPB scheme have also been reported in the Compliance Audit Reports on Customs from 2005-06 to 2011-12.

The mandate of the Department of Commerce (DoC) is regulation, development and promotion of India's international trade and commerce through formulation of appropriate international trade and commercial policy and implementation of the various provisions thereof. The basic role of the Department is to facilitate the creation of an enabling environment and infrastructure for accelerated growth of international trade. The Department formulates, implements and monitors the Foreign Trade Policy (FTP) which provides the basic framework of policy and strategy to be followed for promoting exports and growth. Report of the Working group on "Boosting India's Manufacturing Exports" of DoC for XII<sup>th</sup> Plan period chaired by Secretary DoC, provides an interesting insight into the evolution and pertinence of both international trade and domestic manufacturing challenges, leading to export and growth.

Director General of Foreign Trade (DGFT), New Delhi, a 'responsibility center' of DoC under the PMES<sup>1</sup> is headed by Director General and is an attached office under the administrative control of DoC. DGFT is assigned the role of a 'facilitator' with responsibility to implement the FTP and promote India's exports. DGFT also issues licenses to exporters and monitors their corresponding obligations through a network of 41 Regional Offices (Regional Authorities).

Objectives in the Result Framework Document (RFD) of DoC included increase in exports and implementation of trade facilitating measures to improve trade environment for accelerating growth of exports. DoC has not assigned priority to the review of the outcome of the export promotion schemes under FTP 2009-14. According to Outcome Budget of DoC, the department had not fixed any quantifiable deliverables against the budget outlay for the export subsidy granted. No documentation was made available to show if the scheme was analysed for revenue impact prior to its implementation while transiting from VABAL to DEPB.

Similarly, as per paragraph 3.1 (XIII) of the Strategic Plan of DoC, DGFT is responsible for implementation of various provisions and schemes under FTP and is the main interface with the trading community. Accordingly, a

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<sup>1</sup> Performance Monitoring and Evaluation System of Cabinet Secretariat.

comprehensive review of the various export promotion schemes was to be undertaken and the schemes reformulated to make them more effective, but DEPB has not been reviewed by DoC; therefore, the achievements of this scheme as claimed by DoC are mostly unsubstantiated.

The Scheme was subjected to vigorous questioning during successive trade policy review of India by World Trade Organisation (WTO). The computation of DEPB credit has been treated as countervailable because of the subsidies provided by it and has been proceeded against by US, Canada and EU between 1999-2002. Ministry of Commerce, in turn engaged experts (NCAER, ICRIER, NIPFP etc) to formulate a new scheme to replace DEPB; moreover, from 2002 onwards, closure of the scheme was contemplated which finally materialized in September 2011. In the mean time, successive extensions were granted on grounds of making the exports competitive.

While a new scheme to replace DEPB was being explored by DoC, DEPB items were finally incorporated in duty drawback schedule from 1 October 2011. Given the slow progress of Doha rounds of talks in WTO, comprehensive bilateral Free Trade Agreements (FTAs) and Regional Trade Agreements (RTAs-SAARC, ASEAN) were engaged in. CECA<sup>2</sup>, Singapore was negotiated in this background. The revealed competitive advantage and trade advantage of India computed for this agreement included trading advantage to the Indian exporters because of the extant FTP which included DEPB.

Therefore, it was imperative to conduct a performance audit, taking into account both inter-related components of the scheme (DEPB) and non scheme, Preferential Trade Agreement (PTA) related incentives (CECA) to exports which could help in formulating reward and incentive schemes by DoC in future, to promote exports, strengthen the manufacturing exports and yet not attract anti-subsidy countervailing duties worldwide.

## **1.2 Objectives of the scheme**

The objective of DEPB Scheme was to neutralise incidence of customs duty on import content of export product. Neutralisation was provided by way of grant of duty credit against export product. Duty credit under the scheme was calculated by taking into account deemed import content of said export product as per Standard Input-Output Norms (SIONs). Value addition achieved by export of such product was also taken into account while determining the rate of duty credit under the scheme {paragraph 4.37 of Hand Book of Procedure (HBP) vol.1}. Value caps were imposed on export products having high DEPB rates to curb the misuse of the incentive.

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<sup>2</sup> Comprehensive Economic Co-operation Agreement

DEPB duty credit thus availed was utilised by exporters for adjusting customs duty, both basic and countervailing duties (CVD), against import of any importable items/restricted items into India. The exporters could use the credit for importing any product, and not necessarily the material used in the export product. DEPB and/or the items imported against it were freely transferable. DEPB Scrips could also be utilised for payment of duty against import under Export Promotion Capital Goods (EPCG) Scheme.

### **1.3 Process of sanction of duty credit**

Under the scheme, an exporter was allowed credit on duty payments as a percentage of the free on board (FOB) value of exports made. Credit was provided at the time of export at an *ad valorem* rate notified by DGFT, in relation to the FOB value of the export product. These rates were based on the computation of basic customs duty (BCD) paid by the exporters on the inputs listed in SIONs applicable to the export product. The crucial feature of DEPB scheme was that all the inputs listed under the SION were deemed to have been imported and to have been subjected to customs duties. The credit under DEPB scheme allowed import of any item except the items which are otherwise restricted for imports.

### **1.4 Audit Objectives**

The system in place was test checked in audit for DEPB scheme during the scheme tenure with a view to seek assurance regarding:

- a. Effectiveness of the internal control procedures and internal audit system for management of the scheme by DoC, DGFT and Customs;
- b. Efficacy of the monitoring and interdepartmental co-ordination mechanism involved in administration of the Scheme;
- c. Analysis of the rates of DEPB items after being incorporated under Duty Drawback Scheme;
- d. Implication of a Preferential Trade agreement (CECA, Singapore) on export under DEPB scheme;
- e. Compliance with the extant provision to guard against any irregular issue and use of DEPB scrips;
- f. Fixation of DEPB rates;
- g. Timely disposal of scrip applications.

### 1.5 Audit Scope, Sample and Criteria

Audit scrutinised DEPB scrips in a sampled population in 28 RAs<sup>3</sup> out of 36 RAs of DGFT, 7 DC-SEZ<sup>4</sup> out of 8 SEZs of DoC and 31 Customs ports (Appendix I). In these 28 RAs, 5,64,321 DEPB scrips amounting to ₹ 51,489 crore were issued during 2005-06 to 2011-12. 12,139 valid scrips were issued during 2011-12. 4,443 DEPB scrips were scrutinised. Similarly, in the seven SEZs, 2,592 DEPB scrips amounting to ₹ 104.66 crore were issued, out of those 508 scrips were selected for audit scrutiny. Sample for the performance audit was selected, based on the volume of DEPB scrips issued in the field formations of DGFT using stratified random sampling with strata as tabulated below:-

**Table: 1**

Sl. No.	Value of DEPB scrips	Sample size
1.	₹ 1 crore and above	100 per cent
2.	Above ₹ 50 lakh and upto ₹ 1 crore	50 per cent
3.	Above ₹ 10 lakh and upto ₹ 50 lakh	5 per cent
4.	Above ₹ 5 lakh and upto ₹ 10 lakh	1 per cent
5.	Below ₹ 5 lakh	0.2 per cent

Records relating to DEPB scheme maintained by DGFT were also scrutinised.

The records were audited inter alia, with reference to the following:

- RFD of DoC, DGFT and CBEC.
- Strategic Plan; Outcome budget of DoC; Receipt Budget of DoR.
- FTP 2009-14.
- Hand Book of Procedures, Volumes I and II.
- CECA, Singapore Agreement.
- Public notifications, Circulars and orders issued by DGFT.
- Customs notifications, circulars etc of CBEC.
- Reports on DEPB scheme and CECA, Singapore.
- C&AG's Audit Reports 2000 and 2004-05.

At the commencement of the performance audit, an entry conference was held with DGFT on 12 April 2013 wherein audit methodology, scope, objectives and sampling were explained. Simultaneously, entry conferences were held by the Director Generals/ Principal Directors of Audit with RAs involved in the implementation of the scheme. Exit conference was held on 15 January 2014. The draft PA report was again sent to DoC (DGFT)/DoR (CBEC) for final comments.

<sup>3</sup>Delhi, Bhopal, Raipur, Mumbai, Pune, Goa, Chennai, Coimbatore, Madurai, Puducherry, Kochi, Thiruvananthapuram, Kolkata, Panipat, Jammu, Ludhiana, Amritsar, Chandigarh, Hyderabad, Vishakhapatnam, Cuttack, Ahmedabad, Bengaluru, Jaipur, Kanpur, Moradabad, Varanasi, Dehradun

<sup>4</sup>Indore, Mumbai, Chennai, Kochi, Falta, Kandla, Noida

### 1.6 Financial outlay and domain of Audit

In pursuance to the Fiscal Responsibility and Budget Management Act, 2003 (FRBM) the Government started showing estimates of major tax expenditure under Central Tax System from the Receipt Budget, 2006-07 onwards. Though the statement of revenue forgone under Central Tax System in the Receipt Budget of the Union Government indicates the tax expenditure on DEPB scheme, there was no budgetary provision for the scheme of the Department of Commerce. The benefits were given in the form of duty credit scrips that could be used to pay the import duty at the time of actual import. There were no statement of scheme outcome in FRBM disclosures as envisaged by Finance Commission. During the year 2005-06 to 2011-12, DEPB scrips valuing ₹ 51,489 crore were issued by DGFT (Table 2) and DEPB scrips with duty credit of ₹ 104.66 crore were issued by seven SEZs.

DGFT could not provide the number of DEPB authorisations issued by RAs and DCs SEZ all over the country, FOB value of export, value of duty credit allowed for imports during the years 2005-06 to 2011-12. Table 2 summarizes information as made available to audit by RAs and SEZs.

**Table: 2**

Year	Number of DEPB authorizations issued (Nos.)	Amount of authorizations (₹ In crore)	FOB value of export (₹ In crore)	Revenue forgone* (₹ In crore)
2005-06	1,20,902	5,010	1,10,267	5,650.00
2006-07	1,04,752	4,618	1,20,495	4,842.00
2007-08	91,508	5,496	1,25,183	5,311.50
2008-09	1,10,856	7,729	1,67,410	7,087.49
2009-10	1,12,413	8,267	1,68,044	8,008.45
2010-11	11,750	9,204	1,97,664	8,736.40
2011-12	12,139	11,165	2,50,532	10,404.37
<b>Total</b>	<b>5,64,321</b>	<b>51,489</b>	<b>11,40,495</b>	<b>50,040.21</b>

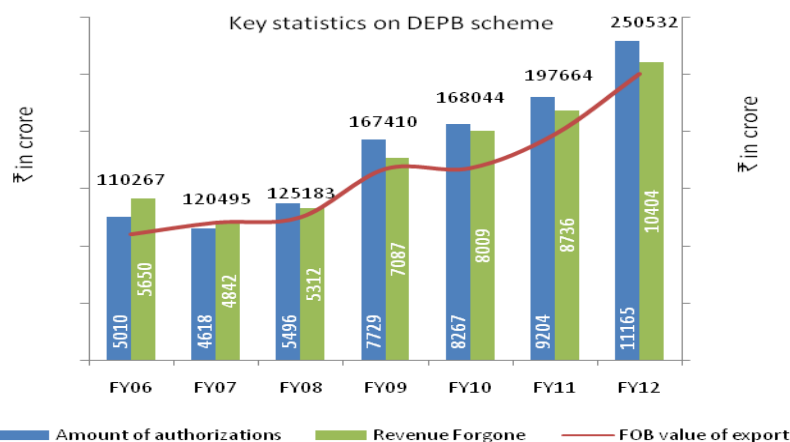
(Source-DGFT)

(\*Source-Department of Revenue)

Analysis of year wise DEPB scrips issued during FY06 to FY10 revealed that scrips were mostly issued for chemical and allied products, engineering products, textile products and packing material as detailed in Appendix II.

As per the information furnished by the 28 RAs and 7 SEZs where audit was conducted, total number of DEPB scrips issued, duty credit and FOB value of export allowed for the period 2005-06 to 2011-12 is given in Appendix III and IV. The all-India figures published in DGFT's Annual report and information furnished by individual RAs and DCs do not match clearly indicating that there was lack of control on the information/reports furnished by the RAs. The same was also not reconciled by DGFT during the second journey after the Exit conference. Audit has relied upon the data presented to audit by DGFT, DoC, DoR and their field formations. The duty forgone (₹ 10,404 crore) under DEPB scheme during FY 12 was nearly 16 per cent of the total duty forgone under 17 export promotion schemes of the Government.

The summary of DEPB scrips issued vis-a-vis scrips utilised and duty forgone against them is given in Appendix V.



**Table: 3**  
**Average rate of DEPB credit**

Year	DEPB credit	duty	FOB value of Export (₹ In crore)	Average rate
2005-06	5,010		1,10,267	4.54
2006-07	4,618		1,20,495	3.83
2007-08	5,496		1,25,183	4.39
2008-09	7,729		1,67,410	4.62
2009-10	8,267		1,68,044	4.89
2010-11	9,204		1,97,664	4.66
2011-12	11,165		2,50,532	4.46

Source: DGFT

Though the peak rate of Customs duty over a period from 2005-06 to 2011-12 had declined by 50 per cent (from 20 per cent to 10 per cent), however, the average rate of DEPB credit over a period of seven years between 2005-12 had remained almost the same at 4.48 per cent.

The year-wise details of import under PTA-CECA Singapore during 2005-06 to 2012-13 were as under:

**Table: 4**  
**Import under PTA-CECA Singapore during 2005-06 to 2012-13**

Year	Assessable Value of imports	Growth per cent	Duty Payable	Duty Forgone	Value of Export	Growth per cent
2005-2006	743.04	-	119.79	101.54	24019.65	--
2006-2007	1,633.37	1.19	350.18	241.48	27461.61	4.80
2007-2008	2,020.26	0.23	389.85	293.74	29662.23	4.52
2008-2009	3,299.58	0.63	625.11	437.58	37756.88	4.49
2009-2010	3,274.58	-0.01	419.11	470.19	35948.30	-4.25
2010-2011	4,823.31	0.47	679.94	617.18	44731.73	3.91
2011-2012	5,191.11	0.07	701.95	783.42	80362.99	5.48
2012-2013	6,245.30	0.20	1,031.51	695.19	73994.97	4.52
<b>TOTAL</b>	<b>27,230.54</b>	<b>0.40 (Avg)</b>	<b>4,317.45</b>	<b>3,640.32</b>	<b>3,53,938.40</b>	<b>3.35 (Avg)</b>

Worldwide recession started from 2009-10. DEPB was completely phased out from September 2011. An analysis of data furnished by DoR, Ministry of Finance revealed that total amount of duty forgone on import under CECA Singapore for the year 2005-06 to 2012-13 was ₹ 3,640 crore against import of ₹ 27,231 crore with staggered growth of 0.40 per cent after signing the agreement. Export grew at a much higher rate of 4.7 per cent.