

EXECUTIVE SUMMARY

Customs duty is levied on import of goods into India and on export of certain goods out of India (Entry 83 of List 1 of the Seventh Schedule of the Constitution). Customs receipts form part of the indirect tax revenue of the Government.

Duties of Customs are levied under the Customs Act, 1962 (the Act), and the rates of duties are governed under the Customs Tariff Act and notifications issued from time to time.

Customs receipts before the introduction of Goods and Services Tax (GST) comprised of the Basic Customs duty (BCD), Countervailing duty (CVD) and Special additional duty of Customs (SAD). After introduction of GST w.e.f. 1 July 2017, the CVD and SAD on import of all commodities, except petroleum products and spirits, have been subsumed and replaced by Integrated Goods and Services Tax (IGST).

Department of Revenue (DoR) under Ministry of Finance (MoF) is responsible for administration of Indirect taxes and Direct taxes, through two statutory Boards namely, the Central Board of Indirect Taxes and Customs (CBIC) and Central Board of Direct Taxes (CBDT) constituted under the Central Board of Revenue Act, 1963.

The levy and collection of Customs duty and cross-border preventive functions are administered by the CBIC through 70 Customs Commissionerates across the country.

The Department of Commerce (DoC) under Ministry of Commerce and Industry (MoCI), through Directorate General of Foreign Trade (DGFT) 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 trade.

During 2018-19, exports worth ₹23.08 lakh crore (1,33,60,422 transactions) and imports worth ₹35.95 lakh crore (1,21,88,592 transactions) took place. The Customs receipts to GDP ratio was 0.62 *per cent* while Customs receipts as percentage of gross tax receipts was six *per cent*. Customs receipts as a percentage of indirect taxes was 14 *per cent*.

The compliance audit of Customs revenue covers transactions involving levy and collection of Customs duties, any other levies of Customs, transactions of imports and exports undertaken under various schemes implemented under the FTP and specific compliance areas reviewed by audit from time to time.

This year the compliance audit had reviewed the “Show Cause Notices (SCN) and Adjudication process” in Customs Commissionerates/ Regional authorities (RA) of DGFT and Development Commissioners (Special Economic Zone) (DC-SEZ)). The transactions covered in this report pertain to FY 2018-19, but in some cases prior period transactions have also been reviewed for getting a holistic picture.

The sample of Commissionerates selected for test check included 48 out of total of 70 Customs Commissionerates. We audited 285 assessment units and 206 non-assessment units working under the Customs Commissionerates selected for audit. The audit was based on the examination of Bills of Entry (BsE) and Shipping bills (SBs) filed electronically into the Indian Customs EDI System (ICES) through a Customs House Service Centre or web based ICEGATE. In non-EDI Customs locations, the BsE and SBs are physically filed and assessed. The ICES uses Risk Management System (RMS) to process the data through a series of automated steps and results in an electronic assessment. This assessment determines whether the BE will be taken-up for action, i.e. manual appraisal by assessing officer or examination of goods, or both, or be cleared after payment of duty and out of charge directly, without any assessment and examination. We audited BsE and SBs cleared by both the RMS and manual appraisal system.

Audit of incentives provided under FTP was carried out in 28 RAs under the DGFT through test check of license files under various schemes of the FTP.

This report is divided into five chapters. Chapter I provides a brief description of functions of DoR and DoC and an overview of statistical information regarding Customs receipts, India’s Imports and Exports, performance of Special Economic Zones, arrears of Customs receipts and results of Department’s internal audit. Chapter II describes the CAG’s audit mandate, scope and results of audit efforts. Chapters III, IV and V contain significant audit findings. There are 114 paragraphs with revenue implication of ₹10,909 crore in this report. In 93 paragraphs involving money value of ₹62 crore, rectificatory action has been taken by the Department/Ministry in the form of issuing SCNs, adjudicating SCNs and recovery of ₹32 crore in 66 cases has been effected till date.

Responses received from DoC and DoR have been included in the report at appropriate places.

Chapter I: Overview- Customs Revenue

- After introduction of GST w.e.f. 1 July 2017, the CVD and SAD on import of all commodities, except petroleum products and alcohol, have been subsumed and replaced by IGST. The IGST is in addition to the applicable BCD which is levied as per the Customs Tariff Act. In addition, GST compensation cess is also leviable on certain luxury and demerit goods under the GST (Compensation to States) Cess Act, 2017. Levy of education cess as well as anti-dumping duty and safeguard duty remains unchanged.

{Paragraph 1.4.2}

- During FY 2018-19, Customs receipts realised were ₹1,17,813 crore as against ₹1,29,030 crore realised in FY 2017-18. One of the reasons for decrease in the Customs receipts during FY 2018-19 may be attributed to the fact that after introduction of GST, CVD and SAD which used to be part of Customs receipts, have been subsumed into IGST.

{Paragraphs 1.6.1 to 1.6.3}

- Imports registered growth of 19.78 *per cent* during FY 2018-19, while Exports registered a growth of 17.95 *per cent* during the same period.

{Paragraph 1.7}

Chapter II: CAG's audit mandate and extent of Audit

- During FY 2018-19, audit issued 353 inspection reports to the respective Commissionerates/ RAs containing 2,299 observations and carrying a revenue implication of ₹3,296 crore. Out of these, 114 audit observations with revenue implication of ₹10,909 crore noticed during FY 2018-19 have been included in this report. The remaining cases are being pursued by respective field formations.

{Paragraph 2.6}

Chapter III: Show Cause Notices and Adjudication process

- An SCN is issued when the Department contemplates any action prejudicial to the assessee, giving him an opportunity to present his case. SCN is to be served under Section 28(1) or 28 (4) of the Act, in the cases where Customs duty has not been paid or short paid or erroneously refunded. The issue of SCN under Section 28 (1) or 28 (4) of the Act is followed by adjudication which is a quasi-judicial function of the officers of the Customs department under the Act. There shall be a written Order in Original (OIO) after the completion of adjudication process, detailing facts of the case and justification of the adjudication order under Section 28 of the Act.
- Audit was conducted in 25 Customs Commissionerates, 12 RAs of DGFT and eight DC-SEZs. Audit examined the adjudication process of SCNs, SCNs

issued and OIOs passed during the financial years 2016-17 to 2018-19 and the SCNs pending for adjudication as on 31 March 2019.

- Audit noticed shortcomings in issue of SCNs, deficiencies in the process and procedures leading to adjudication, lack of proper follow up of adjudication and review orders and deficiency in monitoring and internal controls. Total 141 audit observations were issued with a money value of ₹10,649 crore.
- Audit of the issue of SCNs and adjudication process in Customs Commissionerates revealed non-compliance to the extant provisions of the Act and rules at various stages from Pre Notice Consultation (PNC) stage till issue of adjudication orders and follow up of review orders.
- On one hand, SCNs were issued instead of issuing a simple letter for failure of licence holder to submit proof of discharge of export obligation (EO) and on the other, failure to issue SCNs within the prescribed period rendered them time-barred. Extended period of time under Section 28 (4) of the Act was invoked even in cases where SCNs were ought to be issued within the normal period under Section 28 (1) of the Act.
- In case of SEZs, delays were noticed in issue of SCNs by DCs as well as dropping of SCNs by the Adjudicating authority because of non-adherence to prescribed procedures and mis-representation of facts.
- Absence of provisions for prescribed timelines for issue of SCNs and their adjudication in the Foreign Trade (Development and Regulation) {FTDR} Act, 1992 to act swiftly against the defaulters left discretion in the hands of administrative authorities of RAs and DCs and avoidable delays in recovery of Government revenue. Considerable delays were noticed in issue of SCNs by RAs, even though the EO period had already expired, including cases where the EO period expired 2 to 11 years ago.
- The SCNs were pending for adjudication beyond prescribed timelines, with highest pendency being 182 months beyond prescribed time limit, inspite of timelines for adjudication of SCNs being clearly laid out in the Act. Even in cases where adjudication was completed, there were considerable delays, with 37 *per cent* cases, representing 32 *per cent* of total revenue involved in delayed cases, getting adjudicated with delay of more than 6 months. The Personal Hearing (PH) was granted beyond permissible number and delays were noticed in issue of adjudication order even after holding last PH, leading to avoidable blocking of revenue. SCNs were pending adjudication for want of Relied Upon Documents (RUDs), a basic requirement for issuing SCN.

- In the absence of prescribed provisions in FTDR Act, 1992 regarding fixing of PH, it was noticed that the DCs were providing PH without any limit to numbers, leading to delay in adjudication.
- While the adjudication process itself was fraught with delays, deficiencies were noticed even in follow up of adjudication orders in both Customs Commissionerates and RAs.
- The DRI Intelligence Gathering and Investigation Tools (DIGIT), made mandatory since 1st April 2018 with the objective of creating a complete database of Customs offences was found to be partly functional.
- Deficiencies were also noticed in key monitoring and reporting mechanisms such as data discrepancies in Monthly Progress Reports, incomplete SCN and Confirmed Demand registers in Customs Commissionerates. The lax monitoring in RAs is evident from non-issuance of adjudication orders despite preparation of fact sheet.
- Inconsistencies were noticed in the redemption status of Export Promotion Capital Goods (EPCG) licences furnished by RA and Customs department. It was also noticed that Customs department was not using Export obligation discharge certificate (EODC) details available on DGFT's EODC Monitoring System, available in public domain, leading to non-closure of SCNs even in cases where EODC was granted by DGFT. Thus, in spite of standing orders on monitoring EO and sharing of information between the Customs and RAs through institutional mechanism, there is no established mechanism in place and the Departments continue to function as independent silos.
- *Audit recommended:*
 - (i) *Ministry may consider providing specific time limit in FTDR Act, 1992 for issuance and adjudication of SCN.*
 - (ii) *In order to give a fair opportunity to the noticee to reply to SCN and also to prevent unlimited discretion in hands of Adjudicating authority to allow any number of PH, express provision needs to be incorporated in the FTDR Act, 1992 regarding number of PH to be granted on same lines as in Customs Act.*
 - (iii) *The monitoring and reporting mechanisms need to be strengthened to ensure that timely and proper action as per the Act is taken by the field formations in issuing and adjudicating SCNs.*

- (iv) Cases of irregularities including issuance of SCN under inapplicable section of the Act may be examined in detail and responsibility may be fixed for errors of omission and commission.*
- (v) The database of Customs offences as envisaged under DIGIT must be completed in a time bound manner.*
- (vi) Monitoring of RAs need to be enhanced. Coordination between Customs Department and DGFT's EODC monitoring system needs to be improved.*
- (vii) As audit has checked only a sample of cases, the Department may examine all other cases also to identify and fix systemic deficiencies.*

{Paragraphs 3.1 to 3.5}

Chapter IV: Non-compliance to provisions of Customs Act, Customs Tariff Act and Tariff notifications

- Data for import and export transactions for the year 2018-19 was not received. In the absence of data, the conclusions in this chapter on compliance audit were based on limited audits carried out in the field. However, the range of audit findings noticed even in the test check point to systemic deficiencies that need to be addressed by the Department.
- During 2018-19, a total of 1.22 crore BsE and 1.34 crore SBs were generated, out of which Audit selected a sample of 4.09 lakh BsE and 2.21 lakh SBs. Significant audit observations with revenue implication of ₹10 lakh or more noticed during test check of import/export documents in the Customs Commissionerates have been reported in this Report. Audit has, wherever applicable, attempted to quantify potential risk to revenue by ascertaining the total number of similar transactions by using the import data received from CBIC for the year 2017-18.

The cases of non-compliance noticed during audit could be broadly categorized as follows:

- I. Incorrect application of notifications
 - II. Misclassification of imports
 - III. Incorrect levy of applicable levies and other charges
- Audit noticed 86 cases of under assessments of applicable Customs duties due to incorrect application of notifications, misclassification of imported goods and Incorrect levy of applicable levies and other charges, as result of which revenue of ₹233 crore was at risk etc.

{Paragraphs 4.1 to 4.13}

Systemic issues

Audit noticed systemic issues in few import cases wherein the Risk Management System (RMS) allowed clearance even though the prescribed import conditions were not fulfilled. The RMS needs to address the issues flagged by audit so that the prescribed import conditions are complied with and applicable duties are automatically charged once the BE passes through the system.

Few cases are mentioned below and also discussed in Chapter IV of the Report.

- Short levy of BCD on I phones (Smart phones) imports due to incorrect application of the notification.

{Paragraph 4.7.1}

- Short levy of BCD on incorrect exemption granted to 'Camera module and printed circuit Board Assembly'.

{Paragraph 4.7.2}

- Import of restricted commodity below Minimum Import Price.

{Paragraph 4.7.3}

- Improper exemption of IGST on import of pharmaceutical products.

{Paragraph 4.8.3}

- Incorrect application of IGST rate on import of Carpets and other textile floor coverings.

{Paragraph 4.8.5}

Persistent irregularities

Similar instances of non-realisation of cost recovery (establishment) charges from the units in the SEZ and misclassification of imports flagged to the Ministry in the previous Audit Reports continue to be reported in the Customs field formations, notwithstanding assurances of the CBIC that their field formations have been sensitised to check similar issues cautiously. Few cases are mentioned below:

- Non realisation of cost recovery charges from the developers.

{Paragraph 4.12.1}

- Misclassification of machinery for animal feed.

{Sl.No.5, Annexure 9}

- Misclassification of RFID tags.

{Sl.No.6, Annexure 9}

General Recommendations

Though the Ministry has taken corrective action to recover duty in many cases, it may be pointed out that audit paragraphs in this Report are only a few illustrative cases. There is every likelihood that such errors of omission and

commission, whether in RMS based assessments or manual assessments, may exist in many more cases. Audit has, wherever applicable, attempted to quantify potential risk to revenue by ascertaining the total universe of similar transactions by using the import data received from CBIC for the year FY 2017-18. These need to be examined by the Department.

It is pertinent to note that a large number of BsE examined by audit in test check had been assessed through the RMS which indicated that the assessment rules mapped into the RMS to facilitate system based assessments were inadequate.

The process of mapping and updating of risk parameters in the RMS also needs to be reviewed.

{Paragraphs 4.7 to 4.11}

Chapter V: Non-compliance to provisions of various Export Promotion schemes of FTP

Irregularities in Export promotion schemes of FTP

- Test audit of 28 RAs revealed instances of violations of prescribed rules, procedures framed to give effect to the provisions of the FTP and procedures regarding fulfilment of EO and awarding export incentives. Revenue of ₹27.74 crore was due from exporters/ importers who had availed the benefits of the duty under Export promotion schemes but have not fulfilled the prescribed obligations/conditions.
- Irregularities reported, especially the issue of non-fulfilment of EO and other non-fulfilment of conditions by exporter/ importer as per FTP seem to be widespread and need to be addressed by the DGFT, New Delhi and CBIC. The cases pointed out in above paragraphs are illustrative based on test check by audit and similar violation of rules and procedures and errors of omission and commission cannot be ruled out. Department is advised to review all cases of non-fulfilment of conditions of EPCG and other schemes and take necessary action. Appropriate action to recover the duty saved in cases pointed in Audit also needs to be taken.

{Paragraphs 5.1 to 5.3}