

CHAPTER II

IRREGULARITIES IN DUTY EXEMPTION/REMISSION SCHEMES

Directorate General of Foreign Trade (DGFT), under Ministry of Commerce and Industry is responsible for formulating and implementing the FTP with the main objective of promoting India's exports. The DGFT issues scrips/authorisation to exporters under various export promotion schemes and monitors their corresponding obligations through a network of 37 regional license offices (RLAs). All 37 RLAs are computerised and connected to the DGFT Central server.

To regulate imports under scrips/authorisation issued by DGFT under Customs notifications are issued by CBEC and these scrips has to be registered by the exporter concerned in the Customs house under the Commissionerates. Import of inputs and capital goods under export promotion schemes are exempt, wholly or partly from Customs duties. Importers of such exempted goods undertake to fulfill prescribed export obligations (EO) as well as to comply with specified conditions, failing which the full rate of duty becomes leviable.

During test check of records (July 2014 to February 2017), Audit noticed 39 persistent irregularities regarding non fulfillment of export obligation, short levy of duty on Domestic Tariff Area (DTA) clearances, non-achievement of minimum value addition, non-recovery of drawback where exports proceeds have not been realized, mis-utilization of duty credit scrips because of improper registration of scrips etc. These persistent irregularities indicate weak coordinating mechanism between DGFT and CBEC despite computerization of transactional data. Total revenue implication involved in these 39 cases was ₹ 46.50 crore where duty exemptions were availed of without fulfilling EOs/conditions. Out of these, 12 cases are discussed in the following paragraphs and 27 cases which have been accepted by the department and recoveries made/ recovery proceedings initiated are mentioned in **Annexure 4**.

2.1 Reward/Incentive schemes under chapter 3 and 4 of Foreign Trade Policy

In terms of chapter 3 of FTP 2009-14, the DGFT issues Status Holders Incentive Scheme (SHIS) duty credit scrips and Vishesh Krishi and Gram Udyog Yojana (VKGUY) scrips through various Regional Joint Director General of Foreign Trade offices (JDGFT). The scrip numbers printed on the scrips issued by DGFT offices is a system generated unique 10 digit number. scrips are freely transferable and can be utilized for importing goods without payment of duty to the extent credit is available. The export benefits for the schemes are determined as a percentage of Free on Board (FOB) value of shipping bills. For utilizing the duty credit, the scrip (issued in the form of a certificate by JDGFT office) has to be

registered at the port of registration by the exporter concerned manually in the Customs house.

As per section 28 AAA of the Customs Act, 1962, where an instrument issued to a person was obtained by collusion or wilful mis-statement or suppression of facts for the purpose of the Act or the Foreign Trade (Development and Regulation) Act, 1992 by any person and such instrument is utilized under the provisions of Act, rules or notification issued there under, by a person other than to whom the licence was issued, the duty relatable to utilization of such as instrument shall be deemed never to have been exempted or debited and the duty should be recoverable from the person to whom the said instrument was issued. This recovery action on the person to whom the scrip was issued is without prejudice to the action taken on the actual importer under section 28 of the Act.

Audit carried out an analysis of DGFT data (as on 31st March 2015) and the licence debit details maintained by Customs Department (ICES) (as on 31st March 2015) which revealed excess utilization of duty credit in respect of instruments issued under Chapter 3 of FTP through manipulation of registration of scrip/use of scrip by deploying following methods e.g. improper registration of scrips having single/double/three digits instead of mandatory 10 digit number, registering licences for imports which were not allowed (without Standard Input Output Norms (SION)), excess utilization of duty credit scrip at different ports.

The cases are discussed below:

Similar cases were also reported in Audit Report No. 1 of 2017 (Paragraphs nos. 4.1.1 to 4.1.5).

2.1.1 Mis-utilization of duty credit scrips because of improper registration of scrips

An analysis of licence debit details maintained by Customs Department (ICES) (up to March 2015) revealed that in 70 cases scrip number having single/double/three digits were registered at Chennai Sea port and utilized for importing goods for a duty foregone amount of ₹ 4.17 crore.

As these scrip numbers were not issued by any of the JDGFT offices as seen from the DGFT dump data, the matter was pointed (March 2016/March 2017) to Chennai Sea Customs authorities to check the genuineness of the scrips and if warranted, to take action as contemplated under the provisions cited.

Lack of appropriate validation controls, lacunae in the ICES system and manual transmission of licences details by DGFT to Customs made the system vulnerable to continued misuse which allowed registration of fake licences.

Assistant Commissioner (AC), Custom House, Chennai stated (April 2017) that importers have been directed to produce the scrip copy for verification and alerts have been raised against all the importers to expedite the matter.

As regards mis-utilisation of the scrips AC further stated that no such evidence have been placed before the department. However, on verification of the scrips the facts will be reported and progress will be intimated.

CBEC and DGFT may investigate the matter and take protective action to avoid recurrence of such cases and protect revenue.

2.1.2 Irregular registration of licence for imports without Standard Input Output (SION) norms and more than 10 digit scrip number

Test check of ICES EDI data (upto March 2015) revealed that licence number 04101011388 dated 9 February 2010 having more than 10 digit number and therefore not a valid licence, was wrongly registered at Chennai Sea port and duty of ₹ 29.41 lakh was foregone on imports. Audit verified from DGFT, EDI licence data that the licence number was not issued by the any of the JDGFT offices. Further audit noticed that this licence was utilized for duty free import of inputs such as lactose, orange juice and red grape concentrate which are otherwise not allowed because there is no SION available to these inputs in FTP Vol.II. Thus, not only was an invalid licence registered with the Chennai Sea Port, duty of ₹ 29.41 lakh was incorrectly foregone on an invalid licence, which was recoverable along with action under section 28 of the Act.

The matter was communicated (April 2016) to Chennai Sea Customs for checking the genuineness of the licence and if warranted, to take action as contemplated under the aforesaid provisions. Reply of Customs department is awaited (September 2017).

2.1.3 Excess utilisation of a duty credit scrip at different Ports

The DGFT Mumbai had issued licence number 03110582246 dated 7 July 2010 under Duty Exemption Pass Book (DEPB) post export (transferable) with c.i.f. value ₹ 50.45 lakh with port of Registration INLDH6 (Ludhiana). It was observed that the DEPB scrip was registered and mis-utilized twice vide licence registration no.310582246 dated 7 July 2010 at port/site INLDH6 and no.785193/09/2010 at port INNSA1 (Nhava Sheva Sea) in Customs data system. This has resulted in excess utilization/mis-utilization of scrip to the tune of ₹ 50.45 lakh.

This was pointed to the department in November 2016/March 2017, their reply is awaited (September 2017).

DGFT, New Delhi, Department of Commerce in their reply to similar cases mentioned in last year Audit Report (AR No. 1 of 2017) stated (June 2017) that these issues fall in the domain of Department of Revenue, Ministry of Finance and Customs' system should be upgraded to prevent misuse due to fraudulent registration of duty credit scrips. DGFT has already provided the data dump of all Chapter 3 scrips to Directorate of Revenue Intelligence (DRI) in March 2017 as they are investigating the matter.

CBEC in respect of last year similar cases stated (July 2017) that ICES 1.5 has been suitably changed (December 2016) to allow registration of only 10 digits numerical as the license number and also ensure that such 10 digit numeric number is unique (July 2017). However, the reply is silent about excess utilization/mis-utilisation of scrips.

CBEC further stated that all duty credit scrips under FTP 2015-20 are being received electronically thereby totally eliminating any chance for incorrect data, forgery etc. as none of the parameters of the duty credit scrip could be changed manually in such electronically transmitted scrips.

CBEC may intimate to Audit results of investigation done by DRI and action taken in the matter.

As regards CBEC reply about changes made in ICES 1.5 to eliminate forgery etc., CBEC may provide the relevant ICES 1.5 data to audit for verification.

2.2 Advance Authorization Scheme

2.2.1 Non fulfilment of export obligation

As per paragraph 4.1.3 of the FTP, 2004-09, and paragraph 4.22 of Handbook of Procedure (HBP) 2004-09, Vol-I, an Advance Authorization (AA) is issued for import of duty free inputs against which prescribed export obligation (EO) was to be fulfilled within a period of 36 months from the date of issue of the authorization. In case of failure to fulfil EO or to submit relevant information/documents in support of EO fulfilment within prescribed period of two months, RLA shall refuse further authorization to the importer and enforce conditions of authorization and undertaking for recovery of Customs duty on unutilized imported materials with interest, along with penal action as per law (paragraph 4.24.1 & 4.28 of HBP).

M/s Himadri Chemicals & Industries Limited, Kolkata was issued two AA (both in July 2011) for duty free import of 26625 MT of 'Coal Tar Pitch (Hard pitch)' with an obligation to export 23300 MT of 'Coal Tar Pitch (Binder pitch)' within a period of 36 months, i.e. by July 2014. The firm imported total 16625 MT of duty free inputs in 30 consignments through Kolkata (Sea) port between August

2011 and January 2012 availing the concession of Customs duty aggregating ₹ 12.48 crore but failed to furnish any document in support of fulfilment of EO even eight months after expiry of the specified EO period, as noticed in audit in March 2015. In the absence of proof of exports, the duty concession availed along with interest amounting to ₹ 18.92 crore was recoverable from the licensee.

On this being pointed out (March 2015/March 2017), the RLA Kolkata furnished (February 2017) the Export obligation discharge certificate (EODC) in one licence stating that the exporter has fulfilled the EO quantity wise. For shortfall in achieving prescribed value addition, composition fee of ₹ 0.09 lakh was levied.

RLA further stated that in respect of second licence shortfall in EO was regularised by payment of duty (₹ 25.43 lakh) and interest (₹ 34.19 lakh). However on verification of records Audit noticed short recovery of duty of ₹ 20.70 lakh and interest of ₹ 14.32 lakh because of incorrect computation. On being intimated (April 2017) RLA, Kolkata reported (July 2017) that the firm has been informed (June 2017) about outstanding duty amount of ₹ 20.70 lakh and interest of ₹ 14.32 lakh.

However, no action has been taken for delay in submission of documents towards fulfilment of EO in both authorisations. Such instances not only indicate failure of the Scheme to promote the desired exports, they also highlight weak monitoring system within the Commissionerates resulting in non-realisation of the Government revenue due along with interest even after three years of expiry of the EO period.

2.3 Export oriented units (EOUs)

2.3.1 Short levy of duty on DTA clearances

As per paragraph 6.8 (a) of FTP 2009-14, units, other than Gems and Jewellery units, may sell goods up to 50 percent of Free on Board (FOB) value of exports, subject to fulfilment of positive Net Foreign Exchange¹² (NFE), on payment of concessional duties. Within entitlement of DTA sale, unit may sell in DTA, its products similar to goods which are exported or expected to be exported from units. Units which are manufacturing and exporting more than one product can sell any of these products into DTA, up to 90 percent of FOB value of export of the specific products, subject to the condition that total DTA sale does not exceed overall entitlement of 50 percent of FOB.

¹² Net Foreign exchange is the difference between total outflow of foreign exchange on imports and foreign exchange earned on exports.

M/s Pentair Water India Private Limited, a 100 percent EOU, in Verna, Goa, was issued letter of permission (LOP) in May 2003 for manufacture and export of component for Industrial Water Treatment Plant/Apparatus (Pressure Vessels). The unit manufactured water pumps Customs Tariff Heading (CTH) (84137070), Components (CTH 84212190), Filter valves (CTH 84818030) and HRO membranes (CTH 84219900).

Audit scrutiny revealed that every year during 2012-13 to 2014-15, the EOU had violated the condition prescribed under paragraph 6.8 (a) of FTP, that total DTA sale should not exceed over all entitlement of 50 percent of FOB value of export. The unit had exported products with FOB value of ₹ 382.52 crore during the above period and had made DTA sales of ₹ 326.83 crore which was more than prescribed 50 percent FOB value of export products. Thus, there was an excess clearance in DTA to the tune of ₹ 135.58 crore involving short levy of duty of ₹ 5.56 crore.

This was pointed out to the department in January 2016/June 2017, their reply is awaited (September 2017).

2.3.2 Non-achievement of minimum value addition

As per FTP 2009-14, 100% Export oriented units (EOUs) are to achieve positive NFE earning cumulatively in blocks of five years, starting from commencement of production, except for sector specific provision where a higher value addition will be required. The minimum value addition for 100% EOUs in the tea sector has been specified as 50 percent (Appendix 14-1-c of HBP, Vol-I). In case of failure to achieve NFE, duty in the same proportion as the unachieved portion of NFE bears to the positive NFE to be achieved, is recoverable along with applicable interest, in terms of notification no.52/2003-cus dated 31 March 2003.

M/s Swiss Singapore India Private Limited, Kolkata (Formerly M/s BGH Exim Limited) a 100% EOU under office of the Development Commissioner, Falta SEZ, holding letter of permission for manufacture and export of 'Bulk tea, tea bags and tea packets' had during the third block year period 2010-11 to 2014-15 used imports worth ₹ 887.37 lakh for which goods valued at ₹ 1331.06 lakh needed to be exported to achieve 50 percent value addition. Against the prescribed export obligation, the unit exported goods worth ₹ 1192.71 lakh at the end of block year period upto 2014-15. Accordingly, there was shortfall of 10.39 percent in value addition for which proportionate duty foregone amounting to ₹ 50.14 lakh along with interest was recoverable from the EOU.

On this being pointed out (December 2015), Assistant Development Commissioner, Falta SEZ forwarded (March 2017) a copy of reply received from M/s Swiss Singapore India Pvt. Ltd. wherein the firm while accepting non-

achievement of value addition of 50 percent stated that as per Statute it is not mandatory to achieve minimum value addition of 50 percent rather it is only “insisted upon” which means it is not a mandatory requirement.

The reply of the firm is not acceptable in view of provisions of Appendix 14-1-c of HBP, Vol-I.

Development Commissioner, Falta SEZ accepting audit contention subsequently issued (August 2017) a show cause notice to the firm. Further progress is awaited (September 2017).

2.4 Deemed Exports drawback/ Duty Drawback Scheme

2.4.1 Irregular grant of deemed export drawback on imported goods

As per paragraph 8.1 of FTP, 2009-14, “Deemed exports” refer to those transactions in which goods supplied does not leave country and payment for such supplies is received either in Indian rupees or in free foreign exchange. Further, as per paragraph 8.2 of FTP 2009-14, supply of goods by main/subcontractors shall be regarded as “Deemed exports” under FTP, provided goods are manufactured in India.

DGFT vide their circular no.50/2009-2014 (RE-2010) dated 28 December 2011 cleared that in case the capital goods have been imported by the contractor/sub-contractor and supplied as such to project authorities, Customs duties paid on such imports cannot be refunded as deemed export duty drawback under paragraph 8.3 (b) of FTP.

Audit scrutiny of refund records of Terminal Excise Duty /Drawback finalized by Jt. DGFT, Ahmedabad for the period from 2012-13 to 2014-15 revealed that M/s L & T (contractor), imported various items such as couplers, FLRS cables, Gaskets etc. and supplied as such to the project authority (Chennai Metro Rail Limited) and was allowed deemed export benefit under paragraph 8.2 (d) of the FTP. As per the provision *ibid*, supply of goods by main/subcontractors shall be regarded as “Deemed Exports” under FTP, provided goods are manufactured in India. As the subject goods were not manufactured in India, grant of drawback of ₹ 3.62 crore was incorrect.

Further, it was also noticed that the project authority vide certificate (Appendix 22-C) dated 3 February 2015, had allowed imports valued at ₹ 12 crore only. However, the contractor had imported goods worth ₹ 12.75 crore. This has resulted in excess import of ₹ 74.73 lakh involving drawback amount of ₹ 19.32 lakh included in total drawback of ₹ 3.62 crore paid.

On this being pointed out (March 2016), the department without furnishing any evidence stated (April 2017) that firm had not supplied goods as such and

value addition was done using various inputs either procured domestically or imported.

Department reply is not acceptable as the contractor had shown in its drawback claim that the imported goods were supplied as inputs to the project. Hence, no further processing appears to have been done on the imported inputs before supply to the project. Therefore no value addition was made and goods were supplied as such. This was communicated to the department in May 2017 with a request to furnish evidence in support of their reply. Department response is awaited (September 2017).

2.4.2 Non recovery of drawback on failure to realize export proceeds

As per Rule 16A of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, where an amount of drawback has been paid to an exporter but the export proceeds have not been realized within the specified time as per Regulation 9 of the Foreign Exchange Management (Export of Goods and Services) Regulation, 2000, the drawback amount so paid should be recovered. Customs officer should initiate action for recovery viz issuance of notice, passing the order for recovery, if no evidence of realization of export proceeds is produced within 30 days of notice, and effect recovery within 30 days of such order.

Scrutiny of Export Outstanding Statement (XOS) for the half year ended 30 June 2015, received from RBI, Kolkata, together with the online information available on Indian Customs EDI System (ICES) revealed that the sale proceeds were not realized even after expiry of stipulated/extended period in respect of 147 consignments exported between January and April, 2014, for which duty drawback of ₹ 1.84 crore had been sanctioned by Commissionerate of Customs (Port), Kolkata. Audit noticed that no action for recovery was initiated for period ranging between 44 days to 660 days after expiry of stipulated period of realization as per XOS.

On this being pointed out (January 2016), the department intimated (February/March 2017) that in 112 shipping bills drawback amounting to ₹ 1.49 crore was recoverable apart from applicable interest, out of which ₹ 2.55 lakh in 25 cases were recovered, while in seven cases involving ₹ 27.10 lakh demands were confirmed and remaining 80 cases involving ₹ 1.20 crore were under adjudication. In 35 cases, Bank realization certificates (BRCs) were furnished by the exporters and hence they were either dropped or not pursued.

Further progress is awaited (September 2017).

2.5 Served from India Scheme (SFIS)

2.5.1 Incorrect grant of SFIS duty credit

In terms of paragraph 3.12.4 of the FTP, 2009-14, Service Providers of services listed in Appendix 41 of HBP Vol-I, are entitled to Duty Credit Scrip equivalent to 10 percent of free foreign exchange (FFE) earned during current financial year, under the Served from India Scheme (SFIS). As per paragraph 9.53 (ii) FTP, “Service Provider’ means a person providing supply of a ‘service’ from India to service consumer of any other country in India. Therefore, while allowing SFIS duty credit to service providers in terms of paragraph 9.5.3 (ii), it is necessary to ensure that the services had been supplied to the service consumers of any country other than India.

M/s SASTRA University, Thanjavur was issued (September 2014) duty credit scrips under SFIS for the “Higher education services” which is covered vide serial number 4 C of Appendix 41 of HBP, Vol-I. Audit scrutiny indicated that the charges were collected towards “Tuition fees” by the University from the students. However, the list of students from whom the tuition fees were received was scrutinized and it was observed that most of them were Indians.

As the university had claimed SFIS duty credit in terms of paragraph 9.53 (ii), the grant of duty credit without ensuring whether the service consumers belong to a country other than India, was not in order. This had resulted in incorrect grant of duty credit under SFIS to the tune of ₹ 1.02 crore which was recoverable with interest.

On this being pointed out (January 2016/June 2017), DGFT, New Delhi stated (Aug 2017) that firm has been asked to furnish details of students for verification of their eligibility or to remit the entire duty credit of ₹ 1.02 crore with interest. Further progress is awaited (September 2017).

2.5.2 Non/short imposition of late cut

Paragraph 3.6 (b) of HBP, Vol-I, 2009-14 stipulates that an application for grant of duty scrip for foreign exchange earned under SFIS during current financial year shall be filed on monthly/quarterly/half yearly/annual basis along with prescribed documents at the option of the applicant to be exercised along with first application for the current financial year. The last date for filing application shall be 12 months from the end of relevant month/quarter/half year/year. In case of failure to submit the applications after the due date, licensing authorities shall impose late cut as provided in paragraph 9.3 of HBP, Vol-1.

Audit scrutiny revealed that M/s John Energy Limited was issued (October 2013 to March 2014) three SFIS licences by JDGFT Ahmedabad for total duty credit amount of ₹ 6.13 crore for foreign exchange earned. Audit noticed that

licencee had filed the applications after expiry of more than one year from the due date, however, the RLA had not applied late cut on two licencees while in one case late cut was applied at five percent instead of applicable 10 percent. This resulted in non/short imposition of late cut of ₹ 51.06 lakh which is recoverable.

This was pointed out to the department in January 2017, their response is awaited (September 2017).

2.6 Incremental exports incentivisation scheme (IEIS)

2.6.1 Grant of excess duty credit due to non-verification of export details

As per paragraph 3.14.5 of FTP, 2009-14, an exporter is entitled for duty credit scrip at the rate of two percent of the growth in FOB value of exports achieved during the year 2013-14 over the previous year 2012-13 under Incremental exports incentivisation scheme (IEIS). Certain ineligible exports for this purpose were enlisted in paragraph 3.14.5 (d) of FTP.

In Audit, cross verification of details of exports, as claimed by M/s SSK Exports Ltd and two other exporters, with ICES exports data obtained from the Customs authority relating to these exporters for the year 2012-13 revealed that the exporters did not include exports worth ₹ 17.02 crore made under 62 shipping bills, for calculating incremental export growth for the year 2013-14 over previous year (2012-13). Accordingly, there was overstatement of exports growth in 2013-14 over 2012-13 which resulted in grant of excess duty credit of ₹ 31.48 lakh. The office of the Additional Director General of Foreign Trade, Kolkata failed to verify the exports declared by exporters in their claims.

On this being pointed out (March 2016), the ADGFT, Kolkata asked (May/June 2016) exporters to refund the excess duty credit amount. Later, the department furnished (August 2016) a reply of an exporter (M/s SSK Exports Limited) in which it was stated that undeclared exports pointed out by audit were made under Advance Authorization.

The reply of the department was not tenable as exports under Advance Authorization were not ineligible exports for the purpose of IEIS, therefore, they should be included in exports for computation of growth in exports.

In case of another exporter (M/s Milsha Agro Exports Private), department further intimated (August 2016) that the exporter admitted in case of only two exports that were made by them out of nine pointed out by Audit. However, on further verification at www.icegate.gov.in, a Customs website for online filling and checking status of shipping bills etc, we found that all the nine shipping bills were pertaining to the exporters. Hence, the reply was not tenable.

This was intimated (April 2017) to the department, however, their reply is awaited (September 2017).

Department's failure to verify all exports of the exporter even after being pointed by audit reinforces the audit observation about weak monitoring and scrutiny.

2.7 Merchandise Exports from India Scheme (MEIS)

2.7.1 Grant of excess duty credit due to incorrect adoption of exchange rate

Merchandise Exports from India Scheme (MEIS) is one of the schemes introduced in the FTP, 2015-20, to offset infrastructural inefficiencies and associated costs involved in export of goods/products which are produced/ manufactured in India, especially those having high export intensity, employment potential and thereby enhancing India's export competitiveness.

As per paragraph 3.04 of FTP 2015-20, export of notified goods/products, to notified markets as listed in Appendix 3B, shall be rewarded under MEIS. The basis of calculation of reward is on FOB value of exports realized in free foreign exchange or on FOB value of exports as given in the shipping bills in free foreign exchange, whichever is less, unless otherwise specified. Paragraph 1.15 (a) of the HBP, 2015-20 also stipulates that the foreign exchange realized (as mentioned by bank in the electronic Bank Reconciliation Certificate) is converted to Indian Rupee using the monthly exchange rates published by CBEC as on the date of Let export order (LEO)¹³ for the purpose of calculating the duty credit.

Test check of the exchange rates adopted for calculating the FOB value in rupee terms for the export proceeds realized and the corresponding sanction of duty credit under MEIS by JDGFT, Chennai, for the period from 1 April 2015 to 31 March 2016, disclosed that in 184 shipping bills, the exchange rate for Euro currency (LEO between 2 October 2015 to 15 October 2015) was incorrectly adopted at ₹ 74 as against the correct rate of ₹ 72.30 which was prevailing on the LEO date for calculation of FOB value. This had resulted in excess sanction of MEIS credit aggregating to ₹ 13.90 lakh.

This was pointed to the department in January 2017, their reply is awaited (September 2017).

¹³ Let Export Order is the final export legal procedure to move goods out of India under export shipment.