30

SPECIAL ECONOMIC ZONES (SEZs)

MINISTRY OF COMMERCE AND INDUSTRY (DEPARTMENT OF COMMERCE) AND MINISTRY OF FINANCE (DEPARTMENT OF REVENUE)

PUBLIC ACCOUNTS COMMITTEE

(2010-2011)

THIRTIETH REPORT

FIFTEENTH LOK SABHA

LOK SABHA SECRETARIAT
NEW DELHI

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MINISTRY OF COMMERCE AND INDUSTRY
(DEPARTMENT OF COMMERCE)

AND
MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)

Presented to Lok Sabha on 24.2.2011

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LOK SABHA SECRETARIAT
NEW DELHI

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COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE
(2010-2011)

Dr. Murli Manohar Joshi—*Chairman*

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4. Shri Ramen Deka
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6. Shri Satpal Maharaj
7. Shri Bhartruhari Mahtab
8. Dr. K. Sambasiva Rao
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12. Shri K. Sudhakaran
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14. Shri D. Venugopal
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Rajya Sabha

*16. Vacant
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18. Shri Prasanta Chatterjee
19. Shri Kalraj Mishra
20. Shri N.K. Singh
21. Shri Tiruchi Siva
22. Prof. Saif-ud-Din Soz

SECRETARIAT

1. Shri Devender Singh — *Joint Secretary*
2. Smt. A. Jyothirmayi — *Under Secretary*

*Vacancy occurred *vice* Shri Ashwani Kumar has been appointed as Minister of State *w.e.f.* 19th January, 2011.

COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE
(2009-2010)

*Shri Gopinath Munde—*Chairman*

MEMBERS

Lok Sabha

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4. Shri Khagen Das
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6. Shri Satpal Maharaj
7. Shri Bhartruhari Mahtab
8. Dr. K. Sambasiva Rao
9. Shri Jaswant Singh
10. Shri Jitendra Singh (Alwar)
11. Kunwar Rewati Raman Singh
12. Shri Yashwant Sinha
13. Shri K. Sudhakaran
14. Dr. M. Thambidurai
15. Shri Aruna Kumar Vundavalli

Rajya Sabha

16. Shri Prasanta Chatterjee
17. Shri Sharad Anantrao Joshi
#18. Vacant
19. Shri Shanta Kumar
20. Dr. K. Malaisamy
21. Shri N.K. Singh
22. Prof. Saif-ud-Din Soz

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* Appointed as the Chairman of the Committee *w.e.f.* 6th January, 2010 *vice* Shri Jaswant Singh resigned from the Chairmanship of the Committee.

Vice the expiry of the term of Shri Ashwani Kumar *w.e.f.* 9th April, 2010.

COMPOSITION OF THE SUB-COMMITTEE-II OF THE PUBLIC ACCOUNTS COMMITTEE (2009-10)

Shri Bhartruhari Mahtab — *Convenor*

MEMBERS

Lok Sabha

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3. Shri Aruna Kumar Vundavalli

Rajya Sabha

4. Shri Sharad Anantrao Joshi

COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE

(2008-09)

**Shri Santosh Gangwar — *Chairman*

MEMBERS

Lok Sabha

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3. Shri Vijay Bahuguna
4. Shri Khagen Das
5. Shri Sandeep Dikshit
6. Shri P.S. Gadhavi
7. Shri Shailendra Kumar
8. Shri Bhartruhari Mahtab

***9. Vacant

10. Prof. M. Ramadass

*11. Shri K.S. Rao

12. Shri Sita Ram Singh
13. Shri Kharabela Swain
14. Shri Tarit Baran Topdar
15. Shri Arun Yadav

Rajya Sabha

16. Shri Raashid Alvi
17. Shri Prasanta Chatterjee
18. Shri B.K. Hariprasad
19. Shri Shanta Kumar
20. Prof. P.J. Kurien
21. Dr. K. Malaisamy
22. Sardar Tarlochan Singh

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* Elected *w.e.f.* 17th December, 2008 *vice* Shri Rajiv Ranjan 'Lalan' Singh resigned his seat in Lok Sabha on 11th November, 2008.

** Elected *w.e.f.* 17th December, 2008 *vice* Shri Brajesh Pathak ceased to be a Member of Committee consequent upon his election to Rajya Sabha.

*** Prof. Vijay Kumar Malhotra resigned his seat in Lok Sabha *w.e.f.* 18th December, 2008.

INTRODUCTION

I, the Chairman, Public Accounts Committee (2010-11), having been authorised by the Committee, do present this Thirtieth Report (Fifteenth Lok Sabha) on **'Special Economic Zones (SEZs)'** based on C&AG Report No. 6 of 2008 (Performance Audit), Union Government (Civil) for the year ended March, 2007 relating to the Ministry of Commerce and Industry (Department of Commerce) and the Ministry of Finance (Department of Revenue).

2. The Report of Comptroller and Auditor General of India for the year ended March, 2007 was laid on the Table of the House on 11th March, 2008.

3. The Public Accounts Committee (2008-09) selected the subject for examination and report. The Committee took evidence of the representatives of the Ministry of Commerce and Industry (Department of Commerce) and the Ministry of Finance (Department of Revenue) on the subject at their sitting held on 8th December, 2008. As the examination of the subject could not be completed due to paucity of time, the Public Accounts Committee (2009-10) re-selected the subject for examination. A Sub-Committee was constituted for the purpose. Further evidence of the representatives of the Ministry of Commerce and Industry (Department of Commerce) and the Ministry of Finance (Department of Revenue) was taken by the Sub-Committee on 14th December, 2009. However, due to paucity of time they also could not finalize the Report on the subject. The Public Accounts Committee (2010-11) decided to continue the examination of the subject and present a Report thereon based on the earlier evidences taken by their predecessor Committees/Sub-Committee. Accordingly, a Draft Report was prepared and placed before the Committee for their consideration. The Committee considered and adopted the Thirtieth Report at their sitting held on 15th February, 2011. Minutes of the sittings from Appendices to the Report.

4. For facility of reference and convenience, the Observations and Recommendations of the Committee have been printed in thick type in the body of the Report.

5. The Committee thank their predecessor Committees and the Sub-Committee for taking oral evidence and obtaining information on the subject.

6. The Committee would also like to express their thanks to the representatives of the Ministry of Commerce and Industry (Department of Commerce) and the Ministry of Finance (Department of Revenue) for tendering evidence before them and furnishing the requisite information to the Committee in connection with the examination of the subject.

7. The Committee place on record their appreciation of the assistance rendered to them in the matter by the office of the Comptroller and Auditor General of India.

NEW DELHI;
21*st February,* 2011
2 *Phalguna,* 1932 *(Saka)*

DR. MURLI MANOHAR JOSHI
Chairman,
Public Accounts Committee.

REPORT

PART I

I. Introductory

The Special Economic Zone (SEZ) Scheme was introduced by the Government with effect from 1st April, 2000 with a view to overcome the shortcomings experienced on account of multiplicity of controls and clearances, absence of world-class infrastructure, an unstable fiscal regime and to attract larger foreign investments in India. This policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations.

2. The main objectives of the SEZ Act are:

(a) Generation of additional economic activity;

(b) Promotion of exports of goods and services;

(c) Promotion of investment from domestic and foreign sources;

(d) Creation of employment opportunities; and

(e) Development of infrastructure of facilities.

The objective of the Scheme was to trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

3. The SEZ Rules provide for simplified procedure for development, operation and maintenance of the SEZs and for setting up units and conducting business in SEZs. It also included single window clearance for setting up of an SEZ, for setting up a unit in a Special Economic Zone and on matters relating to Central as well as State Governments and simplified compliance procedures and documentation with an emphasis on self certification.

II. Incentives and facilities offered to the SEZs

4. The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:—

— Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units;

— 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years;

— Exemption from minimum alternate tax under section 115JB of the Income Tax Act;

— External commercial borrowing by SEZ units upto US $ 500 million in a year without any maturity restriction through recognized banking channels;

— Exemption from Central Sales Tax;

— Exemption from Service Tax;

— Single window clearance for Central and State level approvals;

— Exemption from State sales tax and other levies as extended by the respective State Governments.

The major incentives and facilities available to SEZ developers include:—

— Exemption from customs/excise duties for development of SEZs for authorized operations approved by the Board of Approval (BoA);

— Income Tax Exemption on income derived from the business of development of the SEZ in a block of 10 years in 15 years under Section 80-1AB of the Income Tax Act;

— Exemption from minimum alternate tax under Section 115 JB of the Income Tax Act;

— Exemption from dividend distribution tax under Section 115O of the Income Tax Act;

— Exemption from Central Sales Tax (CST).

— Exemption from Service Tax.

All these fiscal incentives are implemented by the Development Commissioner.

5. All the export benefits including drawback for supplies to SEZ developer/unit are given to developer/unit within SEZ by the specified officers in the SEZs. However, in case of "No Objection" from the unit/developer in SEZ, drawback/DEPB benefit can be availed of by the supplier in Domestic Tariff Area, in terms of Rule 30 (5) of SEZ Rules. All the import/export operations of the SEZ units are on self-certification basis. The units in the zones are required to be Net Foreign Exchange (NFE) earners, calculated cumulatively for a period of five years from the commencement of production. These Units have to execute a legal undertaking with the Development Commissioner to achieve positive NFE. Periodical monitoring on the functioning and performance of the units in the SEZ is carried out by the Approval Committee. The performance of the Units is required to be monitored quarterly, based on the reports received in prescribed formats.

According to Section 53 of the SEZ Act, a Special Economic Zone is deemed to be a territory outside the Customs territory of India. As per the definition under Section 2(m) of the SEZ Act, bringing goods or services into the SEZ from the Domestic Tariff Area (DTA) is treated as export. As per provisions of Section 30 of the Act, the goods can be cleared from SEZ to DTA on payment of duties of Customs including Anti-dumping, Countervailing and Safeguard duties under the Customs Tariff Act, where applicable, as leviable on such goods when imported.

The Department of Revenue provides some of the officers in SEZs known as 'specified' and 'authorized' officers. Officers when posted in an SEZ work under the control of the Development Commissioner of the concerned SEZ.

III. Roles of Ministry of Commerce & Industry and Ministry of Finance

6. Detailing the roles assigned for Ministry of Commerce & Industry and Ministry of Finance with reference to a unit in the SEZ, it was stated that the inter-ministerial Board of Approval (BoA) constituted under the SEZ Act, 2005 for approval of SEZs, *inter alia* includes the representatives of both Commerce and Finance Ministries. At the unit level, an Approval Committee has been constituted under the SEZ Act, for approval of projects and for periodic monitoring of their import-export activities. This Approval Committee has representatives of both Commerce and Finance Ministries. The decision-making in both the BoA and the Approval Committee is by consensus only. While the Development Commissioner is overall in-charge of the SEZ, officials from the Customs Department deputed to the Zone under the administrative control of the Development Commissioner attend to the day-to-day operations of these Units.

7. Regarding the role of the Ministry of Finance it was stated that the Department of Revenue is represented in the Board of Approval for SEZs by a Member of the Central Board of Excise and Customs and a Member of the Central Board of Direct Taxes, both of whom are ex-officio members of the said Board. The Board of Approval grants approval to SEZs and approves authorized operations in terms of the SEZ Act, 2005, and SEZ Rules, 2006. The Board also deals with appeals filed against orders passed by Development Commissioners of SEZs.

8. The SEZ scheme provides for the constitution of an Approval Committee for every SEZ. This Committee, which is headed by the Development Commissioner of the SEZ, has two representatives from the Department of Revenue, the jurisdictional Commissioner of Customs/Central Excise and the jurisdictional Commissioner of Income Tax or their nominees. The Approval Committee, *inter alia,* approves the import or procurement of goods from the Domestic Tariff Area, monitors the utilization of goods or services or warehousing or trading in the SEZ, approves, modifies or rejects proposals for setting up of units and monitors and supervises compliance of conditions of the Letter of Approval granted to Units.

9. Elaborating on the institutional coordination mechanism at the Department level in both the Ministries for resolving cases, it was stated as under:

> "The SEZ Act, 2005 provides for multi-member authorities at the central level and for each SEZ as given below:
>
> > Section 8 of the Special Economic Zones Act, 2005 provides for the constitution of a Board of Approval. The Board of Approval has representatives from various Departments. A Member of the Central Board of Excise and Customs (CBEC) and a Member of the Central Board of Direct Taxes (CBDT), both of whom are ex-officio members of the said Board, represent the Department of Revenue in the Board of Approval (BoA) for SEZs. The Board of Approval grants approval to SEZs and approves authorized operations in terms of the SEZ Act, 2005, and SEZ

Rules, 2006. The Board also deals with appeals filed against orders passed by Development Commissioners of SEZs. In terms of Section 8(6) of SEZ Act, all the acts of the BoA shall be decided by a general consensus of the Members present.

Section 13 of the SEZ Act, provides for the constitution of an Approval Committee for every SEZ. This Committee, which is headed by the Development Commissioner of the SEZ, has two representatives from the Department of Revenue, the jurisdictional Commissioner of Customs/ Central Excise and the jurisdictional Commissioner of Income Tax or their nominees. This Committee, *inter alia,* approves the import or procurement of goods from the Domestic Tariff Area, monitors the utilization of goods or services or warehousing or trading in the SEZ, approves, modifies or rejects proposals for setting up of units and monitors and supervises compliance of conditions of the Letter of Approval granted to Units. In terms of Section 13(5) of the SEZ Act, all the acts of the Approval Committee shall be decided by a general consensus of the Members present.

Apart from the statutory bodies set up as indicated above, regular interaction has been taking place between the Departments of Commerce and Revenue on various issues which arise regarding the SEZ scheme. Further a Joint Committee of both the Departments, Department of Commerce (DoC) and Department of Revenue (DoR) has been constituted to look into various administrative, operational and procedural issues relating to SEZs. This Joint Committee is headed by the Joint Secretary, DoC.

As explained above, decisions in the Board of Approval and the Approval Committee are taken by the general consensus. However, in case of difference of opinion, which cannot be resolved between the two Departments, the matter is then referred to an Empowered Group of Ministers (EGoM) constituted to deal with issues relating to SEZs".

IV. Gist of Audit Para

10. A review of the SEZ scheme by the C&AG (Report no. PA 6 of 2008 — Indirect Taxes) brought out system as well as compliance weaknesses relating to policy and procedures governing the management and functioning of SEZ units to see whether these functioned as intended. While the revenue implication of audit review was Rs. 246.72 crore, an additional Rs. 1724.67 crore was foregone or could not be recovered in the absence of enabling provisions.

11. According to the Audit there was no restriction on 'deemed exports' being reckoned as exports enabling the Units to attain positive Net Foreign Exchange Earning (NFE) predominantly through deemed exports rather than actual exports. As a result, 22 SEZ units had achieved the required positive NFE, notwithstanding the fact that the actual export earnings were only 28 per cent and the remaining 72 per cent came from domestic sales. Further, the units under Domestic Tariff Area (DTA) were put under disadvantageous position as no provision had been made to recover duty foregone on inputs procured by the SEZ units and used in the manufacture of products which were cleared at 'nil' rate of duty in DTA.

12. The SEZ scheme relies mainly on self-certification and does not require the 'Quarterly/Annual Performance Reports (QPRs/APRs)' to be supported by other statutory documents like annual accounts, customs records, income tax (IT) returns, Bank Realisation Certificates (BRC) etc. This facilitated a few Units to provide incorrect/inconsistent data in their APRs/QPRs.

V. Audit Objectives

13. The review was conducted with the objective of verifying that the units in the SEZs had complied with the applicable Customs Act, Rules, notification etc. and had functioned appropriately under the provisions of the Exim Policy and the procedures prescribed as per the 'Handbook of Procedures (HBP) Volume 1'. The adequacy and effectiveness of the internal controls to ensure compliance with the applicable Act/ Rules/procedures were also examined.

VI. Scope of Audit

14. Of the 2061 units that were approved during 2000-01 to 2005-06 in nine SEZs, under the jurisdiction of seven (Mumbai, Gandhidam, Chennai, Cochin, Vishakapatnam, Noida and Kolkata) out of eight DCs, 1,019 Units were functional, 120 Units had debonded and 922 were either closed or were non-functional as on 31 March 2006. Audit reviewed the performance of 370 functional Units and 180 Units that had debonded or were closed.

VII. Achievement of NFE was mostly through deemed exports

15. One of the main objectives of the Scheme was augmentation of exports. Additionally, as per paragraph 7.4 of the Exim Policy 2002-07 (as on 1 April 2003) and the Foreign Trade Policy (FTP) (2004-2009), an SEZ unit had to achieve a positive NFE. For determination of NFE, DTA sales/supplies effected (i) in terms of chapter 8 of the policy (deemed exports), (ii) to other SEZ units, 100 per cent EOUs etc. were also to be reckoned and added to the Free on Board value of actual physical export.

16. However, the policy did not prescribe any percentage of foreign exchange that should be earned by an SEZ unit through actual physical export and that which could be earned through deemed exports in DTA, to be a positive NFE compliant. Audit observed that 22 SEZ units had been achieving the prescribed (positive) NFE mainly through domestic sales. While an overall export of Rs. 7,149.23 crore was made by these 22 Units, the actual export content was only Rs. 1,999.27 crore (28 per cent) and remaining Rs. 5,149.96 crore (72 per cent) related to DTA earnings. The range of the domestic earnings as a percentage of total export earning in these Units was 59 to 100. Customs duty of Rs. 1,043.29 crore was foregone on import of goods by these Units.

17. In their written submission to the Committee, the Ministry of Commerce & Industry have stated as:

> "As per the then Foreign Trade Policy (prior to 10.02.2006), SEZ unit had to be a positive Net Foreign Exchange (NFE) earner. NEF was calculated cumulatively for a period of 5 years from the commencement of production according to the formula given in Chapter 7 of the Hand Book. As per Chapter 7 of the Hand Book, all Deemed Exports are taken into consideration for calculation of NFE. After the

SEZ Act came into force *w.e.f.* 10th February 2006, NFE is calculated as per Rule 53 of SEZ Rules 2006."

18. It has been further added that:

"Rule 53 of SEZ Rules, 2006 deals with modalities for calculation of positive NFE. Under this Rule, following categories of supplies from SEZs have been permitted for reckoning towards positive NFE:

(i) Supply of goods to such entities which are in any case entitled for import of goods without payment of duty. This includes supply of goods against advance license, duty free replenishment certificate, Export Promotion Guarantee (EPG) license, project financed by multi-lateral and bilateral agencies under internal competitive bidding, supply of goods to any project or purpose in respect of which the Ministry of Finance permits the import of goods at zero customs duty, supply to projects funded by United National Agencies, supply against special entitlement of duty free import of goods, supply of goods to EoUs/SEZs etc. Since recipient of these entities from SEZ would lead to that much of foreign exchange saving and lead to manufacturing, value addition and generation of additional economic activity in the country. Hence there is no reason why these supplies should not be counted for NFE.

(ii) Second category of the supplies are like supply of ITA-1 items which are in any case permitted to be imported at zero duty. There again since these can be imported at zero duty, manufacturing of these goods in the SEZs would lead to generation of additional economic activity and creation of manufacturing capabilities in the SEZs.

(iii) Third category of the supplies includes supply against foreign exchange earned from the Exchange Earners Foreign Currency (EEFC) account of the DTA buyer or the free foreign exchange received from overseas. EEFC account holder can spend the foreign exchange for import. Hence spending the same for purchasing goods from SEZ would lead to saving of foreign exchange.

One of the aims of the SEZ scheme is earning of foreign exchange. Since those DTA units which are eligible to import goods for the purpose of export would otherwise have imported these goods resulting in outgo of foreign exchange, supplies being made to such units by SEZ units is logically to be included in the credit of the SEZ unit since it results in saving of foreign exchange.

Export obligation should be looked at cumulatively for a period of 5 years, and any one year's performance alone should not be counted."

19. When the Ministry was asked to furnish their views on the Audit observations that the NFE which was generated within the last two or three years was not actually on account of manufactured goods sold in the foreign market but goods produced here in SEZ's and sold in domestic market, the Ministry in their written submission to the Committee have stated as under:

"In fact, the contribution of DTA sale qualifying for achievement of positive NFE *i.e*. categories enumerated under Rule 53 of the SEZ Rules is only to the

extent of about 11% of the total turnover in SEZs and the share of DTA sale (not counted for positive NFE) is about 5% of the total turnover. Rest 84% of goods produced in the SEZs in the past two years have been exported physically outside India earning foreign exchange."

20. On the mechanism that was prevalent to verify if the foreign exchange earnings declared have been actually received or not, it was stated as:

> "Exporting units in the zone file shipping bills for each export. These bills are assessed by the authorised officers and the Free on Board value is, cumulatively shown as exports in the Annual Performance Report (APR) filed by the Unit in the first quarter of the year following the year of reporting. The APR also contains a declaration about cases pending for foreign exchange realization. Data furnished in the APR is duly certified by independent Chartered Accountant. This is scrutinized during the annual monitoring of SEZ units and the reasons as well as duration of non-realisation are ascertained. Where necessary, remedial directions are given and these details are furnished to the RBI which monitors the foreign exchange remittances."

21. To a pointed question of the Committee, if the country had actually saved foreign exchange by implementation of the SEZ scheme and if so to what extent, the Ministry have replied as under:

> "The foreign exchange realized during the year 2007-08 is Rs. 53984.00 crore (provisional)."

22. Elaborating on Deemed Exports, the Ministry in their written submission made to the Committee have stated as under:

> "Deemed export has not been expressly mentioned in any of provisions of SEZ Act and Rules. But under Rule 53 of the SEZ Rules dealing with the provisions of net foreign exchange earnings, there are about 15 categories of the goods supplied from SEZs which also qualifies for the achievement of positive NFE *i.e.* categories other than physical exports. Since such categories are similar to the categories defined as deemed export under Foreign Trade Policy, as such, above categories of Rule 53 is normally categorized as deemed export in SEZ for statistical purpose as an element of foreign exchange earnings and the quantum of such deemed export categories is not very significant compared to total exports."

VIII. Absence of provision to collect duty foregone on inputs used in exempt products cleared in DTA

23. According to the Audit, an Export Oriented Unit (EOU), which imports inputs, raw materials duty free, could clear its final products into DTA after paying the applicable Basic Customs Duty (BCD) and Countervailing Duty (CVD) as if the final products were imported. However, in cases where both the BCD and the CVD were 'nil' on certain products, the EOU would not pay any duty on clearance of the final products in DTA. A unit in the DTA producing/clearing same final product would also clear these goods at 'nil' rate of duty, but would have suffered duty on inputs used in

the manufacture of these products (as Cenvat credit too is not available when final products are exempt from duty). This had put the DTA units under a comparative disadvantage. To remove this anomaly, the EOUs were required to pay back the duty foregone on inputs utilised for manufacture of such goods cleared into DTA with effect from 1 September 2004. (Paragraph 6.8 (j) of the FTP 2004-09). However, such protection to units in DTA was not provided under the SEZ policy/Act. SEZ units can sell its goods, including by-products, and services in DTA on payment of applicable duty including at 'nil' rate with no requirement to pay back the duty foregone on inputs used in the clearance of products (at nil rate of duty) into the DTA. Audit scrutiny of records of Nokia India Pvt. Ltd., a unit in Madras SEZ, revealed that the Unit cleared mobile phones with a value of Rs. 4,855.69 crore in 2005-06 and 2006-07 in DTA at 'nil' rate of duty. Duty of Rs. 681.38 crore (Rs. 86.76 crore in 2005-06 and Rs. 594.62 crore in 2006-07) foregone on the inputs used in the manufacture of these mobile phones could not be recovered in the absence of enabling provisions. Additionally, this policy had put SEZ units at a distinctly advantageous position compared with similar units in the DTA or even other EOUs.

24. The Ministry of Commerce & Industry in their written submission to the Committee have stated as under:

> "C&AG has observed that SEZ unit can sell its goods and services in DTA on payment of applicable duties as if the final products are imported with no requirement to pay the duty foregone on inputs used in the clearance of products at NIL rate of duty into the DTA. Giving a comparison to an EOU unit which is required to pay the duty foregone on imports utilized for manufacture of goods cleared into DTA, C&AG has observed that there should be a provision to collect duty foregone on imports used by SEZ units in manufacturing final products even cleared at NIL rate into the DTA to provide a level playing field for indigenous industry. C&AG has quoted the example of Nokia India Private Limited, a Unit in Chennai, which cleared mobile phones of Rs. 4855.69 crore at nil duty during 2005-06 and 2006-07. Duty of Rs. 681.38 crore was foregone on the inputs used in the manufacture of these mobile phones which could not be recovered. C&AG has recommended that the Government may consider introducing a provision to collect the duty foregone on inputs used by SEZ units in manufacturing final products cleared at 'nil' rate into the DTA to provide a level playing field for the indigenous industry.
>
> The mobile handsets do not attract any customs duty. Similarly all the components and other inputs which go into the manufacture of mobile handsets also do not attract customs duty.
>
> Even DTA manufacturers are also not required to pay any import duties, be it Customs or Central Excise like the SEZ units and hence it may not be appropriate to say that in comparison with Nokia, the DTA units are at a disadvantage."

25. When asked to explain the views of Department of Commerce and Department of Revenue in the case of the Audit findings with reference to Nokia India Private Ltd.,

the Ministry of Commerce & Industry in their written submission have explained as under:

> "The audit points out specific example of Nokia, which is manufacturing mobile handsets. The moblie handsets do not attract any customs duty. All the components and other inputs which go into the manufacture of mobile handsets also do not attract customs duty. Similarly, all the above items are also exempt from Central Excise.
>
> From the above, it is clear that even DTA manufacturers in this specific case are also not required to pay any duties, be it Customs or Central Excise like the SEZ units. Therefore in comparison with Nokia, the DTA units are not at a disadvantage. Perhaps, the only advantage which Nokia enjoys *vis-a-vis* a DTA unit is only in respect of consumables like packing materials for which a DTA unit will have to pay applicable duty. Even in this case, Nokia imports only eight such consumable items for which the duty foregone in their three year operation period was only to the extent of Rs. 40 crore. Therefore, to say that on account of Nokia's operations in India, India has lost Rs. 681.38 crore on inputs may not be correct.
>
> In any case, all duty exemptions extended are as per the SEZ Act and Rules."

26. An EOU unit is permitted to sell 50 per cent of its Free on Board (FoB) value of export in DTA at concessional rate of duty, while other DTA sales are at full duty, on achieving the prescribed Net Foreign Exchange (NFE). An SEZ unit is also permitted to sell in the DTA at applicable rates of duty. Hence there is similarity in the provisions. However, no percentage of FoB exports is prescribed for DTA sales in case of a SEZ unit.

To this observation of the Committee, the Ministry submitted as under:

> "EOU are permitted DTA sale on concessional duty depending on their export performance. However, for SEZ units no such concept is envisaged. This is because SEZ units have to pay full duty on any DTA sale made by them and such DTA sale will not be reckoned towards their export performance. Therefore, it is felt that fixing a DTA sale norm or ceiling for SEZ units may not be practical or warranted."

27. When further asked about the reason for not extending the same provisions to units in the SEZs, as applicable to the EOUs in respect of the requirement to pay back the duty foregone on inputs used in the clearance of exempted products into the Domestic Tariff Area, the Ministry have replied as under:

> "EOU and SEZs are two separate schemes. In EOUs, DTA clearance is feasible either by way of payment of concessional duty, or by payment of excise duty in lieu of customs duty if only indigenous inputs are used, or by way of duty reversal on Nil duty related items. The general principle in the EOU clearance to DTA is that it should enable the EOU units which are located in different parts of the country to sell their goods. Therefore, an element of incentive is in-built in the case of EOU clearance to DTA.

In the case of SEZs, neither there is question of any concession nor application of any incentive of clearance to DTA. They will have to pay full duty for DTA clearance, are required to fulfil NFE requirement and also not eligible to receive income tax benefits in case of sales to DTA. As the two schemes are not comparable, one principle in a particular scheme cannot be introduced into another scheme.

Clearance to DTA from SEZ is through a legal provision in the Act and such provisions require stability for attracting investment in the manufacturing sector in the SEZs."

28. In response to the Audit observation, the Ministry have submitted that:

"SEZ units have to achieve positive NFE. No income tax benefits are available on DTA sale. For DTA sale, full duty including CVD on the finished product is levied unlike EOUs where DTA sale is allowed on concessional duty. DTA sale is just a part of the overall activity of the SEZ unit and not an activity of the SEZ in its entirety. It is unlikely that SEZ units will clear entire production into DTA because DTA sales attract nil duty."

Further, the Ministry have stated that DTA sale is just a part of the overall activity of the SEZ unit and not an activity of the SEZ in its entirety. In this regard, the Committee sought to know whether the Ministry had considered restricting the component of deemed export by an appropriate scale so that actual physical export became a primary component in calculation of Net Foreign Exchange (NFE). The Ministry in their written submission made to the Committee have stated as:

"As the deemed export component of the total exports is not very significant, therefore, restricting the component of deemed export in SEZ is not felt to be a favoured option. In any case in most of the deemed export categories as enumerated in Rule 53 of SEZ Rules, they are further required to discharge the export obligations against such SEZ supplies. For example in case a SEZ unit clears goods in DTA to an advance license holder, the DTA unit has to further discharge his export obligation which is on a higher side, therefore, the NFE benefit availed by such units gets absorbed by way of higher foreign exchange earning of the export made by the DTA unit, in process of discharge of their export obligation."

29. When asked about the initiative that was taken/proposed to be taken by the Ministry to consider introducing a provision to collect the duty foregone on inputs used by SEZ units in manufacturing final products cleared at nil rate into Domestic Tariff Area to provide a level playing filed for the indigenous industries, the Ministry replied as under:

"EOU and SEZs are two separate schemes. In EOUs, DTA clearance is feasible either by way of payment of concessional duty, or by payment of excise duty in lieu of customs duty if only indigenous inputs are used, or by way of duty reversal on Nil duty related items. The general principle in the EOU clearance to DTA is that it should enable the EOU units which are located in the different parts of the country to sell their goods. Therefore, an element of incentive is in-built in the case of EOU clearance to DTA.

In the case of SEZs, neither there is question of any concession nor application of any incentive of clearance to DTA. They will have to pay full duty for DTA clearnace, are required to fulfil NFE requirement and also not eligible to receive income tax benefits in case of sales to DTA. As the two schemes are not comparable, one principle in a particular scheme cannot be introduced into another scheme.

Clearance to DTA from SEZ is through a legal provision in the Act and such provisions require stability for attracting investment in the manufacturing sector in the SEZs."

30. The Committee during its in-depth study of the subject noted the recommendation in the 83rd Report of the Committee on Commerce relating to the 'The Functioning of Special Economic Zones' wherein it was stated as under:

"Fears have been expressed in many quarters that fiscal benefits to SEZ developers-cum-unit holders would affect competitiveness in the domestic industries. The said benefits have the potential of rendering the project cost cheaper in SEZs by 40% to 50%, which could have negative impact on the domestic industry. The SEZs could, thus, act as a disincentive and a dampener for DTA business. The Committee are of the view that a level playing field should be provided to the domestic industry *vis-a-vis* SEZs."

IX. Absence of mechanism to verify data in QPR/APR

31. As per the Exim Policy/Foreign Trade Policy, every unit in a SEZ has to maintain proper accounts and submit QPR/APR in prescribed format to the DC duly certified by a Chartered Accountant (CA). This data is 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 as intended under the applicable policy and rules. However, the SEZ scheme relies mainly on self-certification and does not require the QPRs/APRs to be supported by other statutory documents like annual accounts, customs records, Income Tax (IT) returns, Bank Realisation Certificates (BRC) etc. This facilitated a few Units to provide incorrect/inconsistent data in their QPRs/APRs. The NFEs derived on the basis of this inconsistent data cannot be relied upon. Audit correlated data furnished by the Units in their annual performance reports with data available in the annual accounts, customs records, IT returns, BRC, etc. and observed that (i) 16 Units had under reported the Cost, Insurance Freight (CIF) value of imports, (ii) 25 Units had inflated the FoB value of exports, (iii) three Units had both under reported imports and inflated exports, and (iv) six Units of Cochin SEZ had shown less foreign exchange outflow, in their APRs.

32. Elaborating on the mechanism to verify data in QPR/APR, the Ministry of Commerce & Industry in their written submission have stated as under:

"The SEZ units as well as developers are required to maintain complete accounts as prescribed under Rule 22 (2) of the SEZ Rules, which provides as follows:

Every Unit and Developer shall maintain proper accounts, financial year-wise, and such accounts which should clearly indicate in value terms

the goods imported or procured from Domestic Tariff Area, consumption or utilization of goods, production of goods, including by-products, waste or scrap or remnants, disposal of goods manufactured or produced, by way of exports, sales or supplies in the domestic tariff area or transfer to Special Economic Zone or Export Oriented Unit or Electronic Hardware Technology Park or software Technology Part Units or Biotechnology Park Unit, as the case may be, and balance in stock; Provided that Unit and Developer shall maintain such records for a period of seven years from the end of relevant financial year.

Provided further that the Units engaged in both trading and manufacturing activities shall maintain separate records for trading and manufacturing activities.

Based on the records maintained by the Units/developers, Unit is required to give APR in Form 1, as prescribed by Rule 22(3) and the Developer is required to give a QPR in Form E as prescribed in Rule 22 (4) to the Development Commissioner and the Development Commissioner in turn is required to place the same before the Unit Approval Committee (UAC). Information given in the APR is required to be authenticated by the authorized signatory of the Unit and is required to be certified by the Chartered Accountant. Therefore, it is felt that the mechanism prescribed is sufficient and in case Approval Committee has any doubt in respect of any information submitted by the Unit or by a Developer, it can always call for the records which the Unit or Developer is required to maintain under rule 22(2) of the SEZ Rules. It is practically not advisable that every APR/QPR should be accompanied by statutory documents like annual accounts, custom records, income tax returns, bank realization certificates etc. as suggested by CAG.. This will merely create additional paper work and certainly it will not be possible for UAC to go through all these documents in respect of all the QPRs and the APRs. In fact, it will be practically impossible to handle all these documents in respect of all APRs/QPRs by UAC.

It must be emphasized that the emphasis of the SEZ Scheme is on simplification of procedures as they are operating in bonded premises. Rule 75 of the SEZ Rule has specifically emphasized on the operation of these units based on self-declaration. White simplifying the procedure enough care has been taken to ensure that there is no revenue leakage. Sale from SEZ to DTA has been prescribed on payment of full duty, whereas earlier such sale from Export Processing Zones were on payment of 50% of the duty. Exemption from income tax is also been given only on physical exports and no income tax exemption is given on profits derived from sale in the DTA or even sale within SEZ.

Hence the present procedure prescribed in respect of APR/QPR coupled with monitoring guidelines as given in Rule 54 read with Form 1 of the SEZ Rules is sufficient mechanism for monitoring the export performance by

the Unit Approval Committee. APR/QPR should not be accompanied by other statutory documents like annual accounts, custom records, income tax returns, BRC etc."

33. On perusal of the information furnished to the Committee it was seen that the SEZ scheme relied mainly on self-certification and did not require the Quarterly/ Annual Performance Reports (QPR/APR) to be supported by other statutory documents. When asked about the system in vogue to safeguard Government Revenue in the event of Units providing incorrect/inconsistent data in their APRs and QPRs, the Ministry of Commerce & Industry in their written submission replied as under:

"The performance reports are statutorily required to be authenticated by an independent Chartered Accountant. Chartered Accountants, being members of an accredited statutory body with their own rules of conduct, are expected to verify the records before certifying. They are liable to action for misconduct. The Approval Committee and/or the Development Commissioner can, at any point of time, challenge the data if they have valid reasons or doubts.

Further, unlike other Export Promotion schemes, the goods admitted into the SEZs are subject to peripheral round the clock physical control by the customs and security staff of the Zone Administration. Goods cannot move in/out without proper documentation and without the permission/knowledge of the customs/security officials.

Further, the statistics are mainly summaries of export and import data of the Unit. Every import, export and other clearance is made against a document prescribed under the SEZ Rules *i.e.* Bill of Entry or Shipping Bills. Copies of these are retained by the Zone administration for record. The assessment of all these documents are done within the zone and, hence, the records are readily available. The APRs are verified against the data available in the zone. In the event of any mismatch, the explanation of the zone unit is called for and decision taken thereafter. Submission of false data in the APR and lead to action against Units.

Hence there are adequate safeguards to protect government revenue."

34. On being asked about the action that was taken against erring Units, so as to prevent misutilisation of the Scheme, the Ministry of Commerce & Industry in their reply have stated as:

"In case of persistent default and violation of conditions of letter of approval, the Approval Committee may take action for cancellation of letter of Approval as per Section 16 of the SEZ Act. Further action for remission of exemptions, drawbacks, concessions and any other benefit in respect of the capital goods, finished goods, raw materials and consumables lying in stock, relatable to the Unit is taken as per Rule 77. In case the Unit has also failed to meet the NFE obligations, it is also liable for penalty under the provisions of the Foreign Trade (Development and Regulation Act) as prescribed under Rule 77(5)."

35. As the Audit had pointed out a number of deficiencies with respect to some of the SEZ units, the Committee wanted to know whether any similar type of deficiencies

had been observed by the Minstry in respect of various SEZs which had not been covered during the Audit examination. To this, it was replied as:

> "The Quarterly Performance Reports and Annual Performance Reports are being reviewed periodically by DCs and Approval Committees and action is taken under FTDR by the concerned DCs, if any deficiency is observed during the course of such reviews."

36. On the initiatives/follow up measures that have been taken by the Ministry to ensure that all units under SEZ scheme provide reliable data in their Quarterly Performance Review/Annual Performance Review, the Ministry have put-fourth as:

> "Rule 22 (3) of SEZ Rules, 2006 provides for submission of APR by SEZ units in the prescribed format given at Form I in terms of which the information furnished therein is required to be authenticated by Authorized Signatory of the unit and certified by Chartered Accountant. Further, Rule 54 provides for monitoring of performance of the SEZ units by the Approval Committee on the basis of the C.A. Certified Annual Performance Report.
>
> Further, the Ministry of Commerce and Industry have issued instructions on 4.12.2008 in terms of which random check of minimum 5% of APRs of Unit is to be carried out by the Development Commissioners to ensure that there is no mismatch of data furnished by the C.A."

37. During the course of Oral Examination, the Committee wanted to know the measures that were taken to prevent recurrence of misreporting in the reports that were submitted to the concerned authorities. To this, the Joint Secretary of the Ministry of Commerce and Industry deposing before the Committee stated as under:

> "One of the basic objectives of the SEZ Act was simplification of procedures and therefore, one of the salient features was that on self-certification basis, allowances would be made. There is a provision of obtaining annual progress reports and quarterly progress reports from the Units and the Developers. Those APRs and QPRs are to be certified by the qualified CAs. Audit, during the process of their audit, came across certain deviations wherein there was a deviation between the report submitted, which was certified by the CA, and actuality, in certain figures. After that, we asked the Development Commissioners in each of these cases to go into the details and give specific replies, case-wise, which we furnished to the audit. In addition to it, we issued instructions that whatever APRs and QPRs are submitted which are certified by the CA, should be randomly verified to the extent of five per cent by the concerned Development Commissioner because if APRs and QPRs are submitted which are certified by the CAs, there may be some intentional and unintentional discrepancy. To avoid that we issued that instruction; we will get a feedback from all the Development Commissioners and report to the Committee, and the Audit on the observations of the Development Commissioners on this particular instruction which we issued five per cent of compulsory random check on them, which were received."

X. Non-achievement of positive NFE

38. An SEZ unit was required to achieve positive NFE, which is calculated cumulatively for a period of five years from the commencement of production as per the formula "NFE=A-B". Where, 'A' is the FOB value of exports by the SEZ unit and 'B' is the sum total of the CIF value of all imported inputs, value of all payments made in foreign exchange by way of commission, royalty etc. The Audit scrutiny of records of 24 units of Falta, Cochin, Madras, Kandla and Vishakhapatnam SEZs revealed that these Units failed to achieve the required positive NFE. Accordingly, a duty of ₹ 106.71 crore (determined in proportion of the shortfall in achieving positive NFE) with interest of ₹ 46.17 crore was recoverable from these Units.

39. While providing the status on the Audit findings, the Ministry of Commerce and Industry in their written submission have stated as under:

> "Information is being collected from the respective Development Commissioners and will be submitted as expeditiously as possible."

40. Replying to the monitoring that was done with reference to arrears in foreign exchange realization, the Ministry have stated as under:

> "Exporting units in the zone file shipping bills for each export. These bills are assessed by the authorised officers and the Free on Board value is, cumulatively, shown as exports in the Annual Performance Report (APR) filed by the Unit. The APR also contains a declaration about cases pending for foreign exchange realization. Data furnished in the APR is duly certified by independent Chartered Accountant. This is scrutinized during the annual monitoring of SEZ units and the reasons as well as duration of non-realisation are ascertained. Wherever necessary, remedial directions are given and if there has been substantial delay without any justifiable reason, the matter is reported to RBI for taking action against the Unit."

41. During the course of examination, the Audit in a case found that the Development Commissioner had permitted (May 2004) broad-banding of dissimilar items such as readymade garment, jewellery etc. which was, however, rejected (June 2004) by the Department of Commerce. Though the broad-banding was cancelled, export turnover of these broad-banded items was included in calculating the NFE achieved.

To a specific query as to how the Development Commissioner allowed broad-banding of dissimilar goods, it was replied as under:

> "The permission for inclusion of various items in the LOP was approved by the then Development Commissioner as per provisions contained in Para 9.37 (b) (iv) as it existed in the Handbook of Procedure (Vol. 1) (1997-2002) under 'broad-banding/diversification'. Till the receipt of the Ministry of Commerce and Industry's communication, the interpretation of 'broad-banding/diversification' was not clear which led to the inclusion of items which were dissimilar in nature from that granted in the original LOP. The matter is being further examined along with the contentions submitted by the Unit, regarding inclusion of export of dissimilar items towards calculation of NFE."

Regarding the latest position on the above issue, the Ministry have added:

"The provisions of SEZ Act, 2005 and Rules have done away with the limitation of allowing broad-banding only to similar goods now."

42. When asked to explain as to how ineligible items were taken against exports, it was replied as under:

"The matter is being further examined alongwith the contentions submitted by the Unit regarding inclusion of export of dissimilar items towards calculation of NFE."

43. On being asked to furnish the action taken by the Ministry of Finance in the instant case, it has been submitted as under:

"The Commissioner of Customs (Airport and Administration), Customs House, Kolkata has reported that consequent to Central Revenue Audit Department's revelation that the said Unit could not achieve the statutory requirements of earning positive NFE, a show cause-cum-demand notice was issued *vide* F. No. FSEZ/12(338)/Customs/668 dated 5.10.2006 by the Specified Officer of SEZ. The Show Cause Notice was made answerable to the said Commissioner of Customs.

However, the Development Commissioner has extended the LOP in respect of the said Unit up to 12.10.2008 and a final decision in the matter in the form of adjudication of the case can be taken only after the expiry of the extended LOP."

44. When the Committee sought to know the current status of examination of the aforesaid matter, the Ministry have made their submission as under:

"Performance of M/s. Plastolene Polymers Pvt. Ltd. for the 5 years period from 1.3.2000 to 28.02.2005 has been monitored and adjudication has been completed after providing an opportunity for personal hearing. Adjudication Order has been passed on 31.12.2008."

45. Asked about the latest position with regard to the Demand Notice issued to an SEZ unit, it has been stated that:

"The Unit had submitted APR for the year 2001-02 only. The Unit had neither submitted APRs for the remaining periods, nor had it appeared for personal hearing on 5.1.2009. Therefore, the matter has been adjudicated on the basis of the APR for 2001-02 and as per customs records. Since the unit's NFE position came out to be negative, Adjudication Order has been passed on 7.1.2009, imposing a penalty of ₹ 10. lakh."

46. To a specific query as to whether any target had been set under the SEZ scheme for Foreign Exchange Earnings, the Ministry in their written reply have stated as:

"The preamble of the SEZ Act, 2005 itself says that:

'An Act to provide for the establishment, development and management of the Special Economic Zone for the promotion of exports and the matters connected therewith or incidental thereto.'

As such, promotion of exports is the basic principle on which the whole scheme rests and only to achieve this very objective, the whole scheme has been formulated and all of the exemptions/benefits are being extended to the Developer as well as to the Entrepreneur. Further, this is included in the objectives of the Scheme as contained in the Section 5 of the SEZ Act, 2005.

Only with a view to achieve the above objectives, it has been made mandatory for each and every SEZ unit to maintain positive NFE for a cumulative period of five years.

The procedure to calculate NFE is provided in Rule 53 of the SEZ Rules, 2006 and if a Unit fails to maintain positive NFE, they are liable to face penal action under Foreign Trade (Development and Regulation) Act, 1992."

The Committee note that the Government has not fixed yearly targets for NFE but has fixed the cumulative target for a period of five years.

XI. Units functioned in SEZ in violation of the conditions of LOP

47. According to the Exim Policy/FTP, the Letter of Permission (LoP) issued to an SEZ unit is valid for five years from the date of commencement of production and is treated as a licence for all purposes. On completion of five years' period, the LoP may be renewed by the DC for a further period of five years. Further, each LoP should have separate earmarked premises and has to specify the items of manufacture/service activity and capacity, etc. In case of any change in approved activity, the DC has to issue an amended LoP. An SEZ unit has to fulfil the terms and conditions of the LoP failing which the Unit is liable for penal actions under the FT (D&R), Act, 1992. Scrutiny of records of Falta, Madras, Vishakhapatnam, SEEPZ, Kandla and Surat SEZs revealed that 41 Units had violated the conditions of the approved LoPs while carrying out their business. These included (i) carrying out trading activity though the LoP was for manufacture, (ii) manufacturing in a premises not mentioned in the LoP, (iii) excess trading that what was permitted in the LoP, (iv) operating without a valid LoP, (v) clearing all goods in DTA despite the fact that these were required to be exported to the General Currency Area (GCA), countries etc. Penal action should have been initiated by the DC under the FT (D&R) Act, 1992. Additionally, customs duty of ₹ 74.90 crore was also recoverable from these Units.

48. Audit in their findings observed that carrying out manufacturing activity in a premises, other than that permitted in the LoP was not in order.

Replying to the Audit observations it was stated as:

"The Unit has been operating from both the locations under the single Letter of Approval. Accordingly, the Unit is submitting the Annual Performance Reports, covering both locations."

49. In respect of M/s Patni Computers Systems Ltd., a unit of SEEPZ, SEZ converted from EPZ unit, was issued a LoP for development of computer software. The LoP expired in March, 2003 after periodical renewals. The Unit had not applied for renewal thereafter and was functioning within the SEZ without a valid LoP. The Unit

had imported capital goods of ₹ 9.41 crs. during 2003-04 to 2005-06 on which duty of ₹ 3.34 crs. was foregone, which according to the Audit was to be recovered, as the Unit had no valid LOP for these imports.

To this, the Ministry have replied as under:

> "The Unit was granted LOP on 01.06.1981. The third five year block of the Unit ended on 31.03.2004. The Unit submitted fresh projections for the next five year block only on 26.06.2007. During this period, the import/export activities of the Unit continued. The fresh projections submitted by the Unit on 26.06.2007 were processed and the intervening period was regularized by taking the actual imports and exports for the year 2004-05, 2005-06 and 2006-07 as projections for the same period."

50. Deposing before the Committee about the popular perception of SEZ Scheme, the Commerce Secretary stated as under:

> "There has been a lot of mis-representation about Special Economic Zones for a veriety of reasons. I can tell you with very great confidence that out of 271 zones which have been notified—we have about 80-90 zones which have started functioning in the sense infrastructure has come, employment factories have been established and so on and so forth-there is no case of misutilisation in any one zone and it is a challenge which we have put out publicly to anyone to show the case of misutilisation in any manner in any SEZ notified in the country."

51. When the Committee sought to know the checks available in respect of Units already in existence and wanted to shift to SEZ, the Commerce Secretary deposed before the Committee as under:

> "Firstly, it is new Unit. The investments are all new. We do not have any case where somebody has shifted second-hand machinery from 'x' to SEZ. Even otherwise, if it is shifted, it is the Income Tax Department which really examines to see whether it is a company inside the SEZ which has been formed by the reorganizing. There are a number of provisions under the Income Tax Act. This is specifically prohibited under the current rules."

52. While clarifying on the issue of utilization of the land by a unit in SEZ scheme, the Commerce Secretary stated as under:

> "About the land utilization by the SEZ, there was a view that this is all for the real estate play and a lot of real estate people are making money. There is not a single SEZ—where there is any real estate activity.
>
> If a developer comes and says that he wants to build 10,000 houses in an SEZ, he is giving us a plan that he is going to have more than 10,000 houses in an SEZ, he is giving us a plan that he is going to have more than 10,000 employees and we give him the permission to build 10,000 houses and say, 'All right, according to your plan, you are going to have 20,000 workers and you are going to have houses for 10,000 of them'. We say that principle approval is given for 10,000 houses. He is allowed to first build 2000, that is, only 20 per cent and then he has

to fill up those 2000 houses with workers from the factories that have come up and only when these 2000 houses are filled up, we allow the next 2000 to be built up. Then the next 2000 will be built after the workers occupy it. We are so strict to see that there is no real estate activity. The developer cannot build anything on his own. He has to come to the Board of Approval where not only Commerce Secretary is there; there is member, Customs; member, CBDT is there, and other representatives of the Ministries are there. Everybody will ask as to why he wants 3000 houses, the type of houses, area will depend upon the type of workers. Workers will have much smaller houses, middle level houses will be for executives and a little bigger for Chairmen of companies, etc. Each aspect is looked into by the board of approval and only he can do what is authorized by the board of approval. He cannot do anything on his own."

53. To a query as to what percentage of land was used for industrial purpose it was stated that:

"Out of the total notified area, minimum 50% of the area is to be used for undertaking the industrial activity and the remaining land is to be utilised for economic activity and for providing support facilities and social infrastructure."

54. On being asked if the defaulting SEZ units had been identified throughout the length and breadth of the country, the Ministry in their written submission have stated as:

"Action is taken as per the provisions of the SEZ Act/Rules against the defaulting SEZ units, whenever it comes to the notice. Details as regards to the defaulting Units will be furnished in due course."

55. Elaborating on the proper system of monitoring the compliance of the provisions of Letter of Permission which is issued by the office of the Development Commissioner, it has been stated that:

"Performance of Units is examined by Approval Committees which is headed by Development Commissioners, who is also overall in-charge of the whole SEZ. As such, there is full fledged machinery to administrate the SEZ including the SEZ Units. Further, the Units work strictly in accordance with the conditions of the LOA and Bond cum LUT. For this purpose, there is a whole time custom wing in every SEZ, which is manned by officers from the Department of Revenue, to take care of any inward/outward movement of goods, their valuation, duty component involved, job work from outside the SEZ. As such, there is a proper system of monitoring the compliance of provisions of LOP by the office of Development Commissioner."

XII. Short levy of duty on DTA sales

56. As per paragraph 7.8 (a) of the Exim Policy (2000-07), an SEZ unit can sell goods including by-products, in DTA, in accordance with the import policy in force, on payment of applicable duty. Assessable value for such DTA sale is determined under Section 14 of the Customs Act. The Audit scrutiny of the records of 21 Units of Falta,

Cochin, SEEPZ, Manikanchan and Madras SEZs revealed short levy of duty of ₹ 8.03 crore due to undervaluation of goods sold in the DTA.

57. When the Committee enquired if the Ministry had made any comparative study on imported goods costing more because it is produced in SEZ which was catering to domestic market, the Ministry replied as under:

> "No such comparative study has been made.
>
> After considering all aspects, SEZ Act and Rules have been framed. DTA sale is just a part of overall economic activity of the SEZ unit which is allowed on payment of full duty including payment of Countervailing Duty on the finished product, while DTA unit is supposed to pay duty on inputs only. Moreover, no Income Tax benefit is available on such DTA sales. Therefore, there is no revenue loss in case of DTA sales. Further, as per requirement of the SEZ Rule, the unit in SEZ has to achieve positive NFE which is absent in case of DTA unit.
>
> Another factor that should also be kept in mind while making a comparison is the benefit that accrues to our economy by way of production in the country arising out of the SEZ units set up."

58. When asked if any intervention had been initiated by the Ministry with regard to DTA sales it was stated as:

> "No such intervention is required as the quantum of DTA sales is minimal."

59. On whether any corrective/remedial measures had been taken to prevent recurrence of cases of short levy of duty on Domestic Tariff Area sales by SEZ units, the Ministry stated as under:

> "Necessary precautions like verifying the valuation, quantification of duty are being undertaken at the time of assessment of DTA bills."

XIII. Irregular/excess payment of drawback/interest

60. Supply from the DTA to an SEZ unit is treated as a 'deemed export' and for such deemed export, the DTA supplier is entitled to the drawback or the DEPB credit. However, on the submission of a disclaimer from the DTA supplier, the SEZ unit could avail this drawback.

However, the Audit scrutiny of records of 11 units in Falta, Cochin and Madras SEZs revealed irregularities like (i) drawback being paid to SEZ units without the disclaimer certificates of the DTA units, (ii) drawback being paid on goods procured from DTA for manufacture of products, which were not covered under the LOP issued and (iii) payment of interest on drawback at higher rates.

61. On the mechanism that was prevalent in ensuring that irregular/excess drawback is not paid, the Ministry of Commerce and Industry in their written submission to the Committee have stated as:

> "Grant of drawback in such cases is governed *w.e.f.* 10.02.2006 by SEZ Act and Rules. The drawback rates are fixed by the Government in the Drawback Rules

from time to time and these are taken into account in addition to the relevant circulars/notifications prevalent during the period. Scrutiny of all drawback claims is meticulously conducted. After processing the claim, the bill is sent to the Regional Pay & Accounts Office, for further scrutiny and issue of cheque. Adequate safeguards exist to ensure that irregular/excess drawback is not paid."

62. Explaining the position of the Ministry with reference to the Audit findings, it has been submitted as under:

"Prior to 11th May 2004, suppliers to SEZ units were eligible for drawback on deemed exports under the Foreign Trade Policy payable by the Department of Commerce. The SEZ unit could claim the drawback on getting a disclaimer from the supplier. In CSEZ, 10 claims were filed by M/s Sterlite Industries, the supplier of CSEZ unit, M/s Elmag Wires between July, 2002 and July, 2003 and drawback on deemed exports totalling ₹ 24,04,206 was granted. This was as per procedure and hence regular. Between August, 2003 and February, 2004, the zone unit, M/s Elmag Wires filed the claim with disclaimer from supplier and drawback to ₹ 12,58,355 was sanctioned as per procedure. Payment of drawback as deemed exports paid to M/s Sterlite and M/s Elmag is in order and hence there has been no misuse.

Audit has erroneously raised this objection as the drawback paid out refers to the period 2001-02 to 2003-04, as stated by audit, but the relevant citation from the Foreign Trade Policy quoted by audit is para 7.2(b) of FTP 2004-09. It is apparent that the period covered and the transaction enquired into by audit precedes the policy provision cited in the audit objection."

63. Regarding the steps that have been taken to prevent drawback being paid on goods procured from Domestic Tariff Area, which were not covered under the Letter of Permission it was explained as under:

"In the Letter of Approval issued to the SEZ units, only authorized operations are defined/included and no specific goods/services are mentioned. As such only those goods/services are allowed to enter/utilized in the Unit which is required by it to carry on its authorized operations. In addition, SEZs strictly follow the provisions of the SEZ policy and also various stipulations on the subject."

XIV. Goods removed for inter-unit transfer/job work not accounted for

64. When goods are transferred from one SEZ unit to another SEZ unit or 100 per cent EOU, the supplying Unit has to submit the re-warehousing certificate to the proper officer within 45 days from the date of clearance, failing which the proper officer should initiate action for recovery of duty from the receiving Unit through the jurisdictional officer of the receiving Unit. Further, when goods are sent for job work, such goods are required to be returned to the Unit within a period of 90 days from date of removal. Any failure on the part of the Unit to get back the goods within the prescribed time attracts recovery of the applicable customs duty. Audit scrutiny of the records of 14 Units in Falta and Vishakhapatnam SEZs revealed that the re-warehousing

certificates for 99 consignments of goods of a total value of Rs. 3.76 crore, which were cleared (during May 2004 to March 2006) for transfer to other SEZ units (outside the zone) and 100 per cent EOUs, were not received. In the absence of any evidence that these goods were used for the intended purpose, the applicable customs duty of Rs.1.38 crore was recoverable from these Units.

65. To a query on the procedure that was in vogue to monitor the goods when they are removed for inter-unit transfer/job work the Ministry have stated as under:

> "Detailed Procedure for Inter unit transfer of goods has been laid down under Rule 46(12) of SEZ Rules, 2006. Similarly, detailed procedure for job work has been laid down under Rule 50 and Rule 51 of SEZ Rules, 2006."

66. On being asked about the action that was taken in cases where the re-warehousing certificate is not produced within the stipulated time, the Ministry have replied as:

> "In case of failure to submit re-warehousing certificate, action is initiated for recovery of duty."

67. Regarding the action that was taken by the Department in cases where the Audit had pointed out that re-warehousing certificates were not furnished for 99 cosignments of goods of a total value of Rs. 3.76 crore which were cleared for transfer to other SEZ units and 100 per cent EOUs, the Ministry in their written submission made to the Committee have stated as under:

> "Out of the 99 consignments mentioned in the Audit Para, only 6 consignments pertain to Visakhapatnam Special Economic Zone. The goods were transferred to MEPZ and in all cases rewarehousing certificates were received within the time frame of 45 days and the details and copies of B.Es are already submitted. In Visakhapatnam Special Economic Zone, no permission has been accorded to any Unit for carrying out job work during the relevant period and hence question of non-accountable does not arise as no goods were cleared. There is transfer of Raw material/Capital goods which cannot be put to use by the Unit and then all these cases Re-warehousing Certificates were received. The details are as under:

Sl. No.	B.E. No. & Date	Item	Value (₹)	Date of clearance from VSEZ	Date of Re-ware-housing in Chennai MEPZ/SEZ
1.	6722/10.8.2005	Cotton yarn	33351	16.8.2005	23.8.2005
2.	7173/25.8.2005	Knitting Machines	2421980	01.9.2005	13.9.2005
3.	7172/25.8.2005	Linking Machines	633223	01.9.2005	13.9.2005

Sl. No.	B.E. No. & Date	Item	Value (₹)	Date of clearance from VSEZ	Date of Re-ware-housing in Chennai MEPZ/SEZ
4.	3881/19.5.2005	Colour Monitors	15000	27.5.2005	31.5.2005
5.	11153/26.12.2005	Linking Machines	543008	30.12.2005	05.01.2006
6	11154/26.12.2005	Matrix Printer	10036	30.12.2005	05.01.2006
			3656598		

FALTA

Regarding inter-unit transfer: Out of 96 consignments, re-warehousing certificates for 83 consignments were received by Custom Wing later on. For the rest 13 consignments, Notices had been issued to the concerned Units by Dy. Commissioner of Customs. Subsequently, another re-warehousing certificate has been received. Since the other 12 Units had not taken any action, the jurisdictional Customs authorities have been requested by Superintendent of Customs, FSEZ on 08.12.2008 to raise demand of duty from the receiving units.

Regarding Job Work: Return of goods after job work was pending only in respect of one Unit in FALTA SEZ. Demand Notice was issued by Dy. Commissioner of Customs on 08.12.2008. Duty including interest of Rs. 32969/- has been deposited by the Unit on 13.12. 2008."

XV. Short levy of duty from de-bonded units

68. An SEZ unit has the option to opt out of the scheme with the approval of the DC. Such exit from the Scheme is subject to the payment of applicable customs and central excise duties on the imported and indigenous capital goods, raw material and finished goods lying in stock. The Audit scrutiny of records of two de-bonded units in Cochin and Vishakhapatnam SEZs revealed short levy of duty of Rs. 84.87 lakh and interest of Rs. 11.36 lakh upon these Units opting out of the SEZ scheme.

69. Elaborating the conditions that govern de-bonding of Units, the Ministry of Commerce & Industry have submitted as under:

> "Units can be de-bonded voluntarily or on a direction from the Development Commissioner. In either case, the Specified Officer of the SEZ is directed to calculate the duty liability. Any material that is to be shifted out of the SEZ into the domestic tariff area is liable to duty. If the SEZ unit is NFE negative, penalty under Foreign Trade (Development and Regulation) Act, 1992 is also imposed. Once the unit has cleared all its dues thus calculated, the final de-bonding order is issued along with cancellation of Letter of Approval."

70. On being asked about the latest position regarding short levy of duty of ₹ 84.87 Lakh in case of two de-bonded Units in Cochin and Vishakhapatnam SEZs, the Ministry have replied as under:

> **"CSEZ**
>
> No duty is leviable from the de-bonded Unit in Cochin SEZ. So no action is required.
>
> **VSEZ**
>
> Only Rs. 5.24 lakh duty has to be collected. The duty will be collected as per rules and procedures."

71. Providing the latest status with regard to collection of outstanding duty from a Unit in Visakhapatnam SEZ, the Ministry have stated as:

> "The Unit has imported Capital Goods for a value of Rs. 12.00 lakhs. The Letter of Permission granted to the Unit has been *suo moto* cancelled and the unit has been advised to clear the dues. As there is no response from the unit, action will be initiated to recover the dues by adjusting the lease rent deposit and also by auctioning the goods/materials lying in the Unit."

XVI. Unit approval committees were not constituted

72. The performance of SEZ units was to be monitored by the Unit Approval Committee as per the guidelines given in the appendix-14-IG of the HBP. The Committee was to be chaired by the DC and should have other members including those from the revenue department (central excise/customs). The performance of the SEZ units was to be monitored quarterly on the basis of reports received from the Units on the prescribed formats. Based on the review, the DC was to prepare a report for the information of the Department of Commerce and CBEC and suggest corrective measures to enable the defaulting Units to fulfil their obligations as per the SEZ Scheme/Customs Notifications. Further, Circular No. 33/2004-cus dated 12 May, 2004 stipulates that the monitoring of SEZ units is also to be done by the jurisdictional customs authority through participation in such a committee. Scrutiny of the records of the DCs at Noida, SEEPZ, Surat and Vishakhapatnam SEZs revealed that no such committee had been constituted in these zones.

73. In response to the Audit observation, the Ministry in their submission made to the Committee have stated as:

> "Approval Committees have already been constituted for all the SEZs set up by the Central Government, including NOIDA SEZ, SEEPZ SEZ and Vishakhapatnam SEZ on 7th February, 2007.
>
> Out of the 231 SEZs notified under the SEZ Act, 2005 Approval Committees have been constituted for 124 SEZs *vide* notifications dated 26th July, 2007 and 25th April, 2008 and notifications for 63 more newly notified SEZs is in the final stages of issue, in consultation with the Ministry of Law. Since Junuary, 2008. The practice of constituting Approval Committees simultaneously alongwith notification of the SEZ is being followed so as to obviate delay in constitution of the Approval Committees."

74. The purpose of constituting an "Approval Committee" was to periodically monitor the performance of SEZ units. Explaining in detail regarding its role, the Ministry have stated as under:

> "The performance monitoring of Units carried out by the Approval Committee includes review of performance of the Units in terms of the Letter of Approval conditions with regard to their import, local procurements, exports and resultant foreign exchange earnings. Units are required to submit Annual Performance Report duly certified by independent Chartered Accountant. The details furnished relate to exports/imports for the year, cumulative value of exports/imports, utilization of raw materials, consumables, components, capital goods, other outflow of foreign exchange. DTA sales, investment details employment statistics, details of external commercial borrowing and details of foreign exchange not realized. This is certified by a Chartered Accountant before submission. Based on this data, the Net Foreign Exchange Earning (NFE) status is monitored as per Rule 53."

75. When asked to furnish reasons for the delay in constituting the Approval Committee which were intended to oversee the functioning of Units in SEZ, the Ministry of Commerce and Industry have replied as under:

> "There was delay in constitution of the Approval Committee initially as these committees were being formed for the first time. The Approval Committee being an inter-ministerial Committee. Nominations had to be received from different departments such as Revenue, Economic Affairs, etc. and the notifications had to be vetted by the Law Department. However, now Approval Committee in all cases are constituted simultaneously with the notification of the Special Economic Zones.
>
> Further Section 14(2) of the SEZ Act empowers the Development Commissioners to discharge all functions and exercise all powers of the Approval Committee till such time the Approval Committee is constituted."

76. During Oral Examination, the Committee putforth the view that in certain SEZs, one had to have small committees to resolve issues so that decisions could be taken at a quicker pace.

To this, the Joint Secretary of the Ministry of Commerce and Industry stated as under:

> "Realizing that all the issues of differences should not go at the highest level, we have Unit Approval Committees at the zone level and Board of Approval at the Central Government level. The Development Commissioner which is an appointee of the Central Government is the Chairman of the Unit Approval Committee. All the members of all the concerned ministries at domestic level and at the Zone level also are represented in the Unit Approval Committee. They are representatives from local customs Commissioner."

77. When the Committee opined that the Unit Approval Committee's scope was very vast, the Joint Secretary of the Ministry of Commerce & Industry deposed before the Committee as under:—

> "Basically it is a two-tier approach. One is at the domestic/field level and the other is at the Central Government level. At the Central Government level we have a Board of Approval which consists of 19 members of different Ministries as well as the concerned State Governments and Commerce Secretary is the Chairman of the Board of Approval. On any contentious issue we prepare an agenda item and put it in the Board of Approval and try to arrive at a consensus in the BoA meeting itself. For BoA we have a specific stipulation that all decisions of Board of Approval are to be taken on consensus basis. So, even if there is one agreement or one dissent, BoA defers the decision till a consensus is built up. So, at the Central Government level, we have a Board of Approval and at the field level, we have a Unit approval Committee which are represented by the concerned ministries which are stakeholders in the implementation of the schemes."

XVII. Monitoring Mechanism

78. On the steps that were taken to strengthen the monitoring mechanism at the SEZ level so as to avoid recurrence of irregularities, it has been stated as:—

> "In order to strengthen the monitoring mechanism at the SEZ level, a check list has been prepared which also *inter-alia* includes information as to whether the units has a valid LOP."

79. Elaborating on the mechanism in the Ministry to monitor cases where the LOP has been expired and the Unit has not sought its renewal it has been submitted as:—

> "The validity of LOP/LOA is monitored by the Office of the Development Commissioner. Moreover, if the LOA expires, the Customs formation would not allow further clearances. Furthermore, in case renewal of LOP has not been sought, the LOP shall be deemed to have been lapsed with effect from the date on which its validity expired."

80. While examining the issue of the monitoring of the SEZ Scheme, the Committee found that the 83rd Report of Committee on Commerce on 'The Functioning of Special Economic Zones' had recommended that:—

> "The Government should, at some stage, pause and ponder, to evaluate the efficacy of the SEZ policy. It should, therefore, consider to put in place a system for appraisal of the scheme."

81. Further the Committee found that the Ministry of Commerce & Industry while furnishing Action Taken Notes to the Recommendations contained in the 83rd Report of Committee on Commerce (The Functioning of SEZs) with regard to monitoring aspect, it was stated as under:—

> "The recommendation of the Committee to put in place a system for appraisal of the scheme after the already notified SEZs have functioned for five years is accepted and suitable action will be taken in this regard at the appropriate time."

PART II

OBSERVATIONS AND RECOMMENDATIONS

1. The Special Economic Zone (SEZ) Scheme was introduced by the Government with effect from 1st April, 2000 in order to overcome the shortcomings experienced on account of multiplicity of controls and clearances, absence of world-class infrastructure, an unstable fiscal regime and also to attract larger foreign investments in India. The SEZ policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with minimum possible regulations. The exemptions included Customs duties, Central Excise duties and Service Tax for the authorized operations. Also there were exemptions from Income Tax, Minimum Alternate Tax (MAT) etc., alongwith exemptions from dividend Distribution Tax for the developer and all these fiscal incentives were implemented by the Development Commissioner. All the export benefits including drawback for supplies to SEZ developer/unit were given to them within SEZ by the specified officers in the SEZs. The import/export operations of the SEZ units were on self-certification basis. The Units in the zones were required to be the Net Foreign Exchange (NFE) earners, calculated cumulatively for a period of five years from the commencement of production. These Units were to execute a legal undertaking with the Development Commissioner to achieve the positive NFE. The performance of the Units was required to be monitored quarterly by the Approval Committee constituted for each SEZ based on the reports received in the prescribed format. In short, a Special Economic Zone was deemed to be a territory outside the Customs territory of India. Bringing goods or services into the SEZ from the Domestic Tariff Area (DTA) was treated as exports. The goods could be cleared from SEZ to DTA on payment of duties of Customs including Anti-dumping, Countervailing and Safeguard duties under the Customs Tariff Act, where applicable, as leviable on such goods when imported. While the Development Commissioner was overall in-charge of the SEZ, officials from the Customs Department deputed to the Zone under the administrative control of the Development Commissioner attended to the day-to-day operations of these Units.

The detailed examination of the SEZ scheme has revealed a number of deficiencies which include system as well as compliance weaknesses relating to policy and procedures governing the management and functioning of SEZ units. Besides, as highlighted by the Audit, revenue implication to the tune of ₹ 246.72 crore and an additional amount of ₹ 1724.67 crore was foregone or could not be recovered in the absence of enabling provisions. The detailed examination of these deficiencies and the findings of the Committee are dealt with in-detail in the ensuing paragraphs.

2. One of the main objectives of the Scheme was augmentation of exports so as to boost Foreign Exchange Earnings. The Committee in the course of examination found that out of an overall export of ₹7,149.23 crore made by 22 SEZ units, the actual

export content was only ₹1,999.27 crore (28 per cent) and the remaining ₹5,149.96 crore (72 per cent) related to Domestic Tariff Area (DTA) earnings. Though the Committee were apprised that the percentage of deemed exports and the DTA sales were minimal, they find that the actual physical export which augments the foreign exchange earnings was quite dismal. The Committee, therefore, recommend that the Ministry consider to restrict reckoning of deemed exports by an appropriate scale for the purpose of calculating Net Foreign Exchange Earnings with a view to reduce the misuse of the Scheme.

3. The Committee find that an Export Oriented Unit (EOU), which imported inputs and raw materials duty free, could clear its final products into DTA after paying the applicable Basic Customs Duty (BCD) and Countervailing Duty (CVD) as if the final products were imported. However, in cases where both the BCD and the CVD were 'nil' on certain products, the EOUs would not pay any duty-on clearance of the final products in Domestic Tariff Area (DTA). A Unit in the DTA producing/clearing the same final product would also clear these goods at 'nil' rate of duty, but would have suffered duty on inputs used in the manufacture of these products. This had put the DTA units under a comparative disadvantage. Subsequently, this anomaly was removed as the EOUs were required to payback the duty foregone on inputs utilised for manufacture of such goods cleared into DTA *w.e.f.* 1st September, 2004. However, no such protection to Units in DTA was provided under the SEZ Policy/Act. Surprisingly, SEZ units can sell their goods, including by-products, and services in DTA on payment of applicable duty including at 'nil' rate with no requirement to payback the duty foregone on inputs used in the clearance of products (at nil rate of duty) into the DTA. The Committee deplore such a discriminatory policy which puts SEZ units at a distinctly advantageous position compared with similar Units in the DTA. Such a discrimination was also noticed by the Committee on commerce and they, in their 83rd Report (relating to 'The Functioning of SEZs'), had recommended that a level playing field should be provided to the domestic industry *vis-a-vis* SEZs. The Committee, therefore, strongly recommend that SEZ Scheme needs a through reappraisal with a view to provide a level playing field for the indigenous industry as well.

4. The Committee find that the mechanism for monitoring the functioning of SEZ units is based on the data provided by the SEZ units through Self-Certification in the form of Quarterly Performance Reports/Annual Performance Reports (QPR/APR). If the erring Units provide incorrect or incomplete data in their QPRs/APRs, there is no alternative and reliable method or procedure for correct monitoring or the Net Foreign Exchange Earnings (NFEs) data. The Committee feel that the collection of such vital statistics relating to NFE cannot be based merely on self-certification of the SEZs units. The Government must put in place a suitable and reliable oversight mechanism for monitoring the actual NFEs. Further, the Committee recommend that in cases of default, prompt and timely action must be taken to recover the duty foregone owing to concessions.

5. The Committee while examining the issue of achievement of positive Net Foreign Exchange Earnings (NFE) found that duty to the tune of ₹107 crore was recoverable as there had been a shortfall in achieving positive NFE. As pointed out in

audit, the shortfall had occurred owing to the fact that broad-banding of dissimilar goods had been allowed. When the Committee sought an explanation from the Ministry in this regard, they were informed that the interpretation of "broad-banding/ diversification" was not clear, leading to inclusion of items which were dissimilar in nature from those granted in the original Letter of Permission. Further, the Committee were informed that the provisions of SEZ Act 2005 and the Rules made thereunder have done away with the limitation of allowing broad-banding only to similar goods. The Committee would, therefore, like to know the effect of this amendment and the impact it has had on the foreign exchange earnings of the country.

6. The Committee are concerned to note that 41 SEZ units had functioned in violation of the conditions that were stipulated in the Letter of Permission (LOP) leading to considerable loss of revenue. The violation included carrying out trading activity though the LOP was for manufacture; manufacturing in a premises not mentioned in the LOP; excess trading that what was permitted in the LOP; operating without a valid LOP and clearing all goods in the Domestic Tariff Area (DTA) against the strict stipulation that the goods shall be exported to the General Currency Area (GCA) countries. The Committee note that the functioning of SEZs was reviewed by the Audit between July 2006 and May 2007. When asked during evidence whether defaulting Units had been identified, the witness submitted that "the details of the defaulting Units will be furnished in due course". This is unfortunate, to say the least. The Committee would like to be furnished the details of the defaulting Units, the action taken to recover the revenue forgone, to award deterrent punishment to them and the action taken to prevent such recurrences alongwith the reasons for delay in compiling the details of the defaulting Units.

7. With respect to the accounting of goods removed for inter-unit transfer/job work, the Committee note that when goods were transferred from one SEZ unit to another SEZ unit or to a 100 per cent EOU, the supplying Unit had to submit the re-warehousing certificate to the proper officer within 45 days from the date of clearance, failing which the proper officer had to initiate action for recovery of duty from the receiving Unit through the jurisdictional officer of the receiving Unit. Goods sent for jobwork were to be returned to the Unit within a period of 90 days from the date of removal and failure to do so attracted recovery of the applicable Customs Duty. When queried about the procedure that was in vogue to monitor the goods, the Committee were informed that detailed procedure for inter-unit transfer of goods was laid down and in cases of failure to submit re-warehousing certificate, action was initiated for recovery of duty. However, the Committee found that there were cases where re-warehousing certificates were not furnished and the Ministry had failed to take prompt action against them. Concerned over such glaring lapses, the Committee recommend that the monitoring mechanism must be strengthened and the defaulting Units inflicted deterrent punishment.

8. The Committee were apprised that an SEZ unit had the option to opt out of the Scheme with the approval of the Development Commissioner. However, such an exit from the Scheme was subject to payment of applicable Customs and Central Excise duties on the imported and indigenous capital goods, raw materials and finished

goods lying in stock. When asked about the short levy of duty in respect of a few de-bonded Units which had opted out of the SEZ Scheme, the Committee were assured that duty would be collected as per rules and procedures. The Committee would like to know the recoveries that have been effected in this regard. Further, the Committee be apprised of the measures taken by the Government to ensure that such lapses do not recur.

9. On their concern over poor monitoring of SEZ units, the Committee were apprised that the Unit Approval Committees (UAC) were assigned the specific task of periodically monitoring the performance of SEZ units. The performance of the SEZ units was to be monitored quarterly on the basis of reports received from the Units in the prescribed format. Based on the review, the Development Commissioner (DC) was to prepare a report for the information of the Department of Commerce and the Central Board of Excise and Customs (CBEC) and suggest corrective measures to enable the defaulting Units to fulfil their export obligations. The monitoring of SEZ units was also to be done by the jurisdictional Customs Authority through participation in the respective Unit Approval Committee. The Committee are constrained to observe that there was considerable delay in constitution of the Unit Approval Committees charged with the onerous responsibility of overseeing the functioning of these SEZ units. The Committee, therefore, reiterate the need for strengthening the monitoring mechanism for concurrent and effective appraisal of the functioning of the SEZ units. Since the Monitoring Committee involves members from different departments, the Committee hope that there would be effective and regular Inter-Ministerial Co-ordination between Ministries for timely resolution of differences and removal of handicaps so to facilitate effective functioning of the SEZ scheme. In view of the persistent complaints that the SEZ had degenerated into a Scheme to garner land at advantageous prices and obviate taxes without expected multiplier benefits the Committee are of the considered opinion that the continuation of the Scheme in its present form needs serious reconsideration.

NEW DELHI;
21 *February*, 2011
2 *Magha,* 1932 (*Saka*)

DR. MURLI MANOHAR JOSHI,
Chairman,
Public Accounts Committee.

APPENDIX-I

MINUTES OF THE ELEVENTH SITTING OF PUBLIC ACCOUNTS COMMITTEE (2008-2009) HELD ON 8TH DECEMBER, 2008

The Committee sat from 1130 hrs. to 1300 hrs. on 8th December, 2008 in Committee Room 'C', Parliament House Annexe, New Delhi.

PRESENT

Sardar Tarlochan Singh — *In the chair*

MEMBERS

Lok Sabha

2. Shri Khagen Das
3. Shri Shailendra Kumar
4. Shri Bhartruhari Mahtab
5. Shri Kharabela Swain
6. Shri Tarit Baran Topdar

Rajya Sabha

7. Shri Raashid Alvi
8. Shri Prasanta Chatterjee
9. Shri B.K. Hariprasad
10. Dr. K. Malaisamy

SECRETARIAT

1. Shri A. Mukhopadhyay	—	*Joint Secretary* (*AM*)
2. Shri Gopal Singh	—	*Director* (*SP & C*)
3. Shri M.K. Madhusudhan	—	*Deputy Secretary-II*
4. Shri Sanjeev Sharma	—	*Deputy Secretary-II*

Representatives of the Office of the Comptroller and Auditor General of India

1. Shri Anupam Kulshreshtha	—	ADAI (RA)
2. Shri R.G. Viswanathan	—	Pr. Director (Addl. Charge of Dir. General of Audit, CR)
3. Shri Jayanti Prasad	—	Pr. Director (INDT)
4. Shri P.S. Das	—	Director (Customs)

Representatives of the Ministry of Commerce and Industry (Department of Commerce)

1.	Shri G.K. Pillai	—	Secretary
2.	Shri R. Gopalan	—	Additional Secretary
3.	Shri Anil Mukim	—	Joint Secretary
4.	Dr. R.K. Mitra	—	Director

Representatives of the Ministry of Finance (Department of Revenue)

1.	Shri P.V. Bhide	—	Secretary, Dept. of Revenue
2.	Shri P.C. Jha	—	Chairman, CBEC
3.	Shri J.K. Batra	—	Member (Cus. & EP) CBEC

2. In the absence of Chairman, PAC the Members who were present in the sitting asked Sardar Tarlochan Singh, Member, PAC to preside over the sitting. At the outset, the acting Chairman welcomed the Members and Audit Officers to the sitting of the Committee.

*** *** *** ***

3. Thereafter, the Committee proceeded to take oral evidence of the representatives of Ministry of Commerce and Industry (Department of Commerce) and Ministry of Finance (Department of Revenue-CBEC) on Chapter VI of C&AG's Report PA No. 6 of 2008 Union Government (Indirect Taxes-Customs Central Excise and Service Tax-Performance Audit) on 'Special Economic Zones'.

4. The Audit Officers then briefed the Committee on the important points arising out of the Audit Report. Thereafter, the representatives of the Ministry of Commerce and Industry (Department of Commerce) and Ministry of Finance (Department of Revenue-CBEC) were called in. The acting Chairman read out the contents of the Direction 58 by the Speaker regarding secret nature of the proceedings of the Committee.

5. Then, the Secretary, Ministry of Commerce and Industry (Department of Commerce) made a brief presentation on Department's position with regard to the Audit findings. The Secretary also responded to the various queries raised by the Members. To certain queries, for which the witnesses could not give ready replies, the acting Chairman directed the representatives of both the Ministries to furnish the requisite information in writing at the earliest, particularly in regard to:—

(i) appraisal of SEZ scheme with special reference to earning of Net Foreign Exchange and employment generation;

(ii) need to restrict the share of deemed exports in the overall exports by an appropriate scale for the purpose of calculating Net Foreign Exchange;

(iii) need to introduce a provision to ensure/provide a level playing field between SEZ units and other EOUs operating in Domestic Tariff Areas;

***Matter does not pertain to this Report.

(iv) ways to check misuse of tax incentives by SEZ units;

(v) means to take appropriate action against defaulting units including recovery of duty;

(vi) protection of worker's right in the SEZ units;

(vii) proper coordination between Ministry of Commerce and Industry (Department of Commerce) and the Ministry of Finance (Department of Revenue—CBEC) to achieve the objectives set under the SEZ scheme; and

(viii) need for effective monitoring of the implementation of SEZ scheme.

6. A copy of the verbatim proceedings of the sitting has been kept on record.

The Committee then adjourned.

APPENDIX-II

MINUTES OF THE SECOND SITTING OF SUB-COMMITTEE-II OF THE PUBLIC ACCOUNTS COMMITTEE (2009-10) ON 'SPECIAL ECONOMIC ZONES (SEZs)'

Sub-Committee-II of the Public Accounts Committee (2009-10) sat on Monday the 14th December, 2009 from 1500 hrs. to 1630 hrs. in Room No. '139', First Floor, Parliament House Annexe, New Delhi.

PRESENT

Shri Bhartruhari Mahtab — *Convenor*

MEMBERS

Lok Sabha

2. Shri Aruna Kumar Vundavalli

Rajya Sabha

3. Shri Sharad Anantrao Joshi

SECRETARIAT

1. Shri Raj Shekhar Sharma — *Director*
2. Shri D.R. Mohanty — *Under Secretary*

Representatives of the office of the Comptroller and Auditor General of India

1. Shri Jayanti Prasad — Principal Director (INDT)
2. Shri P.S. Das — Director (Cx. & Customs)

Representatives of the Ministry of Finance (Department of Revenue)

1. Shri S.D. Majumdar — Member
2. Ms. Praveen Mahajan — Director General (EP)

Representatives of the Ministry of Commerce and Industry (Department of Commerce)

1. Shri R. Gopalan — Addl. Secretary
2. Shri Anil Mukim — Joint Secretary

2. At the outset, the Convenor, Sub-Committee-II of the Public Accounts Committee (2009-10) welcomed the Members and the representatives of the Office of C&AG to the second sitting of the Sub-Committee. Thereafter, the Audit Officers briefed the Sub-Committee on various issues concerning the subject 'Special Economic Zones (SEZs)'.

3. The representatives of the Ministries of Finance (Department of Revenue) and Commerce and Industry (Department of Commerce) were then called in to tender evidence and the Convenor welcomed them to the sitting of the Sub-Committee. The representatives of both the Ministries, briefed the Sub-Committee on the current status of the subject and attended to various queries of the Members on related aspects.

4. The Convenor thanked the Members for their active participation in the deliberations of the Sub-Committee. He also thanked the representatives of the Ministries of Finance (Department of Revenue) and Commerce and Industry (Department of Commerce) for appearing before the Sub-Committee and for furnishing information that the Sub-Committee desired in connection with the examination of the subject.

The witnesses, then, withdrew.

A copy of the verbatim proceedings has been kept on record.

The Sub-Committee then adjourned.

APPENDIX-III

MINUTES OF THE TWENTY THIRD SITTING OF THE PUBLIC ACCOUNTS COMMITTEE (2010-11) HELD ON 15TH FEBRUARY, 2011

The Committee sat on Tuesday, the 15th February, 2011 from 1130 hrs. to 1230 hrs. in Room No. '62', First Floor, Parliament House, New Delhi.

PRESENT

Dr. Murli Manohar Joshi — *Chairman*

MEMBERS

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Shri Ramen Deka
4. Shri Naveen Jindal
5. Shri Bhartruhari Mahtab
6. Dr. K. Sambasiva Rao
7. Dr. M. Thambidurai
8. Shri Aruna Kumar Vundavalli

Rajya Sabha

9. Shri Prasanta Chatterjee
10. Shri N.K. Singh
11. Prof. Saif-ud-Din Soz

SECRETARIAT

1. Shri Devender Singh — *Joint Secretary*
2. Shri Sanjeev Sharma — *Deputy Secretary*
3. Shri D.R. Mohanty — *Deputy Secretary*
4. Smt. A. Jyothirmayi — *Under Secretary*

Representatives of the office of the Comptroller and Auditor General of India

1. Shri K.R. Sriram — Principal Director of Audit (ESM)
2. Shri Subir Mallick — Principal Director (Indirect Taxes)
3. Shri C.M. Sane — Principal Director of Audit (Air Force & Navy)

2. At the outset, the Chairman welcomed the Members and the representatives of the Office of the C&AG of India to the Committee. The Chairman then apprised the Members that the meeting had been convened to consider and adopt three Draft Reports *viz.* two Original Reports and the one Action Taken Report which was deferred adoption in the last sitting held on 3rd February, 2011.

3. **** **** ****

4. The Committee, thereafter, took up the following Draft Reports for consideration:—

(i) **** **** ****
(ii) **** **** ****
(iii) **** **** ****
(iv) **** **** ****

(v) Draft Report on **"Special Economic Zones (SEZs)"** (Ministry of Commerce & Industry and Ministry of Finance) based on C&AG Report No. PA 6 of 2008; and

(vi) **** **** ****

5. After going through the Draft Reports one by one, the Committee adopted the Draft Reports with some modifications/amendments. The Committee, then, authorized the Chairman to finalise the above mentioned Reports adopted by them, in light of their suggestions and the factual verifications received from the Audit and present the same to the House on a date convenient to him.

6. The Chairman thanked the Members for their valuable suggestions on the consideration of the Draft Reports.

The Committee, then, adjourned.

**** The Matter does not pertain to this Report.

GMGIPMRND—6592LS—(S3)—23.04.2011.