PUBLIC ACCOUNTS COMMITTEE

(2001-2002)

(THIRTEENTH LOK SABHA)

THIRTY-FOURTH REPORT

EXPORT INCENTIVES AND DEDUCTIONS IN RESPECT

OF PROFITS RETAINED FOR EXPORT BUSINESS

MINISTRY OF FINANCE

Presented to Lok Sabha on : 24 April, 2002

Laid in Rajya Sabha on : 24 April, 2002

L O K S A B H A S E C R E T A R I A T

N E W D E L H I

April 2002/Chaitra 1924(Saka)

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* Elected w.e.f. 29 November, 2001 vice Shri Vijay Goel ceased to be Member on his appointment as a Minister.

**Elected w.e.f. 29 November, 2001 vice Shri Annasaheb M.K. Patil ceased to be Member on his appointment as a Minister.

PCeased to be Member of the Committee consequent upon their retirement from Rajya Sabha w.e.f.9.4.2002.

ÌCeased to be Member of the Committee consequent upon his retirement from Rajya Sabha w.e.f.12.4.2002.

INTRODUCTION

I, the Chairman, Public Accounts Committee having been authorised by the Committee do present on their behalf, this Thirty-Fourth Report (13th Lok Sabha) on "Export Incentives & Deductions in respect of profits retained for Export Business" based on para 3.1 of the Comptroller and Auditor General Report No.12 of 1999.

2. The C&AG Report No.12 of 1999 for the year ended March,1998 Union Government (Civil) was laid on the Table of the House on 14th December, 1999.

3. The Committee (2000-2001) took oral evidence of the representatives of the Ministry of Finance at their sittings held on 4th October, 2000 and 20th December, 2000. The Committee (2001-2002) considered and finalised this report at their sitting held on 19th April, 2002. Minutes of the sittings form Part-II of 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 and have also been reproduced in a consolidated form in the Annexures to the Report.

5. The Committee would like to express their thanks to the officers of the Ministry of Finance for the cooperation extended by them in furnishing information and tendering evidence before the Committee.

6. 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; ***N. JANARDHANA REDDY,***

19 April, 2002 ***Chairman,***

29 Chaitra 1924 (Saka) *Public Accounts Committee*

REPORT

INTRODUCTION

With a view to encouraging establishment of export oriented industries to boost the foreign exchange earnings for the country, certain fiscal benefits were introduced by the Government under the Income Tax Act in the 1980s. Accordingly, Section 10A, 10B of Chapter-III and Section 80 HHC of Chapter VI of the Income Tax Act provided for exemption of profits and gains derived by an assessee from an Industrial Undertaking in a Free Trade Zone (FTZ) or a 100% Export Oriented Undertaking (EOU) or from exports to outside India of eligible goods and merchandise. Under this Scheme, the Central Board of Direct Taxes (CBDT) of the Department of Revenue, Ministry of Finance acted as the nodal agency.

AUDIT APPRAISAL

2. This Report is based on Paragraph 3.1* of the Report of C&AG of India for the year ended March,1998, No.12 of 1999, Union Government (Revenue Receipts – Direct Taxes) relating to the Export Incentives and Deductions Scheme in respect of profits retained for export business* and the examination of the representatives of Ministry of Finance, Department of Revenue by the Committee at their sittings held on 4th Oct., 2000 and 20th December, 2000 and examination of written replies furnished to the Committee. An appraisal of the Scheme was undertaken by Audit with a view to evaluating the impact of the concessions on the total revenue collection vis-à-vis net foreign exchange realisation and the degree of statutory compliance by the assessing officers in the implementation of the scheme. The review covered a test check of 6680 assessments completed in 1217 wards/circles across the country during the years 1994-95 to 1996-97 involving an aggregate short levy of tax worth Rs.438.74 crore which was a direct result of irregular deductions allow and other types of irregular concessions extended in a large number of cases. The test check revealed that during 1994-95 to 1996-97, there was a net increase by more than three times in net foreign exchange realisation and the number of beneficiaries availing of deductions increased from 1296 to 3348. The Audit paragraph, however, indicated that despite the fact that the tax holiday provisions, export incentives and deductions from profits retained from exports have been in the Statute for over over 15 years, no review/study was ever made by the department to evaluate the impact of the Scheme. Moreover, no records/data registers were maintained in the department in respect of the assessees availing the export incentives under Sections 10A, 10B and 80 HHC of the Act. Consequently, Audit observed that it was unable to gauge the impact of the scheme in totality except with reference to the cases test-checked.

***For the text of paragraph 3.1, please see C&AG Report No.12 of 1999**

3. Audit scrutiny of test-checked cases revealed that irregular deductions in 1273 cases out of 6680 cases formed 10 per cent of total deductions involving an aggregate tax effect of Rs.43874 lakh. The revenue foregone on account of irregular deductions constituted 16 per cent of total revenue concession. The Audit scrutiny cited few cases wherein irregular deductions were allowed to the new industrial undertakings established in Free Trade Zones and to newly established 100% Export Oriented Undertakings on ineligible goods and items other than goods and merchandise. Audit scrutiny of quite a few cases revealed incorrect computation of total turnover, export turnover and export profits/adjusted profits of business; omission to set off unabsorbed depreciation etc. against the profits and to exclude incomes chargeable under other heads of income; incorrect computation of direct and indirect taxes; incorrect allowance of deduction to supporting manufacturers; allowing deduction despite non-realisation of foreign exchange within the prescribed period and omission to file the required forms alongwith the return and other mistakes in allowing the deductions and omission to set off export losses against the export incentives, which resulted in short levy of tax.

4. Out of the 1273 cases test checked in Audit, the Ministry investigated 108 cases and accepted the contention of the Audit that there were some irregular benefits to the assessees in 20 cases and reopened those cases so that the revenue loss to the Government could be recovered.

The Audit Report was presented to Parliament on 14 December, 1999.

Maintenance of Records/Data in respect of assessees availing export incentives

5. Audit scrutiny highlighted non-maintenance of records in the Department in respect of assessee availing the export incentives under various provisions of the Income Tax Act, despite the fact that tax holiday provisions, export incentives and deductions from profits retained from exports have been in the Statute for over 15 years. In a written reply furnished to the Committee, the Ministry had stated that there were no specific instructions to maintain registers to ascertain the number of assessees availing the concessions and the corresponding revenue foregone. Moreover, the Committee noted that the Department had carried no review/study of the impact of the scheme. During evidence of the representatives of the Ministry of Finance, when asked how was it possible for the Department to study the efficacy of the impact of the scheme, the Chairman, CBDT testified:-

> "As far as maintenance of registers and data is concerned, the Central Board of Direct Taxes is not getting any data from the field formations in respect of the specific numbers of the units getting exemption under Section 10A and 10B or for that matter even under Section 80 HHC".

The Chairman, CBDT further observed:-

> "We have got 2.5 crore of tax payers. Various exemptions that have claimed by them are recorded in the course of the assessment that are made. But we are not in a position to get all the details from the field formations to the Centre because of the huge number involved and also because there are various other sections under which also exemptions are provided".

6. When the Committee asked whether the people who are claiming exemptions under Section 10A and 10B are a particular category and not all the 2.5 crore assessees and how is it possible for the Board without proper data to ensure that the assessing officers are assessing properly, the Chairman, CBDT replied:-

> "I fully agree with your point. If data is available then definitely the initiative taken by the CBDT in respect of policy would be fully useful. But unfortunately because of the system that we are adopting, we were not able to collect the data. We are changing the system".

Review of fiscal benefits

7. At their subsequent sitting held on 20th December, 2000, when the Committee enquired about review mechanism, they were informed by the representative of the Department of Revenue that the Department has set up an Internal Expert Committee consisting of 7 Members for re-appraisal of the provisions of Sections 10A , 10B and 80 HHC with the following terms of reference:-

i) To collect a sample data in respect of export benefits provided under Section 80 HHC/10A/10B of the Income Tax Act.

ii) To ascertain the extent to which the provisions are serving their objective

iii) To estimate the extent of revenues foregone on this account each year

iv) To identify misuse of the concessions, if any.

v) To make recommendations, including rationalization of the existing provisions, if any.

8. The Committee noted that the Expert Committee appointed by the Department of CBDT, Department of Revenue on 21st September, 1999 submitted its report to the Government in January, 2000.

GIST OF RECOMMENDATIONS OF EXPERT COMMITTEE APPOINTED BY THE GOVERNMENT

9. The Committee further noted that the Expert Committee appointed by the Department, after examining a whole gamut of connected issues, concludes that the export benefits under the direct taxes have outlived their utility and were more relevant in 1980's than in 1990's. And that at present these provisions are leading to misuse as well as the tax free profits by the exporters. The Expert Committee has also recommended that in view of substantial revenue loss, need of direct investment in infrastructure, misuse of the provisions and misuse of tax free profits, the Government may do away with the exemptions and may resort to direct investment in infrastructure by way of budget allocations.

10. The gist of the major recommendations of the Expert Committee as summarized by the Ministry are as under:

1. The provisions of Section 80HHC, Section 10A and 10B have outlived their utility and, therefore, may be abolished. However, Section 10A and 10B may be continued for the existing beneficiaries for the remaining period.

2. If for any reason it is not possible to abolish the provisions at this stage, the following alternative proposals are suggested.

   (i) As **second option**, the suggestions of the Expert Group made in the Working Draft of the Income Tax Bill, 1997 in Section 64, could be accepted with the modification that the deduction is allowed at the rate of 5% of the net foreign exchange brought into India, instead of gross foreign exchange, with the condition that the said amount will be invested in specified securities bearing low interest rate of 2 to 3%. The money so received could be allocated to the Export Fund for the development of export sector. 'Net foreign exchange' for this purpose will mean the value addition made in terms of the foreign exchange;

   (ii) As **third option**, the existing system of the computation of deduction under Section 80 HHC might continue with the condition that the deduction allowed under Section 80 HHC will be invested in specified securities bearing low rate of interest of 2 to 3% as suggested in the second alternative. The amounts so collected may be allocated to the **Export Fund** which will be invested in infrastructure improvement in the Export sector;

   (iii) As **fourth option**, the Committee suggested that the deductions presently available at the rate of 100% should be reduced to 50% in the first instance and it should be phased out in the next 2-3 years. At the same time, the Government may make budgetary allocation to the Export Fund as referred to in the second alternative for the development of the Export sector.

   (iv) If Section 80HHC is maintained, the Section may be rationalized by inserting the following Explanation to sub-section (1) of Section 80HHC after the proviso."

PROVISIONS OFFERING EXPORT INCENTIVES & DEDUCTIONS IN THE INCOME TAX ACT

(A) Newly established industrial undertakings in Free Trade Zones (FTZ)- Section 10A.

11. This section was inserted by Finance Act, 1981 with effect from 1 April 1981 and is applicable to an industrial undertaking which manufactures or produces articles or things on or

after 1 April 1981, in any Free Trade Zone. From I April 1994, the benefit has been extended to any industrial undertaking in any notified electronic hardware technology park or software technology park. The Committee noted that under this Section, it is provided that in order to allow the industrial undertakings to dispose of the export rejects and by- products, such industrial undertakings, which begin to manufacture or produce things or articles on or after 1.4.1995, are allowed to sell upto 25% of total sale in the domestic market. The scheme contemplates 100% tax holiday in respect of entire profits derived by the exporter including sales in domestic market, provided a minimum of 75% of total sales in terms of value is exported. If the actual export achieved falls short of the prescribed minimum, the exporter does not qualify for any tax exemption under the scheme and he/she may avail tax concession as proportionate export profits under section 80 HHC of Income Tax Act.

12. The Audit Para stated that under the provisions, the entire profits and gains earned by the industrial undertaking are exempt in respect of any five consecutive assessment years as specified by the assessee at his option, falling within a period of eight assessment years from the assessment year in which it begins to manufacture or produce articles or things, subject to the condition that the assessee will not be allowed the benefit of certain specified unabsorbed allowances, brought forward business losses or capital losses, unabsorbed depreciation and other deductions as specified during the tax holiday. Accordingly, unabsorbed depreciation allowance, unabsorbed investment allowance and development rebate, unabsorbed capital expenditure on scientific research, etc. relating to tax holiday period will not be taken into account after that period. Similarly, unabsorbed business loss or loss under the "capital gains" cannot be carried forward and set off. Moreover, no deduction under Sections 80HH, 80HHA, 80-I or 80-IA or 80J will be allowed during tax holiday period.

13. In a written reply furnished to the Committee, the Board informed that the relief under Section 10A & 10B is available subject to the following conditions laid down in the Sub-Section (2) of these provisions:-

(i) The industrial unit has begun or begins to manufacture or produce articles or things during the previous year relevant to the assessment year

(a) Commencing on or after 1st April, 1981 in any Free Trade Zone; or

(b) Commencing on or after 1st April, 1994 in any electronic hardware technology park or as the case may be, software technology park

(ii) It exports not less than 75% of the total sales during the previous year on or after the specified date

(iii) It is not formed by the splitting up, or the reconstruction of a business already in existence

(iv) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose provided that in the case of transfer for plant & machinery, the total value of machinery transferred does not exceed 20 per cent of the cost of machinery used in the business.

14. During the oral evidence of the Ministry representatives, the Committee wanted to know as to how the Board ensures that the assessing officers are assessing properly and in case of the assessing officers accepting claims from even those who are not fulfilling above-mentioned conditions, how does the Board check him unless the C&AG points it out. Replying to this query, the Chairman, CBDT stated as follows:-

"Though the compliance with the conditions that are in the Statute Book is done initially by the assessing officer, subsequently, we have a supervisory mechanism and audit mechanism at various levels. Officers do supervise the assessment and ensure that as to what is provided in the law is really effected correctly by the assessing officer or not."

15. However, the system still lacked teeth, for the audit scrutiny revealed, during their test check, 11 cases wherein irregular relief allowed to the new Industrial Undertakings established in Free Trade Zones resulted in short levy of tax worth Rs.609.72 lakh.

(B) Newly established hundred percent Export Oriented Undertakings (EOU)- Section 10B

16. The Committee noted that this Section was inserted by the Finance Act, 1988 with effect from 1 August 1989 and was applicable to any approved 100% Export Oriented Undertaking (EOU) which manufactures or produces any article or thing. During evidence, the Secretary, Ministry of Finance informed the Committee that a 100% EOU should be approved by the Board appointed on this behalf by the Ministry of Commerce in exercise of powers conferred by Section 14 of the IDRA Act and the rules made under the Act. The Audit observation was that in relation to an EOU which begins to manufacture or produce any article or thing on or after 1 April 1994, the same economic flexibility has been allowed as in the case of section 10A of the Act. Under the provisions of this section, entire profits and gains derived from the above mentioned Undertaking shall not be included in the total income of the assessee in respect of any five consecutive assessment years to be specified by him and falling within a period of eight assessment years from the assessment year in which it beings to manufacture or produce articles or things. The provisions regarding bar on availing other benefits under other provisions of the Act are similar to that of section10A.

17. The Committee observed from the Audit para that during the test-checking of cases, there were 41 cases wherein irregular relief allowed to the newly established 100% EOUs resulted in short levy of tax of Rs.6213.86 lakh.

18. While commenting on the legal requirements of the provision, the Audit observed that under the Export-Import Policy (1992-97), a 100 per cent EOU or a unit in the FTZ is liable to pay excise duty at a concessional rate on the manufactured goods, which the unit is permitted to sell in the Domestic Tariff Area (DTA). The excise regime is more justified in as much as the manufactured goods sold in the DTA are chargeable to excise levies, though at a concessional rate. The Audit observed that similar provisions need to be made for taxing the profits earned by such units from their sales in the DTA alongwith requirement of certification of export performance.

(C) Profits retained for export business – Section 80 HHC

19. The Committee noted that this section was inserted by Finance Act, 1983 with effect from 1 April, 1983. Originally the incentive was turnover based, being certain percent of export turnover and incremental turnover. From 1 April 1989, the entire profits from export activity were made exempt from tax and the benefit was extended also to the supporting manufacturers selling goods or merchandise to any Export/Trading House.

20. The Committee noted that under Section 80HHC, deduction is allowed on profits retained from the export out of India of any goods or merchandise other than mineral oil (including crude as well as petroleum and natural gas) or minerals and ores (other than processed minerals and ores specified in the Twelfth Schedule to the Act).

21. The Committee observed from the Audit that the deduction is allowed to an assessee who directly exports outside India, the goods, subject to fulfillment of eligibility conditions, manufactured or processed by him and those by others, and to a supporting manufacturer i.e. an assessee who supplies goods or merchandise manufactured by him to an Export/Trading House for purposes of export. Under the provisions, where the business carried on by the supporting manufacturer consists exclusively of sale of goods or merchandise to one or more Export/Trading Houses, the entire profits of the business are exempt. Where the business carried on by the supporting manufacturer does not consist exclusively of sale of goods or merchandise to one or more Export Houses, the deduction will be the amount which bears to the profits of the business the same proportion as the turnover in respect of sale to the respective Export Houses bears to the total turnover of the business carried on by the assessee. The Committee further observed that a certificate to this effect is to be issued by the Export House or Trading House to its supporting manufacturer.

22. As per the audit para, incorrect allowance of deduction to supporting manufacturers, allowing deduction despite non-realisation of foreign exchange within the prescribed period, omission to file the requisite forms alongwith the return and other mistakes in allowing the

deductions resulted in short levy of tax of Rs.3733.48 lakh in 225 cases out of those test-checked by them.

23. The Ministry representatives further confirmed that there were cases of filing of bogus claims under Section 80 HHC. During their oral evidence, the Ministry cited a case that occurred in August, 2000, when during the searches in Mumbai of some diamond merchants who were normally selling diamonds, the Board officials came across a racket of bogus claims under Section 80 HHC. On being enquired by the Committee, it was informed that the Board gets in touch with the Enforcement Directorate whenever it comes across wrong claims under Section 80 HHC. The Ministry also stated that the Enforcement Directorate and the CBDT coordinate in the High-level Regional Economic Coordination Committee meetings, which take place once in every quarter, where such important cases are discussed.

Amendments made by the Government in the Provisions after the submission of the report of the Expert Committee constituted by CBDT

24. When enquired by the Committee on the action taken by the Government on the recommendations made by the Expert Committee, the Ministry of Finance furnished a status report vide their OM dated September 7, 2001, to the Committee informing, inter-alia, that:-

(i) Section 80HHC of the Income Tax Act was amended by the Finance Act, 2000 so as to phase out the deduction over a period of five years by allowing 80 per cent deduction for the assessment year 2001-02, 60 per cent deduction for the assessment year 2002-03, 40 per cent deduction for the assessment year 2003-04 and 20 per cent deduction for assessment year 2004-05. It was further decided that no deductions would be allowed in respect of the assessment year 2005-06 onwards. (owing to an economic slowdown, the deductions has now been phased out by the Finance Act, 2001 over the same period at the rate of 70%, 50% and 30% respectively instead of 60%, 40% and 20% earlier).

(ii) Sections 10A and 10B had also been substituted by new Sections by the Finance Act, 2000 w.e.f. the assessment year 2001-2002. Various features of the new section 10A are as follows:

(a) Under Section 10A, a deduction of such profits and gains as are derived by an Undertaking from the export of articles/things/computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the Undertaking begins to manufacture or produce such articles/things/computer software, as the case may be, shall be allowed from the total income of the assessee.

(b) No deduction under Section 10A would be available from the assessment year 2010-11 onwards.

(c) The Undertaking qualified for exemption, must have begun or begins to manufacture or produce articles/things/Computer software during the previous year relevant to the assessment year commencing on or after April,1981 in any Free Trade Zone or commencing on or after April, 1994 in any electronic hardware technology park, or as the case may be, software technology park or commencing on or after April, 2001 in any Special Economic Zone.

(iii) This provision would be applied to an Undertaking, if sale proceeds of articles/things/computer software exported out of India are received in, or brought into India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or, within such further period as RBI may allow in this behalf.

(iv) The deduction would not be admissible from the assessment year 2001-02 onwards unless the assessee furnishes in the prescribed form, alongwith the return of income, the report of a Chartered Accountant certifying that the deduction has been correctly claimed in accordance with the provisions of this Section.

(v) The profits derived from export of articles/things/computer software would be the amount which bears to the profits of the business, the same proportion as the export turnover (i.e. the amount brought into India in convertible foreign exchange, excluding freight, insurance, telecommunication charges etc.) in respect of such articles/things/computer software bears to the total turnover of the business carried on by the assessee.

Certification of Accounts by Chartered Accountant

25. The Committee observed that certification of the audit of accounts of the assessee under sections 10A & 10B of the Income Tax Act to ensure legal compliance by a qualified Chartered Accountant was not provided till the provisions were amended to this effect after the presentation of the report of the Expert Committee in January,2000. The Committee further noted that the provisions under Section 80 HHC too, did not provide for certification of accounts by a Chartered Accountant to confirm that the exemption claimed is in accordance with the provisions of the Act till the provisions were modified suitably by the Finance Act, 1988. The amended provision ***inter alia*** stated that the deductions would not be admissible for the assessment year 2001-02 onwards unless the assessee furnishes in the prescribed form (No.10 CCAC) alongwith the return of income, the report of a Chartered Accountant certifying that the deduction has been correctly claimed in accordance with the provisions of this Section. The Committee were informed that if the assessee is a supporting manufacturer, he/she is also required to furnish a disclaimer certificate (in Form No.10 CCAB) to the effect that in respect of export turnover mentioned in the certificate, the Export House or Trading House has not claimed the deduction.

26. In this context, the Committee enquired as to why the certification of accounts was not provided under Section 10A & 10B. The Ministry in their written reply explained, that as the schemes provided for value additions, norms and increase in export turnover on the basis of EXIM policy guidelines notified by the Ministry of Commerce, the certification of accounts by an accountant was not provided. It was further stated by the Ministry that as adequate safeguards were provided in the scheme, multiplicity of requirements would have increased the hassles for exporters thus negating the objective of the schemes.

Misuse of the Provisions

27. The Audit appraisal of the implementation of the provisions offering export incentives and deductions revealed that irregular concessions to exporters in 1273 test-checked cases led to short levy of tax of Rs.43874 lakh. The Committee noted that the Audit paragraph had observed following misuses of the provisions either by the assessees or the assessing officers during the test check of cases:

(i) By transferring old machinery to a new unit even if the cost of machinery exceeded the stipulated limit of 20 per cent

(ii) By non-fulfilling prescribed export quota

(iii) By including income from other sources e.g. interest income received from banks etc.

(iv) By incorrect computation of business incomes, total turnover & export turnover and direct & indirect costs

(v) By grant of irregular relief beyond tax holiday

(vi) By allowance of deduction on incomes attributable to business (and not derived)

(vii) By allowance of deductions on items other than goods or merchandise like exhibition rights of films

(viii) By incorrect allowance of relief on profit on sale of licenses granted under the Imports (Control) Order, 1955

28. The Committee also noted the recommendation of the Expert Committee, that there was no need for 100% tax exemption under the Income Tax Act because a sufficiently large number of claims suggested an excessive misuse of the provisions. The Committee observed that during the course of examination, the Expert Committee also felt that unscrupulous businessmen claimed benefits on bogus deals through following means:

(i) By channelising unaccounted income gained from domestic business into export profits thus avoiding tax on income.

(ii) By facilitating bogus transactions and producing bogus bills to claim tax exemptions.

(iii) By misusing trade pacts between India and another country e.g. the USSR through manipulation of currency exchange rates, export of junk or items at highly inflated prices and resorting to dual billing in which the goods were shown to have been exported to the country with which the Trade pact is signed while actually it was offloaded in another country.

(iv) By misusing the provisions of Section 10A & 10B which deal with newly established Industrial undertakings in Free Trade Zones by setting up domestic companies under the guise of 100% EOUs at Software Technology Parks.

(v) By manipulating the selling price of exported goods to obtain higher tax free profits.

29. From the Audit scrutiny, the Committee gathered that apart from incorrect computation, in certain cases, assessing officers also completed the assessments in a summary manner and omitted to deduct business losses, unabsorbed investment allowances and unabsorbed depreciation relating to earlier years and to exclude income chargeable under other heads of income, which led to short levy of tax. The Audit examination further revealed omission on the part of assessees to file requisite forms, for instance, form No.10CCAC for a supporting manufacturer and form No.10CCAB, a disclaimer certificate. When enquired, the Ministry accepted the objections of the Audit in respect of certain cases and took remedial action.

30. While discussing the misuse of the provisions granting relief under Sections 10(A), 10(B) and 80 HHC during oral evidence of the representatives of the Ministry of Finance, the Committee observed that a number of irregularities in the context were pointed out by the Committee during the Seventh Lok Sabha also. During the oral evidence of the officials from the Ministry, the Chairman, CBDT also admitted as follows:-

"…….in respect of the export benefit that is given, the claim of relief under Section 10(A) or 10(B) or 80 HHC does arise on account of bogus exports. In other words, where there are no physical exports, only papers pass through and on that basis, export profits are claimed. The money is sent abroad through clandestine means and brought back to India through the legal means. They claim this as export profit. In other words, it is a sort of a laundering of the unaccounted money into accounted money……"

31. During the discussions, while replying to a query from the members of the Committee regarding various measures followed by the Department to check such fradulent claims, the Chairman, CBDT stated as follows:-

"……..we resort to the provision of `Search' (& Seizure) under Section 132 (of the Income Tax Act)……"

When pointed out by the Committee on frequent defaulters repeatedly getting concessions, it was so explained by the Chairman, CBDT:-

"…….The Enforcement Directorate and the CBDT coordinate in the Regional Economic Coordination Committee meetings……..where such important cases are discussed……"

32. Further, during the oral evidence, the Committee observed that there were two aspects involved in detecting tax evasion in cases claiming exemption under Articles 10A, 10B and 80 HHC i.e. first, loss of tax revenue and second, using the unaccounted money as accounted money under the guise of export profits. The Committee also noted the Expert Committee's finding that mainly the tax evaders have followed two techniques:

(a) Inflating the export profits by suppressing the cost of the raw materials and related expenses by either incurring such expenses out of unaccounted money or transferring a part of the costs and expenses to the domestic business.

(b) Receiving the foreign exchange illegally i.e. on bogus purchase exports and generating huge profits in the process.

33. Drawing attention to the report appearing in the press about bogus claims U/S 80 HHC of the Income Tax Act and the resultant tax revenue loss and laundering of black money into accounted money during the evidence, the Committee desired to know as to whether CBDT has a Cell/Separate Section to investigate such cases. Responding to the query, the Chairman, CBDT explained:-

"We do have a Tax Planning Cell within the CBDT who attend to this as part of their work. Definitely, it would be useful to have a separate section to deal only with the Tax Exemption – we not only lose tax revenue – but the taxable income masquerades itself as non-taxable income. We are alive to that problem. We are restructuring our Department. After the restructuring is over we do propose to have a separate cell on this also. We will keep this recommendation in view".

34. Another aspect regarding misuse of Section 10A, as observed by the Committee during the discussions, related to the provision where an undertaking which begins to manufacture or produce any articles or things on or after 1st April, 1994 is allowed to sell up to 25 per cent of its total sales in the domestic market in order to provide economic flexibility to allow it to dispose of the export reject and by-products. In this context, the Ministry's written reply stated that since a higher technical quality was generally insisted upon by the overseas buyers, a 100% EOU would have implied that `rejects' are an outright loss to the exporter. Therefore, a more pragmatic reasoning had been reflected in the provisions.

35. Not satisfied with the Ministry's view, the Committee observed during evidence that the assessees were claiming exemptions/concessions on excise duty upto 25% of their total production. Further, though meant for exports, such goods were sold in the Domestic Tariff Area on the presumption that being defective, they were export rejects. The Committee noted that by selling one-fourth of the production in the internal market, the assessees were still making profits and getting exemptions, which was an irregularity and against the spirit of the Income Tax Act as the income earned within the country was also being exempted.

36. In this connection, the Committee noted that the Audit para had also observed that a 100 per cent EOU or a unit in FTZ was liable to pay excise duty at a concessional rate on goods sold in DTA area under the EXIM Policy (1992-97), which was more justified. The Audit had also opined that similar provisions should be made for taxing the profits made by such units from their sales in the DTA. The Audit findings of test-checked cases revealed that out of 1273 cases, 52 (11+41) cases showed grant of irregular relief to units in FTZs and 100 per cent EOUs

that had resulted in short levy of tax worth Rs.6823.58 lakh. During evidence when enquired by the Committee as to whether there exists any proposal to amend the Act to rectify this lacunae, the Chairman, CBDT informed the Committee that, on the contrary, a proposal put forth by the Ministry of Commerce had suggested that since their EXIM Policy had already extended this limit of 25 per cent to 50 per cent, tax exemption could also be considered for 50 per cent. However, he informed that this was not agreed to by the Ministry of Finance and the existing provision of 25 per cent was retained.

37. Another significant factor contributing to the misuse of provisions was the in-correct summary assessments made by the Assessing Officers of the Department. During the evidence also, the Committee pointed out that the provisions of the Act could not be misused just by the assessee only. It was observed that the fault was equally of those Assessing Officers who either failed to detect the misuse of provisions and bogus transactions on the part of assessees or resorted to irregular assessment. The Committee further observed that if there was no application of mind at the Assessing Officer's level, the provisions would be further misused.

38. During evidence when the Committee enquired to know about the steps being taken by the Ministry after detection of cases leading towards bogus transactions on the part of assessees, the representative of the Ministry informed the Committee that in all cases where misuse, deficiencies and irregularities were being brought to their notice, two types of action was taken by them: one, reexamining the assessment to find out whether the assessee was liable for greater tax and second, for criminality, if that so existed. The Committee were also informed that the Department would automatically recover the interest amount also. Finally, the Ministry also submitted that frequent misuse of the provisions of a law could be corrected only if such law was removed and that in this direction, the Government had already taken necessary steps to gradually phase out the benefits of the scheme.

Monitoring Measures & Rectification of Mistakes

39. The C&AG in his report had pointed out incorrect computation of total turnover, export turnover and export profits/adjusted profits, incorrect deductions well as incorrect computation of direct and indirect costs, which, the Committee felt, consequently meant that the assessments made by the officials lacked proper monitoring by their higher authorities. The Committee were also of the view that misuse of the provisions is done not only by the assessee but the assessing officers too. In this connection, the Ministry, in a written reply furnished to the Committee had also admitted that some of the irregularities reported in the audit paragraph were mistakes committed inadvertently during the normal course of assessment by the assessing officers. Thus, while discussing the monitoring mechanism, the Committee enquired as to whether the Department had ever attempted to evolve a checklist for guidance of the assessing officers, particularly in view of the audit observations contained in earlier Audit Reports, in order to ensure that the mistakes and irregularities were not committed and recurred year after year. In their written reply, the Department informed that the Directorate of Income Tax and Audit, New Delhi had prepared two such checklists for the guidance of their Internal Audit Wing, keeping in view the audit observations contained in earlier Audit Reports and the important provisions of law. It was also stated that these checklists had been circulated among assessing officers.

40. The Ministry further informed the Committee that the Department was taking following steps to avoid recurrence of mistakes/irregularities in future:-

(i) National Academy of Direct Taxes, Nagpur has been requested to formulate a specialised training course in which the knowledge of Tax laws is updated and common mistakes made are highlighted.

(ii) The Internal Audit Manuals are also being updated for guidance of officers.

(iii) Checklists have been updated and circulated

(iv) A compendium of common mistakes made by the assessing officers as noticed at the time of Internal as well as Receipt Audit is proposed to be prepared and circulated.

(v) The C&AG reports for the year ended March, 1997 and March, 1998 have been circulated to all Chief Commissioners of Income Tax for necessary action and guidance of the assessing officers and the Audit wings.

41. The Committee also desired to know whether the assessments in the cases mentioned in the C&AG Report (No.12 of 1999) were checked by the Internal Audit Wing of the Department and if so, the reasons as to why the mistakes escaped their notice. In their written reply, the Ministry stated that mistakes in some of the cases mentioned in the C&AG's report were detected by the Internal Audit Wing of the Department. However, due to shortage of manpower in the Internal Audit Wing, all cases, as highlighted in the audit report, could not be checked.

42. During oral evidence of the Ministry, the Secretary, Ministry of Finance submitted that the intention and the efforts of the Income Tax Department was to ensure that all due taxes are collected. He also informed that whenever arrears were found, the Act empowered the authorities to reopen the cases to levy the missed tax amount as well as penalise and levy interests also.

43. The Ministry further informed the Committee that there were following three ways of taking rectificatory action :-

i) Simple rectification under Section 154 in which an apparent mistake on the record can be rectified within 4 years of the assessment order

ii) Reopening the cases under Section 147 of the Act within 10 years' period

iii) Review by Commissioners of Income Tax under Section 263 of the Act.

44. On being questioned by the Committee as to what action was taken by the Department against the erring officials, the Ministry informed the Committee that stern administrative action, sometimes leading to suspension, was also being taken against the defaulting assessment officers.

OBSERVATIONS / RECOMMENDATIONS

45. The Committee note that the Export Incentives and Deductions Scheme under the Income Tax Act was initiated by the Government in the Eighties, when the country was facing a difficult external debt and balance of payment position, to encourage the establishment of Export-oriented industries and provide a boost to the foreign exchange earnings of the country. According to the scheme, Sections 10A,10B and 80HHC were introduced in the Income Tax Act providing direct tax exemptions and deductions, subject to certain conditions, to assessees engaged in export activity. The Committee's examination has revealed that the direct tax exemptions had a positive psychological effect on the exporters and helped them expand their capital base, and it also marginally contributed to the growth of export trade. The Committee, however, note that the Government paid a heavy price in the form of substantial direct revenue loss owing to misuse of the provisions by unscrupulous businessmen who channelised their unaccounted income into export profits to evade tax.

Audit appraisal of the scheme reveals that although there was a net increase by more than 3 times in net foreign exchange realisations from 1994-95 to 1996-97 and a sharp increase by more than two and a half times in the number of beneficiaries, irregular concessions to exporters in 1273 cases out of 6680 cases test-checked, led to short levy of tax of Rs. 43874 lakh, constituting 16 per cent of total revenue concession. Out of 6509 cases covered under Section 80 HHC and test checked, the audit detected 1221 cases of irregular deductions involving Rs. 54607 lakh with a revenue effect of Rs.37051 lakh constituting 13 per cent of revenue foregone as a direct result of irregular deductions/reliefs and concessions. The Committee cannot but express their dissatisfaction over the fact that it took the Government 16 long years (after C&AG's Audit) to set up an

expert Committee to examine the efficacy of the provisions of the Income Tax Act offering special fiscal benefits for export of goods or merchandise.

46. The Committee note that out of 81 illustrative cases contained in the report of C&AG which was presented in December, 1999, the Ministry were unable to submit their comments on 16 cases till September, 2001 on the ground that the requisite information was still awaited from the field formations. Obviously, the Committee consider it a reflection on the ability of the Board to glean information relating to cases test checked in Audit belonging to the Assessment Year as far back as 1992-93. In view of the deposition of the representatives of the Board before the Committee that no data registers have been maintained by CBDT in respect of assessees availing export incentives under the Sections 10A, 10B and 80HHC (or any other deduction under Chapter VIA of the Act), the Committee reiterate that it would not be possible to gauge the impact of the scheme in totality except with reference to the cases test-checked in Audit. The Committee observe that lack of proper data is a serious impediment in evaluating the efficacy/impact of the special schemes launched by the Government. The Committee, therefore, recommend that the Board should make optimum use of computronics and devise mechanism to receive, collate and maintain necessary data at a Centralised level so as to assess the effectiveness of the special schemes/provisions of the Act. The Committee hope that the Ministry will get necessary data from their field formations and submit final replies to the cases referred to in the Audit paragraph.

47. As regards the overall provisions in the Income Tax Act, which enable an assessee to obtain benefits out of the Export Incentives & Deductions, the Committee feel that the scheme suffers from gaping loopholes, particularly, of not providing certification of accounts by a Chartered Accountant while claiming incentives under Sections 10A and 10B. Although the Committee note that the Government have amended section 10A to include a proviso that the deductions under 10A and 10B would not be admissible for the assessment year 2001-2002 onwards, unless the assessee furnishes a report from a Chartered Accountant about correctness of claims, the Committee feel that the non-provision of certification of the accounts of an assessee by a Chartered Accountant under Sections 10A & 10B must have led to a substantial number of cases of wrong claims being filed and entertained. They feel that the Ministry should have provided some inbuilt safeguard by making such a certification mandatory for assessees claiming exemption under Sections 10A & 10B of the I.T.Act. The Committee are in agreement with the findings of the Expert Committee appointed by the Department which concludes that misuse of incentives and benefits provisions have resulted in unscrupulous exporters enjoying the subsidised credit facilities given by the Government who utilise their huge unaccounted tax-free profits not for export-oriented activities but for leading a lavish life style and other supposedly lucrative businesses, like shares, construction activity and film production etc. The Committee hope the Department takes appropriate remedial measures on the findings of the Expert Committee to plug the loopholes.

48. Audit had observed that under the Exim Policy (1992-97), the industrial units in FTZs were liable to pay excise duty at a concessional rate on the goods sold in the DTA. The Department could not explain to the Committee as to why goods sold by such units in DTA could be treated as exports for availing the benefit of Sections 10A & 10B of the Income Tax Act. In view of the Audit observation that similar provisions should be made for taxing the profits earned by such units by DTA sales, since by selling their manufactured goods in the internal market, the assessees were still making profits and by granting tax reliefs to such sales, the income earned within the country was being tax exempted through provisions made for exports, the Committee feel that tax exemptions for profits made from DTA sales need a re-look so as to ensure that the interest of revenue is safeguarded and the provision is not misused.

49. The Committee reject the reason cited by the Ministry for large scale irregularities involving substantial loss of Government Revenue owing to mistakes said to be committed

inadvertently during the normal course of assessment by the Assessing officers. The Committee are disappointed to note that despite existence of an Internal Audit Wing in the CBDT, the cases mentioned in the C&AG's report could not be detected, ostensibly due to shortage of manpower in the Internal Audit Wing. The Committee reiterate their recommendation (75th & 194th Reports – 7th Lok Sabha) as to the need for qualitatively strengthening the Internal Audit Wing as they believe that any extra expenditure incurred on this account is certain to be more than compensated by increase in revenue as a result of detection of mistakes by the Internal Audit Wing. The Committee observe that there is an immediate need for effective coordination between the Ministries of Commerce and Finance, particularly with respect to the exercise of delegated powers by officials, to monitor Export Processing Zones. The Committee would also urge upon the Government to take essential remedial measures including the revamping of Internal Audit Wing and strengthen coordination mechanism between the Ministries of Commerce and Finance so as to keep stringent check on financial irregularities. The Committee would also like the Department to prepare the compendium of common mistakes made by the assessing officers as noticed at the time of Internal as well as Receipt Audit and circulate it expeditiously, as proposed by it, for the guidance of assessing officers.

50. The Committee observe that the findings of the Expert Committee appointed by the CBDT open a pandora's box insofar as it concerns various defects/loopholes/shortcomings in the operation of the scheme. In the considered opinion of the Committee, there could not, perhaps, be more severe indictment of the scheme than what the Expert Committee has concluded, namely, that the export benefits under the direct taxes have outlived their utility and were more relevant in the 80's and 90's and that they are currently being misused. The Committee, therefore, refrain from commenting further in the matter in view of the findings and observations of the Expert Committee and the steps already taken by the Government to phase out export deductions completely by 2005-06. The Committee, would, however, like to be apprised of the conclusive action taken on all the recommendations/observations of the Expert Committee in due course.

NEW DELHI; ***N. JANARDHANA REDDY,***

19 April, 2002 ***Chairman,***

29 Chaitra 1924 (Saka) ***Public Accounts Committee***